

# Basic Concepts of FEMA & Overseas Direct Investment – Part I

**BGSS & Associates**

Chartered Accountants

# Basic Concepts

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# FEMA Act – Substantive Provisions

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Section	Description
1	Application and Commencement of FEMA
2	Definitions
3 to 9	Provisions relating to Regulations and Management of Foreign Exchange
10 to 12	Provisions relating to Authorized Person
13 to 15	Provisions relating to Contraventions and Penalties
16 to 38	Provisions relating to Adjudication, Appeal and Directorate of Enforcement
39 to 49	Miscellaneous Provisions

# Applicable Regulatory Framework

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- Sections of FEMA
- Relevant Notifications
- Master Direction issued by RBI from time to time
- AP DIR Circulars issued by RBI from time to time
- FAQs issued by RBI

# Distinction between FEMA and Income tax law

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Particulars	FEMA	Income tax law
<b>Type of law</b>	Regulatory law	Tax law
<b>Interpretation</b>	More intent based than actual wordings of the provisions	More emphasis on wordings of provisions compared to intent
<b>Purpose of determining residential status</b>	To determine whether a particular transaction can be undertaken or not	To determine taxable income and consequentially tax liability for full year
<b>Point of determining residential status</b>	On particular date	Year end
<b>Purpose and intention of stay</b>	Relevant for determining residential status as compared to actual number of days	Mostly not relevant and actual number of days in India is determining factor

# Section 2(e) – Capital Account transaction

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**Condition 1** – Transaction which alters assets or liabilities including  
Contingent liabilities

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**Condition 2** – Outside India for person resident in India OR  
In India for persons resident outside India

## Specifically Includes following transactions specified in Section 6(3)

- transfer or issue of any foreign security by a person resident in India and person resident outside India;
- transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
- any borrowing or lending in foreign exchange;
- any borrowing or lending in rupees between a person resident in India and a person resident outside India;
- deposits between persons resident in India and persons resident outside India;
- export, import or holding of currency or currency notes;
- transfer of immovable property outside India, **other than a lease not exceeding five years**, by a person resident in India;
- acquisition or transfer of immovable property in India, **other than a lease not exceeding five years**, by a person resident outside India;
- giving of a guarantee or surety in respect of any debt, obligation or other liability incurred,—
  - (i) by a person resident in India and owed to a person resident outside India; or
  - (ii) by a person resident outside India.

# Section 6 – Capital Account transaction

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- **Section 6(1) – Subject to provisions of Section 6(2), person can withdraw or sell foreign exchange with regards to capital account transactions**
- Section 6(2) - With regards to capital account transaction, RBI can specify following:
  - Class or classes of capital account transactions which are permissible;
  - Limit up to which foreign exchange is permissible;
  - Conditions which should be imposed on such transactions
- RBI has notified Foreign Exchange Management (Permissible Capital Account Transactions) Regulations 2000 vide FEMA 1/2000-RB which covers capital account transactions
- FEMA 1/2000-RB specifies that capital account transaction can be undertaken only when its permitted under Act, Rules or Regulations. It specifies following Capital Account Transactions:
  - **Schedule I – By person resident in India:**
  - **Schedule II – By person resident outside India**

**General Principle – Capital Account Transaction are prohibited unless specifically permitted by RBI**

# Section 2(j) – Current Account transaction

## Condition 1 – Transaction other than Capital Account Transaction

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### Specifically Includes following transactions specified in Section 2(j)

- Payments due in connection with foreign trade, Short term banking and credit facilities.
- Payment due as interest on loan and income from investment.
- Remittances for living expenses of parent, spouse and children residing abroad.
- Expenses in connection with foreign travel, education and medical care of parents, spouse and children

- **Regulated by Section 5**
- Section 5 – Any person can enter into a current account transaction **provided RBI can impose reasonable restrictions** as may be prescribed
- Foreign Exchange Management (Current Account Transactions) Rules, 2000 prescribed which specified following:
  - Schedule I – Transactions which are prohibited;
  - Schedule II – Transactions which require prior approval of GOI;
  - Schedule III – Transactions which require prior approval of RBI;

**General Principle – Current Transaction are permissible unless specifically restricted by RBI**



# NRI – definition under FEMA

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- FEM (Borrowing & Lending in Rupees) Regulation, 2000
- FEM (Permissible Capital Account Transactions) Regulations, 2000
- FEM (Deposit) Regulations, 2016
- FEM (Remittance of Assets) Regulations, 2016
- FEM (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017
- FEM (Acquisition and Transfer of Immovable Property in India) Regulations, 2018

**NRI means**  
*“a person resident outside India  
who is a citizen of India”*

# PIO – definition under FEMA

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PIO as defined under:

- FEM (Deposit) Regulations, 2016
- FEM (Borrowing & Lending in Rupees) Regulation, 2000
- FEM (Remittance of Assets) Regulations, 2016

**PIO means a person resident outside India who is a citizen of any country other than Bangladesh or Pakistan, or such other country as may be specified by Central Government, satisfying following conditions:**

- a) Who was a citizen of India by virtue of Constitution of India or Citizenship Act, 1955 **OR**
- b) Who belonged to a territory that became part of India after 15 August, 1947 **OR**
- c) Who is a child or grandchild or a great grandchild of a citizen of India or of a person referred to in clause (a) or (b)
- d) Who is a spouse of foreign origin of a citizen of India **OR** spouse of foreign origin of a person referred to in clause (a) or (b) or (c)

**Explanation: for the purpose of this sub-regulation, the expression 'Person of Indian Origin' includes an 'Overseas Citizen of India' cardholder within the meaning of Section 7(A) of the Citizenship Act, 1955.**

# OCI – definition under FEMA

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## OCI as defined under:

- FEM (Deposit) Regulations, 2016
- FEM (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017
- FEM (Acquisition and Transfer of Immovable Property in India) Regulations, 2018

**OCI means a person resident outside India who is registered as an Overseas Citizen of India Cardholder under Section 7(A) of the Citizenship Act, 1955\***

\* Relevant extract given in Annexure 1

# Distinction between NRI, PIO and OCI

Particulars	NRI	PIO	OCI
<b>Definition</b>	NRI means a person resident outside India who is a citizen of India	PIO means a person resident outside India who is a citizen of any country (excluding Bangladesh, Pakistan) and fulfills any of following conditions: i) Was citizen of India as per Indian constitution or Citizenship Act; or ii) Belonged to territory which became part of India after 1947; or iii) Who is a child or grandchild or a great grandchild of a citizen of India or person referred above; iv) Who is a spouse of foreign origin of a citizen of India or person referred above;	OCI means a person resident outside India who is registered as an Overseas Citizen of India Cardholder under Section 7(A) of the Citizenship Act, 1955
<b>Citizenship</b>	Indian	Any country (excluding Bangladesh and Pakistan)	Any country (excluding Bangladesh and Pakistan)
<b>Includes</b>	None	Includes OCI card holder	Existing PIO cardholders are deemed to be OCI card holders but separate OCI card to be obtained

**Going forward, as PIO card is discontinued, only two categories would remain, NRI and OCI card holder**

# Overseas Direct Investment – Definitions

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# ODI – Applicable Regulatory Framework

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- **Meaning of ODI – Overseas Direct investment by Indian Resident**
- Section 6 of FEMA – Capital Account Transactions
- Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 [FEMA 120/2000-RB]
- Master Direction on Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad
- AP DIR Circulars issued by RBI from time to time
- FAQs issued by RBI

# Definition (1/3)

## Core Activity

An activity carried on by an Indian entity, turnover wherefrom constitutes not less than 50% of its total turnover in the previous accounting year.

