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FEMA FOCUS

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(I) LIBERALISATION OF THE FDI REGIME

On 28th August, 2019 the Union Cabinet chaired by the Prime Minister approved several proposals for review of Foreign Direct Investment in the coal mining, contract manufacturing and single brand retail trade sectors. A press release stated that the Cabinet had approved major proposals for relaxation of the existing Foreign Direct Investment Policy (FDI Policy) in these sectors:

COAL MINING

Proposal

Permit 100% FDI under automatic route for sale of coal, for coal mining activities, including associated processing infrastructure, subject to provisions of the Coal Mines (Special Provisions) Act, 2015 and the Mines and Minerals (Development and Regulation) Act, 1957 as amended from time to time, and other relevant acts on the subject. 'Associated Processing Infrastructure' would include coal washery, crushing, coal handling, and separation (magnetic and non-magnetic).

CONTRACT MANUFACTURING

Proposal

The present FDI policy provides for 100% FDI under automatic route in the manufacturing sector. There is no specific provision for contract manufacturing in the policy. In order to provide clarity on contract manufacturing, it has been decided to allow 100% FDI under automatic route in contract manufacturing in India as well.

Foreign investment in 'manufacturing' sector is under automatic route. Manufacturing activities may be conducted either by the investee entity or through contract manufacturing in India under a legally tenable contract, whether on principal-to-principal or principal-to-agent basis.

Comments

The law proposes to clarify that manufacturing need not be done by the FDI entity but can also be done by any other entity. This proposal will set to rest concerns expressed by some quarters that contract manufacturing is a trading activity because a company only sells a product after getting it manufactured.

The contract manufacturer need not be a group company or working exclusively for an FDI entity. Further, the arrangement can be on principal-to-principal or principal-to-agent basis. Thus, the policy includes the typical contract manufacturer as also the toll manufacturer.

A manufacturer is permitted to sell products manufactured in India through wholesale and / or retail, including through e-commerce, without government approval.

Thus, this proposal is likely to open up a number of opportunities for retail trading and promote label products without inviting extant restrictions applicable to retail trading.

SINGLE BRAND RETAIL TRADE (SBRT)

Proposal

As per the existing FDI policy, 100% FDI is allowed under automatic route for SBRT activity. However, there are various conditions that need to be fulfilled. The government has relaxed some of these conditions to attract more FDI for SBRT activities in India.

Local sourcing norms

The existing FDI policy provides that in respect of the SBRT entity having more than 51% FDI, the sourcing of 30% of value of goods purchased must be done from India only. In this regard, the SBRT entity is permitted to set off its incremental sourcing of goods (by non-residents undertaking SBRT in India either directly or through their group companies) from India for global operations against the mandatory 30% local sourcing requirement during the initial five years only. After five years, the SBRT entity is required to meet the 30% sourcing norms directly towards its India operations on an annual basis.

With regard to the above, the government has now proposed to relax these conditions as under:

Local sourcing for domestic as well as export sales by SBRT entity: All the procurements made from India by the SBRT entity for the single brand shall be counted towards local sourcing, irrespective of whether the goods procured are sold in India or exported, and the same would apply even beyond the initial five years.

Incremental sourcing vs. year-on-year sourcing: As per the extant policy, only that part of the global sourcing is considered for abovementioned set-off towards local sourcing requirement which is over and above the previous year's value, i.e., only incremental sourcing is considered for set-off against local sourcing requirements. The government has now decided the entire (and not the incremental) sourcing from India for global operations shall be considered towards local sourcing requirement.

Direct and indirect sourcing: It has also been decided that the global sourcing would cover sourcing of goods from India for global operations not only by non-residents undertaking SBRT in India either directly or through their group companies (resident or non-resident), but also by an unrelated third party, done at the behest of the SBRT entity or its group companies under a legally tenable agreement.

E-commerce

As per the existing policy, an SBRT entity must operate through brick-and-mortar stores before starting retail trading of that brand through e-commerce. However, the government has now decided to allow retail trading through online trade prior to opening of brick-and-mortar stores, subject to the condition that the SBRT entity opens brick-and-mortar stores within two years from the date of start of online retail.

DIGITAL MEDIA

Proposal

The extant FDI policy provides for 49% FDI under approval route in up-linking of ‘News and Current Affairs’ TV channels. It has been decided to permit 26% FDI under government route for uploading / streaming of news and current affairs through digital media on the lines of print media.

