BATHIYA

WEBINAR

Amendments to Overseas Investment Regime in India

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Backdrop

Enabling Global Integration + Trust based regime + Enhances clarity

- **FEMA**
  - > ~~FEM (Transfer or Issue of Any Foreign Security) Regs~~
  - > ~~FEM (Acquisition and Transfer of Immovable Property Outside India) Regs~~

FEM (Overseas Investment) Rules, 2022

FEM (Overseas Investment) Regulations, 2022

FEM (Overseas Investment) Directions, 2022

Overseas Investment

Overseas Investment

Financial Commitment

Overseas Direct Investment:

- Acquisition of unlisted equity capital
- Subscription as part of MoA
- Investment in listed entity being more than 10% of PUC
- Investment with control in a listed foreign entity, even if less than 10% of PUC

- Debt in ODI entities
- Non-fund based facilities
  - Guarantees
  - Pledge or Charge

Overseas Portfolio Investment

- Investment other than ODI
- Covers all securities *except* unlisted debt instruments

Once a ODI remains a ODI and vice versa

Overseas Investment

Limits –

- Overall limit of Financial Commitment shall not exceed *400%* of networth
- Additional limit of *50%* of networth available for OPI
- LRS Limits *(USD 250k)* apply to individuals for Overseas Investment.

ODI in Financial Services activity –

- For Indian Entity engaged in financial services activities:
    - **Allowed,** subject to Indian entity being (i) profitable for preceding three years, (ii) regulated \ registered by a financial services regulator in India and (iii) obtained approvals as may be required from such regulators.
- For Indian Entity **not** engaged in financial services activities:
    - **Allowed,** except banking and insurance, subject to such Indian entity has posted net profits during three preceding financial years.

Fundamental changes and concepts

Indian Entity –

- The old concept of ***Indian party (IP)*** where all the investors from India in a foreign entity were together considered as IP, **substituted with** the concept of "**Indian Entity"** where each investor entity shall be separately considered as an Indian entity.

Foreign Entity –

- The term **"Foreign Entity" replaces** the old concept of ***Joint Venture (JV)*** and ***Wholly Owned Subsidiary (WOS)***
- Means an entity **formed** or **registered** or **incorporated** outside India, including in IFSC in India, that has **limited liability**
- Now, popular form of entities like **LLC in USA and LLP in other countries** which are formed and registered but not incorporated would **become eligible for receiving ODI** from person resident in India.

Strategic Sector –

- Allowed upon obtaining necessary permission from competent authority, wherever applicable
- **Includes energy and natural resources** sectors such as Oil, Gas, Coal, Mineral Ores, Submarine cable system, **Start-ups** and any other sector or sub-sector as deemed fit by the Central Government

Fundamental changes and concepts

Subsidiary / Step Down Subsidiary (SDS) of a foreign entity **–**

- means **an entity in which the foreign entity has control** and
- has limited liability *(where the foreign entity's core activity is not in strategic sector)*
- where no control exists henceforth no reporting required

Control –

- definition similar to that in FEM (Non-Debt Instrument) Rules, 2019
- the right to appoint majority of the directors; or
- to control the management or policy decisions exercisable individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders' agreements or voting agreements that **entitle** them **to 10% or more of voting rights** or in any other manner in the entity

Bona fide business activity –

- any business activity permissible under any law in force in India and host country / jurisdiction

Fundamental changes and concepts

Equity Capital –

- means **equity shares** or **perpetual capital** or **instruments** that are **irredeemable** or **contribution to non-debt capital** of a foreign entity, which is **in the nature of fully and compulsorily convertible** instruments
- Accordingly, any instrument which is **redeemable** or **non-convertible** or **optionally convertible** shall be **treated as Debt**

Debt Instruments –

- Government bonds, Corporate bonds;
- all tranches of securitisation structure which are not equity tranche;
- borrowings by firms through loans; and
- depository receipts whose underlying securities are debt securities;

Non-Debt Instruments –

- all investments in equity, capital participation in Limited Liability Partnerships;
- all instruments of investment as recognised in the FDI policy from time to time;
- investment in units of AIFs and REITs and InvITs; and MFs and ETFs which invest >50% in equity;
- the junior-most layer (i.e., equity tranche) of securitisation structure;
- **acquisition, sale or dealing directly in immovable property**;
- contribution to trusts; and
- depository receipts issued against equity instruments;

Fundamental changes and concepts

Grandfathering –

- Existing OI **made in accordance with** erstwhile ODI regime

Non-applicability of OI Rules and Regulations in following cases –

- any **investment** made outside India **by a financial institution in an IFSC**;
- **acquisition or transfer** of any investment outside India made–

  (i) out of **Resident Foreign Currency Account**; or

  (ii) out of **foreign currency resources held outside India** by a person who is employed in India for a specific duration irrespective of length thereof or for a specific job or assignment, duration of which does not exceed three years; or

  (iii) in accordance with sub-section (4) of section 6 of the Act.

