

INBOUND AND OUTBOUND TRANSACTIONS UNDER FEMA



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Rajkot



CA. Yash N. Bhatt

Maloo Bhatt & Co.
CHARTERED ACCOUNTANTS

Vadodara • Bharuch
www.malooibhatt.com

OVERVIEW OF FEMA

(WHAT CANNOT BE DONE DIRECTLY, CANNOT BE DONE INDIRECTLY)

FEMA 1999

- Replaced the draconian Foreign Exchange Regulation Act 1973
- Appointed date 1 June 2000

Aims of FEMA

- Facilitate external trade and payments
- Promotion of foreign exchange markets

FEMA Rules / Regulations

- Rules notified by the Central Government and
- Regulations notified by the RBI
- Consultation between Government and RBI**

RBI website (www.rbi.org.in)

- A P (Dir Series) -issued from time to time
- Master Directions –updated now periodically
- FAQs
- **Every Transaction is either Current (generally permissible unless prohibited) or Capital (only if and as permitted) either entered by Resident o/s India, PROI within India.**
- Several powers /responsibilities delegated to the AD / Banker by RBI –their role / concurrence critical but primary responsibility is of constituents and their role is compliance & monitoring

STRUCTURE OF FEMA

Chapter	Chapter title	Subject	Sections
I	Preliminary	Jurisdiction, Definitions	1-2
II	Regulation & Management of Forex	<ul style="list-style-type: none"> • Restriction on manner and dealing with PROI • Holding of forex, foreign security & immovable property • Current a/c transactions • Capital a/c transactions • Export of goods & services • Realisation and repatriation of forex with exemptions 	3-9
III	Authorised Persons	Provisions relating to Authorised Persons	10-12
IV	Contravention and Penalties	Provisions relating to Contravention, its consequences and Compounding	13-15
V	Adjudication and Appeal	<ul style="list-style-type: none"> • Provisions relating to terms of service, composition, appointment of Adjudicating Authority, Members to Appellate Tribunal • Provisions relating to Appeal to Special Director (Appeals), Appellate Tribunal and High Court 	16-35
VI	ED	Provisions relating to Appointment & Powers (*37A*)	36-38
VII	Miscellaneous	Management culpability; Power to make Rules and Regulations, etc	39-49

Sec 3 (Restrictions on dealing in foreign exchange)

❖ Save as otherwise provided in this Act, rules or regulations made thereunder, or with the general or special permission of the Reserve Bank, no person shall—

- a) deal in or transfer any foreign exchange or foreign security to any person not being an authorised person;
- b) make any payment to or for the credit of any PROI in any manner;
- c) receive otherwise (than) through an authorised person, any payment by order or on behalf of any PROI in any manner;

Explanation.—For the purpose of this clause, where any person in, or resident in, India receives any payment by order or on behalf of any PROI through any other person (including an authorised person) **without a corresponding inward remittance from any place outside India**, then, such person shall be deemed to have received such payment otherwise than through an authorised person;

- d) enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.

Explanation.—For the purpose of this clause, financial transaction means making any payment to, or for the credit of any person, or receiving any payment for, by order or on behalf of any person, or drawing, issuing or negotiating any bill of exchange or promissory note, or transferring any security or acknowledging any debt.

Sec 5 (Current Account Transactions)

- ❖ Current account transaction is a transaction other than a capital account transaction
- ❖ Current account transactions are governed by Foreign Exchange Management (Current Account Transaction) Rules, 2000 ("Current Account Transactions Rules").
- ❖ India is signatory to WTO Agreement and in terms of Article VIII; it states that “.....no member shall, without the approval of the Fund (IMF), impose restrictions on the making of payments and transfers for current international transaction.”
- ❖ Current account transactions are divided into 3 schedules in Current Account Transactions Rules:-
 - Schedule I – Prohibited Transactions
 - Schedule II – Transactions requiring prior approval of Government of India
 - Schedule III – Transactions requiring prior approval of RBI
- ❖ Drawal of foreign exchange is prohibited for –
 - Transactions specified in Schedule I; or
 - Travel to Nepal and / or Bhutan; or
 - Transaction with person resident in Nepal or Bhutan (this prohibition may be relaxed by special approval).

Sec 6 (Capital Account Transactions)

Capital Account transaction means a transaction –

- which alters assets or liabilities including contingent liabilities, outside India of person resident in India or
- assets and liabilities in India of persons resident outside India and
- includes transactions referred to in sub-section (3) of Section 6.

Section 6(3) – Lists the Capital Account Transactions that are prohibited, restricted or regulated by RBI (capital account transactions as also referred to in definition of Capital Account Transaction in Section 2(e)]

- a) Transfer or issue of any security by a person resident in India-
- b) Transfer or issue of any security by a person resident outside India-
- c) Transfer or issue of any security or foreign security by any branch, office or agency in India to a person resident outside India.
- d) Any borrowing or lending in foreign exchange in whatever form or by whatever name called
- e) Any borrowing or lending in Indian rupees in whatever form or by whatever name called between person resident in India and a person resident outside India.
- f) Deposits between persons resident in India and persons resident outside India
- g) Export, import or holding of currency or currency notes.
- h) Transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident outside India
- i) Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India.

- j) Giving of a guarantee or surety in respect of any debt, obligation or other liability incurred –
- By a person resident in India and owed to a person resident outside India; or
 - By a person resident outside India.

Apart from above transactions, RBI has made FEM (Capital Account Transactions) Regulations, 2000. Schedules I and II of this regulation specify the classes of capital account transactions of resident and non-residents for which foreign exchange may drawn or sold to an authorized person.

Sch. I Permitted Capital A/c. Transactions by PRI	Sch. II Permitted Capital A/c. Transactions by PROI
Foreign Securities	Investment in securities and capital contribution
Foreign currency loans raised in India and abroad	Acquisition and transfer of immovable property
Transfer of immovable property outside India	Guarantee in Favour of PRI
Guarantees in favour of PROI	Import and export of currency/currency notes into/from India
Export, import and holding of currency/currency notes	Deposits between a person resident in India and a person resident outside India.
Maintenance of foreign currency accounts in India and outside India	Foreign currency accounts in India
Taking out of insurance policy from Insurance Co. o/s India	Remittance outside India of capital assets in India
Remittance outside India of capital assets	
Sale and purchase of foreign exchange derivatives in India and abroad and commodity derivatives abroad	

KEY TERMS/ DEFINITIONS

❖ **Person Resident in India:**

❑ Individuals:

- **Basic Rule:** A person residing in India for >182 days in preceding FY but does not Include:

A. Person going o/s India for:

- For Employment o/s India
- For carrying on business/vocation o/s India
- For any other purpose indicating his intention to stay o/s India for uncertain period.

B. Person Coming to India otherwise than:

- For Employment o/s India
- For carrying on business/vocation o/s India
- For any other purpose indicating his intention to stay o/s India for uncertain period.

❑ Other than Individuals

- Any body Corporate incorporated in India
- Office, branch or agency in India owned or controlled by PROI
- Office, branch or agency o/s India owned or controlled by PRI

❖ **PRI but not permanently resident:**

Employment for specified duration specific job assignment ≤ 3 years. Used at following places:

- No limit for possession of foreign currency in India FEMA 11 (R)
- Contribution to foreign PF superannuation pension fund for expatriate staff - FEMA 13 (R)
- FEMA 120 not to apply when foreign security is purchased out of forex resources o/s India
- LRS not to apply for net salary remittance- Sch III to CAT Rules, 2000

- ❖ Basic rule mandatory satisfaction + 3 exceptions to be established with supporting documentation including visa: MOF press release dated 1st Feb 2009 (Government's advice on acquiring land by persons residing outside India)

- ❖ 3 exceptions are superlative Designation of resident account as NRO upon change of residential status of account holder [FEMA 5 (R)]

❖ Debt Instruments

Debt Instruments means the instruments listed under Schedule I of the regulations.

❖ FPI or Foreign Portfolio Investor

“FPI” or “Foreign Portfolio Investor” means a person registered in accordance with the provisions of the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014.

❖ Foreign Direct Investment (FDI)

- FDI means **investment through equity instruments** by a person resident outside India in an unlisted Indian company; Or
- in 10 percent or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company;

❖ **Financial Commitment:** Direct investment by way of contribution to equity, loan and 100 per cent of the amount of guarantees and 50 per cent of the performance guarantees issued by an IP to or on behalf of its overseas Joint Venture Company or Wholly Owned Subsidiary

❖ **Joint Venture:** Means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country in which the IP makes a direct investment.

❖ Foreign Investment

Foreign Investment’ 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 an LLP;

Note: A PROI may hold foreign investment either as Foreign Direct Investment or as Foreign Portfolio Investment in any Indian company.

Explanation: If a declaration is made by a person as per the provisions of the Companies Act, 2013 about a beneficial interest being held by a person resident outside India, then even though the investment may be made by a resident Indian citizen, the same shall be counted as foreign investment read with Sec. 3.

❖ NRI

“NRI” or “Non-Resident Indian” means an individual resident outside India who is a citizen of India.

❖ OCI

“OCI” or “Overseas Citizen of India” means an individual resident outside India who is registered as an Overseas Citizen of India Cardholder under section 7(A) of the Citizenship Act, 1955 (57 of 1955);.

❖ **Equity Instruments:**

- Equity shares
- Convertible Debentures (CCD)
- CCPS
- Share warrants
- Equity instruments can contain an optionality clause subject to a minimum lock-in period of one year or as prescribed for the specific sector, whichever is higher, but without any option or right to exit at an assured price.

❖ **Direct Investment outside India (ODI):**

Investment by IP by way of (i) contribution to the capital or (ii) subscription to the Memorandum of Association of a foreign entity or (iii) by way of purchase of existing shares of a foreign entity either by:

- Market Purchase;
- Private Placement;
- Through Stock Exchange;

But does not include Portfolio Investments

❖ **Indian Party P (IP):** An IP is:

- a company incorporated in India; or
- a body created under an Act of Parliament; or
- a partnership firm registered under the Indian Partnership Act, 1932
- a LLP registered under the LLP Act
- any other entity in India notified by the RBI

Who is making an investment in overseas JV / WOS.

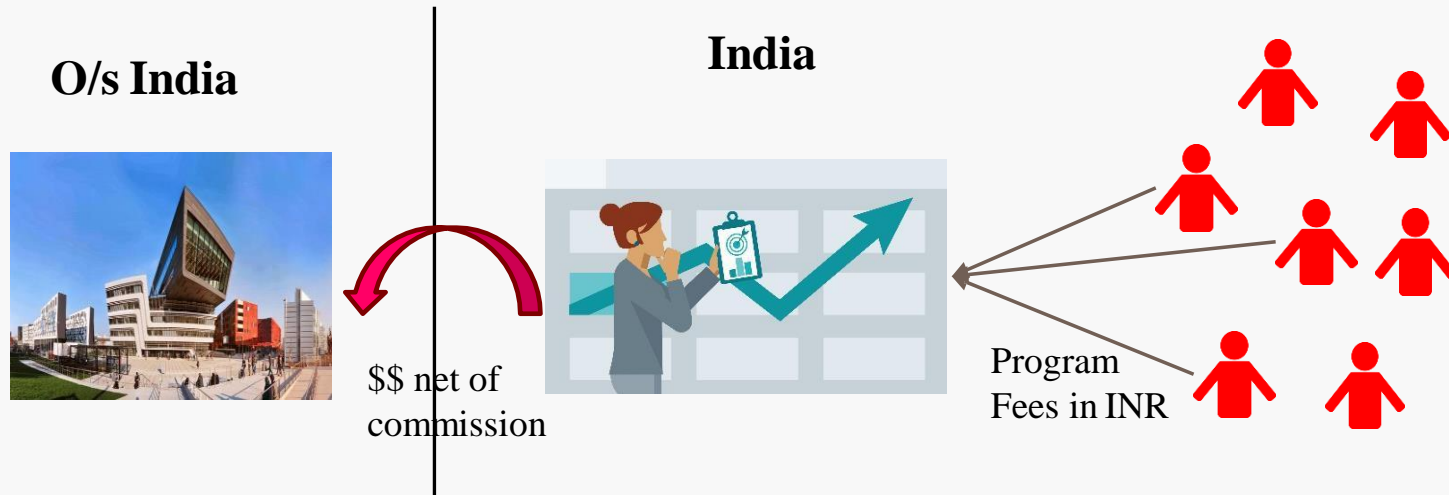
[Note: where more than one IP make investment in one foreign entity, all of them together constitute IP]

❖ **WOS:** Means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country, whose entire capital is held by the IP.

❖ **Host Country :** Means the country in which the foreign entity receiving the direct investment from an IP is registered or incorporated.

❖ **Designated AD Bank:** The concern branch of the AD Bank designated by IP to route all ODI transactions with respect to the overseas JV / WOS.

Case Study



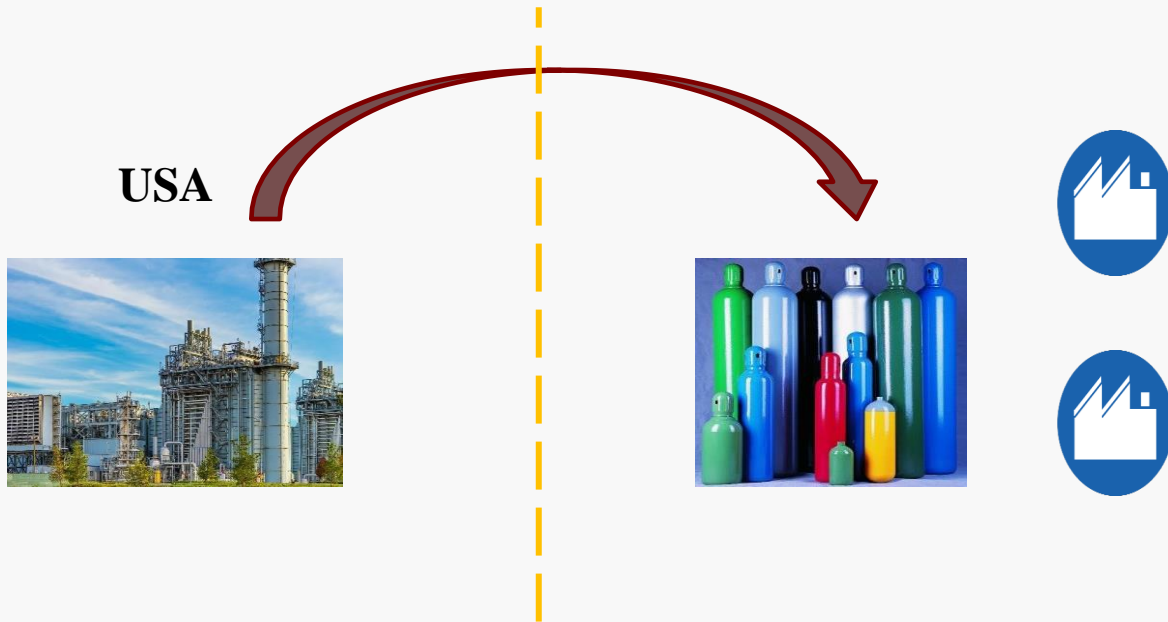
Facts:

A renowned foreign university wants to offer executive management programs in India. It has already engaged an exclusive marketing partner in India. However, the foreign university does not want the hassle of collecting payments from each participant and wants the Indian marketing partner to collect participant fees in India on its behalf. Subsequently, the Indian partner could remit the net participant fees after deduction of its commission fees.

