

Foreign Direct Investment (FDI) – Frequently Asked Questions

I. Foreign Direct Investment (FDI)

Q. 1. What are the forms in which business can be conducted by a foreign company in India?

Ans. A foreign company planning to set up business operations in India may:

- Incorporate a company under the Companies Act, 1956, as a Joint Venture or a Wholly Owned Subsidiary.
- Set up a Liaison Office / Representative Office or a Project Office or a Branch Office of the foreign company which can undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office or Other Place of Business) Regulations, 2000.

Q.2. What is the procedure for receiving Foreign Direct Investment in an Indian company?

Ans. An Indian company may receive Foreign Direct Investment under the two routes as given under :

i. Automatic Route

FDI up to 100 per cent is allowed under the automatic route in all activities/sectors except where the provisions of the consolidated FDI Policy, paragraph on 'Entry Routes for Investment' issued by the Government of India from time to time, are attracted.

FDI in sectors /activities to the extent permitted under the automatic route does not require any prior approval either of the Government or the Reserve Bank of India.

ii. Government Route

FDI in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance. Application can be made in Form FC-IL, which can be downloaded from <http://www.dipp.gov.in>. Plain paper applications carrying all relevant details are also accepted. No fee is payable. Indian companies having foreign investment approval through FIPB route do not require any further clearance from the Reserve Bank of India for receiving inward remittance and for the issue of shares to the non-resident investors.

The Indian company having received FDI either under the Automatic route or the Government route is required to report in the Advance Reporting Form, the details of the receipt of the amount of consideration for issue of equity instrument viz. shares / fully and mandatorily convertible debentures / fully and mandatorily convertible

preference shares through an AD Category –I Bank, together with copy/ies of the FIRC evidencing the receipt of inward remittances along with the Know Your Customer (KYC) report on the non-resident investors from the overseas bank remitting the amount, to the Regional Office concerned of the Reserve Bank of India within 30 days from the date of receipt of inward remittances.

Further, the Indian company is required to issue the equity instrument within 180 days, from the date of receipt of inward remittance or debit to NRE/FCNR (B) account in case of NRI/ PIO.

After issue of shares / fully and mandatorily convertible debentures / fully and mandatorily convertible preference shares, the Indian company has to file the required documents along with Form FC-GPR with the Regional Office concerned of the Reserve Bank of India within 30 days of issue of shares to the non-resident investors. The form can also be downloaded from the Reserve Bank's website at the following address :

<http://www.rbi.org.in/Scripts/BSViewFemaForms.aspx>

Q.3. Which are the sectors where FDI is not allowed in India, both under the Automatic Route as well as under the Government Route?

Ans. FDI is prohibited under the Government Route as well as the Automatic Route in the following sectors:

- i) Retail Trading (except single brand product retailing)
- ii) Atomic Energy
- iii) Lottery Business
- iv) Gambling and Betting
- v) Business of Chit Fund
- vi) Nidhi Company
- vii) Agricultural (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors) and Plantations activities (other than Tea Plantations) (cf. Notification No. FEMA 94/2003-RB dated June 18, 2003).
- viii) Housing and Real Estate business (except development of townships, construction of residential/commercial premises, roads or bridges to the extent specified in Notification No. FEMA 136/2005-RB dated July 19, 2005).
- ix) Trading in Transferable Development Rights (TDRs).
- x) Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

Q.4. What is the procedure to be followed after investment is made under the Automatic Route or with Government approval?

Ans. A two-stage reporting procedure has to be followed :.

- On receipt of share application money :

Within 30 days of receipt of share application money/amount of consideration from the non-resident investor, the Indian company is required to report to the Regional Office concerned of the Reserve Bank of India, under whose jurisdiction its Registered Office is located, the Advance Reporting Form, containing the following details :

- Name and address of the foreign investor/s;
- Date of receipt of funds and the Rupee equivalent;
- Name and address of the authorised dealer through whom the funds have been received;
- Details of the Government approval, if any; and
- KYC report on the non-resident investor from the overseas bank remitting the amount of consideration.

- Upon issue of shares to non-resident investors :

Within 30 days from the date of issue of shares, a report in Form FC-GPR- PART A together with the following documents should be filed with the Regional Office concerned of the Reserve Bank of India.

- Certificate from the Company Secretary of the company accepting investment from persons resident outside India certifying that:

The company has complied with the procedure for issue of shares as laid down under the FDI scheme as indicated in the Notification No. FEMA 20/2000-RB dated 3rd May 2000, as amended from time to time.

The investment is within the sectoral cap / statutory ceiling permissible under the Automatic Route of the Reserve Bank and it fulfills all the conditions laid down for investments under the Automatic Route, namely-

a) Non-resident entity/ies - (other than individuals), to whom it has issued shares have existing joint venture or technology transfer or trade mark agreement in India in the same field and Conditions stipulated at Paragraph 4.2 of the Consolidated FDI policy Circular of Government of India have been complied with.

OR

Non-resident entity/ ies - (other than individuals), to whom it has issued shares do not have any existing joint venture or technology transfer or trade mark agreement in India in the same field.

Note – For the purpose of the 'same' field, 4 digit NIC 1987 code would be relevant.

b) The company is not an Industrial Undertaking manufacturing items reserved for small sector.

OR

The company is an Industrial Undertaking manufacturing items reserved for the small sector and the investment limit of 24 per cent of paid-up capital has been observed/ requisite approvals have been obtained.

c) Shares issued on rights basis to non-residents are in conformity with Regulation 6 of the RBI Notification No FEMA 20/2000-RB dated 3rd May 2000, as amended from time to time.

