An analytical study of Outward remittances under the Liberalized Remittance Scheme (LRS)

And

India's Overseas Direct Investments (ODI) through the automatic approval route.

***Sayantani Banerjee**

*Bharathiar University, Research and Development Centre

Abstract:

The LRS (Liberalised Remittance Scheme) allows a resident individual to currently remit up to USD 250000 per financial year for any permissible current or capital account transaction or a combination of both. Outward remittances therefore bear direct relation with limits as per the LRS. This paper attempts to analyze the heads under which outward remittances have taken place over the past five years using secondary data and the pattern of change in remittances. It is found that outward remittances under the LRS have shown enormous increase in the area of travel, maintenance of close relatives and studies abroad in the past year which remains partly unexplained. At the same time investments outside India have declined which could be triggered by demonetization and the difficulty in channelizing unaccounted money to business ventures abroad. A resident Indian can also remit up to the limit prescribed by the Reserve Bank from time to time, per financial year under the Liberalized Remittance Scheme (LRS), for permitted current and capital account transactions including purchase of securities and also setting up/acquisition of JV/WOS (Joint Venture/Wholly owned subsidiary) overseas with effect from August 5, 2013 (vide RBI Notification No. 263). Also, an Indian party can currently invest up to 400 % of its net worth in JV/WOS for activities permitted in the host country through the Automatic Route, thus giving rise to increased opportunities for entrepreneurship outside the boundaries of the country.

KEYWORDS: Automatic route, Liberalised Remittance Scheme (LRS), Outward Remittances.

Introduction:

In India, any money which is send overseas is subject to controls, as the excessive outflows of foreign exchange may drain government reserves and result in destabilizing the rupee. At the same time there has been an effort to gradually liberalize these controls. While India continues to maintain controls on most types of capital outflows for prudential reasons, it has been steadily liberalising overseas investments by Indian companies. The window that was opened up in 2004 for individuals to remit money across the border, without seeking specific approvals, was called the Liberalised Remittance Scheme (LRS). Under this Scheme, Authorized Dealers (Banks dealing in foreign exchange) freely allow remittances by resident individuals currently up to USD 250,000 per financial year (April-March) for any permitted current or capital account transactions or a combination of both. Accordingly, while net FDI inflows have risen steadily in India since the initiation of reforms in 1991, gross outflows since 2000 have largely kept pace with gross FDI inflows (Ramkishen S.Rajan, 2009). In other words, while India has become a far more attractive destination for FDI, the country is also becoming a significant source of outflows as many Indian enterprises view outward investments as an important dimension of their corporate strategies The LRS facility is available to all resident individuals including minors. Remittances are permitted for overseas education, travel, medical treatment, apart from maintenance of relatives living abroad, gifting and donations. Individuals can also open, maintain and hold foreign currency accounts with overseas banks for carrying out transactions. In addition the scheme allows an individual to make investment abroad – acquire shares or debt instruments of both listed and unlisted overseas company; acquire ESOP's; Invest in units of Mutual Funds, Venture Capital Funds, unrated debt securities, promissory notes without prior approval of the Reserve Bank. More importantly, a resident Indian can set up wholly owned subsidiaries and joint ventures abroad subject to terms and conditions stipulated in RBI's Notification No. FEMA.263/RB-2013 dated 5 March 2013. However, the rules do not allow remittances for trading on the foreign exchange markets, margin or margin calls to overseas exchanges and counterparties and the purchase of Foreign Currency Convertible Bonds issued by Indian companies abroad. The permissible capital account transactions by an individual under LRS are:

i. opening of foreign currency account abroad with a bank;

ii. purchase of property abroad;

iii. making investments abroad- acquisition and holding shares of both listed and unlisted overseas company or debt instruments; acquisition of ESOPs (the Scheme is in addition to acquisition of ESOPs linked to ADR / GDR and acquisition of qualification shares); investment in units of Mutual Funds, Venture Capital Funds, unrated debt securities, promissory notes;

iv. setting up Wholly Owned Subsidiaries and Joint Ventures (with effect from August 05, 2013) outside India for bonafide business subject to the terms & conditions stipulated in Notification No FEMA.263/ RB-2013 dated March 5, 2013;

v. Extending loans including loans in Indian Rupees to Non-resident Indians (NRIs) who are relatives as defined in Companies Act, 1956.

