

CTC FEMA Study Circle

CA. SIDDHARTH BANWAT

LLP Key Features

Body Corporate with perpetual succession

Separate legal entity governed by LLP Act, 2008

Limited liability of partners

Efficient structure of a body corporate

ROC Administered

Draw down of capital without restrictions

No limit on max number of partners (minimum 2)

An individual / body corporate can be a partner

Interest in LLP can be assigned / transferred by a partner

INBOUND INVESTMENT
**Foreign Direct Investment in Limited
Liability Partnership (LLP)**

FDI In LLP: Regulatory Developments

Press Note No. 1 dated 20 May 2011 issued by DIPP to amend the FDI policy allowing FDI in LLPs with certain conditions subject to **Govt approval**

Provisions first incorporated in FDI policy issued in Oct 2011

2011

Inbound Regulations (FEMA 20) amended to incorporate provisions of FDI in LLP by Notification dated 13 March 2014

2014

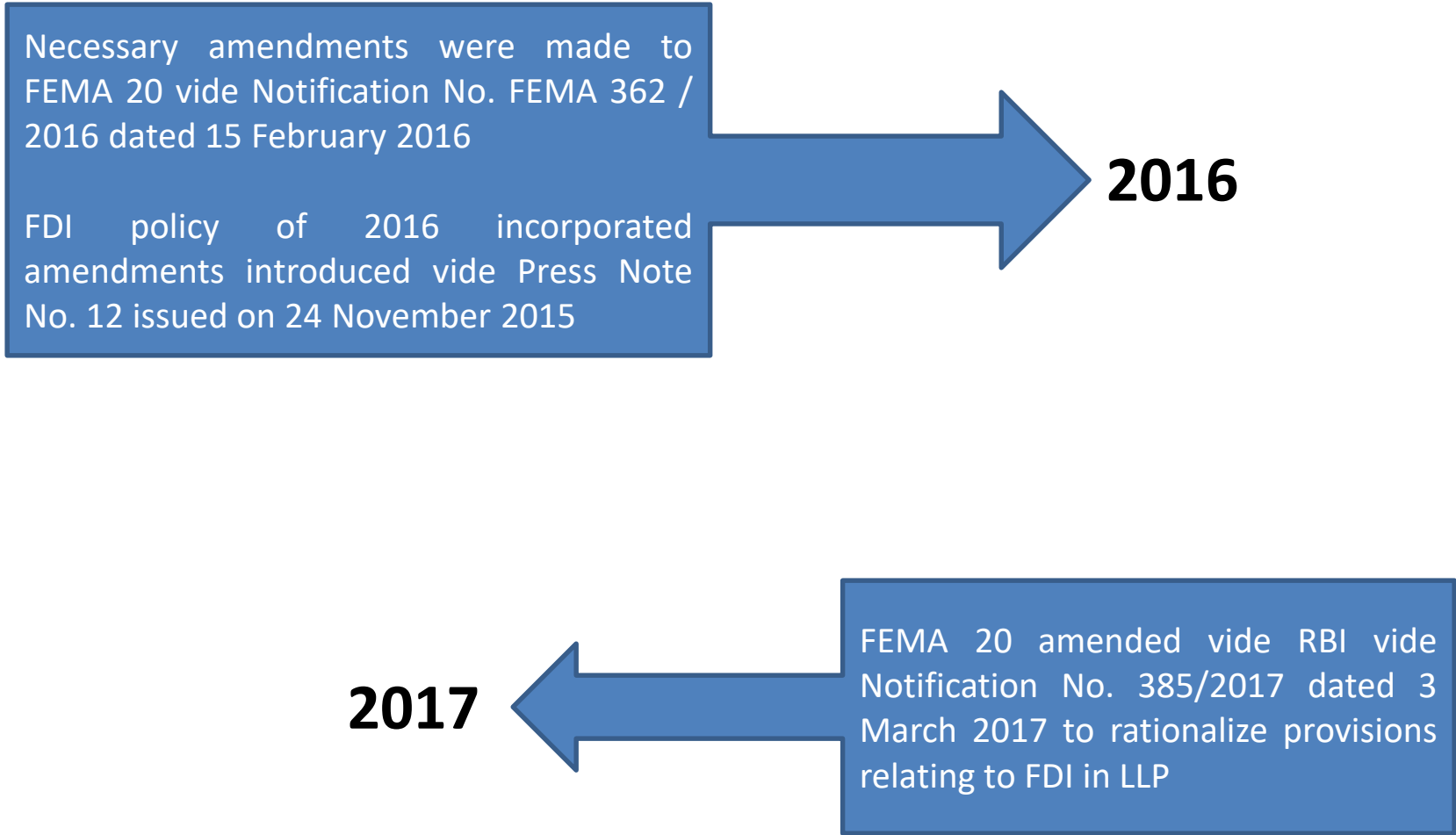
FDI permitted subject to Govt approval

Press Note No. 1 dated 20 May 2011 issued by DIPP to amend the FDI policy allowing FDI in LLPs with certain conditions subject to **Govt approval**

Provisions first incorporated in FDI policy issued in Oct 2011

2015

FDI In LLP: Regulatory Developments



Investment in LLP-Schedule 6

A Snapshot

- A person resident outside India (other than a citizen of Pakistan or Bangladesh) or an entity incorporated outside India (other than an entity incorporated in Pakistan or Bangladesh), not being a Foreign Portfolio Investor (FPI) or a Foreign Venture Capital Investor (FVCI), may contribute to the capital of an LLP operating in sectors/ activities where foreign investment up to 100 percent is permitted under automatic route and there are no FDI linked performance conditions.
- Investment by way of 'profit share' will fall under the category of reinvestment of earnings
- Investment in an LLP is subject to the compliance of the conditions of Limited Liability Partnership Act, 2008.
- A company having foreign investment, engaged in a sector where foreign investment up to 100 percent is permitted under the automatic route and there are no FDI linked performance conditions, can be converted into an LLP under the automatic route.