OR

Shares issued are bonus shares.

OR

Shares have been issued under a scheme of merger and amalgamation of two or more Indian companies or reconstruction by way of de-merger or otherwise of an Indian company, duly approved by a court in India.

OR

Shares are issued under ESOP and the conditions regarding this issue have been satisfied.

- Shares have been issued in terms of SIA/FIPB approval No. ----- dated -----

- Certificate from Statutory Auditors/ SEBI registered Category - I Merchant Banker / Chartered Accountant indicating the manner of arriving at the price of the shares issued to the persons resident outside India.

Q.5. What are the guidelines for transfer of existing shares from non-residents to residents or residents to non-residents?

Ans. A. Transfer of shares/ fully and mandatorily convertible debentures from Non-Resident to Resident:

The term 'transfer' is defined under FEMA as including "sale, purchase, acquisition, mortgage, pledge, gift, loan or any other form of transfer of right, possession or lien" {Section 2 (ze) of FEMA, 1999}.

The FEMA Regulations give specific permission covering the following forms of transfer i.e. transfer by way of sale and gift. These permissions are discussed below :

i. Transfer of shares/ fully and mandatorily convertible debentures by way of sale :

A person resident outside India can freely transfer shares/ fully and mandatorily convertible debenture by way of sale to a person resident in India as under :

- Any person resident outside India (not being a NRI or an erstwhile OCB), can transfer by way of sale the shares/ fully and mandatorily convertible debentures to any person resident outside India or an NRI may transfer by way of sale, the shares/ fully and mandatorily convertible debentures held by him to another NRI only provided that the person to whom the shares are being transferred has obtained prior permission

of the Central Government to acquire the shares if he has previous venture or tie up in India through investment in shares or debentures or a technical collaboration or a trade mark agreement or investment by whatever name called in the same field or allied field in which the Indian company whose shares are being transferred is engaged.

- Any person resident outside India may sell shares/ fully and mandatorily convertible debenture acquired in accordance with the FEMA Regulations, on a recognized Stock Exchange in India through a registered broker.
- Any person resident outside India may also sell share or convertible debenture of an Indian company to a resident subject to adherence to pricing guidelines, documentation and reporting requirements as specified from time to time.
- Shares/convertible debentures of Indian companies purchased under Portfolio Investment Scheme by NRIs and erstwhile OCBs cannot be transferred, by way of sale under private arrangement.

ii. Transfer of shares/ fully and mandatorily convertible debentures by way of Gift :

A person resident outside India can freely transfer shares/ fully and mandatorily convertible debentures by way of gift to a person resident in India as under :

- Any person resident outside India, (not being a NRI or an erstwhile OCB), can transfer by way of gift the shares/ fully and mandatorily convertible debentures to any person resident outside India;
- a NRI may transfer by way of gift, the shares/convertible debentures held by him to another NRI only, provided that the person to whom the shares are being transferred has obtained prior permission of the Central Government to acquire the shares if he has previous venture or tie up in India through investment in shares or debentures or a technical collaboration or a trade mark agreement or investment by whatever name called in the same field or allied field in which the Indian company whose shares are being transferred is engaged.
- Any person resident outside India may transfer share/ fully and mandatorily convertible debentures to a person resident in India by way of gift.

B. Transfer of shares/ fully and mandatorily convertible debentures from Resident to Non-Resident :

i. Transfer of shares/ fully and mandatorily convertible debentures by way of sale - General Permission under Regulation 10 of Notification No. FEMA 20/2000-RB dated May 3, 2000

A person resident in India may transfer by way of sale to a person resident outside India any shares/ fully and mandatorily convertible debenture of an Indian company whose activities (other than financial service sector activities¹) fall under the Automatic Route of the FDI Scheme provided the parties concerned comply with the

FDI sectoral limits, pricing guidelines, documentation and reporting requirements for such transfers, as may be specified by the Reserve Bank of India, from time to time.

However, the above general permission is not available where :

- a) The transfer of shares/ fully and mandatorily convertible debentures falls within the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, as amended from time to time.
- b) The transfer of shares/ fully and mandatorily convertible debentures is at a price which does not adhere to the pricing guidelines specified by the Reserve Bank of India from time to time
- c) The activity of the Indian investee company falls outside the automatic route and where FIPB approval has been obtained for the said transfer.

Q.6. Can a person resident in India transfer security by way of gift to a person resident outside India?

Ans. A person resident in India who proposes to transfer security by way of gift to a person resident outside India [other than an erstwhile OCBs] shall make an application to the Central Office of the Foreign Exchange Department, Reserve Bank of India furnishing the following information, namely:

- Name and address of the transferor and the proposed transferee
- Relationship between the transferor and the proposed transferee
- Reasons for making the gift.
- In case of Government dated securities, treasury bills and bonds, a certificate issued by a Chartered Accountant on the market value of such securities.
- In case of units of domestic mutual funds and units of Money Market Mutual Funds, a certificate from the issuer on the Net Asset Value of such security.
- In case of shares/ fully and mandatorily convertible debentures, a certificate from a Chartered Account on the value of such securities according to the guidelines issued by the Securities & Exchange Board of India or the Discount Free Cash Flow Cash (DCF) method with regard to listed companies and unlisted companies, respectively.
- Certificate from the Indian company concerned certifying that the proposed transfer of shares/convertible debentures, by way of gift, from resident to the non-resident shall not breach the applicable sectoral cap/ FDI limit in the company and that the proposed number of shares/convertible debentures to be held by the non-resident transferee shall not exceed 5 per cent of the paid up capital of the company.