The LRS limit has been revised in stages consistent with prevailing macro and micro economic conditions in the financial environment. The limit has generally shown an increasing trend except for circumstances when the government deemed necessary to control currency outflow. During the period from February 4, 2004 till date, the LRS limit has been revised as under:

Table 1: Revision of limits under Liberalised Remittance Scheme

Date	Feb 4, 2004	Dec 20, 2006	May 8, 2007	Sep 26, 2007	Aug 14, 2013	Jun 3, 2014	May 26, 2015
LRS limit (USD)	25,000	50,000	1,00,000	2,00,000	75,000	1,25,000	2,50,000

Source: RBI Database

Outward remittances under LRS:

The outward remittances under LRS are recorded under ten heads by the RBI. Till 2014-15 the remittances under investment in debt/equity and gifts comprised a large share of the total remittances. Any gift is credited in the NRO account of the NRI/PIO close relative. Any legal asset(s) - listed/unlisted shares, ESOPs, units of mutual funds, venture funds, unrated debt securities, promissory notes, paintings and works of arts - can be bought under LRS. Even a loan abroad taken by a resident Indian when he was an NRI could be repaid under the LRS. Real estate can also be purchased either outright or in installments. Resident individual investors can also retain and reinvest the income earned on investments made under the LRS. So, it is not mandatory to repatriate back to India the funds generated out of the overseas investments. Over the years, funds sent for studies abroad have also shown an increasing trend. However with the revision of the limit under LRS with effect from May 26, 2015 the entire pattern of remittances has shown a complete new trend with gift taking a back seat and a lot being sent on account of travel and maintenance of close relatives. Following table shows the remittances for various purposes under the LRS:

Table 2: Outward remittances under different heads

Year	Deposits	Purchase of immovable property	Investment in Equity /Debt	Gift	Donation
2011-12	26.60	62.20	239.50	244.60	3.45
2012-13	20.13	77.72	236.90	261.61	4.54
2013-14	31.56	58.69	165.55	267.09	1.96
2014-15	51.35	45.54	195.45	403.51	3.22
2015-16	74.48	64.15	207.39	398.88	3.17

All amounts in Million US$

Year	Travels	Maintenance of close relatives	Medical Treatment	Studies	Others
2011-12	34.90	165.20	3.60	114.30	107.20
2012-13	44.84	226.64	4.91	124.73	204.12
2013-14	15.94	173.90	4.70	159.27	215.25
2014-15	10.96	174.41	7.25	277.07	157.08
2015-16	361.68	875.15	12.18	782.02	245.00

Source: RBI Database

From the above table it is evident that the pattern of outward remittances has changed over the last few years and especially in the last year after the revision of limit of LRS. It is but natural that the total outward remittances will roughly double as a result of the increase in the limit from 125000 US$ to 250000 US$. During this time the total outward remittances under different heads has increased from 1325 Million US$ to about 3000 Million US$. However it is noticed that the increase in the remittances has not followed the same pattern of allocation. The amount remitted under gift which comprised a major component earlier, now shows negative increase whereas studied abroad and maintenance of close relatives have recorded over 400 % increase. Travel has shown unexplained increase from 10.96 to 361.68 Million US$ pointing out distinctly to the disposable income of the residents and the huge scope of the tourism industry worldwide along with travels associated with multinational jobs. Other areas of remittances like deposits, purchase of immovable properties and investment shave showed proportionate increase in line with the revision of limits prescribed by the government under LRS.

