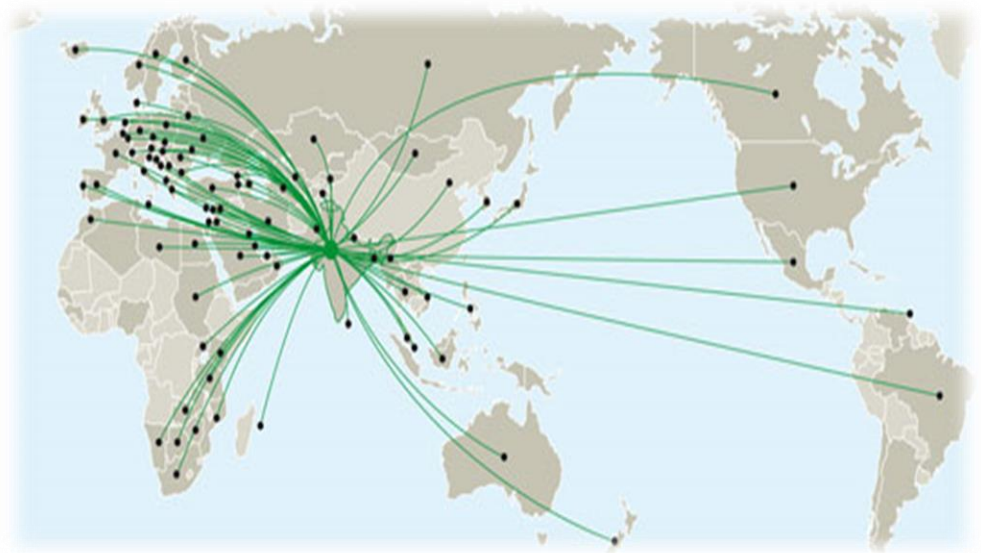


# Overseas Direct Investment

**Harshal Bhuta**

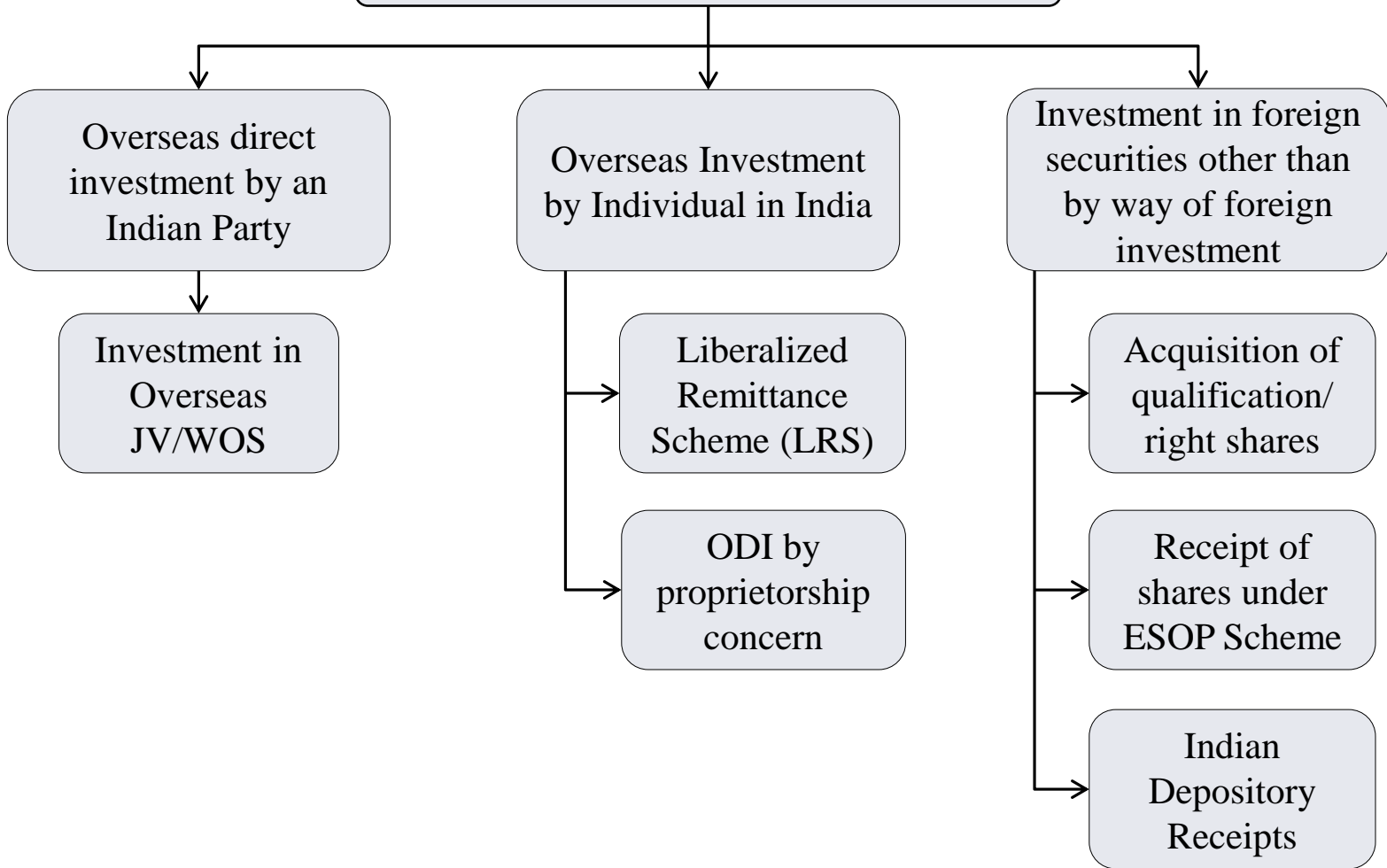
M.Com., F.C.A., A.D.I.T., LL.M. (Hons.)  
in International Tax Law [WU]

