FDI in Defence Sector - Upto 74% allowed under the automatic route

INSIGHTS

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The Government of India has revised the sectoral cap in the defence sector, by carrying out changes in the FDI Policy, vide Press Note 4/2020, dated September 17, 2020 (available here). As per the changed norms, FDI in defence sector is allowed upto 74% under automatic route as compared to earlier 49%. Beyond 74% will be through Government route wherever it is likely to result in access to modern technology or for other reasons to be recorded.

Following conditions are applicable for such investment:

- FDI up to 74% under automatic route shall be permitted for companies seeking new industrial licenses;
- Infusion of fresh foreign investment up to 49%, in a company not seeking industrial license or which already has Government approval for FDI in Defence, shall require mandatory submission of a declaration with the Ministry of Defence in case change in equity/shareholding pattern or transfer of stake by existing investor to new foreign investor for FDI up to 49%, within 30 days of such change. Proposals for raising FDI beyond 49% from such companies will require Government approval;
- License applications will be considered by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce & Industry, in consultation with Ministry of Defence and Ministry of External Affairs;
- Foreign investment in the sector is subject to security clearance by the Ministry of Home Affairs and as per guidelines of the Ministry of Defence;
- Investee company should be structured to be self-sufficient in the areas of product design and development. The investee/joint venture company along with the manufacturing facility, should also have maintenance and life cycle support facility of the product being manufactured in India;
- Foreign Investments in the Defence Sector shall be subject to scrutiny on grounds of National Security and the Government reserves the right to review any foreign investment in the Defence Sector that affects or may affect national security.

ELP Comments

The press note clearly aims to bring in technology for platforms and critical technologies which generally fall under Press Note 1 (2019 series) issued by DPIIT (then- DIPP), by increasing investment under automatic route from 49% to 74%. The benefit of this increase is prima facie available for companies seeking new industrial licenses. For all other items where licensing requirement is not applicable, the FDI continues to remain upto 49% and FDI beyond that will require Government approval. Interestingly, even existing FDI investors looking to infuse fresh equity beyond 49% whether or not falls under the purview of ID&R Act will also require Government approval. This appears to be giving a favorable treatment to companies seeking new industrial licenses as opposed to those who already have existing licenses. The rationale behind this needs to be understood. However, the decision of Government is subject to language of FEMA notification and we will need to see fine prints of that once it is released.

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at insights@elp-in.com

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