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cutting through complexity

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Major FDI Policy reforms notified

Background

The Department of Industrial Policy and Promotion (DIPP) vide Press Note 12 dated 24 November 2015 (Press Note) has codified the amendments proposed to the Foreign Direct Investment (FDI) Policy on 10 November 2015. These amendments are aimed at (i) increasing in sectoral caps in select sectors to permit more foreign investments, (ii) bringing in more activities under the automatic route and (iii) easing some entry conditionalities for foreign investment in certain key sectors. The changes introduced by the DIPP, which came into effect from 24 November 2015, have been summarised in the ensuing paragraphs.

I. Sector impact

E-commerce

A manufacturer is permitted to sell its products made in India through wholesale and/or retail, including through e-commerce platforms, without prior government approval.

Definition of ‘manufacture’ for the purposes of the FDI Policy has also been provided. It is largely in sync with the definition as per the Income Tax Act, 1961 (the Act).

‘Manufacture’, with its grammatical variations, means a change in a non-living physical object or article or thing:
(a) resulting in the transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or
(b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

Construction development sector

- Construction development sector in India has been plagued with high cost debt and a slump in demand. In order to provide impetus to the sector, the Government of India (GoI) has decided to do away with the majority of the onerous conditionalities laid down under Press Note 10 (2014). The Press Note provides that each phase of the construction development project would be considered as a separate project for the purposes of FDI policy. Further, investment will be subject to following conditionalities:

  - The exit is permitted at any time if project or trunk infrastructure (i.e. roads, water supply, street lighting, drainage and sewerage) is completed before the lock-in period.
  - Notwithstanding the above, foreign investors will be permitted to exit and repatriate foreign investment before completion of the project under the automatic route, subject to compliance with lock-in condition of three years (calculated with reference to each tranche of foreign investment). However, the condition of lock-in period will not apply to hotels and tourist resorts, hospitals, special economic zones, educational institutions, old age homes and investment by Non-Resident Indians (NRIs).
  - Transfer of stake from one non-resident to another, without repatriation of investment, will not be subject to any lock-in period or any government approval.
  - It has been clarified that earning of rent/income on the lease of the property, not constituting a transfer, will not amount to ’real estate’ business.

- 100 per cent FDI under automatic route is permitted in completed projects for operation and management of townships, malls/shopping complexes and business centres. Consequent to foreign investment, transfer of ownership and/or control of the investee company from residents to non-residents is permitted, subject to compliance with minimum lock-in condition of three years, calculated with reference to each tranche of FDI.

- Definition of transfer for the purpose of FDI in the construction development sector has been provided.

- The erstwhile FDI policy required foreign investors to comply with minimum area and minimum capitalisation conditions. The minimum floor area restriction of 20,000 sq. meters in construction development projects and minimum capitalisation of USD5 million (to be brought in within six months of commencement of business) have also been removed.

The above-mentioned reforms could help the Indian construction development projects and also help achieve GoI's goal of building 50 million houses for the poor and creation and maintenance of leading housing infrastructure.

Defence sector

FDI in the defence sector was increased from 26 to 49 per cent under the government approval route vide Press Note 7 (2014). Investments beyond 49 per cent required approval from the Cabinet Committee on Security (CCS). However, since the amendment was made, there has been a lukewarm response from global defence manufacturers who have expressed concern over the transfer of technology to companies not owned and controlled by them.

In order to allay some of the concerns of defence manufacturers and provide clarity on different routes of investment (FDI and portfolio investment), the Press Note has amended the FDI Policy as under:

- Foreign investment up to 49 per cent to be allowed under the automatic route.

- Proposals for foreign investment in excess of 49 per cent to be considered under the government approval route i.e. Foreign Investment Promotion Board (FIPB)

- Portfolio investment and investment by Foreign Venture Capital Investments (FVCIs) will be allowed up to permitted automatic route level of 49 per cent.

- In the case of infusion of fresh foreign investment within the permitted automatic route level, in a company not seeking an industrial licence, resulting in the change in the ownership pattern or transfer of stake by existing investor to new foreign investor, government approval will be required.

- Foreign investment in the defence sector would be subject to security clearance and guidelines of Ministry of Defence (MoD).

