The Department of Industrial Policy and Promotion ("DIPP") Ministry of Commerce and Industry, Government of India, issued a consolidated FDI policy (the "Circular") on March 31, 2010 In an attempt to simplify the rules and regulations pertaining to the foreign direct investment ("FDI") policy. The Circular which became effective from April 1, 2010 consolidates and more importantly, subsumes, all prior press notes / press releases / clarifications issued by the DIPP as on March 31, 2010 and reflects the current policy framework on FDI.

The press release issued by the Ministry of Commerce and Industry on March 31, 2010 has One of the most significant aspects , that all the Press Notes issued in the past will be rescinded with the issue of this Press Note, which would now comprise the single document on FDI policy. Really this marks the inception of a whole new chapter on FDI policy. The major significant aspects brought in the policy are as follows:

- The press release clarifies that the Circular is a mere consolidation / compilation and does not intend to change the existing legal framework.
- Any changes notified by the Reserve Bank of India from time to time would have to be complied with.
- In the event of any need / scope of interpretation of the Circular, the relevant Foreign Exchange Management Act, 1999 ("FEMA") notification / rule / regulation would prevail.
- The Government has decided to update the FDI policy on a six monthly basis.
- By issuing a new circular which would supersede all prior press notes and circulars. Hence, this Circular would be superseded with a circular to be issued on September 30, 2010.

However this press release is not only a mayor compilation of earlier Press notes and policies, but it has brought some specific changes in the policy guidelines as follows:

**Capital**. 2.1.5 defines word 'Capital' means

- "equity shares;
- fully, compulsorily & mandatorily convertible preference shares;
- fully, compulsorily & mandatorily convertible debentures.

*Note : 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."*

Now the warrants and partly paid up shares, even the FIPB would not be able to approve their issuance to foreign investors.

**Definition of Joint Venture (JV) (newly inserted)**

JV in India means an Indian entity incorporated in accordance with the laws and regulations in India in whose capital a foreign entity makes an investment. Earlier there is no such definition exists.

**Industry Specific changes**

**I. Venture Capital Funds ("VCF") and Trusts**

| Earlier Provisions | Existing Provision |
|---|---|
| Earlier, a SEBI registered foreign venture capital investor ("FVCI") was allowed to invest in a domestic VCF registered under the SEBI (Venture Capital Fund) Regulations, 1996 under the automatic route (i.e. without any approval being required).<br><br>Accordingly, there was no distinction were made to accepting foreign investment from an FVCI for a VCF, structured either as a company or as a trust. | Investment Restrictions on trust have affected FVCI investment as follows:<br><br>**a.** An FVCI can now invest in a VCF (that is set up as a trust registered under the Indian Trust Act, 1882) upon obtaining a prior government approval.<br><br>**b.** Investment in a trust which is not registered with SEBI as a VCF is not permitted. |
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It seems that the government has tried to develop a 'unified' structure and severely restrict the structural alternatives available for such funds.

Another issues that may arise is on account of ambiguity as to whether in case of a 'unified' structure that is already in place and in the absence of any grandfathering provision in the Policy, if an FVCI (registered prior to April 1, 2010) has to invest in the units of a VCF (registered prior to April 1, 2010) whether any further governmental approval would be required. Such investments were being made under the automatic route thus far.

## II Agriculture (development of transgenic seeds/vegetables)

| Earlier Provision | Existing Provision |
|---|---|
| 100% Foreign Direct investment was allowed under automatic route in the following activities:<br>• Floriculture,<br>• Horticulture,<br>• Development of Seeds,<br>• Animal<br>• Husbandry,<br>• Pisciculture,<br>• Aquaculture,<br>• Cultivation of Vegetables & Mushrooms under<br>• controlled conditions and<br>• Services related to agro and allied sectors.<br>***Besides the above, FDI was not allowed in any other agricultural sector /activity*** | the Circular has **added certain conditions for companies dealing with the development of transgenic seeds/vegetables**, namely:<br><br>· When dealing with genetically modified seeds or planting material the **company shall comply with safety requirements in accordance with laws enacted under the Environment (Protection) Act** on the genetically modified organisms.<br>(ii) Any import of **genetically modified materials if required shall be subject to the conditions laid down vide Notifications issued under Foreign Trade (Development and Regulation) Act, 1992.**<br>(iii) The company shall comply with any other Law, Regulation or Policy governing genetically modified material in force from time to time.<br><br>(iv) Undertaking of business activities involving the use of genetically engineered cells and material shall be **subject to the receipt of approvals from Genetic Engineering Approval Committee (GEAC) and Review Committee on Genetic Manipulation (RCGM).**<br><br>(v) **Import of materials shall be in accordance with National Seeds Policy.** |

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## III. Mining Industry

| Earlier Provision | Existing Provision |
|---|---|
| **In Mining industry,** covering exploration and mining of diamonds & precious stones; gold, silver and minerals (allowed **100% FDI** through automatic route) for setting up 100% owned subsidiaries were out of the purview of Press Note 18 (1998) and Press Note 1 (2005), subject to a declaration from the applicant that he has no existing joint venture for the same area and / or the particular mineral. | No similar Provision is; It is not clear whether such declaration requires still today or not. |

As with the introduction of Circular 1 of 2010, all existing press notes have been rescinded; those sectors earlier exempted upon fulfillment of certain conditions have not been clearly mentioned whether they still have to comply with those requirements.

