

FAQ ON FOREIGN INVESTMENTS IN INDIA

The FAQs cover broadly the following areas :

- 1) Foreign Direct Investment
- 2) Foreign Technical Collaboration
- 3) Foreign Portfolio Investment
- 4) Investment in Government Securities and Corporate debt
- 5) Foreign Venture Capital Investment
- 6) Procedure for opening Branch/Project/Liaison Office

1) FOREIGN DIRECT INVESTMENT

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

A foreign company planning to set up business operations in India has the following options:

1. As an incorporated entity by incorporating a company under the Companies Act, 1956 through
2. Joint Ventures; or
3. Wholly Owned Subsidiaries
4. As an office of a foreign entity through
5. Liaison Office / Representative Office
6. Project Office
7. Branch Office

Such offices can undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office or other place of business) Regulations, 2000.

2. How does a foreign company invest in India? What are the regulations pertaining to issue of shares by Indian companies to foreign collaborators/investors?

Automatic Route

FDI up to 100% is allowed under the automatic route in all activities/sectors except the following which require prior approval of the Government:

- i) where provisions of Press Note 1 (2005 Series) issued by the Government of India are attracted.
- ii) where more than 24% foreign equity is proposed to be inducted for manufacture of items reserved for the Small Scale sector.

- iii) FDI in sectors/activities to the extent permitted under Automatic Route does not require any prior approval either by the Government or the Reserve Bank of India.
- iv) The investors are only required to notify the Regional Office concerned of the Reserve Bank of India within 30 days of receipt of inward remittances and file the required documents along with form FC-GPR with that Office within 30 days of issue of shares to the non-resident investors.

Government Route

FDI in activities not covered under the automatic route requires prior Government approval and are considered by the Foreign Investment Promotion Board (FIPB), Ministry of Finance. Application can be made in Form FC-IL, which can be downloaded from <http://www.dipp.gov.in>. Plain paper applications carrying all relevant details are also accepted. No fee is payable.

General permission of RBI under FEMA

Indian companies having foreign investment approval through FIPB route do not require any further clearance from the Reserve Bank of India for receiving inward remittance and issue of shares to the non-resident investors. The companies are required to notify the concerned Regional Office of the Reserve Bank of India of receipt of inward remittances within 30 days of such receipt and submit form FC-GPR within 30 days of issue of shares to the non-resident investors.

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

FDI is prohibited under Government as well as Automatic Route for the following sectors:

- i) Retail Trading (except single brand product retailing)
- ii) Atomic Energy
- iii) Lottery Business
- iv) Gambling and Betting
- v) Business of Chit Fund
- vi) Nidhi Company
- vii) Agricultural or plantation activities (Notification No. FEMA 94/2003-RB dated June 18, 2003).
- viii) Housing and Real Estate business (except development of townships, construction of residential/commercial premises, roads or bridges to the extent specified in Notification No. FEMA 136/2005-RB dated July 19, 2005)
- ix) Trading in Transferable Development Rights (TDRs).

4. What should be done after investment is made under the Automatic Route or with Government approval?

A two-stage reporting procedure has been introduced for this purpose.

1) On receipt of money for investment:

Within 30 days of receipt of money from the non-resident investor, the Indian company will report to the Regional Office of the Reserve Bank of India, under whose jurisdiction its Registered Office is located, containing details such as:

- i) Name and address of the foreign investor/s
- ii) Date of receipt of funds and their rupee equivalent
- iii) Name and address of the authorised dealer through whom the funds have been received, and
- iv) Details of the Government approval, if any.

2) Upon issue of shares to non-resident investors:

- i) Within 30 days from the date of issue of shares, a report in Form FC-GPR, PART A together with the following documents should be filed with the concerned Regional Office of the Reserve Bank of India.
- ii) Certificate from the Company Secretary of the company accepting investment from persons resident outside India certifying that;

- 1) the company has complied with the procedure for issue of shares as laid down under the FDI scheme as indicated in the Notification No. FEMA 20/2000-RB dated 3rd May 2000 as amended from time to time
- 2) The proposal is within the sectoral policy / cap permissible under the automatic route of RBI and it fulfills all the conditions laid down for investments under the Automatic approval route namely:

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

b) The company is not investing in an SSI unit & the investment limit of 24 % has been observed/ requisite approvals have been obtained.

c) Shares have been issued on rights basis and the shares are issued to non-residents at a price that is not lower than that at which shares are/were issued to residents.

