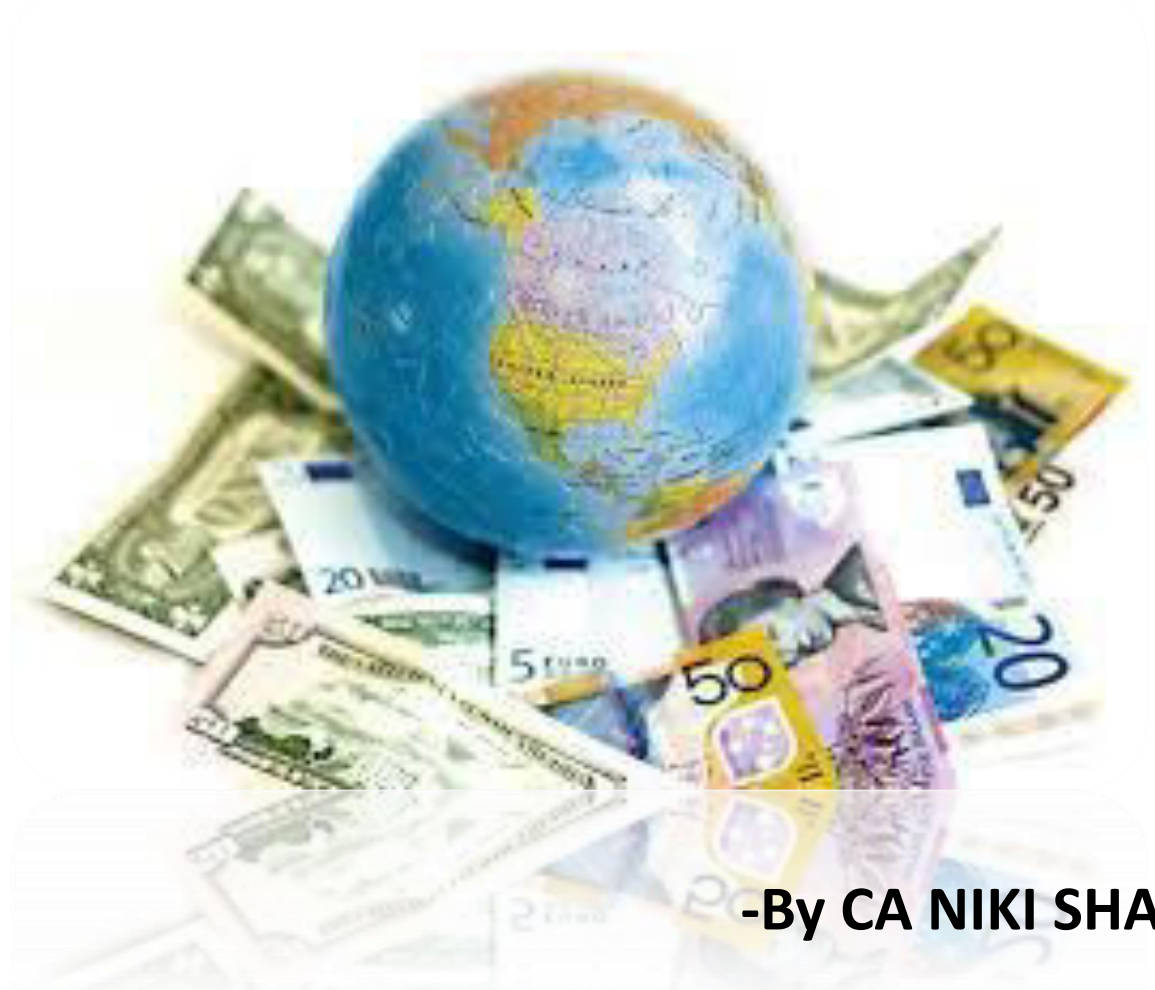


Overseas Direct Investment



-By CA NIKI SHAH

Index

Sr No	Particulars
1.	Introduction to ODI
2.	Important Definitions
3.	Route for ODI by Indian Parties
4.	Restrictions/Prohibitions
5.	Funding for ODI
6.	Valuations of Shares
7.	Compliance obligations
8.	Transfer of Shares
9.	Compounding of fees

Introduction:

1. Overseas investments (or financial commitment) in :

- Joint Venture (JV) &
- Wholly Owned Subsidiaries (WOS)

have been recognized as important avenues for promoting global business by Indian entrepreneurs.