The transfer of security by way of gift may be permitted by the Reserve bank provided :

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

- (ii) 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
- (iii) The applicable sectoral cap/ foreign direct investment limit in the Indian company is not breached
- (iv) The donor and the donee are relatives as defined in section 6 of the Companies Act, 1956.
- (v) The value of security to be transferred by the donor together with any security transferred to any person residing outside India as gift in the calendar year does not exceed the rupee equivalent of USD 25,000.
- (vii) Such other conditions as considered necessary in public interest by the Reserve Bank.

Q.7. What if the transfer of shares from resident to non-resident does not fall under the above categories?

Ans. In case the transfer does not fit into any of the above categories, either the transferor (resident) or the transferee (non-resident) can make an application to the Reserve Bank for permission for the transfer of shares. The application has to be accompanied with the following documents:

- A copy of the FIPB approval (if required).
- Consent letter from transferor and transferee clearly indicating the number of shares, name of the investee company and the price at which the transfer is proposed to be effected.
- The present/post transfer shareholding pattern of the Indian investee company showing the equity participation by residents and non-residents category-wise.
- Copies of the Reserve Bank of India's approvals/ acknowledged copies of FC-GPR evidencing the existing holdings of the non-residents.
- If the sellers/ transferors are NRIs / OCBs, the copies of the Reserve Bank of India's approvals evidencing the shares held by them on repatriation / non-repatriation basis.
- Open Offer document filed with the SEBI if the acquisition of shares by non-resident is under SEBI Takeover Regulations.
- Fair Valuation Certificate from the SEBI registered Category-I-Merchant Banker or Chartered Accountant indicating the value of shares as per the following guidelines :
 - a) where shares of an Indian company are listed on a recognized stock exchange in India, the price of shares transferred by way of sale shall not be less than the price at which a preferential allotment of shares can be made under the SEBI Guidelines, as applicable, provided that the same is determined for such duration as specified therein, preceding the relevant date, which shall be the date of purchase or sale of shares.
 - (b) where the shares of an Indian company are not listed on a recognized stock exchange in India, the transfer of shares shall be at a price not less than the fair value

to be determined by a SEBI registered Category – I - Merchant Banker or a Chartered Accountant as per the Discounted Free Cash Flow (DCF) method.

Q8. What are the reporting obligations in case of transfer of shares between resident and non-resident ?

Ans. The transaction should be reported by submission of form FC-TRS to the AD Category – I bank, within 60 days from the date of receipt/remittance of the amount of consideration. The onus of submission of the form FC-TRS within the given timeframe would be on the resident in India, the transferor or transferee, as the case may be.

Q.9. What is the method of payment and remittance/credit of sale proceeds in case of transfer of shares between resident and non-resident ?

Ans. The sale consideration in respect of the shares purchased by a person resident outside India shall be remitted to India through normal banking channels. In case the buyer is a Foreign Institutional Investor (FII), payment should be made by debit to its Special Non-Resident Rupee Account. In case the buyer is a NRI, the payment may be made by way of debit to his NRE/FCNR (B) accounts. However, if the shares are acquired on non-repatriation basis by NRI, the consideration shall be remitted to India through normal banking channel or paid out of funds held in NRE/FCNR (B)/NRO accounts.

The sale proceeds of shares (net of taxes) sold by a person resident outside India) may be remitted outside India. In case of FII the sale proceeds may be credited to its special Non-Resident Rupee Account. In case of NRI, if the shares sold were held on repatriation basis, the sale proceeds (net of taxes) may be credited to his NRE/FCNR(B) accounts and if the shares sold were held on non repatriation basis, the sale proceeds may be credited to his NRO account subject to payment of taxes. The sale proceeds of shares (net of taxes) sold by an erstwhile OCB may be remitted outside India directly if the shares were held on repatriation basis and if the shares sold were held on non-repatriation basis, the sale proceeds may be credited to its NRO (Current) Account subject to payment of taxes, except in the case of erstwhile OCBs whose accounts have been blocked by Reserve Bank.

Q. 10. Are the investments and profits earned in India repatriable?

Ans. All foreign investments are freely repatriable (net of applicable taxes) except in cases where:

- i) the foreign investment is in a sector like Construction and Development Projects and Defence wherein the foreign investment is subject to a lock-in-period; and
- ii) NRIs choose to invest specifically under non-repatriable schemes.

Further, dividends (net of applicable taxes) declared on foreign investments can be remitted freely through an Authorised Dealer bank.

Q.11. What are the guidelines on issue and valuation of shares in case of existing companies?

Ans. A. The price of shares issued to persons resident outside India under the FDI Scheme shall not be less than :

- i. the price worked out in accordance with the SEBI guidelines, as applicable, where the shares of the company is listed on any recognised stock exchange in India;
- ii. the fair valuation of shares done by a SEBI registered Category - I Merchant Banker or a Chartered Accountant as per the discounted free cash flow method, where the shares of the company is not listed on any recognised stock exchange in India; and
- iii. 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.

