

**PRESENTATION
ON
FDI UPDATES**

FOR

**INSTITUTE OF COST ACCOUNTANTS OF INDIA
(07.05.2020)**

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STRUCTURE OF PRESENTATION

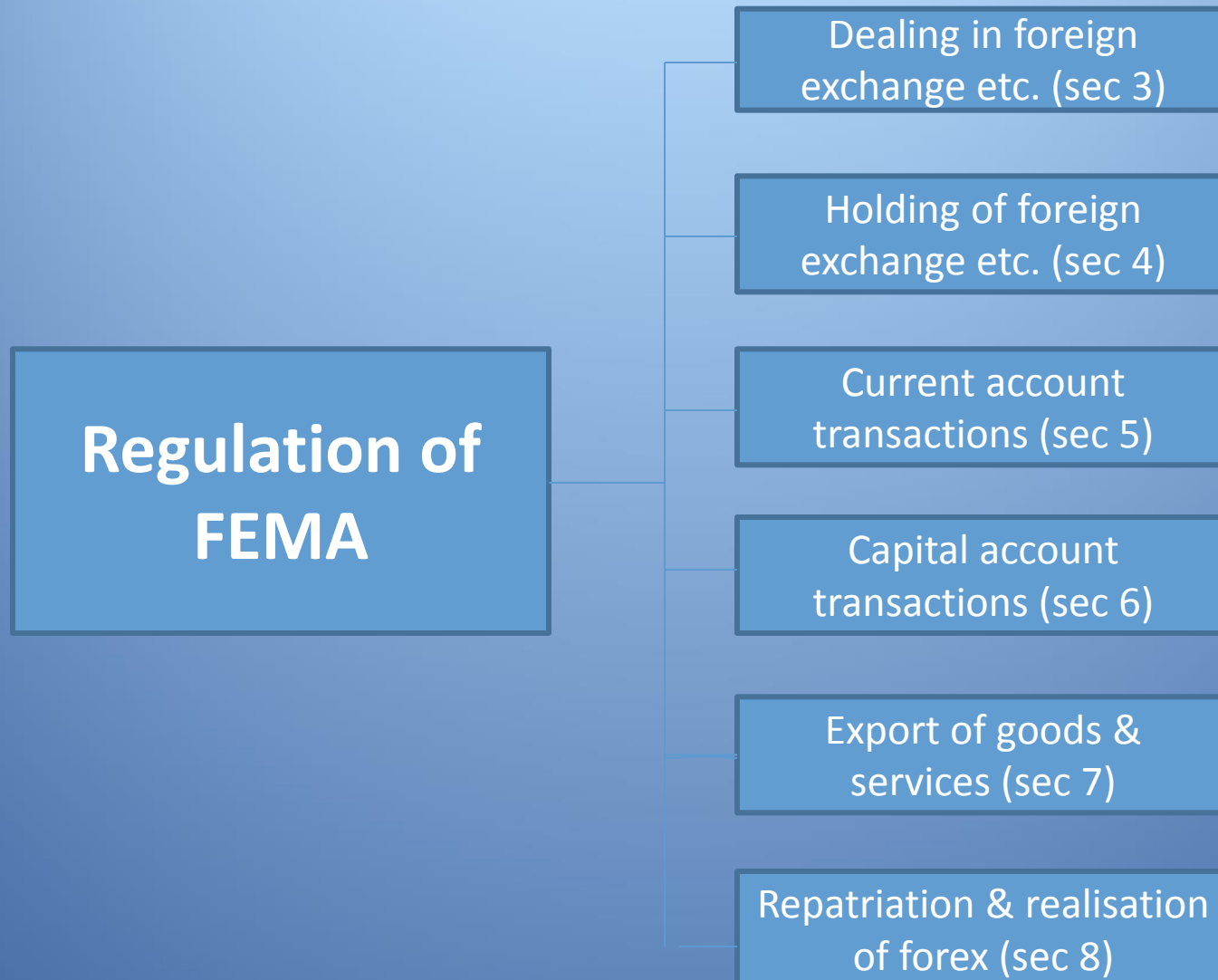
- Overview of Foreign Exchange Management Act (FEMA)
- Governing Framework with respect to FDI prior to October 17, 2019
- Amendment to the FDI framework (17.10.2019)
- Highlights of the FEM(Non – Debt Instruments) Rules, 2019
- Overview of Foreign Investment Framework
- FDI in certain key sectors
- Downstream Investment & Snapshot of Reporting requirements
- Recent Amendments in FDI framework
- Compounding under FEMA - framework

OVERVIEW OF FEMA

FEMA V FERA

BASIS FOR COMPARISON	FEMA	FERA
What it stands for	Foreign Exchange Management Act, 1999	Foreign Exchange Act, 1973
Enactment	Current, new and continuously emerging	Old and Historic
Number of Sections	49	81
Situation when law was introduced	Foreign exchange position was satisfactory	Foreign exchange reserves were low
Approach towards forex transactions	Flexible	Rigid
Basis of residential status	Stay of 182 days or more	Citizenship
Violation – Nature of offence	Civil Offence	Criminal Offence
Punishment for contravention	Fine or imprisonment (if fine not paid in time)	Imprisonment

Overview of FEMA



**GOVERNING FRAMEWORK
WITH RESPECT TO FDI
PRIOR TO AMENDMENTS
DATED OCTOBER 17, 2019**

Governing Framework prior to October 17, 2019 Amendments

- FDI Policy pronouncements by Government of India, the last one being Consolidated FDI Policy (2017) as amended from time to time.
- Press Notes issued by Department for Promotion of Industry and Internal Trade (DIPP) from time to time.
- Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017
- Master Directions issued by RBI
- AP (Dir Series) Circulars

Governing Framework prior to October 17, 2019 Amendments

- **FEMA 20(R)/ 2017-RB** dated 7.11.2017 entitled **Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017**, which superceded Notification No. FEMA 20/2000-RB and Notification No. FEMA 24/2000-RB both dated May 3, 2000 (FEMA, Transfer or Issue of Security by a Person Resident Outside India, Regulations, 2000)
- These regulations came into force on 7th November, 2017, being the date of its publication in the Official Gazette
- These regulations were amended 5 times prior to the amendments dated 17th October, 2019

The erstwhile 2000 Regulations notified in May 2000 were amended no less than 92 times to give effect to changes in FDI policy framework and also to certain other regulatory changes required to make the regulations effective. The 2017 regulations *inter alia* brought all these changes at one place thus making it a single point of reference.