2. Joint ventures are perceived as a medium of:

- economic &
- business co-operation between India and other countries.

3. Transfer of :

- Technology & skill
- Sharing of results of R&D
- Access to wider global market
- Promotion of brand image
- Generation of employment &
- Utilization of raw materials

available in India & in the host country are other significant benefits arising out of such overseas investments (or financial commitment).

How it operates

- No person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India –Section 4 of FEMA.
- Section 6 of FEMA-
Section 6(1)-Any person may sell or draw forex for a capital account transaction. Sections 6(2) and 6(3) gave powers to RBI to prescribe, regulate, prohibit or restrict transactions.
- FEMA Notification No.1 lists Permissible Capital Account Transactions
ODI is a capital account transaction
- FEMA Notification No. 120“Transfer or Issue of any Foreign Security” lays down overseas investment regulation.-Unless permitted, transaction is prohibited
- Regulated **by RBI & Enforced by ED.**

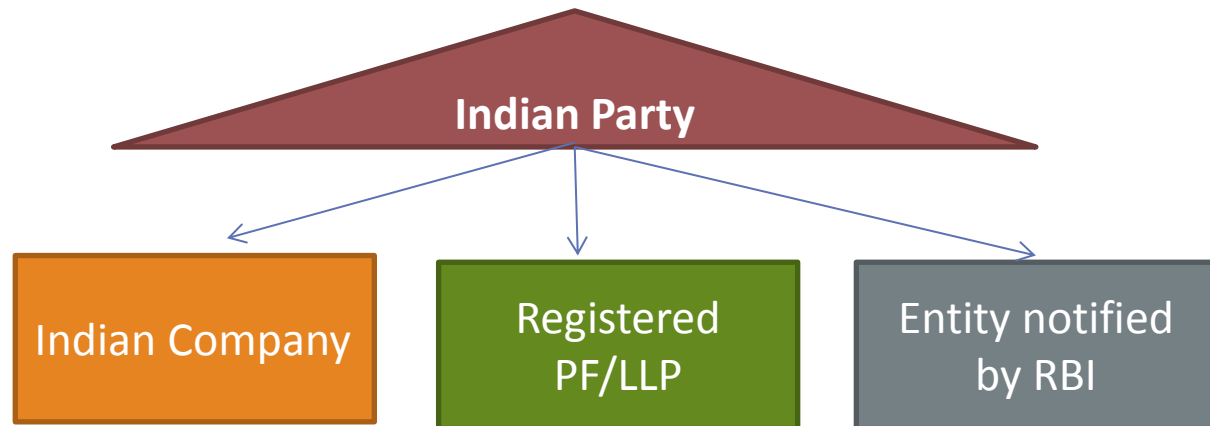
S N & Co.

CHARTERED ACCOUNTANTS

!!Audit !!Taxopedia !!Advisory

Important Definitions

- **“Direct Investment outside India”** by an **“Indian Party”** in a **“JV”** or **“WOS”** is allowed under Automatic Route if the total **“Financial Commitment”** of the Indian Party in JV/WOS does not exceed 400% of its **“net worth”**.



Where more than one such entities make investment jointly, all entities together shall constitute “Indian Party”

Investment by Resident Individuals-LRS-ODI

- Resident Individuals -allowed to form JV/WOS outside India under LRS-ODI from 5thAugust 2013 vide Notification No FEMA 263/RB-2013
- Portfolio Investment not allowed.
- Investment limited to USD 2,50,000 per Financial Year
- Investment only in equity or compulsorily convertible preference shares (No guarantees allowed)
- Valuation to be done by Category I Merchant Banker registered with SEBI or a registered Investment Banker / Merchant Banker in host country if investment is more than USD 5 million and in all other case by CA or CPA.

