

## **CHAPTER 3: ORIGIN, TYPE, ELIGIBILITY, CONDITIONS AND ISSUE/TRANSFER OF INVESTMENT**

### **3.1 ORIGIN OF INVESTMENT IN INDIA**

3.1.1 A non-resident entity (other than a citizen of Pakistan or an entity incorporated in Pakistan) can invest in India, subject to the FDI Policy. A citizen of Bangladesh or an entity incorporated in Bangladesh can invest in India under the FDI Policy, only under the Government route.

3.1.2 NRIs resident in Nepal and Bhutan as well as citizens of Nepal and Bhutan are permitted to invest in the capital of Indian companies on repatriation basis, subject to the condition that the amount of consideration for such investment shall be paid only by way of inward remittance in free foreign exchange through normal banking channels.

3.1.3 OCBs have been derecognized as a class of Investors in India with effect from September 16, 2003. Erstwhile OCBs which are incorporated outside India and are not under the adverse notice of RBI can make fresh investments under FDI Policy as incorporated non-resident entities, with the prior approval of Government of India if the investment is through Government route; and with the prior approval of RBI if the investment is through Automatic route.

3.1.4 (i) An FII may invest in the capital of an Indian company either under the FDI Scheme/Policy or the Portfolio Investment Scheme. 10% individual limit and 24% aggregate limit for FII investment would still be applicable even when FIIs invest under the FDI scheme/policy.

(ii) The Indian company which has issued shares to FIIs under the FDI Policy for which the payment has been received directly into company's account should report these figures separately under item no. 5 of Form FC-GPR (**Annex-1**) (Post-issue pattern of shareholding) so that the details could be suitably reconciled for statistical/monitoring purposes.

(iii) A daily statement in respect of all transactions (except derivative trade) have to be submitted by the custodian bank in floppy / soft copy in the prescribed format directly to RBI to monitor the overall ceiling/sectoral cap/statutory ceiling.

3.1.5 No person other than registered FII/NRI as per Schedules II and III of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations of FEMA 1999, can invest/trade in capital of Indian Companies in the Indian Stock Exchanges directly i.e. through brokers like a Person Resident in India.

3.1.6 A Foreign Venture Capital Investor (FVCI) may contribute upto 100% of the capital of a Venture Capital Fund/Indian Venture Capital Undertaking and may also set up a domestic asset

management company to manage the fund. All such investments are allowed under the automatic route subject to SEBI & RBI regulations and FDI Policy. However FVCIs are also allowed to invest as non-resident entities in other companies subject to FDI Policy.

## 3.2 **TYPES OF INSTRUMENTS.**

3.2.1 Indian companies can issue equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares subject to pricing guidelines/valuation norms prescribed under FEMA Regulations. The pricing of the capital instruments should be decided/determined upfront at the time of issue of the instruments.

3.2.2 Other types of Preference shares/Debentures i.e. non-convertible, optionally convertible or partially convertible for issue of which funds have been received on or after May 1, 2007 are considered as debt. Accordingly all norms applicable for ECBs relating to eligible borrowers, recognized lenders, amount and maturity, end-use stipulations, etc. shall apply. Since these instruments would be denominated in rupees, the rupee interest rate will be based on the swap equivalent of London Interbank Offered Rate (LIBOR) plus the spread as permissible for ECBs of corresponding maturity

3.2.3 The inward remittance received by the Indian company vide issuance of DRs and FCCBs are treated as FDI and counted towards FDI.

### 3.2.4 **Issue of shares by Indian Companies under FCCB/ADR/GDR**

- (i) Indian companies can raise foreign currency resources abroad through the issue of FCCB/DR(ADRs/GDRs), in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India there under from time to time.
- (ii) A company can issue ADRs / GDRs if it is eligible to issue shares to persons resident outside India under the FDI Policy. However, an Indian listed company, which is not eligible to raise funds from the Indian Capital Market including a company which has been restrained from accessing the securities market by the Securities and Exchange Board of India (SEBI) will not be eligible to issue ADRs/GDRs.
- (iii) Unlisted companies, which have not yet accessed the ADR/GDR route for raising capital in the international market, would require prior or simultaneous listing in the domestic market, while seeking to issue such overseas instruments. Unlisted companies, which have already issued ADRs/GDRs in the international market, have to list in the domestic market on

making profit or within three years of such issue of ADRs/GDRs, whichever is earlier. ADRs / GDRs are issued on the basis of the ratio worked out by the Indian company in consultation with the Lead Manager to the issue. The proceeds so raised have to be kept abroad till actually required in India. Pending repatriation or utilization of the proceeds, the Indian company can invest the funds in:-

