



**THE INSTITUTE OF
Company Secretaries of India**
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

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CS UPDATE

October 01, 2010

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Disclaimer: - CS Update contains government notifications, case laws and contributions received from the members. Due care and diligence is taken in compilation of the CS Update. The Institute does not own the responsibility for any loss or damage resulting from any action taken on the basis of the contents of the CS Update. Anyone wishing to act on the basis of the contents of the CS Update is advised to do so after seeking proper professional advice.

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FORTHCOMING PROGRAMME

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October 01, 2010

International Competition Law Conference, October 19, 2010, New Delhi

September 20, 2010

Dear Members,

Sub: International Competition Law Conference, October 19, 2010, New Delhi

You are aware that the ICSI is actively engaged in capacity building of its members in new and emerging areas. The Competition Law is one such area where the Company Secretaries by virtue of their knowledge and expertise can render valuable services to corporates and clients, by appearing before Competition Commission of India and Competition Appellate Tribunal besides advisory services on competition related matters.

Carrying forward its capacity building initiatives in Competition Law, the ICSI is pleased to be associated as **Knowledge Partner** in the organisation of International Competition Law Conference being hosted by Competition Law Bar Association on [October 19, 2010 at New Delhi](#).

I invite you to register for the Conference and benefit from the interaction with galaxy of experts in competition law.

A copy of the brochure is placed below for your ready reference.

For more details please visit www.competitionlaw2010.com.

With kind regards,

Your sincerely,

(N K JAIN)
SECRETARY & CEO

To view as a Webpage, [click here](#)



INTERNATIONAL COMPETITION LAW CONFERENCE

19th October 2010
The Lalit Hotel, New Delhi

SPEAKERS

- A. K. Chauhan
DG, CCI, India
- A. N. Haksar
Senior Advocate, India
- Anand S. Pathak
Partner, P&A Law Offices, India
- Bobby Chandhoke
Senior Partner, Luthra & Luthra, India
- Bernard E. Amory
Partner, Jones Day, Belgium
- Christine C. Wilson
Partner, O'Melveny & Myers LLP, USA
- Dhanendra Kumar
Chairman, CCI, India
- D. S. Sengar
Director, ILI, India
- Dushyant Dave
Senior Advocate, India
- Ian Forrester
QC, Partner, White & Case, Belgium
- Joseph Winterscheid
Partner, McDermott, USA
- K. K. Sharma
Advisor, CCI, India
- Kala Anandarajah
Partner, Rajah & Tann LLP, Singapore
- Madhu Khatri
Corp. Vice President and General Counsel, Wipro Ltd., India
- Manas Kumar Chaudhuri
Partner, Khaitan & Co, India
- Marc Waha
Partner, Norton Rose, Hong Kong
- Martina Maier
Partner, McDermott, Belgium
- P. N. Parashar
Member, CCI, India
- Pravin Tripathi
Member, COMPAT, India
- P. H. Parekh
Senior Advocate, India
- Percy Billimoria
Partner, AZB & Partners, India
- Rahul Goel
Partner, Seth Dua & Associates, India
- Rahul Sarin
Member, COMPAT, India
- Riccardo Celli
Partner, O'Melveny & Myers LLP, Belgium
- Vijaya Sampath
General Counsel & Company Secy., Bharti Enterprises Ltd., India

INTERNATIONAL COMPETITION LAW CONFERENCE

Competition Law Bar Association is hosting a Conference covering all aspects of the Indian and Foreign Competition Laws. This coincides with the 1st Anniversary of the Competition Appellate Tribunal (COMPAT).

The inaugural and valedictory sessions are being organized by COMPAT whereas Competition Law Bar Association would be organizing four technical sessions with academic inputs provided by the Indian Law Institute, the Premier Legal Research Institute and Amity Law School.

Hon'ble Judges of the Supreme Court, High Courts; Chairman & Members of Competition Commission of India, Dignitaries from Government of India; Lawyers; Chartered Accountants; Company Secretaries and other Professionals; Policy Makers; Academicians; Students from various Universities and Eminent persons in the field of Competition Law from different parts of the World are likely to participate.

Primarily in four technical sessions which are being organized, the various aspects of the newly enforced Competition Law would be discussed.

Please block the 19th October 2010 in your schedule of engagements.

Email us at: secretariat@competitionlaw2010.com

**Last Date of Early
bird Registration is
27th September.**

COMPETITION LAW BAR ASSOCIATION EXECUTIVE COMMITTEE

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- Hon'ble Mr. M. Veerappa Moily
Minister of Law & Justice, Government of India
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Chief Justice of India
- Hon'ble Dr. Justice Arijit Pasayat
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- Hon'ble Mr. Gopal Subramaniam
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- Atul Dua
Advocate, Secretary, CLBA
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Former Attorney General of India

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Conferences & Incentives
Management (I) Pvt. Ltd

For More Details Please Visit www.competitionlaw2010.com

FOR DETAILS PLEASE CONTACT US AT:- secretariat@competitionlaw2010.com

Dear Member,

**INSOL INTERNATIONAL SEMINAR ON DECEMBER 3, 2010
EARLY BOOKING DEADLINE 1ST OCTOBER 2010**

Dear Member,

The Companies Bill, 2009 provides a larger role for Company Secretaries in the area of restructuring and liquidation. Keeping this in mind, you are aware, that the Institute has taken initiative towards the capacity building of its members in the area of restructuring and insolvency.

It is in this direction, I am pleased to inform you that Institute has joined hands with **INSOL International** as **Knowledge Partner** in organizing a Seminar on Insolvency on December 3, 2010 at Hotel Oberoi, New Delhi.

On the 3rd of December, key figures from the world of International insolvency and restructuring will be addressing this seminar. Speakers are some of the most respected professionals with the the banking, legal and wider corporate restructuring industry.

