

# AccountAble™

During Trojan wars (when fear of foreigners bearing gifts first arose), it was fairly easy to make out who was a foreigner and who was not. In these days of globalisation, it is much more confusing. Name, skin colour, dress or type of hair is no longer a reliable indicator of one's foreignness. The tortuous definition in FCRA also does not help.

In this issue of AccountAble, we try to help by explaining what a foreign source under FCRA 2010 looks like.

## Foreign Source

Foreign source is defined in sec. 2(1)(j) of FCRA 2010 (see chart). The foreignness of most of these sources is self-evident. However, people and companies pose a challenge. We discuss these below.

### People: Foreigners

How do you know whether a person is foreign or not? This is based on his or her citizenship — not on their ethnicity. A person with citizenship of a foreign country is a foreign source. Always!

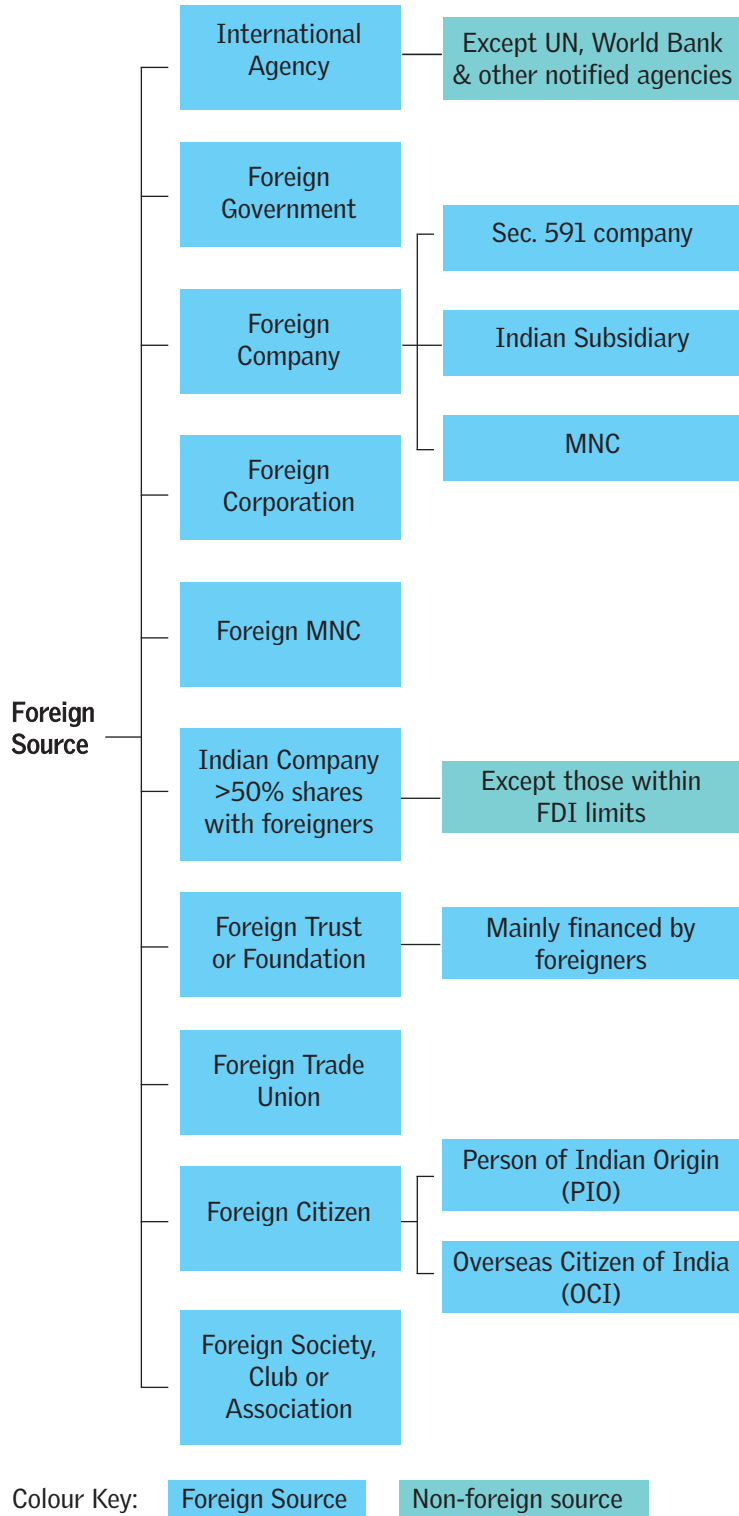
A foreigner living in India, married to an Indian or earning money in India remains a foreign source. This is true even if the donation is in Indian rupees. This is also true if the person was an Indian earlier, and took up foreign citizenship later on.

