2nd Workshop on Foreign Exchange Management Act, 1999 ('FEMA')

Session V: Foreign Direct Investment ('FDI')

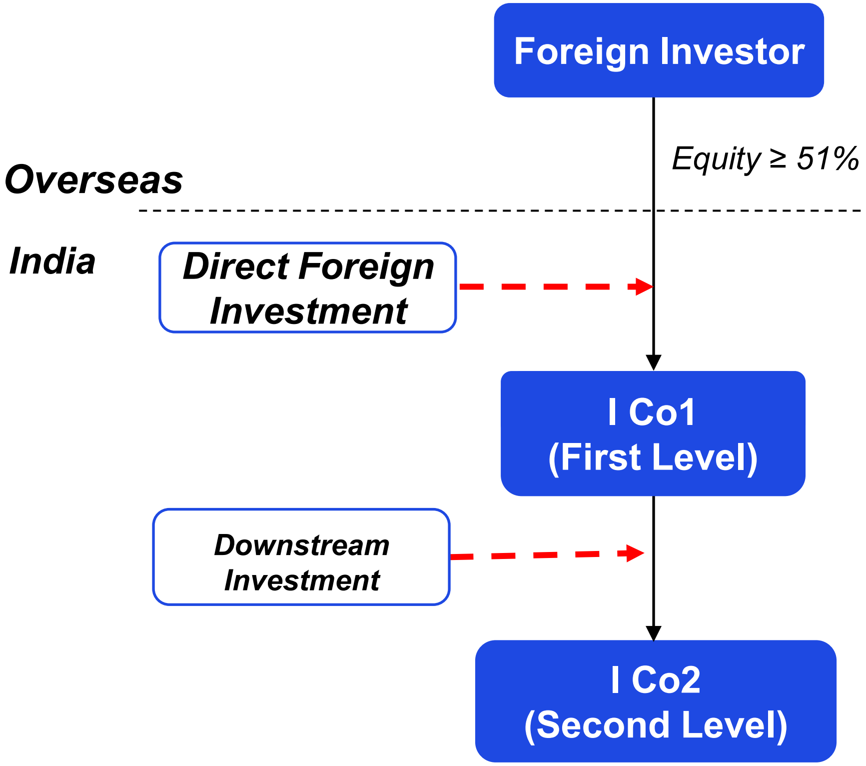
Overview of FDI provisions

FDI or Foreign Investment	▪ FDI is: • Investment made by person resident outside India (Non-resident) in equity of an unlisted co.; or • ≥10 per cent of post issue paid-up capital of a listed co.; or • In capital of a Limited Liability Partnership ('LLP'). ▪ Foreign investment may be made Directly or Indirectly ▪ Investment may be made through equity or quasi equity instruments* by a person resident outside India
Eligible foreign investors	▪ Person resident outside India – including Individuals, Company, body corporate.

