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**SUPPLEMENT FOR  
ECONOMIC AND COMMERCIAL LAWS  
MODULE 1  
PAPER 3**

The study material Economic and Commercial Laws available on the web link: [https://www.icsi.edu/media/webmodules/publications/EC-L-AUGUST\\_2017.pdf](https://www.icsi.edu/media/webmodules/publications/EC-L-AUGUST_2017.pdf).

The students are advised to read their Study Material along with these updates. These academic updates are to facilitate the students to acquaint themselves with the amendments in the Foreign Direct Investment Policy 2017, applicable for December, 2018 Examination.

# Lesson 1

## Foreign Direct Investment Policy 2017

### INTENT AND OBJECTIVE

It is the intent and objective of the Government of India to attract and promote foreign direct investment in order to supplement domestic capital, technology and skills, for accelerated economic growth. Foreign Direct Investment, as distinguished from portfolio investment, has the connotation of establishing a 'lasting interest' in an enterprise that is resident in an economy other than that of the investor.

The Government has put in place a policy framework on Foreign Direct Investment, which is transparent, predictable and easily comprehensible. This framework is embodied in the Circular on Consolidated FDI Policy, which may be updated every year, to capture and keep pace with the regulatory changes, effected in the interregnum. The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry, Government of India makes policy pronouncements on FDI through Press Notes/Press Releases which are notified by the Reserve Bank of India as amendments to the Foreign Exchange Management (Transfer or Issue of Security by Persons Resident Outside India) Regulations, 2000 (notification No. FEMA 20/2000-RB dated May 3, 2000). These notifications take effect from the date of issue of Press Notes/ Press Releases, unless specified otherwise therein. In case of any conflict, the relevant FEMA Notification will prevail. The procedural instructions are issued by the Reserve Bank of India vide A.P. (DIR Series) Circulars. The regulatory framework, over a period of time, thus, consists of Acts, Regulations, Press Notes, Press Releases, Clarifications, etc.

### DEFINITIONS

**'AD Category-I Bank'** means a bank (Scheduled Commercial, State or Urban Cooperative) which is authorized under Section 10(1) of FEMA to undertake all current and capital account transactions according to the directions issued by the RBI from time to time.

**'Authorized Bank'** means a bank including a co-operative bank (other than an authorized dealer) authorized by the Reserve Bank to maintain an account of a person resident outside India.

**'Authorized Dealer'** means a person authorized as an authorized dealer under sub-section (1) of section 10 of FEMA.

**'Authorized Person'** means an authorized dealer, money changer, offshore banking unit or any other person for the time being authorized under sub-section (a) of section 10 of FEMA to deal in foreign exchange or foreign securities.

**'Capital'** means equity shares; fully, compulsorily & mandatorily convertible preference shares; fully, compulsorily & mandatorily convertible debentures and warrants.

The equity shares issued in accordance with the provisions of the Companies Act, as applicable, shall include equity shares that have been partly paid. Preference shares and convertible debentures shall be required to be fully paid, and should be mandatorily and fully convertible. Further, 'warrant' includes Share Warrant issued by an Indian Company in accordance to provisions of the Companies Act, as applicable.

**'Capital account transaction'** means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6 of FEMA.

**'Competent Authority'** means the concerned Administrative Ministry/Department empowered to grant government approval for foreign investment under the extant FDI Policy and FEMA Regulations.

**'Control'** shall include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements. For the purposes of Limited Liability Partnership, 'control' will mean right to appoint majority of the designated partners, where such designated partners, with specific exclusion to others, have control over all the policies of the LLP.

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

**'Depository Receipt'** (DR) means a negotiable security issued outside India by a Depository bank, on behalf of an Indian company, which represent the local Rupee denominated equity shares of the company held as deposit by a Custodian bank in India. DRs are traded on Stock Exchanges in the US, Singapore, Luxembourg, etc. DRs listed and traded in the US markets

are known as American Depository Receipts (ADRs) and those listed and traded anywhere/elsewhere are known as Global Depository Receipts (GDRs). DRs are governed by Notification No. FEMA 330/ 2014-RB, issued by Reserve bank of India.

***“Employees’ Stock Option”*** means the option given to the directors, officers or employees of a company or of its holding company or joint venture or wholly owned overseas subsidiary/subsidiaries, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

***‘Erstwhile Overseas Corporate Body’***(OCB) means a company, partnership firm, society and other corporate body owned directly or indirectly to the extent of at least sixty percent by non-resident Indians and includes overseas trust in which not less than sixty percent beneficial interest is held by non-resident Indians directly or indirectly but irrevocably and which was in existence on the date of commencement of the Foreign Exchange Management (Withdrawal of General Permission to Overseas Corporate Bodies (OCBs) ) Regulations, 2003 (the Regulations) and immediately prior to such commencement was eligible to undertake transactions pursuant to the general permission granted under the Regulations.

***‘Foreign Currency Convertible Bond’*** (FCCB) means a bond issued by an Indian company expressed in foreign currency, the principal and interest of which is payable in foreign currency. FCCBs are issued in accordance with the Foreign Currency Convertible Bonds and ordinary shares (through depository receipt mechanism) Scheme, 1993 and subscribed by a non-resident entity in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part.

***‘FDI’*** means investment by non-resident entity/person resident outside India in the capital of an Indian company under Schedule 1 of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations.

***‘FDI linked performance conditions’*** means the sector specific conditions for companies receiving foreign investment.

***‘FEMA’*** means the Foreign Exchange Management Act, 1999 (42 of 1999).

***‘Foreign Institutional Investor’***(FII) means an entity established or incorporated outside India which proposes to make investment in India and which is registered as a FII in accordance with the Securities and Exchange Board of India (SEBI) (Foreign Institutional Investor) Regulations 1995.

**'Foreign Portfolio Investor'**(FPI) means a person registered in accordance with the provisions of Securities and Exchange Board of India (SEBI) (Foreign Portfolio Investors) Regulations, 2014, as amended from time to time.

**'Foreign Venture Capital Investor'** (FVCI) means an investor incorporated and established outside India, which is registered under the Securities and Exchange Board of India (Foreign Venture Capital Investor) Regulations, 2000 {SEBI(FVCI) Regulations} and proposes to make investment in accordance with the regulations.

**'Government route'** means that investment in the capital of resident entities by non-resident entities can be made only with the prior approval of Government (Competent Ministry/Department for grant of approval).

**'Group Company'** means two or more enterprises which, directly or indirectly, are in a position to:

- (i) exercise twenty-six percent or more of voting rights in other enterprise; or
- (ii) appoint more than fifty percent of members of board of directors in the other enterprise

**'Holding Company'** would have the same meaning as defined in Companies Act, as applicable.

**'Indian Company'** means a company incorporated in India under the Companies Act, as applicable.

**'Indian Venture Capital Undertaking'** (IVCU) means an Indian company:

- (i) whose shares are not listed in a recognised stock exchange in India;
- (ii) which is engaged in the business of providing services, production or manufacture of articles or things, but does not include such activities or sectors which are specified in the negative list by the SEBI, with approval of Central Government, by notification in the Official Gazette in this behalf.

**'Investment Vehicle'** shall mean an entity registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose and shall include Real Estate Investment Trusts (REITs) governed by the SEBI (REITs) Regulations, 2014, Infrastructure Investment Trusts (InvIts) governed by the SEBI (InvIts) Regulations,

2014 and Alternative Investment Funds (AIFs) governed by the SEBI (AIFs) Regulations, 2012.

**'Investing Company'** means an Indian Company holding only investments in other Indian company/(ies), directly or indirectly, other than for trading of such holdings/securities.

