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Refresh

Changing Regulatory Landscape

Newsletter

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The FIPB meeting

In its meeting held on 29 July 2013, the FIPB gave its approval to an Indian air transport service sector company to make a preferential allotment of 24% of its equity shares to a foreign airline.

The FIPB approved this proposal subject to various conditions, including changes in shareholders agreement that control of foreign airline would be in minority in all aspects.

The proposal will now be put forward before the Cabinet Committee on Economic Affairs for approval.

FDI policy liberalisation

The CCEA on 1 August 2013 announced certain reforms in the FDI policy in order to attract more foreign investment into the country.

- **"Control" redefined**: In order to ensure that 'effective' control lies in the hands of resident Indian citizens, with respect to sectors subject to FDI caps and conditions, the term, 'control' has been redefined to now mean, *"the right to appoint a majority of the directors or to control the management or policy decisions in that company by virtue of their shareholding or management rights or shareholders agreements or voting agreements"*.

- To keep the government's commitment of making MBRT attractive to foreign investors, certain conditions have been relaxed under the FDI policy governing this sector.

  - It has been clarified that mandatory investment in back-end infrastructure shall be limited to 50% of the minimum FDI to be brought in, that is 50% of 100 million USD.

  - Addressing the industry's concern on sourcing from small and medium enterprises, which organically outgrow the 1 million USD plant and machinery investment condition, the government has decided to increase this investment limit to 2 million USD. Further, the small industry status will be seen at the time of the initial arrangement, and if such a small industry outgrows the 2 million USD investment limit, sourcing from such vendors will continue to qualify towards meeting the mandatory 30% sourcing norm.

  - It has been clarified that procurements from agricultural and farmer's cooperatives will qualify for meeting sourcing requirements.

  - State governments have been given the powers to allow the setting-up of multi- brand retail outlets, even in cities having a population less than one million as per the 2011 census.

- Under the SBRT window, following the recommendations of the Arvind Mayaram Committee, the government has decided to allow FDI up to 49% under the automatic route.

- Further to the decision taken during the high-powered meeting chaired by the Prime Minister of India on 16 July 2013, the Cabinet has approved an FDI enhancement in the following sectors:

	Sector	**Existing**		**Proposed**	
		Cap	**Route**	**Cap**	**Route**
1.	Petroleum and natural gas and refining (PSU)	49%	FIPB	49%	Automatic
2.	Commodity exchanges	49%*	FIPB	49%	Automatic
3.	Power exchanges	49%*	FIPB	49%	Automatic
4.	Stock exchanges, depositories, corporation	49%*	FIPB	49%	Automatic
5.	Asset reconstruction companies	Up to 49%	FIPB	Up to 49%	Automatic
		49% to 74%	FIPB	49% to 100%	FIPB
6.	Credit information companies	Up to 49%	FIPB	74%	Automatic
7.	SBRT	Up to 49%	FIPB	Up to 49%	Automatic
		49% to 100%	FIPB	49% to 100%	FIPB
8.	Telecom services	Up to 49%	Automatic	Up to 49%	Automatic
		49% to 74%	FIPB	49% to 100%	FIPB
9.	Courier services	100%	FIPB	100%	Automatic
10.	Tea sector, including tea plantations	100%**	FIPB	100%	FIPB
11.	Defence production	26% (No FII investment)	FIPB	Above 26%***	CCS
12. The test marketing window has been removed since it has lost its relevance since opening up of the retail sector.					
* FDI -26% - FIPB, FII - 23% - Automatic route					
** Divestment of 26% to the Indian partner within five years					
*** - CCS may approve proposals on a case-to-case basis beyond 26% which may result in access to modern and state- of-the-art technology in the country.					

It is pertinent to note that the above-mentioned changes shall be applicable once the DIPP, which is the nodal body for the formulation of FDI policies, notifies the changes in due course.