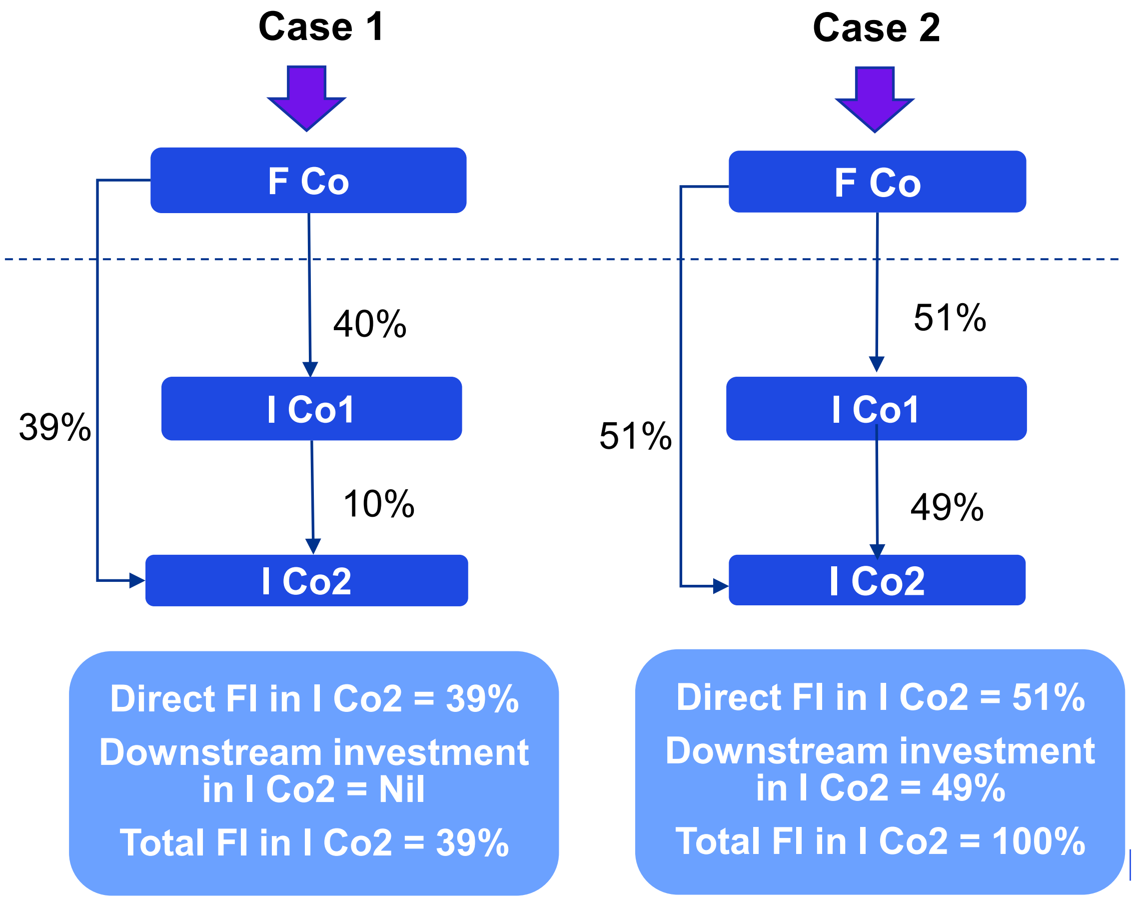
Downstream Investment

Investment by an intermediate Indian company (which is owned or controlled by a NR) into another Indian entity is considered as indirect foreign investment or downstream investment.

FDI & Downstream Investment



Calculation of Downstream Investment



Downstream Investment – Key Conditions

- Downstream investment is considered as indirect foreign investment for the investee entity. Downstream Investment is subject to the following conditions:
  - Downstream Investment requires the approval of the Board of Directors as also a shareholders agreement (if any);
  - The Indian Co. making downstream investment shall bring in requisite funds from abroad and not use funds borrowed in the domestic markets and the investments may be made through internal accruals;
  - Internal accruals shall mean profits transferred to reserve account after payment of taxes; and
  - The first level Indian Co. making investment shall be responsible for ensuring compliance with these rules for the investment made by it at second level and so on and so forth.

Investment routes

FDI in India

Category I Automatic route	Category II Government route	Category III Prohibited sectors
• **No approval is required.** • FDI is allowed under 100% automatic route for following sectors (illustrative): – Manufacturing; – Cash and wholesale trading; – E-commerce; – NBFC; – Single brand retail trading; – Pharmaceuticals (greenfield) etc.	• **Prior approval from GOI is required (Illustrative list)** • Defence - *up to 74% under automatic route rest under government route*; • Multi brand retail trading – *upto 51% under automatic route*; • Food Products Retail Trading – *100 per cent*; • Pharmaceuticals (brownfield) - *up to 74% under automatic route rest under government route.*	• Chit funds; • Nidhi company; • Trading in Transferable Development Rights; • Real estate business; • Activities or sectors not open to private sector investment; and • Foreign technology collaborations.

