

FOREIGN DIRECT INVESTMENT IN INDIA

(Policies, Procedure and Legal Framework)

India is one of the fastest growing economies since last few years and witnessed a large amount of Foreign Investment in various sector. The government has formulated it Policy aiming towards attracting more and more funds considering the domestic business concerns simultaneously. This article throws a light upon what has been formulated and the procedure to be followed in the same. This article will help to understand the legal formalities of the FDI in India.

Policy toward FDI

FDI up to 100% is allowed under the automatic route in all activities/sectors except the following which will require approval of the Government:

- Activities/items that require an Industrial Licence
- Proposals in which the foreign collaborator has a previous/existing venture/tie up in India in the same. Prior Government approval for new proposals would be required only in cases where the foreign investor has an existing joint venture, technology transfer, trade mark agreement in the same field. With the amendment of the Press Note 18, joint ventures formed with foreign investment before December 12, 2004 would be considered as “existing JVs” which will fall under the ambit of Press Note 18. The foreign partner in such JV has to obtain a No Objection Certificate (NOC) from the Indian partner for starting new venture in India in the “same” field of activity.
- All proposals relating to acquisition of shares in an existing Indian company by a foreign/NRI investor.
- All proposals falling outside notified sectoral policy/caps or under sectors in which FDI is not permitted.

FDI policy is reviewed on an ongoing basis and measures for its further liberalization are taken. Change in sectoral policy/sectoral equity cap is notified from time to time through Press Notes by the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion. Policy announcement by SIA are subsequently notified by RBI under FEMA.

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AUTOMATIC ROUTE

FDI Policy permits FDI up to 100 % from foreign/NRI investor without prior approval in most of the sectors including the services sector under automatic route. FDI in sectors/activities under automatic route does not require any prior approval either by the Government or the RBI. The investors are required to notify the Regional office concerned of RBI of receipt of inward remittances within 30 days of such receipt and will have to file the required documents with that office within 30 days after issue of shares to foreign investors.

The present Automatic Route allows Indian companies engaged in all industries except for certain select industries/sectors to issue shares to foreign investors up to 100% of their paid up capital in Indian companies. There are also some areas where though Automatic Route is available, foreign investors cannot invest beyond a certain percentage of the paid up capital of the Indian companies or where investment is subject to some other conditions.

Foreign investors have to, however, keep in mind that they may invest freely under the Automatic Route described above but where such investment does not conform to policies of Government of India, a specific approval from Government must be sought. For example, there are Government guidelines on location of industrial units, or there are certain items like explosives or liquor that need an industrial licence. If the Indian company does not conform to the locational guidelines or needs an Industrial licence then it cannot issue shares under the Automatic Route.

GOVERNMENT APPROVAL ROUTE

All activities which are not covered under the automatic route, prior Government approval for FDI/NRI shall be necessary. Areas/sectors/activities hitherto not open to FDI/NRI investment shall continue to be so unless otherwise decided and notified by Government.

An investor can make an application for prior Government approval even when the proposed activity is under the automatic route.

Proposals requiring Govt's Approval

Application for proposals requiring prior Govt's approval should be submitted to FIPB in FC-IL form. Plain paper applications carrying all relevant details are also accepted. No fee is payable. The following information should form part of the proposals submitted to FIPB: -

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- a) Whether the applicant has had or has any previous/existing financial/technical collaboration or trade mark agreement in India in the same or allied field for which approval has been sought; and
- b) If so, details thereof and the justification for proposing the new venture/technical collaboration (including trade marks).
- c) Applications can also be submitted with Indian Missions abroad who will forward them to the Department of Economic Affairs for further processing.
- d) Foreign investment proposals received in the DEA are placed before the Foreign Investment Promotion Board (FIPB) within 15 days of receipt. The decision of the Government in all cases is usually conveyed by the DEA within 30 days.

PROHIBITED SECTORS FOR FDI IN INDIA

FDI is not permissible in the following cases

- ✓ Gambling and Betting, or
- ✓ Lottery Business, or
- ✓ Business of chit fund
- ✓ Nidhi Company
- ✓ Housing and Real Estate business (to a certain extent has been opened. For details please see note on Construction)
- ✓ Trading in Transferable Development Rights (TDRs)
- ✓ Retail Trading (discussions are being held to open this area-B2B and Cash & Carry are permitted)
- ✓ Atomic Energy
- ✓ Agricultural or plantation activities or Agriculture (excluding Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisciculture and Cultivation of Vegetables, Mushrooms etc. under controlled conditions and services related to agro and allied sectors) and Plantations(other than Tea plantations)

General Permission of RBI under FEMA

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RBI has granted general permission under Foreign Exchange Management Act (FEMA) in respect of proposals approved by the Government. Indian companies getting foreign investment approval through FIPB route do not require any further clearance from RBI for the purpose of receiving inward remittance and issue of shares to the foreign investors.