Investment in LLP-Schedule 6

A Snapshot

- An LLP having foreign investment, engaged in a sector where foreign investment up to 100 percent is permitted under the automatic route and there are no FDI linked performance conditions, may be converted into a company under the automatic route.
- Investment in an LLP either by way of capital contribution or by way of acquisition/ transfer of profit shares, should not be less than the fair price worked out as per any valuation norm which is internationally accepted/ adopted as per market practice (hereinafter referred to as "fair price of capital contribution/ profit share of an LLP") and a valuation certificate to that effect shall be issued by the Chartered Accountant or by a practicing Cost Accountant or by an approved valuer from the panel maintained by the Central Government.

Investment in LLP-Schedule 6

A Snapshot

- In case of transfer of capital contribution/ profit share from a person resident in India to a person resident outside India, the transfer shall be for a consideration not less than the fair price of capital contribution/ profit share of an LLP. Further, in case of transfer of capital contribution/ profit share from a person resident outside India to a person resident in India, the transfer shall be for a consideration which is not more than the fair price of the capital contribution/ profit share of an LLP.
- Payment by an investor towards capital contribution of an LLP shall be made by way of an inward remittance through banking channels or out of funds held in NRE or FCNR(B) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.
- The disinvestment proceeds may be remitted outside India or may be credited to NRE or FCNR(B) account of the person concerned.

Who can Invest in an LLP?

LLP Act

As per Section 5 of LLP Act, 2008,

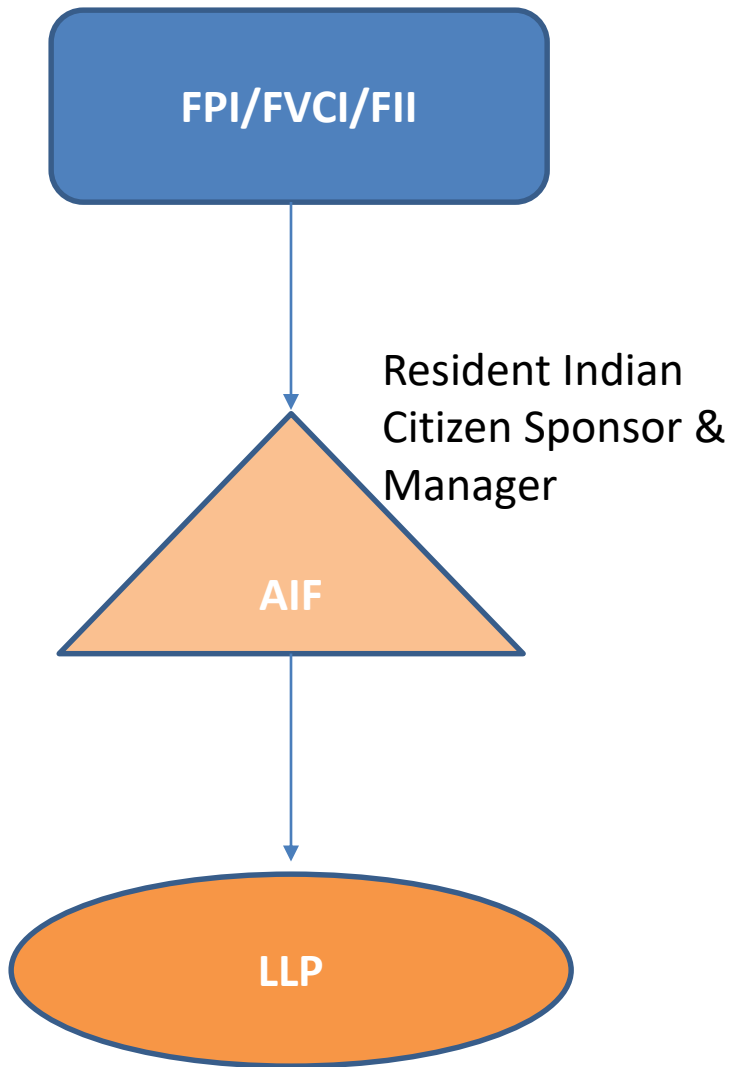
- any individual; or
- body corporate can be partner in LLP

FEMA 20

As per Regulation 5(9) of FEMA 20 read with Schedule 6, any person resident outside India or an entity incorporated outside India are permitted to invest in an LLP

Following persons are specifically restricted from investing in an LLP:

- ❖ a citizen / entity in Pakistan and Bangladesh
- ❖ a SEBI registered FII
- ❖ a SEBI registered FVCI
- ❖ a SEBI registered FPI



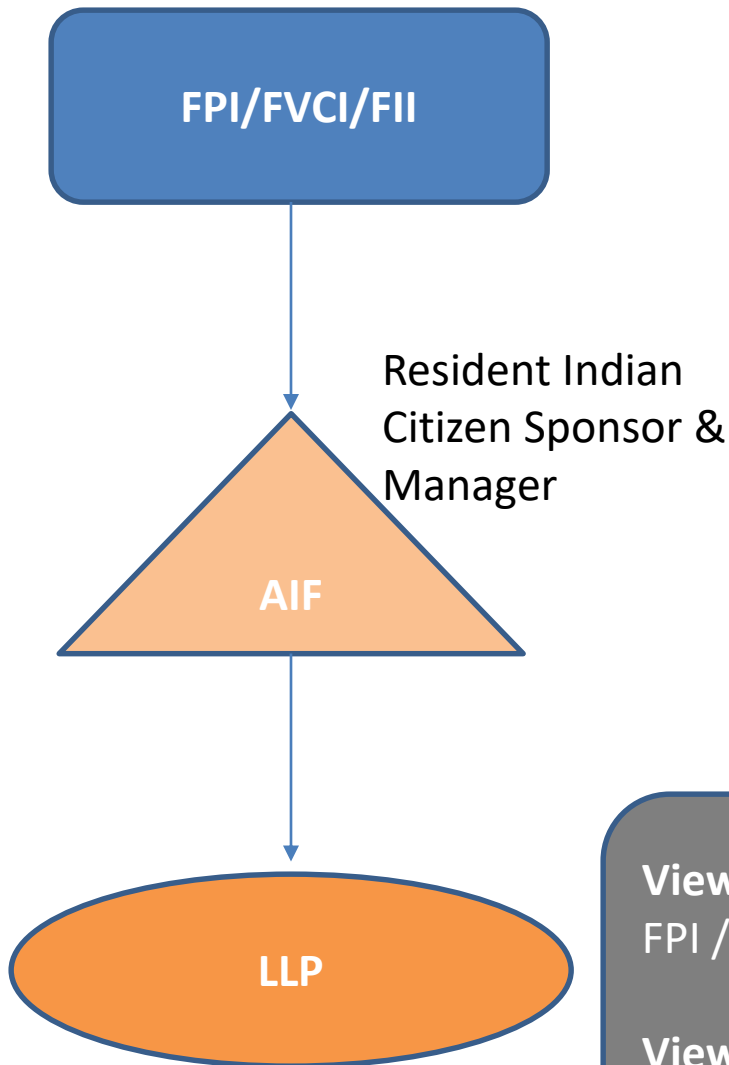
Whether FPI / FVCI / FII can invest in LLP through AIF ?

