

Overseas Direct Investment - History

- Investment outside India is a 'capital account transaction' governed under Section 6(3)(a) of the Foreign Exchange Management Act, 1999
- Section 6(3)(a) Reads thus: "Without prejudice to the generality of the provisions of sub-section (2), the Reserve Bank may, by regulations, prohibit, restrict or regulate the following —
 - (a) transfer or issue of any foreign security by a person resident in India
- Pursuant to the powers vested in the RBI Notification No.19/2000-RB, dated 3-5-2020 titled "Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2000
- This Regulation was "Superseded" by Notification FEMA 120/2004-RB dated 7.7.2004 which comes into effect from 19.11.2004 titled "Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 [hereinafter referred to as "ODI Regulations, 2004" for short]
- Eventhough Section 6(3) of the Act was omitted by Finance Act, 2015 wef., 15-10-2019 however section 47(3) of the Act saves this Regulation and the Master Directions issued by the RBI till the time this Regulation is amended or Rescinded by the Central Government

Overseas Direct Investment – Changes to Regulation of 2000

- The following major amendments were made to the 2004 Regulations.
- A Registered Partnership Firm under the Indian Partnership Act, 1932 was permitted to invest under ODI Regulations for the first time from 19.11.2004 by including it under definition of "Indian Party"
- From 7-5-2014 a Limited Liability Partnership (LLP) was also included under the definition of "Indian Party" as a permissible entity to invest under ODI Regulations.
- Till 28-3-2012 Individuals were permitted to acquire shares in a foreign entity with prior permission of RBI, when offered as consideration for professional services.
- Regulations, 2004 was substituted by 2013 Regulation with Retrospective effect from 28.3.2012 to
 also include acquisition of shares in lieu of director's remuneration which value should not exceed
 the amount of LRS permitted at the relevant point in time. Permission had to be sought only if the
 amount for which the shares were to be acquired either for professional service fee or director's
 remuneration exceeds the LRS limit.
- On 5-3-2013 Regulation 20A was inserted permitting 'resident individual' to invest outside India under the ODI Regulations if they satisfy the conditions provided under Schedule V of the Regulations. Investment can be made in equity shares or convertible preference shares of a JV/WOS, outside India which was notified on 5.8.2013 in the official gazette from which date the investment is permissible.

Overseas Direct Investment - changes and consequence

• For those resident individuals who had invested prior to 05.08.2013 A.P.(D.I.R.) Series Circular No.24 dated August 14, 2013 clarifies that they can continue to hold the investment subject to such individuals preferring an application for compounding the violation for holding shares without the authority of law. One of the compounding order dated May 17, 2018 in CA No.4594/2017 can be read.

How the Regulation has to be read:

- Section 6 of FEMA, 1999 states that subject to provisions of sub-section (2), any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction.
 Sub-section (2) now governs capital account transaction involving debt instruments.
 Sub-section (2A) is inserted from 15.10.2019 which prescribes conditions, admissibility and limits that may be placed all other classes of capital account transactions other than debt instruments.
- Reference may be had to Regulation 3 of ODI Regulations, 2004 specifically deals with 'prohibition' on issue or transfer of foreign security. It states that save as otherwise provided in the Act or rules or regulations made or directions issued, no person resident in India shall issue or transfer any foreign security. Hence there has to be a positive affirmation of the transaction that is proposed to be undertaken by a person resident in India.

Overseas Direct Investment – Persons permitted to invest

- 1. Indian Party defined under the Act to include :
 - Company incorporated in India
 - Body Corporate created under an Act of Parliament
 - Partnership Firm registered under the Indian Partnership Act, 1932
 - Limited Liability Partnership incorporated as per Limited Liability Partnership Act, 2008
 - ∘ Indian Party- engaged in Financial Services sector as per conditions prescribed under Regulation 7
- 2. Resident Individual as per the conditions prescribed under Regulation 20/ Regulation 20A read with Schedule V of the Act
- Mutual Funds registered with SEBI Conditions provided under Regulation 6C
- Banking Company licenced by RBI can acquire shares of SWIFT as per Regulation 6D
- Registered Trust and Societies engaged in Manufacture/Educational Sector/Hospitals in India – Regulation 9A read with Schedule III
- Listed Indian Company Can invest in shares of overseas company also listed on recognised stock exchange. Investment not to exceed 50% of the Net worth as on last audited balance sheet.
- Indian Party Engaged in Financial Service Sector Further conditions provided under Regulation 7

