

FOREIGN DIRECT INVESTMENT IN INDIA

INTRODUCTION

The historical background of FDI in India can be traced back with the establishment of East India Company of Britain. British capital came to India during the colonial era of Britain in India. After Second World War, Japanese companies entered Indian market and enhanced their trade with India, yet U.K. remained the most dominant investor in India. After Independence issues relating to foreign capital, operations of MNCs, gained attention of the policy makers. Keeping in mind the national interests the policy makers designed the FDI policy which aims FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resource.

The Ernst & Young's 2012 India Attractiveness Survey says investors view India as an attractive investment destination. In the survey's global ranking, India is the fourth destination for foreign direct investment (FDI) just below the United States, China and Britain. China is the largest competitor of India in terms of attractiveness, according to the survey.

With an eight-fold increase, India attracted foreign direct investment (FDI) of \$8.1 billion in March, the highest ever monthly inflows, despite a brouhaha over Rs 11,000 crore Vodafone tax dispute.

MEANING

Foreign direct investment (FDI) is direct investment by a company in production located in another country either by buying a company in the country or by expanding operations of an existing business in the country. Foreign direct investment is done for many reasons including to take advantage of cheaper wages in the country, special investment privileges such as tax exemptions offered by the country as an incentive to gain tariff-free access to the markets of the country or the region.

FDI INDIA

Foreign Direct Investment (FDI) in India is undertaken in accordance with the FDI policy formulated and announced by the Government of India and is governed by the provisions of Foreign Exchange Management Act, 1999.

ENTRY ROUTES FOR INVESTMENT IN INDIA

Under the Foreign Direct Investments (FDI) Scheme, investments can be made in shares, mandatorily fully convertible debentures and mandatorily fully convertible preference shares of an Indian company by non-residents through two routes:

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 on 'Entry Routes for Investment' 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.

Government Route

FDI in activities not covered under the automatic route requires prior approval of the Government which is considered by the FIPB, Department of Economic Affairs, Ministry of Finance.

Indian companies having foreign investment approval through FIPB route do not require any further clearance from the RBI for receiving inward remittance and for the issue of shares to the non-resident investors.

ELIGIBILITY FOR INVESTMENT IN INDIA

Person resident outside or entity incorporated outside India

- Person/Entity of Bangladesh and Pakistan require prior approval of FIPB.
- FDI from Pakistan is not permitted in defence, atomic energy and space

NRIs in/Citizens of Nepal & Bhutan

- Can invest on repatriation basis
- Investment should be made in free foreign exchange through normal banking channels only

OCBs de-recognised as investor w.e.f 16.09.2003

PROHIBITION ON FDI IN INDIA

Foreign investment in any form is prohibited in a company or a partnership firm or a proprietary concern or any entity, whether incorporated or not (such as, Trusts) which is engaged or proposes to engage in the following activities:

- (a) Business of chit fund, or
- (b) Nidhi company, or
- (c) Agricultural or plantation activities, or
- (d) Real estate business, or construction of farm houses, or
- (e) Trading in Transferable Development Rights (TDRs).

SECTOR SPECIFIC CONDITIONS

I. Prohibited sectors

Retail Trading (Except Single Brand Product)	Atomic Energy	Lottery Business
Nidhi Company	Gambling and Betting	*Agriculture
Chit Fund Business	Manufacture of Tobacco, Cigars	Gambling And Betting
	*Housing and Real Estate	

*Conditions Apply

I. Permitted sectors

In the following sectors/activities, FDI up to the limit indicated against each sector/activity is allowed, subject to applicable laws/ regulations; security and other conditionalities. In sectors/activities not listed below, FDI is permitted upto 100% on the automatic route, subject to applicable laws/ regulations; security and other conditionalities.

