The Institute of Company Secretaries of India

Investing in India

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Overview of FDI Regulations

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Section 1

Background

Background

- In the early 20th century, focus was on 'exchange control'
- Post independence, State's role was dominant in industrial licensing – 'License Raj'
- FERA focused on 'controlling' and 'conserving' foreign exchange transactions – permitted only certain transactions and had stringent penal provisions
- Economic liberalization in 1991 born out of a severe foreign exchange crisis
- New Industrial Policy of 1991 abolished industrial licensing in all, but 16 industries and threw open India's doors to FDI
- The SIA was then responsible for approving FDI proposals
- FEMA, 1999 was enacted with the objective of facilitating external trade and payments and for promoting the 'orderly development' and 'maintenance' of foreign exchange markets in India
- Now foreign exchange transactions are permitted, unless specifically prohibited/ regulated
- FEMA mainly a civil law with monetary fines prescribed for contravention; FERA penal provisions shifted to the Prevention of Money Laundering Act, 2002

From FERA to FEMA – quantum leap in perspective!

Key Regulators

FEMA

Central Govt.

Department of Industrial Policy & Promotion (DIPP)

- Under the Ministry of Commerce & Industry
- Policy maker
- Co-ordinates with industry bodies
- SIA to provide investor guidance, process applications
- Annual consolidated FDI policy, Press Notes, Press Releases & Discussion Papers

Foreign Investment Promotion Board (FIPB)

- Secretarial body, chaired by Secretary, Dept. of Economic Affairs, Ministry of Finance
- Administrative body- clears FDI proposals
- Provides clarifications
- Publishes meeting details and approved cases

RBI

Foreign Exchange Department

- RBI set up under the RBI Act, 1934
- Derives its power from Section 5 (current account transactions) & 6 (capital account transactions) of the FEMA
- All Regulations like FDI & ODI are notifications of the RBI under the FEMA
- RBI also issues A.P. (Dir) Circulars- essentially, directions to Ads (Section 10 and 11 of the FEMA)
- Annually, Master Circulars issued as part of a consolidation exercise

Section 2

Entry Options for FDI

Choice of Entity

- ***Company – either a JV/ WOS***
- ***Liaison/ Branch/ Project Office***
- ***Partnership Firm/Proprietary Concern***
- ***LLP***

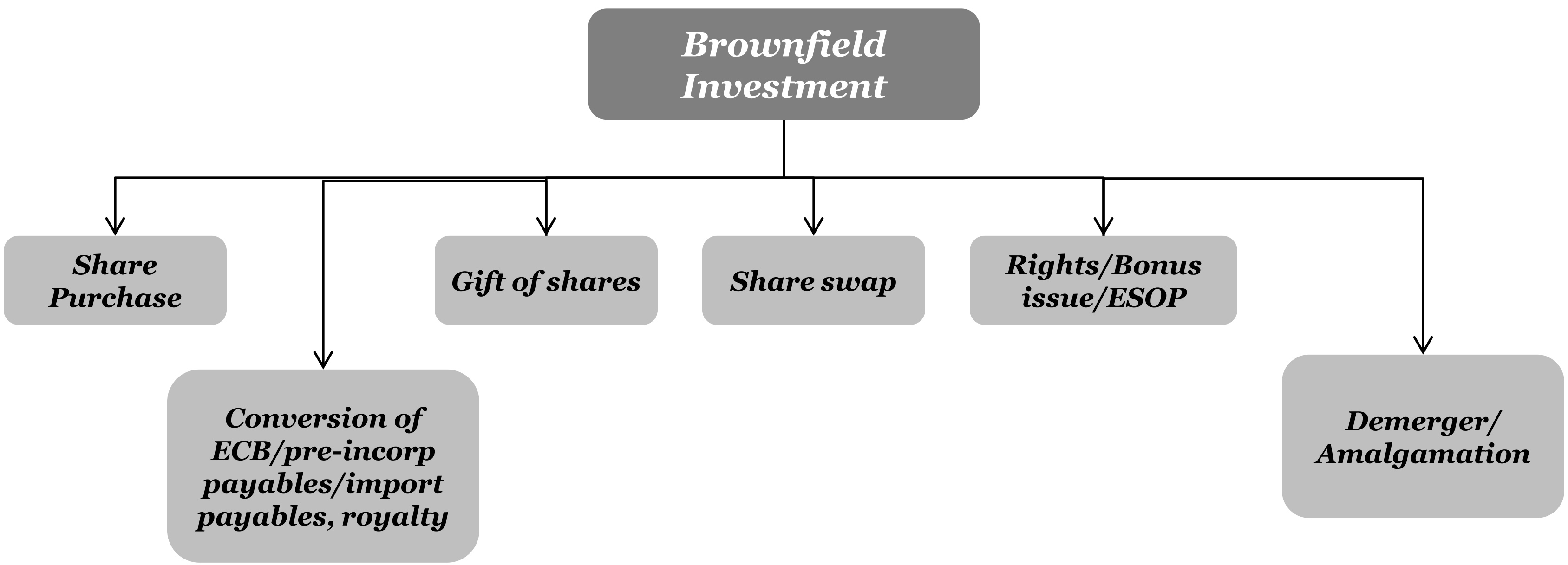
Foreign Investment into an Indian company

