Overseas Direct Investments

A Deep Dive

ICAI SIRC

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Scope of today's discussion

- Restricting to Overseas Direct Investments – Not covering OPI
  - Investment in unlisted equity, unlisted debt and non-fund based obligations
  - Investment in listed equity more than 10% of the paid up capital of the foreign entity
  - Not covering ESOPs and Sweat Equity since these are largely in the domain of OPI
- Assumes a basic understanding of Overseas Investments and related terms/concepts
- Covers investment by Resident Individuals and Indian Entities

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Introduction

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Applicable regulations

- Overseas Investment Rules, 2022
- Overseas Investment Regulations, 2022
- Overseas Investment Directions, 2022

Notified on Aug 22, 2022

What is control?

- Right to appoint majority of directors
- Right to control management or policy decisions
- 10% or more voting rights

How to evidence control?

- If IE/RI holds more than 51% stake in FE, deemed to have control of FE
- If IE/RI holds less than 10% stake in FE, deemed to have no control in FE
- If IE holds more than 10%, but less than 51% stake in FE, evidence control or no control by scrutinizing subscription agreement, shareholder agreement, or voting agreements

Effect of Control

Investor	Parameter	With Control	Without Control
Indian Entity	Type of financial commitment	Equity Loan Guarantees	Equity
	APR based on	Audited financials	Unaudited financials
	Step Down Subsidiary	Permitted in India or abroad (up to two levels)	Permitted in India or abroad (up to any level)
Resident Individual	Type of financial commitment	Equity	Equity
	APR based on	Audited financials	Unaudited financials
	Step Down Subsidiary	Not permitted	Permitted in India or abroad (up to any level

Investment limits

Investor	FC
Indian Entity	Overall Financial Commitment (Equity + Debt + Non-funded) should not exceed 400% of the net worth of the IE as per the last audited balance sheet
Resident Indian	As per the overall limits of the Liberalized Remittance Scheme - currently USD 250,000 per Financial Year, per individual

Overall Financial Commitment

Cumulative INR value of

a. Equity invested; PLUS
b. Loan advanced; PLUS
c. Bank Guarantee/SBLC issued; PLUS
d. Corporate guarantees issued on behalf of the FE; PLUS
e. Personal guarantees issued by resident promoters of the IE, on behalf of the FE; PLUS
f. Pledge of shares of FE or SDS (value of pledge); PLUS
g. Mortgage of assets of IE in India or assets of FE outside India

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How to determine the INR value?

- Total Financial Commitment in USD as on 30 Apr 2025: USD 28,800,000
- USD/INR on 30 Apr 2025: 85.60
- INR value = Rs.246,52,80,000

Date	Type of investment	Currency	Amount	Exchange rate	INR value
07-Dec-17	Equity	USD	10,00,000	64.5388	6,45,38,800
21-Dec-17	Equity	USD	6,00,000	64.0883	3,84,52,980
12-Mar-18	Loan	USD	2,50,000	65.0199	1,62,54,975
27-Mar-18	Guarantee	USD	15,00,000	64.7973	9,71,95,950
20-Sep-18	Guarantee	USD	15,00,000	72.6781	10,90,17,150
28-Jan-19	Loan	USD	3,00,000	71.1340	2,13,40,200
23-Feb-19	Guarantee	USD	15,00,000	71.2177	10,68,26,550
31-Aug-19	Guarantee	USD	22,00,000	71.7586	15,78,68,920
01-Sep-19	Guarantee	USD	15,00,000	71.7586	10,76,37,900
16-Dec-19	Guarantee	USD	25,00,000	70.9410	17,73,52,500
22-Jul-24	Equity	USD	5,00,000	83.6654	4,18,32,700
29-Nov-24	Equity	USD	7,00,000	84.4971	5,91,47,970
06-Feb-25	Equity	USD	5,00,000	87.5617	4,37,80,850
25-Mar-25	Guarantee	USD	39,50,000	85.7302	33,86,34,290
30-Apr-25	Guarantee	USD	1,03,00,000	85.6000	88,16,80,000
	Total		**2,88,00,000**		**2,26,15,61,735**

Networth as on 31/03/2024 = Rs.60,65,00,000

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Net Worth

For companies

Paid up capital + Free reserves + Securities Premium – accumulated losses – deferred expenses – miscellaneous expenses not written off

