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Clarity eludes China FDI rules

Hong Kong investment a grey area

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The finance ministry has notified the changes in FDI rules that require the prior approval of the government for investment from countries that share their borders with India, necessitated by fears of the Chinese swooping up stakes in Indian companies available cheaply following the stock crash in the wake of Covid-19, particularly after the Chinese central bank picked up a 1 per cent stake in mortgage giant HDFC.

However, analysts said the amendments to the foreign direct investment (FDI) policy under the Foreign Exchange Management Act, 1999 (Fema) lacks clarity on the "beneficial owner" clause and investments from Hong Kong.

“In exercise of the powers conferred by clauses (aa) and (ab) of sub-section (2) of section 46 of the Foreign Exchange Management Act, 1999, the Central Government hereby makes the following rules further to amend the Foreign Exchange Management (Non-debt Instruments) Rules, 2019...,” the department of economic affairs, under the ministry, said in the notification. Change in the FDI policy need to be notified under FEMA for its implementation.

The notification picks out investments from neighbouring country and beneficial owners who are in these countries or are a resident.

“Provided that an entity of a country, which shares 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 only with the Government approval,” the notification said.

The Department for Promotion of Industry and Internal Trade (DPIIT) on April 18 issued a press note regarding this change in policy, which would impact both direct and indirect FDI from China. It said that the government has amended the FDI (foreign direct investment) policy to curb “opportunistic takeovers/acquisitions” of Indian companies on account of the COVID-19 pandemic.

However, analysts said there are two criteria for beneficial owners, which will create uncertainty. “Fema Notification does not provide clarity on who can be regarded as a beneficial owner, hence creating a state of uncertainty for the investor as well as the investee company in India,” said Prashant Prakhar of Nishith Desai Associates.

“Currently, there are two tests of BO prescribed under the companies rules and anti-money laundering rules, and it is likely that the authorities may insist for the most stringent test of BO to be followed while making the investments. However, given the different applicability of both these laws, it would not be a very clear choice to make,” Prakhar said.

He said question marks remained on investments from Hong Kong or into a limited liability partnership or if the investments were in the nature of a follow-up investments in entities that already have investments from neighbouring countries. “If all of such investments were to now fall under the government route, it is likely to adversely impact the existing businesses that may be under distress, due to delayed timelines of getting Government approvals.”

Atul Pandey partner at law firm Khaitan & Co said “It is now clear that the curbs introduced by the government will apply only to FDI by Chinese firms.”