

Global Rules on foreign direct investment

India

Foreign investment in India is governed by the Foreign Exchange Management Act, 1999 and the rules and regulations thereunder (FEMA), including the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (as amended from time to time) (the NDI Rules). Accordingly, all Indian persons (including Indian companies) either looking to receive foreign investment or having foreign investment are required to comply with these laws and regulations including entry route norms, sectoral caps, investment limits and pricing guidelines, as applicable.

The Government of India has reviewed its foreign investment regime of India with the objective of curbing opportunistic takeovers and acquisitions of Indian companies due to the COVID 19 pandemic. On April 17, 2020, the Ministry of Commerce, Government of India issued Press Note 3 (2020 Series) (**PN 3/20**) amending the then extant Foreign Direct Investment Policy (**FDI Policy**). The concomitant amendments made to the NDI Rules (**NDI Amendment Rules**) pursuant to PN 3/20 came into effect on April 22, 2020. Related amendments have also been made to the FDI Policy on October 15, 2020.

The foreign direct investment laws in India as they stood prior to the NDI Amendment Rules, provided that a person being a citizen of Bangladesh or Pakistan or being an entity incorporated in Bangladesh or Pakistan cannot invest in an Indian company without the prior approval of the Government of India. Further, any citizen of Pakistan or an entity incorporated in Pakistan is not permitted to invest in defense, space, atomic energy and sectors or activities prohibited for foreign investment at all. The NDI Amendment Rules read with PN 3/20 expand the scope of these restrictions briefly summarised below:

- An entity of a country sharing 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 in an entity in India only with the prior approval of the Government of India.

- In the event of the transfer of ownership of any existing or future foreign investment in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the above restriction, such subsequent change in beneficial ownership shall also require prior approval of the Government of India.

Consequently, investments from countries like China, Nepal, Myanmar, Bhutan and Afghanistan, in addition to Bangladesh and Pakistan (countries that share land border with India) in India, would also now be subject to the prior approval of the Government of India. Further, the use of the expression 'directly or indirectly' in PN 3/20 and the NDI Amendment Rules also implies that an overseas acquisition of an entity by an investor from any of the aforesaid countries, which, upon completion, will result in an indirect acquisition/change in shareholding resulting in acquisition of beneficial interest of an Indian company, will be covered within the ambit of the amendments and such transaction will require the prior approval of the Government of India.

Under a notification dated 8 December 2020, it has been clarified that investments by Multilateral Banks or Funds of which India is a member are not covered by the aforesaid requirements.

Accordingly, there are a few key aspects which should be analysed, with respect to investments in India from any of the aforementioned countries, going forward, which are as follows:

1. The amendments seem to cover follow-on investments by investors from these bordering countries in those Indian companies in which they are already invested.
2. The amendments seem to apply to investments not leading to a change in the shareholding of the foreign investor from a bordering country in the Indian company or where such investment is in exercise of an existing shareholder right/obligation.
3. Any investments in India through a fund sponsored and/or beneficially owned by investors resident of such country will require approval of the Government of India.
4. The investments in India from countries which are governed or claimed to be governed by China such as Hong Kong, Macau and Taiwan, are likely to be covered within these amendments.
5. Given that the terms "beneficial owner" and "beneficial ownership" used in PN 3/20 and in the NDI Amendment Rules are not defined either in the FDI Policy (though used therein) or in the NDI Rules, the meaning of these terms will have to be determined as per the other statutes such as (Indian) Companies Act, 2013, until the Government of India issues a clarification in this regard.
6. An acquisition of a foreign entity by an investor from China, which, upon completion, will result in an indirect acquisition/change in shareholding resulting in acquisition of beneficial interest of an Indian company, will also be covered by these amendments. The use of the expression 'directly or indirectly' in PN 3/20 and the NDI Amendment Rules directly applies to this

situation. Therefore, such indirect acquisitions will also be covered within the ambit of the amendments.

7. Whether acquisition of shares by an investor from the aforementioned countries in a foreign listed company which holds shares in an Indian company will be impacted by these amendments. This would depend on the facts of each case. An investor (in that foreign listed company) without any special rights cannot be said to be in a position of holding the beneficial ownership of the Indian company through that listed company. If however the investor itself is in control of that listed company or if he has certain special rights in the listed company (for example, special dividend rights or affirmative voting rights or management rights of such nature that indirectly give that investor the beneficial ownership of the Indian company), then the amendments will apply to his investment, irrespective of his shareholding, in the foreign listed company.

Although there are seven countries that share land borders with India, the immediate fallout of the amendments is their impact on investments in India from China including Hong Kong, Macau, and Taiwan. In line of PN 3/20, the Government of India has also amended some procedural rules as prescribed under the (Indian) Companies Act, 2013 including (i) requiring new directors (being national of countries sharing land border with India) to obtain security clearance from Government of India prior to their appointment in an Indian company; and (ii) requiring new investors to provide relevant declarations stating their compliance with PN 3/20 in relation to acquisition of securities of an Indian company through fresh offer or transfer of securities.

The world is moving towards an end to the COVID-19 pandemic, however, India is strictly adhering to the above revised norms under the FDI Policy. The Government of India is being cautious while reviewing the applications for investments from China including Hong Kong, Macau, and Taiwan.

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