I request you to register for this Seminar as delegate and network with other professionals and interact with a range of exceptional speakers and technical experts.

For registration please : [Click here](#)

Please click here for the [registration brochure](#) .

If you have any questions about the event, please do not hesitate to contact at : tina@insol.ision.co.uk

Regards,

N K JAIN
Secretary & CEO

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**ANNUAL FILING OF BALANCE SHEET AND ANNUAL
RETURN FOR THE CURRENT YEAR**

September 27, 2010

Dear Professional Colleagues,

The Institute has received a request letter from the Ministry of Corporate Affairs regarding streamlining the filing of Balance Sheet and Annual Return to RoC by companies during the month of October and November, 2010 and avoidance of the last minute rush and system congestion in MCA21 during that period. Copy of the letter is appended below for your ready reference.

Regards,

Yours sincerely,

CS N K Jain
Secretary & CEO**Avinash K. Srivastava**
Joint Secretary

DO No. HQ/60/2005-Computerisation

Government of India
Ministry of Corporate Affairs
New Delhi

Dated: September 22, 2010

Dear Shri Khanvalkar,

This has reference to streamlining the filing of Balance Sheet and Annual Return to RoC by companies during the month of October and November, 2010 and avoidance of the last minute rush and system congestion in MCA21 during that period.

2. The Ministry has initiated multipronged actions so that peak filing during the month of October and November, 2010 can be smoothened under MCA21. Initiatives have also been taken to augment the infrastructural facilities to meet the extra load during that period.

3. The Ministry seeks the support of the professionals from your Institute towards filing Annual Returns and Balance Sheets in an organized manner so that peak hour filing rush during the month of October and November, 2010 can be met smoothly.

4. The Ministry requests the Companies to plan filing of their statutory returns / Forms as per Schedule below drawn in alphabetical order of the names of companies. I seek your active co-operation in dissemination of the information

amongst the professionals to plan and file the Annual Returns and Balance Sheets as per the following order:-

| Preferable Dates for filing | | | |
|------------------------------------|---------------------------|---|---|
| Company Names starting with | September 2010 | October 2010 | November 2010 |
| Alphabets A to D | All days during the month | 1 st Oct to 05 Oct 2010 | 1 st Nov to 05 Nov 2010 |
| Alphabets E to K | -do- | 6 th Oct to 10 th Oct 2010 | 6 th Nov to 10 th Nov 2010 |
| Alphabets L to Q | -do- | 11 th Oct to 15 th Oct 2010 | 11 th Nov to 15 th Nov 2010 |
| Alphabets R & S | -do- | 16 th Oct to 20 th Oct 2010 | 16 th Nov to 20 th Nov 2010 |
| Alphabets T to Z | -do- | 21 st Oct to 25 th Oct 2010 | 21 st Nov to 25 th Nov 2010 |
| Remaining/ Left out companies | -do- | 26 th Oct to 31 st Oct 2010 | 26 th Nov to 30 th Nov 2010 |

With best regards,

Yours sincerely,

(Avinash Srivastava)

Shri Vinayak Sadashiv Khanvalkar
President, ICSI
3-4, Aishwarya Sankul
S. No. 17, G.A. Kulkarni Path,
Opp. Joshi Railway Museum, Kothrud
Pune – 411 038

Room No. 507, A Wing, Shastri Bhawan, Dr. Rajendra Prasad Road, New Delhi – 110 001
Phone: 23383180 Fax 23386068

SEBI Updates

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Compliance with circular dated April 15, 2010.**CIRCULAR**

CIR/IMD/FII/12/2010

September 29, 2010

To

All Foreign Institutional Investors

through their designated Custodians of Securities
&
Stock Exchanges

Dear Sir/ Madam,

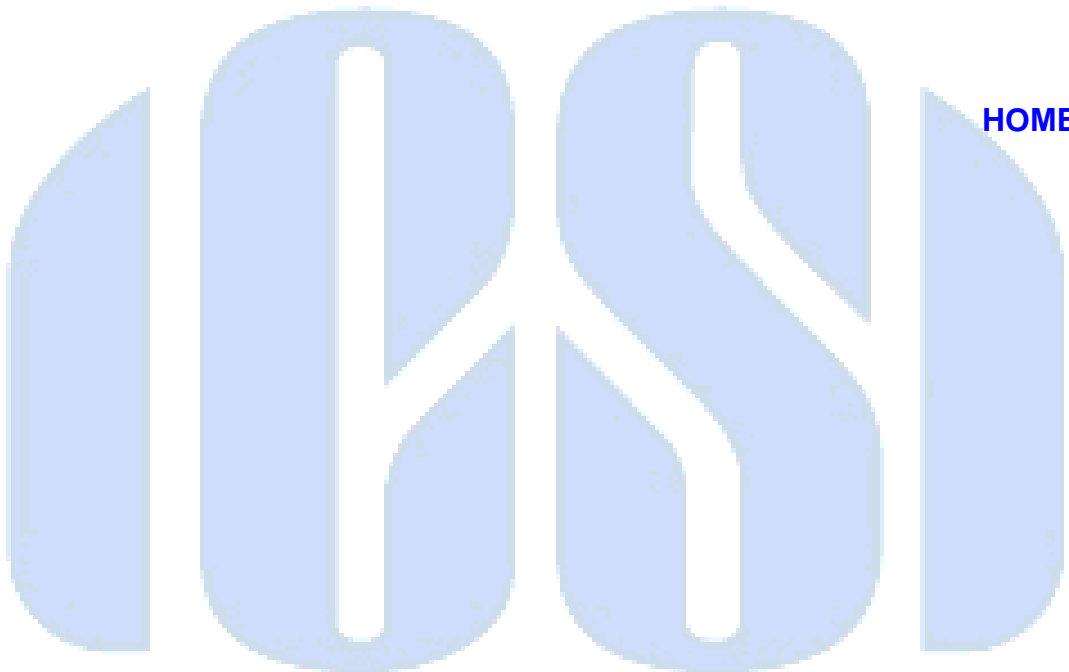
Sub: Compliance with circular dated April 15, 2010.

