

FEMA — Key aspect under FEMA Outbound investment

CA. M. Jagannathan

WIRC presentation

22nd September, 2018



Why Outbound Investment?

Promoting Global Business by Indian entrepreneurs

Joint Ventures are medium of economic and business co-operations

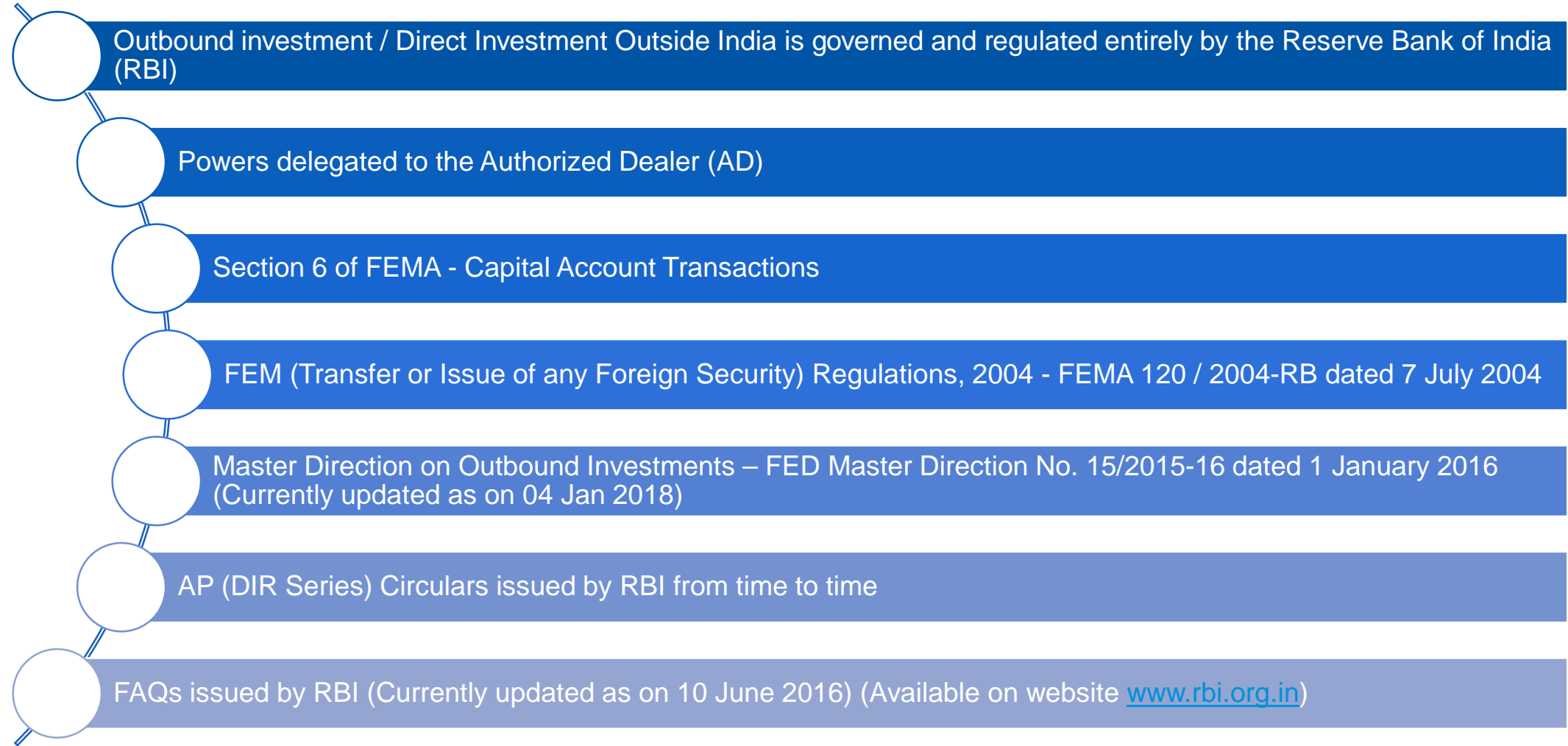
Transfer of technology and skill

Generation of employment opportunity

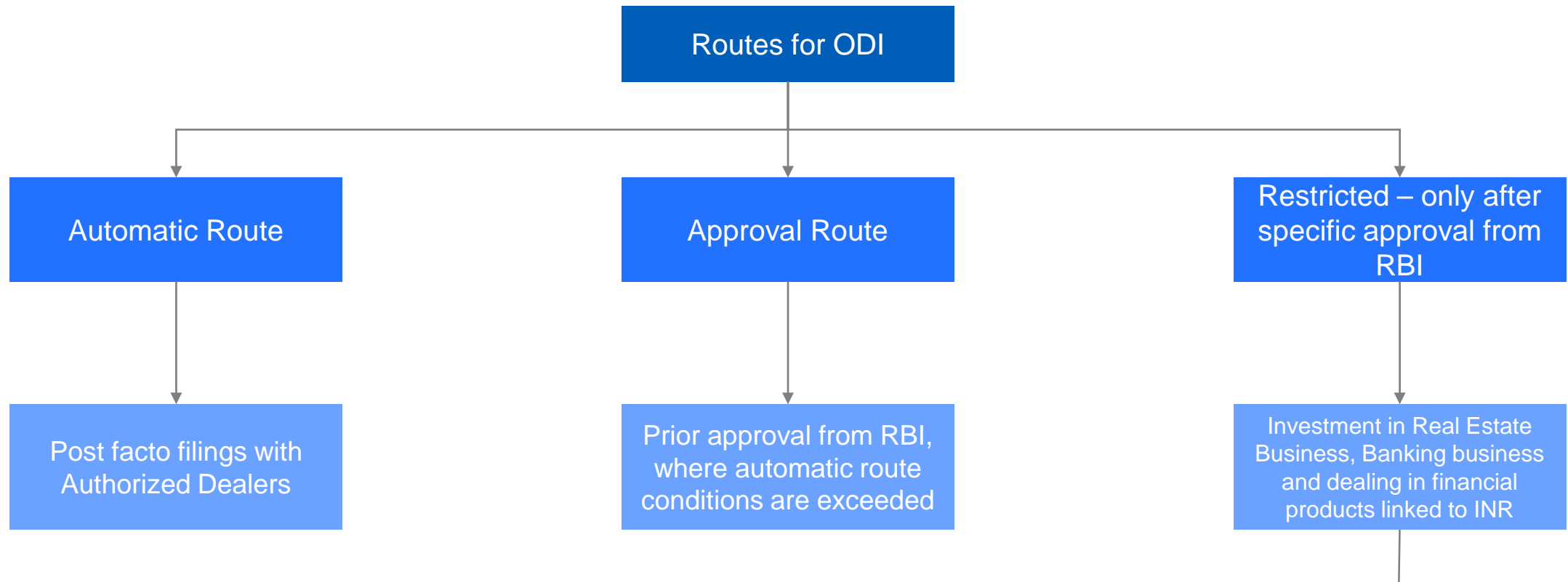
Access to wider global market and utilization of raw material

Increases source of exports, foreign exchange earnings, royalty, technical know-how.

Statutory Framework



Routes for ODI



Real Estate Business means buying and selling of real estate or trading in Transferable Development Rights but does not include development of townships, construction of residential/commercial premises, roads or bridges

Important Definitions

Direct Investment outside India

- Investment by way of contribution to the capital or subscription to the MOA of a foreign entity; or
- By way of purchase of existing shares of a foreign entity by:
 - through stock exchange; or
 - Private placement in that entity; or
 - Market purchase
- But does not include Portfolio Investment

How does one determine that an investment is a portfolio investment? If an Indian party takes 1% stake in a foreign company, is it ODI?

Important Definitions

Indian Party

Means

- A company incorporated in India;
- A body created under an Act of Parliament; or
- A partnership firm registered under the Indian Partnership Act, 1932 or LLP incorporated under LLP Act 2008

making investment in a JV or WOS abroad, and includes any other entity in India as may be notified by the RBI.

What about unregistered partnership firms and sole proprietorship firms?

What if an Indian party is on Reserve Bank's Exporters' caution list / list of defaulters to the banking system circulated by the Reserve Bank / Credit Information Bureau (India) Ltd. (CIBIL) / or any other credit information company or under investigation by any investigation / enforcement agency or regulatory body?

What if a group company is under investigation or violation?

Important Definitions

Wholly Owned Subsidiary

Foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country whose entire capital is held by an Indian party

Joint Venture

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

Whether foreign entity can be a company or LLP or unregistered firm?

Whether foreign company needs to have limited liability?

