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Kishore Joshi and Prashant Prakhar[1]

Investments by NRIs under Schedule 4 of TISPRO Regulations

Introduction

Non-resident Indians (**"NRI"**) are a group of people who, despite being settled overseas, have been instrumental for economic development of their ancestral home i.e., India. Realising the value of their contributions, Government of India has provided special treatment to NRIs with respect to their investments in India under the extant Consolidated FDI Policy of 2017 (**"FDI Policy"**) and the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 (**"TISPRO Regulations"**) issued by the Reserve Bank of India (**"RBI"**), without losing their status and benefits available as 'non-residents'.

TISPRO Regulations allow NRI investors to invest in India, either on repatriation basis or non-repatriation basis. Investments made on repatriation basis are such investments, sale/maturity proceeds (net of taxes) of which are eligible of being fully repatriated outside India.[2] However, such investments are subject to conditions, as prescribed under Schedule 1 of the TISPRO Regulations, similar to that applicable to any non- resident investor. On the other hand, investments made by NRIs on non-repatriation basis, as prescribed under Schedule 4 of the TISPRO Regulations, cannot be repatriated outside India and hence, such investments are also deemed to be domestic investment at par with the investments made by resident investors.[3]

Definition of NRI

Over the years, the definition of NRI under Foreign Exchange Management Act, 1999 and rules and regulation issued thereunder (**"FEMA"**) has undergone several changes to accommodate evolving definition of Overseas Citizen of India (**"OCI"**) and Person of Indian Origin (**"PIO"**) within its scope. For the purposes of making investments into India, NRIs were originally defined under the Foreign Exchange Management (Deposit) Regulations, 2000

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2 Para 2.13 of the Master Directions – Foreign Investment in India dated January 4, 2018 (updated as on April 6, 2018), available at https://rbi.org.in/scripts/BS_ViewMasDirections.aspx?id=11200

3 Para 3 (ii) of the Press Note 7 (2015 Series)

(**"Deposit Regulations"**) to include a person resident outside India who is a citizen of India or a person of Indian origin.[4] Subsequently, in 2015 the Citizenship Act, 1955 and extant Consolidated Foreign Direct Investment Policy of 2015 were amended to merge the category of PIO cardholder with the category of OCI cardholder.

PIOs are citizens of any country (other than Pakistan, Afghanistan Bangladesh, China, Iran, Bhutan, Sri Lanka and Nepal) who held an Indian passport at any time or who are children or grand-children of an individual who was a citizen of India (after the Constitution of India came into force) or who is a spouse of an Indian citizen or a PIO.[5] PIO cardholders registered as such under Notification No. 26011/4/98 F.I. dated 19.8.2002 issued by the Central Government are now deemed to be 'Overseas Citizen of India' cardholders.

OCI cardholder is a person registered as such by the Central Government under Section 7 (A) of the Citizenship Act, 1955 and includes citizen of any country (other than Pakistan or Bangladesh) who was eligible to become a citizen of India at the time of commencement of the Constitution of India, or was a citizen of India on or any time after the commencement of the Constitution or belonged to a territory that became part of India after August 15, 1947.[6]

Currently, TISPRO Regulations define both the terms (i.e. NRI and OCI) separately to include any individual resident outside India who is a citizen of India, and an individual resident outside India who is registered as an OCI cardholder under Section 7(A) of the Citizenship Act, 1955, respectively.[7] However, for the purposes of the FDI Policy, the term NRI is broad enough to also include the OCI cardholders (including erstwhile PIO cardholders) beside an individual resident outside India who is a citizen of India.[8]

Investments on non-repatriation basis

Under Schedule 4 of the TISPRO Regulations, an NRI or OCI can invest, on non-repatriation basis, in:

(a) the capital instruments (i.e., equity shares, compulsorily convertible debentures, compulsorily convertible preference shares and share warrants) (**"Capital Instruments"**) of an Indian company, without any limit, either on the stock exchange or outside it;

(b) units issued by an investment vehicle (i.e. AIF, REIT or InvIT), without any limit, either on the stock exchange or outside it;

(c) the capital of a limited liability partnership, without any limit; and

(d) convertible notes issued by a start-up company.

