India's DPIIT Clarifies on Issue of Bonus Shares in Prohibited Sectors

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Introduction

As per Para 1 of Annexure 3 of India's consolidated foreign direct investment policy, Indian companies are allowed to freely issue rights/ bonus shares to their existing non-resident shareholders, subject to adherence of sectoral caps and compliance of applicable laws like the Companies Act, 2013. By Press Note 2 of 2025 (the "**Press Note**"), India's Department for Promotion of Industry and Internal Trade has clarified that, under Para 1 of Annexure 3 of the policy, an Indian company may issue bonus shares in compliance with applicable law to pre-existing non-resident shareholders in sectors where foreign direct investment ("**FDI**") is currently prohibited, subject to the condition that the shareholding percentage of the pre-existing non-resident shareholders does not change due to the bonus shares issuance.

Analysis

To give some context, currently, FDI in India is allowed in most sectors through the automatic route (no approval required from the government) and through the approval route (approval required from the government) in some sectors, such as defence and insurance. However, FDI is not allowed in certain prohibited sectors, such as:

(i) lottery business;
(ii) gambling and betting;
(iii) chit funds;
(iv) Nidhi company;
(v) trading in transferable development rights;
(vi) real estate business or construction of farmhouses, excluding, *inter alia*, the development of townships and construction of residential/ commercial premises, roads or bridges; and
(vii) manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

FDI is also prohibited in sectors that are not open to private sector investment, such as atomic energy and railway operations.

The FDI policy has evolved over the decades following India's independence from British rule in 1947. Although many foreign investors exited their India businesses as the FDI policy in some sectors got restrictive, foreign ownership continued in some companies. As per press reports, an Indian cigarette manufacturer, Godfrey Phillips India Ltd., sought a clarification from the DPIIT on whether it could issue bonus shares to its original non-resident shareholder, Philip Morris, because FDI in the cigarette manufacturing sector was now prohibited. It appears that the DPIIT assessed and acceded to this request, and the Press Note was a culmination thereof.

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As a result of the Press Note, Indian companies engaged in any of foregoing prohibited sectors will be eligible to issue bonus shares to their existing non-resident shareholders. However, such an issuance should not result in additional foreign investment coming into the company and the foreign shareholding percentage should remain the same.

The Press Note will be effective from the date of issue of the applicable Foreign Exchange Management Act, 1999 notification, which is awaited.

In our view, the Press Note is a welcome clarification and will eliminate the ambiguity surrounding the issuance of bonus shares to pre-existing investors in restricted sectors.

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