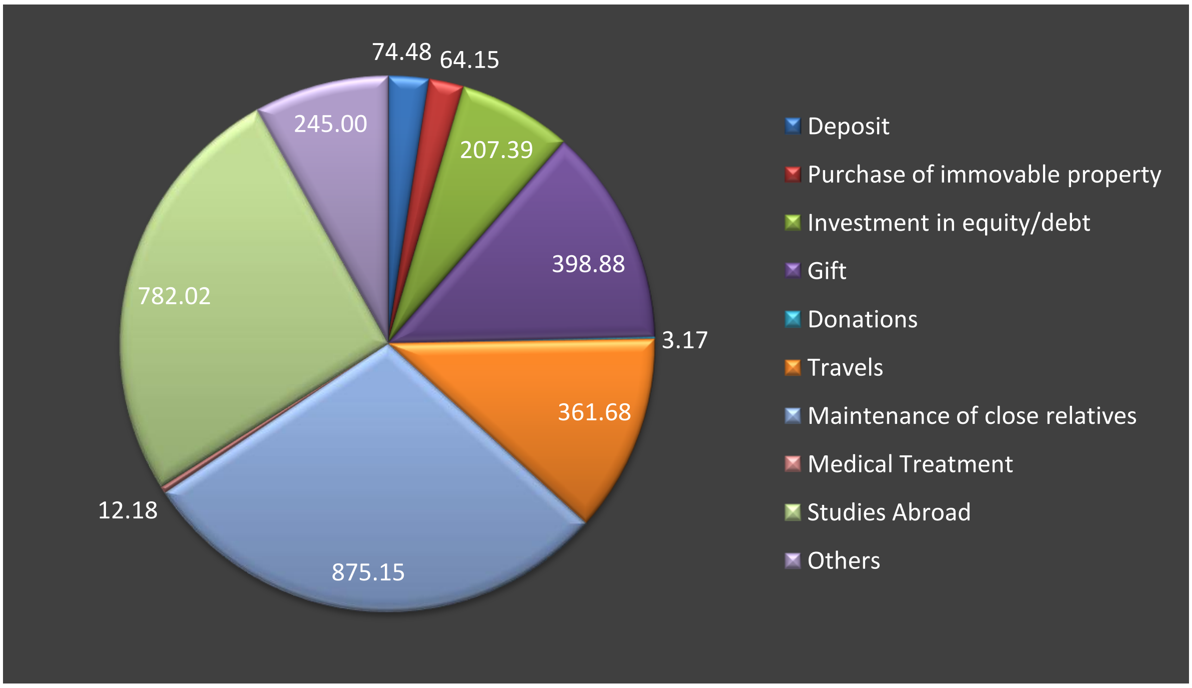

Figure 1: Remittances for the year 2015-16

Monthly remittances under LRS:

The revision in limit of LRS on May 2015 was double the limit as on June 2014, but the allocation of the remittances as seen in figure 1 above was more for travels, maintenance of close relatives as well as studies abroad. Therefore the remittances for these three items have been further studied on a monthly basis as shown in figure 2 below.

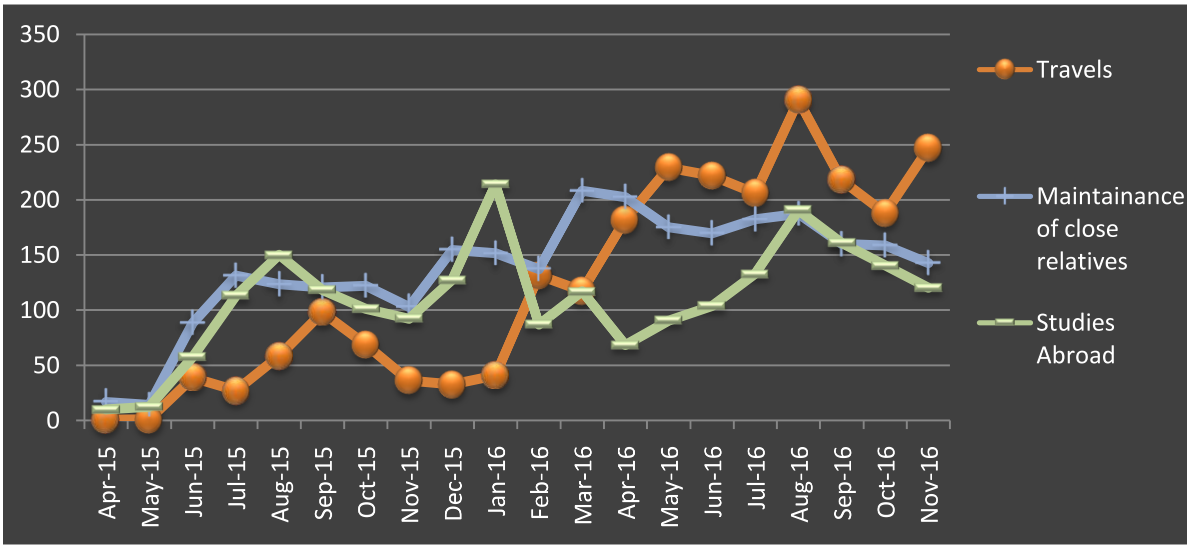

Figure 2: Monthly outward remittances

The remittances between May 2015 and June 2015 for travel has recorded 37 times increase just in a span of one month. Thereafter remittances on account of travel have been increasing consistently except a few months (festival season at year end) and its share in total remittances by the end of 2016 was 40% as compared to less than 2% before the last revision in LRS. It may be noted that the decision by the RBI to enhance the limit under the LRS to $250,000 per person per year was the result of the review of the external sector outlook and as a further exercise in macro prudential management. At the same time the CRR (Cash Reserve Ratio) and the Repo rate remained unchanged while the SLR (Statutory Liquidity

Ratio) was cut by 50 basis points. Although the enhancement in the limit of LRS was seen as a potential measure to strengthen the external sector, the monthly remittances data showed irrational channelization of domestic funds which had no indication of capital appreciation in the long run but only current account spending on travels, maintenance of relatives, studies abroad and gifts. The details of monthly remittances for all the avenues are shown below in Table 3 studying the month on month variation for 2015.

