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FOREIGN DIRECT INVESTMENT IN INDIA: AN OVERVIEW OF FEMA REGULATIONS

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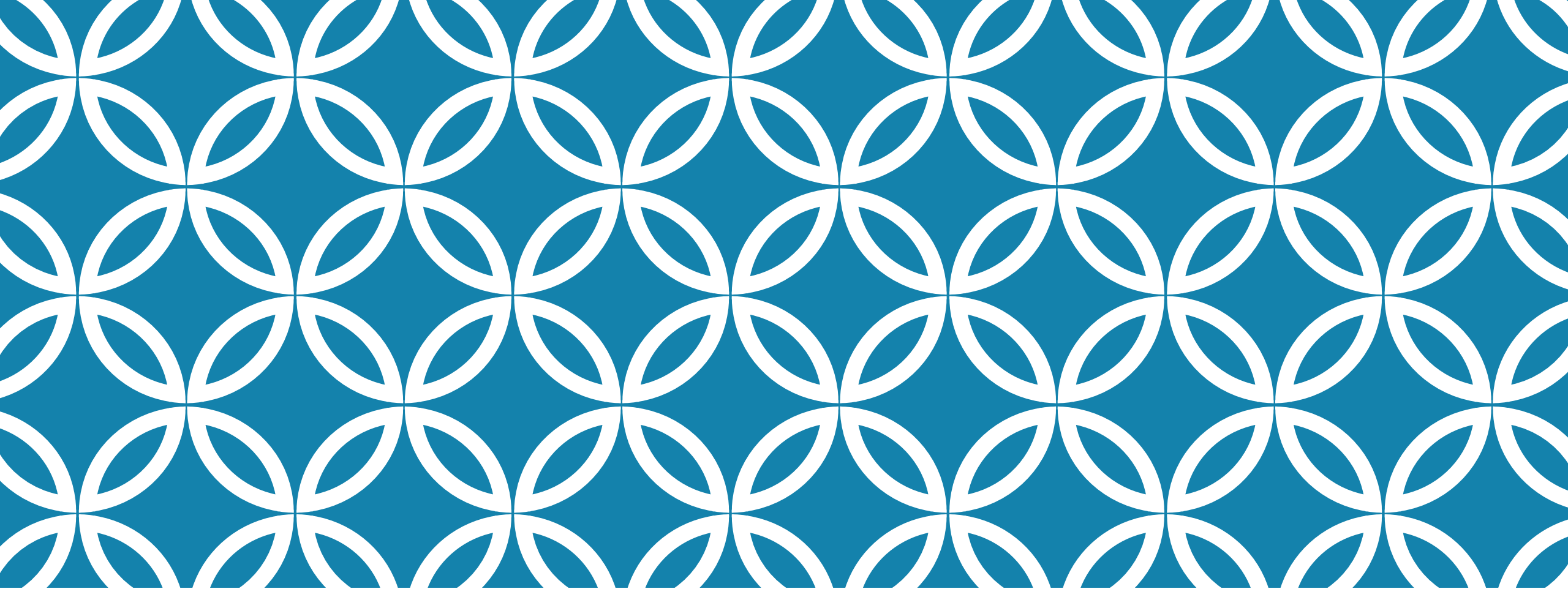
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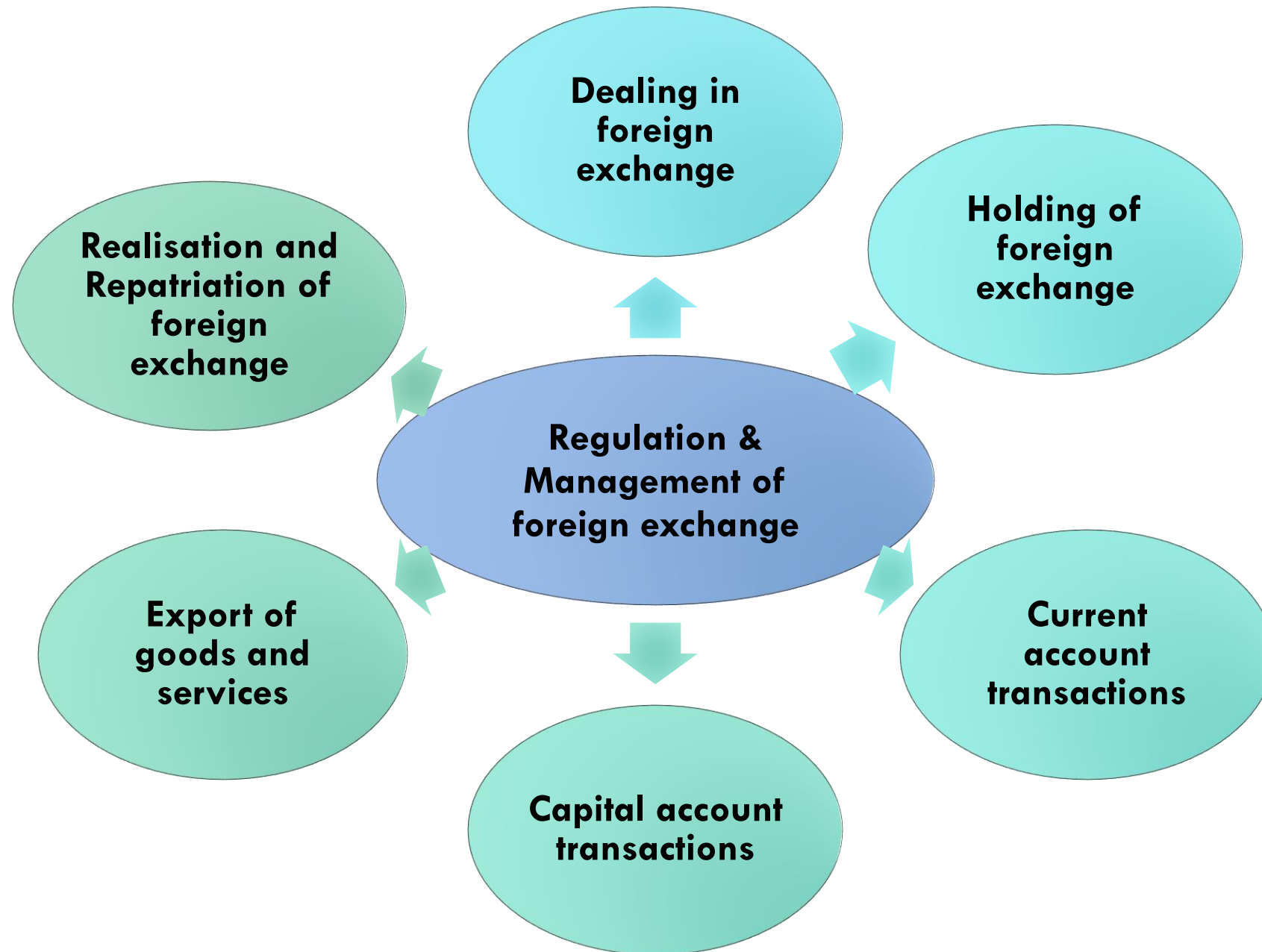
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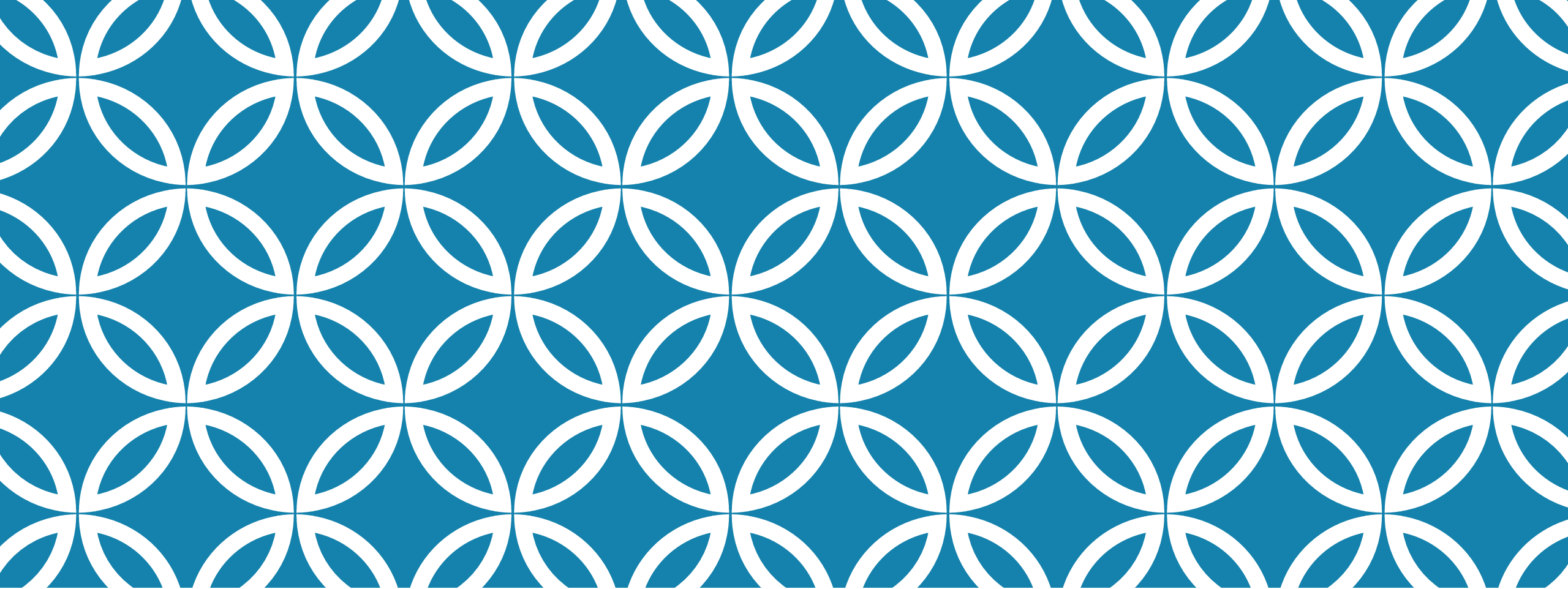
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OVERVIEW OF REGULATORY FRAMEWORK OF FEMA