LLP Act

- As per section 5 of LLP Act, an individual or body corporate permitted to become partner in LLP
- MCA vide General Circular no. 37/2014 dated 14.10.2014 has clarified that for the trusts set up under prescribed SEBI Regulations, it is not barred for a Trustee, being a body corporate, to hold partnership in LLP

FEMA 20 (Schedule 9)

- Schedule 6 of FEMA 20 restricts FPI / FVCI from investing in LLP

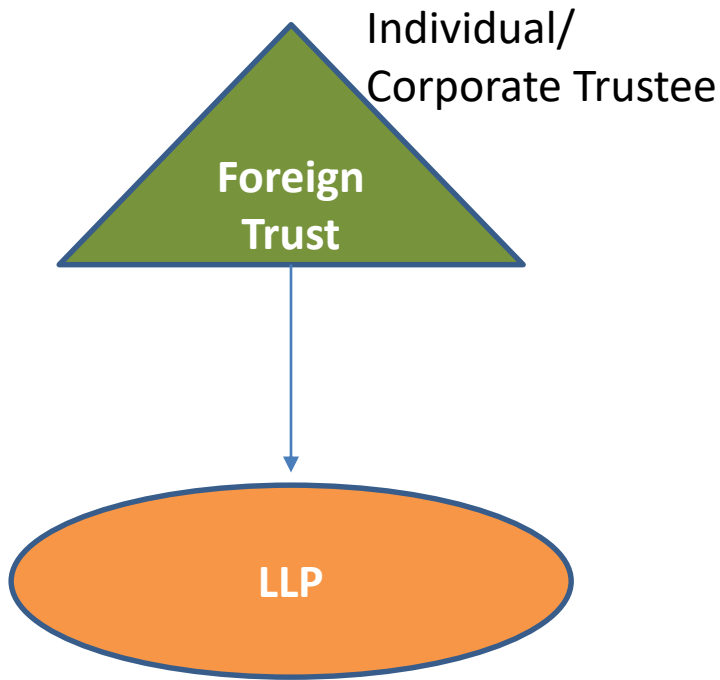


FEMA 20 (Schedule 11)

- A person resident outside India including an FPI may invest in units of AIF in accordance with Schedule 11 of FEMA 20
- Downstream investment by AIF not to be regarded as foreign investment where sponsor as well as manager are Indian owned and controlled
- AIF III with foreign investment shall make portfolio investment in only those securities or instruments in which FPI is allowed to invest as per FEMA 20

View 1: Indian owned and controlled AIF I / AIF II wherein FPI / FVCI / FII has invested funds may invest in an LLP

View 2: What cannot be directly should not be done indirectly



Whether Foreign Trust can become a Partner in LLP

LLP Act

- As per section 5 of LLP Act, an individual or body corporate permitted to become partner in LLP
- MCA vide General Circular no. 37/2014 dated 14.10.2014 has clarified that for the trusts set up under prescribed SEBI Regulations, it is not barred for a Trustee, being a body corporate, to hold partnership in LLP

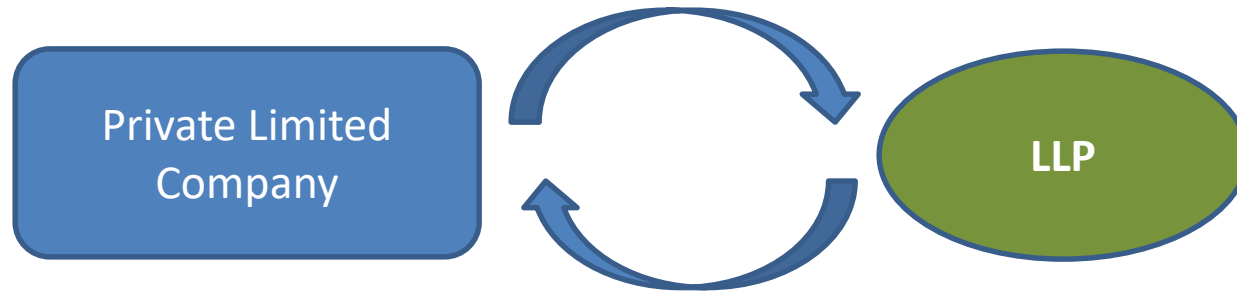
FEMA 20

As per Regulation 5(9) of FEMA 20 read with Schedule 9, any person resident outside India or an entity incorporated outside India are permitted to invest in an LLP

FEMA Act Section 2(u)

Person Includes an Individual, a Hindu undivided family, a company, a firm, an association of persons or a body of individuals, whether incorporated or not, every artificial juridical person, not falling within any of the preceding sub-clauses, and any agency, office or branch owned or controlled by such person

CONVERSION OF COMPANY INTO LLP AND LLP INTO COMPANY-FDI PERSPECTIVE



FDI in LLP permitted under automatic route where –

- LLP operates in sectors / activities where 100% FDI is allowed under the automatic route **and**
- there are no FDI linked performance conditions

FDI in LLP is subject to the compliance of conditions of LLP Act, 2008

- Company having FDI can be converted into LLP under automatic route where It is engaged in a sector where foreign investment **up to** 100% is permitted under automatic route **and**
- there are no FDI linked performance conditions
- Similarly, an LLP having foreign investment, engaged in a sector where foreign investment up to 100 percent is permitted under the automatic route and there are no FDI linked performance conditions, may be converted into a company under the automatic route.

