Foreign Investment in India

(Updated as on May 07, 2018)

These FAQs attempt to put in place the common queries that users have on the subject in an easy to understand language. However, for conducting a transaction, the Foreign Exchange Management Act, 1999 (FEMA) and the Regulations made or directions issued thereunder may be referred to. The relevant principal regulations are the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 dated November 7, 2017 as amended from time to time (hereinafter referred to as FEMA 20 (R)). The modalities as to how the foreign exchange business has to be conducted by the Authorised Persons with their customers/ constituents with a view to implementing the regulations framed is laid down in Master Direction on Foreign investment in India.

Q.1: How can an Indian company receive foreign investment?

Answer: The routes under which foreign investment can be made is as under:

Automatic Route: Foreign Investment is allowed under the automatic route without prior approval of the Government or the Reserve Bank of India, in all activities/ sectors as specified in the Regulation 16 of FEMA 20 (R).

Government Route: Foreign investment in activities not covered under the automatic route requires prior approval of the Government. Procedure for applying for Government approval is given at http://fifp.gov.in/Forms/SOP.pdf

Q.2: What are the Capital instruments permitted for receiving foreign investment in an Indian company?

Answer: 'Capital Instruments' means equity shares, debentures, preference shares and share warrants issued by the Indian company.

Equity shares: Equity shares are those issued in accordance with the provisions of the Companies Act, 2013 and will include partly paid equity shares issued on or after July 8, 2014.

Share warrants: Share warrants issued on or after July 8, 2014 will be considered as capital instruments.

Debentures: 'Debentures' means fully, compulsorily and mandatorily convertible debentures.

Preference shares: 'Preference' shares means fully, compulsorily and mandatorily convertible preference shares.

Non-convertible/ optionally convertible/ partially convertible preference shares issued as on and up to April 30, 2007 and optionally convertible/ partially convertible debentures issued up to June 7, 2007 till their original maturity are reckoned to be FDI compliant capital instruments. Non-convertible/ optionally convertible/ partially convertible preference shares issued after April 30, 2007 and optionally convertible/ partially convertible debentures issued after June 7, 2007 shall be treated as debt and shall require conforming to External Commercial Borrowings guidelines regulated under Foreign Exchange Management (Borrowing and Lending in Foreign Exchange Regulations), 2000, as amended from time to time.

Q.3: Whether extension of compulsorily convertible preference shares (CCPS) or compulsorily convertible debentures (CCDs) requires RBI approval?

Answer: Tenor of convertible instruments will be guided by the instructions framed under the Companies Act, 2013 and the rules framed thereunder. However, the investee company should ensure that the price/ conversion formula of convertible capital instruments is determined upfront at the time of issue of the instruments. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the extant FEMA regulations.

Q.4: What is a convertible note?

Answer: A convertible note is an instrument issued by a start-up company evidencing receipt of money initially as debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of such startup company, within a period not exceeding five years from the date of issue of the convertible note, upon occurrence of specified events as per the other terms and conditions agreed to and indicated in the instrument.

Q.5: Who can invest in a convertible note and what are the instructions in this regard?

Answer: A person resident outside India (other than an individual who is a citizen of Pakistan or Bangladesh or an entity which is registered/ incorporated in Pakistan or Bangladesh), may purchase convertible notes issued by an Indian start-up company for an amount of twenty five lakh rupees or more in a single tranche. A start-up company engaged in a sector where foreign investment requires Government approval may issue convertible notes to a non-resident only with the approval of the Government. The amount of consideration should be received by inward remittance through banking channels or by debit to the NRE/ FCNR (B)/ Escrow account maintained by the person concerned.

Q.6: What is meant by Foreign Investment, Foreign Direct Investment and Foreign Portfolio Investment?

Answer: Foreign Investment means any investment made by a person resident outside India on a repatriable basis in capital instruments of an Indian company or to the capital of an LLP.

Foreign Direct Investment (FDI) is the investment through capital instruments by a person resident outside India (a) in an unlisted Indian company; or (b) in 10 percent or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company.

Foreign Portfolio Investment is any investment made by a person resident outside India in capital instruments where such investment is (a) less than 10 percent of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company or (b) less than 10 percent of the paid up value of each series of capital instruments of a listed Indian company.

Q.7: What is meant by capital on a fully diluted basis?

Answer: Fully diluted basis means the total number of shares that would be outstanding if all possible sources of conversion are exercised.

Q.8: Whether the foreign investment will be classified as FDI or FPI based on the schedule under which the investment is being made.