Sectoral regulations

Telecommunication

Guidelines for activating and deactivating VAS

Time and again, the TRAI has been receiving complaints from consumers, regarding the activation and deactivation of VAS without their explicit consent. Accordingly, the TRAI has issued guidelines dated 10 July 2013 whereby service providers have been instructed to obtain explicit consent from customers before activating or de-activating any VAS. The directions issued by the authority are set out below:

- VAS activation procedure to include all forms of activations and scenarios. This includes outbound dialling, interactive voice response, wireless application protocol, mobile internet, USSD, SMS, tele-calling or any other mode of activation.
- The service provider has to provide a system which takes a second consent from the customer, before providing any VAS. A second confirmation from the customer is through a dedicated consent gateway, owned by a third-party, and not by the service provider.
- In case of a situation of wrong activation, the amount deducted shall be refunded within 24 hours of the customer's request.
- In case of USSD and SMS mode of activation, activation response time shall not be greater than 10 seconds and 60 minutes respectively, and in case of the customer not responding to such a request, the same needs to be treated as a 'no activation required'.

Food and agro

Draft food import regulations

The FSSAI on 23 July 2013, issued its draft food import regulations inviting suggestions from stakeholders who will be impacted by these regulations. The draft regulations, once finalised, will be applicable to an importer of food or food articles into India or importing such products for carrying out activities such as manufacturing, storage, distribution, packaging, etc.

Presently, the import of food or food articles is regulated through *ad-hoc* guidelines issued by the FSSAI from time to time. Some of the salient features incorporated in the draft import regulations include key definitions, administrative authorities and its powers, licensing requirements for food importers, prohibitions, inspection framework, import requirements, food import clearance, sampling requirements, laboratory analysis, etc. Some of the key features of the draft regulations are summarised below:-

- **Licensing requirement:** Every person importing food items (barring some exceptions like baggage for gifts or for bonafide medicinal use, and not exceeding a specified limit) shall be required in order to obtain a licence from the FSSAI. For applying for such a licence, the applicant needs to possess a valid IEC. The licence granted to partnership, a company or any other AOP will not transferable. A successor in interest will have to apply afresh for a new licence. Every food importer will be required to file or submit annual returns, as prescribed by the FSSAI, with respect to each class of food items imported in the previous financial year.

- **Food inspection prioritisation based on risk:** Under the proposed regulation, the FSSAI will adopt a risk-based framework as well as a risk-based inspection process for the clearance of food items, based on the potential hazards of various food categories, in order to assess the safety of food items. For prioritizing its risk, the particular food item shall be classified according to the risk presented. This includes risk foods (medium- to highrisk), surveillance foods (low- risk food), compliance agreement foods (subjected to a compliance agreement by an official certification) and monitored food. The FSSAI shall, from time to time, review the food imports and its risks, and accordingly specify the sampling structure, sampling methods, sample size, sampling frequency to be conducted for different categories of imports.

- **Import requirements:** Every food importer shall have to follow standards laid down by the FSSAI under the provisions of the Food safety and standard Act 2006 and its regulations, including the furnishing of documents as may be specified for the clearance of imported food, packaging and labelling regulations, specified from time to time, in relation to the import of food, inspection, collection of samples and other necessary steps in order to ensure compliance.

- **Clearance of food imports for special purposes:** Under the proposed law, the FSSAI proposes to provide accelerated clearance for food imported for special purposes such as the accredited food import programme, imports by food export-oriented units, diplomatic missions, international trade fairs, sports-related events and imports for quality assurance and R&D, wherein laboratory sampling and testing will not be required.

- **Procedure for obtaining clearance**: The FSSAI has defined the procedure that will have to be followed by the authorized officers during instances such as at the time of inspection by the authorised officer, sampling of imported food, analysis of samples in the laboratory, disposal of food samples and rejected food imports.

- **Review mechanism:** Under this, the importer will have the right to approach a review officer, in case the goods are rejected in the first instance.

The comments on draft regulations will have to be submitted by 22 August 2013. The copy of the same is available on the website www.fssai.gov.in.

Broadcasting

The TRAI has released a consultation paper on FDI limits within various segments of the broadcasting sector in India. Comments on the consultation paper are now being invited from stakeholders by 12 August 2013.