Kinds of Investment

- Automatic Route – no prior approval from the RBI/Government
- Approval Route- prior approval of the FIPB required (no separate RBI approval)

Mode of Investment

- Greenfield : Setting up a new JV/WOS (fresh issue of shares/ADR/GDR)
- Brownfield: Relating to existing investments/business activities



Sectors where FDI is prohibited

- Lottery business including Government /private lottery, online lotteries
- Gambling & betting including casinos
- Business of chit fund
- Nidhi company
- Trading in Transferable Development Rights (TDRs)
- Real estate business or construction of farm houses
- Manufacturing of cigars, cheroots, cigarillos & cigarettes, of tobacco or of tobacco substitutes
- Activities/sectors not opened to private sector investment including atomic energy and railway transport (other than mass rapid transport systems)

100% FDI permitted through Automatic Route

- Agriculture & animal husbandry
- Almost all forms of manufacturing and service industries
- Mining
- Coal & lignite
- Electricity generation, transmission, distribution & trading (not in atomic plants)
- E-commerce activities (B to B)
- SEZ development
- Development of townships, housing, built-up infrastructure & construction-development projects
- Industrial parks
- NBFCs
- Petroleum & natural gas sector
- Cash & carry wholesale trading/ wholesale Trading (including sourcing from MSEs)
- Airports – Greenfield projects

Section 3

Funding Options

Funding Options

- Equity Shares
- Compulsorily Convertible Preference Shares
- Compulsorily Convertible Debentures
- External Commercial Borrowings
- Optionally Convertible Preference Shares
- Optionally Convertible Debentures

Equity Shares & CCPS

Equity Shares

- Simplest mode for funding
- No end use restrictions
- Pricing guidelines applicable
- Limited repatriation options – DDT payable

Compulsorily Convertible Preference Shares

- Preference Shares have preferential right over Equity Shares, in terms of:
  - Repayment of capital on winding-up of the company
  - Payment of dividend
- Preference Shares have to be compulsorily redeemed/ converted within 20 years
- Only fully and mandatorily Convertible Preference Shares are construed as part of equity and considered as FDI
- All other forms of preference shares construed on par with ECB
- Maximum dividend: SBI PLR + 3% – DDT payable
- No end use restrictions

CCD

Compulsorily Convertible Debentures

- Only Fully and Mandatorily Convertible Debentures are construed as part of equity and considered as FDI
- All other forms of debentures construed on par with ECB
- No time limit for conversion prescribed
- Interest payment to comply with Indian transfer pricing regulations
- Interest deductible in hands of the company – Lower cost of capital
- Interest income would be taxable in the hands of debenture holders as per IT Act or DTAA
- The applicable withholding tax rate under the IT Act would be 43.26%
- Interest payment to non-residents – taxes to be withheld
- No end use restrictions

