HOW NON-DEBT RULES REGULATE CROSS BORDER INVESTMENTS IN INDIA?

Pramit Chakraborty [*]

ABSTRACT

The Foreign Exchange Management (Non-Debt Instrument) Rules(NDI Rules) pertain to the regulatory framework governing non-debt instruments under the Foreign Exchange Management Act (FEMA) in a specific jurisdiction. These rules outline the guidelines and provisions for the acquisition, transfer, and management of non-debt instruments by residents and non-residents. The objective of the FEM (Non-Debt Instrument) Rules is to ensure proper monitoring, control, and facilitation of investments in non-debt instruments, which include equity instruments, compulsorily convertible preference shares, and other similar instruments issued by Indian companies. These rules aim to promote transparency, attract foreign investments, and safeguard the interests of investors and the economy as a whole. The FEM (Non-Debt Instrument) Rules play a significant role in facilitating foreign investments in India while maintaining regulatory oversight. These rules provide a comprehensive framework for investors and regulatory authorities, promoting clarity, consistency, and accountability in the acquisition and transfer of non-debt instruments. By fostering a conducive investment climate, the FEM (Non-Debt Instrument) Rules contribute to the growth and development of the Indian economy.

INTRODUCTION

The world is changing at a rapid pace and businesses are leading the charge to such change. Businesses require investments to operate and in an increasingly interconnected and interdependent world, cross-border investment has emerged as a transformative force shaping global commerce. As economies become more integrated multinational corporations, entrepreneurs and investors are seeking opportunities beyond their domestic borders to tap into new markets, access resources, and foster innovation.

Cross-border investment refers to the flow of capital, technology, and expertise across national boundaries, creating mutually beneficial partnerships and contributing to economic

[*] ADVOCATE, CALCUTTA HIGH COURT.

growth and development. These investments are made through various instruments which can broadly be classified as Debt Instruments and Non-Debt Instruments. In recent times a special kind of instrument has come up which is being called a Hybrid Instrument which is a merger between debt and non-debt instruments. Examples of such Instruments are Optionally Convertible Preference Shares (OCPS), Compulsory Convertible Preference Shares (CCPS), etc.

India has established a comprehensive legal framework to regulate cross-border investments primarily through legislation, regulatory policies and judicial precedents. The Non-debt Instruments are governed by the Foreign Exchange Management (non-debt Instruments) Rules (non–debt rules)which are amended from time to time to suit the ever-changing commercial landscape. Additionally, India's membership in International Organisations and participation in multilateral agreements, such as the World Trade Organisations, further shapes the legal framework governing cross-border transactions and provides a basis for harmonization of laws and regulations.

This Article aims to explore and analyse how the non-debt rules govern cross-border transactions in India. By examining the legal framework, notable precedents and relevant regulatory policies, I seek to shed light on the intricacies and implications of these rules. Furthermore, I will delve into the practical implications for businesses and investors, identifying potential challenges and opportunities that arise from the non-debt aspects of cross-border transactions in India.

Journal of Legal Research and Juridical Sciences

WHAT IS FOREIGN EXCHANGE MANAGEMENT (NON – DEBT INSTRUMENTS) RULES, 2019

This piece of legislation has been drawn up to be the guidelines under which the law laid down in Foreign Exchange Management Act (FEMA) is organised and established in an industry and sector-specific manner. The Foreign Exchange Management (non-debt instruments) Rules, more commonly known as the NDI Rules, were notified by the Central Government on 17th October 2019. The Rules abolished two very important legislations governing cross-border trade in India at the time namely the Foreign Exchange Management (Transfer of issue of security by a person resident outside India) Regulations, 2017 (TISPRO) and the Foreign Exchange Management (Acquisition and Transfer of immovable property in India) Regulations, 2018.

Broadly speaking the NDI Rules lay down sector-specific and method-specific guidelines with regard to investment. An investor who wants to invest in India can invest in the sectors that are permitted for investment by the Government of India and can either invest through the automatic route or approval route as described in section–3(a) of Schedule–I of the NDI Rules and also subject to the sectoral cap as defined in section–3(b) of Schedule–I of the NDI Rules.

All investments must be made in accordance with the rules and guidelines set up by the RBI. For example – every single investment made in India must be registered with the Foreign Investment Promotion Board (FIPB).