For LLP/registered partnerships

Capital contribution by partners + undistributed profits – accumulated losses – deferred expenses – miscellaneous expenses not written off

FC by RI and IE

Resident Individual

- Investment limit subsumed under the LRS limit (currently USD 250,000 per FY)
- Financial Commitment can only be by way of equity; debt and non-funded exposure not permitted
- RI can only invest in operating entity abroad; FEs, in which Resident individuals are shareholders with control, cannot create Step Down Subsidiaries (either in India or abroad)

Indian Entity

- Investment limit fixed at 400% of Net Worth as per last audited financials
- Financial Commitment can be by way of equity, debt or non-funded exposure
- Investment by IE can be either in operating entity or in SPV; FE can create SDS either abroad or in India (subject to conditions)

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Receivables from Foreign Entity

- Realise and repatriate all receivables from the Foreign Entity to the Indian Entity/Resident Individual
  - Interest on loans
  - Loan instalments
  - Dividend on equity
  - Service charges
  - Any other non-trade income
- Repatriation to be done within 90 days from the date on which receivable falls due

ODI-FDI structures

Erstwhile regulations

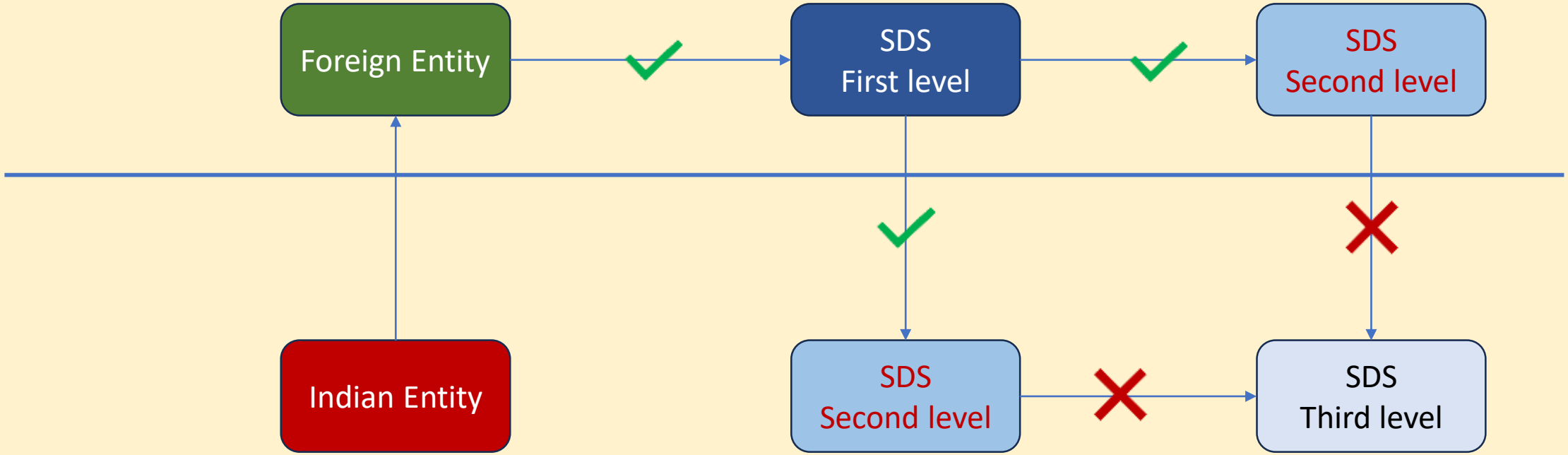
- An overseas entity, in which an Indian Party holds equity investment, cannot create a Step Down Subsidiary in India under the automatic route
- An Indian Party cannot acquire an overseas entity, which has an existing subsidiary in India, under the automatic route

ODI-FDI structures

Current rules

- Permits IE to do overseas investment in FE with SDS in India, subject to the condition that the structure does not result in more than two layers of subsidiaries
- Investment by Resident Individuals should continue to be in operating entities outside India, with no subsidiary or SDS for the FE

ODI-FDI structure



Non-compliance in reporting

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Issuing Stat Auditor Certificate

Form FC – Section E

"We have verified the records and certify that no delay in reporting is pending for regularization as required under Regulation 12 of Foreign Exchange Management (Overseas Investment) Regulations, 2022."