# Outbound Investment



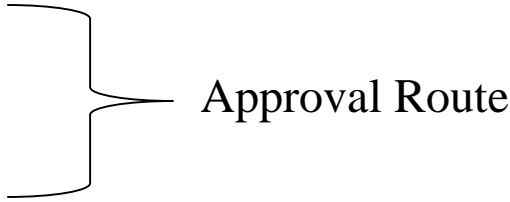
# Outbound Investments

## Routes for Overseas Investment



# Outbound Investments

## □ Eligible Investors:

- An **Indian Party** who is -
    - A company incorporated in India; or
    - A body created under an Act of Parliament; or
    - A Partnership Firm registered under the Indian Partnership Act, 1932; or
    - Limited Liability Partnership as defined under clause (ma) of Regulation 2 of FEMA Notification No. 120/2004-RB; or
    - Any other entity in India as may be notified by the Reserve Bank
  
  - **Resident Individual**
  
  - **Proprietary / Firm**
  - **Trust / Society**
  - **Un-incorporated Entities**
- 
- Approval Route

# Outbound Investments

## Important Definitions

### ❑ Direct Investment Outside India:

Investment by way of contribution to the Capital or Subscription to Memorandum of Association of a Foreign entity; OR

Investment by way of purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange but does not include portfolio investment

### ❑ Joint Venture (JV):

A foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party makes a direct investment.

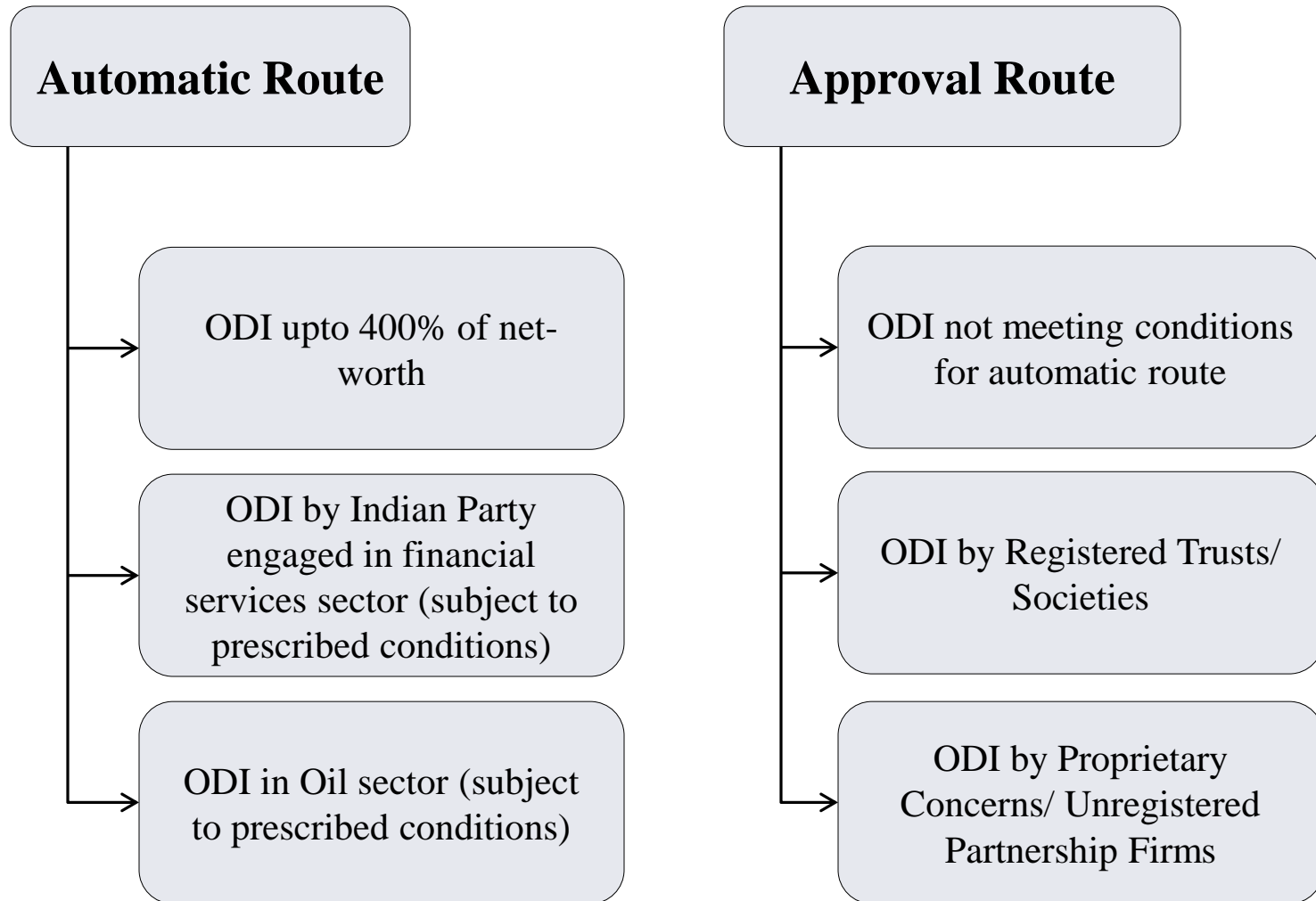
### ❑ Wholly Owned Subsidiary (WOS):

A foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country, whose entire capital is held by the Indian party.

*No specific % of investment specified for regarding a foreign entity as JV – therefore, even nominal investment may result in foreign entity being regarded as JV.*

# Outbound Investments

## Approval Route and Automatic Route



# Outbound Investments

## ❑ Criteria for ODI under Automatic Route:

- Financial Commitment up to 400% of Net worth (covered in later slide)
- Valuation requirements (covered in later slide)
- All transactions relating to a JV / WOS routed through one branch of an AD bank
- Indian Party not on RBI's caution list / under investigation by enforcement agency
- Indian subsidiary is required to report its investments in form ODI to the AD bank (covered in later slide)
- Submission of APR by December each year in respect of all overseas investments

# Outbound Investments

## □ Total Financial Commitment in all JV/WOS includes :

- a. 100% of the amount of **equity shares and/ or Compulsorily Convertible Preference Shares (CCPS)**;
- b. 100% of the amount of **other preference shares**;
- c. 100% of the amount of **loan**;
- d. 100% of the amount of **guarantee** (other than performance guarantee) issued by the Indian Party;
- e. 100% of the amount of **bank guarantee** issued by a resident bank on behalf of JV or WOS of the Indian Party provided the bank guarantee is backed by a counter guarantee / collateral by the Indian Party.
- f. 50% of the amount **of performance guarantee** issued by the Indian Party provided that if the outflow on account of invocation of performance guarantee results in the breach of the limit of the financial commitment in force, prior permission of the Reserve Bank is to be obtained before executing remittance beyond the limit prescribed for the financial commitment.



# Outbound Investments

## ❑ Methods of Funding :

- ❖ Investment (or financial commitment) in an overseas JV / WOS may be funded out of one or more of the following sources:
  - Drawal of foreign exchange from an AD bank in India;
  - Capitalization of exports;
  - Swap of shares;
  - Proceeds of External Commercial Borrowings (ECBs) / Foreign Currency Convertible Bonds (FCCBs);
  - In exchange of ADRs/GDRs issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993, and the guidelines issued thereunder from time to time by the Government of India;
  - Balances held in EEFC account of the Indian Party and
  - Proceeds of foreign currency funds raised through ADR / GDR issues.
- ❑ General permission to persons resident in India for purchase/ acquisition of securities :
  - Out of funds held in RFC account;
  - As bonus shares on existing holding of foreign currency shares; and
  - When not permanently resident in India, out of their foreign currency resources outside India

# Outbound Investments

## ❑ Extending loan/ guarantee to overseas JV/ WOS or its SDS:

- An Indian Party may extend a **loan/ guarantee** to or on behalf of overseas **JV/ WOS** within the permissible financial commitment provided, Indian Party has made investment by way of contribution to the equity capital of JV/ WOS.
- Notwithstanding anything contained above, an Indian Party may extend corporate **guarantee** on behalf of its first generation **step down operating company** within prevailing limit.
- However, issue of corporate guarantee on behalf of second level or subsequent level step down operating company will be considered under approval route provided, Indian Party indirectly holds  $\geq 51\%$  stake in such SDS.
- The indirect resident individual promoters of the Indian Party can issue personal guarantee on behalf of overseas JV/ WOS of the Indian Party provided, provisions specified under FEMA Notification No. 120 has been complied with.

