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Foreign Direct Investment

February 2017

The Foreign Direct Investment (FDI) regime for Limited Liability Partnerships (LLPs)

Background

The Limited Liability Partnership Act, 2008 (the "LLP Act"), which came into effect on March 31, 2009, gave form to the theoretically proposed structure of LLPs by the Seventh Law Commission in 1957.

An LLP, with its inherent flexibility and tax efficient structure, is essentially a hybrid between a limited liability company ("**company**") and a partnership. Receiving the best of both worlds, it embodies limited liability for its partners, just like a company, and taxation benefits of a partnership firm. Some advantages of using an LLP structure are:

- Simpler and less expensive process of formation as compared to a company.
- Being a separate legal entity, an LLP can enter into contracts and hold property in its own name, therefore limiting the liability of its partners to their agreed contribution. The few exceptions to this being matters of negligence, fraud or unauthorized acts.
- Unlike partnership firms, an LLP being a regulated body can raise funds from private equity investors or other financial institutions.
- LLPs have no mandatory requirement for account auditing, unless contribution of LLP exceeds 25 lakhs or annual turnover exceeds 40 lakhs.
- Internal management, rights of the partners and profit sharing ratio of partners in an LLP are governed as per the mutual agreement between the partners.
- Unlike companies, LLPs are not subject to Dividend Distribution Tax.

Foreign Direct Investment ("FDI") in LLPs

Since their inception, LLPs in India have been riddled with obtaining prior government approval for receiving FDI and facing blanket restrictions on downstream investments. However, on November 24, 2015, in line with the Indian Government's "ease of doing business in India" campaign, the Department of Industrial Policy and Promotion ("DIPP") issued Press Note 12 of 2015 to relax FDI investments in LPPs in the following two ways:

i. FDI permitted under automatic route in LLPs operating in sectors which have 100% FDI allowance under automatic route.

ii. LLPs having FDI may make downstream investments into another company or LLP in sectors where 100% FDI is allowed under the automatic route.

Both (i) and (ii) are permitted, provided there are no FDI-linked performance conditions. This essentially means that in sectors where 100% FDI is allowed under automatic route and which have prescribed conditions, such as minimum capitalization, LLPs will not be allowed to bring FDI in such sectors without prior governmental approval.

Further, downstream investments by LLPs have the following compliance requirements:

- LLP to notify SIA, DIPP and FIPB of its downstream investment within 30 days of such investment, even if capital instruments have not been allotted along with the modality of investment in new/existing ventures.

- Downstream investment by way of induction of foreign equity into an existing Indian company must be supported by a Board resolution and shareholders agreement, if any.

- Issue/transfer/pricing/valuation of shares shall be in accordance with applicable SEBI/RBI guidelines.

- LLPs making the downstream investments would have to bring in requisite funds from abroad and not leverage funds from the domestic market. This would, however, not preclude downstream LLPs, with operations, from raising debt in the domestic market.

- Downstream investments through internal accruals are permissible. Here, 'internal accruals' means profits transferred to reserve account after payment of taxes.

Despite the allowance of FDI, the LLP structures in India still face some restrictions. Foreign Capital participation in LLPs is allowed only by way of cash considerations, received by inward remittance, through normal banking channels, or by debit to NRE/FCNR account (maintained with an authorized dealer/authorized bank) of the person concerned. Further, prior governmental permission is required to make non-cash/intangible contribution towards the capital of an LLP. The government has also not permitted Foreign Institutional Investors (FIIs) and Foreign Venture Capital Investors (FVCIs) to invest in LLPs. LLPs are also not permitted to avail External Commercial Borrowings (ECBs).

Conclusion

LLP structures have long been in use globally and have proven to be specifically advantageous for professionals to come together under its umbrella and work seamlessly without being burdened with the compliance requirements of a company or the personal exposure involved in a partnership firm. By allowing FDI investments into LLPs, India has taken a bold step in the right direction. However, to bring Indian LLPs at par with the global LLP structures, the government will soon have to address the above stated shortcomings.

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