OR

d) Shares issued are bonus shares.

OR

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

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

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

TRANSFER FROM NON-RESIDENT TO RESIDENT

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

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

A: Transfer by way of sale:

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

- i) Any person resident outside India (other than NRIs/OCBs) can transfer by way of sale the shares/convertible debentures to any person resident outside India; subject to the condition that the acquirer or transferee does not have any previous venture or tie up in India in the same field or sector.
- ii) A non-resident Indian (NRI) or an erstwhile Overseas Corporate Body may transfer by way of sale, the shares/convertible debentures held by him to another NRI only.
- iii) Any person resident outside India may sell share/convertible debenture acquired in accordance with FEMA Regulations, on a recognized Stock Exchange in India through a registered broker.

B: Transfer by way of Gift:

A person resident outside India can freely transfer share/convertible debenture by way of gift to a person resident in India as under:

- i) Any person resident outside India, (not being a non-resident Indian or an erstwhile overseas corporate body), can transfer **by way of gift** the shares/convertible debentures to any person resident outside India; subject to the condition that the acquirer or transferee does not have any previous venture or tie up in India in the same field or sector.

- ii) A non-resident Indian (NRI) may transfer by way of gift, the shares/convertible debentures held by him to another NRI only.
- iii) Any person resident outside India may transfer share/convertible debenture to a person resident in India by way of gift.

TRANSFER FROM RESIDENT TO NON-RESIDENT

A: Transfer by way of sale - General Permission under Regulation 10 of Notification No. FEMA 20/2000-RB dated May 3, 2000.

- 1) A person resident in India may transfer to a person resident outside India any share/convertible debenture of an Indian Company whose activities fall under the Automatic Route for FDI subject to the Sectoral Limits, **by way of sale** subject to complying with pricing guidelines, documentation and reporting requirements for such transfers, as may be specified by the Reserve Bank of India, from time to time.
- 2) This general permission is not available where:
 - a) Indian Company whose shares or convertible debentures are proposed to be transferred is in financial service sector (financial services sector means service rendered by banking and non-banking companies regulated by the Reserve Bank, insurance companies regulated by Insurance Regulatory and Development Authority (IRDA) and other companies regulated by any other financial regulator, as the case may be).
 - b) The transfer falls within the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

B: Transfer by way of gift:

A person resident in India can transfer by way of gift shares to a person resident outside India in the following ways:

- a) A person resident in India who proposes to transfer to a person resident outside India [other than erstwhile OCBs] any security, **by way of gift**, shall make an application to the Central Office of the Foreign Exchange Department, Reserve Bank of India furnishing the following information, namely:
 - b) Name and address of the transferor and the proposed transferee
 - c) Relationship between the transferor and the proposed transferee
 - d) Reasons for making the gift. The gifts are permissible up to a limit of:
 - (i) 5% of the paid up capital of the company per donee, and
 - (ii) Amount does not exceed USD 25,000 per calendar year for each donor. The valuation of these shares shall be in accordance with pricing guidelines prescribed.

6. What if the transfer from resident to non-resident does not fall under the above facility?

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

- a) A copy of FIPB approval (if required).
- b) Consent letter from transferor and transferee clearly indicating the number of shares, name of the investee Company and the price at which the transfer is proposed to be effected.
- c) The present/post transfer shareholding pattern of the Indian investee company showing the equity participation by residents and non-residents category-wise.
- d) Copies of the Reserve Bank of India's approvals/acknowledged copies of FC-GPR evidencing the existing holdings of the non-residents.
- e) If the sellers/transfersors are NRIs / OCBs, the copies of the Reserve Bank of India's approvals evidencing the shares held by them on repatriation / non-repatriation basis.
- f) Open Offer document filed with SEBI if the acquisition of shares by non-resident is under SEBI Takeover Regulations.
- g) Fair Valuation Certificate from Chartered Accountant indicating the value of shares as per the following guideline.
- h) In the case of unlisted shares the fair value is worked out as per the erstwhile Controller of Capital Issue/s.
- i) For listed shares, the price worked out is not less than the higher of average weekly high and low quotations for 6 months and average of daily high and low quotation or two weeks preceding 30 days prior to the date of making application to FIPB.

