

April 21, 2014

Foreign Direct Investment in Limited Liability Partnerships in India

The Reserve Bank of India (“**RBI**”) has issued a notification dated March 13, 2014, amending the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 (“**FEMA 20**”) to include limited liability partnerships (“**LLPs**”) within the purview of these regulations and permitting foreign direct investment (“**FDI**”) in LLPs. The amending notification is the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Third Amendment) Regulations, 2014 (“**Amendment**”), which is applicable with retrospective effect from May 20, 2011.

The Amendment has been long overdue in light of the fact that the Department of Industrial Policy & Promotion (DIPP) had in its press note 1 of 2011 permitted foreign direct investment (FDI) in LLPs, subject to certain conditions specified therein. Provisions relating to investment in LLPs are also incorporated in the consolidated FDI Policy effective from April 17, 2014.

Introduction

A LLP is a hybrid entity which merges characteristics of a body corporate with that of a partnership firm. The Limited Liability Partnership Act, which was notified in April 2009, allowed LLPs to be incorporated for the purposes of undertaking business in India. This note sets out the salient conditions with respect to FDI in LLPs.

1. Are all LLPs eligible for accepting an FDI investment?

No. Only the LLPs which are operating in sectors where 100% FDI under automatic route is allowed with no FDI linked performance conditions (such as Non Banking Finance Companies or Development of Townships, Housing, Built up infrastructure and construction development projects) are eligible to accept FDI. Accordingly LLPs operating in sectors where less than 100% FDI is permitted or sectors which are under approval route including sectors where any FDI linked performance conditions are attached (such as minimum capitalizations or other conditions) cannot accept FDI. Further, LLPs with FDI are not permitted to operate in agricultural / plantation activity, print media or real estate business.

Details of the sectors where 100% FDI under automatic route is allowed are set out in Schedule 1 Part B of FEMA 20.

2. **Who can invest in an LLP?**

A person who is resident outside India and an entity incorporated outside India (except a citizen or entity of Pakistan or Bangladesh) can invest in an LLP in India. Certain SEBI registered entities such as foreign venture capital investors, foreign institutional investors, qualified financial investor and foreign portfolio investors are not eligible to invest in an LLP in India.

3. **Method of Investment**

An eligible investor can invest in an LLP in India by way of a capital contribution or by way of acquisition of profit shares in the LLP from a partner of the LLP. Any investment in an LLP will require prior Government / FIPB approval.

A LLP is not eligible to avail of any external commercial borrowings.

4. **Pricing and Payment**

The fair price of any profit shares of an LLP (whether in context of investment by way of acquisition of profit shares or transfers) will need to be calculated based on any valuation norm which is internationally accepted / adopted per market practice. Such valuation shall be required to be undertaken by a chartered accountant, practicing cost accountant or an approved valuer from the panel maintained by the Central Government, and the valuer will need to issue a valuation certificate in this regard.

In cases of transfers of any capital contribution or profit shares from a resident to a non-resident, the transfer consideration shall be equal to or more than the fair price of capital contribution / profit share of the LLP. Where transfers of capital contribution / profit share is from a non-resident to resident, the transfer consideration shall be equal to or less than the fair price of the capital contribution / profit share of the LLP.

The payment by an eligible investor towards capital contribution or profit shares of an LLP is allowed only by way of cash consideration to be received by way of inward remittance through normal banking channels or by way of a debit to the NRE / FCNR(B) account of the investor maintained with an AD Category – I Bank.

5. **Reporting Requirements**

Any receipt of investment towards capital contribution or profit shares is required to be intimated by the LLP receiving the investment to the regional office of the RBI by way of 'Form Foreign Direct Investment – LLP (I)' within a period of 30 (thirty) days from the date of receipt of the amount of consideration. This form should be submitted together with copies of the foreign inward remittance certificate evidencing receipt of remittance, Know Your Customer report on the non-resident investor submitted through an AD Category I Bank and valuation certificate as regards pricing.

The regional office of the RBI will, after receipt of the above information, allot a unique identification number for the amount reported.

Any disinvestment / transfer of capital contribution or profit share between a resident and a non-resident (or vice versa) is required to be reported in 'Form Foreign Direct Investment – LLP (II)' within a period of 60 (sixty) days from the date of receipt of funds by the transferor.

It has also been clarified that LLPs which have received FDI from May 20, 2011 up to the date of issuance of these instructions by the RBI, are required to comply with the reporting requirements in respect of FDI (as specified above), from the date of issuance of these instructions.

6. Downstream Investments in and by LLPs

An Indian company with FDI is permitted to make downstream investment in LLPs only if both, the company and the LLP are operating in sectors where 100% FDI is permitted under the automatic route and there are no FDI linked performance related conditions. The onus to ensure compliance with the same, is on the LLP which accepts the investment.

An LLP which has received FDI is not eligible to make any downstream investments in any entity in India.

7. Certain Other Conditions

If the LLP receiving investment has a body corporate as a designated partner or nominates an individual to act as a designated partner in accordance with the provisions of Section 7 of the Limited Liability Partnership Act, 2008, the body corporate should only be a company registered in India under the provisions of the Companies Act, as applicable and not any other body, such as LLP or trust. In such LLPs, the designated partner 'resident in India' (*defined in Explanation to Section 7(1) of the Limited Liability Partnership Act, 2008*) is also required to satisfy the definition of 'person resident in India' as defined under Section 2 (v) (i) of the Foreign Exchange Management Act, 1999.

Conversion of a company with FDI, into an LLP, is allowed only if the aforementioned conditions are met and with the prior approval of the FIPB / government.

8. Compliance and Penalties

The designated partners of the LLP receiving an FDI will be responsible for compliance with all the above conditions and shall also be liable for all penalties imposed on the LLP for contraventions, if any.

Conclusion

The Amendment issued by the RBI comes as a welcome move as it clears the confusion which was hitherto existing relating to investments in LLPs in India. Although the DIPP had issued a press note permitting FDI in LLPs with a view to attracting more foreign investments, companies remained wary of such investments in the absence of a clear notification by the RBI in this regard. While the RBI has issued the Amendment opening up FDI for LLPs, it remains to be seen if there will be a significant change in the investment scenario in LLPs as this move of the RBI only seems to be a tentative opening considering that the conditions for making the FDI investment in LLPs are very restrictive.

On the larger point of determination of valuation, the Amendment seems to pave the way for change in the valuation norms as regards FDI transactions in general, as the RBI has recently suggested that it will revise the pricing guidelines for FDI to make it subject to acceptable market practices.

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