RULES & REGULATIONS UNDER FEMA

RULES V/S REGULATIONS

Power with Central Government to frame Rules [Section 46]

- restriction on current account transactions;
- instruments which can be determined as debt instruments, permissible classes of capital account transactions;
- manner of compounding of contravention u/s 15 (1);
- manner of holding an inquiry by AA u/s 16 (1);
 - inserted by Finance Act, 2015 w.e.f. a date yet to be notified.
- **Form of appeal and fee for filing appeal;**
 - u/s 17 – Appeal to Special Director (Appeals)
 - u/s 19 – Appeal to Appellate Tribunal

RULES V/S REGULATIONS

Power with RBI to frame Regulations [Section 47]

- permissibility of capital account transactions;
 - Power shifted to CG by virtue of amendment by Finance Act, 2015 w.e.f. a date yet to be notified.
- manner of declaration to be furnished in case of export of goods and services;
- period and manner of repatriation of foreign exchange;
- limit on possession of foreign currency and foreign coins;
- class of persons and limit upto which foreign currency may be held in foreign currency a/c;
- export, import or holding of currency or currency notes;
- limit upto which forex acquired may be exempted or retained.

RULES/REGULATIONS UNDER FEMA

Nature of Transactions

- FEM (Current Account Transactions) Rules, 2000
- FEM (Permissible Capital Account Transactions) Regulations, 2000

Borrowing/ Lending/ Guarantee

- FEM (Borrowing or Lending in Foreign Exchange) Regulations, 2000
- FEM (Borrowing and Lending in Rupees) Regulations, 2000
- FEM (Guarantee) Regulations, 2000

Others

- FEM (Establishment in India of a Branch Office or Liaison Office or a Project Office or any other Place of Business) Regulations, 2016
- FEM (Investment in Firm or Proprietary Concern in India) Regulations, 2000
- FEM (Deposit) Regulations, 2016

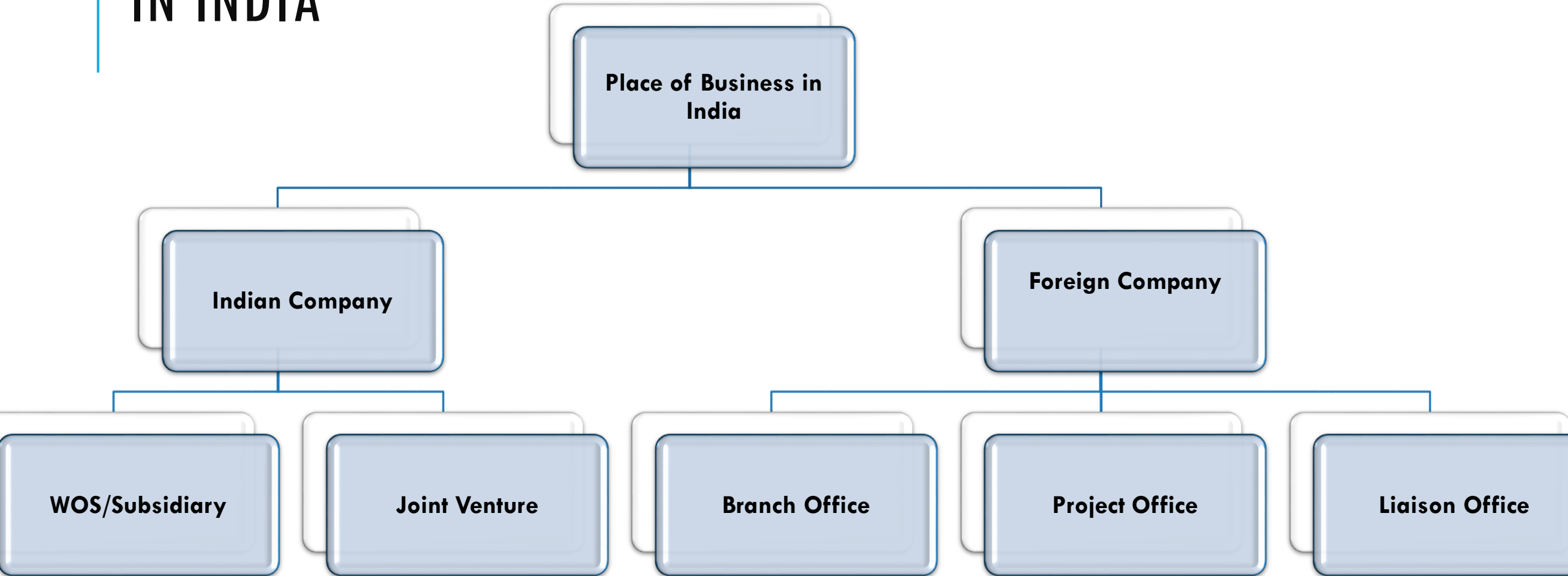
Issue of Securities

- FEM (Transfer or Issue of Security by a person resident outside India) Regulations, 2017
- FEM (Transfer or Issue of any Foreign Security) Regulations, 2004

Assets

- FEM (Acquisition and Transfer of Immoveable Property outside India) Regulations, 2015
- FEM (Acquisition and Transfer of Immoveable Property in India) Regulations, 2000
- FEM (Remittance of Assets) Regulations, 2016
- FEM (Regularisation of Assets held abroad by a person resident in India) Regulations, 2015

VARIOUS MODES OF ENTRY FOR ANY FOREIGN ENTITY IN INDIA





FOREIGN DIRECT INVESTMENT

FDI — AN OVERVIEW

FEMA (Transfer of Issue of security by a person resident outside India) Regulations, 2017

- effective from 7th November, 2017
- except proviso (ii) to Reg. 10 (1) and proviso (ii) to Reg. 10 (2)
- Master Direction on Foreign Investment in India – January 4, 2018

DIPP v/s RBI

- press notes v/s amendment regulations

FDI Policy v/s FEMA Regulations

Master Circular v/s Master Directions

Sectors specified v/s Sectors not specified

Automatic v/s approval route

Direct investment v/s indirect foreign investment

Repatriable v/s non-repatriable

CAPITAL INSTRUMENTS UNDER FDI

Equity shares

- issued as per Companies Act, 2013
- includes partly paid up shares
 - 25% payment upfront, full payment in 12 months

Preference shares

- fully, compulsorily and mandatorily convertible into equity

Bonds/debentures

- fully, compulsorily and mandatorily convertible into equity

Share warrants

- issued as per SEBI Regulations
- 25% payment upfront, full payment within 18 months

