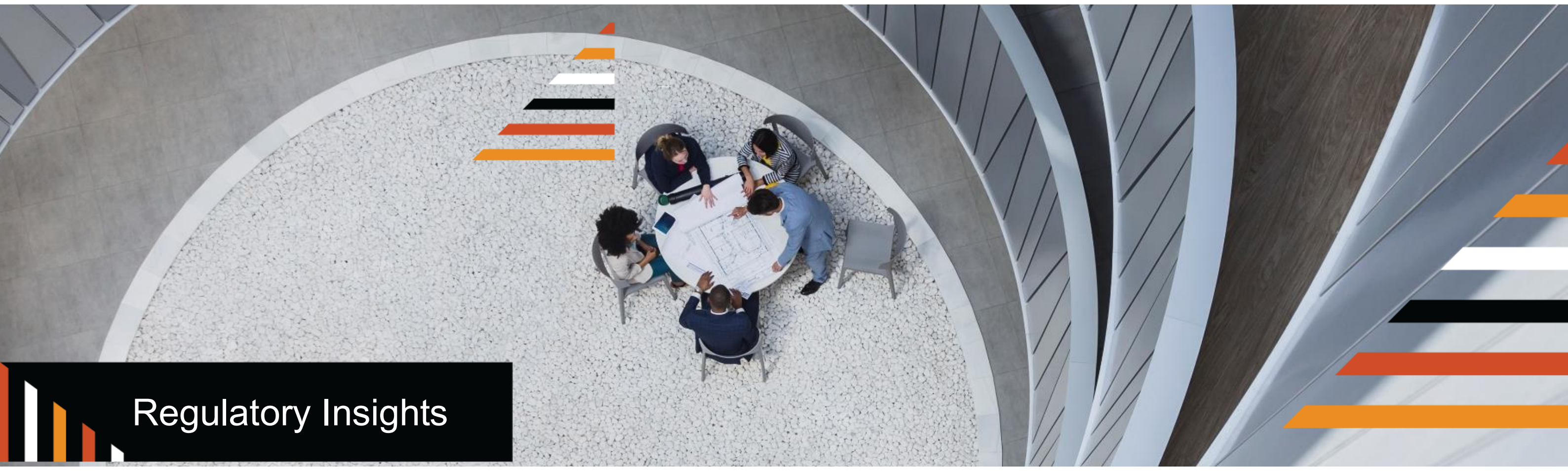

13 August 2021

Draft Rules and Regulations governing Overseas Investments by persons resident in India

In brief

The Reserve Bank of India (RBI) has placed on its website the Draft Foreign Exchange Management (Non-debt Instruments – Overseas Investment) Rules, 2021 (Draft Rules) and the Foreign Exchange Management (Overseas Investment) Regulations, 2021 (Draft Regulations), governing overseas investment in equity and debt instruments and immovable property outside India by persons resident in India. These guidelines are open for public comments until 23 August 2021. While the Draft Rules deal with overseas investment in equity and immovable property, the Draft Regulations deal with overseas financial commitment by debt and guarantee and other miscellaneous matters. The Draft Rules and Regulations introduce several procedural and conceptual changes, which are expected to rationalise the regulatory regime and improve the ease of doing business.

While the Draft Rules and Regulations appear to be comprehensive, some provisions might need further clarification from the Government of India and RBI, which may get addressed in due course.

In detail

Draft Foreign Exchange Management (Non-Debt Instruments – Overseas Investment) Rules, 2021

Introduction of new definitions

1. The term ‘control’ has been defined in a manner similar to that in the Foreign Exchange Management (Non-debt Instruments) Rules, 2019.
2. The term ‘disinvestment’ has been introduced, which means transfer by sale of right, title or possession of equity capital and includes liquidation.
3. The term financial commitment has been amended to clarify that portfolio investments made overseas shall not be included and all overseas direct investment in equity, debt instruments and non-fund based facilities shall be considered.
4. The term ‘foreign entity’, which replaces ‘joint venture’ and ‘wholly owned subsidiary’ has been introduced. This includes an entity incorporated and registered outside India and an unincorporated entity engaged in a strategic sector (energy and mineral resources) and formed under the laws of the host country.
5. The term ‘listed foreign entity’ is defined to include a foreign entity whose equity shares or any other fully and compulsorily convertible instruments that are listed on a recognised stock exchange outside India

(including IFSC). Similarly, listed Indian company means an Indian company that has equity shares or any of its fully and compulsorily convertible instruments listed on a recognised stock exchange in India.