Comments

(i) This proposal has given rise to more questions than answers. FDI policy in print media and broadcasting content service provides for uplinking news and current affairs TV channels and were defined;
(ii) There was no clarity in law for FDI in digital media. As per one view, since uploading / streaming of news and current affairs through digital media is not covered by sectors or activities listed in Regulation 16 of FEMA 20(R)/2017, FDI up to 100% was permitted under automatic route;
(iii) Thus, considering the exponential growth, internet penetration, reducing prices of smart phones and so on, Indian companies engaged in digital media invited FDI investments, such as Quint, Dailyhunt, Huffpost, VC Circle, etc. A question arises on FDI investments made in such companies. Will the law require such companies

to reduce FDI holding?
(iv) In case of startups engaged in said activities, cap on foreign investment may hamper future funding as such startups will have to rely on domestic investors to raise capital;
(v) It is a popular practice for media companies to stream news live on their apps and websites (e.g., Republic TV, NDTV News, Aaj Tak Live TV, etc.). Extant FDI policy provides for 49% FDI under approval route in up-linking of news and current affairs TV channels. Now, the proposal provides 26% limit for streaming news through digital media. Thus, the issue arises whether differing FDI threshold will mandate media companies to house digital media in a separate company and comply with FDI norms. Even if the division is spun off, the company will be required to give exit to FDI investors which may be a complicated affair;
(vi) Further, the proposal brings uploading / streaming of news and current affairs through digital media under government route. This may result in delays and mandatory compliance with conditions imposed by ministries concerned;
(vii) Impact of the above proposal on streaming services offered on social media platforms such as Facebook and Google is also not clear, or whether foreign digital news websites that can be accessed in India will continue to be available or not;
(viii) It is not clear whether OTT platforms such as Zee5, Hotstar, Voot and others that have both entertainment and news content would be covered under the 26% or the 49% FDI regime.

Since the policy announcement is yet to be legislated, one expects that the fears expressed by the media industry will be adequately clarified.

(II) ANALYSIS OF RECENT COMPOUNDING ORDERS

An analysis of some interesting compounding orders passed by the Reserve Bank of India in the month of August, 2019 and uploaded on the website[1] are given below. The article refers to regulatory provisions as existing at the time of offence. Changes in regulatory provisions are noted in the comments section.

1 https://www.rbi.org.in/scripts/Compoundingorders.aspx

FOREIGN DIRECT INVESTMENT (FDI) COMPOUNDING ORDERS

A. Dharmpal Agarwal (for self and on behalf of Vineet Agarwal, Chander Agarwal, Urmila Agarwal, Priyanka Agarwal & Chandrima Agarwal)
Date of order: 19th July, 2019
Regulation: FEMA 3/2000-RB Foreign Exchange Management (borrowing and lending in foreign exchange)

ISSUE

Availing of foreign currency loan overseas, for the purpose of purchasing property abroad

FACTS

(a) The applicant and the others, resident individuals, jointly acquired a residential property in Singapore at a total cost of SG$ 3,032,320;
(b) SG$ 606,464 was met through remittances under LRS; the remaining amount of SG$ 2,425,856 (Rs. 6,78,26,933) was paid by availing a loan from OCBC Bank, Singapore;
(c) During personal hearing it was submitted that instalments for repayment of loan and payment of interest (EMIs) with respect to the loan were met out of the proceeds of lease rental received on the lease of the property;
(d) In the initial years of loan repayment, reduction in principal amount of loan was small and the interest component made up a large part of the EMI. Therefore, considering the total amount paid under EMIs on the loan over the years, the applicant ended up effectively re-paying more than the amount of loan;
(e) The applicant and the others have sold the property and repaid the loan. The applicant submitted that he had not made any gains through availing loans overseas for acquisition of the property abroad.

Regulatory provisions

Regulation 3 of Notification No. FEMA 3/2000-RB states that, 'Save as otherwise provided in the Act, Rules or Regulations made thereunder, no person resident in India shall borrow or lend in foreign exchange from or to a person resident in or outside India'.

CONTRAVENTION

Nature of default	Amount involved (in Rs.)	Time period of default
Availing of foreign currency loan overseas, for the purpose of purchasing property abroad	Rs. 6,78,26,933	Nine years and six months approximately

Compounding penalty
Compounding penalty of Rs. 5,58,702 was levied.
Comments
While remitting money under LRS for purchase of property is permitted, availing of foreign currency loan overseas for the purposes was not permitted and was in contravention of Regulation 3 of FEMA 3(R)/2000-R.

Interestingly, in this case immovable property was leased to earn rental income. In the past, RBI has taken a view that under LRS route only purchase of immovable property was permitted and leasing activity was not permitted. However, no such observations have been made in the instant case. Additionally, it is interesting to note that under FDI provisions real estate business has been defined to specifically include earning of rental income from leasing of property. However, real estate business as defined under ODI regulations does not include earning of rental income from leasing of property resulting in dichotomy between real estate business as defined under FDI regulations and the ODI regulations.

B. Mindtree Limited
Date of order: 11th July, 2019
Regulation: FEMA 20/2000-RB Foreign Exchange Management (transfer or issue of security by a person resident outside India)

ISSUE
Delay in reporting the issuance of shares under the Employee Stock Options Plans (ESOP) beyond the stipulated time period; as also delay in reporting the issuance of bonus shares beyond the stipulated time period.

