Foreign Investment – FEMA provisions

Institute of Chartered Accountants of India – Beginner's Study course on FEMA

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Inbound Investment

- Inbound investment refers to:
  - Foreign Direct Investment.
  - NRI Direct investment.
  - Portfolio investment - FII, QFI and NRI.
  - Foreign Venture Capital investment.
  - Government securities, Corporate debt.
- Different routes have different policies and rules.

FDI - Basic provisions

- Non-residents are allowed to invest in most of the sectors under automatic – except for negative list.
- Some sectors have additional conditions.
- Investment is permitted through Indian companies.
- **NRIs** have an option of **non-repatriable** investment in companies, firms and proprietory concerns.

FDI - Basic provisions

- Valuation norms have to be adhered to.
- Transfer of shares is mostly on automatic basis – subject to valuation norms.
- Allot shares within 180 days of receipt of funds.
- There are reporting requirements for investment and transfer.
- Further liberalisation is on sensitive / difficult issues. It will be a slow process.

FDI - regulators

- Foreign Direct Investment is governed by **Consolidated FDI Policy** and **FEMA**.
- Three way governance:
- - **Reserve Bank of India** – for FEMA regulations and administration

  – Ministry of Commerce and Industry – **DIPP** – for Policy and some approvals.

  - Ministry of Finance - **FIPB** – for only approvals.

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FDI Policy versus FEMA

- There are differences of views between Government and RBI.
- FDI Policy is not issued under any specific law. FEMA is a statutory enactment.

  In case of difference of interpretation, FEMA prevails. FDI policy states this specifically.
- Supreme Court has also ruled that without FEMA notification, press releases are not effective.

Who can invest in India?

- Any non-resident can invest.
- A resident or an entity of **Bangladesh** can invest under the approval route.
- A resident or an entity of **Pakistan** can invest under the approval route in sectors other than defence, space, sectors prohibited for FDI.
- **Unincorporated entities** cannot invest. Thus private trusts cannot invest.

Entities in which FDI permitted

- A non-resident can invest in:

  - Indian company.

  - Partnership firm – NRI can invest on non-repatriable basis.

  Foreigners / NRIs can invest with RBI approval on repatriable basis. (Practically RBI / FIPB does not give approvals.)

Entities in which FDI permitted

- Venture Capital Funds – FVCIs can invest. If VCF is set up as trust, approval from FIPB is required for **NRs and NRIs**. If VCF is set up as company, normal FDI guidelines apply.

- Trusts / AOP, etc. – not permitted.

Limited Liability Partnership

- Investment is permitted under FIPB route.
- Permitted in sectors where 100% FDI is permitted under automatic route. No FDI linked conditions.
- Indian company with FDI can invest in downstream LLP only if the company and the LLP are in sectors where 100% FDI is under automatic route.

Limited Liability Partnership

- LLP with FDI cannot invest in any downstream investments.
- Only cash contribution for capital permitted.
- FII / FVCI cannot invest in LLP.
- LLP cannot borrow from abroad (ECB).
- Conversion of company with FDI into LLP is permitted with FIPB approval.

Limited Liability Partnership

- Investment by NRIs on non-repatriable basis is not yet permitted.
- As per LLP Act, one of the **designated partners should be an Indian resident**. Practically it is difficult to form a LLP where all partners are non-residents.
- Withdrawal of capital – is it all right?
- Interest on partner's capital?

Permitted securities

- Investment is permitted only in equity shares or instruments which are fully convertible into equity shares.
- Warrants can be issued only with FIPB approval.
- Securities should be allotted within 180 days of receipt of funds.
- Valuation should be as DCF method for investment in unlisted company, or as per SEBI rules in case of listed companies.

Consideration for Issue of shares

- Shares can be issued against:

  - Cash (normally).

  - Knowhow fees and royalty due for payment.

  - Conversion of ECBs.

Shares against Import of capital goods, machinery

- Share issue under **approval route**.
- Import as per Export / Import Policy.
- Independent valuation report from the valuer in the country of import.
- Identification of beneficial ownership of importer and overseas entity.
- Application should be made within 180 days of shipment.

Shares against Pre-incorporation and Pre-operative expenses

- Share issue under **approval route**.
- Submission of FIRCs.
- Certification by statutory auditor.
- Payment should be made directly by the foreign investor or through its bank account.
- Application should be made within 180 days of incorporation.

