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PRACTICAL ASPECTS OF FOREIGN DIRECT INVESTMENT

INTRODUCTION

Foreign Direct Investment (FDI) plays a pivotal role and shares lion's contribution in the economic development of India. India is one of the fastest growing economies of the world and there is no doubt that foreign companies are keen to invest in India to take the benefit of demographic dividend, tax exemptions, favourable business environment, sound banking system, educated and astute young workforce etc. Attracting FDI, was one of the key promises made by the Mr. Narendra Modi led Government. By launching Make in India, Ease of Doing Business and e-Biz portal, the government is willing to leave no stone unturned to make India a Global Investment Destination. If we look at the recent amendments made in FDI policy of India (*which is given in detail in this document*), it shows the government is serious to boost its foreign exchange reserves. India was ranked the No.1 investment destination in the world as per the 2015 Baseline Profitability Index (BPI). The aim behind this topic is to present an overview and practical aspects of FDI in India.

ROUTES TO INVEST IN INDIA

There are only two routes to invest in India:

1. Approval Route- It means there is requirement of approval from Government of India to invest in India. Very few sectors now fall under the Approval Route.

2. Automatic Route- It means there is no requirement of approval from Government of India to invest in India. Interestingly, most of the sectors/activity now falls under the Automatic Route.

The fundamental principle of the FDI policy of the country has been to keep maximum of the sectors under automatic rule. It is not surprising that more than 90% of the FDI received in the country comes under automatic route. However the last year saw significant jump in the approval route though no new sector was placed under the government approval.

SECTORAL CAP

Sectoral FDI Cap is a limitation prescribed by Department of Industrial Policy & Promotion, Government of India for investment in Indian Equity by Foreign Company and same is prescribed Sector / activity wise. The percentage of the foreign investment in that specific sector cannot exceed the prescribed permission. For instance, in Multi Brand Retail Trading, Foreign Investment of 51% is allowed through Government route. Recently, Government of India has amended the FDI policy to introduce the composite caps for simplification of FDI policy to attract foreign investment.(*Refer Major Amendments in FDI Policy of India in this document).*

BROWNFIELD INVESTMENT & GREENFIELD INVESTMENT

Brownfield investment simply means acquiring stake in an existing company.

Greenfield investment simply means starting a new venture in overseas country.

WHO CAN INVEST IN INDIA?

- A Non-Resident entity and Non-Resident Indian[1].
- Foreign National, Foreign Institutional Investor/Foreign Portfolio Investor, Foreign Venture Capital Investor, Qualified Foreign Investors.
- A citizen of Bangladesh or an entity incorporated in Bangladesh can invest only under the approval route.
- A citizen of Pakistan or an entity incorporated in Pakistan can invest, only under the approval route. Further, they can invest only in sectors/activities other than defence, space and atomic energy and sectors/activities which are prohibited for foreign investment.
- NRIs resident in Nepal and Bhutan as well as citizens of Nepal and Bhutan are permitted to invest in the capital of Indian companies on repatriation basis. This is subject to the condition of inward remittance.

  The government has made an important amendment to treat the investments by NRI as domestic investment. (Refer Major Amendments in FDI Policy of India in this document.)

ENTITIES INTO WHICH FDI CAN BE MADE:

- Indian Company
- Partnership Firm/Proprietary Concern
- Venture Capital Fund (VCF)
- Limited Liability Partnerships (LLPs)
- FDI in Trust is not permitted in India.

ENTRY MODES TO INVEST IN INDIA:

- Incorporating a company in India.
- Limited liability partnerships.
- Sole proprietorship/partnership firm
- Liaison office, Branch office (BO) or Project Office (PO)
- Joint Venture with Indian partner
- Foreign Institutional Investors

TYPES OF INSTRUMENTS THAT CAN BE ISSUED TO FOREIGN INVESTORS:

Indian companies can issue following types of securities:

- Equity Shares.
- Fully, compulsorily and mandatorily debentures
- Fully, compulsorily and mandatorily convertible preference shares.
- External Commercial Borrowing (ECB).
- Non convertible, partially or optionally convertible Preference shares will be treated as ECB.

