



## OVERSEAS DIRECT INVESTMENT BY INDIAN ENTITIES – REVISED REGULATORY FRAMEWORK

The Foreign Exchange Management (Overseas Investment) Rules, 2022 and The Foreign Exchange Management (Overseas Investment) Regulations, 2022, were issued on 22<sup>nd</sup> August 2022. There will be a natural question as to the purpose of these Rules and Regulations. Both will, inter alia, apply when an Indian Entity or Resident Individual propose to make any investment in the share capital by subscribing equity shares or to any other instruments convertible into equity shares (non-debt instruments) of any Foreign Entity. In short, if an entity or an individual resident in India would like to make investment in the capital of a foreign entity, it is necessary to ensure that the requirements stipulated under the aforementioned Rules and Regulations are complied with.

### [The Overseas Investment Rules and Regulations](#)

The Overseas Investment Rules are issued by the Ministry of Finance, Government of India and they are administered by Reserve Bank of India (RBI). They are the main Rules. These Rules define the expressions such as Indian Entity, Resident Individual, Foreign Entity, Financial Commitment, Debt Instruments and Non-Debt Instruments. Most importantly these Rules state what is meant by Overseas Investment, in the first place.

On the other hand, the Overseas Investment Regulations issued by RBI takes care of important aspects such as the mode of payment, deferred payment of consideration, reporting, realisation, and other requirements for any investment outside India by a person resident in India.

Let us take the case of a company incorporated in India (Indian Entity) that proposes to establish a wholly owned subsidiary (WOS) in a foreign jurisdiction. The WOS will be essentially a Foreign Entity (an entity formed or registered or incorporated outside India). Questions such as where, when and for what objects are business considerations. In some cases, the Indian Entity may want a local partner and therefore the Foreign Entity will not be a WOS. These Rules and Regulations do not specify that the stake of the Indian Entity should be 100% or any other minimum threshold. These are matters falling under the topic of business considerations and therefore they are left to the wisdom of the investing Indian Entity to take appropriate commercial decisions.



## Types of Indian Entities

An Indian Entity may be (i) a company defined under the Companies Act, 2013; (ii) a body corporate incorporated by any law for the time being in force; (iii) a Limited Liability Partnership duly formed and incorporated under the Limited Liability Partnership Act, 2008; and (iv) a partnership firm registered under the Indian Partnership Act, 1932.

## Business Activity of the Foreign Entity

The first thing the Indian Entity must look at is the business activity that the Foreign Entity is engaged in or proposes to engage in. Overseas Investment is not permitted in a foreign entity engaged in (a) real estate activity; (buying and selling of real estate or trading in Transferable Development Rights but does not include the development of townships, construction of residential or commercial premises, roads or bridges for selling or leasing); (b) gambling in any form; and (c) dealing with financial products linked to the Indian rupee without specific approval of the Reserve Bank.

The Foreign Entity must be engaged in a “bonafide business activity”, directly or through step down subsidiary or the special-purpose vehicle. “bonafide business activity” shall mean any business activity permissible under any law in force in India and the host country or host jurisdiction, as the case may be. Since the conjunction “and” is used, in our plain understanding the business must be lawful in India as well as in the other country. For example, in India, if any business activity is prohibited (unlawful), even if the carrying on of such business activity is lawful in the other country, the Overseas Investment for such business activity cannot be termed as “bonafide business activity”.

## Maximum extent of Financial Commitment

The next question that would ordinarily arise is what is maximum extent up to which the Overseas Investment could be made. An Indian Entity may undertake investment in fund based and non-fund-based forms too. This is known as Financial Commitment. The total Financial Commitment made by an Indian entity in all the foreign entities taken together at the time of undertaking such commitment shall not exceed 400% of its net worth as on the date of the last audited balance sheet.

