**Online retailers need to show transactions on arm’s length**

Online retailers facing charges of foreign exchange-related violations, such as Flipkart, will have to demonstrate that their transactions are on an ‘arm's length basis’ with FDI-funded associates and other entities, including those supplying them goods wholesale.

Some of the e-commerce companies are facing an investigation by the Enforcement Directorate (ED) for allegedly violating the current policy that explicitly bans foreign direct investment (FDI) in online multi-brand retail while full foreign ownership is allowed in wholesale e-commerce.

Although companies deny any wrongdoing, authorities suspect that many have structured their business in such a way that foreign capital comes to the wholesale business and other associates, which indirectly support the retail operations.

Official sources said one of the aspects the ED investigation focuses on is whether foreign-funded wholesale trading entities have entered into transactions such as under-invoiced sale of goods or soft loans amounting to indirect infusion of foreign funds into the retail outfits of e-commerce companies in violation of the FDI policy.

The probe also covers whether there is a firewall in terms of ownership and management between the retail entity engaged in e-commerce activity and the wholesale trading associate. The idea is to ensure that foreign investors do not influence the businesses decisions of the e-retailing.

Portals such as snapdeal.com, yebhi.com, myntra.com, jabong.com, firstcry.com and lenskart.com are among the major players in India's roughly $12-billion e-commerce industry growing at about 34% a year. According to an investment tracking agency, capital flow into India's e-commerce firms rose 258% to $805 million in 2013-14 from $224.85 million a year-ago, indicating the high capital requirement of the fledgling industry.

Arm’s length principle in transactions with a foreign- funded entity would mean that these are done as if the parties concerned are totally independent and are doing business subject to market forces. That would prevent any shifting of foreign funds into the retail e-commerce business under the garb of trade deals.

“Foreign Exchange Management Act (FEMA) is a civil law and its violation is generally not considered a serious offence. ED's notice to businesses are usually in the nature of asking for facts for the agency to satisfy itself about the status of legal compliance,” said a person privy to the ED investigation.

The person also said that ED, although empowered to prosecute the accused, has no power to arrest anyone. Besides, FEMA allows compounding of an offence or settling the case with the authorities by paying a penalty.

Reportedly, the ED had earlier found no wrongdoing in the operations of Bharti Wal-Mart joint venture as alleged by a member of Parliament.

Officials in the Department of Industrial Policy and Promotion, which recently brought out a discussion paper on FDI in e-commerce, said they are yet to get any details on the probe.

“It (the probe) would send a negative signal to investors as, on one side, the government has put out a discussion paper to open up the sector and, on the other, companies are being investigated (for alleged violations),” said Akash Gupt, head, regulatory practices, PwC.

***Source : The Financial Express***

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