Regularization of irregularities of erstwhile ODI structure or unwinding due to irregularities?

Fundamental changes and concepts

No Objection Certificate (NOC) to be obtained **–**

- by any person resident in India who -
  - has a NPA account,
  - is classified as wilful defaulter by bank,
  - is under investigation by a financial service regulator or by investigative agencies in India (CBI, ED, SFIO)
- from the lender bank or regulatory body or investigative agency
- Expiry of 60 days from request date shall be deemed NOC

ODI – FDI Structures (Round Tripping) –

- **Now explicitly permits structure with Two layers of subsidiaries**
- **Computation of Subsidiary layers seems to be below the Foreign Entity**
- Layering condition NOT applicable to **Banks, NBFC, Insurance** and **Government** Company
- No addition of subsidiaries beyond 2 layers after notification of new OI regime
- For Structure beyond 2 layers, suggestive to seek RBI approval under Rule 9, justifying commercial rationale

Whether SPV entity permissible in ODI-FDI Structure?
Satisfaction of Bona fide business activity criteria test

Fundamental changes and concepts

ODI Restrictions and Prohibitions –

- ODI not permitted in foreign entity *inter-alia* engaged in -
  - real estate activity
  - gambling in any form; and
  - dealing with financial products linked to the Indian rupee without specific approval of the RBI. ***Crypto?***

- Now clarified that **leasing** shall **NOT** be treated as **real estate activity**

OI by Resident Individuals

- A resident individual may make overseas investment in accordance with **schedule III - Rule 13 of OI Rules**.
- Overseas Investment = Financial Commitment +Overseas Portfolio Investment (OPI) made by person resident in India.

- Resident individual may make or hold Overseas Investment by the way of :
  - ODI in operating foreign entity (not engaged in financial services activity) without control
  - OPI, including by the way of reinvestments
  - ODI or OPI shall be within LRS limit of USD 250,000.

- Different modes of Overseas Investment via Capitalization, Swap of securities, rights or bonus issue, Gift, inheritance, sweat equity shares, minimum qualification shares, ESOPs and Employee benefit schemes.
- Resident individuals are not permitted to transfer any overseas investment by way of gift to a person resident outside India
- Investment in units of overseas unlisted investment fund shall be considered as OPI

OI by Person Resident in India Other than Indian entity and Resident Individual

- A person resident in India, other than Indian entity or resident individual may make overseas investment in accordance with **schedule IV - Rule 14 of OI Rules.**
- Mutual Funds (MFs) and Venture Capital Funds (VCF) / Alternative Investment Funds (AIFs) registered with SEBI can invest in overseas within an overall cap of USD 7 Bn and USD1.5 Bn respectively.
- Limited number of MFs are permitted to invest cumulatively USD 1 Bn in overseas Exchange Traded Funds.
- Any Investments by AIFs shall be classified as OPI.
- AD bank including overseas branch may acquire or transfer foreign securities in normal course of its business.
- ODI by Registered Trust or Society engaged in educational sector or which has set up hospitals :
  - Foreign entity engaged in same sector
  - Existence of atleast last three financial years before investment
  - Permissibility of proposed ODI by Trust deed / MOA
  - Investment approval / Obtain Special license or Permission from authorities

OI in IFSC by person resident in India

- A person resident in India may make overseas investment in an International Financial Service Centre (IFSC) in India in accordance with **schedule V - Rule 15 of OI Rules.**
- ODI in IFSC - Requisite approval by the financial services regulator shall be decided within 45 days of application.
- Indian entity, not engaged in financial services, may make ODI in IFSC without meeting the net profit condition.
- Resident person allowed to invest in the units of investment fund or vehicle setup in an IFSC as OPI
- Resident individual allowed to make ODI in foreign entity engaged in financial service sector (except banking / insurance) in IFSC if such entity does not have subsidiary or step down subsidiary outside IFSC where the resident individual has control in the foreign entity.

