Insert or Drag & Drop Your Photo

FOREIGN DIRECT INVESTMENT

CA MANAS CHUGH

C.A., B.A (HONS) ECONOMICS

+91-9811226085 | CAMANASCHUGH@GMAIL.COM

Valuation Examination Syllabus

Reserve Bank of India and Regulations under Foreign Exchange Management Act, 1999:

- FEMA (Transfer or Issue of Security by a Person Resident Outside India), Regulations, 2017;
- Foreign Direct Investment (Pricing Guidelines);
- Direct Investment by Residents in Joint Venture/ Wholly Owned Subsidiary abroad;
- Prudential Norms for Classification, Valuation and
- Operation of Investment Portfolio by Banks; Guidelines on Sale of Stressed Assets by Banks

Legislation

Project analysis slide 2

Foreign Exchange Management Act, 1999

Policy issued by DPIIT & Ministry of Commerce and Industry

Management
(Non-debt Instruments)
Rules,

Foreign Direct Investme nt

ess notes issued by DPIIT & Ministry Of Commerce and Industry

(Mode of Payment and Repor
of
Non-Debt Instruments)
Regulations,

fications/ Clarifications issued by RBI

FEM NON-DEBT INSTRUMENTS RULES, 2019

- Schedule I: Purchase or sale of equity instruments of an Indian company by a person resident outside India (FDI)
- Schedule II: Investments by Foreign Portfolio Investors
- Schedule III: Investments by Non-Resident Indian (NRI) or Overseas Citizen of India (OCI) on repatriation basis
- Schedule IV: Investment by NRI or OCI on non-repatriation basis
- Schedule V: Investment by other non-resident investors
- Schedule VI: Investment in a Limited Liability Partnership (LLP)
- Schedule VII: Investment by a Foreign Venture Capital Investor (FVCI)
- Schedule VIII: Investment by a person resident outside India in an Investment Vehicle
- Schedule IX: Investment in Depository Receipts by a person resident outside India
- Schedule X: Issue of Indian Depository Receipts

FOREIGN INVESTMENT IN INDIAN COMPANIES

FOREIGN DIRECT INVESTMENT

- All investments in unlisted company
- Investments in listed companies > 10%
- Continuation of FDI status in case of dilution of stake below 10% on further capital raise

Fully diluted capital base to be considered

FOREIGN PORTFOLIO INVESTMENT

- Investments in listed companies < 10% (in aggregate for group entities)
- Investment in unlisted certain securities also permitted (NCD)
- 10% limit in relation to each series of capital instruments

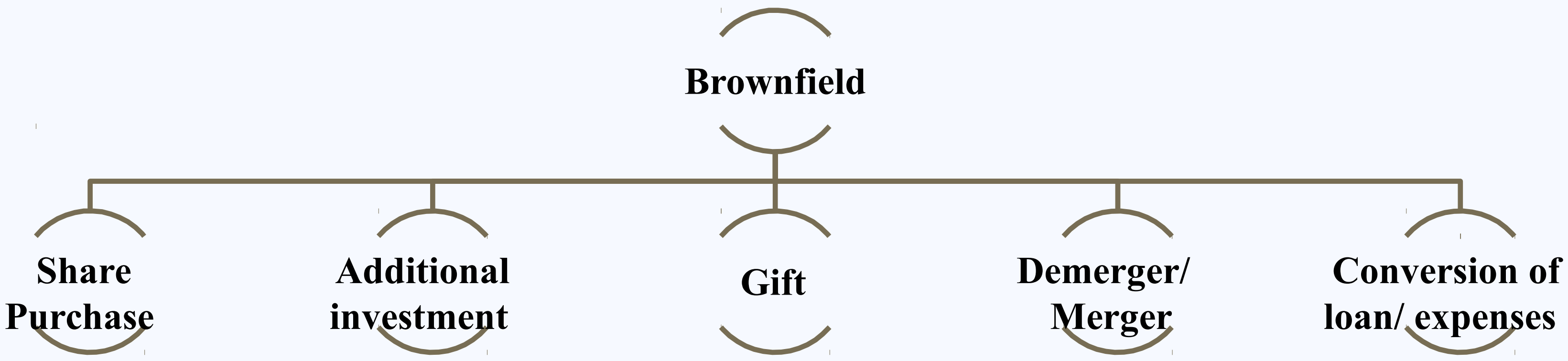
Foreign Investment into an Indian Company