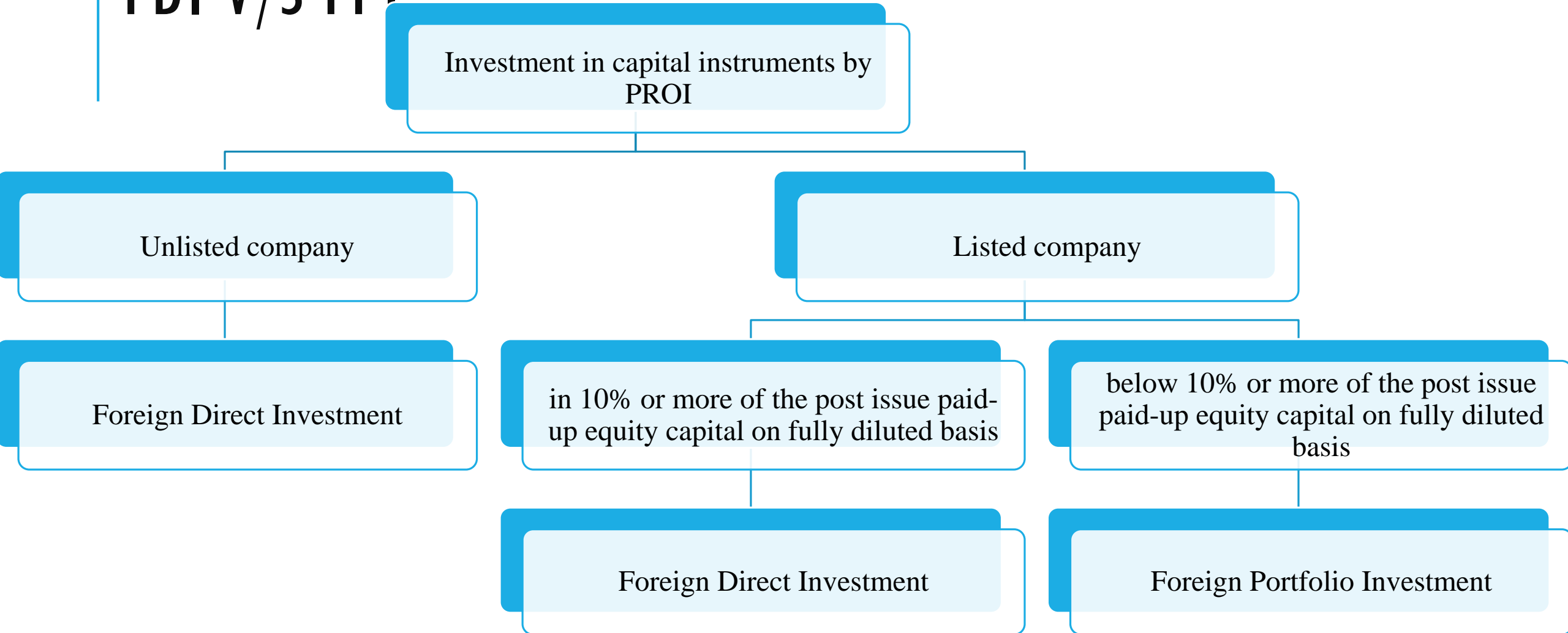
NC/ OC/ PC Preference shares

- issued on and upto April 30, 2007
- After that, regarded ECB.

OC/ PC debentures

- issued upto June 7, 2007
 - till their original maturity.

FDI V/S FPI



RELEVANT DEFINITIONS

Foreign Investment

- means any investment in capital instruments of an Indian company or to the capital of an LLP
 - made by a PROI
 - on a repatriable basis
- PROI may hold foreign investment either as FDI or FPI

Foreign Direct Investment (FDI)

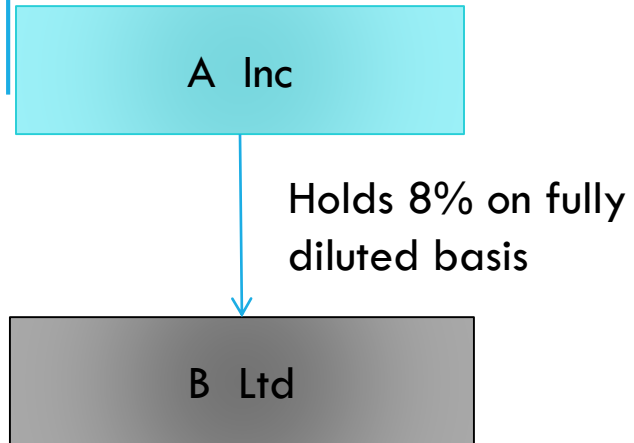
- Investment by PROI through capital instruments
 - in unlisted Indian company
 - in listed Indian company
 - in 10% or more of the post issue paid-up equity capital on a fully diluted basis (if all possible sources of conversion are exercised).
 - existing investment below 10% shall continue to be treated as FDI

RELEVANT DEFINITIONS

Foreign Portfolio Investment (FPI)

- Investment by PROI through capital instruments
 - in listed Indian company
 - in less than 10% of the post issue paid-up equity capital on a fully diluted basis
 - The 10 percent limit for foreign portfolio investors shall be applicable to each foreign portfolio investor or an investor group as referred in Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014
 - in less than 10 % of the paid up value of each series of capital instruments

EXAMPLE 1



Case 1: A Inc invests on non-repatriation basis.

Case 2: B Ltd is an unlisted Indian Company.

Case 3: B Ltd is a Listed Indian Company.

Which of the aforesaid in a case of FDI?

Case 1;

Case 2;

Case 3;

