FDI – Recent development

S & B – Special coverage

Meaning of FDI

- The term ‘Foreign Direct Investment’ (FDI) means investment from another country (foreign country) in a business situated in the host country.
- FDI is an essential tool which has helped boost the economies of developing countries like India.
- There are two routes of investment by a foreign country in India- automatic and government.
- The automatic route does not require the investor to take any approval whereas through the government route, no investment can be made without taking the prior approval of the Government of India.
- The FDI Policy under the Foreign Exchange Management Act (“FEMA”), 1999 allowed all the countries to invest in India through automatic route except Pakistan and Bangladesh, however, certain sectors are prohibited for investment even to the other countries.
- Due to the current situation of COVID-19, certain changes have been brought about in the FDI Policy in India to stabilize its economy which has been severely hit.

FDI POLICY IN INDIA BEFORE THE AMENDMENT:

- The FDI Policy in India allowed foreign investment by all the countries (except Pakistan and Bangladesh) automatically, however, any kind of investment in certain sectors/activities were prohibited.
- The position before the amendment under the Consolidated Foreign Direct Investment Policy of 2017 (“FDI Policy”) is as under:
  - A non-resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited.
  - However, a citizen of Bangladesh or an entity incorporated in Bangladesh can invest only under the Government route.
  - Further, a citizen of Pakistan or an entity incorporated in Pakistan can invest, only under the Government route, in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment.”
  - Rule 6 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (“NDA Rules”) lays down a similar rule which restricts the citizens of Bangladesh and Pakistan to invest in India without obtaining the prior approval of the Government except in cases of investments in prohibited sectors/activities like defence, space and atomic energy where investment even through the Government route is restricted.

FDI policy – Post amendment

- A non-resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited.
- However, an entity of a country, which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, can invest only under the Government route.
- Further, a citizen of Pakistan or an entity incorporated in Pakistan can invest, only under the Government route, in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment.
- In the event of the transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the restriction/purview of the preceding para , such subsequent change in beneficial ownership will also require Government approval.”

FDI policy – Post amendment

- Rule 6 of the NDI Rules was amended by way of a Gazette Notification dated 22nd April, 2020. The Gazette Notification has substituted the earlier proviso to Clause (a) of Rule 6 with three new provisos which are reproduced below: “Provided that an entity of a country, which shares land border with India or the beneficial owner of an investment into India who is situated in or is a citizen of any such country, shall invest only with the Government approval: Provided further that, a citizen of Pakistan or an entity incorporated in Pakistan shall invest only under the Government route, in sectors or activities other than defence, space, atomic energy and such other sectors or activities prohibited for foreign investment: Provided also that in the event of the transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the restriction or purview of the above provisos, such subsequent change in beneficial ownership shall also require government approval”.

Effect of the amendment

- The position before the amendment is stated above which made it clear that a non-resident entity can invest in India except in the prohibited sectors/activities, however, a citizen of Bangladesh and Pakistan can invest in India only through Government approval.
- The amendment has made it mandatory that any investment by an entity of a country which shares land border with India can be made only with the prior approval of the Government.
- The countries that share its land border with India are Afghanistan, Nepal, China, Myanmar, Bhutan, Pakistan and Bangladesh.
- The countries sharing land borders with India cannot invest in India automatically but require Government approval for the same.
- The said amendment does not ban any investment to be made by these bordering countries, the only requirement for the same is prior Government approval. The amendment is silent as to the maximum or minimum threshold of investment
- Further when there is a transfer of ownership of an existing or future FDI in India, directly or indirectly, resulting in beneficial ownership falling within the restrictions stated above, the subsequent changes in the beneficial ownership shall also require the prior approval of the Government

Beneficial owner

- The term 'beneficial owner' has not been defined under the FEMA or the NDA Rules. In order to understand the concept of beneficial owner, the Companies (Significant Beneficial Owners) Rules 2019 (“Companies Rules”) and/or the Prevention of Money-laundering Act, 2020 (“PMLA”) would have to be referred to.
- Both the acts prescribe different thresholds for determining beneficial ownership.
- The term beneficial interest in a share has been defined under Section 89 of the Companies Act, 2013 which includes, directly or indirectly, through any contract, arrangement or otherwise, the right or entitlement of a person alone or together with any other person to—
  - (i) exercise or cause to be exercised any or all of the rights attached to such share; or
  - (ii) receive or participate in any dividend or other distribution in respect of such share.

Beneficial owner

- As per Section 90 of the Companies Act, 2013, an individual is referred to as 'significant beneficial owner' who holds (alone or together, or through one or more persons or trust) beneficial interests of not less than 25% per cent or such other percentage as may be prescribed, in the shares of a company or the right to exercise.
- However, rule 2(h) of the Companies (Significant Beneficial Owners) Rules, 2019, prescribes a 10% threshold in terms of shareholding. Apart from the term beneficial owner being defined under the Companies Act and its rules, the same has been interpreted in PMLA.
- As per Section 2(fa) of the PMLA 2002, 'beneficial owner' is "an individual who ultimately owns or controls a client of a reporting entity or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person". The thresholds under the PMLA Rules for identifying the beneficial owner of a company is 25% controlling ownership /profit share of the company. However, there is a likelihood that a 10% beneficial ownership cap for FDI from the bordering countries would be set. The 10% threshold would be in line with the Companies (Significant Beneficial Owners) Rules, 2019.
- As the FEMA Act or the NDA Rules does not define the word beneficial owners or does not prescribe any threshold, it would be very important for the Department of Promotion of Industry and Internal Trade to provide a clarification on the same by way of a further notification.

Recent development

- The Finance Minister, on 16th May, 2020 conducted a conference for 'Atmanirbhar Bharat' which announced, in several tranches, steps that shall be stimulus to help and extend assistance to the government.
- Raising the Foreign Direct Investment (FDI) limit in the defence sector under the automatic route from 49% to 74%.
- Import of some weapons and platforms will not be allowed.
- Gazette notification is awaited to be issued implementing the conference held on 16th May, 2020 by the Finance Minister.