In addition to the above, an NRI or OCI is also allowed to invest, by way of contribution to the capital of a firm or a proprietary concern in India.

Further, NRIs or OCIs are now also allowed to make above-said investments, through the companies, trusts or partnership firms that are incorporated outside India and are owned and controlled by NRIs or OCIs.

4 Regulation 2(vi) of Foreign Exchange Management (Deposit) Regulations, 2000 dated May 3, 2000 available at https://rbi.org.in/Scripts/BS_FemaNotifications.aspx?Id=159

5 Ministry of External Affairs, PIO/OCI Card, available at https://www.mea.gov.in/Portal/CountryQuickLink/703_PIO- OCI.pdf

6 Id

7 Regulation 2 (XXXV) and 2 (XXXVI) of Foreign Exchange management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017

8 Para 2.1.32 of the Consolidated Foreign Direct Investment Policy of 2017 (w.e.f. August 28, 2017)

Prohibition on investments under Schedule 4 of TISPRO Regulations

NRIs or OCIs are, however, prohibited to invest in the Capital Instruments or units of a Nidhi company or a company engaged in agricultural/ plantation activities or real estate business or construction of farm houses or dealing in Transfer of Development Rights.

Further, NRIs and OCIs are also prohibited from making investments by way of capital contribution to a firm or a proprietary concern which is engaged in any agricultural/ plantation activity or print media or real estate business.

Benefits available on investments under Schedule 4 of TISPRO Regulations

Schedule 1 of the TISPRO Regulations permit any non-resident investor, including a NRI or a OCI, to invest into the capital instruments of Indian companies on a repatriation basis, subject to certain terms and conditions and filings as prescribed by the RBI. As against this, Schedule 4 of the TISPRO Regulations allows NRIs or OCIs to make investments, on a non-repatriation basis, without any such conditions or filings.

Thus, an NRI or OCI (or the entities owned and controlled by them) can make investment in any sector (except a few, as given herein below), and that too, without any limit, either in a company listed on the stock exchange or a private company. This benefit is available to NRIs or OCIs, primarily because such investment on non-repatriation basis is treated as domestic investment at par with the investment made by a resident Indian.

Additionally, for investments in the capital instruments of an Indian company under Schedule 4 of TISPRO Regulations, no filings of Form FC-GPR or any similar reporting is required. This gives a huge relief to not only the NRI or OCI investor but, to the Indian investee company as well, considering it saves great amount of time and efforts in creating / managing number of documents.

This route has also benefited the Indian economy, as the NRIs or OCIs have been using their monies in their Indian bank accounts, to invest into Indian assets (i.e., capital instruments, debt instruments, real estate, MFs, etc.), instead of repatriating it out of India.

Mode of Investment under Schedule 4 of TISPRO Regulations

The amount of consideration in case of NRI investments on non-repatriation basis may either be paid directly through inward remittance from abroad (through proper banking channels) or out of funds held in Non-Resident External (NRE) / Foreign Currency Non-Resident (Bank) (FCNR(B)) / Non-Resident Ordinary (NRO) account maintained in accordance with the Deposit Regulations.

However, the sale/ maturity proceeds (net of applicable taxes) of such investments shall be credited only to the NRO account of the NRI investor, irrespective of the type of account from which the consideration was paid. Further, the capital appreciation on such investments are also not allowed to be repatriated abroad. However, dividend and interest income will be freely allowed to be repatriated, being of current account in nature.

a) Non-Resident External Account: It is a rupee account that only NRIs (including OCIs) are permitted to open and maintain with the authorised dealers and with banks (including co-operative banks) authorised by Reserve Bank of India (**"RBI"**) to maintain such accounts. These accounts may be maintained in any form viz. savings, current, recurring or fixed deposit account. Credits permitted to this account as inward remittances are: a) interest accruing on the account or on the investment; b) transfer from other NRE/FCNR(B) accounts; and c) maturity

proceeds if such investments were made from this account or through inward remittance. The debits allowed from this account are local disbursements, transfer to other NRE/FCNR(B) and investments in India.

b) Foreign Currency Non-Resident (Bank) (FCNR(B)): It is an account maintained only by NRIs (including OCI) in foreign exchange with the authorised dealers and banks authorised by the RBI to maintain such accounts. These accounts can be maintained only in the form of fixed deposits and the conditions related to debit and credit to such accounts shall be same as applicable on the NRE accounts.