### People: Indians

An Indian citizen will always be an Indian source, if they are donating their own funds. It does not matter whether the donation is in dollars or rupees.

### People: Indians Abroad

Indians living abroad fall mainly in three categories: Non-Resident Indians (NRIs), Persons of Indian Origin (PIO) and Overseas Citizens of India (OCI).



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### a. Non-Resident Indians (NRIs)

In general, NRIs are not a foreign source. They might be working or settled abroad but are still Indian citizens. However, the term NRI is sometimes used very casually. Therefore, it is best to confirm this by asking whether the person has become a foreign citizen. If the answer is 'no', then funds given by him / her will be treated as Indian.

### b. Persons of Indian Origin (PIOs)

Who are persons of Indian origin? These are people who were Indian at some point of time. In some cases, their parents may have been Indian. A PIO is never an Indian citizen.

PIOs can apply and get a PIO card, which gives them some extra facilities, such as visa-free travel to India. However, they do not get any political rights, such as right to vote in India. Persons of Indian Origin are treated as a foreign source. It does not matter whether they actually hold a PIO card or not.

### c. Dual Citizenship (OCI)

In 2004, the Government introduced the concept of Overseas Citizens of India (OCI). This means that Indians who have acquired foreign citizenship can also remain

Indian citizens, with limited rights.

Does this make a difference so far as FCRA 2010 is concerned? Surprisingly, the answer is 'no'.

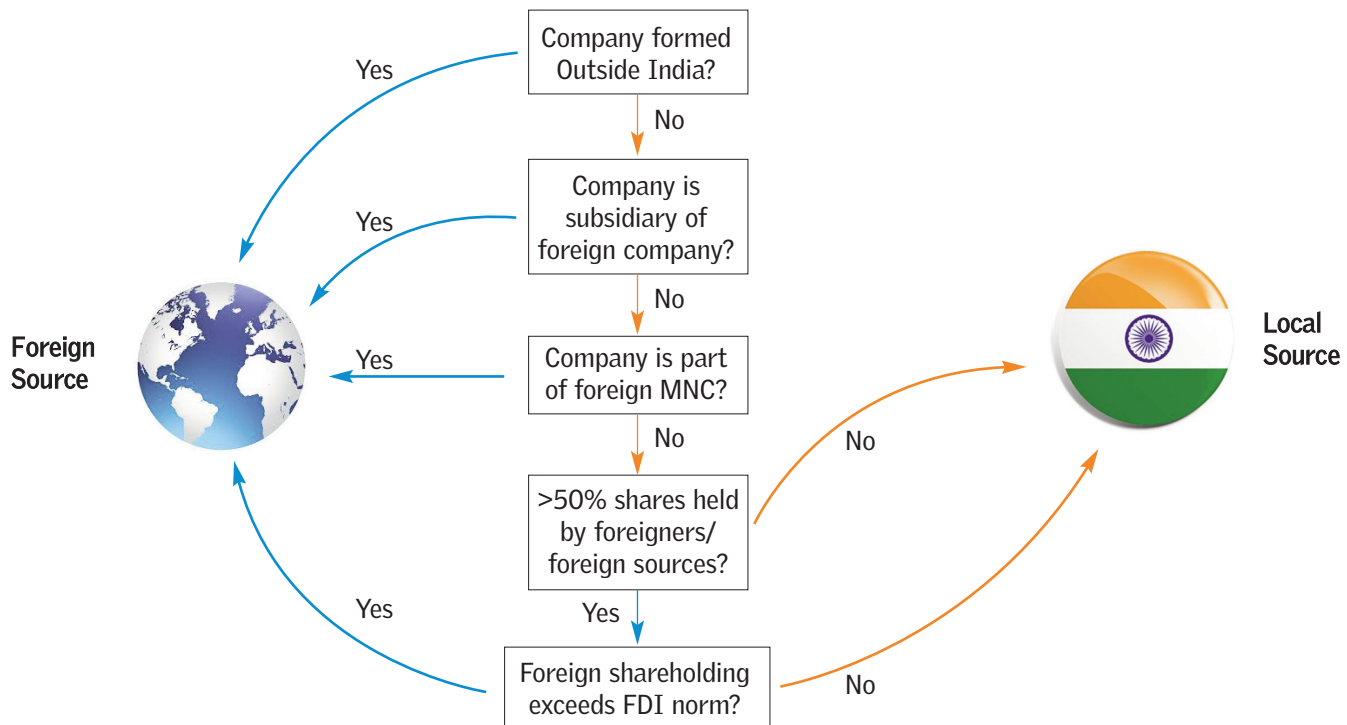
Section 2(1)(j)(x) says clearly that a citizen of a foreign country is a foreign source. In the case of dual-citizenship, a person will be an Indian citizen but will also be a foreign citizen. Thus, he or she will attract clause (x) and will be treated as a foreign source!