Other Permissible Investment in Foreign Securities

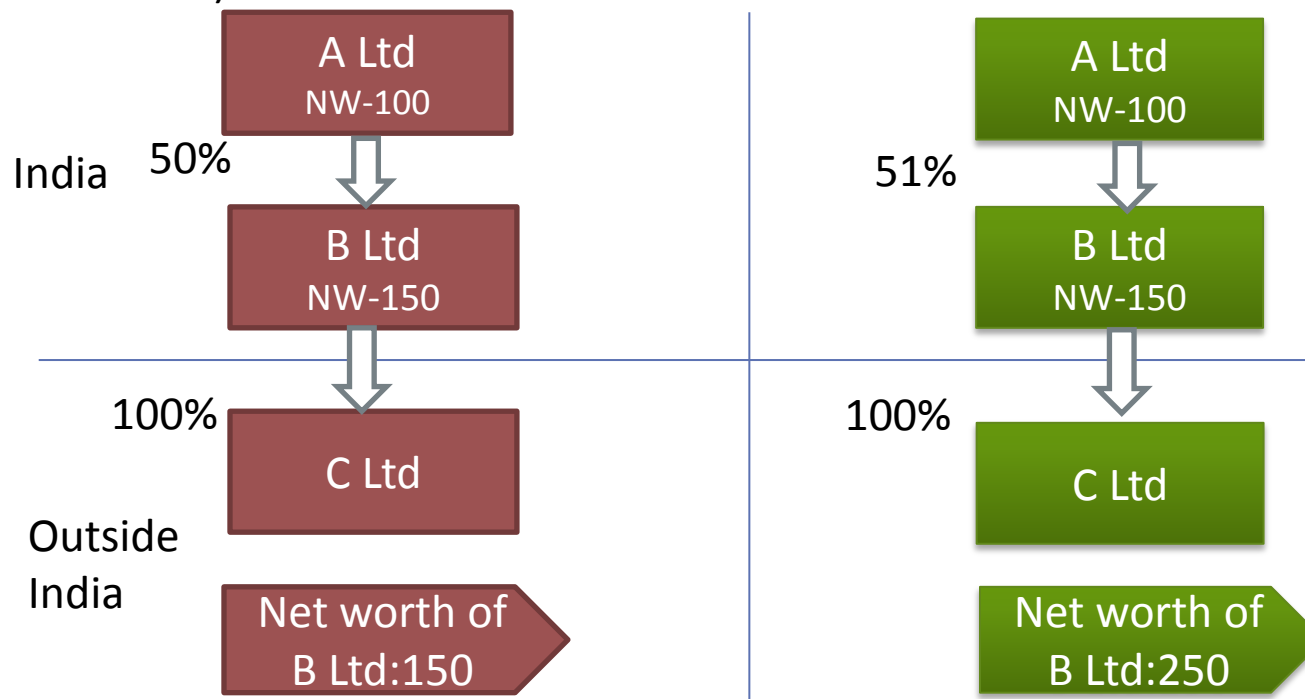
General permission to Individuals resident in India for:

- Gift from a person resident outside India;
- Shares under ESOP;
- Shares by way of inheritance from a person whether resident in or outside India;
- When not permanently resident in India, from the foreign currency resources outside India.
- Qualification shares for becoming director of company outside India as per law of host country within LRS limit;
- Foreign security in part/full consideration of professional service rendered to foreign company or in lieu of director remuneration within LRS limit;
- **Rights shares** provided such shares are issued by virtue of holding shares in accordance with law

➤ Net Worth

For Calculating of Net Worth of the Indian Party following to be Considered:

- Net worth of the Indian Investing company (say B Ltd).
- Net worth of the Indian Holding company of B Ltd (which holds at least 51% stake of B Ltd.).
- Net worth of the Indian Subsidiary Company of B Ltd (in which A Ltd holds at least 51%).



➤ **Direct Investment**

- Investment by way of contribution to the capital of a foreign entity; 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**.
- **“Joint Venture (JV)”** means 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.
- “Even if Indian entity make Investment only to extent of 5% of the total investment Such investment under “ODI” route ?**
- **“Wholly Owned Subsidiary (WOS)”** means 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 .
- “ Can ODI investment be made in LLC?**

➤ Financial Commitment

-Personal guarantee by the indirect resident individual promoters of the Indian Party

-Primary or collateral.

-Guarantee by the promoter company, group company, sister concern or associate company in India.

No guarantee should be 'open ended'.