INVESTMENTS MADE BY PERSONS RESIDING OUTSIDE INDIA (PROI) IN CASE OF FOREIGN DIRECT INVESTMENT

Any person who is residing outside India can invest in India, however after the publication of press note 3, residents of Bangladesh, Pakistan, Afghanistan and China will have to come through the government route for any kind of investment in India. In 2020 during the surge of covid pandemic, the government with the aim to restrict the Chinese capital from flooding the Indian Start Upmarket and ultimately taking control of the Indian Start-Ups issued Press Note 3 (PN 3), wherein the government notified when an investing entity is sharing a border with India or the owner or beneficial owner of the Investing Entity is situated in any country bordering India, then such investment must be made through the government route only. Important to note that in the event there is a transfer of ownership of the entity giving FDI in India in the hands of any of the PN-3 countries then also prior approval of the government is needed on that behalf. The tremors of PN-3 can be felt in 2022 also with the government approving only 66 out of 347 investment requests from the neighboring countries as of March 2022.[1]Pakistani Nationals however cannot invest in Defense, space and atomic energy sectors even through the Government Route.

A Person resident Outside India (PROI) may invest in any Indian Company and the Indian Company may also issue equity in favour of the PROI, however, it must be in accordance with the rules laid down in Schedule – I of the NDI Rules.

[1] Ministry of Commerce and Industry, FDI from neibouring Countries (16.03.2022) <https://pib.gov.in/PressReleasePage.aspx?PRID=1806626> accessed on 25.05.2023

For Example–A PROI is interested in investing in the Indian Petroleum Refining PSU. The automatic cap is set at 49% for FDIs. Therefore up to the 49% equity issue, the government will allow the FDI to go through automatically and without any interference, however, if the share issued is beyond the limit government approval will be necessary. If the investment was in one of the 5 Plantation Sectors to which the government has granted 100% FDI permission like Olive Tree Plantation then no such cap need to be considered and the PROI can fully acquire any Indian company or set up a new Company in India for the purpose of doing business in that sector.

In the case of a wholly owned subsidiary (WOS) situated or established in India by a PROI, then such Indian WOS may issue equity as compensation to the foreign entity as pre-incorporation expenses. This equity for this purpose can be issued up to 5% of the authorized capital or 50,000 US Dollars, whichever is less.

If the sectoral FDI cap as specified in Schedule – I of the NDI Rules is not breached then an Indian Company can issue equity to the PROI for swap equity instruments, and import of assets or machinery or equipment (except second-hand). All the payments have to be made through proper RBI-approved methods.

In the case of LLPs, PROI or foreign entities except the PN-3 countries are allowed to invest. Foreign Portfolio Investors (FPIs) and Foreign Venture Capitalist Investors(FVCI) are not allowed to invest. LLPs investments are a little tricky as only those sectors which allow FDI of 100% through automatic route can be accessed by PROIs that too without FDI-linked performance conditions. An FDI can also convert into LLP if the sector allows 100% inflow through an automatic route and in a similar fashion an LLP can also be converted into a company. Valuation of the entity shall be the fair market value calculated as per internationally accepted methods like NAV Method or Discounted Cash flow method. [2]

Journal of Legal Research and Juridical Sciences

Investments can be made by a PROI in investment vehicles subjected to the conditions of SEBI in the case of listed entity or AIFs and in any other case subject to conditions set forth by RBI from time to time. An AIF category- III fund can invest in any venture in India out of the funds received by it from outside India subject to the market cap and other rules as specified in the NDI rules. Important to note here that if an investment vehicle or its sponsor or manager is being controlled by PROI or a Foreign Entity and such vehicle makes an

[2] Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 6(b) Schedule - VI

investment in an Indian Entity or company, as the case may be, then such investment shall come under Indirect Foreign Investment Category. Therefore in this case, all the laws of FEMA, the Sectoral Caps, valuation methods, and regulatory compliances will apply and also in case of taxation, it will be taxed as per the slabs of income tax and non-residence tax, in case it is not an AIF or if the investee entity is not registered with DPIIT. [3]