Answer: No, FDI and FPI are agnostic from the point of view of the schedule under which investment has been made. It is the percentage which defines whether it is direct or portfolio investment.

Q.9: For an FPI investment, once the investment is classified as FDI (basis total holding), if the FDI holding comes back to <10%, will the holdings be classified as FPI again?

Answer: Once an FDI always an FDI.

Q.10: Whether any approval is required for an entity which has received foreign investment under automatic route and subsequently the sector was brought under approval route

Answer: As long as the foreign shareholding in the entity remains the same and there is no corporate action pursuant to the sector being brought under approval route, approval is not required.

Q.11: Whom to approach for Government approval or in case of doubt regarding the concerned Administrative Ministry/ Department or regarding the classification of an activity or the sectoral route?

Answer: Please refer to the 'Standard Operating Procedure (SOP) for Processing FDI Proposals' issued by Department of Industrial Policy & Promotion, Government of India → http://fifp.gov.in/Forms/SOP.pdf

Q.12: Whether the definition of Indian company in FEMA 20(R) covers companies incorporated under both the Companies Act, 1956 and Companies Act, 2013

Answer: Indian company includes all those entities covered under section 1(4) of the Companies Act, 2013.

Q.13: Whether the percentage of foreign investment should be calculated at the time of issuance of Employee Stock Options (ESOP) or vesting stage or exercising stage?

Answer: Foreign investment percentage has to be calculated on a fully diluted basis i.e. at the time of issuance of Employee Stock Options.

Q.14: Whom to approach for clarifications if any required, related to Schedule 5 to FEMA 20(R)

Answer: Financial Markets Regulation Department, RBI.

Q.15: Whether cash is a permissible mode of payment for making foreign direct investment in Indian company.

Answer: No, refer to Para 7.13 of Master Direction-Foreign Investment in India.

Q.16: Are the investments and profits earned in India repatriable?

Answer: All foreign investments are repatriable (net of applicable taxes) except in cases where the investment is made or held on non-repatriation basis.

Q.17: What is meant by investment on repatriation basis and investment on non-repatriation basis?

Answer: Investment on repatriation basis means an investment, the sale/ maturity proceeds of which are, net of taxes, eligible to be repatriated out of India. The expression investment on non-repatriation basis may be construed accordingly.

Q.18: What are the guidelines on valuation of capital instruments?

Answer: Please refer to regulation 11 of FEMA 20(R).

Particulars	Listed Company	Un-Listed Company
Issue by an Indian company or transferred from a resident to non-resident - **Price should not be less than**	The price worked out in accordance with the relevant SEBI guidelines	The fair value worked out as per any internationally accepted pricing methodology for valuation on an arm's length basis, duly certified by a Chartered Accountant or a SEBI registered Merchant Banker or a practicing Cost Accountant.
Transfer from a non-resident to resident - **Price should not be more than**	The price worked out in accordance with the relevant SEBI guidelines	The fair value as per any internationally accepted pricing methodology for valuation on an arm's length basis, duly certified by a Chartered Accountant or a SEBI registered Merchant Banker.

The pricing guidelines shall not be applicable for investment by a person resident outside India on non-repatriation basis.

Q.19: What is meant by FDI linked performance conditions?

Answer: FDI linked performance conditions are the sector specific conditions stipulated in regulation 16 of FEMA 20(R) for companies receiving foreign investment

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

Answer: Only NRIs/ OCIs are allowed to invest in partnership/ proprietorship concerns in India on non-repatriation basis.

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

Answer: There are no restrictions under FEMA for investment in Rights shares issued at a discount by an Indian company under the provisions of the Companies Act, 2013. The offer on rights basis to the persons resident outside India shall be:

in case of shares of a company listed on a recognized stock exchange in India, at a price, as determined by the company; and

in case of shares of a company not listed on a recognized stock exchange in India, at a price, which is not less than the price at which the offer on right basis is made to resident shareholders.

Q.22: Whether RBI approval is required for renunciation of rights shares?

Answer: No, renunciation of rights shares shall be done in accordance with the instructions contained in Para 6.11 of Master Direction - Foreign Investment in India dated January 4, 2018, read with Regulation 6 of FEMA 20(R).

Q.23: Can an AD bank allow pledge of shares of an Indian company held by non-resident investor in favour of an Indian bank or an overseas bank or an NBFC?

Answer: Yes, subject to conditions laid down in para 7.11 of the Master Direction on Foreign Investment in India.

Q.24: Is a person resident outside India permitted to acquire capital instruments on stock exchange?

