Amendments to Foreign Direct Investment Guidelines in FEMA

The Department of Industrial Policy and Promotion (DIPP) made the following changes to the Foreign Direct Investment (FDI) policy through Press Note 7 issued on 3 June 2015 and Press Note 12 issued on 24 November, 2015:

- Press Note 7 (2015) reviewed the FDI policy on investments made by Non Resident Indians (NRIs), Persons of Indian Origin (PIO) and Overseas Citizens of India (OCI). It amended the definition of an NRI and also provided that investments by NRIs under Schedule 4 of Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000 (FEMA 20) would be deemed domestic investments at par with investments made by residents.

- Press Note 12 (2015) made prominent changes to the FDI policy and thereby increased the sectoral caps, brought more activities under the automatic route, and eased the conditions under which foreign investment is permitted.

Separately, the Reserve Bank of India (RBI) issued Notification No. 355/2015-RB dated 16 November, 2015 under which it permitted foreign investments in investment vehicles [such as Real Estate Investment Trusts (REITs), Infrastructure Investment Trusts (InvITs) and Alternative Investment Funds (AIFs)] under the automatic route, subject to certain conditions.

To bring these changes into effect, vide Notification Nos. FEMA 361/2016-RB and 362/2016-RBI, the RBI made the necessary amendments to the FEMA 20. These notifications are effective from the date of their publication in the Official Gazette that is: 15 February 2016.

In the ensuing paragraphs, we have summarised the key amendments made vide these notifications:

- **Inclusion of OCI in the definition of NRI [in line with Press Note 7 (2015)]**
  
  The existing definition of an NRI [Regulation 2(viia) of FEMA 20] has been amended to include OCI cardholders. The revised definition is as follows:

  “Non-Resident Indian (NRI) means an individual resident outside India who is citizen of India or is an ‘Overseas Citizen of India’ cardholder within the meaning of section 7 (A) of the Citizenship Act, 1955”.

- **Investment by NRIs – Amendment to Regulation 5(3) of FEMA 20 [amendments made in line with Press Note 7 (2015) relating to investments by NRIs]**
  
  The existing Regulation 5(3) has been revised and now an NRI may acquire securities or units on repatriation basis under Schedule 3 and non-repatriation basis under Schedule 4.
Accordingly, revisions made to Schedule 3 and Schedule 4 are as follows:

- **Amendments to Schedule 1 of FEMA 20**
  - Specific condition mentioning that shares cannot be issued by an Indian company under Schedule 1 with a view to acquire existing shares of any other Indian company (except by way of a downstream investment) has been deleted.
  
  - With regards to swap of shares as permitted vide Press Note 12 (2015), the RBI has amended paragraph 2(4) and thereby permitted the issue of shares by way of a share swap under the automatic route provided the activity of the Indian company falls under the automatic route (the RBI has inserted clause (v)).
  
  - Consequentially, it has deleted clause (c) of paragraph 3 dealing with the issue of shares against share swaps requiring government approval.

- **Foreign investment in investment vehicles**
  
  - Besides incorporating the amendments made vide Notification no. 355/2015, the RBI has also provided that sponsors or managers or investment managers can be organized in the form of a LLP as well. Previously, LLPs were excluded from acting as sponsors or managers or investment managers of an investment vehicle.

  - A downstream investment by an investment vehicle will be regarded as a foreign investment, if either its sponsor or the manager or the investment manager is not Indian owned and controlled as defined in Regulation 14 of FEMA 20.

- NRIs are permitted to invest in securities or units (namely shares, convertible preference shares, convertible debentures and warrants of an Indian company or units in an investment vehicle) [previously shares and convertible debentures].

- Under Schedule 3, an NRI is permitted to open and maintain Non-resident External (NRE) accounts (as opposed to both the NRE and Non-resident Ordinary (NRO) accounts allowed at present). The existing NRO (PIS) accounts may be re-designated as NRO accounts.

- The limit of investment of up to 5 per cent of the paid up value of shares/convertible preference shares/convertible debentures/warrants by an individual NRI is applicable to investments on a repatriation basis only.

- NRI investment on a repatriation basis under Schedule 3 will be subject to the provisions of FDI policy and Schedule 1 of FEMA 20 with respect to sectoral caps wherever applicable.

- Under Schedule 4, NRIs, including companies, trusts and partnership firms incorporated outside India that are owned and controlled by NRIs, can invest in the securities of a company/units of an investment vehicle/contribute to the capital of a partnership firm or a proprietary concern or Limited Liability Partnership (LLP) on non-repatriation basis without any limit. Such investments would be deemed to be domestic investments at par with investments made by residents.

- The definition of ‘real estate business’ provided under Schedule 4 has been revised to incorporate the changes made vide Press Note 12 (2015). It has been clarified that the earning of income from rent on the lease of a property, not amounting to a transfer, will not amount to a ‘real estate business’. In addition to this, the RBI has excluded investments in units of REITs registered with SEBI from the definition of real estate business.
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