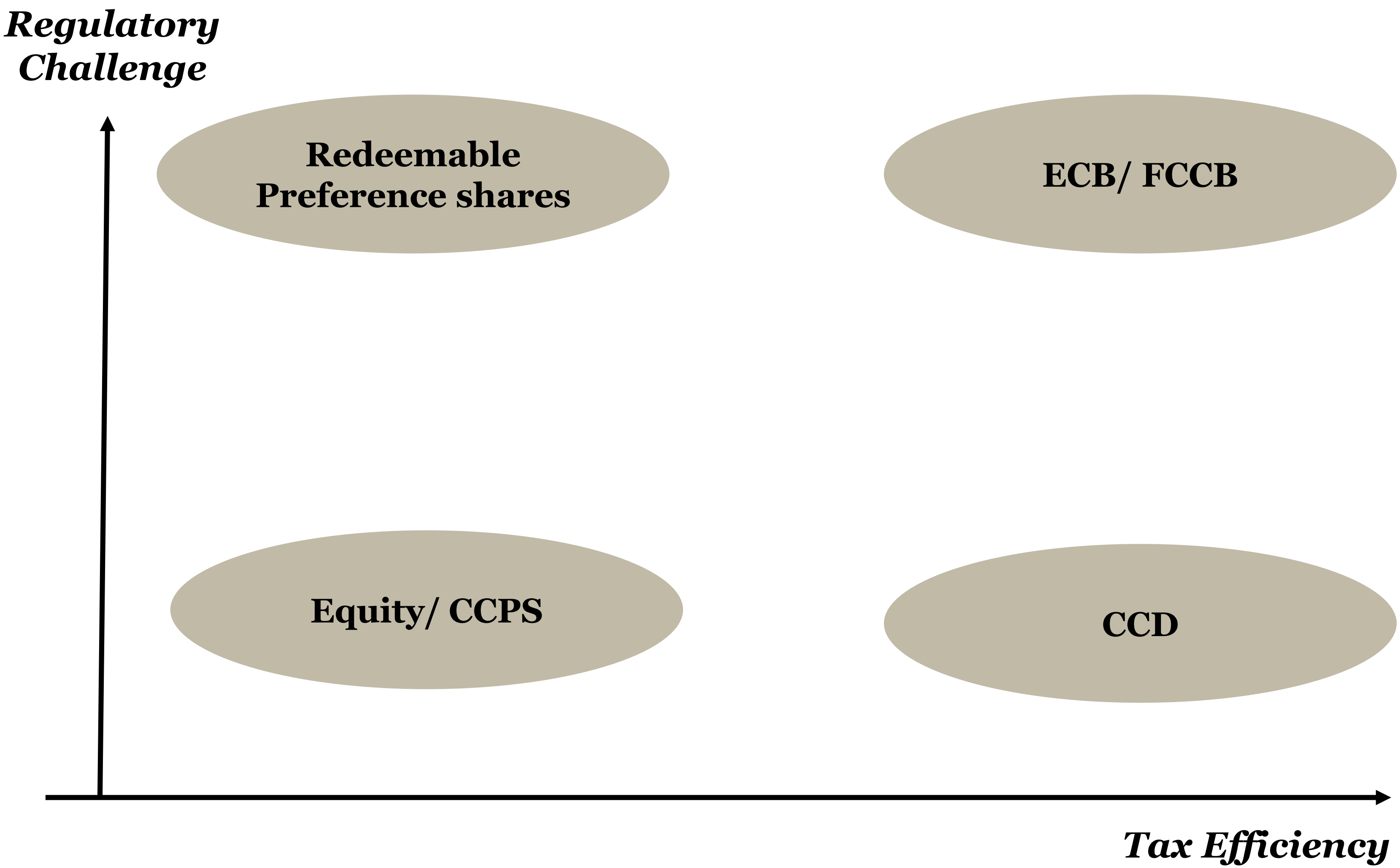
ECB

- ECB means overseas foreign currency borrowings by Indian companies
- Automatic route/ approval route
- Recognized lenders for raising ECB:
  - International banks, multilateral financial institutions (such as IFC, ADB, CDC etc.)
  - Export credit agencies and suppliers of equipment
  - Foreign collaborators or foreign equity holders holding at least 25% in the equity share capital of the Indian company
  - Ultimate holding company/ group companies
- ECB liability-equity ratio shall not exceed 4:1 for ECB > USD 5 mn from holding co
- Entities in manufacturing, services, software, hotels, hospitals can access ECB
- Limits:
  - Non-services sector – USD 750 mn per FY
  - Services sector – USD 200 mn per FY
- Minimum average maturity/ repayment period
  - ECB upto USD 20 million – 3 years
  - ECB above USD 20 million – 5 years

ECB

- Payment of interest – All-in-cost ceilings:
  - Maturity period between 3 to 5 years – LIBOR + 350 basis points
  - Maturity period more than 5 years – LIBOR + 500 basis points
- Permitted end uses:
  - Capital expansion
  - Outbound investment
- End-use restrictions – ECB proceeds cannot be utilized for:
  - Repayment of rupee loans
  - Investment in real estate
  - Deployment in capital markets and acquiring an Indian company
  - General working capital and corporate purposes
- Withholding tax rate – 5%++/ 21.115%
- Ease in repatriation of funds