1. Please refer to the circular dated April 15, 2010 wherein SEBI had mandated all registered FIIs to provide the requisite declarations and the undertakings about their structures to SEBI by September 30, 2010.
2. It was also communicated to FIIs through their custodians that those entities that do not file the requisite information by the stipulated date shall not be able to take fresh positions in the cash as well as the derivatives market w.e.f. October 01, 2010. From this date, non compliant entities could either, retain their current positions or sell off/ unwind.
3. Accordingly, w.e.f. October 01, 2010 the FIIs and sub-accounts that have not complied with the above mentioned requirements will not be permitted to take fresh positions in cash and derivatives markets while they can retain their current positions or sell off/ unwind.
4. SEBI shall place the list of the non compliant entities on the SEBI website – under tab- *Statistics- Foreign Institutional Investors- List of non compliant entities*.
5. The custodians are requested to bring the contents of this circular to the notice of their respective FII clients.
6. The Stock Exchanges shall bring the contents of this circular to the attention of its trading and clearing members.

7. This circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 to protect the interests of investors in securities and to promote the development of, and to regulate the securities markets.

Yours faithfully,

Jeevan Sonparote
General Manager
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DIPP Updates

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**FOREIGN DIRECT INVESTMENT IN LIMITED
LIABILITY PARTNERSHIPS****DISCUSSION PAPER****SUBJECT: FOREIGN DIRECT INVESTMENT IN LIMITED
LIABILITY PARTNERSHIPS**

1.1 The Department of Industrial Policy and Promotion has decided to release Discussion Papers on various aspects related to FDI. In the series of these Discussion Papers, this is the fifth paper on 'Foreign Direct Investment in Limited Liability Partnerships'. Views and suggestions are invited on the gamut of issues raised in the enclosed discussion paper, particularly on Paragraph 6.0: *'Issues for consideration'* by October 31, 2010. It is requested that, to the extent possible, facts, figures and empirical evidence may be furnished, in the context of the specific observations/suggestions made.

1.2 The views expressed in this discussion paper should not be construed as the views of the Government. The Department hopes to generate informed discussion on the subject, so as to enable the Government to take an appropriate policy decision at an appropriate time.

DISCUSSION PAPER**SUBJECT: FOREIGN DIRECT INVESTMENT IN LIMITED
LIABILITY PARTNERSHIPS****1.0 INTRODUCTION**

1.1. The Limited Liability Partnership Act, 2008 (LLP Act) was notified on April 1, 2009. With the passing of this Act, a new hybrid entity, incorporating the features of both- a body corporate, as well as a traditional partnership-can be formed for the purposes of undertaking business in India. The LLP has not yet been recognized under FDI policy. The LLP structure lies between that of a company where FDI is permitted and that of a partnership, where it is generally not permitted. Key features of an LLP, as well as a comparison between the other existing ownership structures, are provided in the Annexure.

2.0 LIKELY USERS OF THE LLP STRUCTURE

2.1 The LLP model is attractive to professional sectors for its lower compliance costs, greater flexibility in operations, better control over management and limited liability. Many professionals in India, such as advocates/lawyers, chartered accountants and doctors are precluded from practicing through

companies. The LLP structure would be particularly advantageous for providing such professional services.¹ As is the practice outside India, LLPs could prove very useful for certain professionals who are unable to use the corporate structure and who do not find the partnership structure viable.

2.2 Further, allowing FDI in entrepreneurial projects carried out through the LLP model would encourage small entrepreneurs in India to explore business ventures with foreign investment/collaboration. Other than professionals and small entrepreneurs, the LLP structure may also be preferred by small businesses. Additionally, foreign entities having project offices in India could consider reducing risk by using the LLP structure. Further, any structure where different members want to control different segments and also bear full responsibility for their acts, could conveniently use the LLP structure. This includes infrastructure project SPVs where different partners bring in different expertise into the project.

2.3 The report of the Naresh Chandra Committee, on regulation of private companies and partnerships (1997), had suggested that "*the LLP form should initially be made available only to those providing defined professional services like lawyers, company secretaries, accountants as these professions are already governed by regulations that adequately controls and disciplines errant professional conduct*". The committee report suggested that LLPs may be extended, at a later stage, to other services and business activities, once the experience gained with this form of organization has been evaluated and tested. However, taking into consideration representations from various industries, the LLP Act has not restricted the use of LLPs only to professional services. All activities are permissible.

3.0 INTERNATIONAL EXPERIENCE

3.1 Such hybrid entities are prevalent across the globe. They are commonly used by Private Equity/Venture Capital Funds and professionals. In countries like the United States (some states), Canada, Germany, Poland and China, LLPs can be formed only by professional service providers.

3.2 In the United States of America, the concept of LLP originated in 1991, through the Texas Statute. It is now adopted by almost every state in the US. Other 'hybrid' entities include Limited Partnerships and Limited Liability

¹ Professional services are those where unique functions are performed by independent contractors or consultants, whose occupation is the rendering of such services. Such service providers would include accountants, brokerage firms, business consultants, business development managers, engineers, law firms, software engineers and web designers. Such services may be delivered through a host of structures, including partnerships, firms and corporations, in addition to delivery by individuals holding professional licenses.

Companies. In the United Kingdom, LLPs are governed by the LLP Act, 2000. LLPs are treated as incorporated entities for legal purposes. In Singapore, LLPs are governed by the LLP Act, 2005, which is similar to the UK legislation. The Indian LLP Act is similar to the UK and Singapore LLP statutes, though it is unique in its tax treatment.

