

Foreign Direct Investment in India

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Since 1991, India has been increasingly open to foreign direct investment (FDI), bringing about relaxations in several key economic sectors.

FDI into India is primarily governed by the 1999 Foreign Exchange Management Act (FEMA) and rules and regulations issued by the Reserve Bank of India (RBI), along with the Consolidated Policy on FDI and press notes and circulars (FDI Policy) issued by Department for Promotion of Industry and Internal Trade under the Ministry of Commerce & Industry (DPIIT). The most significant RBI rules include the 2019 Foreign Exchange Management (Non-Debt Instruments) Rules and the 2019 Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations (together, the NDI Rules).

The FDI Policy sets out the entry routes for different sectors (i.e. automatic or government approval), investment limits for the different sectors, conditions for investment, and eligible instruments, among other matters. These policy conditions are then enacted into law through the NDI Rules.

Basic principles of FDI into India

India's business sectors may be divided into three for the purposes of FDI inflow:

- prohibited sectors – prohibited from receiving FDI. Includes atomic energy, real estate business, lottery business, manufacturing tobacco products, gambling and betting;
- automatic route – no prior approval required from the government for receiving FDI. Includes airports, construction, industrial parks, mining, manufacturing and IT; and
- government approval route – prior approval required from the government for receiving FDI. Includes air transport services, satellites, print media and public sector banks.

The FDI Policy further imposes sector-specific FDI thresholds based on the sensitivity of the sector, regardless of whether the sector falls under the automatic route or the government approval route. These are, generally:

- up to 100% FDI allowed (includes manufacturing, construction and IT);
- up to 74% FDI allowed (includes pharmaceuticals and defence);
- up to 49% FDI allowed (includes air transport services and private sector banking); and
- up to 26% FDI allowed (print media).

If the NDI Rules and FDI Policy do not specifically prescribe any conditions for any sector, 100% FDI under the automatic route is allowed for that sector.

“Even as recently as 2021 and going against the tide of the prevailing protectionist trends, India has brought about relaxations [in FDI controls] in several key sectors.” – Kosturi Ghosh, Partner, Trilegal

Where an Indian entity is neither 'owned' nor 'controlled' by resident Indian citizens, any investment made by that entity in another Indian entity will be considered downstream foreign investment, and governed by the NDI Rules and FDI Policy. For the purposes of the NDI Rules, 'owned' refers to a beneficial holding of more than 50% of the equity instruments of a company, and 'controlled' refers to the right to appoint a majority of directors or to control the company's management or policy decisions.

Under the NDI Rules, FDI includes any investments made by a person resident outside India in equity instruments of Indian companies. For listed entities, investments of at least 10% or more of the post issue paid-up capital is treated as FDI.

The NDI Rules permit investment into:

- equity shares (including partly paid equity shares, provided that at least 25% of the consideration is received upfront and they are fully called-up within 12 months of issuance);
- convertible debentures which are fully and mandatorily convertible, and fully paid;
- preference shares which are fully and mandatorily convertible, and fully paid; and
- share warrants, for which at least 25% of the consideration is to be received upfront and the balance is to be received within 18 months of issuance.

While FDI is only permitted in these equity instruments, a recent exception applies to start-ups, as discussed below.

Recent amendments to India's FDI regime

On 17 April 2020, the Indian government amended the FDI Policy making it mandatory to obtain government approval for FDI received from countries that “share a land border” with India, which include China, Bangladesh, Pakistan, Bhutan, Nepal, Myanmar and Afghanistan. While the move was ostensibly intended to “curb opportunistic takeovers / acquisitions”, the intention has been widely held to have stemmed from the need to limit the inflow of Chinese investments since FDI from Pakistan and Bangladesh was already subject to similar restrictions. As a result of this amendment, FDI inflow from these countries has been restricted, with only 80 of 388 proposals received as of July 2022 granted approval, [according to a Right to Information Act request \(RTI\) submitted by The Hindu](#).

However, other than this protective limitation, India has been on the path of liberalisation since 1991. Even as recently as 2021, and going against the tide of the prevailing protectionist trends, India has brought about relaxations in several key sectors, including:

- insurance – the FDI limit in the insurance sector was raised from 49% to 74% under the automatic route.
- defence – the FDI limit in the defence sector was significantly liberalised by raising the FDI limit for investment under the automatic route from 49% to 74%.
- telecoms – as a much-needed boost to the telecoms sector in India, the government increased the FDI limit into the sector from 49% to 100% under the automatic route.
- oil and gas – while the overall cap for FDI into the oil and gas sector continues to remain at 49% under the automatic route, a window has been created for 100% FDI in oil and gas public sector undertakings (PSU) that have obtained 'in-principle approval' from the government for strategic disinvestment.

Further, and in line with government policy to create an ever-burgeoning start-up ecosystem in India, the 'Start-up India Initiative' has introduced two further changes targeted at start-up investment.

