

## Overseas Investments by India Residents - New Rules and Regulations pave the way!

### Snapshot

Regulations pertaining to overseas investment have been totally revamped to factor the changing economic scenario. The new notifications provide for various regulations and rules including those pertaining to round tripping, valuation norms, investment in IFSC, investment in start-ups, adherence to arm's length principle for debt transactions, deferred payment considerations, etc.

The reporting requirements have also undergone a change and the rules & regulations now provide for multiple new forms and implications in cases pertaining to delay in reporting overseas investments.

While the new regulations would bring in a lot of certainty on various areas, it would be important that the Government periodically updates the same to meet with the requirements of changing times.

### Background

With a view to rationalize the provisions for investment overseas by a person resident in India, **Foreign Exchange Management (Overseas Investment) Rules, 2022** have been framed by the Government of India in consultation with the Reserve Bank and notified with effect from **August 22, 2022**. In addition, **Foreign Exchange Management (Overseas Investment) Regulations, 2022** have also been notified by the Reserve Bank of India with effect from **August 22, 2022**. Till now, the overseas investment by a person resident in India was governed by the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015, which now stand superseded by the new Rules / Regulations. The said notifications have been issued after a comprehensive analysis and evaluation by various stakeholders on the draft Rules and Regulations which were put in the public domain for consultations in August of last year. The primary objective of the introduction of new provisions was that the extant Regulations were almost issued two decades back and did not encompass the new economic scenario and the aspirations of Indian corporate sector to establish a footprint outside India. Furthermore, in line with the Foreign Investment in India Rules, the investment norms for Overseas Investments too have been reviewed from a fresh perspective and instead of adopting a 'pick and choose' approach through AP Circulars and Notifications, a comprehensive revamp has been carried out. The whole exercise is to enable the thrust for "Ease of Doing Business" mantra.

Some of the **salient features** of these notifications are:

1. Investment in '**Strategic sector**' permitted beyond the overall investment limits of 400% of the net-worth of the Indian entity.
2. Overseas Direct Investment (ODI) and Overseas Portfolio Investment (OPI) have been clearly defined to avoid ambiguity and compliance issues.
3. Overseas Investment by an Indian entity in a foreign entity, which already has investment in India or proposes investment now permitted.
4. Profit making Indian entities not engaged in the financial services sector permitted to invest in an entity engaged in the financial services sector outside India.
5. An Indian entity is permitted to make Overseas Portfolio Investment (OPI) up to 50% of its net worth as per the last audited balance sheet.
6. No Objection Certificate (NOC) required for an Indian entity having NPA with a financial institution / declared willful defaulter or undergoing investigation by an investigative agency such as ED/CBI etc., before undertaking financial commitment overseas.
7. Divestment from overseas investment permitted even if such investment held for less than one year for certain cases such as merger / demerger / amalgamation.
8. Restructuring of balance sheet permitted for cases where the overseas entity has been incurring losses for the previous two financial years, as evidenced from the audited balance sheet.
9. Resident Individual is permitted to make ODI and OPI subject to the overall ceiling under the Liberalized Remittance Scheme (LRS).
10. Resident Individual is permitted to acquire foreign securities by way of inheritance (from a person resident in India or outside India) or gift (from a relative resident in India) without any limits.

11. Overseas Investment in International Financial Services Centre ('IFSC') permitted to a person resident in India as per the new Rules / Regulations regulating such investments.
12. Deferred payment consideration for acquisition of equity stake in overseas entity permitted subject to the same being specified in terms of share purchase agreement and will be treated as non-fund-based commitment till payment of consideration.
13. Financial commitment in the form of debt to comply with arm's length principle.
14. Reporting compliances have also been strengthened and enhanced to include:
  - OPI investment by person resident in India (other than resident individual) shall report such investment / sale within 60 days from end of half year (Sep & Mar) when such activity takes place.
  - New forms Form FC, Form APR and Form OPI replaces existing Form ODI.
  - Late Submission Fees ('LSF') shall be levied on delays in reporting compliances, subject to maximum of three years from the due date of such submission. A window of three years to regularize the past reporting compliances is granted for a period of three years from the date of publication of the Regulations in the Gazette (i.e.) August 22, 2022.
  - No further financial commitment (fund or non-fund based) can be undertaken by a person resident in India till the reporting compliances are regularized.

