

New ODI Regime, 2022

Background

The Government of India vide Notification No. G.S.R. 646(E) notified the Foreign Exchange Management (OI) Rules, 2022 post which Reserve Bank of India vide Notification No. FEMA 400/2022-RB and A.P. (DIR Series) Circular No. 12, dated 22nd August 2022, notified Foreign Exchange Management (OI) Regulations, 2022 and the Foreign Exchange Management (Overseas Investment) Directions, 2022 (hereinafter collectively referred to as "OI Rules"). The OI Rules were notified after incorporating the feedback received from various stakeholders on the draft rules and regulations issued and circulated on 9th August 2021. The OI Rules are effective immediately and any ODI ('Overseas Direct Investment') made under the erstwhile regime will be considered to have been made under the new regime.

The OI Rules have been designed to liberalize and streamline the existing framework of overseas investment by a PRI, in line with existing economic conditions in the country and have significantly reduced the need for seeking approvals.

The key changes introduced under the new overseas investment regime are tabulated herein below:

Particulars	Erstwhile ODI Regime	New ODI Regime
Overseas Direct Investments ('ODI')	<p>ODI includes investment made by way of:</p> <ul style="list-style-type: none"> Contribution to capital of a foreign entity Subscription to the MOA of a foreign entity Purchase of shares of a foreign entity (by market purchase / private placement/ on the stock exchange). 	<p>ODI includes investment made by way of</p> <ul style="list-style-type: none"> Acquisition of unlisted equity capital of a foreign entity Subscription as a part of the MOA of a foreign entity Investment in 10% or more of equity capital of a listed foreign entity Investment with control where investment is less than 10% of equity capital of a listed foreign entity <p>An IE may make ODI which shall not exceed 400% of its net worth (subject to financial commitment limit of USD 1 billion, beyond which prior RBI approval will be required). ODI made by RIs shall not exceed the limits prescribed under Liberalized Remittance Scheme (LRS) i.e., USD 2,50,000 per financial year. This is in line with the erstwhile ODI regime.</p>
Overseas Portfolio Investment ('OPI')	<ul style="list-style-type: none"> Under the erstwhile regime, OPI was not specifically defined and was permitted only by listed Indian companies. Furthermore, OPI by RIs was governed by Liberalized Remittance Scheme with a limit of USD 2,50,000 per financial year, subject to applicable conditions 	<p>The ambiguity with respect to OPI that existed under the erstwhile regulations has now been resolved by the OI Rules. Under the new regime, the term OPI has been defined to mean 'investment, other than ODI, in foreign securities'.</p> <p>The OI Rules permit the following persons in India to make OPI as mentioned:</p> <ul style="list-style-type: none"> <u>A listed Indian company</u> - OPI including investment in units of a regulated overseas investment fund, including by way of reinvestment. <u>An unlisted IE</u> - rights issues, bonus shares, capitalization of amount due from foreign entity which does not require

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		<p>prior permission from government or RBI, swap, merger, demerger, amalgamation or any scheme approved under laws of India or host country.</p> <ul style="list-style-type: none"> • <u>ARI</u> - investment by way of sweat equity shares, minimum qualification shares and shares/interest under ESOP/Employee Benefits Scheme, the investment should not exceed 10% of the paid-up capital/stock in foreign entity and should not result in control. A RI may also invest in units of any regulated overseas investment fund. • <u>APRI</u> - contribution to an investment fund or vehicle set up in an IFSC • <u>Registered Mutual Funds (MFs), VCFs and AIFs</u> – OPI permitted subject to compliance of SEBI regulations. <p>OPI is not permitted in the foreign instruments being:</p> <ul style="list-style-type: none"> • any unlisted debt instruments; or • any security which is issued by a PRI who is not in an IFSC; • any derivatives unless otherwise permitted by Reserve Bank; or • any commodities including Bullion Depository Receipts (BDRs). <p>IE (listed/ unlisted) may make OPI which shall not exceed 50% of its net worth and OPI by RIs shall be within the prescribed LRS limit.</p>
ODI in financial services sector	ODI in financial services sector overseas is permitted only for an IE engaged in financial services activity, subject to fulfilment of prescribed conditions, such as profitability criteria, registration / approval of regulatory authority in India and abroad and applicable prudential norms.	<ul style="list-style-type: none"> • ODI in the financial services sector¹ is permitted by IE engaged in financial services activity in India (and registered/regulated by a financial services regulator in India). • An IE not engaged in Financial service sector (except banking and insurance), provided they meet 3 years profitability track record. • The IE making such ODI would need to meet the profitability criteria² viz. profitability track record of preceding 3 financial years. • Further, where an IE engaged in financial services activity makes such ODI, approval should be obtained from the concerned regulatory authorities in India and abroad.