Pricing of shares

- The shares have to be issued at a price not less than the value arrived at by Discounted Cash Flow method in case of unlisted companies, or as per SEBI rules for listed companies.
- For Convertible instruments – pricing basis should be decided upfront. The value should not be less than the value at the time of investment.

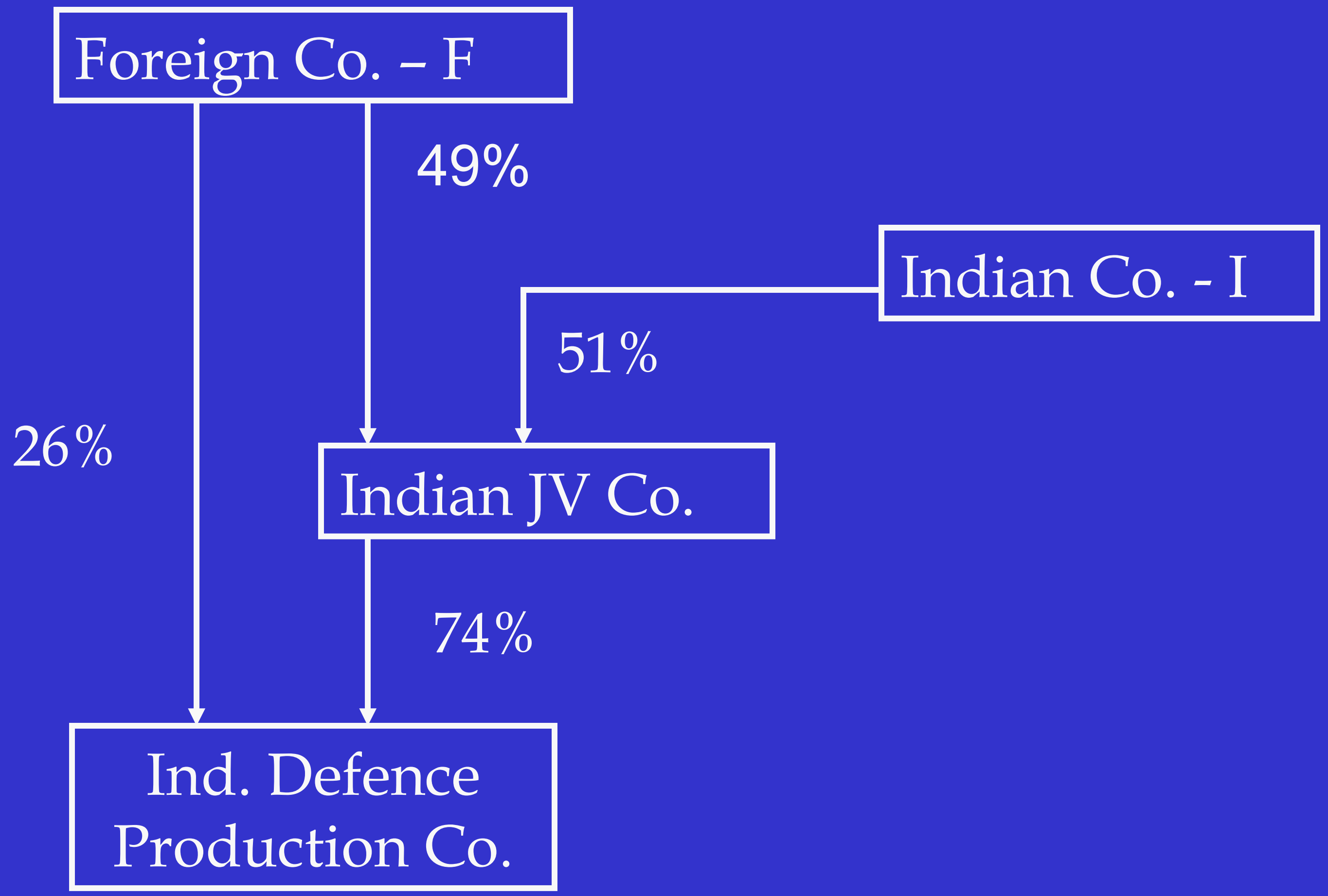
Investment in "same field"

- Investors having investment as on 12.1.2005 required a prior approval for the second investment in the "same field".
- This condition has been removed by the Consolidated Policy of 31.3.2011.