## Direct investment outside India

An investment by way of

- contribution to the capital; or
- subscription to the Memorandum of Association of a foreign entity; or
- by way of purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange excluding *portfolio investment*
- **Portfolio investment not defined by RBI but following can be considered as its guiding principles:**
  - a) Not subscribing to the Memorandum of Association of the overseas entity;
  - b) Shall not have undertaken any other financial commitments in the overseas entity. For e.g. investment in preference shares, loan, guarantee, etc.;
  - c) Shares should be acquired in an existing entity and not be incorporated;
  - d) It should not be a wholly owned company / majority stake should not be with Indian entity;
  - e) Indian entity should be a passive investor;
  - f) Generally the portfolio investment should be in a listed entity.

# Definition (2/3)

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## Indian Party

- 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
- A Limited Liability Partnership (LLP); and
- Includes any other entity in India as may be notified by the Reserve Bank

## Joint Venture

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

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.



# Definition of Real Estate business (3/3)

Particulars	ODI Regulations	ECB Regulations	FDI Regulations
<b>Includes</b>	<ul style="list-style-type: none"> <li>• Buying and selling of real estate; or</li> <li>• Trading in TDRs</li> </ul>	<ul style="list-style-type: none"> <li>• Buying, selling and renting of commercial and residential properties or land;</li> <li>• <b>Activities either on a fee or contract basis assigning real estate agents for intermediating in buying, selling, letting or managing real estate.</b></li> </ul>	<ul style="list-style-type: none"> <li>• Dealing in land and immovable property with a view to earning profit.</li> </ul>
<b>Excludes</b>	<ul style="list-style-type: none"> <li>• Development of township;</li> <li>• Construction of residential/commercial premises, roads or bridges.</li> </ul>	<ul style="list-style-type: none"> <li>• Development of integrated township;</li> <li>• <b>purchase/ long term leasing of industrial land as part of new project/modernization; or</b></li> <li>• <b>expansion of existing units or any activity under 'infrastructure subsectors' as given in the Harmonised Master List of Infrastructure sub-sectors</b></li> </ul>	<ul style="list-style-type: none"> <li>• Development of townships;</li> <li>• construction of residential/commercial premises, roads or bridges, <b>educational institutions, recreational facilities, city and regional level infrastructure;</b></li> <li>• <b>Real estate broking services</b></li> <li>• <b>Earning of rent income on lease of the property</b></li> </ul>

# Meaning of Financial Commitment (1/2)

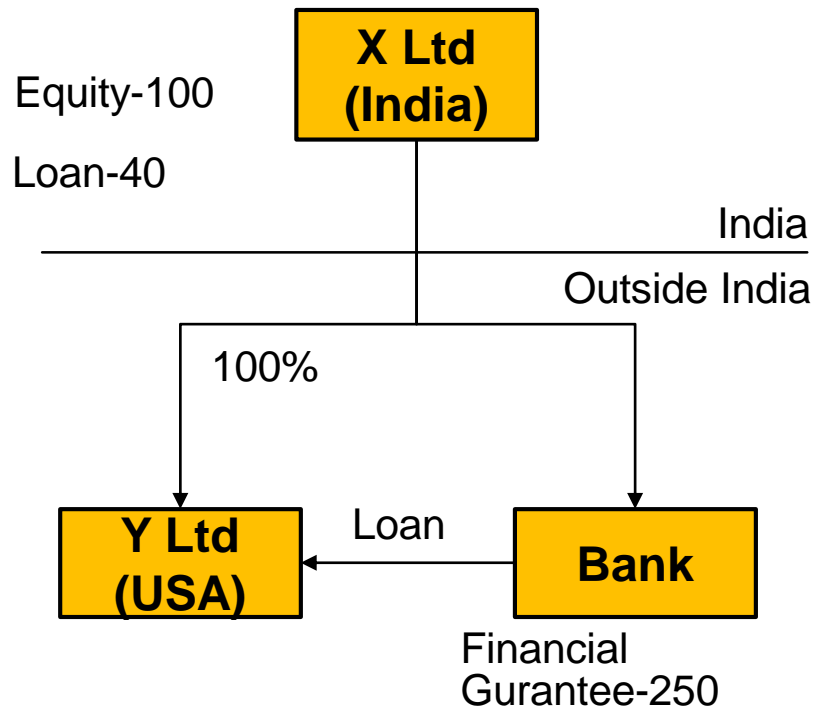
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Financial Commitment means the amount of direct investment issued by an Indian party *to or on behalf of* its overseas JV or WOS by way of contribution to :

- 100% amount of Equity shares and/ or CCPS;
- 100% amount of other preference shares;
- 100% amount of Loan;
- 100% amount of guarantee issued by Indian party
- 100% amount of bank guarantee issued by resident bank provided bank guarantee is backed by collateral by Indian party;
- 50% amount of performance guarantee

**Financial commitment in JV / WOS cannot exceed 400% of net worth of Indian investing entity**

# Financial Commitment-Calculation (2/2)



Y Ltd., a company incorporated in USA is a wholly owned subsidiary of X Ltd., an Indian company.

X Ltd.'s investment in Y Ltd are as under:

- Equity Contribution-Rs.100 cr
- Loan-Rs.40 cr
- Financial Guarantee of Rs.250 cr to a bank on behalf of Y Ltd.