A PROI can invest in Depository Receipts (DR) subject to the condition that the Securities to be offered by DR should be instruments allowed under the rules of the Depository Receipts Scheme, 2014. The Aggregate Limit of DR to be issued must be within the limits of the FDI capital cap as listed in Schedule – I of the NDI rules. If the cap is breached special permission must be undertaken from the respective ministry of the government of India or the state government as the case may be. The Pricing method of such securities must be according to an internationally accepted methodology. However, FEMA is yet to clear the air on what it considers an internally accepted methodology and what the rule of thumb one must take into consideration while calculating the price. The Finance Act 2023. Reiterated the already written down NDA rule and the Discounted Cash Flow method enshrined in the Income Tax Act, 1969 (IT Act). Although IT Act will not affect the transaction at the time of investment, it will affect the company at the time of exit for the purpose of capital gains tax. The government is yet to clarify its stance on this issue. [4]

A PROI holding investments in an Indian company is allowed to invest in the equity instruments offered through the Rights or Bonus Issues. A Rights issue is an invitation to the existing shareholders to subscribe or buy additional shares in the company at a discounted price. Therefore only the investors present in the company can buy the shares through the Rights issue as well as the bonus issue. What is to be kept in mind here is that in this case also FDI cap is to be maintained. Therefore, Schedule – I of the NDI Rules cannot be breached by a rights issue. Further, the right must be issued in compliance with the Companies Act. Pricing must be made by internationally accepted methods. In the case of Listed Company rights issue price shall be decided by the company itself and in the case of an unlisted company the price shall not be less than the price of FMV in India. This is done to prevent foul play by foreign investors. Any breach of this provision will invite scrutiny from the concerned authorities. Further, if a PROI received a Rights issue or shares when he was a

[3]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 6(C) Schedule - VIII
[4]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 6(d) Schedule - IX

resident, then he will be allowed to operate those shares on a non-repatriable basis that is he cannot sell and collect the money of those shares without government intervention. [5]

Indian Companies are allowed to issue ESOPs/Swat Equity Shares to their employees or Directors and to its Holdings, subsidiary, WOS, Joint Ventures Employees or Directors who are PROIs. Such issue shall be in accordance with the provisions of the Companies Act, 2023 and in the case of listed entities, the rules of SEBI must also be followed. In the case of PN-3 Countries, government approval is required. Apart from this all the sectoral regulations and FDI caps will apply. [6]

Transfer of Equity Instruments by an Indian Company can be done in three distinct ways, that is by a PROI to PROI, by PROI to PRI and by PRI to PROI

- By PROI to PROI – Transfer may be made through the instruments of Gift or sale. If the industry operates in the approval route then prior approval is needed. Further, if the shares are held on a non-repatriation basis and the transferee intends to make it on a repatriation basis, then shall be made in compliance with the Entry Route, Investment Limits, and Pricing Rules of FEMA and RBI guidelines.
- BY PROI to PRI – Transfer can be made through Sale or Gift or sale at the stock exchange executed as per SEBI regulations. RBI guidelines on Pricing and Transfer shall apply.
- BY PRI to PROI – Transfer by way of Sale can be made subject to the conditions like Pricing, Entry Route and Investment Limits as laid down in Schedule – I of the NDI Rules. However, if the transfer is proposed to be made by way of a gift then RBI approval is mandatory. The gift can only be made if i) the donor and donee are relatives within the meaning of section 2(77) of the Companies Act, 2013, ii) Donee must be eligible and not come under restrictions imposed under PN-3, iii) the Investment cannot exceed 5% of paid-up capital or Debentures or mutual funds, iv) Value of investment can be up to 5000 US Dollars, v) Sectional cap must be maintained.

In this kind of transaction, 75% of purchase consideration has to be transferred on an immediate basis. Deferred payment is allowed up to 25% but it will have to be completed

[5]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 7
[6]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 8

within 18 months. The seller may need to be indemnified by the buyer if the buyer does not pay the amount specified within the time limit mentioned above. For the purpose of doing the above-stated transaction, the PROI can open an Escrow account under the FEM (Deposit) Regulations, 2016, which may be funded through normal banking channels or guaranteed by authorized dealer bank. However, this is not mandatory.

TRANSFER OF EQUITY INSTRUMENT BY PLEDGE

This kind of transfer can be made by two entities viz.- i) by a promoter of an Indian Company and ii) by PROI holding shares in an Indian Company.

