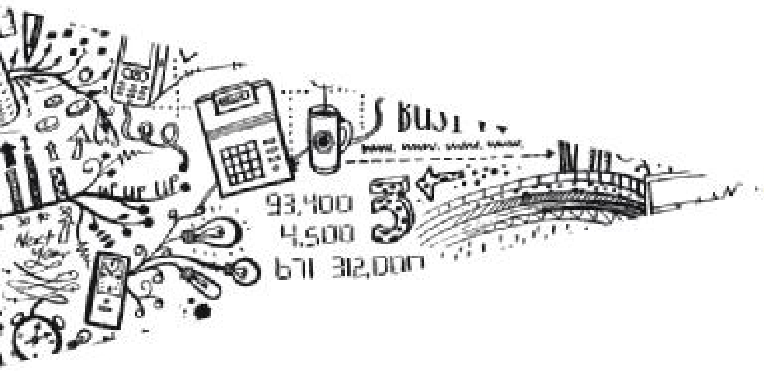
1 July 2011

EY Regulatory Alert

Foreign Direct Investment – Issue of equity shares against import of goods and pre-incorporation expenses



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Background

The Department of Industrial Policy and Promotion (DIPP) in the Ministry of Commerce & Industry, Government of India (Government) has, vide Circular no 1 of 2011 issued a Consolidated Foreign Direct Investment (FDI) Policy earlier this year. This policy became effective from 1 April 2011.

The new consolidated FDI policy permitted issue of equity shares under the Government route against import of capital goods and pre-operative/ pre-incorporation expenses, subject to certain conditions.

The Reserve Bank of India (RBI) has issued directions vide A. P. (DIR Series) Circular No. 74 (the Circular), which gives effect to the above provision inserted in the new FDI Policy.

Current Provisions

General permission is available for issue of shares/ preference shares against External Commercial Borrowing (ECB) and lumpsum technical know-how fee, royalty, subject to entry route, sectoral cap, pricing guidelines and compliance with applicable tax laws.

Amended Provisions

The Circular permit issue of equity shares/ preference shares under the FDI scheme with prior approval of the Government for the following categories of transactions:

- Import of capital goods/ machinery/ equipment (including second-hand machinery) (jointly referred to as Capital Goods); and
- Pre-operative/ pre-incorporation expenses (including payment of rent etc) (jointly referred to as Pre-incorporation expenses).

Key conditions for granting permission for share issue against Capital Goods are as under:

- The import of Capital Goods should be in accordance with the Export/Import Policy issued by the Government and Foreign Exchange Management Acct, 1999
- The Capital Goods are valued by a third party, preferably by an independent valuer from the country of import and the valuation certificate is submitted along with documents/certificates issued by the custom authorities towards fair value of such imports
- The conversions of import payables for Capital Goods into FDI should be completed within 180 days from the date of shipment of goods

Key conditions for granting permission for share issue against Pre-incorporation expenses are as under:

- Foreign Inward Remittance Certificate for remittance of funds by the overseas promoters for the expenditure incurred should accompany the application
- A certificate from the statutory auditor which verifies and certifies the expenses should be submitted along with the application
- Payments should be made directly by the foreign investor to the company
- The capitalization should be completed within 180 days as permitted for retention of advance against equity under the extant FDI Policy

Further, the RBI has also provided that the Government approval for issue of equity shares/ preference shares by an Indian company, for the aforementioned transactions shall be subject to the following:

- A copy of the special resolution, for issue of equity shares/ preference shares, to be accompanied with the application (for seeking approval) to be filed with the Government;

- Government's approval would be subject to pricing guidelines of RBI and appropriate tax clearance.

Our offices

Ahmedabad
2nd floor, Shivalik Ishaan
Near CN Vidhyalaya Ambawadi
Ahmedabad - 380 015
Tel: + 91 79 6608 3800
Fax: + 91 79 6608 3900

Bengaluru
"UB City", Canberra Block
12th & 13th floor
No.24 Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 4027 5000
+ 91 80 6727 5000
Fax: + 91 80 2210 6000 (12th floor)
Fax: + 91 80 2224 0695 (13th floor)

Chennai
TPL House, 2nd floor
No. 3 Cenotaph Road Teynampet
Chennai - 600 018
Tel: + 91 44 6632 8400
Fax: + 91 44 2431 1450

Hyderabad
205, 2nd floor
Ashoka Bhoopal Chambers
Sardar Patel Road
Secunderabad - 500 003
Tel: + 91 40 6627 4000
Fax: + 91 40 2789 8851

Oval Office, 18, iLabs Centre
Hitech City, Madhapur
Hyderabad - 500081
Tel: + 91 40 6736 2000
Fax: + 91 40 6736 2200

Kochi
9th Floor, Abad Nucleus
NH-49, Maradu PO
Kochi -682304
Tel: +91 484 3044000
Fax: +91 484 2705393

Kolkata
22 Camac Street
Block 'C', 3rd floor
Kolkata - 700 016
Tel: + 91 33 6615 3400
Fax: + 91 33 2281 7750

Mumbai
14th floor, The Ruby,
Dadar, Mumbai - 400 028.
Tel: + 91 22 6192 0000
Fax: + 91 22 6192 1000

6th Floor, Express Towers,
Nariman Point,
Mumbai - 400 021
Tel: + 91 22 6657 9200
Fax: + 91 22 2287 6401

Block B-2, 5th Floor
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E), Mumbai - 400 063.
Tel: + 91 22 6749 8000
Fax: + 91 22 6749 8200

NCR
Golf View Corporate Tower B
Near DLF Golf Course Sector 42
Gurgaon - 122002
Tel: + 91 124 464 4000
Fax: + 91 124 464 4050

6th floor, HT House
18-20 Kasturba Gandhi Marg
New Delhi - 110 001
Tel: + 91 11 4363 3000
Fax: + 91 11 4363 3200

4th & 5th Floor, Plot No 2B, Tower 2,
Sector 126, NOIDA 201 304
Gautam Budh Nagar, U.P. India
Tel: + 91 120 671 7000
Fax: + 91 120 671 7171

Pune
C-401, 4th floor Panchshil Tech Park
Yerwada (Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 6603 6000
Fax: + 91 20 6601 5900

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