**'Investment on repatriable basis'** means investment, the sale proceeds of which, net of taxes, are eligible to be repatriated out of India and the expression 'investment on non-repatriable basis' shall be construed accordingly.

**'Joint Venture'** (JV) means an Indian entity incorporated in accordance with the laws and regulations in India in whose capital a non-resident entity makes an investment.

**'Limited Liability Partnership'** means a Limited Liability Partnership firm, formed and registered under the Limited Liability Partnership Act, 2008.

**'Manufacture'**, with its grammatical variations, means a change in a non-living physical object or article or thing- (a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or (b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

**'Non-resident entity'** means a 'person resident outside India' as defined under FEMA.

**'Non-Resident Indian'** (NRI) means an individual resident outside India who is a citizen of India or is an 'Overseas Citizen of India' cardholder within the meaning of section 7 (A) of the Citizenship Act, 1955. 'Persons of Indian Origin' cardholders registered as such under Notification No. 26011/4/98 F.I. dated 19.8.2002 issued by the Central Government are deemed to be 'Overseas Citizen of India' cardholders'

A company is considered as **'Owned'** by resident Indian citizens if more than 50% of the capital in it is beneficially owned by resident Indian citizens and / or Indian companies, which are ultimately owned and controlled by resident Indian citizens. A Limited Liability Partnership will be considered as owned by resident Indian citizens if more than 50% of the investment in such an LLP is contributed by resident Indian citizens and/or entities which are ultimately 'owned and controlled by resident Indian citizens' and such resident Indian citizens and entities have majority of the profit share.

**'Person'** includes-

- (i) an individual,

- (ii) a Hindu undivided family,
- (iii) a company,
- (iv) a firm,
- (v) an association of persons or a body of individuals whether incorporated or not,
- (vi) every artificial juridical person, not falling within any of the preceding sub-clauses, and
- (vii) any agency, office, or branch owned or controlled by such person.

**'Person of Indian Origin'** (PIO) means a citizen of any country other than Bangladesh or Pakistan, if

- (i) he at any time held Indian Passport; or
- (ii) he or either of his parents or any of his grandparents was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955); or
- (iii) the person is a spouse of an Indian citizen or a person referred to in sub-clause (i) or (ii).

**'Person resident in India'** means-

(i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include-

(A) A person who has gone out of India or who stays outside India, in either case-

(a) for or on taking up employment outside India, or

(b) for carrying on outside India a business or vocation outside India, or

(c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;

(B) A person who has come to or stays in India, in either case, otherwise than-

(a) for or on taking up employment in India; or

(b) for carrying on in India a business or vocation in India, or

(c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;

(ii) any person or body corporate registered or incorporated in India,

(iii) an office, branch or agency in India owned or controlled by a person resident outside India,

(iv) an office, branch or agency outside India owned or controlled by a person resident in India.

**'Person resident outside India'** means a person who is not a Person resident in India.

**'Portfolio Investment Scheme'** means the Portfolio Investment Scheme referred to in Schedules 2, 2A & 3 of FEMA (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000

**'RBI'** means the Reserve Bank of India established under the Reserve Bank of India Act, 1934.

**'Resident Entity'** means 'Person resident in India' excluding an individual.

**'Resident Indian Citizen'** shall be interpreted in line with the definition of 'person resident in India' as per FEMA, 1999, read in conjunction with the Indian Citizenship Act, 1955.

**'SEBI'** means the Securities and Exchange Board of India established under the Securities and Exchange Board of India Act, 1992.

**'SEZ'** means a Special Economic Zone as defined in Special Economic Zone Act, 2005.

**'SIA'** means Secretariat of Industrial Assistance in DIPP, Ministry of Commerce & Industry, Government of India.

**'Sweat Equity Shares'** means such equity shares as issued by a company to its directors or employees at a discount or for consideration other than cash, for providing their know-how



or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

**'Transferable Development Rights'** (TDR) means certificates issued in respect of category of land acquired for public purposes either by the Central or State Government in consideration of surrender of land by the owner without monetary compensation, which are transferable in part or whole.

**'Unit'** shall mean beneficial interest of an investor in the Investment Vehicle and shall include shares or partnership interests.

**'Venture Capital Fund'** (VCF) means a Fund registered as a 'venture capital fund' under SEBI (Venture Capital Funds) Regulations, 1996.

## **ELIGIBLE INVESTORS**

A non-resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited. However, a citizen of Bangladesh or an entity incorporated in Bangladesh can invest only under the Government route. Further, a citizen of Pakistan or an entity incorporated in Pakistan can invest, only under the Government route, in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment.

NRIs resident in Nepal and Bhutan as well as citizens of Nepal and Bhutan are permitted to invest in the capital of Indian companies on repatriation basis, subject to the condition that the amount of consideration for such investment shall be paid only by way of inward remittance in free foreign exchange through normal banking channels.

OCBs have been derecognized as a class of investors in India with effect from September 16, 2003. Erstwhile OCBs which are incorporated outside India and are not under the adverse notice of RBI can make fresh investments under FDI Policy as incorporated non-resident entities, with the prior approval of Government of India if the investment is through Government route; and with the prior approval of RBI if the investment is through Automatic route.

A company, trust and partnership firm incorporated outside India and owned and controlled by NRIs can invest in India with the special dispensation as available to NRIs under the FDI Policy.

Foreign Institutional Investor (FII) and Foreign Portfolio Investors (FPI) may in terms of Schedule 2 and 2A of FEMA (Transfer or Issue of Security by Persons Resident Outside India)

Regulations, as the case may be, respectively, invest in the capital of an Indian company under the Portfolio Investment Scheme which limits the individual holding of an FII/FPI below 10% of the capital of the company and the aggregate limit for FII/FPI investment to 24% of the capital of the company. This aggregate limit of 24% can be increased to the sectoral cap/statutory ceiling, as applicable, by the Indian company concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body and subject to prior intimation to RBI. The aggregate FII/FPI investment, individually or in conjunction with other kinds of foreign investment, will not exceed sectoral/statutory cap.

Only registered FIIs/FPIs and NRIs as per Schedules 2,2A and 3 respectively of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000, can invest/trade through a registered broker in the capital of Indian Companies on recognised Indian Stock Exchanges.

A SEBI registered Foreign Venture Capital Investor (FVCI) may contribute up to 100% of the capital of an Indian company engaged in any activity mentioned in Schedule 6 of Notification No.FEMA 20/2000,including startups irrespective of the sector in which it is engaged, under the automatic route. A SEBI registered FVCI can invest in a domestic venture capital fund registered under the SEBI (Venture Capital Fund) Regulations, 1996 or a Category- I Alternative Investment Fund registered under the SEBI (Alternative Investment Fund) Regulations, 2012. Such investments shall also be subject to the extant FEMA regulations and extant FDI policy including sectoral caps, etc. The investment can be made in equities or equity linked instruments or debt instruments issued by the company (including start-ups and if a startup is organised as a partnership firm or an LLP, the investment can be made in the capital or through any profit-sharing arrangement) or units issued by a VCF or by a Category-I AIF either through purchase by private arrangement either from the issuer of the security or from any other person holding the security or on a recognised stock exchange. It may also set up a domestic asset management company to manage its investments. SEBI registered FVCIs are also allowed to invest under the FDI Scheme, as non-resident entities, in other companies, subject to FDI Policy and FEMA regulations.

A Non- Resident Indian may subscribe to National Pension System governed and administered by Pension Fund Regulatory and Development Authority (PFRDA), provided such subscriptions are made through normal banking channels and the person is eligible to

invest as per the provisions of the PFRDA Act. The annuity/ accumulated saving will be repatriable.