Overseas Direct Investment - other General Permissions - Reg 4

- If a person is holding a Resident Foreign Currency Account (RFC) in accordance with FEM (Foreign Currency Accounts by a Person Resident In India) Regulations, 2015 he is free to purchase a foreign security out of the funds held in that account. These are funds received either as pension/superannuation/monetary benefits from an employer outside India. Foreign Exchange earned by the person when he was resident outside India and repatriated as per section 6(4) of the Act. Foreign exchange received/acquired as gift, inheritance from a person resident outside India or such person acquires it when he was a person resident outside India. Regulation 4(B)(2) of 2015 regulation states that the funds held in this Account shall be free from all restrictions regarding utilization of foreign currency balances including any restriction on investment in any form, by whatever name called, outside India. They are also permitted to sell such investment
- General permission is also accorded to acquire bonus shares if the foreign security is held in accordance with the provisions of the Act. Permission is also accorded to sell such investment.
- If a person who is "Not permanently resident in India" he is permitted to purchase foreign security out of his foreign currency resources outside India. Not permanently resident in India means a person resident in India for employment of specific duration (irrespective of the length thereof) or for a specific job or assignment, the duration of which does not exceed three years.

Overseas Direct Investment - Conditions in Part I

- Regulation 5 Prohibitions
- Direct Investment outside India by a Person resident in India is possible only when it is specifically provided for in the Act, rules or regulations or directions or when prior approval of RBI is obtained.
- Indian Party is not permitted to make Direct Investment in foreign entity engaged in real estate business or banking business and portfolio investment is also prohibited. Investment can be made in any bonafide activity.
- What is Portfolio investment is not defined under the Act. There is ambiguity on what is to be construed as portfolio investment. It should mean that the investor is either a subscriber to the Memorandum of the overseas company. Portfolio investment would generally mean that the investor invests in stocks, bonds, mutual funds, exchange traded funds, ADRs or GDRs. The understanding is if the investment in the listed company is not above 10% of the paid up capital of each series of capital instrument.

REGULATION 6

- o Conditions imposed by the Indian Party which is not in Financial Services Sector
- Can make "direct investment" in JV or WOS abroad ie., contribution to the Capital or subscription to MoA or purchase of existing shares or by
 market purchase or private placement or through stock exchange even CCPS is allowed as it is treated at par with equity shares.
- Financial Commitment: Not to exceed 100% of the "Net Worth" based on the last audited balance sheet, or as decided by RBI from time to time. Explanation defines how to compute "total financial commitment"
- o Investment by Indian Party in Pakistan is always under Approval Route under Regulation 9
- Investment in JV or WOS should engage in bona fide business activity
- Indian Party is not on RBI caution list, list of defaulters to banking system or under investigation by any investigating agency or enforcement agency or regulatory body
- In case of prior investment already they should have submitted APR on such overseas investments in the form provided ie., Part III of Form ODI.
- All the transaction relating to overseas investment should be routed through one branch of AD for one stream of Investment in the JV/WOS. For different investment they can designate different branch of AD
- o Investment in countries notified by FATF as "non co-operative countries and territories" is not permitted

Overseas Direct Investment – Total Financial Commitment – Reg 6(2)

- Financial Commitment should be within 400% of the Net Worth as per last audited balance sheet. From July 03, 2014 if the Financial Commitment is USD 1 Billion in a financial year Prior Approval of RBI is required even if the amount is within 400% of Net Worth.
- Net Worth is defined under Regulation 2(o) to mean paid up capital and free reserves.
- · 'Financial Commitment' should be computed as follows:
 - Remittance by market purchase of foreign exchange
 - Capitalization of export proceeds other dues as per Regulation 11
 - 100% of value of Guarantees issued to JV/WOS by Indian Party
 - Investment in agricultural operations through overseas office or directly
 - ECB investment
 - 50% of value of performance guarantee If during invocation of Performance Guarantee if it breaches the 400% limit obtain permission of RBI before making remittance of funds from India
 - 100% of value of BG issued by resident bank on behalf of overseas JV/WOS, backed by counter guarantee/collateral of Indian Party to the resident bank.
 - Regulation 18A Indian Party can create charge by way of mortgage, pledge, hypothecation or otherwise of its assets also of the assets of JV/WOS in favour of overseas lender as security for availing fund based or non-fund based facility for its JV/WOS subject to the value not exceeding the financial commitment. Subject to other conditions prescribed under the Regulation. Inverse is also possible for securing facility in India from a bank in India subject to the conditions being satisfied [Regulaiton 16A(2)]