Kinds of Investment

- Automatic Route – no prior approval from the RBI/ Government
- Approval Route – prior approval of the RBI/ Government required (no separate RBI approval)

Mode of Investment

- Greenfield: Setting up a new JV/ WOS (fresh issue of shares/ ADR/ GDR)
- Brownfield: Relating to existing investments/ business activities



Investment from Restricted Investors

- Government of India issued Press Note 3 on April 17, 2020 with an aim to curb opportunistic takeovers/ acquisitions of Indian companies due to the COVID-19 situation
- It was followed up with a notification amending Schedule I to the NDI Rules covering FDI only with effect from April 22, 2020
- Prior Government Approval is required in respect of foreign direct investment (including transfer of shares, directly or indirectly) emanating from:
  - Entities which are based in countries sharing land borders with India; or
  - Entities whose beneficial owners of investments are situated in such countries or is a citizen of such country which shares land border with India
- Countries covered within this restriction are **China, Pakistan, Nepal, Bangladesh, Myanmar, Bhutan and Afghanistan**
- Hong Kong, and Macau should also be covered as Restricted Countries, given these areas are under the Chinese administration
- Meaning of 'Beneficial Owner':
  - (a) Having a controlling interest in the entity (i.e. 10%, 25% etc. of the shares/ voting power of the entity); or
  - (b) In a position to exercise control i.e. right to appoint majority of board members of the entity, etc.
  - Various bankers have been interpreting the Beneficial Owner threshold as 10% or 26%

Sectors where FDI is prohibited

- Lottery business including Government/ private lottery, online lotteries
- Gambling & betting including casinos
- Business of chit fund
- Nidhi company
- Trading in Transferable Development Rights (TDRs)
- Manufacturing of cigars, cheroots, cigarillos & cigarettes, of tobacco or of tobacco substitutes
- Activities/ sectors not opened to private sector investment including atomic energy
- Real Estate or Construction of Farm Houses

Explanation: "Real Estate Business" shall not include development of township, construction of residential/commercial premises, roads or bridges & REISs registered & regulated under the SEBI (REITs) Regulations 2014.

Eligible Investee Entities

- Indian Companies
- Partnership Firm/ Proprietary Concern
- Trusts
- Limited Liability Partnerships (LLPs)
- Investment Vehicle
- Startup Companies
- Other Entities

FDI in LLP

- FDI in LLP allowed under the automatic route in sectors where 100% FDI is allowed under automatic route for companies and there are no FDI- linked performance conditions (minimum cap, lock-in, etc.)
- **Indian companies** having FDI are permitted to make downstream investment in LLPs
  - Only if both the Indian company and the LLP operate where 100% FDI is permitted under automatic route and no FDI-linked conditions attached
- LLPs with FDI are also eligible to make downstream investments in India
- Conversion of an LLP having foreign investment into a company is permitted under automatic route. Similarly conversion of company into LLP is permitted under automatic route.

ODI by an Indian LLP

- Overseas investment by an Indian LLP permitted
- Indian LLPs with FDI can make investments in overseas companies

ECB by LLP

- LLPs can not raise foreign currency loan (ECB) as per FAQ

FDI in Partnership Firm/ Proprietary concern

A Non-Resident Indian (NRI) or a Person of Indian Origin (PIO) can invest in the capital of the from or a proprietary concern in India on non-repatriation basis provided:

- The amount invested shall not be eligible for repatriation outside India
- The firm or proprietary concern is not engaged in any agriculture/plantation or real estate business or print media sector.
- Amount invested by inward remittance or out of NRE/ FCNR(B)/NRO account.

Investment with repatriation option is allowed with prior permission of Reserve Bank of India. The application will be decided in consultation with Government of India.

Investment by Non-Residents other than NRI or PIO has to seek prior approval of RBI.