A comparative analysis of the erstwhile and the new provisions is provided in the subsequent pages.

### Comparative Analysis

Sr. No.	Particulars	Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004	Foreign Exchange Management (Overseas Investment) Rules, 2022 and Foreign Exchange Management (Overseas Investment) Regulations, 2022	Observations / Impact
1	Definitions			
A	Net Worth	Net Worth means paid up capital and free reserves	Net Worth means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, excluding the reserves created out of revaluation of assets, write-back of depreciation and amalgamation.	<ul style="list-style-type: none"> <li>• Net Worth of Companies to be determined as per clause (57) of section 2 of the Companies Act, 2013.</li> <li>• Methodology for working out Net Worth of LLP/Partnership firm specified.</li> <li>• Enhanced clarity on the determination of Net Worth now avoids ambiguity.</li> <li>• Limit for Overseas Investment however remains unchanged at 400% of Net Worth.</li> </ul>
B	Control	Control not defined	Control means the right to appoint majority of the directors or to control management or policy decisions by virtue of the shareholding or management rights or shareholders' agreements or voting agreements that entitle them to ten per cent. or more of voting rights or in any other manner in the entity.	<ul style="list-style-type: none"> <li>• Definition of 'control' introduced as threshold limits for investment under for Overseas Portfolio Investment (OPI) now put in place.</li> <li>• Control is subjective and how to determine the same may be left to AD Bank interpretation. <i>One of the major ramifications is that if an Indian Entity does not have control over the Foreign Entity, it shall not be permitted to extend loan to such entity.</i></li> </ul>

Sr. No.	Particulars	Old Regulations	New Regulations	Observations / Impact
C	Indian Party / Indian Entity	Indian Party was defined	Nomenclature 'Indian Party' replaced with 'Indian Entity', with definition remaining the same for persons who can invest outside India.	<ul style="list-style-type: none"> <li>Indian Party renamed to 'Indian Entity'.</li> <li>Investments made through other than persons specified in the definition of 'Indian Entity' shall be under the RBI approval route.</li> </ul>
D	Last Audited Balance Sheet	Not defined	Last audited balance sheet means audited balance sheet as on date not exceeding eighteen months preceding the date of the transaction.	<ul style="list-style-type: none"> <li>Definition provides clarity on which balance sheet can be used for the purposes of ODI.</li> </ul>
E	Overseas Direct Investment	"Direct investment outside India" means 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 but does not include portfolio investment	<p>It means investment by way of</p> <ul style="list-style-type: none"> <li>acquisition of unlisted equity capital of a foreign entity, or</li> <li>subscription as a part MOA of a foreign entity, or</li> <li>investment in ten per cent, or more of the paid-up equity capital of a listed foreign entity or</li> <li>investment with control where investment is less than ten per cent of the paid-up equity capital of a listed foreign entity.</li> </ul>	<ul style="list-style-type: none"> <li>Definition more elaborate and clearly demarcates between what constitutes Overseas Direct Investment ('ODI') vis a vis Overseas Portfolio Investment ('OPI').</li> <li>Concept of 'control' introduced in the definition so as to ensure that with a limited investment stake too, an Indian Entity can have management control, thereby ensuring that such limited holding also gets covered under the ODI Rules.</li> </ul>
F	Foreign Entity	Overseas direct investment was categorised either as a Joint Venture or a Wholly Owned Subsidiary	Foreign Entity means an entity formed or registered or incorporated outside India, including International Financial Services Centre that has limited liability.	<ul style="list-style-type: none"> <li>Any entity incorporated outside India with Indian shareholding will be considered a Foreign Entity, irrespective of the % held by Indian Entity.</li> <li>Entity incorporated in IFSC has been brought into the definition of foreign entity.</li> </ul>