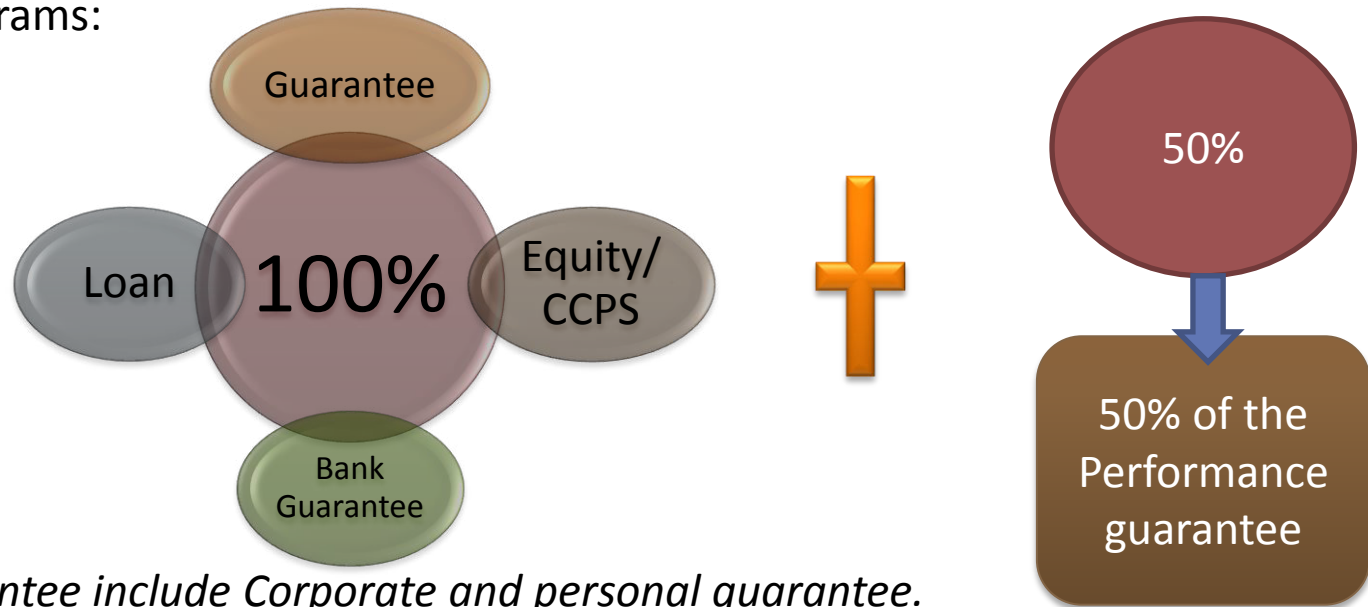
The Indian Party / entity may extend loan / guarantee only to an overseas JV / WOS in which it has **equity participation**.

Proposals from the Indian Party for undertaking financial commitment **without equity contribution** in JV / WOS may be considered by the Reserve Bank under the approval route.

All the financial commitments, including all forms of guarantees and creation of charge are within the overall ceiling prescribed for the Indian Party

All guarantees (including performance guarantees and Bank Guarantees / SBLC) are required to be reported to the Reserve Bank in Form ODI-Part II.

- **“Financial Commitment”** means Sum total of the following pictorial diagrams:



**Guarantee include Corporate and personal guarantee.*

Total Financial Commitment in JV/WOS restricted of 400% of Indian Party's Net Worth.

-Any financial commitment exceeding USD 1 billion (or its equivalent) in a financial year to require prior approval of RBI even if total financial commitment is within the above limit.

-Ceiling of 400% not to apply in case of ODI out of balances held in EEFC account and ADR/GDR proceeds.