Question:

Can the Indian marketing partner collect fees in India and subsequently remit them net of its commission fees?

Case Study



Facts

US Co sells chemical products to various Indian customers in returnable cylinders. Since Indian customers are sluggish in returning the cylinders to US Co., US Co intends to begin with charging a refundable deposit per cylinder for such returnable Cylinders.

Question

Can US Co. charge refundable deposit from Indian Customers?

ODI Regulatory framework:

- ❖ Section 6(3)(a) of FEMA 1999
- ❖ RBI Regulations: FEMA 120/RB-2004 as amended from time to time
- ❖ RBI Master Direction no. 15 (dated 1 January 2016 update till 18 September 2019)
- ❖ RBI's A.P. DIR Circulars (few ones not covered above)
- ❖ RBI Master Circulars issued earlier
- ❖ RBI FAQs (updated from time to time)
- ❖ RBI compounding orders (full up to Feb 2020 and only summary post 1 March 2020).
- ❖ Other items -Monthly ODI Data on RBI Website, clarifications issued to AD-Banks

ROUTES FOR ODI

ODI = an IP can make investment / undertake financial commitment in overseas JV / WOS as per the ceiling prescribed by the RBI from time to time

Automatic Route (General Permission)

Through AD Bank

Approval Route

Prior RBI approval and then transaction through the designated AD-Bank as in Automatic Route

Specifically prohibited activities / Investments / other items

- **Real Estate** -*Real Estate Business means buying and selling of real estate or trading in Transferable Development Rights but does not include development of townships, construction of residential / commercial premises, roads or bridges.
- **Banking Business** (Indian Banks can do ODI as per Banking Guidelines and RBI Banking Div. clearance)
- **Dealing in financial products linked to Indian Rupee** (eg. non-deliverable trades involving foreign currency, rupee exchange rates, stock indices linked to Indian market, etc.)
- **Approval Route** -Investment / financial commitment in Pakistan and countries identified by Financial Actions Task Force as “non-co-operative countries and territories” or as notified by RBI
- **Country specific:** Nepal –ODI only in Rupees. Bhutan –ODI can be in Rupees / Fx
- **Special provisions /Schedule for ODI by Individuals**

ODI -AUTOMATIC ROUTE

- An IP can make direct investment in JVs / WOSs outside India without any RBI approval if:
 - **Total Financial Commitment (FC)** of the IP in all its overseas JVs / WOSs (**existing and proposed**) is **within applicable RBI Ceiling (currently 400 percent of the Net Worth** of IP as stipulated).
 - Prior RBI approval required if FC exceeds USD 1 billion in a Financial Year even if the total FC is within the eligible limit of 400%.
 - IP can extend loan / guarantee only to an overseas JV / WOS in which it has equity participation
 - Overseas JVs / WOSs to be engaged in a bonafide business activity except real estate and banking .
 - IP not on the RBI's Exporters' Caution list / list of defaulters / under investigation by any Authority.
 - Submission by IP of Form APR (Annual Filings for ODI) in respect of all its overseas investments.
 - IP to route all transactions through one branch of AD only
 - Investment in Nepal permitted only in INR, Bhutan in INR as well as freely convertible currency
- IP to approach the designated AD Bank with an application in Form ODI with the prescribed documents including fair valuation certificate (see next slide)
- The ceiling of 400% of net-worth not applicable if ODI is from EEFC A/c or proceeds of ADR / GDR funds.
- ODIs can be direct or through a overseas SPV (Single Layer)

Pricing Guidelines

Valuation Provisions

Partial/Full acquisition of Foreign Company by an IP

- Share price should not be lesser than valuation Amt.
- In case Investment > USD 5 million – SEBI Reg. Merchant Banker/ Foreign MB
- For all other cases- CA/CPA

Swap of Shares

- Share price should not be less than valuation done by SEBI Reg. Merchant Banker / Foreign MB.

Sale of an unlisted Foreign JV/WOS by its Indian Shareholder

- Share price should not be less than valuation done by CA/CPA

Partial/ Full acquisition of a Foreign Co. by RI

- Share price should not be lesser than valuation Amt.
- In case Investment > USD 5 million – SEBI Reg. Merchant Banker/ Foreign MB
- For all other cases- CA/CPA

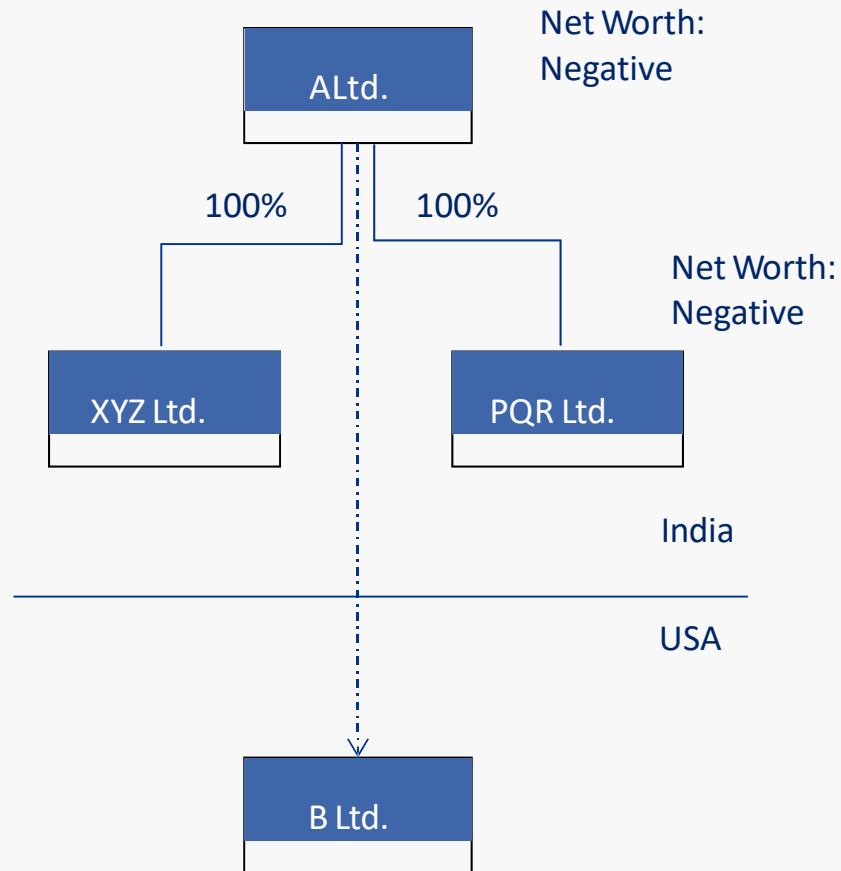
ODI –FINANCIAL COMMITMENT AND NET WORTH

- **Total Financial Commitment in JVs / WOSs is:**
 - 100% of amount of equity shares / amount of compulsorily and mandatorily convertible preference shares (CCPS on par with Equity);
 - 100% of amount of other preference shares;
 - 100% of amount of Loan;
 - 100% of amount of guarantee (other than performance guarantee) issued by the Indian Party
 - 100% of amount of bank guarantee (BG) issued by a resident bank on behalf of JV or WOS of the IP and the BG is backed by a counter guarantee/collateral by the Indian party
 - 50% of amount of performance guarantee

- **Net worth = Paid up capital + Free Reserves**
- For calculation of Net worth of the IP following to be considered:
 - Net worth of the IP
 - Net worth of its Indian Holding company which directly holds at least 51% stake in IP subject to letter of disclaimer*
 - Net worth of Indian Subsidiary Company in which IP is holding of at least 51% and subject to letter of disclaimer*

* The facility not available to / from registered partnership firms

CASE STUDY- NET WORTH



- A Ltd. holds 100% of XYZ Ltd. & PQR Ltd.
- A Ltd. proposes to set up a wholly owned subsidiary (B Ltd.) in USA.
- As on the last date of audited balance sheet, A Ltd.'s net worth is negative, XYZ's net worth is positive & PQR's net worth is negative.

Question:

Whether A Ltd. has an option to consider only the positive net worth of XYZ Ltd. & ignore the negative net worth of PQR Ltd. for calculating its net worth for the proposed investment?

What happens if PQR is under investigation by ED?

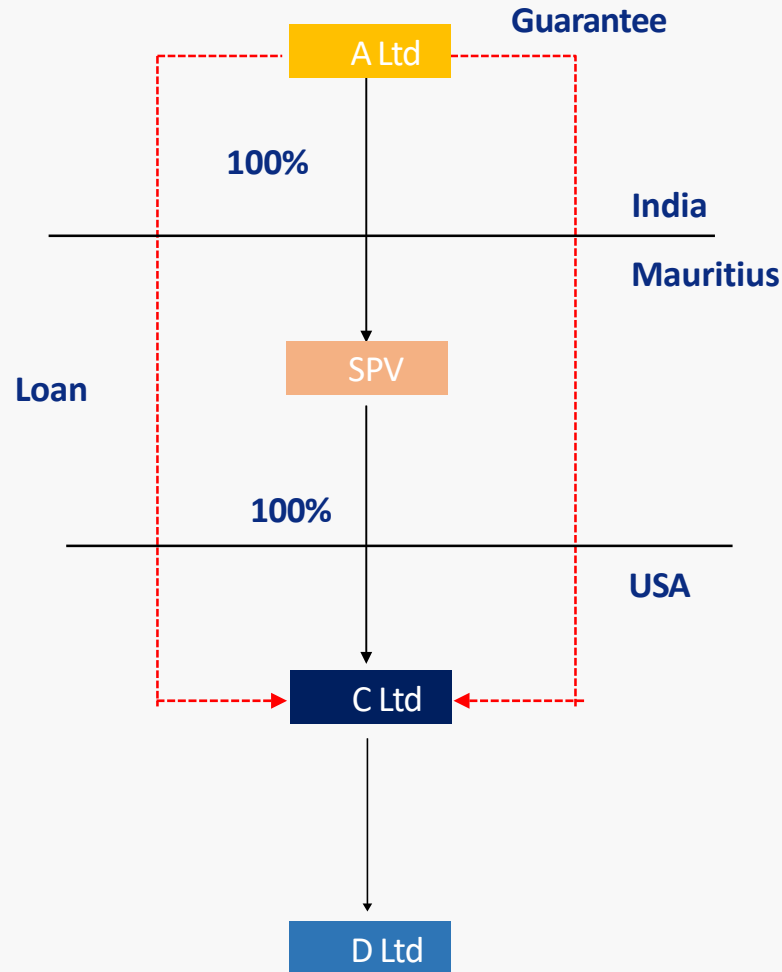
ODI in Financial Sector

- **There are additional conditions for ODI in financial services sector as under:**
 - Registration with appropriate regulatory authority in India for conducting the FS activity
 - Track record of earning net profits in preceding 3 years from the FS activity
 - Approval from concerned regulators in India and abroad for such ODI in FS activity
 - Compliance with prudential norms relating to capital adequacy norms as prescribed by the concerned regulatory authority in India
- **Other conditions**
 - An additional investment or financial commitment by an existing JV / WOS or step down subsidiary in the FS Sector to also comply with above regulations
 - Regulated entities in FS making investment in any sector are required to comply with above guidelines.
 - Unregulated entities in FS can invest in non-FS sectors without satisfying above conditions
- **Financial service sector not defined in the regulations**
 - E.g. NBFC, Insurance, Asset management etc.
 - Trading in Commodities Exchanges overseas and setting up JV/WOS for trading in overseas exchanges reckoned as Financial services activity.

ODI -Loan / guarantee to overseas JV / WOS

- IP may extend a loan / guarantee to only to an overseas JV / WOS in which it has equity participation (else prior RBI approval required)
 - All the financial commitments including Guarantee and creation of charge to be within the overall ceiling prescribed for the IP
 - Guarantee can be any form -corporate, personal, primary or collateral, guarantee by promoter company / group company / sister concern / associate company in India
 - No guarantee can be open ended (have an end date and validity period) and for performance guarantee validity of contract relevant
 - Invocation of performance guarantee in excess of ceiling -400% of net-worth –prior RBI approval
 - AD Bank can give a bank guarantee / issue SBLC to an Overseas JV / WOS of IP in connection with its business abroad. Subject to Banking Norms.
- Guarantee to step down subsidiaries
 - Corporate guarantee on behalf of first level step down operating subsidiaries falls under the Automatic Route
 - Corporate guarantee on behalf of second generation and subsequent level step down operating subsidiary to be considered under Approval Route provided the IP holds 51% or more stake in the overseas subsidiary for which the guarantee is intended to be issued
 - All guarantees are required to be reported through Form ODI
 - Rollover / Renewal of guarantee is permissible and not to be treated as fresh financial commitment subject to certain conditions –no other change except extending the period of guarantee (else prior RBI approval required).

Case Study- Loan and Guarantee



- A Ltd proposes to set up a SPV in Mauritius through which investments would be made in USA (C Ltd.) which would be an operating entity. Please advise:
 - Whether investment through SPV is permitted under the automatic route?
 - Whether A Ltd can fund (Loan / Equity) to C Ltd directly?
 - Whether A Ltd can give guarantee to or on behalf of C Ltd for its business?
 - Whether SPV can give guarantee to or on behalf of C Ltd for its business?
 - Whether A Ltd can give guarantee to or on behalf of D Ltd for its business?