In the case of the first situation, the promoters of the Indian Company can pledge their shares for raising external commercial borrowing (ECB). This kind of borrowing is generally made for utilization in business purposes, however, these funds have to be utilized as per the end-use activities of the company, which are the permitted activities as per the memorandum of association. There is no restriction with regard to the period of pledge that can be undertaken. This has the effect of promoting debt-funding commerce in India. The pledge, however, must be certified by a statutory auditor. Further, a NOC should also be undertaken by the authorized bank. In case of invocation of pledge, transfer of shares shall be as per the sectoral cap, entry route, pricing guidelines, etc.

In the case of the Second scenario, the PROI can pledge his shares for raising a loan to be utilized for company use only. The Pledge can be made to Indian Banks, Overseas Banks, NBFCs, etc. In case of invocation of pledge, transfer of shares shall be as per the sectoral cap, entry route, pricing guidelines, etc.[7]

INVESTMENTS BY FOREIGN PORTFOLIO INVESTMENT

The rules are somewhat different from FDI in this regard. FPIs generally consist of financial investors who are only interested in returns on their investment, in contrast, FDIs generally consist of strategic investors who want some type of control in the company, i.e. a seat on the board of directors table, voting powers, drag along rights, etc. The rules for their cross-border investment are therefore framed to cater to their needs.

[7] Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 9

- An FPI may purchase or sell securities of listed companies or a to-be-listed company recognized by the Stock Exchange. All the exchanges must be subject to the NDI rules.
- Individual Investments in equity shares by an FPI or Investor Group shall be less than 10% of the paid-up equity capital on a fully diluted basis. This 10% threshold applies for each series of debentures on performance shares or warrants.
- The total holding of all FPIs and Investment Groups shall not exceed 24% of equity paid-up capital on a fully diluted basis or debentures or preference shares or warrants. The above-said limit can be extended by the Board of Directors with the approval of members by special resolution at the General Meeting subject to the equity cap in case of FDI as described in Schedule- I of the NDI Rules. Similarly the above-stated limit can also be reduced by the shareholders by a special resolution to that effect. However, once the equities are subscribed the shareholders lose the right to reduce the limit.

In case the sector-specific limit is breached by the FPI, then it will have 5 days' time to divest the excess holding within 5 days. If, however, it fails to do so, the entire holding shall be treated as FDI and such FPI and investment group shall not make further investments that is it will be barred from making any kind of further investments for such a period as the statutory authority deems fit. The Notice of such breach of sectoral investment cap shall be disclosed by the FPI, through its custodian to the depository bank within 7 days of settlement of the breach. The period between the breach and sole divestment or conversion to FDI shall not be treated as contravention.

Journal of Legal Research and Juridical Sciences

SHORT SELLING, LENDING OR BORROWING BY FPI

FPIs are allowed to do short-selling lending or borrowing of securities subject to RBI and SEBI regulations

PURCHASE, SELL OF INSTRUMENTS OTHER THAN EQUITY INSTRUMENTS

FPIs are allowed to purchase, and sell the following instruments in addition to equity instruments –

i. Units of mutual funds, AIF Category – III, offshore funds allowed by SEBI. Such funds can invest more than 50% of funds equity instruments on a repatriable basis with the conditions of RBI and SEBI.
ii. Units of REIT, and INVIT following the conditions of SEBI
iii. Indian Depository Receipts

TRANSFER BY WAY OF SALE OR GIFT OF SECURITIES BY FPIs

FPIs are allowed to transfer by way of the Sale or Gift of investment securities to any PROI. Such Transfers shall include transfers resulting in the Merger, De-Merger and Amalgamation of the Company. In case of company is covered under the approval route, prior approval of the appropriate ministry of government is necessary.

INVESTMENTS BY NRI OR OCI

These kinds of investments can be classified under 2 broad heads i.e. repatriable basis and non-repatriable basis.

Repatriable basis – This sector can further be classified into 4 sub-sectors, viz – equity instruments, the share of public sector undertakings, units of domestic mutual funds and subscription to national pension scheme

Equity Instruments – An NRI or OCI may purchase equity instruments of a listed company in any recognized stock exchange in India subject to the individual limit of up to 5% of total paid-up equity capital on a fully diluted basis or up to 5% of total paid-up value of debentures or performance shares or warrants. The total aggregated purchase by NRI or OCIs can be up to 10% of equity or debt instruments as the case may be. The aggregate can be increased up to 24% with a Special Resolution passed in the General Meeting.