MASTER DIRECTIONS

- RBI has come up with Master Directions covering foreign exchange transactions.
- Master Directions consolidate instructions rules and regulations.
- One Master Direction will be issued for each subject matter covering all instructions on the subject.
- Master Directions will be updated as and when there is change in rules/regulations or change in policy.
- Existing set of Master Circulars stand withdrawn with issue of Master Directions.
- 16 Master Directions were issued by RBI in January 2016 and 3 further Master Directions have been issued since then. These directions subsume the position as on date and consolidating all the existing changes (subject wise). These are updated from time to time.

A P (Dir Series) Circulars

- Directions issued by RBI u/s. 10(4) and 11(1) of FEMA to Authorized Persons (AP)
- These directions are called – **A.P. (Dir Series) Circulars**
- APs are Authorized Dealers, Money Changers and banks who are authorized to deal in Foreign Exchange
- These Circulars are operational instructions to AP by RBI
- Legal validity of these Circulars have been upheld in the case of Prof. Krishnaraj Goswami v. RBI, [2007 (6) Bom. CR 565]
- Court upheld the power of RBI to issue such Circulars based on powers conferred to RBI u/s. 10(4) & 11(1) & negated the contention that RBI has no jurisdiction to issue such Circulars

CURRENT ACCOUNT AND CAPITAL ACCOUNT TRANSACTIONS

- Capital Account transaction means a transaction which alters assets or liabilities including contingent liabilities outside India of person resident in India and vice-versa. (An economic definition rather than an accounting or legal definition.)
- Current Account transaction is transaction other than a capital account transaction.

Current Account Transactions are freely permitted unless prohibited

Capital Account Transactions are prohibited unless they are permitted

**THE AMENDMENT
TO THE
FDI FRAMEWORK
(17.10.2019)**

AMENDMENTS TO FEMA w.e.f 15.10.2019

Section 6 amended :-

- Reserve Bank of India (RBI) will govern capital account transactions involving debt instruments.
- Central Government (CG) will govern capital account transactions involving non-debt instruments, limits and other conditions.
- Debt instruments would be determined by CG in consultation with RBI

Section 46 amended :-

- CG is empowered to determine instruments to be debt instruments under Section 6(7)
- CG has power to stipulate permissible classes of Capital Account transactions as per Section 6(2A) of FEMA with reference to limits, prohibition or regulation of such transactions

Debt and Non Debt Instruments

“Debt Instrument” defined in Rule 2(f) of FEM (Non Debt Instruments) Rules, 2019 to mean all instruments other than Non Debt Instruments defined in Rule 2(ai) of the said rules.

Rule 2(ai) lists the Instruments that are “Non Debt Instruments”

All instruments other than those listed as Non Debt Instruments are Debt Instruments

Non Debt Instruments

- All investments in equity in incorporated entities (public, private, listed and unlisted);
- Capital participation in limited liability partnerships;
- All instruments of investment as recognized in the foreign direct investment (FDI) policy as notified from time to time;
- Investment in units of alternative investment funds (AIFs), real estate investment trusts (REITs) and infrastructure investment trusts (InVITs);
- Investment in units of mutual funds and exchange-traded funds (ETFs) that invest more than 50% in equity;
- The equity tranche of a securitization issue;
- The acquisition, sale or other direct dealing in immovable property;
- Contributions to trusts; and
- Depository receipts issued against equity instruments.

Debt Instruments

Listed as per Notification by C.G. dated 16.10.2019

- Government bonds;
- Corporate bonds;
- All tranches of a securitization issue other than the equity tranche;
- Borrowings by Indian firms via loans; and
- Depository receipts whose underlying securities are debt securities.

**HIGHLIGHTS OF FOREIGN EXCHANGE
MANAGEMENT (NON DEBT
INSTRUMENTS) RULES, 2019**

The Commencement Notification

- Notification No. **3732(E) dated 17.10.2019**

In exercise of the powers conferred by clauses (aa) and (ab) of sub-section (2) of section 46 of the Foreign Exchange Management Act, 1999 (42 of 1999), and in supersession of the Foreign Exchange Management (Transfer of Issue of Security by a Person Resident outside India) Regulations, 2017 and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018, except as respects things done or omitted to be done before such supersession, the Central Government makes the following rules namely :-

The Foreign Exchange Management (Non Debt Instruments) Rules, 2019

A SNAP SHOT OF THE RULES

Chapter	Sections	What it covers
I	1 to 2	Preliminary – Short Title & Definitions
II	3 to 5	Restrictions / Permissions for making investments in India by Persons Resident Outside India
III	6	Investment by Persons Resident Outside India (Schedule I, VI, VIII and IX)
III	7	Rights or Bonus Issue
III	8	ESOP/ SWEAT EQUITY
III	9	Transfer of Equity Instruments
IV	10-11	Investment by Foreign Portfolio Investors (FPI)
V	12-13	Investment by NRI / OCI
VI	14-15	Investment by other Non Resident Investors

A SNAP SHOT OF THE RULES (Contd.)

Chapter	Sections	What it covers
VII	16-17	Investment by FVCI
VIII	18	Issue of convertible notes by Indian Start Up Company
VIII	19	Merger or Demerger of Amalgamation of Companies
VIII	20	Reporting requirements
VIII	21	Pricing guidelines
VIII	22	Taxes and remittances of sales proceeds
VIII	23	Downstream Investments
IX	24-33	Acquisition and Transfer of Immovable Property in India

IMPORTANT DEFINITIONS

Equity Instruments (Rule 2(k)) - Capital Instruments' means equity shares, debentures, preference shares and share warrants issued by an Indian company. Explanation added to provide for conditions in case of partly paid up shares and Warrants

Convertible Note (Rule 2(e)) - means an instrument issued by a startup company evidencing receipt of money initially as debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of such startup company, within a period not exceeding five years from the date of issue of the convertible note, upon occurrence of specified events as per the other terms and conditions agreed to and indicated in the instrument

Foreign Direct Investment (Rule 2(r)) - means any investment made by a person resident outside India on a repatriable basis in equity instruments of an Indian Company or to the capital of a LLP.

Foreign Investment (Rule 2(s)) - means any investment made by a person resident outside India through equity instruments where such investment is less than ten percent of the post issue paid-up share capital on a fully diluted basis

Explanation added that if an investment is made by an Indian resident, but a declaration of beneficial interest of a Non Resident is filed in accordance with the provisions of Companies Act, 2013, the same will be counted as a Foreign Investment.