B. The price of shares transferred from resident to a non-resident and vice versa should be determined as under:

i) Transfer of shares from a resident to a non-resident:

- a) In case of listed shares, at a price which is not less than the price at which a preferential allotment of shares would be made under SEBI guidelines.
- b) In case of unlisted shares at a price which is not less than the fair value as per the Discount Free Cash Flow (DCF) Method to be determined by a SEBI registered Category-I- Merchant Banker/Chartered Accountant.

ii) Transfer of shares from a non-resident to a resident - The price should not be more than the minimum price at which the transfer of shares would have been made from a resident to a non-resident.

In any case, the price per share arrived at as per the above method should be certified by a SEBI registered Category-I-Merchant Banker / Chartered Accountant.

Q. 12. What are the regulations pertaining to issue of ADRs/ GDRs by Indian companies?

Ans.

- Indian companies can raise foreign currency resources abroad through the issue of ADRs/ GDRs, in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India thereunder from time to time.
- A company can issue ADRs / GDRs, if it is eligible to issue shares to persons resident outside India under the FDI Scheme. However, an Indian listed company,

which is not eligible to raise funds from the Indian Capital Market including a company which has been restrained from accessing the securities market by the Securities and Exchange Board of India (SEBI) will not be eligible to issue ADRs/GDRs.

- Unlisted companies, which have not yet accessed the ADR/GDR route for raising capital in the international market, would require prior or simultaneous listing in the domestic market, while seeking to issue such overseas instruments. Unlisted companies, which have already issued ADRs/GDRs in the international market, have to list in the domestic market on making profit or within three years of such issue of ADRs/GDRs, whichever is earlier.
- After the issue of ADRs/GDRs, the company has to file a return in Form DR as indicated in the RBI Notification No. FEMA.20/ 2000-RB dated May 3, 2000, as amended from time to time. The company is also required to file a quarterly return in Form DR- Quarterly as indicated in the RBI Notification *ibid*.
- There are no end-use restrictions on GDR/ADR issue proceeds, except for an express ban on investment in real estate and stock markets.
- Erstwhile OCBs which are not eligible to invest in India and entities prohibited to buy, sell or deal in securities by SEBI will not be eligible to subscribe to ADRs / GDRs issued by Indian companies.
- The pricing of ADR / GDR issues including sponsored ADRs / GDRs should be made at a price determined under the provisions of the Scheme of issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India and directions issued by the Reserve Bank, from time to time.

Q.13. What is meant by Sponsored ADR & Two-way fungibility Scheme of ADR/ GDR?

Ans. Sponsored ADR/GDR: An Indian company may sponsor an issue of ADR/ GDR with an overseas depository against shares held by its shareholders at a price to be determined by the Lead Manager. The operative guidelines for the same have been issued vide A.P. (DIR Series) Circular No.52 dated November 23, 2002.

Two-way fungibility Scheme : Under the limited Two-way fungibility Scheme, a registered broker in India can purchase shares of an Indian company on behalf of a person resident outside India for the purpose of converting the shares so purchased into ADRs/ GDRs. The operative guidelines for the same have been issued vide A.P. (DIR Series) Circular No.21 dated February 13, 2002. The Scheme provides for purchase and re-conversion of only as many shares into ADRs/ GDRs which are equal to or less than the number of shares emerging on surrender of ADRs/ GDRs which have been actually sold in the market. Thus, it is only a limited two-way fungibility

wherein the headroom available for fresh purchase of shares from domestic market is restricted to the number of converted shares sold in the domestic market by non-resident investors. So long the ADRs/ GDRs are quoted at discount to the value of shares in domestic market, an investor will gain by converting the ADRs/ GDRs into underlying shares and selling them in the domestic market. In case of ADRs/ GDRs being quoted at premium, there will be demand for reverse fungibility, i.e. purchase of shares in domestic market for re-conversion into ADRs/ GDRs. The scheme is operationalised through the Custodians of securities and stock brokers under SEBI.

Q.14. Can Indian companies issue Foreign Currency Convertible Bonds (FCCBs)?

Ans. FCCBs can be issued by Indian companies in the overseas market in accordance with the Scheme for Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

The FCCB being a debt security, the issue needs to conform to the External Commercial Borrowing guidelines, issued by RBI vide Notification No. FEMA 3/2000-RB dated May 3, 2000, as amended from time to time.

Q.15. Can a foreign investor invest in Preference Shares? What are the regulations applicable in case of such investments?

Ans. Yes. Foreign investment through preference shares is treated as foreign direct investment. However, the preference shares should be fully and mandatorily convertible into equity shares within a specified time to be reckoned as part of share capital under FDI. Investment in other forms of preference shares requires to comply with the ECB norms.

Q.16. Can a company issue debentures as part of FDI ?

Ans. Yes. Debentures which are fully and mandatorily convertible into equity within a specified time would be reckoned as part of equity under the FDI Policy.

Q.17. Can shares be issued against Lumpsum Fee, Royalty and ECB?

Ans. An Indian company eligible to issue shares under the FDI policy and subject to pricing guidelines as specified by the Reserve Bank from time to time, may issue shares to a person resident outside India :

- i. being a provider of technology / technical know-how, against Royalty / Lumpsum fees due for payment; and
- ii. against External Commercial Borrowing (ECB) (other than import dues deemed as ECB or Trade Credit as per RBI Guidelines).

Provided, that the foreign equity in the company, after the conversion of royalty / lumpsum fee / ECB into equity, is within the sectoral cap notified, if any.

Q.18. What are the other modes of issues of shares for which general permission is available under RBI Notification No. FEMA 20 dated May 3, 2000?

