

EY Regulatory Alert

Revised overseas investment guidelines

Regulatory Alerts cover significant Regulatory news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest regulatory issues. For more information, please contact your EY advisor.

Executive summary

The Government of India (GOI), in consultation with the Reserve Bank of India ('RBI'), has issued the Overseas Investments Rules and Regulations ('OI Guidelines') dated 22 August 2022 superseding the earlier framework of outbound investments in India governed by the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 ('FEMA 120') and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations 2015

In order to provide clarity, RBI has also issued Foreign Exchange Management (Overseas Investment) Directions, 2022 on 22 August 2022 ('OI Directions') giving effect to the above, in supersession of the erstwhile Master Directions on Direct Investment by Residents in Joint Venture ('JV') / Wholly Owned Subsidiary ('WOS') abroad

This Regulatory Alert summarizes the key changes brought vide the OI Guidelines and Directions.



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Background

- ▶ In a move to enhance the ease of doing business and to bring more clarity and transparency in undertaking Overseas Investments ('OI'), the GOI, in consultation with RBI has issued revised guidelines.
- ▶ The guidelines unfold a liberal architecture of self-regulation keeping in mind the evolving business needs in an increasingly integrated global market, thereby, aligning with the current business and economic dynamics.
- ▶ This alert highlights and summarizes the key changes brought in by the OI Guidelines read with OI Directions.

Key changes

- ▶ **New definitions:**

Foreign investee entity

The term Joint Venture ('JV') and Wholly owned subsidiary ('WOS') has been replaced by the term 'foreign entity' that is formed or registered or incorporated outside India".

It has been mentioned that such foreign entity should have 'limited liability' (viz, limited liability company, limited liability partnership, etc.) where the liability of the person resident in India is clear and limited. This restriction would not be applicable on entities with core activity in any strategic sector which includes energy and natural resources sectors such as oil, gas, coal, mineral ores, submarine cable system and start-ups and any other sector or sub-sector as deemed necessary by the Central Government.

Overseas Direct Investment and Overseas Portfolio Investment

- Overseas Direct Investment is now defined as follows :

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
- In case of a listed foreign entity:
 - Investment in ten per cent, or more of the paid-up equity capital of the listed foreign entity; or
 - Investment with control where investment is less than ten per cent of the paid-up equity capital of the listed foreign entity.

By redefining the ODI definition, an ODI in a foreign entity shall be continued to be treated as ODI even if such investment

falls below 10% of the paid-up equity capital or the investor loses control in the foreign entity.

- Further, Overseas Portfolio Investment ('OPI') is now defined as:

'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'.

Concept of control

Control has been defined to mean the right to appoint majority of the directors or control management or policy decisions exercisable by a person or persons acting 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 ten per cent or more of voting rights or in any other manner in the entity.

Bonafide business activity

'Bonafide business activity' has been defined to mean any business activity permissible under any law in force in India and the host country or host jurisdiction, as the case may be.

Replacing 'Indian Party' with 'Indian entity'

The extant concept of Indian party ('IP') where all the investors from India in a foreign entity were together considered as IP, has been substituted with the concept of Indian entity where each investor entity shall be separately considered as an Indian entity.

Alignment of definition of Net-Worth

The definition of 'Net-worth' has been aligned with clause (57) of section 2 of the Companies Act, 2013 which includes securities premium. Clarity has also been provided as to computation of Net-worth in respect of OI by registered partnership firms and LLP.

▶ **Round-tripping structures**

Person resident in India has now been permitted to invest in a foreign entity that has invested or invests into India, directly or indirectly, up to 2 layers of subsidiaries, without RBI approval.

▶ **Acquisition by way of gift**

- A resident individual has been permitted to gift foreign securities to his relative resident in India without RBI approval.
- A resident individual is permitted to receive foreign securities by way of gift from a person resident outside India, subject to compliance with the provisions of Foreign Contribution (Regulation) Act, 2010 ('FCRA').

▶ **Investments from Resident Foreign Currency Account ('RFC')**

A resident individual making investments from

RFC Account will not be subject to liberalized remittance scheme limit.

► **Emphasis towards control**

Subsidiary or step-down subsidiary ('SDS') of a foreign entity now means an entity in which the foreign entity has 'control'. Hence, the investee entities of the foreign entity where such foreign entity does not have control or stipulated voting rights shall not be treated as Subsidiary or SDSs and hence, reporting requirement does not trigger.

Such subsidiary/SDS shall also have limited liability where the foreign entity's core activity is not in strategic sector.

► **Financial commitment by Indian entity by way of debt.**

In terms of these guidelines, financial remittances towards loan to the foreign entity and/or in respect of the issuance of bank guarantee to/on behalf of the foreign entity is permitted only after ensuring that the Indian entity has made ODI and has control in the foreign entity.