6. The term 'net worth' has been aligned with the definition under section 2(57) of the Companies Act, 2013. For LLP, net worth means capital contribution and undistributed profits reduced by accumulated losses, deferred expenditure and miscellaneous expenditure not written off.

7. *Bona fide* business activity shall mean any business activity legally permissible both in India and host jurisdiction.

8. The term Overseas Direct Investment (ODI) means investment by way of acquisition of equity capital of an unlisted foreign entity, or subscription to the MoA of a foreign entity, or investment in ten percent or more of the paid-up equity capital of a listed foreign entity, or where the person resident in India making such investment has or acquires control, directly or indirectly, in the foreign entity. Any sponsor contribution made, directly or indirectly, by an Indian Entity to an Alternative Investment Fund or Investment vehicle set up in an overseas jurisdiction as per the laws of such host jurisdiction; or any acquisition outside India of 'participating interest or right' in the energy sector or investment outside India in agricultural shall also be treated as ODI by way of equity capital.

9. The term Overseas Portfolio Investment means investment, other than ODI, in foreign securities, including units of Exchange-traded Funds and depository receipts, which are listed, unless stated otherwise, on a recognised stock exchange outside India but not in any securities issued by a person resident in India (outside an IFSC).

10. The term Step Down Subsidiary (SDS) means the subsidiary of a foreign entity having ODI, where the Indian entity has control in the foreign entity at the time of the creation of SDS. It excludes a subsidiary in which the foreign entity holds equity capital in the nature of listed securities and not exceeding 10% of the paid-up capital of the investee entity.

11. The term 'write-off' means any shortfall in the amount of consideration received against the amount of equity capital at the time of disinvestment (proportionate in case of partial divestment) or the amount of diminution in the capital and other receivables on account of restructuring of the balance sheet of the foreign entity.

ODI-FDI structures

Financial Commitment in a foreign entity that has invested or invests into India which is designed for the purpose of tax evasion or tax avoidance is not permitted and any contravention under this Draft Rule shall be considered to be a contravention of serious and sensitive nature.

NOC requirements

An Indian entity appearing as special mention account or Non-Performing Asset (NPA) or wilful defaulter as per Credit Information Company (CIC) or is under investigation by a regulatory body, *viz.*, SEBI, Insurance Regulatory and Development Authority (IRDA) or Pension Fund Regulatory and Development Authority (PFRDA) or National Housing Bank (NHB) or any other regulator as may be prescribed by the Central Government, or is under investigation by investigative agencies in India, *viz.*, Central Bureau of Investigation or Directorate of Enforcement or Income-tax Department or Serious Frauds Investigation Office or any other agency as advised by the Central Government, an NOC is a pre-requisite from the lender bank(s) or regulatory body or investigative agency concerned before making financial commitment or undertaking disinvestment. Expiry of 60 days from date request without any response shall be deemed as NoC.

Overseas investment by individuals

- Overseas investment by individual under the ODI window is permissible only when such individual also acquires control, directly or indirectly, in such foreign entity, subject to limits prescribed under the Liberalised Remittance Scheme (LRS). Investment out of an RFC account and foreign currency deposits of a person 'not permanently resident' in India (for specific duration or job not exceeding three years) are not considered for LRS limits.

- Resident individuals shall be permitted to acquire foreign securities by way of gift only from –

a. A person who acquired such property when he was a resident outside India or inherited from a person who was a resident outside India; or

b. A person resident outside India who is a relative (as defined under Companies Act, 2013).

