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Table of contents

- Key takeaways from the Union Budget 2021-22
- RBI proposes revised regulatory framework for Non-Banking Financial Companies - A Scale-Based Approach
- SEBI relaxes eligibility norms for fintech companies for entering mutual fund business
- Regulatory compliance portal
- 4th amendment to FEMA NDI Rules – Increase in FDI limit In the Defence Sector and FDI from Multilateral Banks/Funds
- International Financial Services Centers Authority in India inducted as a Member of IOSCO

Key takeaways from the Union Budget 2021-22

Union Budget 2021 (**Budget**) is a dynamic attempt at strengthening an economy that had weakened significantly in 2020. Here, we discuss about the key takeaways from a business and corporate laws perspective.

Prospects for M&A and corporate transactions

- **Increase in FDI limits in Indian insurance companies:** The sectoral cap for foreign direct investment (**FDI**) into Indian insurance companies has been increased. Earlier, up to 49% FDI was permissible under the automatic route, meaning no prior governmental approval would be required. This would now be increased to 74%. Majority stake and shareholder level control is something that strategic investors would certainly be enthused by. However, from a governance perspective, there still are conditions to ensure that control and profits/returns are not entirely offshored. These come in the form of requiring majority of board and key managerial personnel to be Indian residents; at least half the board being independent directors; and maintenance of certain percentage of profits as general reserves. This percentage might become critical, as it could determine how incentivized or dis-incentivized a foreign investor might feel towards investing in the insurance sector. Similarly, temporary lock-in of that percentage (e.g. three years from when profits accrued) would be more encouraging than a permanent bar on automatic repatriability of said percentage amounts. It must also be noted that IRDAI, the insurance regulator, also has regulations around Indian control of insurance company. These would have to be amended to be aligned with the relaxation of the FDI regime for the sector.
- **Infrastructure and healthcare:** Other sectors that are slated to see significant government investments are infrastructure and healthcare. Correspondingly, it is expected that these sectors would see opportunities for transactions. While public private partnership in the infra space is a well known model, it could also be seen becoming more prominent in the healthcare space. More so, with the push on technology driven healthcare and nutrition access. These transactions could be through technology partnerships, joint ventures, or substantial commercial contracts. It is expected that there could be more government fund raising activities from the debt market as well.
- **Definition of slump sale:** The definition of slump sale is set to become wider to include expressly all types of transfer, and depreciation of goodwill would no longer qualify as a depreciable asset. Both would impact structuring of transactions, potentially increase tax impact and make transactions costlier. Therefore, transacting companies will have to look at the final letter of the revised law to determine the most efficient structuring options for them.

Corporate compliance

- **Decriminalization of certain corporate non-compliances under the LLP Act, 2008 (LLPA):** In the past, the prospect of imprisonment, often due to technical non compliances, had raised great apprehension in the promoter and senior management community. Some of this was addressed last year for the Act. This year, a similar exercise is intended for limited liability partnerships as well, although this is expected to be a shorter list since the LLPA is a simpler governance regime. In effect, designated partner liability under the LLPA would stand reduced.
- **Rationalizing all security market laws into a Securities Market Code:** The other interesting element is the planned Securities Market Code. Much like the labour laws were consolidated into limited and specific labour codes, the Securities Market Code intends to consolidate legislations like the SEBI Act, 1992; Depositories Act, 1996; Securities Contracts (Regulation) Act, 1956; and the Government Securities Act, 2007. As is the case with any regulatory revamp, the Securities Market Code could create some teething troubles for public companies in particular. Thus, its framing and implementation should be a gradual process – inviting public comments before finalising the code, as well as legislated timeline for adoption and corresponding liability, after it is notified as law.