PRICING REQUIREMENT



LLP Rules, 2009 [Rule 23(2)]

- Contribution of a partner consisting of tangible, movable or immovable or intangible property or other benefits brought or contribution by way of an agreement or contract for services shall be valued by a practicing Chartered Accountant or by a practicing Cost Accountant or by approved valuer from the panel maintained by the Central Government

FEMA 20 (Schedule 9)

- FDI in LLP to be more than or equal to the fair price as worked out as per any valuation norm which is internationally accepted/ adopted as per market practice
- A valuation certificate to be issued by a Chartered Accountant or a practicing Cost Accountant or an approved valuer from the panel maintained by the Central Government

PRICING REQUIREMENT

FEMA 20 (Schedule 9)

Transfer of capital contribution / profit share also subject to above valuation requirement

- In case of transfer from a resident to a non-resident – transfer to be for a consideration equal to or more than fair price of capital contribution/profit share of an LLP
- In case of transfer from a non-resident to resident –transfer to be for a consideration less than or equal to fair price of capital contribution/profit share of an LLP

HOW TO DETERMINE PRICE

- The fair market value of the LLP can be determined using any of the international accepted methodology such as Discounted Free Cash Flow Method (DCF), Net Asset Value Method (NAV), Earning Capitalisation Approach.
- The value represents 100% Profit share of the LLP and therefore, the price per percent of profit needs to be determined. Accordingly, the value of share for which the FDI is coming needs to be computed
- For Instance

Particulars	Amount in INR
Value of LLP using any of the international accepted methodology	10,00,000
Value Per Percent of Profit Share (A/100)	10,000
Fair value for FDI coming for acquiring 20%	2,00,000

FDI IN LLP –SECTOR WISE

Particulars	Route
Mining Mining and Exploration of metal and non-metal ores including diamond, gold, silver and precious ores but excluding titanium bearing minerals and its ores; subject to the Mines and Minerals (Development & Regulation) Act, 1957.	100%-Automatic
Petroleum & Natural Gas Exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas, marketing of natural gas and petroleum products, petroleum product pipelines, natural gas/ pipelines, LNG Regasification infrastructure, market study and formulation and Petroleum refining in the private sector, subject to the existing sectoral policy and regulatory framework in the oil marketing sector and the policy of the Government on private participation in exploration of oil and the discovered fields of national oil companies.	100%-Automatic

Whether conditions under respective sectoral legislation can be interpreted to be FDI-linked performance related conditions?

FDI IN LLP ENGAGED IN CONSTRUCTION

PROI

FDI

LLP



FDI Policy

FDI Policy was amended vide press note 12 dated 24 November 2015 wherein conditions relating to minimum capitalization and area restrictions were removed

However, FDI policy still contains condition permitting investor to exit on completion of the project / after development of trunk infrastructure i.e. roads, water supply, street lighting, drainage and sewerage or after 3 years whichever is earlier

Whether exit related conditions would be considered as FDI linked performance conditions which would restrict FDI in LLP operating in construction sector under automatic route ?

FDI IN LLP ENGAGED IN CONSTRUCTION

NRI/OCI

FDI

LLP

Condition of lock-in period **will not apply** to Hotels and Tourist Resorts, Hospitals, Special Economic Zones (SEZs), Educational Institutions, Old Age Homes and **investment by NRIs/ OCIs.**



MODE OF FDI IN LLP

LLP Act

Section 32 of LLP Act permits a partner to contribute to capital of LLP either in cash or in kind

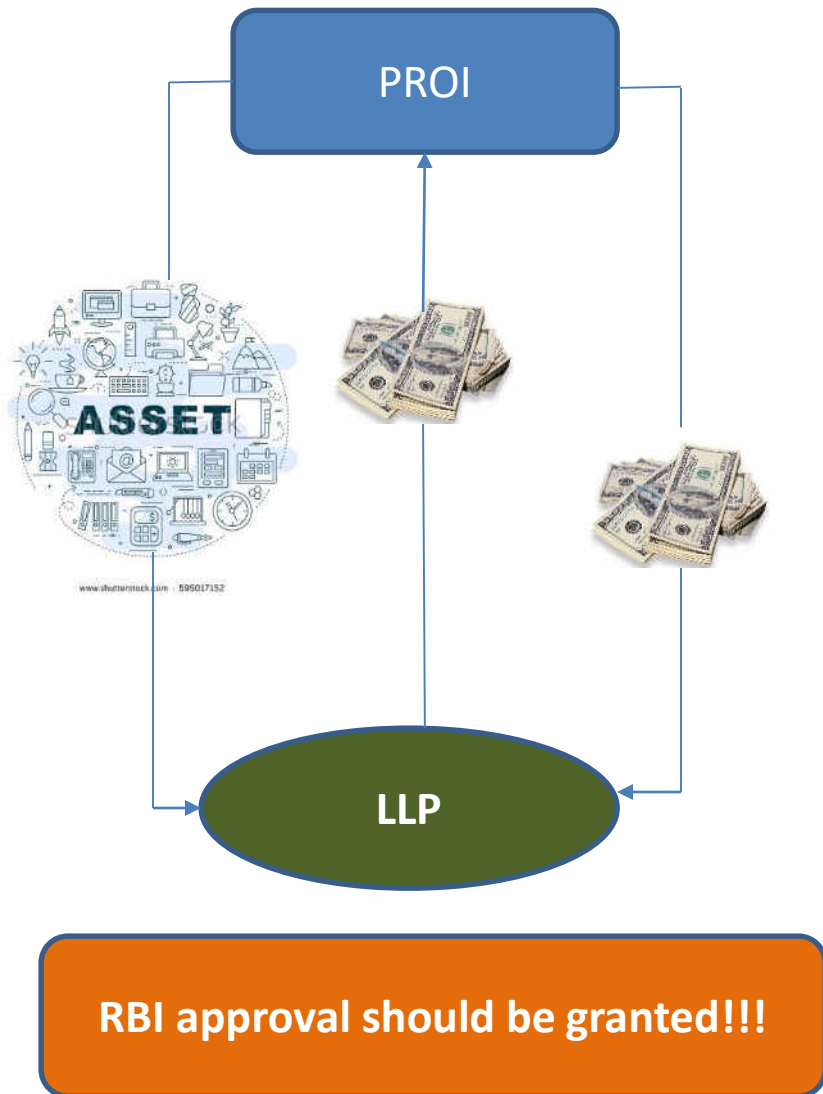
FEMA 20 (Schedule 9)