The companies are, however, required to notify the Regional office concerned of the RBI of receipt of inward remittances within 30 days of such receipt and to file the required documents with the concerned Regional offices of the RBI within 30 days after issue of shares to the foreign investors or NRIs.

FDI IN EOUS/SEZS/INDUSTRIAL PARK/EHTP/STP

Special Economic Zones (SEZs)

100% FDI is permitted under automatic route for setting up of special Economic Zone.

Units in SEZ qualify for approval through automatic route subject to sectoral norms. Details about the type of activities permitted are available in the Foreign Trade Policy issued by Department of Commerce. Proposals not covered under the automatic route require approval by FIPB.

100% Export Oriented Units (EOUs)

100% FDI is permitted under automatic route for setting up 100% EOU, subject to sectoral norms. Proposals not covered under the automatic route would be considered and approved by FIPB.

Capitalization of Import Payables

FDI inflows are required to be under the following modes;

- ✓ By inward remittances through normal banking channels or
- ✓ By debit to the specified account of person concerned maintained in an authorized dealer/authorized bank.

Issue of equity to non-residents against other modes of FDI inflows or in kind is not permissible.

However, Issue of equity shares against lump sum fee, royalty payable and external commercial borrowings (ECBs) in convertible foreign currency are permitted, subject to meeting all applicable tax liabilities and sector specific guidelines.

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INDUSTRIAL LICENSING

Industrial Licensing Policy

Industrial Licenses are regulated under the Industries (Development & Regulation) Act, 1951. The requirements of Industrial licence has been progressively reduced. At present industrial licence for manufacturing is required only for the following:

- ✓ Industries retained under compulsory licensing,
- ✓ Items reserved for small scale sector; and
- ✓ When the proposed location attracts locational restriction industries requiring Compulsory Licensing

The following industries require compulsory industrial license:

- ✓ Distillation and brewing of alcoholic drinks;
- ✓ Cigars and cigarettes of tobacco and manufactured tobacco substitutes;
- ✓ Electronic Aerospace and defence equipment: all types;
- ✓ Industrial explosives including detonating fuses, safety fuses, gun powder, nitrocellulose and matches;
- ✓ Hazardous chemicals;
 - a) Hydrocyanic acid and its derivatives
 - b) Phosgene and its derivatives
 - c) Isocyanates and di-isocyanates of hydrocarbon, not elsewhere specified example: Methyl Isocyanate); and
- ✓ Drugs and Pharmaceuticals (according to modified Drug Policy issued in September, 1994 and subsequently amended in February, 1999)

INDUSTRIES UNDER SMALL-SCALE SECTOR

An industrial undertaking is defined as a small-scale unit if the capital investment in plant and machinery does not exceed Rs 10 million.

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Small-scale units can get registered with the Directorate of Industries/District Industries Centre of the State Government. Such units can manufacture any item, and are also free from locational restrictions.

Manufacture of items reserved for small-scale sector

Non-small scale units can manufacture items reserved for the small scale sector only after obtaining an industrial license. In such cases, the non-small scale unit is required to undertake an obligation to export 50 per cent of the production of SSI reserved items.

FDI IN SSI UNITS

A small scale unit can not have more than 24 per cent equity in its paid up capital from any industrial undertaking, either foreign or domestic. If the equity from another company (including foreign equity) exceeds 24 per cent, even if the investment in plant and machinery in the unit does not exceed Rs 10 million, the unit loses its small-scale status.

Locational Restrictions

Industrial undertakings are free to select the location of a project. Industrial Licence is required if the proposed location is within 25 KM of the Standard Urban Area limits of 23 city having population of 1 million as per 1991 census.

Locational restriction does not apply:

- i) If the unit were to be located in an area designated as an “industrial area” before the 25th July, 1991.
- ii) Electronics, Computer software and Printing and any other industry, which may be notified in future as “non polluting industry”, are exempt from such locational restriction.

The location of industrial units is subject to applicable local zoning and land use regulations and environmental regulations.

FOREIGN TECHNOLOGY AGREEMENTS

General Policy

For promoting technological capability in Indian industry, acquisition of foreign technology is encouraged through foreign technology collaboration agreements. Induction of know-how through such agreements are permitted either through automatic route or with prior approval from the Government.

