

REVISED OVERSEAS INVESTMENT REGIME IN INDIA



A. INTRODUCTION

On 22 August 2022, the Ministry of Finance and the Reserve Bank of India (**RBI**) have notified the Foreign Exchange Management (Overseas Investment) Rules, 2022 (**OI Rules**), the Foreign Exchange Management (Overseas Investment) Regulations, 2022 (**OI Regulations**), and the Foreign Exchange Management (Overseas Investment) Directions, 2022 (**OI Directions**). The OI Rules, OI Regulations, and OI Directions hereinafter are collectively referred to as **New Laws**. The New Laws supersede the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004, the Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015, and relevant circulars and master directions issued by RBI under the earlier regime. This update briefly covers key concepts and the changes introduced by the New Laws.

B. KEY DEFINED TERMS AND CONCEPTS

What is Overseas Direct Investment?

The following investments are treated as Overseas Direct Investment (**ODI**):

- (a) Acquisition of equity capital of an unlisted foreign entity (irrespective of percentage of acquisition), where equity capital means any form of equity shares, perpetual capital, irredeemable instruments, or fully and compulsorily convertible instruments;
- (b) Acquisition of 10% or more of the paid-up equity capital, or acquisition with control (irrespective of shareholding) of a listed foreign entity; and
- (c) Subscription to the memorandum of association of the foreign entity.

What is Overseas Portfolio Investment?

Overseas Portfolio Investment (**OPI**) means investments in foreign securities that is not ODI. Further, investments in unlisted debt instruments or securities issued by persons resident in India (except IFSC) are also excluded from the ambit of OPI.

In addition to the above, the following investments are treated as OPI:

- (a) An acquisition by a resident individual of less than 10% and without acquisition of control by way of sweat equity shares, minimum qualification shares or acquisition of shares under an employee stock ownership plan (**ESOP**) or employee benefit scheme (**EBS**); and
- (b) Any investment made outside India by mutual funds, venture capital funds (**VCFs**) and alternative investment funds (**AIFs**).

What is Financial Commitment and Overseas Investment?

Financial Commitment means the total amount of investment made by a person resident in India, by way of (a) ODI, and (b) debt other than OPI including the non-fund-based facilities extended by such persons.

Overseas Investment is the aggregate of Financial Commitment and OPI made by a person resident in India.

C. WHAT IS PERMITTED AND WHAT IS NOT?

Who may make Overseas Investments?

Overseas investments may be made by 'Indian entities', resident individuals, registered trusts and societies, mutual funds, VCFs, and AIFs. 'Indian entities' means duly incorporated companies, body corporates, duly incorporated limited liability partnerships, and registered partnership firms (**Indian Entities**). Earlier, all Indian Entities making overseas investment in a foreign entity were collectively referred to as 'Indian party'. Under the New Laws, each entity is individually considered as an Indian Entity, and investment limits are to be considered for each Indian Entity.

Who may receive Overseas Investments?

Investments may be made in entities that are formed, registered, or incorporated outside India, or in an International Financial Services Centre (**IFSC**) in India having a limited liability structure. However, entities with its core activities in strategic sectors such as energy, and natural resources, or startups, need not have a limited liability structure to be eligible to receive Overseas Investments.

The foreign entities must also be engaged, directly or indirectly, in a 'bonafide business activity', i.e., a business activity permissible as per the laws of India and the host jurisdiction, either by itself or through a subsidiary or a special purpose vehicle.

Monetary limits on Overseas Investments

Indian Entities may make Financial Commitments subject to an overall cap of 400% of their net worth in all foreign entities combined, whereas the overall cap for OPI is 50% of the Indian Entity's net worth.

Resident individuals may make ODI by way of investment in equity capital, or OPI subject to the overall limit under RBI's Liberalised Remittance Scheme, which limit is currently set at USD 250,000 per year.

The individual limits for investments by mutual funds, VCFs and AIFs shall be as prescribed by the Securities and Exchange Board of India (**SEBI**). The aggregate limit for all such investment shall be prescribed by RBI.





Overseas Investment by Indian Entities

Indian Entities may make ODI by way of: (a) subscription or purchase of equity capital; (b) acquisition through bidding or tender processes; (c) acquisition by way of rights issue or bonus shares; (d) capitalisation of permitted amounts due to the Indian Entity; (e) swap of securities; or (f) through any schemes of arrangement.

Listed Indian Entities may make OPI, including by way of reinvestment, and unlisted Indian Entities may only make OPI by way of actions mentioned under points (c), (d), (e) and (f) of the preceding paragraph.

Indian Entities may also lend, invest in debt instruments, or extend non-fund-based commitment to or on behalf of foreign entities in which the Indian Entity has made ODI and has control, subject to the following:

- (a) Lending or investments in debt instruments by Indian Entities should be pursuant to a loan agreement where the rate of interest should be charged at an arms' length basis;
- (b) An Indian Entity, or its group company (holding company, subsidiary company, or promoter group company) may issue guarantees to or on behalf of a foreign entity or its step-down subsidiary in which the Indian Entity exercises control. The resident individual promoter of the Indian Entity may also issue personal guarantees to or on behalf of such foreign entities. Foreign entities mentioned under this paragraph may also obtain bank guarantees from banks in India which are backed by the Indian Entity or its group company; and
- (c) An Indian Entity may pledge the equity capital held by it in a foreign entity, or create charges on its assets for the purposes of availing or securing fund based or non-fund-based facilities for the foreign entity in which it has made ODI, or other entities as has been prescribed.