- (a) Deposits, Certificate of Deposits or other instruments offered by banks rated by Standard and Poor, Fitch, IBCA ,Moody's, etc. with rating not below the rating stipulated by Reserve Bank from time to time for the purpose;
  - (b) Deposits with branch/es of Indian Authorized Dealers outside India; and
  - (c) Treasury bills and other monetary instruments with a maturity or unexpired maturity of one year or less.
- (iv) There are no end-use restrictions except for a ban on deployment / investment of such funds in real estate or the stock market. There is no monetary limit up to which an Indian company can raise ADRs / GDRs.
- (v) The ADR / GDR proceeds can be utilized for first stage acquisition of shares in the disinvestment process of Public Sector Undertakings / Enterprises and also in the mandatory second stage offer to the public in view of their strategic importance.
- (vi) Voting rights on shares issued under the Scheme shall be as per the provisions of Companies Act, 1956 and in a manner in which restrictions on voting rights imposed on ADR/GDR issues shall be consistent with the Company Law provisions. Voting rights in the case of banking companies will continue to be in terms of the provisions of the Banking Regulation Act, 1949 and the instructions issued by the Reserve Bank from time to time, as applicable to all shareholders exercising voting rights.
- (vii) Erstwhile OCBs who are not eligible to invest in India and entities prohibited from buying, selling or dealing in securities by SEBI will not be eligible to subscribe to ADRs / GDRs issued by Indian companies.
- (viii) The pricing of ADR / GDR issues should be made at a price determined under the provisions of the Scheme of issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India and directions issued by the Reserve Bank, from time to time.
- (ix) The pricing of sponsored ADRs/GDRs would be determined under the provisions of the Scheme of issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through

Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India and directions issued by the Reserve Bank, from time to time.

3.2.5 (i) **Two-way Fungibility Scheme:** A limited two-way Fungibility scheme has been put in place by the Government of India for ADRs / GDRs. Under this Scheme, a stock broker in India, registered with SEBI, can purchase shares of an Indian company from the market for conversion into ADRs/GDRs based on instructions received from overseas investors. Re-issuance of ADRs / GDRs would be permitted to the extent of ADRs / GDRs which have been redeemed into underlying shares and sold in the Indian market.

(ii) **Sponsored ADR/GDR issue:** An Indian company can also sponsor an issue of ADR / GDR. Under this mechanism, the company offers its resident shareholders a choice to submit their shares back to the company so that on the basis of such shares, ADRs / GDRs can be issued abroad. The proceeds of the ADR / GDR issue are remitted back to India and distributed among the resident investors who had offered their Rupee denominated shares for conversion. These proceeds can be kept in Resident Foreign Currency (Domestic) accounts in India by the resident shareholders who have tendered such shares for conversion into ADRs / GDRs.

### 3.3 **ELIGIBILITY OF FDI IN RESIDENT ENTITIES**

#### 3.3.1 **FDI in an Indian Company**

(i) Indian companies including those which are micro and small enterprises can issue capital against FDI.

#### 3.3.2 **FDI in Partnership Firm / Proprietary Concern:**

- (i) A Non-Resident Indian (NRI) or a Person of Indian Origin (PIO) resident outside India can invest by way of contribution to the capital of a firm or a proprietary concern in India on non-repatriation basis provided;
  - (a) Amount is invested by inward remittance or out of NRE/FCNR(B)/NRO account maintained with Authorized Dealers / Authorized banks.
  - (b) The firm or proprietary concern is not engaged in any agricultural/plantation or real estate business or print media sector.
  - (c) Amount invested shall not be eligible for repatriation outside India.
- (ii) Investments with repatriation benefits: NRIs/PIO may seek prior permission of Reserve Bank for investment in sole proprietorship concerns/partnership firms with repatriation benefits. The application will be decided in consultation with the Government of India.