IMPORTANT DEFINITIONS (Contd.)

- **Foreign Portfolio Investment (Rule 2(s))** - means any investment made by a person resident outside India through equity instruments where such investment is less than ten percent of the post issue paid-up share capital on a fully diluted basis
- **Investment Vehicle (Rule 2(ae))** - means an entity registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose and shall include Real Estate Investment Trusts (REITs) governed by SEBI (REITs) Regulations, 2014, Infrastructure Investment Trusts (Inv Its) governed by SEBI (InvIts) Regulations, 2014 and Alternative Investment Funds (AIFs) governed by SEBI (AIFs) Regulations, 2012
- **Manufacture (Rule 2 (ah))** - with its grammatical variations, means a change in a non-living physical object or article or thing,:-
 - (i) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or
 - (ii) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure
- **Start Up Company (Rule 2 (an))** means a private company incorporated under the Companies Act, 2013 and recognized as such by DIPP.

Start Up means an entity which complies with the conditions laid down in Notification No. G.S.R 180(E) dated February 17, 2016 issued by DIPP, Ministry of Commerce and Industry, Government of India

Restriction on making and receiving investment

- Rule 3 - Save as otherwise provided in the Act, or rules or regulations made thereunder, no person resident outside India shall make any investment in India.
 - **Provided** that an investment made in accordance with the Act or the rules or the regulations framed thereunder and held on the date of commencement of these Regulations, shall be deemed to have been made under these Regulations and shall accordingly be governed by these Regulations.
 - **Provided further** that RBI may, on an application made to it and for sufficient reasons, permit a person resident outside India to make any investment in India subject to such conditions as may be considered necessary.
- Rule 4 - Save as otherwise provided in the Act, or rules or regulations made thereunder, an Indian entity or an investment vehicle, or a venture capital fund or a Firm or an Association of Persons or a proprietary concern shall not receive any investment in India from a person resident outside India or record such investment in its books
 - **Provided** that the Reserve Bank may, on an application made to it and for sufficient reasons, permit an Indian entity or an investment vehicle, or a venture capital fund or a Firm or an Association of Persons or a proprietary concern to receive any investment in India from a person resident outside India or to record such investment subject to such conditions as may be considered necessary.

Investment by a person resident outside India

Schedule No.	Nature of Investment by a Person Resident Outside India (Non Resident)
1	Purchase/ Sale of capital instruments of an Indian company by a Non Resident [Rule 6(a)]
2	Investment by Foreign Portfolio Investors [Rule 10(1)]
3	Investments by Non-Resident Indian (NRI) or Overseas Citizen of India (OCI) on repatriation basis [Rule 12(1)]
4	Investment by Non-Resident Indian (NRI) or Overseas Citizen of India (OCI) on Non-Repatriation basis [Rule 12(2)]
5	Investments by other Non Residents [Rule 14]
6	Investment in a LLP [Rule 6(b)]
7	Investment by a Foreign Venture Capital Investor (FVCI) [Rule 16]
8	Investment by a Non Resident in an Investment Vehicle [Rule 6(c)]
9	Investment in a Depository Receipt (DR) by a Non Resident [Rule 6(d)]
10	Issue of Indian Depository Receipts (IDR) by Companies Incorporated outside India [Rule 10(2)]

Purchase / Sale of Capital Investments – Schedule I

(a) An Indian company may issue equity instruments to a person resident outside India subject to entry routes, sectoral caps and attendant conditionalities prescribed in this Schedule.

(b) A person resident outside India may purchase equity instruments of a listed Indian company on a stock exchange in India:

Provided that -

(i) the person resident outside India making the investment has already acquired control of such company in accordance with SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 and continues to hold such control;

(ii) the amount of consideration may be paid as per the mode of payment specified by the Reserve Bank or out of the dividend payable by Indian investee company in which the person resident outside India has acquired and continues to hold the control in accordance with SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 provided the right to receive dividend is established and the dividend amount has been credited to a specially designated non-interest bearing rupee account for acquisition of shares on the recognised stock exchange.

Purchase / Sale of Capital Investments – Schedule I (Contd.)

c) A WOS set up by a Non Resident Entity operating in a sector where 100% FDI is allowed through automatic route and where there are no FDI linked Performance conditions may issue capital instruments to such Non resident entity up to 5% of its Authorised Capital or USD 500,000, whichever is less subject to :-

- The Indian company filing within 30 days from the date of issue of capital instruments, but not later than 1 year from incorporation date or such time as RBI or Central Government permits, report the transaction in FCGPR
- The Indian company obtains certificate from its statutory auditors that the amount of pre-incorporation/ pre-operative expenses against which capital instruments have been issued has been utilized for the purpose for which it was received and this should be submitted with the Form FC-GPR.

d) An Indian company may issue, subject to compliance with the conditions prescribed by the Central Government and/or the RBI from time to time, equity instruments to a person resident outside India, if the Indian investee company is engaged in an automatic route sector, against,-

- (i) swap of equity instruments; or
- (ii) import of capital goods or machinery or equipment (excluding second-hand machinery); or
- (iii) pre-operative or pre-incorporation expenses (including payments of rent etc.) :

Provided that the Government approval shall be obtained if the Indian investee company is engaged in a sector under Government route and the applications for approval shall be made in the manner prescribed by the Central Government from time to time.

Purchase / Sale of Capital Investments – Schedule I (Contd.)

e) An Indian company may issue equity shares against any funds payable by it to a Non Resident, the remittance of which is permitted under the Act or the rules and regulations framed or directions issued thereunder or does not require prior permission of the Central Government or RBI under the Act or the rules and regulations framed or directions issued thereunder or has been permitted by the RBI under the Act or the rules and regulations framed or directions issued thereunder.

