FOREIGN DIRECT INVESTMENT IN INDIA

N. RAJA SUJITH
Partner

MAJMUDAR & CO.
INTERNATIONAL LAWYERS

202, Pride Elite, 10 Museum Road, Bangalore - 560001
Tel: +91 80 41470000, Fax: +91 80 41470010
Other offices: Mumbai, New Delhi, Chennai and Hyderabad
E-mail: mailbox@majmudarindia.com
Website: www.majmudarindia.com
SYNOPSIS

- What is FDI?
- Phases of the Indian economy
- FDI and the legal framework
- Foreign Indirect investment
- Non-compliance with FDI regulations
- Role of company secretaries
What is FDI?

IMF and OECD says

➢ Cross border investment
➢ Objective – ‘establishing lasting interest’

Indian context

➢ investment by non-resident entity/person resident outside India in the capital of the Indian company as per the prescribed sectoral policies
Indian Economy

Phases

- Independence till 1991
- 1991 – 2000
- Post 2000
Independence till 1991

Controlled economy

- Protectionism
- Extensive regulation
- Public ownership
- License Raj
From 1991-2000

**Liberalization** of the economy

- Abolition of license raj
- Private sector participation
- Limited extent of FDI participation
- Gradual relaxation in the controlled economy
Post 2000

- Government to get out of owning and managing business - disinvestment policy
- Gradual relaxation in the FDI policy
<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre- 1991</td>
<td>FDI was allowed selectively up to 40% under FERA</td>
</tr>
<tr>
<td>1991</td>
<td>35 high priority industry groups were placed on the Automatic Route for FDI up to 51%</td>
</tr>
<tr>
<td>1997</td>
<td>Automatic Route expanded to 111 high priority industry groups up to 100%/ 74%/ 51%/50%</td>
</tr>
<tr>
<td>2000</td>
<td>All sectors placed on the Automatic Route for FDI except for a small negative list</td>
</tr>
<tr>
<td>Post 2000</td>
<td>Many new sectors opened to FDI; viz., insurance (26%), integrated townships (100%), mass rapid transit systems (100%), defence industry (26%), tea plantations (100%), print media (26%). Sectoral caps in many other sectors relaxed;</td>
</tr>
</tbody>
</table>
The present picture

- India - fourth largest economy in Purchasing Power Parity
- Projected GDP growth rate for 2011-12 – 9%
- FDI inflow
  - April-Jan 2010-11 is **USD 17.08 billion**
  - April-Jan 2009-10 is **USD 22.96 billion**
- Drop attributed to financial troubles in the several European economies
FDI and the legal framework

Regulated under *Foreign Exchange Management Act, 1999* and the various regulations framed under it

**Regulators**

- RBI
- FIPB, Department of Economic Affairs, Ministry of Finance
- DIPP, Ministry of Commerce and Industry
FDI and the legal framework

Sector specific

- 100% FDI allowed in almost all sectors. FDI in certain sectors is subject to certain conditions and limitations.

Entry Routes

- Automatic route – no government approval required
- Approval route – approval of the FIPB required in specified sectors

Investments subject to ‘existing venture/tie up condition’

Investment Routes

- By subscription of fresh shares
- By acquisition of existing shares through transfer
Prohibited in certain sectors

- Retail Trading (except single brand retail)
- Atomic Energy and Railway transport (other than mass rapid transport system)
- Manufacturing of any form of tobacco or tobacco substitutes
- Certain kinds of agriculture
- Lottery business, gambling and betting
- Real estate business/construction of farm houses
## Certain key sectors

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Permitted FDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and carry wholesale trading</td>
<td>100 %</td>
</tr>
<tr>
<td>Single brand retail trading (after FIPB approval)</td>
<td>51 %</td>
</tr>
<tr>
<td>Information Technology and BPO</td>
<td>100 %</td>
</tr>
<tr>
<td>Development of Townships, Housing, Built up Infrastructure and Construction- development projects</td>
<td>100 %</td>
</tr>
<tr>
<td>Telecommunications (after FIPB approval)</td>
<td>74 %</td>
</tr>
<tr>
<td>Power</td>
<td>100 %</td>
</tr>
<tr>
<td>Biotechnology</td>
<td>100 %</td>
</tr>
<tr>
<td>SEZ and Free Trade Warehousing Zones</td>
<td>100 %</td>
</tr>
<tr>
<td>Drugs and Pharmaceuticals</td>
<td>100 %</td>
</tr>
<tr>
<td>Insurance</td>
<td>26 %</td>
</tr>
<tr>
<td>Agriculture (specified) and animal husbandry</td>
<td>100 %</td>
</tr>
</tbody>
</table>
Who can invest?