As a stated policy in the Press Note, it is the endeavour of GoI to 'put more and more FDI proposals under the automatic route instead of government route', and allowing FDI up to 49 per cent under the automatic route coupled with recent streamlining of the industrial licence regime is a welcome step.

Single Brand Retail Trading (SBRT)

Although a number of foreign retailers have entered the Indian market under the SBRT, there have been concerns with respect to some of the conditionalities under the FDI policy. The Press Note has liberalised /clarified these conditionalities as under:

- Domestic sourcing requirement (of 30 per cent of the value of goods purchased) to be reckoned from the opening of the first store, as against the earlier requirement of meeting these from date of infusion of foreign investment.

- To provide an opportunity to high technology single brand entities, in the case of 'state-of-art' and 'cutting-edge technology', sourcing norms can be relaxed subject to government approval.

- An entity which has been granted permission to undertake SBRT is now permitted to undertake e-commerce activities.

- Indian brands are eligible for undertaking SBRT activities.

- Definition of 'Indian manufacturer' would be the investee company, which is the owner of the Indian brand and which manufactures in India, in terms of value, at least 70 per cent of its products in-house, and sources, at most 30 per cent from Indian manufacturers.

- Indian brands should be owned and controlled by resident Indian citizens and/or companies which are owned and controlled by resident Indian citizens.

- 100 per cent FDI permitted in Duty-Free Shops under the automatic route.

- Same entity permitted to carry out both wholesale and SBRT provided each business separately complies with conditions laid down in the FDI policy and maintains separate books of accounts for both business arms.

The above changes, more particularly the significant relaxation in sourcing norms is likely to pave the way for global retailers and manufacturers of high-end products for setting up retail operations in India. Permitting e-commerce in SBRT is also a welcome step, and could help these retailers in effectively marketing their products on a pan India basis.

II. Enhancement of FDI limit/approval requirements

In line with the stated objective of bringing a large number of sectors under the automatic approval route, the Press Note has proposed the following enhancement(s) of FDI caps and liberalisation of approval route. These changes are predominantly aimed at media, broadcasting sector and aviation sector.

Sector /Activity	Erstwhile Cap and Route	New Cap and Route
Broadcasting carriage services		
Teleports (setting up of up-linking HUBs/teleports)	74% (up to 49% - automatic route Beyond 49% and up to 74% - under government route)	100% (up to 49% - automatic route Beyond 49% - under government route)
Direct to Home (DTH)		
Cable networks (Multi System operators (MSOs) operating at national or state or district level and undertaking upgradation of networks towards digitalisation and addressability)		
Mobile TV		
Headend-in-the Sky Broadcasting Service (HITS)		
Cable networks (Other MSOs not undertaking upgradation of networks towards digitalisation and addressability and Local Cable Operators (LCOs)	49% - automatic route	
Broadcasting content services		
Terrestrial broadcasting FM (FM Radio)	26% - government route	49% - government route
Up-linking of 'news and current affairs' TV channels		
Up-linking of non 'news and current affairs' TV channels	100% - government route	100% - automatic route
Down-linking of TV channels		
Air transport services		
Non-scheduled air transport service	74% FDI (100% for NRIs) (Automatic up to 49% government route beyond 49% and up to 74%)	100% - automatic route
Ground handling services		
Satellites - establishment and operation		
Satellites - establishment and operation	74% - government route	100% - government route
Credit information companies		
Credit information companies	74% - automatic route (FDI+FII/FPI*) *allowed up to 24% only for listed companies	100% - automatic route (Condition with respect to FII/FPI investment condition has been retained)

III. Opening up new sectors to FDI

100 per cent foreign investment in plantation activity was earlier permitted only in the tea sector with government approval. 100 per cent FDI is now be permitted in the tea sector and also in coffee, rubber, cardamom, palm oil tree and olive oil tree plantations under the automatic route. In addition to companies

engaged in these sectors, this could also benefit manufacturing companies procuring the above products as raw materials for further processing.

Further, regional air transport service is now eligible for foreign investment up to 49 per cent under the automatic route.

IV. Removal of impediments

100 per cent FDI in Limited Liability Partnerships (LLPs) permitted under the automatic route

100 per cent FDI has been permitted under the automatic route in LLPs operating in sectors/activities where 100 per cent FDI is allowed, through the automatic route without FDI-linked conditionalities.