ODI –Other Scenarios

Swap of Shares

- Valuation by Category I Merchant Banker registered with SEBI or an Investment Banker outside India registered with regulatory body of the Host Country.
- Prior Government approval to be obtained if applicable (e.g. inbound sector under Approval Route)

Exchange of ADR / GDRs subject to

- ADRs / GDRs are listed and backed by issue of shares by IP
- FDI Sector Caps are complied with for issue of ADR / GDR
- Fair valuation of F CO shares –Unlisted by Investment Banker and Listed as per methodology prescribed

Capitalization of Exports and other dues

- Automatic Route –Dues from foreign entity towards exports, fees, royalties or any other dues for supply of technical know-how, consultancy, managerial and other services
- Approval Route –Outstanding dues beyond prescribed threshold (9 / 15 months); Indian software exporter for 25% of value of exports to overseas start up in the form of shares without JV Agreement

Investment by Registered Partnership Firm

- If entire funding is done by the Registered Partnership Firm, the individual Partners can hold the shares in Overseas JV / WOS for and on behalf of the Firm subject to the host country regulations

ODI –Other Scenarios

Cross Border Merger –Inbound / Outbound Merger FEMA 389 (2018)

- Any consequential ODI / disinvestment of ODI to be in accordance with FEMA 120
- Any non-compliant ODI to be disposed within two years from sanction of scheme and repatriate proceeds to India

Mutual Funds in specified foreign securities

- Aggregate ceiling for overseas investment by Mutual Funds registered with SEBI is \$7 bn
- A limited number of qualified Indian Mutual Funds are permitted to invest cumulatively up to \$1 bn in Overseas Exchange Traded Funds
- Prior approval of SEBI necessary

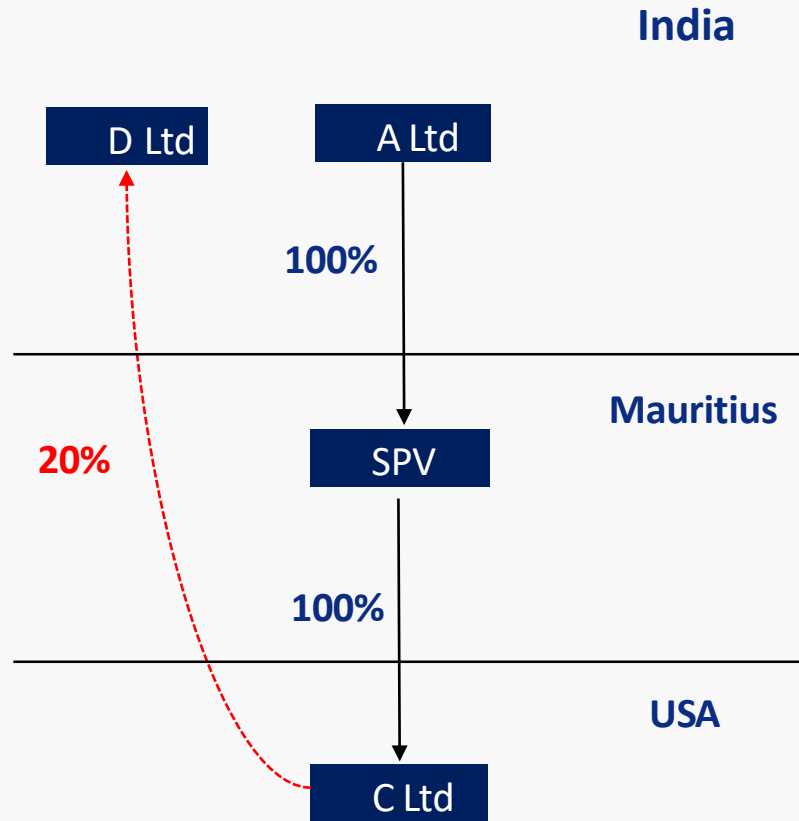
Domestic Venture Capital Fund ('DVCF')

- SEBI registered DVCF may invest in equity and equity linked instruments of off-shore Venture Capital Undertakings, subject to an overall limit of \$500 Mn
- Prior approval of SEBI necessary

Listed Indian Companies

- Portfolio investment permitted to invest up to 50% of their net-worth in overseas listed portfolio investments (shares, bonds, etc)

Case Study - Round Tripping



- Whether C Ltd can invest in D Ltd?
- RBI FAQs No. 64

Q. Can an Indian Party (IP) set up a step-down subsidiary/joint venture in India through its foreign entity (WOS/JV), directly or indirectly through step-down subsidiary of the foreign entity?

A: No, the provisions of Notification No. FEMA 120/RB-2004 dated July 7, 2004, as amended from time to time, dealing with transfer and issue of any foreign security to Residents do not permit an IP to set up Indian subsidiary(ies) through its foreign WOS or JV nor do the provisions permit an IP to acquire a WOS or invest in JV that already has direct/indirect investment in India under the automatic route.

Note: A Ltd can consider approaching the RBI for prior approval.

ODI -APPROVAL ROUTE

- RBI approval required for cases not falling under the Automatic route including ODI in Pakistan
- RBI inter alia consider the following factors:
 - Prima facie viability of JV/WOS outside India
 - Contribution to external trade and other benefits which will accrue to India through such investment
 - Financial position and business track record of the IP and foreign entity
 - Expertise and experience of the IP in the same or related line of activity of the JV / WOS outside India

- ODI by Trust / Society under Approval Route:
 - Trust /Society engaged in manufacturing / educational / hospital sector
 - Trust / Society should be registered under Indian Trust Act / Societies Registration Act
 - Trust deed / MOA permits proposed investment
 - Proposed investment approved by trustees / governing body of the Trust / Society
 - AD is satisfied that the trust / society is KYC compliant and engaged in bonafide activity
 - Trust / Society has been in existence at least for a period 3 years
 - Not come under adverse notice of Regulatory / Enforcement agency like DoE / CBI etc.
- ODI by Proprietary concerns and unregistered partnership firms are under Approval Route.

Pledge and Charge

Pledge of shares of JV / WOS / SDS	<ul style="list-style-type: none">• IP may pledge shares of JV / WOS / SDS outside India as security in favor of AD -Bank / PFI in India / overseas lender to avail fund or non-fund-based facility for itself or its JV / WOS / SDS whose shares have been pledged or for any other JV / WOS / SDS of the Indian Party. <p>Note: Subject to terms and conditions prescribed under Regulation 18 of FEMA 120 and A.P. (DIR Series) Circular No. 54 dated 29 December 2014.</p>
Charge on domestic and foreign assets	<ul style="list-style-type: none">• IP may create charge (mortgage / pledge / hypothecation or otherwise) on its assets (including assets of group companies, sister concern or associate company in India, promoter and / or director) in favor of overseas lender as security for availing fund and / or non-fund-based facility for its JV / WOS / SDS outside India.• IP may create charge (mortgage / pledge / hypothecation or otherwise) on the assets of its overseas JV / WOS / SDS in favor of AD –Bank in India as security for availing of fund based and / or non-fund-based facility for itself or its JV / WOS / SDS outside India. <p>Note: Subject to terms and conditions prescribed under Regulation 18A of FEMA 120 and A.P. (DIR Series) Circular No. 54 dated 29th December 2014</p>

ODI –Restructuring of Balance Sheet

❖ Permissible framework

- Applicable to IP having overseas WOS or JV with minimum 51% stake
- IP permitted to write off capital (equity/preference shares) or other receivables such as loans, royalty, technical know-how fees and management fees in respect of such JV/ WOS, even while such JV/ WOS continues to function
- The limits for write-off of receivables are:
 - Listed Indian Companies –up to 25% of the equity investment in JV/ WOS under the Automatic Route; and
 - Unlisted Indian Companies –up to 25% of the equity investment in JV/ WOS under the Approval Route

❖ Compliance

- The write-off / restructuring have to be reported to the Reserve Bank through the designated AD Category-I bank within 30 days of write-off/ restructuring.
- The documents to be submitted with the AD Bank under the Automatic Route or to RBI through the AD-Bank under the Approval Route for scrutiny:
 - Certified copy of Balance Sheet showing the loss in the overseas JV/ WOS
 - Projections for next 5 years indicating consequential benefit of such restructuring / write-off

ODI –Disinvestment without write-off

- ❖ Transfer by way of sale of shares of a JV/ WOS by IP to another IP or to a non-resident allowed without prior approval of the RBI subject to the following conditions:
 - a. Sale does not result in write-off of the investments made;
 - b. Shares of the listed JV/WOS –sale effected through a stock exchange;
 - c. Unlisted shares –share price is not less than the value certified by a CA/CPA as the fair value based on latest audited financial statements of the JV/WOS
 - d. IP does not have any outstanding dues like dividend, technical know-how fees, royalty, consultancy, commission or other entitlements, and/or export
 - e. Overseas concern has been in operation for at least one full year and the APR and accounts has been submitted to RBI
 - f. IP is not under investigation by CBI/ DoE/ SEBI/ IRDA or any other regulatory authority in India
 - g. The IP to submit details of the disinvestment through its AD within 30 days from date of disinvestment
 - h. Repatriation of sales proceeds within 90 days

ODI- Disinvestment with write-off

- ❖ Transfer by way of sale of shares of JV / WOS involving write off :
 - Disinvestments without prior approval of the RBI, where the amount repatriated on disinvestment is less than the amount of the original investments (in foreign exchange) is permitted in the following cases:
 - a. JV/ WOS is listed in overseas stock exchange
 - b. Where the IP is listed on a stock exchange in India and has net worth of not less than Rs. 100 Cr
 - c. Where the IP is an unlisted company and the investment in the overseas venture does not exceed USD 10 million
 - d. Where the IP is a listed company with net worth of less than Rs.100 crore but investment in an overseas JV/WOS does not exceed USD 10 million
 - e. Satisfying all other conditions of disinvestment except write-off –refer earlier slide
 - An Indian Party, which does not satisfy the conditions stated above –prior RBI approval required
 - Disinvestment –sale / merger / liquidation / capital reduction / Buy-Back

ODI by Resident Individuals v. LRS

❖ ODI by Resident Individual (RI) w.e.f 5 August 2013

- Covers strategic ODI akin to Indian party's ODI in JV / WOS.
- Only in Equity / CCPS
- JV / WOS to be engaged in bonafide business activity except real estate / banking / financial services which are prohibited activities
- JV / WOS not to be located in non-cooperative countries identified by FATF
- RI not to be on RBI caution / defaulter list or under investigation by any Authority
- Investment to be within overall LRS limits
- The operating JV / WOS should not have or not allowed to set-up or acquire step down subsidiary (anywhere)
- Valuation guidelines, reporting requirements including APR and other post investment changes obligation similar to IP
- Disinvestment (sales / merger / liquidation) permitted by after one year from the date of investment but no write-off permitted under Automatic Route

❖ LRS Schemes permits Portfolio investment to RI and not ODI –following principles relevant for portfolio:

- Not subscribing to MOA,
 - No other financial commitment apart from equity investment
 - Less than 100 percent investment
 - Passive investor not managing the affairs of the company
 - Generally investment in a listed entity.
- ❖ To invest out of funds held in Resident Foreign Currency ('RFC') account
- ❖ To invest in Bonus shares on securities held in accordance with law

Note: Under LRS scheme income is not obliged to be repatriated back to India

❖ Resident Individuals are granted general permission to purchase / acquire foreign securities:

- Under Gift from NR or Inheritance from R / NR (even sale under general permission subject to realization within 90 days)
- ESOP
 - To acquire share under cashless ESOP issued by a company outside India provided no remittance from India
 - To purchase shares under ESOP (by employees / directors of its branch / office / subsidiary in India) either direct or through a Trust / SPV on a globally uniform basis; and filing Annual Return
 - Sale / repurchase by Foreign Company is permitted if as per initial offer and Annual Return (subject to realization within 90 days)
- The above shares can be pledged in favor of Banks / PFI in India for obtaining credit facilities

❖ To invest from Foreign currency resources outside India (when not permanently resident in India, etc)

❖ To acquire right shares provided original holding is as per the law

❖ To acquire qualification shares on becoming director of overseas company (**LRS Ceiling**)

❖ To acquire of shares of a foreign company offered as consideration for professional services rendered to the foreign company or Director's remuneration (**LRS Ceiling**)

❖ To acquire shares of JV / WOS of Indian Co. engaged in Software by Employees / Directors (within the 5% ceiling prescribed by RBI and other conditions)

❖ Indian Co. in knowledge based sector –ADR/ GDR linked ESOP (within the ceiling prescribed by RBI and other conditions)

Foreign Currency Investment made outside India under LRS and ODI:

- ❖ All foreign currency investment made under LRS can be continued.
- ❖ In case of ODI transactions, upon turning NRI it will no longer remain ODI. Intimation to RBI is required to be given and Form ODI Part III will be required to be filed for cancellation of UIN.

Gift Transactions

- ❖ Gift of sum of money by resident to a non-resident or non-resident to resident is a Current A/c Transaction.
- ❖ Gift of foreign security is a Capital A/c Transaction having following implications:

DONOR	DONEE	Remarks
NR	R	Permissible Reg 22(1)(i) of 120
R	R	Not covered by general permission
R	NR	Not covered by general permission

❖ Inheritance of foreign security:

Donor	Donee	Remarks
NR	R	Permissible Reg 22(1)(iii) of 120
R	R	Permissible Reg 22(1)(iii) of 120
R	NR	Not covered by general permission

❖ Gift and inheritance of Immovable Property Situated outside India:

Donor	Donee	Remarks
NR	R	Not covered by general permission
R	R	Regulation 5(1)(a) for Sec 6(4) cases and 5(2) of Not. 7(R)
R	NR	Not covered by general permission

- ❖ In terms of Section 4 of FEMA, 1999 – foreign exchange, foreign security or any overseas immovable property must be held as per permissible modes of FEMA.
- ❖ Contravention of this can lead to penal consequences under Section 13(1A) – Penalty up to three times and seizure of equivalent assets in India.

Case Study



Question: How should Mr. Seth approach this situation?

Facts:

Mr. Seth is a practicing advocate in civil law in India. Mr. Seth desires to purchasing an immovable property outside India. Remittance for the acquisition would be made under the Liberalised Remittance Scheme (LRS) of RBI out of Mr. Seth's surplus balance in Indian bank account.

Mr. Seth has been advised by his peers from corporate law background that such acquisition is permissible under LRS route since Master Direction of LRS expressly lists purchase of property abroad as one of the permissible capital account transactions. Upon going through Master Direction, Mr. Sheth finds that though the transaction is covered under the Master Direction on LRS, Master Direction simply consolidates instructions on rules and regulations framed by the Reserve Bank. However, upon perusal of FEMA notification dealing with acquisition of property outside India, Mr. Sheth could not find any general permission in this regard.

Analysis:

- RBI has the power under Sections 10(4) and 11(1) of FEMA to issue such directions to Authorised Persons through A.P. (DIR Series) Circulars and Master Directions on various subject matters. [Krishnaraj Goswami vs. RBI (2007 (6) BomCR 565)]
- However, Master Direction on LRS has not been issued under Sections 10(4) and 11(1) of FEMA. This may lead to challenge concerning its legality.
- Liberal interpretation by RBI while administering FEMA. Much broader than interpretation of FEMA by judicial forums.

ODI-FDI structure:

- ❖ An individual was having a company outside India while he was being a non-resident.
- ❖ At that time such overseas company had made FDI in India.
- ❖ Upon return to India 6(4) permits to continue existing investment outside India.
- ❖ Therefore, whether ODI-FDI structure still be continued to be allowed?
- ❖ Whether Overseas company [i.e. 6(4) - Company] can make fresh FDI in India? Will it amount to round tripping?