## Net worth

For this purpose, the net worth of the Indian Entity shall be computed within the meaning of “net worth” as per Section 2(57) of the Companies Act, 2013. Accordingly, “net worth” means the aggregate value of the paid-up share capital and all reserves created out of the profits, securities premium account and debit or credit balance of profit and loss account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

Where the investing Indian Entity is a registered partnership firm or Limited Liability Partnership, net worth of such firm shall be the sum of the capital contribution of partners and undistributed profits of the partners after deducting therefrom the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the last audited balance sheet.



## Procedure for exceeding the ceiling on Financial Commitment

The next question will naturally be whether there is any possibility of the Indian Entity making an Overseas investment beyond this threshold. These Rules clarify that (i) the Central Government may, on an application made to it through the Reserve Bank, permit financial commitment in strategic sectors or geographies, above the limits laid down in these rules and subject to such terms and conditions as it considers necessary; and (ii) the Reserve Bank may, on an application made to it through the designated AD bank and for sufficient reasons, permit a person resident in India to make or transfer any investment or financial commitment outside India subject to such conditions as may be laid down by it.

## ODI, OPI and OI

ODI is slightly different from Overseas Investment. ODI means investment by way of acquisition of unlisted equity capital of a foreign entity, or subscription as a part of the memorandum of association of a foreign entity, or investment in ten per cent, or more of the paid-up equity capital of a listed foreign entity or investment with control where investment is less than 10% of the paid-up equity capital of a listed foreign entity. The term Overseas Investment (OI) includes financial commitment and Overseas Portfolio Investment (OPI) also.

“OPI” means investment, other than ODI, in foreign securities, but not in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC. Since we are going to confine our discussion in this newsletter to ODI only, we shall touch upon OPI in another occasion.

## Various Forms of Financial Commitment

Under the Overseas Investment Regulations, undertaking Financial Commitment by an Indian Entity in debt instruments issued by a Foreign Entity, Financial Commitment by way of Guarantee and Financial Commitment by way of pledge or charge are also discussed. Finer aspects of Financial Commitments could be discussed on a case-to-case basis for specific client needs. Once the Indian Entity has decided to make an ODI and has arrived at the Financial Commitment it is required to undertake, the next question would be the mode of payment.

## Mode of Remittance

A person resident in India (this term includes an Indian Entity as well as any resident individual, who is a natural person) making Overseas Investment may make payment – (i) by remittance made through banking channels; (ii) from funds held in an account maintained in accordance with the provisions of the Act; (iii) by swap of securities; (iv) by using the proceeds of American Depository Receipts or Global Depository Receipts or stock-swap of such receipts or external commercial borrowings raised in accordance with the provisions of the Act and the rules and regulations made thereunder for making ODI or financial commitment by way of debt by an Indian entity.

## Foreign Entity in Financial Services Sector

An Indian entity not engaged in financial services activity in India may make ODI in a Foreign Entity, which is directly or indirectly engaged in financial services activity, except banking or insurance, subject to the condition that such Indian entity has posted net profits during the preceding three financial years. Provided that an Indian entity not engaged in the insurance sector may make ODI



in general and health insurance where such insurance business is supporting the core activity undertaken overseas by such an Indian entity. A Foreign Entity shall be considered to be engaged in the business of financial services activity if it undertakes an activity, which if carried out by an entity in India, requires registration with or is regulated by a financial sector regulator in India.

### Indian Entity in Financial Services Sector

An Indian Entity engaged in financial services activity in India may make ODI in a Foreign Entity, which is directly or indirectly engaged in financial services activity, subject to the following conditions, namely: (i) the Indian entity has posted net profits during the preceding three financial years; (ii) the Indian entity is registered with or regulated by a financial services regulator in India; (iii) the Indian entity has obtained approval as may be required from the regulators of such financial services activity, both in India and the host country or host jurisdiction, as the case may be, for engaging in such financial services.

