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September 29, 2010 New Delhi, India

Government Reconsidering Downstream Foreign Investment Regulations

No Immediate Relief For Vodafone

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Government Reconsidering Downstream Foreign Investment Regulations

The Ministry of Commerce and Industry and the Finance Ministry are deliberating over the permissibility of downstream investments/indirect foreign investments in sectors where foreign direct investment ("FDI") is restricted or prohibited.

In terms of the existing FDI policy, there is a possibility for the joint ventures, controlled by resident Indian citizens, to invest in the restricted as well as prohibited sectors through their subsidiaries, as long as foreign investment in such joint ventures remains below 49%.

Following the release of the consolidated FDI policy announced by the Ministry of Commerce on March 31, 2010, its officials had in May, 2010 expressed their views that this indirect investment possibility was not intended. Reportedly, the Ministry of Finance was also of the view that the joint ventures having less than 50% foreign investment should seek approval of the foreign investment promotion board for downstream investments in restricted sectors, while the investing companies in prohibited sectors should not have any foreign investment at all.

Except for the above and similar statements in the media, perhaps based on the inter-ministerial exchange of ideas and correspondences, there has till date been no official public release to bar the possibilities of indirect foreign investment in restricted or prohibited sectors in terms of the FDI policy.

The media statements however led to confusion and debates involving the stakeholders and officials of the Ministries, which appear to have prompted the Ministries to reconsider the implications threadbare.

In a recent correspondence, the Ministry of Commerce has reportedly told the Ministry of Finance that any move to bar even miniscule investments by joint ventures in FDI restricted or prohibited sectors would be inconsistent with the current policy environment. The Ministry has also recommended formation of an oversight body, to subject all foreign investment to greater scrutiny.

The parameter of downstream investments being permitted if they are "miniscule" however does not find place in the existing policy.

The Ministry of Commerce is expected to shortly release the new FDI policy, to come into effect October 1, 2010 onwards.

It however appears that the deliberations between the Ministries over the issues discussed above may conclude only subsequently, to be notified separately. The Finance Ministry has, reportedly, also formed an internal panel to finalize its view on permitting foreign investments in multi brand retail sector.

No Immediate Relief for Vodafone

The Supreme Court has refused to stay the order of the Bombay High Court passed against Vodafone allowing the Government to tax Vodafone's $11 billion deal with Hutch, thus denying any immediate relief to Vodafone.

Earlier this month, the Bombay High Court had held that the Indian tax authorities were correct in assessing Vodafone for its Indian tax liability in the $11 billion acquisition of a controlling 67% stake in the mobile phone operator Hutchison Essar in 2007.

Vodafone has approached the Supreme Court against the judgment of the Bombay High Court. While refusing to stay the order of the Bombay High Court, Justice Kapadia said, "For a stay of the high court order, you (Vodafone) have to deposit part of the amount (i.e. the tax liability raised by the Income Tax Department)".

The Supreme Court has however directed the tax authorities to calculate and state Vodafone's exact tax liability, before the next date of hearing i.e. on October 25, 2010.