Foreign Investment – Capital Instruments

Project analysis slide 6

- Equity Shares
- Compulsorily Convertible Preference Shares
- Compulsorily Convertible Debenture
- Share Warrants
- Partly paid-up shares
- Convertible Note for Start-ups

Equity Shares

- Simplest mode for funding and no end use restrictions
- Pricing guidelines applicable
- Valuation to be undertaken as per internationally accepted valuation methodology
- Allotment of shares pertaining to the Subscribed Capital as per MoA can be carried out at face
- value, which can be in excess of minimum capital requirement

Rights Issue

- Should be in compliance with Companies Act,2013
- Shall not breach security cap applicable to the company
- Allotment of shares on assignment of rights entitlement to a NR shall comply with pricing guidelines
- In case of Listed Company, right issue shall be at a price determined by the company
- In case of Unlisted Company, allotment price to NR $\geq$ R
- Unsubscribed portion of Rights Issue can be subscribed by NR on same terms

Bonus Issue

- Pricing guidelines not applicable

Compulsorily Convertible Preference Shares

- Preference Shares have preferential right over Equity Shares, in terms of:
  - Repayment of capital on winding-up of the company
  - Payment of dividend
- Preference Shares have to be compulsorily redeemed/ converted within 20 years
- Only fully and mandatorily Convertible Preference Shares are construed as part of equity and considered as FDI
- All other forms of preference shares construed on par with ECB
- Maximum dividend cap SBI PLR + 3% has been done away with
- No end use restrictions
- Conversion price or conversion formula to be fixed upfront
- Conversion price under conversion formula should be in compliance with pricing guidelines
- Conversion price > Current Fair Value
- Variable conversion ratio – Conversion price at the lower end (maximum shares allotted) > Current Fair Value
- No reporting on conversion

Compulsorily Convertible Debentures

- Only Fully and Mandatorily Convertible Debentures are construed as part of equity and considered as FDI
- All other forms of debentures construed on par with External Commercial Borrowings
- No time limit for conversion prescribed
- Interest payment to comply with Indian transfer pricing regulations
- Interest deductible in hands of the company – Lower cost of capital
- Interest income would be taxable in the hands of debenture holders as per IT Act or DTAA
- Interest payment to non-residents – taxes to be withheld
- No end use restrictions

Convertible Notes

- Convertible Notes can be issued by Indian Startup for an amount of INR 25 lacs rupees or more in a single tranche
- Registration of the start-up with the Department of Industrial Policy and Promotion required
- Key eligibility conditions for qualifying as a start-up:
  - Turnover shall not have exceeded INR 100 crore during any of the financial years
  - Not more than 10 years should have elapsed from the date of incorporation
  - Entity should not have been formed by splitting up or reconstruction a business already in existence
  - Should be working towards innovation, development or improvement of products or processes or services, or should be a scalable business model with a high potential of employment generation or wealth creation
- Registration process is fairly simple and can be completed online
- Option to convert Convertible Notes into equity shares
- Convertible Notes to be repaid or converted into equity shares within five years
- Period of holding of equity shares allotted on conversion to commence from the date of conversion
- No end use restrictions on Convertible Notes proceeds

Issue of Partly Paid Shares and Warrants

Partly paid equity shares

- Partly paid shares FDI compliant
- Pricing to be determined upfront
- 25% of consideration to be paid upfront (balance within 12 months)
- Can be received after 12 months, if issue size > 500 Cr and appoint monitoring agency in line with the ICDR regulations

Warrants

- Warrants now FDI compliant
- Pricing of warrants and price/conversion formula to be determined upfront
- 25% of consideration to be paid upfront (balance within 18 months)
- Price for conversion not to be lower than fair value at the time of issuance of warrants
  - – Investee company can receive more than pre-determined price