4.0 COMPARISON BETWEEN LLPs, COMPANIES AND PARTNERSHIPS:

4.1 The incorporation process for LLPs is identical to that of incorporation of companies. LLPs are required to submit constitutive documents, details of profit or loss sharing ratio, rights of partners *vis-à-vis* other partners and *vis-à-vis* the LLP, details of designated partners etc. In case of any change in the above, the LLP is mandated to submit information relating to such changes. Given this, it may be argued that LLPs are subject to same level of regulation as are companies. However, in case of certain specified transactions, the Companies Act requires a company to seek specific approval (either of the Board or of shareholders), through either an ordinary or a special resolution etc. No such requirements, however, appear to have been mandated under the LLP Act.

4.2 Further, the Government has reserved the right to make any of the provisions of the Companies Act, 1956, applicable to LLPs by notification (*section 67 of the LLP Act*). Certain protections have also been carved out, whereby the Central Government would be able to take appropriate action against LLPs if there are circumstances suggesting fraud, unlawful purpose or oppression of some partners (*section 43 of the LLP Act*).

4.3 In contrast, some of the provisions of the LLP Act are similar to the law applicable to partnerships. Upon incorporation of the LLP, the partners would be required to enter into a partnership agreement in writing, which would be filed with the ROC. The mutual rights and duties of the partners of the LLP *inter se* and that of the LLP and its partners, would be governed by the LLP agreement. In the absence of such an agreement, the mutual rights and duties would be determined in the manner set out in the LLP Act.

4.4 Unlike most other countries, LLPs in India do not have pass-through status, as regards taxation. The LLP entity itself is a taxable entity and the income of the LLP is not taxed in the hands of the individual partners. Partners would, therefore, be unable to benefit from tax-structuring of profit distribution. However, the LLP structure still offers certain tax advantages, as, unlike companies, LLPs are currently not subject to certain corporate taxes, such as dividend distribution tax, minimum alternate tax or presumptive taxation.

4.5 Certain features in the LLP structure however could be seen as inhibitors to business. Whereas shareholders of a company have no liability towards the company, partners of an LLP are liable for their own wrongful and fraudulent acts. Also, LLPs cannot raise capital from the market.

5.0 ISSUES RELATED TO INDUCTION OF FDI IN LLPs:

5.1 Under the present Foreign Direct Investment ('FDI') policy, foreign investment in Indian Companies is permitted under: (i) the automatic route and (ii) the approval route (with prior approval of the Foreign Investment Promotion Board ('FIPB')), depending on the sector in which FDI is being inducted. The Foreign Exchange Management (Investment in Firm or Proprietary Concern in India) Regulations, 2000 ('FEMA 24') provide that, persons resident outside India are not permitted to invest in firms and proprietary concerns, unless otherwise approved by the Reserve Bank of India ('RBI'). There are, currently, no specific provisions addressing LLPs. In the context of prescribing a regime for FDI in LLPs, five issues have been identified for analysis, which are discussed below.

5.2 OWNERSHIP

5.2.1 The issue of 'ownership' is relevant because FDI policy prescribes caps on the level of FDI and prohibits foreign ownership in specified sectors. FDI Policy lays down procedures for determining the level of foreign 'ownership' and 'control' in a corporate entity. Under this, a foreign investor 'owns' an Indian company, if he/she owns more than 50% of the share capital of the company. Such an approach may, however, not be applicable to an LLP, as the LLP Act provides flexibility for partners to decide the manner in which they wish to contribute to the capital of the LLP, extract profits, participate in voting and limit their liability. Every partner of a LLP has two rights attached to the partnership interest – one being an 'ownership' right and the other being the right of 'management & control'. The "ownership right" provides the partner with a right to share in the profits/ losses of the LLP. The "right of management & control" allows a partner to participate in the management of the LLP and also provides for the right to vote. However, any transfer of the rights of a partner to a share in the profits and losses of the LLP, does not, by itself, affect the right of management and control. There appears to be no requirement for an individual/ body corporate, enjoying economic benefits, to be a legal partner in an LLP. Such flexibility in the LLP Act can result in a variety of formulations being available to partners/ LLP . It may, thus, be challenging to set norms for ascertaining ownership & control of a LLP.

5.2.2 One suggestion is that foreign ownership could be determined with reference to the profit sharing percentages, i.e. right to the share of profits of the LLP. This is akin to determining the beneficial interest in shareholding in

companies by rights over dividends. Another view is that, ownership, in the context of LLPs, could be determined in accordance with the capital sharing percentage of the foreign investors. Here, the analogue in companies is determining ownership on the basis of equity contribution, regardless of whether the shares issued to foreign investors are with or without the right to vote or dividend. The latter view has been opposed on the ground that partners' capital could be in different proportions, as compared to their profit or loss sharing ratios, for variety of reasons. These could include differences in the time of entry, differences in the withdrawal pattern etc. It is, thus, argued that the latter approach is relevant only in case of distribution on liquidation of a LLP and should not be used for determining ownership.

5.3 VALUATION

5.3.1. The LLP Act states that every contribution to the capital of the LLP shall have a monetary value, determined by a chartered accountant. However, no valuation guidelines have been prescribed as yet. One approach could be adopting, similar to companies, a discounted free cash flow method for valuations in LLPs. Such valuations could take into account various factors, including the extent of contribution in the partnership capital, the share in profits, the extent of voting rights in the partnership, the extent of liability sharing and the share in proceeds on liquidation of the partnership.

5.3.2 This requires that adequate disclosure requirements, with respect to transactions in LLPs, may need to be introduced. RBI has prescribed valuation guidelines governing the acquisition and sale of shares by a foreign investor in an unlisted Indian company. It needs to be considered as to what extent these guidelines could be applied to LLPs.