Funding Options – Comparison



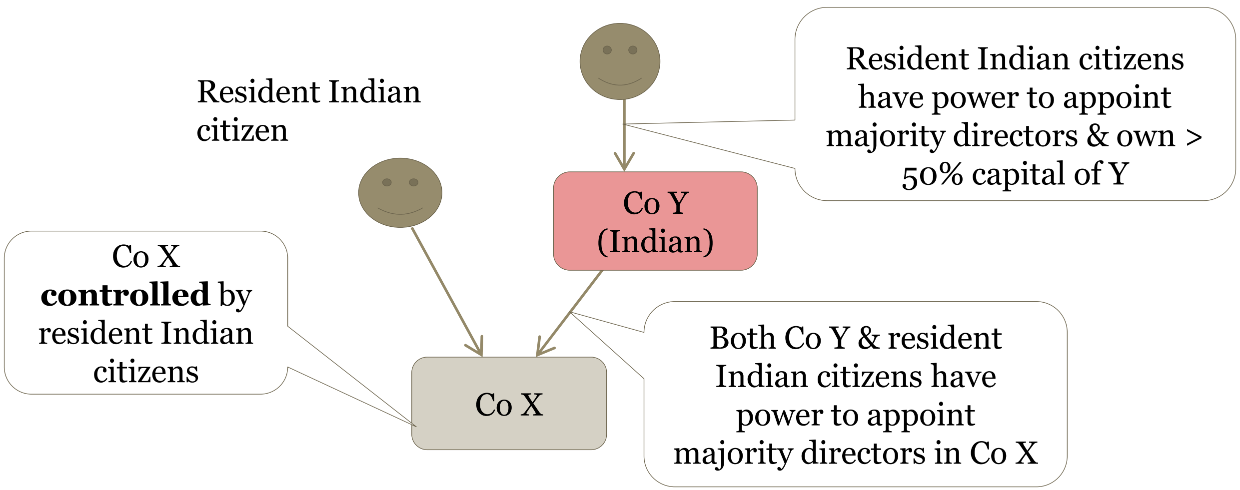
Funding Options – Classification

Funding Instruments	Exchange Control	Income Tax
Equity Shares	Equity	Equity
CCPS	Equity	Equity
CCD	**Equity**	**Debt**
RPS/ OCPS	**Debt**	**Equity**
ECB/ Loans/ Debt/ OCD/ PCD	Debt	Debt

CCD – Most Tax & Regulatory Efficient Instrument

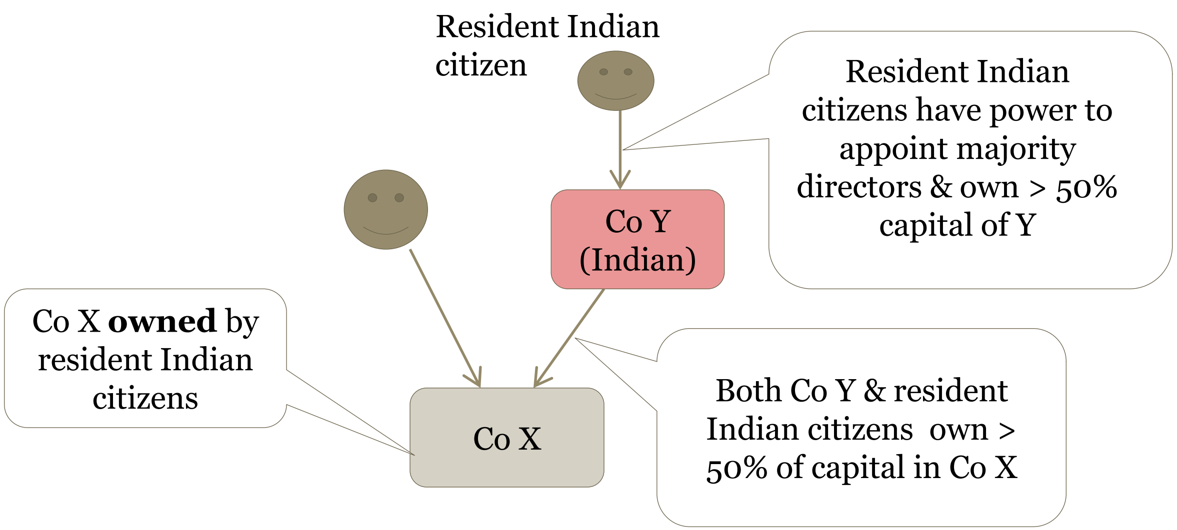
Downstream Investments

'Controlled by resident Indian citizens'



