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RBI NOTIFIES GUIDELINES FOR DOWNSTREAM INVESTMENT

EXISTING GUIDELINES

The guidelines for calculation of total foreign investment (i.e. direct & indirect) in Indian companies, transfer of ownership and control of Indian companies and downstream investment by Indian companies (“**Guidelines**”) have been set out in Press Notes 2 and 3 of 2009 dated 13 February 2009 issued by the DIPP¹. The Guidelines are also comprehensively incorporated in the Consolidated FDI policy dated 5 April 2013.

AMENDMENT TO THE FEMA REGULATIONS

Pursuant to notification dated 7th June, 2013 (“**Notification**”), the RBI has issued regulations to amend the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 (“**FEMA Regulations**”). Pursuant to the Notification, the FEMA Regulations have been amended to incorporate the same Guidelines by inserting a new Regulation 14 therein. The amendments to the FEMA Regulations come into force from 13 February 2009.

DIRECTIONS BY THE RBI IN RELATION TO THE GUIDELINES ON FOREIGN INVESTMENT

The RBI has on 4 July 2013 issued a circular containing the following directions with respect to the Guidelines:

- a. Foreign investment made prior to 13 February 2009 (in accordance with the then applicable guidelines) will not require any modification to conform to the Guidelines.
- b. All investments made after 13 February 2009 would come under the ambit of the Guidelines.
- c. In case of foreign investments made between 13 February 2009 and 7 June 2013, Indian companies are required to intimate, **within 90 days** from 4 July 2013 (i.e. before 2 October 2013), through an AD Category I bank to the RBI, detailed position where the issue/transfer of shares or downstream investment is not in conformity with the Guidelines. RBI shall consider treating such cases as compliant with the Guidelines within a period of six months or such extended time as considered appropriate by RBI in consultation with Government of India.

¹ Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India

BRIEF SUMMARY OF THE GUIDELINES FOR CALCULATION OF FOREIGN INVESTMENT AND DOWNSTREAM INVESTMENT:

- A company '**owned by resident Indian citizens**' shall be an Indian company if more than 50% of the capital in it is beneficially owned by resident Indian citizens and/or Indian companies, which are ultimately owned and controlled by resident Indian citizens; Company shall be considered '**controlled by resident Indian citizens**' if the residents Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, have the power to appoint a majority of its directors in that company.
- Company '**owned by non-residents**' means an Indian company where more than 50% of the capital in it is beneficially owned by non-residents; Company '**controlled by non-residents**' means an Indian company where non-residents have the power to appoint a majority of its directors in that company.
- '**Indirect foreign investment**' means entire investment in other Indian companies by an Indian company (IC), having foreign investment in it provided IC is not '**owned and controlled**' by resident Indian citizens and/or Indian Companies which are owned and controlled by resident Indian citizens or where the IC is owned **or** controlled by non-residents. However, as an exception, the indirect foreign investment in the 100% owned subsidiaries of operating-cum-investing/investing companies will be limited to the foreign investment in the operating-cum-investing/ investing company.
- '**Total foreign investment**' in an Indian Company would be the sum total of direct and indirect foreign investment.
- **Counting of Direct foreign investment:** All investments made directly by non-resident entities into the Indian company would be counted towards '**Direct foreign investment**'.
- **Counting of indirect foreign Investment:** The entire indirect foreign investment by the investing company into the other Indian Company would be considered for the purpose of computation of indirect foreign investment. However, as an exception, the indirect foreign investment in the 100% owned subsidiaries of operating-cum-investing/investing companies will be limited to the foreign investment in the operating-cum-investing/ investing company.
- If a declaration is made by persons as per section 187C of the Indian Companies Act about a **beneficial interest** being held by a non resident entity, then even though the investment may be made by a resident Indian citizen, the same shall be counted as foreign investment.
- **Downstream investment** by an Indian company, which is **not owned and/ or controlled by resident entity**, into another Indian company, would be in accordance/compliance with the relevant sectoral conditions on entry route, conditionalities and caps, with regard to the sectors in which the latter Indian company is operating; and will be subject to the following conditions:
 - (a) Such a company has to **notify SIA², DIPP and FIPB** of its downstream investment in the prescribed form within 30 days of such investment, even if capital instruments have not been allotted along with the modality of investment in new/existing ventures (with/ without expansion programme);

² Secretariat for Industrial Assistance

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- (b) downstream investment by way of induction of foreign equity in an existing Indian Company to be duly supported by a **resolution of its Board of Directors** as also a Shareholders' Agreement, if any;
- (c) issue/transfer/pricing/valuation of shares shall continue to be in accordance with extant **SEBI/RBI guidelines**;
- (d) For the purpose of downstream investment, the Indian companies making the downstream investments would have to bring in requisite funds from abroad and not use funds borrowed in the domestic market. This would, however, not preclude downstream operating companies, from raising debt in the domestic market. Downstream investments through internal accruals are permissible by an Indian company engaged only in activity of investing in the capital of another Indian company, subject to the provisions above and as also elaborated below:
 - (i) Foreign investment into an Indian company, engaged only in the activity of **investing** in the capital of other Indian company, will require **prior Government/FIPB approval**, regardless of the amount or extent of foreign investment.
 - (ii) For infusion of foreign investment into an Indian company which does not have any operations and also does not have any downstream investments, **Government/FIPB approval** would be required, regardless of the amount or extent of foreign investment.
 - (iii) The FDI recipient Indian company at the first level which is responsible for ensuring compliance with the FDI conditionalities for the downstream investment made by it in the subsidiary companies at second level and so on and so forth is required to obtain a **certificate** to this effect from its **statutory auditor** on an annual basis as regards status of compliance with the instructions on downstream investment and compliance with FEMA provisions. The fact that statutory auditor has certified that the company is in compliance with the regulations as regards downstream investment and other FEMA prescriptions will be duly mentioned in the Director's report in the Annual Report of the Indian company. In case statutory auditor has given a **qualified report**, the same shall be immediately brought to the **notice of the RBI** and shall also obtain acknowledgement from the RBI of having intimated it of the qualified auditor report.

ALMT CONCLUDES

- Indian companies must intimate RBI (through its AD bank) before 2 October 2013, the details of any foreign investments (direct/ indirect/ downstream) made between 13 February 2009 and 7 June 2013 which was not in compliance with the Guidelines. RBI will consider treating such cases as compliant with the Guidelines within a period of six months or such extended time as considered appropriate by RBI in consultation with Government of India.
- The RBI circular is silent with respect to any penalty implications/ compounding of such non-compliances.

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