- Provided in case where permission has been granted by RBI for making remittance, the Indian company may issue equity shares against such remittance provided all regulatory actions with respect to the delay or contravention under FEMA or the rules or the regulations framed thereunder have been completed

f) The mode of payment and other attendant conditions for remittance of sale or maturity proceeds shall be specified by RBI

Foreign Portfolio Investments – Schedule II

Limit up to which Foreign Portfolio Investor may invest in capital instruments on a recognized SE	<p>Holding of each FPI or an investor group having meaning as defined in SEBI FPI regulations</p> <p>< 10% of paid up equity on a fully diluted basis or < 10% of paid up value of each series of debentures or preference shares or share warrants issued by an Indian Company AND</p> <p>Total holdings of all FPI's shall be ≤24% of paid up equity on a fully diluted basis or of each series, as the case may be</p>
If investee company seeks to cross the limit of 24%	Then it has to pass Board resolution and also obtain shareholder approval through Special Resolution. However, the maximum limits as per sectoral cap / statutory ceiling would apply
If 10% is exceeded, then the total investment made by FPI will be classified as FDI – then	Reporting requirements as per Rule 20 with respect to FDI will be applicable to the investee company
Mode of Investment by FPI	<ul style="list-style-type: none"> - Public Offer - Private Placement
Pricing in case of Public Offer	Not less than the price at which the shares are issued to residents
Pricing in case of Private Placement	Not less than the fair price worked out as per internationally accepted pricing methodology for valuation of shares on arms' length basis by a Merchant Banker or CMA or CA
Short selling, lending or borrowing	Is allowed but subject to such conditions as may be stipulated by SEBI and / or RBI

Investments by NRI's / OCI's in SE – Schedule III

<p>Limit up to which Non Resident Indian (NRI) or Overseas Citizen of India may invest in capital instruments on a recognized SE</p>	<p>Holding of each NRI or an OCI $\leq 5\%$ of paid up equity on a fully diluted basis or $\leq 5\%$ of paid up value of each series of debentures or preference shares or share warrants issued by an Indian Company AND Total holdings of all shareholding of NRI's and OCI's shall be $\leq 10\%$ of paid up equity on a fully diluted basis or of each series, as the case may be</p>
<p>If investee company seeks to cross 10%</p>	<p>Then it has to pass Board resolution and also obtain shareholder approval through Special Resolution. However, the maximum limits up to which NRI's and OCI's put together can invest cannot exceed 24%, even with board resolution and special resolution.</p>
<p>Purchase or sale of shares of units of domestic mutual funds</p>	<p>A NRI or OCI may without limit purchase or sell units of domestic MF's which invest more than 50% in equity.</p>
<p>Purchase or sale of shares in Public Sector enterprises (PSU)</p>	<p>No limits in cases of purchase or sale of shares of PSU being disinvested by Central Government, provided the purchase is in accordance with the terms and conditions stipulated in the notice inviting bids.</p>
<p>Subscription to National Pension System (NPS)</p>	<p>A NRI or OCI may subscribe to NPS governed by Pension Fund Regulatory and Development Authority (PFRDA), if eligible. Annuity / Accumulated Savings will be repatriable</p>

Investment in Non Repatriation Basis – Schedule IV

Permitted Investments

Following Investments by a NRI or OCI, including a company, a trust, and a partnership firm incorporated outside India and owned and controlled by NRI's or OCI on Non Repatriation basis shall be deemed to be domestic investments at par with investments made by residents :-

- (a) Any capital instrument issued by a company without any limit either on the stock exchange or outside it.
- (b) Units issued by an investment vehicle without any limit, either on the stock exchange or outside it.
- (c) The capital of a Limited Liability Partnership without any limit.
- (d) Convertible notes issued by a startup company in accordance with these Regulations.
- (e) Purchase or sale of Units of domestic mutual fund on non –repatriation basis, which invest more than 50% in equity.
- (f) Contribution to capital of a firm or Proprietary Concern

Prohibited Investments

Following investments in capital instruments or units by above mentioned persons on Non Repatriation basis is however prohibited ,

- a) of a Nidhi company or
- b) a company or a firm engaged in agricultural/ plantation activities or real estate business or construction of farm houses or dealing in Transfer of Development Rights.

Investment by other Non Resident Investors – Schedule V

- (1) Long term investors like Sovereign Wealth Funds (SWFs), Multilateral Agencies, Endowment Funds, Insurance Funds, Pension Funds and Foreign Central Banks may purchase securities subject to such terms and conditions as may be specified by RBI and SEBI.
- (2) “Eligible Foreign Entity (EEE)” as defined in SEBI circular dated the 9th October 2018 and having actual exposure to Indian physical commodity market may participate in domestic commodity derivative markets in accordance with framework specified by SEBI
- (3) The mode of payment and other attendant conditions for remittance of sale or maturity proceeds shall be specified by RBI.

Schedule VI – Investment in LLP

- A Non Resident (other than citizen of Pakistan or Bangladesh) other than a Foreign Portfolio Investor (FPI) or FVCI may contribute to capital of LLP operating in sectors where 100% foreign investments is permitted under automatic route and there are no FDI linked performance conditions.
- Investment by way of 'profit share' will fall under the category of reinvestment of earnings
- Investment in LLP is subject to compliance of conditions of LLP Act, 2008
- Inter-se conversion ie. Company to LLP or LLP to company is permitted provided the entity is operating in a sector where 100% foreign investments is permitted under automatic route and there are no FDI linked performance conditions.
- Investment by way of capital contribution or by way of acquisition / transfer of profit shares should not be less than fair price worked out as per internationally accepted / adopted market practice supported by a valuation certificate from CA or CMA or approved valuer of a panel maintained by Central Government
- In the case of transfer by Non Resident to a Resident, the consideration for such transfer shall not be more than the fair price worked out and supported by a valuation certificate (as aforesaid)

Schedule VII – Investment by FVCI

1. Subject to conditions as may be laid down by RBI, FVCI may purchase
 - (a) securities, issued by an Indian company engaged in any sector mentioned at para 4 of this Schedule and whose securities are not listed on a recognized stock exchange at the time of issue of the said securities;
 - (b) securities issued by a startup;
 - (c) units of a Venture Capital Fund (VCF) or of a Category I Alternative Investment Fund (Cat-I AIF) or units of a scheme or of a fund set up by a VCF or by a Cat-I AIF.Provided if the investment is in capital instruments, then the sectoral caps, entry routes and attendant conditions shall apply;
2. An FVCI may purchase the securities/ instruments mentioned above either from the issuer of these securities/ instruments or from any person holding these securities/ instruments. The FVCI may invest in securities on a recognized stock exchange subject to the provisions of SEBI (FVCI) Regulations, 2000.
3. The FVCI may acquire, by purchase or otherwise, from, or transfer, by sale or otherwise, to, any person resident in or outside India, any security/ instrument it is allowed to invest in, at a price that is mutually acceptable to the buyer and the seller/ issuer.