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Scope of Technology Collaboration

The terms of payment under foreign technology collaboration, which are eligible for approval through the automatic route and by the Government approval route are technical know how fees, payment for design and drawing, payment for engineering service and royalty. Payments for hiring of foreign technicians, deputation of Indian technicians abroad, and testing of indigenous raw material, products, indigenously developed technology in foreign countries are governed by separate RBI procedures and rules and are not covered by the foreign technology collaboration approval. Similarly, payments for imports of plant and machinery and raw material are also not covered by the foreign technology collaboration approval.

Automatic Route

Government has delegated powers to Reserve Bank of India to allow payments for foreign technology collaboration by Indian companies under automatic route subject to the following limits:

- (i). the lump sum payments not exceeding US \$ 2 Million;
- (ii). royalty payable being limited to 5 per cent for domestic sales and 8 per cent for exports. The aforesaid royalty limits are net of taxes and are calculated according to standard conditions.

Terms of payment qualifying for automatic route is irrespective of the extent of foreign equity in the Indian company.

Use of trademarks and brand name

Payment of royalty up to 2% for exports and 1% for domestic sales is allowed under automatic route for use of trademarks and brand name of the foreign collaborator without technology transfer. Royalty on brand name/trade mark shall be paid as a percentage of net sales, viz., gross sales less agents'/dealers' commission, transport cost, including ocean freight, insurance, duties, taxes and other charges, and cost of raw materials, parts and components imported from the foreign licensor or its subsidiary/affiliated company.

In case of technology transfer, payment of royalty subsumes the payment of royalty for use of trademark and brand name of the foreign collaborator.

ENTRY OPTIONS FOR FOREIGN INVESTORS IN INDIA

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Entry Options

A foreign company planning to set up business operations in India has the following options:

Incorporated Entity

1. By incorporating a company under the Companies Act, 1956 through
 - ✓ Joint Ventures; or
 - ✓ Wholly Owned Subsidiaries

Foreign equity in such Indian companies can be up to 100% depending on the requirements of the investor, subject to equity caps in respect of the area of activities under the Foreign Direct Investment (FDI) policy.

As an Unincorporated Entity

As a foreign Company through

- ✓ Liaison Office/Representative Office
- ✓ Project Office
- ✓ Branch Office

Such offices can undertake activities permitted under the Foreign Exchange Management (Establishment in India of branch or office of other place of business) Regulations, 2000.

Incorporation of Company

For registration and incorporation, an application has to be filed with Registrar of Companies (ROC). Once a company has been duly registered and incorporated as an Indian company, it is subject to Indian laws and regulations as applicable to other domestic Indian companies.

Liaison Office/Representative Office

The role of the liaison office is limited to collecting information about possible market opportunities and providing information about the company and its products to prospective Indian customers. It can promote export/import from/to India and also facilitate technical/financial collaboration between parent company and companies in India. Liaison office can not undertake any commercial activity directly or indirectly and can not, therefore,

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earn any income in India. Approval for establishing a liaison office in India is granted by Reserve Bank of India (RBI).

Project Office

Foreign Companies planning to execute specific projects in India can set up temporary project/site offices in India. RBI has now granted general permission to foreign entities to establish Project Offices subject to specified conditions. Such offices can not undertake or carry on any activity other than the activity relating and incidental to execution of the project. Project Offices may remit outside India the surplus of the project on its completion, general permission for which has been granted by the RBI.

Branch Office

Foreign companies engaged in manufacturing and trading activities abroad are allowed to set up Branch Offices in India for the following purposes:

- (i). Export/Import of goods
- (ii). Rendering professional or consultancy services
- (iii). Carrying out research work, in which the parent company is engaged.
- (iv). Promoting technical or financial collaborations between Indian companies and parent or overseas group company.
- (v). Representing the parent company in India and acting as buying/selling agents in India.
- (vi). Rendering services in Information Technology and development of software in India.
- (vii). Rendering technical support to the products supplied by the parent/ group companies
- (viii). Foreign airline/shipping company.

A branch office is not allowed to carry out manufacturing activities on its own but is permitted to subcontract these to an Indian manufacturer.

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Branch Offices established with the approval of RBI, may remit outside India profit of the branch, net of applicable Indian taxes and subject to RBI guidelines Permission for setting up branch offices is granted by the Reserve Bank of India (RBI).

Branch Office on “Stand Alone Basis” in SEZ

Such Branch Offices would be isolated and restricted to the Special Economic zone (SEZ) alone and no business activity/transaction will be allowed outside the SEZs in India, which include branches/subsidiaries of its parent office in India.