# Outbound Investments

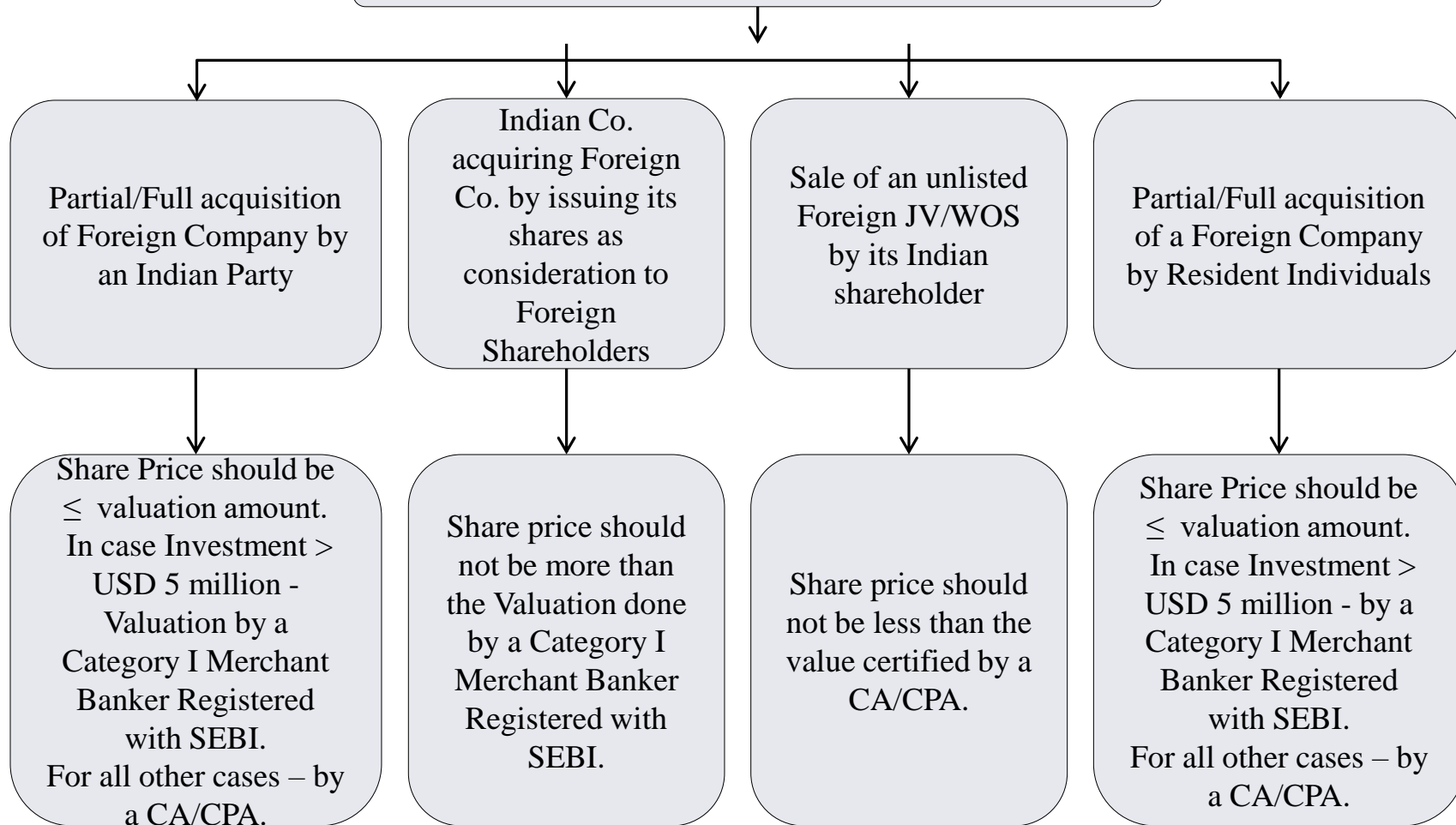
## □ Business Activity of Overseas JV/WOS:

- ODI in overseas JV/ WOS engaged in *bonafide business activities* is permissible
- However, Indian Party is *prohibited* from making direct investment in foreign entity engaged in business of
  - *Real estate*
  - *Banking*
- ODI in *financial services sector* by an Indian Party (IP) permissible subject to following conditions:
  - IP is engaged in financial services sector in India;
  - IP has earned net profit during preceding 3 FY from financial service business;
  - IP is registered with regulatory authority in India for conducting the financial service business;
  - IP has obtained approval from concerned regulatory authorities both in India and abroad;
  - IP has fulfilled prudential norms relating to capital adequacy as prescribed.

