

## New Rules and Regulations for Overseas Investment

### Background

The Central Government ("CG") has recently notified the Foreign Exchange Management (Overseas Investment) Rules, 2022 ("rules") and the Reserve Bank of India ("RBI") has notified the Foreign Exchange Management (Overseas Investment), regulations 2022 ("regulations"), dated 22nd August 2022. The new rules and regulations are intended to globally connect and widen the global network by liberalizing norms which aims to provide impetus and growth opportunities and promote ease of doing business in India. These rules and regulations supersede the Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India), Regulations 2015 and the Foreign Exchange Management (Transfer or issue of Any Foreign Security) Regulations, 2004.

The new rules/regulations provide the regulatory framework for the permissions, conditions, restrictions for making Overseas Direct Investment ('ODI'); pricing guidelines; Liberalization of provisions of write off on account of disinvestment, restructuring, round tripping structures; tightening of the reporting requirements for Indian entities opting for ODI etc. The alert captures the various key changes/highlights introduced by the RBI in consultation with the CG.

Already existing ODI transactions shall be construed to be compliant under the new regulations. With the new imposed restrictions, it would be imperative for companies to be as compliant as possible to match to the amendment of financial commitment/investment overseas. For example, Investment in start-ups earlier could be funded in any manner and not necessarily through internal accruals. The guidelines are silent about repercussions in such cases. Gift of foreign securities are permitted only between 'relatives', earlier anyone could have gifted foreign securities to Indian persons.

## Part I: Key Changes/Highlights:

Title	Description
<b>Round Tripping Structures</b>	<ul style="list-style-type: none"> <li>A PRI is prohibited to make financial commitment in a Foreign entity which has invested or invests into India on or after the date of making such financial commitment, whether directly or indirectly, resulting in a structure of more than 2 layers of subsidiaries.</li> <li>This new rule shall not apply to banking company, non-banking financial company, insurance company and government company which are specified under Companies (Restriction on number of layers) Rules, 2017.</li> </ul>
<b>Restructuring, disinvestment and write off of Overseas direct investment</b>	<ul style="list-style-type: none"> <li>A PRI having ODI in a Foreign entity incurring losses for the previous 2 years (as evidenced by last audited balance sheets) can restructure the balance sheet (i.e., write off capital/other receivables) without RBI approval to the extent of accumulated losses in the Foreign entity.</li> <li>Where the original investment made in overseas entity was more than USD 10 million or the amount of diminution exceeds 20% of total outstanding dues of Indian entity, diminution would need to be duly certified on an arm's length pricing by a registered valuer as per Companies Act, 2013 or by a valuer registered with the regulatory authority or by a certified public accountant in the host country/jurisdiction. Further, certificate date should not be more than 6 month from the date of transaction.</li> </ul>
<b>Requirement of No Objection Certificate</b>	<ul style="list-style-type: none"> <li>Any PRI whose account is classified as a non-performing asset or as a willful defaulter by any bank or is under investigation by any agency/regulator, shall have to mandatorily obtain No Objection Certificate ("NOC") from the bank/agency/regulator before making any financial commitment or doing any disinvestment activity.</li> <li>Time limit specified to obtain NOC from lender bank, regulatory body or investigative agency is 60 days, beyond which it will be considered to have received deemed consent.</li> </ul>
<b>Investment in foreign start-ups</b>	<ul style="list-style-type: none"> <li>An ODI in a foreign startup by an Indian entity is permissible through its internal accruals (i.e., own profits or fund), Borrowed funds cannot be used for investment in foreign start-ups.</li> <li>Further, necessary certification is to be provided to the AD bank from statutory auditors or chartered accountants of Indian entity.</li> </ul>
<b>Application for making financial commitment above the threshold limit</b>	<p><b>Strategic sector:</b></p> <ul style="list-style-type: none"> <li>Financial commitment can now be made by a PRI in excess of the threshold limit prescribed in strategic sector and geographies, by making an application to CG through the RBI.</li> </ul> <p><b>Non-strategic sector:</b></p> <ul style="list-style-type: none"> <li>In case of non-strategic sector, the financial commitment can be made by a PRI in excess of the threshold limit prescribed, by making an application to the RBI through Authorized Dealer Category-I Bank ("AD bank") citing the reasons for such overseas financial commitment.</li> </ul>
<b>Rights issue and bonus shares</b>	<ul style="list-style-type: none"> <li>Renunciation of rights are now permissible to a PRI, in favour of PRI or Person Resident Outside India ("PROI"), for shares acquired through right or bonus issue.</li> </ul>
<b>Permission of deferred payment</b>	<ul style="list-style-type: none"> <li>Deferred consideration is now permissible for a PRI for acquiring and transferring foreign securities without RBI approval.</li> <li>The period of deferment shall be defined upfront in the agreement/documents/applicable laws.</li> </ul>