Is there any prescribed percentage of holding? What if there are two Indian parties making co-investment in the same JV?

ODI – Automatic Route

Under Automatic Route an Indian Party can make direct investment in JVs / WOSs outside India without obtaining any prior RBI approval. The following conditions to be fulfilled

- Total Financial Commitment (FC) of the Indian Party in all its overseas JVs / WOSs not to exceed 400% of its Net Worth as per its last audited balance sheet
- FC exceeding USD 1 billion in a financial year require prior approval of RBI even when total FC of the Indian Party is within the eligible limit of 400%
- Overseas JVs / WOSs to be engaged in bonafide business activity except real estate and banking
- Indian party is not on the RBI's Exporters' Caution list / list of defaulters / under investigation by an Authority
- Indian party routes all the transaction relating to such investment through only one branch of an authorized dealer to be designated by the Indian party
- Submission of application in Form ODI along with the prescribed enclosures/ documents
- Submission of Form APR (Annual Filings for ODI) in respect of all its overseas investments

*Investments in Pakistan are permissible under the Approval Route.

Investments in Nepal are permitted only in Indian Rupees.

Investments in Bhutan are permitted in Indian Rupees as well as in freely convertible currencies.

What is Financial Commitment?

Financial Commitment is the sum total of the following

- 100% of the amount of equity shares;
- 100% of the amount of compulsorily and mandatorily convertible preference shares;
- 100% of the amount of other preference shares;
- 100% of the amount of Loan;
- 100% of the amount of guarantee (other than performance guarantee) issued by the Indian Party;
- 100% of the amount of bank guarantee (BG) issued by a resident bank on behalf of JV or WOS of the Indian party and the BG is backed by a counter guarantee/collateral by the Indian party; and
- 50% of the amount of performance guarantee issued by an Indian Party to or on behalf of its overseas JV / WOS

Ceiling not applicable for investments out of EEFC a/c or funds raised through ADRs/GDRs

Maximum Limit would be:

400% of net worth

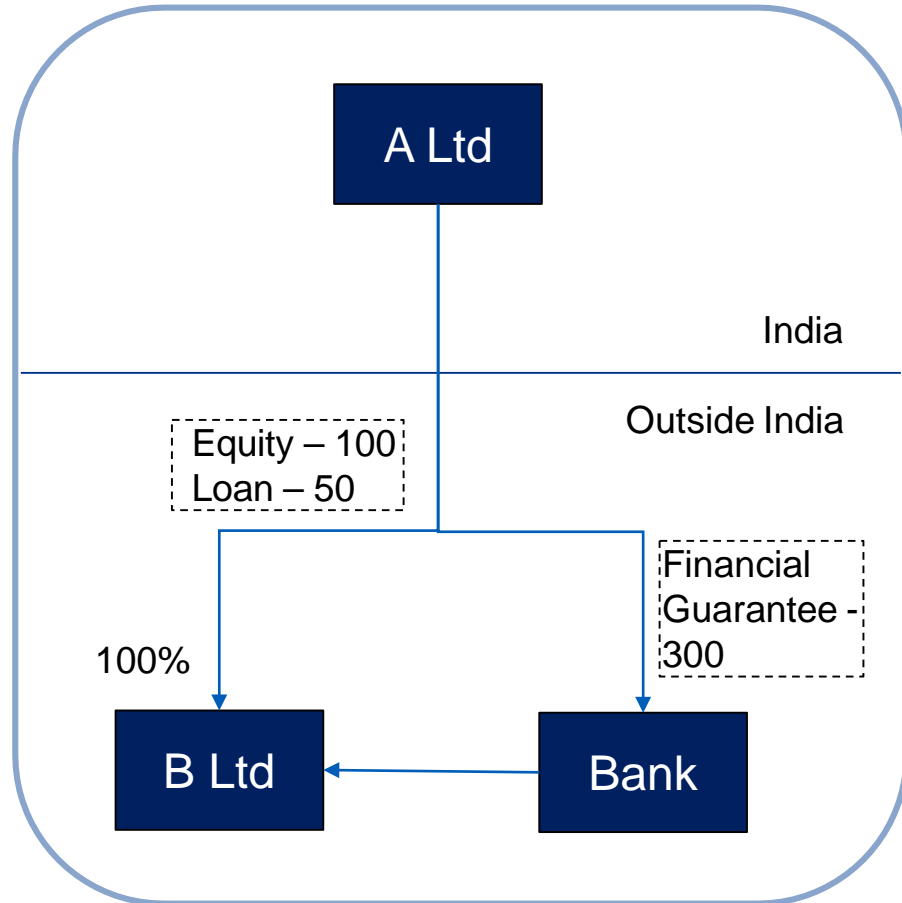


Balance in EEFC
Accounts



ADR / GDR proceeds

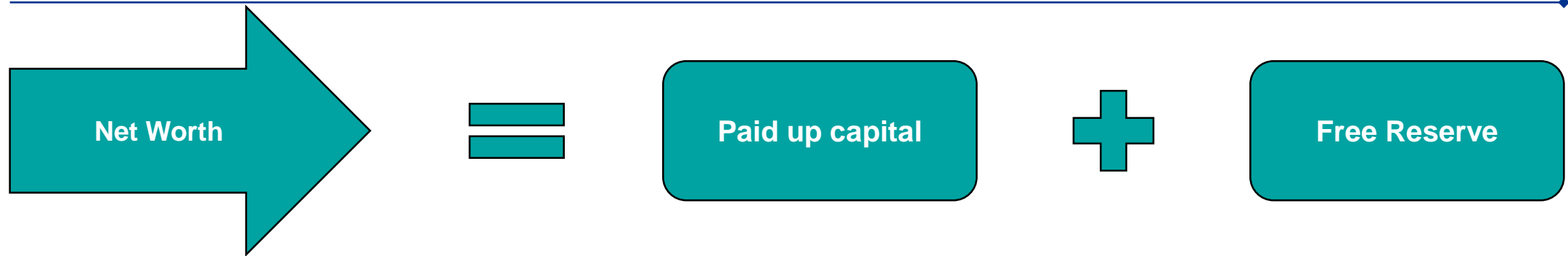
Calculation of Financial Commitment



- B Ltd., a company incorporated in USA is a wholly owned subsidiary of A Ltd., an Indian company
- A Ltd's investment in B Ltd is as under:
 - Equity contribution – 100
 - Loan – 50
 - Financial Guarantee of 300 to a Bank on behalf of B Ltd
- What is the financial commitment?

Financial Commitment of A Ltd – 100 (E) + 50 (L) + 300 (FG)= 450

What is Net Worth?