FDI from land bordering countries – Regulation

- The press note 3 of 2020 (‘PN3’) made amendment to Rule 6 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 whereby all investments from land bordering countries may be made only through the Government approval route.
- Relevant extract of the regulations is given below:

  “Provided that an entity of a country, which shares land border with India or the beneficial owner of an investment into India who is situated in or is a citizen of any such country, shall invest only with the Government approval:

  Provided further that, a citizen of Pakistan or an entity incorporated in Pakistan shall invest only under the Government route, in sectors or activities other than defence, space, atomic energy and such other sectors or activities prohibited for foreign investment:

  *Provided also that in the event of the **transfer of ownership** of any **existing or future FDI** in an entity in India, **directly or indirectly**, resulting in the **beneficial ownership** falling within the restriction or purview of the above provisos, such subsequent change in beneficial ownership shall also require government approval*”.

FDI from land bordering countries – Key aspects

01

Entity of a country which shares land border with India

- India shares land border with **7 Countries** which are **China**, Bangladesh, Pakistan, Bhutan, Nepal, Myanmar and Afghanistan (referred to as Specified Country).
- Among above countries, China has the largest share of FDI inflow into India. Therefore, the restrictions largely impact Chinese investors investing into India.

02

Beneficial Ownership not defined

- The term 'beneficial ownership' is not defined under this regulation.
- 'Beneficial Ownership' is defined under Companies (Significant Beneficial Owners) Rules 2018 ('Companies Rules') and/or the Prevention of Money-laundering (Maintenance of Records) Rules, 2005 ('PMLA Rules') or under and/or the standard operation procedure issued by the DPIIT and/or Know your Customer Directions issued by RBI. Combination of economic interest (ranging from 10 to 25 per cent) or control are key deciding factors.

Meaning of Non-debt instruments

Non Debt instruments-

Definition

- ‘Non-debt instruments’ means the following instruments:-
  - Investments in equity instruments of public, private, listed and unlisted;
  - Capital participation in LLP;
  - All instruments of investment recognised in the FDI policy notified from time to time;
  - Investment in units of AIF, REIT;
  - Investment Trusts (‘InvIts’);
  - Investment in units of mutual funds or ETF which invest more than fifty per cent in equity;
  - Acquisition, sale or dealing directly in immovable property;
  - Contribution to trusts; and
  - Depository receipts issued against equity instruments.

Types of instruments for making investment in India

Equity instrument	**Equity share**	▪ NR may invest in equity shares of an Indian Co.
	Compulsorily convertible instruments	▪ NR may invest in compulsorily convertible instruments which are: • Preference shares of an Indian Co. ('CCPS'); or • Debentures of an Indian company ('CCDs').
	Share warrants	▪ Share warrants are instruments issued by Indian Co. against which equity shares are allotted on a later date.

Convertible note	▪ Convertible notes are hybrid instruments issued by start-up[1] companies in exchange of funds. No valuation is required for issue of Convertible Notes. ▪ Allows start-ups to raise funds from angel investors. ▪ Issued for at least 25 lakhs rupee in a single tranche, repayable anytime or can be converted into equity shares within 10 years from the date of issue.

[1]"startup company" means a private company incorporated under the Companies Act, 2013 and identified under G.S.R. 180(E), dated the 17th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry;

Issue of shares against non-cash consideration

Non-cash consideration for issue of equity shares

- A company engaged in business allowed under automatic route can issue equity shares against the following:
  i. Swap of equity instruments;
  ii. Import of capital goods;
  iii. Pre- incorporation expense; and
  iv. Against any other amount payable which is permitted for remittance.

Regulation for issue against non-cash consideration

- Shares can be issued against the aforesaid considerations in accordance with:
  - The pricing guidelines;
  - Sectoral caps; and
  - Approval route.

Modes of issuance of shares

Modes of Issuance of shares

Preferential allotment	Right issue	Bonus shares
▪ Shares may be issued under the preferential allotment route in compliance with other laws. ▪ **Listed Co** - Price determined by the company as per SEBI guidelines. ▪ **Unlisted Co -** Issue price to be minimum of the price determined as per internationally accepted pricing methodology on an arm's length basis duly certified by a Chartered Accountant or a Merchant Banker.	▪ **Listed Co** - Rights issue to NR will be at a price determined by the company as per SEBI guidelines. ▪ **Unlisted Co** - Rights issue to persons resident outside India will not be at a price less than the price offered to persons resident in India. ▪ **Renunciation -** Any acquisition of shares by a NR pursuant to renunciation of rights shall be subjected to pricing guidelines.	▪ Foreign investors may receive bonus shares for their holdings in Indian companies.

