

Due Diligence under FEMA

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Overview

Foreign Exchange Management Act, 1999

The preamble of the Act provides that it is an Act to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.

Foreign Exchange Management Act, 1999 (“FEMA”) has come in force from 1st June, 2000 by replacing Foreign Exchange Regulations Act (“FERA”). The main change that has been brought is that FEMA is a civil law, whereas the FERA was a criminal law. FERA was popular for its draconian provisions. The shift of FERA to FEMA was the shift of control of foreign exchange to regulation and promotion and orderly development of Foreign exchange. FEMA is forward looking legislation which aims to facilitate foreign trade.

FEMA aims to achieve self-regulation instead of imposed restrictions. The rationale for strict regulations under FERA 1973 after Independence was that India was left with little forex reserves and during the oil-crisis of seventies ballooning oil import bills further drained foreign exchange reserves. Unsatisfactory reserves made it imperative to put in place stringent controls to conserve foreign exchange and to utilise it in the best interest of the country.

FEMA has 49 Sections of which 9 Sections (Sections 1 to 9) are substantive and the rest are procedural or administrative. RBI is entrusted with the administration and implementation of FEMA. RBI has so far issued over 200 Notifications, each of which contains several regulations for a particular class of transactions, e.g., Notification No. FEMA/21/RB-2000, deals with acquisition and transfer of immovable property in India.

Notifications are type of self-contained set of regulations, which are mostly divided into three broad parts

- (i) Short title and commencement
- (ii) Definitions and
- (iii) Other provisions

It is interesting to note that the same term may be defined differently for different purposes in different Notifications. For example, the term “Person of Indian Origin (PIO)” is defined differently in three Notifications, namely:

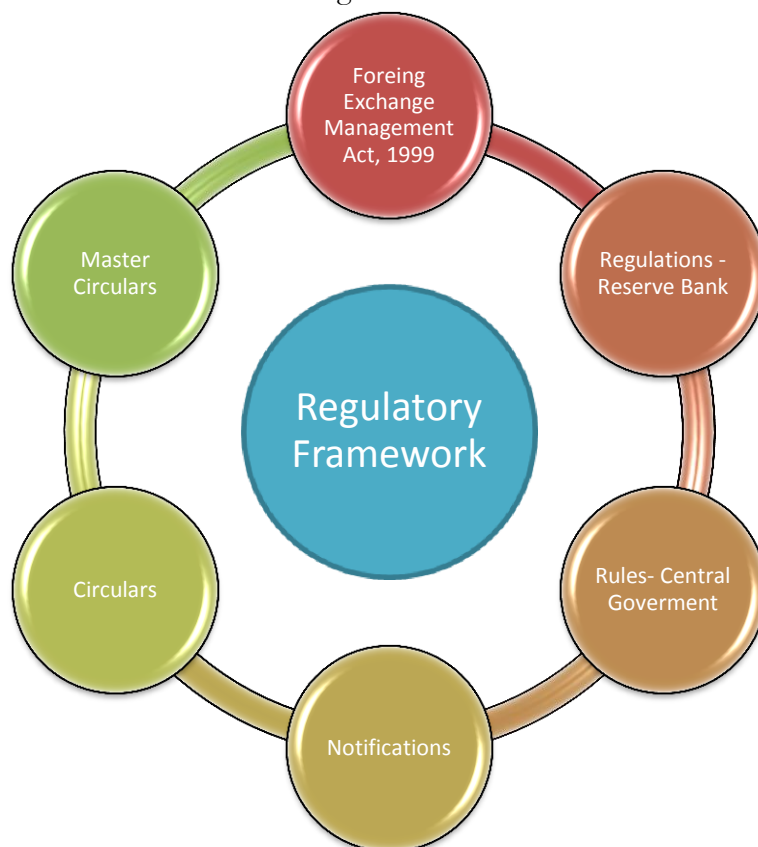
- (i) FEMA 13/2000-RB pertaining to remittance of assets;
 - (ii) FEMA 21/2000-RB pertaining to acquisition and transfer of immovable property in India and;
 - (iii) FEMA 24/2000-RB pertaining to investment in a firm or a proprietary concern in India.
- The definition section of each Notification makes it clear that the words and expressions

used therein, but not defined in that particular notification shall have the same meanings respectively assigned to them in the Act. Therefore, wherever a particular term is defined in the Notification, the meaning to be assigned is unique to that Notification and mostly cannot be applied to another.

Thus, interpretation and application of FEMA provisions and Notifications require utmost care. FEMA is applicable to the whole of India. The expression “whole of India” would indicate that the provisions of the Act are applicable to all transactions taking place in India. Thus, any person who is present in India at the time of transaction has to comply with provisions of FEMA. FEMA is applicable to all branches, offices and agencies outside India owned or controlled by a person resident in India. Thus, FEMA has retained its extra-territorial application, as under FERA.

The Enforcement of FEMA is done through Reserve Bank of India and Central Government. The power has been given to Central Government [section 46] and RBI [Section 47] to lay down detailed rules and regulations to carry out the various provisions of the Act. Where under Section 47 the reserve bank of India can make regulations governing procedural and administrative aspects of FEMA the central government have been given the power to make rules governing enforcement of FEMA.

The Central Government has established a Directorate of Enforcement for the purpose of enforcement of Act [section 36]. Officers under Directorate of enforcement are known as officers of Enforcement. These officers can investigate the contraventions of FEMA.



Epicenter of FEMA: Current Account Transactions and Capital Account Transactions

Under FEMA all the transactions are divided into two categories:

- (1) Capital Account transactions
- (2) Current account transactions

As a general rule all the current account transactions under FEMA are permitted except those specified and all the capital account transactions are prohibited or regulated.

Current Account Transaction

As per Section 2(j) of FEMA “*Current Account Transaction*” means a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes:

- (i) *Payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business,*
- (ii) *Payments due as interest on loans and as net income from investments,*
- (iii) *Remittances for living expenses of parents, spouse and children residing abroad, and*
- (iv) *Expenses in connection with foreign travel, education and medical care of parents, spouse and children;*

As per section 5 of FEMA

“Any person may sell or draw foreign exchange to or from an authorized person if such sale or drawal is a current account transaction:

Provided that the Central Government may, in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as may be prescribed.”

In exercise of the power conferred under Section 5 and Section 46 of FEMA the central government in consultation with RBI have framed **Foreign Exchange Management (Current Account Transactions) Rules, 2000** as notified by the Government of India vide Notification No. G.S.R.381 (E) dated 3rd May 2000 (Rules). In terms of the said Rules, drawal of foreign exchange for certain categories of transactions as listed in Schedule I is expressly prohibited. Exchange facilities for transactions included in Schedule II to the Rules may be permitted by the Authorised Dealer banks provided the applicant has secured the approval from the Ministry/Department of the Government of India as specified therein. In respect of transactions included in Schedule III, prior approval of the Reserve Bank would be required for remittance exceeding the specified limits. The release of foreign exchange up to the threshold ceilings specified in Schedule III stands delegated to

the Authorised Dealer banks. All applications for release of foreign exchange exceeding the limits as prescribed in Schedule III to the Rules should be referred to the Regional Office concerned of the Foreign Exchange Department of the Reserve Bank, under whose jurisdiction the applicant is functioning / residing.

Capital Account Transactions:

As per Section 2(e) of FEMA “*capital account transaction*” means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6;

Section 6 of FEMA provides that:

- (1) Subject to the provisions of sub-section (2), any person may sell or draw foreign exchange to or from an authorized person for a capital account transaction.
- (2) The Reserve Bank may, in consultation with the Central Government, specify:
 - (a) any class or classes of capital account transactions which are permissible;
 - (b) the limit up to which foreign exchange shall be admissible for such transactions :

Provided that the Reserve Bank shall not impose any restriction on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business.

- (3) Without prejudice to the generality of the provisions of sub-section (2), the Reserve Bank may, by regulations, prohibit, restrict or regulate the following:
 - (a) transfer or issue of any foreign security by a person resident in India;
 - (b) transfer or issue of any security by a person resident outside India;
 - (c) transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
 - (d) any borrowing or lending in foreign exchange in whatever form or by whatever name called;
 - (e) any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;
 - (f) deposits between persons resident in India and persons resident outside India;

- (g) export, import or holding of currency or currency notes;
- (h) transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India;
- (i) acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
- (j) giving of a guarantee or surety in respect of any debt, obligation or other liability incurred:
 - (i) by a person resident in India and owed to a person resident outside India; or
 - (ii) by a person resident outside India.

In practice, the distinction between current and capital account transactions is not always clear-cut. There are transactions which straddle the current and capital account. Illustratively, payments for imports are a current account item but to the extent these are on credit terms, a capital liability emerges.

Fuller Capital Account Convertibility*

Currency convertibility refers to the freedom to convert the domestic currency into other internationally accepted currencies and vice versa. Convertibility in that sense is the obverse of controls or restrictions on currency transactions. While current account convertibility refers to freedom in respect of payments and transfers for current international transactions, capital account convertibility (CAC) would mean freedom of currency conversion in relation to capital transactions in terms of inflows and outflows. Article VIII of the International Monetary Fund (IMF) puts an obligation on a member to avoid imposing restrictions on the making of payments and transfers for current international transactions. Members may cooperate for the purpose of making the exchange control regulations of members more effective. Article VI, however, allows members to exercise such controls as are necessary to regulate international capital movements, but not so as to restrict payments for current transactions or which would unduly delay transfers of funds in settlement of commitments.

Certain global developments have led to considerable caution being exercised by Emerging economies in opening up the capital account. The link between capital account liberalisation and growth is yet to be firmly established by empirical research.

Nevertheless, the mainstream view holds that capital account liberalisation can be beneficial when countries move in tandem with a strong macroeconomic policy framework, sound financial system and markets, supported by prudential regulatory and supervisory policies. Following a gradualist approach, the 1997 Committee recommended a set of measures and their phasing and sequencing. India has cautiously opened up its capital account since the early 1990s and the state of capital controls in India today can be considered as the most liberalised it has ever been in its history since the late 1950s. Nevertheless, several capital controls continue to persist. In this context, FCAC would signify the additional measures which could be taken in furtherance of CAC and in that sense, 'Fuller Capital Account Convertibility' would not necessarily mean zero capital regulation. In this context, the analogy to de jure current account convertibility is pertinent. De jure current account convertibility recognises that there would be reasonable limits for certain transactions, with 'reasonableness' being perceived by the user. FCAC is not an end in itself, but should be treated only as a means to realise the potential of the economy to the maximum possible extent at the least cost. Given the huge investment needs of the country and that domestic savings alone will not be adequate to meet this aim, inflows of foreign capital become imperative. The risks of FCAC arise mainly from inadequate preparedness before liberalisation in terms of domestic and external sector policy consolidation, strengthening of prudential regulation and development of financial markets, including infrastructure, for orderly functioning of these markets.