## **ELIGIBLE INVESTEE ENTITIES**

### **FDI in an Indian Company**

Indian companies can issue capital against FDI.

### **FDI in Partnership Firm/Proprietary Concern**

- (i) A Non-Resident Indian (NRI) or a Person of Indian Origin (PIO) resident outside India can invest in the capital of a firm or a proprietary concern in India on non-repatriation basis provided;
  - (a) Amount is invested by inward remittance or out of NRE/FCNR(B)/NRO account maintained with Authorized Dealers/Authorized banks.
  - (b) The firm or proprietary concern is not engaged in any agricultural/plantation or real estate business or print media sector.
  - (c) Amount invested shall not be eligible for repatriation outside India.
- (ii) Investments with repatriation option: NRIs/PIO may seek prior permission of Reserve Bank for investment in sole proprietorship concerns/partnership firms with repatriation option. The application will be decided in consultation with the Government of India.
- (iii) Investment by non-residents other than NRIs/PIO: A person resident outside India other than NRIs/PIO may make an application and seek prior approval of Reserve Bank for making investment in the capital of a firm or a proprietorship concern or any association of persons in India. The application will be decided in consultation with the Government of India.
- (iv) Restrictions: An NRI or PIO is not allowed to invest in a firm or proprietorship concern engaged in any agricultural/plantation activity or real estate business or print media.

### **FDI in Trusts**

FDI is not permitted in Trusts other than in 'VCF' registered and regulated by SEBI and 'Investment vehicle'.

## **FDI in Limited Liability Partnerships (LLPs)**

FDI in LLPs is permitted subject to the following conditions:

- (i) FDI is permitted under the automatic route in Limited Liability Partnership (LLPs) operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI-linked performance conditions.
- (ii) An Indian company or an LLP, having foreign investment, is also permitted to make downstream investment in another company or LLP in sectors in which 100% FDI is allowed under the automatic route and there are no FDI-linked performance conditions.
- (iii) Conversion of an LLP having foreign investment and operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI-linked performance conditions, into a company is permitted under automatic route. Similarly, conversion of a company having foreign investment and operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI-linked performance conditions, into an LLP is permitted under automatic route. FDI in LLP is subject to the compliance of the conditions of LLP Act, 2008.

## **Investment Vehicle**

An entity being 'investment vehicle' registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose including Real Estate Investment Trusts (REITs) governed by the SEBI (REITs) Regulations, 2014, Infrastructure Investment Trusts (InvIts) governed by the SEBI (InvIts) Regulations, 2014, Alternative Investment Funds (AIFs) governed by the SEBI (AIFs) Regulations, 2012 and notified under Schedule 11 of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 is permitted to receive foreign investment from a person resident outside India (other than an individual who is citizen of or any other entity which is registered / incorporated in Pakistan or Bangladesh), including an Registered Foreign Portfolio Investor (RFPI) or a non-resident Indian (NRI).

## **Startup Companies**

Start-ups can issue equity or equity linked instruments or debt instruments to FVCI against receipt of foreign remittance, as per the FEMA Regulation. In addition, start-ups can issue convertible notes to person resident outside India subject to the following conditions:

- (i) A person resident outside India (other than an individual who is citizen of Pakistan or Bangladesh or an entity which is registered / incorporated in Pakistan or Bangladesh), may purchase convertible notes issued by an Indian startup company for an amount of twenty five lakh rupees or more in a single tranche.

‘Startup Company’ means a private company incorporated under the Companies Act, 2013 or Companies Act, 1956 and recognised as such in accordance with notification issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, and as amended from time to time.

- (ii) A startup company engaged in a sector where foreign investment requires Government approval may issue convertible notes to a non-resident only with approval of the Government.

- (iii) A startup company issuing convertible notes to a person resident outside India shall receive the amount of consideration by inward remittance through banking channels or by debit to the NRE / FCNR (B) / Escrow account maintained by the person concerned in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016, as amended from time to time. However an escrow account for the above purpose shall be closed immediately after the requirements are completed or within a period of six months, whichever is earlier. However, in no case continuance of such escrow account shall be permitted beyond a period of six months.

- (iv) NRIs may acquire convertible notes on non-repatriation basis in accordance with Schedule 4 of the regulation Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000.

- (v) A person resident outside India may acquire or transfer, by way of sale, convertible notes, from or to, a person resident in or outside India, provided the transfer takes place in accordance with the pricing guidelines as prescribed by RBI. Prior approval from the Government shall be obtained for such transfers in case the startup company is engaged in a sector which requires Government approval.

- (vi) The startup company issuing convertible notes shall be required to furnish reports as prescribed by Reserve Bank of India.

### **Entry Routes for Investment**

Investments can be made by non-residents in the equity shares/fully, compulsorily and mandatorily convertible debentures/fully, compulsorily and mandatorily convertible

preference shares of an Indian company, through the Automatic Route or the Government Route. Under the Automatic Route, the non-resident investor or the Indian company does not require any approval from Government of India for the investment. Under the Government Route, prior approval of the Government of India is required. Proposals for foreign investment under Government route, are considered by respective Administrative Ministry/Department.

Foreign investment in sectors/activities under government approval route will be subject to government approval where:

- (i) An Indian company is being established with foreign investment and is not owned by a resident entity or
- (ii) An Indian company is being established with foreign investment and is not controlled by a resident entity or
- (iii) The control of an existing Indian company, currently owned or controlled by resident Indian citizens and Indian companies, which are owned or controlled by resident Indian citizens, will be/is being transferred/passed on to a non-resident entity as a consequence of transfer of shares and/or fresh issue of shares to non-resident entities through amalgamation, merger/demerger, acquisition etc. or
- (iv) The ownership of an existing Indian company, currently owned or controlled by resident Indian citizens and Indian companies, which are owned or controlled by resident Indian citizens, will be/is being transferred/passed on to a non-resident entity as a consequence of transfer of shares and/or fresh issue of shares to non-resident entities through amalgamation, merger/demerger, acquisition etc.
- (v) It is clarified that Foreign investment shall include all types of foreign investments, direct and indirect, regardless of whether the said investments have been made under Schedule 1 (FDI), 2 (FII), 2A (FPI), 3 (NRI), 6 (FVCI), 9 (LLPs), 10 (DRs) and 11(Investment Vehicles) of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations. FCCBs and DRs having underlying of instruments which can be issued under Schedule 5, being in the nature of debt, shall not be treated as foreign investment. However, any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned as foreign investment.

- (vi) Investment by NRIs under Schedule 4 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations will be deemed to be domestic investment at par with the investment made by residents.
- (vii) A company, trust and partnership firm incorporated outside India and owned and controlled by non-resident Indians will be eligible for investments under Schedule 4 of FEMA (Transfer or issue of Security by Persons Resident Outside India) Regulations and such investment will also be deemed domestic investment at par with the investment made by residents.

### **Caps on Investments**

Investments can be made by non-residents in the capital of a resident entity only to the extent of the percentage of the total capital as specified in the FDI policy.

### **Entry Conditions on Investment**

Investments by non-residents can be permitted in the capital of a resident entity in certain sectors/activity with entry conditions. Such conditions may include norms for minimum capitalization, lock-in period, etc.

### **Other Conditions on Investment besides Entry Conditions**

Besides the entry conditions on foreign investment, the investment/investors are required to comply with all relevant sectoral laws, regulations, rules, security conditions, and state/local laws/regulations.

For establishment of branch office, liaison office or project office or any other place of business in India if the principal business of the applicant is Defence, Telecom, Private Security or Information and Broadcasting, approval of Reserve Bank of India is not required in cases where Government approval or license/permission by the concerned Ministry/Regulator has already been granted.