Sectors/Activities falling under Government Route with percentage of FDI permitted

Upto 26 %	Upto 49 %	Upto 74 % (Automatic upto 49%)	Upto 100 %
•Defence Industry subject to Industrial license under the IDRA •Terrestrial Broadcasting FM (FM Radio) •Up-linking a News & Current Affairs TV Channel •Publishing of Newspaper and periodicals dealing with news and current affairs •Publication of Indian editions of foreign magazines dealing with news and current affairs •Banking- Public Sector (up to 20% only)	•Petroleum refining by PSU without any disinvestment or dilution of domestic equity in the existing PSUs. •Cable Network & DTH (FDI component not to exceed 20%) •Setting up of Up-linking HUB/ Teleports •Private Security Agencies •Commodity exchange •Credit Information Companies •Infrastructure Company in the Securities Market •Financial Services ARC (49% of paid up capital of ARC)	•Headend-In-The-Sky (HITS) Broadcasting Service •Non-Scheduled Air Transport Service •Ground Handling Services •Satellites – Establishment and operation, subject to the sectoral guidelines of Department of Space/ISRO •Telecom services •Internet Service Providers with/without gateways, radip paging, end to end bandwidth •Banking –Private sector	•Mining and mineral separation of titanium bearing minerals and ores, •Up-linking a Non-News & Current Affairs TV Channel •Publishing/printing of Scientific and Technical Magazines/specialty journals/ periodicals •Publication of fax edition of foreign newspapers •Airports - Existing Project •Courier services •Tea Plantation •Financial Services •Test Marketing •Infrastructure provider (dark fibre, right of way, duct space, tower, electronic, voice mail)

Sectors/Activities falling under Automatic Route where FDI is not permitted up to 100%

Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline

- 100% for NRIs and 49% for others

Insurance

- 26 %

MODES OF INVESTMENT UNDER FDI

Foreign Direct Investment in India can be done through following modes:

Modes of FDI

Fresh Issuance to a person resident outside India of:

1. Shares
2. Convertible Debentures

Acquisition by way of transfer by a person resident outside India:

1. NR to NR (Sale/Gift)
2. NRI to NRI (Sale/Gift)
3. NR to R (Sale/Gift)
4. R to NR (Sale)
5. NR on Stock Exchange

RESTRICTIONS ON TRANSFERS

- Prior permission of RBI is required in following cases:
 - Indian company engaged in financial services sector, Insurance, Infrastructure companies in the securities market.
 - Transactions which attract the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997
 - Activity of Indian Company falls outside automatic route and FIPB approval is obtained for transfer.
 - Pricing guidelines are not adhered
 - Payment of consideration by non-resident is proposed to be deferred.
 - Transfer by way of gift from resident to non-resident.
 - Transfer of shares from NRI to NR.
- Approval of Government followed by permission from RBI is required in following cases:
 - Activity falls under government route
 - Sectoral cap is breached