Issue of Shares under Employees Stock Option Scheme

ESOPS

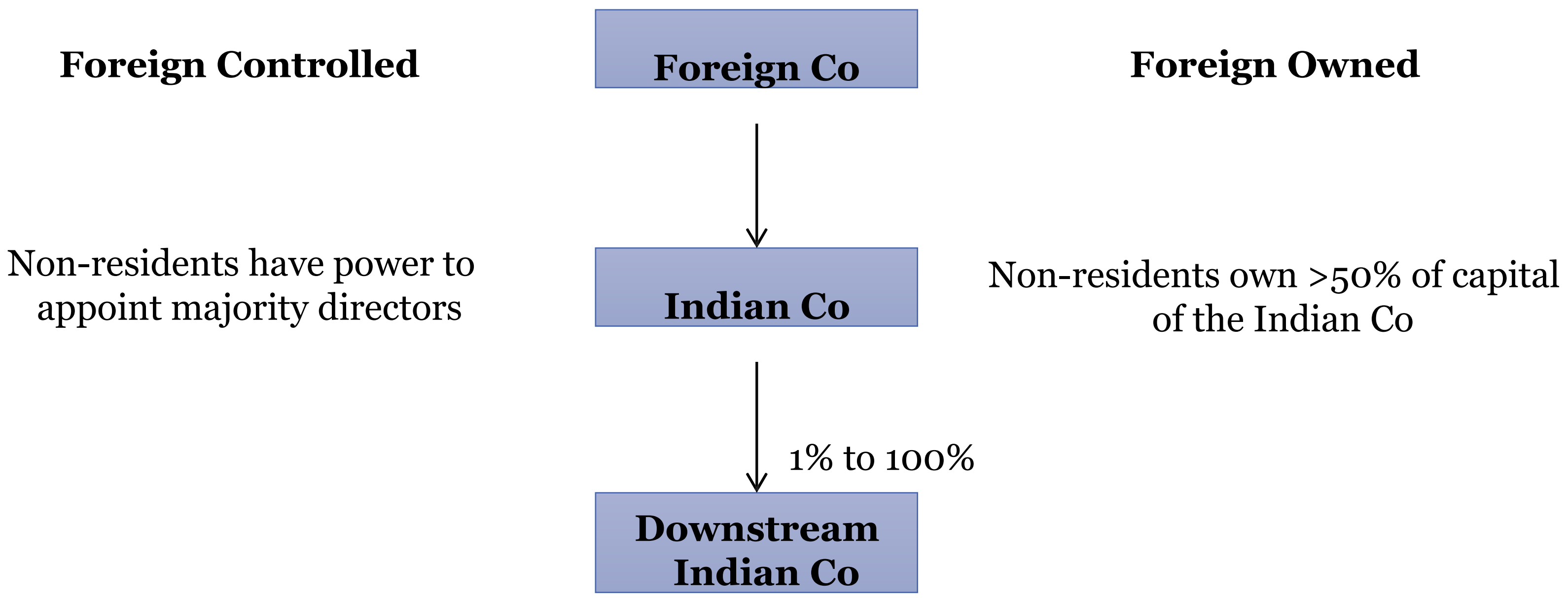
- Employee, Directors of Company/ Holding Company /Joint Venture /Wholly Owned Subsidiary are eligible;
- Scheme should be as per Companies Act 2013 and SEBI;
- Adherence of Sectoral cap;
- Issuance by Company under approval route shall require prior approval;
- GOI approval for issuance of shares to citizen of countries sharing land border with India;
- Person who was resident at the time of grant of shares shall hold the share on non-repatriation basis.

Downstream Investment

Downstream Investment

Downstream investment shall mean investment made by an Indian entity or an Investment vehicle in the capital instruments or the capital of another Indian entity.

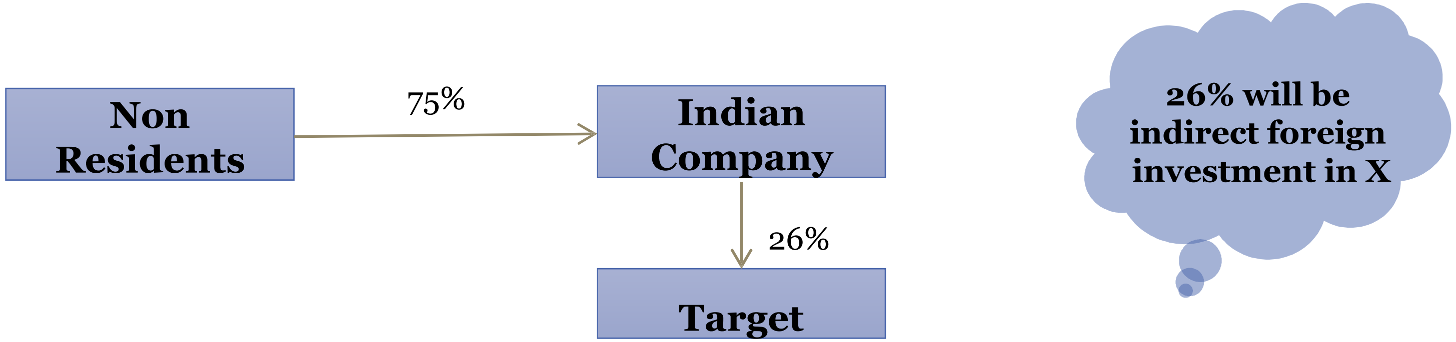
Indirect Foreign Investment means downstream investment received by an Indian entity from another Indian Entity which has received Foreign Investment & is the Indian Entity is owned or controlled by another resident outside India



