BUSINESS ARTICLE

Investing in Overseas Ventures

Introduction

Nowadays, the Indian entrepreneurs are seeking to expand their business globally. The same can be clearly inferred from the recent statistics published by the Reserve Bank of India (RBI), on outward foreign direct investments (ODI)[i]. It can be also inferred that, there has been a considerable rise in the investments being made by the Indian entrepreneurs (individuals and corporates), through their respective overseas joint ventures (JVs) and/or wholly owned subsidiaries (WOS).

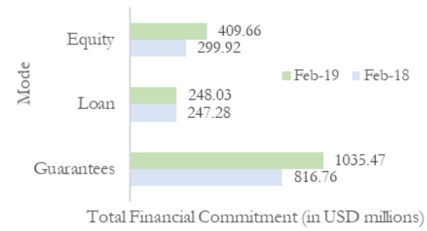

Figure 1: Total ODI made during February-2019 and February-2018

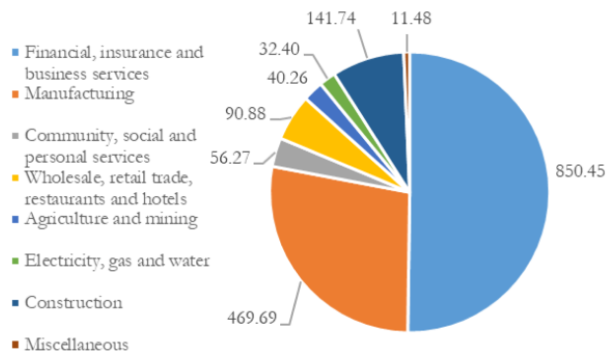

Figure 2: Total ODI made during February-2019 (Activity-wise) [Amounts in USD millions]

However, it has been also observed that, at time, few aspiring Indian entrepreneurs, drops out the plan of investing in foreign markets, on account of complexities involved in transferring of funds i.e. lengthy as well as less known procedures/compliance (s) involved in it or on account of weak knowledge of their respective financial consultant(s), who are unable to provide a trustworthy and a straight-forward solution to their client(s).

Given the same, our current article aims to provide a high-level insight on the permissible ways through which, an enthusiastic investor can setup his own business outside India. Please note that the current article is silent on investments in overseas JV/WOS, by way of granting loans or by issuance of bank/performance/corporate guarantees or any other means.

We hope that the article will serve the purpose of providing a thoughtful direction for taking such type of decisions. Along-with the same, it is also advised that an in-depth consultation with an appropriate financial expert/consultant with respect to nature and mode of investment is also undertaken, before making an actual investment.

Key considerations before making an overseas investment

A. Norms and procedures

The transactions pertaining to outbound and inbound investments i.e. making investments in the ventures or corporations outside India and receiving the investments in India, are regulated primarily by the Reserve Bank of India (RBI).

The RBI periodically issues and updates guidelines with respect to the permissible transactions which can be undertaken by the potential investors along with thresholds/ transaction value limits and restrictions/ additional terms along with the procedures to be followed for the same.

The same has been briefly discussed in the subsequent sections.

B. Taxability and compliances

Before making an investment, it is also essential to analyse the estimated amount of tax which will have to be paid on the expected returns i.e. dividend and capital gain (at the time of selling securities) and additional compliance(s) to be undertaken in India and in the respective overseas country where the investment has been made.

The same is also helpful in evaluating the feasibility of making the investment outside India i.e. whether the investment would fetch expected level of returns or not?

Note: Please note that our current article is silent on the subject of taxability of returns from investments held outside India and compliance(s) to be undertaken by the parties in India and the host country.

i. "Outward FDI from India for February 2019" published by RBI on 07 March 2019, accessed on 11 March 2019

Norms and Procedures

As per the Foreign Exchange Management Act, 1999 (FEMA), a person resident in India, is free to invest in foreign assets out of the income received when he/she was resident outside India. However, there are certain prohibition/restrictions/limitations associated with the same, which are required to be taken care before making an actual investment.

