

Corpsec Hotline

February 11, 2009

FOREIGN INVESTMENTS INTO INDIA: UNSHACKLED?

In a move that can be touted as the government's response to the present economic downturn, the Cabinet Committee on Economic Affairs has approved certain guidelines that acknowledge the need to facilitate greater foreign capital inflows. The guidelines govern the mechanism for calculation of foreign investments in Indian companies and the transfer of ownership or control of Indian companies that are engaged in sectors that have a sectoral cap prescribed for foreign investments.

Background

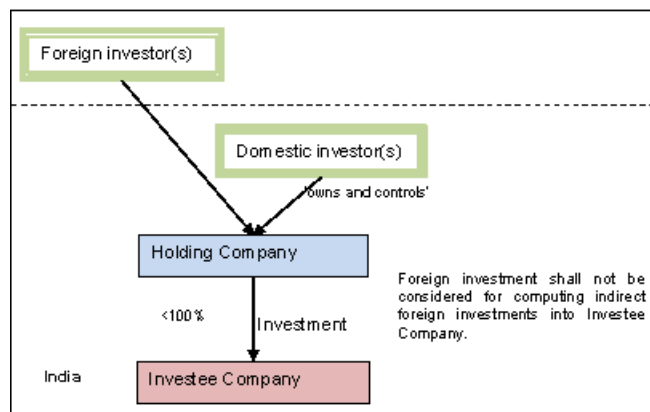
Press Note 9 (1999) governs the direct investment by foreign entities and enables foreign-owned Indian holding companies to make downstream investments under the automatic route of the foreign direct investment policy ("FDI") framework. Over the last couple of years, interpretation of certain issues envisaged under Press Note 9 (1999) had been extended by the governmental authorities to such an extent that virtually each foreign investment in India was posed with the requirement of obtaining prior governmental approval. This was because it was contemplated that every Indian company having downstream investments would require prior approval for seeking foreign investment no matter the extent of such foreign investment (even 1%) in the concerned Indian holding company. There were also several representations made in this regard by industry players, foreign investors and other stake holders concerning the foreign investments into India. In response to the same, the present release clarifies that Indian holding company would not be treated as foreign owned holding/holding-cum-operating company as long as such Indian holding company is ultimately 'owned and controlled' by Indian residents.



The Press Release

The clarifications brought about by the release are as follows:

1. All foreign investments made directly by a non-resident entity into an Indian company, are to be aggregated on a cumulative basis to determine the extent of foreign investment into the concerned Indian company.
2. Foreign investment into an Indian holding company would not be considered for calculation of indirect foreign investment into the Indian investee company as long as the Indian holding company is 'owned and controlled' by resident Indian citizens, either directly or on a look-through basis.



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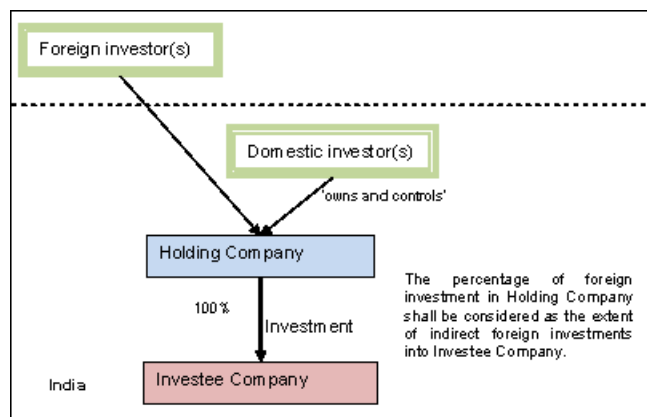
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3. If the 'ownership' or control' of the Indian holding company, is with non-Indian residents, the entire investment by such Indian holding company into the Indian investee company, would be categorized as indirect foreign investments into the concerned Indian investee company.

It is significant that the terms 'ownership' and 'control' are being used disjunctively with respect to determining control or ownership by foreign entities whereas in the case of ownership and control by Indian residents, the terms are read conjunctively and therefore the moment either of the ownership or control of the Indian holding company vests with foreign entities, the entire investment by such Indian holding company into the Indian investee company, would be categorized as indirect foreign investments into the concerned Indian investee company.

As a matter of added clarification, the release further clarifies that in case of investment into a 100% subsidiary of a holding/operating-cum-holding company, the extent of indirect foreign investment shall be taken to be the percentage of actual foreign investment in the Indian holding company.



4. Transfer of 'ownership' or 'control' from Indian residents to non-Indian resident entities, of Indian companies that are engaged in sectors that have prescribed sectoral caps, would require prior Foreign Investment Promotion Board ("FIPB") approval in all cases where such transfer is effected through fresh foreign investment in an existing Indian company or when such transfer is effected through direct acquisition or through corporate reorganisations, i.e. amalgamations or mergers.

Ambiguities: Some cleared some still prevail

As with a recent draft press note circulated by DIPP, the release does not clarify on what should be the percentage of foreign investment to infer 'ownership' or 'control' in an Indian company. The government has indicated that the guidelines to be issued would stipulate a definition to the key terms – 'control' and 'ownership'. For the purposes of computing foreign investments, 'ownership' could consider both equity and debt infusion into the Indian investee company on a fully diluted basis. Separately, the term 'control' could be defined on the basis of certain thresholds. Critically, this would help ascertain whether the concerned Indian entity qualifies to be construed as a foreign owned Indian holding company that triggers the requirement of prior and specific approval of FIPB/Government.

Another clarification that the release requires is to whether the term 'foreign investment' as referred to under point 1 above, envisages investments under the direct investment route or even those under other inbound investment regimes.

Also, in respect to specific sectors which in addition to prescribed caps, require compliance envisaged by the concerned authority/regulator and the indirect computation of indirect holding would depend on requirements specified for such sector in addition to the mechanism evinced in the release.

Conclusion

The guidelines seem to have addressed some of the concerns of foreign investors and Indian corporates, giving them a sigh of relief. However some ambiguities still pervade the overall direct investment framework.

Source: <http://pib.nic.in/release/release.asp?relid=47408>

- **Richie Sancheti & Vyapak Desai**

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