Acquisitions or Transfer of Immovable Property Outside India – Rule 21

- AD Bank may allow an Indian entity having overseas office to acquire immovable property outside India for business and residential purpose of its staff.
- Remittance limit for initial and recurring expenses.

Pricing and Mode of Payment

- **Pricing guidelines**

  ✓ Issue or transfer of shares shall be subject to Price arrived on an arm's length basis (ALP)

  ✓ AD Bank to ensure compliance with ALP considering any internationally accepted pricing methodology

  ✓ AD Bank to be guided by their board approved policy for documents to be taken

- **Mode of payment**

  ✓ Payment for OI can be made:

    - Remittance made through banking channels
    - Funds held in an account maintained in accordance with the provisions of the FEMA
    - By swap of securities
    - Using proceeds of ADR, GDR, stock-swap of such receipts, ECB
    - Financial commitment by way of debt by an Indian entity

Deferred Consideration and Indemnification

- **Deferred consideration**
  - ✓ Deferred consideration mechanism permitted without approval route
  - ✓ Permitted in case of acquisition or transfer of equity capital reckoned as ODI subject to TWO conditions:
    - Condition 1: entire foreign securities to be transferred / issued upfront
    - Condition 2: full consideration to be compliant with pricing guidelines
  - ✓ Deferred part of the consideration treated as non-fund based commitment
- **Indemnification**
  - ✓ Indemnification from the Seller to the Buyer permitted
  - ✓ Indemnification amount and other terms / conditions may be mutually agreed by the parties and laid down in the Agreement
  - ✓ Such agreement to be in compliance with FEMA Act, rules and regulations

Transfer and Liquidation

- **Sale / Transfer permitted generally unless otherwise provided**
  - ✓ Sale to an Indian resident, who is eligible to make such investment OR to a foreign resident
  - ✓ Transfer pursuant to corporate restructuring events like merger, demerger, buyback or liquidation permissible if such transfer / liquidation approved by competent authority
  - ✓ If Disinvestment pertain to ODI:
    - Full disinvestment permitted only if no dues are outstanding for receipt, which such transferor is entitled to receive as in investor in equity and debt (not applicable to Liquidation)
    - any disinvestment permissible only after a period of 1 year
  - ✓ Holding or transfer not permitted if the initial investment was not permissible under FEMA

Restructuring

- **Restructuring of foreign entity involving diminution of OI**

  ✓ Restructuring permissible if
  - FE incurring losses for 2 years as per AFS and
  - diminution in the total value not exceeding proportionate amount of the accumulated losses

  ✓ In case Original investment is more than 10 Mn USD or diminution is more than 20%, such diminution to be duly certified on an ALP by a registered valuer in India or corresponding valuer in host jurisdiction or CPA

  ✓ Such certificate to be not older than 6 months

  ✓ If restructuring involves only equity, only equity investment of the foreign entity may be taken into consideration for computing proportionate losses

  ✓ Benefit of this provision not allowed where the assets are simply revalued in the books of the IA without any restructuring of the balance sheet of the FE

Reporting Obligations

- **ODI investment – submission of share certificate within 6 months to AD Bank**
- **UIN specific to each FE to be pre-obtained from RBI before remittance**
- **All transactions in respect of an UIN to be routed only from a designated AD Bank**
  - ✓ All investors need to route transactions from same AD Bank
- **All realisation and proceeds from disinvestment to be remitted back to India within 90 days**
- **An Indian resident may make remittance towards EMD or obtain a bid bond guarantee for participation in bidding or tender procedure**

Reporting Obligations

- **ODI investment reporting**
  - ✓ Financial commitment to be reported at the time of remittance
  - ✓ Disinvestment and restructuring to be reported within 30 days
  - ✓ APR with respect to foreign entity to be submitted every year by 31st December
    - Reporting not applicable in case only equity investment which is less than 10% without control
    - FE is under liquidation
  - ✓ APR to be based on AFS
  - ✓ Person holding highest stake to submit APR
  - ✓ SDS details also to be reported

- **OPI investment reporting**
  - ✓ An Indian resident other than individual to report OPI investment in half yearly basis within 60 days
  - ✓ September and March

- **Delay in reporting – LSF concept introduced – maximum within 3 years**

- **Restriction on further investment until delay in reporting is regularised**

Thank you

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