7. Are the investments and profits earned in India repatriable?

All foreign investments are freely repatriable except for the cases where NRIs choose to invest specifically under non-repatriable schemes. Dividends declared on foreign investments can be remitted freely through an Authorised Dealer.

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

- a. Allotment of shares on preferential basis shall be as per the requirements of the Companies Act, 1956, which will require special resolution in case of a public limited company.
- b. In case of listed companies, valuation shall be as per the Reserve Bank of India /SEBI guidelines as follows:

The issue price shall be either at:

- i) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date or
 - ii) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the two weeks preceding the relevant date.
- c. In case of unlisted companies, valuation shall be done in accordance with the guidelines issued by the erstwhile Controller of Capital Issues.

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

Indian companies are allowed to raise capital in the international market through the issue of ADRs/GDRs. They can issue ADRs/GDRs without obtaining prior approval from RBI if it is eligible to issue ADRs/GDRs in terms of the Scheme for Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and subsequent guidelines issued by Ministry of Finance, Government of India.

After the issue of ADRs/GDRs, the company has to file a return in the proforma given in Annexure 'C' to the RBI Notification No.FEMA.20/ 2000-RB dated May 3, 2000. The company is also required to file a quarterly return in a form specified in Annexure 'D' of the same regulations.

There are no end-use restrictions on GDR/ADR issue proceeds, except for an express ban on investment in real estate and stock markets.

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

a) Sponsored ADR/GDR:

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

b) Two-way fungibility Scheme:

Under the limited Two-way fungibility Scheme, a registered broker in India can purchase shares of an Indian company on behalf of a person resident outside India for the purpose of converting the shares so purchased into ADRs/GDRs. The operative guidelines for the same have been issued vide A.P. (DIR Series) Circular No.21 dated February 13, 2002. The Scheme provides for purchase and re-conversion of only as many shares into

ADRs/GDRs which are equal to or less than the number of shares emerging on surrender of ADRs/GDRs which have been actually sold in the market. Thus, it is only a limited two-way fungibility wherein the headroom available for fresh purchase of shares from domestic market is restricted to the number of converted shares sold in the domestic market by non-resident investors. So long ADRs/GDRs are quoted at discounts to the value of shares in domestic market, an investor will gain by converting the ADRs/GDRs into underlying shares and selling them in the domestic market. In case of ADRs/GDRs being quoted at premium, there will be demand for reverse fungibility, i.e. purchase of shares in domestic market for re-conversion into ADRs/GDRs. The scheme is operationalised through the Custodians of securities and stockbrokers under SEBI.

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

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

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

12. Can I invest through Preference Shares? What are the regulations applicable in case of such investments?

Foreign investment through preference shares is treated as foreign direct investment. Foreign investment in preference share is considered as part of share capital and fall outside the External Commercial Borrowing (ECB) guidelines/cap.

Preference shares to be treated as foreign direct equity for purpose of sectoral caps on foreign equity, where such caps are prescribed, provided they carry a conversion option. If the preference shares are structured without such conversion option, they would fall outside the foreign direct equity cap.

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

Issue of equity shares against lump sum fee, royalty and external commercial borrowings (ECBs) in convertible foreign currency are permitted, subject to meeting all applicable tax liabilities and sector specific guidelines.

14. Other than issue of shares under Automatic /Government Route, what other general permissions are available under RBI Notification No.FEMA 20 dt.3-5-2000?

Issue of shares under ESOP by Indian companies to its employees or employees of its joint venture or wholly owned subsidiary abroad who are resident outside India directly or through a Trust up to 5% of the paid up capital of the company.

Issue and acquisition of shares by non-residents after merger or de-merger or amalgamation of Indian companies.

Issue shares or preference shares or convertible debentures on rights basis by an Indian company to a person resident outside India.

