



Volume VIII ◇ Issue IV ◇ Year 2010

DSK Legal Knowledge Center

Updates on

- Corporate

CORPORATE: Circular 1 of 2010 - Consolidated FDI Policy

Foreign Direct Investment (“**FDI**”) by non residents in Indian companies is regulated by the Government of India in accordance with the provisions of Foreign Exchange Management Act, 1999 (“**FEMA**”), regulations made there under and the various press notes, press releases, and clarifications etc., issued on the subject over a period of time.

With the objective of consolidating all the prior press notes / press releases / clarification etc. the Department of Industrial Policy & Promotion (“**DIPP**”), Ministry of Commerce & Industry, Government of India has issued a circular dated March 31, 2010 (“**Circular**”). The Circular reflects the current ‘policy framework’ on FDI prevailing as of March 31, 2010. The Circular shall be effective from April 1, 2010.

The Circular has been issued with the sunset clause of six months. A new Circular consolidating all amendments to the FDI Policy shall be issued on September 30, 2010 superseding the present Circular.

The Circular has six chapters dealing with the issues related to (i) intent and objective (ii) definitions (iii) origin, type, eligibility, conditions and issue / transfer of investment (iv) calculation, entry route, caps, entry conditions of investment (v) policy on route and sectoral caps and (vi) remittance, reporting and violations related to FDI.

Some of the important provisions of the Circular are as under:

1. **Issue of Warrants:**

Clause 2.1.5 of the Circular has defined the term ‘**Capital**’ to mean equity shares; fully, compulsorily and mandatorily

convertible preference shares; fully, compulsorily and mandatorily convertible debentures. It has further been set out in the same Clause that 'any other type of instruments like warrants, partly paid shares etc. are not considered as capital and cannot be issued to person resident outside India'.

Clause 3.2.1 of the Circular states that Indian companies can issue equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares subject to pricing guidelines / valuation norms prescribed under FEMA Regulations. The pricing of the capital instruments should be decided / determined upfront at the time of issue of the instruments.

Thus from the aforesaid it could be construed that public listed or private companies cannot issue warrants or partly paid shares to a non-residents under the automatic route.

2. **Cash & Carry Wholesale Trading / Wholesale Trading:**

Clause 5.39.1.1 (i) of the Circular defines Cash & Carry Wholesale trading / Wholesale trading, to mean sale of goods / merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and

related subordinated service providers. Wholesale trading would, accordingly, be sales for the purpose of trade, business and profession, as opposed to sales for the purpose of personal consumption. The yardstick to determine whether the sale is wholesale or not would be the type of customers to whom the sale is made and not the size and volume of sales. Wholesale trading would include resale, processing and thereafter sale, bulk imports with ex-port / ex-bonded warehouse business sales and B2B e-Commerce.

Clause 5.39.1.1 (ii) sets out the Guidelines for Cash & Carry Wholesale Trading / Wholesale Trading ("WT"):

- (a) For undertaking WT, requisite licenses / registration / permits, as specified under the relevant Acts / Regulations / Rules / Orders of the State Government / Government Body / Government Authority / Local Self-Government Body under that State Government should be obtained.
- (b) Except in case of sales to Government, sales made by the wholesaler would be considered as 'cash & carry wholesale trading / wholesale trading' with valid business customers, only when WT are made to the following entities:

- (I) Entities holding sales tax / VAT registration / service tax / excise duty registration; or
 - (II) Entities holding trade licenses i.e. a license / registration certificate / membership certificate / registration under Shops and Establishment Act, issued by a Government Authority / Government Body / Local Self-Government Authority, reflecting that the entity / person holding the license / registration certificate / membership certificate, as the case may be, is itself / himself / herself engaged in a business involving commercial activity; or
 - (III) Entities holding permits / license etc. for undertaking retail trade (like tehbazari and similar license for hawkers) from Government Authorities / Local Self Government Bodies; or
 - (IV) Institutions having certificate of incorporation or registration as a society or registration as public trust for their self consumption.
- (c) Full records indicating all the details of such sales like name of entity, kind of entity, registration / license / permit etc. number, amount of sale etc. should be maintained on a day to day basis.
 - (d) WT of goods would be permitted among companies of the same group. However, such WT to group companies taken together should not exceed 25% of the total turnover of the wholesale venture and the wholesale made to the group companies should be for their internal use only.
 - (e) WT can be undertaken as per normal business practice, including extending credit facilities subject to applicable regulations.
 - (f) A Wholesale / Cash & Carry trader cannot open retail shops to sell to the consumer directly.

For more information please refer to

http://siadipp.nic.in/policy/fdi_circular/fdi_circular_1_2010.pdf

Note: An Entity to whom WT is made, may fulfill any one of the 4 conditions.

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