Answer: The following persons can acquire capital instruments on the stock exchanges:

FPIs registered with SEBI

NRIs

Other than (a) and (b) above, a person resident outside India, can acquire capital instruments on stock exchange, subject to the condition that the investor has already acquired and continues to hold the control of such company in accordance with SEBI (Substantial Acquisition of Shares and Takeover) Regulations and subject to conditions specified in Annex I of the Master Direction – Foreign Investment in India.

Q.25: Within how many days from the date of receipt of the consideration should the capital instrument be issued?

Answer: The capital instrument has to be issued by the Indian company within sixty days from the date of receipt of the consideration.

Q.26: What if the Capital Instruments are not issued within the stipulated time period?

Answer: If the capital instruments are not issued by the Indian company within sixty days from the date of receipt of the consideration, the amount so received has to be refunded to the person concerned by outward remittance, through banking channels or by credit to his NRE/ FCNR (B) accounts, as the case may be, within fifteen days from the date of completion of sixty days.

Q.27: What are the instructions for transfer of shares against deferred payment?

Answer: In case of transfer of shares between a resident buyer and a non-resident seller or vice-versa, not more than twenty five per cent of the total consideration can be paid by the buyer on a deferred basis, within a period not exceeding eighteen months from the date of the transfer agreement. The amount deferred can also be either in the form of an indemnity or an Escrow. In all cases, the pricing guidelines should be complied with.

Q.28. In case of transfer of capital instruments between a person resident in India and a person resident outside India on deferred payment basis, at which stage the form FC-TRS is required to be filed?

Answer: Form FC-TRS has to be filed with the AD bank on receipt of every tranche of payment. The onus of reporting shall be on the resident transferor/ transferee.

Q.29: What is the concept of downstream investment and Indirect Foreign Investment?

Answer: Downstream investment is investment made by an Indian entity which has total foreign investment in it or an Investment Vehicle in the capital instruments or the capital, as the case may be, of another Indian entity.

If the investor company has total foreign investment in it and is not owned and not controlled by resident Indian citizens or is owned or controlled by persons resident outside India then such investment shall be "Indirect Foreign Investment" for the investee company.

Q.30: Whether an Indian company (owned or controlled by persons resident outside India or not owned and not controlled by resident Indian citizens (FOCC)) investing in instruments other than capital instruments of another Indian company will be treated as downstream investment?

Answer: No

Q.31: Since the instructions on Downstream Investment were issued by the Reserve Bank in 2013, what is the status of investment made prior to the issue of the instructions?

Answer: Downstream investment made in accordance with the guidelines in existence prior to February 13, 2009 would not require any modification to conform to these regulations. All other investments, after the said date, would come under the ambit of FEMA 20(R). Downstream investments made between February 13, 2009 and June 21, 2013 which were not in conformity with these regulations should have been intimated to the Reserve Bank by October 3, 2013, for treating such cases as compliant with these regulations.

Q.32: Whether RBI's approval is required for transfer of shares from NRI or an OCI to a non-resident other than an NRI or an OCI?

Answer: No

Q.33: Whether Pricing Guidelines apply for Indian company buying back shares in a scheme of merger/ de-merger/ amalgamation of Indian companies approved by NCLT/ competent authority for Buyback of shares/ Reduction of Capital by an Indian company?

Answer: Yes. Also, FC-TRS is required to be filed by the Indian company.

Q.34: What are the guidelines for reporting of transfer of shares?

Answer: Form FC-TRS is required to be filed for transfer of capital instruments by way of sale in accordance with FEMA 20(R), from:

a person resident outside India holding capital instruments in an Indian company on a repatriable basis to a person resident outside India holding capital instruments on a non-repatriable basis;

a person resident outside India holding capital instruments in an Indian company on non-repatriable basis to a person resident outside India holding capital instruments on repatriable basis;

a person resident outside India holding capital instruments in an Indian company on repatriable basis to a person resident in India;

a person resident in India holding capital instruments in an Indian company to a person resident outside India holding capital instruments on repatriable basis.

Sale of capital instruments on a recognized stock exchange by a person resident outside India as prescribed in regulation 10(3) of FEMA 20(R) has to be reported by such person in Form FC-TRS.

FC-TRS is not required for:

for transfer of shares of an Indian company from a non-resident holding the shares on non-repatriable basis to a resident and vice versa.

for transfer of shares from a person resident outside India holding capital instruments in an Indian company on a repatriable basis to a person resident outside India holding capital instruments on a repatriable basis

for transfer of shares by way of gift.

