



## *NEWSFLASH*

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### **Liberalisation of Foreign Direct Investments**

Foreign Direct Investments (“**FDIs**”) in India are governed by the provisions of the Foreign Exchange Management Act, 1999 (“**FEMA**”), rules and regulations made thereunder as well as the policies and guidelines issued by various authorities such as the Reserve Bank of India (“**RBI**”) and the Department of Industrial Policy and Promotion (“**DIPP**”). DIPP has recently issued Press Notes 2 & 3 of 2009 for clarity and liberalization of FDI in India.

#### ***Previous Provisions***

Under the previous FDI provisions (prior to the issuance of press notes 2 & 3 of 2009) the method of calculation of indirect foreign investment was different for various sectors. The new press notes have attempted to bring homogeneity to such calculations and have thereby simplified and liberalized, to some extent, indirect foreign investment in some sectors.

#### ***Recent Amendments vide Press Notes 2 & 3 of 2009***

Press note 2 of 2009 provides that:

- In the case of Indian companies which are “owned **and** controlled” by resident Indian citizens, the indirect foreign investment via downstream investment by such companies, irrespective of the foreign shareholding in them, shall be nil.
- A company is said to be “owned” by resident Indian citizens if more than 50% of the equity in the company is held by resident Indian citizens, and that it is said to be “controlled” by resident Indian citizens if majority of the directors are nominated by resident Indian citizens.
- In order for the indirect foreign investment via an Indian company to be nil the said Indian company must be both owned **and** controlled by resident Indian citizens, and if either one of these factors is not complied with, the indirect foreign investment via that company cannot be nil.
- Investments by Indian companies either owned **or** controlled by non-residents, in downstream companies are viewed as indirect foreign investments. In such cases, the entire investment made by the Indian company in the downstream company will be treated as indirect foreign investment. (i.e. if the investment by the Indian company (owned **or** controlled by non-residents) in the downstream company is 60% then the indirect foreign investment in the downstream company will be considered to be 60%)
- Investment by an Indian company (owned **or** controlled by non-residents) in a wholly owned subsidiary will be considered to be indirect foreign investment. In

such case, however, unlike the bullet point above, the indirect foreign investment in the wholly owned subsidiary will be considered to be the same as the foreign investment in the Indian company.

- An exception has been made for the highly regulated sectors i.e. Information & Broadcasting and Defense, to provide that the Indian company making an investment in a downstream company would need to be both owned **and** controlled by resident Indian citizens /Indian companies (which, in turn are owned and controlled by resident Indian citizens). (This exception is applicable to those sectors of Information and Broadcasting and Defense where FDI is restricted up to 49% such as Direct-to-Home, Cable Network, FM Radio, etc.).

Press note 3 of 2009 provides that transfer of ownership or control of existing Indian companies from Indian residents to non-residents in sectors which have prescribed sectoral caps would require prior FIPB approval in all cases. The press note further provides that where an Indian company is being established with foreign investment and non-resident ownership or control of such company is contemplated in sectors which have prescribed sectoral caps, then prior FIPB approval will be required. These provisions would not be applicable where 100% FDI is permitted under the automatic route.

### ***Conclusion***

The press notes appear, *prima facie*, to allow an indirect increase in foreign investments in certain sectors such as the telecom sector, media etc. Observers believe that these changes will open avenues for foreign investments in restricted, sensitive sectors through a guided route on the one hand, but have lead to more ambiguity in certain other sectors such as gambling, multi-brand retail trading, etc. While these press notes provide clarity with respect to the methodology of calculation of indirect foreign investment, they fail to address regulatory hurdles with respect to the conversion of operating companies to operating cum holding companies. The conversion of operating companies to operating cum holding companies still requires FIPB approval.

### ***Disclaimer***

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