



# GBCA Crossborder Insights

## Tax & Regulatory Edge



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## OVERSEAS INVESTMENTS UNDER FEMA – COMPARATIVE ANALYSIS

The Central Government has notified the Foreign Exchange Management (Overseas Investment) Rules and Regulations, 2022 on 22.08.2022 in supersession of FEMA Notification No. 120 i.e. Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015. Some significant changes and relaxations have been brought in for investment by Indian entities and individuals in foreign securities. Key highlights are mentioned below:

Sr. No.	Particulars	Erstwhile ODI law	New ODI law
1	Definition of Overseas Direct Investment (ODI) and Overseas Portfolio Investment (OPI)	<p>- ODI means:</p> <p>a. Investment by contribution to the capital</p> <p>b. Subscription to Memorandum of Association</p> <p>c. Purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange</p> <p>but does not include portfolio investment.</p> <p><i>(Portfolio investment was not explicitly defined in the regulations).</i></p>	<p>- ODI means :</p> <p>a. Investment by acquisition of unlisted equity capital of a foreign entity</p> <p>b. Subscription as a part of the Memorandum of Association</p> <p>c. Investment in 10% or more of paid-up equity capital of a listed foreign entity</p> <p>d. Investment with control where investment is less than 10% of paid-up equity capital of a listed foreign entity.</p> <p>- OPI means investment, other than ODI, in foreign securities, but not in any <b>unlisted debt instruments</b> or any security issued by a person resident in India who is not in IFSC.</p>
	<i>Analysis</i>	<i>Under the new ODI Rules, any investments in unlisted entity, irrespective of percentage holding, shall be considered as ODI.</i>	

Sr. No.	Particulars	Erstwhile ODI law	New ODI law
2	Definition of Control	No such concept in old law	<p>a. Right to appoint majority of the directors</p> <p>b. Right to control management or policy decisions exercisable individually or in concert, directly or indirectly</p> <p>c. Control by virtue of shareholding, management rights, shareholder rights, voting rights that entitle to <b>10% or more voting rights or any other manner.</b></p>
3	Definition of Bonafide Business Activity	The overseas JV/WOS should be engaged in bonafide business activity. However, the phrase “bonafide business activity” was not defined.	“Bonafide business activity” means business activity permissible under any law in force in India and the host jurisdiction/country.
4	Definition of Networth	Paid-up Capital plus Free Reserves.	<p>“Net worth” shall have the meaning as per section 2(57) of the Companies Act, 2013.</p> <p>Net worth of registered partnership firm or LLP shall be the sum of the capital contribution of partners and undistributed profits.</p>
	<i>Analysis</i>	<p><i>The Net Worth under Companies Act, 2013 consists of</i></p> <ul style="list-style-type: none"> <li>- <i>Paid up share capital</i></li> <li>- <i>All reserves created out of profits</i></li> <li>- <i>Securities premium account</i></li> <li>- <i>Debit/credit balance of Profit &amp; Loss account</i></li> <li>- <i>But does not cover revaluation reserve</i></li> </ul>	

Sr. No.	Particulars	Erstwhile ODI law	New ODI law
5	Net worth calculation	For the purpose of reckoning net worth of an Indian party, the net worth of holding company (which holds at least 51% stake in the Indian Party) or subsidiary (in which the Indian party holds at least 51% stake) could be taken into account to the extent not availed independently subject to conditions.	The concept of utilising the net worth of the subsidiary/holding company by the Indian entity has been discontinued henceforth.
6	Requirement of obtaining a No Objection Certificate (NOC)	In a situation where the Indian party was in defaulter's list of banks or under investigation, ODI by such entity required RBI approval.  <i>There was no NOC requirement.</i>	The onus is now on the lender bank/ investigating agency/regulator to permit or disallow ODI or disinvestment. Such body is required to issue a NOC before the transaction is undertaken. In case no such certificate is issued within 60 days from the receipt of the application, it will be considered as deemed approval.
7	Real Estate Exclusion  <i>Analysis</i>	Real estate business does not include development of townships, construction of residential / commercial premises, roads or bridges.  <i>Real estate activity continues to be prohibited under the new ODI Rules as well. However, now leasing is explicitly excluded from the definition of Real Estate activity.</i>	Real estate activity does not include development of townships, construction of residential / commercial premises, roads or bridges <b>for selling or leasing.</b>
8	ODI in International Financial Services Centre (IFSC)	There was no specific provisions for ODI in IFSC and hence general conditions would apply	The new rules provide a separate <b>Schedule V</b> for ODI in IFSC.