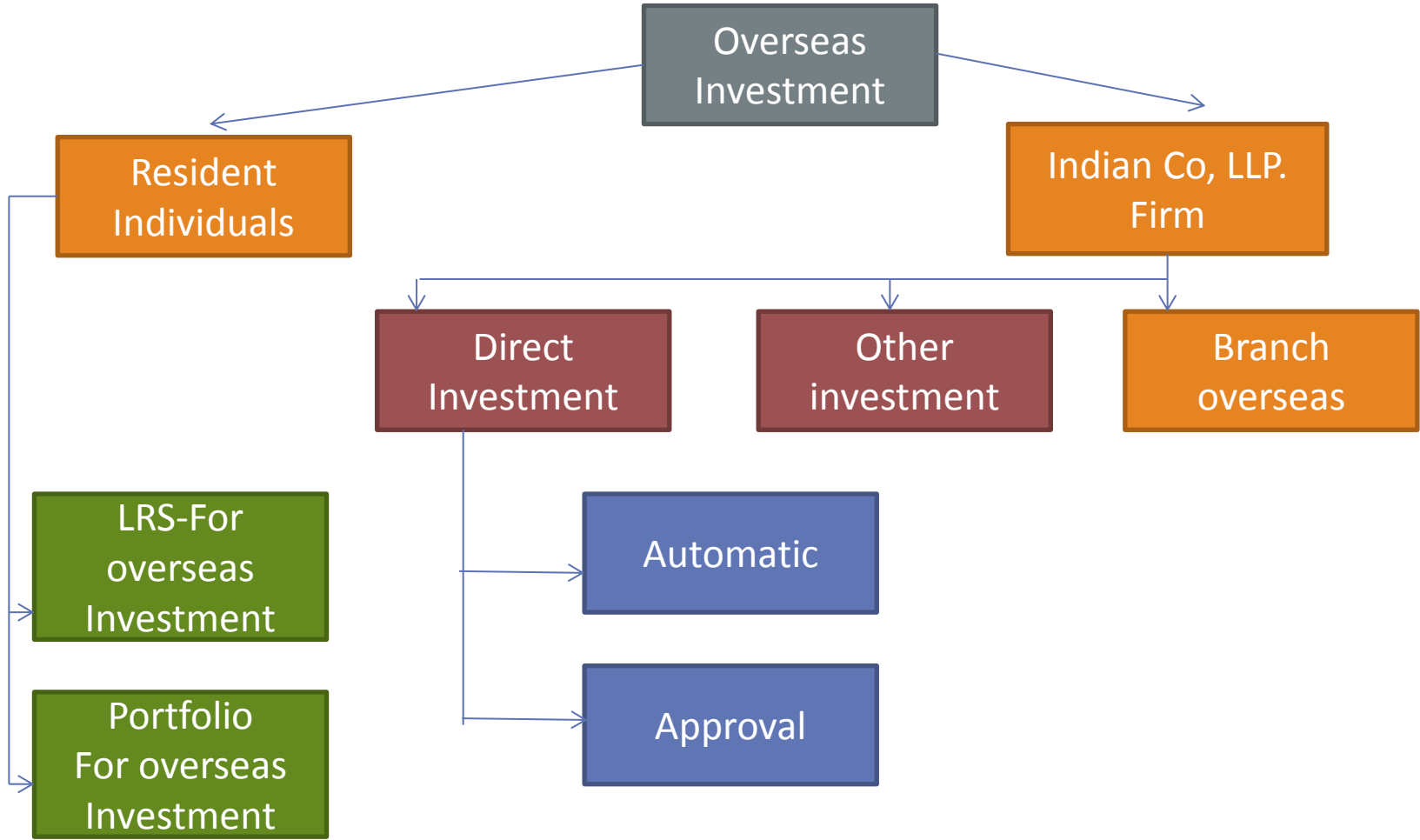
Case Study: Financial Commitment

Z LTD, Indian Co.		
Particulars	Option 1	Option 2
Net Worth of Z Ltd	500	500
Balance in EEFC Account	100	200
Acquired A LTD,USA	50	50
What is the balance limit to Indian Co for Financial Commitment ?		
Answer	1950	1970

Rollover of Guarantees

- An existing / original guarantee, which is part of the total financial commitment of the Indian Party, should not be treated / reckon the renewal / rollover, as a fresh financial commitment, provided that:
 - **the existing / original guarantee** was issued in terms of the then extant / prevailing FEMA guidelines;
 - there is no **change in the end use of the guarantee**, i.e. the facilities availed by the JV / WOS / StepDown Subsidiary;
 - there is no change in any of the terms & conditions, including the amount of the guarantee except the validity period;
 - the reporting of the rolled over guarantee would be done in Form ODI - Part I; and
 - if the Indian Party is under investigation by any investigation / enforcement agency or regulatory body, the concerned agency / body shall be kept informed about the same.

Overseas Investment Routes



➤ **Automatic Route**

- ODI Investment or Financial Commitment within limit of 400% of the Net Worth as per last audited balance sheet.
- Investment (or financial commitment) in unincorporated/ incorporated entities overseas in oil sector (Subject to prescribed Conditions).
- Construction and maintenance of submarine cable systems (Subject to prescribed Conditions).
- Investments (or financial commitment) in Financial Services Sector. (Subject to prescribed Conditions).

➤ **Approval Route**

- Indian party undertaking financial commitment without equity contribution in JV / WOS.
- Overseas Investments by proprietorship, unregistered partnership firms; Registered Trusts /Societies satisfying certain eligibility criteria.
- ODI not meeting conditions prescribed for automatic route.