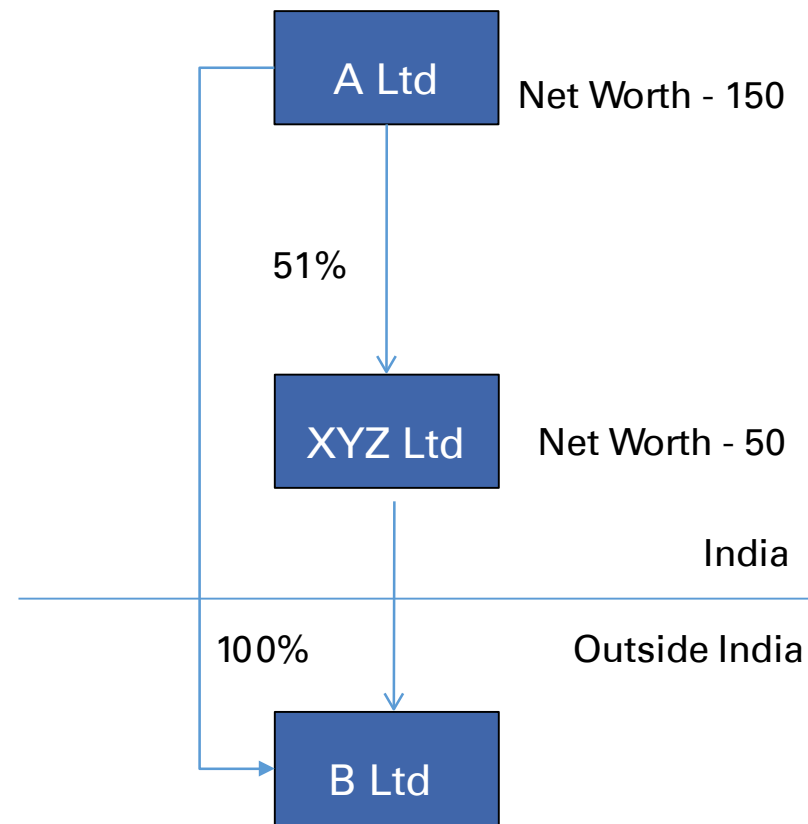
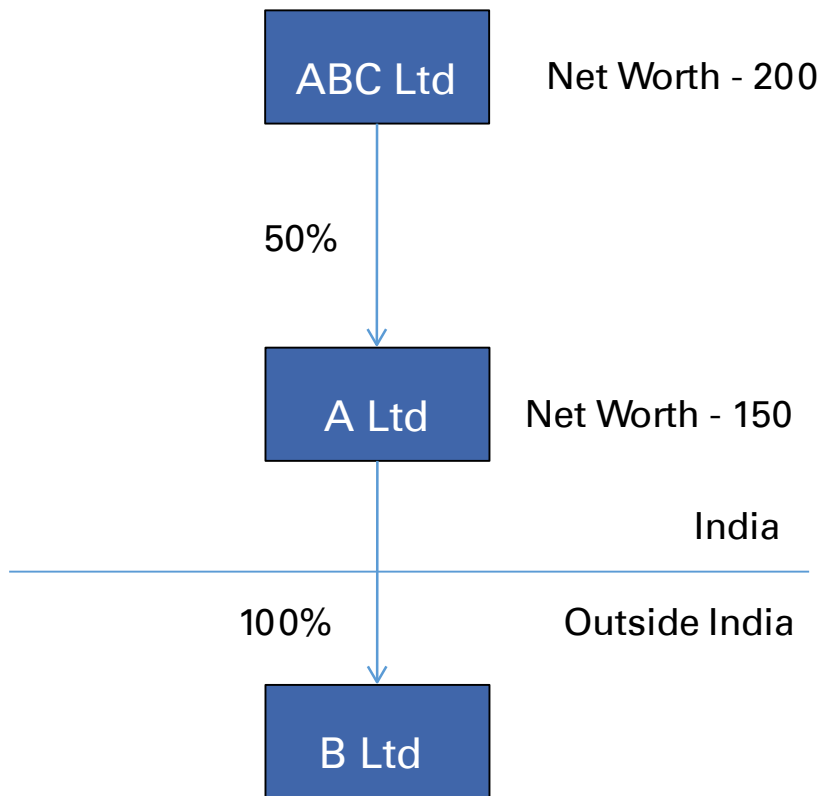
For calculation of Net worth of the Indian party following to be considered:

- Net worth of the Indian Investing company (say A Ltd)
- Net worth of the Indian Holding company of A Ltd (which holds at least 51% stake of A Ltd.)
- Net worth of the Indian Subsidiary Company of A Ltd (in which A Ltd holds at least 51%)
- Any financial commitment by the Holding Company / Subsidiary Company shall be reduced

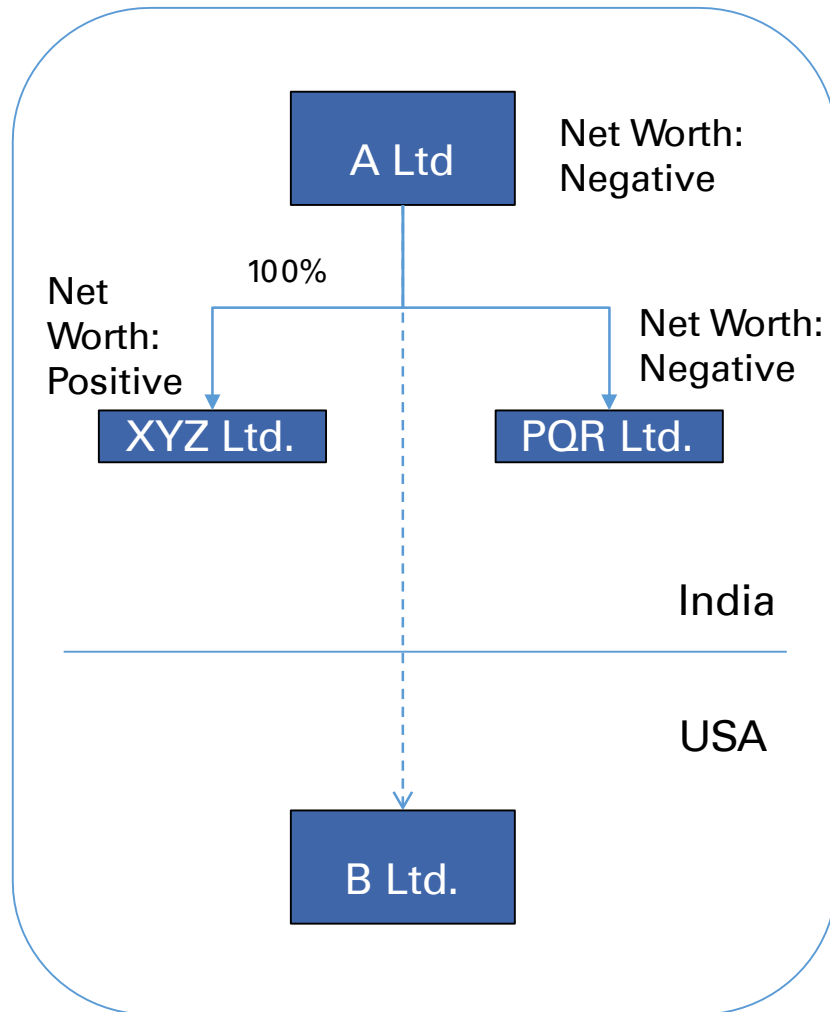
Calculation of Net Worth

A Ltd	
Particulars	Amount
Equity Share Capital	100
General Reserves	50
Securities Premium Account	250
Revaluation Reserves	150
Amalgamation Reserves	50
Total	600

Calculation of Net Worth



Calculation of Net Worth



- A Ltd. holds 100% of XYZ Ltd. & PQR Ltd.
- A Ltd. proposes to set up a wholly owned subsidiary (B Ltd.) in USA.
- As on the last date of audited balance sheet, A Ltd's net worth is negative, XYZ's net worth is positive & PQR's net worth is negative.

Question:

- Whether A Ltd. has an option to consider only the positive net worth of XYZ Ltd. & ignore the negative net worth of PQR Ltd. for calculating its net worth for the proposed investment?

Methods of Funding

Drawal of foreign exchange from an AD bank in India

Capitalization of exports

Swap of shares

Proceeds of External Commercial Borrowings (ECBs) / Foreign Currency Convertible Bonds (FCCBs)

In exchange of ADRs/GDRs issued in accordance with the prescribed scheme of FCCB and the guidelines issued thereunder

By giving corporate guarantees and performance guarantee

Balances held in EEFC account of the Indian Party and

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

Valuation Norms / Other Conditions

- **Investment in shares of existing company**

- Mandatory valuation requirements - > USD 5 mn then Category I merchant banker registered with SEBI or an Investment Banker / Merchant Banker outside India registered with the appropriate regulatory authority in the host country
- In all other cases – by a Chartered Accountant or a Certified Public Accountant

- **Investment by way of swap of shares**

- Mandatory valuation of shares only by Category I Merchant Banker registered with SEBI or an Investment Banker / Merchant Banker outside India registered with the appropriate regulatory authority in the host country / overseas regulated Investment Banker irrespective of amount
- Prior approval of FIPB is required where the inbound investment sector is under Approval route

- **Investment by swap of ADRs / GDRs subject to**

- ADRs/GDRs are listed
- Sectoral Caps
- Prescribed method for valuation of shares

- **Investment by registered Partnership firm**

- Entire funding is done by the Firm
- Partners can hold shares on behalf of firm if permissible under the host country regulations

