

TAX FLASH NEWS

21 March 2022



Ahead of the IPO, Government clears 20 per cent FDI in LIC under the Automatic Route and makes other changes to bring clarity to the FDI policy

Background

The Government of India has reviewed the extant Foreign Direct Investment (FDI) policy for permitting foreign investment in IPO-bound Life Insurance Corporation of India (LIC) with an aim to facilitate disinvestment of the country's largest insurer and other modifications for consistency and further clarity of the existing FDI Policy. Accordingly, the following amendments¹ have been made under the Consolidated FDI policy Circular of 2020, as amended from time to time (FDI Policy):

Key Highlights

I. Permitting Foreign Investment in LIC

A new paragraph has been inserted in the FDI policy (Insurance) for permitting foreign investment in LIC to the extent of 20 percent under the Automatic Route. The erstwhile paragraph of the FDI policy on Other Conditions for the Insurance Sector has now been bifurcated into two parts as other conditions applicable on Indian insurance companies / intermediaries or insurance intermediaries and LIC, respectively.

The key other conditions as applicable for LIC are as under:

- Foreign investment in LIC shall be subject to compliance with the provisions of the Life Insurance Corporation Act, 1956, as amended from time to time (LIC Act) and such provisions of the Insurance Act, 1938, as amended from time to time, as are applicable to LIC as per the provisions of Section 43 of the LIC Act.

- Foreign portfolio investment in LIC shall be governed by the provisions contained in the NDI Rules and provisions of the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019.
- Any increase in foreign investment in LIC shall be in accordance with the pricing guidelines specified by RBI under the FEMA Regulations.
- The terms 'Equity Share Capital', 'Foreign Direct Investment' (FDI), 'Foreign Investors', 'Foreign Portfolio Investment', 'Indian Insurance Company', 'Indian Company', 'Non-resident Entity', 'Public Financial Institution', 'Resident Indian Citizen', 'Total Foreign Investment' will have the same meaning as provided in the rules notified by the Department of Financial Services under the Insurance Act, 1938 or in the regulations issued by Insurance Regulatory and Development Authority of India from time to time, in respect of foreign investment in LIC.

II. New Inclusion / Modification of Definitions under FDI Policy

Following definitions have been modified/ newly introduced to align the above permitted Foreign Investment in LIC:

- The definition of capital and foreign investment in the FDI policy have been modified to include equity shares / share warrants / declarations made for beneficial interest being held by non-residents, under 'any other applicable law' in addition to the provisions of the Companies Act, 2013 so as to include Life Insurance Corporation Act, 1956 (LIC Act) within its ambit.

¹ Press Note No. 1 (2022 Series) DPIIT File No 5(3)/2021-FDI Policy dated 14 March 2022

- The definition of Convertible Note in the FDI policy has been modified to mean an instrument issued by a start-up company acknowledging receipt of money initially as debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of such start-up company, within a period not exceeding **ten years** (*amended from five years*) from the date of issue of the convertible note, upon occurrence of specified events as per the other terms and conditions agreed to and indicated in the instrument.

- The definition of Indian Company in the FDI policy has been amended to include a body corporate established or constituted by or under any Central or State Act in addition to the Company as defined in the Companies Act 2013 incorporated in India. Further, the following explanation has been added to the definition of Indian Company:

1. *It is clarified that reference to 'company' or 'investee company' or 'transferee company' or 'transferor company' in the FDI Policy also includes a reference to a body corporate established or constituted by or under any Central or State Act.*

2. *It is further clarified that if the term 'Company' or 'Indian company' or 'Investee Company' is qualified by reference to a company incorporated under the Companies Act, such term shall mean a company incorporated under the Companies Act but not a body corporate.*

3. *It is also clarified that 'Indian Company' does not include a society, trust or any entity, which is excluded as an eligible investee entity under the FDI Policy.*

- Following new definitions has been inserted under the FDI policy:

'Share Based Employee Benefits' means any issue of capital instruments to employees, pursuant to share based employee benefits schemes formulated by a body corporate established or constituted by or under any Central or State Act.

'Subsidiary' shall have the same meaning as is assigned to it under the Companies Act, 2013, as amended from time to time.

Earlier, these terms were not specifically provided. The specific mention of these terms will lead to more clarity now. Also the conditions prescribed for Issue of Employees Stock Option (ESOP) scheme / sweat equity shares in the FDI policy will apply to Share Based Employee Benefits as well.