(iii) **Investment by non-residents other than NRIs/PIO:** A person resident outside India other than NRIs/PIO may make an application and seek prior approval of Reserve Bank for making investment by way of contribution to the capital of a firm or a proprietorship concern or any association of persons in India. The application will be decided in consultation with the Government of India.

(iv) **Restrictions:** An NRI or PIO is not allowed to invest in a firm or proprietorship concern engaged in any agricultural/plantation activity or real estate business (i.e. dealing in land and immovable property with a view to earning profit or earning income there from) or engaged in Print Media.

3.3.3 **FDI in Trusts:** FDI in Trusts other than VCF is not permitted.

3.3.4 **FDI in other Entities:** FDI in resident entities other than those mentioned above is not permitted.

#### 3.4 **CONDITIONS ON ISSUE/TRANSFER OF SHARES**

3.4.1 The capital 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. In case, the capital instruments are not issued within 180 days from the date of receipt of the inward remittance or date of debit to the NRE/FCNR (B) account, the amount of consideration so received should be refunded immediately to the non-resident investor by outward remittance through normal banking channels or by credit to the NRE/FCNR (B) account, as the case may be. Non-compliance with the above provision would be reckoned as a contravention under FEMA and would attract penal provisions. In exceptional cases, refund of the amount of consideration outstanding beyond a period of 180 days from the date of receipt may be considered by the RBI, on the merits of the case.

3.4.2 **Issue price of shares** – Issue price of shares to persons resident outside India under the FDI Policy, 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 (CCI).

3.4.3 **Foreign Currency Account** – Indian companies which are eligible to issue shares to persons resident outside India under the FDI Policy may be allowed to retain the share subscription amount in a Foreign Currency Account, with the prior approval of RBI.

#### 3.4.4 Transfer of shares and convertible debentures –

(i) Subject to FDI sectoral policy, foreign investors can also invest in Indian companies by purchasing/acquiring existing shares from Indian shareholders or from other non-resident shareholders. General permission has been granted to non-residents/NRIs for acquisition of shares by way of transfer subject to the following:

(a) A person resident outside India (other than NRI and erstwhile OCB) may transfer by way of sale or gift, the shares or convertible debentures to any person resident outside India (including NRIs).

(b) NRIs may transfer by way of sale or gift the shares or convertible debentures held by them to another NRI.

**In both the above cases, the ‘Existing Venture/tie-up condition’ as defined in para 4.2.2 would apply.**

(c) A person resident outside India can transfer any security to a person resident in India by way of gift.

(d) A person resident outside India can sell the shares and convertible debentures of an Indian company on a recognized Stock Exchange in India through a stock broker registered with stock exchange or a merchant banker registered with SEBI.

(e) A person resident in India can transfer by way of sale, shares/convertible debentures (including transfer of subscriber’s shares), of an Indian company in sectors other than financial services sectors (i.e. Banks, NBFC, Insurance, ARCs, CICs, infrastructure companies in the securities market viz. Stock Exchanges, Clearing Corporations, and Depositories, Commodity Exchanges, etc.) under private arrangement to a person resident outside India, subject to the guidelines given in **Annex-2**.

(f) General permission is also available for transfer of shares/convertible debentures, by way of sale under private arrangement by a person resident outside India to a person resident in India, subject to the guidelines given in **Annex-2**.

(g) The above General Permission also covers transfer by a resident to a non-resident of shares/convertible debentures of an Indian company, engaged in an activity earlier covered under the Government Route but now falling under Automatic Route, as well as transfer of shares by a non-resident to an Indian company under buyback and/or capital reduction scheme of the company. However, this General Permission is not available in case of transfer of shares / debentures, from a Resident to a Non-Resident/Non-Resident

Indian, of an entity engaged in any activity in the financial services sector (i.e. Banks, NBFCs, ARCs, CICs, Insurance, infrastructure companies in the securities market such as Stock Exchanges, Clearing Corporations, and Depositories, Commodity Exchanges, etc.).