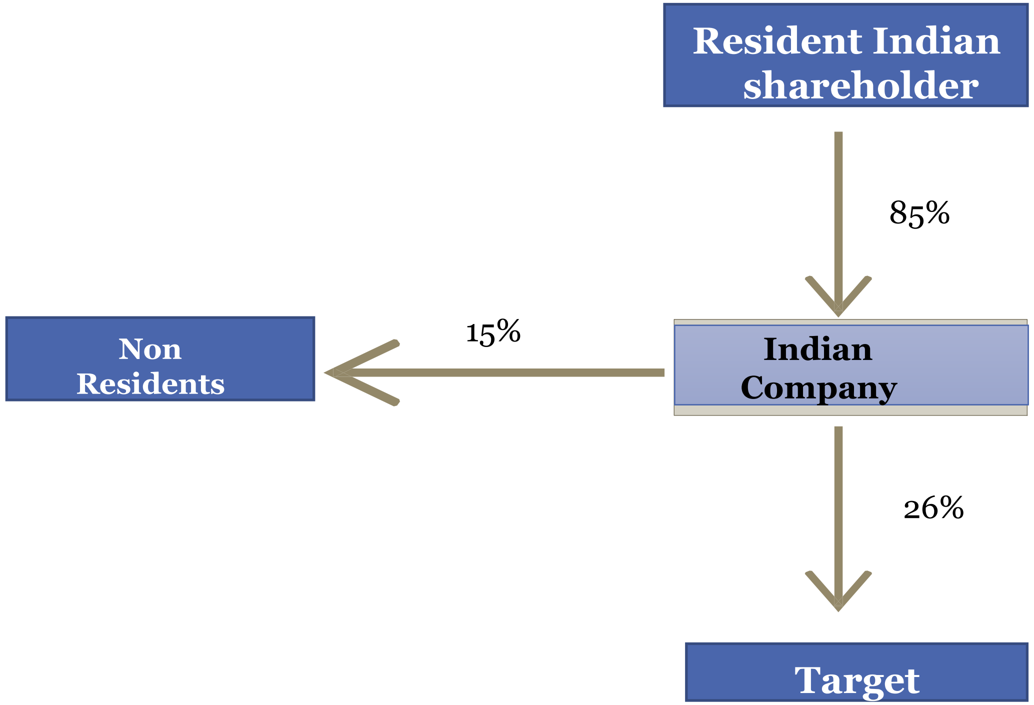
Downstream Investment

- Total Investment means **Direct + Indirect**
  - Direct – All investments held directly by Non Resident entity
  - Indirect
- **Calculation of Indirect foreign investment**

  In case the investing Indian company is **owned or controlled by 'non resident entities'**, the entire investment by such company into the target would be considered as indirect foreign investment.