Direct tax

- **Extension of filing under Vivad se Vishwas Scheme and discontinuation of Income-tax Settlement Commission:** The filing under said scheme has been extended up to February 28, 2021. The Budget also proposes to discontinue the age-old Income-tax Settlement Commission (**ITSC**). It is also proposed to allow taxpayers to withdraw applications pending with the ITSC. In case of such withdrawal, the application shall stand abated and the AO before whom the proceeding was pending prior to the application to the ITSC shall dispose of the matter in accordance with the relevant provisions of the ITA.
- **Formation of the Dispute Resolution Committee for small & medium taxpayers:** Under the new scheme, the Central Government shall constitute one or more Dispute Resolution Committee(s) (**DRC**), which shall resolve disputes of such persons or class, or persons as may be specified by the CBDT. To have the disputes resolved by the DRC shall be at the discretion of the taxpayers. It is proposed to only be applicable to those disputes where the returned income is INR 50 lakh (USD 68,500) or less and the aggregate amount of variation proposed in the assessment order INR 10 lakh (USD 13,695) or less. Further, search/survey/requisition cases would not be eligible to approach for DRC for settlement.
- **No change in Income Tax Slabs:** Also, Senior Citizens ages 75 years and above who only have Pension & Interest income, need not file Income Tax Returns.
- **Reduction of time limit for completing assessments:** The Budget has proposed to reduce the time limit for completion of assessments under Section 143-144 to 9 months from 21 months from the end of the AY in which the income was first assessable for AY 2021-22 onwards.
- **Reduction of time limit to reopen assessment:** Time period of opening of assessment reduced to 3 years from 6 years and serious tax evasion cases, where there is evidence of concealment of income of INR 50 lakh or more in a year, the assessment can be reopened upto 10 years but only in certain cases of search, seizure or requisition and that too after the approval of the Principal Chief Commissioner. This is also likely to favorably impact M&A deals where negotiation of tax indemnities has been a moot point lately.
- **Time limits for income escaping assessment are reformed as below:**

  No notice shall be issued under Section 148 of the ITA, in normal cases, if 3 years have lapsed from the period of relevant AY.

In cases of search, requisition, or survey where the AO has in his possession books of accounts or other documents or evidence which reveal that the income chargeable to tax, represented in the form of asset, which has escaped assessment amounts to or is likely to amount to INR 50 lakh (USD 68,500), notice can be issued beyond 3 years but not beyond 10 AYs from the end of the relevant AY.

For the purposes of computing the time-limit under Section 148 of the ITA, the time allowed to the taxpayer in providing opportunity of being heard or periods during which such proceedings are stayed by a court, shall be excluded.

Earlier, for re-assessment proceedings under Section 147 to be initiated, the pre-requisite was for the AO to have a 'reason to believe'. However, as per the revamped provisions, the pre-requisite now is for the AO to have 'information which suggests that income chargeable to tax has escaped assessment', which as discussed above, has been clearly defined. The earlier threshold of 'reason to believe' was vague and subjective which led to widespread litigation on the matter. Considering that the newly introduced threshold of 'information which suggests that income chargeable to tax has escaped assessment' has been defined, it is likely to reduce litigation in this regard.

- **Faceless ITAT:** From now on Income Tax Appellate Tribunal to become Faceless – Only electronic communication will be done. Constitution of Faceless Dispute Resolution Panel for people with Total Income upto INR 50 lakh and disputed income of INR 10 lakh.
- **Expansion of Scope of Equalisation Levy (EL):** Finance Bill has made the following three changes to the EL retroactively, with effect from April 1, 2020:

  Payments which are taxable as royalty or fee for technical services (**FTS**) are not subjected to EL. It is clarified that if the consideration received or receivable for specified services & for e-commerce supply or services are taxable as royalty or FTS under the ITA, read with the notified tax treaties, then such consideration should not be taxable under the EL provisions.

  Online sale of goods and online provision of services have been defined very widely. The use of the word 'online' before sale of goods or provision of services, in the definition of '*e-commerce supply or services*', may lead to unintended consequences wherein the mere fact that a component of sale of goods or provision of services is undertaken online would be enough to bring the entire transaction within the ambit of the EL. The terms 'online sale of goods' or 'online provision of services' to include one or more of the following online activities, namely:

  - Acceptance of offer for sale
  - Placing of purchase order
  - Acceptance of the purchase order
  - Payment of consideration
  - Supply of goods or provision of services, partly or wholly.

  EL has to be paid on a gross basis henceforth and not on a net basis, which was possible earlier.

  Definition of *'consideration received or receivable from e-commerce supply or services'* to include the below:

  - Consideration for sale of goods irrespective of whether the e-commerce operator owns the goods.
  - Consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator.

  These proposed amendments however does not provide any clarity regarding various issues. For example, it is unclear whether the EL will be applicable on provision of services by not-for-profit organizations including but not limited to education institutions providing online education, healthcare services etc.