Regulation 12

"A person resident in India who has made a financial commitment in a foreign entity in accordance with the Act or rules or regulations made thereunder, shall not make any further financial commitment, whether fund-based or non-fund-based, directly or indirectly, towards such foreign entity or transfer such investment till any delay in reporting is regularised."

Due dates for reporting

Event/Report	Due date
Incorporation of a FE	Date of incorporation as per MOA or COI
Equity infused/ Loan advanced into FE	Date of outward remittance
Bank Guarantee/SBLC issued on behalf of FE	Issuance date of BG/SBLC
CG/PG issued on behalf of FE	Date of issue of CG/PG as per guarantee document
Conversion of loan to equity in FE	Date of conversion
Restructuring of financials of FE	30 days from date of restructuring
Disinvestment	30 days from date of inward remittance
Setting up of a Step Down Subsidiary	Due date for APR for the year
Inclusion of a JV partner/change in shareholding pattern of FE	Due date for APR for the year
Submission of share certificates	6 months from remittance date

Regulation 11 of FEMA 400

- Reporting delays for transactions done after 22 Aug 2022
  - Delay up to three years: To be regularized by way of Late Submission Fee
  - Delay beyond three years: To be regularized by way of compounding
- Reporting delays for transactions done prior to 22 Aug 2022
  - Till three years from notification date (i.e., till 22 Aug 2025): To be regularized by way of Late Submission Fee
  - Beyond 22 Aug 2025: To be regularized by way of compounding

Remember!!!

- Regularization is not just completing the reporting activity. Regularization requires payment of Late Submission Fee for the delayed reporting.
- Even if the reporting activity was completed late prior to 22 Aug 2022, the Late Submission Fee for such delayed reporting is to be paid before 22 Aug 2025; else, future transactions will not be permitted.

Case 1

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Contraventions

- Applicable regulation: FEMA 120
- Contraventions observed
  1. Investment by way of capitalization of receivables is not permitted for a Resident Individual – Contravention of Regulation 5(1)
  2. Retention of receivables in the Foreign Entity, without repatriating the same to India, is to be considered as loan being extended to the Foreign Entity by the RI, which is prohibited – Contravention of Para A(8) of Schedule V read with Regulation 20A
  3. RI has not complied with the obligations placed on Indian investors, by not filing the APRs – Contravention of Regulation 15(iii) read with Para D(3) of Schedule V read with Regulation 20A

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How to generate UIN for this case?

- Shares have been acquired by way of capitalization, which is a non-permitted mode of investment
- Approval from RBI needed to regularize
- Form FC under approval route to be filed with supporting documents
    1. Copy of MT103 for initial remittance of CAD 1,695
    2. Confirmation from C Bank Ltd, regarding the purpose code used for the remittance
    3. Invoice of overseas consultant
    4. Share certificate in the name of RI
- Post approval from RBI, UIN can be generated for the Foreign Entity

How we handled

1. Form FC under approval route prepared and filed
2. RBI approval received for transaction to be considered as investment by way of deferred payment (which was prohibited under FEMA 120), instead of approving capitalization of receivable
3. Existing shares issued to RI by FE, to be considered as ‘unpaid’
4. UIN generated under approval route
5. Entire receivables of CAD 1,695 repatriated to RI’s account in India
6. Outward remittance of CAD 10 done as ‘deferred payment of share capital’
7. APRs filed for periods starting from 2019 till date
8. LSF paid for
    1. Delay in reporting financial commitment
    2. Delay in filing APRs
9. Compounding application being filed for contraventions

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Case 2

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Contraventions

- Applicable regulation: FEMA 120
- Investment done by Resident Individual after change of Residential Status has to be considered as NR investment in Foreign Entity
- Change in shareholding pattern to be reported within 30 days from the date of such change
- Contraventions
  1. Delay in reporting post-investment change in shareholding pattern of Foreign Entity – Regulation 13 of FEMA 120
  2. Delay in filing of APR – Regulation 15(iii) of FEMA 120; Regulation 10(4) of FEMA 400