While FDI is generally permitted only through equity instruments, eligible start-ups have the benefit of issuing convertible notes (CN): instruments evidencing receipt of money initially as a debt, and which are either repayable at the option of the holder or convertible into such number of equity shares of the company upon occurrence of specified events and as per the other terms and conditions agreed to and indicated in the instrument. For start-ups to be eligible to issue CNs, the minimum amount of investment required from a single investor is INR 25 lakhs (roughly US\$ 30,000) in a single tranche. The maximum tenor of conversion or repayment of a CN is 10 years.

Eligible start-ups can also benefit from the 'angel tax' exemption under Income Tax Act if their aggregate paid-up share capital and share premium after the issue or proposed issue of shares do not exceed INR 25 crores (roughly US\$3 million). The angel tax exemption comes with end use restrictions of investments on specified assets. If the investment consists of a capital contribution made to any other entity, shares and securities, bullion, archaeological collections, or any work of art, the angel tax exemption will not apply.

Legal consequences

Punishment for contravention of the NDI Rules and other FDI laws is covered under the penal provisions of FEMA, the enforcement of which is tasked upon the Directorate of Enforcement (ED). Every contravention is punishable with a penalty of up to three times the amount involved in the contravention, if such amount is quantifiable; or up to INR 200,000 (roughly US\$2,400) where the amount is not quantifiable. Where the contravention is continuing, the ED can

impose a further penalty of up to INR 5,000 (roughly US\$60) for every day that such contravention continues after the date of its occurrence.

Further initiatives

A number of government initiatives are expected to boost FDI inflows into India in the coming years.

PM Gati Shakti Scheme

The Prime Minister Gati Shakti scheme, launched in October 2021, has been billed as a transformative plan for achieving economic development by focusing on different modes of transportation and a logistics infrastructure which is complimented by clean energy transmission, IT communications and social infrastructure.

The scheme envisages a three-fold approach under which 16 government ministries are brought under a single platform to ensure transparency and synchronicity, combined with the establishment of a multimodal transportation grid in order to cut logistics cost and a joint committee between the ministries to ensure the effective implementation of the scheme. The three-fold approach seeks to eliminate the wastage of time and costs by government departments, simplify the existing ministerial framework in India by phasing out excessive departmentalisation and synergising efforts between different government ministries.

Single window clearance process

India's National Single Window System (NSWS) is a digital platform designed to facilitate and ease the process of applying for approvals across different businesses, covering 32 central government departments and 31 state government departments across India. The NSWS includes a database where all approvals are found in a single portal without requiring the end-user to visit individual ministries and departments along with implementation of a secure document repository; a 'know your approvals' module containing government guidance; real-time status tracking of approval applications; fast query management to enable speedy resolution of procedural questions or ambiguities; and a system of easy renewal of approvals.

Disinvestment

In its 2021-22 budget, the government introduced a new disinvestment regime, which distinguishes between 'strategic' and 'non-strategic' sectors. The government's intention is to entirely privatise the non-strategic sectors, while retaining a minimal presence of PSUs in the strategic sectors.

Notably, in recent times, the government has successfully divested from two major PSUs:

- Air India, through a 100% stake sale to the Tata Group (along with a 100% stake sale of low-cost carrier Air India Express and a 50% stake sale in the ground handling services provider Air India SATS); and

- Life Insurance Corporation of India, through an initial public offering whereby the government offloaded 3.5% of its 100% stake in the insurer.

The budgeted disinvestment target for the financial year 2022-23 was set at INR 65,000 crore (roughly US\$7.8 billion). As of December 2022, the government had already raised over INR 28,000 crore through stake sales, [according to local media reports](#).

Production Linked Incentive (PLI) scheme

The PLI scheme is another recent initiative introduced by the Indian government, in line with its goal of creating a self-reliant economy. Under the scheme, financial incentives are provided to eligible companies on sales of goods manufactured in India. The scheme has been extended to manufacturing-focused sectors including automobiles, textiles and pharmaceuticals, with a total budgeted outlay of close to INR 200,000 crore (roughly US\$24bn).

Future prospects

FDI equity inflow to India for the first half of financial year 2022-23 was approximately US\$27bn, according to DPIIT figures – notably, a higher figure than the inflow for the first half of financial year 2018-19.

The figures indicate that India's standing as a favoured investment hub has withstood the Covid-19 pandemic as well as the geopolitical and macroeconomic uncertainty that has followed it. The government's proactiveness in liberalising the investment framework during this time has also improved the country's favourability. According to the [OECD FDI restrictiveness index](#), India's FDI restriction level has been halved from 0.42 in the year 2003 to 0.21 as of its last update in 2020, signifying a quantifiable measure of the liberalisation made to India's FDI framework over the Covid-19 pandemic period.

With the World Bank revising the real GDP estimate for India to 6.9% from 6.5% for the financial year 2022-23 on account of higher resilience of the Indian economy to global shocks and better-than-expected second quarter numbers, it remains to be seen how India performs in the coming years in the face of the continuing global headwinds.

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