The companies need to be alert as far as ECB is concerned. Any loan from foreign nation is termed as ECB. The company has to obtain a Loan Registration Number or LR number from RBI before obtaining ECB from overseas countries. It is strictly prohibited to bring funds under ECB route without obtaining LR number.

PRICING GUIDELINES:

The issue of instruments under FDI is subject to pricing guidelines/valuation norms as prescribed under FEMA regulations. The issue price or the conversion formula of the instruments should be determined at the time of issue only. The issue price or the conversion price cannot be, in any case, less than the fair value determined by the valuer. The valuation has to be determined as per any internationally accepted pricing methodology on arm's length basis for the unlisted companies and valuation in terms of SEBI (ICDR) Regulations, for the listed companies. Erstwhile, RBI used to accept the valuation in Discounted Cash Flow method only. Now this method has been done away and any internationally accepted pricing methodology on arm's length basis is accepted.

NORMAL PROCEDURE TO INVEST IN THE EQUITY CAPITAL OF INDIAN COMPANY:

Foreign Investor to bring funds in the capital of Indian company through normal banking channels.

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Indian Company to collect Foreign Inward Remittance Certificate (FIRC) from the Authorized Dealers (AD)

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After collecting the FIRC from AD, the Indian company need to report to Reserve Bank of India about the remittance received within 30 days from the date of remittance in the Advance Reporting Form-Annex 5 of FDI policy

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The company will receive Unique Identification Number or UIN after reporting the remittance.

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The company need to allot shares to the foreign investor within 180 days from the date of remittance. ***As per FDI policy, the shares has to be issued within 180 days whereas as per Companies Act, 2013 the shares has to be issued within 60 days from the date of remittance.*** The investee company need to be vigilant as far as the time limit of allotment is concerned.

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On allotment of shares to the Foreign Investors, the company must report to RBI regarding the allotment of shares in form FCGPR within 30 days from the date of allotment.

It is important to note the reporting as mentioned above must reach RBI within 30 days from the date of remittances or date of allotment, as the case may be. It shall be the duty of the companies to follow up with the Authorized Dealers to submit the reporting with RBI within the statutory deadlines.

It is also important to note that the purpose of remittance in the FIRC copy should be Equity capital for investing in equity shares. In other words, the FIRC should mention the same purpose which the foreign investor is willing to bring funds in India.

RIGHTS ISSUE

Right issue refers to issue of shares to existing shareholders on proportionate basis.

The shareholder who is not willing to buy the shares issued on right basis always has the option to renounce his entitlement to third person.

In cases where shares on right basis are issued to foreign individuals or entities, the issuing company is required to submit a certificate from Company Secretary of the Company or Practising Company Secretary, as the case may be, certifying the compliance of Right Issue under FEMA Regulations in addition to standard certificate as per FCGPR.

It pertain to note that, Right Issue is the exception to the pricing guidelines of FDI, if the shares are issued at below fair value.

BONUS ISSUE

Foreign shareholders are also eligible for the bonus shares issued by the company. At times, it is seen that Authorized Dealers insist the companies to submit Advance Reporting Form (ARF)-Annex 5 while issuing bonus shares to foreign shareholders.

As a matter of the fact is there is no requirement to submit ARF because there is no actual remittances received in India as the shares are issued free of cost.

The only responsibility of the company is to submit FCGPR within 30 days of bonus issue alongwith Company Secretary of the Company or Practising Company Secretary, as the case may be, Certificate who will certify the compliance of bonus issue to foreign shareholders in addition to standard certificate as per FCGPR.

TRANSFER OF SHARES

It is simple and convenient to transfer the shares in Indian company from resident to non-resident or non-resident to resident. Companies need to submit form FC-TRS within 60 days from the date of receipt of funds.