Sr. No.	Particulars	Old Regulations	New Regulations	Observations / Impact
G	Overseas Portfolio Investment ('OPI')	Not defined	It means investment, other than ODI, in foreign securities, but not in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC.	<ul style="list-style-type: none"> <li>Any investment in a foreign entity below 10% of paid-up capital with a non-controlling stake shall be considered OPI.</li> <li>Earlier portfolio investment was subject to interpretation with every AD Bank making own interpretation.</li> <li>For Indian Entities OPI includes:                             <ul style="list-style-type: none"> <li>investments in listed securities (subject to the overall investment cap of 50% of the net worth)</li> </ul> </li> <li>For Resident Individual OPI includes (subsumed under LRS limits):                             <ul style="list-style-type: none"> <li>investments in listed securities</li> <li>Sweat equity shares</li> <li>Qualification shares</li> <li>ESOPs / Employee Benefits Scheme</li> </ul> </li> </ul>
H	Strategic Sector	Not defined	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.	<ul style="list-style-type: none"> <li>New concept for overseas investment introduced.</li> <li>RBI on application permit financial commitment in strategic sector or geographies, in excess of the threshold limit of 400%.</li> </ul>

Sr. No.	Particulars	Old Regulations	New Regulations	Observations / Impact
I	Debt Instruments	Not defined	The constituents of debt instruments <sup>1</sup> are defined in Foreign Exchange Management (Overseas Investment) Rules, 2022.	<ul style="list-style-type: none"> <li>Debt instrument defined as the Overseas Investment Rules now covers both non-debt instruments as well as debt instruments.</li> </ul>
J	Non-Debt Instruments	Not defined	The constituents of Non debt instruments <sup>1</sup> are defined in Foreign Exchange Management (Overseas Investment) Rules, 2022.	<ul style="list-style-type: none"> <li>Akin to debt instruments, non-debt instruments also defined so as to provide clarity on which are the NDI instruments for investment under ODI.</li> <li>The list of non-debt instruments helps in determining the nature of financial commitment.</li> </ul>
2	Cases where Overseas Investment Rules & Regulations provisions NOT APPLICABLE	Covered under the head "Purchase and sale of foreign security by a person resident in India" in the extant Regulations	<p>It shall not apply to – any investment made outside India by a financial institution in an IFSC;</p> <p>acquisition or transfer of any investment outside India made –</p> <p>out of Resident Foreign Currency Account; or out of foreign currency resources held outside India by a person who is employed in India for a specific duration irrespective of length thereof or for a specific job or assignment, duration of which does not exceed three years; or in accordance with sub-section (4) of section 6 of the Act (i.e. a person resident in India had acquired when he was resident outside India or inherited from a person who was resident outside India).</p>	<ul style="list-style-type: none"> <li>The erstwhile regulations covered such investments under the general permission while the current rules omit them from the Overseas Investment Rules.</li> <li>Furthermore, the exclusion covered in the new Rules extends to all investments held u/s 6(4).</li> </ul>

