FDI in India

Policy Update September 2009

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I. Introduction

India is back on the radar of global investors, even in the midst of the global financial crisis, with 56 percent year-on-year rise in FDI inflows in July this year. With both the global economy and the Indian economy on a recovery mode, FDI inflows are expected to increase steadily in coming months.

India has been an attractive destination for investors on account of its large domestic market with low penetration levels across industry segments, a sizable pool of technically qualified manpower and a fairly stable policy framework. Of course, there are some challenges also relating to ground level problems of implementation but these are being increasingly addressed through active competition among states to attract FDI.

II. Expected changes in FDI rules:-

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

(i) FDI norms liberalised for micro and small enterprise

The government has liberalised FDI norms for micro and small enterprises (MSEs), especially the current 24 percent ceiling on FDI, to match the norms guiding other large enterprises. However, if non-MSEs manufacture any of the 21 items reserved for MSEs, FDI above 24 percent will require the FIPB approval.

Recently issued Press Note 6 has replaced Press Note 18 of 1997. Changed policy permits FDI subject only to sectoral equity caps, entry routes and other relevant regulations. The move is expected to bring more FDI into the cash starved MSE sector.

Press Note 18 stipulated that since the maximum foreign equity participation allowed for small scale units (SSIs) was 24 percent, any proposal for induction of foreign equity over 24 percent would require the company to get it de-registered as an SSI.
http://www.business-standard.com/india/news/fdi-norms-liberalised-for-small-scale-sector/02/33/72678/on

(ii) New FDI norms will be applicable on banks also

Government has decided to apply the new FDI guidelines (Press Notes 1, 2 & 3) introduced in February this year to the banking sector. DIPP had earlier indicated that banks may be kept outside the ambit of the new rules as these are regulated by RBI. Now Indian banks in which foreign investors own more more than half the share capital will be covered by the new FDI guidelines, thus restricting their ability to open branches and invest in other ventures.

RBI had pointed out earlier this year that these guidelines will create a new category of "foreign owned and Indian controlled banks", which could pose regulatory challenges. So far, there have been only 'Indian' and 'foreign' banks, and separate rules for priority sector lending and market access are being applied for these two categories. RBI also mentioned that with the new guidelines, seven private sector banks viz. ICICI Bank, HDFC Bank Ltd., Yes Bank Ltd., Indus-Ind Bank Ltd., Federal Bank Ltd., ING Vysya Bank Ltd., & Development Credit Bank Ltd., may be referred to as foreign owned as the level of foreign ownership in them is greater than 50 percent.

RBI also indicated that the new guidelines may ignite the formation of "shell" companies with intentions of undertaking downstream investment in sectors with FDI limitations.
http://www.livemint.com/2009/09/30235355/New-FDI-norms-to-cover-banks-t.html

(iii)FEMA is to be updated to simplify the implementation of new FDI guidelines
The government decided to put an end to the ambiguities in the implementation of Press Notes 2 and 4 of 2009, which significantly relaxed FDI guidelines, by asking the RBI to make changes in the Foreign Exchange Management Act (FEMA) to implement the guidelines.

It stops RBI's opposition to the Press Notes also. RBI was opposing the Press Notes on grounds that they would encourage investors to breach sectoral FDI limits.

The government has also asked RBI to incorporate the changes in FEMA according to the FDI rules for small scale and micro scale industrial undertakings indicated in Press Note 6 of 2009.
http://www.business-standard.com/india/news/update-fema-for-press-notes-24-government-tells-rbi/369650/

(iv) Foreign investment leeway for newly formed companies
Companies will now be able to bring foreign investment without prior government approval even before they start operations or invest in other firms. However, this leeway will be available only to those firms planning to do business in sectors not requiring prior approval for foreign investment. The government has decided to do away with the requirement of prior regulatory approval (Press Note 4 issued in February this year) for such firms.
http://economictimes.indiatimes.com/News/Economy/Finance/Bigger-foreign-investment-leeway-for-newborn-firms/articleshow/5011595.cms

(v) Tighter norms for foreign investment in duty free shops
The entry process of foreign investments into duty free shops may become more stringent. Now that licenses to set up duty free shops may not be given to holding companies through their subsidiaries, a subsidiary or business vehicle of a holding company wishing to set up duty-free shops at individual locations has to get Foreign Investment Promotion Board (FIPB) approval on a case-to-case basis.