- **New computation mechanism proposed to calculate capital gains on distributions by firm/APO/BOI:** The new provisions envisage taxability in two scenarios where a partner or member receives a capital asset at the time of dissolution or reconstitution of the entity:

  - Where the capital asset represents the balance in the capital account of the person in the books of the entity (without considering increase due to revaluation of assets or self-generated assets)
  - Where the money or other asset is in excess of the balance in the capital account of the individual in the books of the entity

  However, the proposed provisions still do not address the issue as to whether a distribution of a share in the value of goodwill, a self-generated asset, to a retiring partner constitutes a transfer as per Section 2(47) of the ITA.

- **Relaxation to NRIs:** Double Taxation Tax Audit Limit to be increased to INR 10 crores from INR 5 crores for those having less than 5% cash transactions.
- **Dividend tax:** The Budget proposes to make dividend payment to REIT/InvIT exempt from TDS. For Foreign Portfolio Investors, the Budget proposes deduction of tax on dividend income at lower treaty rate. The Budget provides that advanced tax liability on dividend income shall arise only after the declaration or payment of dividend.
- **Tax treaty rate:** As the rate of TDS being 20% is already specifically set out under the section, a more beneficial tax rate provided under the relevant tax treaty ca nnot be applied. The Budget proposes to add a proviso to Section 196 which provides that tax treaty rate of deduction will be applicable if the FPI furnishes the tax residency certificate required under Section 90(4) or 90A(4) of the ITA.
- **Goodwill to become a non-depreciable asset:** The proposed budget seeks to exclude goodwill from the definition of 'block of assets' with effect from April 1, 2022, and in the interim i.e., with effect from April 1, 2021, make provision for the issuance, by the CBDT, of specific rules for the computation of capital gains arising from the transfer of a block of assets that includes goodwill.
- **Introduction of Board of Advance Ruling (BAR):** It is proposed that the AAR shall cease to operate from a date notified by the Central Government. Procedural provisions which applied to AAR to now apply to BAR. To cater to the backlog of cases at the AAR, a new Section 245P has been proposed under which all pending applications where

  - No admission order of the AAR has been passed or
  - No final order has been passed, will be transferred from the AAR to the BAR (once constituted).

    Further, an appeal from a ruling of the BAR is available to the taxpayer to the High Court, within 60 days of date of communication of the ruling. It is proposed that a scheme by notification by the Central Government may also be made for the purposes of filing of appeal by the tax officer against the ruling of the BAR.

- **Tax holidays:** Tax Holiday for Capital Gains for Aircraft Leasing Companies and Tax Exemption to Lease paid to Foreign Persons.
- **Pre-filling of Returns:** Details of Capital Gains, Dividend Income & Interest income will be pre-filled in the Returns.
- **Relief to trusts:** Charitable trusts running Hospitals & Educational Institutions relief increased from INR 1 crore to INR 5 crore.

Indirect tax

- Several measures have been taken to further simplify the GST regime. The capacity of GSTN system has been announced.
- Proposed to review 400 old exemptions in the custom duty structure this year. It was announced that extensive consultation will be conducted and from October 01, 2021, and a revised custom duty structure free of distortions will be put in place. This is order to rationalise customs duty structure by eliminating outdated BCD exemptions.
- It is proposed to withdraw a few exemptions on parts of chargers and sub-parts of mobile phones further some parts of mobiles will move from "NIL" rate to a moderate 2.5 per cent. The Finance Minister also announced reducing custom duty uniformly to 7.5% on semis, flat, and long products of non-alloy and stainless steel. Further, duty on steel scrap is proposed to be exempted upto March 31, 2022.
- Uniform deduction of the BCD rates on Caprolactam, nylon chips and nylon fiber and yarn to 5% in order to help the textile industry, MSMEs and exports too, was announced. Calibration of customs duty rate on chemicals was proposed in order to encourage domestic value addition & to remove inversions.
- Proposed to raise BCD on solar inverter from 5% to 20% and on solar lanterns from 5% to 15%.
- It is proposed also proposed that an Agriculture Infrastructure and Development Cess will be levied on petrol, diesel, gold and some other imported agricultural products in an attempt to boost agriculture infrastructure.

