

Overseas Direct Investment

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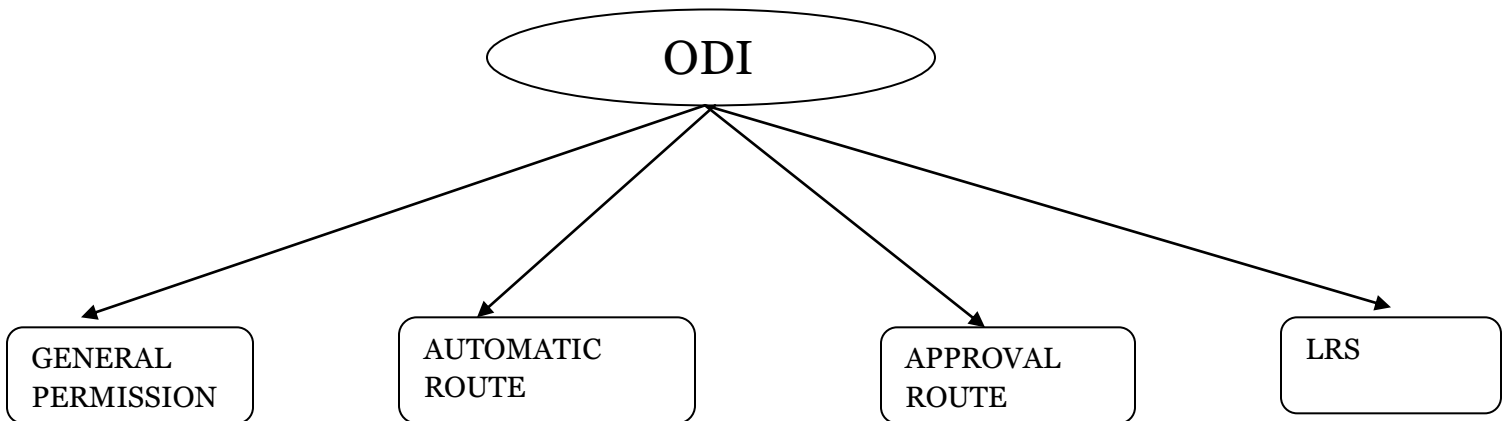
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What is Overseas Direct Investments (ODI)

Overseas Direct Investments or “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 vide market purchase or private placement but shall not include portfolio investments.

WHAT ARE THE ROUTES/APPROACHES CAN A INDIAN RESIDENT MAKES INVESTMENT ABROAD

Residents of India are prohibited for making direct investment outside India save as otherwise the following routes



This article will be mainly focusing on the automatic route available for Overseas Direct Investment (i.e investment without prior approval of RBI)

AUTOMATIC ROUTE

It is one of the most common routes for making direct investment outside India. In terms of Regulation 6 of the FEMA (Transfer or issue of any foreign security) Regulations 2004 :-

An *Indian Party* may make direct investment/ total financial commitment in *Joint venture (JV)* or *Wholly Owned Subsidiary* outside India (WOS) up to 400 percent of its net worth without any permission or approval from RBI.

The Indian Party should approach an Authorized Dealer Category-I bank with an application in relevant form and prescribe documents/enclosures for effecting the remittance towards the investments.

**Indian Party* = A company incorporated in India or
Body created under an act of parliament or
Partnership firm registered under Indian Partnership Act 1932
Limited Liability Partnership
Where more than one Indian party make an investment in the foreign entity, all such parties together shall constitute the Indian party.
"All Indian parties shall be taken on consolidation basis vis a vis with direct investment in foreign entity."

**Net worth* = Paid up capital + Free reserves on the last audited Balance sheet date.

**Joint Venture* = Simple process of investment in overseas entity will constitute a formation of Joint venture. There is no inherent requirement for formation of a separate overseas entity.

**WOS* = Foreign entity formed, registered or incorporated in the overseas host country, whose entire capital is held by Indian Party.

**Financial*

Commitment = For purpose of determining the ceiling of 400% in all the JV/WOS shall comprise of the following

- a) 100% of amount of equity shares
- b) 100% of Compulsorily convertible preference shares
- c) 100% of other preference shares
- d) 100% of amount of loan
- e) 100% of amount of guarantee issued by Indian party to overseas entity.
- f) 100% of the amount of bank guarantee backed by counter guarantee by Indian party
- g) 50% of amount of performance guarantee.

The financial commitment can be made subject to the following conditions:

- The direct investment should be made in overseas JV/WOS engaged in bonafide activities (except real estate business, banking or business of providing financial services).
- The Indian Party must have submitted its Annual Performance Report in respect of all its overseas investments in Part III of Form ODI
- No guarantee should be open ended i.e. the amount of guarantee should be specified upfront.
- Indian Party should not be on RBI's Exporters caution list/List of defaulters /CIBIL or under any investigation by enforcement agency or regulatory body.

- All transactions relating to JV/WOS will be routed through one branch of an authorized dealer.