5.4 CONTROL

5.4.1 For companies, FDI policy defines 'control' as the ability to appoint the majority of the Board of Directors. As an LLP does not have a Board of Directors, alternative formulations have to be sought. An LLP is managed by one or more of its members (described as 'Designated Partners' in the LLP Act), as provided in the LLP's deed. The Designated Partners are appointed collectively by the members of the LLP, by casting votes in accordance with the LLP deed. Thus, the Designated Partners appointed to manage the affairs of the LLP, could be equated to the Board of Directors of a company. The extent of voting interest that a member may have, in terms of his ability to appoint a Designated Partner, could determine the extent of control exercised on the LLP by such a member. This would, possibly, be specified in the LLP deed.

5.4.2 Thus, for the purpose of the FDI Policy, one option could be to consider the voting rights of a foreign investor in a LLP, for determining whether the LLP is controlled by a foreign investor or by a domestic investor. The structure in the case of LLPs is similar to that of companies, which are permitted to have different classes of shares, with differential voting rights. Whether the different classes of shares should individually, or in the aggregate, be considered to determine 'control', also needs resolution.

5.4.3. However, it must be recognised that the LLP Act does not prescribe the manner of management of the LLP. It leaves it to the discretion of the partners to agree upon specific aspects related to powers of the partners, voting rights, meeting of partners and other matters incidentals thereto. It is, thus, possible, to confer the management decisions / control of a LLP on a few identified partners, including non residents, irrespective of their ownership holding. Further, as the law also delinks economic and legal ownership i.e. a partner in a LLP can transfer his economic interest without transferring his share in the LLP-ascertainment of 'control' of an LLP can be extremely challenging. It can, thus, be argued that interpreting 'control' as the right to take majority decisions, may not be relevant in the context of LLPs.

5.4.4 The LLP Act itself has no provision which can provide a benchmark for the determination of control in LLPs. It provides freedom to the partners to decide the manner in which management decisions will be taken. It is possible that decision making is divided in the LLP amongst committees or governing councils having partners from different fields of expertise, instead of a single body of partners taking decisions uniformly. Although this could be an efficient method for decision making, it is not possible to determine the partners who take the majority management decisions of the LLP. Although the LLP Act suggests that the decisions of the LLP shall be taken by a majority (in the absence of a specific agreement), there do not appear to be guidelines within either-the LLP Act, or the LLP rules-on how to determine the majority in making key decisions.

5.4.5 The LLP Act provides that every LLP shall have at least two designated partners who are individuals and at least one of them shall be a 'person resident in India'. The designated partners are responsible for ensuring effective compliance with the provisions of LLP Act and liable for all penalties imposed on LLP for any contravention. Under the LLP Act, the term 'person resident in India' means a person who has stayed in India for a period not less than 182 days during the immediately preceding one year. By this definition, it is possible to appoint foreign residents (who have stayed in India for more than 182 days in the preceding one year), as designated partners.

5.5 TREATMENT OF DOWNSTREAM INVESTMENTS

5.5.1 As per the FDI Policy for companies, all downstream investments by an investing or investing-cum-operating company, which is owned or controlled by non-resident entities, are to be considered as indirect foreign investment. The issue is whether LLPs should be similarly treated.

5.6 TREATMENT OF NON-CASH CONTRIBUTIONS

5.6.1 Under Clause 32 of the LLP Act, “a contribution of a partner may consist of tangible, movable or immovable or intangible property or benefit to the LLP, including money, promissory notes, other agreements to contribute cash or property and contracts for services or to be performed”. This effectively means that a partner may contribute in a LLP “other than for cash”. However, as per the existing FDI policy, issue of shares for consideration other than cash requires prior FIPB approval. Discussion Paper No 4 raises various issues relating to issue of shares for non cash considerations in the case of companies. Whether the final decision on this subject taken for companies should apply *mutatis mutandis* to LLPs is an issue that needs resolution.

6.0 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?

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

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?

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?

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?

e) 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?

f) 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?

g) 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?

eod

ANNEXURE

COMPARISON BETWEEN A PRIVATE LIMITED COMPANY / PUBLIC LIMITED COMPANY / LLP / PARTNERSHIP CONCERN

| CRITERIA | PRIVATE LIMITED COMPANY | PUBLIC LIMITED COMPANY | LIMITED LIABILITY PARTNERSHIP | PARTNERSHIP CONCERN |
|--|----------------------------------|----------------------------------|--------------------------------------|----------------------------|
| REGISTRATION , MEMBERSHIP AND CHARTER DOCUMENTS | | | | |
| Applicable Law | Companies Act, 1956 | Companies Act, 1956 | LLP Act 2008 | Partnership Act, 1908 |
| Mandatory registration | Yes, with Registrar of Companies | Yes, with Registrar of Companies | Yes, with Registrar of Companies | Optional |
| Charter Documents | Memorandum and | Memorandum and Articles | LLP Agreement | Partnership Agreement |

| | | | | |
|---|---|---|---|--|
| | Article of Association | of Association | | |
| Charter Documents needs to be filed with regulator | Yes, with Registrar of Companies | Yes, with Registrar of Companies | Yes, with Registrar of Companies | Optional |
| Identification number | Company Identification number granted by ROC | Company Identification number granted by ROC | LLP Identification number granted by ROC | Optional. Partnership registration granted only to registered Partnerships |
| Minimum Paid-up Capital | Rupees 100,000 | Rupees 500,000 | Not specified | Not specified |
| Number of members | Minimum - 2 Maximum - 50 | Minimum - 7 Maximum - No Limit | Minimum - 2 Maximum - No Limit | Minimum – 2 Maximum - 20 |
| Identity of Partners / directors | Mandatory, needs to obtain Director Identification Number | Mandatory, needs to obtain Director Identification Number | Mandatory, needs to obtain Designated Partner Identification Number | Not required |
| Liability of Partners / members | Limited | Limited | Limited | Unlimited |
| Legal Entity | Yes , can sue or be sued in the name of Company | Yes , can sue or be sued in the name of Company | Yes , can sue or be sued in the name of LLP | No, only Partners can sue or be sued. |
| Perpetual Succession | Yes | Yes | Yes | No. |
| COMPLIANCE | | | | |
| Prior approval of Name | Mandatory. Name should be in accordance with the | Mandatory. Name should be in accordance with the | Mandatory. Name should be in accordance with the LLP Act | Not required. |