Real estate sector

- **Tax holiday in affordable housing projects:** With the government's push towards 'Housing for All' under the Pradhan Mantri Awas Yojna (**PMAY**), now, under Section 80EA of the ITA, an individual is permitted to claim deduction from the amount of deduction paid on a loan facility derived from any financial institution for the purpose of buying a residential property.

  The aforementioned deduction was permissible within a stipulated timespan denoted as 'tax-holiday' of April 01, 2019 to March 31, 2021. However, Finance Bill 2021 has extended the Tax holiday beyond March 31, 2021 owing to the crunch faced by the real estate sector and, therefore, the benefits can be availed until the end of next Financial Year March 31, 2022.The maximum deduction allowed under the provisions of IT is INR 1.5 lakh or interest payable on the loan, whichever is less, wherein, the maximum value of the property should not exceed INR 45 lakh, subject to the stipulation that the prospective buyer does not have any other residential house, as on the date of such sanction of loan.

  The stakeholders displayed a positive attitude towards this move. It is expected and advocated to draw more incentives for private sector investments in affordable housing and generation of stimulus from the Government to bolster profit margins.
- **New Tax Exemption for the notified affordable rental housing projects:** A legislation will be promulgated, which will allow for additional tax deduction up to INR 1.5 lakhs for the purposes of acquisition of notified Rental Housing projects. This move seeks to further the objectives of the "Pradhan Manti Gareeb Awas Yojana-Urban" and will benefit migrant workers, who are key-contributors to the Real-estate sector.
- **Low stamp duty on sale of residential property:** A relaxation of up to 20% difference between stamp value and sale consideration has been provided for sale of a residential property unit, up to a value of INR 2 crore.The aforementioned relaxation is applicable on sale of property between November 12, 2020 to June 30, 2021.This move will aid in attracting more buyers, ultimately helping the developers to clear a large amount of unsold inventory lying with developers.

Infrastructure sector

- **Debt financing of InVITs & REITs by FPI:** The Infrastructure Investment Trusts (**InVITs**) and Real Estate Investment Trusts (**REITs**) are an important tool for the infrastructure development of the country through investments under Business Trusts. Amongst others, they offer, more particularly to small investors liquidity, security, diversification and performance. This year, the Union budget has allowed Foreign Portfolio investors to invest in the InVITs & REITs through the mode of 'debt financing'. The creation of an appropriate legislation for the abovementioned has been announced. Market experts are elated by this move as this could solve the liquidity issues in the infrastructure sector. The proposed reforms and easing of InvITs/REITs will catapult fresh investments in real estate.
- **Dividend payment to InVITs/ REITs exempt from TDS:** Additionally, it was also announced by the FM, that the dividend paid to the IVITs/ REITs will be exempt from TDS (Tax Deductible at Source), and deduction of tax on income (inclusive of dividend income of FPIs, which are to be dealt with as per the treaty rate.)
- **MAT exempt from dividend payment to foreign companies:** The FM also announced the exemption of Dividend payment for foreign companies from Minimum Alternate Tax (MAT). The exemption will be application on the event that the applicable tax rate is less than the rate of MAT.
- **Setting up of Development Financial Institution (DFI):** The infrastructure sector requires long term debt financing and is risk-averse on being declared as 'stressed assets'. Therefore, to allay these concerns, the FM has proposed to set-up the "Development Financial Institution" which is to be managed by the experts, which will, in turn, act as provider, enabler and catalyst for infrastructure financing. The ministry will provide a corpus of INR 20,000 crores to capitalize this institution. The government aims to create a lending portfolio of at least INR 5 lakh crore for this DFI in three years' time. This is a very good initiative and will be pivotal towards funding projects in India and freer flow of capital.
- **Special Purpose Vehicle to Monetize surplus government land:** In a move to encourage maximum utilization of surplus land held by various departments/ ministries/ public sector enterprises and others, the government made a policy announcement to set up an SPV to monetize such surplus land as held by the various wings of government. This move has been aimed to give a renewed push to disinvestment and asset monetization as the government strives for capital creation.

- **Portal for record keeping of construction workers:** The FM also announced the creation of a portal which shall oversee the collection of relevant information of the organized sector including the gig, building, and construction-workers among others. Such data collection and record keeping will be helpful in extending the relevant schemes & other benefits to this sector. This is a welcome move, especially in the wake of the pandemic where the workers were worst hit, which exposed the need of action in this area.