Title	Description
<p><b>Overseas direct investment in financial services activity</b></p>	<p><b>ODI in financial services activity by Indian entity:</b></p> <ul style="list-style-type: none"> <li>• Earlier, an Indian entity engaged in financial services could make investment in a Foreign entity engaged in financial services activity.</li> <li>• As per the new rules, any Indian entity not engaged in the financial services activity can also make investment into Foreign entity engaged in financial services activity (except banking and insurance).</li> <li>• Further, the Indian entity is required to generate net profit for 3 preceding financial years.</li> </ul> <p><b>ODI in financial services activity by Resident individuals:</b></p> <ul style="list-style-type: none"> <li>• Resident individuals are generally not permitted to make ODI in a Foreign entity engaged in financial services activity.</li> <li>• However, a Resident individual is permitted to make ODI in a Foreign entity in the following scenarios: <ul style="list-style-type: none"> <li>• Acquisition of shares are by way of inheritance;</li> <li>• Acquisition of Sweat Equity Shares;</li> <li>• Acquisition of minimum qualification shares issued for holding a management post in a Foreign entity; and</li> <li>• Acquisition of shares/interest under ESOP or Employee Benefits Scheme.</li> </ul> </li> </ul> <p><b>ODI in financial services activity in International Financial Services Centre ("IFSC") by PRI (i.e., Indian entity and Resident individual)</b></p> <p><b>PRI can make investment in IFSC as per guidelines prescribed for any other entity subjected to fulfillment of following conditions:</b></p> <ul style="list-style-type: none"> <li>• The PRI is required to obtain approval from the financial service regulator within 45 days of application. A PRI may make contribution to Investment in fund or vehicle set up in an IFSC as OPI.</li> <li>• The Resident individuals can make ODI in Foreign entity in IFSC including entity engaged in financial services activity (except banking or insurance) if such entity does not have subsidiary or step-down subsidiary outside IFSC where the Resident individual has control in the Foreign entity.</li> <li>• Further, the three years profitability criteria for overseas investment in financial service sector is not applicable to Indian entity making ODI in IFSC.</li> </ul>
<p><b>Acquisition by way of gift or inheritance by Resident individual</b></p>	<ul style="list-style-type: none"> <li>• A Resident individual can acquire foreign securities from a PROI by way of gift subject to the compliance of the Foreign Contribution (Regulation) Act, 2010.</li> <li>• Now, a Resident individual can also acquire foreign securities from a relative of Resident individual without any limit and approval from the RBI.</li> <li>• A Resident individual can acquire foreign securities by way of inheritance from a PRI or PROI, without any limit.</li> </ul>

Title	Description
<b>Acquisition of shares or interest under Employee Stock Ownership Plan or Employee Benefits Scheme or Sweat Equity Shares</b>	<p><b>Addition of Employee Benefits Scheme and Sweat Equity Shares:</b></p> <ul style="list-style-type: none"> <li>• Apart from Employee Stock Option Plan, Employee Benefits Scheme and Sweat Equity Shares have also been covered for acquisition of shares/interest in Foreign entity by a Resident individual.</li> <li>• Employee Benefit Scheme has been newly defined, which includes benefit in respect of any compensation or incentive which gives ownership interest in an overseas/Foreign entity.</li> </ul> <p><b>Waiver of minimum percentage holding requirement of the Foreign entity:</b></p> <ul style="list-style-type: none"> <li>• A Resident individual who is an employee or a director of an office in Indian or branch or subsidiary of an overseas/Foreign entity or an entity in which overseas/Foreign entity has direct or indirect holding may acquire, without any limit, shares, or interest under employee benefit scheme.</li> <li>• Earlier, the overseas/Foreign entity was required to hold 51% or more stake in the Indian entity. As per the new rules, there exists no minimum threshold percentage holding requirement by the overseas/Foreign entity in the Indian entity.</li> </ul>
<b>Overseas investment by Mutual Funds or Venture Capital Funds or Alternative Investment Funds</b>	<ul style="list-style-type: none"> <li>• Mutual Funds (“MFs”) or Venture Capital Funds (“VCFs”) or Alternative Investment Funds (“AIFs”) can acquire or transfer foreign securities as stipulated by Securities and Exchange Board of India, subject to fulfillment of RBI conditions.</li> <li>• AIFs have been newly inserted under the new rules.</li> <li>• MFs has an overall cap limit of USD 7 billion for making overseas investment, whereas for VCFs or AIFs the overall limit is USD 1.5 billion.</li> <li>• Any investment by the MFs/VCFs/AIFs shall be treated as an Overseas Portfolio Investment (“OPI”) irrespective of whether the foreign securities are listed or not.</li> </ul>
<b>Transfer or liquidation of foreign securities</b>	<p><b>By way of sale:</b></p> <ul style="list-style-type: none"> <li>• PRI can transfer foreign equity shares to a PRI/PROI.</li> </ul> <p><b>By way of merger/demerger/amalgamation/buy-back:</b></p> <ul style="list-style-type: none"> <li>• Approval of the competent authority as per the applicable laws in India/ laws of the host county/jurisdiction must be obtained by PRI.</li> </ul> <p><b>By way of disinvestment:</b></p> <ul style="list-style-type: none"> <li>• Transferor, being a PRI, desirous of selling shares as a part of disinvestment should not have any outstanding dues receivable as an investor in equity capital and debt.</li> </ul>
<b>Acquisition of Immovable property on lease basis</b>	<ul style="list-style-type: none"> <li>• Investment in Immovable property by a PRI through lease arrangement has been permitted by the RBI, provided the lease does not exceed a term of 5 years.</li> </ul>