Payment by an investor towards capital contribution in LLP is permitted:

- by way of inward remittance through normal banking channels; or
- by debit to NRE/FCNR(B) account of the person concerned, maintained with AD Category - I bank

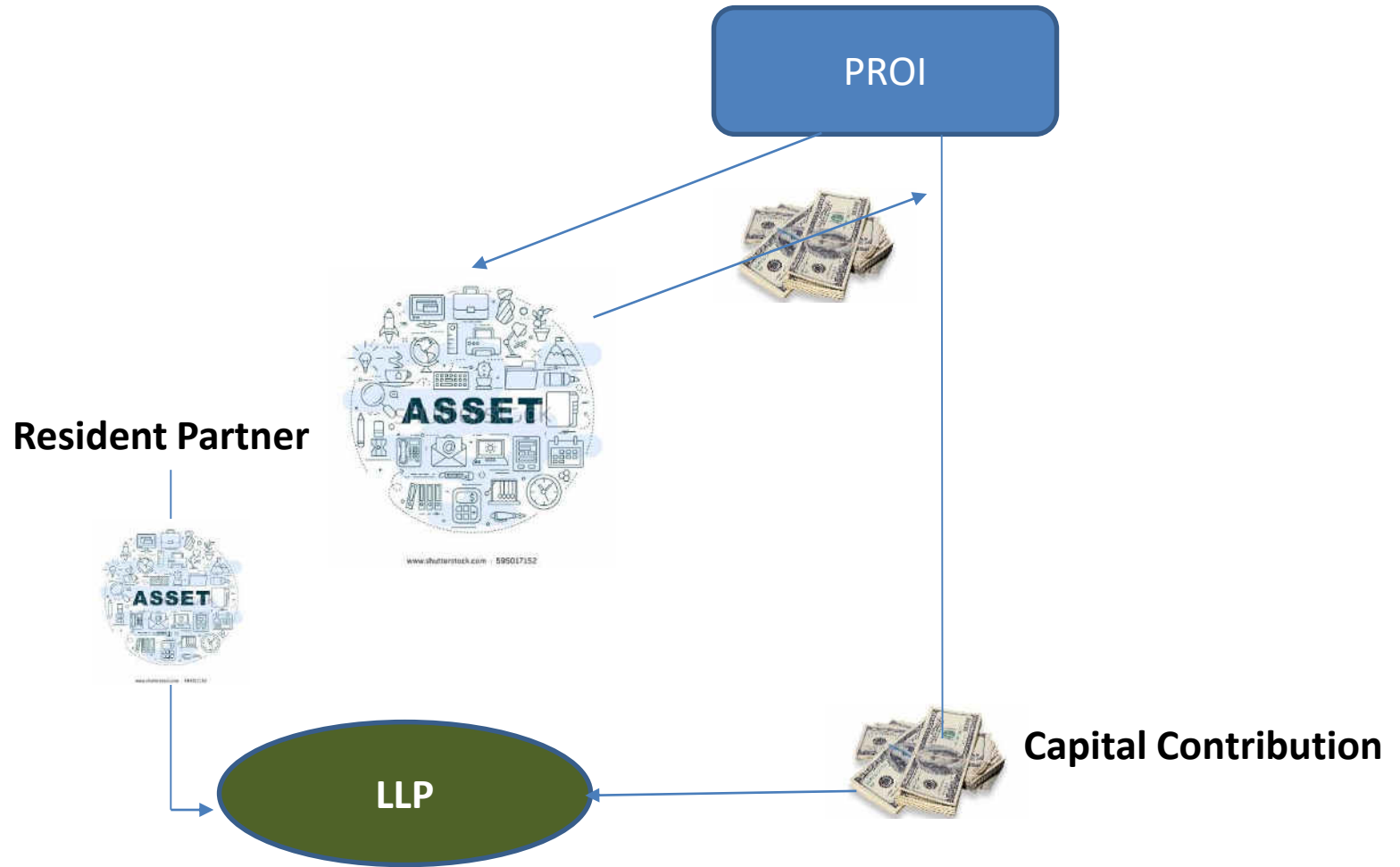
Non-resident partner is not permitted to contribute assets / technical know-how / IP as capital contribution in LLP

MODE OF FDI IN LLP



- Person Resident Outside India sells the asset to the LLP and receives consideration in cash.
- Thereafter, with such cash consideration received, PROI will invest in the capital of the LLP
- Issuing equity against import of capital goods is permitted under automatic route
- Unnecessary charges for remittance of funds from India to Outside and then bringing it back into India
- Valuation of asset being contributed