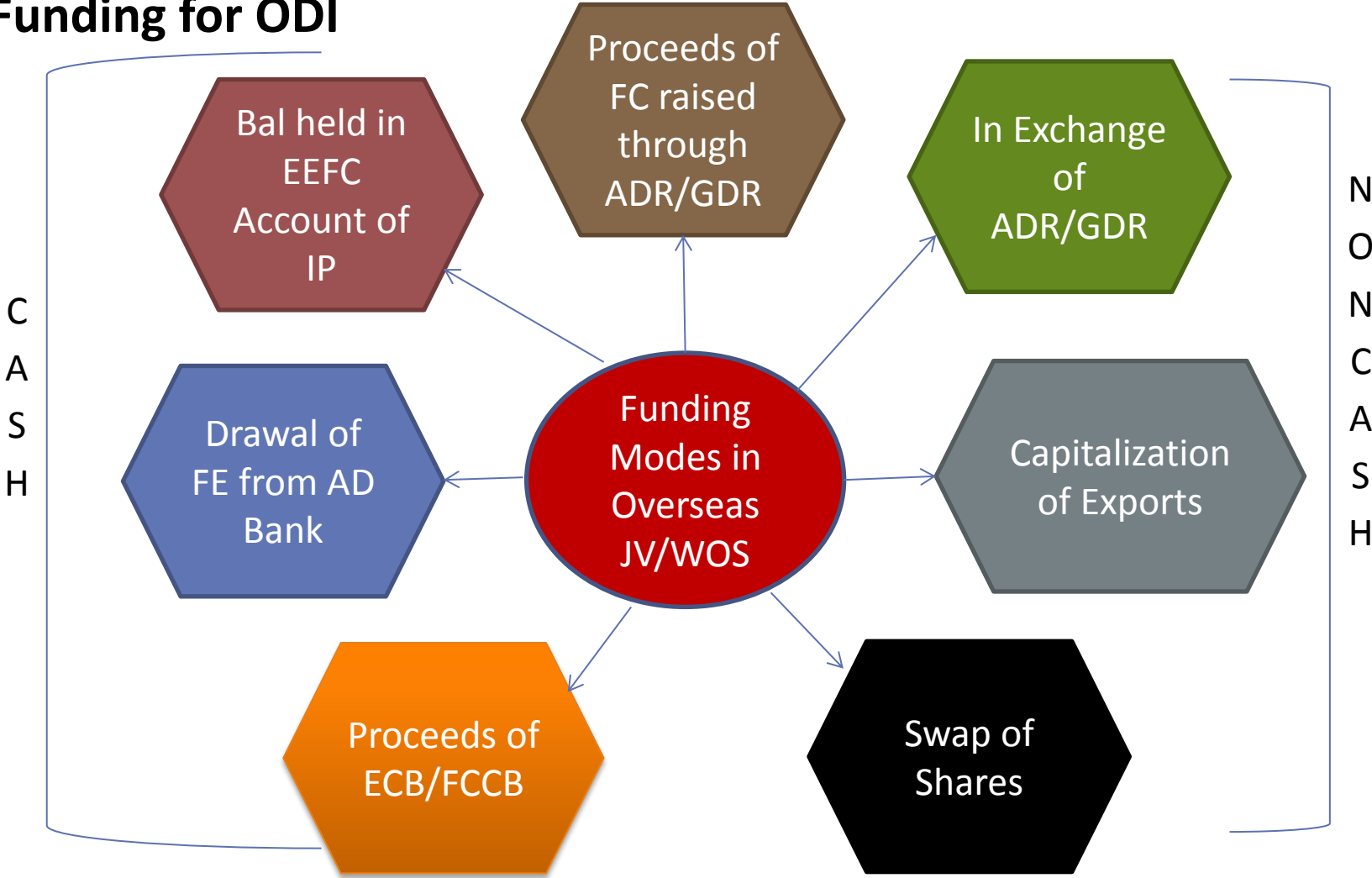
Restrictions/Prohibitions:

- Prohibited to invest in a JV / WOS which is engaged in:



- **Cannot invest** in countries identified as “non-cooperative countries and territories” by FATF.
- Resident individual should not be on Reserve Bank's Exporters Caution List or List of defaulters to the banking system or under investigation by any investigation/enforcement agency or regulatory body.
- Investment only in operating entity.
- In case of Individual residents-No step-down subsidiary is allowed.

