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Indirect Foreign Investment or Downstream Investment in India

Guidelines for calculation of total foreign investment i.e. direct and indirect foreign investment in Indian companies is primarily governed by Press Note No 2 (2009 Series) issued by Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Government of India.

Entry routes for investments in India

Under the Foreign Direct Investments (FDI) Scheme, investments can be made in shares, mandatorily and fully convertible debentures and mandatorily and fully convertible preference shares of an Indian company by non-residents through two routes:

- a. **Automatic Route:** Under the Automatic Route, the foreign investor or the Indian company does not require any approval from the Reserve Bank or Government of India for the investment.
- b. **Government Route:** Under the Government Route, the foreign investor or the Indian company should obtain prior approval of the Government of India (Foreign Investment Promotion Board (FIPB), Department of Economic Affairs (DEA), Ministry of Finance or Department of Industrial Policy & Promotion, as the case may be) for the investment.

Meaning of Foreign Direct Investment (FDI)

In Indian perspective, FDI in simply words means Investment by foreign entity or enterprise into an Indian entity or enterprise with a view to create long business relations. FDI may be made in an Indian entity or enterprise by way of purchasing equity shares. In other words any non-resident investment in an Indian company is foreign direct investment.

Meaning of Indirect Foreign Direct Investment (Indirect FDI)

Investment in Indian companies can be made both by non-resident (Foreign Entities) as well as resident Indian entities. Investment by resident Indian entities could again comprise of both resident and non-resident investment. Thus, such an Indian company would have indirect foreign investment if the Indian investing company has foreign investment in it.

Example: XYZ Limited (resident Indian entities) is having Foreign Direct Investment made by Fidelity fund Mauritius (non-resident). ABC Limited is subsidiary of XYZ Limited in India having investment of XYZ Limited. Here XYZ Limited comprise of both resident and non-resident investment. Accordingly ABC Limited said to have indirect foreign investment as XYZ Limited (Indian investing company) has foreign investment in it

For the purpose of computation of indirect Foreign investment, Foreign Investment in Indian company shall include all types of foreign investments i.e. FDI, investment by FIIs (holding as on

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March 31), NRIs, ADRs, GDRs, Foreign Currency Convertible Bonds (FCCB) and convertible preference shares, convertible Currency Debentures regardless of whether the said investments have been made under Schedule 1, 2, 3 and 6 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations.

Regulatory framework for foreign Direct Investment (FDI)

Foreign investment in India is governed by sub-section (3) of Section 6 of the Foreign Exchange Management Act, 1999 read with Notification No. **FEMA 20/2000-RB dated May 3, 2000**, as amended from time to time.

Foreign Direct Investment (FDI) in India is undertaken in accordance with the FDI Policy which is formulated and announced by the Government of India. The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India issues a "Consolidated FDI Policy Circular " on an yearly basis on March 31 of each year (since 2010) elaborating the policy and the process in respect of FDI in India.

The latest "Consolidated FDI Policy Circular" dated April 17, 2014 is available in the public domain and can be downloaded from the website of Ministry of Commerce and Industry, Department of Industrial Policy and Promotion. Please find below the link:

http://dipp.nic.in/English/Policies/FDI_Circular_2014.pdf
http://www.rbi.org.in/scripts/BS_ViewMasCircularDetails.aspx?id=9006

Methodology for calculating Indirect Foreign Investment

The method of calculation of total foreign investment in an Indian company including indirect foreign investment through other Indian companies has been detailed out in entry 10 of Press Note 2(2000), Press Note 1(2006), Press Note 3(2007) and entry 24 of Press Note 7 (2008). The methodology for some sectors is also separately contained in either sectoral regulations or rules and regulations under specific statutes. Essentially the present FDI guidelines provide for three different regimes for calculation of Indirect Foreign Equity.