FACTS
(i) The applicant is an international information technology consulting and implementation company that delivers business solutions through global software development;
(ii) The applicant company issued shares under ESOP (value – Rs. 1,96,00,000) to foreign nationals / non-resident Indians (NRIs), but delayed the reporting of the same beyond the stipulated time period;
(iii) Besides, the applicant also delayed reporting the issuance of bonus shares (total value – Rs. 40,12,500) beyond the stipulated time period;
(iv) During personal hearing it was submitted that the applicant was under inquiry by the Directorate of Enforcement (DoE) in connection with trade-related transactions of the company;
(v) RBI, vide its letter reference No. FED.CO.CEFA/4994/15.20.67/2018-19 dated 21st February, 2019, had sought a No-Objection Certificate (NOC) from the DoE to proceed with the compounding process;
(vi) DoE, vide its letter reference No. RBI/SDE/WR/B-223/2019/335 dated 30th April, 2019, conveyed their no objection to compounding of the abovementioned contraventions.

Regulatory Provisions
(a) Regulation 8(3) of Notification No. FEMA.20/2000-RB, which dealt with 'Issue of shares under Employees' Stock Options Scheme to persons resident outside India', as then applicable, says, 'The issuing company shall furnish to the Reserve Bank, within thirty days from the date of issue of shares under the scheme, a report…';
(b) Regulation 6B of the above-mentioned Notification states 'A company issuing rights shares or bonus shares or warrants in terms of these regulations shall report to the Reserve Bank in Form FC-GPR as stipulated in Paragraph 9(1)(B) of Schedule 1 to these Regulations'.

CONTRAVENTION

Regulations of FEMA 20/2000-RB	Nature of default	Amount involved (in rupees)	Time period of default
Regulation 8(3)	Delay in reporting the issuance of shares under the Employee Stock Options Plans (ESOP)	Rs. 1,96,00,000	7 days
Regulation 6B	Delay in reporting the issuance of bonus shares	Rs. 40,12,500	8 days

Compounding penalty

Compounding penalty of Rs. 24,750 was levied.

Comments

(I) The applicant is required to give an undertaking at the time of filing compounding application that it is not under any inquiry / investigation / adjudication by any agency such as Directorate of Enforcement, CBI, etc., as on the date of the application;

(II) This condition results in difficulty in making compounding application by the applicant who is before ED for any other violation (e.g., non-receipt of export proceeds within permissible time) or replies to notice issued by ED, but there is no further correspondence from ED. Issue arises whether existence of on-going ED proceeding shuts the door for compounding;

(III) In this order, as also in the case of Satyanarayan Goel[2], RBI has taken a practical view by taking an NOC from the ED and thereafter compounding the offence. Thus, it is advisable for an applicant to approach the RBI for compounding by disclosing all pending proceedings before the ED.

OVERSEAS DIRECT INVESTMENT (ODI) COMPOUNDING ORDERS

C. Tata Chemicals Limited

Date of order: 10th July, 2019

Regulation: FEMA 120/2004-RB – Foreign Exchange Management (transfer or issue of any foreign security) Regulations, 2004

ISSUE

Extending loan without any equity contribution to overseas Joint Venture (JV), without prior approval of the Reserve Bank of India.

FACTS

(i) The applicant is engaged in the business of manufacturing chemicals and fertilizers;

(ii) The applicant set up an overseas JV, namely, Grown Energy Zambeze Limitada (GEZ), Mozambique, under overseas direct investment (ODI) on 22nd April, 2008;

(iii) The applicant company remitted an amount of USD 275,000 (Rs. 1,19,15,500) in three tranches between 26th February and 26th September, 2008 as project advance. No shares were issued against the remittances sent and these remittances were treated as loans / advances by the applicant;

(iv) In June, 2009, the applicant decided to quit the project due to uncertainty around allotment of land. The money has now been brought back to India and the UIN has been closed on 7th May, 2019.

Regulatory provisions

Regulation 6(4) of Notification No. FEMA.120/2004-RB, as then applicable, states 'an Indian party may extend a loan or a guarantee to or on behalf of the joint venture / wholly-owned subsidiary abroad, within the permissible financial commitment, provided that the Indian party has made investment by way of contribution to the equity capital of the joint venture.'

2 CA No 4910 / 2019

Contravention

The applicant has contravened the provisions of Regulation 6(4) of Notification No. FEMA 120/2004-RB. The amount of contravention is Rs. 1,19,15,500 and the period of contravention is approximately eleven years.

Compounding penalty

Compounding penalty of Rs. 1,39,366 was levied.

Comments

This order reflects that conditions prescribed in FEMA 120 of 2004 need to be complied with strictly. In fact, the amount was disclosed as loans / advances and thus it resulted in violation of Regulation 6(4) of FEMA 120 of 2004. The provision does not specify the threshold for investment in equity capital. Thus, theoretically, a loan based on infusion of nominal equity capital would have been permissible. Regulation 15(i) obligates an Indian party which has acquired foreign security to receive a share certificate or other document as evidence of investment in the foreign entity to the satisfaction of RBI within six months or such further period as RBI may permit. Flexibility of extended time limit by RBI is available provided investment is for acquisition of foreign security. In this case, the amount was stated as loans / advances and, accordingly, Regulation 15(i) would not apply.

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