FOREIGN DIRECT INVESTMENT NORMS – GUIDELINES FOR CALCULATION OF FOREIGN INVESTMENT

The Reserve Bank of India (RBI) has vide its Notification dated 4 July 2013, issued comprehensive guidelines on the calculation of total foreign investment in Indian companies, transfer of ownership and control of Indian companies and downstream investment by Indian companies ("Guidelines"). These Guidelines are pertinent in the resolution of the ongoing debate regarding the stake bought by Etihad in Jet Airways.

Press Notes. 2 & 3 dated 4th July, issued by the Department of Industrial Policy and Promotion (DIPP) provided for issued guidelines for calculation of total foreign investment, i.e., direct and indirect foreign investment in Indian companies and for transfer of ownership or control of Indian companies from resident Indian citizens to non-resident entities, in sectors with caps. This was modified by the DIPP vide its Press Note 2 dated July 31, 2012,

The Guidelines provide that any foreign investment already made in accordance with the guidelines in existence prior to February 13, 2009 would not require any modification to conform to these guidelines. All other investments, after the said date, would come under the ambit of these new Guidelines.

The Guidelines define the concepts of "ownership", "control", "downstream investment", "holding company" "indirect foreign investment" etc. The definitions of some of the key terms are summarized hereunder.

According to the Press Note, a company is considered "controlled by resident Indian citizens" if the power to appoint a majority of the directors on its board is held by Indian companies and citizens. On the other hand, a company is considered to be "owned by resident Indians" if more than 50% of the capital in it is owned by resident Indian residents and/or Indian companies, which are ultimately owned and controlled by resident Indian citizens.

Similarly if a more than 50% of the capital of an Indian company is beneficially owned by non-residents it will be construed to be 'owned by a non-resident'. Whereas a company 'Controlled by 'non-residents ' shall mean where non-residents have the power to appoint a majority of its directors in that company.

In accordance with the Guidelines, investment in Indian companies can be made by both non-resident as well as resident entities. Any non-resident investment in an Indian company is direct foreign investment. Investment by resident Indian entities could again comprise both resident and non-resident investments. Thus, such an Indian company would have indirect foreign investment if the Indian investing company has foreign investment in it. The indirect investment can also be a cascading investment, i.e. through multi-layered structure.

In addition to abovementioned, the Press Note prescribes guidelines for calculation of direct and indirect foreign investment. As per the Press Note, the entire indirect foreign investment by the investing company in an 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. This exception has been made since the downstream investment of a 100% owned subsidiary of the holding company is akin to investment made by the holding company and the downstream investment should be a mirror image of the holding company. This exception, however, is strictly for those cases where the entire capital of the downstream subsidiary is owned by the holding company. The methodology for calculation of total foreign investment would apply at every stage of investment in Indian companies and in each and every Indian company.

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