Rights issue

- Rights issue can be made to non-residents subject to sectoral caps.
- **Additional allotment** can be made to the non-residents subject to sectoral caps.
- Price offered should be the same as that offered to Indian residents.
- No valuation norms are prescribed. However banks are insisting on the valuation report.

Indirect Foreign Investment



Downstream investment

- Holding company requires FIPB approval – for downstream companies.
- Operating company can invest in downstream companies under automatic route – subject to FDI policy.

Transfer of shares

- Transfer from NR to NR – automatic route except where purchasing NR requires approval.
- Transfer from NR to NRI – automatic route.
- Transfer from NRI to NR – FIPB approval.

Transfer of shares

- Transfer from NR to R; and R to NR – automatic basis subject to valuation rules and guidelines.
- If the Indian investee company is in financial services, transfer requires regulator's NOC for **transfer from R to NR**.
- Gift from R to NR relative – permitted upto US$ 50,000 p.a. under RBI approval route.

Some specific sectors

- Retail trading prohibited.
- Single brand retail permitted with FIPB approval – 100%.
- Multi brand retail permitted with FIPB approval – 51%.
- Wholesale cash and carry trade – automatic route.
- Defence related services.
- Real Estate Development … next slides.

Real Estate Development

- FDI and NRIs are permitted to invest in **Real Estate Development** business upto 100%.
- NRIs can also invest on non-repatriable basis – in companies, firms and proprietary concerns.
- FDI guidelines on real estate development do not apply to NRIs.
- Investment in LLPs is not permitted.

Real Estate Development

- 3 categories of Real Estate Business:
  - Trade - x Not permitted
  - Buy and lease - x Not permitted
  - Construction - √ Permitted
- Hotel, Hospital, SEZ, Infrastructure, Education, Old age homes – Not Real estate.
- Project related conditions and Investment related conditions are prescribed.

Project related conditions

- **Minimum constructed area** – 50,000 sq. meters built-up area for construction; and 10 hectares for serviced plots.
- **Completion certificate** from the local authority will determine whether the project is complete.
- 50% of the project should be completed within 5 years of obtaining statutory clearances.

Investment related conditions

- Non-resident investor is required to invest:

  - US$ 10 mn. for WOS,

  - US$ 5 mn. for JVs with Indian residents.

- Funds have to be brought within 6 months of commencement of business.
- Lock-in for 3 years from the date of achieving minimum capitalisation.

Sale of shares

- Two main conditions to be fulfilled for exit:

  - Lock-in period of 3 years.
  - 50% **project completion** within 5 years of obtaining statutory clearances.

NRI Direct investment

- FDI guidelines do not apply to NRI investment on non-repatriable basis.
- Restriction on agriculture, real estate trading.
- NRIs can invest on non-repatriable basis in a company, firm or a proprietory concern.

FIPB

- Application can be filed online.
- The application is sent to relevant ministries and also to the revenue.
- **Ultimate beneficial owner** - especially in case of investment from offshore centres - is asked for.

Foreign Institutional Investors

- FIIs are permitted to invest as per SEBI rules and FEMA rules.
- FIIs can invest in equity shares, corporate debt, Government debt, exchange traded derivatives.
- Individual FII can invest in equity capital upto 10%. Overall FIIs can invest upto 24%. Higher limit can be approved by the investee company.

NRI Portfolio Investment

- NRIs can invest in equity shares of listed company on stock market – repatriable and non-repatriable.
- NRIs can invest in equity, preference shares, exchange traded derivatives on non-repatriable basis.
- Individual NRI can invest in equity capital upto 5%. Overall NRIs can invest upto 10%. Higher limit can be approved by the investee company.

NRI Portfolio Investment

- They can also invest in mutual funds, Government debt, shares in PSU on divestments, etc.
- No investment in PPF and small savings.

Qualified Foreign Investors

- QFIs who satisfy KYC requirements can invest in equity, equity schemes, debt schemes (infrastructure funds).
- Individual QFI can invest in equity capital upto 5%. Overall QFIs can invest upto 10%.
- This limit is over and above FII and NRI portfolio investment limits. However investment cannot exceed the overall sectoral cap.

FVCI

- FVCI can invest in IVCU, SEBI registered VCF and scheme floated by VCF.
- FVCI should be registered with SEBI and RBI.
- Investment can be made in equity, equity linked instruments, debt, units of schemes.

Thank you.

Questions and comments are welcome.

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