- a. **Telecom/ Broadcasting sectors:** Proportionate method is used in Telecom/ Broadcasting sectors through Press Note 5 of 2005, Press Note 1 of 2006 and Press Note 3 of 2007.
- b. **Insurance:** Outlined in IRDA regulations (IRDA (Registration of Indian Insurance Companies) Regulations, 2000) and
- c. **Other Sectors:** In all other sectors, for an investing company in the infrastructure / service sector attracting equity caps, indirect equity is calculated as was given in Press Note 2 of 2000: *Investing companies in infrastructure/service sectors (entry no. 10). This policy was reiterated by Press Note 4 of 2006(Entry no.18) which was modified by a Press release dated November 13,*

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2006 and Press Note 7(2008) (entry 24). According to this, foreign investment in an investing company will not be set off against this cap where the foreign equity in the investing company does not exceed 49% and the Management of the investing company is with Indian owners. FIPB approval is required by Investing Companies for downstream investment.

Guidelines for calculation of total foreign investment i.e. direct and indirect foreign investment in an Indian company

a. Counting the Direct Foreign Investment:

All investment directly by a non-resident entity into the Indian company would be counted towards foreign investment.

b. Counting of indirect foreign Investment:

Methods for counting of indirect foreign Investment may be divided into 2 parts which are mentioned below:

Method No. 1

The foreign investment through the investing Indian company would not be considered for calculation of the indirect foreign investment in case of Indian companies which are 'owned **and** controlled' by resident Indian citizens and/or Indian Companies which are owned and controlled by resident Indian citizens.

For this purpose, an Indian company may be taken as being:

- **"owned"** by resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, if more than 50% of the equity interest in it is beneficially owned by resident Indian citizens and Indian companies, which are owned and controlled ultimately by resident Indian citizens;

And

- **"controlled"** by resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, if the resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens, have the power to appoint a majority of its directors .

Example: Suppose the indirect foreign investment is being calculated for Company ABC Limited which has investment through an investing company XYZ Limited having foreign investment by Fidelity Fund Mauritius, the following would be the method of calculation:

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(i) where Company XYZ Limited has foreign investment less than 50%- Company ABC Limited would not be taken as having any indirect foreign investment through Company XYZ Limited.

Method No. 2

Method 2 applied where method 1 above is not satisfied or if the investing company is owned **or** controlled by 'non-resident entities', the entire investment by the investing company into the subject Indian Company would be considered as indirect foreign investment.

Example: Suppose the indirect foreign investment is being calculated for Company ABC Limited which has investment through an investing company XYZ Limited having foreign investment by Fidelity Fund Mauritius, the following would be the method of calculation:

(ii) where Company XYZ Limited has foreign investment of say 65% and:

a. invests 34% in Company ABC Limited, the entire 34% investment by Company XYZ Limited would be treated as indirect foreign investment in Company ABC Limited;

b. Invests 90% in Company ABC Limited, the indirect foreign investment in Company ABC Limited would be taken as 90%.

Exception

There is one exception created for Method No. 2. As an exception, the indirect foreign investment in 100% owned subsidiaries of operating-cum-investing/investing companies will be limited to the foreign investment in the operating-cum-investing/ investing company. For the purposes of explanation, it is clarified that this exception is being 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.

For the above purpose, an Indian company may be taken as being:

- **"owned"** by 'non-resident entities', if more than 50% of the equity interest in it is beneficially owned by non-residents.
- **"controlled"** by 'non-resident entities', if non-residents have the power to appoint a majority of its directors

Example: Suppose the indirect foreign investment is being calculated for Company ABC Limited which has investment through an investing company XYZ Limited having foreign investment by Fidelity Fund Mauritius, the following would be the method of calculation:

(iii) where Company ABC Limited is a wholly owned subsidiary of Company XYZ Limited (i.e. Company XYZ Limited owns 100% shares of Company ABC Limited) and Company XYZ Limited

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has foreign investment of 65%, then only 65% would be treated as indirect foreign equity and the balance 35% would be treated as resident held equity. The indirect foreign equity in Company ABC Limited would be computed in the ratio of 65: 35 in the total investment of Company XYZ Limited in Company ABC Limited.

The total foreign investment would be the sum total of direct and indirect foreign investment. The above methodology of calculation would apply at every stage of investment in Indian Companies and thus to each and every Indian Company.

Disclaimer:

This write up is intended to start academic discussion on few significant interpretations. It is not intended to be a professional advice and should not be relied upon for real time professional facts. Readers are advised to refer relevant provision of law before applying or accepting any of the point mentioned above. Author accepts no responsibility whatsoever and will not be liable for any losses, claims or damages which may arise because of the contents of this write up.

Thanks

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