# Outbound Investments

## Pricing Guidelines

### Valuation Provisions



# Outbound Investments

## Obligation of Indian Party

### □ Reporting of Form ODI

#### **Part I – Application for allotment of Unique Identification Number (UIN) and reporting of Remittances / Transactions:**

- Section A – Details of the IP / RI.
- Section B – Capital Structure and other details of JV/ WOS/ SDS.
- Section C - Details of Transaction/ Remittance/ Financial Commitment of IP/ RI.
- Section D – Declaration by the IP/ RI.
- Section E – Certificate by the statutory auditors of the IP/ self-certification by RI.

#### **Part II - Annual Performance Report (APR) - every year on or before December 31, in respect of each JV or WOS outside India**

#### **Part III – Report on Disinvestment by way of**

- Closure / Voluntary Liquidation / Winding up/ Merger/ Amalgamation of overseas JV / WOS;
- Sale/ Transfer of the shares of the overseas JV/ WOS to another eligible resident or non-resident;
- Closure / Voluntary Liquidation / Winding up/ Merger/ Amalgamation of IP; and
- Buy back of shares by the overseas JV/ WOS of the IP / RI.

# Outbound Investments

## Obligation of Indian Party

### ❑ Receive share certificates:

An Indian Party which has acquired foreign security shall receive share certificates or any other documents as an evidence of investment in the foreign entity *within 6 months from the date of effecting remittance* or the date on which the amount to be capitalised becoming due or the date on which the amount due was allowed to be capitalised.

### ❑ All dues receivable to repatriate to India:

An Indian Party shall repatriate to India, all dues receivable from the foreign entity, like dividend, royalty, technical fees etc., *within 60 days of its falling due*, or such further period as the Reserve Bank may permit.

### ❑ Post investment changes in existing JV/ WOS:

A JV/ WOS set up by an Indian Party may diversify activities/ set up step down subsidiary/ alter the shareholding pattern.

An Indian Party shall report to the Reserve Bank, the details of such decision taken by the JV/ WOS *within 30 days of the approval* of those decisions by the competent authority concerned of such JV/ WOS.

# Outbound Investments

## ❑ Transfer by way of sale of shares of JV/ WOS outside India:

- An Indian Party may transfer by way of sale to another Indian Party or to a resident outside India, any share or security held by it in a JV/ WOS outside India subject to following conditions:
  - The sale **does not result in any write-off** of the investment made;
  - In case *shares of overseas JV/ WOS are listed*, sale is to be effected through stock exchanges;
  - In case *shares of overseas JV/ WOS are not listed* and shares are disinvested by a private arrangement – share price should not be less than – value certified by CA/ CPA;
  - An Indian Party **does not have any outstanding dues** from the overseas JV/ WOS;
  - The overseas JV/ WOS has been **in operation for atleast one full year** and the **APR** together with audited accounts for that year has been submitted to Reserve Bank;
  - An Indian Party is not under any investigation by CBI/ DoE/ SEBI/ IRDA or any other regulatory authority in India.

# Outbound Investments

## ❑ Transfer by way of sale of shares of JV/ WOS outside India:

- Indian Party may disinvest, without prior approval of the Reserve Bank, in any of the under noted cases where the **amount repatriated after disinvestment is less than the original amount invested**:
  - in case where the **JV / WOS is listed in the overseas stock exchange**;
  - in cases where the *Indian Party is listed on a stock exchange in India* and has a net worth of not less than Rs.100 crore;
  - where the *Indian Party is an unlisted company* and the investment (or financial commitment) in the overseas venture does not exceed USD 10 million. and
  - where the *Indian Party is a listed company* with net worth of less than Rs.100 crore but investment (or financial commitment) in an overseas JV/WOS does not exceed USD 10 million.
- Indian Party shall **repatriate** to India **sale proceeds** of shares/securities within **90 days** from the date of sale of shares/securities and the documentary evidence to this effect shall be submitted to the RBI through the designated AD bank.



# Cross Border Merger – Outbound Merger

## □ Foreign Exchange Management (Cross Border Merger) Regulations, 2018

[Notification No. FEMA.389/2018-RB Dated: March 20, 2018]

- ‘**Outbound merger**’ means a cross border merger where the resultant company is a foreign company;
- A person resident in India (including resident individual) may acquire or hold securities of the resultant company in accordance with the Foreign Exchange Management (Transfer or issue of any Foreign Security) Regulations, 2004.
- Any transaction on account of a cross border merger undertaken in accordance with these Regulations shall be deemed to have prior approval of the Reserve Bank as required under Rule 25A of the Companies (Compromises, Arrangement and Amalgamations) Rules, 2016.