Overseas Direct Investment – Conditions in Part 1 contd....

Regulation 6(3) – How can Investment be **funded out of the following sources**:

- Balances held in EEFC account
- Drawing of foreign exchange from AD maximum allowed to the extent of 400% of net worth. Explanation provides as to how 'net worth' should be reckoned:
 - a. cash remittance by market purchase
 - b. capitalisation of export proceeds or other dues or entitlement Regulation 11 and 12
 - c.if by guarantees (not to be open ended)issued to the foreign company 100% of the guarantee to be considered.
 - d. utilising amount raised on issuing ADRs/GDRs
 - e. ECB as per the conditions
 - f. Swap of shares
 - g. ADR/GDR stock swap valuation norms are specified
 - h. 50% of Performance Guarantee
 - i. 100% of BG issued by resident bank on behalf of overseas JV/WOS, backed by counter guarantee/collateral by Indian Party. Not applicable if the original investment is made by Indian Party out of the balance held in EEFC account

Overseas Direct Investment - Conditions in Part I contd...

- Indian Party can also give loan to JV/WOS within the permissible financial commitment If investment is made by way of contribution to the Equity of JV/WOS [Regln.6(4)(i)]
- First Generation Step Down operating company Corporate Guarantee can be extended within the prevailing limit of financial commitment. Second and subsequent generation step down operating subsidiary cannot receive any corporate guarantee under approval route.
- Indirect resident Individual promoters of Indian Party can also give personal guarantee within the permissible financial commitment. Guarantee cannot be open ended. All the conditions of regulation 6 to be fulfilled.
- Financial commitment may be made by Indian Party without equity contribution in JV/WOS with prior approval of RBI Two conditions to be satisfied. It should be as per business requirement and as per legal requirement of host country [RegIn 6(4)(iv).
- Indian Party can make investment without any limit in any foreign security If the investment is
 made out of proceeds of its international offering of shares through the mechanism of ADR
 and/or GDR. Subject to the guidelines issued by Central Government. The filing requirement is
 to be met ie., Part I and II of Form ODI has to be filed with full details of investment proposed.
 [Regln 6(5)]

Overseas Direct Investment – Part I Contd...

VALUATION - REGULATION 6(6)(a)

- Where investment is made under these Regulations by way of remittance from India in existing company outside India Valuation of Shares shall be made as follows:
- Investment is > USD 5 million Valuation by Category I Merchant Banker registered with SEBI or Investment Banker/Merchant Banker registered with the Regulatory Authority of the host country
- ∘ Investment < USD 5 million by a Chartered Accountant or CPA
- Investment by issue of Indian Party's shares -
 - Valuation by Category I Merchant Banker registered with SEBI or Investment Banker/Merchant Banker registered with the Regulatory Authority of the host country. The FDI Regulations on swap of shares should also be adhered to. [Regln.6(6)(b)]
 - However, Regulation 6(6) does not provide the method to be adopted in valuing the shares of the existing
 company outside India. The valuation has to be undertaken based on the Internationally accepted method. The
 basis of valuation should closely relate to the purpose of a given valuation exercise. In case of transactions
 relating to investment under the Act, DCF method is accepted by the Reserve Bank of India

Overseas Direct Investment – Specific Approval when required.