Start-ups

- **Taxation:** Start-ups with turnover of below INR 25 crore could avail tax holidays on long term capital gains if they were invested in government notified fund within a particular period. This would be extended by an additional year. Similarly, investor exemption from capital gains tax was also being extended by an additional year. Tax relief being available till March 31, 2022 should boost the funding and financial health of the start-up segment of the industry.
- **One Person Company (OPC):** Another positive signal for start ups and innovators is the OPC which follows an easier governance model for small businesses under the Companies Act, 2013 (**Act**) with only one person in charge – as sole shareholder and director. To qualify for setting up an OPC under the Act, he would have to be a natural person who was an Indian citizen and resident in India. The manner of calculating residency has been relaxed: 120 day residency (annualized) in India would be sufficient compared to the previous 182 days (that was linked to the non-resident Indian test under exchange control laws). This makes it easier for more individuals (including NRIs) to establish and operate OPCs. A connected change is the relaxation of OPCs converting to any other kind of company (e.g. a private company limited by shares, or a public company limited by shares). Earlier, unless certain financial and time thresholds were met, an OPC could not convert into other forms of company. Given that growth capital from investors is relatively difficult to source into OPCs, this relaxation would bode well for innovators and start up promoters.
- **Small company:** On a similar note, a 'small company', which is another easy governance model for small businesses under the Act, also saw relaxations. In order to let these businesses grow more freely, the qualifying financial thresholds (paid up share capital and turnover) for small companies was raised from INR 50 lakh to INR 2 crore and INR 2 crore to INR 20 crore, respectively.

Disinvestments

- Last year was expectedly a weak year in terms of meeting disinvestment targets. The government has now set itself an ambitious target of INR 1.75 lakh crore in order to accelerate government spending and simulatenously keep a check on fiscal deficit. Under these conditions, deal terms and valuations for the year can be expected to be buyer friendly, if the government wants to achieve its target. Of particular interest is the strategic disinvestment policy, where the Central Public Sector Enterprises would fall under either strategic or non-strategic sectors. In the former, the government wishes to retain bare minimum presence while divesting the rest. In the non-strategic sectors, the government seems intent on gradually extinguishing its presence altogether.
- While sectors like agriculture, chemicals, heavy industries, pharmaceuticals and manufacturing are in the non-strategic sector, indicating that they could see control deals; strategic sectors (such as atomic energy, space, defence, transport, telecom, power, petroleum, minerals, banking, insurance and financial services) could see minority stake dilutions or hiving off of non-core businesses under strategic assets. In addition, idle real estate – something that many government companies hold in good quantity – shall also be monetized, either outright or through concessions. This should see private sector interest as well.

RBI proposes revised regulatory framework for NBFCs

The Reserve Bank of India (**RBI**) on January 22, 2021, issued a discussion paper on 'Revised Regulatory Framework for NBFCs – A Scale-Based Approach' (**Discussion Paper**). RBI, through the Discussion Paper, has introduced a scale-based approach to the regulation of non-banking financial companies (**NBFCs**).

NBFCs are growing at rate seen never before and are directly linked with the banking and capital markets sectors, and thus, considering the complex nature of the mechanism, the Discussion Paper proposes a new regulatory structure for NBFCs, based on asset size of the NBFCs.

As of now, the present scenario of classifying NBFC's is based on different criteria such as:

- 'Systemically important': NBFCs having an asset size of INR 500 Crore or more, which are regulated in a rigorous manner and are under constant supervision
- Deposit taking NBFCs
- Based on nature of business undertaken, i.e., Investment and Credit (**ICC**), Micro Finance Institutions (**MFI**), Peer to Peer Lending (**P2Ps**), Infrastructure Finance, etc
- Type I NBFCs that are not accepting public funds and not intending to have customer interface in the future and Type II NBFCs that are accepting public funds and intending to have customer interface in the future

The Discussion Paper seeks to simplify and consolidate the classification of NBFCs into four categories, based on size, risk perception, complexity, and nature of activity of the NBFCs, as follows:

- Base Layer (**NBFC-BL**)
- Middle Layer (**NBFC-ML**)
- Upper Layer (**NBFC-UL**)
- Top Layer (**NBFC-TL**)

