

India Desk News Alert

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India Circular on Foreign Direct Investment

The Government of India has recently issued the Circular No 1 of 2011 (the “Circular”) to update the Foreign Direct Investment (FDI) policy. This is effective from 1 April 2011. Some of the key changes brought about by the Circular are listed below.

1. Existing foreign investors in joint venture/ collaboration in the “same field”

As per Press Note 1 (2005), a non-resident investor having a joint venture or technical collaboration with Indian partners could not make a new investment into a similar venture unless it obtained a prior approval from the Government of India (the “Government”) and the existing Indian partner gave no objection.

The recent Circular has removed the requirement to obtain prior approval from the Government and also the need to demonstrate that there is no jeopardy of Indian partners’ interest. The change is effective from 1 April 2011.

2. Pricing of convertible investment instruments

Circular 1 of 2011 has relaxed the conditions of upfront pricing of convertible instruments.

The Circular allows the non-resident investors to set any formula to determine the conversion price, provided it is specified upfront, at the time of allotment. However, the price at the time of conversion should not be lower than the fair value worked out at the time of the issuance of such convertible instruments, in accordance with the Foreign Exchange Management Act Regulations (i.e. Discounted Cash Flow method for valuation of unlisted companies and valuation prescribed by the Securities Exchange Board of India for listed companies).

3. Issuance of shares in Indian investment in lieu of capital expenditure and pre-incorporation expenditures borne by foreign investors

The Circular has clarified that prior approval of the Government is required for issuance of equity shares for non cash consideration under the below mentioned categories: (i) issuance of equity shares against import of capital goods/ machinery/ equipment (including second-hand machinery and equipment); and (ii) issuance of equity shares against pre-operative / pre-incorporation expense incurred by the foreign companies.

The general criteria for making an application to the Government is that the foreign company should be eligible to subscribe to the shares of the Indian company under the FDI policy. As per the Circular, it is necessary that payments should be made directly by the foreign investors to the Indian company. Any payments made through third parties (due to the absence of bank account) will not be granted approval by the Government.

4. Non-banking Finance Company (NBFC)

The Circular has clarified that no approval is required for foreign direct investment in the following prescribed 18 activities:

- Merchant Banking,
- Underwriting, Portfolio Management services,
- Investment Advisory Services,
- Financial Consultancy,
- Stock Broking,
- Asset Management,
- Venture Capital,
- Custodial Services,
- Factoring,
- Credit Rating Agencies,
- Leasing and Finance,
- Finance
- Housing Finance,
- Forex Broking,
- Credit Card Business,
- Money Changing Business,
- Micro Credit,
- Rural Credit.

An approval would be required from Foreign Investment Promotion Board (FIPB) for undertaking any other NBFC activity.

5. Downstream investment by Indian companies

The Circular has simplified the policy on downstream investments by Indian companies.

The existing classification of Indian companies into “operating companies”, “operating-cum-investing companies” and “investing companies” has been removed. The Circular specifies that any foreign investment in the following Indian companies would require FIPB approval:

- Indian companies which are engaged only in downstream investment activities for holding purposes
- Indian companies which do not have any operations and also do not have any downstream investment.

Downstream investments by Indian companies which are owned and/or controlled by non-residents would be subject to relevant sectoral conditions or entry route, conditionalities and caps pertaining to the relevant sector in which the investee Indian company is operating.

For further information, please contact PricewaterhouseCoopers' India Desk in Singapore.

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