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FDI Update

December 2015

LIBERALISATION OF FDI POLICY

The Department of Industrial Policy and Promotion **("DIPP")** issued Press Note No. 12 (2015 Series) on 24 November 2015 **("Press Note")**, introducing substantial changes to the Foreign Direct Investment Policy **("FDI Policy")**. This update sets out significant amendments brought about by the Press Note.

A. Limited Liability Partnership ("LLP")

The Press Note makes the following vital changes with respect to FDI in LLPs:

- Government approval previously required for FDI in LLPs (irrespective of sector) is no longer required in sectors/activities where 100% FDI is allowed under the automatic route and there are no FDI-linked performance conditions;
- Previously LLPs with FDI were prohibited from making downstream investments. Now such LLPs have been permitted to make downstream investments in another company or LLP in sectors in which 100% FDI is allowed under the automatic route and where there are no FDI-linked performance conditions.
- Certain conditions such as the manner of foreign participation, restrictions on Foreign Portfolio Investors **("FPIs")** and Foreign Venture Capital Investors investing in LLPs etc. appear to have been done away with.
- Consequential changes have also been made to the definitions of '*owned*' and '*control*' and the applicability of the conditions on downstream investments.

B. Entities owned and Controlled by Non-resident Indians ("NRIs")

Investments made by companies, trusts and partnership firms incorporated outside India and owned and controlled by NRIs –

- are now granted the special dispensation that has historically been available only to NRIs under the FDI Policy; and
- can be eligible for investment on a non-repatriation basis and such investment will be deemed as domestic investment at par with investments made by residents.

C. Manufacturing

Previously Government approval was required for FDI exceeding 24% in entities that manufacture items reserved for the micro and small enterprises sector. This requirement has now been dispensed with and FDI is now permitted in entities undertaking manufacturing subject only to the conditions specified for the relevant sector.

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

Further, the Press Note introduces the definition of the term '*Manufacture*'.

D. Swap of Shares

Government approval is no longer required for investments made by way of swap of shares in the automatic route sectors. This amendment is likely to provide a lot more flexibility to parties when structuring FDI transactions.

E. Sector Specific Changes

The Press Note has further amended investment limits and conditions applicable to FDI in certain sectors, as set out below:

1. Agriculture and Animal Husbandry

The FDI-linked conditions applicable to companies dealing with development of transgenic seeds and vegetables have now been removed.

2. Tea Plantations

While FDI was previously permitted only in the tea sector (including tea plantations) with Government approval, now 100% FDI is permitted under the automatic route, not only in the tea sector but also in coffee, rubber, cardamom, palm oil tree and olive oil tree plantations.

3. Defence

- In August 2014 the Government increased the FDI limit from 26% to 49% under the approval route. The Press Note further liberalises this condition by bringing FDI in defence under automatic route upto 49%.
- While several restrictive conditions have been removed two new conditions for FDI in this sector have been introduced, i.e. (i) fresh foreign investment in a company not seeking industrial license, resulting in change in the ownership pattern or transfer of stake by existing investor to new foreign investor will require Government approval; and (ii) foreign investments are to be subject to security clearance and guidelines of the Ministry of defence.

4. Services Sector (Broadcasting)

- The sectoral cap for all Broadcasting Carriage Services has been increased to 100%, (i.e. automatic route upto 49% and subject to Government approval beyond 49%).
- The sectoral cap for Terrestrial Broadcasting FM and Up-linking of News and Current Affairs TV Channels is increased to 49% (from 26%), while FDI in Up-linking of Non-'News & Current Affairs' TV Channels and Down-linking of TV Channels is permitted upto 100% under the automatic route (previously under the Government approval route).

5. Air Transport Services and other services under civil aviation sector

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- The Press Note introduces a new sector, Regional Air Transport Services wherein FDI is permitted upto 49%, with FDI by NRIs being permitted upto 100%.
- FDI in '*Non-scheduled Air Transport Service*' and '*Ground Handling Services*' sectors has been increased to 100% under the automatic route.

6. Construction

The conditions for investment have been amended significantly, including as follows:

- Minimum floor area and minimum capitalization conditions are removed.
- The foreign investor is now permitted to exit and repatriate foreign investment before the completion of project under the automatic route, subject to a lock in period of 3 years (calculated with reference to each tranche). It is clarified that transfer of any such immovable property during the lock-in period is forbidden. It is should be noted that a definition of transfer has been inserted, which includes compulsory acquisition under any law. It will be interesting to see how the prohibition on transfer under the FDI Policy and a mandatory requirement to transfer under another law will be reconciled.
- Transfer of stake from by a non-resident investor to another non-resident, without repatriation of investment would neither be subject to any lock-in period nor to any Government approval.
- The definition of real estate business has been modified to specify that earning of rent/ income on lease of the property not amounting to transfer will not amount to real estate business.

7. Trading

- Wholesale cash and carry traders are now permitted to undertake single brand retail trading subject to the conditions attached to FDI in single brand retail trading. However, they would be required to maintain separate books of accounts for each of the businesses require to be maintained.
- FDI in single brand retail trading has been amended as follows:
  - Entities operating through brick and mortar stores are also entitled to undertake retail trading through e-commerce.
  - The requirement for procurement of locally sourced goods is now applicable from the date of opening the first store. This requirement may be relaxed by the Government in the case of products having '*state of the art*' and '*cutting technology*'.
  - The concepts of '*Indian manufacturer*' and '*Indian brand*' have been introduced.
  - An '*Indian manufacturer*' is permitted to sell its own products in any manner, including via wholesale and retail as well as e-commerce.
  - In case of '*Indian brands*' the product need not be sold under the same brand internationally and the foreign investor need not show that it owns the brand or has a right to it under a legally tenable agreements.

8. Banking – Private Sector

The aggregate limit for FIIs/FPIs/QFIs in private sector banking has been increased to 74%.

9. Satellites-establishment and operation

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- FDI in the Satellites- establishment and operation sector is increased to 100% under the Government approval route.

10. Credit Information Companies

- 100% FDI is now permitted under the automatic route in this sector.

11. Duty Free Shops

One of the biggest changes is that FDI in duty free shops located and operated in Customs bonded area is now permitted upto 100% under the automatic route.

F. Other Sector Agnostic Changes

Other significant liberalisations include:

- FDI is now permitted under the automatic route in Indian companies which do not have any operations or downstream investments for undertaking activities which are under automatic route and without FDI linked performance conditions. However, Government approval will have to be obtained when FDI is made in sectors requiring such approval and FDI linked conditions, sectoral caps will have to be complied when these are applicable to the FDI.
- The guidelines for establishment of Indian companies/transfer of ownership or control of Indian companies, from resident Indian citizens to non-resident entities, which were earlier applicable to sectors with caps being applicable now only to sectors in which Government approval is required.
- Investment proposal of more than INR 5,000 Crores would need to be considered by the Cabinet Committee of Economic Affairs instead of the requirement of the Foreign Investment Promotion Board.

ALMT analysis

While the DIPP has amended the FDI Policy in response to concerns and demands from various industries and to encourage FDI, it remains to be seen if these amendments would have the desired effect.

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