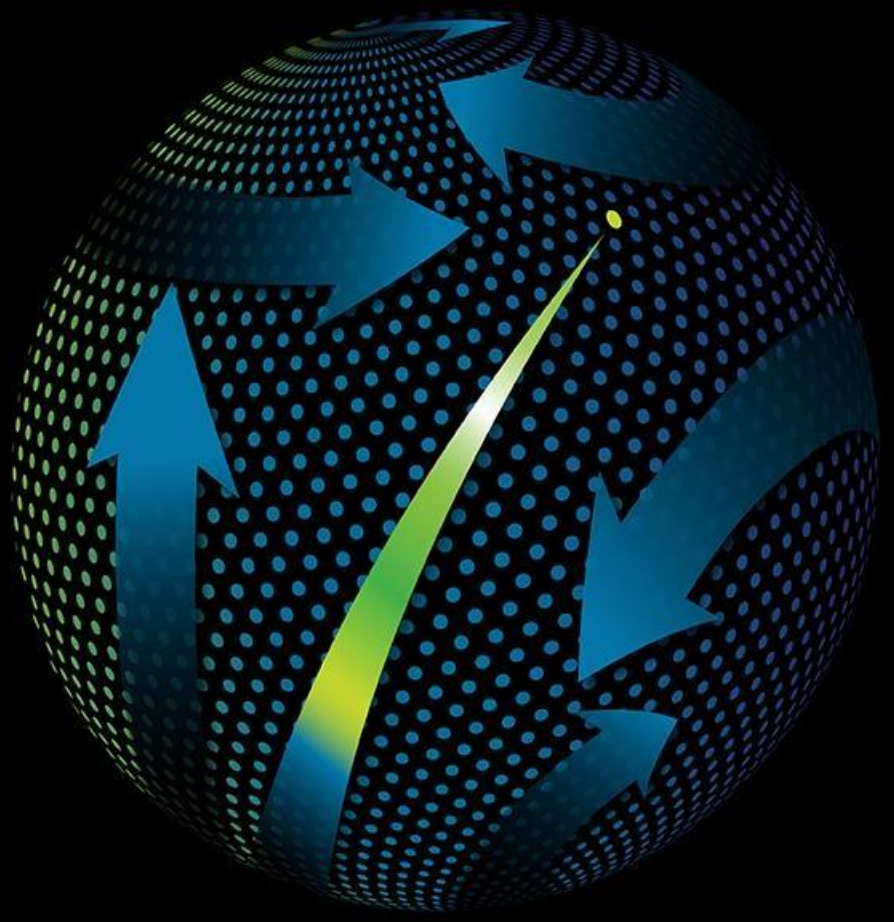
Deloitte.

Regulatory L&E



April 2023
India

Regulatory Structure of FEMA



Foreign Exchange Management Act, 1999 (FEMA)

FEMA replaced Foreign Exchange Regulation Act, 1973.

FEMA was designed to boost external payments and foreign trades

Total 49 Sections (out of which 8 are omitted).

Regulations: Total 26

Sec. 47 grants power to Reserve Bank of India to make Regulations on:

(a) permissible capital account transactions involving Debt Instruments

(b) the period within which and the manner of repatriation of Foreign Exchange

(c) limit up to which any person may posses foreign exchange

(d) export, import or holding of currency or currency notes

Rules : Total 8 Nos.

Sec. 46(2) read with Sec. 5 grant power to Central Government to make Rules on:

(a) Capital Account Transactions

(b) the instruments which are determined to be debt instruments under section 6 (7)

(c) Permissible Capital Account Transactions under Sec. 6 (2A)

(d) Compounding Provisions

Authorised Persons Directive (AP-DIR) Circulars

RBI has power under Section 10 (4) and Section 11(1) to issue general or special directions or order to the Authorised Persons for the purpose of securing compliance of the provisions of FEMA

Master Directions

Master Directions are issued under sections 10(4) and 11(1) of the Foreign Exchange Management Act, 1999

CG took powers from RBI for making rules on Capital Account Transactions involving non-debt instruments in 2019 through amendments in FEMA