Table 3: Effect of enhanced limit of remittances under LRS in last revision

REMITTANCES ON ACCOUNT OF	MAY 2015	JUNE 2015	INCREASE
Deposits	5.07	14.16	179%
Purchase of immovable property	6.51	11.16	71.4%
Investment in Equity /Debt	18.32	24.5	33.73%
Gift	35.5	44.27	24.70%
Donation	0.59	0.23	-61%
Travel	1.01	38.77	3738.6%
Maintenance of close relatives	14.32	88.6	518.7%
Medical treatment	0.42	1.38	228.57%
Studies abroad	12.46	57.54	361.8%
Others	11.81	19.73	67%

Source: RBI website and Author's calculation

Direct Investment outside India:

Direct investment outside India means investments, either under the Automatic Route or the Approval Route, which may be by way of contribution to the capital or subscription to the Memorandum of a foreign entity or by way of purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange, signifying a long-term interest in the foreign entity (JV or WOS). Under the Automatic Route, an Indian Party does not require any prior approval from the Reserve Bank for making overseas direct investments (ODI) in a JV/WOS abroad. Proposals not covered by the conditions under the automatic route require prior approval of the Reserve Bank for which a specific application is required to be made through the Authorized Dealers. A resident Indian can remit; up to the limit prescribed by the Reserve Bank from time to time, per financial year under the Liberalised Remittance Scheme (LRS), currently 250000 US$, for permitted current and capital account transactions including purchase of securities and also setting up/acquisition of JV/WOS overseas with effect from August 5, 2013 (vide Notification No. 263). The new regulation 20A permits a resident individual (single or in association with another resident individual or with an 'Indian Party' as defined in the Notification) satisfying the criteria as per Schedule V of the Notification, to make overseas direct investment in the equity shares and compulsorily convertible preference shares of a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) outside India.

Outward remittances under Automatic Route:

Any Indian Party may make investments in a Joint Venture / Wholly Owned Subsidiary (JV / WOS) abroad under the Automatic Route. "Indian Party" includes any of the following:

• A company incorporated in India

• A body created under an Act of Parliament

• A partnership firm registered under the Indian Partnership Act, 1932

• A limited liability partnership incorporated under the Limited Liability Partnership Act, 2008

It should be noted that individuals are not allowed to invest under the Automatic Route.

The criteria for direct investment under the Automatic Route are as under:

i. The Indian Party can invest up to 400% of its net worth (as per the last audited Balance Sheet) in JV / WOS for any bonafide activity permitted as per the law of the host country. The ceiling of 400% of net worth will not be applicable where the investment is made out of balances held in the EEFC (Exchange Earner's Foreign Currency) account of the Indian party or out of funds raised through ADRs/GDRs (American Depository Receipts / Global Depository Receipts). The limit was 100% during the period 14th August 2013 to 3rd July 2014. In case the financial commitment in any financial year is above USD 1 billion, prior approval of Reserve Bank will be required;

ii. The Indian Party is not on the Reserve Bank's exporters' caution list / list of defaulters to the banking system published/ circulated by the Credit Information Bureau of India Ltd. (CIBIL) / RBI or any other credit information company as approved by the Reserve Bank or under investigation by the Directorate of Enforcement or any investigative agency or regulatory authority; and

iii. The Indian Party routes all the transactions relating to the investment in a JV/WOS through only one branch of an authorized dealer (bank) to be designated by the Indian Party.

Table 4: ODI under Automatic route and Approval Route

Million US$

YEAR	2015-16	2014-15	2013-14	2012-13	2011-12
ODI	21839.64	30918.53	36900.47	26872.38	25772*
Total LRS remittances	4541.87	1325.84	1093.92	1206.41	1001.6

- Source: RBI database, Author consolidation
- Date for the month April and May 2011 not available.

