FOREIGN EXCHANGE LAWS

N. A. SHAH BULLETIN

N. A. SHAH ASSOCIATES LLP
Chartered Accountants

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EXECUTIVE SUMMARY

- Banks can now issue Perpetual Debt Instruments overseas and Rupee Denominated Bonds for financing affordable housing and infrastructure
- Sectoral cap for FDI in pension funds has been changed. Now 49% investment is allowed under automatic route subject to certain conditions. Earlier investment up to 26% was allowed under automatic route and Government approval was required for investment up to 49%.
- Indian Party is now prohibited from making overseas direct investment in countries identified by the Financial Action Task Force as "Non Co-Operative Countries and territories"
- Startup Companies have been permitted to issue convertible notes to persons, resident outside India subject to certain conditions.
- FDI in commodity exchange up to 49% permitted under automatic route, subject to the Guidelines/ Regulations issued by the Central Government, SEBI and RBI
- Powers pertaining to compounding of contraventions for delay in filing the annual FLA return delegated to Regional Offices (except Kochi & Panaji).
- Multilateral & regional Financial Institution (where India is a member country) are also allowed to invest in the Rupee denominated bonds issued abroad
- Foreign Direct Investment (FDI) in Limited Liability Partnership (LLP) has been liberalized.
- The limit for investment by Foreign Portfolio Investors (FPI) in Government securities has been revised by the Reserve Bank of India (RBI).
- Amendments pertaining to FDI in E-commerce sector issued through a Press Note have now been notified by the RBI.

1. **FDI in various permitted sectors**

The RBI has brought changes in the permitted sector for Foreign Investment as under:

Sector	Extant Position	Revised Position
Animal Husbandry, Pisciculture and Aquaculture	Investment in the Animal Husbandry, Pisciculture and Aquaculture under controlled conditions was permitted upto 100% under the automatic route.	The requirement of controlled conditions has now been done away with.
Apiculture	Not Permitted	Investment in apiculture is permitted up to 100% under automatic route.
Manufacturing Sector		Notwithstanding the foreign investment policy provisions on trading sector, 100% foreign investment under Government approval route is allowed for trading, including through e-commerce, in respect of food products manufactured and/or produced in India. Applications for foreign investment in food products retail trading would be processed in the Department of Industrial Policy & Promotion before being considered by the Government for approval.
Broadcasting Carriage Services	Automatic upto 49% Government Approval for 49% to 100%	Automatic upto 100% where license/ permission from sectoral Ministry is required. Infusion of fresh foreign investment, beyond 49% in a company not seeking license/ permission from sectoral Ministry, resulting in change in

		the ownership pattern or transfer of stake by existing investor to new foreign investor, will require Government approval
Civil Aviation Airports	For existing projects, up to 74% - automatic route. Beyond 74% - government approval	100% Automatic

2. **Direct investment in "Non Co-operative countries and territories"**

   As per the extant FEMA guidelines, there are no restriction on an Indian Party with regard to the countries where it can undertake Overseas Direct Investment. Now, an Indian Party is prohibited from making direct investment in an overseas entity, either set up or acquired abroad directly as a joint venture or a wholly owned subsidiary or indirectly as a step down subsidiary, located in countries identified by Financial Action Task Force (FATF) as "non co –operative countries and territories".

   Currently, Democratic People's Republic of North Korea is in the list.

3. **Issue of Convertible Notes by startup companies**

   A startup company[1], as defined under FEMA regulations is now permitted to issue convertible notes to persons resident outside India subject to the following conditions:

   a. The convertible notes issued by an Indian startup company to a person resident outside India should exceed INR 25 lakhs or more, in a single tranche.
   b. The Instrument is convertible into equity shares of the startup company within 5 years from the date of issue of convertible notes.

[1] A 'startup company' means a private company incorporated under the Companies Act, 2013 or Companies Act, 1956 and recognized as such in accordance with notification number G.S.R. 180(E) dated February 17, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry. It may be noted that the definition of startup under DIPP includes LLP & partnership firm which is wider than what is defined under FEMA.

c. A startup company engaged in a sector where foreign investment requires Government approval, can issue convertible notes only with approval of Government.
d. The consideration for the convertible notes shall be received by inward remittance through banking channels or by debit to NRE / FCNR (B) / Escrow account maintained by the person resident outside India in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016, provided the escrow shall be closed immediately after the requirements are completed or within six months whichever is earlier.
e. NRIs may acquire convertible notes on non-repatriation basis.
f. The person resident outside India may acquire or sell convertible notes from or to a person resident in or outside India, provided the transfer is in accordance with the pricing guidelines by RBI. Prior approval from the Government shall be obtained if the startup company is engaged in a sector which requires government approval.

4. Foreign Direct Investment ("FDI") in Commodity Exchange

As per the recent amendment, commodity exchanges have now been included in the definition of Infrastructure Company in Securities Markets. Accordingly FDI up to 49% under automatic route has now been permitted in commodity exchanges, subject to the Guidelines/ Regulations issued by the Central Government, SEBI and RBI.