All of above

Answer: Case 2



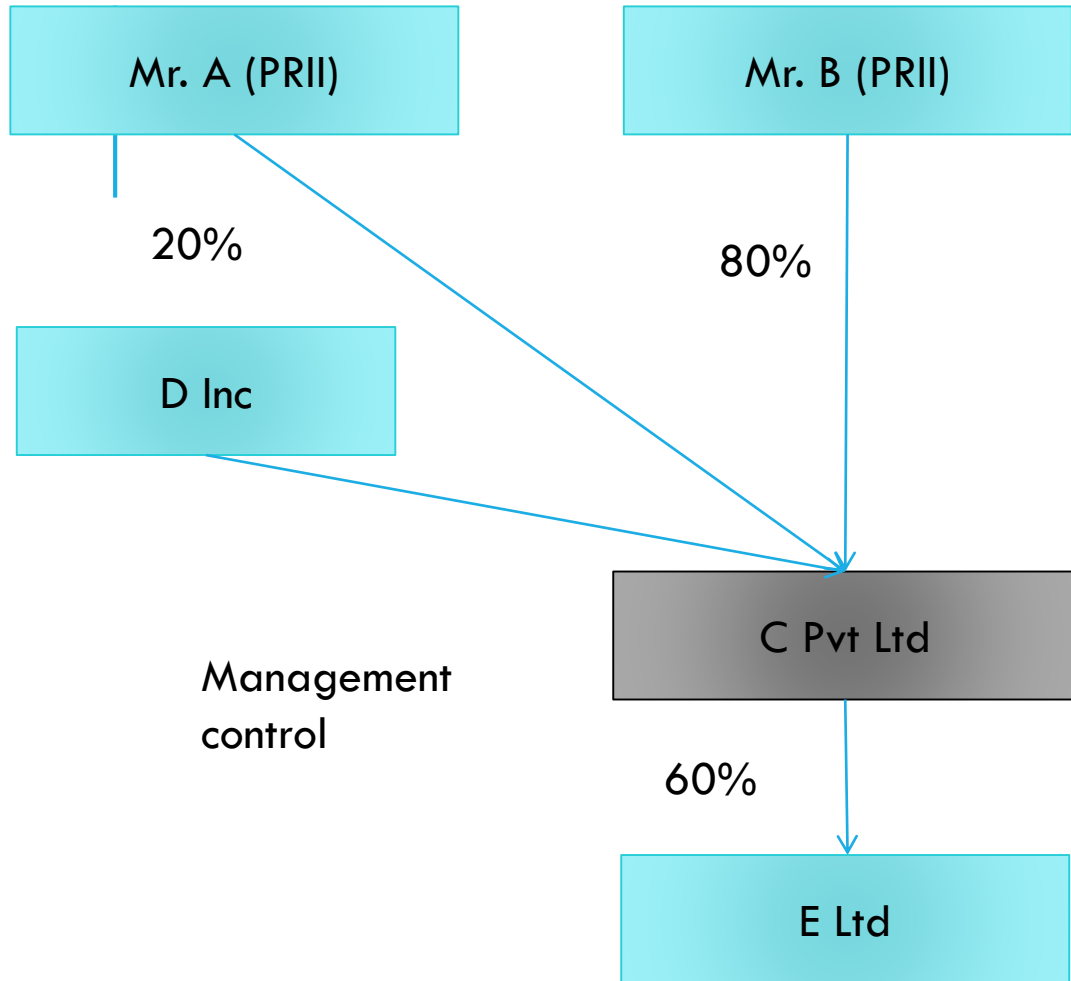
EXTENT OF INVESTMENT



Indirect foreign investment means Downstream Investment

- Investment in the capital instruments of another Indian company
 - by an Indian entity or
 - which has received foreign investment; and
 - is not owned and not controlled by resident Indian citizens; or
 - is owned or controlled by persons resident outside India.
 - by an Investment Vehicle
 - whose sponsor or manager or investment manager
 - is not owned and not controlled by resident Indian citizens; or
 - is owned or controlled by persons resident outside India.

EXAMPLE 2



Case 1: Mr. B holds shares as nominee of D Inc, what will be extent of indirect foreign investment in E Ltd?

- 80%
- 60%
- 48%
- None of above

Answer: 60%

Case 2: Mr. B holds shares as nominee of D Inc . What will be extent of indirect foreign investment in E Ltd is 100 % is held by C Pvt Ltd?

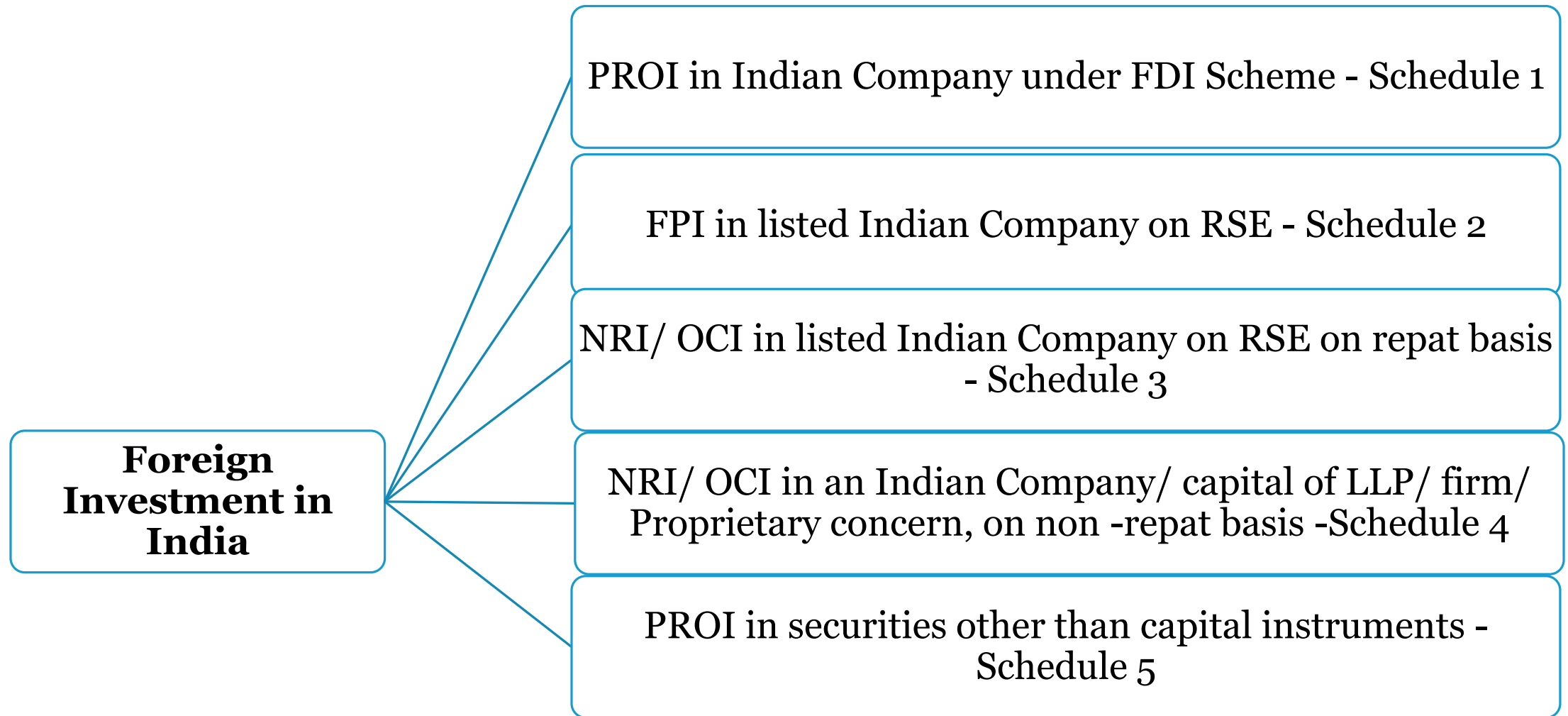
- 80%
- 100%
- None of above

Answer: 80%

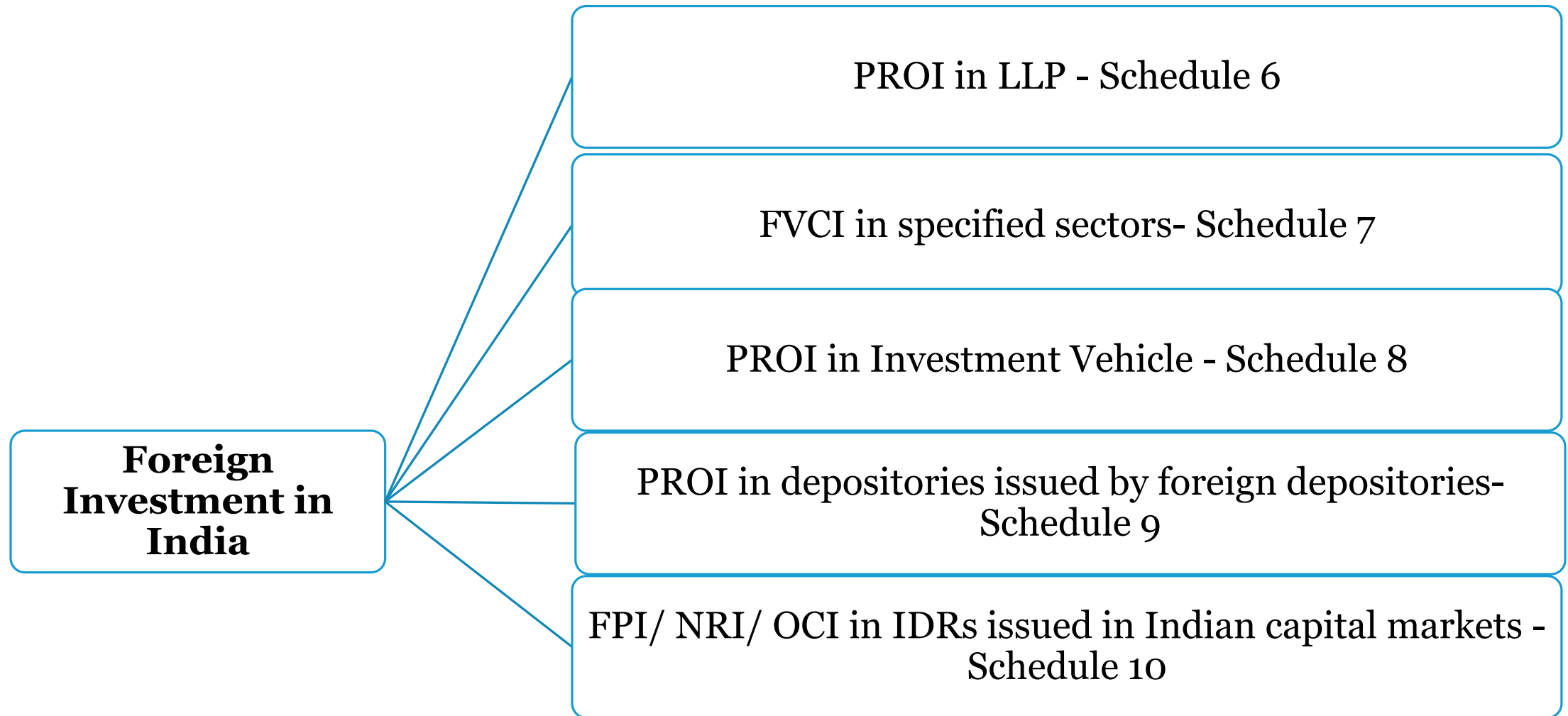


ELIGIBILITY FOR DIRECT FOREIGN INVESTMENT

WHO CAN INVEST?



