FDI AND ISSUE OF SHARES FOR CONSIDERATION OTHER THAN CASH

The introduction of guidelines on Indian companies issuing shares to foreign entities for considerations other than cash, was brought about pursuant to the Foreign Direct Investment Policy in April 2011. This was primarily with the objective of keeping a tab on possible FDI policy violation and money laundering in the wake of rising number of cases, where shares were issued against non-cash considerations like trade payables and import of capital goods.

Prior to the revised Foreign Direct Investment Policy in April 2011, Indian companies were allowed to issue equity and/or compulsorily convertible equity-linked instruments under the automatic route only if they were on cash consideration basis. The only exception to this was that an Indian company could issue equity shares and/or convertible instruments in lieu of its repayment obligations towards external commercial borrowings or payment obligations towards lump sum fees or royalties (including lump-sum technical know-how fees).

Pursuant to a discussion paper issued by the DIPP in September 2010, the Foreign Direct Investment Policy was revised in April 2011 and the issue of shares for consideration other than cash has been permitted in case of (i) import of capital goods/machinery/equipment (including second-hand machinery) and (ii) pre-operative/pre-incorporation expenses (including payments of rent etc) subject to prior approval of the government through the Foreign Investment Promotion Board (FIPB). Vide its circular dated May 8, 2012 the Reserve Bank of India has now excluded the conversion of imported second-hand machinery from the purview of this provision in order to promote the use of machinery embodying the latest state-of-the-art technology, in terms of being green, clean and energy efficient,. A non-cash transaction is an exception to the general rule and approvals are few and far between.

The following conditions are required to be complied with by the issuing company in order to receive government approval:

1. In case of issue of shares towards import of capital goods/ machinery/ equipment (excluding second-hand machinery):
   - Compliance with Export/Import Policy: Any import of capital goods/machinery etc., made by a resident in India, must be in accordance with the Export/ Import Policy issued by Government of India/as defined by DGFT/FEMA provisions relating to imports.
   - Independent Valuation: There must be an independent valuation of the capital goods/machinery/equipments (excluding second-hand machinery) by a third party entity, preferably by an independent valuer from the country of import along with production of copies of documents/certificates issued by the customs authorities towards assessment of the fair-value of such imports.
   - Identity of the Parties: The application should clearly indicate the beneficial ownership and identity of the Importer Company as well as overseas entity.
   - Time Line: Applications complete in all respects, for conversions of import payables for capital goods into FDI must be made within 180 days from the date of shipment of goods.

2. In case of issue of shares towards pre-operative/pre-incorporation expenses (including payments of rent etc):

   - Documents required: Submission of a Foreign Inward Remittance Certificate (FIRC) for remittance of funds by the overseas promoters for the expenditure incurred.

- Auditor Certificate: Verification and certification of the pre-incorporation/pre-operative expenses by the statutory auditor.
- Compliance with FEMA regulations: Payments should be made by the foreign investor to the company directly or through the bank account opened by the foreign investor as provided under FEMA Regulations.
- Time line: The applications for capitalization, complete in all respects, must be made within the period of 180 days from the date of incorporation of the company

In both the above cases, all requests for conversion must be accompanied by a special resolution of the company and the Government's approval would be subject to pricing guidelines of RBI and appropriate tax clearance.

The new policy makes little difference to the prevailing regime, as the issue of shares for the purposes described above continues to be under the approval route. Having said that, it would be beneficial to the economic sectors that are highly dependent on procuring equipment from foreign suppliers and collaborators.

The discussion paper issued by the DIPP in September 2010 also considered certain other scenarios for issue of shares for consideration other than cash such as services, import of raw material/ trade payables, share swaps, intangible assets (including franchisee rights); e) one time extraordinary payments (including arbitration awards). However, the new policy has not expressly adopted these other methods. Allowing share swaps would have immensely benefitted structuring overseas acquisitions by Indian companies.