Cross-Border Transaction: Factors to Consider
written by Aravindh | November 7, 2022

Do you want to invest in a foreign country but are having a difficult time deciding how to?

In the era of strong globalization and the kind of global economy that we live in, businesses at an international level, collaborations with foreign companies, etc. are very common. The primary way of collaborating in such a way is cross-border investment. Before understanding cross-border investment, it is important to understand what is cross-border transaction. A cross-border transaction is essentially any transfer of property, goods, or services between individuals or organisations residing in separate nations.

Following the pandemic, FDI saw a global surge of 88% in 2021.[1] US has been the top FDI destination, followed by China, Canada, and Brazil.[2] India's position in the UNCTAD World Investment Report 2022 has improved to No. 7. The FDI equity inflows of India by country in the Financial Year 2021 are as follows[3]:

It is evident that such cross-border transaction & transfers will play a significant role in the growth of India's economy despite the factors of protectionism, the Russia-Ukraine crisis, etc. However, certain aspects must be kept in mind while investing in foreign countries. This Article will elaborate upon the factors to be considered for cross-border transaction, with specific reference to India, in the following manner:

- Types of companies attracting FDI in India and the most active sectors.
- Factors to consider for investing in India
- Procedures related to Foreign Investment in India

The Most Active Sectors and the Types of Companies Attracting FDI in India

Since the economic liberalization of the country, several sectors have opened partially or wholly for foreign investment. The top 5 sectors receiving FDI

Equity Inflow in 2021-22, in order, are Computer Software & Hardware, Services Sector, Automobile Industry, Trading, and Construction (Infrastructure) Activities.[4]

FDI in both public and private companies is the most popular form of foreign investment. The foreign investor, under the Companies Act, 2013, can register as:

- Wholly-Owned Subsidiary: 100% ownership of the company by a foreign entity in India. Example: Facebook India.
- Subsidiary: Majority stake owned by the foreign investor. Example: Hindustan Unilever Ltd.
- Joint Venture: A collaboration between an Indian and a foreign corporate entity with the majority stake held by the Indian entity. The minimum required ratio is 51:49. Example: Arvind OG Pvt. Ltd.
- Associate Company: Minority stake held by the foreign investor. Example: ArvindOG Pvt. Ltd.
- Extension of Foreign Entity: This can be done through liaison, branch, or project offices.

Factors to Consider for Investing in India

According to the Reserve Bank of India (RBI), FDI refers to investment through capital instruments by a person residing outside India either:

- In an unlisted Indian company; or
- In a listed Indian company in 10 percent or more of the post issue paid-up equity capital on a fully diluted basis.

The following factors must be considered before indulging in any cross-border transaction with India.

Eligible Investors

A non-resident entity is allowed to invest in India as per the FDI Policy except in the prohibited sectors. However, any entity in any bordering country can only invest via the Government route. Companies, trusts, and partnerships incorporated outside of India and owned and controlled by NRIs can invest in India under the FDI Policy’s special dispensation for NRIs.

Eligible Investee Entities

Indian companies are allowed to issue capital against FDI.

1. Partnership/ Proprietary Concern: NRIs can invest in such entities on a non-repatriation basisif the amount is invested by inward remittance or from accounts maintained with Authorized Dealers, and if the firm is not engaged in agricultural, real estate or print media sector. For investments with the option of repatriation, NRI’s need to seek prior permission of RBI.Non-residents who are not NRIs need to seek approval of RBI for investing.
2. Trusts: A foreigner cannot invest in Trusts other than ‘VCF’ registered and SEBI regulated and Investment vehicles.
3. Limited Liability Partnerships (LLPs): Foreign Investment in LLPs can be done via the automatic route, even upto 100% FDI. An Indian LLP with foreign investment can also make a downstream investment in another entity. Conversion of such an LLP into company is also allowed under the automatic route and vice-versa. All this is subject to the compliance with the provisions of the LLP Act, 2008.
4. Investment Vehicle: Foreign Investment can be made in an investment vehicle registered and regulated by SEBI regulations subject to compliance with Schedule VIII of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (FEMR).

5. Start-up companies: Investment can also be made in start-up companies in accordance with Schedule VII of FEMR. Start-ups are also allowed to issue convertible notes to foreigners.

Entry Routes for Investment

There are primarily two entry routes for FDI in India: Automatic Route and Government Approval Route.

- Automatic Route: Under this route, the foreigner investing company or the Indian company do not require any Government approval for the investment. This is applicable to sectors and activities such as animal husbandry, mining, petroleum, manufacturing, broadcasting, defence, print media, civil aviation, construction, satellites, telecommunications, pharmaceutical, financial services etc., as under Regulation 16 of the FEMA 20 (R). In some sectors, there are specific conditions, such as automatic investment allowed till 49% and government approval required after that, such as in the sector of defence.
- Government Approval Route: All activities or sectors which are not covered under the automatic route require approval of the Government of India for FDI. This is applicable in situations when an Indian company is being established with foreign investment is not owned or controlled by a resident entity, when such ownership or control is undergoing a cross- border transfer, and so on. Another situation requires all neighbouring countries of India to obtain government approval for FDI.