- When the investment does not confirm to the conditions provided under Regulation 6 and 7, in such cases Specific Approval should be obtained from the Reserve Bank of India before making any outbound investment.
- Such Application seeking approval of the RBI should be made in Part I of Form ODI.
- RBI would consider the following factors while according their approval :
 - Prima Facie viability of the JV/WOS outside India
 - Contribution to external trade and other benefits to India on such investment
 - Financial position/business track record of the Indian Party/foreign entity
 - Expertise and experience of Indian Party in the activity proposed for investment.
 - Eg: Can an Indian Party/resident Indian acquire shares of foreign company without making any upfront payment or even on deferred payment basis. The FAQ states that it is not permitted to acquire shares without payment or on deferred payment basis. Such investment should be with the specific approval of the Reserve Bank of India.

Overseas Direct Investment - Procedural Requirements

- The Reporting of overseas Investment is provided under "Master Direction on Reporting under Foreign Exchange Management Act". Form ODI is available as Annexure to this Master Direction.
- From April 13, 2016, AD Banks have to file Form ODI online with RBI for allotment of Unique Identification Number [UIN].
 Procedure for submission of returns is provided vide A.P.(D.I.R Series) Circular No.62 dt. April 13, 2016.
- Allotment of UIN number by the RBI would not mean that the investment is approved by the Reserve Bank of India. UIN
 only signifies taking on record of the investment for maintaining the Database. The onus for ensuring proper compliance of
 the conditions in the Regulations rests with the AD bank and the Indian Party.
- Post investment changes Regulation 13 A JV/WOS set up by the Indian Party may diversify its activities/set up a step down subsdiary or alter the shareholding pattern subject to the Indian Party reports the details of such decision taken by JV/WOS within 30 days of the approval of these decisions by the competent authority concerned in terms of the local laws of the host country and also includes the same in their Annual Performance Report (APR) which is required to be forwarded/filed annually to the RBI in terms of Regln.15. It is permitted under the Regulations for Individual Partners to hold shares in their name when the investment is effected from the Firm due to country's operational requirement and the investment is completely done by the Firm.
- Obligations of Indian Party [RegIn 15] -
 - Receive share certificates or any other document evidencing investment to the satisfaction of RBI within six months, or a further period
 permitted by RBI from the date of remittance being made/effected or date on which the amount was permitted to be capitalised
 - Repatriate dues ie., Dividend, royalty, technical fees etc. within 60 days of it falling due, or further period permitted by RBI

Overseas Direct Investment – Procedure to be followed – Regln 15 cont...

- Annual Performance Report to be submitted to RBI through AD, every year before the specified date. To be submitted in Form ODI Part III within 30th June of every year by Indian Party and Resident Individual. It is also important to note that if the investor [Indian Party/Resident Individual] from April 13, 2016 before undertaking any ODI transaction should have submitted all the APRs in respect of JV/WOS. If there are multiple investors from India the obligation to submit APRs will be with the investor holding maximum stakes in such JV/WOS.
- Return on Foreign Liabilities and Assets (FLA) which is a annual return which has to be filed online by all the Indian Companies on or before 15th of July, every year.
- If the host country does not mandate the accounts to be audited, then the APRs of such company can be submitted based on the un-audited annual accounts of the JV/WOS. It would be required for the Statutory Auditors to certify that the host country does not mandatorily require auditing of books of accounts of the JV/WOS and the figures submitted in the APRs is according to the un-audited accounts of the overseas JV/WOS. The un-audited accounts should be ratified by the Board of the Board of the Indian Party.
- This facility will not be available if the country/jurisdiction in which the Company is situated is under observation of FATF or in respect of which enhanced due diligence is recommended by FATF
- Delayed/non-submission of APRs would entail penal measures as per Section 13 of FEMA, 1999.