The FVCI may also receive the proceeds of the liquidation of VCFs or of Cat-I AIFs or of schemes/ funds set up by the VCFs or Cat-I AIFs

Schedule VII – Investment by FVCI (Contd.)

4. Sectors in which FVCI is allowed to invest are :-

- (1) Biotechnology
- (2) IT related to hardware and software development
- (3) Nanotechnology
- (4) Seed research and development
- (5) Research and development of new chemical entities in pharmaceutical sector
- (6) Dairy industry
- (7) Poultry industry
- (8) Production of bio-fuels
- (9) Hotel-cum-convention centres with seating capacity of more than three thousand.
- (10) Infrastructure sector. The term 'Infrastructure Sector' has the same meaning as given in the Harmonised Master List of Infrastructure sub-sectors approved by Government of India vide Notification F. No. 13/06/2009-INF dated March 27, 2012 as amended/ updated.

Rights or Bonus Issue (Rule 7)

- (1) The offer made by the Indian company is in compliance with the provisions of the Companies Act, 2013;
- (2) Such issue shall not result in a breach of the sectoral cap applicable to the company;
- (3) The shareholding on the basis of which the rights issue or the bonus issue has been made must have been acquired and held as per the provisions of these Regulations;
- (4) In case of a listed Indian company, the rights issue to Non Residents shall be at a price determined by the company;
- (5) In case of an unlisted Indian company, the rights issue to persons resident outside India shall not be at a price less than the price offered to persons resident in India.
- (6) Such investment made through rights issue or bonus issue shall be subject to the conditions as are applicable at the time of such issue.
- (7) Mode of payment shall be as specified by RBI.

Explanation: The above conditions shall also be applicable in case a person resident outside India makes investment in capital instruments (other than share warrants) issued by an Indian company as a rights issue that are renounced by the person to whom it was offered.

Issue of Shares under ESOP – Rule 8

An Indian company may issue “employees’ stock option” and/ or “sweat equity shares” to its employees/ directors or employees/ directors of its holding company or joint venture or wholly owned overseas subsidiary/ subsidiaries who are resident outside India, provided that:

- (1) The scheme has been drawn either in terms of regulations issued under the Securities and Exchange Board of India Act, 1992 or the Companies (Share Capital and Debentures) Rules, 2014 notified by the Central Government under the Companies Act 2013, as the case may be;
- (2) The “employee’s stock option”/ “sweat equity shares” so issued under the applicable rules/ regulations are in compliance with the sectoral cap applicable to the said company;
- (3) Issue of “employee’s stock option”/ “sweat equity shares” in a company where investment by a person resident outside India is under the approval route shall require prior Government approval. Issue of “employee’s stock option”/ “sweat equity shares” to a citizen of Bangladesh/ Pakistan shall require prior Government approval.

Provided an individual who is a person resident outside India exercising an option which was issued when he/ she was a person resident in India shall hold the shares so acquired on exercising the option on a non-repatriation basis.

ISSUE OF CONVERTIBLE NOTES BY START UP CO. – Rule 18

(1) A Non Resident (other than an individual who is citizen of Pakistan or Bangladesh or an entity which is registered/ incorporated in Pakistan or Bangladesh), may purchase convertible notes issued by an Indian startup company for an amount of Rs. 25 lakhs or more in a single tranche.

(2) A startup company, engaged in a sector where investment by a Non Resident requires Government approval, may issue convertible notes to a person resident outside India only with such approval. Further, issue of equity shares against such convertible notes shall be in compliance with the entry route, sectoral caps, pricing guidelines and other attendant conditions for foreign investment.

(3) The mode of payment and other attendant conditions for remittance of sale or maturity proceeds shall be specified by RBI.

(4) A NRI or an OCI may acquire convertible notes on non-repatriation basis in accordance with Schedule 4 of these Regulations.

(5) A Non Resident may acquire or transfer by way of sale, convertible notes, from or to, a person resident in or outside India, provided the transfer takes place in accordance with the entry routes and pricing guidelines as prescribed for capital instruments.

Merger / Demerger / Amalgamation – Rule 19

(1) Issue of Capital Instruments by Transferee Company

- Scheme is approved by NCLT or competent authority
- Transfer or issue of capital instruments is in compliance with entry routes, sectoral caps or investment limits and other attendant conditions are complied with by the Non resident investor, otherwise transferor or transferee company must obtain necessary Government approval
- Transferor / Transferee Company shall not engage in any sector prohibited for non-resident investment.

(2) Where a scheme of merger or amalgamation of two or more Indian companies or a reconstruction by way of demerger or otherwise of an Indian company where any of the companies involved is listed on a recognised stock exchange in India, then the scheme of arrangement shall be in compliance with the SEBI (Listing Obligation and Disclosure Requirement) Regulations, 2015

TRANSFER OF CAPITAL INSTRUMENTS (RULE 9)

TRANSFER BY	TRANSFER TO	MODE	NATURE OF PERMISSION
Non Resident	Non Resident	Sale / Gift	General
Non Resident	Resident	Gift	General
Non Resident	Resident	Sale (including buy back or capital reduction by Indian company)	General (subject to pricing guidelines, documentation and reporting)
Non Resident	Resident	Sale in case of sector requiring CG approval	CG approval
Resident	Non Resident	Sale in case of sector requiring CG approval	CG approval
Resident	Non Resident	Gift	Prior RBI Permission
Resident	Non Resident	Sale	General (subject to pricing guidelines, documentation and reporting)
Non Resident Indian	Non Resident	Sale	General (earlier RBI Permission)

PRICING GUIDELINES – Rule 21

	Circumstances	Pricing Guideline
1	Issue by Indian Company	Listed company – As per SEBI Unlisted – Internationally accepted pricing methodology * Valuation by Cat I Merchant Banker or CA or CMA
2	Transfer from Resident to Non Resident	Listed company – As per SEBI Unlisted – Not less than price as determined by Internationally accepted pricing methodology * Valuation by Cat I Merchant Banker or CA or CMA
3	Transfer from Non Resident to Resident	Listed company – As per SEBI Unlisted – Not more than price as determined by Internationally accepted pricing methodology * Valuation by Cat I Merchant Banker or CA or CMA
4	Swap of capital instruments	Valuation by SEBI registered Merchant Banker or Investment Banker registered abroad with appropriate authority in the host country
5	Subscription to M/A of Indian Company	At face value, subject to entry route and sectoral caps
6	Warrants	Pricing and Price / conversion formula should be determined upfront