Downstream Investments

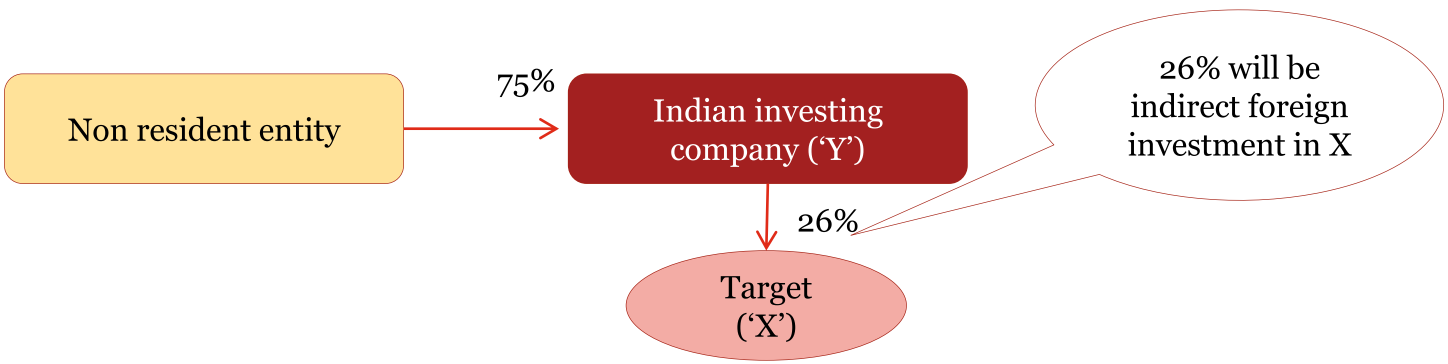
'Owned by resident Indian citizens'



Downstream Investments

- Calculation of total foreign investment in a company : **direct + indirect**
  - Direct- All investments held directly by non resident entity
  - Indirect
- ***<u>Calculation of indirect foreign investment</u>***

  In case the investing Indian company is owned **or** controlled by 'non resident entities', the entire investment by such company into the target would be considered as indirect foreign investment