WHO CAN INVEST?



WHO CANNOT INVEST?

a person who is citizen of

- Bangladesh
- Pakistan

Entity incorporated in Pakistan or Bangladesh

Can invest in Indian Company only under Government route

- in sectors other than defence, space, atomic energy and prohibited sectors (Reg. 15)
 - Lottery, gambling, betting, casino;
 - including foreign technology collaboration in any form.
 - to ensure foreign companies do not maintain their trade interests in India through the trademark or licensing route.
 - chit funds, nidhi company;
 - TDRs, real estate business or construction of farm house;
 - Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes;
 - Activities/ sector not open for private investment
 - Atomic energy, Railways.

ENTRY ROUTES

Automatic route:

- No approval required
- Only reporting

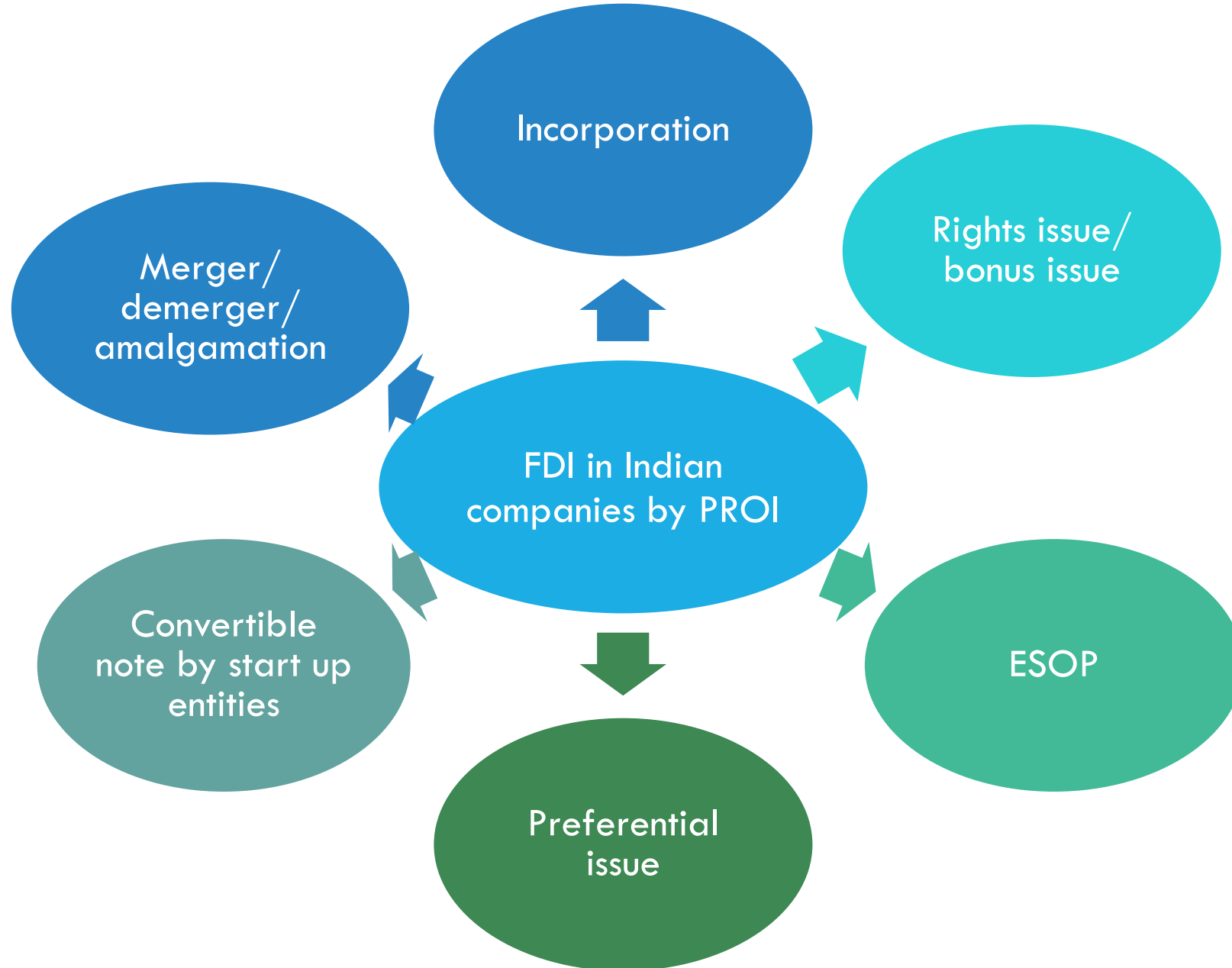
Approval route:

- Prior approval required
- Approval to be sought from Competent Authority

Transfer of control in all sectors where there are conditions will also require government approval



MODES OF INVESTMENT





PRICING GUIDELINES, REPORTING REQUIREMENTS IN CASE OF ISSUE

PRICING GUIDELINES IN CASE OF ISSUE

Swap of capital instruments

- valuation by SEBI registered Merchant Banker; or
- Investment Banker outside India

Shares by way of subscription to MOA

- at face value
 - subject to entry route & sectoral caps.

Share warrants

- pricing and price/conversion formula shall be determined upfront.

Pricing guidelines not applicable for investment in capital instruments by PROI on non-repatriation basis.

PRICING GUIDELINES IN CASE OF ISSUE

Listed company

- as per SEBI Guidelines

Unlisted company

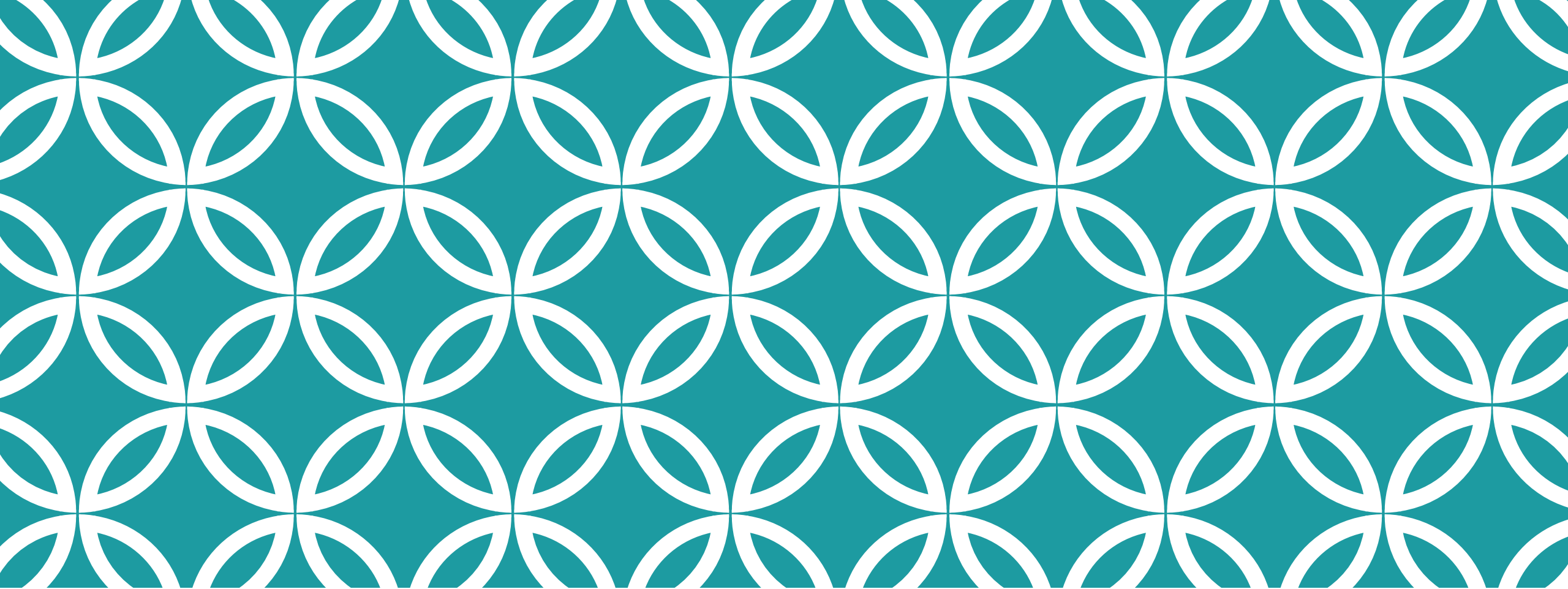
- as per valuation
 - done as per any internationally accepted pricing methodology for valuation on an arm's length basis;
 - duly certified by
 - Chartered Accountant;
 - SEBI registered Merchant Banker
 - Practising Cost Accountant

Company going through delisting process

- as per SEBI (Delisting of Equity Shares) Regulations, 2009.

