

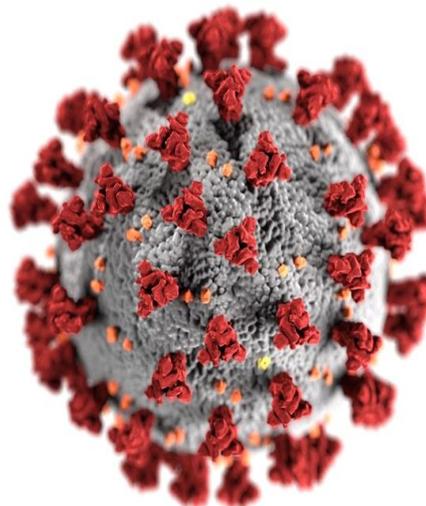
COVID -19 LEGAL FAQ SERIES

FOX MANDAL & ASSOCIATES



COVID-19 GLOBAL PANDEMIC

The sudden outbreak of the pandemic and the nation-wide lock-down has put a heavy constraint on individuals as well as the economy. To minimise the impact of the pandemic on the general public as well as business establishments and ensure minimum disruption in the supply chain, many amendments, advisories and announcements have been introduced which would ideally subsist during the containment period but could have long-term implications. Understanding the ramifications of these developments is essential for the smooth operation of enterprises. We decode the queries that have surfaced appurtenant to the multitudinous notifications that attorneys across our diverse practice domains have responded to.



In the wake of the COVID-19 pandemic and the potential unwarranted hostile takeovers resulting from the economic turmoil, Governments across the globe have revised their regulatory framework on foreign investments into their countries. In this regard, the Government of India through the Department for Promotion of Industry and Internal Trade has issued a [Press Note 3 \(2020 series\) on 17th April 2020](#) (“Press Note”) which has mandated Government approval for foreign investments if the source of origin of such foreign investment can be traced to the countries which shares land border with India.

In this note, we have provided a brief analysis of the Press Note and its implications in respect of few significant scenarios:

What are the changes effected by the Press Note?

Vide the said Press Note, the Government has modified the existing Para 3.1.1 of the foreign director investment policy (“FDI Policy”). The existing provision permits a non-resident entity to invest in India subject to the extant provisions of the FDI Policy. However, a citizen of Bangladesh or an entity incorporated in Bangladesh needs Governmental approval for investment into India. The scope of the said provision has been expanded to “an entity of 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” would require Government approval. The existing and modified provisions of the FDI Policy has been set out as follow:

| Existing FDI Policy | Modified FDI Policy |
|--|--|
| <p>Para 3.1.1: 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 defense, space, atomic energy and sectors/activities prohibited for foreign investment.</p> | <p>Para 3.1.1(a): 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 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 defense, space, atomic energy and sectors/activities prohibited for foreign investment.</p> <p>Para 3.1.1 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 para 3.1.1(a), such subsequent change in the beneficial ownership will also require Government Approval.</p> |

What is the ambit of the changes made?

The modified and newly added paragraphs of the Press Note evince that the intent of the Government is to regulate and bring foreign investment under the Government approval route if either of the following factors is fulfilled:

- a) If the investing entity is situated in a country which shares the land border with India, or
- b) Where the beneficial owner of the investment is situated in or is a citizen of any such country which shares the land border with India.

As per the details provided by the Ministry of Home Affairs, the following countries share the land border of 15,106 kilometre with India, namely, Bangladesh, Bhutan, China, Myanmar, Nepal, Pakistan and Afghanistan ("[Countries Sharing Land Boundary](#)"). A foreign investment by any entity situated in the said neighbouring Countries Sharing Land Boundary or the beneficial owner of the investment – is either situated in or citizen of any of the said Countries Sharing Land Boundary, then in such case it would require prior approval of the government before making any investment (collectively, "**Regulated Investing Person**").



Does investment by way of secondary transfer also fall within Government Approval route?