Reporting At Glance

Forms	Purposes
ODI-Part I	<ul style="list-style-type: none">• Prior to making the ODI• Details of JV/WOS• Investment under LRS• Post Investment changes, if any.
FLA	<ul style="list-style-type: none">• Annual return on Foreign Liabilities and Assets• Indian company / LLP who has invested overseas• E-filing on or before 15th day of July 20XX
ODI- Part III	<ul style="list-style-type: none">• Disinvestment from JV/ WoS within 10 days of disinvestment.• Fair Valuation based on audited books of accounts
APR (ODI-Part II)	<ul style="list-style-type: none">• Financial Statement of overseas• Before 31st December each year
Form ECB	<ul style="list-style-type: none">• Form ECB for obtaining LRN• Any changes in repayment schedule and other terms of the ECB
Form ECB-2	<ul style="list-style-type: none">• Monthly returns for outstanding borrowings• Any changes in ECB parameters• within 7 days of the subsequent month• To be certified by CA / CS

FDI Regulatory framework:

- ❖ Section 6(3)(b) of FEMA 1999
- ❖ Regulations: FEM (NDI) Rules, 2019 & FEM(DI) Regulations, 2019 as amended from time to time (erstwhile FEMA 20(R)/2017-RB)
- ❖ RBI Master Direction no. 11 (dated 4th January 2018 updated till 08 March 2019)
- ❖ RBI's A.P. DIR Circulars (few ones not covered above)
- ❖ RBI Master Circulars issued earlier
- ❖ RBI FAQs (updated from time to time)
- ❖ RBI compounding orders (full up to Feb 2020 and only summary post 1 March 2020).
- ❖ Other items -Monthly FDI Data on RBI Website, clarifications issued to AD-Banks

Power to legislate on Capital Account Transactions w.e.f. 15.10.2019

Section 6(2)	Section 6(2A)
<p>The Reserve Bank may, in consultation with the Central Government, specify—</p> <ul style="list-style-type: none">(a) any class or classes of capital account transactions, involving debt instruments, which are permissible;(b) the limit up to which foreign exchange shall be admissible for such transactions;(c) any conditions which may be placed on such transactions	<p>The Central Government may, in consultation with the Reserve Bank, prescribe—</p> <ul style="list-style-type: none">(a) any class or classes of capital account transactions, not involving debt instruments, which are permissible;(b) the limit up to which foreign exchange shall be admissible for such transactions; and(c) any conditions which may be placed on such transactions

Note:

The amendments to Section 6 which were proposed in Finance Act 2015, have been notified with effect from 15th October 2019.

What happens to pre-existing FEMA Notifications dealing with Cap a/c transactions?

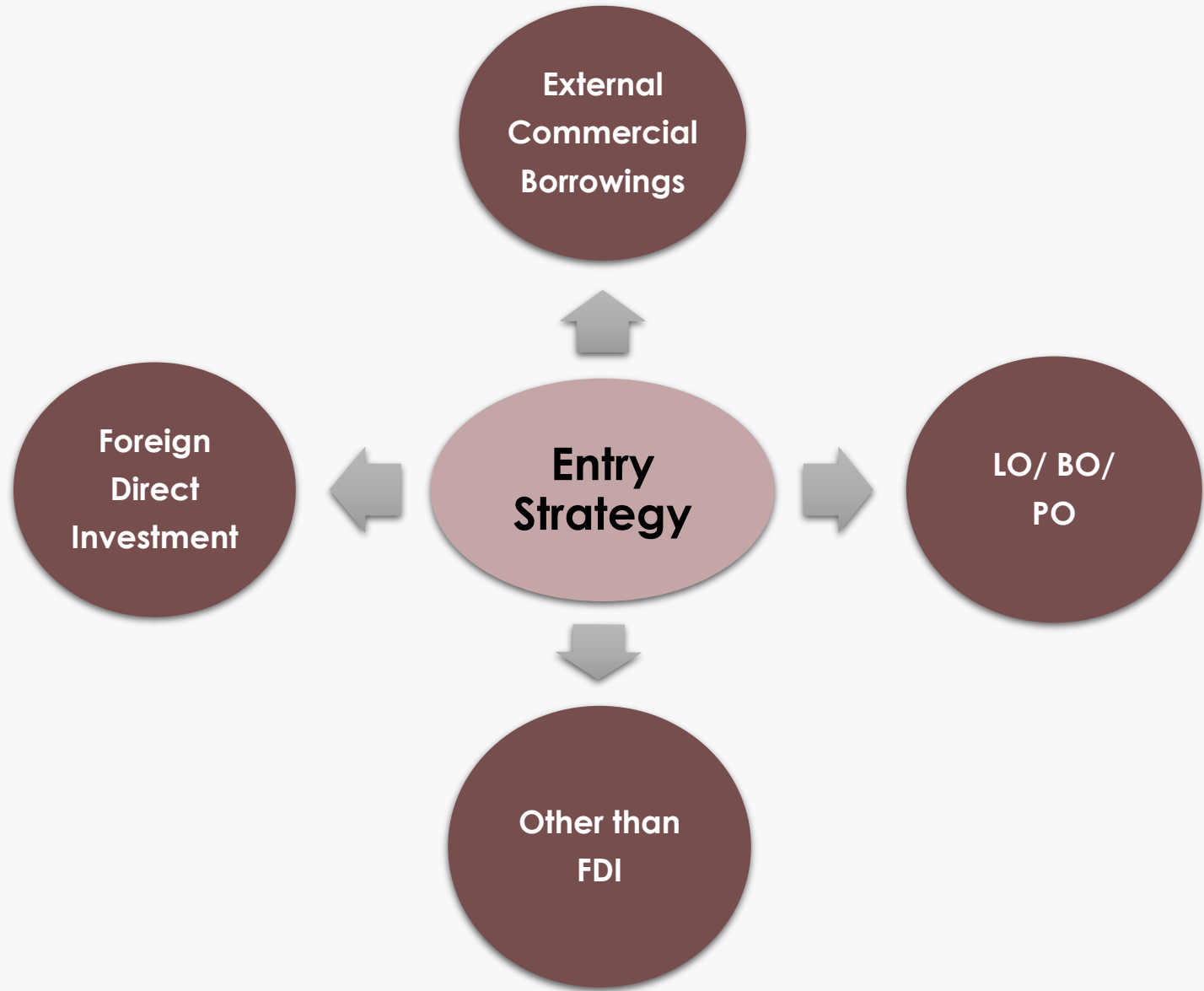
As per Section 47(3), all regulations made by the Reserve Bank under pre-existing Notifications on capital account transactions shall continue to be valid unless until amended or rescinded by the Central Government.

Power to legislate on Capital Account Transactions w.e.f. 15.10.2019

Debt Instruments	[RBI]	Non-Debt Instruments	[CG]
Government Bonds		All investments in equity in incorporated entities (public, private, listed and unlisted)	
Corporate Bonds		Capital participation in Limited Liability Partnerships (LLPs)	
All tranches of securitisation structure which are not equity tranche		All instruments of investment as recognised in the FDI policy as notified from time to time	
Borrowings by Indian firms through loans		Investment in units of Alternative Investment Funds (AIFs) and Real Estate Investment Trust (REITs) and Infrastructure Investment Trusts (InVITs)	
Depository receipts whose underlying securities are debt securities		Investment in units of mutual funds and Exchange-Traded Fund (ETFs) which invest > 50% in equity	
		The junior-most layer (i.e. equity tranche) of securitization structure	
		Acquisition, sale or dealing directly in immovable property	
		Contribution to trusts	
		Depository receipts issued against equity instruments	

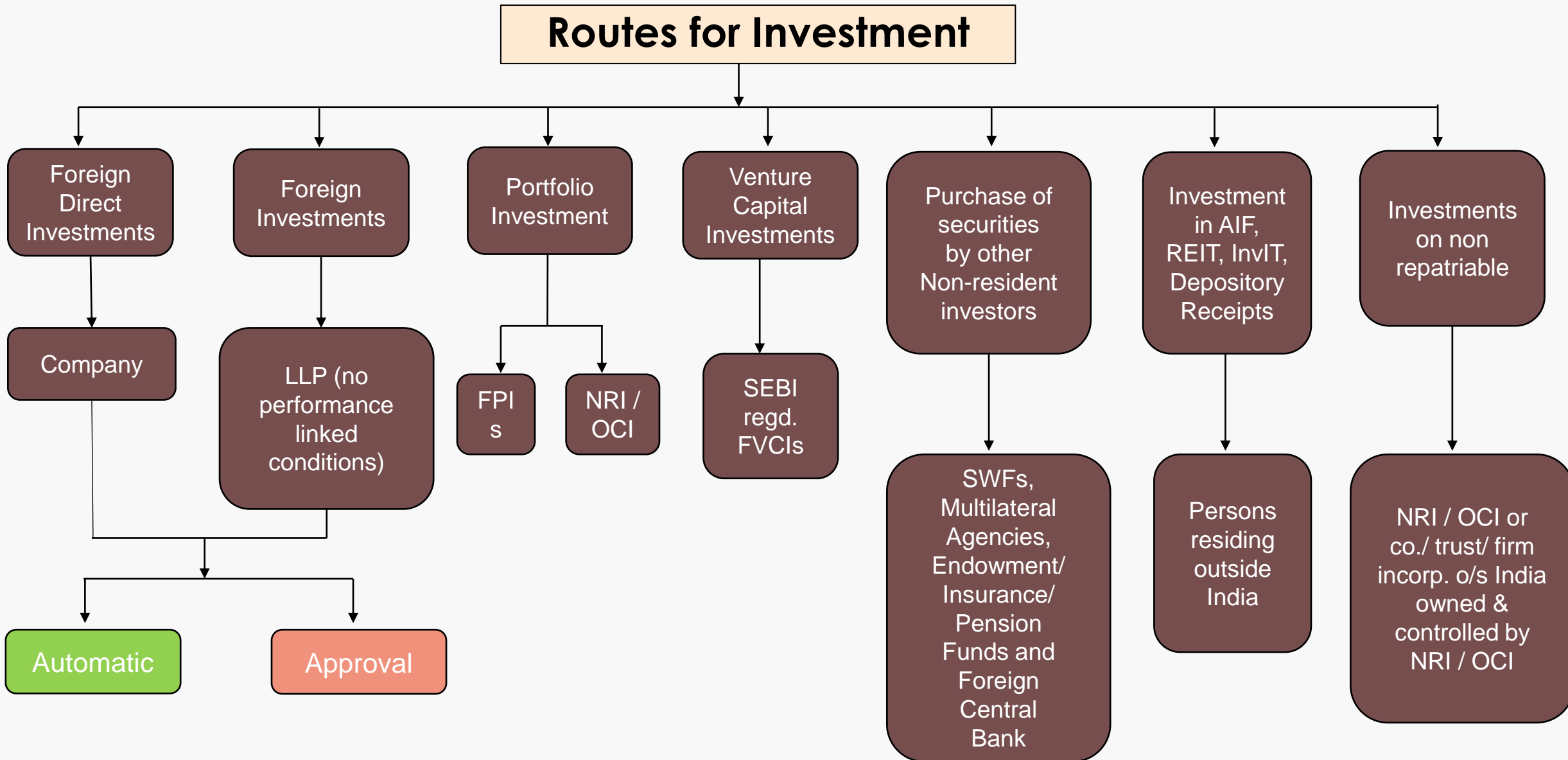
Any other instrument not defined above shall be deemed as debt instrument.

Entry Strategy into India



Inbound Investment

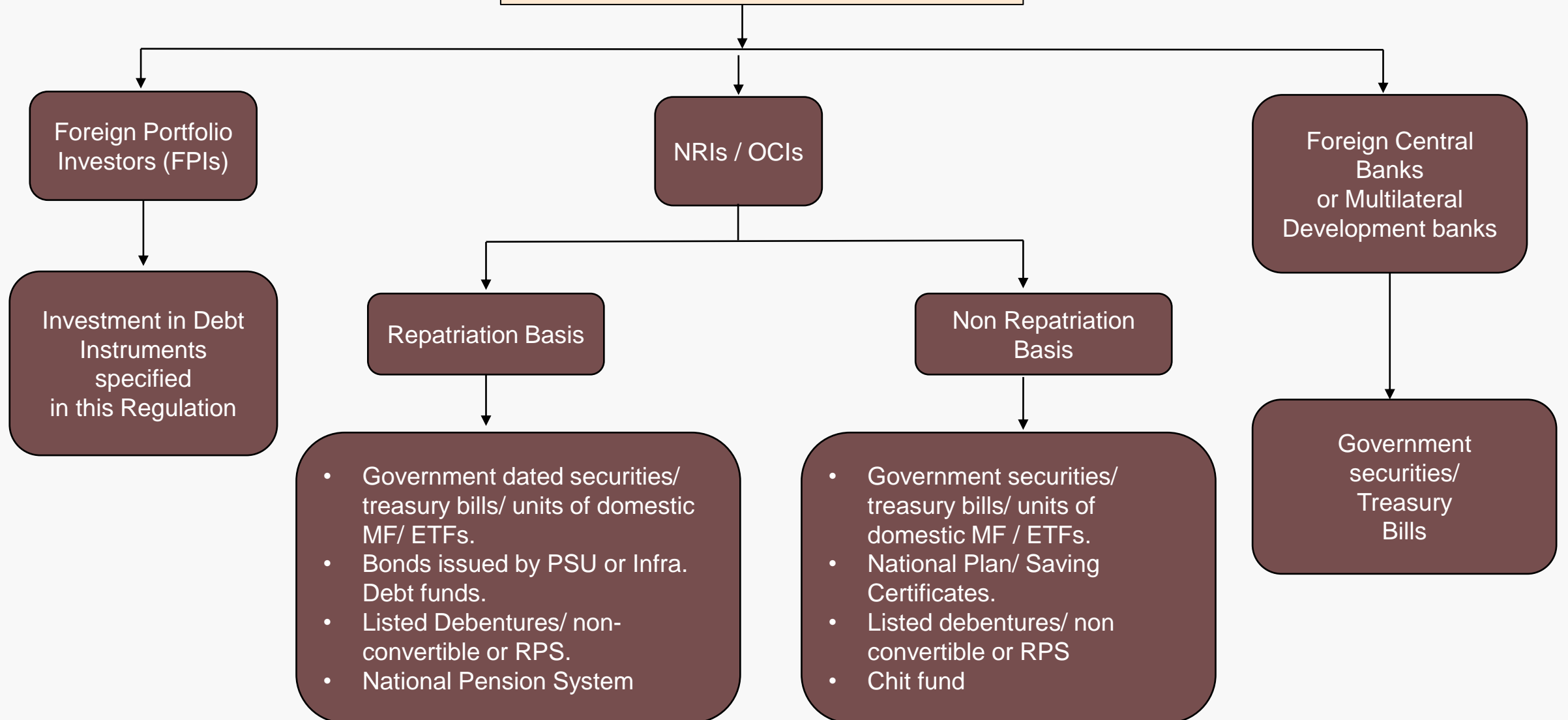
FEM (Non-Debt Instruments) Rules, 2019 dated 17.10.2019