Key Terminologies

Joint Venture (JV)/ Wholly Owned Subsidiary (WOS)

JV/WOS means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party/Resident Indian makes a direct investment.

A foreign entity is termed as JV of the Indian Party/Resident Indian when there are other foreign promoters holding the stake along with the Indian Party. In case of WOS entire capital is held by the one or more Indian Party/Resident Indian.

Indian Party

An Indian Party is a company incorporated in India or a body created under an Act of Parliament or a partnership firm registered under the Indian Partnership Act 1932 or a Limited Liability Partnership (LLP) incorporated under the LLP Act, 2008 and any other entity in India as may be notified by the Reserve Bank.

When more than one such company, body or entity makes investment in the foreign JV / WOS, such combination will also form an "Indian Party".

Authorized Dealer (AD)

AD means the person, authorized by the RBI, to deal in foreign exchange or in foreign securities, as an authorized dealer, money changer or off-shore banking unit or in any other manner as it deems fit.

Generally the AD, are banks and financial institution, which are categorised by the RBI and undertakes certain activities (related to forex transactions), as permitted by the RBI.

Direct investment outside India

Direct investment outside India means investments, either under the Automatic Route or the Approval Route, by way of:

(a) Contribution to the capital or subscription to the Memorandum of a foreign entity; or

(b) Purchase of existing shares of a foreign entity either by market purchase; or

(c) Private placement or through stock exchange, signifying a long-term interest in the foreign entity (JV or WOS).

Permissible Routes for Investment

A. General Permissions/Automatic Route

Individual Investors

I. General Permission

General permission has been granted to persons (individual) resident in India for purchase / acquisition of securities as under:

a) Out of funds held in the Resident Foreign Currency (RFC) account;

b) As bonus shares on existing holding of foreign currency shares;

c) When not permanently resident in India, from the foreign currency resources outside India.

II. Liberalised Remittance Scheme (LRS)

A resident Indian can remit, up to the limit prescribed by the Reserve Bank from time to time, per financial year under the Liberalised Remittance Scheme (LRS), for permitted current and capital account transactions including purchase of securities and also setting up/acquisition of JV/WOS overseas.

Currently, under the LRS, all resident individuals (including minors) are allowed to freely remit up to **USD 2,50,000 (approx. INR 17.2 million)** per financial year (April – March) for any permissible current or capital account transaction or a combination of both, subject to certain prohibitions.

Permissible Routes for Investment (Contd.)

A. General Permissions/Automatic Route (Contd.)

Non-Individual Investor i.e. Indian Party [Automatic Route]

An Indian Party does not require any prior approval from the RBI, for making overseas direct investments in a JV/WOS abroad, under the Automatic Route.

The Indian Party intending to make overseas direct investment under the automatic route is required to fill up "Form ODI" duly supported by the documents listed therein and approach an AD (designated AD) for making the investment/remittance.

Limits and requirements

⇒ The Indian Party can invest up to the prescribed limit (i.e. currently 400%) of its net worth (as per the last audited Balance Sheet) in JV / WOS for any bonafide activity permitted as per the law of the host country. The prescribed limit vis-a-vis the net worth will not be applicable where the investment is made out of balances held in the EEFC account of the Indian party or out of funds raised through American Depositary Receipts (ADRs)/ Global Depositary Receipts (GDRs);

⇒ The Indian Party is not on the RBI's exporters' caution list / list of defaulters to the banking system published/ circulated by the Credit Information Bureau of India Ltd. (CIBIL) /RBI or any other credit information company as approved by the RBI or under investigation by the Directorate of Enforcement or any investigative agency or regulatory authority;

⇒ The Indian Party routes all the transactions relating to the investment in a JV/WOS through only one branch of an AD to be designated by the Indian Party

B. Approval Route

Proposals not covered by the conditions under the Automatic Route require prior approval of the RBI for which a specific application in Form ODI along with prescribed documents is required to be made through the AD Category – I banks.
Certain key proposals which require prior approval are:

⇒ Overseas Investments in the energy and natural resources sector exceeding the prescribed limit;