It is pertinent to note that Para 3.1.1. (b) states that a transfer of an existing or future FDI in an Indian entity (whether directly or indirectly) which results in the beneficial ownership falling within the restriction/

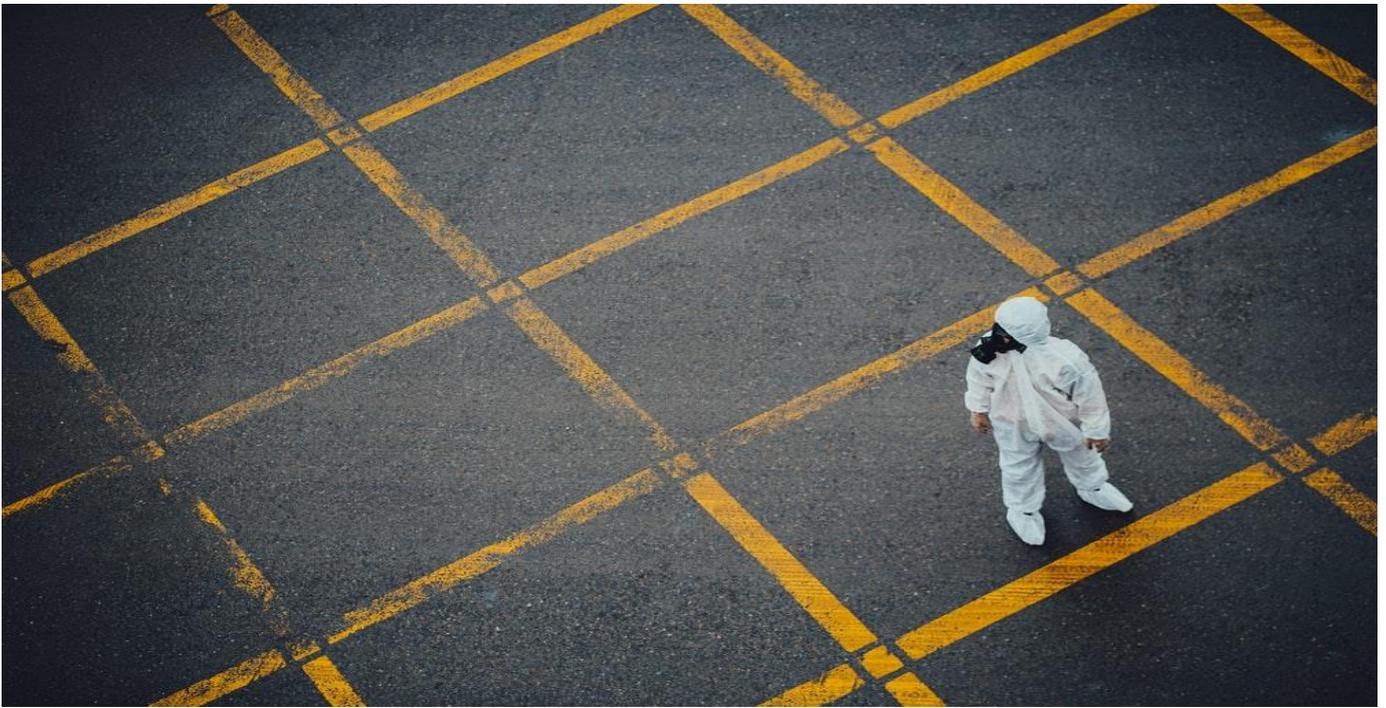
purview of Para 3.1.1 (a), then such change in beneficial ownership will also require Government approval. In this regard, it is essential to understand the scope of the term 'beneficial ownership'. The Consolidated FDI Policy or the Press Note does not expressly specify any definition of beneficial owner. As per the [RBI circular no. RBI/2012-13/419 A. P. \(DIR Series\) Circular No. 84, dated February 22, 2013](#) ("RBI Circular"), a beneficial owner:

- i. in case of a 'company', is a natural person(s), who, whether acting alone or together, or through one or more juridical person(s), has/have (a) a controlling ownership interest (i.e. ownership of more than 25% of the shares or capital or profits of the company); or (b) who exercise control through other means (such as a right to appoint majority of directors or control the management or policy decisions or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner); or
- ii. in case of partnership (if it qualifies as juridical person), a natural person, whether alone or together or through one or more persons, has controlling ownership of entitlement to more than 15% of the capital or profits of such partnership qualifying as juridical person.