Key Rules and Regulations

Overseas Investment

- Foreign Exchange Management (Overseas Investment) Rules 2022
- Foreign Exchange Management (Overseas Investment) Regulations, 2022
- Foreign Exchange Management (Overseas Investment) Directions, 2022

FEMA Act, Current Account Transactions, Imports and Exports

- FEMA Act
- FEM (Current Account Transaction) Rules, 2000
- FEM (Export of Goods & Services) Regulations, 2015
- FEM (Manner of Receipt & Payment) Regulations, 2016
- Master Directions on Exports
- Master Directions of Imports



Remittance facilities for NRIs + Individuals

- FEM (Remittance of Assets) Regulations, 2016
- FEM (Acquisition & Transfer of Immovable Properties out of India) Regulations, 2000
- FEM (Realization, Repatriation and Surrender of Foreign Exchange) Regulations, 2015
- Master Directions on remittance facilities for NRIs
- Master Directions on Liberalized Remittance Scheme for Resident Indians
- FAQ's on RBI Website

FDI + LO/BO/PO

- FEM (Manner of Receipt & Payment) Regulations, 2016
- FEM (Non-Debt Instruments) Rules, 2019
- FEM (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019
- FEM (Establishment in India of a BO or a LO or a PO) Regulations, 2016
- FDI Policy
- FAQs given on RBI's website

Reporting and Compounding

- FEM (Compounding Proceedings) Rules, 2000
- Master Directions on Compounding
- Master Directions on Reporting under FEMA
- FAQ's on RBI Website

Borrowing or Lending Under FEMA

- FEM (Debt Instruments) Regulations, 2019
- FEM (Borrowing or Lending) Regulations, 2018
- FEM (Deposits) Regulations, 2016
- FEM (Guarantees) Regulations, 2000
- Master Directors on ECB
- FAQ's on RBI Website

OVERVIEW OF FEMA



CURRENT ACCOUNT TRANSACTIONS

- Current Account Transaction means a transaction other than a capital account transaction.
- Freely permitted unless specifically restricted*
- Powers delegated to AD Bankers
- Royalty, trade, services, foreign travel, education, medical, reimbursements etc.,

CAPITAL ACCOUNT TRANSACTIONS

- Capital account transaction means a transaction which:
  - alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India; or
  - assets or liabilities in India of persons resident outside India
- Prohibited/ restricted unless specifically permitted
- Onus on the applicant
- FDI, ODI, immovable property, loans, guarantee etc.,

* *Current account transaction rules*

Current Account - Key Issues

- Advance against export of services
- Non-trade payables and receivables
- Replacement vs. repair for EDF waiver
- Net-off of inter company debit and credit notes
- Whether LSF applicable for current account transactions
- FoC export of spare parts – EDF waiver
- FoC import in IDPMS
- Carbon credits – capital or current ?
- Subvention payment



Repair vs Replacement



X Pvt Ltd. owns and operates multiple datacenters across various states in India to provide data hosting services. X Pvt Ltd. for operation of such datacenters procures server racks which comprise of various parts and components including processors, hard disks, RAM, wiring etc. These equipment are purchased by X Pvt Ltd., from both overseas supplier (‘direct import’) and domestic suppliers (’local purchase’). Apart from the server racks

Post receipt and usage of the equipment, it may happen that some part or component of the asset is detected as a defective item or becomes faulty

Both the faulty part of the server rack and individual spare part are exported by X Pvt Ltd. to the overseas vendor, OEM and/ or foreign affiliate (‘AWS Labs’) for testing and repair purposes on returnable and non returnable basis

Key Issues:

1. Whether replacement covered under automatic route
2. Will destruction be coveted under automatic route ? Under what cases
3. Documentation support for repair, destruction, replacement ?

