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Regulatory Alert
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FEMA (Transfer or issue of security by a Person Resident Outside India) Regulations, 2017

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Background

- The Foreign Exchange Management Act, 1999 (FEMA) administers foreign investment into India. One of the significant regulations under FEMA is Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 (FDI Regulations 2000), which deals with foreign investment in India and provides for sectoral limits, pricing and reporting requirements etc.
- Reserve Bank of India (RBI), has notified on 7 November 2017, the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017 (TISPROI Regulations 2017). The FDI Regulations 2017 supersede the prevalent FDI Regulations 2000 and Foreign Exchange Management (Investments in Firms or Proprietary concern in India) Regulations, 2000, as amended.
- The TISPROI Regulations 2017 has brought in major changes in connection with foreign investment in India by non-resident. The TISPROI has brought in few new concepts viz. defining FDI, Foreign Portfolio Investment, Listed Indian Companies etc.
- This alert summarizes the key amendments in the TISPROI Regulations 2017.

Highlights

Definitions:

Some of the definitions that merit attention are:

1. Capital instrument: The definitions of 'capital', 'preference shares', 'debentures' and 'warrants' which were earlier considered as FDI instruments have been clubbed under one definition of 'Capital Instruments' which means equity shares (including partly paid-up shares), debentures (fully, compulsorily and mandatorily convertible), preference shares (fully, compulsorily and mandatorily convertible) and share warrants issued by an Indian company.
2. Share warrants are now defined to mean that those issued by an Indian company in accordance with the Regulations issued by the Securities and Exchange Board of India (SEBI).

   Accordingly, foreign investment in share warrants issued by unlisted Indian companies may not be permitted.
3. Foreign Portfolio Investment (FPI) means any investment made by a person resident outside India, through capital instruments, where such investment is less than 10% of the post issue paid-up share capital on a fully diluted basis of a listed Indian company or less than 10% of the paid-up value of each series of capital instruments of a listed Indian company. For computation of 10% limits as applicable to FPI, investment by investor group (i.e. the same set of ultimate beneficial owners investing through multiple entities) to be considered. An investor can make investments under the FPI route after obtaining FPI license from SEBI under the SEBI (FPI) Regulations, 2014.

Where the total holding of FPI increases to 10% or more of the total paid-up equity capital on a fully diluted basis, the total investment made by the FPI in such company shall be re-classified as FDI subject to the conditions to be specified by SEBI and RBI. Further, the Indian company and the FPI need to comply with reporting requirements prescribed in the TISPROI Regulations 2017. FPIs are now allowed to remit sales proceeds (net of taxes) directly outside India.

4. Foreign Direct Investment (FDI) has been defined to mean investment through capital instruments by a person resident outside India, in an unlisted Indian company or in 10% or more of the post issue paid-up equity capital on a fully diluted basis (i.e. total shares that would be outstanding if all possible sources of conversion are exercised) of a listed Indian company. As per the Note explaining the purport of the definition of FDI, even if the existing FDI falls below 10% of the post issue paid-up equity capital on a fully diluted basis of an Indian company, it would still be classified as FDI.

   Accordingly, in case of listed Indian companies, FDI route is available only if the investor acquires at least 10% of the post-issue equity share capital (on fully diluted basis). If a foreign investor invests less than 10% of the equity share capital (on fully diluted basis) of a listed Indian company, such investor will have to make investments under the FPI route.

   It has been clarified that that a person resident outside India may hold foreign investment either as FDI or FPI in any particular Indian company.

5. Listed Indian Company means an Indian company which has any of its capital instruments listed on a recognized stock exchange in India. Investment in capital instrument of a Listed Indian Company is permitted by FPI and other non-resident investors subject to prescribed conditions.

Issue and transfer of capital instruments:

6. A Non-resident Indian (NRI) or an Overseas Citizen of India (OCI) holding capital instrument of an Indian company on repatriation basis (under automatic route) may transfer the same by way of sale or gift to any person resident outside India subject to prescribed conditions. Earlier under FDI Regulations 2000, transfer of such instruments by an NRI to a person resident outside India (other than NRI) required prior RBI approval (irrespective of whether NRI held such instrument on repatriation or non-repatriation basis).