### Regulatory Obligations and Reporting Requirements:

The Indian Entity making ODI shall ensure the following:

- Through its designated AD bank, the Indian Entity shall obtain a Unique Identification Number (UIN) from RBI. For each Foreign Entity in which the ODI is intended to be made, UIN should be separately obtained and UIN should be obtained before sending outward remittance or acquisition of equity capital in the Foreign Entity, whichever is earlier.
- It is required to report through its AD the financial commitment at the time of sending outward remittance or making a financial commitment, whichever is earlier.
- The Indian Entity is liable to route all transactions relating to a particular UIN only through the same AD. If more than one Indian Entity or other person resident in India intend to make jointly ODI in the same Foreign Entity, all such persons shall route all transactions relating to that UIN through the AD bank designated for that UIN.
- It should submit to the AD bank share certificates or any other relevant documents as per the applicable laws of the host country or the host jurisdiction, as the case may be, as evidence of such investment in the foreign entity within 6 months from the date of effecting remittance or the date on which the dues to such person are capitalised or the date on which the amount due was allowed to be capitalised, as the case may be.
- Further, the Indian Entity shall submit an Annual Performance Report (APR) with respect to each Foreign Entity every year by 31st December and where the accounting year of such foreign entity ends on 31st December, the APR shall be submitted by 31<sup>st</sup> December of the next year:
- Where more than one Indian Entity or any other person resident in India have made ODI in the same Foreign Entity, the person holding the highest stake in the foreign entity shall be required to submit APR and in case of holdings being equal, APR may be filed jointly by such persons.
- It should submit an Annual Return on Foreign Liabilities and Assets within such time as may be decided by the Reserve Bank from time to time, to the Department of Statistics and Information Management, Reserve Bank of India.



Certain Words and Expressions:

The word "person" includes - (i) an individual; (ii) a Hindu undivided family; (iii) a company; (iv) a firm; (v) an association of persons or a body of individuals, whether incorporated or not; (vi) every artificial juridical person, not falling within any of the preceding sub-clauses; and (vii) any agency, office or branch owned or controlled by such person.

The word "person resident in India" means –

(i) a person residing in India for more than 180 days during the course of the preceding financial year but does not include –

(A) a person who has gone out of India or who stays outside India, in either case, (a) for or on taking up employment outside India, or (b) for carrying on outside India a business or vocation outside India, or (c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;

(B) a person who has come to or stays in India, in either case, otherwise than - (a) for or on taking up employment in India, or (b) for carrying on in India a business or vocation in India, or (c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;

(ii) any person or body corporate registered or incorporated in India;

(iii) an office, branch or agency in India owned or controlled by a person resident outside India;

(iv) an office, branch or agency outside India owned or controlled by a person resident in India.

More to come!

In another occasion, we shall bring more information on the following:

- (a) Resident Individuals making Overseas Investment and buying immovable property outside India;
- (b) Layers of Subsidiaries;
- (c) Making Financial Commitment in Foreign Entities engaged in Financial Sector;
- (d) Transfer of holdings and winding up Foreign Entity where Overseas Investment has been made.
- (e) ODI in start-ups recognized under the laws of the host country or host jurisdiction as the case may be.

#####

CENTRAL OFFICE

BRANCH OFFICE

BRANCH OFFICE

#7C, Mayflower Signature,  
#365/13, Peelamedu,  
Avinashi Road, Coimbatore - 641004.  
Tel No: - (0422)2302868, 4982868  
Email: [info@ksrandco.in](mailto:info@ksrandco.in)  
Linked in: [gene@ksrandco.in](https://www.linkedin.com/company/ksrandco)

Flat No.1, 26/27, Venkatesham Flat,  
Gopal Street,  
T-Nagar,  
Chennai – 600 017.  
Tel No: - (044)24337620,  
Email: [chennai@ksrandco.in](mailto:chennai@ksrandco.in)

S-311, 3<sup>rd</sup> Floor, South Block,  
Manipal Centre,  
No.47, Dickenson Road.  
Bangalore – 560042,  
Tel No: - 9901400995  
Email: [bangalore@ksrandco.in](mailto:bangalore@ksrandco.in)