Overview of the proposed changes

The proposed changes to regulatory framework of NBFCs shall be based on a four-layered structure as follows:

- **NBFC-BL:** NBFC-BL will consist of the NBFCs that are presently classified as NBFC-ND (besides Type I NBFCs), P2Ps, Non-Operative Financial Holding Company (**NOFHC**), and Account Aggregators (**NBFC-AA**). The Discussion Paper views these as NBFCs involving low risk, based on their activity, and consolidating them in one category as the Base Layer seems to be a thoughtful approach in streamlining the classification. However, the classification pertains to certain important changes such as:
  - The threshold for NBFC-SI is INR 500 crore and the same has been raised to INR 1,000 crore in the proposed classification, bringing more NBFCs within the NBFC-BL category;

- Stern entry norms have been introduced by raising the minimum net-owned fund (**NOF**) from INR 2 crore to INR 20 crore taking in consideration, a general increase in price levels and real GDP; and
- Reduction from 180 days to 90 days, in the threshold for non-performing asset classification.

- **NBFC-ML:** All non-deposit taking NBFCs classified currently as being systemically important i.e., 'NBFC-ND-SI' and all deposit taking NBFCs that do not meet the criteria of NBFC-UL, would be placed within this category.

  Apart from the above, housing finance companies (**NBFC-HFCs**), infrastructure debt funds (**NBFC-IDF**), standalone primary dealers (**SPD**) and core investment companies (**CICs**), irrespective of their asset size shall also frame part of this category. Thus, this classification is entirely based on the nature of the NBFCs and not the asset size.

- The proposed changes in NBFC-ML category are as follows:
  - The lending and investment limits are proposed to be merged into a single exposure limit of 25% and a group exposure of 40%, which is computed based on Tier 1 capital rather than net owned funds.
  - Financing regulation will become stricter with the imposition of an INR 1 crore cap per individual per NBFC, restrictions on buy-back of shares or on loans to directors, etc.
  - The introduction of a remuneration committee, and additional disclosures, and rotation of statutory auditors, and
  - Requirement to have a Board-approved policy on Internal Capital Adequacy Assessment Process (**ICAAP**), similar to that of banks.

- **NBFC-UL:** The NBFCs in the Upper Layer will be based quantitative as well as qualitative measures as follows:
  - Qualitative parameters such as size (35%), inter-connectedness (25%), complexity (10%).
  - Qualitative parameters like supervisory inputs (30%, which includes type of liabilities, group structure and segment penetration).

  According to the Discussion Paper, ten largest NBFCs (as per their asset size) will automatically be placed under this category. Further, it aims to level regulatory framework for NBFC-ULs to be on similar lines as that of banks, including:
  - Maintaining a minimum common equity tier 1 (**CET 1**) capital of 9%.
  - Subjecting NBFC-ULs to the differential standard asset provisioning norms applicable to banks.
  - Placing a mandatory listing requirement as is applicable to private banks.

- **NBFC-TL:** The top layer is proposed to remain empty as per the Discussion Paper. In case any unsustainable systemic risk is perceived from a specific entity in the NBFC-UL category, it may be shifted to this layer, subject to scrutiny by RBI. Basically, a miscellaneous category, which shall consist of any NBFC, that cannot be categorised in the category of NBFC-Ul and bear incalculable risks.

Conclusion

The proposed mechanism in the Discussion Paper aims to significantly revise the governance framework based on various parameters. It is pertinent to note that the regulatory framework for NBFCs needs to be re-oriented to keep pace with changing realities in financial sector and the proposed changes and classification seems to be a right step in moving forward, considering the ease and improved classification measures and a systematic approach towards the same.

SEBI relaxes eligibility norms for fintech companies for entering mutual fund business

The Securities and Exchange Board of India (**SEBI**) vide its board meeting conducted on December 16, 2020 amended SEBI (Mutual Fund) Regulations, 1996 (**Regulations**) by issuing Press Release no. 61/2020 on the same day (**Amendment**). The Amendment seeks to relax profitability norms applicable to sponsors of mutual funds. As per the Amendment, sponsors having a net worth of not less than INR 100 crore will be considered as eligible sponsors for the purpose of contributing towards the net-worth of the Asset Management Company (**AMC**) and will not be required to fulfil the profitability criteria under the Regulations at the time of making an application to act as a sponsor.

