1 Wholesale Trading
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Missing buzz around FDI in India

- Pessimism amongst Foreign Investors
- ~20% fall in Foreign Direct Investment in India during the last Financial Year
- Uncertainties / issues surrounding policies and taxation
- Key Policy changes announced to boost investor sentiments and attract more Foreign Investments
  - Single Brand / Multi-Brand Retail Trading
  - Defence – 26% (beyond 26% on case to case basis)
  - Telecom – 100% (upto 49% Automatic Route)
  - Courier – 100% Automatic Route
  - Credit Information Companies – 74% Automatic Route

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## FDI in Trading -- History

### 1997
- 100% FDI in Wholesale Cash and Carry Trading permitted under Approval Route

### 2006
- 100% FDI in Whole Cash and Carry Trading brought under Automatic Route
- 51% FDI in Single Brand Retail Trading (‘SBRT’) permitted under Approval Route
- FDI in Multi-Brand Retail Trading (‘MBRT’) not permitted

### January 2012
- Increase of ceiling from 51% to 100% FDI in SBRT subject to additional conditions

### September 2012
- Conditions for FDI in SBRT modified / clarified
- Upto 51% FDI in MBRT permitted subject to conditions under Approval Route

### June 2013
- DIPP issues clarification on FDI Policy for MBRT

### August 2013
- FDI in SBRT upto 49% under Automatic Route
- Conditions for FDI in SBRT and MBRT further modified / clarified
Wholesale Trading -- Issues with respect to definition of Group Companies (1/3)

**Framework**

- Guidelines for Cash and Carry Wholesale Trading / Wholesale Trading (‘WT / WCCT’) allow Wholesale trade of goods among Group Companies

- However Wholesale Trade between Group Companies should not exceed 25% of the total turnover of the wholesale venture

- The DIPP has issued Press Note No. 2 of 2013 on 3 June 2013 defining “Group Company” as two or more enterprises which directly, or indirectly, are in a position to:
  
  i. exercise 26% or more voting rights in the other enterprise; OR

  ii. appoint more than 50%, of members of Board of Directors in the other enterprise”

**Key Issues**

- Meaning of the term ‘Indirectly’?

- Does the Definition cure the ‘perceived abuse’?
Wholesale Trading
-- Issues with respect to definition of Group Companies (2/3)

- A Co. is a foreign company and holds 100% shares of FCO1 and FCO2
- FCO1 holds 100% shares of an Indian Company engaged in Wholesale / Cash and Carry (WCCT).
- FCO2 holds 100% shares of an Indian Company engaged in Manufacturing Activity (MFG Co)
- WCCT and MFG Co both have No common Directors
- Whether WCCT and MFG Co, being sister concerns, be treated as Group Companies for the restriction of 25% inter-se transactions?
• Whether WCCT and Retail Co be treated as group companies?
  
  – When there is no right to appoint Directors on each other’s BOD?
  
  – When there is such a right?

Transactions on B2B basis
Single-Brand Product Retail Trading – Updates (1/3)

Press Note 1 of 2012 dated 10 January 2012

- Earlier 51% FDI allowed under Approval Route subject to prescribed conditions
- Key changes:
  - 100% FDI under Approval Route subject to additional conditions
  - For FDI beyond 51% - mandatory sourcing of at least 30% of value of products sold should be from Indian small industries / village and cottage industries, artisans and craftsmen.
  - Foreign Investor should be the owner of the Brand

Press Note 4 of 2012 issued in September 2012

- Modify / liberalized aspects like
  - Only one non-resident entity, whether owner of brand or otherwise through a legal agreement with the brand owner to undertake SBRT in India
  - Term mandatory sourcing replaced with Preferable sourcing
  - Term small industries replaced with MSMEs
Press Note 6 of 2013 dated 22 August 2013

• Further liberalizes conditions for FDI in SBRT
  
  - FDI up to 49% under Automatic Route beyond 49% under Approval Route

  - A non-resident entity or entities, whether owner of brand or otherwise through a legal agreement with the brand owner to undertake SBRT in India
• Possible interpretation of the term “Preferable sourcing”
  - As far as possible sourcing to be attempted from MSME over the 5 year period starting from 1 April of year in which 1st tranche of FDI is received
  - However, despite genuine efforts if such sourcing is not possible you may need to demonstrate why compliance with that condition is not feasible

• In case an Indian Company is engaged in two businesses (SBRT and other trading business), whether calculation of sourcing of at least 30% of value of products sold will include total purchases of the Company (purchases for SBRT + purchases for other business activities) OR purchases only pertaining to SBRT?