## **PROHIBITED SECTORS**

FDI is prohibited in:

- a) Lottery Business including Government/private lottery, online lotteries, etc.
- b) Gambling and Betting including casinos etc.
- c) Chit funds
- d) Nidhi company
- e) Trading in Transferable Development Rights (TDRs)
- f) Real Estate Business or Construction of Farm Houses

'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.

- g) Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes
- h) Activities/sectors not open to private sector investment e.g.(I) Atomic Energy and (II) Railway operations(other than permitted activities).

**Foreign technology collaboration in any form** including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery Business and Gambling and Betting activities.

### **PERMITTED SECTORS**

- Floriculture, Horticulture, Apiculture and Cultivation of Vegetables & Mushrooms under controlled conditions;
- Development and Production of seeds and planting material;
- Animal Husbandry (including breeding of dogs), Pisciculture, Aquaculture, under controlled conditions; and
- Services related to agro and allied sectors
- Tea sector including tea plantations
- Mining and Exploration of metal and non-metal ores
- Coal & Lignite
- Petroleum & Natural Gas
- Manufacture of items reserved for production in Micro and Small Enterprises (MSEs)
- Defence Industry subject to Industrial license under the Industries (Development & Regulation) Act, 1951
- Broadcasting Carriage Services
- Broadcasting Content Services
- Print Media
- Civil Aviation
- Airports
- Air Transport Services
- Courier services
- Construction Development: Townships, Housing, Built-up Infrastructure
- Industrial Parks
- Satellites- establishment and operation
- Private Security Agencies
- Telecom Services
- Cash & Carry Wholesale Trading/Wholesale Trading



- E-commerce activities
- Single Brand product retail trading
- Multi Brand Retail Trading
- Railway Infrastructure
- Asset Reconstruction Companies
- Banking- Private Sector
- Banking- Public Sector
- Commodity Exchanges
- Credit Information Companies (CIC)
- Infrastructure Company in the Securities Market
- Insurance
- Non-Banking Finance Companies (NBFC)
- Pharmaceuticals
- Power Exchanges.

## **TYPES OF INSTRUMENTS**

1. Indian companies can issue equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares subject to pricing guidelines/valuation norms prescribed under FEMA Regulations. The price/conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the extant FEMA regulations [as per any internationally accepted pricing methodology on arm's length basis for the unlisted companies and valuation in terms of SEBI (ICDR) Regulations, for the listed companies].

Optionality clauses are allowed in equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares under FDI scheme, subject to the following conditions:

(a) There is a minimum lock-in period of one year which shall be effective from the date of allotment of such capital instruments.

(b) After the lock-in period and subject to FDI Policy provisions, if any, the non-resident investor exercising option/right shall be eligible to exit without any assured return, as per pricing/valuation guidelines issued by RBI from time to time.

2. Other types of Preference shares/Debentures i.e. non-convertible, optionally convertible or partially convertible for issue of which funds have been received on or after May 1, 2007 are considered as debt. Accordingly all norms applicable for ECBs relating to eligible borrowers, recognized lenders, amount and maturity, end-use stipulations, etc. shall apply. Since these instruments would be denominated in rupees, the rupee interest rate will be

based on the swap equivalent of London Interbank Offered Rate (LIBOR) plus the spread as permissible for ECBs of corresponding maturity.

3. The inward remittance received by the Indian company vide issuance of DRs and FCCBs are treated as FDI and counted towards FDI.

4. *Acquisition of Warrants and Partly Paid Shares* - An Indian Company may issue warrants and partly paid shares to a person resident outside India subject to terms and conditions as stipulated by the Reserve Bank of India in this behalf, from time to time.

5. Issue of Foreign Currency Convertible Bonds (FCCBs) and Depository Receipts (DRs)

a) FCCBs/DRs may be issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and DR Scheme 2014 respectively, as per the guidelines issued by the Government of India there under from time to time.

b) DRs are foreign currency denominated instruments issued by a foreign Depository in a permissible jurisdiction against a pool of permissible securities issued or transferred to that foreign depository and deposited with a domestic custodian.

c) In terms of Notification No. FEMA.20/2000-RB dated May 3, 2000 as amended from time to time, a person will be eligible to issue or transfer eligible securities to a foreign depository, for the purpose of converting the securities so purchased into depository receipts in terms of Depository Receipts Scheme, 2014 and guidelines issued by the Government of India there under from time to time.

d) A person can issue DRs, if it is eligible to issue eligible instruments to person resident outside India under Schedules 1, 2, 2A, 3, 5 and 8 of Notification No. FEMA 20/2000-RB dated May 3, 2000, as amended from time to time.

e) The aggregate of eligible securities which may be issued or transferred to foreign depositories, along with eligible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such eligible securities under the relevant regulations framed under FEMA, 1999.

f) The pricing of eligible securities to be issued or transferred to a foreign depository for the purpose of issuing depository receipts should not be at a price less than the price applicable to a corresponding mode of issue or transfer of such securities to domestic investors under the relevant regulations framed under FEMA, 1999.

g) The issue of depository receipts as per DR Scheme 2014 shall be reported to the Reserve Bank by the domestic custodian as per the reporting guidelines for DR Scheme 2014.

6. (i) *Two-way Fungibility Scheme*: A limited two-way Fungibility scheme has been put in place by the Government of India for ADRs/GDRs. Under this Scheme, a stock broker in India, registered with SEBI, can purchase shares of an Indian company from the market for

conversion into ADRs/GDRs based on instructions received from overseas investors. Re-issuance of ADRs/GDRs would be permitted to the extent of ADRs/GDRs which have been redeemed into underlying shares and sold in the Indian market.

(ii) *Sponsored ADR/GDR issue:* An Indian Company can also sponsor an issue of ADR/GDR. Under this mechanism, the company offers its resident shareholders a choice to submit their shares back to the company so that on the basis of such shares, ADRs/GDRs can be issued abroad. The proceeds of the ADR/GDR issue are remitted back to India and distributed among the resident investors who had offered their Rupee denominated shares for conversion. These proceeds can be kept in Resident Foreign Currency (Domestic) accounts in India by the resident shareholders who have tendered such shares for conversion into ADRs/GDRs.

### **PROVISIONS RELATING TO ISSUE/ TRANSFER OF SHARES**

The capital instruments should be issued within 180 days from the date of receipt of the inward remittance received through normal banking channels including escrow account opened and maintained for the purpose or by debit to the NRE/FCNR (B) account of the non-resident investor. In case, the capital instruments are not issued within 180 days from the date of receipt of the inward remittance or date of debit to the NRE/FCNR (B) account, the amount of consideration so received should be refunded immediately to the non-resident investor by outward remittance through normal banking channels or by credit to the NRE/FCNR (B) account, as the case may be. Non-compliance with the above provision would be reckoned as a contravention under FEMA and would attract penal provisions. In exceptional cases, refund of the amount of consideration outstanding beyond a period of 180 days from the date of receipt may be considered by the RBI, on the merits of the case.

#### **Issue price of shares**

Price of shares issued to persons resident outside India under the FDI Policy, shall not be less than –

a. the price worked out in accordance with the SEBI guidelines, as applicable, where the shares of the company are listed on any recognised stock exchange in India;

b. the fair valuation of shares done by a SEBI registered Merchant Banker or a Chartered Accountant as per any internationally accepted pricing methodology on arm's length basis, where the shares of the company are not listed on any recognised stock exchange in India; and

c. the price as applicable to transfer of shares from resident to non-resident as per the pricing guidelines laid down by the Reserve Bank from time to time, where the issue of shares is on preferential allotment.