Definition of the terms 'control' and 'owned' have also been expanded to incorporate LLPs. Accordingly, for the purpose of LLPs, 'control' would mean the right to appoint a majority of the designated partners, where such designated partners, with specific exclusion to others, have control over all the policies of the LLP.

An LLP will be considered as 'owned' by resident citizens if more than 50 per cent of the investment in such LLP is contributed by resident Indian citizens and/or entities which are ultimately 'owned and controlled by resident Indian citizens' and such resident Indian citizens and entities have the majority of the profit share.

Further, LLPs having foreign investment permitted to make downstream investment in another company or LLP in sectors in which 100 per cent FDI is allowed under the automatic route and there are no FDI-linked performance conditions. These changes aim to provide flexibility to foreign investors in setting up operations in India under an LLP structure without the requirement to seek any prior government approval.

With respect to downstream investments, LLPs would also have to ensure existing reporting compliances as applicable to companies. Also for the purpose of downstream investment, the Indian LLP making downstream investments would need to bring in requisite funds from aboard and not leverage funds from the domestic market. This, would, however, not preclude LLPs with operations, from raising debt in the domestic market. Also, for the purposes of FDI policy, internal accruals would mean as profits transferred to reserve account after payment of taxes.

Full fungibility of foreign investment permitted in banking: Private sector

Although DIPP's Press Note 8 (2015) introduced the concept of composite caps, the private banking sector had a specific condition which capped portfolio investment to 49 per cent of the total paid-up share capital of said banks. In line with recommendations of the Chandrasekhar Committee, the Press Note has introduced full fungibility of foreign investment in the private banking sector. Accordingly, FIIs/FPIs/ QFIs (subject to applicable norms) can invest up to a sectoral limit of 74 per cent, provided that there is no change of control and management of the investee company. This will provide greater accessibility to foreign capital by the private banking sector.

Investment by companies/trusts/partnerships owned and controlled by NRIs on non-repatriation basis to be treated as domestic investment

Implementing the recommendations of the Mayaram Committee, the Press Note has now reinstated a concept somewhat similar to the erstwhile concept of Overseas Corporate Bodies (OCBs) to include NRI owned and controlled companies, trusts and partnerships. It has been provided that investments made by such entities under Schedule 4 of FEMA (Transfer or Issue of Securities by Person Resident Outside India) Regulations, would get covered under Press Note 7 (2015), i.e. treated as a domestic investment.

Companies without operations do not to require government approval for FDI for undertaking automatic route sector activities

For an infusion of foreign investment into an Indian company which does not have any operations and also does not have any downstream investments, government approval would not be required, for undertaking activities which are under the automatic route.

However, approval would be required for such companies for infusion of foreign investment for undertaking activities which are under the government route, regardless of the amount or extent of foreign investment. Upon commencement of business or making a downstream investment, compliance with sectoral caps and conditionalities would need to be ensured.

Establishment and transfer of ownership and control of Indian companies

Approval of the government would be required only if the company concerned is operating in sectors/ activities which are under the government approval route rather than capped sectors.

Swap of shares

No approval of the government will now be required for investment in automatic route sectors by way of a swap of shares. However, valuation of shares will have to be made by a merchant banker registered with SEBI or an investment banker outside India registered with the appropriate regulatory authority of the host country. This will foster merger and acquisitions in India and outside India.

Separation of titanium bearing minerals

Separation of titanium bearing minerals and ores, its value addition and integrated activities have been simplified.

FDI in certain agricultural activities

Conditionalities with respect to the development of transgenic seeds/vegetables have been dispensed with.

Raising the threshold limit for approval by FIPB

Earlier, foreign investments beyond INR30 billion under government approval route were placed before the Cabinet Committee on Economic Affairs (CCEA) after FIPB clearance. The threshold limit has now been increased to INR50 billion. This is expected to speed up the process of obtaining FIPB approval, wherever required.

Conclusion

The above mentioned amendments came into effect from 24 November 2015. This is a key step towards further liberalisation of the FDI policy. These broad based reforms touching upon a variety of sectors have removed some of the key hurdles that were an impeding inflow of capital in sectors in need of foreign funds. Hopefully, the tangible impact of these policy measures would be assessed in due course.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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