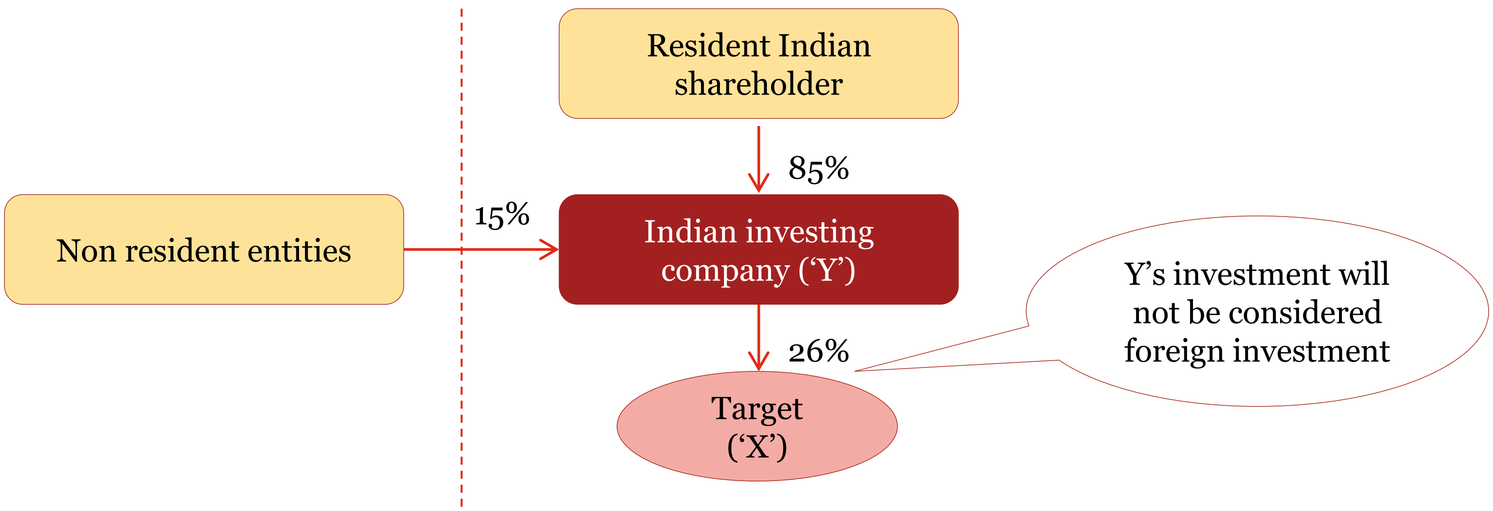


•Downstream investments by such companies are to be notified to SIA/FIPB

Downstream Investments

Calculation of indirect foreign investment…

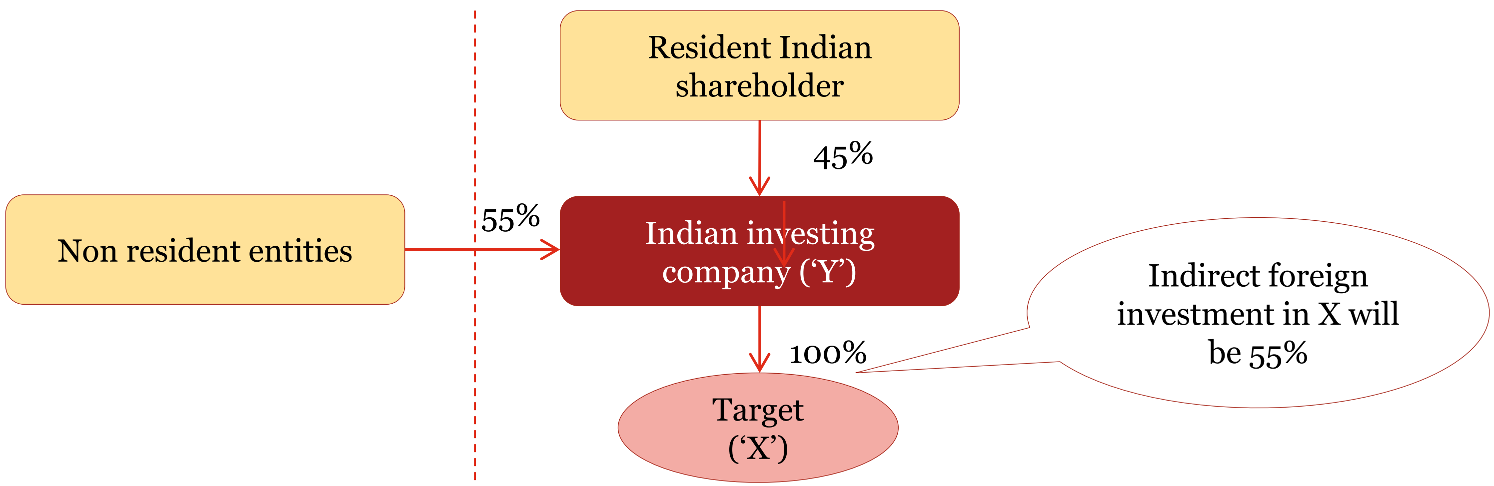
In case the investing Indian company is owned **and** controlled by resident Indian citizens and/or Indian companies which are owned and controlled by resident Indian citizens, investment by such company into the target will not be considered foreign investment



Downstream Investments

Calculation of indirect foreign investment…

Indirect foreign investment in 100% owned subsidiaries of an investing Indian company, will be limited to the foreign investment in such Indian company



Section 4

Trading – SBRT/ MBRT/ WCC

FDI Policy – Trading Sector

Wholesale / Cash & Carry Trading

- 100% FDI permitted under Automatic Route
- Restriction on Sales to group companies, in excess of 25%

Multi Brand Retail

- 51% FDI permitted with FIPB approval
- Local Sourcing Norms Applicable

Single Brand Retail

- **100%** FDI permitted with FIPB approval
- Local Sourcing Norms Applicable for FDI > 51%

Subject to Conditions

Retailing is allowed, Retail Trading is regulated

B2C e-commerce prohibited for FDI

Wholesale Trading

Eligible Customers

- Sales tax/ VAT registration/ service tax/ excise duty registration holders
- Trade license holders
- Permits/ license, etc. from Government Authorities
- Certificate of incorporation or society registration or trust registration

Sales to Group Companies

- Wholesale trading to group companies not to exceed 25% of the total turnover of the wholesale venture
- Meaning of ‘group company’ not specified

Single Brand Retail Trading

Key Aspects	• ***Up to 100% FDI with Government Approval – Increased from 51% earlier*** • Single Brand products only • Sold internationally under same brand • Products to be branded during manufacturing • The investor should be the brand owner
Local Sourcing	• 30% mandatory sourcing of the value of goods ***purchased*** from India, ***preferably*** from MSME (does not apply in case the FDI is capped to 51%)
Changes Notified	• Sourcing – From anywhere in India (preferably small industries*) – Base of purchase cost (not turnover) • Exclusive License/ Franchisee can also be Investor

Multi Brand Retail Trading

- 51% FDI Cap with Government approval
- US$ 100 mn minimum capitalization
- 50% investment in ***back-end infrastructure*** within 3 years
- Stores only in select States and Cities
- 30% procurement from small enterprises
- Compliance – averaged in first 5 years, then annual

Back-end Infrastructure

- Processing, manufacturing, distribution
- Design improvement, quality control, packaging
- Logistics, storage, ware-house, agriculture marketing infrastructure .....
- Land cost and rentals – Excluded