Shares of Public Sector Undertaking – In this case, the divestment program of the government comes into the picture. An NRI or OCI may purchase shares in the PSUs that allow investments within the limit as specified in Schedule –I.

Units of Domestic Mutual Funds – In this case, investments can be made without any limits in any mutual fund provided that the mutual fund invests more than 50% in Equity Instruments.

Subscription to National Pension Scheme – May subscribe to NPS if governed by Pension Fund Regulatory & Development Authority Act.

Non – repatriable basis – NRIs/OCIs are allowed to invest in equity, units of mutual funds, capital contribution in LLP, Firms or proprietorship firm

An NRI or OCI or Trust or Firm which is incorporated outside India by NRI or OCI is allowed to invest without any limits in equity instruments of listed & unlisted companies, units of any investment vehicle / mutual fund, convertible instruments in start-ups and capital contribution in LLP. All investments shall be treated at per with resident investors.

It is to be noted that no investment by any NRI or OCI is allowed in Nidhi Company, Company engaged in agriculture, or plantation activities apart from the 5 plantations in which the government has approved foreign investment, real estate business or construction of a firm house to the extent in which the investment in purely for financial basis and no development is done on the property bought by such investment and dealing in the transfer of development rights

NRI/OCIs are permitted to invest in the capital of a firm or proprietorship entity without any limit except –

- In firms and entities engaged in real estate, agriculture, and plantation activities apart from the 5 plantations in which the government has approved foreign investment, print media

The NRIs and OCIs are allowed to invest in:

- Derivative contracts at the stock exchange
- Indian Derivative Receipts (IDR)

All investments have to be made as per RBI guidelines and the guidelines mentioned in Schedules–III and IV of the NDI rules.

Journal of Legal Research and Juridical Sciences

INVESTMENT AND TRANSFER OF SECURITIES BY OTHER NON-RESIDENT INDIANS

Any other PROI except the NRIs and OCIs can invest, buy, sell and transfer securities in any Indian Company. Long-term Investors like Sovereign Wealth Funds, Multilateral Agencies, Insurance Funds, Pension Funds, and foreign central banks are permitted to invest subject to the sectoral cap, entry route, and also regulations of RBI and SEBI governing that specific sector. [8] A special exception has been given to the entities that qualify for the test given by SEBI under the SEBI circular dated 9th October 2018 to be called Eligible Foreign Entity (EFE). These EFEs which have previous experience in the Indian physical commodities market may participate in the Indian Derivatives market subject to the guidelines framed by SEBI in this regard. [9] Every single mode of payment must be approved by RBI. [10]

ISSUE OF CONVERTIBLE INSTRUMENT BY AN INDIAN STARTUP

A PROI other than from Bangladesh and Pakistan and other PN-3 countries may purchase and sell convertible notes issued by Indian Startups:

- Upton 25 Lakhs in value,
- If the startup sector requires government approval then such government approvals shall be needed. This rule is applicable in case of further issue of convertible instruments by the Indian Entity to any PROI.

Journal of Legal Research and Juridical Sciences

Sectional Cap, pricing, approval route etc. must be followed. Apart from this NRIs and OCIs can also invest in these Indian Entities subject to the conditions as laid down in Schedule – IV. [11]

MERGER, DEMERGER OR AMALGAMATION OF INDIAN START-UPS

In case of the issue of equity instruments by a new entity or transfer of company due to merger, de-merger, amalgamation, or reconstruction, as the case may be, equity instruments can be issued to a PROI. Prior to the issue of such instruments, some conditions have to be fulfilled:

[8] Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 14, 15 Schedule - V
[9] Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Schedule - V
[10] *ibid*
[11] Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 18

i. The scheme of the above-noted transactions must be approved by NCLT or any other competent authority.
ii. The transaction must be within the sectoral cap as specified in Schedule – I of the NDI rules.
iii. If the company is a listed company then SEBI regulations must be followed. [12]

REPORTING REQUIREMENTS

The reporting requirement is controlled by the RBI on a sector-specific basis and it must be followed by every PROI along with NRIs and OCIs. [13]

PRICING REQUIREMENTS

If a company is listed in any recognized stock exchange then the pricing method must be approved by SEBI. SEBI or RBI as the case may be have set some guidelines for the purpose of calculating the minimum price of Indian Company securities. This means that a PROI can never invest in any Indian Company Securities below the FMV as calculated by standards set by SEBI or RBI as the case may be. Broadly, the guidelines go as follows :

i. For a listed company, it must be according to the guidelines set up by SEBI
ii. For an unlisted company, the valuation must be done by an internationally accepted method for valuation on an arm's length basis (that is the proper market price)
iii. The valuation in both cases must be certified by a CA or Marchant Banker registered with SEBI or a Practicing cost accountant
iv. In case of delisting of a listed company, the share price here also must be according to SEBI regulations.