The status of capital account convertibility in India for various non-residents is as follows:

For foreign corporates, and foreign institutions, there is a reasonable amount of convertibility; for non-resident Indians (NRIs) there is approximately an equal amount of convertibility, but one accompanied by severe procedural and regulatory impediments. For non-resident individuals, other than NRIs, there is near-zero convertibility. As regards residents, the capital restrictions are clearly more stringent than for non-residents. Furthermore, resident corporates face a relatively more liberal regime than resident individuals. Till recently, resident individuals faced a virtual ban on capital outflow but a small relaxation has been undertaken in the recent period. There is justification for

some liberalisation in the rules governing resident individuals investing abroad for the purpose of asset diversification. The experience thus far shows that there has not been much difficulty with the present order of limits for such outflows.

Movement towards FCAC implies that all non-residents (corporates and individuals) should be treated equally. This would mean the removal of the tax benefits presently accorded to NRIs via special bank deposit schemes for NRIs, viz., Non-Resident External Rupee Account [NR(E)RA] and Foreign Currency Non-Resident (Banks) Scheme [FCNR(B)].

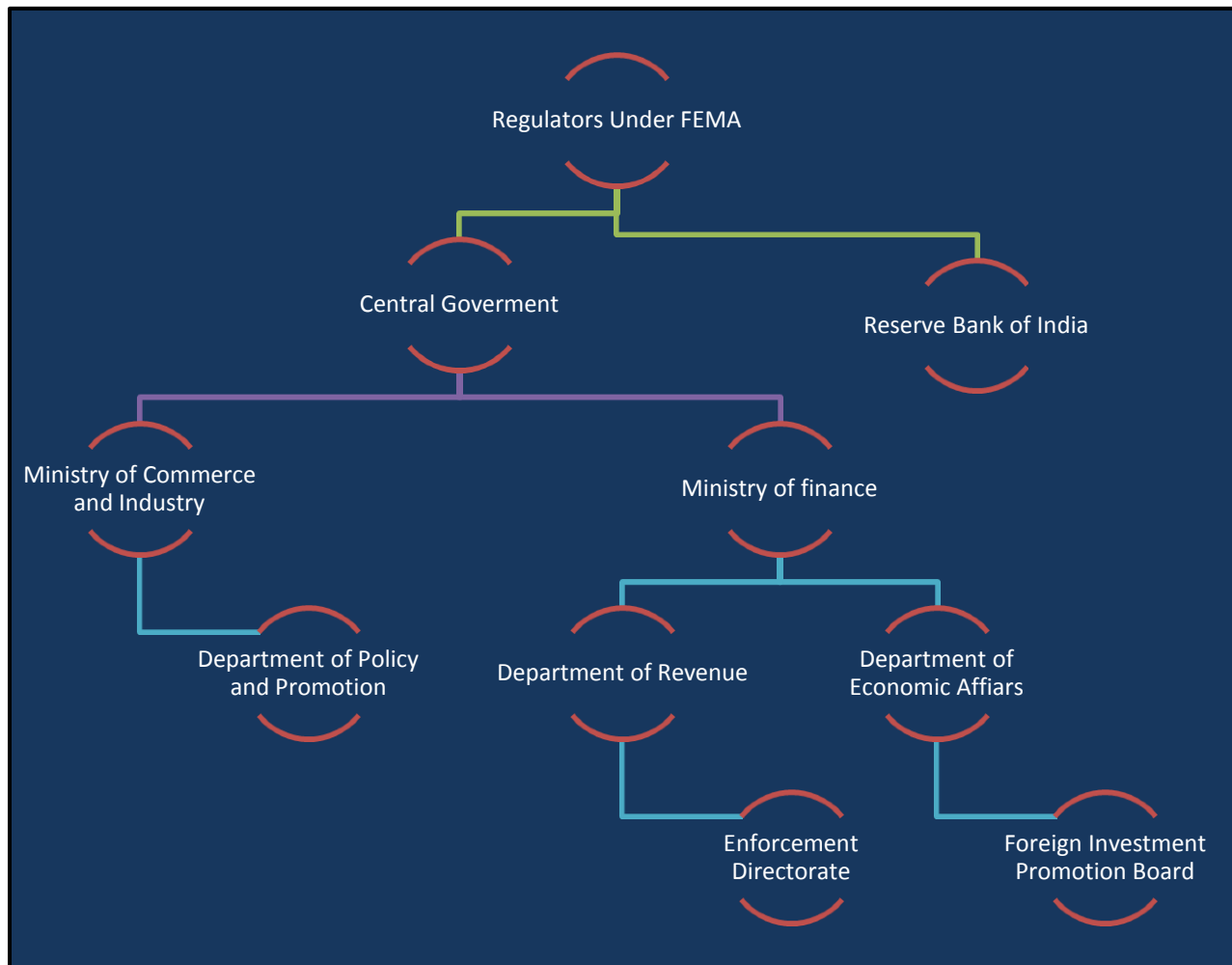
It would be desirable to consider a gradual liberalisation for resident corporates/business entities, banks, non-banks and individuals. The issue of liberalisation of capital outflows for individuals is a strong confidence building measure, but such opening up has to be well calibrated as there are fears of waves of outflows. The general experience is that as the capital account is liberalized for resident outflows, the net inflows do not decrease, provided the macroeconomic framework is stable.

As India progressively moves on the path of FCAC, the issue of investments being channelled through a particular country so as to obtain tax benefits would come to the fore as investments through other channels get discriminated against. Such discriminatory tax treaties are not consistent with an increasing liberalisation of the capital account as distortions inevitably emerge, possibly raising the cost of capital to the host country. With global integration of capital markets, tax policies should be harmonised. It would, therefore, be desirable that the government undertakes a review of tax policies and tax treaties.

* **Source:** *Report on Fuller account convertibility by S.S. Tarapore Committee.*

Regulators under FEMA

FEMA lays down the board provisions for regulation of foreign exchange. The power has been given to Central Government [Section 46] and Reserve Bank of India (“RBI”) [Section 47] to lay down detailed rules and regulations to carry out the various provisions of the Act. Where under Section 47 the Reserve Bank of India can make regulations governing procedural and administrative aspects of FEMA, under Section 46 the Central Government has been given the power to make rules governing enforcement of FEMA.



Reserve Bank of India

The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934. The Central Office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai in 1937. The Central Office is where the Governor sits and where policies are formulated. Bank is having 22 regional offices, most of them in state capitals.

Though originally privately owned, since nationalization in 1949, the Reserve Bank is fully owned by the Government of India.

Preamble

The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as:

"...to regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

It governs by following Acts:

- ❖ Public Debt Act, 1944/Government Securities Act (Proposed): Governs government debt market
- ❖ Securities Contract (Regulation) Act, 1956: Regulates government securities market.
- ❖ Indian Coinage Act, 1906: Governs currency and coins.
- ❖ **Foreign Exchange Regulation Act, 1973/Foreign Exchange Management Act, 1999: Governs trade and foreign exchange market**
- ❖ "Payment and Settlement Systems Act, 2007: Provides for regulation and supervision of payment systems in India"

Main Functions of the RBI:

Monetary Authority:

- Formulates implements and monitors the monetary policy
- Objective: maintaining price stability and ensuring adequate flow of credit to productive sectors.

Regulator and supervisor of the financial system:

- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.

- Objective: maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

Manager of Foreign Exchange

- Manages the Foreign Exchange Management Act, 1999.
- Objective: to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

Issuer of currency:

- Issues and exchanges or destroys currency and coins not fit for circulation.
- Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality.

Developmental role

- Performs a wide range of promotional functions to support national objectives.

Related Functions

- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.

Department of Industrial Policy and Promotion

The Department of Industrial Policy & Promotion was established in 1995 and has been reconstituted in the year 2000 with the merger of the Department of Industrial Development. Earlier separate Ministries for Small Scale Industries & Agro and Rural Industries (SSI&A&RI) and Heavy Industries and Public Enterprises (HI&PE) were created in October, 1999.

With progressive liberalisation of the Indian economy, initiated in July 1991, there has been a consistent shift in the role and functions of this Department. From regulation and administration of the industrial sector, the role of the Department has been transformed into facilitating investment and technology flows and monitoring industrial development in the liberalised environment.

The role and functions of the Department of Industrial Policy and Promotion primarily include:

- Formulation and implementation of industrial policy and strategies for industrial development in conformity with the development needs and national objectives;

- Monitoring the industrial growth, in general, and performance of industries specifically assigned to it, in particular, including advice on all industrial and technical matters;
- Formulation of Foreign Direct Investment (FDI) Policy and promotion, approval and facilitation of FDI;
- Encouragement to foreign technology collaborations at enterprise level and formulating policy parameters for the same;
- Administration of Industries (Development & Regulation) Act, 1951
- Promotion of productivity, quality and technical cooperation.
- Department of Industrial Policy & Promotion is responsible for formulation and implementation of promotional and developmental measures for growth of the industrial sector, keeping in view the national priorities and socio-economic objectives. While individual Administrative Ministries look after the production, distribution, development and planning aspects of specific industries allocated to them, Department of Industrial Policy & Promotion is responsible for the overall Industrial Policy.
- The Department is also responsible for facilitating and increasing the FDI inflow in the country. Foreign Investment Promotion Board (FIPB), now located in Department of Economic Affairs, Ministry of Finance, provides a time bound, transparent and pro-active FDI regime for approval of FDI investment proposals. The Department also plays a pro-active role in resolution of the problems faced by foreign investors in implementation of their projects through Foreign Investment Implementation Authority (FIIA), which interacts directly with the Ministry/State Government concerned.
- The Department is responsible for encouraging acquisition of technological capability in various sectors of the industry through liberal foreign technology collaboration regime. Foreign technology induction is facilitated both through FDI and through Foreign Technology Collaboration (FTC) agreement. FTC agreements are approved either through the automatic route under the delegated power exercised by the RBI or by the Government.
- In tune with its role as a facilitator of industrial development and investment, the Department plays an active role in investment promotion through dissemination of information on investment climate and opportunities in India and by advising prospective investors about licensing policy and procedures, foreign collaboration and import of capital goods etc. The information about policy and procedures is also available at internet website (<http://dipp.nic.in/>) of the Department.