| | Companies Act | Companies Act | | |
|--|---|---|---|---|
| Board meetings | Mandatory, at least four in every year. | Mandatory, at least four in every year. | Depends upon the procedure prescribed in the LLP Agreement. | Depends upon the procedure prescribed in the Partnership Agreement. |
| Shareholders meeting | Mandatory | Mandatory | Not applicable | Not applicable |
| Preparation of Minute Books | Mandatory | Mandatory | Depends upon the procedure prescribed in the LLP Agreement. | Depends upon the procedure prescribed in the LLP Agreement. |
| Appointment of Auditors | Mandatory | Mandatory | Mandatory | Mandatory |
| Maintenance of other statutory registers | Mandatory | Mandatory | Not Applicable | Not Applicable |
| Maintenance of Books of accounts | Mandatory | Mandatory | Mandatory | Mandatory |
| Filing of Annual return and Balance sheet with the statutory authority | Mandatory with ROC | Mandatory with ROC | Mandatory with ROC | Not required |
| Invitation to the public to subscribe for any Shares or debentures of the Company | Restricted | Possible | Restricted | Restricted |
| Listing on stock exchange | Restricted | Possible | Restricted | Restricted |
| Issue of shares / interest other than cash | Not Possible except sweat equity | Not Possible except sweat equity / ESOP | Possible | Possible |
| Merger/ amalgamation | Possible | Possible | Possible | Not possible |

ACCOUNTING AND TAXATION

| | | | | |
|-----------------------------|------------|------------|----------------|----------------|
| Obtaining PAN /TAN | Mandatory | Mandatory | Mandatory | Mandatory |
| Audit requirement | Mandatory | Mandatory | Mandatory | Mandatory |
| Filing of ITR | Mandatory | Mandatory | Mandatory | Mandatory |
| Accounting Standards | Applicable | Applicable | Not yet issued | Not applicable |
| Tax Rate | 33.21% | 33.21% | 30.90% | 30.90% |
| MAT | 19.93% | 19.93% | NA | NA |
| DDT | 16.61% | 16.61% | NA | NA |

Other Provisions Relating to LLPs:

1. The Registrar of Companies (ROC) has powers under section 36 to inspect documents (such as incorporation documents, details of partners, statements of Accounts, returns etc) of LLP
2. The ROC has powers under Section 37 to levy penalties for submission of false statements
3. The ROC has powers under Section 38 to obtain any such information from the LLP as it considers necessary for the purposes of the LLP Act
4. Central Government has powers under Section 39 to compound the offences of LLP Act
5. The Tribunal has powers under Section 41 to direct the LLP and its partners to make good any default under the LLP Act.
6. The Central Government has powers under Section 43 to appoint competent persons to investigate the affairs of the LLP. There is a detailed investigation procedure laid down under the LLP Act.
7. Section 79(2) prescribes 39 items whereby the Central Government has powers to make rules for a LLP.
8. As per Rule 8 of the LLP Rules, all LLPs are compulsorily required to get their accounts audited by a Chartered Accountant. However, compulsory audit of accounts is not required when the turnover in any financial year does not exceed 40 lakhs or the contribution does not exceed 25 lakhs.
9. As per section 34(2) of the LLP Act, every year on or before six months from the end of the financial year, each LLP is required to file a Statement of Accounts and Solvency in Form signed by Designated Partners.
10. As per section 35(1) of the LLP Act, every LLP is required to file an Annual Return with the Registrar in Form 11, within sixty days from the end of the financial year.

ISSUE OF SHARES FOR CONSIDERATIONS OTHER THAN CASH

DISCUSSION PAPER

SUBJECT: ISSUE OF SHARES FOR CONSIDERATIONS OTHER THAN CASH

1.1 The Department of Industrial Policy and Promotion has decided to release Discussion Papers on various aspects related to FDI. In the series of these Discussion Papers, this is the fourth paper, on the 'Issue of shares for considerations other than cash'. Views and suggestions are invited on the observations made in the enclosed discussion paper by October 31, 2010, particularly on Paragraph 4.0: '*Issues for consideration*'. It is requested that, to the extent possible, facts, figures and empirical evidence may be furnished, in the context of the specific observations/suggestions made.

1.2 The views expressed in this discussion paper should not be construed as the views of the Government. The Department hopes to generate informed discussion on the subject, so as to enable the Government to take an appropriate policy decision at an appropriate time.

DISCUSSION PAPER

SUBJECT: ISSUE OF SHARES FOR CONSIDERATIONS OTHER THAN CASH

2.0 INTRODUCTION:

2.1 CURRENT FOREIGN DIRECT INVESTMENT (FDI) POLICY

2.1.1 As per extant FDI policy, shares can be issued to a non-resident against receipt of funds through normal banking channels. If the funds are not received through normal banking channels, prior approval of the Government is required for such issue. The only exception to the above condition is the situation where shares are to be issued against External Commercial Borrowings (ECBs) and/or royalty payments (including lump-sum technical know-how fees). In such cases, shares can be issued under the automatic route without funds being received specifically for the purpose of issues of shares.