What is the financial commitment?

$$\text{Financial Commitment of X Ltd: } 100(E)+40(L)+250(FG)=390$$

# Net worth (1/2)

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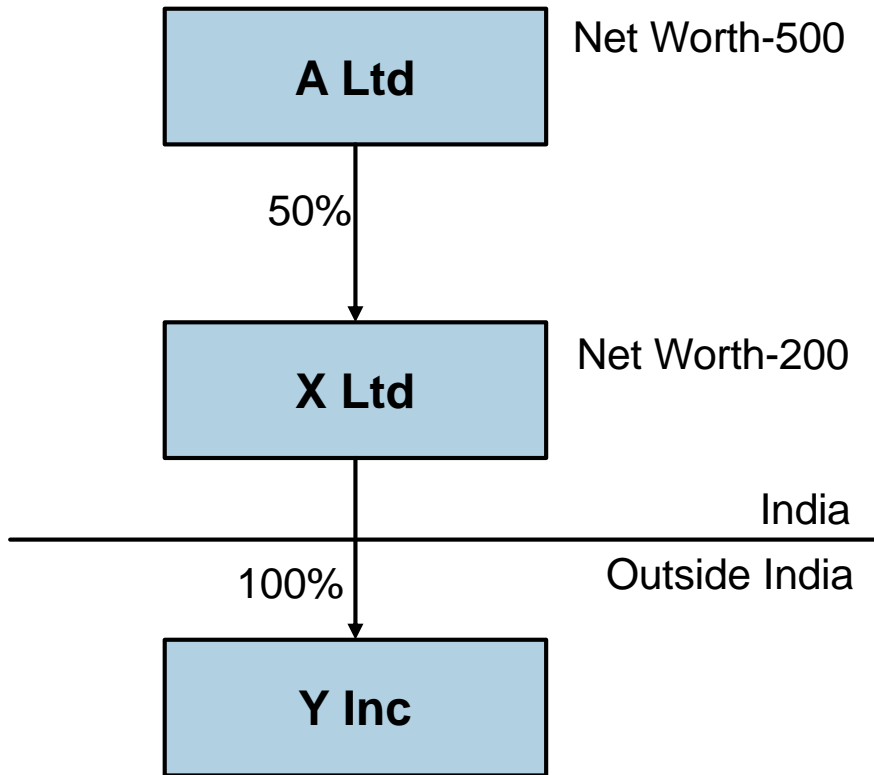
## **Net Worth = Paid up Capital + Free Reserves**

In case, net worth of Indian investing entity is not sufficient, following points needs to be considered:

- Net worth of the Indian Holding company (which holds at least 51% stake of investing company); or
- Net worth of the Indian Subsidiary Company (in which investing company holds at least 51%);
- If Indian holding company or subsidiary company has not availed its ODI limit and a letter of disclaimer in favour of the Indian Investing Company is issued.
- **This facility not available to partnership firms**

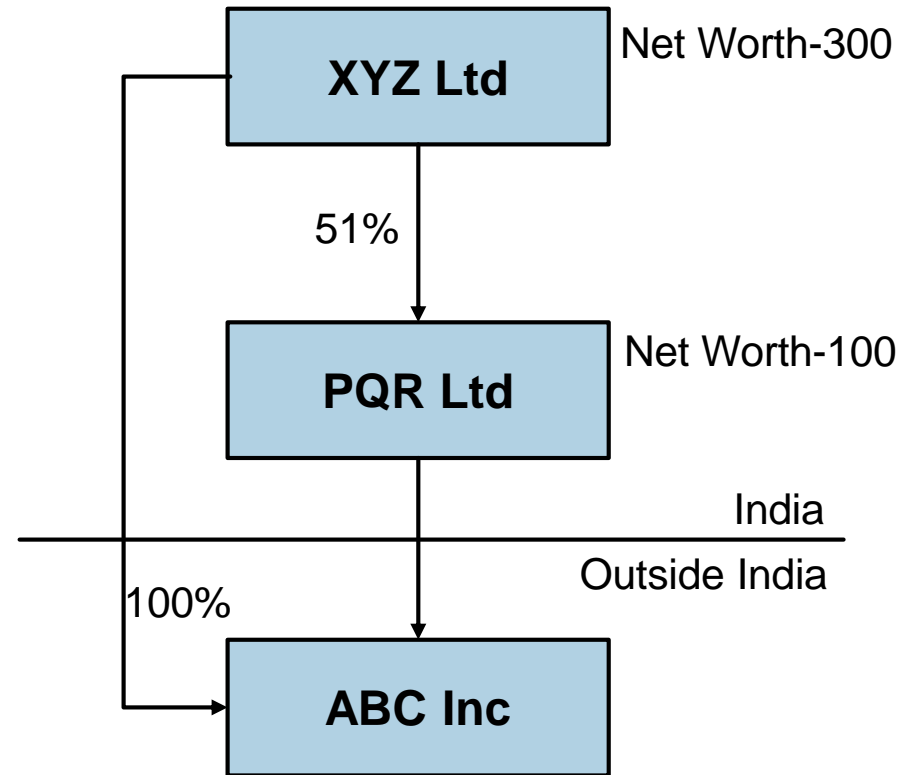
# Net worth calculation (2/2)

## Example:1



**Net Worth of X Ltd: 200**

## Example:2

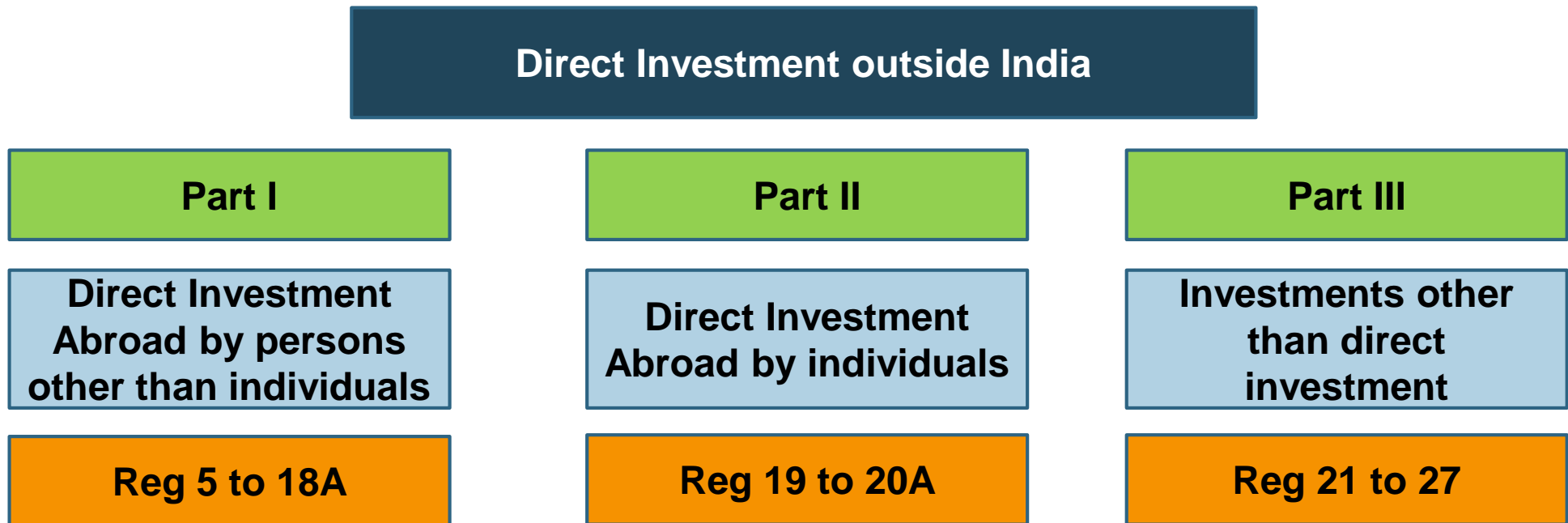


**Net Worth of XYZ Ltd: 300+100=400**

## ODI – Routes

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# Direct Investment outside India