Caps and Entry Conditions on Investment

For entities in certain sectors, there are specific caps, which mean that foreign investment can only be made to the extent of a specific percentage of the total capital. Generally, for the entities in which investment can be made via automatic route, the cap is 100%. However, there are certain exceptions such as 49% cap in petroleum, 74% cap in defence for automatic route, and specific caps in broadcasting and print media.

In certain sectors or activities, there also exist specific entry conditions such as minimum capitalization, lock-in period etc. which need to be considered before investing in an Indian entity.

Regulatory Compliance

The FEMA, 1999 lays down rules pertaining to capital account transactions excluding debt instruments. The Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (NDI Rules) were drawn in supersession of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017,[5] and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018[6].

By virtue of Section 47 of FEMA and the consequent NDI Rules, the RBI issued Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 (FEMA 395)[7] which pertain to mode of payment and reporting requirements for investment in India by a person resident outside India.

Procedures related to Foreign Investment in India

Foreign Investment in India can be done by establishing a business entity or by investing via shares and capital in Indian entities. For both these scenarios, certain procedures must be followed, for which investors must take aid from transaction advisors.

Procedure to be followed under the Government Approval Route for FDI
The transaction advisors would guide the investor to adhere to the following procedure to indulge in FDI under the approval route.
Step1: Arranging the Documents
Several documents such as the Certificate of Incorporation, Memorandum of Association, Board Resolution, Audited Financial Statement, Article of Association, Names and Addresses of all foreign collaborators, Affidavit, Valuation Certificate, Standard Operating Procedure Form, and so on, must be arranged.
Step 2: Filing the Application
The Investor is then required to file an application with the Department for Promotion of Industry and Internal Trade (DPIIT) in accordance with the prescribed norms.
Step 3: Submitting the Documents
The documents arranged must be submitted to DPIIT with the filing of the application.The application for approval has to be presented before the concerned Administrative Ministry/ Department which is also responsible for the post factor approval for foreign investment.[8]
Step 4: Scrutiny of Application and Documents
The Competent Authorities as per the Standard Operating Procedure (SOP)[9]laid down by the DPIIT checks the adequacy and accuracy of the application and the documents submitted. This is then forwarded to RBI for check compliance, followed by the Ministry of Home Affairs and External Affairs for security clearances. When the total foreign equity inflow exceeds 5000 crores, the application is placed before the Cabinet Committee on Economic Affairs (CCEA).
Step 5: Sanction
Following these steps, the investor obtains the sanction from the Government to proceed with FDI.
Conclusion
India is an attractive destination for foreign investments because of the conducive government policies, the rising young population, the technological skillset of the labour force, cheap labour etc. The government has constantly undertaken several initiatives to boost FDI in India such as by streamlining the tax regime, liberalising the policies, encouraging technological innovations etc. The boost is evident from the FDI equity inflow of India in the past year.
Cross-border transaction are primary drivers of India’s economic growth. In addition, such cross-border transfers are also a crucial source of non-debt finance for the nation’s economic development. Therefore, it is imperative to ensure a robust and accessible FDI regime.
FAQs
What are the factors that attract FDI to India?
Factors attracting FDI to India include:
1. Conducive and beneficial government policies
2. Trade Policies (Tariff and Non-Tariff Barriers)
3. Treatment standards of foreign affiliates
4. Streamlined tax regime
5. Cheap labour and the technological skill-set of the labour force
What are the five factors affecting FDI?
Five factors affecting FDI include:

1. Eligibility of Investors
2. Eligibility of Investee Entities
3. Entry Routes for Investment
4. Conditions on caps for Investment
5. Entry conditions for Investment

What are the steps taken by the Government to attract foreign investment in India?

Some of the steps taken by the government include:

1. Production-linked Incentive scheme for electronics manufacturing.
2. Amendment of FDI Policy to permit 100% FDI under automatic route in coal mining activities and several other activities.
3. Introduction of the Foreign Investment Facilitation Portal to facilitate FDI.
4. Permitting foreign investment in valuable sectors such as defence manufacturing.

What are the regulations that govern different investment vehicles?

1. Real Estate Investment Trusts (REITs) governed by the SEBI (REITs) Regulations, 2014
2. Infrastructure Investment Trusts (InvIts) governed by the SEBI (InvIts) Regulations,
2014,
3. Alternative Investment Funds (AIFs) governed by the SEBI (AIFs) Regulations, 2012

The above are allowed to accept foreign investment from a person residing outside India (other than a citizen of or any entity registered or incorporated in Pakistan or Bangladesh)subject to Schedule VIII of the Foreign Exchange Management (Non Debt Instruments) Rules, 2019.

What regulations should start-ups follow to raise capital?

Start-ups can issue equity or equity-linked instruments or debt instruments to FVCIagainst receipt of foreign remittance, as per the Schedule VII of Foreign ExchangeManagement (Non-Debt Instruments) Rules, 2019.

[1] https://www.oecd.org/investment/mne/investmentnews.htm.
[2] https://www.oecd.org/investment/mne/investmentnews.htm.
[3] https://pib.gov.in/PressReleasePage.aspx?PRID=1845719.
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https://dpiit.gov.in/sites/default/files/FDI-PolicyCircular-2020-29October2020.pdf, page 25.
[9] https://fifp.gov.in/Forms/SOP.pdf