## Companies

Ever since joint stock companies were invented some four centuries ago, their holding patterns have become more and more intricate. We discuss here four categories which cause the maximum confusion under FCRA: a. Indian companies where foreigners hold more than 50% voting power, b. foreign companies, c. their subsidiaries, and d. foreign MNCs. The chart below can help you figure out whether a company is a foreign source or not?

### a. Company with Foreign Shareholders

This applies to ordinary companies registered in India. This clause has been amended in 2016,<sup>1</sup> with retrospective effect from 1976. These are treated as a foreign source under this clause, only if:



<sup>1</sup> Cl. 233 of Finance Act 2016, read with cl. 217 of Finance Act 2018.

1. More than 50% of their share capital is held by foreigners or foreign entities; and,
2. Such foreign investment does not meet FDI norms.

Both the above conditions have to be met for a company to become a foreign source under this clause. It is unlikely that a company will be in violation of FDI norms, as foreign investment in India is tightly regulated. Therefore, this clause has become redundant for all practical purposes.

What about foreign companies, which have come under control of Indian shareholders? These will still be treated as a foreign source.

### b. Foreign Company

What is a foreign company? Any company or association or body of individuals incorporated outside India is a foreign company. This definition covers foundations, corporations also, provided they are incorporated outside India. It also includes a company covered by section 591 of the Companies Act, 1956.

### c. Subsidiary of Foreign Company

Any subsidiary of a foreign company is also treated as a foreign company. It does not matter if the subsidiary itself is an Indian company.<sup>2</sup> It also does not matter if the holding company is actually not a company – so long as it is a body corporate.<sup>3</sup> This is valid even after the 2016 change in definition of company under foreign control.<sup>4</sup>

## Foreign Control, Subsidiaries & MNCs

What happens if an Indian company such as Suzuki India Ltd. (let's call it Y) is:

1. A subsidiary of a foreign company;
2. Foreigners hold more than 50% shares in Y;
3. The investment is within FDI limits?

Before the 2016 amendment, Y would have been a foreign source. What happens after the amendment?

In this case, Y would still remain a foreign source, as it is also a subsidiary of a foreign company.

The amendment has affected only companies like ICICI, HDFC, etc. Such companies are not foreign subsidiaries even though more than 50% shares are held by foreigners. Therefore, they are no longer treated as foreign sources.