Loan and Guarantee

Loan

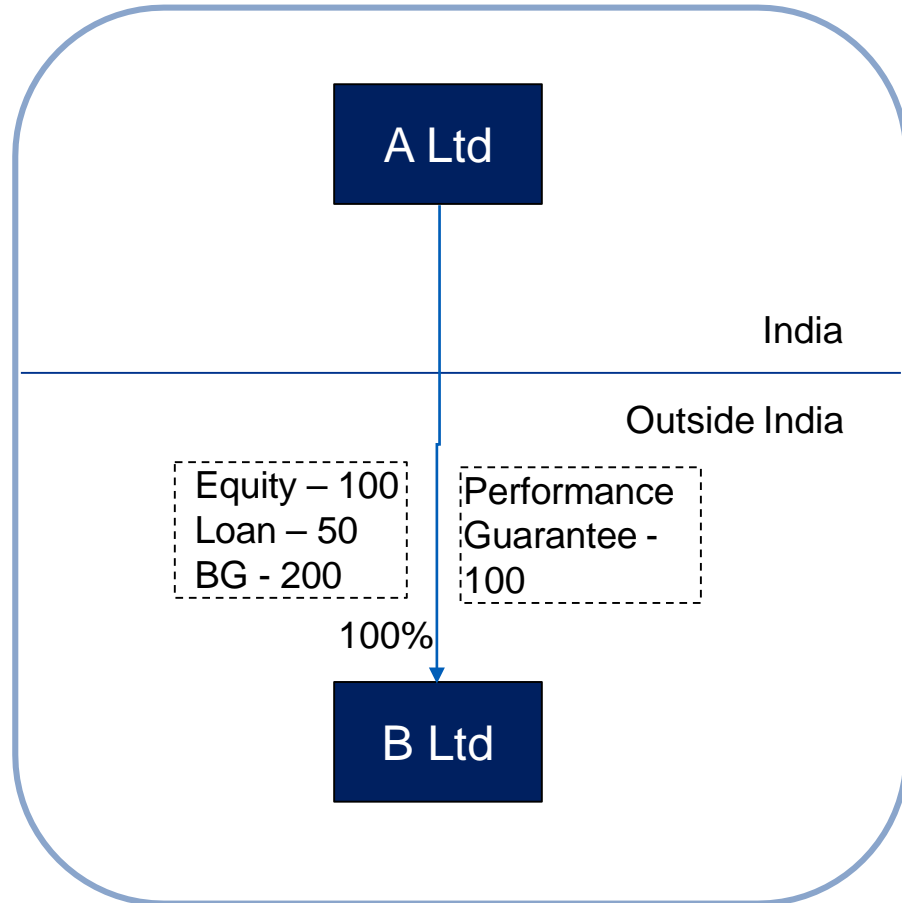
- Indian Entity can extend loan only to WOS / JV in which it has Equity participation. However, proposals for undertaking financial commitment without equity contribution may be considered by RBI under the approval route.

Guarantee

Indian Party can issue Guarantee to:

- Its Overseas JV / WOS
- Its step-down first generation operating subsidiary – JV / WOS may be SPV or Operating company
- Its step-down second generation or subsequent level operating subsidiaries
 - Under the prior RBI approval route, provided the Indian Party holds indirectly 51% stake in the overseas subsidiary for which such guarantee is intended to be issued
- No Guarantee should be 'open-ended'. The amount and period of guarantee should be specified upfront
- In case the invocation of the performance guarantee breaches the ceiling for financial commitment, prior approval of RBI is to be taken before remitting the funds from India on account of such invocation
- Guarantee given may be corporate or personal
- Authorised dealer in India may also give a Bank guarantee/ issue SBLC to a joint venture company or a wholly-owned subsidiary of a company in India in connection with its business abroad

Invocation of performance guarantee



- A Ltd has a net worth of Rs 100 crs
- It holds equity of Rs 100 crs in B Ltd, its overseas WOS. It has also given loan to B Ltd of Rs 50 crs, and bank guarantee of Rs 200 crs on behalf of B Ltd.
- A Ltd has also given a performance guarantee of Rs 100 crs on behalf of B Ltd
- Thus, A Ltd's total financial commitment is Rs 400 crs (i.e.100+50+200+ 50% of 100), within the 400% limit
- On invocation of performance guarantee, A Ltd's total financial commitment would be Rs 450 crs (i.e. 100 + 50 + 200 + 100)
- Would RBI approval be required, as financial commitment now exceeds 400% of net worth?

Rollover of Guarantee

Renewal / Rollover of an existing / original guarantee (which is part of the total FC of the Indian party) not be treated as a fresh FC, provided:

- The existing / original guarantee was issued as per FEMA guidelines
- No change in the end use of guarantee
- No change in the terms and conditions including the amount of guarantee (except the validity period).
- Other conditions as stipulated in the FEMA regulation
- 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.

If the above conditions are not fulfilled, the Indian Party shall obtain prior approval from RBI for rollover / renewal.

Capitalization of exports and other dues

Automatic Route

- General permission is given for capitalization of payments due from the foreign entity towards exports, fees, royalties or any other dues from the foreign entity for supply of technical know-how, consultancy, managerial and other services

Approval Route

- Capitalisation of export proceeds remaining unrealized beyond the prescribed period of realization -(9 months SEZs, EOU and other specified ones and 15 months for export to warehouse)
- Indian software exporters can receive 25 per cent of value of their exports to an overseas software start-up company in the form of shares without entering into Joint Venture Agreements

General Permission – resident individual

Acquisition of foreign securities by way of gift from non resident[#]

Acquisition of shares under cashless Employees Stock Option Programme (“ESOP”) issued by foreign company (does not involve any remittance from India)[#]

Acquisition of shares by way of inheritance from nonresident person[#]

Purchase of equity shares by way of ESOP offered by foreign company to employees / director of its office / branch / subsidiary in India[#]

Acquisition* of foreign securities in lieu of part / full consideration of professional services rendered to the foreign company (issuing company)

Subscribing to the rights shares by virtue of holding equity shares of the foreign (issuing) company

Qualification* shares for becoming a director of a company outside India to the extent prescribed as per the law of the host country where such foreign company is located

Purchase** of shares of a foreign JV/WOS of the Indian Promoter Company (“IPC”) by the employees/directors of such IPC which is involved in the field of software^{##}

Purchase** of foreign securities of foreign JV/WOS of Indian company under ADR/GDR linked stock option schemes by the employees (including working directors) of such Indian Company

It is mandatory for a resident individual to provide PAN to make remittance under LRS.

*Such acquisition/qualification of shares does not exceed the limit prescribed in LRS for Resident Individuals

** Such purchase of shares does not exceed the ceiling limit stipulated by RBI from time to time

Sale of such securities is permitted provided the proceeds of such sale are repatriated not later than 90 days

##The shares so acquired shall not exceed 5% of the paid up share capital of the foreign JV/WOS of such IPC; and after allotment, The percentage of shares held by (IPC + employees) >= shares held by IPC before such allotment

ESOP

- AD may allow remittance for acquiring equity shares of Foreign Company by individual :
 - If such individual is an employee / directors of Indian office/branch/subsidiary / Indian Company in which foreign equity holding , either direct or indirect, irrespective of percentage of equity stake; and
 - Shares offered under ESOP is offered by Foreign Company globally on uniform basis
- Individuals to repatriate dividends / sales proceeds within specified time frame
- Foreign Company can repurchase ESOP shares provided:
 - Shares issued in accordance with FEMA Rules and Regulations
 - Repurchase in terms of initial offer document
 - Annual return submitted by Indian Company

ODI under approval route

- Cases not covered under Automatic route
- Proprietary / unregistered partnership firms setting up a JV/ WOS subject to certain criteria (Refer Annexure A)
- Specific application to RBI with necessary documents in Form ODI through the AD (Category I Bank)
- RBI would *inter alia* consider the following factors:
 - Prima facie viability of JV/WOS outside India
 - Contribution to external trade and other benefits which will accrue to India through such investment
 - Financial position and business track record of the Indian party and foreign entity
 - Expertise and experience of the Indian party in the same or related line of activity of the JV / WOS
outside India

Obligation of Indian Party

Receive share certificates or any other document as an evidence of investments in the JV/ WOS and submit the same designated AD within six months

Repatriate to India all dues receivable from the foreign entity, like dividend, royalty, technical fees, etc.

Submit the Annual Performance report (APR) for each JV / WOS every year based on the audited accounts

- In case more than one Indian Party has invested in the same JV, then APR to be filed by the largest shareholders or by the Indian Party authorised by all parties for this APR filing

Where the Laws of Host country does not mandatorily require auditing of books of accounts of JV / WOS, the APR may be submitted by Indian Party based on unaudited annual accounts provided:

- The Statutory Auditor of the Indian Party to certify that the information provided in the APR are as per the unaudited annual accounts, and that the host country does not mandatorily require auditing of the books of accounts of the JV / WOS
- That the unaudited annual accounts of the JV / WOS has been adopted and ratified by the Board of the Indian Party
- The above exemption from filing the APR based on unaudited balance sheet will not be available in respect of JV/WOS in a country / jurisdiction which is either under the observation of the Financial Action Task Force (FATF) or in respect of which enhanced due diligence