Ans.

- Issue of shares under ESOP by Indian companies to its employees or employees of its joint venture or wholly owned subsidiary abroad who are resident outside India directly or through a Trust up to 5% of the paid up capital of the company.
- Issue and acquisition of shares by non-residents after merger or de-merger or amalgamation of Indian companies.
- Issue shares or preference shares or convertible debentures on rights basis by an Indian company to a person resident outside India.

Q.19. Can a foreign investor invest in shares issued by an unlisted company in India?

Ans. Yes. As per the regulations/guidelines issued by the Reserve Bank of India/Government of India, investment can be made in shares issued by an unlisted Indian company.

Q. 20. Can a foreigner set up a partnership/ proprietorship concern in India?

Ans. No. Only NRIs/PIOs are allowed to set up partnership/proprietorship concerns in India on non-repatriation basis.

Q.21. Can a foreign investor invest in Rights shares issued by an Indian company at a discount?

Ans. There are no restrictions under FEMA for investment in Rights shares issued at a discount by an Indian company, provided the rights shares so issued are being offered at the same price to residents and non-residents. The offer on right basis to the persons 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; and
- (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.

II. Foreign Technology Collaboration Agreement

Whether the payment in terms of foreign technology collaboration agreement' can be made by an Authorised Dealer (AD) bank?

Ans. Yes, RBI has delegated the powers, to make payments for royalty, lumpsum fee for transfer of technology and payment for use of trademark/brand name in terms of the foreign technology collaboration agreement entered by the Indian company with its foreign partners, to the AD banks subject to compliance with the provisions of Foreign Exchange Management (Current Account Transactions) Rules, 2000. Further, the requirement of registration of the agreement with the Regional Office of Reserve Bank of India has also been done away with.

III. Foreign Portfolio Investment

Q.1. What are the regulations regarding Portfolio Investments by SEBI registered Foreign Institutional Investors (FIIs)?

Ans.

- Investment by SEBI registered FIIs is regulated under SEBI (FII) Regulations, 1995 and Regulation 5(2) of FEMA Notification No.20 dated May 3, 2000, as amended from time to time. FIIs include Asset Management Companies, Pension Funds, Mutual Funds, Investment Trusts as Nominee Companies, Incorporated / Institutional Portfolio Managers or their Power of Attorney holders, University Funds, Endowment Foundations, Charitable Trusts and Charitable Societies.
- SEBI acts as the nodal point in the registration of FIIs. The Reserve Bank of India has granted general permission to SEBI Registered FIIs to invest in India under the Portfolio Investment Scheme (PIS).
- Investment by SEBI registered FIIs and its sub accounts cannot exceed 10 per cent of the paid up capital of the Indian company. However, in case of foreign corporates or High Networth Individuals (HNIs) registered as sub accounts of an FII, their investment shall be restricted to 5 per cent of the paid up capital of the Indian company. All FIIs and their sub-accounts taken together cannot acquire more than 24 per cent of the paid up capital of an Indian Company. An Indian company can raise the 24 per cent ceiling to the sectoral cap / statutory ceiling, as applicable, by passing a resolution by its Board of Directors followed by passing a Special Resolution to that effect by their General Body. The Indian company has to intimate the raising of the FII limit to the Reserve Bank to enable the Bank to notify the same on its website for larger public dissemination.

Q.2. What are the regulations regarding Portfolio Investments by NRIs/PIOs?

Ans.

- Non- Resident Indian (NRIs) and Persons of Indian Origin (PIOs) can purchase or sell shares/ fully and mandatorily convertible debentures of Indian companies on the Stock Exchanges under the Portfolio Investment Scheme. For this purpose, the NRI/ PIO has to apply to a designated branch of a bank, which deals in Portfolio Investment. All sale/ purchase transactions are to be routed through the designated branch.
- An NRI or a PIO can purchase shares up to 5 per cent of the paid up capital of an Indian company. All NRIs/PIOs taken together cannot purchase more than 10 per cent of the paid up value of the company. This limit can be increased by the Indian company to 24 per cent by passing a General Body resolution. The Indian company

has to intimate the raising of the FII limit to the Reserve Bank to enable the Bank to notify the same on its website for larger public dissemination.

- The sale proceeds of the repatriable investments can be credited to the NRE/ NRO, etc. accounts of the NRI/ PIO, whereas the sale proceeds of non-repatriable investment can be credited only to NRO accounts.
- The sale of shares will be subject to payment of applicable taxes.

IV. Investment in other securities

Q.1. Can a Non-resident Indian(NRI) and SEBI registered Foreign Institutional Investor (FII) invest in Government Securities/ Treasury bills and Corporate debt?

Ans. Under the FEMA Regulations, only NRIs and SEBI registered FIIs are permitted to purchase Government Securities/Treasury bills and Corporate debt. The details are as under :

A. A Non-resident Indian can purchase without limit,

(1) on repatriation basis

i) Dated Government securities (other than bearer securities) or treasury bills or units of domestic mutual funds;

ii) Bonds issued by a public sector undertaking (PSU) in India; and

iii) Shares in Public Sector Enterprises being disinvested by the Government of India.

(2) on non-repatriation basis

i. Dated Government securities (other than bearer securities) or treasury bills or units of domestic mutual funds;

ii. Units of Money Market Mutual Funds in India; and

iii. National Plan/Savings Certificates.

