

M&A Hotline

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GOVERNMENT OF INDIA RELAXES NORMS FOR FOREIGN ACQUIRERS IN PUBLIC M&A

The Reserve Bank of India ("RBI") in continuance with its measures of liberalization of policies governing foreign direct investment ("FDI") in India has, through its circular no. 38 dated September 6, 2013 ("Circular"), relaxed the restriction on non-resident investors in terms of acquisition of shares on the floor of stock exchange. In a commendable move which indicates regulatory sensitivity to boost FDI flows in the country, the Circular now permits a non-resident investor in control (including a non-resident Indian) to acquire shares of a listed Indian company on the floor of stock exchange through a registered broker under the FDI route.

BACKGROUND

Following are the different regimes for foreign investment into India:

1. Foreign Direct Investment regime allows a non-resident investor to invest in securities of an Indian company under Schedule 1 of Foreign Exchange Management (Transfer or Issue of Security by Person Resident Outside India) Regulations, 2000 ("TISPRO") ("FDI Regime");
2. Foreign Institutional Investors ("FII") regime allows a non-resident investor registered with Securities and Exchange Board of India ("SEBI") to invest in listed securities of Indian companies under Schedule 2 of TISPRO and in accordance with SEBI (Foreign institutional investors) Regulations, 1999 ("FI Regime");
3. Non-Resident Indian ("NRI") regime allows NRIs to invest in securities of Indian companies on repatriation and non-repatriation basis under Schedules 3 and 4 of TISPRO respectively ("NRI Regime");
4. Foreign Venture Capital Investment regime allows a non-resident investor registered with SEBI to invest in securities of an Indian company under Schedule 6 of TISPRO and in accordance with SEBI (Foreign Venture Capital Investor) Regulations, 2000; and
5. Qualified Foreign Investor ("QFI") regime allows a non-resident investor to invest in listed securities of Indian companies under Schedule 8 of TISPRO ("QFI Regime").

Further, prior to the Circular, only FIIs, NRIs and QFIs were permitted to acquire shares of listed Indian company on the floor of stock exchange under the FII Regime, NRI Regime and QFI Regime respectively. A non-resident investor was not permitted to acquire shares of a listed company on the floor of stock exchange under the FDI Regime without prior approval of Foreign Investment Promotion Board ("FIPB"). Due to this restriction, acquisition of shares under the creeping acquisition route¹ under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Code") was becoming increasingly difficult and the non-resident promoters of listed Indian companies were unable to consolidate their shareholding in such listed company.

It is essential to note that in case of transfer of shares of listed Indian company on the floor of stock exchange, the transferor is subjected to capital gains tax at the rate of 15% in case of short term capital gains² or shall be tax exempt if the gains are long term capital gains³ provided the securities transaction tax has been paid on the transaction. This advantage is not available in case of transfers off the floor of stock exchange; thereby, placing a non-resident investor under FDI Regime in a dis-advantageous position as compared to FIIs, QFIs and NRIs.

AMENDMENT AND CONDITIONS

The acquisition of shares under the FDI Regime by a non-resident investor on a recognised stock exchange would be allowed subject to fulfillment of the following conditions:

Acquisition of shares by non-resident investor who is already in control. The non-resident investor intending to acquire shares of the listed Indian company on the floor of stock exchange under FDI Regime shall be in control of listed Indian company in terms of the Takeover Code.⁴

The relaxation will be a great relief to offshore promoters or strategic investors who are in control of listed Indian companies and intend to increase their stake in the listed company through acquisition of shares on the floor of stock exchange. However, first time acquisition of shares and control through on-market transaction under FDI Regime is still not permitted and will be subject to prior approval of FIPB.

Amount of consideration. The amount of consideration for acquisition of shares by non-resident for on-market transactions may be paid either by way of (i) inward remittance through normal banking channels or (ii) debit to the non-resident (external) rupee or foreign currency (non-resident) account; by debit to non-interest bearing Escrow account (in Indian Rupees) maintained in India in case of NRIs.

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Additionally, in situations where the non-resident investor who is in control of the listed Indian company and is entitled to receive dividend declared by such listed company, consideration amount for acquisition of shares on the floor of stock exchange may also be paid out of the dividend amount credited to specially designated non -interest bearing rupee account.

Pricing. Acquisition of shares on the floor of stock exchange shall be at market price of the shares of the listed Indian company quoted on the stock exchange or limitation on pricing as applicable in case of block⁵ or bulk deals⁶. However, the Circular states that pricing for subsequent transfer of shares to a non-resident shareholder shall have to be in accordance with pricing norms as applicable.

The above pricing restriction implies that subsequent to acquisition of shares by a non-resident shareholder, any transfer to another non-resident shareholder under the FDI Regime shall be subject to pricing norms as applicable in case of transfer of shares of listed Indian company⁷. This is shift from the current position where no pricing guidelines are applicable for any transfer of shares between two non-resident shareholders under the FDI Regime. A possible reason for the aforesaid pricing restriction could be to ensure that the acquisition of shares on the floor of stock exchange and subsequent transfer to non-resident shareholder is not done with a view to avoid pricing norms applicable in case of transfer of shares of listed Indian company off the floor of stock exchange.

Other conditions to apply. All restrictions in terms of sectoral cap, entry route, reporting requirement, documentation under the extant FDI policy and Foreign Exchange Management Act, 1999 and regulations shall continue to be applicable for the above acquisition of shares by non-resident investor on the floor of stock exchange.

CONCLUSION

Considering the current state of capital markets in India owing to various micro as well as macro-economic factors, this relaxation will help augur foreign investments in India. The relaxation is one of the many steps taken by the Government to boost foreign capital flows into India. The liberalization brought about by the Circular will indeed provide lot of comfort to non-resident promoters to increase their stake in their Indian subsidiary especially when share price of many Indian companies are lower than their valuation.

- **Ruchi Biyani, Sahil Shah & Nishchal Joshipura**

You can direct your queries or comments to the authors

¹ Regulation 3(2) of the Takeover Code provides that an acquirer who already holds 25% or more shares or voting rights but less than maximum permissible non-public shareholding of the target company, can either by themselves or through persons acting in concert with them, acquire further upto 5% shares of voting rights in the financial year ending 31st March.

² Gains arising from transfer of shares held for a period of 12 months or less are short term capital gains.

³ Gains arising from transfer of shares held for a period of more than 12 months are long term capital gains .

⁴ Takeover Code defines "control" to include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner:

⁵ A 'block deal' is a deal undertaken in a separate trading window provided in order to facilitate trades which involve a minimum quantity of 500,000 shares or a transaction value of a minimum of INR 50 million in a single transaction. This trading window is available for the first 35 minutes of trading on trading day, and the orders may be placed within a range of +/- 1% from the then existing market price/previous day's closing price as the case may be.

⁶ A 'bulk deal' constitutes a single/multiple transaction(s) in a single trading day which results in purchase/selling of more than 0.5% of the total listed equity shares of a company on the stock exchange by a single client.

⁷ In case of transfer of shares of an Indian company which are listed on a recognized stock exchange in India, the price at which the transfer to non-resident, shall not be less than the price at which preferential allotment of shares can be made under the SEBI guidelines, as applicable, provided the same is determined for such duration as specified therein, preceding the relevant date, which shall be the date of purchase or sale of shares.

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