## IV. Research and Development

| Earlier Provision | Existing Provision |
|---|---|
| No any provision earlier like this was. | Research and Development Services **excluding basic Research and setting of R&D/ academic institutions which would award degrees/diplomas/certificates**, 100% FDI is allowed under the automatic route |

The para 5.34 of the circular provides for 100% FDI in “research and development excluding basic research and setting of R&D / academic institutions which would award degrees / diplomas / certificates”.

The wordings used above would create many questions and doubts unless it is amended or clarified like:

- "Basic research and setting of R&D / academic institutions which would award degrees / diplomas / certificates" is a vogue and mysterious concept.
    - It is not clear that what is meant by 'basic research'?
    - Along with basic research, is "setting of R&D / academic institutions which would award degrees/ diplomas / certificates" also to be excluded, thereby restricting investment in the education sector?
- Time and again it has been communicated and clarified that there is no restriction on foreign investment in the education sector under the FDI policy (Foreign Universities and education institute can open and set up their branch offices in India to carry out educational activities.) Now use of wordings like
- **"excluding basic Research and setting of R&D/ academic institutions which would award degrees/diplomas/certificates"**

  Then how exclusion can be made to those **which would award degrees/diplomas/certificates?**

***Para 5.43 of the Circular also specifically states that any sector/industry that is not specifically mentioned is eligible to receive 100% foreign investment under the automatic route. It would be better if the education sector has not been specifically mentioned, and therefore would be under the 100% automatic route.***

**V. Retail Trading /Cash and Carry Wholesale Trading**

| Earlier Provision | Existing Provision |
|---|---|
| Whole sale trading (B2B) sale was allowed under automatic route upto 100%. | While the FDI limit has been maintained at 100%, subject to compliance of the following guidelines:<br><br>(a)For undertaking WT, requisite licenses/registration/ permits, as specified under the relevant Acts/Regulations/Rules/Orders of the State Government/Government |

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| | Body/Government Authority/Local Self-Government Body under that State Government should be obtained.<br><br>(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:<br><br>(I) Entities holding sales tax/ VAT registration/service tax/excise duty registration; or<br><br>(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<br>(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<br>(IV) Institutions having certificate of incorporation or registration as a society or registration as public trust for their self consumption.<br><br>**Note: An Entity, to whom WT is made, may fulfill any one of the 4 conditions.**<br>(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.<br>(d) WT of goods would be permitted |

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| | 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.<br>(e) WT can be undertaken as per normal business practice, including extending credit facilities subject to applicable regulations.<br>(f) A Wholesale/Cash & carry trader cannot open retail shops to sell to the consumer directly |

The guidelines introduced for wholesale trading / cash and carry wholesale trading provides that in order to determine whether the sale is a wholesale trading or not,

- **One needs to consider the type of customers to whom the sale is made as opposed to the size or volume of sale**. Accordingly, sale for the purpose of trade, business and profession, as opposed to personal consumption, would be regarded as wholesale trading.

- The guidelines further go on to clarify that a **wholesale trader receiving foreign investment is prohibited from setting up a retail shop which directly cater to the consumers. The guidelines permit wholesale trading between group companies *only to the extent of 25%* of the turnover of such wholesale trading company provided that such sale is for internal use**.

It seems that by the Circular the Government has tried to incorporate major outcome of the 2004 decision of the Hon'ble High Court of Delhi in the case of Federation of Associations of Maharashtra vs. Union of India, discussed at great lengths, the distinction between retail trade and wholesale cash and carry trade.

these guidelines seems to be to ensure that no foreign investment is received in the retail sector (which, barring single-brand retail, falls under the negative list) in the guise of investment in wholesale trading / cash and carry wholesale trading.

**VI. FDI in lottery, gambling and betting sector: Clarification**

| Earlier Provision | Existing Provision |
|---|---|
| Press Note 5 of 2002, clarified that foreign investment and foreign technology collaboration in any form are completely prohibited in the lottery business, gambling and betting sector.<br>However, there existed certain ambiguity as to whether foreign licensing of franchise / trademark / brand name, management contract, etc., are permitted in the lottery business, gambling and betting sector | The Circular has made clear that foreign investment in any form, foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also completely prohibited for lottery business, gambling and betting activities. |

**Issues still unanswered:**

The simplification/consolidation of framework will improve the scenario but some questions are still unanswered like:

(a) **Foreign investment in Limited Liability Partnerships (LLPs)**: The Circular is silent on this aspect.

(b) **Clarifications on issues related to Press Notes 2, 3 & 4 of 2009**: As per the Press Notes 2, 3 and 4 of 2009 issued last year Leading banks in the country (such as HDFC Bank and ICICI Bank) were comes under the definition of owned and controlled by foreign entities and classifies as 'foreign banks'.

(d) **Tightening of FDI norms, Anti money laundering measures and securities related issues:** It was heard some times before that finance ministry has proposed to tighten the FDI policy to ensure Anti money laundering measures and securities related issues and going to propose some stricter norms particularly with respect to downstream investment practices by firms with foreign minority shareholding.

Hope that new circular will more lighten on the above issue. A welcome move by the government.