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	Analysis	<p>As per SEBI AIF Regulation and guidelines in case of AIF in IFSC, the Manager or Sponsor of AIF shall have minimum investment in such AIF of 2.5% (5% in case of Cat 3 AIF) of corpus or USD 750,000 (USD 1.5 million in case of Cat 3 AIF), whichever is lower. AIF in IFSC is considered as foreign entity and accordingly, investment in IFSC by Indian resident is considered as overseas investment. Since AIF is a financial services entity, there were practical issues for investment by Indian Manager/Sponsor under earlier ODI law. In new rules, the issues have been clarified by providing for:</p> <ol style="list-style-type: none"> <li>1. An Indian Entity (i.e. Sponsor/Investment Manager) not engaged in the financial services activity in India can make ODI in such AIF and also, the new condition of profit track record of 3 years does not apply to such investment.</li> <li>2. If Investment by an Indian Entity (i.e. Sponsor/Investment Manager) in the AIF in IFSC requires approval by the financial services regulator, then the same shall be decided within 45 days from the date of application complete in all respects failing which it shall be deemed to be approved. Normally, such approval is required if such Indian Entity is engaged in financial services activity in India.</li> </ol>	
9	ODI in start-ups	There was no specific condition for ODI in start-ups i.e. general conditions would apply	<p>Indian entity can make ODI in start-ups recognized under the laws of the host country <u>only</u> from the internal accruals, whether from the Indian entity or group or associate companies in India.</p> <p>In case of resident individuals, such ODI will be from own funds of such individual.</p>
10	ODI in financial services activity	Financial service sector was not defined and the regulations pertaining to it were ambiguous leading to interpretation issues.	As a welcome move, an Indian entity not engaged in financial services activity can make ODI in a foreign entity engaged in financial services activity (except in

Sr. No.	Particulars	Erstwhile ODI law	New ODI law
			<p>banking or insurance) if the Indian entity has earned net profits during preceding 3 financial years.</p> <p>A foreign entity shall be considered to be engaged in the business of financial services activity if it undertakes an activity, which if carried out by an entity in India, requires registration with or is regulated by a financial sector regulator in India.</p>
11	Round tripping structures	Such structures required RBI approval and on case to case basis and merits of the case, RBI would allow or disallow the proposal.	Prima facie, it seems that a person resident in India can make investment in a foreign entity that has invested or invests into India, subject to condition it shall not result in more than 2 layers of subsidiaries (except in case of banks, SI-NBFC, Insurance and Government Company). However, there are some interpretational issues for determination of 2 layers.
12	OPI by Indian entity	<ul style="list-style-type: none"> <li>- Portfolio investment was permitted for listed entity upto 50% of net worth as on date of the last audited balance sheet.</li> <li>- Portfolio investment was not permitted for unlisted entity</li> </ul>	<ul style="list-style-type: none"> <li>- Indian entity (listed/unlisted) can invest upto 50% of Networth as on date of the last audited balance sheet</li> <li>- Unlisted Indian entity can invest only by way of subscribing to rights issue/ bonus issue or capitalization or swap or merger, demerger, amalgamation or any scheme of arrangement.</li> </ul>