No approval shall be necessary from RBI for a company to establish a branch/unit in SEZs to undertake manufacturing and service activities subject to specified conditions.

INVESTMENT IN A FIRM OR A PROPRIETARY CONCERN BY NRI'S

A non-resident Indian or a person of Indian origin resident outside India may invest by way of contribution to the capital of a firm or a proprietary concern in India on non-repatriation basis provided

- (i). Amount is invested by inward remittance or out of NRE/FCNR/NRO account maintained with AD
- (ii). The firm or proprietary concern is not engaged in any agricultural/plantation or real estate business i.e. dealing in land and immovable property with a view to earning profit or earning income there from.
- (iii). Amount invested shall not be eligible for repatriation outside India NRIs/PIO may invest in sole proprietorship concerns/ partnership firms with repatriation benefits with the approval of Government /RBI.

Investment in a firm or a proprietary concern by other than NRIs

No person resident outside India other than NRIs/PIO shall make any investment by way of contribution to the capital of a firm or a proprietorship concern or any association of persons in India. The RBI may, on an application made to it, permit a person resident outside India to make such investment subject to such terms and conditions as may be considered necessary.

EXCHANGE CONTROL MANAGEMENT

Repatriation of Investment Capital and Profits Earned in India

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- (i). All foreign investments are freely repatriable except for the cases where NRIs choose to invest specifically under non-repatriable schemes. Dividends declared on foreign investments can be remitted freely through an Authorised Dealer.
- (ii). Non-residents can sell shares on stock exchange without prior approval of RBI and repatriate through a bank the sale proceeds if they hold the shares on repatriation basis and if they have necessary NOC/tax clearance certificate issued by Income Tax authorities.
- (iii). For sale of shares through private arrangements, regional offices of RBI grant permission for recognized units of foreign equity in Indian company in terms of guidelines indicated in Regulation 10.B of Notification No. FEMA.20/2000 RB dated 3rd May 2000. The sale price of shares on recognised units is to be determined in accordance with the guidelines prescribed under Regulation 10B(2) of the above Notification.
- (iv). Profits, dividends, etc. (which are remittances classified as current account transactions) can be freely repatriated.

Price at which company can issue shares to non-residents

- (i). A newly constituted company can issue shares at par.
- (ii). If preferential allotment is made in a listed company, the minimum price should be in conformity with the SEBI's guidelines for preferential allotment.
- (iii). If preferential allotment is made by an unlisted company, the minimum price will be determined in accordance with the guidelines issued by erstwhile Controller of Capital Issues (CCI guidelines).
- (iv). In case of issue of right shares, the price should not be lower than that at which the offer is made to resident shareholders.

TAXATION IN INDIA

General Tax Incentives for Industries

Tax holidays in the form of deductions are available for various types of investments. These include incentives to priority sectors and incentives to industries located in special area/regions.

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Infrastructure Sectors

Tax incentives available for those engage in development of infrastructure are listed below:

Deduction of 100% of the profits from business for a minimum period of 10 years depending upon the area of activity:

- (i). Development or operation and maintenance of ports, airports, roads, highways, bridges, rail systems, inland waterways, inland ports, water supply projects, water treatment systems, irrigation projects, sanitation and sewage projects, solid waste management systems.
- (ii). Generation, distribution and transmission of power which commence before 31.3.2006.
- (iii). Development, operation and maintenance of an industrial park or special Economic Zone before 31.3.2006.

Non-resident Taxation

Withholding tax rate applicable to 'royalty' and 'fees for technical services' payments to non-residents reduced from 20% to 10% (effective tax rate of 10.46%) pursuant to agreements made on or after June 1, 2005.

Double Taxation Relief

India has entered into DTAA with 65 countries including countries like U.S.A., U.K., Japan, France, Germany, etc. In case of countries with which India has double taxation avoidance agreements.

What is the Taxation Policy in India?

Foreign nationals working in India are generally taxed only on their Indian income. Income received from sources outside India is not taxable unless it is received in India. The Indian tax laws provide for exemption of tax on certain kinds of income earned for services rendered in India. Further, foreign nationals have the option of being taxed under the tax treaties that India may have signed with their country of residence.

Remuneration for work done in India is taxable irrespective of the place of receipt. Remuneration includes salaries and wages, pensions, fees, commissions, profits in lieu of or in addition to salary, advance salary and perquisites. Taxable payments include all

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allowances and tax equalization payments unless specifically excluded. The stock options granted by the employer are taxable as capital gains at the time of sale of shares acquired due to exercise of options.