The onus of reporting is on the resident (transferor or transferee) or the person resident outside India holding capital instruments on a non-repatriable basis, as the case may be. The form FC-TRS has to be filed with the AD bank within sixty days of receipt/ remittance of funds or transfer of capital instruments whichever is earlier.

II. Foreign Portfolio Investment

Q.35: What are the regulations regarding investments on the stock exchanges in India

Answer: Foreign Portfolio Investors (FPIs) registered in accordance with the provisions of SEBI (FPI) Regulations and NRIs/ OCIs can make investment on the stock exchanges in India, subject to the individual and aggregate limits prescribed in schedules 2 and 3, respectively of FEMA 20(R).

III. Investment in other securities

Q.36: Can a person resident outside India invest in Government Securities/ Treasury bills/ corporate debt/ other securities?

Answer: Foreign Portfolio Investors (FPIs), Non-Resident Indians (NRIs), Overseas Citizens of India (OCIs), Foreign Central Banks, Multilateral Development Bank, Long term investors like Sovereign Wealth

Funds (SWFs), Multilateral Agencies, Endowment Funds, Insurance Funds and Pension Funds which are registered with SEBI Long Term Investors may invest in other securities as specified in Schedule 5 to Notification No FEMA 20.

Q.37: Who is an FVCI?

Answer: Foreign Venture Capital Investor' (FVCI) means an investor incorporated and established outside India and registered with Securities and Exchange Board of India under Securities and Exchange Board of India (Foreign Venture Capital Investors) Regulations, 2000

Q.38: Where can a Foreign Venture Capital Investor (FVCI) invest?

Answer: A SEBI registered Foreign Venture Capital Investor may make investment in terms of schedule 7 of FEMA 20(R) as per the conditions prescribed therein.

Q.39: How can the FVCI make payment for the investment?

Answer: The amount of consideration for all investment by an FVCI has to be received/made through inward remittance from abroad through banking channels or out of funds held in a foreign currency account and/ or a Special Non-Resident Rupee (SNRR) account maintained by the FVCI with an AD bank in India. The foreign currency account and SNRR account shall be used only and exclusively for transactions under the relevant Schedule.

Q.40: How can the sale/ maturity proceeds be taken out by the FVCI?

Answer: The sale/ maturity proceeds (net of taxes) of the securities may be remitted outside India or credited to the foreign currency account or a Special Non-resident Rupee Account of the FVCI.

Q.41: What is an investment vehicle?

Answer: Investment Vehicle is an entity registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose. For the purpose of Schedule 8 of FEMA 20(R), an Investment Vehicle is a Real Estate Investment Trust (REIT) governed by the SEBI (REITs) Regulations, 2014, an Infrastructure Investment Trust (InvIt) governed by the SEBI (InvIts) Regulations, 2014 and an Alternative Investment Fund (AIF) governed by the SEBI (AIFs) Regulations, 2012. It does not include a Venture Capital Fund registered under the erstwhile SEBI (Venture Capital Funds) Regulations, 1996.

Q.42: What are the provisions with regard to Downstream investment for an investment vehicle?

Answer: Investment made by an Investment Vehicle into an Indian company or an LLP will be indirect foreign investment for the investee company or the LLP, as the case may be, if either the Sponsor or the Manager or the Investment Manager (i) is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India.

Q.43: What are the restrictions on the investments made by an AIF?

Answer: An Alternative Investment Fund (Category III) with foreign investment can make portfolio investment in only those securities or instruments in which an FPI is allowed to invest under the Act, rules or regulations made thereunder.

IV. Reporting Delays

Q.44: What is meant by Late Submission Fee (LSF)?

Answer: For the transactions undertaken on or after November 7, 2017, in case of reporting delays, the person/ entity responsible for filing the reports as provided in Part IV of the Master Direction on Reporting shall be liable for payment of Late Submission Fee (LSF). The payment of LSF is an additional option for regularising reporting delays without undergoing the compounding procedure.

Q.45: Whether compounding option is available for reporting delays

Answer: The payment of LSF is an additional facility for regularising reporting delays without undergoing the compounding procedure. However, this does not mean that the applicant cannot apply for compounding. Both options are available to the applicant for the transactions undertaken on or after November 7, 2017.

Q.46: What are the various reporting formalities for foreign investments?

Answer: The reporting requirements are laid down in the Master Direction on Reporting under Foreign Exchange Management Act, 1999.

Q.47: Whether foreign investment can be made based on the press note/ FDI policy?

Answer: Foreign investment can be made based on a notification issued under FEMA, 1999.