Pricing guidelines

The acquisition of equity capital shall be at the price worked out in accordance with the concerned stock exchanges (for a listed company), or within 5% of the fair value arrived on an arm's length basis, as per any internationally accepted pricing methodology as per registered valuer under the Companies Act, 2013, or similar valuer registered with the regulatory authority in the host jurisdiction. The valuation certificate should be dated not more than six months before the date of the transaction.

Transfer and restructuring

- Disinvestment by way of conversion to loan should not result in loss of control in the foreign entity.
- Restructuring of the balance sheet permitted when foreign entity is incurring losses for the previous two years, as per the last audited balance sheets and diminution in the total value of the outstanding dues, after such restructuring, is not exceeding the proportionate accumulated losses. If such diminution is more than US$10m or if the amount of such diminution exceeds 10% of the total value of the outstanding, such diminution shall be duly certified on an arm's length basis by a registered valuer, as per the Companies Act, 2013 or similar valuer registered with the regulatory authority in the host jurisdiction.

Some restrictions

- No additional financial commitment, whether fund based or non-fund based, directly or indirectly, can be made until any delay in reporting is regularised
- ODI in an unincorporated entity engaged in a non-strategic sector (i.e., other than oil, gas, coal and mineral ores or any other sector notified by the Central Government) – no further investment shall be made after six months from the date of notification.
- Indian trusts in the manufacturing sector are not covered under the eligible investor list and only trusts running educational institutions and hospitals in India can make overseas investment in the same sector.
- Overseas investment in countries not FATF and IOSCO compliant or any other country or jurisdiction as may be prescribed by the Central Government is not permitted.

Immovable property

- Acquisition of immovable property by individuals is permitted through the RFC account and out of income or assets outside India (other than ODI) apart from LRS, gift and inheritance. A resident individual can also acquire immovable property jointly with a is no outflow of funds from India.
- An Indian entity can also acquire immovable property outside India for overseas office or residence of its staff. An Indian entity is also permitted to acquire land for agricultural operations either directly or through an office outside India.

Portfolio investments

- Overseas portfolio investment is permitted by an Indian listed company up to 50% of its net worth. Similarly, software exporter, or any other entity prescribed by the Central Government can invest up to 25% of the value of exports made to a foreign software company. Portfolio investment by individuals also include the acquisition of sweat equity shares, minimum qualification shares issued for holding a management post in a foreign entity, acquisition of shares or interest under Employee Stock Ownership Plan ESOP or Employee Benefits Scheme provided such shares do not exceed 10% of the paid-up capital or stock of the foreign entity.

ODI in technology ventures through an OTF

- An Indian listed entity having a minimum net worth of INR 500 crore and with net profits during the preceding three financial years, can invest in an Overseas Technology Fund (OTF) from the internal accruals or group or associate companies in India and not borrowed from banks or financial institutions.

Draft Foreign Exchange Management (Overseas investment) Regulations

- ODI through investment in equity capital in the foreign entity and control over such entity are pre-requisites for making any financial commitment by modes other than equity capital in such foreign entity, i.e., loan, guarantee, pledge, etc.
- The concept of deferred payment has been introduced under ODI guidelines, wherein foreign securities equivalent to the amount of total consideration shall be transferred or issued, as the case may be, upfront by the seller to the buyer, subject to pricing guidelines and indemnification outlined in Guarantee Regulations.

Revised reporting requirements

- The Regulations provide for proposed changes in reporting requirements:

  (i) Form FC – For making financial commitment or undertaking disinvestment

  (ii) Form OPI – For making or transferring OPI – to be submitted within 30 days from the end of the half year in which such investment or transfer is made as in September or March-end.

  (iii) APR – For ODI investment – to be submitted within six months from the date of the end of the accounting period of the foreign entity concerned.

  (iv) FLA return (as per current regulations)

  (v) For investment by way of ODI, reporting for setting up or winding up of a SDS or alteration of shareholding pattern in overseas entity – within 30 days of approval of such decisions by the competent authority of the foreign entity.

  The Regulations also propose to introduce a Late Submission Fee (LSF) for delays in reporting up to three years.

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