

Foreign investment in LLPs: an uncharted voyage

By Kartikeya Singh
and Raghuvveer
Sarathy,
Phoenix Legal



New Delhi

Second Floor,
254, Okhla Industrial Estate,
Phase III, New Delhi-110020
India
Tel +91 11 4983 0000
Fax: +91 11 4983 0099
Email: delhi@phoenixlegal.in

Mumbai

First Floor, CS-242,
Mathuradas Mill Compound,
NM Joshi Marg, Lower Parel
Mumbai - 400 013, India
Tel: +91 22 4340 8500
Fax: +91 22 4340 8501
Email: mumbai@phoenixlegal.in

In 2009, in an important step that gave enterprises the flexibility to combine the features of a partnership with that of a limited liability company, the government of India enabled the creation of limited liability partnerships (LLPs). However, at that time, India's foreign direct investment (FDI) policy did not permit foreign investment in LLPs.

Over the last year, perhaps mindful of falling FDI and the need to create alternate avenues for such investment, the government has been revisiting its FDI norms. As a result it now allows FDI in LLPs, albeit in a restricted manner. This month we discuss certain key aspects of the new policy.

In brief

The main changes introduced are:

(a) FDI is permitted in LLPs in sectors and activities where 100% FDI is allowed through the automatic route and where there are no FDI-linked performance related conditions.

(b) LLPs with FDI will not be eligible to make any downstream investments.

(c) LLPs with FDI will not be allowed to operate in agricultural or plantation activity, print media or real estate business.

(d) Indirect FDI in LLPs would also be permitted under the approval route, if both the investor company and the LLPs are operating in sectors where 100% FDI is allowed under the automatic route and where there are no FDI-linked performance related conditions.

(e) Foreign capital participation in the capital structure of the LLPs will be allowed only by way of cash consideration received by inward remittance through normal banking channels or by debit to non-resident external (NRE) or foreign currency non-resident (FCNR) accounts.

(f) Foreign institutional investors and foreign venture capital investors are not

permitted to invest in LLPs.

(g) LLPs will also not be permitted to avail of external commercial borrowings.

The conversion of a company with FDI into an LLP will be allowed only if the above conditions are met and with the prior approval of the Foreign Investment Promotion Board. The designated partners of an LLP would be responsible for compliance with the FDI conditions and would also be liable for all penalties imposed on the LLP for contravention of FDI related norms. If an LLP with FDI has a body corporate that is a designated partner, such a body corporate must be a company registered under the Companies Act, 1956, and not any other body corporate, such as an LLP or a trust.

Confusing conditions

The press release of 11 May that conveys the Cabinet Committee on Economic Affairs' decision to allow FDI in LLPs does not elaborate on the "FDI-linked performance related conditions". However, a press note issued by the Department of Industrial Policy and Promotion on 20 May gives illustrations of sectors where these conditions are found.

However, there is no guidance from the government on the criterion to determine if a condition is (a) FDI-linked, or (b) performance related. For instance, the press note gives "development of townships, housing, built up infrastructure and construction development projects" as an illustration.

As per the extant norms, FDI in development projects is subject to several conditions which include (a) minimum area to be developed, (b) minimum capitalization, (c) restriction on repatriation of investment, and (d) development milestones to be achieved, such as the development of at least 50% of the project

within five years from the date of obtaining all statutory clearances. While conditions (a) to (c) apply to the investment, they do not have a performance element. But condition (d) clearly provides a performance target. However, conditions for the other sector mentioned in the illustrations in the press note, i.e. non-banking finance companies, do not have any performance-related conditions and rather relate to capitalization levels.

Valuation worries

The Limited Liability Partnership Act, 2008, states that every contribution to the capital of an LLP shall have a monetary value, determined by a chartered accountant. While the Reserve Bank of India (RBI) has prescribed how companies with FDI investments are to be valued, it has not laid down norms for the valuation of LLPs. Specifying valuation norms that apply to LLPs with FDI will offer greater clarity to foreign investors.

The way ahead

The LLP combines the best of both the worlds: the operational flexibility of a partnership with the relatively detached liability of a company. However, there is a lack of commercial familiarity with this novel structure and absence of any jurisprudence (in the form of judicial rulings) relating to LLPs in India. Until this commercial and jurisprudential vacuum is filled, the attractiveness of LLPs for foreign investors will depend on the ability of the government and the RBI to identify and resolve issues.

Kartikeya Singh is a counsel and Raghuvveer Sarathy is an associate at the Mumbai office of Phoenix Legal. They can be reached at kartikeya.singh@phoenixlegal.in and raghuveer.sarathy@phoenixlegal.in.