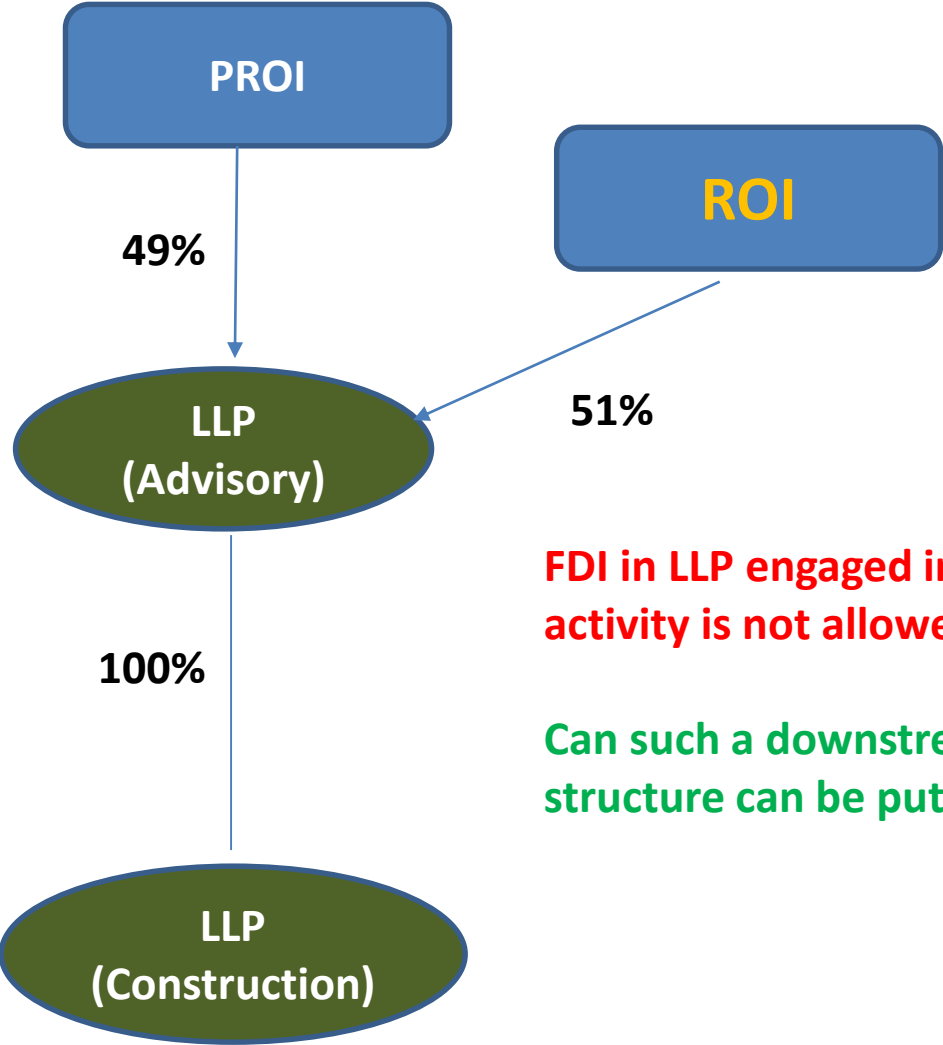
MODE OF FDI IN LLP



DOWNSTREAM INVESTMENT BY LLP HAVING FDI

- Downstream investment means indirect foreign investment, by an Indian entity, into another Indian company / LLP, by way of subscription or acquisition
- Downstream investment by an LLP **not owned and not controlled by resident Indian citizens or owned or controlled by persons resident outside India** is allowed in an Indian company operating in sectors where foreign investment up to 100 percent is permitted under automatic route and there are no FDI linked performance conditions.
- ‘Ownership of an LLP’ shall mean contribution of more than 50 percent in its capital and having majority profit share.
- ‘Control’ shall mean the right to appoint majority of the designated partners, where such designated partners, with specific exclusion to others, have control over all the policies of an LLP