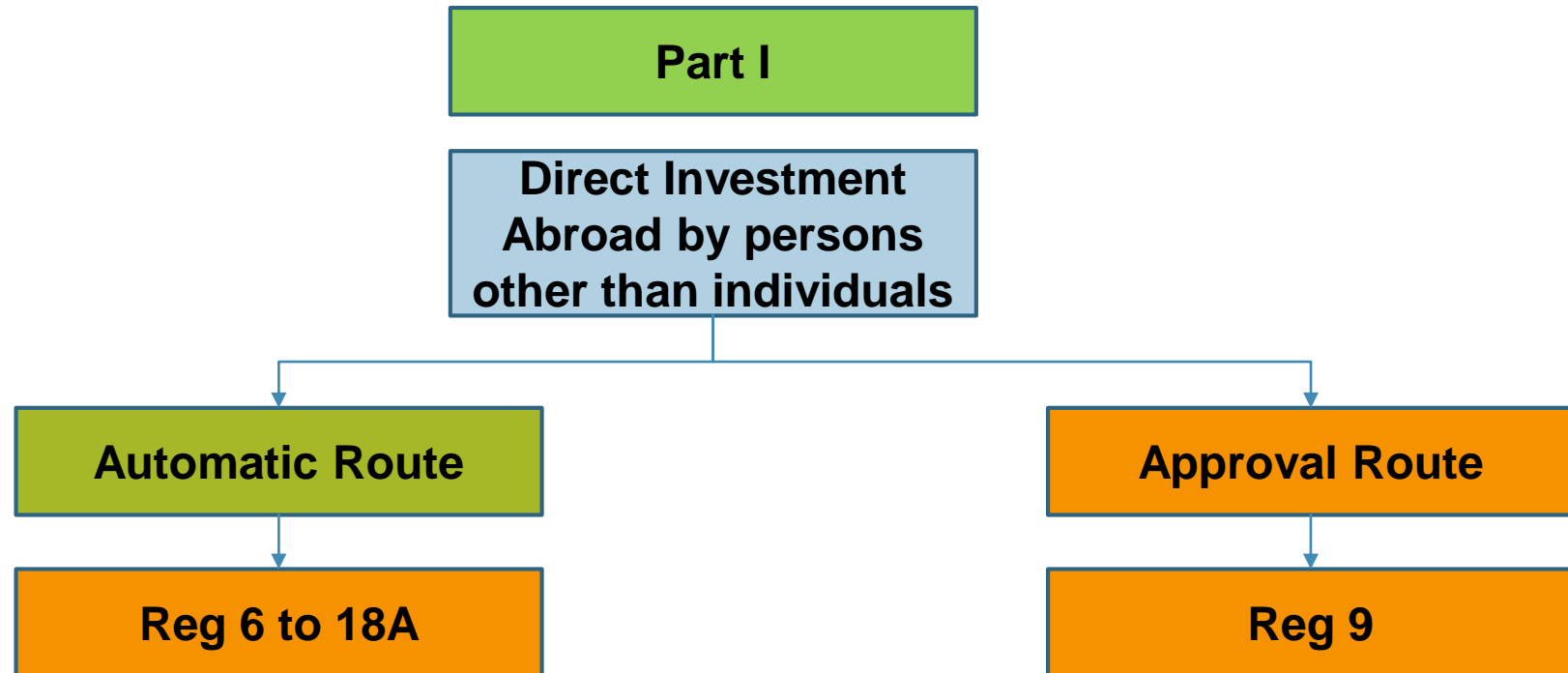
## Exemption - Regulation 4 – Purchase and sale of foreign security by person resident in India:

- Purchase foreign security out of funds held in RFC A/c;
- Bonus shares on foreign securities held as per provisions of FEMA;
- Purchase foreign security out of foreign currency resources held outside India by person not permanently resident in India\*
- Sale of above foreign security;

*\*Not Permanently resident in India means a person resident in India for employment of a specified duration (irrespective of duration) or for specific job or assignment, **which does not exceed 3 years***

# Direct Investment outside India

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**Prohibition – Regulation 5 – ODI not allowed in a foreign entity engaged in real estate business or banking business**



# Direct Investment outside India – Relevant Regulations for investment

Regulation No.	Applicability
6	Direct Investment in WOS / JV under Automatic Route
6A	ODI in Agricultural operations
6B	Investment in overseas listed securities by listed Indian companies
6C	Investment in Mutual Funds
6D	Acquiring equity investment in SWIFT
7	Investment in Financial services sector
9	ODI under Approval Route
9A	ODI by Registered Trust / Society
10	UIN
11	Investment by capitalisation
12	Export of goods towards equity
13	Additional investment in existing JV / WOS
14	Tender bidding

# Direct Investment outside India – Relevant Regulations – Post investment changes

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Regulation No.	Applicability
15	Obligations of Indian Party
16	Transfer by way of sale
16A	Restructuring of balance sheet of JV / WOS
17	Write off of investments in JV / WOS
18	Pledge
18A	Creation of charge

# Direct Investment outside India - Automatic Route (1/3)

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- Under Automatic Route an Indian Party can make direct investment/undertake financial commitment in JV/WOS outside India (except Pakistan\*) without obtaining any prior RBI approval.
- The following conditions to be fulfilled:
  - Investments up to 400% of Net worth
    - ✓ Any financial commitment exceeding USD 1 billion (or its equivalent) in a financial year require prior approval of RBI.
  - Investment made in an overseas JV or WOS should be engaged in bonafide business activity.
  - The Indian party should not be in Reserve Bank's Exporters Caution list/List of defaulters or under investigation by any investigation/enforcement agency or regulatory body.
  - Indian party has submitted APR in respect of all its overseas investments.

# Direct Investment outside India - Automatic Route

## (2/3)

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- All transactions relating to a JV / WOS to be routed through one branch of an AD bank.
- Indian subsidiary is required to report its investments in Form ODI to the AD bank
- Overseas JV/WOS/Step Down Subsidiary not to be in country identified by FATF as non co-operative country or a country notified by RBI in this regard.
- Indian party may extend loan / guarantee only to an overseas JV / WOS in which it has equity participation.
  - ✓ Moreover, extension of loan / guarantee by an Indian party without equity participation is possible subject to RBI approval.