Some of the salient features of the consultation paper are as follows:

- The FDI limit for carriage services is proposed to be allowed up to 100% and FDI up to 49% through the automatic route and FDI beyond 49% through the FIPB route.
- The status for downlinking or uplinking of non-news channels remains the same, i.e. 100% FDI with FIPB approval.
- The FDI limit for uplinking a news and current affairs channel may be increased from 26 to 49% through the FIPB route.
- FM Radio Phase III - FDI limit is proposed to be enhanced from 26 to 49% through the FIPB route.

Special economic zone

SEZ developments

Validity of the IEC for EOUs, SEZ units, EHTP, STP or BTP after de-bonding

As per the extant regulation, at the time of de-bonding and converting a 100% EOU into a DTA unit, a 100% EoU surrenders its IEC to the concerned DC of SEZ (from where it obtained its IEC) for cancellation. Thereafter, the firm approaches the concerned RA of the DGFT for issue of a fresh IEC against the same PAN. However, when a DTA unit converts into a 100% EOU unit, its IEC issued by the RA continues to remain valid.

The DGFT has (*vide circular no 2 (RE-2013)/2009-2014 dated, 26 July 2013*) decided that the IEC will remain valid, irrespective of a firm's status as a DTA , EOU, SEZ, EHTP,STP or a BTP unit. Henceforth, such units, after de-bonding will not be required to surrender the IEC obtained from its DC.

The DC of the SEZ will send the original IEC file to the concerned RA after de-bonding. The RA will become the custodian of the file, and will allow the de-bonded unit to make the necessary modification in the IEC. The de-bonded unit will be eligible for benefits from the RA as per the FTP. Likewise, when a DTA unit converts itself into an EOU or a unit either in an SEZ, EHTP, STP or a BTP, the IEC issued by the RA will continue to be valid even after such conversion.

Disposal of waste or scrap by the SEZ into the DTA

A SEZ unit, developer or co-developer is allowed (*vide notification no 28 (RE-2013)/2009-2014 dated 24 July 2013 issued by the Department of Commerce*) to dispose off in the DTA, any waste or scrap, including any form of metallic waste and scrap, generated during the manufacturing or processing activity, without an authorisation, upon the payment of applicable customs duty.

Exemption of service tax on services used for availing authorised operations

The Department of Revenue has (*vide notification no 12/2013-service tax*) exempted the services on which service tax is leviable under section 66B of the Finance Act, 1994, and are received by a SEZ unit or a SEZ developer, and used for authorised operations from the whole of services tax, education cess and secondary and higher education cess.

The exemption shall be provided by way of refund of service tax paid on specified services received by the SEZ unit or the developer, and used for authorised operations. Alternatively, the unit or developer can also take cenvat credit, in accordance with the Cenvat credit Rules, 2004.

In a situation where the specified services received by the SEZ unit or the developer are used exclusively for the authorised operations, the person liable to pay service tax has the option not to pay the service tax ab-initio, subject to conditions prescribed in the notification.