• Whether SBRT entity can also carry out WCCT?

• Whether selling products of sub-brands permissible? Can a new sub-brand be launched first in India prior to it being sold in any other country?

• Whether FDI in an Indian Trading Company with local brand (without presence in any other country) permissible?
Multi-Brand Retail Trading (MBRT) – Issues
-- Back-end Infrastructure

- DIPP Press Note 5 of 2012 dated 20 September, 2012, permitted FDI in MBRT upto 51% under Approval Route subject to certain conditions:
  - At least 50% of Total FDI brought in shall be invested in ‘back-end’ infrastructure within three years of the first tranche of FDI

- Press Note 5 of 2013 dated 22 August 2013 now clarifies:
  - At least 50% of total FDI brought in the first tranche of USD 100 Mio shall be invested in ‘back-end infrastructure’ within three years
  - Gives option for subsequent investment to the MBRT retailer depending on its business requirements

• What is the liberalization?
Multi-Brand Retail Trading (MBRT) – Issues
-- Back-end Infrastructure

Key issues arising out of clarifications issued by DIPP on its website on 6 June 2013 and not embedded / clarified by the latest Press Note on MBRT

Key Clarifications

- Only captive usage of back-end facilities permissible

- Investment in back-end infrastructure has to be an additionality and can invest only in greenfield assets with no possibility to acquire supply / chain / backend assets or stakes from an existing entity

- Investment in equity of existing infrastructure company will not be treated towards fulfillment of conditionality of 50% investment in back-end infrastructure

- Wholesale trading / Cash and carry cannot be considered to be providing back-end infrastructure

- If the same foreign investor is an investor in various companies (MBRT, logistics etc), investment in multiple infrastructure companies will not be counted towards condition of investing 50% in Back-end infrastructure
Multi-Brand Retail Trading (MBRT) – Issues
-- 30% Sourcing

**Framework**

- At least 30% of value of procurement of manufactured / processed products purchased shall be sourced from Indian “small industries” with a total investment not exceeding USD 1 mio.
- Further at any point if the above value of investment exceeds USD 1 mio, the industry shall not qualify as small industry.
- Press Note 5 of 2013 now clarifies:
  - At least 30% of value of procurement of manufactured / processed products purchased shall be sourced from Indian *micro, small and medium industries* with a total investment *not exceeding USD 2 mio*.
  - The small industry would be reckoned only at the time of first engagement with the retailer and such industry shall continue to qualify as a small industry even if it outgrows investment of USD 2 mio.
  - Sourcing from agricultural & farmer co-operatives considered MSME category.

**Key Issues**

- Key issues arising out of clarifications issued by DIPP on it’s website on 6 June 2013 and not embedded / clarified in the latest Press Note on MBRT:
  - Distribution with respect to 30% sourcing will be reckoned only with reference to front-end stores.
  - MBRT not to engage in any other form of distribution / trading.
Multi-Brand Retail Trading (MBRT) -- Other Clarifications

Other Key Clarifications

• Supplies by MBRT companies to Franchises run by its partners. Clarified that the Policy envisions MBRT in Retail. MBRT entity is not envisaged to undertake wholesale activity i.e. B2B

• Front-end stores set-up by MBRT entity will have to be ‘company owned and company operated only’

• Franchise model is not permissible as per the FDI policy on MBRT

• Front end retail stores also to be set-up as an additionality and not through acquisition of existing stores

• Investment in Back-end infrastructure in non-FDI approved states will be counted towards 50% investment towards Back-end infrastructure provided it is an additionality
Nowhere in the world is the retail sector divided into so many compartments such as single brand, multi-brand, front-end, backend. Retail is retail. Foreign investors, in the current environment, don't want to take any chances; they don't want anything to be left open to interpretations.

– Kishore Biyani
Downstream investments

Framework

- DIPP issued Press Notes 2, 3 and 4 of 2009 to bring in clarity / uniformity with regards to policy and methods of calculation of indirect foreign investment / downstream investments.

