

# LAW & POLICY UPDATE

## DEFENCE & AEROSPACE



## Government allows up to 74% FDI under automatic route in defence sector

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As per the Foreign Direct Investment (FDI) policy, 100% overseas investments are permitted in defence industry. Earlier, up to 49% was permitted under automatic route, while beyond that government approval was required. However, government has now permitted FDI of up to 74% under automatic route in defence sector with a view to attract overseas investors.

Press Note 4 (2020 series) dated September 17, 2020 has been released by Government in this regard. The pertinent aspects are as follows:

- FDI up to 74% under automatic route will be permitted for companies seeking new industrial licences.
- Infusion of fresh investment up to 49% in a company not seeking industrial licence or which already has government approval for FDI in defence, shall require 'mandatory' submission of a declaration with defence ministry in case change in equity/shareholding pattern or transfer of stake by existing investor to new foreign investor for FDI up to 49%, within thirty days of such change. Proposal for raising FDI beyond 49% from such companies will require government approval.
- License applications will be considered and given by Department for Promotion of Industry and Internal Trade, Ministry of Commerce & Industry (DPIIT) in consultation with Ministry of Defence (MoD) and Ministry of External Affairs.
- Foreign investments in defence sector would be subject to scrutiny on grounds of national security and that government reserves the right to review any foreign investment in the sector that affects or may affect national security. This review is subject to security clearance by Ministry of Home Affairs and as per guidelines of MoD.
- The Government has retained the condition that investee company should be structured to be self-sufficient in areas of product design and development. The Note states that 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.
- The decision of Government will take effect from date of FEMA notification.

With this increase in FDI limit in this sector, India can expect to see some positive FDI inflow which will provide momentum to the Government's 'Make in India' scheme. While such investments will continue to be scrutinized on grounds of national security and Government has reserved its right to review any FDI in the defence sector that affects or may affect national security, increase in the foreign ownership limits to 74% would enable foreign players to gain controlling stake in companies, which is critical to them for being liable for the quality and performance of the product. The earlier FDI framework capped FDI under the automatic route at 49%, resulting in reluctance from OEMs to transfer critical proprietary technologies to the holding company, due to negligible control. This concern has now been addressed since foreign shareholders can now own up to 74% stake in a company, thereby allowing for greater protection against further transfer of such technology licensed to Indian companies.