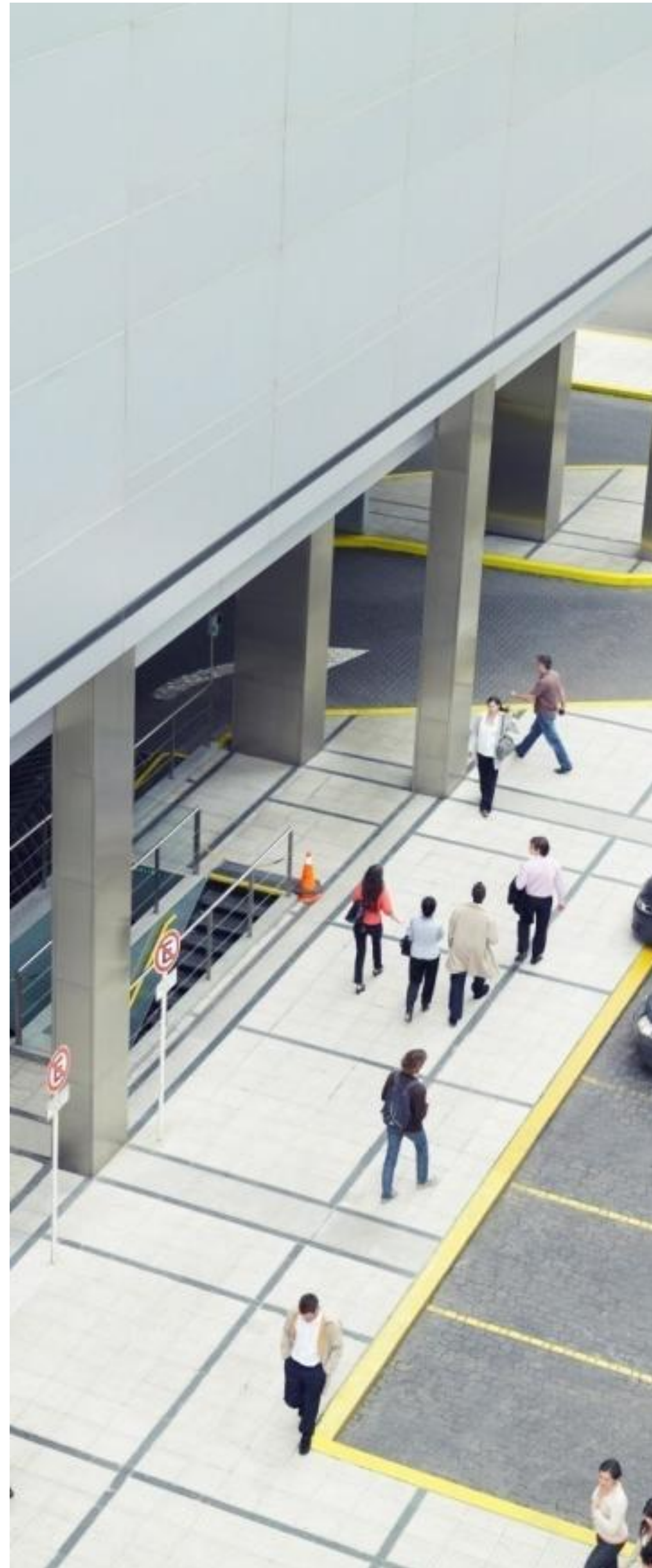
Import of gold by nominated banks, agencies or entities

Certain restrictions were imposed on the import of various forms of gold by nominated banks or agencies, premier or star trading houses, SEZ units or EoUs, which were permitted to import gold for use within the domestic sector. None of these restrictions were applicable to the import of gold for the purpose of exports or to import of gold by units located within a SEZ, exclusively for the purposes of exports. Therefore, it has now been decided *(vide AP (DIR series) circular no 15)* to review the above instructions in order to rationalise the import of gold.

Henceforth, it will be incumbent on all nominated banks or nominated agencies to ensure that at least 20% of every lot of imported gold will be made available for export. Further they shall make available gold for domestic use only to entities engaged in jewellery business or bullion dealers supplying gold to jewellers. They will be required to retain 20% of the imported quantity in customs bonded warehouses and are permitted to undertake fresh imports of gold, only after the exports have taken place to the extent of at least 75% of gold remaining in the customs bonded warehouse.

Entities or units within SEZs and EoUs, premier and star trading houses are permitted to import gold exclusively for export purposes only.

Corporate regulations



Operationalisation of the DIPP guidelines

The RBI has operationalised the DIPP guidelines[1] introduced in 2009 for the calculation of total foreign investments into Indian companies, transfer of ownership and the control of Indian companies and downstream investments made by Indian companies as follows:

- Investments made prior to 13 February 2009, in accordance with guidelines existing at that time, will not require any modification. All other investments after the said date will come under the ambit of these new guidelines.
- For investments made between 13 February 2009 and 21 June 2013, the Indian companies are required to inform the RBI for non-compliance, if any, with the prescribed regulatory framework on or before 1 October 2013.
- A first level Indian company receiving FDI needs to ensure compliance with the FDI conditionalities for downstream investment made in subsidiary companies at the second level and so on.
- A first level Indian company needs to obtain an annual certificate from its statutory auditor with regards to the status of compliance with the aforesaid guidelines. A clean report will need to be mentioned in the director's report and a qualified report will need to be immediately reported to the RBI.