Foreign Investment promotion Board

The Foreign Investment Promotion Board (FIPB) is a government body that offers a single window clearance for proposals on Foreign Direct Investment (FDI) in India that are not allowed access through the automatic route. FIPB comprises of Secretaries drawn from different ministries with Secretary, Department of Economic Affairs, MoF in the chair. This inter-ministerial body examines and discusses proposals for foreign investments in the country for sectors with caps, sources and instruments that require approval under the extant FDI Policy (prescribed vide Circular 1 of 2011) on a regular basis.

The Minister of Finance, considers the recommendations of the FIPB on proposals for foreign investment up to ₹1200 crore. Proposals involving foreign investment of more than ₹1200 crore require the approval of the Cabinet Committee on Economic Affairs (CCEA).

FIPB is mandated to play an important role in the administration and implementation of the

Government's FDI policy. It has a strong record of actively encouraging the flow of FDI into the country through speedy and transparent processing of applications, and providing on-line clarification. In case of ambiguity or a conflict of interpretation, the FIPB has always stepped in with an investor-friendly approach.

Enforcement Directorate

Under Section 36 of FEMA Central Government has established a Directorate of Enforcement for the purpose of enforcement of Act .

Officers under Directorate of Enforcement are known as Officers of Enforcement. The officers shall exercise the like powers which are conferred on the Income Tax authorities under the Income tax Act, 1961 [subject to such conditions and limitations as the central government may impose] [Section 37]. These officers can investigate the contraventions of FEMA.

Following are the Officers of Enforcement

- Directors of Enforcement
- Special Directorate of Enforcement
- Additional Director of Enforcement
- Deputy Directors of Enforcement
- Deputy Legal Adviser
- Assistant Director of Enforcement
- Assistant Legal Adviser

The Role of Directorate of Enforcement is as under:

- ❖ To collect and develop intelligence relating to violation of the provisions of Foreign Exchange Management Act.
- ❖ To conduct searches on suspected persons, conveyances and premises for seizing incriminating materials (including Indian and foreign currencies involved).
- ❖ To enquire into and investigate suspected violations of provisions of the Foreign Exchange Management Act.
- ❖ To adjudicate cases of violations of Foreign Exchange Management Act for levying penalties and also for confiscating the amounts involved in contraventions; To realize the penalties imposed in departmental adjudication;

Due Diligence under FEMA

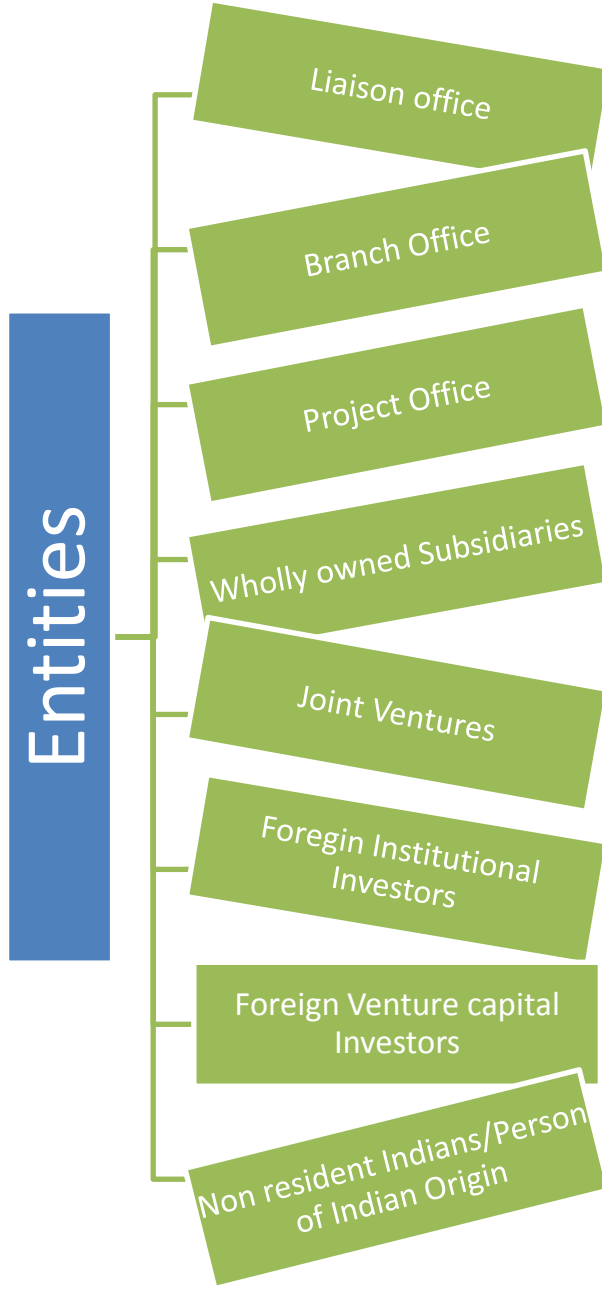
Due diligence is used to investigate and evaluate a business opportunity. The term due diligence describes a general duty to exercise care in any transaction. As such, it spans investigation into all relevant aspects of the past, present, and predictable future of the business of a target company.

India now with consistent growth performance and abundant high-skilled affordable manpower provides enormous opportunity for investment both domestic and foreign. Foreign direct investment (FDI) causes a flow of money into the economies which stimulates economic activity, increases employment and induces the long run aggregate supply and brings in best practices. India continues to be one of the favoured destinations for FDI.

The UNCTAD World Investment Report (WIR) 2010, in its analysis of global trends and sustained growth of Foreign Direct Investment (FDI) inflows, reported India as the second most attractive location for FDI for 2010-2012. There has been a continuing and sustained effort to make the FDI policy more liberal and investor-friendly. Significant rationalization and simplification of the policy has, therefore, been carried out in the recent past.

In the above mentioned scenario the due diligence under the Exchange laws have gained relevance as the world is looking at India as a lucrative Investment Opportunity.

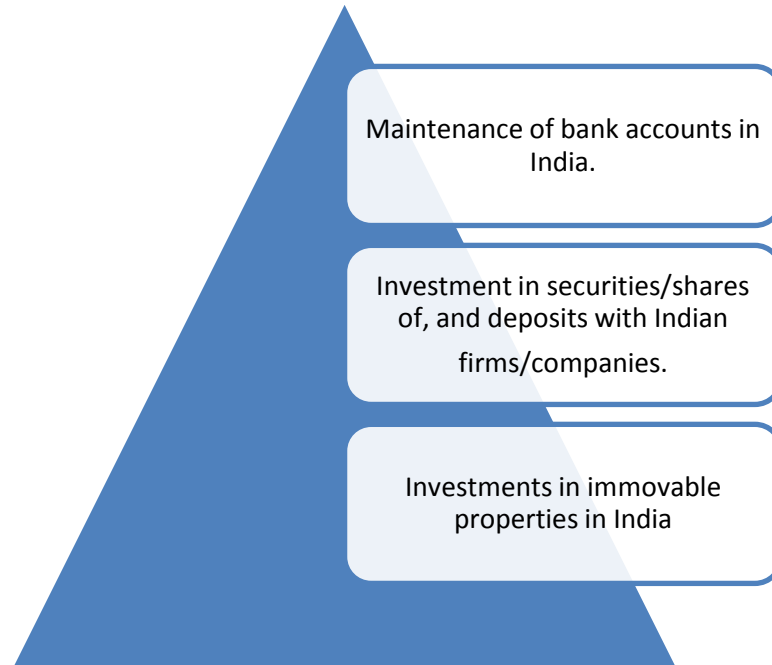
We have tried to bring in the relevant points of check keeping in consideration the relevant provision of FEMA and FDI Policy in India.



Non Residents Indians (NRIs)

Section 2 of the FEMA deals with various definitions. It defines person resident in India (PRI) and a person resident outside India (PROI). However, it does not define the term non-resident (NR) nor it defines the term Non-resident Indian (NRI).

However, Notification No. 5/2000-RB (dealing with various kinds of Bank Accounts) defines the term “Non-resident Indian (NRI)” to mean a person resident outside India who is either a citizen of India or person of Indian origin.



NRIs/PIOs are permitted to open bank accounts in India out of funds remitted from abroad, foreign exchange brought in from abroad or out of funds legitimately due to them in India, with Authorised Dealer. Such accounts can be opened with banks specially authorised by the Reserve Bank in this behalf [Authorised Dealer (AD)].

There are three types of non-resident accounts:

1) Non-Resident (External) Rupee Accounts (NRE Accounts)

NRIs and PIOs, are eligible to open NRE Accounts. These are rupee denominated accounts. Accounts can be in the form of savings, current, recurring or fixed deposit accounts. Accounts can be opened by remittance of funds in free foreign exchange. Foreign exchange brought in legally, repatriable incomes of the account holder, etc. can be credited to the account. Joint operation with other NRIs/PIOs is permitted. Power of attorney can be granted to residents for operation of accounts for limited purposes. The deposits can be used for all legitimate purposes. The balance in

the account is freely repatriable. Interest lying to the credit of NRE accounts is exempt from tax in the hands of the NRI.

2) Ordinary Non-Resident Rupee Accounts (NRO Accounts)

These are Rupee denominated non-repatriable accounts and can be in the form of savings, current, recurring or fixed deposits. These accounts can be opened jointly with residents in India. When an Indian national/PIO resident in India leaves for taking up employment, etc. outside the country, other than Nepal or Bhutan his bank account in India gets designated as NRO account.

The deposits can be used to make all legitimate payments in rupees. Interest income, from NRO accounts is taxable. Interest income, net of taxes is repatriable. Authorised Dealers may allow remittances up to US \$ 1 million, per financial year, out of balances held in NRO account for any bonafide purpose.

3) Foreign Currency Non Resident (Banks) Accounts (FCNR (B) Accounts)

NRIs/PIOs are permitted to open FCNR (B) Accounts in Canadian Dollars and Australian dollars also besides US dollars, Japanese Yen, Sterling Pounds, Euro. The account may be opened only in the form of term deposit for any of the three maturity periods viz;

- (a) one year and above but less than two years
- (b) two years and above but less than three years and
- (c) three years only.