2.1.2 The above situation has been covered under paragraph 3.4.6 of 'Circular 1 of 2010-Consolidated FDI Policy', issued by the Department of Industrial Policy & Promotion, which mentions that:

Indian companies have been granted general permission for conversion of External Commercial Borrowings (ECB) (excluding those deemed as ECB) in convertible foreign currency into shares/preference shares, subject to the following conditions and reporting requirements:

(a) The activity of the company is covered under the Automatic Route for FDI or the company has obtained Government approval for foreign equity in the company;

(b) The foreign equity after conversion of ECB into equity is within the sectoral cap, if any;

(c) Pricing of shares is as per SEBI regulations or erstwhile CCI guidelines² in the case of listed or unlisted companies respectively;

(d) Compliance with the requirements prescribed under any other statute and regulation in force; and

(e) The conversion facility is available for ECBs availed under the Automatic or Government Route and is applicable to ECBs, due for payment or not, as well as secured/unsecured loans availed from non-resident collaborators.

(ii) General permission is also available for issue of shares/preference shares against lump sum technical know-how fee, royalty, under automatic route or SIA/FIPB route, subject to pricing guidelines of SEBI/CCI and compliance with applicable tax laws.

2.2 NEED FOR REVIEW:

2.2.1 In the recent past, the Foreign Investment Promotion Board (FIPB), has been receiving a number of cases related to issue of shares against non-cash considerations, not covered by the above categories. These relate to issue of shares against expenditure which includes trade payables, pre-incorporation expenses, import of capital goods/machinery etc. Some of these cases are listed below.

2.2.2 In the proposal of M/s Kerns Aero Products Private Limited³, shares against machinery imported were allowed subject to *a) consent of the parent company b) supporting audited statement, and c) meeting tax liability, as per law*. In the proposal of M/s Quattro BPO Solutions Private Limited, the Board allowed issuance of sweat equity shares, subject to Section 79A of the Companies Act, notification dated December 4, 2003 issued by D/o Company Affairs (now M/o Corporate Affairs) for "Unlisted Companies (Issue of Sweat

² Now discounted cash-flow method

³ FIPB Review, 2009

Equity Shares) Rules, 2003” and Regulation 8 of FEMA 20. The Board allowed issuance of shares against transfer of technology in the proposal of M/s Actis Biologics Private Limited. Issuance of shares for payment of rent as a part of pre-incorporation expenses also received the approval of the Board in the proposal of M/s GIA India Laboratory Private Limited. FIPB allowed a payment of \$ 214,000 of the purchase price, in the form of shares, in the proposal of M/s Mold-Tek Technologies Limited. Whilst considering M/s Mitsuba Sical India Limited, the Board allowed a request from the applicant to issue equity instead of redemption, as the applicant was unable to redeem the Redeemable Preference shares. However, in the proposal of M/s Marconi Telecommunications (I) Private Limited, FIPB held that issue of shares against trade payables could not be permitted, as it involved a transaction between a parent company and its Wholly Owned Subsidiary and was, anyway, subject to pricing guidelines and relevant norms of SEBI/RBI. Similarly, in the proposal of M/s MD Group Inc, Canada, issuance of shares was sought against Franchisee rights. The Board held that the extant policy permits issuance of shares for consideration other than cash in the case of lump sum fees, royalty and ECB. Issuance of shares against internal accruals, import of second hand machinery etc. has also been allowed on a case to case basis, but it cannot be allowed against an intangible asset like Franchisee rights. The Board also rejected the proposals of M/s Sun Technics Energy Systems Private Limited (*shares against trade payables*), M/s TCL India Holdings Private Limited (*shares against dealing with completely assembled consumer electronics like colour TV, Washing Machines etc.*), and M/s Maharishi Solar Technology (P) Limited (*shares against the arbitration award*).

2.2.3 The FIPB Review, 2009, observed that issues of shares, for other than cash considerations, require a much deeper look and with the increasing numbers of such cases, some objective norms would have to be evolved soon. The Review further observed that, though the Board has been, by and large, liberal in facilitating the industry, this route for FDI cannot be allowed to become a norm, rather than exception it is supposed to be, since the purpose of FDI gets defeated through this mode. Keeping in view the observations made in the Review and the fact that the number of such cases has been on the increase, it is necessary to evolve guidelines on this subject, consistent with overall FDI policy and the genuine requirements of business which have evolved over a period of time.

3.0 CATEGORIES OF CASES ARISING FOR ISSUE OF SHARES ON NON-CASH CONSIDERATIONS:

3.1 IMPORT OF CAPITAL GOODS/ MACHINERY/ EQUIPMENT (INCLUDING SECOND-HAND MACHINERY)

3.1.1 Any import by a resident in India has to be in accordance with the Export/ Import Policy issued by Government of India. Payment against the same also needs to be in compliance with the Foreign Exchange Management Act, 1999 (FEMA) provisions relating to imports. Further, import of such goods is fully documented by the customs authorities, who also make an

assessment of the fair-value of such imports. Since adequate checks on the fair value of such imports are available, allotment of shares against the latter could be permitted, with prior Government approval.

3.2 SERVICES

3.2.1 As per the FEMA, services are classified as transactions under the current account. Payments against the same are, in general, freely permitted, without any limit, under the general permission route. The only exceptions are consultancy payments, wherein approval of the Reserve Bank of India (RBI) is required for payments beyond specified monetary limits.

3.2.2 If issue of shares against services was to be permitted, the challenge from the regulatory perspective could be possible over-invoicing, which may result in allotment of excess shares. This challenge arises from the fact that there is no extant mechanism that can verify the fair value of the services rendered, unlike in the case of import of goods. However, given the fact that, under the FEMA, payment made against supply of services are freely permitted, it could be argued that shares could be issued through Government route against services supplied, subject to the following stipulations:

- (a) Compliance of FEMA regulations in relation to import of the services*
- (b) The service fee being in accordance with the service-fee agreement*
- (c) Furnishing of an auditor's certificate that the services have actually been rendered by the concerned non-residents and that the payment is in accordance with the agreement*
- (d) Obtaining of separate RBI approval, in case the services qualify as consultancy services and the payment is beyond threshold limits.*

3.2.3 On the other hand, it could be argued that transactions in the current account should be consciously excluded from the purview of Foreign Direct Investment, which should be confined to transactions in the capital account. Therefore, such cases should not be considered. It may be noted that the conversion of technology transfer/license/royalty fees etc., which is permitted at present, is also a current account transaction.