Convertible capital instruments

- the price/ conversion formula to be determined upfront at the time of issue.
 - 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.
 - Act, 2013 - it can either be upfront or at the time, which shall not be earlier than thirty days to the date when the holder of convertible security becomes entitled to apply for shares

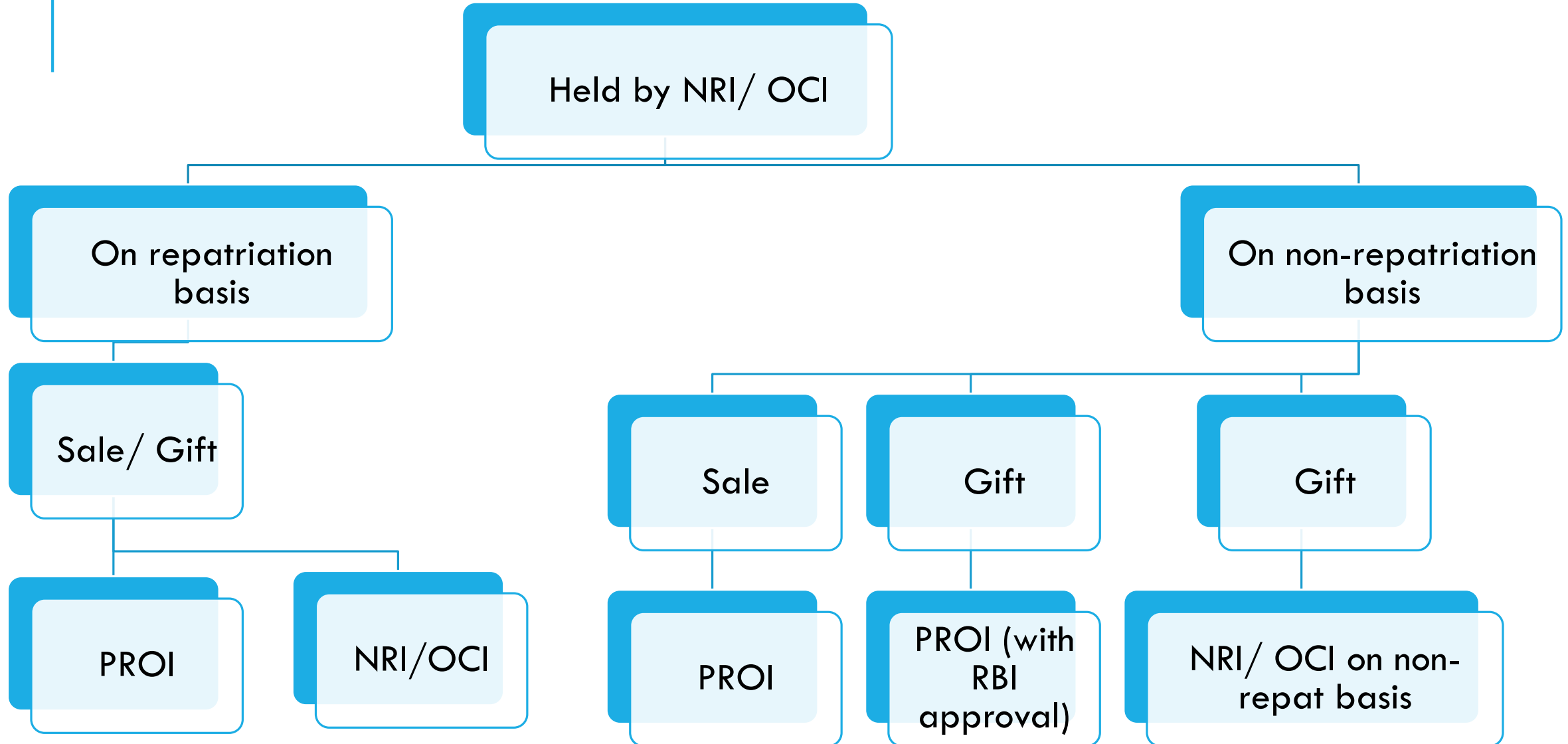


MODES OF TRANSFER

MODES OF TRANSFER OF CAPITAL INSTRUMENTS



MODES OF TRANSFER OF CAPITAL INSTRUMENTS



MODES OF TRANSFER OF CAPITAL INSTRUMENTS



Gift to PROI

- Donee should be eligible to hold security;
- should not exceed 5% of paid-up capital of Indian company;
 - on cumulative basis by a single person to another single person
- Sectoral cap;
- Donor and Donee shall be relatives;
- Value of security to be transferred together with any security transferred to any PROI as gift during the financial year does not exceed USD 50,000.



REPORTING IN SINGLE MASTER FORM

CREATION OF ENTITY MASTER

- Indian entities, which **have/ had received foreign investment**, must get themselves registered with Entity Master:
 - A **company** within the meaning of section 1(4) of the Companies Act, 2013;
 - A Limited Liability Partnership (**LLP**) registered under the Limited Liability Partnership Act, 2008;
 - A **startup** which complies with the conditions laid down in Notification No. G.S.R 180(E) dated February 17, 2016 issued by Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India
- Entity Master is a one stop portal for foreign investment reporting, which has been introduced with the objective of obtaining data on foreign investment in an Indian entity and is the first step towards reporting under Single Master Form.
- Indian entities **not complying** with this pre-requisite **will not be able to receive foreign investment** (including indirect foreign investment) and **will be non-compliant with Foreign Exchange Management Act, 1999** and regulations made thereunder.
- Existing companies with FDI were to register by July 20, 2018 on FIRMS.

9 FORMS OF REPORTING THROUGH SINGLE MASTER FORM

■ **FC-GPR: Foreign Currency – Gross Provisional Return**

- Old ARF + FC-GPR, filed for allotment of capital instruments

■ **FC-TRS**

- Reporting of transfer from PROL to PRII and vice versa

■ **Form LLP-I**

- FDI in LLP through capital contribution and profit shares

■ **Form LLP-II**

- Disinvestment/ transfer of capital contribution and profit shares in LLP

■ **Form CN –**

- issue or transfer of convertible notes

■ **Form ESOP**

- issue of ESOPs / sweat equity shares/ shares against exercise of ESOP by an Indian company to an employee resident outside India.

■ **Form DRR**

- - issue/transfer of Depository Receipts

■ **Form DI**

- Reporting of downstream investment (indirect foreign investment) in a company or LLP

■ **Form InVi-**

- Reporting of investment by a person resident outside India in an Investment vehicle

SEPARATE REPORTING

Annual Return on Foreign Liabilities and Assets (FLA): Submitted annually on or before the 15th day of July of each year. This is submitted by way of an email to fla@rbi.org.in

Form LEC(FII): The AD banks have to ensure that the FPIs registered with SEBI who are purchasing various securities (except derivative and IDRs) should report all such transactions details (except derivative and IDRs) in the Form LEC (FII) to Foreign Exchange Department, Reserve Bank of India, Central Office.