OVERVIEW OF FOREIGN INVESTMENT FRAMEWORK

FDI POLICY

- Foreign Investments is regulated by Govt.'s FDI policy
- Intent and objective is to promote FDI to supplement domestic capital, technology and skills for accelerated economic growth
- Transparent, predictable and easily comprehensible policy framework
- FDI guidelines administered by Ministry of Commerce and Industry

REGULATION OF FDI POLICY

- FDI is regulated by :-
 - DIPP (Department of Industrial Policy & Promotion)
 - SIA (Secretariat of Industrial Approvals)
[FIPB (Foreign Investment Promotion Board) abolished in May 2017]
- Implemented through Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (NDI Rules)
- Administrative and compliance aspects monitored by RBI (Reserve Bank of India)

AUTOMATIC ROUTE & GOVERNMENT ROUTE

- **Automatic Route** means the entry route through which investment by a person resident outside India does not require the prior approval of RBI or Government.
- In the case of Foreign Portfolio Investment, foreign investment limit up to 49% of paid up capital on a fully diluted basis or the sectoral cap limits whichever is lower, will not require Government approval
- **Government Route** means the entry route through which investment by a person resident outside India requires prior Government approval. Foreign investment received under this route shall be in accordance with the conditions stipulated by the Government in its approval.
- There are a few sectors, where prior Government approval is required

GOVT ROUTE

- DIPP has notified Standard Operating Procedure (SOP) for processing FDI proposals which require Govt. approval (No. 1/8/2016-FC-1 dated 29.6.2017)
- Online application to be filed on the portal www.fifp.gov.in (Foreign Investment Facilitation portal which is a revamped version of the erstwhile FIPB portal)
- If application is digitally signed by applicant, no need to submit physical application. If not, then applicant to submit physical application to DIPP within 5 days.
- Applications for approval of foreign investments shall be processed in a time bound manner as outlined in the SOP.
- The SOP stipulates the competent authorities who are entrusted with the responsibility for granting approval for foreign investments.
- The SOP also stipulates time limits with respect to the approval process.

COMPETENT AUTHORITIES FOR APPROVAL

SR NO.	Activity / Sector	Administrative Ministry / Department
1	Mining	Ministry of Mines
2a	Items requiring Industrial Licence under I(D&R) Act and /or Arms Act for which powers are delegated to DIPP by Home Ministry	Department of Defence Production, Ministry of Defence
2b	Manufacturing of Small Arms and Ammunitions under Arms Act	Ministry of Home Affairs
3 & 4	Broadcasting and Print Media	Ministry of Information & Broadcasting
5	Civil Aviation	Ministry of Civil Aviation
6	Satellites	Department of Space
7	Telecommunications	Department of Telecommunications
8 & 9	Private Security Agencies And Applications involving investments from <i>Countries of Concern</i> (which presently include Pakistan and Bangladesh), requiring security clearance as per the extant FEMA 20, FDI Policy and security guidelines, amended from time to time	** as per PN 1/2018 DIPP for countries of concern and for Private Security Agencies Nodal Administrative Ministries / Depts. (earlier Ministry of Home Affairs)

COMPETENT AUTHORITIES FOR APPROVAL UNDER GOVT ROUTE – (Continued)

SR NO.	Activity / Sector	Administrative Ministry / Department
10, 11, 12 & 13	Trading (Single Brand, Multi Brand and Food Product retail trading); FDI proposals by NRI's / EOU requiring Govt approval; Issue of shares for import of capital goods/machinery and Issue of shares for Pre-operative / incorporation expenses	Department of Industrial Policy & Promotion (DIPP)
14	Financial Services activity not regulated by any Financial Service regulator or where part is regulated or where is doubt	Department of Economic Affairs
15	Investment in Core Investment Company or an Indian company engaged only in investing in capital of other company	
16	Banking (Public and Private)	Department of Financial Services
17	Pharmaceuticals	Department of Pharmaceuticals
Note	Where there is doubt about Administrative authority	DIPP shall identify the Administrative Ministry/Dept

APPROVAL UNDER GOVT ROUTE – TIME LIMITS UNDER SOP

Sr No.	Action Points	Time Period	Cumulative Time Period
1	Dissemination of proposal to administrative ministry / dept. by DIPP	2 days	
2	Submission of signed physical copy by applicant, if needed	5 days	7 days
3	Initial scrutiny of the proposal and documents attached therewith, and seeking relevant additional information/documents from the applicant	1 week	2 weeks
4	Submission of clarification by DIPP on specific issues of FDI policy	2 weeks	4 weeks
5	Time limit for Submission of Comments by Consulted Ministry/ Department/ RBI/ Any Other Stakeholder	4 weeks	8 weeks
6	Time limit for submission of Comments by Ministry of Home Affairs on proposals requiring security clearance	6 weeks	8 weeks
7	Time limit for security clearance, if required - If not required	2 weeks/ Nil	10 weeks / 8 weeks
Note	a) Additional time limit for rejection cases or where additional conditions not provided in FDI Policy are proposed to be imposed b) Time taken by applicant to remove deficiencies / clarification to be excluded.	2 weeks	

PROHIBITED SECTORS

FDI is prohibited in the following sectors as per Schedule I of NDI Rules :-

- (a) Lottery Business including Government /private lottery, online lotteries, etc.
- (b) Gambling and Betting including casinos etc.
- (c) Chit funds
- (d) Nidhi company
- (e) Trading in Transferable Development Rights (TDRs)
- (f) Real Estate Business or Construction of Farm Houses
- (g) Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes
- (h) Activities / sectors not open to private sector investment e.g. Atomic Energy and Railway Transport (other than Paras dealing with Railway Infrastructure).

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.

FDI IN CERTAIN KEY SECTORS

E-Commerce (Para 15.2)

Conceptual Framework

- E-commerce is defined as “buying and selling of goods and services including digital products over digital & electronic network.”
- E-commerce entity means a company incorporated under the Companies Act 1956 or the Companies Act 2013
(or a foreign company covered under section 2 (42) of the Companies Act, 2013 or an office, branch or agency in India as provided in section 2 (v) (iii) of FEMA 1999, owned or controlled by a person resident outside India and conducting the e-commerce business) - deleted.
- Inventory based model of e-commerce means an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly.
- Marketplace based model of e-commerce means providing of an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller.