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OVERVIEW OF FOREIGN INVESTMENT



Foreign Direct Investment Schedule 1

- Automatic vs Approval Route
- Unlisted Indian company
- > 10% of the post issue paid up equity capital of a listed Indian company
- Sectoral conditions
- Valuation norms
- Compliances such as EMF/SMF
- Applicability of FOCC compliances
- Valuation and filings for transfer between R and FOCC
- <u>Once an FDI always an FDI</u>

Foreign Portfolio Investment Schedule 2

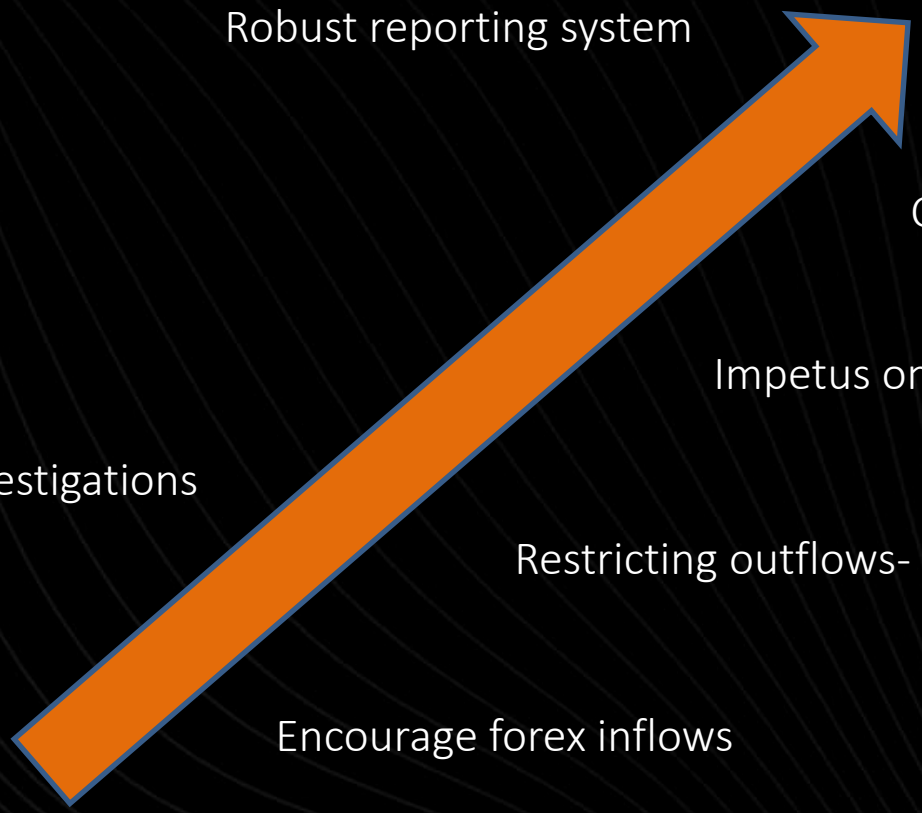
- < 10% of the post issue paid up equity capital of listed Indian company
- Sectoral conditions. Valuation and compliances
- FPI investment in non equity instruments – Schedule 1 of debt instrument regulation

Foreign Venture Capital Investment

- Debt and non debt instruments
- Specific sectors
  - ✓ *Biotechnology*
  - ✓ *Nanotechnology*
  - ✓ *Seed R&D*
  - ✓ *Dairy industry*
  - ✓ *Poultry industry*
  - ✓ *Production of bio fuels*
  - ✓ *Hotel cum convention sectors*
  - ✓ *Infrastructure*
- Valuation and compliances