Interest income is tax free in the hands of NRI until he maintains a non-resident status or a resident but not ordinarily resident status under the Indian tax laws. FCNR (B) accounts can also be utilised for local disbursements including payment for exports from India, repatriation of funds abroad and for making investments in India, as per foreign investment guidelines.

DIRECT INVESTMENT OPPORTUNITIES

NRIs can invest in India as under:

1. Investment under Automatic Route with repatriation benefits
2. Investment with Government approval
3. Other investments with repatriation benefits
4. Investments up to 100% equity without repatriation benefits
5. Other investments by NRIs without repatriation benefits.

1. Automatic Route Of RBI with Repatriation Benefits

NRIs can invest in shares/convertible debentures of Indian companies under the Automatic Route without obtaining Government or RBI permission except for a few sectors where FIPB permission is necessary, or where the investment can be made only upto a certain percentage of paid up capital.

2. Investment with Government Approval

Investments not eligible under the Automatic Route, are considered by the Foreign Investment Promotion Board (FIPB), a high Powered inter-ministerial body under the chairmanship of Secretary, Department of Economic Affairs, subject to sectoral limits/norms. These investments also enjoy full repatriation benefits.

Other Investments with Repatriation Benefits

1. Investment in units of domestic mutual funds
2. Investment in bonds issued by public sector undertakings
3. Purchase of shares of public sector enterprises being disinvested by GOI.
4. Investment in government dated securities (other than bearer securities) or Treasury Bills NRIs are permitted to invest in the securities with repatriation benefits.
5. Investment in Non-Convertible Debentures by way of public issue in listed company

Investment upto 100% Equity without Repatriation Benefits

1. NRIs can invest by way of capital contribution in any proprietary or partnership concern in India provided the firm or the proprietary concern is not engaged in any agricultural/plantation activities or real estate business or print media on non-repatriation basis subject to certain conditions.
2. NRIs have been granted general permission to subscribe to the shares/convertible debentures of an Indian company on non-repatriation basis, *and general permission is also available* to an Indian company to issue shares or convertible debentures by way of new/rights/bonus issue to NRIs on non-repatriation basis provided that the investee company is not a chit fund or a Nidhi company or is not engaged in agricultural/plantation activities or real estate business (real estate business excludes business of township, construction of residential /commercial premises, roads, bridges etc.) or construction of farm houses or dealing in Transfer of Development Rights.

Other Investments by NRIs without Repatriation Benefits

- (i) Investment in Non Convertible Debentures
- (ii) Money Market Mutual Funds
- (iii) Deposits with companies

- (iv) Commercial Papers
- (v) Investment in Non-Convertible Debentures by way of public issue in listed Company

PORTFOLIO INVESTMENT (PI)

NRI's are permitted to make portfolio investment in shares/debentures (convertible and non-convertible) of Indian companies (except print media sector), with or without repatriation benefit provided the purchase is made through a stock exchange and also through designated branch of an authorised dealer. NRI's are required to designate only one branch authorised by Reserve Bank for this purpose.

General Conditions For Purchase With Repatriation Or Nonrepatriation Rights

Investments in equity shares and convertible debentures is permitted subject to an overall ceiling of

- (a) 5 per cent of the total paid-up equity capital/paid-up value of each series of convertible debentures of the company concerned; for individual NRI's
- (b) 10 per cent of the total paid-up equity capital/paid-up value of each series of the convertible debentures issued by the company concerned for all NRI's taken together both on repatriation and on non-repatriation basis.

The purchase of shares and debentures under the scheme is required to be made at the ruling market price. Indian companies listed on recognised stock exchanges in India are however permitted to allow NRI's to acquire shares/debentures up to 24% instead of the 10% limit after a resolution in General Body and necessary information to RBI.

Investment On Non-Repatriation Basis

NRI's intending to invest on non-repatriation basis should submit the application to a designated branch of an Authorised Dealer (AD). The AD will grant general permission to purchase shares/debentures to NRI subject to the condition that the payment for such investment is received through inward remittance or from the investor's NRE/FCNR/NRO Account. Securities acquired by NRI's under PI scheme on a non-repatriation basis can be sold without any permission on the floor of a stock exchange.

Dividend and interest income is fully repatriable.

Investment On Repatriation Basis

NRI's intending to invest with repatriation benefits should submit the application to the designated branch of AD. The AD will grant to NRI permission for purchase of shares/debentures subject to the conditions that -

- ❖ The payment is received through an inward remittance in foreign exchange or by debit to the investor's NRE/FCNR account.

- ❖ Investment made by any single NRI investor in equity/preference shares and convertible debentures of any listed Indian company does not exceed 5% of its total paid-up equity or preference capital or 5% of the total paid-up value of each series of convertible debentures issued by it.
- ❖ NRIs take delivery of the shares/convertible debentures purchased and give delivery of the shares/convertible debentures sold under the Scheme.

NRIs can freely sell securities acquired by them with repatriation benefits, without any permission, through a stock exchange. Dividend and interest income is also fully repatriable.

INVESTMENT IN REAL ESTATE

An Indian citizen resident outside India does not require any permission to acquire any immovable property in India other than agricultural/plantation property or a farm house.

An Indian citizen resident outside India does not require any permission to transfer any immovable property other than agricultural or plantation property or farm house, to a person who:-

- is a citizen of India resident outside India, or
- is a person of Indian origin resident outside India

A person of Indian origin resident outside India does not require any permission to acquire any immovable property in India other than agricultural land/farm house/plantation property by way of gift from a person resident in India or from a person resident outside India who is a citizen of India or from a person of Indian origin resident outside India.

A person of Indian origin resident outside India does not require any permission to acquire any immovable property in India by way of inheritance from a person resident outside India who had acquired such property in accordance with the provisions of the foreign exchange law in force at the time of acquisition by him or the provisions of these Regulations or from a person resident in India.

A person of Indian origin resident outside India does not require any permission to transfer any immovable property in India other than agricultural land/farm house/plantation property, by way of sale to a person resident in India.

A person of Indian origin resident outside India does not require any permission to transfer agricultural land/farm house/plantation property in India, by way of gift or sale to a person resident in India who is a citizen of India.

A person of Indian origin resident outside India does not require any permission to transfer residential or commercial property in India by way of gift to a person resident in India or to person resident outside India who is a citizen of India or to a person of Indian origin resident outside India.

Repatriation outside India, including credit to RFC, NRE or FCNR account, of sale proceeds of any immovable property situated in India, requires prior permission of the Reserve Bank except in circumstances stated in paragraph below.

In the event of sale of immovable property, other than agricultural land/farm house/plantation property in India by a person resident outside India, who is a citizen of India, or a person of Indian origin, the Authorised Dealer may allow repatriation of the sale proceeds outside India, provided all the following conditions are satisfied:-

- the immovable property was acquired by the seller in accordance with the provisions of the Exchange Control Rules/Regulations/Law in force at the time of acquisition, or the provisions of the Regulations framed under the Foreign Exchange Management Act, 1999;
- the amount to be repatriated does not exceed (a) the amount paid for acquisition of the immovable property in foreign exchange received through normal banking channels or out of funds held in foreign currency non-resident account or (b) the foreign currency equivalent, as on the date of payment, of the amount paid where such payment was made from the funds held in non-resident external account for acquisition of the property; and
- in the case of residential property, the repatriation of sale proceeds is restricted to not more than two such properties.

All requests for acquisition of agricultural land/plantation/property/farm house by any person resident outside India or foreign nationals may be made to the Chief General Manager, Reserve Bank of India, Central Office, Foreign Exchange Department, Foreign Investment Division , Mumbai – 400 001.

The NRIs/PIOs can freely rent out their immovable property in India without seeking any permission from the Reserve Bank. The rental income being a current account transaction is freely repatriable outside India.

LIAISON OFFICE

A 'Liaison Office' is a representative office set up primarily to explore and understand the business and investment climate. Such office is not permitted to undertake any commercial / trading / industrial activity, directly or indirectly, and is required to maintain itself out of inward remittances received from parent company through normal banking channels.

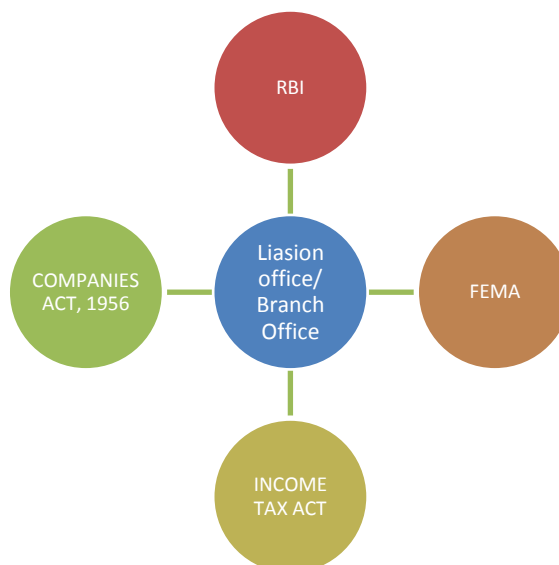
As defined under clause 2(e) of Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations, 2000.

'Liaison Office' means a place of business to act as a channel of communication between the Principal place of business or Head Office by whatever name called and entities in India but which does not undertake any commercial / trading/ industrial activity, directly or indirectly, and maintains itself out of inward remittances received from abroad through normal banking channel;

The liaison office can do only permitted activities in India these are:-

- (i) Representing the parent company/group companies in India.
- (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.

The following pictorial presentation depicts the legal frame work for liaison office in India.



As per sub-section (6) of Section 6 of the Foreign Exchange Management Act, 1999 the Reserve Bank may, by regulation, prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business.

In exercise of the powers given under sub section 6 of section 6 of the Foreign Exchange Management Act, 1999. RBI has framed the regulation by way of notification to regulate the provisions relating the Liaison office in India. **These regulations are Foreign Exchange Management (Establishment in India of branch or office or other place of business) Regulations, 2000 framed by way of Notification No. FEMA 22 /2000-RB dated 3rd May 2000.**

As per the notification mentioned above no person resident outside India shall, without prior approval of the Reserve Bank, establish in India a branch or a liaison office or a project office or any other place of business by whatever name called. The permission for Liaison office is required to be taken in the form of application to the RBI. Such an application is required to be made in the prescribed form i.e. Form FNC. The FNC is the form which serves as the purpose for RBI for getting the required information to arrive at the decision whether the permission is to be granted to Liaison office in India or not.