When does a company become a subsidiary of another?

This has been defined in sec. 2(87) of the Companies Act, 2013 and can be fairly complicated. In simple terms, company Y can become a subsidiary of company X in at least four ways:

- (i) X controls the composition of Y's board of directors - it can change all or majority of the directors;
- (ii) X controls more than 50% of share capital (equity and convertible) in Y.

Company X may exercise the control directly or together with other subsidiaries or grand subsidiaries.

<sup>2</sup> Sec. 2(1)(g) starts off by saying that a foreign company means any company etc. incorporated outside India. It goes on to include any (Indian) company which is a subsidiary of a foreign company [Sec. 2(1)(g)(ii)].

It may be argued that clause Sec. 2(1)(g)(ii) applies only to companies incorporated *outside* India as clause is limited to companies incorporated outside India. This reading is not valid as in such a case, clause (ii) would be repeating what sec. Sec. 2(1)(g) already provides.

As Justice G.P. Singh has clarified 'the definition will embrace only what is comprised within the ordinary meaning of the 'means' part together with what is mentioned in the 'includes' part of the definition.' (Principles of Statutory Interpretation, 12th edn. 2010. p. 185)

Further, Justice R. F. Nariman's observations in a case before the Supreme Court (Commnr. of Central Excise, vs M/s. Detergents India Ltd. & Anr, 8-Apr-2015) are even more clear. In this case, the meaning of 'related person' under sec. 4(4)(c) of Central Excise & Salt Tax Act depended on a means and includes definition:

"... 'means' 'and includes' is a legislative device by which the 'includes' part brings by way of extension various persons, categories, or things which would not otherwise have been included in the 'means' part. If this is so, obviously both parts cannot be read conjunctively. What is in the 'includes' part is relatable only to the subject that is to be defined and takes within its sweep persons, objects, or things which are not included in the first part. We have already pointed out that the reason for including holding and subsidiary companies in the 'includes' part is so that the authorities may look behind the corporate veil. To say that the holding and subsidiary companies must in addition have a mutual interest in the business of each other is wholly incorrect. Further, the word 'and' which joins the two parts of the definition is not rendered meaningless. It is necessary because it precedes the word 'includes' and brings in to the definition clause persons, objects, or things that would not otherwise be included within the 'means' part."

<sup>3</sup> Societies registered under Societies Registration Act 1860 are not bodies corporate. (Ayurvedic & Unani Tibia College vs. State of Delhi, Supreme Court of India, 23-Oct-1961)

<sup>4</sup> According to clause (iii) of Sec. 2(1)(j), a 'foreign company' is a foreign source. This clause is not affected by the 2016 amendment which applies only to clause vi of Sec. 2(1)(j). Further, under sec. 2(1)(g)(ii), any company which is a subsidiary of a foreign company becomes a foreign company, and thus a foreign source.

This effectively boils down to saying that any Indian company which is a subsidiary of a foreign company will be treated as a foreign source Sec. 2(1)(j)(iii) – even if it is no longer a foreign source under sec. Sec. 2(1)(j)(vi) of FCRA 2010.

#### d. Foreign MNC

Multi-national Corporations (MNCs) are treated as a foreign source. However, the term MNC has a special meaning under FCRA.<sup>5</sup>

The definition of an MNC under FCRA 2010 has two requirements:

1. The corporation should have been formed in a foreign country.

2. The corporation should have a presence (subsidiary, branch, office, business activities or other operations) in two or more countries.

What does this mean? If an Indian corporation starts operating in a foreign country, it will not become an MNC (foreign source) for the purpose of FCRA. However, a foreign MNC will be treated as a foreign source.

<sup>5</sup> Explanation to section 2(1)(g) of FCRA 2010

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**Interpretation of law:** Law discussed here is valid as of 1-August-2018. However, the interpretation is of general nature. Please consult your advisors before taking any important decision.

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