Funding for ODI



Valuation of Shares

➤ Requirement of valuation of shares:

- Valuation required for **investment in existing company** outside India
- **No valuation** required for **newly set-up company** outside India
- Valuation not required for issue of right shares
- Remittance for outbound investments can be of an amount which is at or lower than the value of investment

Essentially foreign exchange utilized cannot be more than value per share

➤ **No valuation methodology prescribed under FEMA** – Internationally accepted method can be used

➤ Valuation Certificate to be obtained from :

In case of investment by way of partial or full acquisition of an existing company

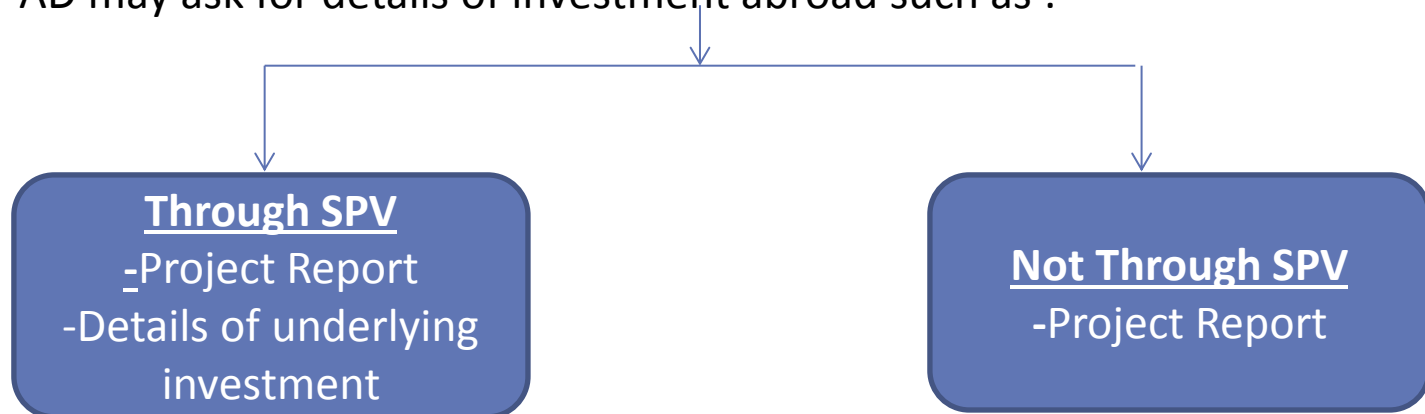
- If Investment is more than USD 5mn. – by a category I Merchant Banker registered with SEBI or a registered Investment Banker/ Merchant banker in host country
- In all other cases by a CA or CPA

In case of investment is by way of swap of shares – irrespective of amount

By registered Category I Merchant Banker or Registered Merchant Banker in the host country.

How to make investment ?

- Indian Party _____ to approach _____ AD Bank with FORM ODI
All transactions relating to a JV / WOS should be routed through one branch of an Authorized Dealer Bank
- To check if all prior FEMA compliance for Indian Party should have been completed (filing of APR forms for other JV/WOS required too).
- All conditions applicable for direct investment apply also to investments through SPV
- AD may ask for details of investment abroad such as :



Compliance and Obligations

Form ODI is divided into 3 parts:



On Investment/Financial Commitment File:

-Form ODI along with:

- Certified copy of Board Resolution for investment
- Statutory Auditor's Certificate
- Valuation report for the value of shares

-Obtain UIN –required for all future investments

-Post investment ensure receipt of share certificates or any other document as evidence and submit within six months to AD from the date of remittance or date when it became due

Compliance and Obligations

During Investment-

- On changes in investment report to RBI through AD Bank within 30 days of approval by competent authority of JV/WOS.
- Repatriate to India all dues viz. dividends, royalty, technical fees, etc. within 60 days of falling due.

During Disinvestment

- Disinvestment allowed only after one year from the date of first remittance
- Disinvestment proceeds to be repatriated to India immediately and in any case not later than 60 days
- No write off shall be allowed
- Disinvestment may be reported by the designated AD to the Reserve Bank in Part IV of Form ODI within 30 days of receipt of proceeds

Annually File-

- Annual Performance Report (APR) by 31st December.
- Annual Return on Foreign Assets and Liabilities (FLA) by 15th July.

Compliance with FEMA a must

- FEMA is now more draconian than FERA
- **Seizure of assets in India**
 - **Section 37A** newly introduced vide Finance Act, 2015 in FEMA
 - Provides that if any person holds any foreign exchange, foreign security or any immovable property outside India in contravention of Section 4 of FEMA, the equivalent value of property in India can be seized.
 - **No opportunity** is to be given to prove that the accused is actually innocent before seizure.
 - Exemption for assets under value of Rs 1 crore.
 - Can lead to **penalty and prosecution**.