Following are the documents that need to be submitted with FCTRS:

- Consent Letter duly signed by the seller and buyer
- The shareholding pattern of the investee company after the transfer of shares.
- Valuation certificate by Chartered Accountant.

It is presumed that there is no requirement to submit any forms with RBI in case of transfer of shares from non-resident to non-resident as the FEMA regulations is silent on this subject. However, as matter of practice, the companies may inform to RBI regarding change in the capital structure of the company.

FOREIGN LIABILITIES & ASSETS (FLA) STATEMENT (FCGPR-Part B):

Annual return on Foreign Liabilities and Assets is required to be submitted by all the India resident companies which have received FDI and/ or made overseas investment in any of the previous year(s), including current year by July 15 every year.

If the company's accounts are not audited before the due date of submission, i.e. July 15, then the FLA Return should be submitted based on unaudited (provisional) account.

JOINT VENTURE / FOREIGN OR TECHNICAL COLLABORATION (PRESS NOTE 1 OF 2005)

According to Press Note 18 (1998 series), foreign investors were required to get approval from the Government in cases where such Foreign investor has or had any previous joint venture or technology transfer/ trademark agreement in the same or allied field in India.

In order to get approval, the investor had to prove that the new investment would not damage the existing venture or get a no objection certificate (NOC) from its earlier partner.

Joint venture between Disney and Modi Enterprises is a landmark case study to understand the impact of Press note 18.

Keeping in view the representations received from foreign investors after introduction of aforesaid mentioned press note, the government introduced Press Note 1 of 2005 series.

According to Press note 1 of 2005 series, prior approval of the government would be required only in specific cases rather than in all cases.

For the joint ventures to be entered after 12.01.2005, the government has stipulated to have "***conflict of interest***" clause to safeguard the interest of Indian partner in case the foreign investor sets up another joint venture or Wholly owned subsidiary in the same field.

However, the above decision of Government, was narrow down the scope of Foreign Exchange inflow into India

Subsequently, ***government has abolished Press Note 1 of 2005*** series, vide introduction of Consolidated FDI policy of 2011 to promote the competitiveness of India as an investment destination and be instrumental in attracting higher levels of FDI and technology inflows into the country.

OVERSEAS DIRECT INVESTMENT:

General Permission has been granted to persons residents in India for purchase / acquisition of securities Outside India.

Indian parties are permitted to make investment / undertake financial commitment in overseas Joint Ventures (JV) / Wholly Owned Subsidiaries (WOS) subject to the ceiling prescribed by RBI guidelines as mentioned below.

- 400% of the net worth as per the last audited balance sheet of the Indian entity. Investments within the aforesaid mentioned prescribed limit will be treated under Automatic Route.

- Any financial commitment exceeding USD 1 billion (or its equivalent) in a financial year would require prior approval of the Reserve Bank even when the total FC of the Indian Party is within the eligible limit under the automatic route (i.e., within 400% of the net worth as per the last audited balance sheet).

Indian party need to fill Form ODI and submit the same to authorized dealers effecting remittances towards such investments / financial commitments.

Every Indian company making ODI need to submit to the Reserve Bank through the designated Authorized Dealer, every year, an Annual Performance Report in respect of each JV or WOS osutside India set up or acquired by the Indian party.

This report need to be submitted on or before 30th June every year.

PROHIBITED SECTORS FROM MAKING ODI

Indian parties are prohibited from making investment(or financial commitment)in a foreign entity engaged in real estate (meaning buying and selling of real estate or trading in Transferable Development Rights (TDRs) but does not include development of townships, construction of residential/commercial premises, roads or bridges)or banking business, without the prior approval of the Reserve Bank.

