

October 29, 2010

To,

Department of Industrial Policy & Promotion

New Delhi

Sub: Discussion Paper on FDI in LLP

Respected Sir,

In reference to the captioned subject, please find our comments on allowing FDI in LLP enclosed herewith for your review and consideration.

Thanking you

Yours Sincerely

For Corporate Professionals (India) Pvt Ltd


Ankit Singhi
Manager

Encl: a/a

SECTORS IN WHICH LLP IS REGISTERED

As per the data available on www.llp.gov.in as on October 15th, 2010, following are some of sectors in which most of LLP have been registered in India till date:

S.No	Activity Description	Number of Registration
1.	Construction	222
2.	Wholesale Trade and Commission Trade, except of motor vehicles and motorcycles	198
3.	Retail trade, except of motor vehicles and motorcycles; repair of personal and household goods	71
4.	Real estate activities	237
5.	Computer and related activities	288
6.	Other business activities	750
7.	Education	86

INTERNATIONAL EXPERIENCE IN FDI IN LLP

In countries like USA, UK and Singapore, FDI is allowed under LLP in most of the sectors and is not only restricted to professionals services.

ISSUES FOR CONSIDERATION:

- a) **Should FDI be permitted in LLPs at all? Can it be argued that given its limited attractiveness for large investments, allowing FDI in LLPs will not significantly accelerate FDI into the country while disproportionately increasing the regulatory burden? Does the present uncertainty on how this business model will proceed, as well its yet unestablished case law, magnify these concerns?**

Currently Foreign investors who are looking to invest or start up their business in India are provided with only one form of business i.e. Company, whereas in

developed countries like USA, UK, apart from company, FDI is allowed in other various forms like LLC, LLP, S corporation etc without any approval. Though FDI is allowed in partnership for NRI under automatic route without repatriation and with government approval with repatriation but because of its loose structure, it has failed to gather any attention and stats with Department in this regards, would also agree.

India with the introduction of the concept of LLP has not only provided an alternative form of business but has also joined the league of developed countries, who has successfully tested the said structure. LLP being body corporate offering similar benefits as compared to company, itself makes a strong point for allowing FDI in it. Though allowing FDI in LLP will not significantly accelerate FDI, as investors who are keen on investing in India will continue to invest, whether LLP form of business is available or not but LLP with its flexible structure and inherent advantages certainly provide an alternate form of business apart from company to investors or business houses situated abroad. Moreover allowing FDI in LLP will also help India meet with global standards of investment.

FDI in LLP will not only promote small and medium sized entrepreneurs abroad to make investment in India but will also provide the much needed impetus to knowledge industry in India, which is is huge need of funds. Through LLP, Indian technocrats, dynamic and budding entrepreneurs can synchronize their knowledge and energy with foreign funds for fuelling their businesses.

LLP is all about partnership, coming together of resources, allowing FDI in LLP will also accelerate more JV among Indian and Foreign Companies. Further LLP as form of business is very akin for Venture Capitalist, as it would facilitate effective pooling of resources , which will consequently finds its way to Indian markets , which will create further stimulus for businesses.

b) What should be the definition of 'person resident in India'? The definition provided in the LLP Act or the definition provided in FEMA?

The LLP Act provides that atleast one designated partner should be a person resident in India and accordingly the definition of person resident in India has been prescribed for the said purpose only and has only very limited relevance. Therefore for the purpose of reckoning whether a designated partner is a person

resident in India or not, definition as prescribed under the LLP Act shall be referred and for other purpose definition as prescribed under FEMA shall be referred.

The said clarification can be provided in policy circular for FDI in LLP.

- c) Given the complexity of some of the issues raised in Section 5, would it be preferable to adopt a calibrated approach to the induction of FDI in LLPs? Initially, should FDI in LLPs be restricted to sectors without caps, conditionalities or entry route restrictions? Should FDI be allowed upto 100% in these sectors or should there necessarily be an Indian partner? Should such approval be confined to the government route?**

For reasons mentioned above, it is imperative that FDI should be allowed in LLP but since this concept has been recently introduced and is in the evolving state, therefore initially FDI in LLP should only be allowed without approval in all sectors where it is allowed under automatic route for companies except NBFC activities.

Making Indian Partner as mandatory requirement will create restriction for making FDI , as lot of businesses will set up in form of wholly owned LLPs and further requirement of Indian Partner will also serve any purpose , if its status is only in form of sleeping partner or partner with no rights. In case of specific sectors, it can be provided that where foreign body corporate is a partner, than the person nominated by it to manage the business i.e. managing partner shall be an Indian.