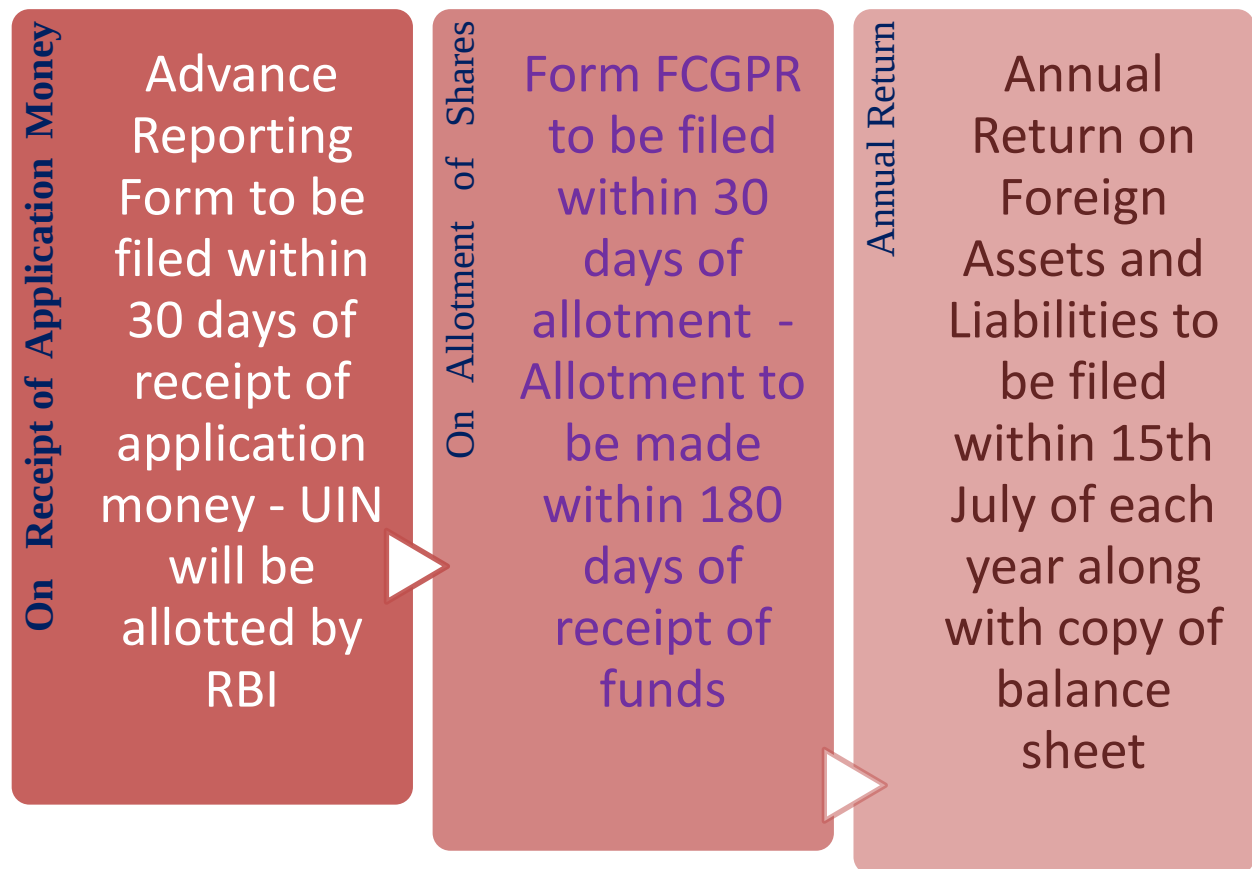
PRICING GUIDELINES ON TRANSFERS

- **In Case Of Transfer Of Shares From Resident To 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.
- **In Case Of Transfer Of Shares From Non-Resident To 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.

REPORTING REQUIREMENTS

I. ON FRESH ISSUE



Details about form FCGPR –

As mentioned above, Form FC-GPR needs to be filed within 30 days of making the allotment to non-residents. It needs to be filed with the authorized dealer through whom funds have been received, supported by –

- Copy of FIRC,
- Valuation Report issued by a Chartered Accountant, and
- Certificate from a Practising Company Secretary

Pricing guidelines -

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 is listed on any recognised stock exchange in India;

b. 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

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.

I. ON TRANSFER

Form FC-TRS to be filed, supported by the following documents:

For sale of shares / compulsorily and mandatorily convertible preference shares / debentures by a person resident in India

i. Consent Letter duly signed by the seller and buyer or their duly appointed agent and in the latter case the Power of Attorney Document.

ii. The shareholding pattern of the investee company after the acquisition of shares by a person resident outside India.

iii. Certificate indicating fair value of shares from a Chartered Accountant.

iv. Copy of Broker's note if sale is made on Stock Exchange.

v. Declaration from the buyer to the effect that he is eligible to acquire shares / compulsorily and mandatorily convertible preference shares / debentures under FDI policy and the existing sectoral limits and Pricing Guidelines have been complied with.

vi. Declaration from the FII/sub account to the effect that the individual FII / Sub account ceiling as prescribed has not been breached.