* *Current account transaction rules*

DIRECTION OF RBI NORMS/ POLICIES

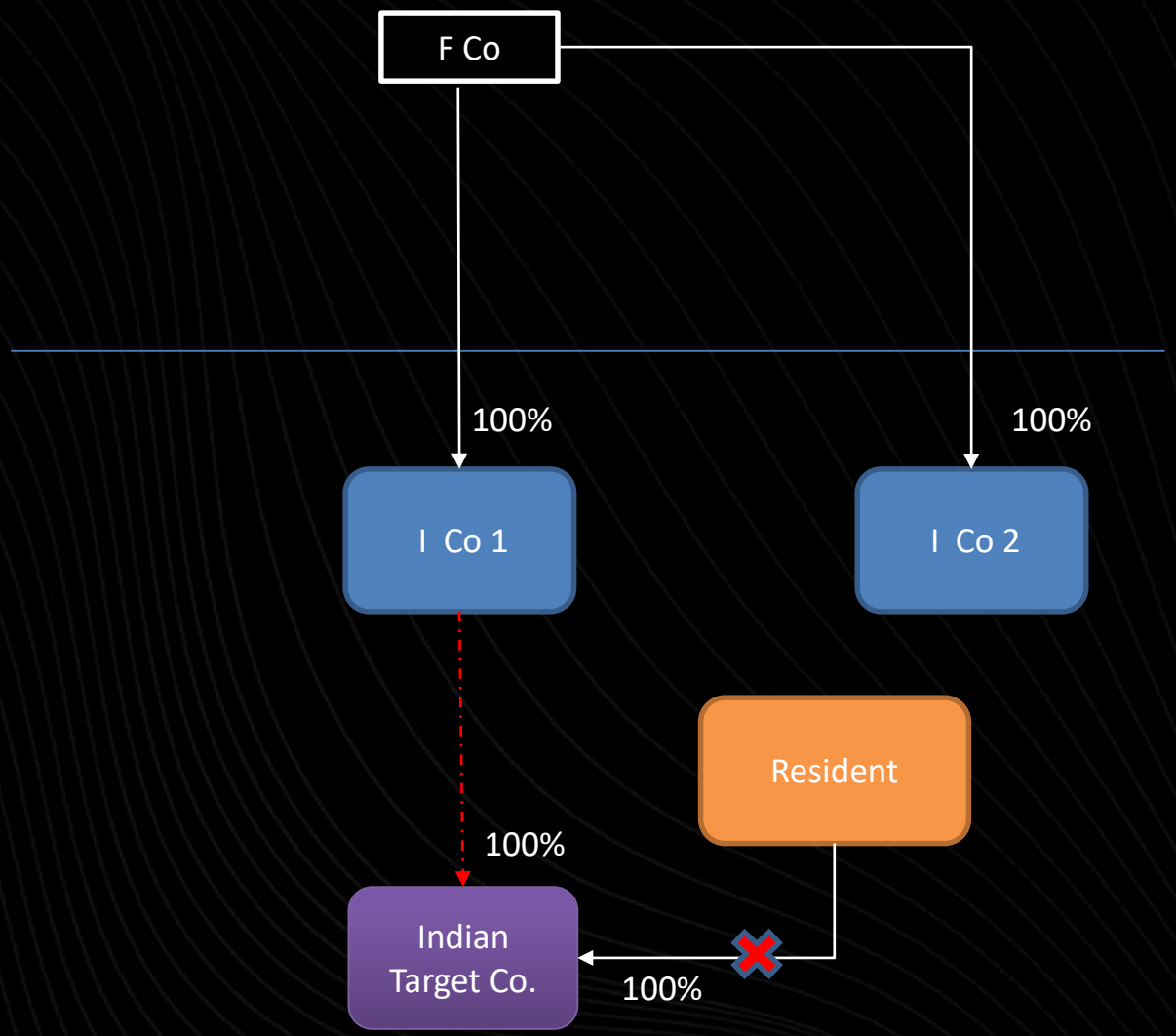


FDI- Key Issues

- Valuation applicability for transfer between FOCC to NR
- LSF for reporting delays
- FDI from Taiwan
- Deferred Consideration norms
- FCTRS compliance in case of transaction with individuals
- Downstream norms - Form DI for transfer between FOCC to FOCC
- Application for approval of FDI from China
- Pricing guidelines in case of buy back of shares
- Valuation for rights issue



Case Study – Downstream Investment



Facts:

F Co is proposing to acquire Indian Target Co. through its WOS - I Co 1 (operating company) from existing Resident Sellers

Case 1:

I Co proposes to use borrow funds from I Co 2 or raise ECB from F Co to acquire the shares of Indian Target Co.