Issuance of equity instruments - Key considerations

Issuance of shares to NR

Investment	Pricing guidelines	FMV	Key Compliances
By a listed Co.	▪ Minimum price as determined under SEBI guidelines.	▪ Valuation methods as per terms of SEBI guidelines.	▪ Form FC-GPR within 30 days of issuance
By an unlisted Co.	▪ Minimum Issue price = FMV of the shares being issued.	▪ Internationally accepted pricing methods.	▪ Form FC-GPR within 30 days of issuance

Other key elements

- Convertible instruments to be issued on the same basis as above;
- Price / Conversion formula for the conversion to be defined upfront;
- Valuation norms and Sectoral caps to be complied with; and
- Shares may be partly paid up to 25% at the time of issue and remaining consideration shall be received within 12 months.

Transfer of equity instruments - Key considerations

Transfer of shares

Investment	Pricing guidelines	FMV	Key Compliances
From R to NR	▪ Minimum transfer price = FMV of the shares.	▪ In case of unlisted entities - Internationally accepted pricing methods. ▪ In case of listed entities – determined by SEBI regulations (market price)	▪ Form FC-TRS within 60 days of transfer ▪ Responsibility of Resident transferor
From NR to R	▪ Maximum transfer price = FMV of the shares.	▪ In case of unlisted entities - Internationally accepted pricing methods. ▪ In case of listed entities – determined by SEBI regulations (market price)	▪ Form FC-TRS within 60 days of transfer ▪ Responsibility of Resident transferee

Other key elements

- In case of transfer of shares the consideration can be settled on deferred basis as per below:
  - 25% of the consideration shall be received at the time of transfer;
  - Remaining shall be received within 18 months.

Depository receipts including IDR (1/2)

Depository Receipt	**Meaning of depository receipt**	▪ A foreign currency denominated instrument listed on an international stock exchange issued by a foreign depository on the back of an eligible securities.
	Eligible instrument	▪ A person resident outside India may invest in the depository receipts ('DRs') issued by foreign depositories against eligible securities.