5. Delegation of powers to the Regional Offices of RBI

RBI has delegated the power compound the contraventions related to delay in filing of Foreign Liabilities Assets Annual Return the Regional offices of RBI, without any limit on the amount of contravention (except for Kochi & Panaji).

Kochi and Panaji Regional offices can compound the above contraventions for amount less than Rs.1,00,00,000 only. The contraventions of Rs.1,00,00,000 or more under the jurisdiction of Kochi and Panaji Regional Offices will continue to be compounded at the Central Office.

6. Issuance of Rupee denominated bond overseas

RBI has now permitted Multilateral & Regional Financial Institutions where India is a member country, to invest in rupee denominated bonds issued by Indian companies.

7. Foreign Direct Investment (FDI) in Limited Liability Partnerships (LLPs)

Radical changes have been made to Schedule 9 (FDI in LLP) of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 (FDI Regulations) in tandem with the Government's initiative for ease of doing business in India.

The following are the salient features of the revised regulations:

Eligible Investor	a. Person Resident Outside India or any entity incorporated outside India (other than an entity in Pakistan or Bangladesh). b. Not permitted: Foreign Portfolio Investors, Foreign Institutional Investors and Foreign Venture Capital Investors
Eligibility of LLP (target)	FDI in LLPs is permitted subject to the following conditions: a. FDI permitted under the automatic route in LLP engaged in sectors where 100% FDI is allowed and there are no performance linked conditions. b. Investment is in compliance with the provisions of the Limited Liability Partnership Act, 2008.
Downstream Investment	LLP having foreign investment will be permitted to make downstream investment, under automatic route, in another company or LLP if: Indian company or LLP is engaged in sector where 100% FDI is allowed and there are no performance linked conditions.
Conversion	A company having foreign investment can be converted into an LLP under the automatic route if it is engaged in sector where 100% FDI is allowed and there are no performance linked conditions.
Valuation or	a. <u>For investment:</u> Investment by way of capital contribution

Pricing	or by transfer of profit share should be more than or equal to the fair price determined as per any internationally accepted valuation methodology as certified by a Charted Accountant or Cost Accountant. b. Transfer of profit share: Transfer of profit share: a. From a resident to non-resident: Consideration to be more than or equal to fair price. b. From a non-resident to resident: Consideration to be less than or equal to fair price.
Conditions deleted	a. Restriction on LLPs to avail external commercial borrowings has been removed. However corresponding changes to the ECB Regulations are yet to be notified. b. A designated partner (being a body corporate) of an LLP with FDI was required to be a company registered in India. Further, a designated partner was required to meet the requirement of being "resident in India" under the Limited Liability Partnership Act, 2008 and a "person resident in India" under the Foreign Exchange Management Act, 1999. These provisions now have been removed. A designated partner is now only required to meet the requirements as set out under the Limited Liability Partnership Act, 2008.

8. Investment by Foreign Portfolio Investors (FPIs) in Government Securities

The revised aggregate FPI investments limits in the Government Securities are as follows:

(INR in billions)

Particulars	Existing limit	Revised limit w.e.f 1st April, 2017
FPIs in general category in Central Government securities	1520	1565

Additional for Long term FPIs in Central Government securities	680	745
FPIs in State Development Loans including long term FPIs	210	270
Total	**2410**	**2580**

All other existing conditions, including the security-wise limits, investment of coupons being permitted outside the limits and investments being restricted to securities with a minimum residual maturity of three years, will continue to apply.

9. Provisions related to FDI in E-commerce notified

Amendments pertaining to FDI in E-commerce sector issued through Press Note 3/2016 dated 29th March 2016 have now been notified by the RBI.

The salient features of the regulations pertaining to E-commerce are as under:

a. 100% FDI is allowed in companies engaged in B2B E-commerce activities. Such companies should be engaged only in B2B Activities and not retail trading activities.
b. 100% FDI in allowed in market based model of E-commerce. FDI is not permitted in inventory based model of E-commerce (i.e. restriction on the entity to exercise ownership over goods).
c. E-commerce marketplace may provide support services to sellers in respect of warehousing, logistics, call centre, payment collection and other services.
d. An e-commerce entity will not permit more than 25% of the sales value on financial year basis affected through its marketplace from one vendor or their group companies.
e. Goods/services made available for sale electronically on website should clearly provide name, address and other contact details of the seller. Post sales, delivery of goods to the customers, customer satisfaction and warranty/guarantee will be responsibility of the seller.
f. Payments for sale may be facilitated by the e-commerce entity in conformity with the guidelines of the Reserve Bank of India.
g. E-commerce entities providing marketplace will not directly or indirectly influence the sale price of goods or services and shall maintain level playing field.

From:

N. A. Shah Associates LLP

Chartered Accountants

Address: B 41-45, Paragon Centre, Pandurang Budhkar Marg, Mumbai – 400013.

Tel: 91-022-4073 3000, Fax: 91-022-4073 3090

E-mail Id: info@nashah.com