Sr. No.	Particulars	Old Regulations	New Regulations	Observations / Impact
3	No Objection Certificate (NOC) – for Financial Commitment	No such provision	<p>Any person resident in India who,</p> <ol style="list-style-type: none"> <li>has an account appearing as a non-performing asset; or</li> <li>is classified as a wilful defaulter by any bank; or</li> <li>is under investigation by a financial service regulator or by investigative agencies in India, namely, the Central Bureau of Investigation or Directorate of Enforcement or Serious Frauds Investigation Office;</li> </ol> <p>has to obtain NOC from the concerned authority before making any financial commitment or divesting their stake in the foreign entity.</p>	<ul style="list-style-type: none"> <li>Important ramifications for Indian entities which have ongoing investigations by a regulatory / investigative authority or debt appearing as NPA.</li> <li>Such Indian entity shall have to take prior permission / NOC from an AD Bank or ED / CBI prior to making financial commitment overseas.</li> <li>If such a financial institution does not give approval within 60 days from date of receipt of such application, it will be treated as there was no objection to the certificate.</li> </ul>
4	Valuation (Pricing Guidelines)	<p><b>For existing company</b></p> <p>For investment more than USD 5 million - Category I Merchant Banker registered with SEBI or an Investment Banker / Merchant Banker outside India. For investments less than USD 5 million, valuation report could be issued by a Chartered Accountant or a Certified Public Accountant.</p>	<p>Issue or transfer of equity capital of a foreign entity (existing or new) shall be to a price arrived on an arm's length basis, which should be as per as per any internationally accepted pricing methodology for valuation.</p>	<ul style="list-style-type: none"> <li>No threshold limit for issuance of valuation report to comply with pricing guidelines.</li> <li>Valuation Report may be issued as per the internal policy of the AD Bank.</li> <li>Though it is not specified, there could be an additional requirement for issuance of valuation certificate by CA/CPA for subscription to memorandum, where shares are issued at par.</li> </ul>

Sr. No.	Particulars	Old Regulations	New Regulations	Observations / Impact
		There was no requirement of valuation report for subscription to memorandum.		
5	Transfer of Shares	Transfer of stake permitted in JV/WOS such entity had been in operation for at least one full year and APR submitted to the RBI	The Indian Entity may divest its stake in foreign entity if it stayed invested for at least one year from the date of making ODI.  The "one year" condition shall not be applicable in case of a merger/ demerger / amalgamation.	<ul style="list-style-type: none"> <li>• Ambiguity of divestment from date of operations removed by replacing it with date of investment.</li> <li>• In case of a merger / demerger / amalgamation the minimum investment period done away with, if arrangement between two or more wholly owned foreign entities or where the Indian shareholding remains unchanged.</li> </ul>
6	Holding of Initial Investment not permitted	No such provision	The holding or transfer of any investment in any manner shall not be permitted if the initial investment was not permitted under the Act.	<ul style="list-style-type: none"> <li>• For cases where the initial investment was not permitted, such person cannot hold or transfer the investment.</li> <li>• Option only to regularize the initial investment and compound post which he may continue to hold/transfer the investment if permitted under the extant rules / regulations.</li> </ul>
7	Restructuring	Restructuring by way of write off was permitted if investment was in WOS or JV with at least 51 per cent stake: <ul style="list-style-type: none"> <li>• Listed Indian companies up to 25 per cent of the equity investment - <b>Automatic Route.</b></li> </ul>	The diminution in value of outstanding dues shall be duly certified on an arm's length basis by a registered valuer (as per CA, 2013) or valuer registered with the regulatory authority or CPA in the host jurisdiction, where: <ul style="list-style-type: none"> <li>• In case of original investment is more than USD 10 million or</li> </ul>	<ul style="list-style-type: none"> <li>• Restructuring permitted under Automatic route for both listed / unlisted Indian Cos.</li> <li>• Restructuring of the balance sheet permitted only for loss making foreign entities.</li> </ul>