Overseas Investment by resident individuals

Resident individuals may make ODI by way of investment in equity capital in operating foreign entities that are not engaged in financial services activity, and which do not have subsidiaries where the resident individual is exercising control. However, the above restrictions on making ODI will not apply if the acquisition is by way of inheritance, sweat equity shares, minimum qualification shares or acquisition of shares under ESOP or EBS. Resident individuals may also make OPI, including by way of reinvestment.

Resident individuals may also acquire foreign securities from persons resident in India without any limit by way of inheritance, or by way of gifts from relatives. Foreign securities may be acquired by resident individuals from persons resident outside India as per the Foreign Contribution (Regulation) Act, 2010.

Restricted sectors for ODI and Round Tripping

ODI may not be made in foreign entities that are engaged in real estate activity, gambling, or dealing with financial products linked to Indian rupee.

The New Laws also address the making of investments in a foreign entity which has direct or indirect investments in India (**Round Tripping**). Under the erstwhile framework, Round Tripping was not allowed except with prior approval of RBI. However, the norms for Round Tripping have been liberalized and such investments are now allowed without RBI approval, if the investment does not result in a structure where there exist more than 2 subsidiaries of the foreign entity.

Specific guidelines for certain categories of Overseas Investments

Investments in startups

Startups have been classified as a strategic sector under the new framework. Accordingly, startup entities need not have a limited liability structure for receiving Overseas Investments. Further, ODI in a startup may be made out of the internal accruals of the Indian Entity or its group or associate companies, without use of any borrowed funds. The foreign entity should be recognised as a startup under the laws of the host country.

Investments in entities engaged in financial services activity

Under the erstwhile framework, only entities engaged in financial services were permitted to invest in foreign entities engaged in financial services. Pursuant to introduction of the New Laws, Indian Entities not engaged in financial services may also make ODI in entities engaged in financial services (except in banking and insurance sector). The Indian Entity should have posted net profits in the previous 3 financial years, and approval should have been obtained from the regulators in India and abroad. Further, Indian Entities not engaged in the insurance sector may also make ODI in general and health insurance businesses, if such investment supports the core activity of the Indian Entity.

Investments by wilful defaulters and like persons

Persons resident in India must obtain a no objection certificate (**NOC**) from the concerned bank, lender or investigative authority prior to making any Financial Commitment or undertaking disinvestment under the New Laws, if such persons: (a) have an account declared as a non-performing asset; (b) are classified as wilful defaulter by a bank; or (c) are under investigation by a financial services regulator or an investigative agency in India, such as the Directorate of Enforcement. In the event the concerned lending or investigative agency does not furnish the NOC within 60 days from the receipt of an application, it will be presumed that the entity has no objection to the transaction.



Transfer or Liquidation

Persons resident in India may transfer foreign equity capital by way of a sale to a person resident in India as per the provisions of the New Laws, or to any person resident outside India.

Additionally, the OI Rules prescribe a lock-in period of 1 year during which foreign securities acquired by way of ODI may not be transferred by the Indian Entity. Further, in the event of a full disinvestment, the transferor should not have any outstanding dues from the foreign entity as an investor.

Restructuring and write off

The new framework has simplified the process of writing off by allowing the restructuring of the balance sheet of the foreign entity if it has incurred losses in the previous 2 years. The decrease in the value of outstanding dues payable to the Indian investor should not be disproportionate to the accumulated losses of the foreign entity.

D. MISCELLANEOUS TERMS

Pricing guidelines

Overseas Investments must be made at prices that are arrived at, on an arm's length basis i.e., every transaction should be conducted in a manner as if the parties involved are unrelated. The authorised dealer bank (**AD Bank**) must ensure compliance with the pricing for all transactions and may consider the valuation of the shares arrived at as per internationally accepted methods.

Permitting deferred payments

The New Laws permit the making of deferred payment in case of subscription by a person resident in India of foreign securities, or transfer of equity capital between a person resident in India and a person resident outside India, subject to the following conditions:

- (a) the deferment of payment must be for a definite period;
- (b) the seller must transfer the foreign securities to the buyer upfront; and
- (c) the full consideration paid must be in line with the applicable pricing guidelines.

Compliance and reporting obligations

Persons resident in India must comply with the reporting obligations prescribed under the Master Direction – Reporting under Foreign Exchange Management Act, 1999, while making Overseas Investments. In particular, persons resident in India must do the following at the time of making ODI, or making Financial Commitment or undertaking disinvestment:

- (a) Form FC to be submitted to the AD Bank for obtaining a Unique Identification Number (**UIN**) prior to or on sending outward remittance;
- (b) Submit to the AD Bank, share certificates or any other relevant documents as evidence of investment within 6 months from the date of effecting remittance;
- (c) Submit an Annual Performance Report in Form APR by 31 December of every year;
- (d) Submit an Annual Return on Foreign Liabilities and Assets every year (only Indian Entities);
- (e) Submit to the AD Bank, details of any restructuring, within 30 days of such restructuring; and
- (f) Submit to the AD Bank, details of any disinvestment within 30 days of receipt of proceeds.

Further, persons resident in India (other than a resident individual) making or transferring OPI by way of sale, are required to report the same within 60 days from the end of the half year in which such investment or transfer is made.

Delays in reporting will attract a late submission fee to be paid through the designated AD Bank within 3 years from the delay. It is to be noted that any delay in reporting even under the previous framework may be



regularized within 3 years from 22 August 2022. No further Financial Commitment can be made unless any existing reporting delays are regularized.

E. CONCLUSION

The New Laws have liberalized and attempted to simplify the existing overseas investment framework. Investors in India seeking to make investment outside will now benefit from expedited timelines to close overseas investment resulting in reduced costs and transaction certainty. This is expected to provide global business opportunities to investors in India and promote ease of doing business.

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