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DSK Legal Knowledge Center

Update on

- **Corporate Laws**

Corporate Laws

The Department of Industrial Policy and Promotion (“**DIPP**”), the Ministry of Commerce and Industry, Government of India has issued a Circular 2 of 2010 (“**Revised Circular**”) consolidating into one document all the prior policies/regulations on foreign direct investment (“**FDI**”) which are contained in the Foreign Exchange Management Act, 1999, Press Notes/Press and Releases/Clarifications issued by DIPP. The Revised Circular subsumes and supersedes all Press Notes/Press Releases/ Clarifications issued by DIPP which were in force as on September 30, 2010. The Revised Circular will take effect from October 1, 2010 and its next revision will be published on March 31, 2011. The DIPP has earlier issued Circular 1 of 2010 on March 31, 2010 (“**FDI Policy**”).

Please find below the revisions/amendments made to FDI Policy through the Revised Circular:

1. Issue of instruments like warrants, partly paid up shares, etc.:

The FDI Policy had earlier excluded instruments like warrants, partly paid up shares, etc. from the definition of capital. It had further stated that any other type of instruments like warrants and partly paid up shares, etc. are not considered as capital and cannot be issued to person’s resident outside India.

The Revised Circular continues to exclude instruments like warrants, partly paid up shares, etc. from the definition of capital. However, the Revised Circular states that they can be issued to person’s

resident outside India after obtaining the prior approval under the Government Route.

2. Issue Price for Shares

The FDI Policy earlier stated that the issue price of shares to person's resident outside India under the FDI Policy, shall be on the basis of SEBI guidelines in case of listed companies. In case of unlisted companies, valuation of shares has to be done by a chartered accountant in accordance with the guidelines issued by the erstwhile Controller of Capital Issues ("**CCI**").

The Revised Circular has amended the pricing guidelines for the issue of shares to person's resident outside India making it consistent with the pricing guidelines issued by the Reserve Bank of India vide A. P. (DIR Series) Circular No. 49, dated May 4, 2010. The Revised Circular provides as under:

Quote

3.4.2 Issue price of shares – Price of shares issued to persons resident outside India under the FDI Policy, shall not be less than -

- a. the price worked out in accordance with the SEBI guidelines, as applicable, where the shares of the company is listed on any recognised stock exchange in India;

- b. the fair valuation of shares done by a SEBI registered Category - I Merchant Banker or a Chartered Accountant as per the discounted free cash flow method, where the shares of the company is not listed on any recognised stock exchange in India ; and
- c. the price as applicable to transfer of shares from resident to non-resident as per the pricing guidelines laid down by the Reserve Bank from time to time, where the issue of shares is on preferential allotment.

Unquote

3. Price for issue of Rights share

The FDI Policy earlier stated that the price of shares offered on rights basis by the Indian company to non-resident shareholders shall not be lower than the price at which such shares are offered to resident shareholders.

The Revised Circular has amended the pricing guidelines for the issue of shares on a rights basis to person's resident outside India making it consistent with the pricing guidelines issued by the Reserve Bank of India vide FEMA Notification No. 205/2010 – RB dated April 7, 2010. The Revised Circular has set out the following pricing guidelines for the issue of shares on a rights basis to person's resident outside India:

Quote

The offer on right basis to the persons resident outside India shall be:

- a. in the case of shares of a company listed on a recognized stock exchange in India, at a price as determined by the company;
- b. in the case of shares of a company not listed on a recognized stock exchange in India, at a price which is not less than the price at which the offer on right basis is made to resident shareholders.

Unquote

4. Share Swaps

The Revised Circular has introduced a specific provision for valuation of shares in case of investment by swap of shares.

Quote

In cases of investment by way of swap of shares, irrespective of the amount, valuation of the shares will have to be made by a Category I Merchant Banker registered with SEBI or an Investment Banker outside India registered with the appropriate regulatory authority in the host country. Approval of the Foreign Investment Promotion Board (FIPB) will also be a prerequisite for investment by swap of shares.

Unquote

5. A specific provision for downstream investment through 'internal accruals'

The Revised Circular has introduced a specific provision whereby downstream investment is permitted through internal accruals. However, the same is subject to the guidelines applicable to downstream investments by Indian companies "owned and/or controlled by non-resident entities" as per paragraph 4.1 of the Revised Circular.