B. A SEBI registered FII may purchase, on repatriation basis, dated Government securities/ treasury bills, listed non-convertible debentures/ bonds issued by an Indian company and units of domestic mutual funds either directly from the issuer of such securities or through a registered stock broker on a recognised stock exchange in India.

The FII investment in Government securities and Corporate debt is subject to a ceiling decided in consultation with the Government of India. Investment limit for the FIIs as a group in Government securities currently is USD 10 billion and in Corporate debt is USD 20 billion.

Q.2. Can a NRI and SEBI registered FII invest in Tier I and Tier II instruments issued by banks in India?

Ans . SEBI registered FIIs and NRIs have been permitted to subscribe to the Perpetual Debt instruments (eligible for inclusion as Tier I capital) and Debt Capital instruments (eligible for inclusion as upper Tier II capital), issued by banks in India and denominated in Indian Rupees, subject to the following conditions :

a. Investment by all FIIs in Rupee denominated Perpetual Debt instruments (Tier I) should not exceed an aggregate ceiling of 49 per cent of each issue and investment by individual FII should not exceed the limit of 10 per cent of each issue.

- b. Investments by all NRIs in Rupee denominated Perpetual Debt instruments (Tier I) should not exceed an aggregate ceiling of 24 per cent of each issue and investments by a single NRI should not exceed 5 percent of each issue.
- c. Investment by FIIs in Rupee denominated Debt Capital instruments (Tier II) shall be within the limits stipulated by SEBI for FII investment in corporate debt instruments.
- d. Investment by NRIs in Rupee denominated Debt Capital instruments (Tier II) shall be in accordance with the extant policy for investment by NRIs in other debt instruments.
- e. Investment by FIIs in Rupee denominated Upper Tier II Instruments raised in Indian Rupees will be within the limit prescribed by the SEBI for investment in corporate debt instruments. However, investment by FIIs in these instruments will be subject to a separate ceiling of USD 500 million.
- f. The details of the secondary market sales / purchases by FIIs and the NRIs in these instruments on the floor of the stock exchange are to be reported by the custodians and designated Authorised Dealer banks respectively, to the Reserve Bank through the soft copy of the Forms LEC (FII) and LEC (NRI).

Q.3. Can a NRI and SEBI registered FII invest in Indian Depository Receipts (IDRs)?

Ans. NRI and SEBI registered FIIs have been permitted to invest, purchase, hold and transfer IDRs of eligible companies resident outside India and issued in the Indian capital market, subject to the following conditions :

- (i) The purchase, hold and transfer of IDRs is in accordance with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 notified vide Notification No. FEMA 20 / 2000-RB dated May 3, 2000, as amended from time to time.
- (ii) Automatic fungibility of IDRs is not permitted.
- (iii) IDRs shall not be redeemable into underlying equity shares before the expiry of one year period from the date of issue of the IDRs.
- (iv) At the time of redemption / conversion of IDRs into the underlying shares, the Indian holders (persons resident in India) of IDRs shall comply with the provisions of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 notified vide Notification No. FEMA 120 / RB-2004 dated July 7 2004, as amended from time to time.
- (v) The FEMA provisions shall not apply to the holding of the underlying shares, on redemption of IDRs by the FIIs including SEBI approved sub-accounts of the FIIs and NRIs.

Q.4. Can a person resident in India invest in the Indian Depository Receipts (IDRs)?
What is the procedure for redemption of IDRs held by persons resident in India?

Ans. A person resident in India may purchase, hold and transfer IDRs of eligible companies resident outside India and issued in the Indian capital market. The FEMA Regulations shall not be applicable to persons resident in India as defined under section 2(v) of FEMA, 1999, for investing in IDRs and subsequent transfer arising out of a transaction on a recognized Stock Exchange in India. However, at the time of redemption / conversion of IDRs into underlying shares, the Indian holders (persons resident in India) of IDRs shall comply with the provisions of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 notified vide Notification No. FEMA 120 / RB-2004 dated July 7 2004, as amended from time to time. The following guidelines shall be followed on redemption of IDRs by persons resident in India:

- i. Listed Indian companies may either sell or continue to hold the underlying shares subject to the terms and conditions as per Regulations 6B and 7 of Notification No. FEMA 120/RB-2004 dated July 7, 2004, as amended from time to time.
- ii. Indian Mutual Funds, registered with SEBI may either sell or continue to hold the underlying shares subject to the terms and conditions as per Regulation 6C of Notification No. FEMA 120/RB-2004 dated July 7, 2004, as amended from time to time.
- iii. Other persons resident in India including resident individuals are allowed to hold the underlying shares only for the purpose of sale within a period of 30 days from the date of conversion of the IDRs into underlying shares.

V. Foreign Venture Capital Investment

Q.1. What are the regulations for Foreign Venture Capital Investment?

Ans.

- A SEBI registered Foreign Venture Capital Investor has general permission from the Reserve Bank of India to invest in a Venture Capital Fund (VCF) or an Indian Venture Capital Undertaking (IVCU), in the manner and subject to the terms and conditions specified in Schedule 6 of RBI Notification No. FEMA 20/2000-RB dated May 3, 2000, as amended from time to time. These investments by SEBI registered FVCI, would be subject to the SEBI regulation and sector specific caps of FDI.
- FVCIs can purchase equity / equity linked instruments / debt / debt instruments, debentures of an IVCU or of a VCF through initial public offer or private placement in units of schemes / funds set up by a VCF. At the time of granting approval, the Reserve Bank permits the FVCI to open a Foreign Currency Account and/ or a Rupee Account with a designated branch of an AD Category – I bank.
- The purchase / sale of shares, debentures and units can be at a price that is mutually acceptable to the buyer and the seller.
- AD Category – I banks can offer forward cover to FVCIs to the extent of total inward remittance. In case the FVCI has made any remittance by liquidating some investments, original cost of the investments has to be deducted from the eligible cover to arrive at the actual cover that can be offered.