PROHIBITED SECTORS FOR MAKING INVESTMENT IN INDIA

There are some sectors wherein FDI is strictly provided due to security and strategic reasons. Following are the sectors in which FDI is not permitted:

- Lottery Business including Government/private lottery, online lotteries, etc.
- Gambling and Betting including casinos etc
- Chit funds
- Nidhi company
- Trading in Transferable Development Rights (TDRs)
- Real Estate Business or Construction of Farm Houses
- Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes
- Activities/sectors not open to private sector investment e.g. (I) Atomic Energy and (II) Railway operations(other than permitted activities)
- Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery Business and Gambling and Betting activities.
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COMPOUNDING OF OFFENCES

The best part in contravention of FEMA regulation is one can also make an application for compounding, *suo moto*, on becoming aware of the contravention. The applicant has to make an application to RBI in the prescribed format and the regional offices of Reserve Bank of India have the power to compound offences under FEMA Regulations such as Delay in reporting inward remittance for issue of shares, Delay in filing form FC(GPR) after issue of shares, Delay in issue of shares/refund of share application money beyond 180 days, mode of receipt of funds, violation of pricing guidelines for issue of shares etc. The compounding process is normally completed within 180 days from the date of receipt of the application complete in all aspects, by the Reserve Bank. It is better to apply to RBI to compound the contravention, *suo moto*, on becoming aware of the offence.

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Sources:

1. *dipp.nic.in*
2. *https://www.rbi.org.in*
3. *http://www.makeinindia.com*
4. *Press releases on Cabinet Decisions.*
5. *International & Domestic News Reports.*

MAJOR AMENDMENTS IN CONSOLIDATED FDI POLICY OF INDIA (w.e.f 12th May,2015)			
Clause No	**Particulars**	**Provision as per Original FDI policy dated 12.05.2015**	**Provision after amendements in FDI vide Press Notes issued by DIPP**
5.2	Levels of Approvals for Cases under Government Route	The Minister of Finance who is in-charge of FIPB would consider the recommendations of FIPB on proposals with total foreign equity inflow of and Below Rs. 2000 crore.	The Minister of Finance who is in-charge of FIPB would consider therecommendations of FIPB on proposals with total foreign equity inflow upto Rs.3000 crore
		The recommendations of FIPB on proposals with total foreign equity inflow of more than Rs. 2000 crore would be placed for consideration of Cabinet Committee on Economic Affairs (CCEA).	The recommendations of FIPB on proposals with total foreign equity inflow of more than Rs. 3000crore would be placed for consideration of Cabinet Committee on Economic Affairs (CCEA).
		The CCEA would also consider the proposals which may be referred to it by the FIPB/the Minister of Finance (in-charge of FIPB)	The CCEA would also consider the proposals which may be referred to it bythe FIPB/the Minister of Finance (in-charge of FIPB).
			The FIBP Secretariat in Department of Economic Affairs will process the recommendations of FIBP to obtain the approval of Minister of Finance and CCEA. The above decision will take immediate effect from 18th June,2015.
2.1.27	Definition of Non Resident Indian (NRI) Intention of the government to amend the definition of Non-Resident :- The government wants to incentivise investments by NRIs, including OCIs and PIOs, resulting in increased investments in the country	(NRI) means an individual resident outside India who is a citizen of India or is a person of Indian origin	NRI means an individual resident outsdie India who is a citizen of India or is an Overseas Citizen of India cardholder within the meaning of Section 7(A) of the Citizenship Act,1955. Person of Indian Origin cardholders registered as such under notification No 26011/4/98 F.I. dated 19.08.2002, issued by Central Government are deemed to be Overseas Citizen of India Cardholders. The meaning of NRI/PIO appearing in the FDI Policy of 2015 will be construed as mentioned above. The above decision will take immediate effect from 18th June,2015.
3.6.2(vii)	Intention of the government to treat NRI investment as domestic investment: Since the investment made under Schedule 4 by NRIs is on non-repatriable basis, it needs to be clearly provided that such investments, for the purposes of FDI policy, are domestic investments.	This is a new para which is to be inserted after para 3.6.2 (vi) of the Consolidated FDI Policy	Investments by NRIs under Schedule 4 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations will be deemed to be domestic investment at par with investment made by residents. The above decision will take immediate effect from 18th June, 2015.