Section 5

Conversion of Companies into LLP with FDI

FDI in Pharma Sector, Civil Aviation Sector

Other changes

FDI in LLP & Civil Aviation

FDI in LLPs

- FDI in LLP permitted since 2011 in sectors where 100% FDI is permitted for companies under the Automatic Route, without performance linked conditions
- Prior approval of the FIPB/Government required
- ECB and downstream investments not permitted

Conversion of Companies with FDI into LLPs

- Conversion allowed on satisfaction of stipulations for non-converted LLP are met
- Condition relaxed: Foreign capital participation in LLP only by way of cash consideration, received by inward remittance

Civil Aviation

- Upto 49% FDI permitted for Foreign Airlines
- 49% limit subsumes FDI and FII investment limit
- Prior approval of the FIPB/Government required
- Control related restrictions – Principal place of business, Chairman & Directors and substantial ownership & effective control

FDI in Pharma Sector & Downstream by Banks

Pharma Sector

• Greenfield	-	100%	Automatic Route
• Brownfield	-	100%	Government Route

- FDI in Brownfield Cases – Government may incorporate appropriate conditions:
  - Production level of NLEM drugs/medical consumables and allied medical devices and their supply to domestic market should be maintained
  - R&D expenses should be maintained in value terms for 5 years at an absolute quantitative level
  - Administrative ministries concerned and the FIPB secretariat should be provided with information on transfer of technology and foreign investment

Downstream Investments by Banking Company

- Shares acquired by FOCC Banking Company under CDR, loan restructuring mechanism, in trading books, on loan defaults, shall not be regarded as indirect FDI
- Strategic downstream investments in subsidiaries, JV and associates shall be counted as indirect FDI

Downstream by NBFCs

Downstream Investments by NBFCs

- NBFCs having foreign investment more than 75%, with a minimum capital of US$ 50 mn, can set up step down subsidiaries for specific NBFC activities
- No restrictions imposed on the number of operating subsidiaries
- Minimum capitalization condition not applicable to downstream subsidiaries

Other Changes

- Broadcasting sector
- Power Exchanges

Section 6

Shares/ CCD Allotments

Shares/ CCD Allotments

Equity Shares

- Allotment of fresh shares by Indian company to NR
- Valuation as per DCF method – Minimum price
- Valuation needs to be done by a CA or Cat I Merchant Banker
- Compliance:
  - Reporting of receipt of funds within 30 days
  - Shares to be allotted within 180 days from the date of receipt of funds
  - Filing of Form FC-GPR with annexures within 30 days from date of allotment

Allotment of Equity Shares in New Companies

- Allotment of shares pertaining to the Subscribed Capital as per MoA can be carried out at face value
- Subscribed Capital as per MoA can be in excess of Rs. 1 lac / 5 lacs
- DCF valuation not applicable in such cases
- Allotment of shares at premium – Boon or Bane ??
- Shell Case

Shares/ CCD Allotments

Convertible Instruments – CCPS or CCD

- Conversion price or conversion formula to be fixed upfront
- Conversion price under conversion formula should be in compliance with pricing guidelines
- Conversion price
  - Conversion price > Current DCF value
- Variable conversion ratio – Conversion price at the lower end (maximum shares allotted) > Current DCF value
- Justification needs to be provided to RBI
- Valuation needs to be done by a CA or Cat I Merchant Banker
- Compliance:
  - Reporting of receipt of funds within 30 days
  - Shares to be allotted within 180 days from the date of receipt of funds
  - Filing of Form FC-GPR with annexures within 30 days from date of allotment of convertible instruments
  - Filing of Form FC-GPR also required on conversion

Transfer of Shares/ CCD

Transfer of Shares in Indian company by R to NR

- Equity Shares
  - Consideration for transfer > Current DCF value
- Convertible Instruments – CCPS or CCD
  - Transfer price to be determined based on conversion ratio
  - Conversion price, based on transfer price > Current DCF value
- Valuation needs to be done by a CA or Cat I Merchant Banker
- Compliance:
  - Filing of Form FC-TRS within 60 days from the date of transfer
  - Indian company can record share transfer only on receiving acknowledged Form FC-TRS

Transfer of Shares in Indian company by NR to NR

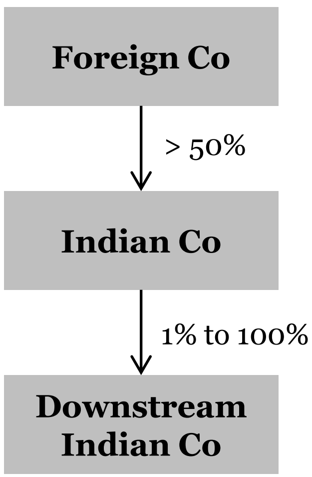
- Valuation guidelines are not applicable
- Technically, no reporting requirements