VI. Branch/ Project/ Liaison Office of a foreign company in India

Q.1. How can foreign companies open Liaison /Branch office in India?

Ans.

A. With effect from February 1, 2010, foreign companies/entities desirous of setting up of Liaison Office / Branch Office (LO/BO) are required to submit their application in Form FNC along with the documents mentioned therein to Foreign Investment Division, Foreign Exchange Department, Reserve Bank of India, Central Office, Mumbai through an Authorised Dealer bank. This form is available at www.rbi.org.in

B. The applications from such entities in Form FNC will be considered by the Reserve Bank under two routes:

- Reserve Bank Route - Where principal business of the foreign entity falls under sectors where 100 per cent Foreign Direct Investment (FDI) is permissible under the automatic route.

- Government Route - Where principal business of the foreign entity falls under the sectors where 100 per cent FDI is not permissible under the automatic route.

Applications from entities falling under this category and those from Non - Government Organisations / Non - Profit Organisations / Government Bodies / Departments are considered by the Reserve Bank in consultation with the Ministry of Finance, Government of India.

C. The following additional criteria are also considered by the Reserve Bank while sanctioning Liaison/Branch Offices of foreign entities :

- Track Record

- For Branch Office — a profit making track record during the immediately preceding five financial years in the home country.

- For Liaison Office — a profit making track record during the immediately preceding three financial years in the home country.

- Net Worth [total of paid-up capital and free reserves, less intangible assets as per the latest Audited Balance Sheet or Account Statement certified by a Certified Public Accountant or any Registered Accounts Practitioner by whatever name].

- For Branch Office — not less than USD 100,000 or its equivalent.

- For Liaison Office — not less than USD 50,000 or its equivalent.

D. Permission to set up such offices is initially granted for a period of 3 years and this may be extended from time to time by the Authorised Dealer in whose jurisdiction the office is set up. The Branch / Liaison offices established with the Reserve Bank's approval will be allotted a Unique Identification Number (UIN) (www.rbi.org.in/scripts/Fema.aspx). The BOs / LOs shall also obtain Permanent Account Number (PAN) from the Income Tax Authorities on setting up the offices in India.

E. Liaison/Branch offices have to file an Annual Activity Certificate (AACs) from the Auditors, as at end of March 31, along with the audited Balance Sheet on or before September 30 of that year, stating that the Liaison Office has undertaken only those activities permitted by Reserve Bank of India. In case the annual accounts of the LO/BO are finalized with reference to a date other than March 31, the AAC along with the audited Balance Sheet may be submitted within six months from the due date of the Balance Sheet.

Q.2. What are the permitted activities of Liaison Office/ Representative Office?

Ans. A Liaison Office (also known as Representative Office) can undertake only liaison activities, i.e. it can act as a channel of communication between Head Office abroad and parties in India. It is not allowed to undertake any business activity in India and cannot earn any income in India. Expenses of such offices are to be met entirely through inward remittances of foreign exchange from the Head Office outside India. The role of such offices is, therefore, limited to collecting information about possible market opportunities and providing information about the company and its products to the prospective Indian customers. A Liaison Office can undertake the following activities in India :

- i. Representing in India the parent company / group companies.
- ii. Promoting export / import from / to India.
- iii. Promoting technical/financial collaborations between parent/group companies and companies in India.
- iv. Acting as a communication channel between the parent company and Indian companies.

Q.3. Can Foreign Insurance Companies / Banks set up Liaison Office in India?

Ans. Foreign Insurance companies can establish Liaison Offices in India only after obtaining approval from the Insurance Regulatory and Development Authority (IRDA). Similarly, foreign banks can establish Liaison Offices in India only after obtaining approval from the Department of Banking Operations and Development (DBOD), Reserve Bank of India.

Q. 4. What is the procedure for setting up Branch office?

Ans. Permission for setting up branch offices is granted by the Foreign Exchange Department, Reserve Bank of India, Central Office, Mumbai. Reserve Bank of India considers the track record of the applicant company, existing trade relations with India, the activity of the company proposing to set up office in India as well as the financial position of the company while scrutinising the application. The application

in Form FNC should be submitted to the Reserve Bank through the Authorised Dealer bank.

Q.5. What are the permitted activities of Branch Office?

Ans. Companies incorporated outside India and engaged in manufacturing or trading activities are allowed to set up Branch Offices in India with specific approval of the Reserve Bank. Such Branch Offices are permitted to represent the parent / group companies and undertake the following activities in India :

- i. Export / Import of goods.
- ii. Rendering professional or consultancy services.
- iii. Carrying out research work, in areas in which the parent company is engaged.
- iv. Promoting technical or financial collaborations between Indian companies and parent or overseas group company.
- v. Representing the parent company in India and acting as buying / selling agent in India.
- vi. Rendering services in information technology and development of software in India.
- vii. Rendering technical support to the products supplied by parent/group companies.
- viii. Foreign airline / shipping company.

Normally, the Branch Office should be engaged in the activity in which the parent company is engaged.