6. Prohibition on manufacture of cigarettes, etc.

The manufacturing of 'cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes', have now been formally included in the list of sectors/activities in which FDI is specifically prohibited.

7. Clarification on the coverage of "controlled conditions" for FDI in Agriculture, Animal Husbandry etc.

With respect to the Agriculture Sector, the coverage/scope of the term 'under controlled conditions' has now been separately defined in respect of 'animal husbandry', 'development of seeds', 'pisciculture and aquaculture' and 'floriculture / horticulture / cultivation of vegetables and mushrooms'. The details of the same are provided in paragraph 5.2.1.1(vi) to the Revised Circular.

8. Clarification on the concept of value-addition in case of mining and mineral separation of Titanium bearing minerals

With respect to the mining sector, the Revised Circular has introduced a clarificatory provision stating as under:

Quote

Clarification: (1) For titanium bearing ores such as Ilmenite, Leucosene and Rutile, manufacture of titanium dioxide pigment and titanium sponge constitutes value addition. Ilmenite can be processed to produce 'Synthetic Rutile or Titanium Slag as an intermediate value added product.

(2) The objective is to ensure that the raw material available in the country is utilized \ for setting up downstream industries and the technology available internationally is available for setting up such industries within the country. Thus, if with the technology transfer, the objective of the FDI Policy can be achieved, the conditions prescribed at (i) (A) above shall be deemed to be fulfilled.

Unquote

9. Development of Townships, Housing, Built - up infrastructure and Construction - development projects

As per the earlier FDI Policy applicable to the Real Estate Sector, the original investment cannot be repatriated before a period of

three years from completion of minimum capitalization. The Revised Circular now clarifies that the term "Original Investment" means the entire amount brought in as FDI. It has further been clarified that the lock-in period of three years will be applied from the date of receipt of each instalment / tranche of FDI or from the date of completion of minimum capitalization, whichever is later. However, the investor may be permitted to exit earlier with prior approval of the government through the FIPB.

10. Minimum capitalisation for 100% foreign owned NBFC's:

As per the earlier FDI Policy applicable to the NBFC Sector, 100% foreign owned NBFCs with a minimum capitalisation of US\$ 50 million can set up step down subsidiaries for specific NBFC activities, without any restriction on the number of operating subsidiaries and without bringing in additional capital.

The Revised Circular has added a provision to the aforesaid condition, stating that, the minimum capitalization condition as mandated by the guidelines for downstream investments by Indian companies, shall not apply to downstream subsidiaries for NBFC's.

11. Non-Fund based activities

With respect to the NBFC Sector, the Revised Circular has introduced a clarification that for Non-Fund based activities, US \$0.5

million *'have to be brought upfront'* for all permitted non-fund based NBFCs irrespective of the level of foreign investment.

For further information please refer to:

http://dipp.nic.in/FDI_Circular/FDI_Circular_02of2010.pdf

12. Deletion of "wholesale trading made to Group companies should be for internal use only"

With respect to the Trading Sector, the words "*wholesale trading made to group companies should be for internal use only*" have been deleted from the Guidelines for Cash & Carry Wholesale Trading/Wholesale Trading as set out in the Revised Circular.

13. Minimum Capitalisation

The Revised Circular has introduced a specific provision on minimum capitalisation stating as under:

Quote

Minimum capitalization includes share premium received alongwith the face value of the share, only when it is received by the company upon issue of the shares to the non-resident investor. Amount paid by the transferee during post-issue transfer of shares beyond the issue price of the share, cannot be taken into account while calculating minimum capitalization requirement.

Unquote

DSK Legal Knowledge Center

Contact Details: dsklegal.knowledgecenter@dsklegal.com

Mumbai Office

4th Floor, Express Towers,
Nariman Point,
Mumbai 400 021
India
Tel: (91 - 22) 6658 8000
Fax: (91 - 22) 6658 8001

Delhi Office

46, Aradhana, Chanakyapuri,
New Delhi 110 066
India
Phone : (91 - 11) 2687 1122; 2687 1133;
2687 1144
Fax : (91 - 11) 2687 1155

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