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Hong Kong may come under new FDI rules; custodians to seek clarity

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Ashley Coutinho | Mumbai April 28, 2020 Last Updated at 21:13 IST

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A clutch of custodians got into a huddle last week to discuss whether the new foreign direct investment (FDI) rules should be applied to regions such as Hong Kong and Taiwan.

It was decided that Hong Kong — a special administrative region of China — ought to be brought under the ambit of the new rules despite it not sharing a land border with India, according to the people privy to the discussions.

The custodians plan to write to the Reserve Bank of India (RBI) and the Department for Promotion of Industry and Internal Trade (DPIIT) for clarity in the matter.

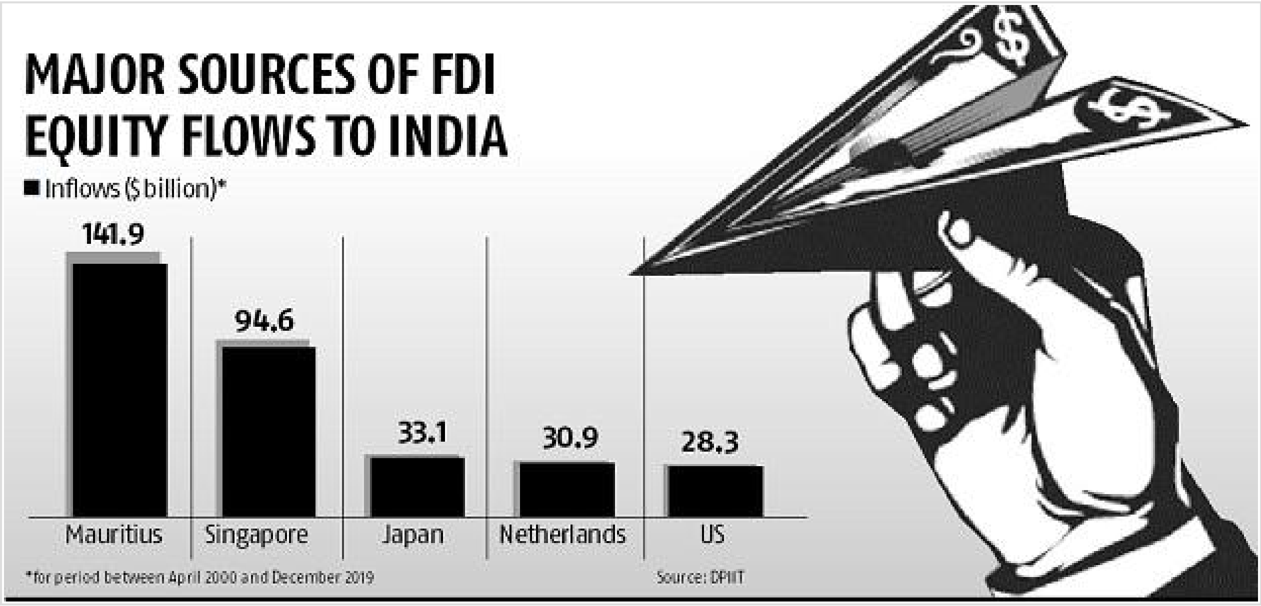
A few days ago, the finance ministry had notified changes in the FDI rules that made government approval mandatory for foreign investments from countries that share a land border with India. These countries are China, Bangladesh, Bhutan, Pakistan, Myanmar, Nepal and Afghanistan.

Hong Kong was ranked 14th on the list of countries with FDI flows to India, contributing $4.2 billion between April 2000 and December 2019, the data from DPIIT shows. India received FDI worth $2.34 billion from China in the same period.

Market players reckon a significant chunk of Chinese investments in Asian markets is routed through the region — either directly or through vehicles set up in other jurisdictions.

"Chinese funds and companies often route their investments to India through offices located in countries such as Singapore, Hong Kong and Mauritius," a recent note by Gateway House observed.

For example, Alibaba's investment in Paytm was through Alibaba Singapore Holdings. "These don't get recorded in India's government data as Chinese investments. Thus, official FDI inflows from China to India do not present the full picture of Chinese investments in India. In several cases, the investment in India has not been made in the name of the Chinese entity/investor, and is, therefore, difficult to trace," said the note.



"The government might take the view that Hong Kong should be covered under the new FDI rules since the region is in China's direct control," said a senior industry official, requesting anonymity.

He also pointed out that Hong Kong is a global financial hub and there are many managers sitting in the country overseeing global offshore funds. The government can track these investors by spelling out what constitutes a beneficial owner and defining control, he said.

"The Press Note not only restricts investment by a citizen or an entity from neighbouring countries, but also restricts investments by any such entity that may have its beneficial owner, either situated in or a citizen, of the neighbouring countries. This leaves the fate of the investment hanging solely on how would the authorities interpret the term beneficial owner in the context of foreign investments," said Pratibha Jain, partner, Nishith Desai Associates.

Since beneficial owner is not defined under the current Foreign Exchange Management Act (Fema) rules, it can be interpreted as per the Companies (Significant Beneficial Owners) Rules 2018 and/or the Prevention of Money-laundering (Maintenance of Records) Rules, 2005 (PMLA Rules). Both these have different thresholds for determination of beneficial owners. While the former defines it as 10 per cent ownership or voting rights, control or significant influence, the latter puts it at 25 per cent controlling ownership or profit share of the company or the person who holds the position of senior managing official.

FDI flows into India from Bangladesh stood at $0.08 million, Nepal at $3.25 million, Myanmar at $8.97 million and Afghanistan at $2.44 million between April 2000 and December 2019. There were no investments from Pakistan and Bhutan.

The FDI is allowed through automatic route in most sectors except defence, telecom, media, pharmaceuticals and insurance. The government route requires prior approval of the respective government departments. Under the automatic route, investors have to inform the RBI after the investment.

The FDI is prohibited in nine sectors, including lottery business, gambling and betting, chit funds, and real estate.