If, however, PROI invested in equity investment on a non-repatriation basis to the extent that the profit the PROI will make, will invest back into the Indian System, then the above regulations shall not be applied in that case.

- If the PROI, wants to transfer the shares that he was issued according to the above rules, then two sets of rules emerge. The two sets are discussed below :

[12]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 19
[13]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 20

Journal of Legal Research and Juridical Sciences

PRI to PROI – if a resident of India wants to transfer his shares by any means of preference to a foreigner (PROI), then –

- For listed companies, the pricing must be in accordance with SEBI for issue, delisting, and preferential allotment of shares.
- For unlisted companies, the valuation must be done by an internationally accepted method for valuation on an arm's length basis (that is the proper market price)

Important to note here that here the government is here setting a minimum threshold that must be followed by the PROI. This is done to attract as much foreign currency inflow specifically US Dollars in India as possible. The situation reverses in the next situation.

PROI to PRI – here the PROI is selling something to a resident Indian. Here the government is keen to set a maximum limit to which the PRI can invest to the PROI. This is done to limit the foreign currency drain from India. Here also the method of pricing described in the previous point shall be followed with the exception that here the maximum limit will be calculated rather than the minimum and specific rules have been set forth by RBI and SEBI as the case may be to this end the certification requirements as mentioned above hold true here also.

In case of a swap of equity the valuation must be done by a merchant banker registered with SEBI. Further, in case the PROI acquired shares by subscription of shares in MOA, then the price shall be calculated at face value. Additionally, in the case of warrants, the price shall be decided on the basis of the time of issue and not on the basis of the time of exercise. If, however, PROI invested in equity investment on a non-repatriation basis to the extent that the profit the PROI will make, will invest back into the Indian System, then the above regulations shall not beed appli in that case. [14]

TAXES AND REMITTANCES OF SALE PROCEEDS

When a PROI sells and equity instrument sells his shares and after tax, if he takes such sale proceeding to his own country, then it shall be called a remittance. These remittances shall be made subject to –

i) payment of applicable taxes

[14]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 21

ii) Only through proper banking channels in India

iii) Subject to RBI rules and regulations, and

iv) Through authorized dealers.

If the securities were held on a non-repatriation basis, prior approval of RBI is necessary. [15]

DOWNSTREAM INVESTMENT

This area is mainly concerned with Holding and Subsidiary companies. In simple words, a downstream investment can be defined that when some company receives some funds and that company transfers the said fund to some other company. Investment may be made by Indian Entity or Investment Vehicle as the case may be, which has total foreign investment by capital or capital Instruments (in the case of LLP or Partnership or Proprietary firm this will be termed as only Capital) invests in other Indian entity.

Another term we need to understand is Indirect Foreign Investment (IFI). In this case, the downstream investment is made by an Indian entity and such investing Indian entity is not controlled by PRI, i.e. owned and controlled by PROI. If such investing entity is an investment vehicle, then if the manager, sponsor or investment manager is owned or controlled by PROI, then any investment made by they will be considered as an indirect foreign investment. It can be said that IFI is a part of Downstream Investment.

Journal of Legal Research and Juridical Sciences

We have to also understand how ownership of an Indian Company will affect the regulatory framework of Investment. If in an Indian Company, a PROI is in control and in that case, the holding must be more than 50% of equity investment. In the case of an LLP, this will be more than 50% of the capital of the LLP. If however, the capital is not more than 50% but the majority of directors are controlled by the PROI then also it will be regarded as an Indian company that is controlled by a PROI. The term Total foreign investment shall mean the combination of Indirect Foreign Investment in addition to total foreign investment on a fully diluted basis.