The application form duly completed should be submitted to **AD Category – I bank designated** by the applicant for onward transmission to the Chief General Manager-in -Charge, Reserve Bank, Foreign Exchange Department, Foreign Investment Division, Central Office, Fort, Mumbai

The information required to be given in form:

- ❖ Full name and address of the applicant company/firm [whether the applicant is a proprietary concern or partnership firm or limited company or public sector undertaking or any other organisation].
- ❖ Date and Place of incorporation / registration of the applicant company.
- ❖ Details of capital of the applicant company.
- ❖ Brief description of activities of the applicant company.
- ❖ Value of goods imported from and / or exported to India by the applicant during each of the last three years.
- ❖ Particulars of existing arrangements if any, for representing the company in India.

- ❖ Particulars of the proposed Branch/ Liaison Office like activities to be undertaken and place of establishment

Documents required to be submitted along with Form:

- ❖ Translated English version of the Company's Certificate of Incorporation/Registration, Memorandum & Articles of Association attested by the Indian Embassy/Notary public in the country of registration (Two original copies)
- ❖ Copies of last three years audited Balance Sheet, Profit & Loss Account of the applicant company/firm.
- ❖ Undertaking that the Liaison office will not carry out any trading and commercial activity in India.
- ❖ Copy of the Board resolution for opening office in India.
- ❖ Declaration by the applicant company
- ❖ Comfort letter by the applicant company

The permission granted to Liaison office shall be for the period of three years. The liaison office is required to approach the AD before the expiry of three years for seeking extension/ renewal of permission otherwise it will be considered that the liaison office is functioning without a valid permission in violation of regulation 3 of *Notification No. FEMA 22 / 2000-RB dated 3rd May 2000*.

Permitted Activities:

The liaison office can do only those activities in India that are permitted as per Schedule II of the said notification. As per the Schedule II, activities that can be done by the liaison office are:-

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

Prohibited/Restricted Activities:

- ❖ The liaison office in India is not allowed to carry on any business activity in India. It shall not take any activity Trading, commercial or industrial activity. There shall be no generation of revenue by Liaison office in India.
- ❖ It shall not enter into any contracts with Indian residents;
- ❖ No commission /fees shall be charged or any other remuneration received /income earned by the office in India for the liaison office activities/services rendered by it or otherwise in India.
- ❖ All the expenses for the set-up, operation and maintenance of the Liaison office have to be met out of foreign exchange remittances from the Foreign company through normal banking channels.
- ❖ The Liaison office shall not borrow/lend any money from/to any person in India without RBI prior permission.
- ❖ It shall not acquire, hold, and transfer any immovable property in India without RBI prior approval.
- ❖ Prior approval of RBI required before shifting of Liaison office

Acquisition of Immovable property in India

As per Foreign Exchange Management (Acquisition and transfer of immovable property in India) Regulations, 2000 FEMA 21/2000-RB, dated 3-5-2000, [the regulations to provide for provision for acquisition and transfer of immovable property in India] the Liaison office is not allowed to own/acquire any immovable property in India however, the same can take on lease the immovable for carrying on the permitted activities in India.

Closure of Business operations

The Reserve Bank of India is required to be intimated with the documents:

- ❖ Copy of the letter of approval of Reserve Bank of India for establishment of Liaison in India.
- ❖ Board resolution from foreign/parent company duly notarised/consularized
- ❖ Power of attorney from foreign/parent company duly notarised/counslarized in favour of person signing documents for closure.
- ❖ Certificate by Liaison office on pending legal proceedings in Indian courts or enquiries from Enforcement Directorate.
- ❖ Certificate by Liaison office that it does not own any immovable property in India.

- ❖ Certificate by Liaison office that it does not own any deposits, loans and advances.
- ❖ An undertaking by Liaison office for remittance of surplus to head office.

Remittance of Funds outside India

The Regulation Foreign Exchange Management (Remittance of Assets) Regulations, 2000 provides for remittance of assets outside India. Regulation 6 of the said notification deals with the Liaison office. It provides that in case of remittance of winding up proceeds of a Liaison office in India of a person resident outside India, the application is required to be made to the RBI together with following documents namely:

- (A) Copy of the Reserve Bank's permission for establishing the branch/office in India;
- (B) Auditor's certificate
 - (i) indicating the manner in which the remittable amount has been arrived 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 Liaison office have been either fully met or adequately provided for;
 - (iii) confirming that no income accruing from sources outside India (including proceeds of exports) has remained unrepatriated to India;
- (C) No-objection or Tax clearance certificate from Income-Tax authority for the remittance; and
- (D) Confirmation from the applicant that no legal proceedings in any Court in India are pending and there is no legal impediment to the remittance.

BRANCH OFFICE

The branch office is defined as per Regulation of Notification No. FEMA 22 /2000-RB dated 3rd May 2000 clause 2(c) as *“'Branch' shall have the meaning assigned to it in sub-section (9) of Section 2 of the Companies Act, 1956 (1 of 1956), and as per the companies Act, 1956 “branch office” in relation to a company means—*

- any establishment described as a branch by the company; or
- any establishment carrying on either the same or substantially the same activity as that carried on by the head office of the company; or
- any establishment engaged in any production, processing or manufacture

As per Sub-section (6) of Section 6 of the Foreign Exchange Management Act, 1999 the Reserve Bank may, by regulation, prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business.

The Branch office is governed by following regulation framed by Reserve Bank of India “Foreign Exchange Management (Establishment in India of branch or office or other place of business) Regulations, 2000 framed by way of Notification No. FEMA 22 /2000-RB dated 3rd May 2000”.

As per the notification mentioned above no person resident outside India shall, without prior approval of the Reserve Bank of India, establish in India a branch office or a project office or any other place of business by whatever name called.

An application is required to be made to the Reserve Bank of India in Form FNC. The application form shall be completed and submitted to the **AD Category – I bank designated** by the applicant for onward transmission to the Chief General Manager-in -Charge, Reserve Bank, Foreign Exchange Department, Foreign Investment Division, Central Office, Fort, Mumbai – 400001.

The information required to be given in form

1. Full name and address of the applicant company/firm [State whether the applicant is a proprietary concern or partnership firm or limited company or public sector undertaking or any other organisation
2. Date and Place of incorporation / registration of the applicant company.
3. Details of capital of the applicant company
4. Brief description of the activities of the applicant company
5. Value of goods imported from and / or exported to India by the applicant during each of the last three years:
6. Particulars of existing arrangements if any, for representing the company in India.
7. Particulars of the proposed Branch/ Liaison Office like activities to be undertaken and place of establishment

Following Documents are required to be submitted along with the Form:

1. Copy of the Certificate of Incorporation / Registration attested by the Notary Public in the country of registration [*If the original Certificate is in a language other than in English, the same may be translated into English and notarized as above and cross verified/attested by the Indian Embassy/ Consulate in the home country*].
2. Latest Audited Balance sheet of the applicant company. [*If the applicants' home country laws/regulations do not insist on auditing of accounts, an Account Statement certified by a Certified Public Accountant (CPA) or any Registered Accounts Practitioner by any name, clearly showing the net worth may be submitted*]
3. Bankers' Report from the applicant's banker in the host country / country of registration showing the number of years the applicant has had banking relations with that bank.

Permitted activities for a branch in India of a person resident outside India

As per Schedule I of Notification No. FEMA 22 /2000-RB dated 3rd May 2000 the following are the activities which can be performed by the Branch office in India:

- ❖ Export/Import of goods
- ❖ Rendering professional or consultancy services.
- ❖ Carrying out research work, in which the parent company is engaged.
- ❖ Promoting technical or financial collaborations between Indian companies and parent or overseas group company.
- ❖ Representing the parent company in India and acting as buying/selling agent in India.
- ❖ Rendering services in Information Technology and development of software in India.
- ❖ Rendering technical support to the products supplied by parent/group companies.

Restricted Activities

- ❖ The Branch office is prohibited from expanding its activities or undertake any new trading, commercial or industrial activity other than that expressly approved by RBI.
- ❖ It is restricted from accepting deposits in India
- ❖ Retail trading activities of any nature is not allowed for a Branch Office in India.

Acquisition of Immovable property in India

As per Foreign Exchange Management (Acquisition and transfer of immovable property in India) Regulations, 2000 FEMA 21/2000-RB, dated 3-5-2000, the regulations to provide for provision for acquisition and transfer of immovable property in India a branch, office in India of a foreign

company established with requisite approvals wherever necessary, is eligible to acquire immovable property in India which is necessary for or incidental to carrying on such activity provided that all applicable laws ,rules, regulations or directions in force are duly complied with. The entity/concerned person is required to file a declaration in Form IPI with the Reserve Bank, within ninety days from the date of such acquisition.

Remittance of Profits

The Regulation Foreign Exchange Management (Remittance of Assets) Regulations, 2000 provides for remittance of assets outside India. Regulation 6 of the said notification deals with the branch office. It provides that in case of remittance of winding up proceeds of a branch/office in India of a person resident outside India, the application is required to be made to the RBI together with following documents namely:

- (A) Copy of the Reserve Bank's permission for establishing the branch/office in India;
- (B) Auditor's certificate:
 - (i) indicating the manner in which the remittable amount has been arrived 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 Liaison office have been either fully met or adequately provided for;
 - (iii) confirming that no income accruing from sources outside India (including proceeds of exports) has remained unrepatriated to India;
- (C) No-objection or Tax clearance certificate from Income-Tax authority for the remittance; and
- (D) Confirmation from the applicant that no legal proceedings in any Court in India are pending and there is no legal impediment to the remittance.

Wholly Owned Companies

A Company once incorporated in India shall be an Indian company. Foreign Direct Investment coming from abroad shall be regulated by the Foreign Exchange management Act, Reserve Bank of India and the policy of Foreign Direct Investment in India as formulated by Reserve Bank of India from time to time.

As per the current Foreign Direct investment policy the investment can be made in India through two routes being Automatic route or Approval route. Under the automatic route the investment can be made without prior approval of central government but in the case of approval route the prior approval of Central government is required. India has among the most liberal and transparent policies on FDI among the emerging economies.

Most of the sectors fall under the automatic route for FDI. In these sectors, investment could be made without approval of the central government. The sectors that are not in the automatic route, investment requires prior approval of the Central Government. The approval is granted by Foreign Investment Promotion Board (FIPB). In few sectors, FDI is not allowed.