Title	Description
<b>Acquisition of Immovable property by PRI from PRI/PROI</b>	<p>Acquisition by PRI from PRI</p> <p>Permissible manner of acquisition of Immovable property</p> <ul style="list-style-type: none"> <li>• Gift</li> <li>• Inheritance</li> <li>• Purchase</li> </ul> <p>PRI from PROI</p> <ul style="list-style-type: none"> <li>• Inheritance</li> <li>• Amount held in Resident Foreign Currency Account (“REFC Account”)</li> <li>• Out of amount remitted under Liberalized Remittance Scheme (“LRS”)</li> <li>• Jointly with relative, who is PROI (Transfer of funds to relative is permitted)</li> <li>• Out of income or sale proceeds of foreign assets (Other than ODI)</li> </ul> <p>Indian entity having an Overseas office</p> <ul style="list-style-type: none"> <li>• Purchase of Immovable property outside India for the business and residential purposes of its staff, as per the RBI directions.</li> </ul> <ul style="list-style-type: none"> <li>• PRI can create a charge against Immovable property acquired outside India.</li> <li>• Holding of any investment in Immovable property would be permissible if the initial investment in Immovable property was permissible.</li> </ul>
<b>Restrictions for making ODI</b>	<ul style="list-style-type: none"> <li>• An ODI by PRI in Foreign entity is not permitted if the Foreign entity is engaged in any of the following: <ul style="list-style-type: none"> <li>(a) Real estate activity;</li> <li>(b) Gambling in any form;</li> <li>(c) Dealing with financial products linked to the Indian rupee without specific RBI approval.</li> </ul> </li> </ul>
<b>Limit of making ODI</b>	<ul style="list-style-type: none"> <li>• Overall investment limit of 400% of net worth of the Indian entity has remained unchanged.</li> <li>• Further, as provided in the erstwhile ODI Master Directions for prior approval of RBI for any FC exceeding USD 1 billion or its equivalent in a financial year even when the total FC of the Indian Party was within the eligible limit under automatic route (i.e. within 400% of the net worth as per the last audited balance sheet), the requirement still continues under the new regime as well.</li> </ul>
<b>Reporting Requirements for Overseas investment</b>	<ul style="list-style-type: none"> <li>• The PRI (other than Resident individual) has made or transferred investment as OPI shall report this activity within 60 days from the end of half-year (i.e., September and March) through AD bank to RBI. (E.g., If Investment/transfer is made between the period from April 2021 to September 2021, then the reporting is required to be done by 29th November 2021).</li> <li>• The new regulation has extended the timeline for reporting of Annual Performance Report (“APR”) from 30th June to 31st December from the end of Financial Year (“FY”). If the FY ends on 31st December, then reporting must be done by 31st December of next year. (E.g., If the reporting period of Foreign entity is 1st July 2020 to 30th June 2021, then reporting needs to be done by 31st December 2021).</li> <li>• No reporting is required to be done if the Foreign entity is under liquidation, or the PRI is holding less than 10% of equity shares without control and there is no other financial commitment other than by way of equity.</li> </ul>