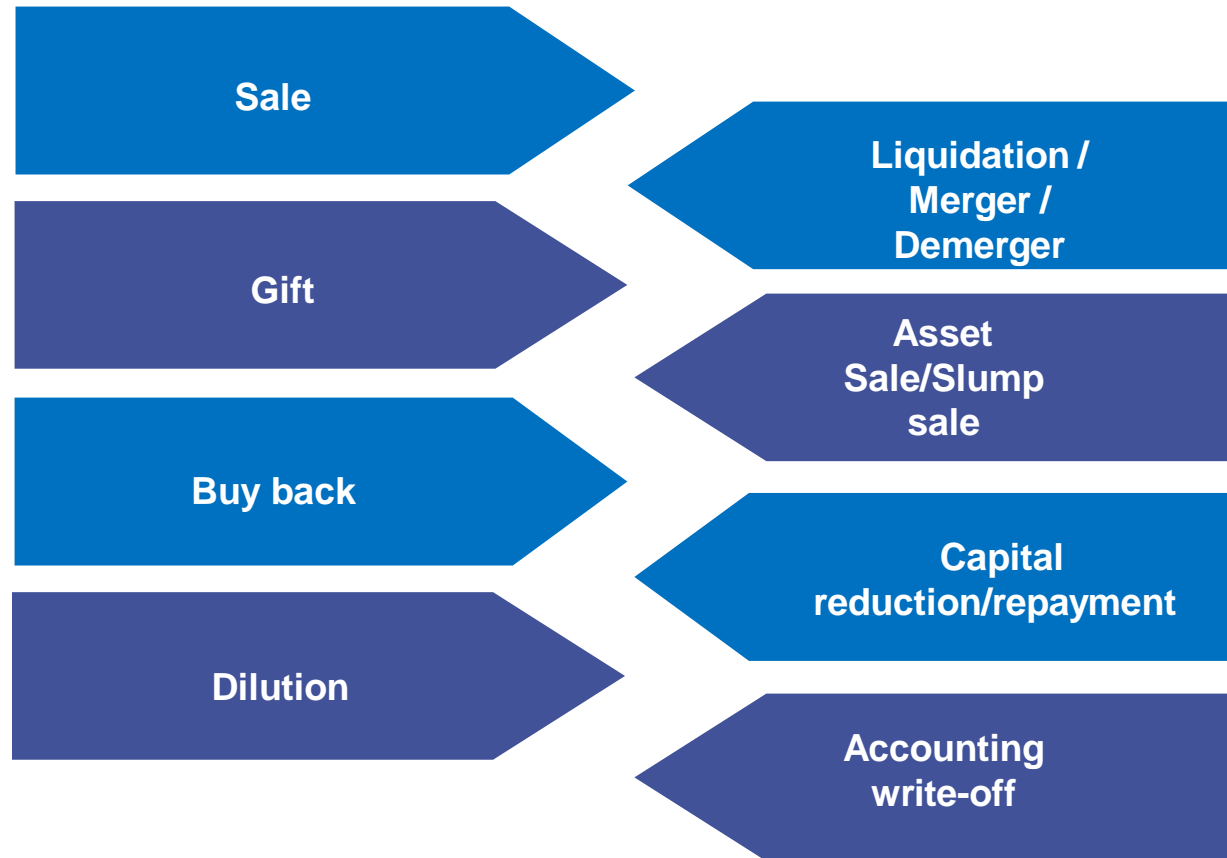
Report the details of the decisions taken by a JV / WOS regarding diversification of its activities / setting up of step down subsidiaries / alteration in its shareholding pattern within 30 days of the approval of those decisions in accordance with local laws

On disinvestment, repatriate the sale proceeds immediately or not later than 90 days from the date of sale of the shares / securities

File Foreign Liabilities and Assets (FLA) return every year by 15 July

Disinvestment in JV / WOS

Forms of disinvestment



Disinvestment in JV / WOS

Disinvestment without write off

- The sale is effected through a stock exchange where the shares of the overseas JV / WOS are listed;
- If the shares are not listed on the stock exchange and the shares are disinvested by a private arrangement at a price not less than the value certified by a CA / CPA as the fair value based on the latest audited financial statements of the JV / WOS
- The Indian Party does not have any outstanding dues from the JV or WOS
- The overseas concern has been in operation for at least one full year and the APR has been filed with RBI
- The Indian party is not under investigation by CBI / DoE / SEBI / IRDA or any other regulatory authority in India
- Other terms and conditions prescribed under ODI Regulations

Disinvestment with write off

- Overseas JV / WOS is listed on an overseas stock exchange
- Indian promoter company is listed on a stock exchange and has net worth of not less than Rs 100 crores
- Indian promoter company is listed (with net worth of less than Rs 100 crores) but investment in overseas venture does not exceed USD 10 million
- Indian promoter company is unlisted and the investment in overseas venture does not exceed USD 10 million

Disinvestment in JV / WOS

Procedural compliances

- Submission of necessary details to AD Bank within 30 days of disinvestment closure / winding up / voluntary liquidation
- Repatriation of sale proceeds of shares / securities within 90 days
- An Indian Party, which does not satisfy the conditions laid down above for undertaking any disinvestment in its JV / WOS abroad, shall have to apply to the Reserve Bank for prior permission

In all other cases, specific approval of RBI is required

Restructuring of Balance Sheet

Conditions

Indian parties which have overseas WOS/ have at least 51% stake in JV, may write off capital (equity/preference shares) or other receivables such as loans, royalty, technical know-how fees and management fees in respect of such JV/ WOS, even while such JV/ WOS continues to function as under:

- Listed Indian Companies – up to 25% of the equity investment in JV/ WOS under the Automatic Route; and
- Unlisted Indian Companies – up to 25% of the equity investment in JV/ WOS under the Approval Route

Reporting Requirements

- Reporting to RBI within 30 days of such restructuring/ write-off with -
 - Certified copy of Balance Sheet showing the loss in JV/ WOS
 - Projections for next 5 years indicating consequential benefit of such restructuring / write off

ODI Form

All transactions relating to investment in JV/WOS to be routed through one branch of AD. ODI form is divided into following :

- Part I - includes the following:
 - Section A - Details of Indian Party / Resident Individual
 - Section B – Capital structure and other details of JV/ WOS/ SDS
 - Section C - Details of Transaction/ Remittance/ Financial Commitment of IP/ RI
 - Section D - Declaration by the IP/ RI.
 - Section E - Certificate by the statutory auditors of the IP/ self-certification by RI.
- Part II – Annual Performance Report (APR)
- Part III - Report on Divestments by way of Closure / Voluntary Liquidation / Winding up / Merger of JV/WOS/IP etc and buyback of shares.

Case Studies

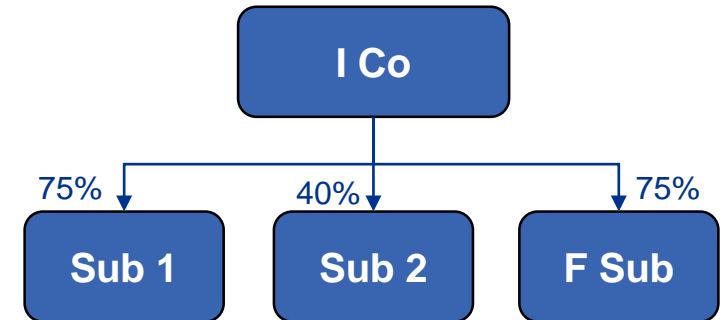
Case Study I

A Ltd

Particulars	Option 1	Option 2
Net worth of Indian Company	100	100
Balance in EEFC Account	80	80
Acquired B Ltd, USA at a cost of	40	40
What is the balance limit available to Indian Co for further overseas acquisitions?	220	440

Case Study 2

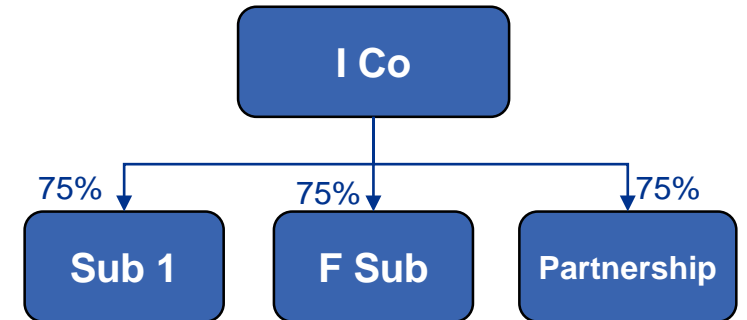
Particulars	I Co	Sub 1 (75%)	Sub 2 (40%)	F Sub (75%)
Equity Share Capital	100	10	30	100
Preference Share Capital	50	4	8	20
General Reserves	25	5	12	40
Securities Premium Account	75	11	50	-
Capital Reserves	110	20	60	-
Revaluation Reserves	90	10	45	-
Total	450	60	205	160



What is the Net worth and FC ?