Additional documents in respect of sale of shares / compulsorily and mandatorily convertible preference shares / debentures by a person resident outside India

vii. If the sellers are NRIs/OCBs, the copies of RBI approvals, if applicable, evidencing the shares held by them on repatriation/non-repatriation basis.

viii. No Objection/Tax Clearance Certificate from Income Tax Authority/ Chartered Account.

DOWNSTREAM INVESTMENT

Downstream Investment is an indirect mechanism of FDI, whereby a Indian company having FDI ('Investing Company'), which is owned or controlled by 'foreign persons/entities', invests in shares of another Indian Company ('Subject Company').

Foreign investment into an Indian company, engaged only in the activity of investing in the capital of other Indian company/ies, will require prior Government/FIPB approval, regardless of the amount or extent of foreign investment.

Core Investment Companies (CICs), will have to additionally follow RBI's Regulatory Framework for CICs.

FDI in an Indian company which does not have any operations and also does not have any downstream investments, - Government/FIPB approval would be required, regardless of the amount or extent of foreign investment

Downstream investment by an Indian company, which is owned and/ or controlled by non-resident entity/ies, into another Indian company, would be in accordance/compliance with the relevant sectoral conditions on entry route, conditionalities and caps, with regard to the sectors in which the latter Indian company is operating.

CONDITIONS FOR DOWNSTREAM INVESTMENTS

Notify SIA, DIPP and FIPB within 30 days of investment

Board Resolution to be passed/Share Holders Agreement to be entered

Funds to be brought from abroad and not leverage funds from the domestic market

Issue/transfer/pricing/valuation of shares shall be in accordance with applicable SEBI/RBI guidelines

CALCULATION OF TOTAL FOREIGN INVESTMENT

(i) **Direct Foreign Investment:** All investment directly by a non-resident entity into the Indian company would be counted towards foreign investment.