c) Non-Resident Ordinary (NRO): These accounts may be maintained by any person resident outside India with an authorised dealer or an authorised bank for the purpose of putting through *bona fide* transaction denominated in Indian rupees. Credits permitted in NRO account are inward remittances from outside India, legitimate dues in India, transfers from other NRO accounts and gift/loan made by a resident to an NRI (including OCI) in Indian rupees. Debits allowed from the NRO account are local payments, transfer to other NRO accounts, remittance of current income abroad or remittance of USD 1 million per financial year (April – March), for all *bona fide* purposes, to the satisfaction of the authorised dealer bank (**"AD Bank"**).

In case of inward remittance received from abroad, upon receipt of such investment amount, the relevant AD Bank seeks a declaration from the investee company as to whether the investor is an NRI or OCI or a company, trust or partnership firm owned and controlled by an NRI or OCI and whether such investment is on a repatriation basis or non-repatriation basis. Based on the declaration given by the investee company, the investment is recorded as on repatriation or on non-repatriation basis and is accordingly processed.

Issues pertaining to investments by NRIs or OCIs (or entities owned and controlled) on non-repatriation basis

NRI investment on non-repatriation basis has often been subject to ambiguities due to its equivocal nature. Prior to Press Note 7 (2015 Series), there had been some ambiguities around whether such investments are subject to the sectoral limits prescribed under the FDI Policy, pricing guidelines prescribed by the RBI or cap on coupon rates (in case of compulsorily convertible debentures), as applicable in case of ordinary foreign direct investment (**"FDI"**) in India by non-residents, including investments by NRIs, on repatriation basis. It was through Press Note 7 (2015 Series) that the Government clarified that all investments by NRIs on non-repatriation basis shall be deemed to be domestic investment at par with the investment made by resident investor and hence, such investment may not be subject to any limits and conditions such as lock-in or minimum capitalization requirements or valuation norms, applicable on other FDI investments.

Subsequently, when the definition of NRI was broadened through Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) (Amendment) Regulations, 2016 to further extend to the companies, trusts, partnership firms that are incorporated outside India and are owned and controlled by NRIs or OCIs, it led to another ambiguity as to when such entities should be regarded as an entity owned and controlled by the NRIs or OCIs. Considering that no specific definition of the phrase 'owned and controlled' has been prescribed in this context, if we were to rely on its meaning within Regulation 14 of the TISPRO Regulation, then any company, trust or partnership firm with 51% of the capital instruments or capital contribution, as the case may be, or the right to appoint majority of the

directors or designated partners, as the case may be, or the right to control the management or policy decisions, in the hands of an NRI or OCI and remaining 49% in the hands of other non-residents, would be regarded as an entity owned by a NRI or OCI and can avail all benefits available to an NRI or OCI investing in India on non-repatriation basis.

Another consequence of the above said broad definition of NRI and OCI under Schedule 4 of the TISPRO Regulations is the challenges faced by the authorised dealers or AD Banks responsible for opening NRO accounts, which as per the Deposit Regulations may be maintained by any 'person resident outside India', however, the RBI has generally been conservative about allowing incorporated entities to maintain such NRO accounts. As mentioned above, the sale / maturity proceeds (net of applicable taxes) of all non-repatriable investments has to be credited only to the NRO account of the relevant NRI or OCI investor, irrespective of the type of account from which the consideration was paid. In which case, RBI should make necessary amendments to Deposit Regulations allowing entities owned and controlled by NRIs or OCIs to be able to maintain NRO account with the authorised dealer or AD Bank.

One more hurdle of investing through companies, trusts or partnership firms owned and controlled by NRIs or OCIs, is that currently only NRIs or OCIs are allowed, under the Foreign Exchange Management (Repatriation of Assets) Regulations, 2016, to repatriate out of India, an amount up to USD 1,000,000 (US dollars one million only) per financial year. Hence, even though the investment by NRIs or OCIs under Schedule 4 of TISPRO Regulations was on a non-repatriation basis, they can repatriate up to USD 1,000,000, out of the sale proceeds that get credited in their NRO accounts. This repatriation facility is currently not available, if the investment under Schedule 4 of TISPRO Regulations is made through companies, trusts or partnership firms.