Note :

- a. Retail trading activities of any nature is not allowed for a Branch Office in India.
- b. A Branch Office is not allowed to carry out manufacturing or processing activities in India, directly or indirectly.
- c. Profits earned by the Branch Offices are freely remittable from India, subject to payment of applicable taxes.

Q.6. Whether Branch Offices are permitted to remit profit outside India?

Ans. Branch Offices are permitted to remit outside India profit of the branch net of applicable Indian taxes, on production of the following documents to the satisfaction of the Authorised Dealer through whom the remittance is effected :

- a. A Certified copy of the audited Balance Sheet and Profit and Loss account for the relevant year;
- b. A Chartered Accountant's certificate certifying -
 - i. the manner of arriving at the remittable profit
 - ii. that the entire remittable profit has been earned by undertaking the permitted activities

iii. that the profit does not include any profit on revaluation of the assets of the branch.

Q.7 What are the documents to be submitted to the AD bank at the time of closure of the Liaison/ Branch Office?

Ans. At the time of winding up of Branch/Liaison offices, the company has to approach the designated AD Category - I bank with the following documents:

- a) Copy of the Reserve Bank's permission/ approval from the sectoral regulator(s) for establishing the BO / LO.
- b) Auditor's certificate - i) indicating the manner in which the remittable amount has been arrived at and supported by a statement of assets and liabilities of the applicant, and indicating the manner of disposal of assets;
ii) confirming that all liabilities in India including arrears of gratuity and other benefits to employees, etc., of the Office have been either fully met or adequately provided for; and
iii) confirming that no income accruing from sources outside India (including proceeds of exports) has remained un-repatriated to India.
- c) No-objection / Tax Clearance Certificate from Income-Tax authority for the remittance/s.
- d) Confirmation from the applicant/parent company that no legal proceedings in any Court in India are pending and there is no legal impediment to the remittance.
- e) A report from the Registrar of Companies regarding compliance with the provisions of the Companies Act, 1956, in case of winding up of the Office in India.
- f) Any other document/s, specified by the Reserve Bank while granting approval.

Q.8. What is the procedure for setting up Project Office?

Ans. The Reserve Bank has granted general permission to foreign companies to establish Project Offices in India, provided they have secured a contract from an Indian company to execute a project in India, and

- i. the project is funded directly by inward remittance from abroad; or
- ii. the project is funded by a bilateral or multilateral International Financing Agency; or
- iii. the project has been cleared by an appropriate authority; or
- iv. a company or entity in India awarding the contract has been granted Term Loan by a Public Financial Institution or a bank in India for the project.

However, if the above criteria are not met or if the parent entity is established in Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran or China, such applications have to be forwarded to the Foreign Exchange Department, Reserve Bank of India, Central Office, Mumbai for approval.

Q.9. What are the bank accounts permitted to a Project Office?

Ans. AD Category – I banks can open non-interest bearing Foreign Currency Account for Project Offices in India subject to the following:

- i. The Project Office has been established in India, with the general / specific permission of Reserve Bank, having the requisite approval from the concerned Project Sanctioning Authority concerned.
- ii. The contract, under which the project has been sanctioned, specifically provides for payment in foreign currency.
- iii. Each Project Office can open two Foreign Currency Accounts, usually one denominated in USD and other in home currency, provided both are maintained with the same AD category–I bank.
- iv. The permissible debits to the account shall be payment of project related expenditure and credits shall be foreign currency receipts from the Project Sanctioning Authority, and remittances from parent/ group company abroad or bilateral / multilateral international financing agency.
- v. The responsibility of ensuring that only the approved debits and credits are allowed in the Foreign Currency Account shall rest solely with the branch concerned of the AD. Further, the Accounts shall be subject to 100 per cent scrutiny by the Concurrent Auditor of the respective AD banks.
- vi. The Foreign Currency accounts have to be closed at the completion of the Project.

Q.10. What are the general conditions applicable to Liaison / Branch / Project Office of foreign entities in India?

Ans. The general conditions applicable to Liaison/Branch/Project Office of foreign entities in India are as under;

- (i) Without prior permission of the Reserve Bank, no person being a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran or China can establish in India, a Branch or a Liaison Office or a Project Office or any other place of business.
- (ii) Partnership / Proprietary concerns set up abroad are not allowed to establish Branch /Liaison/Project Offices in India.
- (iii) Entities from Nepal are allowed to establish only Liaison Offices in India.
- (iv) Branch/Project Offices of a foreign entity, excluding a Liaison Office are permitted to acquire property for their own use and to carry out permitted/incidental activities but not for leasing or renting out the property. However, entities from Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran, Bhutan or China are not allowed to acquire immovable property in India even for a Branch Office. These entities are allowed to lease such property for a period not exceeding five years.

(v) Branch / Liaison / Project Offices are allowed to open non-interest bearing INR current accounts in India. Such Offices are required to approach their Authorised Dealers for opening the accounts.

(vi) Transfer of assets of Liaison / Branch Office to subsidiaries or other Liaison/Branch Offices is allowed with specific approval of the Central Office of the Reserve Bank.

(viii) Authorised Dealers can allow term deposit account for a period not exceeding 6 months in favor of a branch/office of a person resident outside India provided the bank is satisfied that the term deposit is out of temporary surplus funds and the branch / office furnishes an undertaking that the maturity proceeds of the term deposit will be utilised for their business in India within 3 months of maturity. However, such facility may not be extended to shipping/airline companies.