After the grant of approval for FDI by FIPB or for the sectors falling under automatic route, FDI could take place after taking necessary regulatory approvals from the state governments and local authorities for construction of building, water, environmental clearance, etc.

The Act has given general power to the Reserve Bank of India under section 47 to make notifications to regulate various provisions of the Act. Also the specific power has been given under Section 6(3)(b) to make the regulations to regulate the transfer or issue of any security by a person resident outside India.

As mentioned above whole of the FEMA and all the regulations are applicable to any company incorporated in India. We are discussing the following regulations in detail :

- ❖ Share capital
- ❖ Immovable Property outside India
- ❖ External Commercial Borrowings
- ❖ Trade Credit
- ❖ Investments outside India
- ❖ Import
- ❖ Export

Share Capital

The Issue/ transfer of shares of any security by a person resident outside India is regulated by Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000, Notification No. FEMA 20 /2000-rb dated 3rd May 2000, RBI.

As per the regulation 5 of the said regulation “*A person resident outside India (other than a citizen of Bangladesh or Pakistan or Sri Lanka) or an entity outside India, whether incorporated or not, (other than an entity in Bangladesh or Pakistan) , may purchase shares or convertible debentures of an Indian company under Foreign Direct Investment Scheme, subject to the terms and conditions specified in Schedule 1 of the said notification*”

As mentioned above FDI can come under either under automatic route or approval route. FDI in sectors/activities to the extent permitted under automatic route does not require any prior approval either by the Government or RBI. There is only two way intimation to the Reserve Bank of India through the Authorised dealer category I. An Indian company receiving investment from outside India for issuing shares/convertible debentures/preference shares under the FDI Scheme, should report the details of the amount of consideration to the Reserve Bank not later than 30 days from the date of receipt in the prescribed form along with the KYC report. Once the Annexure II along with the KYC report is submitted the regional office of Reserve Bank of India shall acknowledged the receipt by way of allowing the Unique Identification Number (UIN) for the amount reported.

The equity instruments should be issued within 180 days from the date of receipt of the inward remittance or by debit to the NRE/FCNR (B) account of the non-resident investor. After issue of shares/ convertible debentures/ preference shares, the Indian company has to file Form FC-GPR, not later than 30 days from the date of issue. Price of shares issued to persons resident outside India under the FDI Scheme, shall be on the basis of SEBI guidelines in case of listed companies. In case of unlisted companies, valuation of shares has to be done by a Chartered Accountant in accordance with the guidelines issued by the erstwhile Controller of Capital Issues.

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

- (i) A certificate from the Company Secretary of the company certifying that
 - (a) all the requirements of the Companies Act, 1956 have been complied with;
 - (b) terms and conditions of the Government’s approval, if any, have been complied with;
 - (c) the company is eligible to issue shares under these regulations; and

- (d) the company has all original certificates issued by authorised dealers in India evidencing receipt of amount of consideration.
- (ii) A certificate from Statutory Auditors or Chartered Accountant indicating the manner of arriving at the price of the shares issued to the persons resident outside India.

The report of receipt of consideration as well as FC-GPR have to be submitted to the concerned Regional Office of the Reserve Bank under whose jurisdiction the registered office of the company is situated. Annual return on foreign liabilities and assets [previously Part B of FC-GPR] should be filed on an annual basis by the Indian company, directly with the Reserve Bank. This is an annual return to be submitted by 15th of July every year, pertaining to all investments by way of direct/portfolio investments/re-invested earnings/others in the Indian company made during the previous years

Procedure under Government Approval

FDI in activities not covered under the automatic route require prior government approval. Approvals of all such proposals including composite proposals involving foreign investment/foreign technical collaboration are granted on the recommendations of Foreign Investment Promotion Board (FIPB).

Prohibited Sectors

The extant policy does not permit FDI in the following cases:

1. Gambling and betting
2. Lottery Business
3. Atomic Energy
4. Retail Trading
5. Agricultural or plantation activities of Agriculture

Checklist of reporting of Foreign Direct investment

Particulars	Time Frame	Forms	With whom
Intimation to RBI about the amount of consideration received (in the Form of Inward remittance or in the form of debit to NRE/FCNR account)	within 30 days from the date of receipt of the amount of consideration	Annexure II and Annexure III	Authorised dealer category -I bank, with the regional office of the Reserve Bank under whose jurisdiction the registered office of the company is situated
Shares to be allotted	Within 180 days from the date of receipt of consideration		
Reporting of issue of shares	Within 30 days from the date of issue of shares	Form FC- GPR (part A) along with A certificate from the Company Secretary	Authorised dealer category -I bank, with the regional office of the Reserve Bank under whose jurisdiction the registered office of the company is situated
		A certificate from Auditors of the company	
Annual Return pertaining to all the foreign investments in the company as on the balance sheet date	31 July every year	Annual return of Foreign Liabilities and Assets	Director, Balance of Payment, Statistical Division, Department of Statistical Analysis & Computer Services, Reserve Bank of India, C8, 3rd Floor, Bandra-Kurla Complex, Bandra (E), Mumbai

Immovable Property outside India

Purchase of immovable property outside India is a Capital Account transaction and although there is a general prohibition, relaxation has been made from time to time.

A company incorporated in India having overseas office, may acquire immovable property outside India for its business and for residential purposes of its staff, in accordance with the direction issued by RBI from time to time.

RBI has permitted remittance by a company incorporated in India to acquire immovable property outside India for its business and for residential purpose of its staff within the limits for initial expenses of 15% of the average annual sales/income or turnover during the last two financial years or 25% of its net worth, whichever is higher and recurring expenses of 10% of the average annual sales/income or turnover during the last two financial years.

External Commercial Borrowings



External Commercial Borrowings (ECB) refer to commercial loans in the form of bank loans, buyers' credit, suppliers' credit, securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares) availed of from non-resident lenders with a minimum average maturity of 3 years.

ECB can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route. Automatic route can be availed in case the eligibility criteria for automatic route is met. In case of doubt as regards eligibility to access the Automatic Route, applicants may take recourse to the Approval Route.

Automatic route:

- ECB can be given by only recognized lenders and can be availed by eligible buyers only.
- The proposed ECB must satisfy the general conditions (such as the end use restrictions, average maturity and all in cost ceilings etc) prescribed under the ECB guidelines for qualifying under the Automatic Route.
- Software companies can avail ECB for the purpose of import of capital goods.
- The borrower can draw-down the loan only after obtaining the loan registration number ('LRN') from Department of Statistical and Information Systems (DSIM), Reserve Bank of India

- Form 83 (in duplicate), duly certified by the Company Secretary or Chartered Accountant is required to be filed with Authorised dealer. One copy is to be forwarded by the designated AD bank to the Director, Balance of Payments Statistics Division, DSIM, Mumbai. Submission of copy of loan agreement is not required.
- The amount that can be availed under automatic route under ECB is USD 500 Million per financial year. The maturity of ECB in case the amount upto USD 20 million can not be less than three years and in case of ECB above USD 20 million or equivalent and up to USD 500 million or its equivalent with a minimum average maturity of five years.
- There is also ceiling on the all in cost that can be incurred by the borrower towards the cost like rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees etc. The cost is specified to be LIBOR for the respective currency of borrowing of 6 months + 300 basis points in case the period of maturity is 3 years and upto 5 years and it can be LIBOR of 6 months + 500 basis points in case period of maturity is 5 years or more.

Prepayment of ECB

USD 500 million would be allowed by the AD bank without prior approval of RBI subject to compliance with the stipulated minimum average maturity period as applicable to the loan, while pre-payment of ECB for amounts exceeding USD 500 million would be considered by the RBI under the Approval Route.

Monthly return

Borrowers are required to submit ECB-2 Return certified by the designated AD on monthly basis so as to reach DSIM, RBI within seven working days from the close of month to which it relates.

Approval Route

Application in **Form ECB** to be filed with the RBI, with

- (i) A copy of offer letter from the overseas lender/supplier furnishing complete details of the terms and conditions of proposed ECB; and
- (ii) A copy of the import contract, proforma/commercial invoice/bill of lading.

Monthly return

Borrowers are required to submit ECB-2 Return certified by the designated AD on monthly basis so as to reach DSIM, RBI within seven working days from the close of month to which it relates.

Conversion of ECBs to equity

- ECBs can be converted to equity subject to conditions prescribed in this behalf in the ECB guidelines. The equity shares must be valued as per the guidelines/regulations issued by SEBI/ Controller of Capital Issues in case of listed/unlisted
- Conversion of ECB may be reported to the Reserve Bank as follows:
 - (a) Borrowers are required to report full conversion of outstanding ECB into equity in the **Form FC-GPR** to the concerned Regional Office of the Reserve Bank as well as in Form ECB-2 submitted to the DSIM, RBI within seven working days from the close of month to which it relates. The words "ECB wholly converted to equity" should be clearly indicated on top of the **Form ECB-2**. Once reported, filing of ECB-2 in the subsequent months is not necessary.
 - (b) In case of partial conversion of outstanding ECB into equity, borrowers are required to report the converted portion in **Form FC-GPR** to the concerned Regional Office as well as in **Form ECB-2** clearly differentiating the converted portion from the unconverted portion. The words "ECB partially converted to equity" should be indicated on top of the Form ECB-2. In subsequent months, the outstanding portion of ECB should be reported in Form ECB-2 to DSIM.

The policy for ECB is also applicable to FCCB in all respects including reporting requirements. Further FCCBs issue must be in compliance with the guidelines prescribed in the Regulation 21 FEMA 120/2004-RB dated July 7, 2004 and the Schedule 1 thereunder. The issue size of the FCCBs cannot exceed USD 500 million as per the present policy. Issues exceeding USD 500 million would require prior approval of the Reserve Bank of India.

The primary responsibility to ensure that ECB raised / utilised are in conformity with the ECB guidelines and the Reserve Bank regulations / directions is that of the borrower concerned and any contravention of the ECB guidelines will be viewed seriously and will invite penal action under FEMA 1999 (cf. A. P. (DIR Series) Circular No. 31 dated February 1, 2005). The designated AD bank is also required to ensure that raising / utilisation of ECB is in compliance with ECB guidelines at the time of certification.