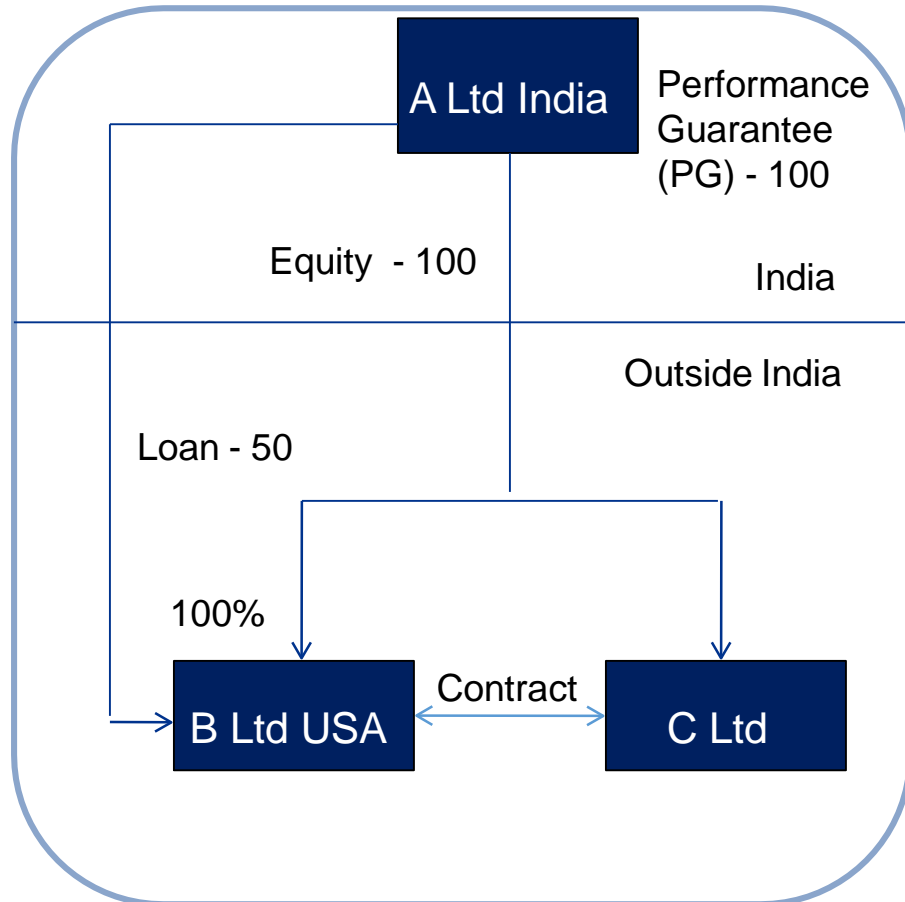
Case Study 3

Particulars	I Co	Sub 1 (75%)	F Sub (75%)	Partnership
Equity Share Capital	100	10	100	60
Preference Share Capital	50	4	20	
General Reserves	25	5	40	40
Securities Premium Account	75	11	-	-
Capital Reserves	110	20	-	-
Revaluation Reserves	90	10	-	-
Total	450	60	160	160



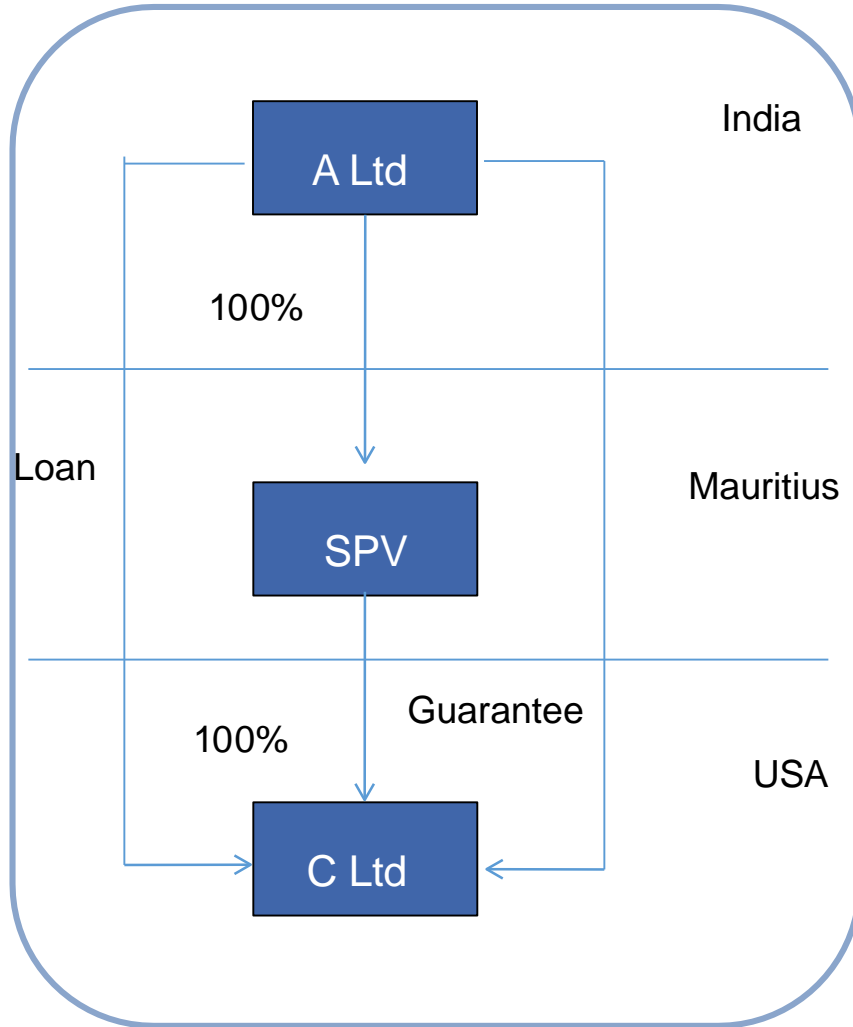
What is the Net worth and FC ?