Overseas Direct Investment - Transfer by way of sale/Disinvestment

- · Regulation 16 deals with transfer of investment
- Regulation 16(1) Permits Indian Party to transfer by way of sale to another Indian Party which complies with
 the provisions of Regulation 6 or to a person resident outside India, of shares or security held by it in JV/WOS
 subject to the following conditions:
 - o (i) sale should not result in write off of the investment made
 - (ii) in case of shares of JV/WOS is listed it should be effected through the stock exchange
 - (iii) if the shares are unlisted, if the disinvestment is by private arrangement then the valuation of the share should be by a CA/CPA, based on the fair value of the shares based on the latest audited financial statement of JV/WOS and the price at which shares are sold cannot be less than the value certified.
 - (iv) all the outstanding dues of Indian Party viz., dividend, technical know-how fees, royalty, consultancy, commission or other entitlement or export proceeds should be received from JV/WOS
 - · (v) the overseas entity is in operation for atleast one full year and APRs are filed with audited accounts for that year
 - · (vi) the Indian party is not under investigation by CBI/DoE/SEBI/IRDA or any other regulatory authority in India.
- Regulation 16(1A) Indian Party is permitted to disinvest if the amount repatriated is less than the amount of the original investment, and the disinvestment is subject to sub-clauses (ii) to (iv) of Reg 16(1):
 - JV/WOS is listed in stock exchange
 - Indian Party is listed in stock exchange in India has a net worth of not less than 100 crore or the investment is less than 10 million USD
 - $\circ~$ Indian party is unlisted and the investment is less than USD 10 million and

Overseas Direct Invesmtent - disinvestment contd...

- Sale proceeds to be received within 90 days evidence to be submitted to RBI through AD
- If any of the condition specified above is not satisfied, then specific permission should be sought from RBI for transfer of shares.

Regulation 16A

- Restructuring of Balance Sheet by Listed Indian Party by write-off Permissible only for Indian Party having a WOS or JV with 51% investment Permission is granted to write-off upto 25% of the equity investment in the JV/WOS. The other receivables such as loans, royalty, technical know-how fees and management fees. The permission for write off is granted by the AD Banks. The Balance sheet certified should show loss. The projection for the next five years should show the benefit that accrues to the Indian Party, if such write off is made.
- In case of write-off by unlisted Indian Party holding 51% shares upto 25% of the shares held should be under the Approval Route.

Regulation 17

Transfer by way of sale resulting in write-off by a Listed Indian Party ie., price for such sale is less than the
amount invested in the share/security. Permissible if the difference is within the percentage notified as compared to
the actual export realisation of the previous year. If the difference is more, specific approval of RBI required prior
to write-off.

Overseas Direct Investment – Investment Abroad by Proprietary Concern and unregistered Partnership Firms.

- o Conditions covered under Part II of Regulations Regulation 10 to 20A
- Proprietary concern, if it has to accept shares of the foreign company in lieu of fees for professional services, should apply to the RBI for permission. The shares can be allotted only for the 50% of the fees due. The share holding of the Indian concern should not exceed 10% of the paid up capital of the company whose shares are accepted. [Regulation 19]
- A Proprietary Concern/Unregistered Partnership Firm in India satisfying all the criteria for ODI may set up/acquire
 a JV/WOS outside India with the **prior approval** of RBI [Regln 19A]. Permission granted to all from 12.11.2014
 earlier permission was available only to Star Export Houses with proven track record and consistently high export
 performance. The permission was accorded for the first time from 27.3.2006.

Overseas Direct Investment – Part II – Resident Individuals

• Resident Individual - Professional Fees/Directors Remuneration [RegIn 20]

- Resident Individual is permitted to acquire shares of a foreign entity in part/full consideration of the professional services rendered to the foreign entity or in lieu of director's remuneration. The value of the shares so acquired should be within the LRS limit prescribed for such resident individual. Such acquisition is under Automatic Route. The amendment comes into effect from 28.3.2012.
- If the investment to be made is beyond the amount specified under the LRS Scheme ie., USD 250,000 then the resident individual should obtain permission from the Reserve Bank of India.
 RBI would consider various factors before according the permission which is stated under Regulation 20(3) of ODI Regulations.
 - Credentials/net worth of individual nature of his profession
 - Extent of forex earning balance held in EEFC account or RFC account
 - Financial and business track record of foreign entity
 - Potential for forex inflows to the country
 - · Other likely benefits to the country.

Overseas Direct Investment – Part II – Resident Individual – by outward Remittance

- Regulation 20A inserted by a Notification dated 5.3.2013 made operational from 5.8.2013 read with Schedule V of the ODI Regulations.
- Resident Individuals single or in association with another resident Individual or with 'Indian Party' can invest directly in JV/WOS in equity shares or compulsorily convertible debentures, as per the conditions provided under Schedule V can purchase foreign exchange within the

Conditions provided in Schedule V

- Foreign entity should not be engaged in real estate business or financial services activity. The entity should not be located in FATF notified countries
- The JV/WOS should be engaged in bona fide business activity
- Resident individual should not be in RBI exporter's caution list or list of defaulters to the Banking System or under investigation by any of the investigating authorities
- The investment should not cross the permissible limits under LRS. Even the investment from EEFC/RFC account will be within the LRS limit

Overseas Direct Investment - Resident Individual contd...