7. Under the erstwhile FDI Regulations 2000, general permission was available to issue shares to a person resident outside India upon merger/ demerger/ amalgamation, subject to prescribed conditions. Under the FDI Regulations 2017, Indian companies can now issue any capital instrument pursuant to merger/ demerger/ amalgamation, subject to prescribed conditions.

   Further, any transfer of capital instrument of an Indian company by a person resident outside India to any person resident outside India pursuant to liquidation, merger, demerger and amalgamation of entities outside India will be permitted under automatic route of RBI unless the Indian company is engaged in a sector requiring government approval.

8. An Indian company can now under automatic route, issue any capital instruments (earlier only equity and fully convertible preference shares were allowed) to a person resident outside India against swap of capital instruments if the Indian investee company is engaged in a sector covered under automatic route.

   An investment vehicle is also allowed to issue its units to a person resident outside India against swap of capital instruments of a Special Purpose Vehicle (SPV) proposed to be acquired by such investment vehicle.

9. In case where an investment by FPI / NRI / OCI results in a breach of the applicable aggregate FPI / NRI / OCI limits or sectoral limits, such persons shall be required to sell such capital instruments to a person resident in India within the time to be stipulated by RBI in consultation with the Central Government. Such breach for the period between the acquisition and sale - provided the sale is within the prescribed time limit - shall not be reckoned as a contravention of FDI Regulations 2017.

Downstream investment:

10. The definition of Downstream Investment has been introduced which provides for investment by an Indian entity or an investment vehicle in the capital instrument or the capital of another Indian entity.

    Accordingly, it provides for investment by Limited Liability Partnership (LLP)/ investment vehicle in downstream Indian company or LLP.

    Further, Foreign Owned and Controlled Indian Companies (FOCCs) in any form of capital that is not mandatorily convertible into equity shares (vis. redeemable preference shares, etc.) may be counted towards downstream investments.

Changes having impact on M&A transactions:

11. In case of issuance of bonus non-convertible redeemable preference shares or debentures (as part of a scheme of arrangement) by an Indian company, the requirement for obtaining No Objection Certificate (NOC) from income-tax authority has been done away with.

12. Non-residents are now permitted to pledge unlisted shares in favour of NBFCs without a specific RBI approval (after the authorised dealer is satisfied of the bona fides of the credit facility).

Foreign Venture Capital Investor (FVCI):

13. FVCIs are now expressly permitted to invest in non-convertible instruments and are also permitted to directly repatriate sale proceeds offshore.

14. FVCIs are now permitted to invest in 'securities' issued by Indian company engaged in specified sectors / start-ups, vis-à-vis earlier position where they could invest only in equity or equity linked instruments or debt instruments.

15. Reporting requirement for inflow/outflow of investments by FVCIs is done away with.

Others:

16. The cap on rate of dividend on preference shares or convertible capital instruments removed.

17. Remittance of sale proceeds of a security outside India allowed without the requirement of obtaining NOC or tax clearance certificate from income tax authority, subject to payment of applicable taxes and other duties/levies in India.

18. Capital instruments shall be issued to the person resident outside India making such investment within 60 days from the date of receipt of the consideration (earlier the time limit was 180 days). In case of partly paid equity shares, the period of 60 days shall be reckoned from the date of receipt of each call payment.

19. RBI's prior approval will be required to make interest payment required as per Companies Act, 2013 to non-resident investor, in case if subscription money is refunded beyond prescribed time.
20. In case of delay in reporting as provided under FDI Regulations 2017, RBI to prescribe late payment fee in consultation with CG.

    Accordingly, delay in reporting may not require compounding application to be filed with RBI.

Conclusion

The amendments to FDI Regulations would bring in clarity on FDI and FPI investments and would facilitate ease of doing business in India.

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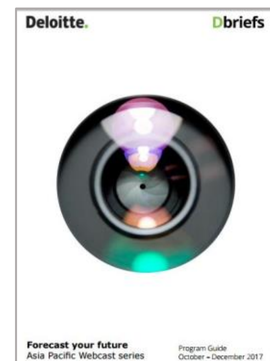

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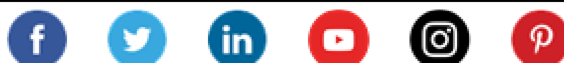

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