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CHANGES TO FOREIGN DIRECT INVESTMENT REGIME - UPDATE

The Narendra Modi Government had made certain significant changes to the Consolidated FDI Policy ("**FDI Policy**") in November 2015 with a view to liberalising India's foreign direct investment ("**FDI**") framework and we had covered this in *Insight Special Edition: Volume VII, Issue 4*. In furtherance of its endeavor to relax FDI Policy for foreign investors, the Government has through its Press Release dated June 20, 2016 ("**Press Release**"), announced far reaching changes to the foreign direct investment, in order to further facilitate ease of doing business in India, provide a major impetus to employment and job creation, incentivize industrialization and attract greater influx of FDI into India.

The new changes introduced through the Press Release can be broadly classified into the following three heads:

Changes in Key Sectors:

Pharmaceuticals

The FDI Policy permitted 100% FDI under the automatic route (i.e., without prior FIPB approval) in a Greenfield pharmaceutical entity and 100% FDI under the government route (i.e., with prior FIPB approval) in a Brownfield pharmaceutical entity. The Press Release has relaxed the FDI investment into a Brownfield pharmaceutical entity by allowing FDI up to 74% under the automatic route. Investment above 74% into a Brownfield pharmaceutical entity would continue to be under the government route.

FDI CHANGES

- **Increase in Sectoral Caps**
  - **(a) Pharmaceuticals**
  - **(b) Airports**
  - **(c) Civil Aviation**
  - **(d) Private Security Agencies**
- **Sectors brought under Automatic Route**
  - **(a) Food Products**
  - **(b) Broadcasting**
- **Liberalization of Sectoral Conditions**
  - **(a) Defence Manufacturing**
  - **(b) Animal Husbandry**
  - **(c) Single Brand Retail Trading**
  - **(d) Branch/Liaison/ Project Office**

Defence

FDI in Defence sector up to 49% was permitted under the automatic route and any investment above 49% was permitted under the government route, on a case to case basis, depending on whether such FDI investment was likely to result in India getting access to modern and 'state-of-art' technology. While there has been no change to the sectoral caps as provided in the erstwhile FDI Policy, the Press Release has brought about a key change by removing the requirement of 'state-of-art' technology and permitting approval under the government route, for FDI beyond 49%, to be granted for access to modern technology or for 'other reasons' to be recorded in writing.

Another key change brought about by the Press Release is the extension of the existing FDI limits to allow foreign entities to enter into manufacturing of small arms and ammunitions under Arms Act, 1959, which was until recently reserved exclusively for Government of India agencies. It may be noted that 'small arms' would include revolvers, self-loading pistols, rifles, carbines, sub-machine guns, assault rifles, light machine guns, certain caliber of shotguns and sporting rifles, as well as their parts, components and ammunition.

Single-Brand Retail Trading

Under the erstwhile FDI Policy, FDI above 49% in single brand product retail trading ("**SBPRT**") was permitted under the government route. Additionally, where such FDI exceeded 51%, certain additional conditions were imposed, including restrictions on sourcing of materials. This specific condition on sourcing mandated that 30% of the value of goods would have to be sourced from within India, preferably from micro, small and medium enterprises, cottage industries and artisans /craftsmen ("**Domestic Sourcing**"). There were additional stipulations on the operation and compliance of the Domestic Sourcing norms. The Press Release has sought to relax the Domestic Sourcing norms and accordingly, there will be relaxed Domestic Sourcing norms for up to 3 years and relaxed Domestic Sourcing regime for an additional 5 years for products having state-of-the-art and cutting edge technology.

Ease of establishing Branch Office, Liaison Office and Project Office

Establishment of Branch/Liaison/Project Offices in India is regulated in terms of Section 6(6) of Foreign Exchange Management Act, 1999 ("**FEMA**") read with Notification No. FEMA 22/2000-RB dated May 3, 2000. Under the said FEMA regulations, a foreign entity (including a firm or other association of individuals) can open a Branch Office or a Liaison Office in India only with the prior approval of the Reserve Bank of India ("**RBI**"). However, for Branch Office or a Liaison Office where principal business of the foreign entity falls under the sectors where 100% FDI is not permitted under the automatic route and foreign non-governmental organisations, non-profit organisations and foreign government bodies and departments desirous of opening a Branch Office or a Liaison Office or a Project Office, the applications will be considered by the RBI in consultation with the Ministry of Finance.

In order to avoid a duplication of the approval process, the Press Release now provides that a foreign entity seeking to establish a Branch Office or a Liaison Office or a Project Office where the principal business of the applicant is in the Defence, Telecom, Private Security or Information & Broadcasting sectors and where the approval under the government route or license/ permission by the concerned ministry or regulator has been granted, then an approval from the RBI or separate security clearance would not be required.

Snapshot of Changes in Other Sectors:

Sector	Erstwhile FDI Policy	Changes pursuant to the Press Release
Brownfield/ Existing Airport projects	100% FDI was permitted with up to 74% being under automatic route and above 74% was under the government route.	100% FDI is permitted under the automatic route.
Scheduled Air Transport Services / Domestic Scheduled Passenger Airline and Regional Air Transport Services	Up to 49% FDI was permitted under the automatic route.	100% FDI is permitted with up to 49% being under the automatic route and above 49% being under the government route.

Sector	Erstwhile FDI Policy	Changes pursuant to the Press Release
		It may be noted that the limit of up to 49% under government route and other conditionalities for foreign airlines investing in the capital of Indian companies operating scheduled and non-scheduled air transport services, continues to apply.
Broadcasting Carriage Services	100% FDI was permitted with up to 49% being under automatic route and above 49% was under the government route.	100% FDI is permitted under the automatic route However, FDI beyond 49% in a company not seeking license/ permission from relevant Ministry and resulting in change in ownership or transfer of stake from existing investor to new foreign investor, will be under government route.
Trading of Food Products manufactured in India, including through e-commerce	Subject to the erstwhile policy on trading (depending on whether it was single brand, multi brand or wholesale cash and carry).	100% FDI is permitted under the government route.
Private Security Agencies	Up to 49% FDI was permitted under the government route.	74% FDI is permitted with up to 49% being under the automatic route and beyond 49% and up to 74% being under the government route.
Animal Husbandry (including breeding of dogs, Pisciculture, Aquaculture and Apiculture)	100% FDI was permitted under 'controlled conditions' (i.e. only under certain conditions specified in the FDI Policy).	100% FDI is permitted without any 'controlled conditions'.

Whilst only the Press Release has been issued, the Press Notes and amendments to FEMA will provide greater clarity on the manner in which the changes shall be effected. These changes make India one of the most open and attractive FDI destinations in the world and should be a welcome sign for foreign investors particularly in the Pharmaceuticals, Defence and Single-Brand Retail Trading sectors.

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The views expressed in this Newsletter do not necessarily constitute the final opinion of Cyril Amarchand Mangaldas and should you have any queries in relation to any of the issues set out herein or on other areas of law, please feel free to contact us at the following coordinates:

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