# Direct Investment outside India - Automatic Route (3/3)

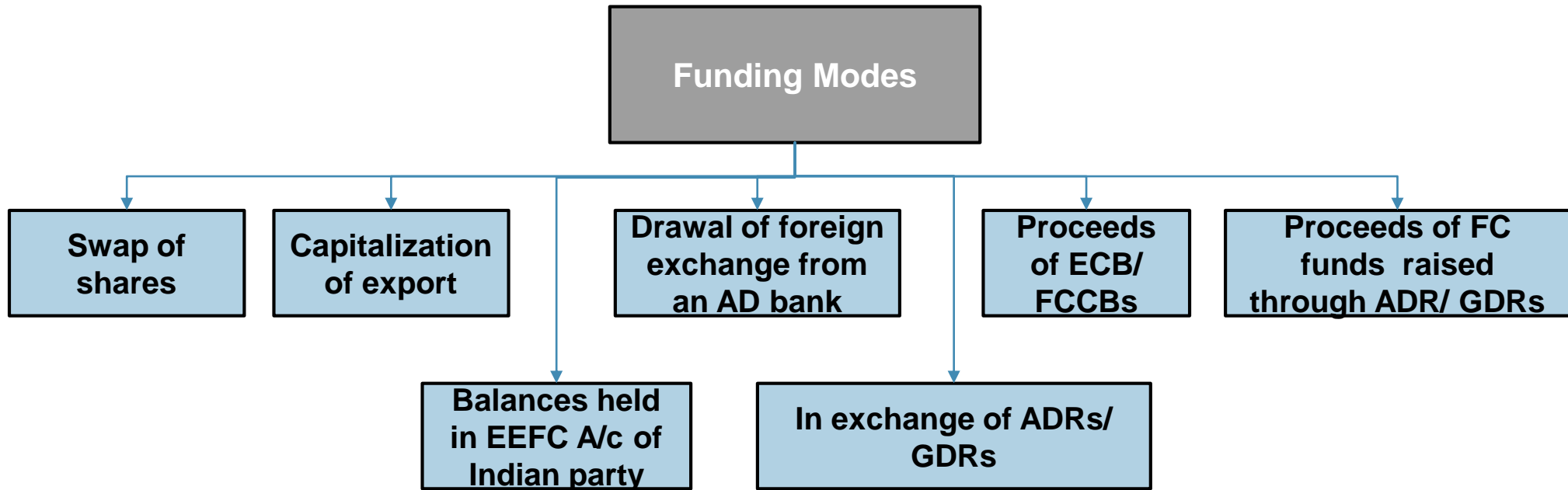
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Valuation of investment in shares of existing company :

Particulars	Valuation by
If investment exceeds USD 5 mn	<ul style="list-style-type: none"><li>• Category I Merchant Banker registered with SEBI; or</li><li>• Investment banker / Merchant banker outside India registered with appropriate authority in the host Country</li></ul>
In all other cases	<ul style="list-style-type: none"><li>• Chartered Accountant; or</li><li>• Certified Public Accountant</li></ul>
Investment by way of swap of shares	<ul style="list-style-type: none"><li>• Category I Merchant Banker registered with SEBI; or</li><li>• Investment banker / Merchant banker outside India registered with appropriate authority in the host Country</li></ul>

# Sources of funding

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# Direct Investment outside India – Automatic Route – Post investment compliances (1/10)

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## **UIN – Unique Identification Number for each JV/ WOS**

- Upon filing of prescribed form, Form ODI-Part I with AD Bankers, UIN would be generated for investment made in JV/WOS
- UIN would be specific each JV / WOS and hence, all subsequent remittances needs to mention the said UIN
- If there are multiple Indian parties making the remittances to same JV, only one UIN would be allotted for each JV which needs to be mentioned by each party

## **Investment by Capitalisation**

- Indian Party is permitted to capitalise the payments due from the foreign entity towards following:
  - Export receivables;
  - Fees;
  - Royalties or any other dues from the foreign entity for supply of technical know-how;
  - Consultancy, managerial and other services within the ceilings applicable.
- Capitalisation of export proceeds and other fees remaining unrealised beyond the prescribed period of realization will require prior approval of RBI;
- Indian software exporters are permitted to receive 25% of the value of their exports to an overseas software start-up company in the form of shares without entering into Joint Venture Agreements, with prior approval of RBI

# Direct Investment outside India – Automatic Route – Post investment compliances (2/10)

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## Investment by Capitalisation

- Indian Party exporting goods / plant and machinery / services towards equity contribution in JV / WOS need to mention on GR / SDF / Softex Form that its **“Exports against equity participation in JV / WOS abroad”**
- File custom certified copy of invoice to RBI through AD bank within 15 days of shipment of goods
- File share certificate with RBI through AD Bank within 6 months of exports of goods / plant & machinery / services

## Post investment changes in existing JV / WOS

- Possible for JV / WOS to diversify its activities / set up step down subsidiary / alter its shareholding pattern.
- Details of such decision along with approval of competent authority of host country of JV / WOS to be reported to RBI through AD Bank within 30 days of its approval
- Include the same in the Annual Performance Report (APR - Part II of Form ODI) for filing with AD Bank.



# Direct Investment outside India – Obligations of Indian Party (3/10)

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## Obligations of Indian Party making ODI

- Receive **share certificates** or any other document as an evidence of investment in the foreign entity to the satisfaction of the RBI **within six months** of making remittance;
- 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 RBI may permit;
- Filing of **Annual Performance Report (APR) in Part II of Form ODI** in respect of each JV or WOS outside India before **31 December** every year;
- The APR, so required to be submitted, has to be based on the audited annual accounts of the JV/WOS for the preceding year;
- APRs to be certified by the Statutory Auditor;
- In case multiple IPs / RIs have invested in the same overseas JV / WOS, the obligation to submit APR shall lie with the IP / RI having maximum stake in the JV / WOS;
- **Annual return on Foreign Liabilities and Assets (FLA)** is required to be submitted on or before **15 July every year**

# Direct Investment outside India – Obligations of Indian Party (4/10)

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## Obligations of Indian Party making ODI