In this regard, it would be relevant to understand how the 'beneficial ownership' will be determined by the Government for the purpose of the restriction under the Press Note and accordingly, to see whether all transfers would fall within the purview of Government scrutiny.

Is the restriction applicable to all sectors irrespective of percentage of holding post investment?

The Press Note stipulates that any investment by entity or beneficial owner of the investment situated in the Countries Sharing Land Boundary with India would require prior Government approval and the **Press Note has not prescribed any sectoral cap**. However, as stated above, in the event of a transfer or infusing foreign investment for establishing a new investee entity in India, it needs to be ascertained what would be the threshold for determining: (i) if the transfers would fall within the purview, or (ii) subscribing to the capital of new investee in India. Further, given that no specific threshold has been stipulated for a direct investment, it is also pertinent to assess how the approval would be considered in an investment which is staggered in tranche-wise manner.



Will the restriction affect the investments by Investment Vehicles under the FDI?

We note that the Press Note at this stage only provides a blanket requirement for Government approval, and there is little clarity on how the investment which is structured through Investment Vehicles will be impacted. Many foreign investors invest in Indian entity through the route of Foreign Venture Capital Investor (“FVCI”), which is required to be registered with the SEBI under the SEBI (Foreign Venture Capital Investors) Regulations 2000. FVCI is inventor incorporated and established outside India.

There may be instances where: (i) FVCI is not incorporated and established in the Countries Sharing Land Boundary with India, however, the investment manager or effective place of management of the FVCI is situated in any of the Countries Sharing Land Boundary with India; or (ii) the FVCI and effective place of management of FVCI is situated outside the Countries Sharing Land Boundary with India, however, majority of the Limited Partners (LPs) are situated in any of the Countries Sharing Land Border with India. The provisions of Press Note connect directly with the nature and place of the beneficial owner of the investment and hence, a strict interpretation of the Press Note would imply a requirement for Government approval. Further, if the principles of determining the ‘beneficial owner, as laid down in the RBI Circular, is squarely applied in the case where LPs are situated in Countries Sharing Land Border with India having controlling ownership in FVCI, then such FVCI may also come under the restrictive provision of the Press Note.

Whether transfer of shares by non-resident person to non-resident Regulated Investing Person in a sector under automatic route would require any prior approval?

Foreign Direct Investment Policy provides the framework of foreign investment by non-resident in India. The Press Note has now made it stringent even in case of transfer of ownership of shares by a non-resident person (assuming original investment was made on repatriation basis) to another non-resident which is under a sector in automatic route. The newly added paragraph 3.1.1. (b) lucidly stipulates that any transfer of ownership of existing foreign investment, either directly or indirectly, that results in a change of beneficial ownership falling within the scope of regulated framework of foreign investment which can be traced to Countries Sharing Land Boundary with India would be subject to Government approval.

Whether incorporation of a new company having proposed investors from Countries Sharing Land Boundary with India would require government approval?

Yes, any new company whose investors or beneficial owners are situated in Countries Sharing Land Boundary with India would require approval prior to incorporation of the Indian investee company. However, as of now, name approval process for the proposed new investee company having investors situated in Countries Sharing Land Boundary with India would not require prior approval from the Government of India, except the MCA requirements. Hence in cases of companies which are already under the process of incorporation or where incorporation certificates are yet to be issued which involves foreign investors who are situated in Countries Sharing Land Boundary with India, there has to be a clarity on whether approval would be required and the process for obtaining the approval, as the Press Note will be effective only from date of official notification.

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