Inbound Investment

FEM (Debt Instruments) Regulations, 2019 dated 17.10.2019

Routes for Investment

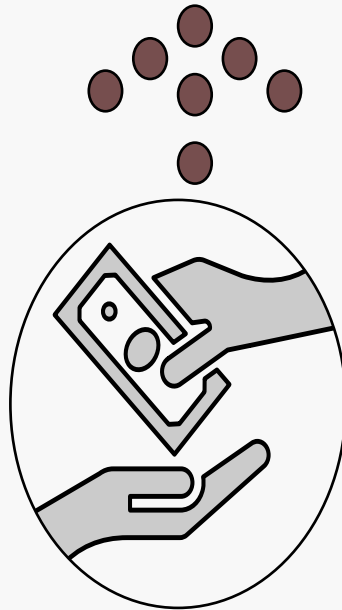


Restriction on Covid Takeovers

- ❖ FDI only under the Government route vide Press Note no. 3 dated 17th April 2020:
 - An entity of a Country, which shares a land border with India or
 - Where the **beneficial owner** of an investment into India is situated
 - in or is a citizen of any such country
- ❖ Direct / Indirect Transfer of ownership of any FDI in an Indian entity resulting in beneficial ownership as above = such change will also require Govt approval.
- ❖ Country sought to be covered: China
- ❖ Trigger Point: People' Bank of China's 1% in HDFC Bank

- Nothing to be done for existing investments
- Is there a threshold?
- What about Hong Kong Investments? At par with China?
- Can Cos with existing Chinese investment raise further funds without approval?
- What if Foreign Parent of Indian Co. gets acquired by Chinese Co.?
- What about PE Funds with Chinese investors?
- ❖ Even if ultimate parent company is Chinese but direct investor is non-Chinese, this restriction would apply

Forms of ECB



FCY Denominated ECB

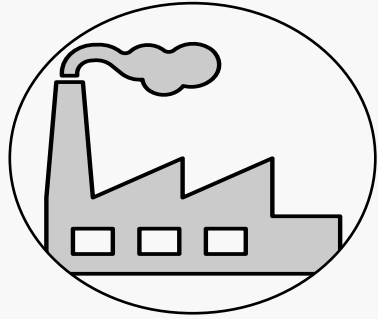
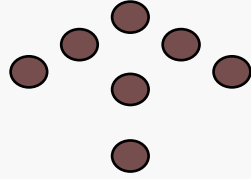
- Loans including bank loans
- Floating/ fixed rate notes/bonds/ debentures/ preference shares (other than fully and compulsorily convertible instruments)
- Trade credits beyond 3 years
- FCCBs FCEBs
- Financial Lease



INR Denominated ECB

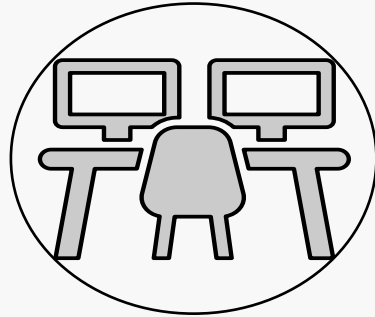
- Loans including bank loans
- Floating/ fixed rate notes/bonds/ debentures/ preference shares (other than fully and compulsorily convertible instruments)
- Trade credits beyond 3 years & Financial Lease
- Plain vanilla Rupee denominated bonds issued overseas, which can be either placed privately or listed on exchanges as per host country regulations

Setting up of LO/ BO/ PO



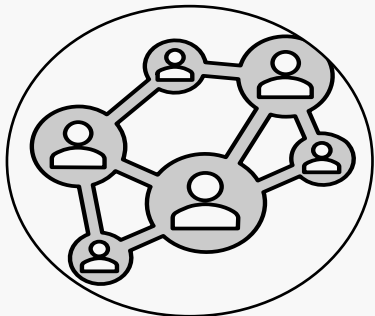
Project Office

For carrying out contract execution in India.



Liaison Office

- To carry out the Liasioning work.
- Promoting export/ import from/ to India.

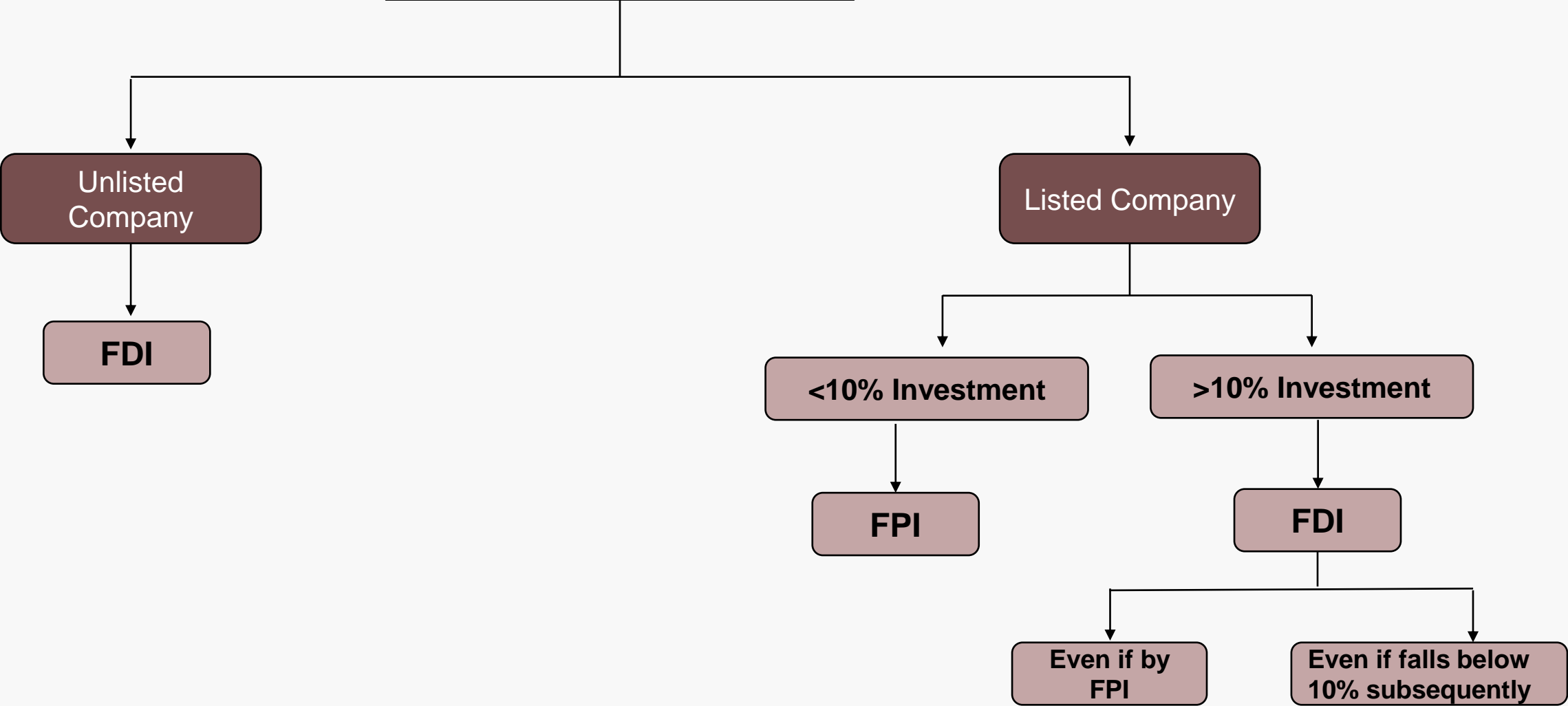


Branch Office

- To carrying on parent company's business activity in India.
- Foreign trade such as import/ export of goods.
- Service sector such as R&D.
- Represent foreign Airline & Shipping Company.

FDI v/s FPI

Foreign Investment



Acquisition through Rights Issue or Bonus Issue

- ❖ PROI having investment in Indian company may acquire equity instruments (other than share warrants) issued by such company as a rights issue or a bonus issue provided that:
 - The offer is in compliance with the provisions of the Companies Act, 2013:
 - Such issue shall not result in a breach of the sectoral cap applicable to Indian company;
 - Original shareholding must have been acquired & held as per provisions of these rules;
 - For listed Indian company: Rights issue to persons resident outside India shall be at a price determined by the company;
 - For unlisted Indian company: Rights issue to persons resident outside India shall not be at a price less than the price offered to persons resident in India.
 - Amount of consideration to be paid as inward remittance from abroad through banking channels or out of funds held in NRE/ FCNR(B) a/c.
 - If the original investment has been made on a non-repatriation basis, the amount of consideration may also be paid by debit to the NRO a/c.

- ❖ An individual who is a PROI exercising a right which was issued when he/ she was a PRI can hold the equity instruments so acquired on exercising the right on a non-repatriation basis. (Change over from PRI to PROI)
- ❖ **Renunciation of Entitlement**
 - PROI can subscribe for additional shares over and above the shares offered on rights basis by the company and PRI & PROI can also renounce the shares offered either in full or part thereof in favour of PROI named by them.
 - Pricing guidelines to be followed in case of acquisition by PROI from renunciation made by PRI
 - Rights shares shall be subject to the same conditions including restrictions in regard to repatriability as applicable to the original shareholding.

Issue of ESOP and Sweat Equity Shares

An Indian company is permitted to 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, subject to the following conditions:

- Compliance with SEBI Regulations or the Companies (Share Capital and Debentures) Rules, 2014;
- Compliance with the sectoral cap applicable to the said company;
- 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 requires prior Government approval.



Merger / Demerger / Amalgamation of Indian companies

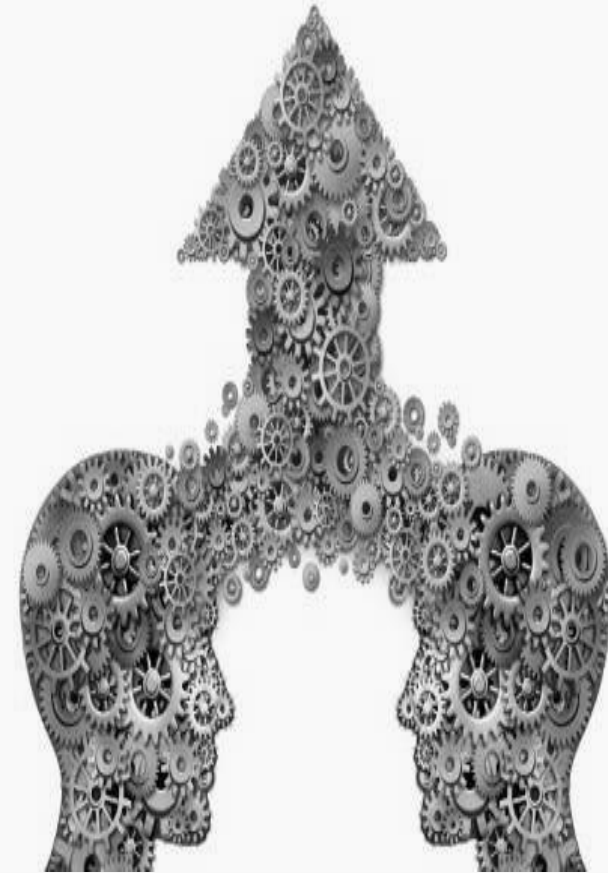
Issue of Redeemable NCPS / Redeemable NCD as bonus in Scheme of Arrangement - Rule 6 of FEM (Debt Instruments) Regulations, 2019:

- ❖ Upon approval by National Company Law Tribunal (Competent Authority, the Indian company can **issue non convertible redeemable preference shares/ debentures to shareholders who are resident outside India, out of its general reserves by way of distribution as bonus** subject to the following conditions:
 - The original investment made in the Indian company by a person resident outside India is in accordance with these regulation and the conditions specified therein
 - The said issue is in accordance with the provisions of the Companies Act, 2013 and the terms and conditions, if any, stipulated in the scheme approved by National Company Law Tribunal (Competent Authority)
 - The Indian company is not engaged in any activity/ sector in which foreign investment is prohibited

CROSS BORDER MERGER – INBOUND MERGER

[NOTIFICATION NO. FEMA.389/2018-RB DATED: MARCH 20, 2018]

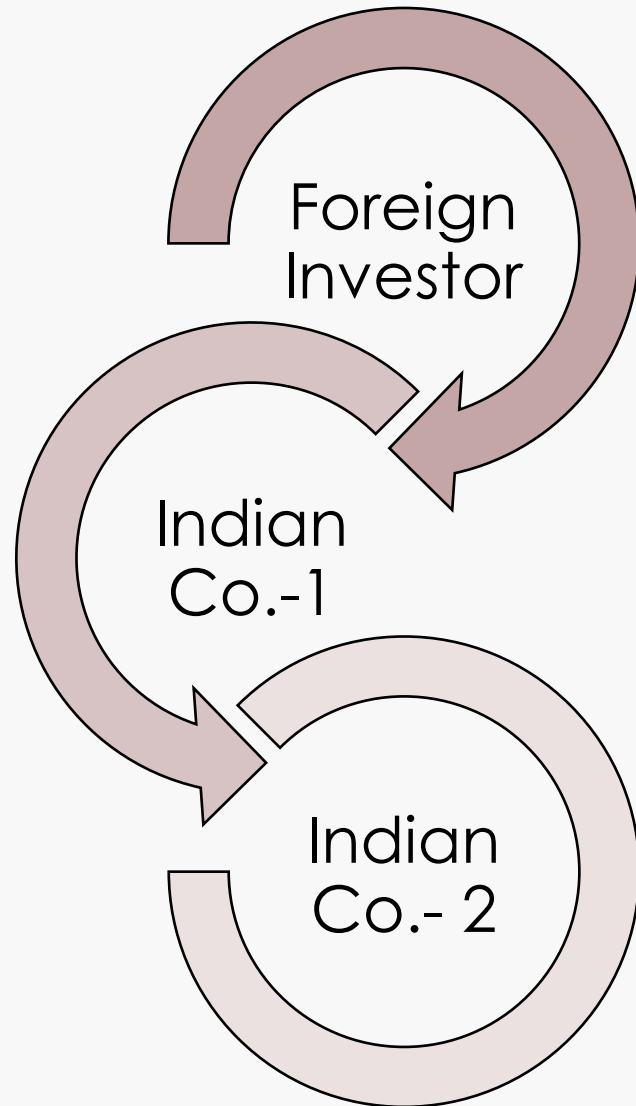
- 'Inbound merger' means a cross border merger where the resultant company is an Indian company;
- The resultant company may issue or transfer any security and/or a foreign security, as the case may be, to a person resident outside India in accordance with the pricing guidelines, entry routes, sectoral caps, attendant conditions and reporting requirements for foreign investment as laid down in Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017.
- Any transaction on account of a cross border merger undertaken in accordance with these Regulations shall be deemed to have prior approval of the Reserve Bank as required under Rule 25A of the Companies (Compromises, Arrangement and Amalgamations) Rules, 2016.
- Valuation as prescribed under Rule 25A of the Companies (Compromises, Arrangement and Amalgamations) Rules, 2016 shall be followed.