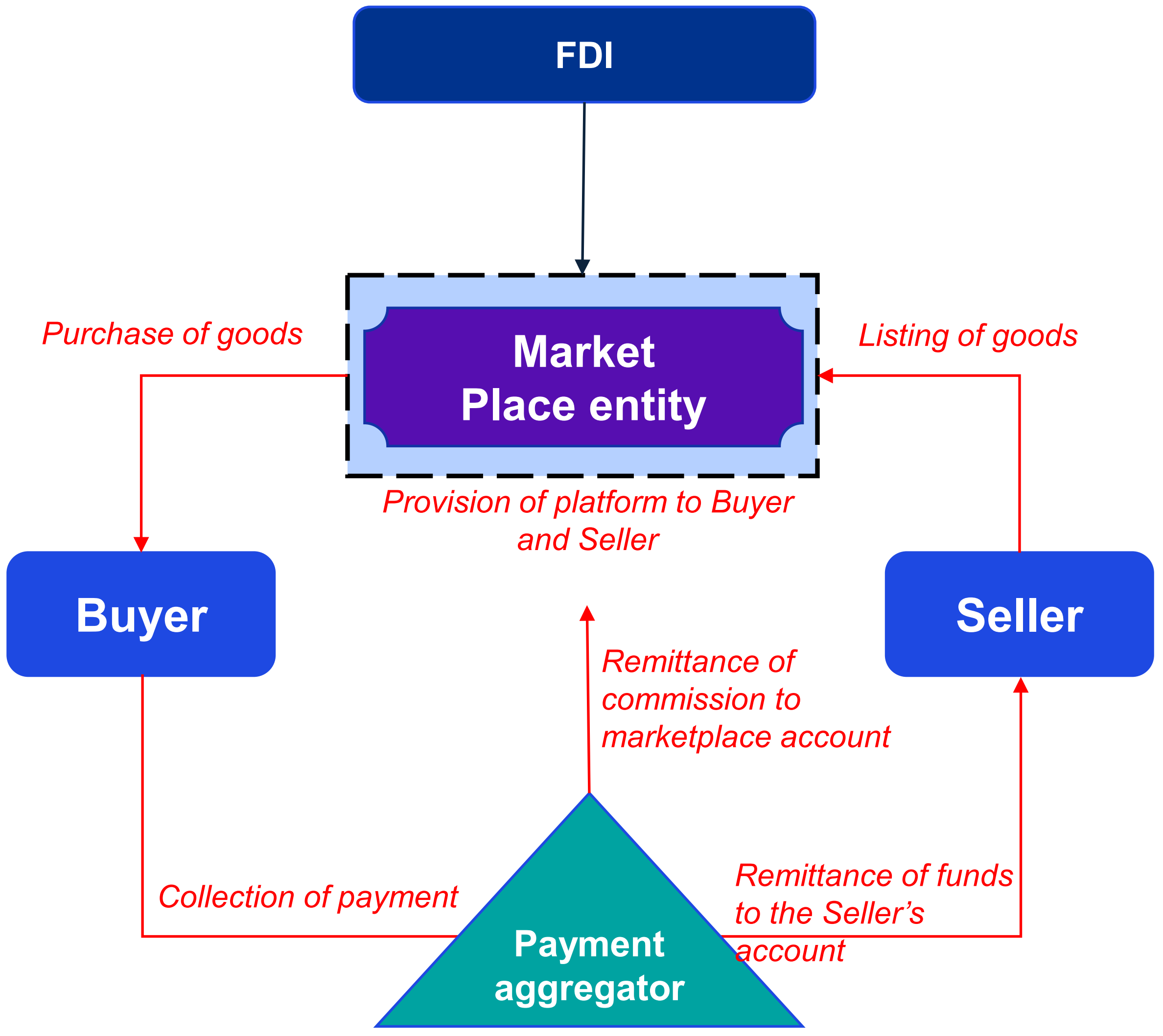
Depository receipts including IDR (2/2)

Indian Depository Receipt ('IDR')		
	Eligibility to issue IDRs	▪ Indian Depository Receipts ('IDRs') is an instrument in the form of a depository receipt created by a domestic depository in India and authorised by a company incorporated outside India making an issue.
	Who can issue	▪ Foreign Companies which satisfies the following conditions: – Continuous trading record; – Track record of distributable profits – 3 out of 5 years. – Mandatory listing in home country with good track record – No regulatory prohibition
	Purchase/ Hold/Sale of ODIs	▪ To be in compliance with ODI Regulations and Rules ▪ IDRs purchased by OCI/ NRI or FPIs shall be convertible into underlying equity shares after the expiry of one year from date of issue or can be redeemed in compliance with the FEMA regulations.

FDI in Limited Liability Partnership

Features of LLP	▪ Body corporate formed under the LLP Act and administered by Registrar of Companies. ▪ Separate legal entity with perpetual existence. ▪ Liability of partners limited to its capital contribution.
Eligible investees	▪ LLPs operating in sectors where 100% foreign investment is allowed under automatic route and there are no FDI linked performance conditions.
Types of investment	• Foreign investors can invest in Indian LLP by: • Capital contribution; • Acquisition or transfer of profit shares of LLP; and • Reinvestment of share of profits in the LLPs.
Valuation for investment	▪ Investment shall be made based on FMV of the LLP. FMV is determined by the valuation principles internationally accepted for arm length price.

Marketplace based e-commerce model under FDI route



- FDI allowed only under marketplace model of e-commerce with conditions.
- Inventory based model of e-commerce is not permitted for FDI.
- Marketplace e-commerce entity can provide other services to vendors like warehousing, logistics, order fulfillment, call-center etc
- Any entity having equity participation by the marketplace entity or its group company is not allowed to sell on the platform.
- Full disclosure of the vendor is required to be made on the platform.
- Marketplace entity will not directly or indirectly influence the sale price of goods or services and shall maintain level playing field.
- Marketplace entity cannot mandate any seller for sale of products exclusively on its platform.
- Marketplace entity to obtain and maintain report from the Statutory Auditor for compliance with the conditions

Thank you