¹ ODI in banking/insurance sector overseas by IE not engaged in financial services activity shall be subject to additional conditions

² Here profitability criteria is not met due to the impact of Covid-19, profits of FY 2020-21 and 2021-22 may be excluded

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Investment in IFSC	Under the extant rules, investment in IFSC by way of Sponsor contribution by an IE to an AIF set up in IFSC in India, as per the laws of the host jurisdiction was allowed, subject to general provisions applicable to IE making investment under ODI.	<p>The definition of foreign entity as introduced in the OI Rules, includes investment in IFSC.</p> <p>ODI in an IFSC may be made by the following persons:</p> <ul style="list-style-type: none"> • <u>An IE not engaged in financial services in India</u> - can without satisfying net profit criteria, make ODI in an entity in IFSC engaged in the financial services sector (except banking /insurance). • <u>An IE engaged in financial services in India</u> - can make ODI in an entity in IFSC engaged in the financial services sector only if it satisfies the net profit criteria. • <u>A RI</u> - where he has control in IFSC (including an entity engaged in the financial services sector – except banking / insurance) which does not have a subsidiary/step down subsidiary outside IFSC. • <u>A PRI</u> may make contribution to an investment fund or vehicle setup in an IFSC as OPI <p>Deemed Approval: For ODI made in IFSC, approval shall be granted by the concerned financial services regulator within 45 days from the date of complete application, failing which such approval shall deemed to have been granted.</p>
Round tripping	ODI-FDI structures entailed prior RBI approval under the erstwhile regime.	ODI-FDI structures are now permitted, subject to the condition that the investment structure does not result in more than 2 layers of subsidiaries outside India.
Deferred consideration	Not permitted	<p>Under the new regime, consideration for equity capital acquired may be deferred for definite period as provided in the agreement:</p> <ul style="list-style-type: none"> • Foreign securities shall be issued/ transferred upfront • The full consideration finally paid shall be compliant with the applicable pricing guidelines, and valuation shall be done upfront • The buyer may be indemnified by the seller as per the terms of the agreement. <p>Deferred consideration to be reckoned as non-fund based financial commitment.</p>

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Pricing Guidelines	Pricing guidelines under the erstwhile regulations prescribed valuation by a CA/CPA or by a Merchant Banker / Investment Banker (where the investment exceeded USD 5 million) – no mention of pricing at arm's length basis.	The OI rules state that any consideration for an ODI shall be computed on an arm's length basis as per any internationally accepted pricing methodology for valuation.
Restructuring of Balance Sheet	<p>Restructuring the balance sheet of a foreign entity (by way of write off of capital/other receivables) up to 25% of the equity investment of IE permitted:</p> <ul style="list-style-type: none"> • IE should hold at least 51% stake in the foreign entity • For Unlisted IE – Prior Approval required • For Listed Entity – under the Automatic Route. 	<p>Restructuring of balance sheet of foreign entity (having ODI) is generally permitted only if:</p> <ul style="list-style-type: none"> • The entity has suffered losses for previous 2 years as per its last audited balance sheet. • Diminution in value should not result in total outstanding dues towards PRI (on account of investment in equity/debt) exceeding the proportionate amount of accumulated losses. <p>However, in cases, where the original investment made was more than 10 million or the amount of diminution exceeds 20% of total outstanding dues towards IE, then diminution in value needs to be certified by a registered valuer in India or valuer /CPA in the overseas country, on an arm's length basis (valuation report not be older than 6 months).</p>
Disinvestment	Under the extant rules, an IE could disinvest from a foreign entity without prior RBI approval subject to meeting conditions prescribed, including <i>inter-alia</i> that the foreign entity was operating for an entire year.	<p>Under the new Rules, disinvestment by PRI in case of:</p> <ul style="list-style-type: none"> – Where the transferor has stayed invested in the foreign entity for at least 1 year from the date of making ODI . – Full divestment other than liquidation is allowed if there are no equity/debt outstanding dues receivable. <p>The above condition shall not apply in case of merger, demerger or amalgamation of two or more foreign entities that are wholly-owned, directly or indirectly, by the IE subject to no change or dilution in aggregate equity holding of the IE in the merged or demerged or amalgamated entity.</p>
Transfer or liquidation		<p>A PRI may transfer investment to PRI or PROI subject to compliance of OI rules and regulation, pricing guidelines, documentation and reporting requirements.</p> <p>However, in case of transfer on account of merger, amalgamation or demerger or on account of buyback of foreign securities or liquidation, subject to approval of competent authority in India and /or host country.</p>