3.6.2(vi)	The government endeavours to put in highly liberalised FDI policy which is not only friendly to foreign investors but also addresses the concerns of domestic constituency by increased manufacturing, job creation and overall economic growth. Further, the Indian companies should have choice between different categories of foreign investments.	It is also clarified that Foreign investment shall include all types offoreign investments i.e. FDI, investment by FIIs, FPIs, QFIs, NRIs,ADRs, GDRs, Foreign Currency Convertible Bonds (FCCB) and fully, mandatorily & compulsorily convertible preference shares/debentures, regardless of whether the said investments have been made underSchedule 1, 2, 2A, 3, 6 and 8 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations.	It is also clarified that Foreign investment shall include all types of foreign investments, direct and indirect, regardless of whether the said investments have been made under Schedule 1 (FDI), 2 (FII), 2A (FPI), 3 (NRI), 6 (FVCI), 8 (QFI), 9 (LLPs) and 10 (DRs) of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations. FCCBs and DRs having underlying of instruments which can be issued under Schedule 5, being in the nature of debt, shall not be treated as foreign investment. However, any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned as foreign investment.
4.1.2	The Finance Minister has already announced in his budget speech that 'to further simplify the procedures for Indian Companies to attract foreign investments; I propose to do away with the distinction between different types of foreign investments, especially between foreign portfolio investments and foreign direct investments, and replace them with composite caps. The sectors which are already on a 100 percent automatic route	For the purpose of computation of indirect foreign investment, foreign investment in an Indian company shall include all types of foreign investments i.e. FDI; investment by FIIs (holding as on March 31); FPIs (holding as on March 31); QFIs (holding as on March 31); NRIs; ADRs; GDRs; Foreign Currency Convertible Bonds (FCCB); fully, compulsorily and mandatorily convertible preference shares and fully, compulsorily and mandatorily convertible Debentures regardless of whether the said investments have been made under Schedule 1, 2, 2A, 3, 6 and 8 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations, 2000.	For the purpose of computation of indirect foreign investment, foreign investment in an Indian company shall include all types of foreign investments regardless of whether the said investments have been made under Schedule 1 (FDI), 2 (FII holding as on March 31), 2A (FPI holding as on March 31), 3 (NRI), 6 (FVCI), 8 (QFI holding as on March 31), 9 (LLPs) and 10 (DRs) of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations. FCCBs and DRs having underlying of instruments which can be issued under Schedule 5, being in the nature of debt, shall not be treated as foreign investment. However, any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned as foreign investment.
3.1.4(1)		An FII/FPI may invest in the capital of an Indian company under thePortfolio Investment Scheme which limits the individual holding of an FII/FPI below 10% of the capital of the company and the aggregate limit forFII/FPI/QFI investment to 24% of the capital of the company. This aggregatelimit of 24% can be increased to the sectoral cap/ statutory ceiling, as applicable, by the Indian company concerned through a resolution by itsBoard of Directors followed by a special resolution to that effect by its General Body and subject to prior intimation to RBI. The aggregate FII/FPI/QFI investment, in the FDI and Portfolio Investment Scheme, should be within the above caps.	An FII/FPI/QFI (Schedule 2, 2A and 8 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations, as the case may be) may invest in the capital of an Indian company under the Portfolio Investment Scheme which limits the individual holding of an FII/FPI/QFI below 10% of the capital of the company and the aggregate limit for HI/FPI/OR investment to 24% of the capital of the company. This aggregate limit of 24% can be increased to the sectoral cap/statutory ceiling, as applicable, by the Indian company concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body and subject to prior intimation to RBI. The aggregate FII/FPI/QFI investment, individually or in conjunction with other kinds of foreign investment, will not exceed sectoral/statutory cap.