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		<ul style="list-style-type: none"> <li>Unlisted Indian companies up to 25 per cent of the equity investment - <b>Approval Route.</b></li> </ul>	<ul style="list-style-type: none"> <li>The amount of such diminution exceeds 25% of the total value of the outstanding dues.</li> <li>diminution in the total value of the outstanding dues after the said restructuring shall not exceed the proportionate amount of the accumulated losses.</li> </ul>	
<b>8</b>	<b>Restrictions &amp; Prohibitions</b>			
<b>A</b>	Start-ups	No specific provisions	<p>Any ODI in start-ups recognised under the laws of the host country:</p> <ul style="list-style-type: none"> <li>- <b>For Indian Entities:</b> From internal accruals (it may be from Indian entity or group or associate companies in India)</li> <li>- <b>For Resident Individuals:</b> From own funds.</li> </ul>	<ul style="list-style-type: none"> <li>Strategic sector includes 'start up'. Thus, all relaxations permitted under strategic sector applicable for investment in start-up.</li> <li>Financial commitment only from internal accruals / own funds.</li> </ul>
<b>B</b>	Investment in Foreign Entity having investment in India (ODI – FDI structure)	Not permitted / prohibited	<p>No financial commitment in a foreign entity that has invested or invests into India, at the time of making such financial commitment or at any time thereafter, either directly or indirectly, resulting in a structure with <b>more than two layers of subsidiaries.</b></p> <p><i>Not Applicable to certain entities such as</i></p>	<ul style="list-style-type: none"> <li>Major shift in stance, where it is now permitted to have an ODI – FDI structure, which was earlier prohibited as covered under 'round tripping'.</li> <li>Investments are subject to ensuring that such transactions do not result in more than two layers of direct / indirect subsidiaries (in India).</li> <li>Note: Erstwhile FEMA ODI Regulations had never defined such structures under the head 'round</li> </ul>

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			<i>financial services sector including Banks, Insurance Cos., NBFCs and Government Cos.</i>	<i>tripping'</i> , but such investments were not permitted.
9	ODI in foreign financial service entity	Only entities which are registered with the regulatory authority (i.e.) RBI / IRDA / PFRDA / SEBI shall be permitted to make investments in financial sector	An Indian entity not engaged in financial services activity in India may make ODI in a foreign entity, engaged in financial services activity, <b>except banking or insurance</b> , provided such Indian entity has posted net profits during the preceding 3 Financial Years.	<ul style="list-style-type: none"> <li>The rationale seems to be to make more sectors open to investment overseas.</li> </ul>
10	Overseas Investment in IFSC	Covered under Foreign Exchange Management (International Financial Service Center) Regulations 2015	Foreign Exchange Management (Overseas Investment) Regulations, 2022 notified.	<ul style="list-style-type: none"> <li>Specific provisions for modalities of investment in IFSC now notified.</li> </ul>
11	Immovable Property Outside India	Not covered. Earlier governed by Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015	<p>Subsumed under the new Rules notified now.</p> <ul style="list-style-type: none"> <li>A person resident in India may acquire immovable property:                             <ul style="list-style-type: none"> <li>✓ from a person resident in India by way of gift / inheritance or by way of purchase.</li> <li>✓ from a person resident outside India, by way of inheritance, balances in RFC account, under LRS with relatives being Indian residents, jointly with relative who</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Acquiring immovable property now covered under the Overseas Investment Rules.</li> <li>Restrictions such as funds cannot be remitted from India if property acquired with relative who is a person resident outside India omitted.</li> <li>For 'representative office' / overseas office, it may be understood that the extant limits as prescribed under FEMA notification 23(R)/2015 – RB on Foreign Exchange Management (Export of Goods and Services) Regulations, 2015, read with Master Direction (Export of Goods and Services) shall continue.</li> </ul>

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			<p>is person resident outside India or out of income or sale proceeds of assets other than ODI.</p> <ul style="list-style-type: none"> <li>Indian entity having overseas office may acquire immovable property for business / residential purposes of its staff.</li> <li>Immovable property outside India can be acquired on a lease for not exceeding 5 years.</li> </ul>	
12	Financial commitment by way of debt	No conditions specified	<p>An Indian entity may lend or invest in any debt instruments issued by a foreign entity subject to:</p> <ul style="list-style-type: none"> <li>loans are duly backed by a loan agreement</li> <li>rate of interest shall be charged on an arm's length basis.</li> </ul>	<ul style="list-style-type: none"> <li>Any Indian Entity extending financial commitment in form of loan shall have to levy an interest on the principal amount which shall be chargeable on an arm's length basis.</li> <li>In addition to interest, the said arrangement has to be recorded in form of a loan agreement / document.</li> </ul> <p><i>Note: Further clarity awaited for cases where a loan has already been extended to a Foreign Entity at either NIL rate or not on arm's length basis.</i></p>
13	Acquisition or transfer by way of deferred payment	Not permitted	<p>A person resident in India acquiring</p> <ul style="list-style-type: none"> <li>equity capital by way of subscription to an issue or</li> <li>purchase from a person resident outside India or</li> </ul>	<ul style="list-style-type: none"> <li>To bring in more operational convenience and ease of transactions the deferred payment norms have been introduced</li> <li>Against the FDI Rules where the period for payment of deferred amount is limited to 18 months, no such restriction prescribed in the OI</li> </ul>