However, where non-residents (including NRIs) are making investments in an Indian company in compliance with the provisions of the Companies Act, as applicable, by way of subscription to its Memorandum of Association, such investments may be made at face value subject to their eligibility to invest under the FDI scheme.

### **Foreign Currency Account**

Indian companies which are eligible to issue shares to person's resident outside India under the FDI Policy may be allowed to retain the share subscription amount in a Foreign Currency Account, with the prior approval of RBI.

### **Transfer of shares and convertible debentures**

Subject to FDI sectoral policy (relating to sectoral caps and entry routes), applicable laws and other conditionalities including security conditions, non-resident investors can also invest in Indian companies by purchasing/acquiring existing shares from Indian shareholders or from other non-resident shareholders. General permission has been granted to non-residents/NRIs for acquisition of shares by way of transfer subject to the following:

(a) A person resident outside India (other than NRI and erstwhile OCB) may transfer by way of sale or gift, the shares or convertible debentures to any person resident outside India (including NRIs). Government approval is not required for transfer of shares in the investee company from one non-resident to another non-resident in sectors which are under automatic route. In addition, approval of Government will be required for transfer of stake from one non-resident to another non-resident in sectors which are under Government approval route.

(b) NRIs may transfer by way of sale or gift the shares or convertible debentures held by them to another NRI.

(c) A person resident outside India can transfer any security to a person resident in India by way of gift.

(d) A person resident outside India can sell the shares and convertible debentures of an Indian company on a recognized Stock Exchange in India through a stock broker registered with stock exchange or a merchant banker registered with SEBI.

(d) A person resident in India can transfer by way of sale, shares/ convertible debentures (including transfer of subscriber's shares), of an Indian company under private arrangement to a person resident outside India, subject to the guidelines.

(f) General permission is also available for transfer of shares/ convertible debentures, by way of sale under private arrangement by a person resident outside India to a person resident in India, subject to the guidelines.

(g) The above General Permission also covers transfer by a resident to a non-resident of shares/convertible debentures of an Indian company, engaged in an activity earlier covered under the Government Route but now falling under Automatic Route, as well as transfer of shares by a non-resident to an Indian company under buyback and/or capital reduction scheme of the company.

(h) The Form FC-TRS should be submitted to the AD Category-I Bank, within 60 days from the date of receipt of the amount of consideration. The onus of submission of the Form FC-TRS within the given timeframe would be on the transferor/transferee, resident in India. However, in cases where the NR investor, including an NRI, acquires shares on the stock exchanges under the FDI scheme, the investee company would have to file form FC-TRS with the AD Category-I bank.

The sale consideration in respect of equity instruments purchased by a person resident outside India, remitted into India through normal banking channels, shall be subjected to a Know Your Customer (KYC) check by the remittance receiving AD Category-I bank at the time of receipt of funds. In case, the remittance receiving AD Category-I bank is different from the AD Category-I bank handling the transfer transaction, the KYC check should be carried out by the remittance receiving bank and the KYC report be submitted by the customer to the AD Category-I bank carrying out the transaction along with the Form FC-TRS.

A person resident outside India including a Non-Resident Indian investor who has already acquired and continues to hold the control in accordance with the SEBI (Substantial Acquisition of Shares and Takeover) Regulations can acquire shares of a listed Indian company on the stock exchange through a registered broker under FDI scheme provided that the original and resultant investments are in line with the extant FDI policy and FEMA regulations in respect of sectoral cap, entry route, mode of payment, reporting requirement, documentation, etc.

**Escrow:** AD Category-I banks have been given general permission to open Escrow account and Special account of non-resident corporate for open offers/exit offers and delisting of shares. The relevant SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SAST) Regulations or any other applicable SEBI Regulations/provisions of the Companies Act, as applicable will be applicable. AD Category-I banks have also been permitted to open and maintain, without prior approval of RBI, non-interest bearing Escrow accounts in Indian Rupees in India on behalf of residents and/or non-residents, towards payment of share purchase consideration and/or provide Escrow facilities for keeping securities to facilitate FDI transactions subject to the terms and conditions specified by RBI. SEBI authorised Depository Participants have also been permitted to open and maintain, without prior approval of RBI, Escrow accounts for securities subject to the terms and conditions as specified by RBI. In both cases, the Escrow agent shall necessarily be an AD Category-I bank or SEBI authorised Depository Participant (in case of securities' accounts). These facilities will be applicable for both issue of fresh shares to the non-residents as well as transfer of shares from/to the non-residents.

In case of transfer of shares between a resident buyer and a non-resident seller or vice-versa, not more than twenty five per cent of the total consideration can be paid by the buyer on a deferred basis within a period not exceeding eighteen months from the date of the transfer agreement. For this purpose, if so agreed between the buyer and the seller, an escrow arrangement may be made between the buyer and the seller for an amount not more than twenty five per cent of the total consideration for a period not exceeding eighteen months

from the date of the transfer agreement or if the total consideration is paid by the buyer to the seller, the seller may furnish an indemnity for an amount not more than twenty five per cent of the total consideration for a period not exceeding eighteen months from the date of the payment of the full consideration.

However the total consideration finally paid for the shares must be compliant with the applicable pricing guidelines.

### **PRIOR PERMISSION OF RBI IN CERTAIN CASES FOR TRANSFER OF CAPITAL INSTRUMENTS**

In the following cases prior approval of RBI required:

(i) Transfer of capital instruments from resident to non-residents by way of sale where:

(a) Transfer is at a price which falls outside the pricing guidelines specified by the Reserve Bank from time to time.

(b) Transfer of capital instruments by the non-resident acquirer involving deferment of payment of the amount of consideration. Further, in case approval is granted for a transaction, the same should be reported in Form FC-TRS, to an AD Category-I bank for necessary due diligence, within 60 days from the date of receipt of the full and final amount of consideration.

(ii) Transfer of any capital instrument, by way of gift by a person resident in India to a person resident outside India. While forwarding applications to Reserve Bank for approval for transfer of capital instruments by way of gift, the documents should be enclosed. Reserve Bank considers the following factors while processing such applications:

(a) The proposed transferee (donee) is eligible to hold such capital instruments under Schedules 1, 4 and 5 of Notification No. FEMA 20/2000-RB dated May 3, 2000, as amended from time to time.

(b) The gift does not exceed 5 per cent of the paid-up capital of the Indian company/each series of debentures/each mutual fund scheme.

(c) The applicable sectoral cap limit in the Indian company is not breached.

(d) The transferor (donor) and the proposed transferee (donee) are close relatives as defined in Section 2 (77) of Companies Act, 2013, as amended from time to time.

(e) The value of capital instruments to be transferred together with any capital instruments already transferred by the transferor, as gift, to any person residing outside India does not exceed the rupee equivalent of USD 50,000 during the financial year.

(f) Such other conditions as stipulated by Reserve Bank in public interest from time to time.

(iii) Transfer of shares from NRI to non-resident.

**IN THE FOLLOWING CASES, APPROVAL OF RBI IS NOT REQUIRED**

**A. Transfer of shares from a Non-Resident to Resident under the FDI scheme where the pricing guidelines under FEMA, 1999 are not met provided that:**

- i. The original and resultant investment are in line with the extant FDI policy and FEMA regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, etc.), reporting requirements, documentation, etc.;
- ii. The pricing for the transaction is compliant with the specific/explicit, extant and relevant SEBI regulations/guidelines (such as IPO, Book building, block deals, delisting, exit, open offer/substantial acquisition/SEBI SAST, buy back); and
- iii. Chartered Accountants Certificate to the effect that compliance with the relevant SEBI regulations/guidelines as indicated above is attached to the form FC-TRS to be filed with the AD bank.