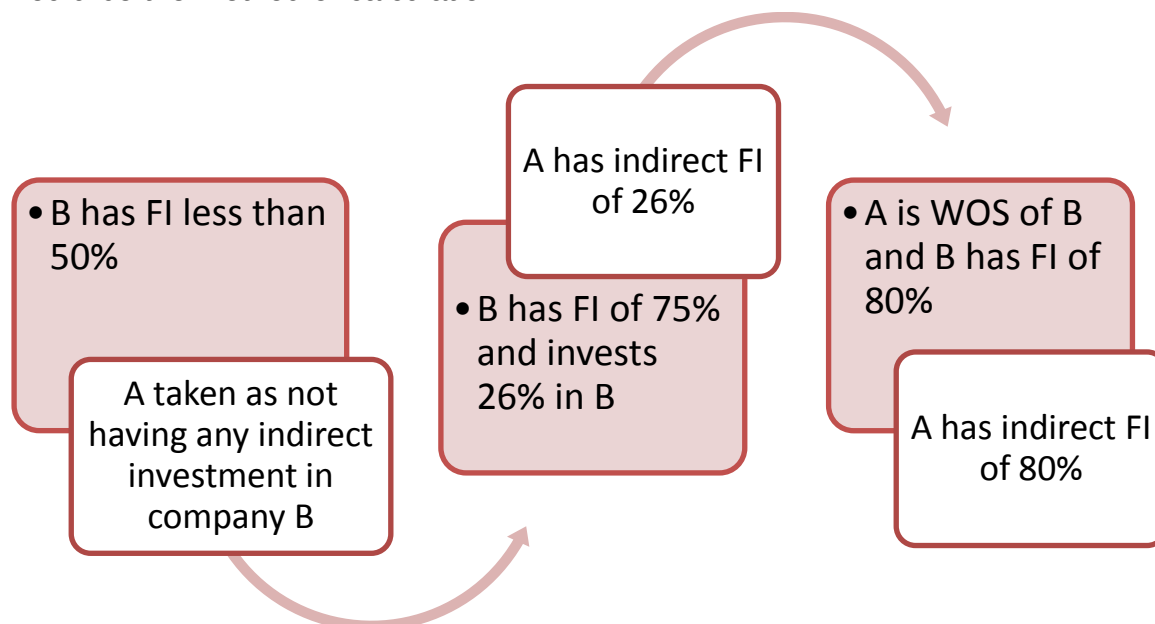
(ii) **Indirect Foreign Investment:**

(a) The foreign investment through the investing Indian company would not be considered for calculation of the indirect foreign investment in case of Indian companies which are owned **and** controlled by resident Indian citizens and/or Indian Companies which are owned and controlled by resident Indian citizens.

(b) For cases where condition (a) above is not satisfied or if the investing company is owned **or** controlled by 'non- resident entities', the entire investment by the investing company into the subject Indian Company would be considered as indirect foreign investment, provided that, as an exception, the indirect foreign investment in only the 100% owned subsidiaries of operating-cum-investing/investing companies, will be limited to the foreign investment in the operating-cum-investing/ investing company.

Illustration

If the indirect foreign investment is being calculated for Company A which has investment through an investing Company B having foreign investment, the following would be the method of calculation:



FDI IN PARTNERSHIP FIRM/PROPRIETARY CONCERN

➤ ON NON-REPATRIATION BASIS –

- Amount is invested by inward remittance or out of NRE / FCNR(B) / NRO account