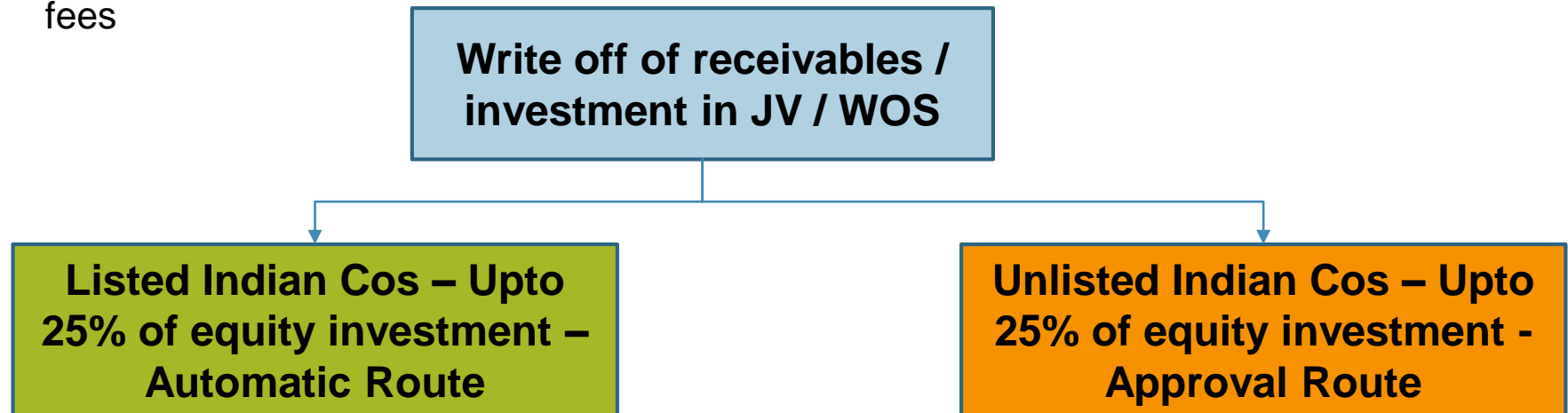
- **Where JV / WOS books of accounts are not statutorily required to be audited, APR can be filed based on un-audited annual accounts of JV / WOS provided:**
  - Statutory Auditors of the Indian Party certify that law of the host country does not mandatorily require auditing of the books of accounts of JV / WOS and the figures in the APR are as per the un-audited accounts of the overseas JV / WOS; and
  - Un-audited annual accounts of the JV / WOS have been adopted and ratified by the Board of the Indian Party.
  - The above exemption from filing the APR based on unaudited balance sheet will not be available in respect of JV/WOS in a country / jurisdiction which is either under the observation of the Financial Action Task Force (FATF) or in respect of which enhanced due diligence is recommended by FATF or any other country / jurisdiction as prescribed by RBI.

# Direct Investment outside India – Automatic Route – Post investment compliances (5/10)

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## Restructuring of Balance Sheet of JV / WOS

- Indian promoters who have set up WOS abroad or have at least 51 per cent stake in an overseas JV may write off its investment in JV / WOS even when its still under operation as under:
  - capital (equity / preference shares);
  - other receivables, such as, loans, royalty, technical knowhow fees and management fees



- Subject to conditions given in succeeding slide

# Direct Investment outside India – Automatic Route – Post investment compliances (6/10)

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## **Restructuring of Balance Sheet of JV / WOS – Conditions to be followed**

- Conditions:
  - Write-off / restructuring to be reported to RBI through the designated AD bank within 30 days of write-off/ restructuring;
  - Write-off / restructuring is subject to the condition that the Indian Party should submit the following documents for scrutiny along with the applications to the designated AD bank under the Automatic as well as the Approval Routes:
    - a) A certified copy of the balance sheet showing the loss in the overseas WOS/JV set up by the Indian Party; and
    - b) Projections for the next five years indicating benefit accruing to the Indian company consequent to such write off / restructuring

## **Acquisition through bidding or tender**

- An Indian party may remit earnest money deposit(EMD) or issue a bid bond guarantee for acquisition of a foreign company through bidding and tender procedure.
- Where an Indian party is successful in bid / tender but decides not to proceed with the investment – AD bank requires to submit details of remittance to RBI
- Where Indian party is successful in the bid but terms and condition of acquisition of overseas company is different from those for which approval was obtained – Obtain approval from RBI

# Direct Investment outside India – Automatic Route – Post investment compliances (7/10)

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## Transfer by way of sale of shares of JV / WOS

- Indian Party can sale shares of JV / WOS to another Indian Party or to a person resident outside India subject to following conditions:
  - i. Sale does not result in any write off of the investment (or financial commitment) made.
  - ii. the sale is effected through a stock exchange where the shares of the overseas JV/ WOS are listed;
  - iii. if the shares are not listed on the stock exchange and the shares are disinvested by a private arrangement, the share price is not less than the value certified by a Chartered Accountant / Certified Public Accountant as the fair value of the shares based on the latest audited financial statements of the JV / WOS;
  - iv. Indian Party does not have any outstanding dues by way of dividend, technical know-how fees, royalty, consultancy, commission or other entitlements and / or export proceeds from the JV or WOS;
  - v. the overseas concern has been in operation for at least one full year and the Annual Performance Report together with the audited accounts for that year has been submitted to the Reserve Bank;
  - vi. Indian Party is not under investigation by CBI / DoE/ SEBI / IRDA or any other regulatory authority in India.
  - vii. Indian Party is required to submit details of disinvestment through AD Bank within 30 days from date of disinvestment

# Direct Investment outside India – Automatic Route – Post investment compliances (8/10)

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## **Transfer by way of sale of shares of JV / WOS involving write off – Automatic Route**

- Indian Party can disinvest shares of JV / WOS involving write off of amount invested under Automatic Route subject to following conditions:
  - i. in case where the JV / WOS is listed in the overseas stock exchange;
  - ii. Indian Party is listed on a stock exchange in India and has a net worth of not less than Rs.100 crore;
  - iii. Indian Party is an unlisted company and the investment (or financial commitment) in the overseas venture does not exceed USD 10 million;
  - iv. 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.
  - v. Such disinvestments would be subject to conditions laid down in preceding slide

## **Transfer by way of sale of shares of JV / WOS involving write off – Approval Route**

- Indian Party can disinvest shares of JV / WOS involving write off of amount invested under Approval Route if it is not able to fulfill above conditions

# Direct Investment outside India – Automatic Route – Post investment compliances (9/10)

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## **Pledge of shares of JV / WOS / SDS**

- Indian Party can pledge shares of JV / WOS / SDS subject to following conditions:
  - i. Value of fund or non-fund based facility is considered as financial commitment of Indian Party;
  - ii. If facility is from overseas lender, it should be regulated and supervised as bank;
  - iii. The loan / facility availed by the JV / WOS / SDS from the domestic / overseas lender shall be utilized only for its core business activities overseas and not for investing back in India in any manner whatsoever;
  - iv. A certificate from the Statutory Auditors' of the Indian party, to the effect that the loan / facility availed by the JV / WOS / SDS has not been utilized for direct or indirect investments in India, is to be obtained and kept by the AD Bank;
  - v. The invocation of charge resulting into the domestic lender acquiring the shares of the overseas JV / WOS / step down subsidiary shall be governed by the extant FEMA provisions;
  - vi. The facilities (funded or non-funded) extended by the domestic lender to the Indian party or to its group / sister / associate concern or to any of its overseas JV / WOS / SDS shall also be governed by the prudential norms issued by RBI; and

# Direct Investment outside India – Automatic Route – Post investment compliances (10/10)

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## Creation of charge on domestic and foreign assets