**B. Transfer of shares from Resident to Non-Resident:**

**i) where the transfer of shares requires the prior approval of the Government as per the extant FDI policy provided that:**

- a) the requisite approval of the Government has been obtained; and
- b) the transfer of shares adheres with the pricing guidelines and documentation requirements as specified by the Reserve Bank of India from time to time.

**ii) where the transfer of shares attract SEBI (SAST) Regulations subject to the adherence with the pricing guidelines and documentation requirements as specified by Reserve Bank of India from time to time.**

**iii) where the transfer of shares does not meet the pricing guidelines under the FEMA, 1999 provided that:**

- a) The resultant FDI is in compliance with the extant FDI policy and FEMA regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, etc.), reporting requirements, documentation etc.;
- b) The pricing for the transaction is compliant with the specific/explicit, extant and relevant SEBI regulations/guidelines (such as IPO, Book building, block deals, delisting, exit, open offer/substantial acquisition/SEBI SAST); and

c) Chartered Accountants Certificate to the effect that compliance with the relevant SEBI regulations/guidelines as indicated above is attached to the form FC-TRS to be filed with the AD bank.

**iv) where the investee company is in the financial sector provided that:**

a) Any 'fit and proper/due diligence' requirements as regards the non-resident investor as stipulated by the respective financial sector regulator, from time to time, have been complied with; and

b) The FDI policy and FEMA regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, pricing, etc.), reporting requirements, documentation etc., are complied with.

**CONVERSION OF ECB/LUMP SUM FEE/ROYALTY ETC. INTO EQUITY**

(i) Indian companies have been granted general permission for conversion of External Commercial Borrowings (ECB) (excluding those deemed as ECB) in convertible foreign currency into equity shares/fully compulsorily and mandatorily convertible preference shares, subject to the following conditions and reporting requirements:

(a) The activity of the company is covered under the Automatic Route for FDI or the company has obtained Government approval for foreign equity in the company;

(b) The foreign equity after conversion of ECB into equity is within the sectoral cap, if any;

(c) Pricing of shares is as per the issue price of shares;

(d) Compliance with the requirements prescribed under any other statute and regulation in force; and

(e) The conversion facility is available for ECBs availed under the Automatic or Government Route and is applicable to ECBs, due for payment or not, as well as secured/unsecured loans availed from non-resident collaborators.

(ii) General permission is also available for issue of shares/preference shares against lump sum technical know-how fee, royalty due for payment, subject to entry route, sectoral cap and pricing guidelines (as per the issue price of shares) and compliance with applicable tax laws. Further, issue of equity shares against any other funds payable by the investee company, remittance of which does not require prior permission of the Government of India or Reserve Bank of India under FEMA, 1999 or any rules/ regulations framed or directions issued there under, or has been permitted by the Reserve Bank under the Act or the rules and regulations framed or directions issued there under is permitted, provided that:

(I) The equity shares shall be issued in accordance with the extant FDI guidelines on sectoral caps, pricing guidelines etc. as amended by Reserve bank of India, from time to time;



Explanation: Issue of shares/convertible debentures that require Government approval in terms of paragraph 3 of Schedule 1 of FEMA 20 or import dues deemed as ECB or trade credit or payable against import of second hand machinery shall continue to be dealt in accordance with extant guidelines;

(II) The issue of equity shares under this provision shall be subject to tax laws as applicable to the funds payable and the conversion to equity should be net of applicable taxes.

(iii) A wholly owned subsidiary set up in India by a non-resident entity, operating in a sector where 100 percent foreign investment is allowed in the automatic route and there are no FDI linked conditionalities, may issue equity shares or preference shares or convertible debentures or warrants to the said non-resident entity against pre-incorporation/ pre-operative expenses incurred by the said non-resident entity up to a limit of five percent of its capital or USD 500,000 whichever is less, subject to the conditions laid down below.

a. Within thirty days from the date of issue of equity shares or preference shares or convertible debentures or warrants but not later than one year from the date of incorporation or such time as Reserve Bank of India or Government of India permits, the Indian company shall report the transaction in the Form FC-GPR to the Reserve Bank.

b. The valuation of the equity shares or preference shares or convertible debentures or warrants shall be subject to the provisions of Schedule 1 of the Regulations.

c. A certificate issued by the statutory auditor of the Indian company that the amount of pre-incorporation/pre-operative expenses against which equity shares or preference shares or convertible debentures or warrants have been issued has been utilized for the purpose for which it was received should be submitted with the FC-GPR form.

Explanation: Pre-incorporation/pre-operative expenses shall include amounts remitted to Investee Company's account, to the investor's account in India if it exists, to any consultant, attorney or to any other material/service provider for expenditure relating to incorporation or necessary for commencement of operations.

(iv) Issue of equity shares under the FDI policy is allowed under the Government route for the following:

(I) import of capital goods/ machinery/ equipment (excluding second-hand machinery), subject to compliance with the following conditions:

(a) Any import of capital goods/machinery etc., made by a resident in India, has to be in accordance with the Export/Import Policy issued by Government of India/as defined by DGFT/FEMA provisions relating to imports.

(b) The application clearly indicating the beneficial ownership and identity of the Importer Company as well as overseas entity.

(c) Applications complete in all respects, for conversions of import payables for capital goods into FDI being made within 180 days from the date of shipment of goods.

(II) Pre-operative/pre-incorporation expenses (including payments of rent etc.), subject to compliance with the following conditions:

(a) Submission of FIRC for remittance of funds by the overseas promoters for the expenditure incurred.

(b) Verification and certification of the pre-incorporation/pre-operative expenses by the statutory auditor.

(c) Payments should be made by the foreign investor to the company directly or through the bank account opened by the foreign investor as provided under FEMA Regulations.

(d) The applications, complete in all respects, for capitalization being made within the period of 180 days from the date of incorporation of the company.

**General conditions:**

(i) All requests for conversion should be accompanied by a special resolution of the company.

(ii) Government's approval would be subject to pricing guidelines of RBI and appropriate tax clearance.

**ISSUE OF RIGHTS/BONUS SHARES**

FEMA provisions allow Indian companies to freely issue Rights/Bonus shares to existing non-resident shareholders, subject to adherence to sectoral cap, if any. However, such issue of bonus/rights shares has to be in accordance with other laws/statutes like the Companies Act, as applicable, SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (in case of listed companies), etc. The offer on right basis to the person's resident outside India shall be:

(a) in the case of shares of a company listed on a recognized stock exchange in India, at a price as determined by the company;

(b) in the case of shares of a company not listed on a recognized stock exchange in India, at a price which is not less than the price at which the offer on right basis is made to resident shareholders.

**Prior permission of RBI for Rights issue to erstwhile OCBs**

OCBs have been de-recognised as a class of investors from September 16, 2003. Therefore companies desiring to issue rights share to such erstwhile OCBs will have to take specific prior permission from RBI. As such, entitlement of rights share is not automatically available to erstwhile OCBs. However bonus shares can be issued to erstwhile OCBs without the approval of RBI.

#### **Additional allocation of rights share by residents to non-residents**

Existing non-resident shareholders are allowed to apply for issue of additional shares/fully, compulsorily and mandatorily convertible debentures/fully, compulsorily and mandatorily convertible preference shares over and above their rights share entitlements. The investee company can allot the additional rights share out of unsubscribed portion, subject to the condition that the overall issue of shares to non-residents in the total paid-up capital of the company does not exceed the sectoral cap.