A P (DIR series) circular no 1, dated 4 July 2013

[1] Press note 2, 3 and 4 of 2009

Foreign borrowing: ECB

ECB – 10 billion USD scheme: Extended for the repayment of rupee loans availed for outbound investments

The RBI has liberalised the existing ECB - 10 billion USD scheme[2] to Indian companies in select sectors which have acquired assets overseas subject to the following:

Eligible borrower: Companies operating within sectors such as manufacturing, infrastructure or hospitality and which have an overseas JV, WOS or overseas assets.

Additional end use: Repayment of term loans having average residual maturity of five years and above or credit facilities availed from domestic banks for overseas investment.

Amount: Maximum permissible ECB shall be higher of the following:

- Seventy five per cent of the average foreign-exchange earnings **realised during the past three financial years**
- Seventy five per cent of the average foreign exchange earnings **estimated from the JV,WOS or assets abroad for next three financial years**.

The monetary ceilings of 3 billion USD for an individual company or a group, and 10 billion USD overall for an ECB, under this scheme will continue to apply.

Repayment: ECB liability shall be repaid out of the foreign exchange earnings from the JV, WOS or assets abroad.

Foreign exchange earnings: For the purpose of this scheme, foreign exchange earnings will be reckoned as past earnings in the form of dividends and repatriated profits, as well as other foreign exchange inflows like royalty, technical know-how, fee, etc received from the overseas JV,WOS or assets.

A P (DIR series) circular no 12, dated 15 July 2013

Extension of various ECB schemes

ECB schemes	Extended up to
All-in-cost ceiling for trade credits of 350 basis over six months LIBOR	30 September 2013
All-in-cost ceiling for ECB are as follows : Three fifty basis points over six months LIBOR for an average maturity of three years to five years Five hundred basis points over six months LIBOR for an average maturity of five years and above	
Refinancing an existing ECB under the approval route by raising fresh ECB at a higher all-in-cost or reschedule an existing ECB at a higher all-in-cost, provided an enhanced all-in-cost falls within the all-in-cost ceiling, prescribed as per the extant guidelines.	

A.P. (DIR series) ircular no 9, 10 and 11 dated, 11 July 2013

ECB policy for NBFCs categorised as asset finance companies

The RBI has liberalised the ECB policy to permit NBFCs categorised as asset finance companies to raise the ECBs in order to finance the import of infrastructure equipments for leasing out to infrastructure projects, subject to prescribed conditions.

A P (DIR series) circular no 6, dated 8 July 2013

[2] Indian companies who are consistent foreign exchange earners and are engaged in manufacturing, infrastructure (as defined under FEMA) or hotel sector (having total project cost of 25 billion INR or more, irrespective of its geographical location) can avail ECBs for the repayment of outstanding rupee loan(s) availed of from the domestic banking system for capital expenditure or for fresh rupee capital expenditure under the **approval route**.

Export of goods and services

Realisation and repatriation period for entities other than SEZ units

The RBI has clarified that the recently reduced period of nine months for the realisation of export proceeds shall be applicable from 1 April 2013 onwards.

A P (DIR series) circular no 14, dated 22 June 2013

Master circulars released by the RBI

The RBI has released its master circulars on 1 July 2013, wherein all changes introduced through the A P (DIR series) circulars issued by the RBI, from July 2012 right up to June 2013, have been incorporated.

Perspective

RBI compounding process

Generally, for any violation of the Indian Exchange Control (FEMA), upon adjudication, a penalty of up to three times the sum involved can be levied.

With the desire to be divine, and considering that the law can at times be complicated, resulting in non-compliance, the Indian Exchange Control provides an opportunity to approach the regulatory authorities in order to regularise any lapse. This process is called compounding.