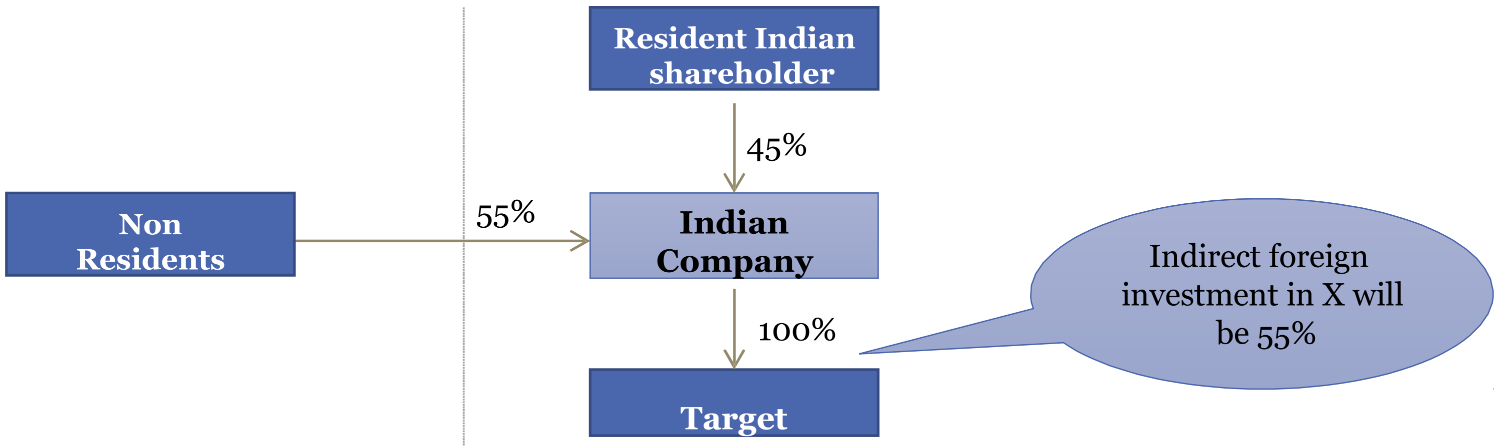


Downstream Investment



Downstream Investment

Indirect foreign investment in 100% owned subsidiaries of an investing Indian company, will be limited to the foreign investment in such Indian company



Downstream Investment

Conditions:

- The downstream investment should have the approval of the Board of Directors
- For the purpose of downstream investment, the Indian entity making the downstream investment shall ring in requisite funds from abroad and not use funds borrowed in the domestic markets.
- But downstream investments can be made through internal accruals i.e. profit transferred to reserve account after payment of taxes.
- The first level Indian company making downstream investment shall be responsible for ensuring compliance with the provisions of these regulations

Reporting Requirements

S. No	Type of Forms	Reporting Requirement
1	Advance Remittance Form (ARF)	An Indian company which has received amount of consideration for issue of capital instruments shall report in ARF to the Regional Office concerned of the RBI not later than 30 days from the date of receipt.
2	Form Foreign Exchange Currency-Gross Provisional Return (FC-GPR)	An Indian company issuing capital instruments shall report such issue in Form FC-GPR to the Regional Office of the RBI not later than 30 days from the date of issue.
3	Form Foreign Currency- Transfer of Shares (FC-TRS)	Form FC-TRS shall be filed for transfer of capital instruments.
4	Annual Return on Foreign Liabilities & Assets (FLA)	An Indian company or LLP which has received FDI by way of capital contribution should submit Form FLA to the Reserve Bank or on before 15th of each year

Foreign Direct Investment (Pricing Guidelines)

Pricing Guidelines

Issue of capital Instruments

- Listed Company: In accordance with the relevant SEBI guidelines
- Unlisted Company: As per Internationally accepted pricing methodology on an arm's length basis duly certified by a Chartered Accountant, Merchant Banker or Cost Accountant.

Transfer from Person resident in India to Person resident outside India

- Listed Company: In accordance with SEBI guidelines
- Unlisted Company: As per Internationally accepted pricing methodology on an arm's length basis duly certified by a Chartered Accountant, Merchant Banker or Cost Accountant.

Note: In case of transfer of capital instruments by a person resident outside India to a person resident in India, the guiding principle would be that person resident outside India is not guaranteed any assured exit price at the time of making such investment & shall exit at the price prevailing at the time of exit.

Where shares in an Indian company are issued to a person resident outside India in compliance with the provisions of the Companies Act, 2013, by way of subscription to Memorandum of Association, such investments shall be made at face value subject to entry route and sectoral caps.

Pricing Guidelines

Investment in LLP

Investment in an LLP either by way of capital contribution or by way of acquisition/ transfer of profit shares, should not be less than the fair price worked out as per any internationally acceptedand a valuation certificate to that effect should be issued by a Chartered Accountant or by a practicing Cost Accountant or by an approved valuer from the panel maintained by the Central Government.

Note: The pricing guidelines will not apply for investment in capital instruments on non-repatriation basis.

Thank you

Manas Chugh

C.A., BA (Hons) Economics

+91-9811226085 | camanaschugh@gmail.com