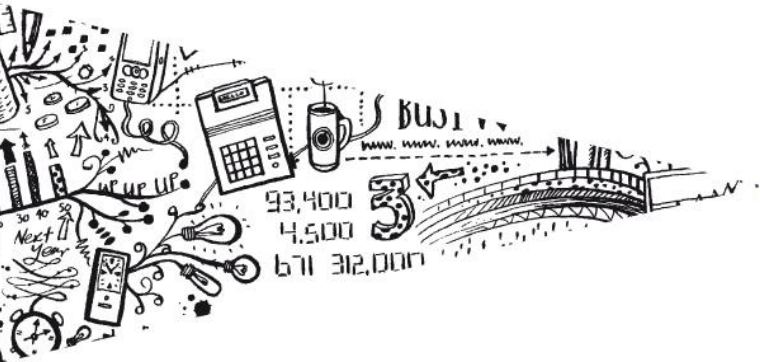


31March 2011

EY Regulatory Alert

Consolidated FDI Policy

Circular 1 of 2011



Background

This alert summarizes the latest consolidated FDI Policy - Circular 1 of 2011 released by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry (Government).

The Circular 1 of 2011 has updated all instructions/clarifications issued by the Government relating to FDI Policy as of 31 March 2011 and have superseded Circular 2 of 2010 issued by the Government on 30 September 2010.

The circular will be effective from 1 April 2011 and has been issued with the sunset clause of six months. A new circular consolidating all further amendments to the FDI Policy shall be issued on 30 September 2011.

Announcement

1. Salient Features of Circular 1 of 2011

1.1 Pricing of Capital Instruments

Government has relaxed the existing pricing guidelines for capital instruments and has specified that pricing/conversion formula of convertible capital instruments needs to be decided upfront at the time of issue of instruments. However, the price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the Foreign Exchange Management Act

(FEMA) regulations [the Discounted Cash Flow method of valuation for the unlisted companies and valuation in terms of Securities and Exchange Board of India (SEBI) (Issue of Capital and Disclosure Requirements) Regulations, for the listed companies]. This will give flexibility to Indian companies to avail future upside benefits.

1.2 Deletion of approval requirements for existing venture/tie up in the same field

Government has removed the requirement of obtaining FIPB approval in case of having existing joint ventures/technical collaborations in the 'same field (erstwhile Press Note 1 of 2005). Removal of condition will give a major boost to foreign investors who have existing ventures in India and there expansion plans were hampered on account of non availability of no objection certificate from the existing Indian joint venture partner.

1.3 Downstream Investment

The existing classification of only operating companies, operating-cum-investing companies and only investing companies has been removed and the following has been specified:

Any percentage of foreign investment into the following companies regardless of its ownership or control would require FIPB approval:

- (a) India companies engaged only in the activity of investing in the capital of other

Indian Companies (Except NBFCs carrying on activities permitted under FDI Policy).

- (b) Indian companies which does not have any operations and downstream investments.

- Downstream Investment by an Indian Company which is owned and/or controlled by nonresident entities would be in accordance/compliance with the relevant sectoral conditions on entry route, conditionalities and caps, with regard to the sectors in which the Indian company into which the downstream investment is being made is operating, subject to compliance with the conditions prescribed for making downstream investment.

1.4 Issue of shares for consideration other than cash

Issue of shares has been permitted under approval route for the following categories:

- (i) Import of capital goods/machinery/equipment (including second-hand machinery), subject to compliance with the following condition:
 - Any import of capital goods/machinery etc., made by a resident in India, has to be in accordance with the Export/Import Policy issued by Government of India/as defined by Director General of Foreign Trade/FEMA provisions relating to imports.
 - Independent valuation of the capital goods/machinery/equipments

(including second-hand machinery) is undertaken by a third party entity, preferably by an independent valuer from the country of import along-with production of copies of documents/certificates issued by the customs authorities towards assessment of the fair-value of such imports.

- The application should clearly indicate the beneficial ownership and identity of the Importer Company as well as overseas entity.
- All such conversions of import payables for capital goods into FDI being done within 180 days from the date of shipment of goods.

(ii) Pre-operative/pre-incorporation expenses (including payment of rent etc.) subject to compliance with the following conditions:

- Submission of Foreign Inward Remittance Certificate for remittance of funds by the overseas promoters for the expenditure incurred.
- Verification and certification of the pre-incorporation/pre-operative expenses by the statutory auditor.
- Payments being made directly by the foreign investor to the company. Payments made through third parties citing the absence of a bank account or similar such reasons will not be allowed.
- The capitalization being done within the stipulated period of 180 days permitted for retention of advance

against equity under the extant FDI policy.

In addition to the aforesaid following conditions will also be applicable:

- All requests for conversion should be accompanied by a special resolution of the company.
- Government's approval would be subject to pricing guidelines of RBI and appropriate tax clearance

1.5 Investments by Foreign Institutional Investors (FII)

It has been clarified that the aggregate limit of 24% referred in Portfolio Investment Scheme may be increased to the sectoral cap/statutory ceiling, as applicable, by the Indian company concerned by passing a board resolution and special resolution to that effect.

1.6 FDI in Venture Capital Fund (VCF)

It has been specified that if a domestic VCF is set up as a trust, a person resident outside India (non-resident entity/individual including an NRI) cannot invest in such domestic VCF without obtaining approval of Foreign Investment Promotion Board. However, if a domestic VCF is set-up as an incorporated company, then a person resident outside India can invest in such domestic VCF under the automatic route, subject to compliance with the FEMA regulations

1.7 Reporting of Issue of shares under Employees Stock Options Plan (ESOP)

Indian companies issuing ESOP to its non residents employees will need to report (plain paper reporting) the details of granting of stock options to the regional office concerned of the Reserve Bank and thereafter the details of issue of shares subsequent to the exercise of such stock options within 30 days from the date of issue of shares in Form FC-GPR.

2. Sector specific changes

2.1 Agriculture

The restriction related to controlled conditions has been removed for the activity of development and production of seeds and planting material.

2.2 Civil Aviation

Government has removed 'Chartered Airlines' from the definition of Non Schedule Air Transport Services.

2.3 Wholesale Trading

Wholesale trading of items sourced from MSE sector has been placed under 100% automatic route.

Comments

With the intent and objective to promote foreign direct investment through a policy which is transparent, predictable, simple and clear Government has released this circular consolidating the FDI policy as on 31 March 2011. Some of the changes highlighted in this alert reflect changes in interpretation of FDI Policy. It is likely that some of these changes may impact existing foreign investments, which would need to be reviewed on a case specific basis.

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