The government is of the view that tracking foreign investments through subsidiaries of holding companies in the duty free business would be very difficult if the FIPB gives an omnibus approval to holding companies.
http://epaper.timesofindia.com/Repository/ml.asp?Ref=RVRELzIwMDkvMDkvMjMjQXIwMDcwMQ==&Mode=HTML&Locale=english-skin-custom

(vi) 100 percent FDI in higher education may be allowed

The government is expected to allow 100% FDI in higher education to facilitate access to cheaper and better education as well as savings of billions of dollars in foreign exchange The Foreign Educational Institutions (Regulation of Entry & Operations, Maintenance & Prevention of Commercialisation) Bill is expected to get passed soon.

The expert view is that this move will be a success only if foreign universities offer the same quality of education in India as these do in their home countries. Moreover, foreign universities would come in only if these are allowed to levy international fees and pay international salaries.
http://www.business-standard.com/india/storypage.php?autono=370155

(vii) India wants data swap clause in tax treaties

In order to place a check on tax evasion, curb avoidance of double taxation on overseas income of residents and facilitate accurate determination of tax liability, India is keen to include the information exchange clause on tax collections in the 75 double tax avoidance agreements (DTAA) it currently is party to, including those with Switzerland and Mauritius. Currently only countries that have accepted Article 26 of the OECD codes; that require the countries to flow the information of their banking systems and exchange the same as deemed relevant, are in a position to exchange information.
http://www.financialexpress.com/news/india-wants-data-swap-clause-in-tax-treaties/516141/

(viii) Courts resolving disputes between foreign & domestic investor on anvil

The Government is planning to set up high value commercial courts for judging disputes relating to FDI between foreign investors and their domestic counterparts. All significant investment related disputes and misunderstandings among foreign investors and their domestic counter parts can be referred to such Courts.
http://www.financialexpress.com/news/courts-resolving-disputes-between-foreign-&-domestic-investors-on-anvil/514655/

III. News & Views

(i) New Company to facilitate FDI

The government has approved the setting up of a not–for-profit; single window facilitator- 'Invest India'- for prospective overseas investors. Invest India will be a joint venture of DIPP and Federation of Indian Chamber of Commerce & Industry (FICCI) and act as a first reference point for prospective foreign investors to facilitate ease of doing business. It is being argued that 'Invest India' will make the country more attractive as an FDI destination. Its core activities will consist of escorting potential foreign investors, investment promotion and FDI policy feedback. However, investors willing to invest in sectors such as telecommunications, defence production and media would have to go through preliminary screening by FIPB.
http://www.financialexpress.com/news/govtficci-agency-to-attract-fdi/515572/

(ii) The much awaited Bharti-MTN merger deal is off

The failure of the Bharti-MTN deal has provided the Indian government with sufficient reason to revisit the existing regulatory frameworks so that domestic companies can realise their ambitions to become global giants.

The primary reason for the collapse of the merger deal was the incompatibility of the Indian and South African regulatory regimes in regard to dual listing of securities of the entities contemplating merger. Under the dual listing arrangements, two merging firms continue with separate identities under a single management and their shares are traded in both the countries. The first precondition for dual listing is full convertibility of the rupee on the capital account. At present, the rupee is convertible on the current account but capital account transactions are still subject to regulation. Dual listing also requires changes in FEMA and RBI regulations governing domestic trading in shares denominated in foreign currency.

For example, if the MTN- Bharti deal had happened with a dual listing provision, Bharti shares would have been traded on the Johannesburg stock exchange and MTN shares in India. Without amendment of the FEMA and capital account convertibility, South African shareholders will be unable to cross-sell shares in India and repatriate the proceeds.

The expert view is that the Bharti-MTN deal highlights the need for India to enhance its preparedness for global acquisitions. India must modernise company law, taxation and currency regimes to facilitate the flexibility that Indian multinationals need to secure deals while battling inflexible regulatory requirements in other countries.
http://economictimes.indiatimes.com/Opinion/Editorial/A-setback-not-failure/articleshow/5074223.cms

(iii) 300 firms to pay RBI penalty for violating FDI sectoral limits
FIPB has directed 300 odd domestic firms to pay the RBI 'compounding' penalty for violating the FDI sectoral limits. These companies had struck joint ventures with their foreign counterparts before the government relaxed FDI sectoral limits through Press Note 2 and 4 in February this year, and had approached FIPB for approvals later. The concerned entities will again be allowed to apply for FDI relaxations pursuant to Press Notes 2 and 4 but not without paying the penalty so levied to the amount of the level of sectoral limits breached.
http://www.business-standard.com/india/storypage.php?autono=369413