Case Study 4



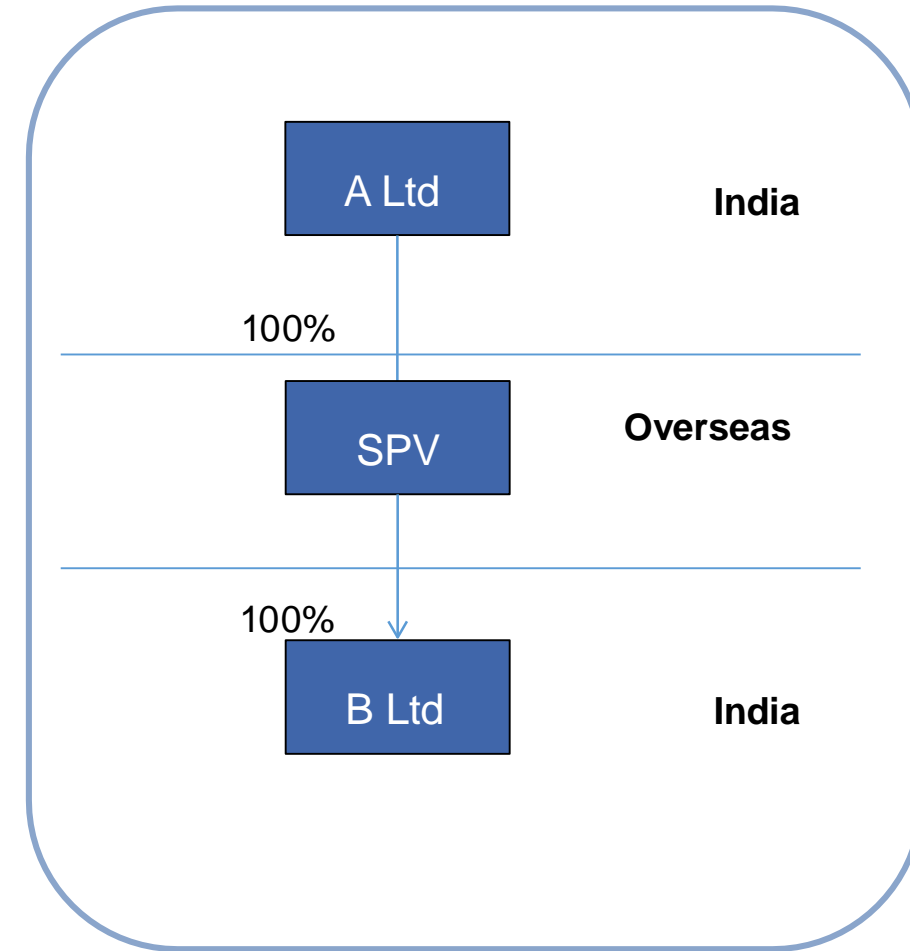
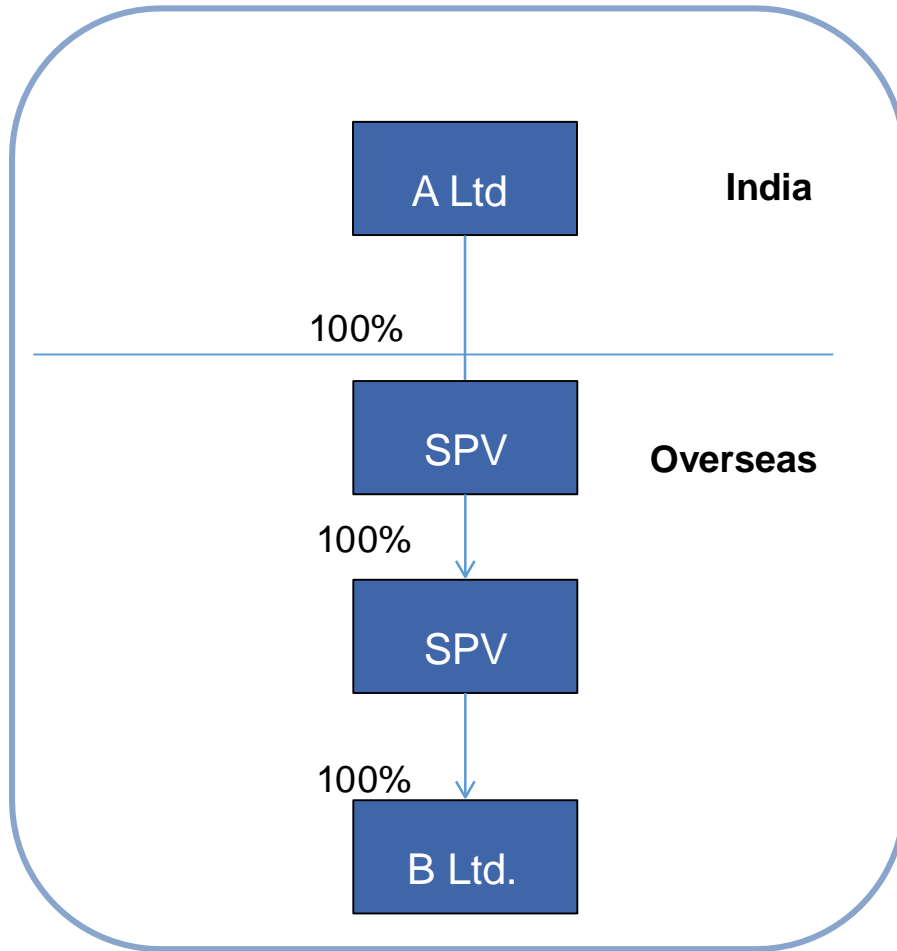
- B Ltd., a company incorporated in USA is a wholly owned subsidiary of A Ltd, an Ind. Co
- A Ltd.'s (with net worth of 50) investment in B Ltd are as under:
 - Equity contribution – 100 ; Loan – 50
 - A Ltd. has also given PG of 100 to C Ltd on behalf of B Ltd
 - What is the financial commitment of A Ltd
 - If the PG is invoked by C Ltd whether A Ltd can remit funds from India on account of such invocation?

Case Study 5



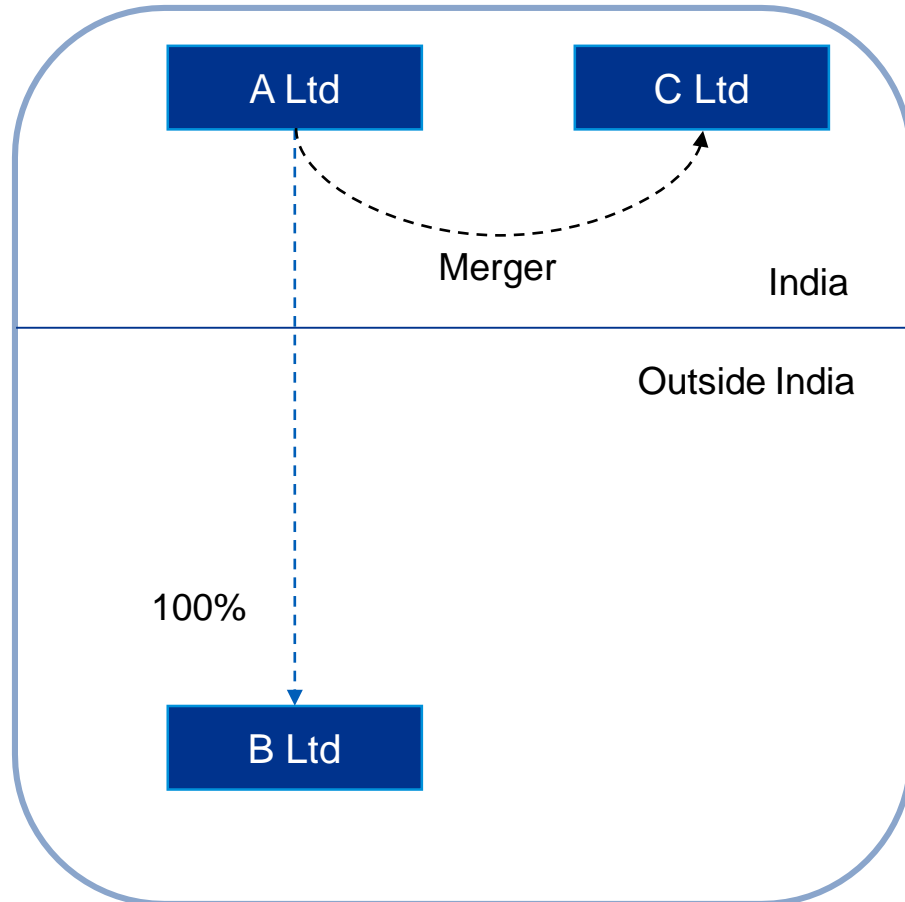
- A Ltd. proposes to set up a SPV in Mauritius through which investments would be made in USA (C Ltd.).
- Whether investment through SPV is permitted under the automatic route ?
- Whether A Ltd can fund (Loan) to C Ltd directly?
- Whether A Ltd. can give guarantee to or on behalf of C Ltd. for its business ?

Case Study 6



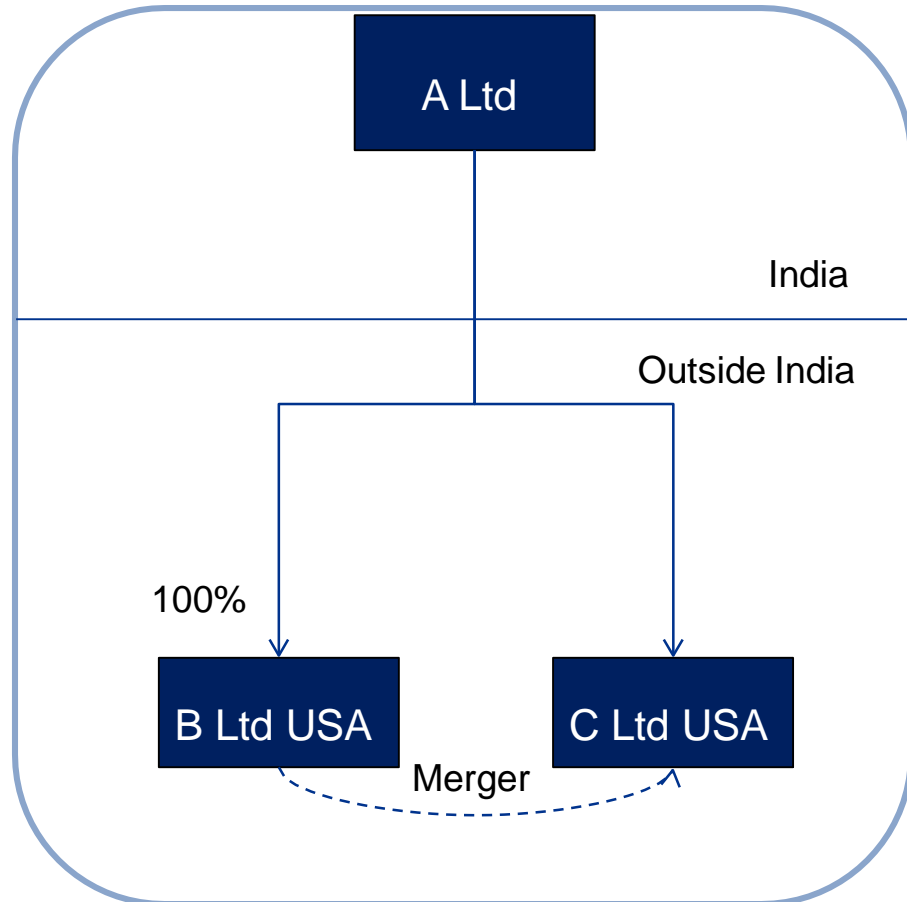
Is the above in compliance with the Outbound regulations?