Exit Routes for Inbound Investments

Rule	Seller	Buyer	Mode of Transfer
9(1)	PROI (Other than NRI/ OCI/ OCB)	PROI	Sale/ Gift
9(2)	PROI	PRI	Sale/ Gift
9(3)	PRI	PROI	Sale
9(4)	PRI	PROI	Gift - RBI Approval with attendant limits: a) Upto 5% of paid capital - Relative b) Upto USD 50000 – Non Relative
9(5)	PROI (optionality clause)	PRI/ PROI	Sale (without any assured return)
9(6)	PRI/ PROI	PROI/ PRI	Sale (deferred consideration-25% and to be paid within 18 months from DoA)
9(8)	PRI/ PROI	PROI/ PRI	Pledge
13(1)	NRI/ OCI (Repat basis)	PROI	Sale/ Gift
13(2 &3)	NRI/OCI (Non-repat)	PROI	<ul style="list-style-type: none"> • Sale (Attendant conditions) • Gift with Limits (RBI Approval)
13(4)	NRI/OCI (Non-repat)	NRI/OCI (Non-repat)	Gift

Indirect/Downstream FDI



- ❖ FDI via Indian Cos
 - Owned & Controlled by Resident Indians Citizens = Domestic
 - Investment not counted as FDI
 - Owned OR Controlled by NRs = Downstream is Indirect FDI

- ❖ Ownership
 - More than 50% of Capital (Eq /CCD/CCPS) Control
 - Right to appoint a majority of Directors or to control management or policy decisions including by virtue of their Shareholding or Management Rights or SHA or Voting Agreements

❖ **1st Level Investor Co.**

- Must have a Board Resolution approving the Indirect FDI
- Must have Shareholders' Agreement
- Must Not raise funds for Investment Via Domestic Markets
- Can use Internal Accruals / Foreign Funds
- Is responsible for compliance with FEMA Regs.
 - Obtain Auditors' Certificate + Report in Directors' Report
 - If Qualified Audit Report, then inform RO of RBI
 - Auditors must understand Indirect FDI very clearly or obtain an Opinion in case of doubt!

❖ **2nd Level Investee Co.**

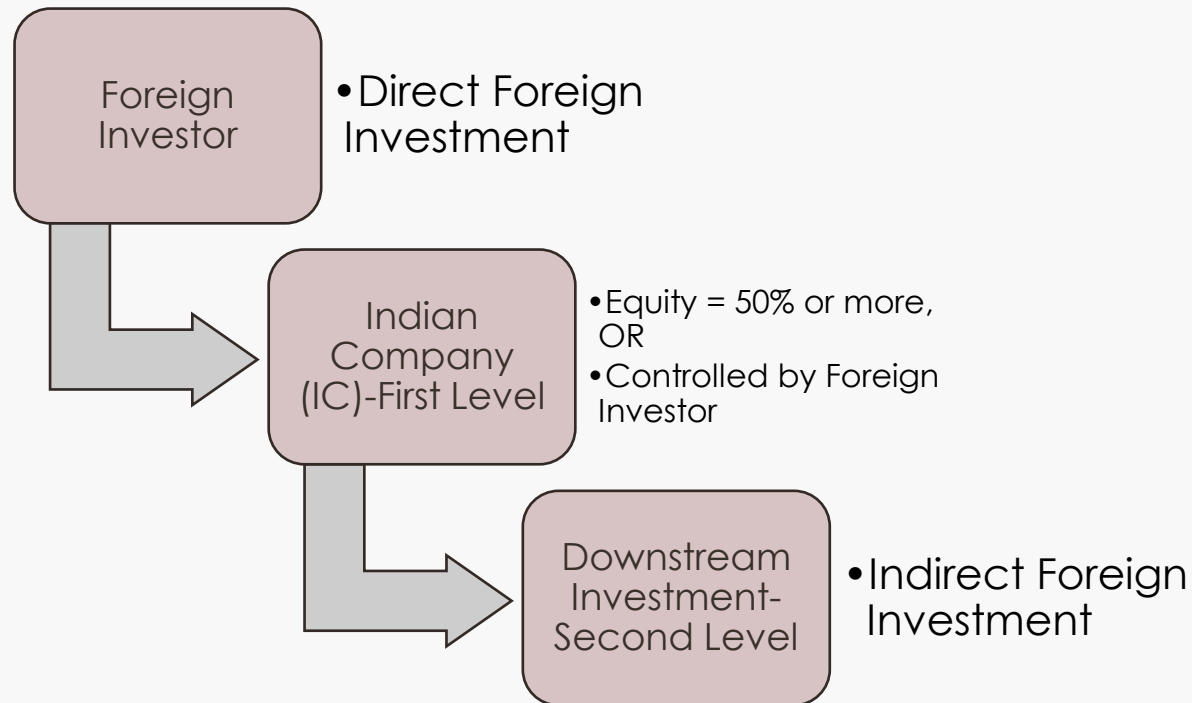
- must comply with:
 - Entry Route
 - Sectoral Caps
 - Pricing Guidelines
 - Other FDI linked Performance Conditions

As if it is a Direct FDI

Calculating-Indirect Foreign Investment

- The foreign investment through Indian Company (IC) would not be considered for calculation of Indirect Foreign Investment if such IC is '**owned and controlled**' by Resident Indian citizens
- If above is not fulfilled, or if IC is owned or controlled by 'non-resident entities', entire investment by IC into Investee Co would be considered as Indirect Foreign Investment

Illustration



- In the illustration, Thus if the IC has foreign investment of 50% or more; OR is controlled by non-resident through the board of directors or any other agreement; it will be considered Indirect foreign investor. On the other hand, only if IC has Resident Indian citizen investment of more than 50% AND is controlled by Resident Indian citizen, it will be considered as domestic investor.
- If IC is considered as indirect foreign investor, the entire investment by IC will be considered as Indirect Foreign Investment (IFI). There is no proportionality. Thus, if there is foreign investment of 60% in IC, investment by IC in downstream company will be entirely considered as IFI. IFI will not be restricted to 60%. If foreign investment in IC is say 40%, entire investment by IC in downstream company will be considered as domestic investment.

This method has to be considered for every downstream company at every level.

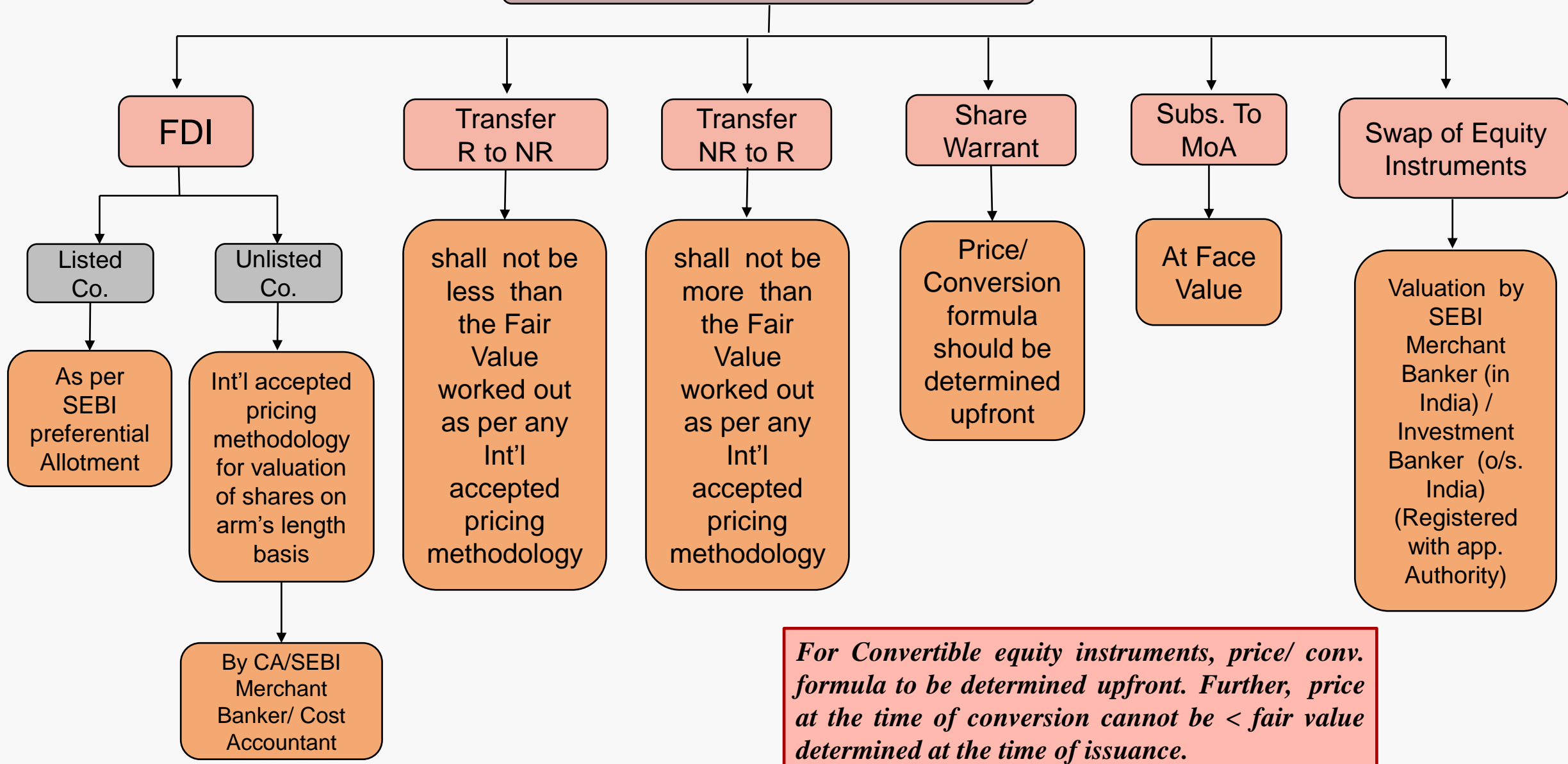
Convertible Notes by an Indian start up company

Rule 18 of NDI Rules

- ❖ “Convertible note” means an instrument acknowledging receipt of money initially as **debt** (having **tenure of 10 years** &
 - **repayable at the option** of the holder, or
 - **convertible into equity shares** upon occurrence of specified events
- ❖ Only private limited company recognized as a **start up by DPIIT** can issue convertible note
- ❖ Minimum amount to be subscribed by single person should be **>INR 25 lakhs in single tranche**
- ❖ Can be issued to PROI (other than an individual who is citizen of Pakistan or Bangladesh or an entity which is registered or incorporated in Pakistan or Bangladesh)
- ❖ Entry routes, sectoral caps, pricing guidelines other attendant conditions to be followed. **No pricing norms for issue of convertible note**, however, pricing guidelines applicable at the time of conversion of CN into equity shares and for subsequent transfer of such equity shares
- ❖ **Mode of Payment** : Inward remittance from abroad through banking channels or out of funds held in NRE/ FCNR(B) account/ Escrow account
- ❖ **Remittance of sale proceeds** : Sale proceeds (net of taxes) may be remitted outside India or may be credited to NRE/ FCNR(B) account

PRICING GUIDELINES

Valuation of Equity Instruments



PROHIBITED ACTIVITIES

[Rule 2 of Schedule I]

- ❖ **Lottery Business including Government/ private lottery, online lotteries**
- ❖ **Gambling and betting including casinos**
- ❖ **Chit funds**
- ❖ **Nidhi company**
- ❖ **Trading in Transferable Development Rights (TDRs)**
- ❖ **Real Estate Business or Construction of Farm Houses**
 - Explanation: For the purpose of this regulation, “real estate business” shall not include development of townships, construction of residential /commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations 2014.
- ❖ **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**
- ❖ **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**

Case Study 4



Facts: A foreign company successfully runs a fantasy gaming app outside India. It wants to incorporate an Indian company to replicate its overseas success in popular Indian sports such as kabaddi and cricket.

Question: Can the foreign company make investment under FDI into Indian company which proposes to operate fantasy gaming app in India on a paid / subscription basis?

Analysis:

- As per rule 2 of Schedule 1 of FEM NDI Rules, 2019, gambling and betting including casinos sectors are prohibited for foreign direct investment.
- **Game of Skill v/s Game of Chance:** The High Courts of Punjab & Haryana, Bombay and Rajasthan had stated that fantasy sports are games of 'mere skill' that do not amount to gambling. *Varun Gumber v. U.T., Chandigarh & Gurdeep Singh Sachar v. Union of India, Bombay*
- Therefore, in case of company operating fantasy gaming app in India - if the same is considered to be a game of skill, it could not be said to be operating in the gambling/ betting sector. Consequently, FDI would be permitted under the automatic route.

Investment in equity instruments of an Indian company by PROI - Sch. I of NDI Rules

- ❖ An Indian company may issue equity instruments to PROI subject to:
 - Entry Routes
 - Sectoral Caps and Attendant Conditionality(s)
 - Against Swap of Shares
 - Against Capital goods (excluding second hand)
 - Against pre-operative/ pre-inc. exp (including payment of rents)
 - Against any funds payable to PROI and which is permissible under FEMA.
- ❖ PROI may purchase equity instruments of a listed Indian company on a stock exchange in India provided that:
 - PROI making the investment has already acquired control of such company in accordance with SEBI (SAST) Regulations, 2011 and continues to hold such control;
 - Amount of consideration may be paid as per the mode of payment prescribed in this Schedule or out of the dividend payable by Indian investee company.

- ❖ WOS can issue equity instruments against pre-incorporation / preoperative expenses incurred by NR entity for lower of:
 - (a) limit of 5% of authorized capital &
 - (b) USD 500,000, within 12 months of incorporation max
 - WOS operates in sector with 100% FDI under Automatic Route and no FDI linked performance conditions;
 - Compliance of reporting requirement;
 - Statutory Auditor utilization certification for pre-incorporation / preoperative expenses.
- ❖ **Mode of Payment:** Inward remittance from abroad through banking channels or out of funds held in NRE/ FCNR(B)/ Escrow account
- ❖ **Remittance of sale proceeds:** Sale proceeds (net of taxes) of the equity instruments may be remitted outside India or may be credited to the NRE/ FCNR(B)

Case Study 5- Pre-Incorporation v/s. Pre-operative



Facts:

UK company has incorporated an Indian subsidiary company to manufacture Solar Panels under Make In India initiative in the year 2019. Indian subsidiary could not commence business operations till 2021 since they could not acquire land on account of various reasons beyond their control. Between 2019 to 2021, UK parent company has directly made payment to consultants in India towards various expenses on behalf of Indian subsidiary for accounting, legal & tax compliance.

Question: Indian subsidiary now wants to issue shares to UK parent company against the above-mentioned expenses. Is it allowed to issue shares under FEMA?

Investment by Foreign Portfolio Investors- Sch. II of NDI Rules

- ❖ FPI may purchase/ sell equity instrument of listed/ to be listed Indian Co. subject to:
 - Total holding by each FPI should be < **10%** of paid up capital (**individual limit**)
 - Total holding of all FPI put together should be < **24%** of paid up capital (**aggregate limit**). However it can be increased to sectoral cap limit by passing special resolution.
 - **W.e.f . 01.04.2020** , the **aggregate limit shall be the sectoral cap limit**. This limit can be decreased to a lower threshold by passing special resolution. Once decreased, can increase the limit also. However, once it is increased then cannot reduce to lower threshold.
 - Aggregate limit in sector where FDI is prohibited shall be 24%.
 - Otherwise no sector specific FDI limits. FPI investments clubbed under sectoral cap.