Outbound investments from India have undergone a considerable change not only in terms of magnitude but also in terms of geographical spread and sectorial composition. Analysis of the remittances shows a perceptible shift in Overseas Investment Destination (OID) in last decade or so. While in the first half, overseas investments were directed to resource rich countries such as Australia, UAE, and Sudan, in the latter half, OID was channeled into countries providing higher tax benefits such as Mauritius, Singapore, British Virgin Islands, and the Netherlands.

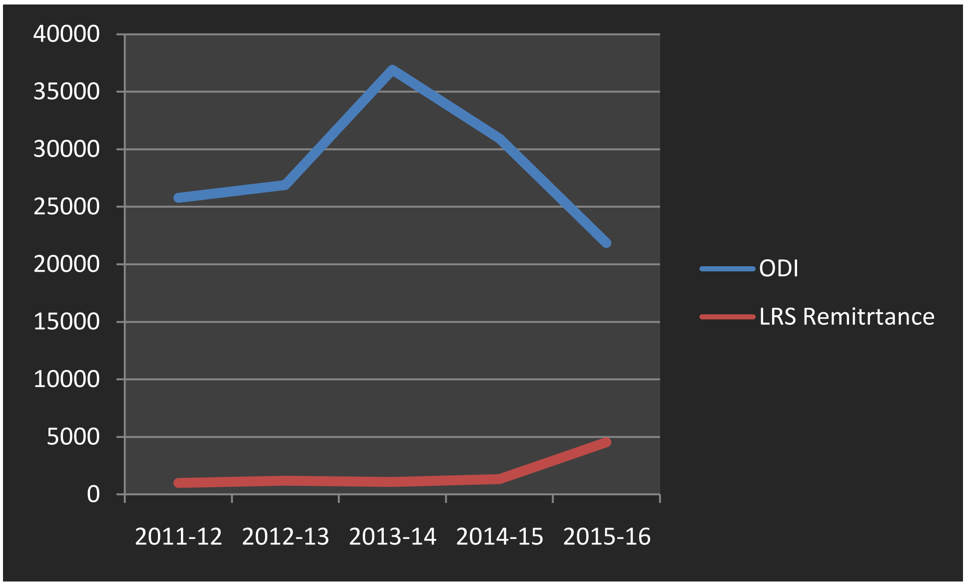

Figure 3: Outward Direct Investment Vs. Individual remittances

The latest data from Reserve Bank of India (RBI) showed that direct investments made overseas by Indian companies declined 57.3 per cent to $1.82 billion in January 2017 as compared to the investments made in January2016 which amounted to $4.25 billion. The same is evident from the trend shown in Figure 3 above where the individual total remittances showed a sharp increase in the last financial year as compared to a sharp decrease in the Investments made by Indian companies abroad in different countries. Therefore the enhancement of limit has not been capitalized, rather revenue expenditure were triggered by the 100% raise in limit of LRS.

Conclusion

The Indian government’s efforts to integrate the country's economy with the rest of the world must be backed by the ‘Indian Party’ investing abroad in more employment generating and rupee appreciating activities. Also the sharp decline in the investment abroad (January 2017 as against January 2016) in spite of enhanced limit of LRS is a close indication about the nature of business ventures earlier as means of channelizing unaccounted sources of funds which became difficult due to the demonetization rules effective from November 2016. The Reserve Bank of India, from time to time, encouraged by adequate forex reserves, has relaxed the norms for domestic companies investing abroad by doing away with the ceiling for raising funds through pledge of shares, domestic and overseas assets. In addition to joint ventures (JVs) and wholly owned subsidiaries (WOSs), the central bank has announced similar concessions for pledging of shares in case of step down subsidiary. The RBI has also relaxed norms for foreign investment by Indian companies by raising the borrowing limit. The financial commitment to be undertaken by an Indian party is now limited to within 400 per cent compared to the earlier 100 per cent of the company's net worth. The RBI has also allowed limited liability partnership (LLP) firms to undertake financial commitment to/ on behalf of JV or wholly owned subsidiaries of Indian companies abroad.

Overseas investment is one of the foremost steps to enter the global marketplace and in recent times, India has taken necessary steps to make its presence felt in the global arena. Investment outlook in some of the overseas market looks positive. For instance, the Indian industry is projected to increase its revenue from Africa. Information technology (IT) services, infrastructure, agriculture, pharmaceuticals and consumer goods are vital to India boosting Africa revenues to US$ 160 billion by 2025, as per McKinsey & Co. In another development, the Ministry of External Affairs has initiated a move to set up a direct sea and air link between

India and the Latin American region, as Indian corporate plan significant investments in the mining, oil, IT and pharmaceutical sectors in that region.

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