# Outbound Investments

## ❑ Investment by Individuals (in lieu of Professional Services):

- A resident individual may acquire shares of foreign entity in part/full consideration of professional services rendered to the foreign company or in lieu of director's remuneration provided:
  - The limit of acquiring shares in terms of the value shall be within the LRS limit in force at the time of acquisition.
- Reserve Bank permission if value of shares exceeds the LRS limit.
- RBI will take following factors into consideration before giving permission:
  - Net Worth of the individual or Nature of his/her Profession;
  - Extent of foreign earnings / balance in EEFC and/or RFC account;
  - Financial and business track record of the foreign entity;
  - Potential for forex inflow to the country;
  - Other likely benefits.

# Outbound Investments

## Setting up JV / WOS outside India by Resident Individuals

### ❑ Overseas Direct Investments by Resident Individuals:

- Resident individual (single or in association with another resident individual or with an 'Indian Party' may make overseas direct investment in the *equity shares and compulsorily convertible preference shares* of JV/WOS outside India subject to following :
  - JV or WOS should **not be engaged** in the **real estate business** or **banking business** or in the **business of financial services activity**. Only **bonafide business activity**.
  - JV/WOS **cannot be located** in “**non co-operative countries & territories**” as identified by FAFT
  - Resident individual **cannot be on the RBI's Exporters Caution List** or **List of defaulters to the banking system** or **under investigation** by any investigation / enforcement agency or regulatory body
  - Permissible **ceiling limit is permissible amount under LRS** from time to time. **No exception** for investment out of **EEFC/RFC A/c** under this ceiling limit.
  - Only **operating JV/WOS**. **No further step down entity** permitted.
  - **Valuation norms** as applicable to ODI transactions applicable here.
  - Investment only in equity shares covered under ODI. (No Loan, Guarantee, etc.)

# Outbound Investments

## Setting up JV / WOS outside India by Resident Individuals

### ➤ Post Investment Changes:

- Any alteration in shareholding pattern of JV or WOS to be **reported to the designated AD within 30 days** as well as reported in **APR**

### ➤ Disinvestment by Resident Individuals:

- Resident individual may disinvest (partially or fully) by way of **transfer / sale** or by way of **liquidation / merger** of the JV or WOS
- Disinvestment to be **allowed after one year from the date of making first remittance** for setting up or acquiring the JV or WOS abroad
- **Disinvestment proceeds** to be **repatriated to India immediately** (not later than 90 days from the date of disinvestment) and the same may be reported to the designated AD
- **No write off** shall be allowed

### ➤ Reporting Requirements:

- Submit Form ODI within 30 days of making remittance to designated AD
- Submit APR by 31<sup>st</sup> December
- Disinvestment to be reported in Form ODI within 30 days of receipt of disinvestment proceeds

# Outbound Investments

## ❑ Investment in foreign securities other than by way of foreign investment: by way of – Gift/ inheritance/ ESOP

- A person resident in India being an individual may acquire foreign securities:
  - by way of gift from PROI;
  - by way of inheritance from PRI/ PROI;
  - Issued by a company incorporated outside India under cashless *employee stock option scheme* provided it does not involve any remittance from India.
- A person resident in India being an individual who is an employee/ director of Indian office/ branch of a foreign entity/ subsidiary of foreign entity in India/ Indian company in which foreign entity has direct/ indirect equity holding\*, may accept shares offered by such foreign entity provided that:
  - the shares under ESOP scheme are offered by the issuing company globally on uniform basis; and
  - An annual return is submitted by the Indian company to RBI through AD Bank giving details of remittance/ beneficiary etc.