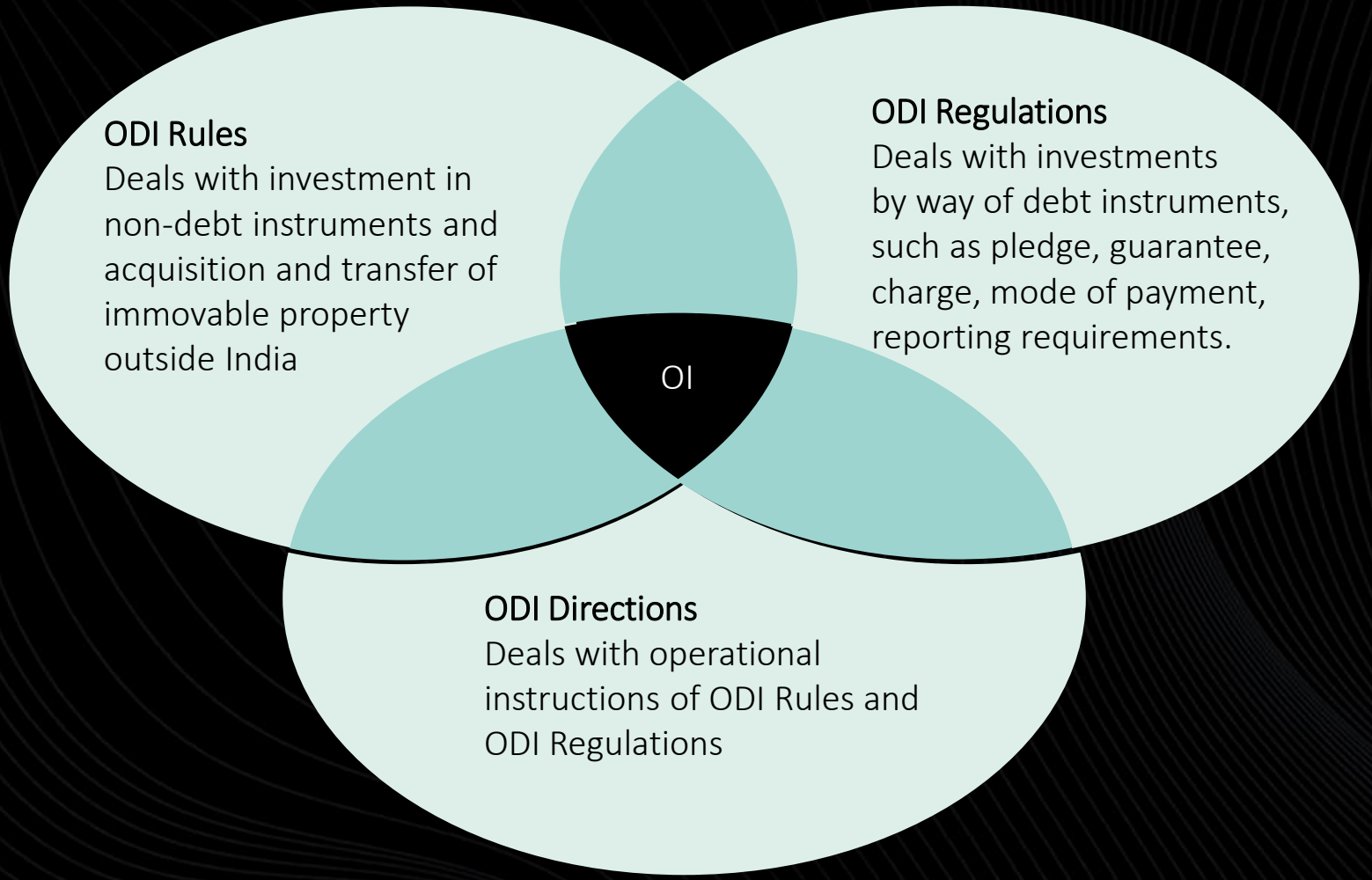
Case 2:

I Co 2 proposes to raise funds from F Co (also having FPI license) through issuance of NCDs under FPI Route / or equity instruments under FDI to acquire the shares of Indian Target Co.