- The firm or proprietary concern is not engaged in any agricultural / plantation or real estate business or print media sector.

➤ WITH REPATRIATION BENEFITS –

- NRIs / PIO may seek prior permission of Reserve Bank for investment in sole proprietorship concerns / partnership firms with repatriation benefits.
- 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 engaged in Print Media.

FDI IN MICRO AND SMALL ENTERPRISES (MSEs)

MANUFACTURE OF ITEMS RESERVED FOR PRODUCTION IN MICRO AND SMALL ENTERPRISES (MSES)

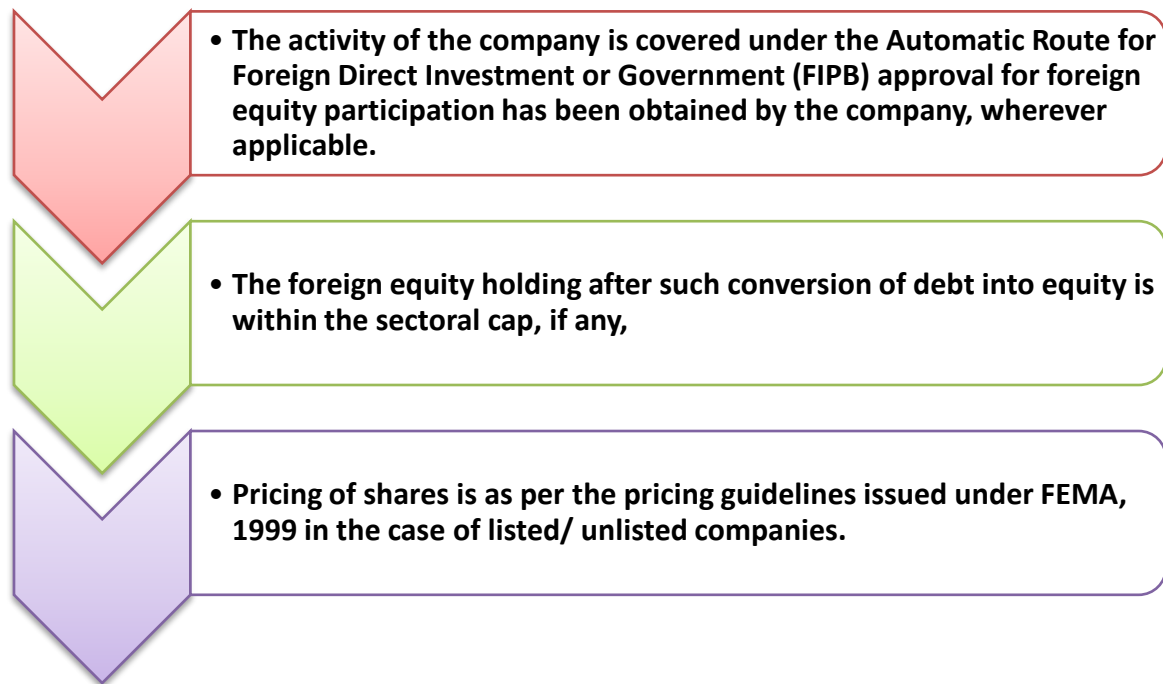
- FDI in MSEs will be subject to the sectoral caps, entry routes and other relevant sectoral regulations.
- Any industrial undertaking which is not a MSE, but manufactures items reserved for the MSE sector would require Government approval where foreign investment is more than 24% in the capital.
- Such an undertaking would also require an Industrial License under the IDRA.
- The issue of Industrial License is subject to a few general conditions and the specific condition that the Industrial Undertaking shall undertake to export a minimum of 50% of the new or additional annual production of the MSE reserved items to be achieved within a maximum period of 3 years.
- The export obligation would be applicable from the date of commencement of commercial production and in accordance with the provisions of section 11 of the IDRA.