What are the important Labour Rules/ Regulations applicable in India?

Some of the important Labour Acts, which are applicable for carrying out business in India, are:

- ✓ Employees' Provident Fund and Miscellaneous Provisions Act, 1952
- ✓ Employees' State Insurance Act 1948
- ✓ Workmen's Compensation Act, 1923
- ✓ Maternity Benefit Act, 1961
- ✓ Payment of Gratuity Act, 1972
- ✓ Factories Act, 1948
- ✓ Dock Workers (Safety, Health & Welfare) Act, 1986
- ✓ Mines Act, 1972
- ✓ Minimum Wages Act
- ✓ Payment of Bonus Act 1965
- ✓ Contract Labour [Regulation & Abolition] Act 1970
- ✓ Payment of Wages Act, 1936

India is a signatory to the agreement concluding the Uruguay Round of GATT negotiations and establishing the World Trade Organization (WTO) and its laws today are WTO compliant.

Can profits, dividends, royalty, know how payments be repatriated from India?

All profits, dividends, royalty, know how payments that have been approved by the Government/RBI can be repatriated. Some sectors like investment in development of integrated township, NRI Investment in real estates, etc. may attract a lock-in period.

Sectoral Cap

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List of activities which either are available under automatic route or where the sectoral cap on investment in certain areas have been fixed by the Government. We may clarify at the outset that this position is as on today and since lot of changes are taking place frequently, before taking any final decision, we should be consulted to find out the exact position in any particular sector.

A) List of Activities for which Automatic Route of Reserve Bank of India (RBI) for investment from person resident outside India is not available

- (i). Domestic Airlines
- (ii). Petroleum Sector (except for private sector oil refining)
- (iii). Investing companies in Infrastructure & Services Sector
- (iv). Defence and Strategic Industries
- (v). Atomic Minerals
- (vi). Print Media
- (vii). Broadcasting
- (viii). Postal Services
- (ix). Courier Services
- (x). Establishment and Operation of Satellite
- (xi). Development of Integrated Township
- (xii). Tea Sector

B) Sectoral cap on investment by persons resident outside India in some of the sectors as desired

a. Advertising and films

- ✓ Advertising sector FDI up to 100% allowed on the automatic route
- ✓ Film sector (film production, exhibition and distribution including related services/products) FDI up to 100% allowed on the automatic route with no entry level condition

b. Insurance

- ✓ FDI up to 26% in the Insurance sector is allowed on the automatic route subject to obtaining licence from Insurance Regulatory & Development Authority (IRDA)

c. Power

- ✓ Up to 100% FDI allowed in respect of projects relating to electricity generation, transmission and distribution, other than atomic reactor power plants. There is no limit on the project cost and quantum of foreign direct investment

d. Trading

- ✓ Trading is permitted under automatic route with FDI up to 51% provided it is primarily export activities, and the undertaking is an export house/trading house/super trading house/star trading house. However, under the FIPB route:-

(i). 100% FDI is permitted in case of trading companies for the following activities:

- Exports
- bulk imports with ex-port/ex-bonded warehouse sales
- cash and carry wholesale trading
- other import of goods or services provided at least 75% is for procurement and sale of goods and services among the companies of the same group and not for third party use or onward transfer/distribution/sales

(ii). The following kinds of trading are also permitted, subject to provisions of Foreign Trade Policy:

- Companies for providing after sales services (that is not trading per se)
- Domestic trading of products of JVs is permitted at the wholesale level for such trading companies who wish to market manufactured products on behalf of their joint ventures in which they have equity participation in India
- Trading of hi-tech items/items requiring specialized after sales service
- Trading of items for social sector

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- Trading of hi-tech, medical and diagnostic items
- Trading of items sourced from the small scale sector under which, based on technology provided and laid down quality specifications, a company can market that item under its brand name
- Domestic sourcing of products for exports
- Test marketing of such items for which a company has approval for manufacture provided such test marketing facility will be for a period of two years, and investment in setting up manufacturing facilities commences simultaneously with test marketing
- FDI up to 100% permitted for e-commerce activities subject to the condition that such companies would divest 26% of their equity in favour of the Indian public in five years, if these companies are listed in other parts of the world. Such companies would engage only in business to business (B2B) e-commerce and not in retail trading FDI is not permitted in retail trading activity.

C) Information Technology

- ✓ 100% FDI is permitted for setting up call centers. However, certain procedures are required to be followed for setting up a call center/BPO.
- ✓ As regards Foreign Direct Investment in construction, a separate note is attached herewith highlighting the changes, which are made recently.

Please Contact If Any Query

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