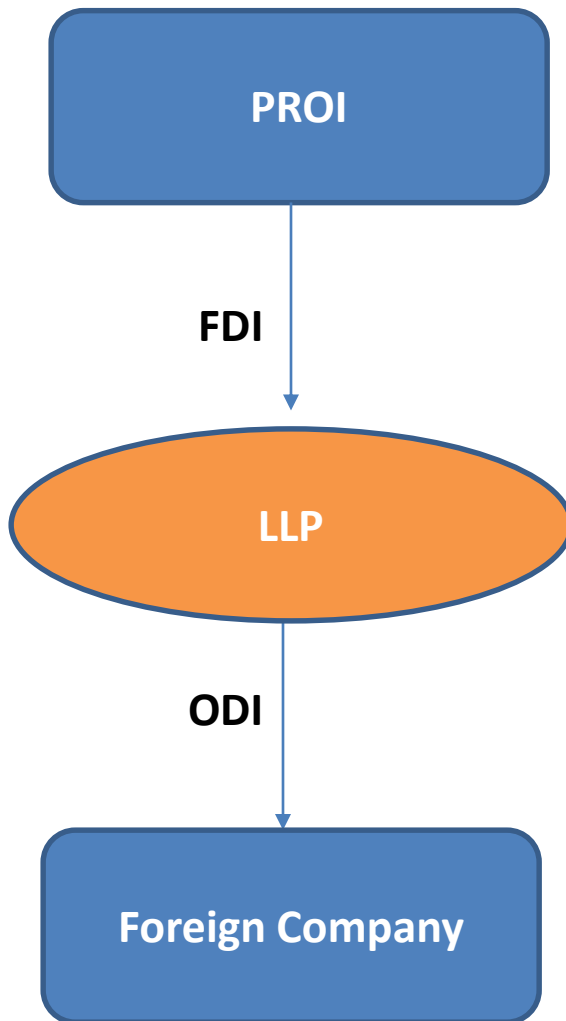
DOWNSTREAM INVESTMENT BY LLP HAVING FDI



FDI in LLP engaged in Construction activity is not allowed

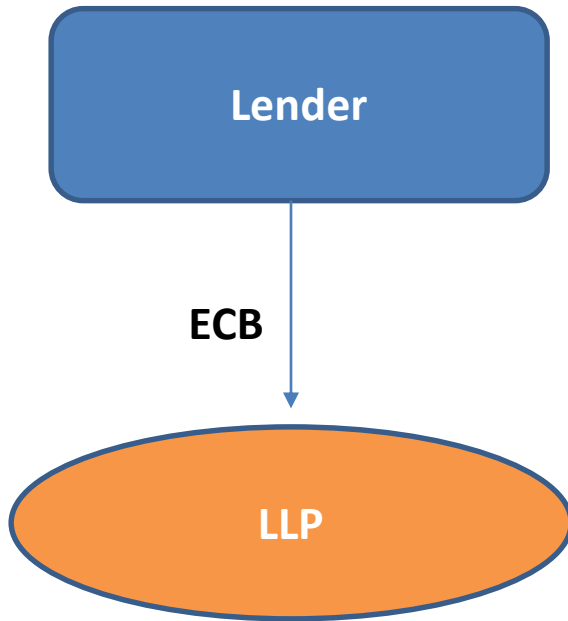
Can such a downstream investment structure can be put in place ?

ODI BY LLP HAVING FDI



- FEMA 120 permits an LLP to make Outbound Investments however it does not explicitly deal with LLP involving FDI
- FDI Policy and FEMA 20 specifically permit an Indian Company or an LLP with FDI to make 'downstream investment' in another company or LLP, subject to certain conditions
- Downstream investment means indirect foreign investment, **by an Indian entity, into another Indian company / LLP**, by way of subscription or acquisition
- Outbound Investment by an Indian LLP having FDI should be permitted and the **same should not be subject to the conditions applicable in case of downstream investment by LLP**

WHETHER LLP CAN AVAIL ECB



- FEMA 20 (prior to Notification No. FEMA 385/2017 – RB dated 03 March 2017 specifically stated that LLPs shall not be permitted to avail ECB
- RBI vide Notification dated 3 March 2017 has amended FEMA 20 wherein prohibition on an LLP from availing ECB was removed. However, ECB regulation was not amended
- New ECB regulation dated December, 17, 2018 has been issued.
- Eligible Borrowers (Schedule 1)

All entities eligible to receive FDI in terms of FEMA 20 dated November, 07,2017.

INVESTMENT IN LLP ON NON-REPATRIATION BASIS

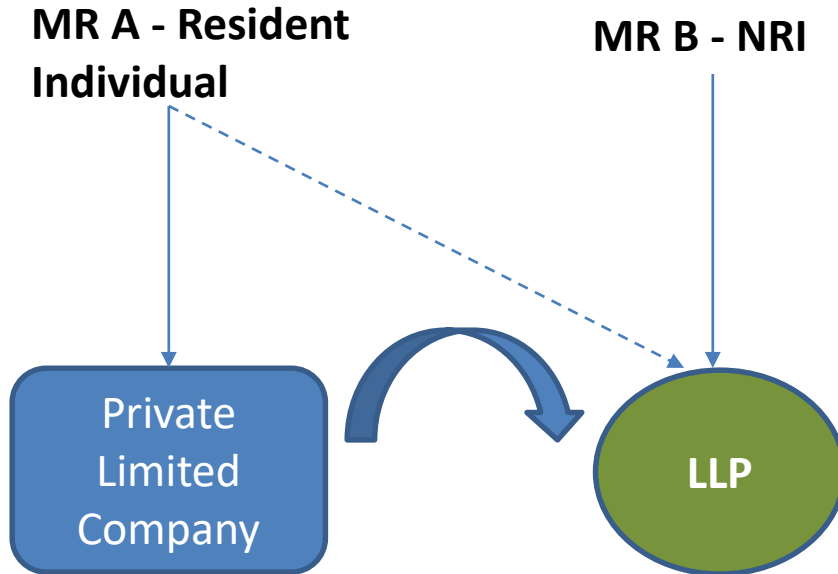
- Subject to the terms and condition specified in Schedule 4 of FEMA 20, a **Non-Resident Indian or an Overseas Citizen of India** may, on non-repatriation basis, purchase or sell capital instruments of an Indian company or purchase or sell units or contribute to the capital of a LLP or a firm or proprietary concern.
- ‘Non Resident Indian (NRI)’ means an individual resident outside India who is a citizen of India
- ‘Overseas Citizen of India (OCI)’ means an individual resident outside India who is registered as an Overseas Citizen of India Cardholder under Section 7(A) of the Citizenship Act, 1955;

SCHEDULE 4

- A Non-resident Indian (NRI) or an Overseas Citizen of India (OCI), including a company, a trust and a partnership firm incorporated outside India and owned and controlled by NRIs or OCIs, may purchase/ contribute, as the case may be, on non-repatriation basis the following:
 - ❖ Any capital instrument issued by a company without any limit either on the stock exchange or outside it.
 - ❖ Units issued by an investment vehicle without any limit, either on the stock exchange or outside it.
 - ❖ **The capital of a Limited Liability Partnership without any limit.**
 - ❖ Convertible notes issued by a startup company in accordance with these Regulations.

The investment on Non-Repatriation basis will be deemed to be domestic investment at par with the investment made by residents

POTENTIAL FEMA IMPLICATION?