Case Study 7



- A Ltd holds investments in B Ltd USA which is getting transferred to C Ltd pursuant merger of A Ltd with C Ltd
 - Whether the above transferred is allowed under automatic route
 - What are the compliances / reporting to be done by A Ltd and C Ltd?

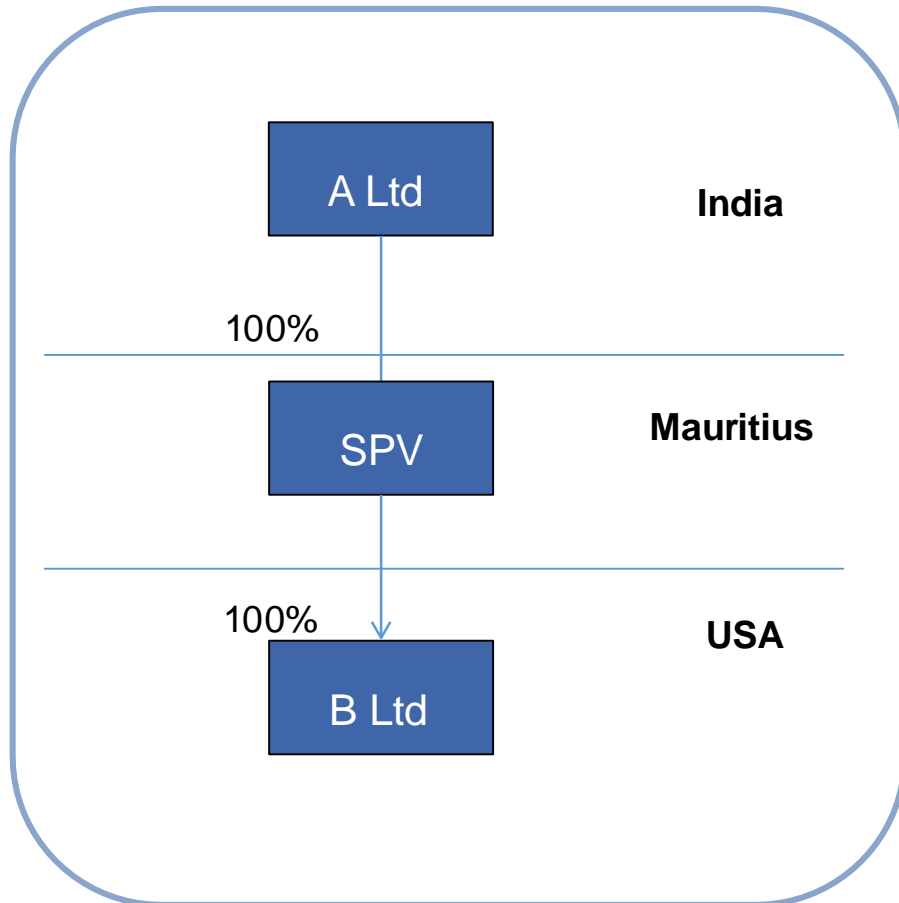
Case Study 8



- A Ltd holds investments in B Ltd USA and C Ltd USA
- B Ltd is to merge with C Ltd as per USA laws and C Ltd to issue additional shares to A Ltd
 - Whether the above transfer is allowed under automatic route
 - What are the compliances / reporting to be done by A Ltd, B Ltd and C Ltd?

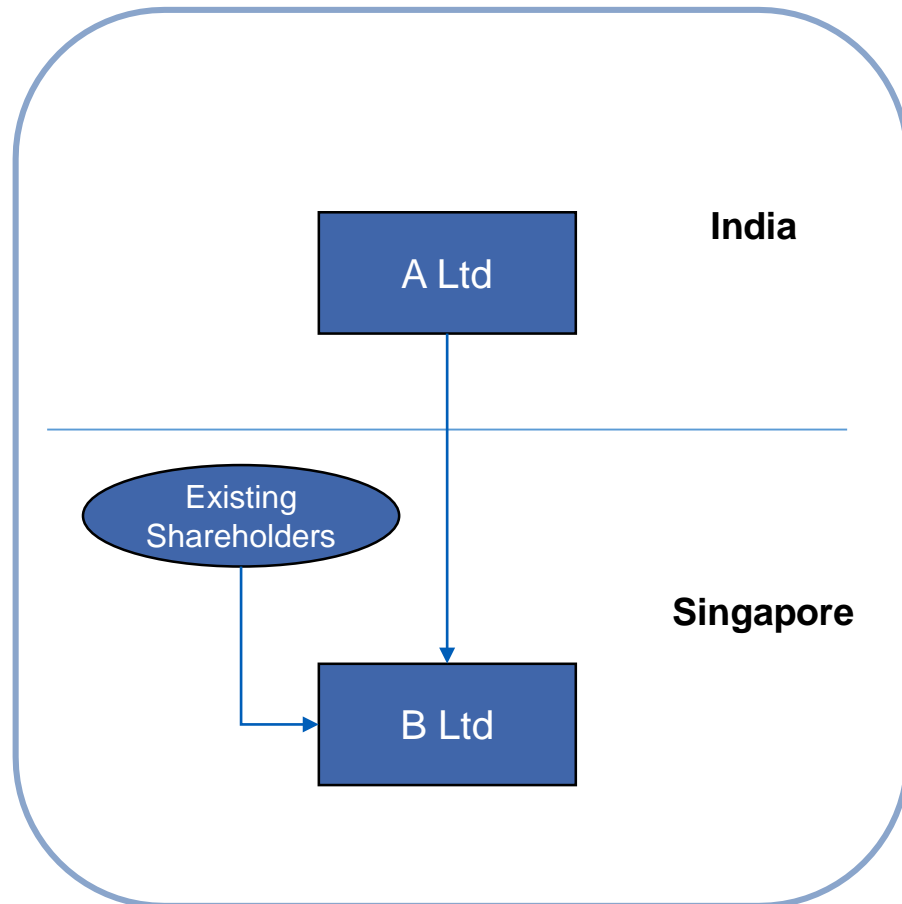
Does above merger result in write-off of investments B Ltd in books of A Ltd?

Case Study 9



- A Ltd holds investments in B Ltd USA through SPV in Mauritius
- B Ltd has incurred losses
- SPV has carried out capital reduction and written off investments in B Ltd
- Should A Ltd also take a write off?

Case Study 10



- Existing shareholders of B Ltd transferred part of their shareholding to A Ltd in March 2018 for USD 4.73 mn (~ Rs20.86 crs)
- At the time of transfer, the net worth of A Ltd was Rs 0.93 crs
- In June 2018, the shareholders of A Ltd infused capital in A Ltd, and the investment in B Ltd came within 400% of the net worth
- Would such a scenario be in contravention of FEMA regulations?
 - Yes, investment must be within 400% of net worth at the time of infusion

Annexure A

The proprietorship concern / unregistered partnership firm in India is classified as 'Status Holder' as per the Foreign Trade Policy issued by the Ministry of Commerce and Industry, Govt. of India from time to time;

The proprietorship concern / unregistered partnership firm in India has a proven track record, i.e., the export outstanding does not exceed 10% of the average export realisation of the preceding three years and a consistently high export performance;

The Authorised Dealer bank is satisfied that the proprietorship concern / unregistered partnership firm in India is KYC (Know Your Customer) compliant, engaged in the proposed business and has turnover as indicated;

The proprietorship concern / unregistered partnership firm in India has not come under the adverse notice of any Government agency like the Directorate of Enforcement, Central Bureau of Investigation, Income Tax Department, etc. and does not appear in the exporters' caution list of the Reserve Bank or in the list of defaulters to the banking system in India; and

The amount of proposed investment (or financial commitment) outside India does not exceed 10 per cent of the average of last three years' export realisation or 200 per cent of the net owned funds of the proprietorship concern/ unregistered partnership firm in India, whichever is lower.



Thank You

This views expressed in this presentation are personal views of the author. This presentation has been prepared for general guidance on matters of interest only and does not constitute professional advice. You should not act upon the information contained in this presentation without obtaining specific professional advice. The presentation should not be reproduced, in part or in whole, in any manner of form, without the author's permission.