Any changes in the terms and conditions of the ECB after obtaining LRN is required to be reported to designated AD Category-I banks to approve the same. Following requests from the ECB borrowers, subject to specified conditions:

- (a) Changes/modifications in the drawdown/repayment schedule

Designated AD Category-I banks may approve changes/modifications in the drawdown/repayment schedule of the ECBs already availed, both under the approval and the automatic routes, subject to the condition that the average maturity period, as declared while obtaining the LRN, is maintained. The changes in the drawdown/repayment schedule should be promptly reported to the DSIM, RBI in Form 83. However, any elongation/rollover in the repayment on expiry of the original maturity of the ECB would require the prior approval of the Reserve Bank.

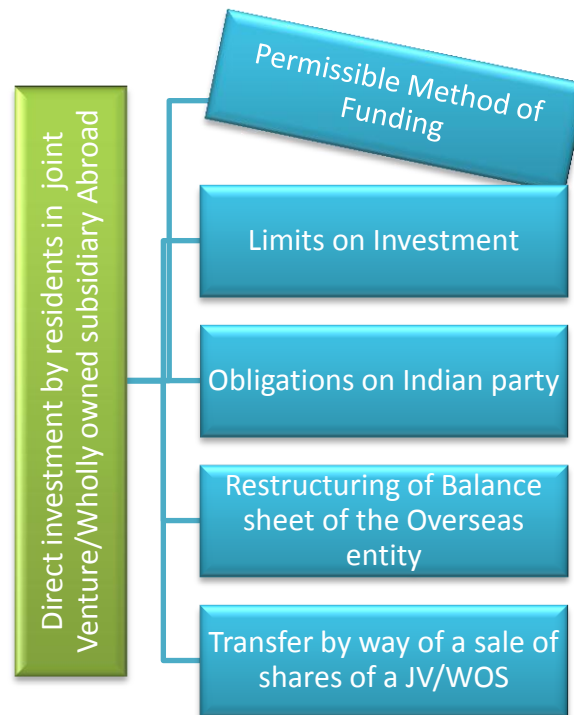
- (b) **Changes in the currency of borrowing**
Designated AD Category-I banks may allow changes in the currency of borrowing, if so desired, by the borrower company, in respect of ECBs availed of both under the automatic and the approval routes, subject to all other terms and conditions of the ECB remaining unchanged. Designated AD banks should, however, ensure that the proposed currency of borrowing is freely convertible.
- (c) **Change of the AD bank**
Designated AD Category-I banks may allow change of the existing designated AD bank by the borrower company for effecting its transactions pertaining to the ECBs subject to No-Objection Certificate (NOC) from the existing designated AD bank and after due diligence.
- (d) **Changes in the name of the Borrower Company**
Designated AD Category-I banks may allow changes in the name of the borrower company subject to production of supporting documents evidencing the change in the name from the Registrar of Companies.

Trade Credit



- 'Trade Credits' ('TC') refer to credits extended for imports directly by the overseas supplier, bank and financial institution for maturity of less than three years. Depending on the source of finance, such trade credits include suppliers' credit or buyers' credit.
- Deferred payment arrangements, including suppliers and buyers credit, providing for payments beyond a period of 6 months from date of shipment up to a period of less than three years, are treated as TCs.
- It may be noted that buyers' credit and suppliers' credit for three years and above come under the ECB which are governed by ECB guidelines
- TCs need to satisfy conditions prescribed in respect of amount and maturity, all-in-cost ceilings etc
- Details of TCs must be submitted to authorized dealers against which the authorized dealer may allot a unique identification number

Investments outside India



Direct investment outside India means investments, either under the Automatic Route or the Approval Route, by way of contribution to the capital or subscription to the Memorandum of Association of a foreign entity, signifying a long-term interest (setting up a Joint Venture (JV) or a Wholly Owned Subsidiary (WOS)) in the overseas entity. The investment can be made either under automatic route or under approval route.

Conditions precedent

- The Indian Party has to submit **Form ODI**, duly completed, to the designated branch of an authorized dealer. In this connection the following must be noted:
 - (a) The Form ODI must be submitted *in duplicate* to the AD for the purpose of making remittance towards investment in overseas JV/WOS.
 - (b) The form should be complete in all respects and accompanied by:
 - (i) a certificate from the statutory auditors in the format given in the form, and
 - (ii) a certified copy of the resolution of the Board of Directors approving the investment. In respect of supplementary proposals involving additional equity, loan or guarantee, the particulars furnished in **Form ODI** submitted earlier in respect of the same JV/WOS

shall not be insisted upon; however, revised particulars of the repatriable entitlements etc., to the extent applicable, must be provided.

- (c) Where there is more than one Indian party making investment in the same JV/WOS overseas, Form ODI should be obtained by all the Indian parties jointly along with a certificate(s) from other ADs, if remittances are effected by the latter.

Methods of Funding:

- (a) drawal of foreign exchange from an AD bank in India;
- (b) capitalisation of exports;
- (c) swap of shares (valuation as mentioned in para B.1 (e) above);
- (d) proceeds of External Commercial Borrowings (ECBs) / Foreign Currency Convertible Bonds (FCCBs);
- (e) in exchange of ADRs/GDRs issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993, and the guidelines issued thereunder from time to time by the Government of India;
- (f) balances held in EEFC account of the Indian party; and
- (g) proceeds of foreign currency funds raised through ADR / GDR issues.

In respect of (vi) and (vii) above, the ceiling of 400 per cent of the net worth will not apply. However, in respect of investments in the financial sector, they will be subject to compliance with Regulation 7 of the Notification *ibid*, irrespective of the method of funding.

Limits till which the overseas investment can be made

An Indian party has been permitted to make investment in overseas Joint Ventures (JV) / Wholly Owned Subsidiaries (WOS), not exceeding 400 per cent of the net worth of the Indian party, i.e. a company incorporated in India or a body created under an Act of Parliament or a partnership firm registered under the Indian Partnership Act, 1932, making investment in a JV/WOS abroad and includes any other entity in India excluding individuals as may be notified by the Reserve Bank as on the date of the last audited balance sheet. Networth means paid up capital and free reserves. The ceiling will include contribution to the capital of the overseas JV / WOS, loan granted to the JV / WOS and 100 per cent of guarantees issued to or on behalf of the JV/WOS. As per the recent amendment 50 per cent of the amount of the performance guarantees may be reckoned for the

purpose of computing financial commitment to its JV/WOS overseas, within the 400 per cent of the net worth of the Indian Party as on the date of the last audited balance sheet.

**400% of Net worth of Indian Party = 100% of capital contribution + Loan granted
+ 100% of Corporate guarantee + 50% of the performance guarantee**

Unique Identification Number:

- On receipt of the form ODI from the AD Category – I bank, Reserve Bank will allot a Unique Identification Number for each JV/WOS outside India and the Indian Party must quote such number in all its communications and reports to the Reserve Bank and the authorized dealer.
- AD Category – I banks may allow additional investment in an existing overseas concern set up by an Indian party, in terms of Regulation 6 only after the Reserve Bank has allotted necessary Unique Identification Number to the overseas project.

Obligations of the Indian party

An Indian Party is required to:

- (i) receive share certificates or any other document as an evidence of investment in the foreign entity within 6 months from the date of remittance
- (ii) repatriate to India, all dues receivable from the foreign entity, like dividend, royalty, technical fees etc., within 60 days of its falling due, or such further period as the Reserve Bank may permit.
- (iii) submit to the Reserve Bank every year within 60 days from the date of expiry of the statutory period as prescribed by the respective laws of the host country for finalisation of the audited accounts of the JV/WOS outside India an annual performance report in **Form APR**.

Valuation of shares to be purchased/acquired

In case of partial / full acquisition of an existing foreign company where the investment is more than USD 5.00 million	Category I Merchant Banker registered with SEBI or an Investment Banker / Merchant Banker outside India registered with the appropriate regulatory authority in the host country
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In all other cases

Chartered Accountant or a Certified Public Accountant.

Capitalization of export and other dues

- Indian entities are permitted to capitalize the payments due from the foreign entity towards exports, fees, royalties or any other entitlements due from the foreign entity for supplying technical know-how, consultancy, managerial and other services within the ceilings applicable. Export proceeds remaining unrealised beyond a period of twelve months from the date of export will require the prior approval of the Reserve Bank before capitalization.

Post Investment changes/additional investment in existing JV/WOS

The overseas JV / WOS set up by the Indian entity may diversify its activities/ set up step down subsidiary/ alter the shareholding pattern in the overseas entity subject to the Indian entity reporting to the Reserve Bank, the details of such decisions taken by the JV / WOS within 30 days of the approval of those decisions by the competent authority concerned of such JV / WOS in terms of local laws of the host country, and, include the same in the Annual Performance Report (APR-Part III of Form ODI) required to be forwarded annually to the Reserve Bank through AD Category-I Bank

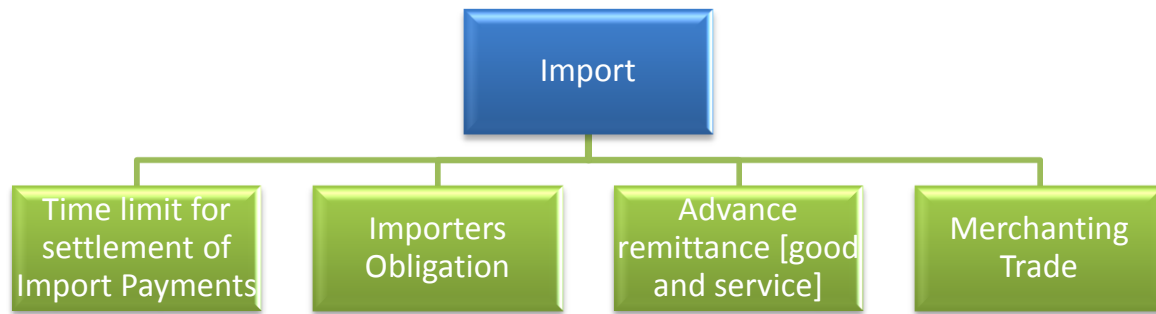
Transfer by way of sale of shares of a JV/ WOS outside India

Subject to satisfaction of conditions prescribed, Indian entities may disinvest without prior approval of the Reserve Bank. The Indian entity is required to submit details of the disinvestment through its designated AD bank within 30 days from the date of investment. An Indian entity, which does not satisfy the conditions laid down, shall have to apply to the Reserve Bank for prior permission.