Q. Whether the said acquisition is allowed under FEMA in above cases?

Broad Construct – OI Framework





Key changes brought under the new OI Framework

1. Introduction of new definitions (ODI, OPI, Control etc.) and clarity with respect to various definitions (Net-worth, Subsidiary etc.)
2. Introduction of concept of Overseas Direct Investment (“ODI”), Overseas Portfolio Investment (“OPI”) and Strategic Sector
3. Permissibility of round-trip structures (ODI-FDI) with adequate safeguards
4. Dispensing with the requirement of RBI approval for deferred consideration, guarantee for second level SDS etc.
5. Introduction of late submission fee (LSF) for delayed filings

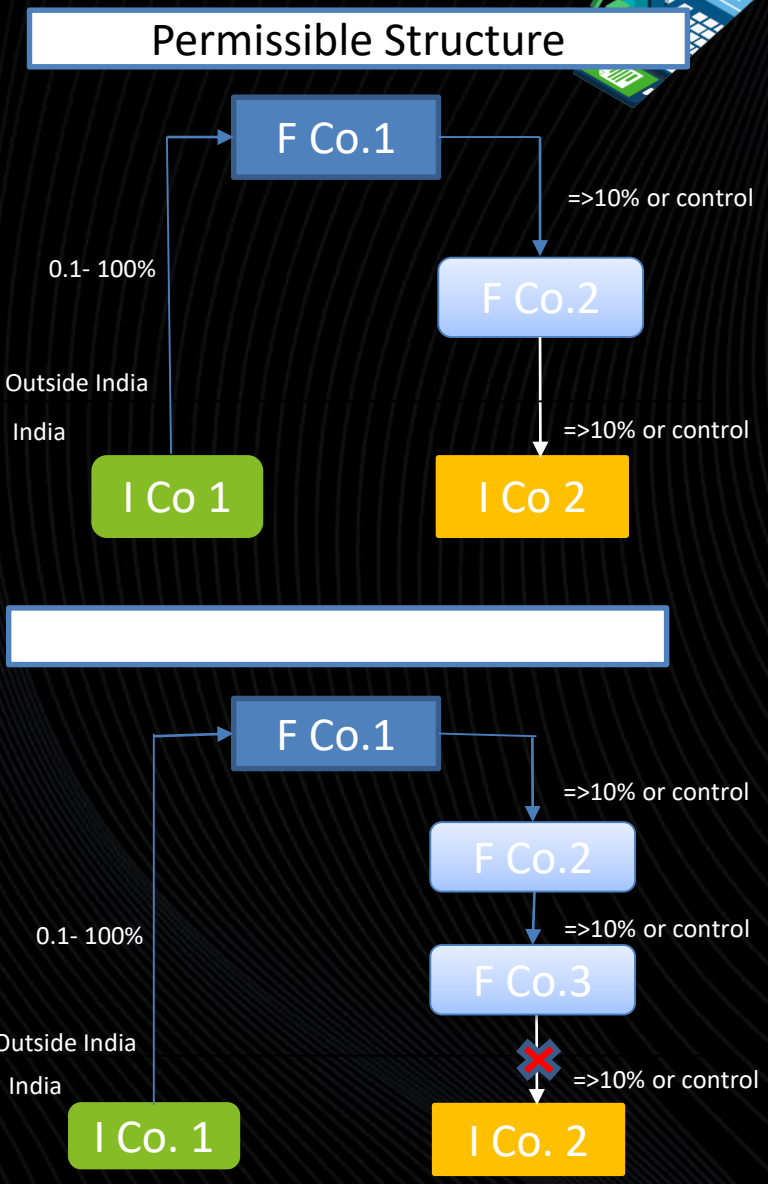
Overseas Investment - Key Issues

- Restrictions relating to layers of investments
- Analysis of transaction as ODI or OPI and permissible investments
- FDI – ODI permissible structures
- Investment in Holding Company / SPV in ODI structure
- ESOP Reporting - what will it cover
- Determining 'control' in Foreign Entity
- Bonafide business activity for a foreign Entity
- LRS vs OPI for resident individuals
- Applicability of LSF upon default of reporting of OI transactions
- Investment in units of overseas fund



Round Tripping (ODI-FDI) structures

No prior RBI approval required for ODI-FDI structures.
Under the new ODI regime, relaxation has been provided to allow such structures with the condition that the number of layers of subsidiaries do not exceed 2 layers
These restrictions are not applicable to banks, systemically important NBFCs, insurance companies and Government companies in India
Subsidiary or step-down subsidiary of a foreign entity means an entity in which the foreign entity has control.