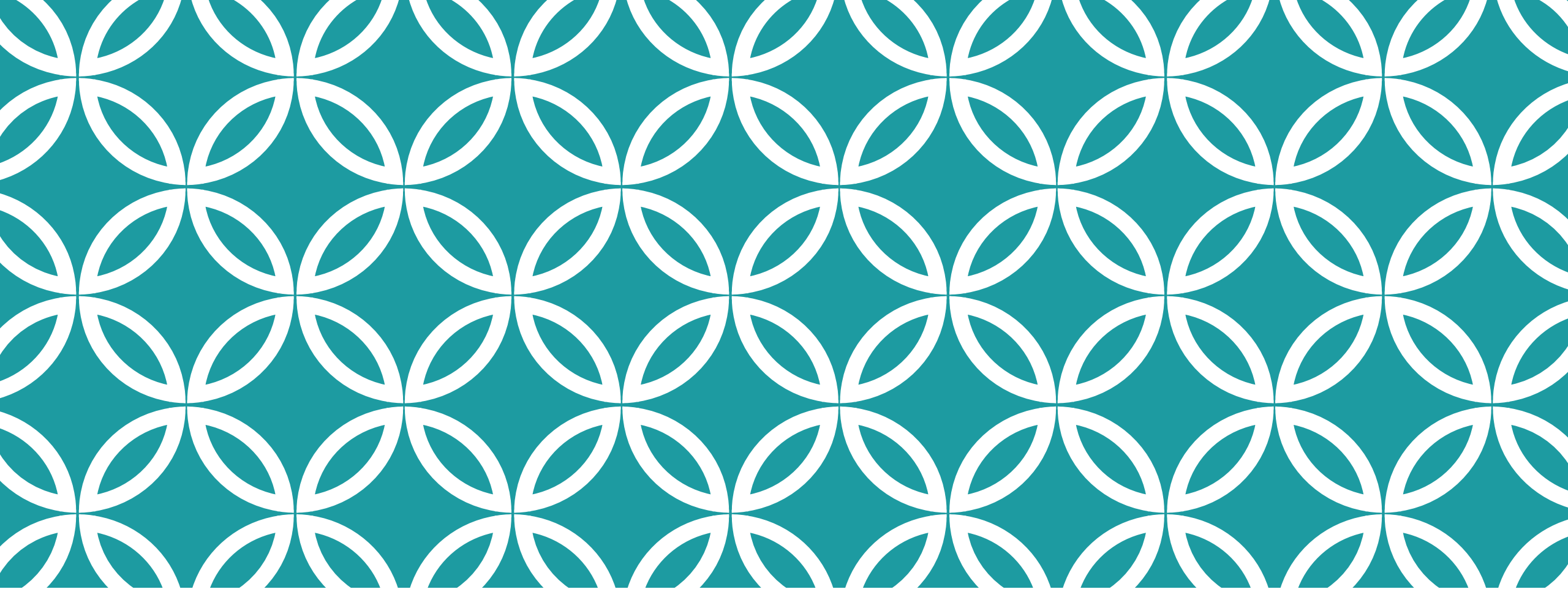
LEC(NRI): The Authorised Dealer Category I banks shall report to the Reserve Bank in Form LEC (NRI) the purchase/ transfer of capital instruments by Non-Resident Indians or Overseas Citizens of India stock exchanges in India.

DELAY IN REPORTING UNDER FEMA

Late Submission Fees

- Period of contravention shall be considered proportionately
 - {(approx. rounded off to next higher month ÷ 12) X amount for 1 year}.
- the period shall begin from the day after the 30th day (from the date of receipt of funds/ allotment or transfer of shares) and end on the day preceding the day on which the transaction report is received.
 - The date of reporting to the AD bank shall be deemed to be the date of reporting to the Reserve Bank provided the prescribed documentation is complete in all respects.
 - In case the reporting form (whether in physical or electronic form) is incomplete then the delay will continue till such time the form is received complete in all respects.
- The LSF may be paid by way of a demand draft drawn in favour of “Reserve Bank of India” and payable at the Regional Office concerned

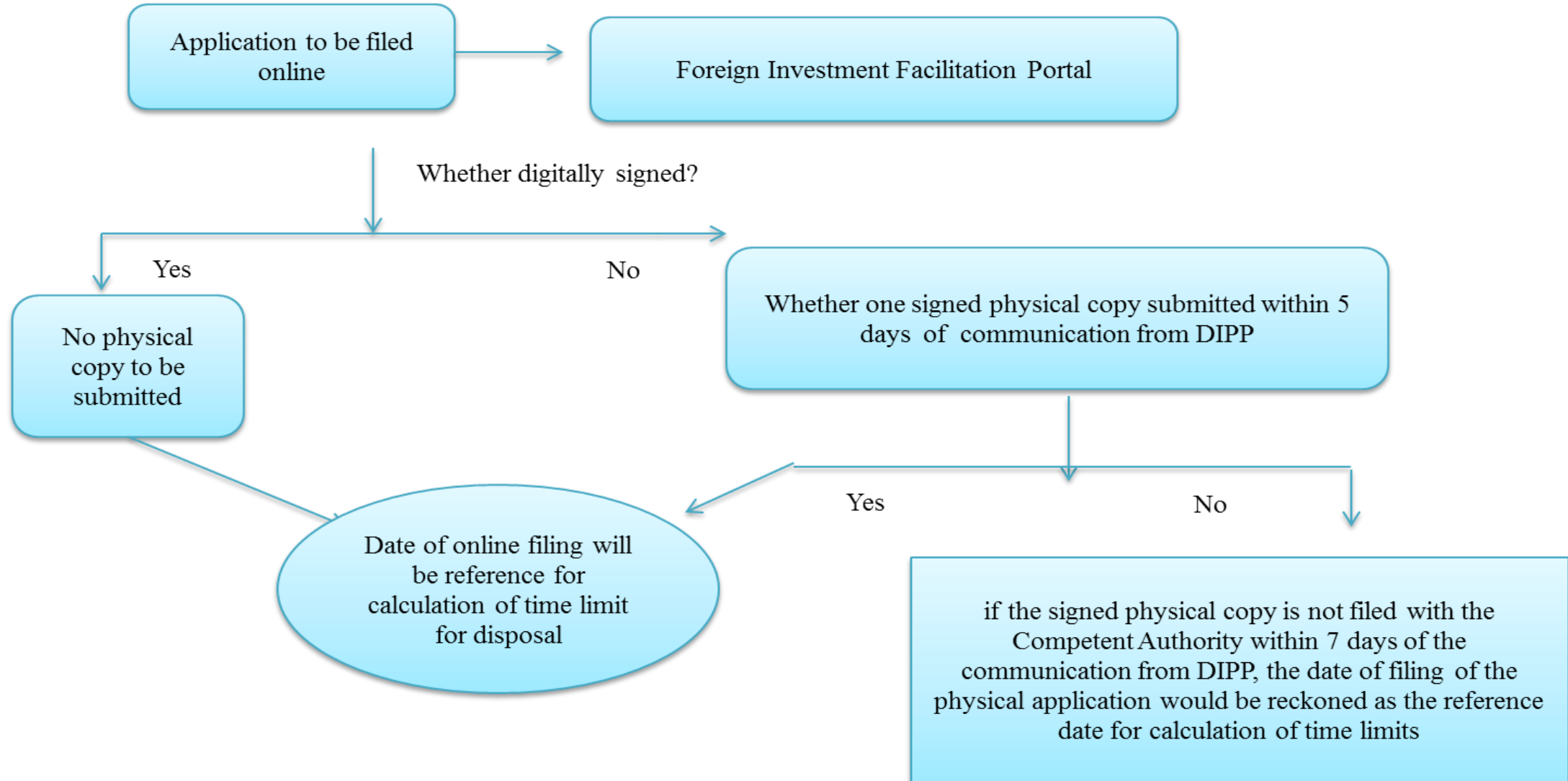
| Amount involved in reporting (in INR) | Late Submission Fee (LSF) as % of amount involved* | Maximum amount of LSF applicable |
|--|--|--|
| Upto 10 million | 0.05% | INR 1 million or 300% of the amount involved, whichever is lower. |
| More than 10 million | 0.15% | INR 10 million or 300% of the amount involved, whichever is lower. |
| • The % of LSF will be doubled every twelve months | | |