Prior to November 7, 2017, Schedule 4 of the old Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 (**"Old TISPRO Regulations"**) allowed an NRI to acquire, on non-repatriation basis, any 'security' issued by a company without any limit either on the stock exchange or outside of it beside investing in the Capital Instrument and units of an investment vehicle. Thus, the Old TISPRO Regulations provided for an option to NRIs to invest in any 'security' in debt instruments, on non-repatriation basis. However, under Schedule 4 of the TISPRO Regulations, an NRI or OCI is allowed to invest on non-repatriation basis only in Capital Instruments or units of an investment vehicle or convertibles notes issued by start-ups or contribution to capital of a limited liability partnership or a firm or proprietary concern. Due to this shift in position of law in the TISPRO Regulations, an NRI can no longer invest in debt instruments, on non-repatriation basis, except in very few listed debt instruments provided in Schedule 5 of the TISPRO Regulations.

Further, investment by NRIs in Non-Convertible Debentures (**"NCDs"**) is allowed under the Foreign Exchange Management (Borrowing and lending in rupees) Regulations, 2000 but, is subject to cumbersome conditions such as NCDs have to be listed, its redemption period must not be less than three years etc.

Since investment on non-repatriation basis is treated at par with domestic investment, the RBI should also consider allowing NRIs or OCIs to investment in debt instruments such as NCDs, without any conditions.

Transfer of shares held on non-repatriation basis

An NRI or an OCI holding Capital Instruments of an Indian company or units of an investment vehicle on non-repatriation basis, may transfer the same by way of sale, either (i) to any person resident outside India who would hold it on repatriation basis, subject to fulfilment of all

conditionalities and reporting requirements prescribed under Schedule 1, or (ii) to another NRO / OCI acquiring such investment on non-repatriation basis.

Further, an NRI or an OCI holding Capital Instruments of an Indian company or units of an investment vehicle on non-repatriation basis, may also transfer the same by way of gift to another NRI or OCI without any prior approval of the RBI, provided that donee shall hold it on non-repatriation basis.

However, in case of transfer by way of gift to a person resident outside India, prior approval of the RBI would be required subject to following conditions:

a) the donee is eligible to hold such a security under relevant schedules of these TISPRO Regulations;

b) the gift does not exceed 5 per cent (on cumulative basis) of the paid up capital of the Indian company/each series of debentures/each mutual fund scheme;

c) the applicable sectoral cap on the Indian company is not breached;

d) the donor and the donee are 'relatives' within the meaning in Section 2(77) of the Companies Act, 2013; and

e) the value of security to be transferred by the donor together with any security transferred to any person residing outside India as gift during the financial year does not exceed the rupee equivalent of US $ 50,000.

Reporting Requirements

NRIs or OCIs are not required to file Advance Remittance Form or Form FC-GPR (at the time of making investment into an Indian company) in respect of their investment under Schedule 4 of TISPRO Regulations on non-repatriation basis.

However, considering that such an investment is regarded as a domestic investment at par with an Indian investor, any transfer of the Capital Instruments held on a non-repatriation basis, to a person resident outside India holding such capital instruments on a repatriation basis, has to be reported by filing form FC-TRS. The obligation of reporting of the said transfer to the AD Bank would be on the NRI or OCI, and has to be done within 60 days of transfer of Capital Instruments or receipt / remittance of funds, whichever is earlier.

Conclusion

Special treatment to the NRIs or OCIs investing on non-repatriation basis in accordance with Schedule 4 of the TISPRO Regulations allows such NRIs and OCIs to ring-fence their investments in India and to have the flexibility to invest through different commercially viable structures. Alongside, such investments also provide the much needed leverage for Indian economy to meet its five-year plan. NRIs or OCIs investing on non-repatriation basis should ensure that their investment is rightly recorded in the books of the company and all filings by the investee company thereafter with any regulator is consistent with the records of the company. An error in case of recording of such investment may result in NRI or OCI being deprived of the privileges available to them in case of investment on non-repatriation basis and in some case it may even be subjected to penalties depending on the nature of contraventions.

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