Prior to the Amendment, entities applying to act as sponsors were required to exhibit evidence of profit for 3 (three) consecutive years as well as maintenance of a net worth of INR 50 crores. SEBI has now waived these eligibility norms to encourage upcoming entrants into the mutual funds market, such as fintech start-ups that are looking to enhance the mutual funds market in India. The Amendment will be applicable to only new players in the market and not to entities that are already sponsoring mutual fund businesses, even with a net worth of INR 50 crore.

Regulatory compliance portal

The Government launched a Regulatory Compliance Portal (**Portal**) on January 1, 2021, to reduce the burden of compliance on businesses and citizens. The Portal is a central repository of all central and state-level compliances. The Portal will simplify processes, decriminalize laws and repeal redundant laws, along with removing burdensome compliances.

The Department for Promotion of Industry and Internal Trade (**DPIIT**), Ministry of Commerce and Industry will act as the nodal department for minimizing the regulatory compliance burden for citizens and business. Industry stakeholders from bodies such as CII, FICCI, and ASSOCHAM can also submit compliances and propose recommendations. This would then be assessed by the relevant government authorities, and suitable action would be taken.

The Government has launched this program to translate Atmanirbhar Bharat Abhiyan into a reality and to compliment the rise on India's rank in the World Bank's Ease of Doing Business Report from 142nd in 2014 to 63rd in 2019.

4th amendment to FEMA NDI Rules – Increase in FDI limit In the Defence Sector and FDI from Multilateral Banks/Funds

The principal Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (**2019 NDI Rules**) notified by the Government on October 17, 2019 were enacted with the primary objectives of simplifying the provisions governing foreign investment in India and vesting the Central Government (**Government**) and the RBI with power over non-debt instruments.

The Ministry of Finance, Government of India vide its notification dated December 8, 2020 notified the Foreign Exchange Management (Non-debt Instruments) (Fourth Amendment) Rules, 2020 (**Amendment Rules**) to amend the 2019 NDI Rules. These amendments have been brought into effect by the Government in exercise of the powers conferred on it under the Foreign Exchange Management Act, 1999 (**FEMA Act**).

The Amendment Rules have been introduced pursuant to the Government's economic stimulus package announcement on May 16, 2020 in response to the pandemic lockdown. The stimulus package announcement specified inter-alia the raising of Foreign Direct Investment (**FDI**) limit in defence manufacturing under the automatic route from 49% to 74%.

Following the foregoing announcement, on September 17, 2020, the Department for Promotion of Industry and Internal Trade (**DPIIT**) of the Ministry of Commerce and Industry issued a press note. Press Note 4 (2020 Series), which elaborated on the details of raising the FDI limit in the defence sector. The details provided in this press note have now been incorporated in the Amendment Rules in order to give effect to the same.

The Amendment Rules

The Amendment Rules set forth two major amendments. As mentioned above, one of the amendments is an increase in the FDI limit with regards to the defence sector up to 74% from the previous limit of 49%. This is specifically under the automatic route where the company is requiring industrial license under the Industries (Development and Regulation) Act, 1951 and manufacturing of small arms and ammunitions under the Arms Act, 1959.

Further, FDI limit beyond 74% and up to the sectoral cap of 100% is permissible under the government route only wherever it is likely to result in access to modern technology or for other reasons to be recorded. It is to be noted that under the automatic route, foreign investors do not require prior approval from the RBI or the Government before making the investment. However, under the government route, foreign investors are required to take prior approval of the respective ministry/department before making the investment, which shall be subject to the conditions stipulated by the Government in its approval.

In this regard, the Amendment Rules further stipulate other conditions which are as stated below:

- The FDI limit under the automatic route for companies seeking new industrial license has been increased up to 74% from the previously permissible FDI limit of 49%.
- 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 submit a declaration with the Ministry of Defence in cases of change in equity/shareholding pattern or transfer of stake by existing investor to new foreign investor, for FDI up to 49%, within a period of thirty days of such change and any proposal for raising FDI beyond 49% from such companies shall require Government approval. This condition is especially important to note as it has been newly introduced vide the Amendment Rules.
- The applications for granting industrial license will be considered by the DPIIT 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 the guidelines of the Ministry of Defence.
- The investee company shall be structured to be self-sufficient in the areas of product design and development, and the investee or joint venture company along with the manufacturing facility should also have maintenance and life cycle support facilities for the product being manufactured in India.
- Lastly, it is important to note another newly introduced condition which states that foreign investments in the defence sector will be subject to scrutiny on the grounds of national security. Further, the government also reserves with itself the right to review any foreign investment in the sector that affects or may affect national security.