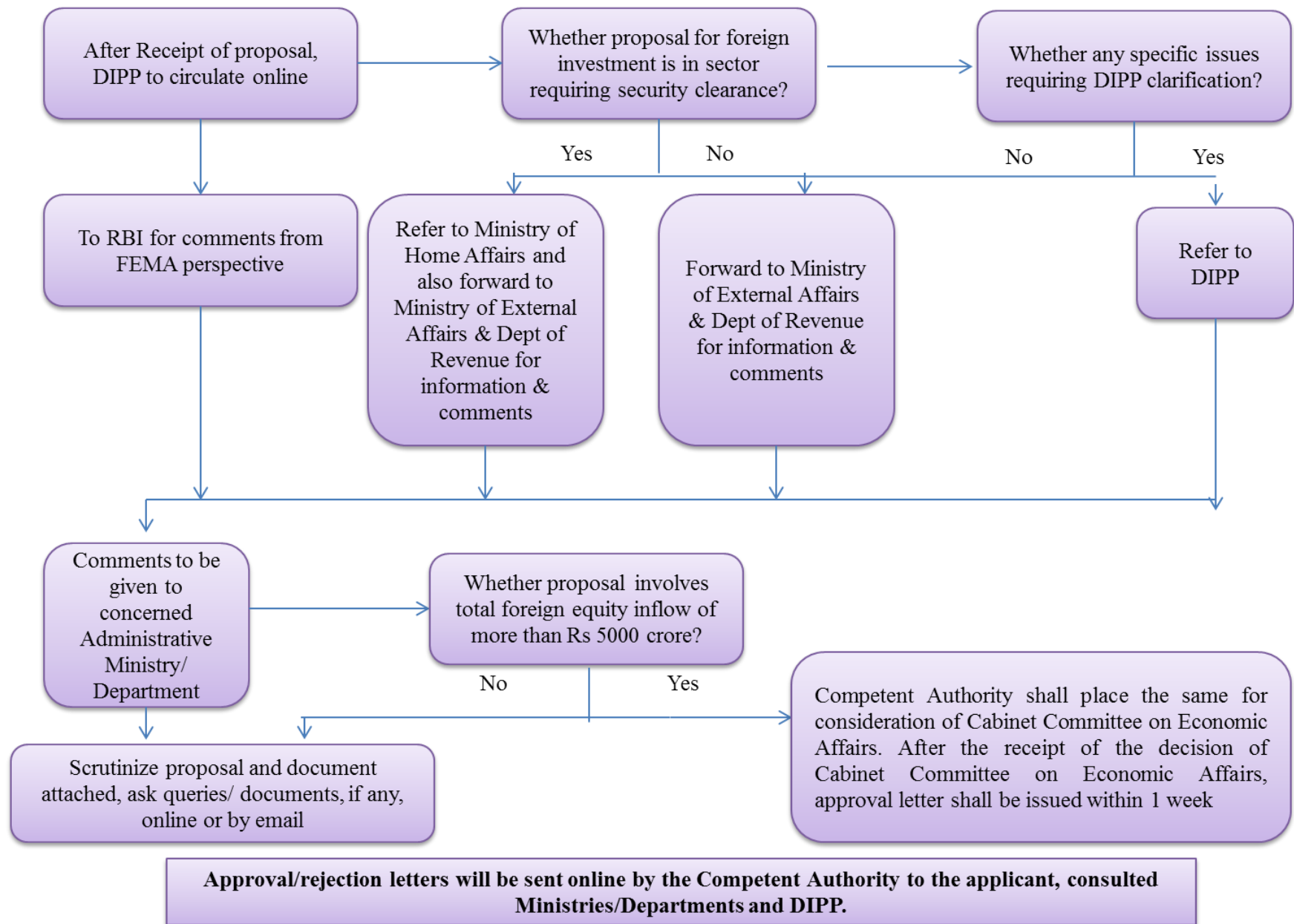


FDI UNDER APPROVAL ROUTE

Process, competent authorities,
timelines

PROCEDURE UNDER APPROVAL ROUTE





COMPETENT AUTHORITIES

| S. No. | Activity/ sector | Administrative Ministry/ Department |
|--------|---|---|
| (i) | Mining | Ministry of Mines |
| (ii) | Defence | |
| | a) Items requiring Industrial Licence under the Industries (Development & Regulation) Act, 1951, and/or Arms Act, 1959 for which the powers have been delegated by Ministry of Home Affairs to DIPP | Department of Defence Production, Ministry of Defence |
| | b) Manufacturing of Small Arms and Ammunitions covered under Arms Act 1959 | Ministry of Home Affairs |
| (iii) | Broadcasting | Ministry of Information & Broadcasting |
| (iv) | Print Media | |
| (v) | Civil Aviation | Ministry of Civil Aviation |

COMPETENT AUTHORITIES

| | | |
|--------|--|---|
| (vi) | Satellites | Department of Space |
| (vii) | Telecommunication | Department of Telecommunications |
| (viii) | Private Security Agencies | Ministry of Home Affairs |
| (ix) | Applications involving investments from <i>Countries of Concern</i> which presently include Pakistan and Bangladesh, requiring security clearance as per the extant FEMA 20, FDI Policy and security guidelines, amended from time to time | |
| (x) | Trading (Single, Multi brand and Food Product Retail Trading) | Department of Industrial Policy & Promotion |
| (xi) | FDI proposals by Non-Resident Indians (NRIs)/ Export Oriented Units (EOUs) requiring approval of the Government | |

Amended vide P.N. 01 / 2018
(not effective yet)

Investment under
automatic route - DIPP

Cases pertaining to
Govt approval route –
Nodal Administrative
Ministries/
Departments

PROPOSALS REQUIRING SECURITY CLEARANCE

■ Investments in

- Broadcasting
- Telecommunication
- Satellites - establishment and operation
- Private Security Agencies
- Defence,
- Civil Aviation and
- Mining & mineral separation of titanium bearing minerals and ores, its value addition and integrated activities.

■ Investments from Pakistan and Bangladesh;

- Security clearance and comments from Ministry of Home Affairs (MHA)
 - within 6 weeks of online receipt of the proposal
 - If not in position to revert in 6 weeks, will inform concerned administrative Ministry/Department of the expected time frame

TIMELINES FOR APPROVAL

| S.No. | Action Points | Time Period | Cum. Time Period |
|---|---|-------------|------------------|
| 1 | Dissemination of Investment Proposal by DIPP to Concerned Ministry/Department | 2 days | 1 Week |
| 2 | Time for submission of signed physical copy of the proposal to the Competent Authority, if needed | 5 days | |
| 3 | Initial scrutiny of the proposal and documents attached therewith, and seeking relevant additional information/documents from the applicant | 1 Week | 2 Weeks |
| 4 | Submission of clarification by DIPP on specific issues of FDI policy | 2 Weeks | 4 Weeks |
| 5 | Submission of comments by Consulted Ministry/ Department/ RBI/ Any Other Stakeholder | 4 Weeks | 6 Weeks |
| 6 | Submission of Comments by Ministry of Home Affairs on proposals requiring security clearance | 6 Weeks | 8 Weeks |
| 7 | Approval on proposals by Competent Authority for grant of approval | 2 Weeks | |
| | Proposals not requiring security clearance | | 8 Weeks |
| | Proposal Requiring security clearance | | 10 Weeks |
| Note: i. Additional time of 2 weeks will be given to DIPP for consideration of those proposals which are proposed for rejection or where additional conditions which are not provided in the FDI policy are proposed to be imposed by the Competent Authority. ii. Time limits allocated exclude the time taken by applicants in removing deficiencies in the proposals/supplying additional information as may be required by the Competent Authority. | | | |

READ OUR RELATED RESOURCES HERE

- **FAQs on SMF and Entity Master** by Vallari Dubey: Click [here](#)
- **INVESTMENT BY MUTUAL FUNDS: WHETHER INDIRECT FOREIGN INVESTMENT?**
By Vinita Nair and Pammy Jaiswal: Click [here](#)
- **FDI IN FINANCIAL SERVICES SECTOR: RESTRICTIONS BROUGHT BACK BUT FOR UNREGULATED ENTITIES** by Anita Bair: Click [here](#)
- **Other write ups on FEMA:** Click [here](#)

ABOUT US



Vinod Kothari & Co.,

- Based in Kolkata, Mumbai, Delhi

We are a team of consultants, advisors & qualified professionals having over 30 years of practice.

Our Organization's Credo:

Focus on capabilities; opportunities shall follow