FDI in India

Policy Update January 2010

Table of Contents

I. Introduction

The performance of FII holdings in India have appreciated by 82 per cent or about US$69 billion in 2009 as compared to the previous year. This is the result of India being a safe destination for foreign investment as it combines prudent macroeconomic management with a stable domestic financial system.

II. Expected changes in FDI rules

The following changes in FDI rules are expected in the near future:

(i) Government is planning to relax FDI norms

The government is planning to enhance the FDI limit for exemption from the approval of Cabinet Committee on Economic Affairs (CCEA). At present, any FDI infusion, irrespective of its size, into projects worth more than Rs 600 crore (Approx. $125 million) requires a formal clearance from CCEA after it passes through FIPB. Now this limit is going to be increased to Rs 1200 crores (Approx. $250 million). Projects below the threshold would get their final approval from the finance ministry after they have been cleared by the FIPB.

The move is part of the policy measures aimed at ensuring smooth FDI flow into the country. The recent report by the OECD indicates that even though FDI inflows have been rising since 2000, it still does not play a significant role in capital formation.

http://www.business-standard.com/india/storypage.php?autono=383232

(ii) Norms governing FDI instruments may be tightened

The government view is that sectoral ceilings, minimum-capitalisation and lock-in period conditions governing foreign investment through equity should be applicable to partly-paid shares, convertible warrants and units issued by venture capital funds (VCFs).

It has been proposed that the time available for overseas owners to convert partly-paid shares into fully-paid shares should be cut down to 6 months from 18 months and that the conversion of convertible warrants into equity shares should happen within 18 months.

Once the new norms come into effect, the government may put FDI through partly-paid shares and convertible warrants on the automatic route.

http://www.taxguru.in/fema/government-may-tighten-norms-governing-fdi-instruments.html

(ii) Automatic FDI route to close for ten sectors

Keen to beef up national security, the government is planning to slap new entry route restrictions on FDI of 49% in eight specified "sensitive" sectors, including airports, seaports, pharma, petroleum refining and gas pipelines. At present, 100% FDI through the automatic route is permitted in all these sectors.

Once the policy is in place, proposals to expand FDI beyond 49% in these sectors would have to be vetted by the FIPB.

Foreign investment in sectors such as hazardous chemicals and industrial explosives would always require approval.

http://www.indianexpress.com/news/automatic-fdi-route-to-close-for-10 sectors/564350/0

(iii) Rethinking on FDI cap in broadcasting

The Telecom Regulatory Authority of India (TRAI) is currently examining whether or not the broadcasting sector should be exempted from FDI regulations notified under Press Notes 2 and 4 of 2009.

The Press Notes 2 and 4 had stated that downstream foreign investment into a non-operating Indian holding company would not affect the determination of the FDI cap in each sector.

TRAI, however, is of the view that the broadcasting sector, being sensitive in nature, should be taken out of the ambit of Press Notes 2 and 4.

(iv) Fifty-fifty joint ventures with overseas firms to get foreign tag

In a bid to further streamline the FDI policy, the government is going to classify a 50:50 joint venture (JV) between a domestic firm and an overseas entity as a foreign company.

To retain the status of an Indian-owned company, all foreign partners, having such joint ventures with an Indian firm, will have to divest at least 0.5% in favour of the Indian partner.

According to new FDI rules, a company established in India with majority Indian holding is termed Indian-held and controlled and its downstream investments are also considered as Indian.

http://www.financialexpress.com/news/5050-jvs-with-overseas-firms-to-get-foreign-tag/562852

(v) Investment from tax havens to come under government lens

The Centre is set to scrutinise FDI from countries whose sources are not yet completely traceable.

To start with, subsidiaries of Indian companies in tax havens will be required to have business operations in those countries, in order to be eligible to invest in India. The government is also planning to scrutinise books of overseas subsidiaries that have been set up with a very low capital base as these are mostly used for round tripping, or reinvestment of capital as foreign investment.

Tax havens such as Mauritius and Cyprus encourage non-residents to park their money there because of zero or close-to-zero tax rates.