3.3 ISSUE OF SHARES AGAINST IMPORT OF RAW MATERIAL/TRADE PAYABLES

3.3.1 In a number of cases, requests have been received by FIPB, for issue of shares against import of raw material. As in the case of import of capital goods/machinery etc., any import, made by a resident in India, has to be in accordance with the Export/ Import Policy issued by Government of India. The same also needs to be in compliance with FEMA provisions relating to imports. Further, import of such goods is also documented by the customs authorities, who also make an assessment of the fair-value of such imports. Since adequate checks on the fair value of such imports are available, similar to the approach of Para 3.1, allotment of shares against imports of raw material could be permitted, with prior Government approval. Conversely, as pointed out in Para 3.2.3, such transactions are current account transactions,

and it can equally well be argued that they fall outside the ambit of FDI and permitting them may inhibit transactions in the capital account which is the bedrock of FDI.

3.3.2 A similar argument can be made against the issue of shares against trade payables. These are also current account transactions which fall outside the ambit of FDI which should confine itself to capital account transactions.

3.4 PRE-OPERATIVE/ PRE-INCORPORATION EXPENSES (INCLUDING PAYMENTS OF RENT ETC.)

3.4.1 A significant amount of expenditure is incurred between the conceptualization of the company, its incorporation and commencement of commercial production. This expenditure is often capitalized. If the overseas promoter has incurred these expenses, it is often proposed that shares be issued against such expenditure. Considering that payments made against pre-incorporation are allowed to be remitted under the general permission route, it could be considered whether issue of shares against such expenses should also be permitted, subject to the following stipulations:

- (a) Submission of FIRC for remittance of funds by the overseas promoters*
- (b) Verification and certification of the pre-incorporation/pre operative expenses by the statutory auditor.*
- (c) Other accounting and regulatory norms on such expenditure being complied with.*

3.4.2 A view also has to be taken whether such issue of shares should be on the automatic route or on the government route.

3.5 SHARE SWAPS

3.5.1 An increasing number of Indian companies are expanding their operations to cover overseas markets. While investing in overseas companies, such Indian companies are required to comply with the Overseas Direct Investment (ODI) regulations, framed under FEMA. Such companies often undertake share-swap transactions. Share-swap transactions are based on the mutual benefits accruing to both the Indian entity, as well as the foreign entity. They reduce the need for cash flows, while simultaneously meeting the end objectives of investment. As far as the Indian companies are concerned, such transactions help by reducing the requirement of funds for making overseas investments. It is argued that such transactions are synergetic and do not supplant conventional FDI but supplement it. This framework presumes swap of shares in an Indian company with shares in a foreign company. There could also be a situation of share swaps of two Indian companies held by either Indian residents or non-residents. Keeping in view the fact that FIPB has been receiving a number of cases related to share swaps, it is necessary to evolve standardized criteria for such cases.

3.5.2 It is felt that share-swaps could continue to be permitted on the Government route, subject to the following requirements:

- (a) *The overseas investment being in accordance with the Overseas Direct Investment guidelines and the inward investment compliant with FDI policy*
- (b) *Valuation norms in relation to overseas investment, as well as in relation to inbound investment in the Indian companies, being complied with.*

3.6 ISSUE OF SHARES AGAINST INTANGIBLE ASSETS (INCLUDING FRANCHISEE RIGHTS):

3.6.1 The need for issue of shares against intangibles has often been expressed. There are, however, no widely accepted criteria for valuation of intangibles. There is a possibility that such cases may lead to situations of issue of excess shares, in the absence of detailed criteria. Since such cases may pose significant challenges in terms of valuation, and would require evolution of detailed guidelines, the balance of convenience may lie in not considering such cases for the present.

3.7 ISSUE OF SHARES AGAINST ONE TIME EXTRAORDINARY PAYMENTS (INCLUDING ARBITRATION AWARDS):

3.7.1 An approach similar to that outlined in Para 3.6 may be preferable.

4.0 ISSUES FOR CONSIDERATION:

4.1 The following issues need consideration in this regard:

a) *Does the issue of shares for considerations other than cash represent a valid and unaddressed business need? Should the Government amend the FDI policy to address this need? Will adoption of such an approach dilute the objective of FDI policy by decelerating the flow of physical capital into the country?*

b) *Should the Government consider categories not covered under extant policy for the issue of shares against considerations other than cash? Should such considerations be limited to the cases mentioned in Section 3 above or should other categories also be added? What regulatory safeguards should be prescribed for each such case/category?*

c) *Where allotment of shares for considerations other than cash is permitted, should Government be concerned with the valuation of shares? Should objective valuation of services/goods received as consideration for the issue of shares be the prime concern in such cases and should it form the basis for the amendments to the FDI policy? What are the guidelines that should be adopted for listed/non listed companies in such cases? Can concerns relating to valuation be effectively addressed elsewhere?*

d) *Should issue of shares to set off payment in the current account/intangibles/ onetime extraordinary payments be permitted? Should the broad principle be adopted that whenever money has been received in India or value has been received in India in lieu of money and valuation*

protocols are in place, issue of shares may be permitted, with prior Government approval?

e) Is there a possibility that the issue of shares for non cash considerations listed in Section 3 above could be misused especially in the context of money laundering? If so, what steps should be taken to address such a contingency?

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**Department of Industrial Policy and Promotion,
Ministry of Commerce and Industry, Government of
India released Consolidated FDI Policy effective
from 01st October, 2010**

NOTE: To view Consolidated FDI Policy log on to:
http://www.dipp.nic.in/FDI_Circular/FDI_Circular_02of2010.pdf

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