- d) Should LLPs be mandated not to make downstream investments and should foreign owned or controlled Indian companies be barred from investing downstream in LLPs? Should investment by FII/FVCI or ECBs be prohibited for LLPs?**

Since there being no prescribed disclosure & accounting norms for LLP, it is necessary that downstream investment by LLP should be barred for time being but foreign owned or controlled Indian companies should not be barred from making downstream investment in LLP as this would bar them from taking the advantage of LLP and will also create a hindrance in entering into partnerships with other businesses, especially in infrastructure sector like roads, bridges, dams, metro projects etc where a majority of work is being executed in form of unincorporated JV as association of persons and freedom to make downstream investment in LLP can help this sector to work in a more organized manner in form of LLP.

In case FDI is allowed in LLP, than why there is need of restriction on investment by FII/FVCI, these are organizations which provide funds and if these only are prohibited, than what object will the policy achieve in allowing FDI in LLP. Moreover, FVCI provides funds to businesses with strong fundamentals or growth outlook and therefore the said advantage should not be taken away from LLP. But necessary amendments should be made in FVCI regulations for allowing them to invest in capital of LLP other than company.

ECB is very cheap source of fund raising for any business, therefore LLP should also be allowed to access the same but accordingly, strict disclosure requirement in respect of utilization of said proceeds should be provided.

- e) Following the Foreign Exchange Management (Investment in Firm or Proprietary Concern in India) Regulations 2000, should it be mandated that foreign participation in the capital structure of LLPs should be on a**

percentage basis, received only by way of cash consideration by inward remittances through normal banking channels, or by debit to the NRE/FCNR account of the person concerned maintained by an authorised dealer? Should it also be mandated that foreign investments in LLPs engaged in agricultural/plantation activity or real estate are prohibited?

LLP being a body corporate and not a firm or Proprietary Concern, should not be covered under the Foreign Exchange Management (Investment in Firm or Proprietary Concern in India) Regulations 2000.

Keeping in view the complexities involved in valuation of intangible capital, it is necessary that contribution received only by way of cash consideration by inward remittances through normal banking channels, or by debit to the NRE/FCNR account of the person concerned maintained by an authorised dealer, should be allowed in LLP. Similar to companies, FDI in prohibited sector should not be allowed for LLP.

- f) Should FDI policy treat LLPs akin to companies? In such a case, how should the issues relating to ownership, valuation, control, downstream investment and non-cash contributions, raised in Section 5 above, be addressed? Should this be only through the government route?**

LLP being a body corporate having similar features to company is different from it in some aspect like regulation by law, flexibility, accounting disclosures, therefore it demands a different treatment and consequently different or modified policy. The FDI policy provided for company with necessary modification can be prescribed for LLP.

OWNERSHIP

In case of company the shareholder who owns the business is not necessarily be the person, who is actually running the business especially in professional managed companies, where ownership and management are completely divorced but the voting rights of the shareholders plays an important role in choosing the management and taking other key decisions.

But as opposed to company, in case of LLP, the business is run and managed by the partners based on decision taken between them. In some cases, decisions are taken by specific majority and in some, specific or individual partner are made authorized to take the key decisions. It might be possible that a partner who has contributed the least capital, is taking all the major decisions of the business and is also controlling the LLP. As rightly mentioned in the discussion paper, that under LLP there may be different ratio for contributing capital and for sharing profit, it is also not necessary that profit sharing ratio is fixed, it can be fluctuating from time to time and therefore capital contribution cannot be single criteria for identifying the ownership of the LLP.

By the term ownership, we mean a person, who has the actual control of the affairs of business, who takes all the key decisions though he would be sharing the profit with others but he is person, who is helm of all the affairs of business. But business is run to earn profit, which is the driving force behind all activities and therefore this factor cannot be sidelined.

In LLP, the ownership should be identified in favour of partner, who has contributed more than 50% of the capital and is entitled to more than 50% of the profits or losses.

CONTROL

It is very important to take note of the fact that LLP is not run and managed by Designated Partners. Designated Partner doesn't mean Managing Partners. In terms of the LLP Act, a Designated Partner is responsible for the compliance of the LLP Agreement and LLP Act. Though a designated partner can be managing partner also but the fact that he is designated partner doesn't makes him as working or managing partner. Therefore power to appoint a designated partner shall not be equated in terms of the control over the LLP.

LLP's are governed by LLP Agreement between them and there can be indefinite types of arrangement between the partners as to decision making, voting right etc therefore it is very difficult to lay out any exact criteria for the same, this problem can be sorted out, if Government prescribes some guidelines as to these factors in LLP's where there will be any foreign investment.