Additionally, rate of interest should be charged at arm's length basis.

► **Requirement of No Objection Certificate ('NOC')**

Any person resident in India whose account is classified as non-performing assets, or as a wilful defaulter by any bank, or is under investigation by a financial service regulator or investigative agency, will have to obtain a NOC from the lender bank or regulatory body or investigative agency, before making any such financial commitment or undertaking disinvestment. By virtue of this, the requirement of seeking RBI approval where the entity is under investigation may no longer be required

► **Disallowing usage of borrowed funds in start-up**

Any ODI in foreign start-ups should be made only from internal accruals of the Indian entity and not from borrowed funds and a resident individual can only use his own funds.

► **Restructuring under automatic route**

A person resident in India who has made ODI in a foreign entity which has been incurring losses for 2 years, is now permitted to restructure its balance sheet without RBI approval.

► **Permissibility of Deferred Payment**

Deferred Payment option is now permissible for acquiring and transferring foreign securities without RBI approval.

► **Prohibition on ODI in foreign entity engaged in gambling**

A person resident in India is prohibited to make ODI in a foreign entity engaged in gambling business.

► **Transfer involving write off**

A person resident in India holding equity capital may transfer such investment involving write off under automatic route subject to certain conditions. It is clarified that, where the transferor is required to repatriate all the dues before disinvestment, such requirement shall not apply to the dues that do not arise on account of investment in equity or debt like export receivables, etc.

► **Opening new avenues for OI**

- International Financial Services Sector ('IFSC')

The definition of foreign entity now also includes IFSC. Further, an Indian entity not engaged in financial services activity in India, making ODI in a foreign entity, which is directly or indirectly engaged in financial services activity, except banking or insurance, and does not meet the net profit condition as required under these rules, may make ODI in an IFSC.

- Indian Entity engaged in non-financial sector permitted to make investment in Foreign Investee involved in Financial Services Sector

An Indian entity which is not engaged in financial services sector in India can now make ODI in a foreign entity engaged directly or indirectly in financial services activities, except banking or insurance.

► **Operational Changes**

- Form FC has now replaced Form ODI and a separate form, Form OPI has been introduced for a person resident in India other than a resident individual, making OPI
- Delay in reporting OI related compliances including Annual Performance Report shall now attract Late Submission Fees ('LSF') and unless it is not regularized, a person resident in India 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.

The option of LSF shall also be available for delayed reporting/submissions under the earlier regulations, up to three years from the date of notification of OI Regulations.

Comments

With the issuance of these guidelines, the regulator has simplified, streamlined, and liberalized the existing framework for OI to cover wider economic activities and significantly reduce the need for RBI approvals.

Permitting round-tripping structures and change in the net-worth definition may help not only in raising funds overseas but also increase the ability for Indian entities to invest. Additionally, it has opened new avenues by permitting non-financial entities to invest in foreign financial entities or the International Financial Services Centre.

However, further clarity is required in respect to what constitutes the two layer structure, the permissibility of OPI in unlisted foreign entities, and the applicability of liberalized remittance limits on various modes of OPI.

Our offices

Ahmedabad

22nd Floor, B Wing, Privilon,
Ambli BRT Road, Behind Iskcon Temple,
Off SG Highway,
Ahmedabad - 380 015
Tel: + 91 79 6608 3800

Bengaluru

6th, 12th & 13th floor
"UB City", Canberra Block
No.24 Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground Floor, 'A' wing

Divyasree Chambers
11, O'Shaughnessy Road
Langford Gardens
Bengaluru - 560 025
Tel: + 91 80 6727 5000

Chandigarh

Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A,
Industrial & Business Park, Phase-I,
Chandigarh - 160002
Tel: + 91 172 671 7800

Chennai

Tidel Park, 6th & 7th Floor
A Block, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR

Golf View Corporate Tower B
Sector 42, Sector Road
Gurgaon - 122 002
Tel: + 91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aeroicity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
NOIDA - 201 304
Gautam Budh Nagar, U.P.
Tel: + 91 120 671 7000

Hyderabad

THE SKYVIEW 10
18th Floor, "Zone A"
Survey No 83/1, Raidurgam
Hyderabad - 500032
Tel: + 91 40 6736 2000

Jamshedpur

1st Floor, Shantiniketan Building
Holding No. 1, SB Shop Area
Bistupur, Jamshedpur - 831 001
Tel: + 91 657 663 1000

Kochi

9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata

22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2

Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

Pune

C-401, 4th floor
Panchshil Tech Park
Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

Ernst & Young LLP

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