The second amendment brought about by the Amendment Rules is the introduction of an additional proviso under the Rule 6 (Investments by person resident outside India) of the 2019 NDI Rules as stated below:

"2. In the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, in rule 6, in clause (a), after the third proviso, the following proviso shall be inserted, namely:

Provided also that a Multilateral Bank or Fund, of which India is a member, shall not be treated as an entity of a particular country nor shall any country be treated as the beneficial owner of the investments of such Bank or Fund in India."

This newly introduced proviso states that a Multilateral Bank or Fund, of which India is a member, shall not be treated as an entity of a particular country nor shall any country be treated as the beneficial owner of the investments of such Bank or Fund in India. This proviso comes as a clarificatory provision to the earlier safeguards provided by the Government which were aimed at enacting protectionist measures against FDI from multilateral banks/ funds from countries sharing land borders with India.

International Financial Services Centers Authority in India inducted as a Member of IOSCO

The Ministry of Finance issued press release confirming that The International Financial Services Centres Authority (**IFSCA**) has become an Associate Member of the International Organization of Securities Commissions (**IOSCO**).

Background

The IOSCO is the international organization that brings together the world's securities regulators, covering over 95 percent of the world's securities markets and is the global standard setter for the securities sector. IOSCO works closely with the G20 and the Financial Stability Board (**FSB**) in setting up benchmark for strengthening the securities markets.

The Objectives and Principles of Securities Regulation of IOSCO have been endorsed by FSB as one of the standards for sound financial systems. IOSCO has three categories of membership namely Ordinary, Associate, and Affiliate that reflect the different approaches to securities markets regulation, while also ensuring that those with an interest in the regulation of securities markets are also involved in the debate on securities market issues. The following entities are eligible for associate membership of IOSCO:

- Supranational governmental regulators
- Subnational governmental regulators where there is a national governmental regulator
- Intergovernmental international organizations and other international standard-setting bodies
- Other governmental bodies with an appropriate interest in securities regulation
- National governmental regulators who are not Memorandum of Understanding (**MoU**) signatories and who are not ordinary members

An association that consists of public regulatory bodies is eligible for associate membership of IOSCO.

IFSCA an Associate member of IOSCO

The membership of IOSCO shall provide IFSCA a platform to exchange information at the global level and regional level on areas of common interests. Further, the IOSCO platform would enable IFSCA to learn best practices and experience from multiple regulators of other well-established financial centres.

Interestingly under FPI Regulations, one of the qualifying conditions to obtain FPI licence is that the FPI applicant should be a resident of a country whose securities market regulator is a signatory to IOSCO or a signatory to the bilateral MoU with SEBI. FPI regulations prescribe that an applicant incorporated or established in an International Financial Services Centre (**IFSC**) shall be deemed to be appropriately regulated for FPI licence purposes.

The induction of IFSCA as an associate member is a significant milestone that will put India in the global map of IFSC for collaboration with other matured regulators of securities markets. This will also provide IFSCA a much-needed platform with a global outreach, for the exchange of information at global and regional levels, on areas of common interest and goals for future development. Moreover, this will enable IFSCA to become a global player to leverage and contribute towards the development and regulation of the financial products, financial services, and financial institutions at the IFSC in India. The membership of IFSCA in the IOSCO will not only allow Indian IFSC a level playing field and advantage to present India’s viewpoint amongst other IFSC across the globe for enhanced investment activities and investor protection but will also enable it to learn from the experiences and best practices of matured regulators that are members of IOSCO, such as the U.S. Commodity Futures Trading Commission and the U.S. North American Securities Administrators Association that are also Associate members, and from prominent Ordinary members, such as the U.S. Securities and Exchange Commission, U.K.’s Financial Conduct Authority and Hong Kong’s Securities and Futures Commission.

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