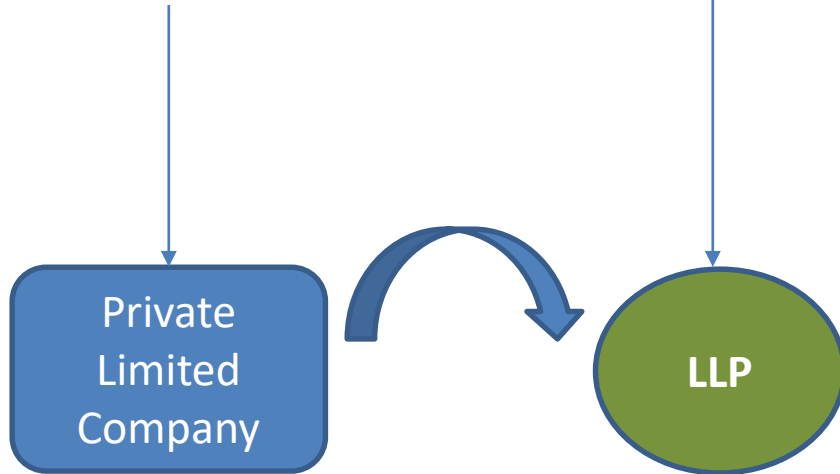


- A parcel of Land lying in a company owned by Mr. A. Mr. A wants to give the land to his brother Mr. B who is a NRI
- If Mr. A gifts the shares of company to Mr. B, then there might be stamp duty implications . Further, distribution will have DDT implication and additional tax under 115BBDA. Mr. A and Mr. B does not want to sell the land as of today as future appreciation is expected in the land parcel
- Instead, Mr. A converts the company into LLP (main object: development of Real Estate). Thereafter, Mr. B contributes nominal capital into LLP on a non-repatriation basis for a profit share of 95% (no pricing guidelines applicable).

POTENTIAL FEMA IMPLICATION?

MR A Resident
Individual

MR B NRI



- The LLP does some development activity on land and then sells it off.
- The profit generated is repatriated by Mr. B as his share of profit without any limit (USD 1 million limit not applicable on current account transaction)

REPORTING

1. **Form FDI- LLP (I)**: A Limited Liability Partnerships (LLPs) receiving amount of consideration for capital contribution and acquisition of profit shares is required to submit a report in Form Foreign Direct Investment-LLP (I) within 30 days from the date of receipt of the amount of consideration. The form shall be accompanied by:
 - i. copy/ies of the FIRC/s evidencing the receipt of the remittance
 - ii. a KYC report in respect of the foreign investor in the format specified in.

2. **Form FDI- LLP (II)**: The LLPs shall report disinvestment/ transfer of capital contribution or profit share between a resident and a non-resident (or vice versa) within 60 days from the date of receipt of funds in Form Foreign Direct Investment-LLP(II).

3. All LLPs which have received FDI in the previous year(s) including the current year shall submit to the RBI '**Annual Return on Foreign Liabilities and Assets**' on or before the 15th day of July of each year

UNADDRESSED ISSUES

- 1. Interest on Partners Capital: It has not been specifically addressed whether interest on Partners Capital can be paid**

Interest on partners capital is in the nature of current account transaction and therefore, there should be no FEMA implication on payment of interest on Partners Capital. Further, maximum rate of interest allowed as per LLP Act is 12%

- 2. Withdrawal Partners Capital: It has not been specifically addressed whether Partners Capital can be withdrawn**

Current capital which is accumulation of profits earned by the LLP can be withdrawn as the same is a current account transaction.

OUTBOUND INVESTMENT
Overseas Direct Investment by a
Limited Liability Partnership (LLP)

Overseas Investment by LLP

A Snapshot

- Notification No. 299/2014-RB dated 24th March, 2014 (published in the Gazette on 7th May, 2014): Definition of “Indian Party” in the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 amended to include ‘LLP’.
- Therefore, an Indian Party, which now includes LLPs, can make ‘direct investment outside India’ and undertake ‘financial commitment’ in an overseas Joint Venture (JV) or Wholly Owned Subsidiary (WOS).
- Prohibited Sectors/ Activities (require prior approval of RBI)
 - Real Estate – buying and selling of real estate or trading in TDRs but does not include development of townships, construction of residential/commercial premises, roads or bridges
 - Banking Business
 - Offering financial products linked to Indian Rupee (e.g. non-deliverable trades involving foreign currency, rupee exchange rates, stock indices linked to Indian market, etc.) – requires specific approval of RBI

Overseas Investment by LLP

A Snapshot

- Reporting to be done

- Form ODI – Part I to report financial commitment (within 30 days of remittance)
- Annual Performance Return (APR) – annually by 31st December for the previous financial year. To report the financial status of the overseas JV/ WOS
- Return of Foreign Liabilities & Assets (FLA) – filed by 15th July every year.

Note: The Regulations & Master Direction on Reporting refers only to 'Indian Companies', not 'Indian Party', being required to file FLA.

- Form ODI – Part III to report disinvestment within 30 days from date of disinvestment

Overseas Investment by LLP

A Snapshot

- Pricing Guidelines

- Investment should be at a price equal to or less than fair value as determined by CA as per internationally accepted pricing methodology
- If investment exceeds US\$5 million or involves swap of capital instruments, valuation to be obtained from Merchant Banker
- Sale/ Transfer must be at price not less than fair value of shares certified by a Chartered Accountant / Certified Public Accountant as the fair value of the shares based on the latest audited financial statements of the JV / WOS

ISSUES

Monetary Limit for Investment – Net Worth

- ODI Limit for financial commitment w/o prior approval is US\$ 1 Billion in a single financial year **and** 400% of Net Worth as per last audited balance sheet.
- "Net Worth" means paid up capital and free reserves. For LLP, there is no concept of 'paid up' capital and 'free' reserves, therefore, meaning has to be inferred – there is potential for ambiguity.

Certification of Statutory Auditor

- Not all LLPs require to appoint a Statutory Auditor and undertake Statutory Audit as per LLP Act, 2008.
- Where certification from Statutory Auditor is required or audited financial statements are required, will LLP have to undertake audit only to comply with ODI Regulations?

ISSUES

Restructuring Balance Sheet involving write off of capital & receivables

- Conditions relating to restructuring balance sheet of overseas entity that involves write off only deal with listed and unlisted companies.
- Does this mean that overseas entity where there is an LLP shareholder, write off of capital & receivables is prohibited, or does it mean that prior approval is required?

Sale of Shares of JV/ WOS involving write off of the investment/ financial commitment

- Where sale involves write off, prior approval is not required in case of unlisted company where investment/ financial commitment in overseas entity does not exceed US\$ 10 mn.
- Does this mean that for LLP with financial commitment less than US\$ 10 million, prior approval would be required for any sale involving write off?

THANK YOU

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