Compounding of contravention allows the contravener to settle an offence through the payment of a monetary penalty, without going in for litigation, after the contravener acknowledges having committed the contravention.

Generally, a contravention is identified by the contravener during a health-check up review, due diligence, or a corporate restructuring process. In certain instances, the RBI, which is India's central bank, identifies the contravention during various processes such as regular reporting, approving some other transactions, getting references from other agencies, voluntary reporting, receiving complaints, during investigations, etc.

Before an application for compounding is made, the contravener needs to obtain the required approval from the concerned authority. For instance, if an Indian company has issued shares to a foreign investor beyond the specified time, the company will need to first seek approval for the issue of shares beyond the specified time, and thereafter, file the compounding application.

The application, which is required to be filed in using a prescribed form, is reviewed by the RBI. The application needs to clearly specify the nature of the contravention, the complete facts and relevant regulations which are contravened.

The company is provided the opportunity of a personal hearing and the order is passed within 180 days of receipt of the application prescribing the amount of the compounding fee (the penalty amount).

The determination of the penalty amount is purely a discretionary process. This is influenced by various factors such as the period of default, amount involved, financial or unfair advantage gained, loss caused to any authority, repetitive defaults, contravener's conduct in undertaking the transaction, disclosure of full facts, track record, etc.

The best part of the compounding process is that once the matter is compounded and the fee is paid within 15 days, no inquiry or adjudication proceedings can be initiated or continued in respect of this contravention.

However, as the compounding order is not appealable, the only option available is non-payment of the fee. In case this option is exercised, the application will be deemed as never having been made. The contravener will risk exposure to penalty under the normal provisions of the FEMA, and the matter may even be referred to the enforcement directorate. Thus, this option needs to be selected only as a last resort.

In case, the sum involved in contravention is not quantifiable, the matter requires investigation or in case there is an evidence of money laundering or any national and security concerns, the contravention cannot be compounded. It is important to note that a similar contravention committed within a period of three years can also not be compounded. Any second or subsequent contravention committed after the expiry of a period of three years shall be deemed to be a first contravention and can be compounded.

General lapses which are compounded are cases such as a delay in reporting the receipt of share subscription money and issue of shares to a foreign investor, shares issued for consideration other than cash to a foreign investor, setting up overseas entities, without complying with the prescribed conditions, funding of pre and post incorporation expenses by an overseas parent, foreign debt used for working capital requirements, reporting lapses, etc.

To conclude, it will be prudent to identify the lapse of one's own accord and approach the RBI in order to seek contravention. This will not only build credibility and possibly have a positive outcome to the compounding proceedings, but also save the contravener the inconvenience of the adjudication process and the subsequent steep penalty.

- Harsh J Vora (manager, Regulatory Services)

Glossary

AoP	Association of persons
BTP	Biotechnology park
CCEA	Cabinet Committee on Economic Affairs
CCS	Cabinet Committee on Security
DC	Development commissioner
DGFT	Directorate General of Foreign Trade
DIPP	Department of Industrial Policy and Promotion
DoC	Department of Commerce
DTA	Domestic tariff area
EHTP	Electronic hardware technology park
EOU's	Export oriented units
FDI	Foreign direct investment
FEMA	Foreign Exchange Management Act
FIPB	Foreign Investment Promotion Board
FSSAI	Food Safety and Standards Authority of India
FY	Financial year
IEC	Importer exporter code
INR	Indian rupee
IT	Information technology
JV	Joint venture
MBRT	Multi-brand retail trading
MIB	Ministry of Information and Broadcasting
MoC	Ministry of Commerce
NBFCs	Non-banking financial companies
PIB	Press Information Bureau
RA	Regional authorities
RBI	Reserve Bank of India
SBRT	Single brand retail trading
SEBI	Securities Exchange Board of India
SEZ	Special economic zone
STP	Software technology park
TRAI	Telecom Regulatory Authority of India
USD	United States dollar
USSD	Unstructured supplementary service data
VAS	Value added services
WOS	Wholly owned subsidiary

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