(h) The Form FC-TRS should be submitted to the AD Category-I Bank, within 60 days from the date of receipt of the amount of consideration. The onus of submission of the Form FC-TRS within the given timeframe would be on the transferor/transferee, resident in India.

(ii) The sale consideration in respect of equity instruments purchased by a person resident outside India, remitted into India through normal banking channels, shall be subjected to a Know Your Customer (KYC) check by the remittance receiving AD Category – I bank at the time of receipt of funds. In case, the remittance receiving AD Category – I bank is different from the AD Category – I bank handling the transfer transaction, the KYC check should be carried out by the remittance receiving bank and the KYC report be submitted by the customer to the AD Category – I bank carrying out the transaction along with the Form FC-TRS.

(iii) **Escrow:** AD Category – I banks have been given general permission to open Escrow account and Special account of non-resident corporate for open offers / exit offers and delisting of shares. The relevant SEBI (SAST) Regulations or any other applicable SEBI Regulations/ provisions of the Companies Act, 1956 will be applicable.

#### 3.4.5 **Prior permission of RBI in certain cases for transfer of capital instruments –**

(i) The following instances of transfer of capital instruments from resident to non-residents by way of sale require prior approval of RBI:

(a) Transfer of capital instruments of an Indian company engaged in financial services sector (i.e. Banks, NBFCs, Asset Reconstruction Companies, CICs, Insurance companies, infrastructure companies in the securities market such as Stock Exchanges, Clearing Corporations, and Depositories, Commodity Exchanges, etc.).

(b) Transactions which attract the provisions of SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 1997.

(c) The activity of the Indian company whose capital instruments are being transferred falls outside the automatic route and the approval of the FIPB has been obtained for the said transfer.

- (d) The transfer is to take place at a price which falls outside the pricing guidelines specified by the Reserve Bank from time to time.
  - (e) Transfer of capital instruments where the non-resident acquirer proposes deferment of payment of the amount of consideration, prior approval of the Reserve Bank would be required, as hitherto. Further, in case approval is granted for a transaction, the same should be reported in Form FC-TRS, to an AD Category – I bank for necessary due diligence , within 60 days from the date of receipt of the full and final amount of consideration. The link office of the AD Category-I Bank will consolidate such Form FC-TRS details and report the same to the Central Office of RBI.
- (ii) The transfer of capital instruments of companies engaged in sectors falling under the Government Route from residents to non-residents by way of sale or otherwise requires Government approval followed by permission from RBI.
- (iii) A person resident in India, who intends to transfer any capital instrument, by way of gift to a person resident outside India, has to obtain prior approval from Reserve Bank. While forwarding applications to Reserve Bank for approval for transfer of capital instruments by way of gift, the documents mentioned in **Annex-3** should be enclosed. Reserve Bank considers the following factors while processing such applications:
- (a) The proposed transferee (donee) is eligible to hold such capital instruments under Schedules 1, 4 and 5 of Notification No. FEMA 20/2000-RB dated May 3, 2000, as amended from time to time.
  - (b) The gift does not exceed 5 per cent of the paid-up capital of the Indian company/each series of debentures/each mutual fund scheme.
  - (c) The applicable sectoral cap limit in the Indian company is not breached.
  - (d) The transferor (donor) and the proposed transferee (donee) are close relatives as defined in Section 6 of the Companies Act, 1956, as amended from time to time. The current list is reproduced in **Annex-4** .
  - (e) The value of capital instruments to be transferred together with any capital instruments already transferred by the transferor, as gift, to any person residing outside India does not exceed the rupee equivalent of USD 25,000 **during the calendar year**.
  - (f) Such other conditions as stipulated by Reserve Bank in public interest from time to time.