6.2		In the following sectors/activities, FDI up to the limit indicated against each sector/activity is allowed, subject to applicable laws/regulations; security and other conditionality. In sectors/activities not listed below, FDI is permitted up to 100% on the automatic route, subject to applicable laws/regulations; security and other conditionalities. Wherever there is a requirement of minimum capitalization, it shall include share premium received along with the face value of the share, only when it is received by the company upon issue of the shares to the non-resident investor. Amount paid by the transferee during post-issue transfer of shares beyond the issue price of the share, cannot be taken into account while calculating minimum capitalization requirement.	a) In the sectors/activities as per Annexure, foreign investment up to the limit indicated against each sector/activity is allowed, subject to the conditions of the extant policy on specified sectors and applicable laws/regulations; security and other conditionalities. In sectors/activities not listed therein, foreign investment is permitted up to 100% on the automatic route, subject to applicable laws/regulations; security and other conditionalities. Wherever there is a requirement of minimum capitalization, it shall include share premium received along with the face value of the share, only when it is received by the company upon issue of the shares to the non-resident investor. Amount paid by the transferee during post-issue transfer of shares beyond the issue price of the share, cannot be taken into account while calculating minimum capitalization requirement. b) Sectoral cap i.e. the maximum amount which can be invested by foreign investors in an entity, unless provided otherwise, is composite and includes all types of foreign investments, direct and indirect, regardless of whether the said investments have been made under Schedule 1 (FDI), 2 (FII), 2A (FPI), 3 (NRI), 6 (FVCI), 8 (QFI), 9 (LLPs) and 10 (DRs) of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations. FCCBs and DRs having underlying of instruments which can be issued under Schedule 5, being in the nature of debt, shall not be treated as foreign investment. However, any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned as foreign investment under the composite cap. Sectoral cap is as per Annexure referred above
			c) Foreign investment in sectors under Government approval route resulting in transfer of ownership and/or control of Indian entities from resident Indian citizens to non-resident entities will be subject to Government approval. Foreign investment in sectors under automatic route but with conditionalities, resulting in transfer of ownership and/or control of Indian entities from resident Indian citizens to non-resident entities, will be subject to compliance of such conditionalities.

			d) The sectors which are already under 100% automatic route and are without conditionalities would not be affected. e) Notwithstanding anything contained in paragraphs a) and c) above, portfolio investment, upto aggregate foreign investment level of 49% or sectoral/statutory cap, whichever is lower, will not be subject to either Government approval or compliance of sectoral conditions, as the case may be, if such investment does not result in transfer of ownership and/or control of Indian entities from resident Indian citizens to non-resident entities. Other foreign investments will be subject to conditions of Government approval and compliance of sectoral conditions as laid down in the FDI policy. f) Total foreign investment, direct and indirect, in an entity will not exceed the sectoral/statutory cap. g) Any existing foreign investment already made in accordance with the policy in existence would not require any modification to conform to these amendments. h) The onus of compliance of above provisions will be on the investee company.

It is clarified that there are no sub-limits of portfolio investment and other kinds of foreign investments in commodity exchanges, credit information companies, infrastructure companies in the securities market and power exchanges.

In Defence sector, portfolio investment by FP1s/FIls/NRIs/QFIs and investments by FVCIs together will not exceed 24% of the total equity of the investee/joint venture company. Portfolio investments will be under automatic route investment.
In Banking- Private sector, where sectoral cap is 74%, FII/ FPI/ QFI investment limits will continue to be within 49% of the total paid up capital of the company.

There is no change in the entry route i.e. Government approval requirement to bring foreign investment in a particular sector/ activity. Further, subject to the amendments mentioned in this Press Note, there is no change in other conditions mentioned in the Consolidated FDI Policy Circular of 2015 and subsequent Press Notes.

Relevant provisions of the FDI policy and subsequent Press Notes will be read in harmony with the above amendments in Consolidated FDI Policy Circular of 2015.

The above decision will take immediate effect.