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UPDATE: Clarifications on FDI Policy in Construction Development Sector

In our Newsletter dated 4 February 2015 we had dealt with Press Note 10 of 2014 ("Press Note") with respect to the Foreign Direct Investment (FDI) Policy in the Construction Development sector ("Policy") which further liberalized FDI into the sector by providing relaxed conditions for 100% FDI under the Automatic route. However, the Press Note contained certain obscurities which needed to be clarified for effective implementation of the Policy. The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry, Government of India has recently provided a Clarification to Press Note 10 of 2014 on FDI policy in the Construction Development Sector.

The Clarification has been provided with a view to mitigate the ambiguities, and includes the following explanations:

- **No new FDI if no minimum capitalization of USD 5 million within 6 months :** The Press Note stipulates minimum FDI capital of USD 5 million is to be brought in by the investee company within six months of commencement of the project. The DIPP has now clarified that no new FDI can be brought in the project if the minimum capitalization of USD 5 million has not been achieved within six months of the commencement of the project. *However, it is not clear whether the project may continue to utilize the FDI, even if the minimum capitalization of USD 5 million has not been achieved within 6 months. In other words, is the original FDI required to be repatriated or will it remain invested in the project until completion of the project (or trunk infrastructure, as the case may be).* Providing a time period for bringing in FDI seems to be a dampener for the real estate sector as new FDI for the project is not allowed if USD 5 million is not brought in within 6 months. Developers would be left high and dry for want of capital even though the project has commenced.
- **Reckoning Date / Commencement of the project :** As mentioned above, FDI of USD 5 million is to be brought in by the investee company within six months of commencement of the project. The Press Note stated that commencement of the project will be the date of approval of the building plan/lay out plan by the relevant statutory authority. *The DIPP has now clarified that the reckoning date for the commencement of the project means the first approval of the building plan/layout plan, and further approvals are just addendum/modification to the first approval.* In India, rules relating to sanction of building plans/layout plans vary significantly in various jurisdictions. Since the first approved building plan/layout plan could be modified and/or amended, as per the clarification, only the first approval will be considered.
- **Exit even prior to completion of project or trunk infrastructure on case to case basis :** The Press Note provides that the investor will be permitted to exit on completion of the project or after development of trunk infrastructure i.e. roads, water supply, street lighting, drainage and

sewerage and the Government may, in view of facts and circumstances of a case, permit repatriation of FDI or transfer of stake by one non-resident investor to another non-resident investor, before the completion of project. The DIPP has now clarified that *exit is permitted only with Foreign Investment Promotion Board (FIPB) approval on case-to-case basis even before completion of the project or development of trunk infrastructure. The Investor can exit automatically i.e without FIPB approval if it has completed trunk infrastructure even if the project is not completed, Similarly, if the project is completed the Investor can exit automatically i.e without FIPB approval.*

- **On whether or not ongoing projects will be subject to the relaxed conditions under Press Note 10 of 2014 :** It was earlier unclear how the government would treat ongoing projects which have already commenced under the older Policy, as the Press Note 10 of 2014 did not address this ambiguity. Now, the DIPP has stated that the Press Note 10 of 14 supersedes the earlier FDI policy contained in the FDI Policy Circular of 2014. While this is fairly evident, *the explanation does not state whether the Press Note 10 of 2014 applies prospectively or retrospectively.* For example, under the Press Note, the investor will be permitted to exit on completion of the project or after development of the trunk infrastructure, however, under the earlier Policy; the original investment could not be repatriated before a period of three years from completion of minimum capitalization. Thus, for projects which commenced under the earlier Policy, it is still unclear whether the investor can exit after trunk infrastructure is completed or whether they need to remain invested until three years after commencement of the project. *The clarification issued by the DIPP in this regard is obscure. In order to not render the revised Policy nugatory with respect to ongoing projects which had commenced earlier, a more detailed/explicit clarification is required.*
- **Certification of completion of trunk infrastructure :** Under the Press Note, the investor will be permitted to exit on completion of project or after development of trunk infrastructure (defined as "roads, water supply, street lighting, drainage and sewerage"). A question remained as to which authority would decide when the trunk infrastructure is complete. Now, the DIPP has clarified that a *certificate from an architect registered with the Council of Architecture certifying the completion of development of trunk infrastructure would be sufficient to prove that the trunk infrastructure development is complete.* This ambiguity has thus been cleared.
- **Unusable/ idle parcels of land; disposal only with prior permission of FIPB :** The Press Note provides that an investor may exit on completion of the project or after development of the trunk infrastructure, and that the Government may permit repatriation of FDI or transfer of stake by one non-resident investor to another, before completion of a project, on a case-to-case basis. The DIPP has now further clarified, *if unused land is part of the project and the trunk infrastructure has not been developed on the same, then exit may take place only with the prior approval of the FIPB.*
- **Minimum capitalization is project specific :** The Press Note stipulates that the investee company will be required to bring in minimum FDI of USD 5 million within 6 months of commencement of the project. *The DIPP now has clarified that this minimum capitalization is project-specific, and not company-specific.* Thus, in each project, a minimum of USD 5 million needs to be brought in within 6 month of commencement of the project ("commencement of the project" means the date of the first approval of the building plan/layout plan by the relevant authority, as explained above).
- **FDI permitted in competed projects if not in "realm of Real Estate Business" :** The Press Note permits FDI in completed projects for operation and management of townships,

malls/shopping complexes and business centres. The term "business centres" was not defined in the Press Note. The DIPP has clarified that "business centre" includes where multiplicity of businesses of the same or different nature are being carried out from a particular building. *Thus, it appears that* ***any building which has commercial user and houses multiple businesses would fall under this definition.*** *Therefore, it appears that 100% FDI under the Automatic route is permitted in completed projects for operation and management of commercial buildings from which there are a number of businesses operating.*

The DIPP has further clarified that FDI in completed projects for operation and management of townships, malls/shopping complexes and business centres *is permitted, only as long as it is not in the "realm of real estate business".* Real estate business means the definition under FEMA Notification No. 1/2000-RB dated 3 May 2000 read with RBI Master Circular, i.e. "the dealing in land and immovable property with a view to earning profit or income therefrom 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". However, FDI in completed projects for operation and management of townships, malls/shopping complexes and business centres naturally does involve "earning profit or income". *Thus, on perusal of the above definition, the question of whether or not "operation and management of townships, malls/shopping complexes and business centres" by definition is in the "realm of real estate business" is unclear.*

While the DIPP has provided some explanations as above, several other ambiguities still remain in the Press Note, as we had reported in our newsletter dated 4 February 2015 titled 'Liberalizing the Construction-Development Sector: Comprehensive Concessions in the FDI Policy'. Further, some of the explanations given are incomplete and may not resolve the issues contained in the Press Note.

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