15. Can I invest in unlisted shares issued by a company in India?

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

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

No. Only NRIs/PIOs are allowed to set up partnership/proprietorship concerns in India. Even for NRIs/PIOs investment is allowed only on non-repatriation basis.

17. Can I invest in Rights shares issued by an Indian company at a discount?

There are no restrictions under FEMA for investment in Rights shares at a discount, provided the rights shares so issued are being offered at the same price to residents and non-residents.

II - Foreign Technical Collaboration

1. What are the payment parameters for foreign technology transfer under the Automatic Route of Reserve Bank of India? How should royalty be calculated?

Payment for foreign technology collaboration by Indian companies are allowed under the automatic route subject to the following limits:

Lump sum payments not exceeding US\$ 2 million.

Royalty payable being limited to 5 per cent for domestic sales and 8 per cent for exports, without any restriction on the duration of the royalty payments.

The royalty limits are net of taxes and are calculated according to standard conditions.

The royalty will be calculated on the basis of the net ex-factory sale price of the product, exclusive of excise duties, minus the cost of the standard bought-out components and the landed cost of imported components, irrespective of the source of procurement, including ocean freight, insurance, custom duties, etc.

RBI has delegated the powers to ADs to make payment of royalty under such agreements. The requirement of registration of the agreement with the Regional Office of Reserve Bank of India has been done away with.

2. What should be done, if Automatic Route of Reserve Bank of India for technology transfer is not available?

Proposals, which do not satisfy the parameters prescribed for automatic route of RBI, require clearance from Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India.

III – FOREIGN PORTFOLIO INVESTMENT

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

Investment by FIIs is regulated under SEBI (FII) Regulations, 1995 and Regulation 5(2) of FEMA Notification No.20 dated May 3, 2000. FIIs include Asset Management Companies, Pension Funds, Mutual Funds, and Investment Trusts as Nominee Companies, Incorporated / Institutional Portfolio Managers or their Power of Attorney holders, University Funds, Endowment Foundations, Charitable Trusts and Charitable Societies.

SEBI acts as the nodal point in the registration of FIIs. The Reserve Bank of India has granted General Permission to SEBI Registered FIIs to invest in India under the Portfolio Investment Scheme (PIS).

Investment by individual FIIs cannot exceed 10% of paid up capital. Investment by foreign registered as sub accounts of FII cannot exceed 5% of paid up capital. All FIIs and their sub-accounts taken together cannot acquire more than 24% of the paid up capital of an Indian Company. An Indian Company can raise the 24% ceiling to the Sectoral Cap / Statutory Ceiling, as applicable, by passing a resolution by its Board of Directors followed by passing a Special Resolution to that effect by their General Body.

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

Non Resident Indian (NRIs) and Persons of Indian Origin (PIOs) can purchase/sell shares/convertible debentures of Indian companies on Stock Exchanges under Portfolio Investment Scheme. For this purpose, the NRI/PIO has to apply to a designated branch of a bank, which deals in Portfolio Investment. All sale/purchase transactions are to be routed through the designated branch.

An NRI or a PIO can purchase shares up to 5% of the paid up capital of an Indian company. All NRIs/PIOs taken together cannot purchase more than 10% of the paid up value of the company. (This limit can be increased by the Indian company to 24% by passing a General Body resolution).

The sale proceeds of the repatriable investments can be credited to the NRE/NRO etc. accounts of the NRI/PIO whereas the sale proceeds of non-repatriable investment can be credited only to NRO accounts.

The sale of shares will be subject to payment of applicable taxes.

IV - INVESTMENT IN GOVERNMENT SECURITIES AND CORPORATE DEBT

1. Can a Non-resident Indian invest in Government Securities/Treasury bills and Corporate debt?

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

A. A Non-resident Indian can purchase,

- (1)
 - i) Government dated securities (other than bearer securities) or treasury bills or units of domestic mutual funds;
 - ii) bonds issued by a public sector undertaking(PSU) in India;
 - iii) shares in Public Sector Enterprises being disinvested by the Government of India
- (2) They can also invest, on non-repatriation basis, in dated Government securities (other than bearer securities), treasury bills, units of domestic mutual funds, units of Money Market Mutual Funds in India, or National Plan/Savings Certificates on non-repatriation basis. The guidelines for these schemes are framed by the concerned Government agencies.