- Indian Party can create charge on its assets for availing fund / non-fund based facility for its JV / WOS / SDS subject to following conditions:
  - i. Value of fund or non-fund based facility is considered as financial commitment of Indian Party;
  - ii. If facility is from overseas lender, it should be regulated and supervised as bank;
  - iii. NOC is obtained from domestic lender in whose favour charge has already been created;
  - iv. The domestic assets, on which charge is being created, are not securitized;
  - v. The period of charge, if not specified upfront, may be co-terminus with the period of end use (like loan or other facility) for which charge has been created;
  - vi. The loan / funds raised overseas by the JV / WOS / SDS shall be utilized only for its core business activities overseas and not for investing back in India in any manner whatsoever;
  - vii. A certificate from the Statutory Auditors' of the Indian party, to the effect that the loan / funds raised overseas by the JV / WOS / SDS has not been utilized for direct or indirect investments in India, is to be obtained and kept by the designated AD;
  - viii. The overseas lender undertakes that, in the event of enforcement of charge, they shall transfer the domestic assets by way of sale to a resident only;
  - ix. In case of invocation of charge, the resultant remittance of the proceeds exceeding the prescribed limit of the financial commitment of the Indian party (prevailed at the time of creation of charge) shall require prior approval of RBI;



# Direct Investment outside India - Approval Route

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- RBI to inter-alia consider the following factors for permitting ODI under approval route:
  - Prima facie viability of JV/WOS outside India
  - Contribution to external trade and other benefits which will accrue to India through such investment
  - Financial position and business track record of the Indian Party and foreign entity
  - Expertise and experience of the Indian Party in the same or related line of activity of the JV/WOS outside India

# Investment in Financial Sector

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If an Indian party desires to make investment in an entity outside India, which is engaged in financial sector, should fulfil following additional conditions:

- Registration with appropriate regulatory authority in India.
- Earned net profits during the preceding 3 years from financial services activity.
- Approval from concerned regulators in India and abroad for such investment.
- Compliance with prudential norms relating to capital adequacy norms as prescribed by the concerned regulatory authority in India.

**Trading in commodities exchanges overseas and setting up JV/WOS for trading in overseas exchanges will be considered as financial services activity and require clearance from SEBI**

# Case study

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## Question:

A. Can any Indian company make investment in a JV/WOS abroad in the financial services sector?

**Answer:** Only an Indian company engaged in financial services sector activities can make investment in a JV/WOS abroad in the financial services sector, provided it fulfils the conditions mentioned in previous slide

B. Can an Indian company in the financial services sector make investment in a JV/WOS abroad in the non-financial services sector ?

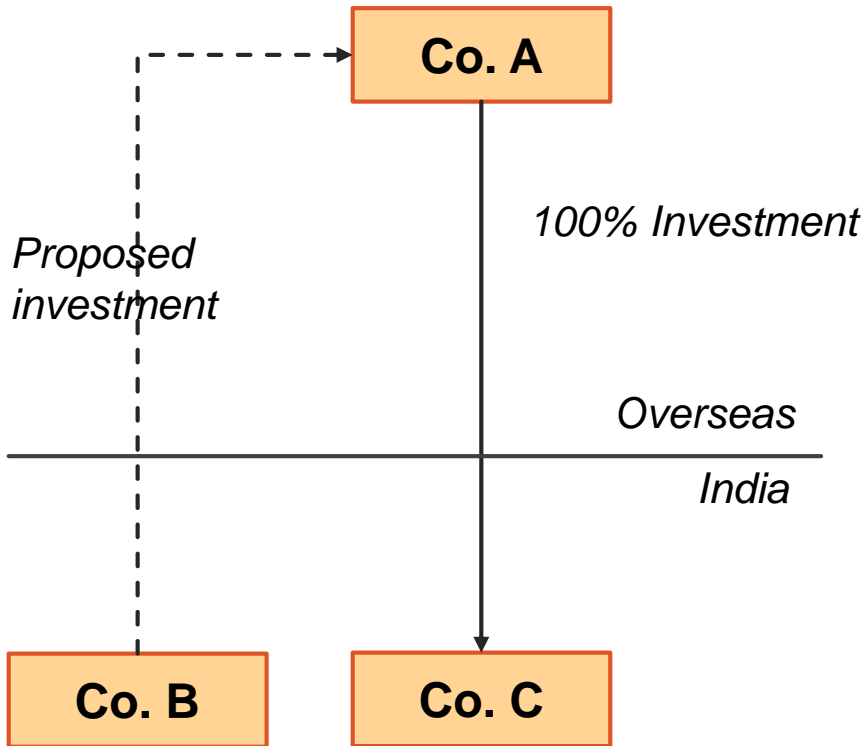
**Answer:** Regulated entities engaged in financial services sector activities in India making investment in non-financial services activities overseas are also required to comply with the additional conditions mentioned above

# Round Tripping (1/2)

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- Round Tripping refers to capital of a country, which leaves the country and is then again re-invested as Foreign Direct Investment ('FDI')
- It is channelling abroad by investors of local funds and the subsequent return of these funds to the local economy in the form of direct investment
- Existence of round tripping is considered from following parameters:
  - Percentage stake held by the foreign entity in the Indian entity;
  - Percentage of funds round-tripped; and
  - Control of the Indian company
- No codified law under FEMA prohibiting or prescribing guidelines for transactions that may constitute 'round tripping'
- Proposed GAAR provisions under Income-tax Act, 1961 provide that an arrangement shall be deemed to lack commercial substance if it involves or includes round trip financing