- A non-resident entity (except citizen/entity incorporated in Pakistan)
- Citizen/entity incorporated in Bangladesh – only approval route
- NRIs resident in Nepal/Bhutan and citizens of Nepal/Bhutan – subject to certain conditions
- Erstwhile OCBs (with prior approval through both routes)
- FIIs (certain compliances mandatory)
- FVCIs
- Only FII/NRIs permitted to invest in Indian companies in Indian stock exchanges directly
OCBs

Derecognized as class of investor from w.e.f. September 16, 2003
Erstwhile OCBs can make fresh investment under FDI policy as incorporated NR entities

IF:
- Not under the adverse notice of RBI
- With prior approval of GOI if investing through approval route
- With prior approval of RBI if investing through automatic route

Issue of shares
- Rights shares – with prior permission of RBI
- Bonus shares – without approval of RBI
- Under DRs – not eligible to subscribe if not eligible to invest in India

Transfer of shares from resident to erstwhile OCBs – not permissible
FVCIs

- Registration with SEBI as FVCI under the SEBI (FVCI) Regulations, 2000
- Registration not mandatory but brings certain advantages

Example:
- No pricing guidelines applicable during entry and exit
- Lock in benefits

- FVCIs may invest in unlisted domestic companies in sectors which are not in the negative list
Permitted entities for FDI

- Indian company
- Partnership Firm/ Proprietary Concern
- Trusts

FDI in resident entities other than those mentioned above is not permitted
Investment Structures

**Traditional modes**
- Distribution or Agency or Franchise business model
- Mostly used in retail sector

**Entry strategies**
- Liaison office
- Branch office
- Project Office
- Joint Venture/Wholly Owned Subsidiary
Investment Structures (contd.)

- **Liaison office**
  - Cannot perform activities that generate revenue – not subject to Indian taxes

- **Branch office**
  - Treated as a foreign company – taxed at 40% plus applicable surcharge – cannot perform manufacturing

- **Project Office**
  - for undertaking activities incidental to a project in India – taxed at 40% plus applicable surcharge

- **Joint Venture/Wholly Owned Subsidiary**
  - It is an Indian company – taxed at 30% plus applicable surcharge
Instruments of investment

Equity
- Equity shares
- Fully, compulsorily and mandatorily convertible debentures
- Fully, compulsorily and mandatorily convertible preference shares

This is subject to pricing guidelines/valuations prescribed under FEMA

Debt
- Non-convertible, optionally convertible or partially convertible preference shares
- Non-convertible, optionally convertible or partially convertible debentures

Debt instruments will attract ECB Guidelines
Investment routes

**Issue of fresh shares**
- Shares to be issued within 180 days from date of receipt of subscription money
- If not issued within the specified time period – refund of money
- Exceptional cases - RBI considers extending the time period based on merits of case

**Issue price**
- Listed company - SEBI guidelines
- Unlisted company – valuation certificate by CA

**Transfer of shares**
- Pricing guidelines applicable
- When transfer is from:
  - R to NR (incorporated non-resident entity other than erstwhile OCBs, foreign national, NRI, FII)
  - NR (incorporated non-resident entity, erstwhile OCBs, foreign national, NRI, FII) to R
- Should not exceed individual limit/sectoral caps/ foreign equity participation under ceilings post transfer
Investment routes (contd.)

**Documentation for transfer**

From R to NR
- Consent letter
- Power of Attorney (if applicable)
- Shareholding pattern of the investee company
- CA’s certificate
- Broker’s note (if sale on stock exchange)
- Undertaking from buyer
- Undertaking from FII/sub account

From NR to R
- Consent letter
- Power of Attorney (if applicable)
- RBI approvals (in case of NRIs/OCBs)
- CA’s certificate
- No objection/tax clearance certificate from IT authority/CA
- Undertaking from buyer
## FDI and downstream investment

<table>
<thead>
<tr>
<th>FDI</th>
<th>Rule</th>
<th>Downstream investment</th>
<th>Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>In Operating company</td>
<td>Governed by relevant sectoral policies</td>
<td>In Operating companies by operating cum investing company</td>
<td>Governed by relevant sectoral policies</td>
</tr>
<tr>
<td>In Operating and investment company</td>
<td>Notification to FIPB within 30 days of investment</td>
<td>In Operating company by investing company</td>
<td>Governed by relevant sectoral policies</td>
</tr>
<tr>
<td>In investment companies</td>
<td>Requires prior FIPB approval</td>
<td>by Non-operating and non-investing company</td>
<td>Governed by relevant sectoral policies</td>
</tr>
<tr>
<td>In Non-operating and non-investing company</td>
<td>Requires prior FIPB approval</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Downstream Investment-thumb rules

- FDI in company A – and then Company A invests in Company B – A & B are both Indian companies

