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Varying beneficial ownership caps muddy waters for FDI investments

Ambiguity on whether investment falls under automatic route or requires govt approval

Ashley Coutinho | Mumbai June 07, 2020 Last Updated at 22:46 IST

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Authorised dealer (AD) banks are applying different thresholds for determining beneficial ownership (BO) for foreign direct investment (FDI) coming into India, adding to the uncertainty surrounding the amended Press Note 3 (PN3) guidelines.

The threshold being applied ranges between 25 per cent and 10 per cent (to even 1 per cent), said people in the know.

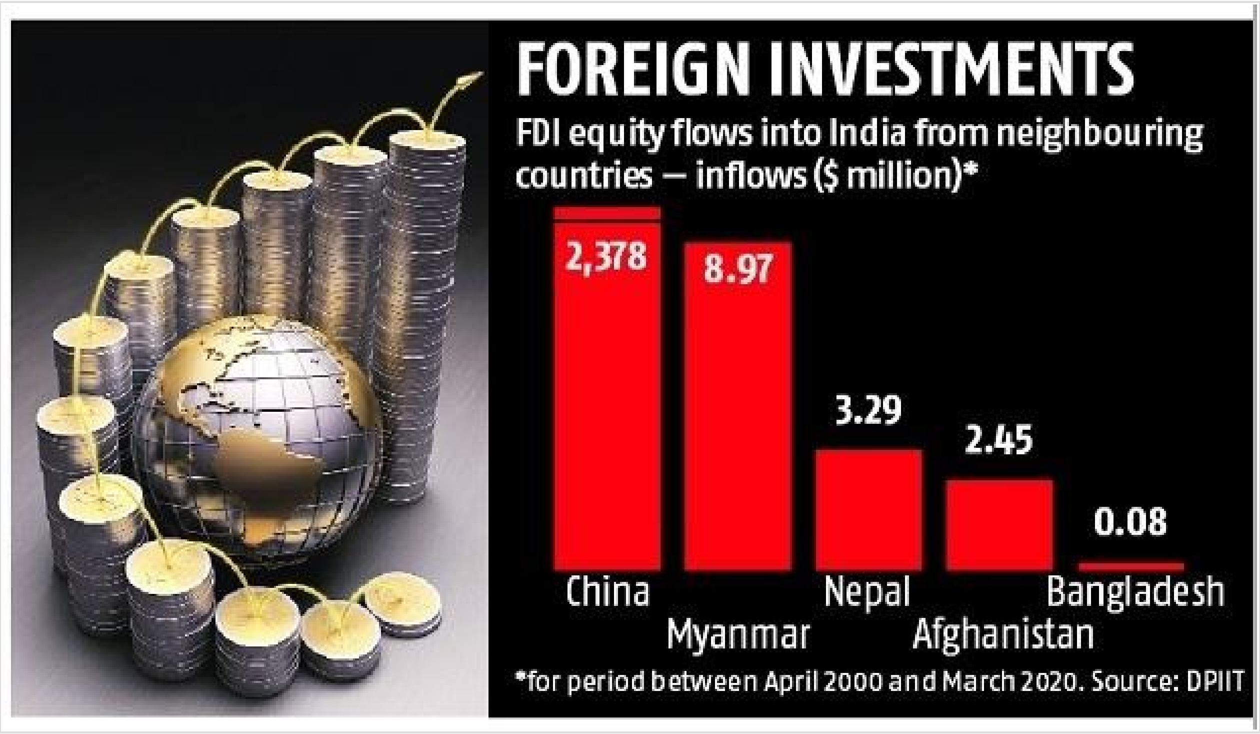
The government, on the other hand, is reportedly in favour of a 10 per cent cap, but there has been no official confirmation on this.

AD banks are those that deal in foreign exchange, and help facilitate FDI transactions.

The BO threshold is a key determinant in deciding whether FDI investment from countries that share land border with India can come under the automatic route or if it requires government approval.

According to the PN3 issued by the government in April, an entity of a 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.

The note, however, does not define the term 'beneficial owner'.



Current non-debt rules or Foreign Exchange Management Act regulations do not define it either. A lot depends on the stand taken by the individual AD banks in deciding on a threshold in relation to a particular investment, said experts.

"AD banks may be guided by the internal directions given by the Reserve Bank of India's (RBI's) Master Direction (based on Prevention of Money Laundering Act, or PMLA, rules) or may be applying a threshold of 10 per cent as prescribed in the Companies Act. A few are even asking investments above 1 per cent routed through countries that share land border to come through the approval route," said Atul Pandey, partner, Khaitan & Co.

The RBI's Master Direction for know-your-customer, or KYC, (2016) regulations refer to the Prevention of Money-Laundering (Maintenance of Records) Rules, 2005, to define BO. The thresholds prescribed are 25 per cent for a company and 15 per cent for non-corporates, such as partnerships and trusts.

A BO can also be interpreted as 10 per cent ownership or voting rights, control or significant influence, according to the Companies (Significant Beneficial Owners) Rules, 2018.

"It is positive that some of the authorised dealers are clearly defining BO as provided under the RBI KYC Master Directions," said Pratibha Jain, partner, Nishith Desai Associates, adding, "However, it is important that the Department for Promotion of Industry and Internal Trade (DPIIT) provides the definition of BO officially, so that investors have the benefit of this clarity and all AD banks can take uniform declaration from investors."

After the notification of Foreign Exchange Management (Non-debt Instruments) Rules, 2019, the finance ministry has become the notifying authority for changes to FDI policies, instead of the RBI.

"We are awaiting final guidelines on the ownership threshold. But what we are taking into account right now is not just economic ownership but also the element of control," said an authorised dealer.

According to Jain, the current uncertainty could particularly impact global private equity funds. “The way global funds are structured, the percentage of BO can vary, especially if they have listed entities as investors in their fund,” she said.

The differing views of banks extend to other areas as well - an AD bank, for instance, has defined China to include Hong Kong, Macau, and Taiwan, which do not share land border with India. Other banks do not mention or define China explicitly.

Notably, the RBI has sought clarity from the government on whether Taiwan ought to be included in the list of jurisdictions that will require government nod for FDI investment.

Separately, the Securities and Exchange Board of India has defined China to include Hong Kong and Taiwan.

FDI flows from China, Hong Kong, and Taiwan into India amounted to $2.4 billion, $4.4 billion, and $360 million, respectively, from April 2000 to March 2020, shows the DPIIT data.