Prior approval of the RBI

Where the overseas direct investment is not eligible under the automatic route and does not comply with the conditions laid down for qualifying under the general permissions, a prior approval of the RBI would be required. For this purpose, application together with necessary documents should be made in **Form ODI**

Import



Import trade is regulated by the Directorate General of Foreign Trade (DGFT) under the Ministry of Commerce & Industry, Department of Commerce, Government of India. Authorised Dealer Category – I (AD Category – I) banks should ensure that the imports into India are in conformity with the Foreign Trade Policy in force and Foreign Exchange Management (Current Account Transactions) Rules, 2000 framed by the Government of India vide Notification No. G.S.R.381 (E) dated May 3, 2000 and the Directions issued by Reserve Bank under Foreign Exchange Management Act, 1999 from time to time. Remittance of payments towards imports.

Time Limit for settlement of Import and other conditions

- Applications by persons, firms and companies for making payments, exceeding USD 500 or its equivalent, towards imports into India must be made on the appropriate Form A-1. Form A- 1 is an exhaustive form covering the details of Import licence particulars, Particulars of import w.r.t description of goods, country of origin etc.
- Remittances against imports should be completed within prescribed time limits for making import payments or an approval from the AD/Reserve Bank of India must be obtained prior to the due date.

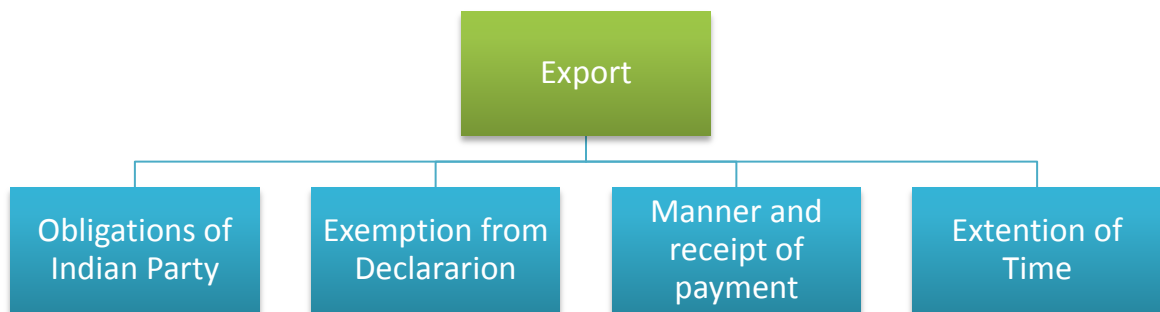
- Interest on delayed payments must be within the prescribed ceilings.
- In case of imports, where value of foreign exchange remitted/paid for import into India exceeds USD 100,000 or its equivalent, the documents evidencing the import like Bill of Entry etc shall be required to be submitted within three months from the date of shipment.
- Where imports are made in non-physical form, i.e., software or data through internet/datacom channels and drawings and designs through e-mail/fax, a certificate from a Chartered Accountant that the software / data / drawing/ design has been received by the importer must be submitted to AD

Merchanting Trade

Merchanting trade transactions or intermediary trade transactions can be undertaken, subject to the following: -

- (a) Goods involved in the transactions are permitted to be imported into India
- (b) All rules, regulations and directions applicable to export (except Export Declaration Form) and import (except Bill of Entry) are complied with.
- (c) The entire merchant trade transaction is completed within a period of 6 months.
- (d) The transactions do not involve foreign exchange outlay for a period exceeding 3 months.
- (e) Payment is received in time for the export leg of the transaction.
- (f) Where payment for the export leg of the transaction precedes payment for the import leg of the transaction, liability for the import leg is extinguished without delay by the payment received for the export leg.
- (g) No short-term credit by way of buyers/suppliers credit is made available for these transactions.

Export



Definition

Section 3(l) of FEMA defines the term “export” as follows: —

(l) “*export*”, with its grammatical variations and cognate expressions, means—

- (i) *the taking out of India to a place outside India any goods,*
- (ii) *provision of services from India to any person outside India.*

While, Section 3(zb) of FEMA defines the term “service” as follows: -

(zb) “service” means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, medical assistance, legal assistance, chit fund, real estate, transport, processing, supply of electrical or other energy, boarding or lodging or both, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service;

Obligations of Exporter

Section 7 provides that every exporter of goods shall furnish to the Reserve Bank declaration in the specified form along with such supporting evidence containing true and correct material particulars in respect of the goods or software exported. Such particulars include IEC Code, specific identification number of the document, details of the full export value of goods or software; and where the full value is not known then the value expected to be realized.

Similarly, every exporter of services is also required to furnish a declaration, in the specified form along with such supporting evidence containing true and correct material particulars in respect of the value of services exported. So far no specific form has been prescribed. Hence, service exporters can export such services without furnishing any declaration, but they are nevertheless liable to realize and repatriate the amount due within the time and in the manner prescribed under the law.

Realization, Receipt and Surrender of Foreign Exchange

Section 8 of FEMA deals with the realization and repatriation of foreign exchange. It casts a duty on every person resident in India to whom any foreign exchange is due or has accrued to take all reasonable steps to realize and repatriate to India within the time and in the manner specified by RBI I.e within 6 months from the date of export. Further, the person shall not do anything that has the effect of delaying the receipt of the foreign exchange or the foreign exchange ceases to be receivable in full or in part by him. Where goods are to be exported on terms of credit exceeding those stated above, permission of the RBI will be required to enter into such sale contracts.

In case it is not possible to realize and repatriate the export proceeds within the time frame provided for an application should be made to the Authorised Dealer Bank. Extension **up to a period of six months, at a time, irrespective of the invoice value of the export** can be granted by the AD subject to fulfilment of the following conditions: —

Manner of repatriation of foreign exchange

On receipt of the foreign exchange due, the exporter may:—

1. Sell it to an authorised dealer.
2. To the extent permitted, retain it in his foreign currency account.
3. Use it to settle a foreign exchange debt or liability.

Period for surrender of foreign exchange

Foreign exchange received towards export of goods and service should be surrendered within 180 days from the date of its receipt. For example, if the exporter has received a cheque or foreign currency from his foreign customer, the same should be surrendered to an authorized dealer within 180 days. But this regulation is not applicable to foreign exchange in the form of currency of Nepal or Bhutan.

Retaining foreign exchange

An exporter of goods or services may retain up to 100% of foreign exchange earned by him with an authorised dealer in foreign currency in an account known as Exchange Earners Foreign Currency (EEFC) Account.

Manner of Receipt of Foreign Exchange

Payments towards export of goods and services from India may be received in the following manner:

1. In the form of bank draft, cheque, pay order.
2. Foreign currency notes, travellers cheques from the buyer during his visit to India.
3. By debit to the buyers FCNR/NRE account.
4. Through International credit card through servicing bank in India.
5. From rupee account held in the name of an Exchange House with an authorized dealer if the amount does not exceed Rs. 2,00,000 per export transaction.
6. In accordance with the directions issued by the RBI, where the export is covered by arrangement between the Central Government and the Government of a foreign country or by credit arrangement entered into by the Exim Bank with a financial institution in a foreign state.
7. All transactions between a person resident in India and a person resident in Nepal may be settled in Indian Rupees, except in case where the importer has been permitted by the Nepal Rashtra Bank to make payment in free foreign exchange.
8. In the form of precious metals i.e. Gold/Silver/ Platinum by the Gem & Jewellery units in SEZs and EOUs in equivalent to value of jewellery exported on the condition that the sale contract provides for the same and the approximate value of the precious metals is indicated in the relevant GR/SDF/PP Forms.

Trade discount

An authorized dealer may negotiate or send for collection export bills in respect of exports by air or sea which involve trade discount only if the same is declared on the GR/SDF forms and is accepted by Custom Authorities.

Reduction in Value of Export Invoice

An exporter can approach his authorised dealers and seek permission to reduce the value of the export invoice under following circumstances.

Reduction in the value of export invoice after it is negotiated or sent for collection is permitted for genuine reasons, provided the exporter is not on the caution list of RBI, if the reduction does not exceed 25% of the invoice value and it does not relate to the export of commodities subject to floor price stipulations. In all such cases the exporter will have to surrender proportionate export incentives availed against such exports.

In case where the exporter has been in the export business for more than 3 years and his export outstandings do not exceed 5% of the average annual export realization during the preceding 3 financial years reduction in value of invoice is permitted without any ceiling i.e. even in excess of 25% of the invoice value.

Write off of Bad Debts

An exporter is permitted to write off the amounts due which in spite of his best efforts are not realizable. He must approach the authorised dealer who handled the export documents for permission to write off the amount not realizable. Write off is permitted where: —

- a. The amount is outstanding for 1 year or more.
- b. The total amount of write off allowed in a financial year does not exceed 10% of the total export proceeds realized during the previous financial year.
- c. Satisfactory documentary evidence is furnished in support of the efforts made by the exporter for the recovery of the amount due. The case falls under one of the categories specified by RBI and the exporter produces a certificate from the Foreign Mission of India concerned, about the fact of non-recovery of export proceeds from the buyer.
- e. The case is not subject matter of any pending civil or criminal suit.
- f. The export is not under investigation by ED, CBI or any other law enforcement agency.

- g. The export has surrendered the proportionate export incentives availed/received under the Duty Drawback Scheme against the relevant exports.

Exporters, whose cases are not covered by any of the above criterion, will have to obtain prior permission from the Regional Office concerned of the Reserve Bank before they can write off any export receivables.

Export of Goods Requiring Prior Approval of the RBI

Prior approval of RBI is required for the following exports: -

- ❖ Export of goods on lease or hire or under any arrangement or in any other manner other than sale or disposal of such goods.
- ❖ Any counter trade arrangement whereby the value of goods imported into India is adjusted against the value of goods exported from India.
- ❖ Export of goods under special arrangement or under rupee credits between the Central Government and the Government of a Foreign State.
- ❖ Export on elongated terms or export after one year of receipt of advance payment or under the line of credit extended to a bank or a financial institution operating in a foreign state by the Exim Bank for financing exports from India.
- ❖ Export of goods not involving any foreign exchange transaction directly or indirectly requires the waiver of GR/PP procedure from the Reserve Bank.

Advance Payment against Exports

Exporters may receive advance payments from their overseas buyers. **Shipments made against the advance payments must be made within one year from the date of receipt of advance** and the same are to be monitored by the Authorized Dealer bank through whom the advance payment is received.

DISCLAIMER

The analysis/views in this booklet do not purport to be and should not be treated as legal opinion.

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