- Filing of form "ESOP Reporting" with the Foreign Exchange Department - The modified policy provides that the form "ESOP Reporting" is to be filed with the Foreign Exchange Department in place of filing of "Form ESOP" with the concerned regional office as required earlier.

III. Other Modifications for consistency/clarity under FDI Policy

- Definition of Real Estate Business in the FDI policy has been amended to align with the definition mentioned in the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (NDI Rules). The amended definition of Real Estate Business is as below:

'Real estate business' means dealing in land and immovable property with a view to earning profit there from and does not include development of townships, construction of residential/commercial premises, roads or bridges, educational institutions, recreational facilities, city and regional level infrastructure, townships and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations 2014. Further, earning of rent/income on lease of the property, not amounting to transfer, will not amount to real estate business.

- Further the conditions prescribed for acquisition of shares under Scheme of Merger/ Demerger/ Amalgamation in the FDI policy have been amended as under:

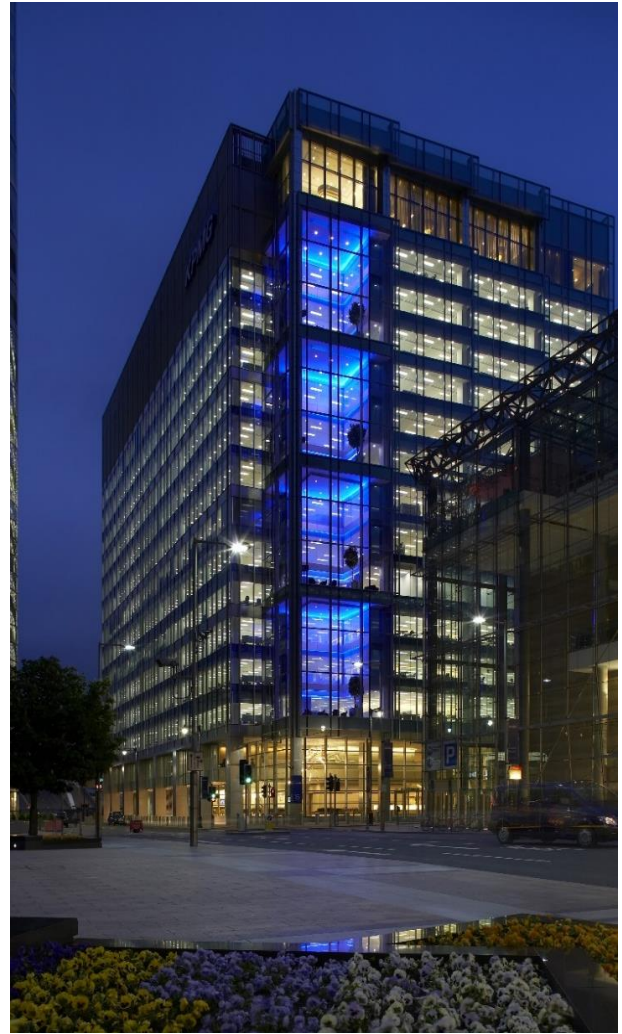
Where a scheme of compromise or arrangement or merger or amalgamation of two or more Indian companies, or a reconstruction by way of demerger or otherwise of an Indian company, or transfer of undertaking of one or more Indian company to another Indian company, or involving division of one or more Indian company, has been approved by the National Company Law Tribunal or other authority competent to do so by law, the transferee company or the new company, as the case may be, may issue **capital instruments** (*amended from equity shares*) to the existing shareholders of the transferor company resident outside India, subject to the stipulated conditions mentioned therein.

Our comments

The Government had announced its plans to launch the LIC IPO in 2022 setting the stage for the country's biggest ever public offering. Continuing with its efforts to make India an attractive investment destination, the Government has now permitted up to 20 per cent FDI under the automatic route with an aim to facilitate disinvestment of the country's largest insurance company. Allowing FDI in LIC would permit strategic investors such as massive pension funds or insurance firms to participate in the initial public offering, which is slated to be India's largest ever IPO.

Other amendments in the existing FDI Policy have also been carried out to provide an updated, consistent and easily comprehensible FDI framework which will further enhance 'ease of doing business' in the country, leading to larger FDI inflows and, thereby, contributing to the growth of investment, income and employment.

Further the alignment of definition of 'real estate business' is also a welcome change to bring parity within the definitions under the NDI Rules and the FDI policy of real estate business specifically in cases of business of earning of lease rentals.



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