- The JV/WOS to be acquired/set up shall be an operating entity only and no step down subsidiary is allowed to be acquired or set up by the JV/WOS
- The valuation of the shares should be in accordance with Regulation 6(6)(a). If it is a new company no requirement of valuation.
- No other modes of financial commitment is permitted. Only investment in equity or compulsorily convertible preference shares permitted.
- Reporting Any post investment changes should be reported within 30 days. Such reporting should also be done in APR ie., in Part III of Form ODI.
- Disinvestment Permissible of the investment partially or fully by way of transfer/sale/liquidation/merger of the JV/WOS. Allowed only after one year of making the first remittance. Disinvestment proceeds should be repatriated within 60 days from the date of disinvestment. No write off will be allowed in case of disinvestment by Resident Individuals. Reporting within 30 days of receipt of disinvestment proceeds in Part IV of Form ODI.
- Reporting Part I of Form ODI Within 30 days of making remittance. AD to report to RBI in Part I and II of Form ODI within 30 days of making the remittance. APRs to be filed in Part III [conditions of Regl 15 should also be fulfilled]

Overseas Direct Investment – Part III – Investment in Foreign Securities otherwise than Direct Investment

- Individual can acquire foreign securities [defined in Section 2(o) of the Act] ie., shares, stocks, bonds, debentures, or any other instrument denominated/expressed in foreign currency includes foreign currency denominated in foreign currency which redemption or return of interest/dividend is payable in Indian currency:
 - · Gift from person resident outside India
 - Issued by foreign company under cashless ESOP Scheme which should not involve any remittance from India
 - By way of inheritance from a person whether resident in or outside India
 - Individual employee/Director Indian Office/branch/subsidiary of foreign entity or Indian Company having direct/indirect equity [
 means indirect foreign equity holding through a Trust/SPV/step down subsidiary] by a foreign entity accept shares of foreign
 entity
 - Under ESOP scheme issued globally on uniform basis and
 - · Annual Return to be submitted by the Indian Company of the beneficiaries through AD giving details of remittances/beneficiaries.
 - Remittance is permitted for purchasing such shares
- Sale of such securities acquired is permissible repatriation to be done within 90 days
- Foreign company can also repurchase such shares issued under ESOP scheme on remittance from resident Individual. If it was issued in terms of FEMA, 1999, repurchase should be part of initial offer document, and later on Annual Returns submitted to AD giving details of remittances/beneficiaries.
- These securities so acquired can be pledged to obtain fund based non-fund based facilities from AD [Regln 23]
- Conditions relating to Domestic Depository holding IDRs provided under Regulation 22(7)

Overseas Direct Investment - Part II Contd..

- Acquisition of Qualification/right shares permitted. Remittance limited to LRS limit. Now there is no restriction that the Qualification shares should not exceed 1% of the paid up capital of the foreign company. Amendment effected from 28.3.2012
- Individuals who are employees/Director of Indian promoter company, can also acquire by purchase of JV/WOS of Indian promoter company in the field of **software** if the consideration does not exceed the ceiling prescribed by RBI, shares acquired will not exceed 5% of paid up capital of the JV/WOS. The percentage of shares held by the Indian promoter company should not reduce after the employee/director acquires such shares
- Sales of the shares held as qualification shares can be done without any prior approval subject to receipt of sale proceeds into India and documentary evidence submitted to AD.
- Indian Company in knowledge based sector can allow its employees/working directors to purchase foreign securities under ADR/GDR linked stock option schemes. The stock option schemes should adhere to the conditions of the Regulator ie., SEBI Guidelines or the guidelines issued by the Government for issue of ADR/GDR linked stock options. Consideration payable should not exceed the monetary limit specified by RBI. Explanation defines the expression 'knowledge based sector'.