FDI Cap for e-commerce sector

- FDI in B2B e commerce – 100% through automatic route (not permitted in B2C)
- FDI in Marketplace based model of e-commerce – 100% (not permitted in inventory based model of e-commerce)

E-Commerce (Continued)

Significant Prescribed Conditions :-

- Marketplace e-commerce entity will be permitted to enter into transactions with sellers registered on its platform on B2B basis
- E-commerce marketplace may provide support services to sellers in respect of warehousing, logistics, order fulfillment, call centre, payment collection and other services
- E-commerce entity providing a marketplace will not exercise ownership over the inventory i.e. goods purported to be sold.
- An e-commerce entity will not permit more than 25% of the sales value on financial year basis affected through its marketplace from one vendor or their group companies
- In marketplace model goods/services made available for sale electronically on website should clearly provide name, address and other contact details of the seller. Post sales, delivery of goods to the customers and customer satisfaction will be responsibility of the seller.
- In marketplace model, payments for sale may be facilitated by the e-commerce entity in conformity with the guidelines of the Reserve Bank of India.
- In marketplace model, any warrantee/ guarantee of goods and services sold will be responsibility of the seller.
- E-commerce entities providing marketplace will not directly or indirectly influence the sale price of goods or services and shall maintain level playing field
- Guidelines on cash and carry wholesale trading as given in Para 15.1.2 of Schedule I of NDI rules will apply for B2B e-commerce

Subject to the conditions of FDI policy on services sector and applicable laws/regulations, security and other conditionalities, sale of services through e-commerce will be under automatic route.

Single Brand Retail (Para 15.3)

FDI – Automatic route up to 100% (earlier above 49% through approval route)

** Press Note No. 1/2018 and again rolled back to “up to 49% automatic”

Conditions to be fulfilled :-

- Products to be sold should be of a “Single Brand” only.
- Products should be sold under the same brand internationally i.e. products should be sold under the same brand in one or more countries other than India.
- “Single Brand” product-retail trading would cover only products which are branded during manufacturing.
- Brand need not be owned by Non Resident, but there should be a legally tenable agreement, evidence of which should be furnished to RBI / FIPB as the case may be
- Compulsory sourcing of 30% of value of goods from Indian MSE sector if Non resident holding is 51% or more
- Application for approval should be product specific. Any additional product under the brand will require fresh approval.
- Single brand retail trading entity would be allowed to set off incremental sourcing of goods from India for global operations for the initial 5 years** (PN 1/2018)

Multi Brand Retail (Para 15.4)

FDI in Multi Brand up to 51% and only through approval route is subject to following conditions :-

- Fresh agricultural produce, including fruits, vegetables, flowers, grains, pulses, fresh poultry, fishery and meat products, may be unbranded.
- Minimum amount to be brought in, as FDI, by the foreign investor, would be US \$ 100 million.
- At least 50% of total FDI brought in the first tranche of US \$ 100 million shall be invested in 'backend infrastructure' within three years of the first tranche of FDI
- At least 30% of the value of procurement of manufactured/ processed products purchased shall be sourced from Indian 'small and medium industries' which have a total investment in plant & machinery not exceeding US \$ 2.00 million
- Sourcing from agricultural co-operatives and farmers co-operatives would also be considered in this category

Multi Brand Retail (Para 15.4) contd

- The sourcing requirement would have to be met, in the first instance, as an average of five years“ total value of the manufactured/ processed products purchased, beginning 1st April of the year during which the first tranche of FDI is received. Thereafter, it would have to be met on an annual basis.
- Self Certification by the companies to ensure compliance. Accordingly, investors shall maintain accounts duly certified by statutory auditors.
- Retail sales outlets may be set up only in cities with a population of more than 10 lakh as per 2011 Census or any other cities as per the decision of the respective State Governments, and may also cover an area of 10 kms around the municipal/urban agglomeration limits of such cities
- Govt has the first right to procure agricultural products
- Retail trading in any form, by means of e-commerce would not be permissible for companies with FDI, engaged in Multi Brand retail.
- FDI policy with respect to Multi Brand retail is an enabling policy and states / union territories have to finally adopt the same.
- So far 11 States and 1 UT have adopted the FDI policy with respect to Multi Brand retail.

CIVIL AVIATION

SECTOR (As per Para 9.2)	% OF EQUITY CAP	ROUTE
<u>AIRPORTS</u> (a) Greenfield Projects (b) Existing Projects	100% 100%	Automatic Automatic (up to 74% and beyond that Approval route till PN 5 dated 24.6.2016)
<u>AIR TRANSPORT SERVICE</u> Scheduled Air Transport Service / Domestic Scheduled Passenger Airline & Regional Air Transport Service	49% FDI & 100% NRI	Automatic and Approval route beyond 49% for FDI ** Policy also applies to Air India
Non Scheduled Air Transport Service & Helicopter service / sea plane services requiring DGCA approval	100%	Automatic
<u>OTHER SERVICES</u> Ground Handling Services; Maintenance & Repair Organisations, flying training Institutes & technical training institutions	100%	Automatic

PHARMA

Sector / Activity (Para 16)	% of Equity Cap	Entry Route
Greenfield	100%	Automatic
Brownfield	100%	Automatic up to 74% and beyond 74% approval route
Medical Devices subject to any amendment in Drugs and Cosmetics Act, 1940	100%	Automatic
Other Conditions applicable both for Automatic and Approval route		<ul style="list-style-type: none"> a) Non Compete clause in only special circumstances with the approval of FIPB b) Govt. may incorporate appropriate conditions for FDI in brownfield cases c) Conditions regarding maintenance of production level of Essential Medicines and maintenance of R&D Expenses at an absolute level higher level over PY (5 years for production & 3 years for R&D)

FINANCIAL SERVICES (PARA F)

- Press Note 6/2016 dated 25.10.2016 expanded the scope of FDI in financial services sector.
- Para 5.2.26 of FDI policy earlier dealing with financial services, referred to NBFC, which enumerated 18 categories of services. Now all financial services regulated by RBI, SEBI, IRADA, PFRDA, NHB or any other financial sector regulator as may be notified by the Government are covered in this Para F (1 to 9)
- FDI for the entire financial services sector coming within the purview of Para F is eligible up to 100% under Automatic Route
- Minimum capitalization norms will be as stipulated by the sectoral regulator under the relevant Act.
- If the particular financial service is not regulated by any of the financial sector regulator, any FDI for such activity will be through approval route. The Central Government in such cases will specify conditions relating to minimum capitalization.