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Reporting obligations

- For individual investor
  - No obligation to report investment done in the Foreign Entity as a Non-Resident, made out of sources outside India
- For Indian Entity
  - **Under FEMA 120:** Post-investment changes in shareholding pattern of the Foreign Entity to be reported 'within 30 days of the approval' of such changes by the competent authority in the host country
  - **Under OI Rules:** Post investment change in shareholding pattern of the Foreign Entity to be reported in Annual Performance Report being filed by 31st December

How we handled

- Reconciled shareholding pattern to reflect pre and post investment position for each allotment date, and position at end of each Financial Year of the FE
- Classified investment of MYR 500 invested by Mr J as non-resident investment in the FE and prepared the reporting
  - **Challenges:** OID system does not permit AD to classify the same investor as Resident and Non-Resident. Had to work with RBI OI Division to make the changes from the back end
- LSF paid for delay in reporting change in shareholding pattern
- APR filed for 2022, 2023 and 2024, and LSF paid for the same

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Case 3

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Contraventions observed

- Applicable regulations: Overseas Investment Rules, 2022 and associated Regulations and Directions
- Contraventions
  - Delay in reporting financial commitment by way of non-fund based obligation – Regulation 10(2) of FEMA 400, Para 10(2) of AP (DIR Series) Circular No. 12 dated Aug 22, 2022

Investment by deferred payment

- Under OI Rules, 2022 Indian investors are permitted to invest in foreign entities, and accept shares against the same, by deferring the payment of capital for such time as mutually agreed
- Liberalisation of provisions compared to FEMA 120, under which, investment by deferred payment was not permitted
- Subscription to MOA, where share capital is not remitted upfront, is to be treated as investment by deferred payment

Treatment of subscription to MOA

Under FEMA 120	Under OI Rules, 2022
Subscription to MOA and incorporation of FE did not trigger any reporting requirement	Subscription to MOA considered as incurring financial commitment at the time of executing the MOA or issuance of Certificate of Incorporation
IE needs to wait for bank account of FE to be opened for making outward remittance	Since remittance not done upfront, this is to be considered as 'Acquisition by way of deferred payment'
Reporting obligation triggered only at the time of effecting outward remittance for capital infusion	To be reported in Form FC as a 'non-funded obligation' with due date as date of MOA/COI

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How we handled

- Indian Entity needs to receive shares for the subscription to MOA, upfront
- A deferred payment agreement to be in place between the IE and FE, capturing the period for which the payment of share capital can be deferred
- Form FC – Section A to E filed with mode of investment as ‘deferred payment’ to record subscription to MOA, and requesting for generation of UIN
- LSF paid for delay in reporting of financial commitment
- APR filed for 2022, 2023 and 2024; LSF paid for the delayed filing
- Form FC – Section B and C filed with mode of investment as ‘equity capital’ through Banking channel
- Outward remittance done for infusion of equity in the Foreign Entity

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Case 4

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Contraventions

- Applicable regulations: OI Rules, 2022 and associated Regulations and Directions
- Contraventions
  - Delay in reporting disinvestment beyond 30 days from the date of disinvestment
  - Delay in reporting Financial Commitment beyond the due date
  - Mode of investment not under automatic route

Value of new Financial Commitment

- Have argued that the value of new FC should be equivalent to the original investment done in the existing FE
- IE is getting 100% stake in the SDS, in lieu of 100% stake that it was holding in the direct subsidiary, which it had originally acquired for USD 10.50 Mn
- We have been asked about the swap ratio, but there is no swap agreement in place, since this has originated out of an insolvency protection application
- Currently under review by RBI

Reporting

- Two transactions to be reported
  1. Acquisition of 1.6 Mn shares of the Step Down Subsidiary by the Indian Entity, to make the SDS into a direct subsidiary – To be reported in Form FC – Section A to E, with due date for reporting as the same date of FC (Aug 2023)
  2. Closure of direct subsidiary in Sep 2024 – To be reported in Form FC – Section G, within 30 days from the disinvestment date

Valuation

- Our argument was that valuation is not needed, since the entire transaction is covered under a judicial process through the Courts in the host country
- However, a valuation report of the SDS was generated to understand the fair value of the asset that was acquired in Aug 2023. The valuation report put the fair value at USD 15.30 Mn
- RBI has now asked for a valuation report of the direct subsidiary which has been liquidated. We are engaging with the AD to understand as on which date the fair value is to be ascertained. Ideally, should be under NAV method.

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Q & A

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About the Trainer

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Thank you

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