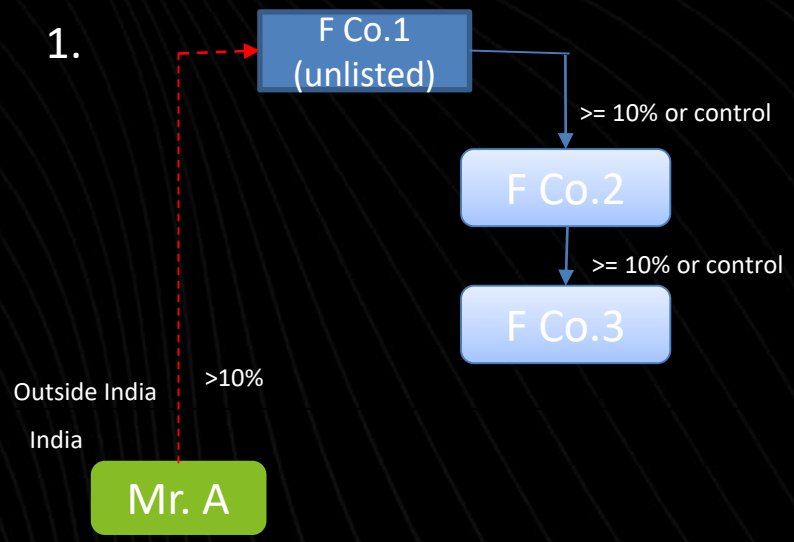
Key Issues:

1. How to identify 2 layers – Layers to be seen from the perspective of Indian level or foreign level?
2. How to determine whether foreign entity has control over investee company?
3. Can ODI funds be used by Foreign Entity for investment into India?

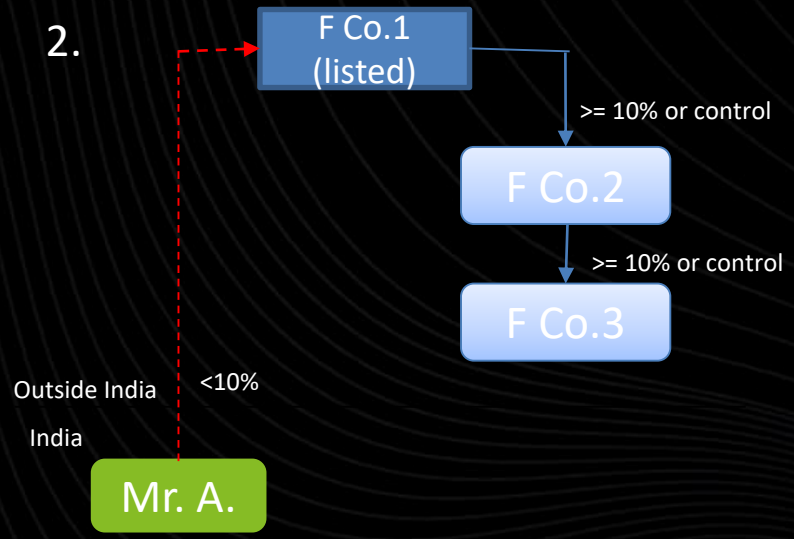
Case Study - Which of the below Investments are permissible?