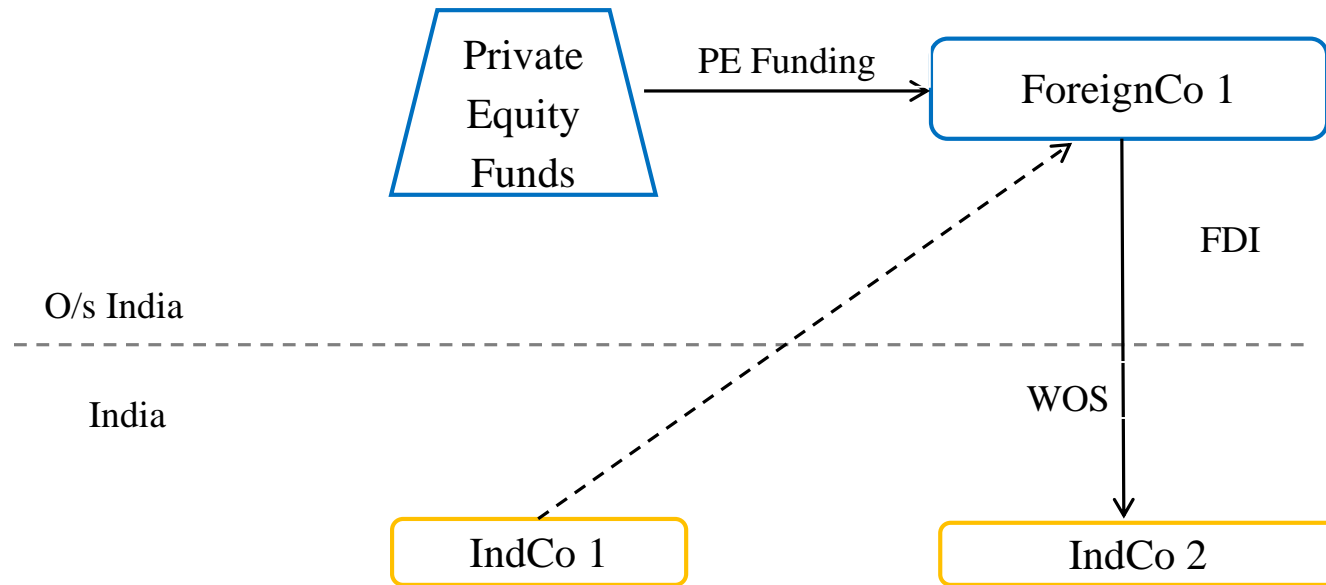
*\*Here, indirect means indirect foreign equity holding through a trust/ SPV/ SDS.*

# Case Studies



# Case Study - I

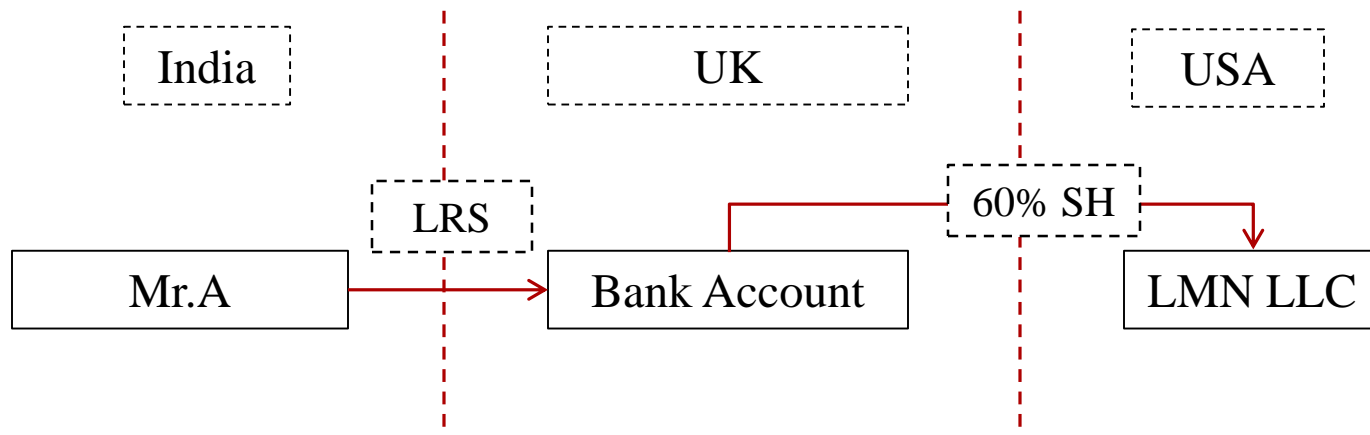
**Facts:** IndCo 2 intends to sell a majority stake in its company to pare down its high debt levels. IndCo 1 has tied up with foreign PE funds to purchase majority stake in IndCo2. However, foreign PE funds advice IndCo 1 to incorporate a new company ForeignCo 1 in tax friendly jurisdiction which will act as a pooling vehicle for acquisition of IndCo 2.



**Question:** Can IndCo 1 acquire IndCo 2 through ForeignCo 1 by partnering with foreign PE funds?

# Case Study - II

**Facts:** Mr.A, a resident individual had sent the US\$ 1,25,000 by way of LRS route to his foreign bank account held in UK. Since the money in his foreign bank account was kept idle, Mr.A invested the same in the equity capital of a LMN LLC, a company incorporated in USA by acquiring 60% stake.