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Financial commitment	<ul style="list-style-type: none"> Under the extant Rules, the IE could utilize the net-worth of its Indian subsidiary/ holding company for computing eligible OI limit. There was no restriction on further financial commitment subject to filing of Form APR Issuing corporate guarantee for second level or subsequent level step down subsidiaries required 51% equity participation in those entities under approval route. 	<ul style="list-style-type: none"> Under the new OI rules, the option available in old regime, to utilize the net worth of its group companies for calculating eligible OI limit has been done away with. Here, until the delay in reporting is regularised, a PRI shall not be permitted any outward remittance/further financial commitment. The guarantees could be of the following types: <ul style="list-style-type: none"> corporate or performance guarantee by the IE. corporate or performance guarantee by a group company (holding/ subsidiary company) or a promoter group company. personal guarantee by the RI promoter of such IE bank guarantee by an Indian bank (duly backed by counter-guarantee/collateral by IE or its group company) <p>Further, guarantees may be issued to or on behalf of the foreign entity or any of its step-down subsidiary in which the IE has acquired control through the foreign entity,</p>
NOC for NPA/ wilful defaulter and entities under investigation	No such facility provided under erstwhile regulation.	<p>Prior to making any investment or divestment, a PRI appearing as a NPA/wilful defaulter/under investigation is required to obtain NOC from lender bank/ financial sector regulator/ investigative agency.</p> <p>Deemed Approval: If no certificate is issued within 60 days from date of application, it will be considered as deemed NOC.</p>
Reporting	<ul style="list-style-type: none"> Under the old Regime, ODI had to be reported in Form ODI. It was compulsory to file Form APR by 31st December. 	<ul style="list-style-type: none"> Under the new Regime, ODI needs to be reported in Form FC. Where there is only one Indian resident investor in a foreign entity and such resident investor neither has control nor holds more than 10% equity shares or any other financial commitment, Form APR is not required to be filed. 'Form OPI' - for reporting OPI by a PRI other than individuals.
Regularization of transaction	Under the extant Rules, no concept of late submission fee existed for delay in reporting.	<p>A PRI can file/submit the requisite form/return along with LSF, if there has been a delay in reporting. The said option is available for maximum period of 3 year from the date of reporting, post which delay will be liable to penal action under FEMA.</p> <p>The said facility has been extended even to delay in reporting under erstwhile regime, but up to maximum period of 3 years from the date of notification of OI rules.</p>

Acronyms

AIF	Alternative Investment Funds
APR	Annual Performance Report
CA	Chartered Accountant
CPA	Certified Public Accountant
ESOP	Employee Stock Option Plan
FEMA	Foreign Exchange Management Act
IE	Indian Entity
IFSC	International Financial Service Sector
LSF	Late submission fees
MOA	Memorandum of association
NOC	No objection Certificate
NPA	Non-performing assets
ODI	Overseas Direct Investment
OI	Overseas Investment
OPI	Overseas Portfolio Investment
PRI	Person resident in India
PROI	Person resident outside India
VCF	Venture Capital Funds

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