### 3.4.6 **Conversion of ECB/Lumpsum Fee/Royalty into Equity.**

- (i) Indian companies have been granted general permission for conversion of External Commercial Borrowings (ECB) (excluding those deemed as ECB) in convertible foreign currency into shares/preference shares, subject to the following conditions and reporting requirements.
  - (a) The activity of the company is covered under the Automatic Route for FDI or the company has obtained Government approval for foreign equity in the company;
  - (b) The foreign equity after conversion of ECB into equity is within the sectoral cap, if any;
  - (c) Pricing of shares is as per SEBI regulations or erstwhile CCI guidelines in the case of listed or unlisted companies respectively;
  - (d) Compliance with the requirements prescribed under any other statute and regulation in force; and
  - (e) The conversion facility is available for ECBs availed under the Automatic or Government Route and is applicable to ECBs, due for payment or not, as well as secured/unsecured loans availed from non-resident collaborators.
- (ii) General permission is also available for issue of shares/preference shares against lump sum technical know-how fee, royalty, under automatic route or SIA/FIPB route, subject to pricing guidelines of SEBI/CCI and compliance with applicable tax laws.

### 3.5 **ISSUE OF INSTRUMENTS.**

3.5.1 **Issue of Rights/Bonus Shares** – FEMA provisions allow Indian companies to freely issue Rights/Bonus shares to existing non-resident shareholders, subject to adherence to sectoral cap, if any. However, such issue of bonus / rights shares has to be in accordance with other laws/statutes like the Companies Act, 1956, SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (in case of listed companies), etc. The price of shares offered on rights basis by the Indian company to non-resident shareholders shall not be lower than the price at which such shares are offered to resident shareholders.

3.5.2 **Prior permission of RBI for Rights issue to erstwhile OCBs-** OCBs have been de-recognised as a class of investors from September 16, 2003. Therefore companies desiring to issue rights share to such erstwhile OCBs will have to take specific prior permission from RBI. As such, entitlement of rights share is not automatically available to erstwhile OCBs. However bonus shares can be issued to erstwhile OCBs without the approval of RBI.

**3.5.3 Additional allocation of rights share by residents to non-residents** – Existing non-resident shareholders are allowed to apply for issue of additional shares/ fully, compulsorily and mandatorily convertible debentures/ fully, compulsorily and mandatorily convertible preference shares over and above their rights share entitlements. The investee company can allot the additional rights share out of unsubscribed portion, subject to the condition that the overall issue of shares to non-residents in the total paid-up capital of the company does not exceed the sectoral cap.

**3.5.4 Acquisition of shares under Scheme of Merger/Demerger/Amalgamation** – Mergers/demergers/ amalgamations of companies in India are usually governed by an order issued by a competent Court on the basis of the Scheme submitted by the companies undergoing merger/demerger/amalgamation. Once the scheme of merger or demerger or amalgamation of two or more Indian companies has been approved by a Court in India, the transferee company or new company is allowed to issue shares to the shareholders of the transferor company resident outside India, subject to the conditions that:

- (i) the percentage of shareholding of persons resident outside India in the transferee or new company does not exceed the sectoral cap, and
- (ii) the transferor company or the transferee or the new company is not engaged in activities which are prohibited under the FDI policy .

**3.5.5 Issue of shares under Employees Stock Option Scheme (ESOPs)** –

- (i) Listed Indian companies are allowed to issue shares under the Employees Stock Option Scheme (ESOPs), to its employees or employees of its joint venture or wholly owned subsidiary abroad who are resident outside India, other than to the citizens of Pakistan. ESOPs can be issued to citizens of Bangladesh with the prior approval of FIPB. Shares under ESOPs can be issued directly or through a Trust subject to the condition that:
  - (a) The scheme has been drawn in terms of relevant regulations issued by the SEBI, and
  - (b) The face value of the shares to be allotted under the scheme to the non-resident employees does not exceed 5 per cent of the paid-up capital of the issuing company.
- (ii) Unlisted companies have to follow the provisions of the Companies Act, 1956. The Indian company can issue ESOPs to employees who are resident outside India, other than to the citizens of Pakistan. ESOPs can be issued to the citizens of Bangladesh with the prior approval of the FIPB.
- (iii) The issuing company is required to report the details of such issues to the Regional Office concerned of the Reserve Bank, within 30 days from the date of issue of shares.