Transfer of Shares/ CCD

Transfer of Shares in Indian company by NR to R & Buy-back of Shares

- Equity Shares
  - Consideration for transfer/ buy-back price < Current DCF value
- Convertible Instruments – CCPS or CCD
  - Transfer price to be determined based on conversion ratio
  - Conversion price, based on transfer price < Current DCF value
- Valuation needs to be done by a CA or Cat I Merchant Banker
- Compliance:
  - Filing of Form FC-TRS within 60 days from the date of transfer
  - Indian company can record share transfer only on receiving acknowledged Form FC-TRS

Downstream Investments



- Investment by FOCC into another Indian company
- Covers fresh investment and acquisition of existing shares
- Regarded as Indirect FDI
- Pricing guidelines applicable to Direct FDI will equally apply
  - Investment/ consideration for transfer > DCF value
- Compliance: Filing of intimation with SIA, DIPP and FIPB within 30 days from date of investment
- Downstream buy-backs also covered by pricing guidelines
  - Buy-back price < Current DCF value
- Valuation needs to be done by a CA or Cat I Merchant Banker
- Anomaly: Downstream investment through acquisition of shares from NR
  - Indian company can record share transfer only on receiving acknowledged Form FC-TRS

Rights Issue, ESOP & Others

Rights Issue

- Price of allotment to NR should not be less than R
- Unsubscribed portion of Rights Issue can be subscribed by NR
- Position if there are no R

ESOP

- Allotment of ESOP by Unlisted Cos not specifically dealt with
- In the absence of specific waiver, normal pricing of allotment to NR should apply

Issue of shares against lump sum technical know how/ royalty, ECB, pre-incorporation expenses/ import payables

- Same guidelines as fresh allotment of shares

Bonus Issue

- Pricing guidelines not applicable
- Selective bonus ?

Changes in Form FC - GPR

Deletion of Declarations

- Declarations with respect to existing JV or technology transfer or trade mark agreement in India in the same field
- Declarations with respect to Small Scale Sector

Introduction of New Declarations

- Additional declaration under the Prevention of Money Laundering Act 2002 and the Unlawful Activities (Prevention) Act, 1967
- The foreign investment received and reported now will be utilized in compliance with the provision of a Prevention of Money Laundering Act 2002 (PMLA) and Unlawful Activities (Prevention) Act, 1967 (UAPA). We confirm that the investment complies with the provisions of all applicable Rules and Regulations

Section 7

Compounding

Compounding

Circular No.11 dated July 31, 2012

- On a contravention being identified by the RBI or brought to its notice by the entity through a reference (other than compounding application), the RBI will decide the following:
  - Whether contravention is technical and/or minor in nature
  - Whether it is material and hence compounding is required
  - Whether the issues involved are sensitive/ serious in nature and refer to DOE
- On filing of a compounding application by entity suo moto:
  - Contravention shall not be considered as 'technical' or 'minor' in nature
  - Compounding process shall be initiated
- Better to file a condonation letter/ application to assess if contravention is considered as 'technical' or 'minor'
- Assess the response from the RBI and then proceed for compounding

Compounding

Circular No. 76 dated January 17, 2013

Repetitive Contraventions

- Delay in Advance Reporting of equity remittance
- Delay in filing FC - GPR
- Delay in filing FC - TRS
- Draw down of ECB without obtaining LRN
- Draw down of ECB under auto route from unrecognized lender, to ineligible borrower, for non-permitted end uses, etc.
- Non-filing of form ODI for obtaining UIN before making the second remittance
- Non-submission of APR / copies of share certificates to the AD (and non-reporting thereof by the AD to Reserve Bank)

Section 8

Changes in ECB Policy

Changes in ECB Policy

- All in cost remains unchanged – L + 3.5%/ 5%
- Corporates under investigation
  - Allowed under the Automatic Route, subject to other applicable conditions
  - AD Banks while approving the proposal shall intimate the concerned agencies by endorsing the copy of the approval letter
- Immediate drawdown of funds meant for Rupee expenditure
  - Bifurcation of utilization of ECB proceeds towards foreign currency and Rupee expenditure to be provided in Form-83
  - Borrower shall repatriate ECB proceeds meant for Rupee expenditure in India for credit to their Rupee accounts
- Illustration for computation of average maturity provided
- Repayment of Rupee Loans
  - Companies in manufacturing and infrastructure sector and be consistent foreign exchange earner
  - Rupee loan should have been availed for 'capital expenditure'
  - Limit – 50% of the average annual export earnings realized during the past 3 FYs
  - Repayment of ECB out of forex earnings

Thank You

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Views expressed in the presentation are personal