[15] Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 22

Now let's talk about the regulations governing downstream investment:-

In the case of the company, the entry route, sectoral cap, pricing guidelines and other applicable conditions based on whether they are listed or not listed shall apply to the Indian Entity receiving the foreign entity. Therefore, if the sectoral cap of an Indian entity is full, then if the investing entity falls in any of the above categories then it will be treated as a PROI entity and all the investment regulations on them will be applied here also.

In the case of LLP, it must be allowed under government regulations, that is funding must be allowed 100% under Schedule – I of NDI rules.

The total foreign Instrument held by a PROI can be calculated in the following manner:-

- Convertible Debt Instruments shall be taken into consideration in total foreign investment. If there is no convertible option, then it will not be counted. For example – Foreign Convertible bonds and Depository receipts are placed in the custody of the share custodian.
- Investments under the portfolio route shall be considered.
- Indirect investment by a foreign entity in WOS Indian Co. shall be taken up to the amount received by a company making investments.

Conditions of downstream investment that is treated as Indirect Foreign Investment:

Journal of Legal Research and Juridical Sciences

- Approval by the Board of Directors and Shareholders by a simple resolution.
- Funds shall be brought from outside India and not borrowed from domestic markets.
- Funds that are in reserve after taxes shall also be counted under this act in case of the funds which were received previously from the international market.

All compliances shall be the responsibility of the first-level Indian company making the downstream investments. Such a company shall obtain a certificate from the statutory authority annually for this purpose.[16]

[16]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 23

ACQUISITION AND TRANSFER OF IMMOVABLE PROPERTY IN INDIA

A PROI can buy property in India except for Agricultural land and Farm House. However, in the case of other conditions also the rules are different for the citizens of India. The conditions will differ in the case of PROI, NRI and OCI.

Citizens of the following countries whether they are natural or legal must obtain prior RBI approval to buy any land in India –

- Pakistan
- Bangladesh
- China
- Nepal
- Bhutan
- Hong Kong
- Macau
- Korea – Democratic Republic of Kora
- Sri Lanka
- Iran

These countries can take leas up to 5 years in any Indian property, but in case of a lease beyond that period, RBI approval will be required. [17]

Journal of Legal Research and Juridical Sciences

NRI or OCI can take property in India except for Agriculture land, Firm house and Plantation except for the 5 plantations that were allowed by the government in 2015. The consideration shall be, in case of a sale, made out of funds received out of India through a banking route or funds held in an NRI account. However, traveler cheques or foreign currency notes are not allowed. In the case of a gift, the Donee must be a relative to the Donor within the meaning of section – 2(77) of the companies act, 2013. In case of inheritance from PROI, who acquired any property in India as per Foreign Exchange laws in force at that time or acquired from PRI, can be given to any person and it will be subject to inheritance laws prevailing at the time of India and subject to the approval mechanism at the time.[18]

[17]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 31
[18]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 24

A PROI who is a spouse of NRI or OCI may jointly acquire any property in India provided they are married for at least 2 years and the marriage is properly registered under Indian Laws and the spouse is not prohibited from acquiring any property in India. [19]

If a PROI has established a business in India and has branch offices or other places of business except for the branch office, may acquire immovable property for necessary work like storage place, etc or for carrying on such activity, in conformity with the applicable laws of the state and for cross-border investment in India. He may also mortgage such property for the purpose of raising loans. A very good example of this can be found in multinational MNCs who are doing good business in India, having properties in their own name. However, in the case of citizens of countries described in rule – 31, they cannot buy a route through automatic route, they have to go through the government approval route. They can only take a lease up to 5 years, if they want more period then they have to go through the government route. [20]

In case of embassy staff or diplomats or consulate generals of foreign countries wants to buy land in India, then approval must be taken from the Central Government Ministry of External Affairs and consideration can only be made through banking channels. They cannot buy Agricultural land, plantation or firm house. [21]

In the case of people who are PROI but living in India with a long-term visa, then in case of citizens of Afghanistan, Bangladesh, and Pakistan, who are minorities in these countries such as Sikhs, Buddhists, Jains, Parsis, Christians and Hindus, then they are allowed to buy properties in India to the extent of one for residential purpose and one for commercial purpose.

Journal of Legal Research and Juridical Sciences

The conditions of such a transaction are –

- Property should not be situated in restricted areas like agricultural land, plantation, firm house, etc.
- Submit a declaration to the revenue authority of that area where the property is situated.