UTILIZATION OF NET WORTH OF ITS INDIAN SUBSIDIARY/HOLDING COMPANY FOR INVESTING IN JV/WOS

For the purpose of reckoning net worth of Indian party, the net worth of its holding company (which holds at least 51% direct stake in the Indian Party) or its subsidiary company (in which Indian party holds at least 51% direct stake) may be taken into account to the extent not availed of by the holding company or the subsidiary independently and has furnished a letter of disclaimer in favor of the Indian Party. However, this facility is not available to / from partnership firms.

VALUATION OF SHARES OF FOREIGN COMPANY

Where the investment is more than USD 5 million, valuation of shares of the company shall be made by a category I Merchant Banker registered with SEBI or an Investment Banker/Merchant Banker registered with SEBI or an Investment Banker outside India registered with appropriate authority.

In other cases valuation shall be made by CA or CPA.

GURANTEE/LOANS TO OVERSEAS ENTITY UNDER AUTOMATIC ROUTE

Loan and guarantee can be extended to an overseas entity only if there is already existing equity / CCPS participation by way of direct investment under automatic route (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)

In case, however, the overseas entity is a first level step down operating subsidiary of the Indian party, guarantee may be issued by the Indian party on behalf of such step down operating subsidiary provided such guarantee is reckoned for the purpose of computing the total financial commitment of the Indian party.

In case, the overseas entity is a second or subsequent level step down operating subsidiary of the Indian party, guarantee may be issued by the Indian party on behalf of such step down operating subsidiary with prior approval of the Reserve Bank provided such Indian party holds indirect stake of not less 51% in the step down operating subsidiary and guarantee is reckoned for the purpose of computing the financial commitment of the Indian party.

➤ PERFORMANCE GUARANTEE

Indian party is permitted to issue performance guarantee and only 50 per cent of the amount of the performance guarantees will be reckoned for the purpose of computing financial. Further, the time specified for the completion of the contract will be the validity period of the related performance guarantee. In cases where invocation of the performance guarantee breach the

limit of the prescribed financial commitment, the Indian Party is required to seek prior approval of the Reserve Bank before remitting funds from India, on account of such invocation.

➤ OPEN ENDED OR CLOSE ENDED GUARANTEE

As per A.P. (DIR Series) Circular No. 29 dated March 27, 2006, no guarantee can be open ended i.e. it must specify the amount and the expiry period of the guarantee (close ended guarantee)

➤ ROLL OVER OF GUARANTEES

A guarantee, which has been issued on behalf of the overseas JV / WOS / step down subsidiary, may be allowed to be rolled over under the automatic route without subjecting the rollover to FEMA compliance afresh, provided only the validity period of the existing guarantee is undergoing change.(the rollover of existing guarantee is to be reported afresh in Part II of Form ODI)

However if there is change in the end use of guarantee or overseas lender or rate of interest or amount or

any other terms & conditions except the validity period then the appropriate FEMA compliance will be required. Any of the above change will be treated as fresh guarantee and reported online accordingly.

➤ FORECLOSURE OF GUARANTEE

The extant FEMA provisions do not envisage reporting of the foreclosure / closure of an existing guarantee by an Indian party on behalf of its JV / WOS / step down subsidiary.

GENERAL PERMISSION

A resident person in India, without any approval from RBI can

- Purchase foreign securities out of funds held in RFC account
- Acquire bonus shares of foreign securities already held
- If not a permanent residence, purchase a foreign security out of foreign currency resources outside India.
- To acquire foreign securities as a gift from any person resident outside India
- To acquire shares under cashless ESOP issued by a company outside India provided it doesn't involve any remittance from India
- To purchase equity shares offered by a foreign company under its ESOP Schemes, if he is an employee, or, a director of an Indian office or branch of a foreign company, or, a subsidiary in India of a foreign company, or, an Indian company in which foreign equity holding, either direct or through a holding company/Special Purpose Vehicle

(SPV) irrespective of the percentage of the direct or indirect equity stake in the Indian company.

- A person resident in India may transfer by way of sale the shares acquired as stated above provided that the proceeds thereof are repatriated immediately on receipt thereof and in any case not later than 90 days from date of sale of such securities.

APPROVAL ROUTE

Prior approval of the Reserve Bank would be required in all other cases of direct investment abroad. For this purpose, application together with necessary documents should be submitted in Form ODI through their Authorised Dealer Category – I banks.

Reserve Bank would, inter alia, take into account the following factors while considering such applications:

- (1) Prima facie viability of the JV / WOS outside India;
- (2) Contribution to external trade and other benefits which will accrue to India through such investment (or financial commitment) ;
- (3) Financial position and business track record of the Indian party and the foreign entity; and
- (4) Expertise and experience of the Indian party in the same or related line of activity as of the JV / WOS outside India.

LIBERALISED REMITTANCE SCHEME

A resident individual (single or in association with another resident individual or with an 'Indian Party' as defined in the Notification) satisfying the criteria as per Schedule V of the Notification, may make overseas direct investment in the equity shares and compulsorily convertible preference shares of a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) outside India. The limit of overseas direct investment by the resident individual shall be within the overall limit prescribed by the Reserve Bank of India under the provisions of Liberalised Remittance Scheme at present USD \$ 250,000