- ❖ In case of breach of prescribed limit:
 - Option to **divest** their holding **within 5 trading days**
 - If **chooses not to divest** - entire investment will be **considered as FDI** and **FDI attendant conditions will apply**.
 - To report within 7 days to the depositories as well as concerned company for effecting necessary changes
- ❖ Investment by foreign Government agencies shall be clubbed with investment by foreign Government or related entity (if they are part of investor group) for the purpose of calculation of 10% limit for FPI investment.

- ❖ FPI may purchase equity instrument of Indian Co. through public offer or private placement subject to satisfaction of individual and aggregate limit:
 - **Pricing in case of public offer:** not less than price at which shares issued to resident.
 - **Pricing in case of private placement:** not less than (a) price arrived as per SEBI guidelines; or (b) fair price as per any Int'l pricing certified by merchant banker/ CA/ Cost Accountant
- ❖ FPI may undertake **short selling/ lending or borrowing of securities** subject to conditions
- ❖ FPI may **purchase units of domestic mutual fund or Cat III AIF or Offshore fund** for which no objection is issued in accordance with SEBI (MF) regulations, 1996 which **invests > 50% in equity** instrument on repatriation basis
- ❖ FPI may **purchase units of REITs and InVITs** (Repatriation) subject to SEBI

- ❖ **Mode of Payment:** Inward remittance from abroad through banking channels or out of funds held in Foreign Currency/SNRR account.
- ❖ **Remittance of sale proceeds:** Sale proceeds (net of taxes) of the equity instruments and units of domestic MF may be remitted outside India or may be credited to the Foreign Currency/ SNRR account.

Investment by NRI/ OCI on repatriation basis- Sch III of NDI Rules

❖ NRI/ OCI may Purchase/ sell of equity instrument of listed Indian Co. subject to:

- Purchase/ sell through branch designated by an AD
- Total holding by any individual NRI/ OCI should be <5% of paid up capital (**individual limit**).
- Total holding of all NRI/ OCI put together should be <10% of paid up capital (**aggregate limit**).
- Ceiling of 10% can be increased to 24% by passing special resolution

❖ NRI/ OCI may purchase/ sell **without any limit** units of domestic mutual fund which invests more than 50% in equity.

❖ NRI/ OCI may purchase/ sell without any limit shares in public sector enterprise being disinvested by CG subject to terms and conditions stipulated in notice inviting bids.

❖ **NRI/ OCI may subscribe to the National Pension System (NPS)** governed by Pension Fund Regulatory and Development Authority (PFRDA) provided:

- Such person is eligible to invest as per the provision of PFRDA Act;
- Annuity/ accumulated saving will be repatriable.

❖ **Mode of Payment:**

- Through NRE Account
- Domestic Mutual Fund: NRE/FCNR Account
- subscription to NPS: NRE/ FCNR/ NRO account.

❖ **Remittance of sale proceeds:**

- Sale proceeds (net of taxes) of the equity instruments may credited to the NRE account.
- Sale proceeds (net of taxes) of the units of mutual funds and subscription to NPS may be credited to the NRE /FCNR /NRO account.

Investment on Non Repatriable Basis- Sch IV of NDI Rules

❖ Non Repatriable means:

- Only Dividend Interest can be sent back abroad
- Principal Gains cannot be repatriated

A. Purchase/ sale of equity instruments or convertible notes or units or contribution to the capital of an LLP

❖ Eligible Investor

- NRI
- OCI
- a company, a trust and a partnership firm incorporated outside India and owned and controlled by NRIs or OCIs [*Owned % Controlled not defined in Sch IV, therefore as per Rule 23, Ownership shall mean beneficial holding of 50% of Share Capital/ Capital in LLP and major profit share & Control shall mean right to appoint majority of Directors /Partners/ DPs with NRIs*]

❖ Investment in

- Equity instruments i.e., shares/CCDs/warrants etc. without any limit either on the stock exchange or outside it
- Units issued by an investment vehicle without any limit, either on/off stock exchange
- The capital of a Limited Liability Partnership without any limit
- Convertible notes issued by a startup company in accordance with these Regulations

❖ Investment deemed to be domestic investment at par with the investment made by residents

❖ Shall not invest in equity instruments or units of a Nidhi or company engaged in agricultural/ plantation activities or Real Estate Business or Construction of Farm Houses or dealing in TDRs.

- Real Estate Business means Dealing in land to earn profits but excludes Leasing of property / Investment in REIT units / earning of rent income

❖ Mode of Payment: Inward Remittance/ NRE/ FCNR(B)/ NRO account.

❖ Sale/ maturity proceeds:

- **Credited only to the NRO account** of the investor, irrespective of the type of account from which the consideration was paid
- Amount invested + capital appreciation shall not be allowed to be repatriated abroad [***NRI may avail USD \$ 1 Million scheme***]

B. Investment in a Firm or Proprietary Concern

❖ Eligible Investor

- NRI
- OCI

❖ Investment in

- Capital of firm or proprietary concern

❖ Restricted Sectors for NRIs/ OCI

- Agricultural /Plantation/ Real Estate Business/ Print Media

❖ Mode of Payment: Inward Remittance/ NRE/ FCNR(B)/ NRO account

❖ Sale/ maturity proceeds:

- **Credited only to the NRO account** of the investor, irrespective of the type of account from which the consideration was paid
- Amount invested + capital appreciation shall not be allowed to be repatriated abroad ***[NRI may avail USD 1 Million scheme]***

#DPIIT Press Note No 1 of 2021 Series: Clarity on Downstream Investment

- DPIIT has clarified that an investment made by an **Indian entity which is owned and controlled by NRIs on a non repatriation basis shall not be considered for calculation of indirect foreign investment** (downstream investment).

Investment in LLP- Sch. VI of NDI Rules

- ❖ **Contribute to the capital of an LLP operating in sectors/ activities where**
 - Foreign investment up to 100% is permitted under automatic route
 - There are no FDI linked performance conditions
 - Investment in compliance of LLP Act, 2008
- ❖ **No FDI in LLP in following cases:**
 - Sectors with performance linked conditions. [E.g. FS, Real Estate, Single Brand Retail]
 - Sectors eligible to receive less than 100% FDI under Automatic Route
 - Sectors where FDI possible only with Govt. permission
 - Agriculture / Plantation / Print Media / Private Security
 - Sectors not opened up for FDI Tobacco / Railways

- ❖ **Foreign Investors not allowed to Invest in LLP:**
 - Pakistani / Bangladeshi entity / citizen
 - FVCI
 - FPI
- ❖ **Meaning of FDI Linked Performance Conditions:**
 - FDI linked performance conditions are the sector specific conditions stipulated in Rule 3 of Schedule I to these Rules for companies receiving foreign investment
- ❖ **Pricing**
 - Capital Contribution \geq FMV worked out as per any Int'l Accepted Valuation Methodology by CA / CMA / Regd. Valuer
 - Transfer of Capital Contribution or profit Share from R to NR \geq FMV & vice versa

- **Payment**
 - Only Cash Consideration
 - Inward remittance / NRE / FCNR (B) Account
- Automatic Route Conversion of Co. with FDI into LLP and Conversion of LLP with FDI into Co. only if:
 - Sector where FDI up to 100% in Automatic Route
 - No FDI linked Performance Conditions
- **Other Conditions**
 - Designated Partner must be an Indian Company / Indian Resident
 - Resident DP u/s. 7 of LLP Act must be a Resident u/s. 2 of FEMA, 1999
 - DP responsible for all compliances and penalties on LLP
 - LLPs cannot avail ECBs



Investment by Foreign Venture Capital Investor (FVCI)- Sch. VII of NDI Rules

❖ Subject to terms & condition as laid down by CG, FVCI may purchase:

- Securities issued by Indian company engaged in sector in which FVCI is allowed to invest
- Units of Venture Capital Fund (VCF) or of a Cat I AIF or units of scheme/ fund set up by VCF/ Cat-I AIF.
- Equity/ equity linked instrument/ debt instrument issued by an Indian start up irrespective of the sector in which start up is engaged . Definition of start up would be as given in DPIIT's notification no. G.S.R. 364(E) dated 11.04.2018.
- If the investment is into the equity instrument, then the sectoral caps/ entry routes/ attendant conditions will apply.

❖ Downstream investment regulations to apply for further investments by VCF / Cat-I AIF

❖ FVCI may purchase the securities or instrument from issuer/ person holding the instrument

❖ FVCI may acquire/ transfer to any person resident in or outside India, any security or instrument at a price that is mutually acceptable to the buyer and seller/ issuer. Thus valuation norms shall not apply.

❖ **Mode of Payment:**

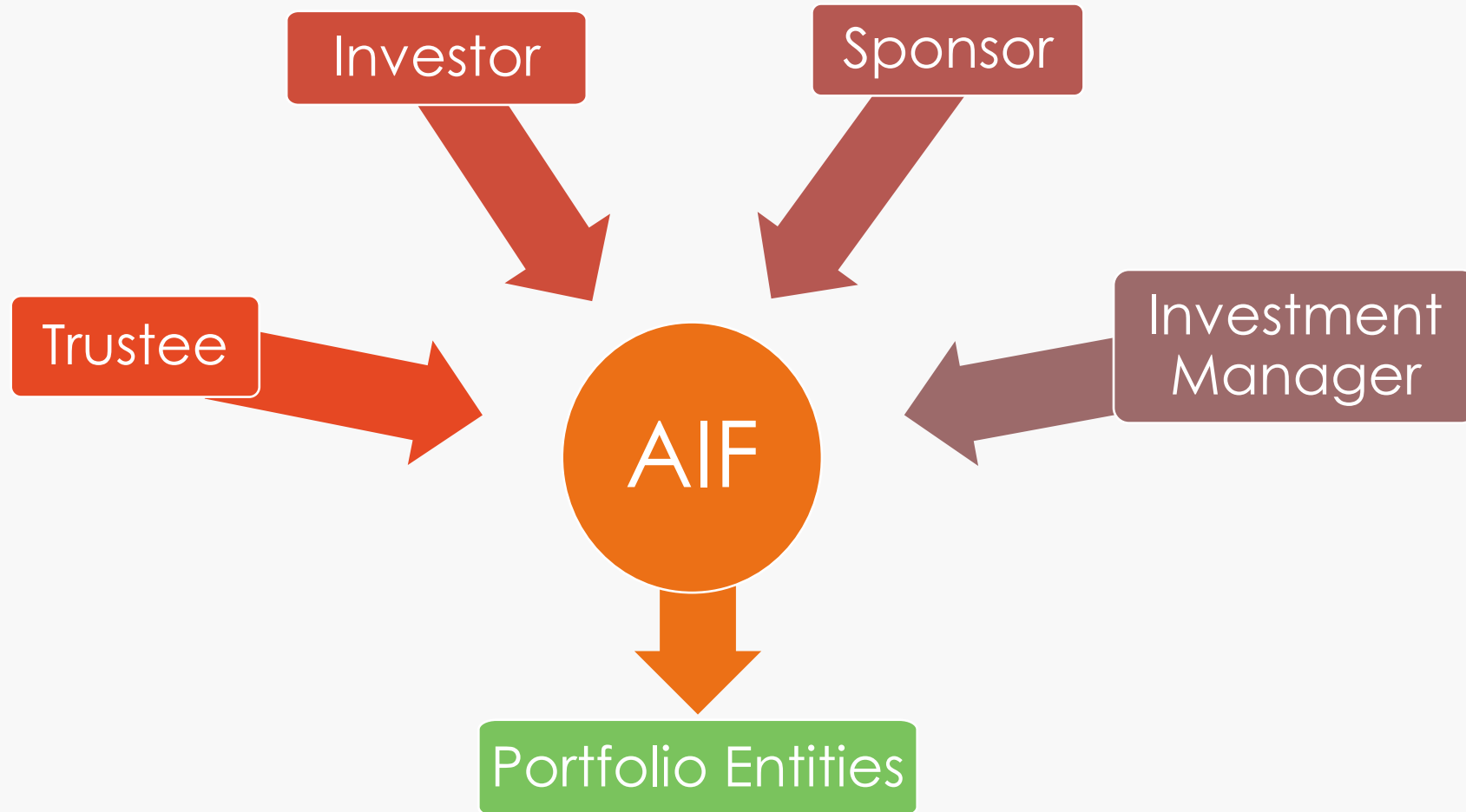
- Inward remittance from abroad through banking channels or
- out of funds held in Foreign Currency/SNRR account.

❖ **Remittance of sale proceeds:**

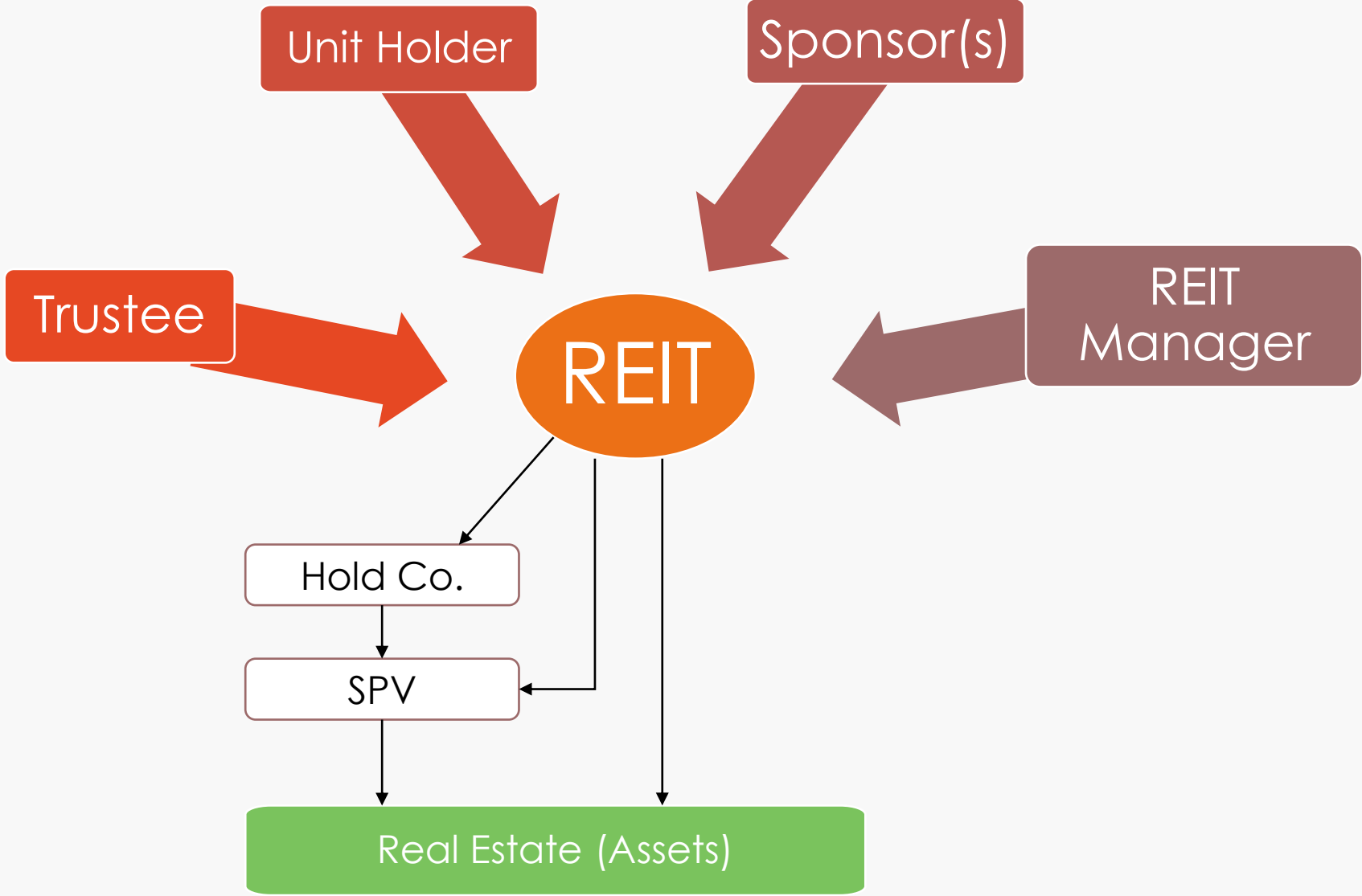
- May be credited to the Foreign Currency/ SNRR account.[Net of Taxes]