Transfer of Shares

- Indian Party can sell shares or security held in JV/WOS to:
 - Another Indian Party satisfying ODI conditions; or
 - Person resident outside India

- No approval from RBI required if:
 - Sale does not result into write off of investment; and
 - Sale is to be effected through a stock exchange where the shares of the overseas JV/ WOS are listed; or
 - In case shares are not listed on the stock exchange and the shares are disinvested by a private arrangement, share price is not less than the value certified by a CA / CPA; and Indian Party does not have any dues outstanding from JV/WOS;
 - JV/WOS has been in operation for one full year;
 - APR for that year is filed with RBI; and
 - Indian Party is not under investigation

Transfer of Shares

- Sale without prior RBI approval allowed even where it results in write off of investment if-
 - JV/WOS is listed in overseas stock exchange;
 - Indian Party is listed on Indian stock exchange and net worth is more than Rs. 100 crore; or
 - Indian Party is listed on Indian stock exchange and net worth is less than Rs. 100 crore, but investment is less than USD 10 million; or
 - Indian Party is unlisted and investment is less than USD 10 million
 - If above conditions not met, prior RBI approval a must

- In case of disinvestment, sale proceeds of shares/ securities to be repatriated to India immediately on receipt thereof (not later than 90 days from the date of sale of the shares / securities).

Write off of Capital and Receivables

- Indian Companies having WOS abroad or at least 51% stake in overseas JV can write off capital / receivables (loans, royalty, technical knowhow fees, etc.) up to:
 - 25% of the equity investment for Listed Companies under Automatic route; and
 - 25% of the equity investment for Unlisted Companies under Approval route

- The Indian Party to apply to AD Bank and submit:
 - Certified copy of the balance sheet showing loss in the overseas JV/WOS
 - Projections for the next 5 years indicating benefit arising out of such write off/restructuring
 - Write-off / Restructuring to be reported within 30 days through AD .

Compounding Fees

Section 37A(1)-Seizure of Assets

Special provisions relating to assets held outside India in contravention of section 4.

37A.(1) Upon receipt of any information or **otherwise**, if the Authorized Officer prescribed by the Central Government has **reason to believe** that any foreign exchange, foreign security, or any immovable property, situated outside India, is **suspected** to have been held in contravention of section 4,

he may after recording the reasons in writing, by an order, **seize value equivalent, situated within India**, of such foreign exchange, foreign security or immovable property:

Provided that no such seizure shall be made in case where the aggregate value of such foreign exchange, foreign security or any immovable property, situated outside India, is less than the value as may be prescribed.

Section 13- Penalties

13.(1A) If any person is found to have acquired any foreign exchange, foreign security or immovable property, situated outside India, of the aggregate value exceeding the threshold prescribed under the proviso to sub-section (1) of section 37A, he shall be liable to a **penalty up to three times** the sum involved in such contravention and confiscation of the value equivalent, situated in India, of the foreign exchange, foreign security or immovable property.

(1B) If the Adjudicating Authority, in a proceeding under sub-section (1A) deems fit, he may, after recording the reasons in writing, recommend for the initiation of **prosecution** and if the Director of Enforcement is satisfied, he may, after recording the reasons in writing, may direct **prosecution by filing a Criminal Complaint** against the guilty person by an officer not below the rank of Assistant Director.

(1C) If any person is found to have acquired any foreign exchange, foreign security or immovable property, situated outside India, of the aggregate value exceeding the threshold prescribed under the proviso to sub-section (1) of section 37A, he shall be, in addition to the penalty imposed under sub-section (1A), **punishable with imprisonment for a term which may extend to five years and with fine.**

S N & Co.

CHARTERED ACCOUNTANTS

!!Audit !!Taxopedia !!Advisory



S N & Co
Chartered Accountants
!! Audit !! Taxopedia !! Advisory

Borivali (W) ::: Sion (W)
Tel No. 022-28910968
+91-9699710968
Website: www.snco.in
Email Id: office@snco.in

Thank you

Disclaimer:

Please note that the above is a summary of ODI provisions and the same should not consider as an advice. We recommend soliciting the advice of the consultant before taking any action. We shall not be held responsible for any action taken by anyone on the basis of this note before consulting us .