B. A SEBI registered Foreign Institutional Investor may purchase, on repatriation basis, dated Government securities/treasury bills, non-convertible debentures/bonds issued by an Indian company and units of domestic mutual funds either directly from the issuer of such securities or through a registered stock broker on a recognised stock exchange in India. The FIIs is required to ensure that;

i) the FII allocation of its total investment between equity and debt instruments (including dated Government Securities and Treasury Bills in the Indian capital market) should not exceed the ratio of 70:30.

ii) In case the FII is set-up as a 100% debt FII, it can invest the entire corpus in dated Government Securities including Treasury Bills, non-convertible debentures/bonds issued by an Indian company subject to limits, if any, stipulated by SEBI in this regard.

The Investment in Government Securities/Treasury bills and Corporate debt is subject to a ceiling decided in consultation with the Government of India. Investment limit for the FIIs as a group in Government securities currently is USD 3.2 Billion. The limit for investment in Corporate debt is USD 1.5 billion. At present, the FIIs can also invest in Innovative instruments such as Upper Tier-II capital upto a limit of USD 500 million.

V - FOREIGN VENTURE CAPITAL INVESTMENT

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

A SEBI registered Foreign Venture Capital Investor with general permission from the Reserve Bank of India can invest in a Venture Capital Fund or an Indian Venture Capital Undertaking, in the manner and subject to the terms and conditions specified in Schedule 6 of RBI Notification No. FEMA 20/2000-RB dated May 3, 2000 as amended from time to time.

VI - PROCEDURE FOR OPENING BRANCH/PROJECT/LIAISON OFFICE

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

Foreign company can set up Liaison/Branch Offices in India after obtaining approval from Reserve Bank of India. Reserve Bank of India has given general permission to foreign companies to establish Project Offices in India subject to certain conditions.

2. What is the procedure to be followed for obtaining Reserve Bank's approval for opening Liaison Office/Representative Office?

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

The companies desirous of opening a liaison office in India may make an application in form FNC-1 along with the documents mentioned therein to Foreign Investment Division, Foreign Exchange Department, Reserve Bank of India, Central Office, Mumbai. This form is available at www.rbi.org.in

Permission to set up such offices is initially granted for a period of 3 years and this may be extended from time to time by the Regional Office in whose jurisdiction the office is set up. Liaison/Representative offices have to file an Activity Certificate on annual basis from a Chartered Accountant to the concerned Regional Office of the Reserve Bank of India , stating that the Liaison Office has undertaken only those activities permitted by Reserve Bank of India .

3. What is the procedure for setting up Project Office?

Foreign companies are granted projects in India by Indian entities. General Permission has been granted by Reserve Bank of India vide Notification No. FEMA 95/2003-RB dated July 2, 2003 to foreign companies to open Project Office/s in India provided they have secured from an Indian company, a contract to execute a project in India, and

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

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

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

Reserve Bank permits companies engaged in manufacturing and trading activities abroad to set up Branch Offices in India for the following purposes:

- i) To represent the parent company/other foreign companies in various matters in India e.g. acting as buying/selling agents in India
- ii) To conduct research work in the area in which the parent company is engaged
- iii) To undertake export and import activities and trading on wholesale basis
- iv) To promote possible technical and financial collaborations between the Indian companies and overseas companies.
- v) Rendering professional or consultancy services
- vi) Rendering services in Information technology and development of software in India
- vii) Rendering technical support to the products supplied by the parent/Group companies.

A branch office is not allowed to carry out manufacturing, processing activities directly/indirectly. A Branch Office is also not allowed to undertake Retail Trading activities of any nature in India. Branch Offices have to submit Activity Certificate from a Chartered Accountant on an annual basis to the Central Office of FED.

For annual remittance of profit Branch Office may submit required documents to an authorised dealer.

Permission for setting up branch offices is granted by the Reserve Bank of India. Reserve Bank of India considers the track record of the Applicant Company, existing trade relations with India, the activity of the company proposing to set up office in India as well as the financial position of the company while scrutinising the application.