#### **Acquisition of shares under Scheme of Merger/Demerger/Amalgamation**

Mergers/demergers/amalgamations of companies in India are usually governed by an order issued by a competent Court on the basis of the Scheme submitted by the companies undergoing merger/demerger/amalgamation. Once the scheme of merger or demerger or amalgamation of two or more Indian companies has been approved by a Court in India, the transferee company or new company is allowed to issue shares to the shareholders of the transferor company resident outside India, subject to the conditions that:

- (i) the percentage of shareholding of persons resident outside India in the transferee or new company does not exceed the sectoral cap, and
- (ii) the transferor company or the transferee or the new company is not engaged in activities which are prohibited under the FDI policy.

**Note:** Government approval would not be required in case of mergers and acquisitions taking place in sectors under automatic route.

#### **Issue of Non-convertible/redeemable bonus preference shares or debentures**

Indian companies are allowed to issue non-convertible/redeemable preference shares or debentures to non-resident shareholders, including the depositories that act as trustees for the ADR/GDR holders, by way of distribution as bonus from its general reserves under a Scheme of Arrangement approved by a Court in India under the provisions of the Companies Act, as applicable, subject to no-objection from the Income Tax Authorities.

#### **Issue of Employees Stock Option Scheme (ESOPs) / Sweat Equity**

An Indian company may issue “employees’ stock option” and/or “sweat equity shares” to its employees/directors or employees/directors of its holding company or joint venture or

wholly owned overseas subsidiary/subsidiaries who are resident outside India, provided that :

- a. The scheme has been drawn either in terms of regulations issued under the Securities Exchange Board of India Act, 1992 or the Companies (Share Capital and Debentures) Rules, 2014 notified by the Central Government under the Companies Act 2013, as the case may be.
- b. The “employee’s stock option”/ “sweat equity shares” issued to non-resident employees/directors under the applicable rules/regulations are in compliance with the sectoral cap applicable to the said company.
- c. Issue of “employee’s stock option”/ “sweat equity shares” by a company where foreign investment is under the approval route shall require prior approval of Government of India.
- d. Issue of “employee’s stock option”/ “sweat equity shares” under the applicable rules/regulations to an employee/director who is a citizen of Bangladesh/Pakistan shall require prior approval of the Government of India.
- e. The issuing company shall furnish to the Regional Office concerned of the Reserve Bank of India under whose jurisdiction the registered office of the company operates, within 30 days from the date of issue of employees’ stock option or sweat equity shares, a return as per the Form-ESOP.

### **Share Swap**

In cases of investment by way of swap of shares, irrespective of the amount, valuation of the shares will have to be made by a Merchant Banker registered with SEBI or an Investment Banker outside India registered with the appropriate regulatory authority in the host country. Approval of the Government will also be a prerequisite for investment by swap of shares for sector under Government approval route. No approval of the Government is required for investment in automatic route sectors by way of swap of shares.

### **Pledge of Shares**

(A) A person being a promoter of a company registered in India (borrowing company), which has raised external commercial borrowings, may pledge the shares of the borrowing company or that of its associate resident companies for the purpose of securing the ECB raised by the borrowing company, provided that a no objection for the same is obtained from a bank which is an authorised dealer. The authorized dealer, shall issue the no objection for such a pledge after having satisfied itself that the external commercial borrowing is in line with the extant FEMA regulations for ECBs and that:

- i) the loan agreement has been signed by both the lender and the borrower,

ii) there exists a security clause in the Loan Agreement requiring the borrower to create charge on financial securities, and

iii) the borrower has obtained Loan Registration Number (LRN) from the Reserve Bank:

and the said pledge would be subject to the following conditions:

a) the period of such pledge shall be co-terminus with the maturity of the underlying ECB;

b) in case of invocation of pledge, transfer shall be in accordance with the extant FDI Policy and directions issued by the Reserve Bank;

c) the Statutory Auditor has certified that the borrowing company will utilized/has utilized the proceeds of the ECB for the permitted end use/s only.

(B) Non-residents holding shares of an Indian company, can pledge these shares in favour of the AD bank in India to secure credit facilities being extended to the resident investee company for bonafide business purpose, subject to the following conditions:

(i) in case of invocation of pledge, transfer of shares should be in accordance with the FDI policy in vogue at the time of creation of pledge;

(ii) submission of a declaration/ annual certificate from the statutory auditor of the investee company that the loan proceeds will be / have been utilized for the declared purpose;

(iii) the Indian company has to follow the relevant SEBI disclosure norms; and

(iv) pledge of shares in favour of the lender (bank) would be subject to Section 19 of the Banking Regulation Act, 1949.

(C) Non-residents holding shares of an Indian company, can pledge these shares in favour of an overseas bank to secure the credit facilities being extended to the non-resident investor/non-resident promoter of the Indian company or its overseas group company, subject to the following:

(i) loan is availed of only from an overseas bank;

(ii) loan is utilized for genuine business purposes overseas and not for any investments either directly or indirectly in India;

(iii) overseas investment should not result in any capital inflow into India;

(iv) in case of invocation of pledge, transfer should be in accordance with the FDI policy in vogue at the time of creation of pledge; and

(v) submission of a declaration/annual certificate from a Chartered Accountant/ Certified Public Accountant of the non-resident borrower that the loan proceeds will be / have been utilized for the declared purpose.

## **REMITTANCE AND REPATRIATION**

### **Remittance of sale proceeds/Remittance on winding up/Liquidation of Companies:**

(i) Sale proceeds of shares and securities and their remittance is 'remittance of asset' governed by The Foreign Exchange Management (Remittance of Assets) Regulations, 2000 under FEMA.

(ii) AD Category-I bank can allow the remittance of sale proceeds of a security (net of applicable taxes) to the seller of shares resident outside India, provided the security has been held on repatriation basis, the sale of security has been made in accordance with the prescribed guidelines and NOC/tax clearance certificate from the Income Tax Department has been produced.

## **REMITTANCE ON WINDING UP/LIQUIDATION OF COMPANIES**

AD Category-I banks have been allowed to remit winding up proceeds of companies in India, which are under liquidation, subject to payment of applicable taxes. Liquidation may be subject to any order issued by the court winding up the company or the official liquidator in case of voluntary winding up under the provisions of the Companies Act, , as applicable. AD Category-I banks shall allow the remittance provided the applicant submits:

- a. No objection or Tax clearance certificate from Income Tax Department for the remittance.
- b. Auditor's certificate confirming that all liabilities in India have been either fully paid or adequately provided for.
- c. Auditor's certificate to the effect that the winding up is in accordance with the provisions of the Companies Act, as applicable.
- d. In case of winding up otherwise than by a court, an auditor's certificate to the effect that there are no legal proceeding pending in any court in India against the applicant or the company under liquidation and there is no legal impediment in permitting the remittance.

### **Repatriation of Dividend**

Dividends are freely repatriable without any restrictions (net after Tax deduction at source or Dividend Distribution Tax, if any, as the case may be). The repatriation is governed by the provisions of the Foreign Exchange Management (Current Account Transactions) Rules, 2000, as amended from time to time.

### **Repatriation of Interest**

Interest on fully, mandatorily & compulsorily convertible debentures is also freely repatriable without any restrictions (net of applicable taxes). The repatriation is governed by the provisions of the Foreign Exchange Management (Current Account Transactions) Rules, 2000, as amended from time to time.

## **REPORTING OF FDI**

### **Reporting of Inflow**

(i) An Indian company receiving investment from outside India for issuing shares/convertible debentures/preference shares under the FDI Scheme, should report the details of the amount of consideration to the Regional Office concerned of the Reserve Bank not later than 30 days from the date of receipt in the Advance Reporting Form.