# Round Tripping (2/2)



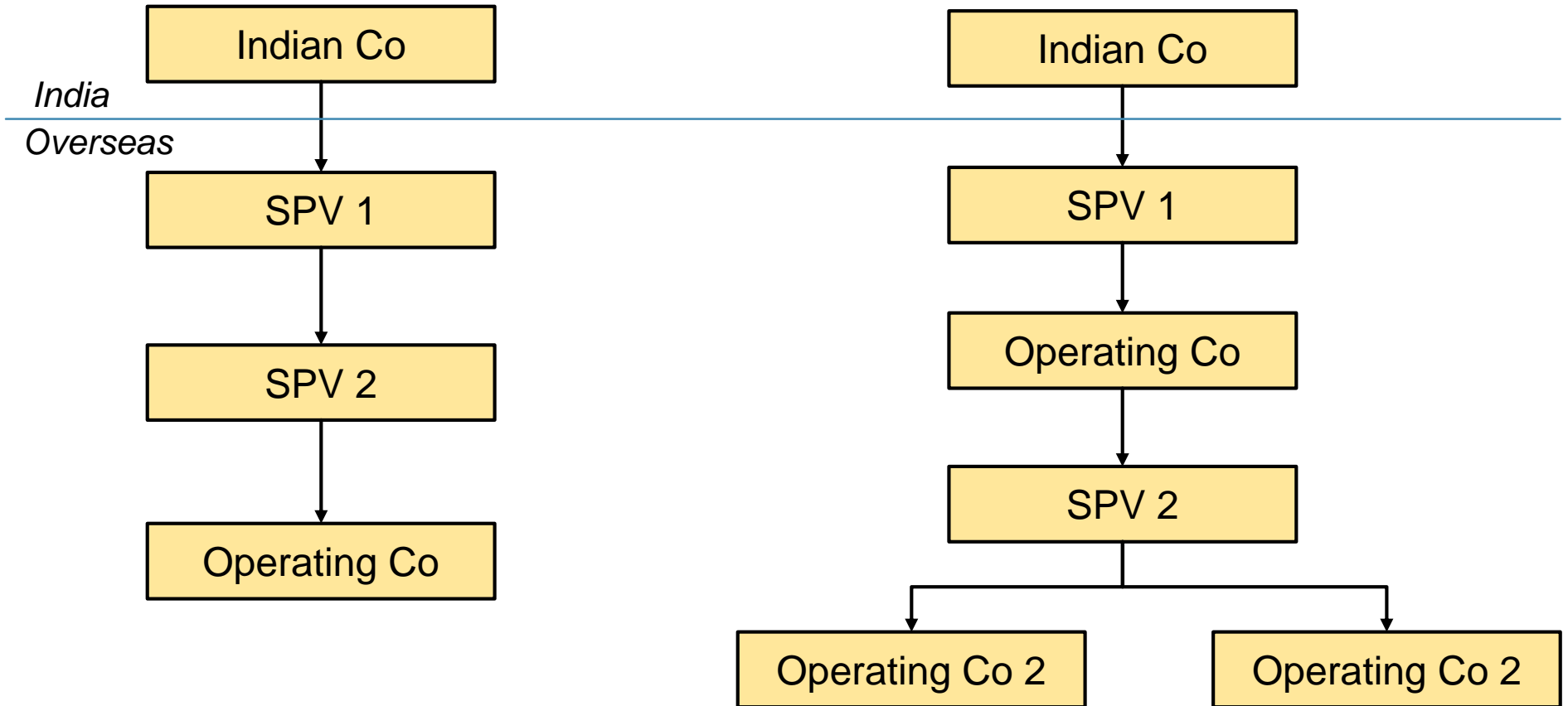
- No regulation / circular laying down guidance on what constitutes round tripping
- In case of ODI by an Indian entity in an overseas entity having prior FDI in another Indian entity
  - Prior approval of RBI should be sought
  - In practice, where such outbound investment is undertaken without RBI approval
- RBI has treated the same as contravention of regulation 6(iii) of FEMA Notification no. 120 by stating that the overseas entity cannot be said to be engaged in bona fide business activity and compounded such contraventions

# Multilayer Outbound Investments (1/2)

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- Overseas JV / WOS investment through SPV – No specific regulations under FEMA 120.
- RBI guidelines / circulars suggest that overseas JV / WOS permitted through a SPV.
- No specific guidelines on multi-layer investments.
- Whether overseas investment through multi-layer SPVs should be permitted in genuine cases where this situation is:
  - Imposed by JV partner
  - Financing structure - overseas loans and Private Equity Funding
  - Overseas Listing Flexibility
  - Regional Benefits

# Multilayer Outbound Investments (2/2)



Whether structuring through multi layered SPVs clearly restricted ?

Whether Operating Companies below SPV can also have SPVS ?

# Our Offices

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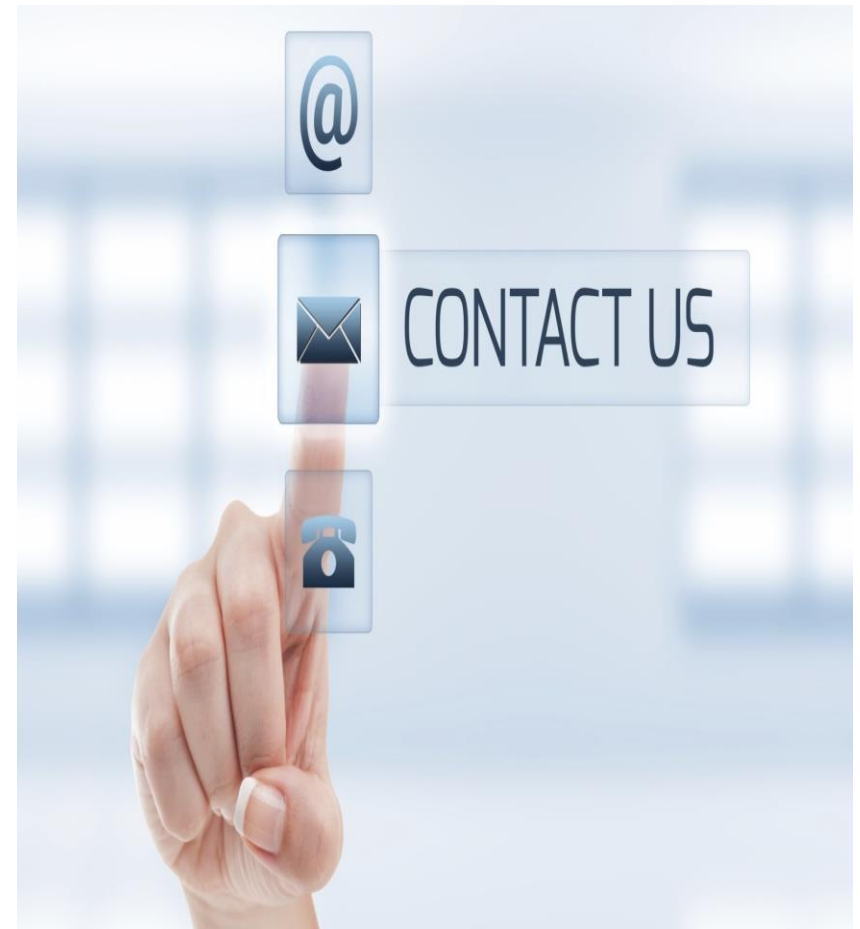
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*Thank You*

The background features abstract geometric shapes, primarily triangles, in various shades of blue and green. These shapes overlap and intersect, creating a dynamic, layered effect. The colors range from light, airy blues to deeper, more saturated blues and greens, with some areas appearing as darker, more complex intersections.

# Annexure 1 – Section 7A of Citizenship Act, 1955

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## Section 7A - Registration of overseas citizens of India

➤ The Central Government may, subject to such conditions and restrictions as may be prescribed, on an application made in this behalf, register as an overseas citizen of India:

(a) any person of full age and capacity,--

(i) who is citizen of another country, but was a citizen of India at the time of, or at any time after, the commencement of the Constitution; or

(ii) who is citizen of another country, but was eligible to become a citizen of India at the time of the commencement of the Constitution; or

(iii) who is citizen of another country, but belonged to a territory that became part of India after the 15th day of August, 1947; or

(iv) who is a child or a grand-child of such a citizen; or

(b) a person, who is a minor child of a person mentioned in clause (a) :

Provided that no person, who is or had been a citizen of Pakistan, Bangladesh or such other country as the Central Government may, by notification in the Official Gazette, specify, shall be eligible for registration as an overseas citizen of India