[19] Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 25
[20] Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 26
[21] Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 27

- Registration of documents shall mention that such owners are on Long Term Visa (LTV)
- If such a person is found involved in anti-India activity then such property shall be confiscated.
- Copy of documents shall be submitted to the local DCP, Foreign registration office (FRO).
- Any sale or transfer of such property shall be communicated to the DCP and FRO. If however during this period the person has acquired citizenship of India then he will have all the rights that a citizen has and he shall not be required to do any compliance mentioned previously.[22]

If a PROI sells a property, then the sale proceeds he can either invest in India or take it in his home country otherwise known as repatriation. He can do that provided that if he invested the property on a non-repatriation basis then general or specific permission may be taken from RBI.

In the case of NRI or OCI, such transaction is allowed through authorized dealers, provided that –

- The property was acquired under the NDI rules mentioned above.
- The amount of consideration was paid in foreign currency received through banking channels in India.
- In the case of residential property up to 2 properties then consideration is allowed. Important to note that the previously discussed 2 property rule for LTV is not applicable here.

Journal of Legal Research and Juridical Sciences

In case a property was bought by an NRI or OCI on an ECB and fails to deposit the EMI, then the external lender can sell the property to reimburse his loan provided he must follow the repatriation rules. [23]

A PROI can only transfer immovable property in India provided –

- RBI permits transfer

[22]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 28
[23]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 29

- If the property has a charge of ECB, then such a charge must be made through authorized dealer.
- Funds of ECB shall be used only for core business outside India.
- In case of invocation of the charge, Indian Banks shall sell a property and remit the sale proceeds to the foreign entity. [24]

RECENT DEVELOPMENTS

The NDI is amended from time to time to cater to the foreign policy of the government at the time. Recently in 2022, the government of India amended to rules vide Notification No. S.O. 1802(E), Dated 1.04.2022. The amendments are as follows:-

- Rule 2(e) of the NDI rules is amended to extend the time frame for startups to issue convertible debentures. The period is now 10 years which is a good step from the previous time frame of 5 years.
- The definition of an Indian Company has been extended to include body corporates established or constituted by or under any central or state act which is incorporated in India. This was done to facilitate the LIC IPO but it will have far-reaching effects to the extent of allowing infrastructure bodies like NHAI or even the BRO in inviting foreign investment in Indian infrastructure projects.
- The introduction of new definitions like Share Based Employee Benefit and Subsidiary will provide much-needed clarity. Now, employees can be given more lucrative incentives which will, in turn, be an impetus in the workforce.
- Changes are made in Rule–19 widening the M&A aspects to Indian Companies. Though procedural in nature, these will have wide effects. It will give another array of restructuring options to Indian Companies within the scope of the Companies Act.
- Schedule – I of the NDI rules was amended to exclude educational institutions, recreational facilities, city and regional-level infrastructure, townships, AND real estate broking services outside the scope of the definition of real estate. This will have a good impact on cross-border investment as real estate is a controlled sector. These exclusions will foster investment in the country.

Journal of Legal Research and Juridical Sciences

[24]Foreign Exchange management (Non – Debt Instruments) Rules, 2019, Rule – 30

CONCLUSION

The FEM (Non-debt Instruments) Rules, 2019 is the premier piece of legislation governing cross boarder investments in India. These rules directly impact how foreign investments will come TO India. It has clearly defined and classified various non-debt instruments and developed monitoring mechanisms, and reporting requirements and made clarifications to avoid confusion by clear definition and classified several non-debt instruments. Further, the rules along with FEMA have brought greater liberalization and relaxation of restrictions, facilitating increased foreign participation in various sectors of the Indian economy. The effect of the relaxation of the definition of real estate and sectoral caps will be felt in the Ease of Doing Business Index.

However, it is important to acknowledge that the rules are not without their challenges. In the highly competitive world where companies and nations are always looking for ways to beat the guy in front and stand out on the global stage, it is very important that we incorporate the best global practices in our system to protect, preserve and promote our business and national commercial interest to the global audience. The NDI rules in this aspect play the much-needed part of a guiding hand to the Indian Companies and investors to best utilize the market access of India and make the business temperament of India grow.

JLRJS
Journal of Legal Research and Juridical Sciences