FDI IN LIMITED LIABILITY PARTNERSHIPS (LLPs)

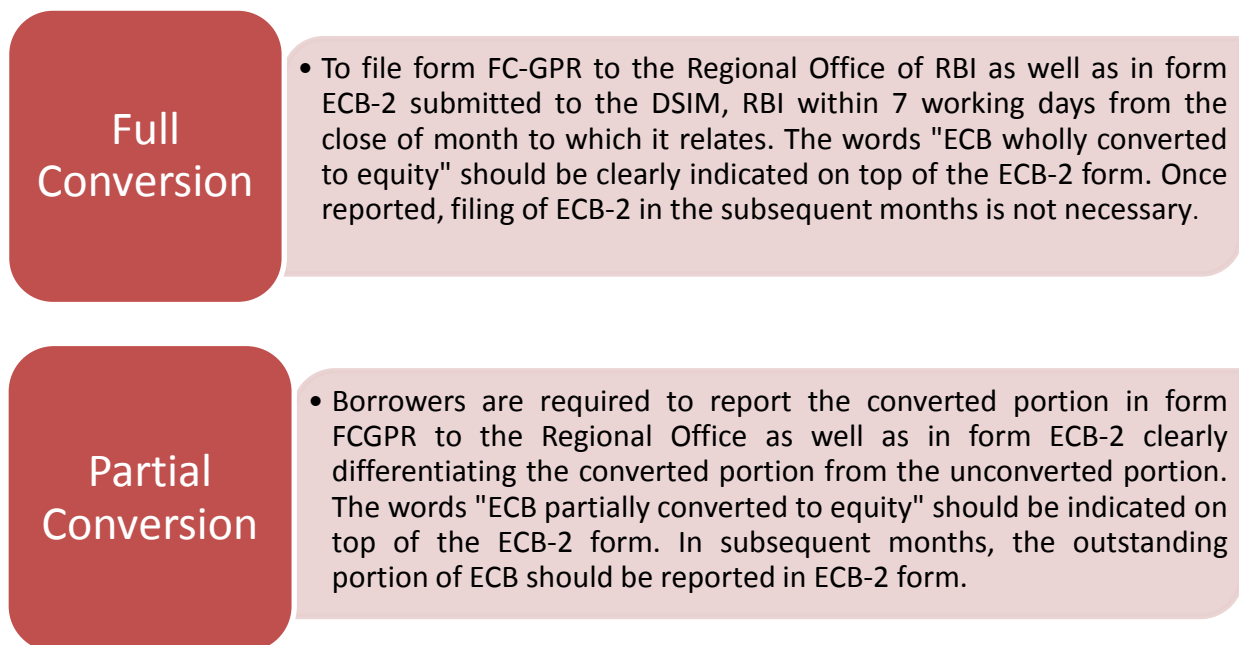
- LLPs with FDI will be allowed, through the Government approval route, in those sectors/activities where 100% FDI is allowed, through the automatic route and there are no FDI-linked performance related conditions.
- By FDI-linked performance related conditions, it is meant that in sectors, where conditions like minimum capitalization etc are prescribed like development of Townships, NBFC, even though 100% FDI is allowed under automatic route, LLP's will not be allowed to bring FDI with the approval of Government of India.
- LLPs with FDI will not be allowed to operate in agricultural/plantation activity, print media or real estate business.
- LLPs with FDI will not be eligible to make any downstream investments, which mean LLP having FDI, cannot make further investment in LLP or companies engaged in any business, even though 100% FDI is allowed under those sectors.
- An Indian Company, having FDI, will be permitted to make downstream investment in LLPs only if both the company, as well as the LLP is operating in sectors where 100% FDI is allowed, through the automatic route and there are no FDI-linked performance related conditions.
- Foreign Capital participation in the capital structure of the LLPs will be allowed only by way of cash considerations, received by inward remittance, through normal banking channels, or by debit to NRE/FCNR account of the person concerned, maintained with an authorized dealer/authorized bank. For making non cash/intangible contribution towards the capital of the LLP, permission of Government of India will be required.
- Foreign Institutional Investors (FIIs) and Foreign Venture Capital Investors (FVCIs) will not be permitted to invest in LLPs.
- LLPs will also not be permitted to avail External Commercial Borrowings (ECBs)
- The designated partners will be responsible for compliance with the above conditions and liable for all penalties imposed on the LLP for their contravention.
- In case of LLP having FDI and a body corporate is a designated partner, than the body corporate should only be a company registered under the Companies Act and not any other body, such as an LLP or a trust.
- Any conversion of a company with FDI into an LLP will be allowed only if the company is engaged in sectors/activities where 100% FDI is allowed, through the automatic route and there are no FDI-linked performance related conditions and prior approval of FIPB/Government is obtained.