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			<ul style="list-style-type: none"> <li>- a person resident outside India acquires equity capital by way of purchase from a person resident in India, and</li> <li>- such equity capital is reckoned as ODI,</li> </ul> <p>the payment of amount of the consideration for acquisition may be deferred for such definite period from the date of the agreement as provided in such agreement,</p> <p>subject to the following terms and conditions:</p> <ul style="list-style-type: none"> <li>• the foreign securities equivalent to the amount of total consideration shall be transferred or issued, upfront by the seller to the buyer;</li> <li>• the full consideration finally paid shall be compliant with the applicable pricing guidelines.</li> </ul>	<ul style="list-style-type: none"> <li>• Regulations, which is subject to terms of the agreement.</li> </ul> <p>For reporting of the deferred payment at the time of initial payment, the deferred part of the consideration shall be treated as non-fund-based commitment.</p>
14	Repatriation of dues in India	Indian Party shall repatriate to India, all dues receivable from the foreign entity <b>within sixty days</b> from the date of becoming due	A person resident in India shall realise and repatriate to India, all dues receivable from the foreign entity <b>within ninety days</b> from the date of becoming due.	<ul style="list-style-type: none"> <li>• Timeline extended by 30 days for receipt of dues from foreign entity.</li> <li>• Relief to overseas entities in remittance given the business considerations / scenario.</li> </ul>

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15	Delay Reporting in	No such provision	<p>A person resident in India who does not submit the evidence of investment within the specified time limit or does not make any filing within the specified time limit may make such submission or filing along with <b>Late Submission Fee</b> within such period and rate as may be advised by RBI.</p> <p>However, such facility can be availed within a maximum period of three years from the due date of such submission or filing.</p>	<ul style="list-style-type: none"> <li>• Under erstwhile Regulations, the only option was to compound the reporting delays.</li> <li>• LSF introduced in line with FDI Rules &amp; Regulations.</li> <li>• LSF to apply to contraventions for reporting delays.</li> <li>• RBI providing relief to pay LSF for delayed reporting / submissions <b>under the Old Regulations up to three years</b> from the date of this notification.</li> </ul>

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For further analysis and discussion, you may please reach out to us.

## Locations

### Ahmedabad

**Arpit Jain**

Level 11, Tower B, Ratnaakar Nine Square, Vastrapur, Ahmedabad - 380 015

Phone: + 91 79 4910 2200  
arpit.jain@kcmehtha.com

### Bengaluru

**Payal Shah**

19/4, Between 7th & 8th Cross, Malleswaram, Bengaluru - 560 003

Phone: +91 80 2356 1880  
payal.shah@kcmehtha.com

### Mumbai

**Vishal Doshi**

508, The Summit Business Bay, Nr. WEH Metro Station, Gundavali, Andheri East, Mumbai - 400069

Phone: +91 22 2612 5834  
vishal.doshi@kcmehtha.com

### Vadodara

**Milin Mehta**

Meghdhanush, Race Course, Vadodara - 390 007

Phone: +91 265 2440400  
milin.mehta@kcmehtha.com

Independent Member of

**B K R**  
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**K C Mehta & Co LLP**

Chartered Accountants