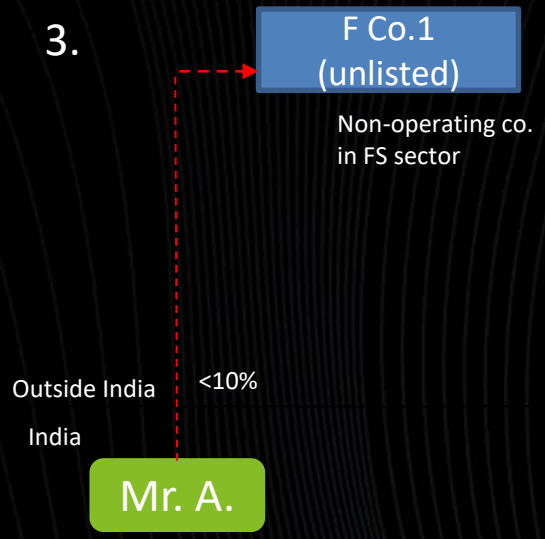
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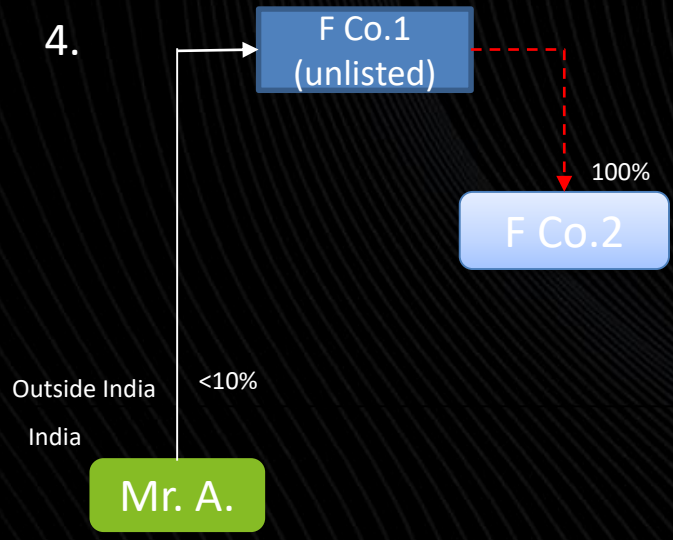
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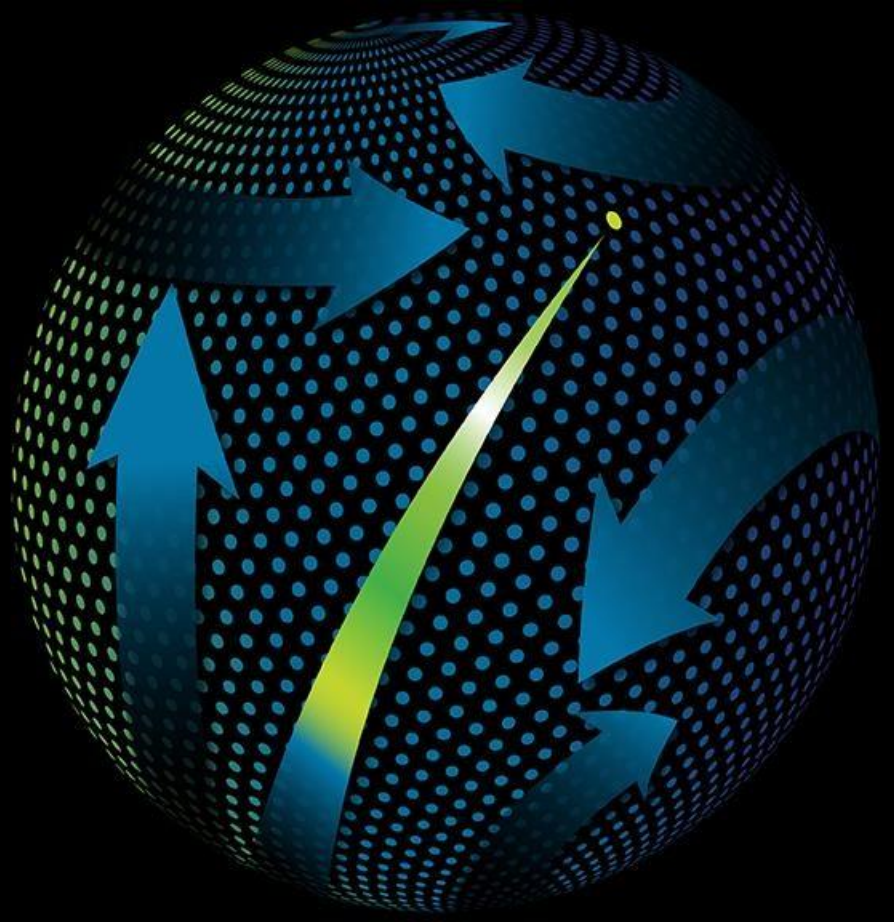


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Q & A

Deloitte.



Thank You

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