- Whether A is “owned” and “controlled” by resident Indians, or by companies “owned” and “controlled” by resident Indians
  - **Yes** – No FDI in Company B
  - **No** – Entire investment by A in B reckoned as FDI – however, if B is wholly owned by A, FDI in B = FDI in A
Illustration 1

No foreign investment in the Indian operating company as the Indian investing company is owned and controlled by resident Indian citizens.
Illustration 2

As the Indian investing company is owned by the foreign company, indirect foreign investment in the Indian operating company will be taken as 51%, i.e., the entire shareholding of the Indian investing company into the Indian operating company.
Illustration 3

As the Indian operating company is 100% owned by an Indian investing company, which is, in turn, owned and controlled by the foreign company, indirect foreign equity in the Indian operating company will be 65%.
Reporting of Inflow

Issue of shares
Intimation to RBI within 30 days of receipt of funds
- Allotment of shares within 180 days of receipt of funds
- Filing of form FC-GPR along with certain documents (including certification from company secretary) within 30 days of allotment of shares

Transfer of shares
- Between resident to non-resident and vice-versa – form FC-TRS to be filed within 60 days of the receipt of the amount of consideration
- Onus of filing – transferor/transferee resident in India
Remittance & Repatriation

Remittance of sale proceeds

- Sale proceeds sold by person resident outside India may be remitted outside India
- In case of FII- credit to Special Non-resident rupee account
  NRI- credit to his NRE/FCNR(B) accounts (repatriation basis)
  credit to his NRO account
Remittance & Repatriation (contd.)

Remittance on winding up/liquidation of Company

- AD Category – I banks permitted to remit winding up proceedings which are under liquidation subject to provision of:
  - No objection/tax clearance certificate from IT department
  - Auditor’s certificate regarding liability
  - Auditor's certificate regarding winding up
  - Auditor’s certificate regarding pending legal proceedings (in case of winding up of company otherwise than by a court)
Remittance & Repatriation (contd.)

Repatriation of dividend
- Freely repatriable without any restrictions
- Governed by provisions of FEM (Current Account Transactions) Rules, 2000

Repatriation on Interest
- Interest on fully, mandatorily and compulsorily convertible debentures is freely repatriable without restrictions
- Governed by provisions of FEM (Current Account Transactions) Rules, 2000
External Commercial Borrowings

- **Automatic route** – no approval required
- **Eligible borrowers** – Indian companies except those engaged in financial sector
- **Eligible lenders** – international banks, international capital markets, multilateral financial institutions, export credit agencies, suppliers of equipment, foreign collaborators and foreign equity holders with the prescribed equity holding (other than erstwhile OCBs)
- **Permissible end-uses** – capital investments, overseas acquisitions, etc. – excludes general corporate purposes, working capital requirements and real estate sector
- Corporate other than hotel, hospital and software company can avail USD 500 million per year
ECB (contd.)

- **Security** – choice of parties – NOC required from Authorized Dealer for security in shares, immovable property and issuance of guarantees

- Approval route – Cases not falling within the automatic route

- In either case, loan has to be registered with the RBI before draw-down – thereafter, monthly reports regarding utilization
Conversion of ECB

Permitted under following conditions:

- Activity of the company falls under automatic route / approval has been obtained if activity falls under approval route
- Foreign equity holding after such conversion is within the sectoral cap, if any
- Pricing of shares is as per SEBI guidelines – listed company
  Valuation of CA – unlisted company

Borrowers to report:

- In form FC-GPR to regional office, RBI and form ECB-2 to DSIM, RBI within 7 days from the close of the month to which it relates
- In case of partial conversion, the outstanding portion of ECB shall be reported in ECB-2 to DSIM, RBI in the subsequent months
Non-compliance with FDI regulations

Adjudicating authorities – officers of the central Government
Appellate Tribunals to hear appeals

Penalties
- up to thrice the sum involved where amount is quantifiable
- up to Rs. 2 Lakhs if amount not quantifiable
- up to Rs. 5,000 per day if case of continuing contravention
- Confiscation of currency/property involved in contravention may be confiscated by Government in addition to the above penalties imposed.
Non-compliance with FDI regulations

Compounding:

- Compounding authority appointed by Central Government
- For compounding the amount involved in contravention should be quantifiable
- Not later than 180 days from application to the compounding authority an order shall be passed
- Any subsequent contravention after expiry of 3 years from the previous contravention shall be deemed as first contravention
Role of company secretaries

- Catalyst between the company and authorities
- Thorough knowledge of FEMA
- Vital role in compliance certifications
Thank You

MAJMUDAR & CO.
INTERNATIONAL LAWYERS

202, Pride Elite, 10 Museum Road,
Bangalore – 560001
Tel: +91 80 41470000, Fax: +91 80 41470010
Other offices: Mumbai, New Delhi, Chennai and Hyderabad
E-mail: mailbox@majmudarindia.com
Website: www.majmudarindia.com