Investment in Investment Vehicle - Sch. VIII of NDI Rules

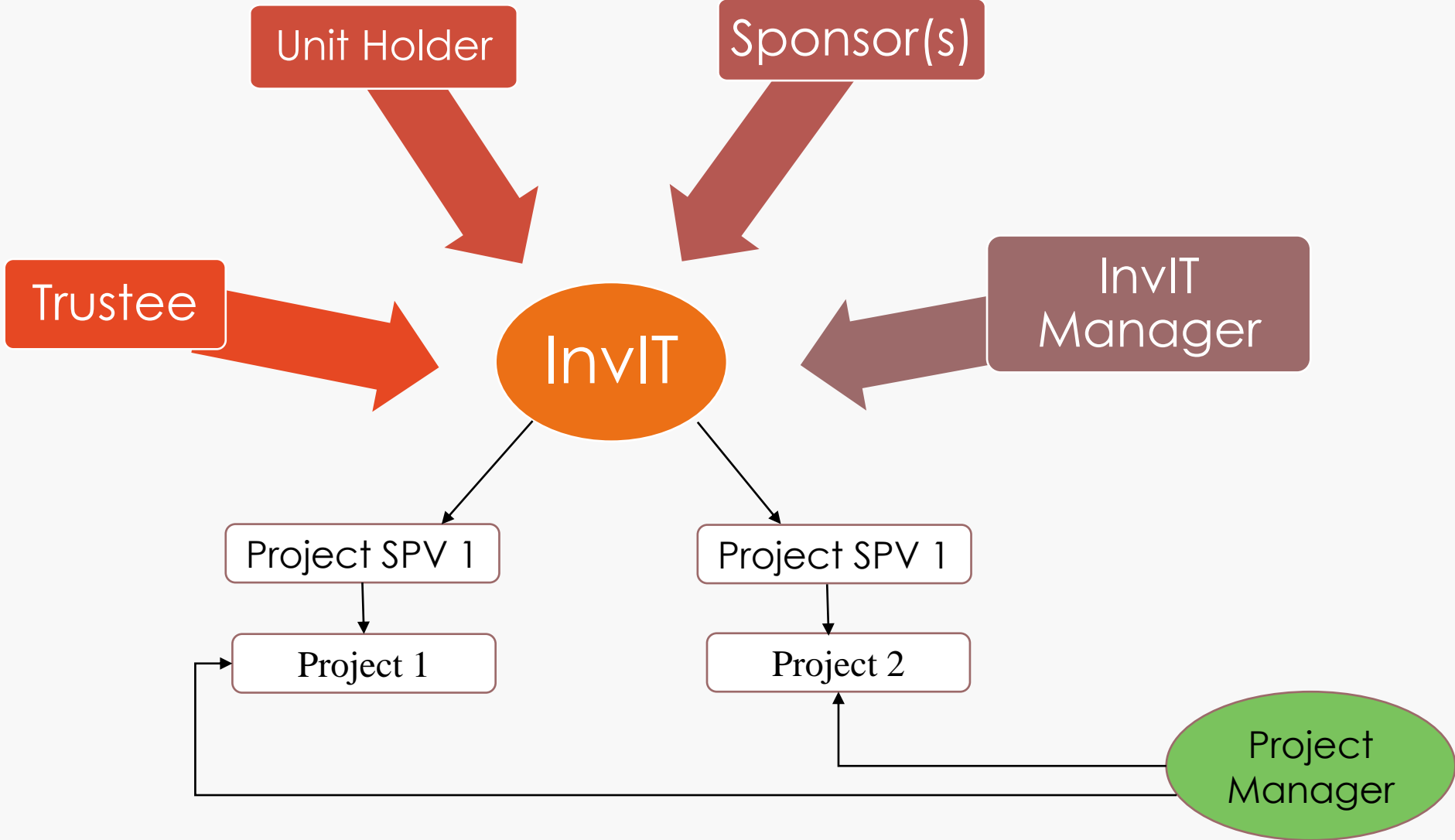
Typical Structure of AIF



Typical Structure of REIT



Typical Structure of InvIT



Investment in Investment Vehicle - Sch. VIII of NDI Rules

- ❖ PROI (other than a citizen of Pakistan or Bangladesh) or an entity incorporated outside India (other than entity incorporated in Pakistan or Bangladesh) may invest in units of Investment Vehicle.
 - ❖ PROI who has acquired/ purchased units may sell/ transfer in any manner or redeem the units as per regulation framed by SEBI/ direction issued by the Reserve Bank.
 - ❖ Investment Vehicle may issue its units to PROI against swap of equity instrument of a SPV proposed to be acquired by such Investment Vehicle
 - ❖ Investment made by IV into an India entity shall be reckoned as indirect foreign investment if Sponsor/ manager/ investment manager:
 - is not owned and controlled by resident Indian citizen; or
 - is owned or controlled by PROI
- ❖ Cat-III AIF which has received investment from FPI can invest only in those securities/instruments in which an FPI can directly invest.
 - ❖ **Mode of Payment:** Inward remittance from abroad through banking channels or out of funds held in NRE/ FCNR (B) account.
 - ❖ **Remittance of sale proceeds:** Sale proceeds (net of taxes) of the units may be remitted outside India or may be credited to the NRE/ FCNR (B) account.

Investment in Depository Receipts- Sch. IX of NDI Rules

- ❖ Issue or transfer of eligible instrument to a foreign depository for the purpose of issuance of depository receipts by eligible persons(s):
 - Any security in which PROI is allowed to invest under these rules shall be eligible instrument
 - Eligibility to issue/ transfer eligible instrument to foreign depository
 - Domestic custodian may purchase eligible instrument on behalf of PROI for converting instruments into depository receipts in terms of Depository Receipt Scheme, 2014 (DR Scheme, 2014)
 - Eligible instrument transferred/ issued to foreign depository + eligible instrument already held shall not exceed the limit on foreign holding
 - Eligible instrument shall not be issued/ transferred at a price less than the price applicable to a corresponding mode of issue/ transfer of such instrument to domestic investor
 - Depository Receipt issued under The Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 shall be deemed to have been issued under corresponding provision of DR Scheme 2014.

Issue of Indian Depository Receipts – Sch. X of NDI Rules

- ❖ Companies incorporated o/s India may issue IDRs through a domestic depository to a PRI/ PROI subject to:
 - Issue is in compliance with Companies (Registration of Foreign Companies) Rules 2014 and the SEBI (Issue of Capital and Disclosure Requirement) Regulation 2009
 - Issue of IDRS by financial/ banking companies having presence in India (either through branch/ subsidiary) shall require prior approval of sectoral regulator(s)
 - IDRs shall be denominated in INR only
 - Proceeds of the IDRs shall be immediately repatriated outside India
- ❖ FPI/ NRI/ OCI may purchase, hold or sell IDRs subject to:
 - Limited two way fungibility of IDRs shall be permissible
 - IDRs shall not be redeemable before expiry of 1 year from date of issue

- ❖ **Mode of Payment:** Out of funds held in their NRE/ FCNR (B) account
- ❖ **Remittance of sale proceeds:** Redemption/ conversion of IDRs into underlying equity shares shall be in compliance with FEM (Transfer or Issue of any Foreign Security) Regulation 2004

Purchase/ Sale of debt instruments by a PROI- Sch. I of DI regulations

A. Permission to Foreign Portfolio Investors (FPI):

- ❖ Subject to terms and condition specified by SEBI and RBI, FPI may purchase the following debt-instrument on repatriation basis:
 - dated Government securities/ treasury bills;
 - NCDs/ bonds issued by an Indian company;
 - commercial papers issued by an Indian company;
 - units of domestic MF or ETFs which invest less than or equal to 50% in equity;
 - Security Receipts (SRs) issued by Asset Reconstruction Companies;
 - debt instruments issued by banks, eligible for inclusion in regulatory capital;
 - Credit enhanced bonds;
 - Listed non-convertible/ redeemable pref. shares or debentures issued in terms of Regulation 6 of these Regulations;
 - Securitized debt instruments, including (i) any certificate or instrument issued by a special purpose vehicle (SPV) set up for securitization of asset/s with banks, Financial Institutions or NBFCs as originators;
 - Rupee denominated bonds/ units issued by Infrastructure Debt Funds;
 - This will include instruments issued on or after 22.11.11 and held by FPIs.
 - Municipal Bonds

FPI Investment in corporate debt securities

- ❖ Under FPI investment limits A.P. (DIR Series) Circular No 31 dt June 15 2018)[Updated up to February 26 2021]
 - Permitted to invest in corporate debt with **Minimum residual maturity of 1 year**
 - Short term investments in corporate debt **<30% of total investment** by FPI in corporate debt Computation of threshold on **end of day basis**
 - Concentration limits
 - Long term FPI- 15% of prevailing investment limit
 - Other FPI -10% of prevailing investment limit
 - Single/Group investor wise limits < 50% of any issue of corporate debt

- ❖ Under VRR [A.P. (DIR Series) Circular No. 34 dt. May 24 2019 (Updated up to January 23 2020)]
 - FPIs voluntarily commit to retain a required minimum percentage of their investments in India for a period
 - Investment through this Route shall be in addition to the General Investment Limit
 - Investment under this route shall be capped at Rs 1,50,000 crore or higher of allocated amount
 - The minimum retention period shall be three years
 - No Minimum residual maturity concept
 - No concentration limit
 - No Single/Group investor wise limits
 - The minimum investment of an FPI during the retention period shall be 75% of the Committed Portfolio Size and within 3 months from date of allotment The required investment amount shall be adhered to on an end of day basis
 - FPIs can exit prior to 3 years completion by selling to other FPIs
 - Repatriation not permitted if FPI's assets fall below 75%.

B. Permission to NRIs or OCIs – Repatriation basis:

- ❖ **NRI or OCI may without limit purchase the following instrument on repatriation basis:**
 - Government dated securities (other than bearer securities) or treasury bills or units of domestic MF or ETFs which invest less than or equal to 50% equity;
 - Bonds issued by a PSU in India;
 - Bonds issued by Infrastructure Debt Funds;
 - Listed non-convertible/ redeemable preference shares or debentures (as per Reg.6);

- ❖ NRI/ OCI may purchase debt instruments issued by the banks.
- ❖ NRI may subscribe to National Pension Scheme provided he is eligible to invest.

C. Permission to NRIs or OCIs – Non-Repatriation basis

- ❖ **NRI/ OCI may without limit on non-repatriation basis:**
 - Purchase Gov. sec. (other than bearer securities), treasury bills, units of domestic MF or ETFs which invest less than or equal to 50% in equity, or National Plan/ Savings Certificates;

 - Purchase listed non-convertible/ redeemable pref. shares or debentures (as per Reg.6);

 - Subscribe to chit funds authorised by the Registrar of Chits or an officer authorised by the State Government in this behalf.

D. Permission to Foreign Central Banks or Multilateral Development Banks for purchase of Government Securities:

- Foreign Central Banks, Multilateral Development Banks or any other entity permitted by the Reserve Bank, may purchase or sell dated Government Securities/treasury bills, as per terms and conditions specified by the Reserve Bank.

❖ Mode of Payment

- **FPI:** Inward remittance from abroad through banking channels or out of funds held in foreign currency/ SNRR account.
- **NRI/ OCI (Non-Repatriation basis):** Inward remittance from abroad through banking channels or out of funds held in NRE/ FCNR(B) account.
- **NRI/ OCI (Repatriation basis):** Inward remittance from abroad through banking channels or out of funds held in NRE/ FCNR(B)/ NRO account.
- **Foreign Central Banks or Multilateral Development Banks:** Inward remittance from abroad through banking channels or out of funds held in an account opened with RBI approval.
- **Other non-resident investors:** inward remittances from abroad through banking channels.

❖ **Permission for Sale of Instrument**

- A person resident outside India who has purchased instruments in accordance with this Schedule may sell/ redeem the instruments subject to such terms and conditions as may be specified by RBI/ SEBI.

❖ **Remittance/ Credit of sale/ maturity proceeds**

- **FPI**: Remit abroad or credit to foreign currency/ SNRR account of the FPI.
- **NRI (Repatriation basis)**: Remit abroad or credit to NRE/ FCNR(B)/ NRO account.
 - However, if the payment for the purchase of instrument was made out of funds held in NRO account, credit should be made to NRO account only.
- **NRI (Non-Repatriation basis)**: Credit to NRO account.
- In all other cases, the sale/ maturity proceeds (net of taxes) may be remitted abroad or credited to an account opened with the prior permission of the RBI.

Reporting At Glance

Forms	Purposes
FC-GPR	<ul style="list-style-type: none"> • For intimating to RBI details of issue of capital instruments to PROI • E-filing within 30 days from the date of such issue • Incorporates the erstwhile ARF • RBI allots UIN /Registration
FLA	<ul style="list-style-type: none"> • Annual return on Foreign Liabilities and Assets • Indian company / LLP who has received foreign investments • E-filing on or before 15th day of July 20XX
FC-TRS	<ul style="list-style-type: none"> • For transfers between R / PROI-NR basis to PROI and PROI to R including each tranche for Reg. 10(9) cases • Resident party to file within 60 days from receipt/ payment of consideration (for stock exchange transfer –PROI) • Transfer to be recorded post AD-Bank approval
Form ESOP	Indian company issuing ESOP to file Form ESOP within 30days
Form FDI-LLP(I)	Intimating RBI receipt of capital contribution / profit shares in LLP by PROI within 30 days from the receipt of the consideration
Form FDI –LLP(II)	Disinvestment/Transfer of capital contribution/profit shares between R & NR or vice versa within 60 days of receipts
Form DI	E-filing within 30 days of allotment of capital instruments

Thank
you