- DIPP Circular 2 of 2010 clarified that companies could make downstream investments through ‘internal accruals’

- RBI Circular No. 01 dated 4 July 2013 (and Notification FEMA – 278/2013 dated 7 June 2013) enacts the downstream investments guidelines in FEMA 20

Key Issues

- Whether Indian Companies with FDI which are not foreign owned and controlled can make downstream investments in any sector?

- Disconnect between the above RBI Circular / FEMA 278 and the FDI Policy

  - Whether downstream investments by an Indian Operating or Operating-cum-investing Company permitted under Automatic Route through ‘internal accruals’? Whether FIPB approval required in such cases?
Definition of ‘Control’

- Earlier under FDI Policy, a company was considered as “Controlled” by resident Indian citizens if 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 in that company.

- DIPP’s Press Note No. 4 dated 22 August, 2013 – revised the definition of ‘Control’ to include right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.

- Definition intended to align with SEBI (SAST) Regulations & Companies Act 2013.

Key Issue

- Meaning of terms like ‘policy decisions’ and ‘management’
Press Note 3 of 2011 dated 8 November 2011 amended the FDI policy with respect to Pharmaceuticals as under:

- Automatic route – FDI up to 100% for greenfield investments.
- Government Route - FDI up to 100% for brownfield investments (i.e. investments in existing companies)

The Consolidated FDI policy of 2013 clarifies that government may incorporate appropriate conditions for FDI in brownfield cases, at the time of granting approval.

- Definition / classification of products falling in Pharmaceuticals sector
- Issue of interpretation of the terms ‘brownfield’ and ‘greenfield’ investments.
Business Line

FinMin to press for re-look at pharma product categories

4 August 2013

The Finance Ministry plans to approach the Department of Industrial Policy and Promotion (DIPP) for ‘finer classification’ of products in the pharmaceutical sector for foreign direct investment norms.

27 August 2013

US-based Mylan Inc's Rs 5,168 crore proposal to acquire Agila Specialties Pvt Ltd -- a subsidiary of pharma firm Strides Arcolab -- was cleared by the Foreign Investment Promotion Board (FIPB) today.

Mayaram, who heads the FIPB, further said that all pending pharmaceutical investment proposals related with brownfield projects too have been cleared.
Real Estate / Construction Development
-- Key issues

Framework

- No change in Policy since then.

Key Issues

- Whether FDI is permissible in an under construction projects / partly developed projects (percentage of completion?)
- Whether minimum capitalization is required to be satisfied at ‘Project level’ / ‘SPV level’
- In case of transfer of shares - amount paid by the transferee beyond the issue price of the share should be taken into account while calculating minimum capitalization?
- FDI in company having agricultural land pending conversion
- Whether minimum built up area means carpet area? Whether car parking area, basement area etc. is included for the purpose of computing built up area?
- Commencement of Business – Not defined – whether acquisition of land constitutes commencement of business
- Whether transfer of shares between non-residents allowed within lock in period?
Compulsorily Convertible Debentures
-- Key Issues

Framework

- As per RBI Circular 74 of 2007 it was clarified that Compulsorily Convertible Debentures (CCD) should be mandatorily convertible within a specified time to be reckoned as part of equity.

Key Issues

- Term ‘specified time’ not defined but relates to period mutually agreed by parties

- Period of Conversion: Can an Indian Company and Foreign Investor extend or pre-pone conversion period of CCD as is mutually agreed / beneficial?

- Rate of Interest: Regulations do not limit rate of interest payable on CCDs. Can an Indian Company and Foreign Investor post issue of CCD change the rate of interest as is mutually agreed / beneficial?
Other Issues

- Earlier Issue of shares by conversion of import of capital goods / machineries / equipments (including second-hand machineries) was permissible under the Government route

- Circular 1 of 2012 issued by the DIPP / RBI Circular No. 120 of 2012 - Exclusion of imported second-hand machinery

- Application to be filed within 180 days from shipment of goods – need for relaxation of such time limit

- Currently issue of shares permissible under Government Route for pre-incorporation / pre-operative expenses

- Operational / administrative difficulties leading to delay in opening bank account and capital infusion - expenses continued to be incurred in the interim

- Issue of shares should also be extended for post-incorporation expenses in genuine cases under approval route