Title	Description
<b>Delay in Reporting</b>	<ul style="list-style-type: none"> <li>• If the PRI does not submit the necessary evidence/filings in relation to the overseas investment through AD bank with the RBI within the relevant due date it can be submitted with the payment of Late Submission Fees ("LSF") (rates and manner to be specified by RBI). Such facility can be availed within a maximum period of 3 years from the relevant due date.</li> <li>• LSF amount is levied per return and maximum amount for LSF will be limited to 100% amount involved in delayed reporting. The erstwhile ODI regulations restricted only in case of non-filing of APR.</li> <li>• Incomplete filing will be considered as non-submission.</li> <li>• If the PRI does not submit the necessary evidence/filings in relation to the overseas investment through AD bank with the RBI within the relevant due date before the issuance of the new regulation, then the same is required to be complied with the provisions of the new regulation.</li> </ul>
<b>Restriction on further financial commitment/transfer of investment</b>	<ul style="list-style-type: none"> <li>• The PRI cannot make any further financial commitment/transfer of such investments in the Foreign entity if the delay in any reporting of financial commitment/transfer of investment previously has not yet been regularized.</li> </ul>
<b>Non-applicability of ODI Rules/Regulations</b>	<ul style="list-style-type: none"> <li>• <b>New Regulations will not be applicable to:</b> <ol style="list-style-type: none"> <li>(a) Any investment made outside India by financial institution in an IFSC;</li> <li>(b) Acquisition or transfer made outside India made out of Resident Foreign Currency Account;</li> <li>(c) Out of foreign currency resources held outside India by a person employed in India subject to some conditions;</li> <li>(d) PRI may hold, own, transfer or invest in foreign currency, foreign security or any Immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.</li> </ol> </li> </ul>

## Part II: Definition/Key terms:

Title	Description
<b>Authorized dealer</b>	Only domestic branch of an Indian Bank can be an Authorized Dealer Category-I Bank ("AD bank").
<b>Control</b>	<p>The definition of control has been widened to include the following;</p> <ol style="list-style-type: none"> <li>(a) Right to appoint majority of directors,</li> <li>(b) Control management,</li> <li>(c) Involvement in policy decision, directly or indirectly, including by way of shareholder or voting agreement which entitle 10% or more of voting right in the entity or in any other manner in the entity.</li> </ol>
<b>Indian Party or Indian entity</b>	<p>Indian Party has been substituted for Indian entity. The definition of Indian entity includes the following;</p> <ol style="list-style-type: none"> <li>(a) Company,</li> <li>(b) Body Corporate,</li> <li>(c) Limited Liability Partnership ("LLP")</li> <li>(d) Registered Partnership Firm ("RPF") Incorporated/Registered under respective act.</li> </ol>

Title	Description
<b>Overseas Direct Investment</b>	<p>Overseas Direct Investment ("ODI") means;</p> <p>(a) Investment by way of acquisition of equity capital of an unlisted Foreign entity, or</p> <p>(b) Subscription to the Memorandum of Association of a Foreign entity, or</p> <p>(c) Investment in ten percent or more of the paid-up equity capital of a listed Foreign entity, or</p> <p>(d) Where the person resident in India making such investment has or acquires control, directly or indirectly, in the Foreign entity.</p> <p>If a PRI's ODI falls below the 10% of paid-up equity capital or it loses control of Foreign entity, it shall continue to be classified as an ODI.</p>
<b>Overseas Portfolio Investment</b>	<p>Overseas Portfolio Investment ("OPI") means;</p> <p>(a) Investment, other than ODI, in foreign securities, but not in any unlisted debt instruments or</p> <p>(b) Any security issued by a person resident in India who is not in an IFSC.</p> <p>Investment by PRI up to 10% of paid-up equity capital in an unlisted foreign company have been permitted, subject to specified conditions.</p>
<b>Strategic Sector</b>	<p>"Strategic sector" shall include 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.</p>
<b>Mutual Fund</b>	<p>Mutual Fund ("MF") means any fund registered as such with the Securities and Exchange Board of India. Hence, unlike earlier, MF does not include MF set up by public sector bank or a public financial institution or authorized by the RBI.</p>
<b>Net worth</b>	<p>In general, it shall have the same meaning as assigned to it in clause (57) of section 2 of the Companies Act, 2013, which specifically includes securities premium as part of reserves.</p> <p>In case of RPF or LLP, it shall be the sum of the capital contribution of partners and undistributed profits of the partners after deducting therefrom the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off.</p>

## RBSA Comments

The new rules and regulations aim to simplify and streamline the existing framework for overseas investment which permit round tripping structure, non-financial entities investing in foreign financial entities or IFSC, etc. However, RBI through FAQs or clarification could specify on what constitutes the two-layer structure for round tripping. Further, in terms of pricing guidelines, AD Bank is required to put in place a board approved policy, within 2 months from the date of the OI Directions i.e. by October 22, 2022 inter alia providing documents to be taken by the AD Bank, method of valuation to be taken into consideration, scenarios when valuation will not be insisted upon etc.

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