(ii) Indian companies are required to report the details of the receipt of the amount of consideration for issue of shares/convertible debentures, through an AD Category-I bank, together with a copy/ies of the FIRC/s evidencing the receipt of the remittance along with the KYC report on the non-resident investor from the overseas bank remitting the amount. The report would be acknowledged by the Regional Office concerned, which will allot a Unique Identification Number (UIN) for the amount reported.

Explanation: An Indian company issuing partly paid equity shares, shall furnish a report not later than 30 days from the date of receipt of each call payment.

### **Reporting of issue of shares**

(i) After issue of shares (including bonus and shares issued on rights basis and shares issued under ESOP and against Convertible Notes)/fully, mandatorily & compulsorily convertible debentures/fully, mandatorily & compulsorily convertible preference shares, the Indian company has to file Form FC-GPR, not later than 30 days from the date of issue of shares.

(ii) Form FC-GPR has to be duly filled up and signed by Managing Director/Director/Secretary of the Company and submitted to the Authorized Dealer of the company, who will forward it to the Reserve Bank. The following documents have to be submitted along with the form:

(a) A certificate from the Company Secretary of the company certifying that:

(A) all the requirements of the Companies Act, as applicable, have been complied with;

(B) terms and conditions of the Government of India approval, if any, have been complied with;

(C) the company is eligible to issue shares under the regulations; and

(D) the company has all original certificates issued by authorized dealers in India evidencing receipt of amount of consideration.

**Note:** For companies with paid up capital with less than Rs.5 crore, the above mentioned certificate can be given by a practicing company secretary.

(b) A certificate from SEBI registered Merchant Banker or Chartered Accountant indicating the manner of arriving at the price of the shares issued to the persons resident outside India.

(c) The report of receipt of consideration as well as Form FC-GPR have to be submitted by the AD Category-I bank to the Regional Office concerned of the Reserve Bank under whose jurisdiction the registered office of the company is situated.

Note: An Indian company issuing partly paid equity shares shall file a report in form FC-GPR to the extent they become paid up.

(d) Annual return on Foreign Liabilities and Assets should be filed on an annual basis by the Indian company, directly with the Reserve Bank. This is an annual return to be submitted by 15th of July every year, pertaining to all investments by way of direct/portfolio investments/reinvested earnings/other capital in the Indian company made during the previous years (i.e. the information submitted by 15th July will pertain to all the investments made in the previous years up to March 31). The details of the investments to be reported would include all foreign investments made into the company which is outstanding as on the balance sheet date. The details of overseas investments in the company both under direct/portfolio investment may be separately indicated.

(e) Issue of bonus/rights shares or stock options to persons resident outside India directly or on amalgamation/merger/demerger with an existing Indian company, as well as issue of shares on conversion of ECB/royalty/lumpsum technical know-how fee/import of capital goods by units in SEZs, has to be reported in Form FC-GPR.

### **Reporting of transfer of shares**

Reporting of transfer of shares between residents and non-residents and vice-versa is to be done in Form FC-TRS. The Form FC-TRS should be submitted to the AD Category-I bank, within 60 days from the date of receipt of the amount of consideration. The onus of submission of the Form FC-TRS within the given timeframe would be on the transferor/transferee, resident in India. However, in cases where the NR investor, including an NRI, acquires shares on the stock exchanges under the FDI scheme, the investee company would have to file form FC-TRS with the AD Category-I bank. The AD Category-I bank, would forward the same to its link office. The link office would consolidate the Form FC-TRS and submit a monthly report to the Reserve Bank.

### **Reporting of Non-Cash**

Details of issue of shares against conversion of ECB have to be reported to the Regional Office concerned of the RBI, as indicated below:

(i) In case of **full conversion** of ECB into equity, the company shall report the conversion in Form FC-GPR to the Regional Office concerned of the Reserve Bank as well as in Form ECB -



2 to the Department of Statistics and Information Management (DSIM), Reserve Bank of India, Bandra-Kurla Complex, Mumbai- 400 051, within seven working days from the close of month to which it relates. The words "ECB wholly converted to equity" shall be clearly indicated on top of the Form ECB-2. Once reported, filing of Form ECB-2 in the subsequent months is not necessary.

(ii) In case of **partial conversion** of ECB, the company shall report the converted portion in Form FC-GPR to the Regional Office concerned as well as in Form ECB-2 clearly differentiating the converted portion from the non-converted portion."The words "ECB partially converted to equity" shall be indicated on top of the Form ECB-2. In the subsequent months, the outstanding balance of ECB shall be reported in Form ECB-2 to DSIM.

### **Reporting of FCCB/DR Issues**

The domestic custodian shall report the issue/transfer of sponsored/unsponsored depository receipts as per DR Scheme 2014 in 'Form DRR' within 30 days of close of the issue/ program.

### **ADHERENCE TO GUIDELINES/ORDERS AND CONSEQUENCES OF VIOLATION**

FDI is a capital account transaction and thus any violation of FDI regulations are covered by the penal provisions of the FEMA. Reserve Bank of India administers the FEMA and Directorate of Enforcement under the Ministry of Finance is the authority for the enforcement of FEMA. The Directorate takes up investigation in any contravention of FEMA.

### **PENALTIES**

If a person violates/contravenes any FDI Regulations, by way of breach/non-adherence/non-compliance/contravention of any rule, regulation, notification, press note, press release, circular, direction or order issued in exercise of the powers under FEMA or contravenes any conditions subject to which an authorization is issued by the Government of India/ Reserve Bank of India, he shall, upon adjudication, be liable to a penalty up to thrice the sum involved in such contraventions where such amount is quantifiable, or up to two lakh Rupees where the amount is not quantifiable, and where such contraventions is a continuing one, further penalty which may extend to five thousand Rupees for every day after the first day during which the contraventions continues.

Where a person committing a contravention of any provisions of this Act or of any rule, direction or order made there under is a company (company means any body corporate and includes a firm or other association of individuals as defined in the Companies Act), every person who, at the time the contravention was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

Any Adjudicating Authority adjudging any contraventions under 3.1(i) above, may, if he thinks fit in addition to any penalty which he may impose for such contravention direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government.

## **ADJUDICATION AND APPEALS**

For the purpose of adjudication of any contravention of FEMA, the Ministry of Finance as per the provisions contained in the Foreign Exchange Management (Adjudication Proceedings and Appeal) Rules, 2000 appoints officers of the Central Government as the Adjudicating Authorities for holding an enquiry in the manner prescribed. A reasonable opportunity has to be given to the person alleged to have committed contraventions against whom a complaint has been made for being heard before imposing any penalty.

The Central Government may appoint as per the provisions contained in the Foreign Exchange Management (Adjudication Proceedings and Appeal) Rules, 2000, an Appellate Authority/ Appellate Tribunal to hear appeals against the orders of the adjudicating authority.

## **COMPOUNDING PROCEEDINGS**

Under the Foreign Exchange (Compounding Proceedings) Rules 2000, the Central Government may appoint 'Compounding Authority' an officer either from Enforcement Directorate or Reserve Bank of India for any person contravening any provisions of the FEMA. The Compounding Authorities are authorized to compound the amount involved in the contravention to the Act made by the person. No contravention shall be compounded unless the amount involved in such contravention is quantifiable. Any second or subsequent contravention committed after the expiry of a period of three years from the date on which the contravention was previously compounded shall be deemed to be a first contravention. The Compounding Authority may call for any information, record or any other documents relevant to the compounding proceedings. The Compounding Authority shall pass an order of compounding after affording an opportunity of being heard to all the concerns as expeditiously as and not later than 180 days from the date of application made to the Compounding Authority. Compounding Authority shall issue order specifying the provisions of the Act or of the rules, directions, requisitions or orders made there under in respect of which contravention has taken place along with details of the alleged contraventions.

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