CONSTRUCTION DEVELOPMENT(PARA 10)

- FDI not permitted in entity which engages or proposes to engage in Real Estate business, construction of farm houses and trading in Transferable Development Rights (TDR's).
- Other than above prohibited activities connected to Real Estate, 100% FDI through Automatic Route is allowed.
- Real Estate Business is defined to mean “dealing in land and immovable property with a view to earn profit therefrom”
- Definition of Real Estate does not include development of townships, construction of residential / commercial premises, roads, bridges, recreational facilities, city and regional level infrastructures, townships.
- Earning of Rent / Income from lease of property not amounting to transfer will not amount to real estate business
- It is explained that Real Estate Broking is not real estate business and is eligible for 100% FDI through Automatic route.
- Lock in Period of 3 years from the date of FDI in construction / development.
- Lock-in shall not apply in case of Hotels & Tourist Resorts, Hospitals, SEZ's, Educational Institutions, Old Age Homes and investment by NRI's
- Foreign investor permitted to exit after completion of project or development of trunk infrastructure. However, if 3 years completed, exit allowed, even if project is not completed
- Transfer of stake from Non Resident to another Non Resident is allowed.

DEFENCE AND BROADCASTING SECTOR

SUBJECT	REFERENCE	CHANGES EFFECTED
DEFENCE SECTOR (Subject to IDRA, 1951 and Arms & Ammunitions Act, 1959)	Para 6	Automatic up to 49% and Govt. Route up to 100% wherever it is likely to result in access to modern technology or for other reasons to be recorded. Other conditions stipulated in Para 6.2 to be fulfilled.
Broadcasting Sector (Teleports, DTH, Cable Networks, mobile TV, Head End in the Sky – Broadcasting Services HITS)	Para 7.1.1 to 7.1.3	Activity covered under Para 7.1 – Automatic route up to 100% Infusion of foreign investment beyond 49% in a company not seeking licence / permission from sectoral regulator / ministry resulting in change of ownership to a new foreign investor will require Government approval
Broadcasting Sector – Terrestrial Broadcasting & Uplinking of News & Current Affairs - TV	Para 7.2	49% - Govt. Route

FDI in Limited Liability Partnership

- FDI up to 100% is permitted under the automatic route in LLPs operating in sectors or activities where
 - 100 per cent FDI is allowed under the automatic route and
 - there are no FDI-linked performance conditions. (eg. NBFC, Township development, housing)
- FDI in legal profession continues to be prohibited.
- Terms – Ownership and control have been defined
- FDI is subject to compliance of LLP Act, 2008

Definition of Ownership and Control in FDI policy

- **Ownership** : A LLP is considered to be owned by resident Indian citizens if more than 50 per cent of the investment in it is contributed by resident Indian citizens or entities and such resident Indian entities have a majority of the profit share.
- **Control** : The term is defined to include the right to appoint a majority of the directors or to control the management or policy through their shareholding or management rights or otherwise through shareholders' agreement or other voting agreements. Further in case of LLPs '*control*' would mean the right to appoint a majority of the designated partners, where such designated partners have control over all the policies of the LLP.

**DOWNSTREAM INVESTMENT &
SNAPSHOT OF
REPORTING REQUIREMENTS**

Downstream Investment (Rule 23)

- Indian entity (Company / LLP) receiving indirect foreign investment shall comply with the entry route, sectoral caps, pricing guidelines and other attendant conditions as applicable for foreign investments.
- Downstream investment shall have the approval of the Board of Directors and shareholders' agreement, if any. For making downstream investments, the Indian entity having non-resident shareholding should bring in funds from abroad and not use funds borrowed from domestic market.
- The Indian company/LLP making downstream investment shall be responsible for ensuring compliance with the provisions of these rules. The Indian Company shall obtain certificate to this effect from Statutory Auditors and the compliance should be reported in the Directors report.
- Issue / transfer / pricing / valuation shall be in accordance with RBI guidelines
- Downstream investments through internal accruals are however permitted, but these are subject to sectoral caps. Internal accruals have been defined to mean profits transferred to reserve account after payment of taxes.

REPORTING REQUIREMENTS – Rule 4 of FEM (Mode of Payment and reporting of Non Debt Instruments) Rules, 2019

FORM	Description	Timelines
FCGPR	Issue of Capital Instruments to a Non Resident	Within 30 days of issue of capital instruments
FLA	Annual Return of Foreign Liabilities and Assets	July 15 following the close of financial year
FCTRS	Transfer of Capital Instruments between Residents (including Non Residents on Non Repatriation basis) and Non Residents	Onus of reporting on person holding capital instrument - within 60 days of receipt of funds or transfer of capital instruments, whichever is earlier
Form ESOP	Indian Company issuing ESOP to Non Residents	Within 30 days of issue of ESOP
Form DRR	Domestic custodian issuing / transferring Depository Receipts (DR's)	Within 30 days of close of the issue
Form LLP (I)	LLP receiving consideration towards capital contribution or profit share	Within 30 days of receipt of consideration
Form LLP (II)	Disinvestment or transfer of profit share	Within 60 days of receipt of funds
Form DI	Reporting of Downstream Investments	Within 30 days of receipt of indirect investment
Form CN	Start Up company issuing convertible notes	Within 30 days of issue of CN

RECENT AMENDMENTS IN FDI FRAMEWORK

FDI FROM COUNTRIES SHARING LAND BORDERS – GOVERNMENT APPROVAL

New provisos in Rule 6(a) of FEM NDI Rules, 2019 dated 22.04.2020:-

- a) FDI (Investment & beneficial ownership) emanating from persons or entities located in countries sharing land borders with India (now extends to China, Nepal, Myanmar, Bhutan and Afghanistan in addition to Pakistan and Bangladesh)
- b) Transfers resulting in such persons or entities acquiring ownership directly or indirectly as also
- c) Investments by Citizen of Pakistan or an entity incorporated in Pakistan in sectors other than defence, space, atomic energy and such other sectors or activities prohibited for foreign investment

Shall require government approval

RENUNCIATION OF RIGHTS IN FAVOUR OF NON RESIDENTS – FAIR PRICING TO BE FOLLOWED

RECENT AMENDMENT – 29.04.2020

- Any acquisition of shares by foreign investors pursuant to renunciation of rights by a resident will be subject to FEMA pricing guidelines (not sufficient that it is at the same price at which it is offered to Indian residents)
- It is not clear if this requirement of pricing guidelines will apply where a non-resident is renouncing the right in favour of another non-resident.

Thank You