CONVERSION OF ECB INTO EQUITY

Conversion of ECB into equity is permitted subject to the following conditions:

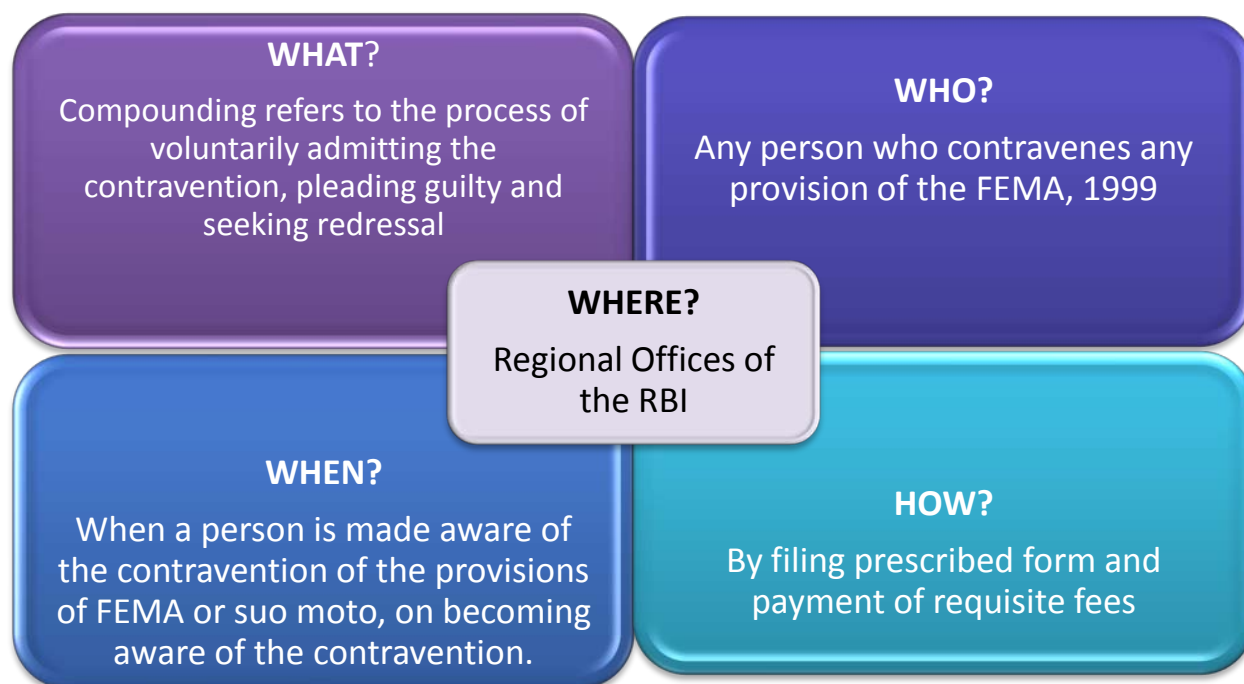


Conversion of ECB may be reported to the Reserve Bank as follows:



COMPOUNDING UNDER FEMA

Contravention is a breach of the provisions of the Foreign Exchange Management Act (FEMA), 1999 and rules/ regulations/ notification/ orders/ directions/ circulars issued there under. The Reserve Bank is empowered to compound any contraventions as defined under section 13 of FEMA, 1999 except the contravention under section 3(a), for a specified sum after offering an opportunity of personal hearing to the contravener. It is a voluntary process in which an Indian citizen or a corporate seeks compounding of an admitted contravention. It provides comfort to any person who contravenes provisions of FEMA, 1999.



Whether contravention under the FEMA is to be treated as technical and/ or minor or serious would be decided by the Reserve Bank on the merits of the case. Persons who have contravened the provisions of FEMA should not take upon themselves suo moto, or on the basis of external advice to decide whether a particular contravention is of a technical or minor in nature and, hence, no compounding application need be submitted to the Reserve Bank. If such applications for compounding are not made, the person concerned shall expose himself/herself to such action under the provisions of FEMA as the authorities may deem appropriate. The persons concerned should, therefore, in their own interest submit their applications for compounding of contravention under FEMA to the Reserve Bank at the earliest opportunity.

REPATRIATION OF INVESTMENT AND PROFITS

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.

LAST WORD

'Indian economy is capable of absorbing US\$ 50 billion in foreign direct investment (FDI) per year', said Mr. P Chidambaram, the Finance Minister, India. FDI is an economic segment that enjoys intense focus and attention from policy makers of the highest rank in the administration.

The Government relaxed FDI regime in sectors including multi-brand retail, single-brand retail, commodity exchanges, power exchanges, broadcasting, non-banking financial institutions (NBFCs) and asset reconstruction companies (ARCs) in 2012. There were several big-bang reforms and the Government allowed 51 per cent FDI in multi-brand retail and 49 per cent in the aviation sector. FDI cap was also raised from 49 per cent to 74 per cent in broadcasting and ARCs, with an aim to bring foreign expertise in the segments. Foreign investment has also been allowed in power exchanges while foreign institutional investors (FIIs) have been allowed to invest up to 23 per cent in commodity exchanges without seeking prior approval from the Government.

In 2013 government has set off another round of economic reforms with big hikes in foreign direct investment caps. The Government on 16th July, 2013 liberalised FDI limits in twelve sectors, including telecom and defense. No decision has been taken as yet on airports, media and multi brand retail.

A glimpse at the sectors which have been liberalized :