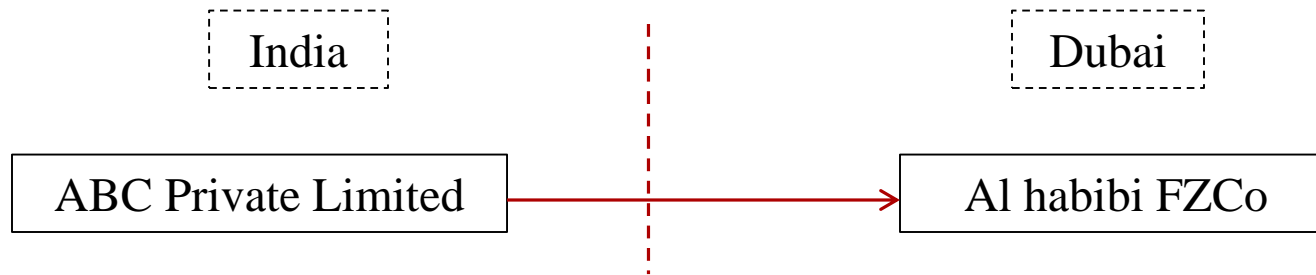


**Question:** Whether investment made by Mr.A in LMN LLC is to be treated as Overseas Direct Investment by Mr.A?



## Case Study - III

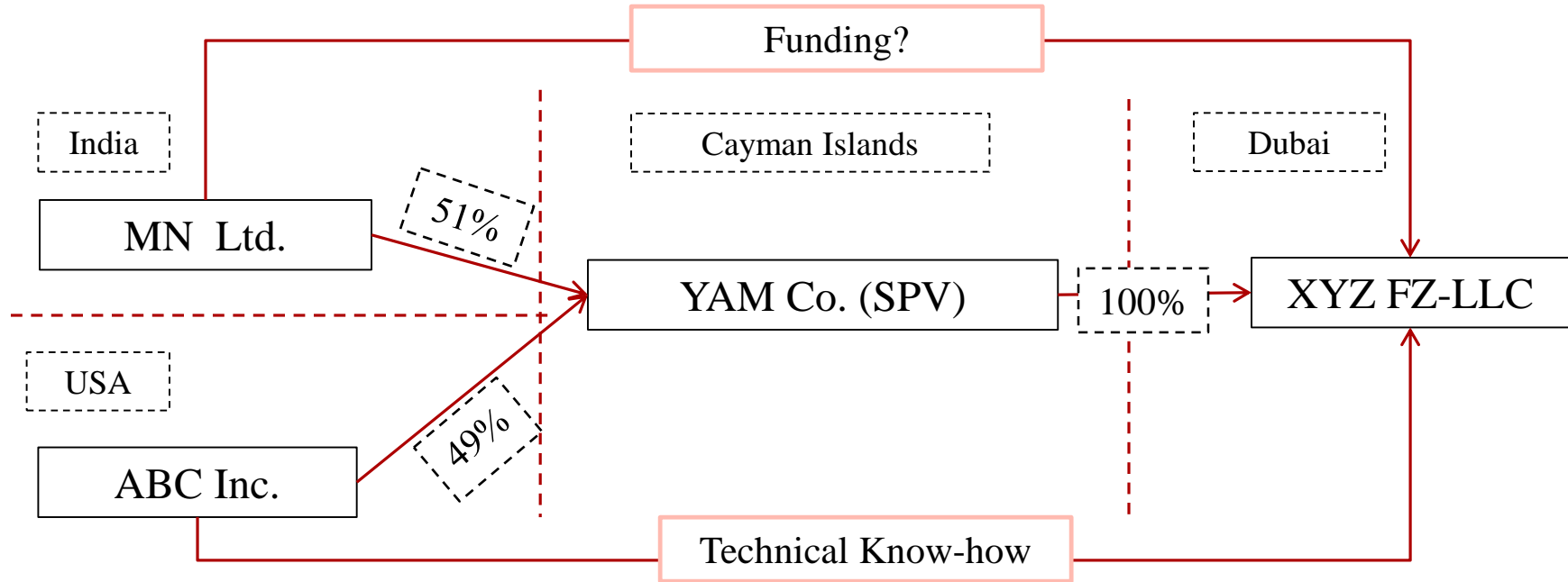
**Facts:** ABC Private Limited is an Indian company engaged in manufacturing of high quality Basmati Rice. To expand their presence in Gulf region, they incorporated a trading company namely Al habibi FZCo in Dubai on 15<sup>th</sup> March 2018. FY for Al habibi FZCo is April to March and it has earned profits for FY 2018-19 primarily on account of negative capital working position. Till date, ABC Private Limited has not made any remittance towards share capital of the Al habibi FZCo.



**Question:** Can ABC Private Limited now make remittance towards share capital of Al habibi FZCo.

# Case Study - IV

**Facts:** MN Ltd. (an Indian company) & ABC Inc. (of USA) have set up JV - Yam Co. in Cayman Islands. YAM Co in Cayman Island is SPV for incorporating operating SDS - XYZ FZ-LLC in Dubai. XYZ FZ-LLC is manufactures products of MN Ltd. for sale in MENA region. MN Ltd. acts as financial investor whereas ABC Inc. of USA acts as strategic investor.



**Question:** What kind of financial commitment can be made by MN Limited in XYZ FZ-LLC?

# Thank You