The Mauritius government has also made it clear that the country cannot be treated as a tax haven. It has warned that licences of entities investing in India will be revoked if they source funds from India.

http://www.financialexpress.com/news/Investments-from-tax-havens-to-come-under-Centre-lens/571603/

III. News & Views

(i) Focus on the larger picture in FDI

An opinion has been expressed that India's expectation of achieving the target of $50 billion FDI by 2012 would depend on the government's moving fast to clear the labyrinth of rules and procedures characterising the FDI regime in the country.

It is being argued that apart from the multitude of sectoral caps, the needless confusion over FDI and FII as also the computation of foreign investment in downstream projects, and the constant flip-flop in policy do not make for a good investment climate. Add to this the numerous operational problems that work as hurdles to the evolution of an enabling business environment.

http://economictimes.indiatimes.com/opinion/editorial/Incremental-Step/articleshow/5486618.cms

(ii) Move to stop security overkill

The Ministry of Commerce and Industry has cautioned the National Security Council (NSC) that any tweaking of the current foreign investment policy regime may adversely affect the flow of FDI into India. The move comes in the wake of reports suggesting extraordinary scrutiny of companies from China and West Asia, which often are scoured by security experts either in relation to domestic security concerns or links with extremism.

The NSC has proposed setting up of a risk management system that would regulate and monitor foreign investment based on parameters such as source of investment, nature of activity and issue of visas to foreigners.

http://in.news.yahoo.com/32/20100114/1059/tbs-fdi-move-to-stop-security-overkill.html

(iii) Implement the Investment Commission recommendations

People are demanding the implementation of the recommendations made by the Investment Commission under the chairmanship of Ratan Tata.

The Commission recommended the removal of restrictions on sector caps and entry routes on all sectors other than those considered strategic, provision of labour flexibility through permission for contractual hiring of labour in all areas, creation of a level playing field in sectors with PSU dominance through the establishment of an Independent Central Regulatory Commission, and the formulation of effective ways to resolve Centre-state issues through the establishment of an Empowered Committee framework for the same.

http://www.financialexpress.com/news/fe-editorial-commission-the-recommendations/566136/

(iv) Government sets up panel to smoothen FII inflows

A working group has been constituted by the government to look at various types of foreign inflows, which are taking advantage of arbitrage opportunities.

Arbitrage is the practice of taking advantage of a price differential between two or more markets and involves the process of buying stocks and bonds in one market and immediately selling them in another market at higher prices. The panel will study arrangements relating to use of participatory notes (PNs) and suggest changes required to increase transparency.

PNs are instruments used by overseas investors investing in the Indian stock markets without registering themselves with the market regulator. Hedge funds, which invest through PNs, borrow money cheaply from overseas markets and invest these funds into stocks in emerging markets.

http://in.news.yahoo.com/32/20100115/1059/tbs-govt-sets-up-panel-to-smoothen-fii-i.html

(vi) FDI in agriculture has failed to make any significant impact

The opening up of the agriculture sector to FDI has failed to make any significant impact. One reason is that FDI in agriculture has been unable to keep pace with the overall increase. For instance, the flow of agriculture investments as a share of total FDI declined from 2.6% in 2004 to 1.5% in 2005 and further to 0.7% in 2006. But the trends have reversed marginally in recent times, with the ratio improving to 2.1% in 2007 and 2% in 2008. However, trends in actual flows are more reassuring as FDI in agriculture has increased six-fold, going up from $96.4 million in 2004 to $656 million in 2008.

A look at the numbers indicates that the gains from growing FDI in agriculture have been unevenly distributed. The most recent numbers show that more than half of FDI flows into agriculture were in fermentation industries followed by the food processing industry.

http://www.financialexpress.com/news/spreadsheet/569706/

(v) India may join CFC laws this year

India may consider enforcing Controlled Foreign Corporations (CFCs) laws that enable authorities to tax the income of a resident derived from a foreign corporation. This is irrespective of whether the profit/dividend of the foreign entity is transferred to India or not.

Countries adopt CFC laws mainly for checking the probable loss of revenue arising from the transfer of profit of foreign corporations to offshore havens.

http://economictimes.indiatimes.com/news/economy/policy/Foreign-arms-of-Indian-cos-under-tax-net-likely/articleshow/5411572.cms

Disclaimer: This information has been collected through secondary research and CUTS C-CIER is not responsible for any errors in the same.