In general term, a partner should be said to be in control of the LLP, when he is responsible for the affairs of the business and taking all key decisions as per the

LLP Agreement and where decisions are taken by voting , he holds the majority voting rights .

VALUATION

The LLP Act says all contribution in LLP shall be accounted for in the books of accounts and any contribution in form of intangible assets shall be valued by a registered valuer or CA or such other person approved by the Central Government. No specific rules has been prescribed as to how to the valuation of intangible assets and therefore the valuation is to be done according to the general accounting principles and the accounting standards.

In case of tangible contribution, as applicable to a company, the DFCF method can also be made applicable to LLP, where the valuation is done based on future profitability and cash flows. In case of company, any surplus value over the face value is contributed towards the share premium and therefore the shareholding structure of the company doesn't get disturbed but in case of LLP, there is no concept such as share premium and therefore any amount brought in as capital by way of DFCF valuation can disturb the capital structure of the LLP and it needs to be looked into, whether the surplus amount brought in by partners can be treated as part of the capital reserves, so that the capital remains intact.

Though contribution of intangible assets as capital gives LLP an edge over other business forms as it will give an opportunity to person with intellect and experience to value and contribute instead of making cash outflows. Moreover, LLP will also promote coming together of riches and intellects in business, each having its contribution in LLP and its activities. Intangible can be anything experience, knowledge, know how etc and allowing such form of capital will not lead to any inflow of capital and will certainly lead to failure of object of allowing FDI. Moreover as there is no standard practice for valuing intangible and it offers space for large scale manipulation & discretion and therefore FDI in intangible form in LLP should be prohibited.

For contribution of capital in form of raw material, machinery, immovable property etc, the policy as applicable to companies should also be made applicable to LLP.

g) Will treating LLPs akin to companies under FDI policy demand the stipulation of certain features of the LLP agreement? Should this include unambiguous specification of profit /loss sharing percentage; clear specification of the power to appoint Designated Partners; congruence of legal and economic ownership; timely notification of changes including

conversion from and to companies/partnerships? Should it be mandated that LLPs cannot have corporate bodies other than companies registered under the companies Act as partners? Is inclusion and coverage of such issues in FDI policy warranted? Would the consequent increase in the regulatory burden be justifiable?

- LLP is governed by LLP Agreement and therefore there is huge scope of various types of combination and permutations, therefore there is strict requirement of providing certain conditions to be take care at the time of drafting the LLP agreement regardless of the fact whether LLPs are treated akin to companies or not under the FDI policy.

Conditions/restrictions with regard to the following can be provided:

- a) Clear specification of capital and profit & loss sharing ratio.
 - b) Clear specification as to control, who is responsible for taking key business decisions or partner having majority voting power.
 - c) Clear demarcation between managing and sleeping partners.
 - d) Restriction on withdrawal by partners in form of drawings.
 - e) Clear specification of role of each partner.
 - f) Restriction on loans by foreign partners.
 - g) Restriction as to transfer of economic interest by any partner.
- It is also to be decided that whether re-investment of profits arising out of LLP, as capital will be treated as FDI or not.
 - Companies having FDI under automatic route should be allowed to convert themselves into LLP and vice versa. In case of conversion of company into LLP, the conversion shall be allowed the reserves and profit & loss account standing as on date of conversion , shall not be distributed among the partners at any point of time after conversion or for a period of 5 years.

- LLP themselves are Body Corporate and restricting membership of LLP to only companies will mean that LLP cannot become member of another LLP, which doesn't seem justified. Moreover apart from Company registered under the Companies Act, lot of body corporate are established under special Act passed by parliament and state assemblies, putting the above restrictions will also mean that these body corporate also cannot become members of LLP.

In case department wants to put restrictions, it should be in form of body corporate, who cannot become partner of the LLP

- h) What additional regulatory safeguards are required to enfold LLPs into FDI policy? Are amendments to any existing regulations required? Should the responsibility for periodic monitoring of compliance with FDI stipulations be allotted to a particular agency?**

Similar to companies, RBI should be the monitoring agency of FDI in LLP and there should be reporting system for investment made in LLP in form of capital and in case of transfer of such interest.

In terms of safeguards, it can be provided that LLP having FDI shall need to comply with necessary accounting standards. The LLP Act doesn't prescribe in detail the disclosures required in the balance sheet similar to Companies Act, the LLP Act should be amended to prescribe a detailed format of Balance Sheet.

For Corporate Professionals (India) Pvt Ltd


Arkit Singh
Manager