⇒ Overseas Investments by proprietorship concerns and unregistered partnership firms satisfying certain eligibility criteria

⇒ Investments by Registered Trusts / Societies (satisfying certain eligibility criteria) engaged in the manufacturing / educational / hospital sector in the same sector in a JV / WOS outside India

⇒ Corporate guarantee by the Indian Party to second and subsequent level of Step Down Subsidiary (SDS)

⇒ All other forms of guarantee which is offered by the Indian Party to its first and subsequent level of SDS

⇒ Capitalization of export proceeds remaining unrealized beyond the prescribed period of realization will require the prior approval of the RBI

Relevant Prohibitions/Restrictions

⇒ **Real estate and banking business are the prohibited sectors for overseas direct investment.**

- Indian banks operating in India can set up JVs/WOSs abroad provided they obtain clearance from RBI
- Real estate business means buying and selling of real estate or trading in Transferable Development Rights (TDRs) but does not include development of townships, construction of residential/commercial premises, roads or bridges.

⇒ **Indian Party shall make no direct investment in an overseas entity [set up or acquired abroad directly as JV/ WOS or indirectly as Step Down Subsidiary] located in the countries identified by the Financial Action Task Force (FATF).** The prohibition on ODI is applicable only on countries identified by FATF as "Call for action" i.e. Democratic People's Republic of Korea (DPRK) & Iran [as on 20 March 2019]

⇒ Investments in Nepal can be only in Indian Rupees. Investments in Bhutan are allowed in Indian Rupees and in freely convertible currencies.

Permissible sources for funding

As per the current guidelines funding for overseas direct investment can be made by one or more of the following sources:

⇒ Drawal of foreign exchange from an AD bank in India.

⇒ Swap of shares i.e. acquisition of the shares of an overseas JV / WOS by way of exchange of the shares of the Indian party.

⇒ Capitalization of exports and other dues and entitlements.

⇒ Proceeds of External Commercial Borrowings / Foreign Currency Convertible Bonds.

⇒ In exchange of ADRs / GDRs issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and the guidelines issued by Government of India in the matter.

⇒ Balances held in Exchange Earners Foreign Currency account of the Indian Party maintained with an AD.

⇒ Proceeds of foreign currency funds raised through ADR / GDR issues.

Obligations/Compliances to be undertaken by the Indian Party [Refer note below]

i. **Receiving of Share Certificates and other relevant evidences:** Receiving of share certificates or any other documentary evidence of investment in the foreign JV/WOS as an evidence of investment and submit the same to the designated AD within 6 months;

ii. **Repatriation of dues receivable from JV/WOS**: The Indian Party is required to ensure that all dues receivable from the foreign JV / WOS, like dividend, royalty, technical fees etc. are repatriated within the time;

iii. **Submission of Annual Performance Report (APR):** Submission of APR to the RBI, through the designated AD, every year, an APR in Part II, **by 31st of December every year** in respect of each Joint Venture (JV) / Wholly Owned Subsidiary (WOS) outside India set up or acquired by the IP / RI. Further, certification of APRs by the Statutory Auditor or Chartered Accountant may not be insisted upon in the case of Resident Individuals. Self-certification may be accepted.

Delayed submission/ non-submission of APRs, entails penal measures against the defaulting Indian Party.

iv. **Reporting of certain restructuring activities**: An Indian Party is required to report the details of the decisions taken by a JV/WOS regarding diversification of its activities /setting up of step down subsidiaries/alteration in its share holding pattern within 30 days of the approval of those decisions by the competent authority concerned of such JV/WOS in terms of the local laws of the host country. These are also to be included in the relevant APR.

v. **Filing of Annual Return on Foreign Liabilities and Assets (FLA return):** The FLA return is required to be submitted directly by all the Indian companies which have received FDI (foreign direct investment) and/or made FDI abroad (i.e. overseas investment) in the previous year(s) including the current year i.e. who holds foreign Assets or Liabilities in their Balance Sheets.

Note - Excludes compliance(s) to be undertaken by the Indian Party on account of divestment activities

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