Sr. No.	Particulars	Erstwhile ODI law	New ODI law
			<ul style="list-style-type: none"> <li>- On making or transferring OPI, the Indian entity has to report within 60 days from the end of the half year in which such investment/ transfer was made.</li> </ul>
13	Pricing Guidelines	<p>- In case of acquisition of shares of an existing foreign company, where the investment is more than USD 5 million, valuation of the shares of the company shall be made by a Category I Merchant Banker registered with SEBI or an Investment Banker / registered Merchant Banker outside India in the host country; and, in all other cases by a Chartered Accountant / Certified Public Accountant.</p> <p>If the shares are disinvested by a private arrangement, the share price should not be less than the value certified by a Chartered Accountant / Certified Public Accountant</p>	<p>The issue or transfer of equity capital of a foreign entity from</p> <ul style="list-style-type: none"> <li>- a person resident outside India or a person resident in India to a person resident in India who is eligible to make such investment or</li> <li>- a person resident in India to a person resident outside India</li> </ul> <p>shall be subject to a price arrived on an <b>arm's length basis</b> as per internationally accepted pricing method.</p>
14	Restructuring of balance sheet of foreign entity	<p>- WOS abroad or entities with at least 51% stake in an overseas JV, may write off capital (equity / preference shares) or other receivables, such as, loans, royalty, technical knowhow fees etc in respect of the JV /WOS:</p>	<p>Restructuring of the balance sheet by foreign entity which has received ODI is permitted :</p> <ul style="list-style-type: none"> <li>- If has been incurring losses for the last 2 years as per its audited balance sheets, subject to compliance with reporting, documentation and</li> </ul>

Sr. No.	Particulars	Erstwhile ODI law	New ODI law
		<p>(i) Listed companies - 25% of the equity investment in the JV /WOS under the Automatic Route and</p> <p>(ii) Unlisted companies - 25% of the equity investment in the JV /WOS under the Approval Route.</p>	<p>- Diminution in the total value of the outstanding dues towards investor on account of investment in equity and debt, does not exceed the proportionate amount of the accumulated losses.</p> <p>In cases where original investment is more than USD 10 million or in cases where the diminution exceeds 20% of the total value of the outstanding dues of investor, the diminution in value shall be duly certified on an arm’s length basis by a registered valuer as per the Companies Act, 2013 or corresponding valuer registered with the regulatory authority or certified public accountant in the host jurisdiction.</p>
15	Stepdown subsidiary	In case where a resident individual made ODI in a foreign entity, such foreign entity could not acquire or set up a step-down subsidiary.	Operating foreign entity cannot have a step down subsidiary <b>if the resident individual has control in that foreign entity.</b>
16	Gift of securities to a resident individual	General permission was granted to a resident individual to acquire foreign securities as a gift from a person resident outside India.	<p>Gift of foreign securities to a Resident Individual:</p> <p>a. From non-residents will be subject to <b>Foreign Contribution (Regulation) Act, 2010.</b></p> <p>b. From a resident individual is permitted only in case of <b>relative as per Companies Act, 2013.</b></p>

Sr. No.	Particulars	Erstwhile ODI law	New ODI law
17	Sweat Equity Shares	There was general permission to acquire foreign security issued by a company under ESOP scheme.	Sweat Equity as a mode of acquisition has been specified for individuals, which will be reckoned within the LRS limit. Investment in sweat equity less than 10% shall be treated as OPI in case of unlisted entity.
18	Delay in reporting	Though there was an implied restriction on further ODI in absence of regularization of delays in filing, there was no explicit clause.	There is an explicit restriction on further financial commitment in a foreign entity or transfer of such investment till reporting delays are regularized.
19	Investment by way of debt	Indian entity can extend loan to the overseas entity where it has equity participation.	Indian entity who has undertaken ODI can invest in debt instrument <b>provided there is control in foreign entity</b> at the time of making such financial commitment.
	<i>Analysis</i>	<p><i>Under the new ODI rules, the possible challenges may be as under:</i></p> <ol style="list-style-type: none"> <li><i>1. Since the term "loan" is not expressly allowed in "financial commitment by way of debt", there is ambiguity that debt investment may be done only in the form of debt instrument.</i></li> <li><i>2. For debt investment, there should be control on the foreign entity.</i></li> <li><i>3. Rate of interest should be charged on arms' length basis.</i></li> </ol>	
20	Deferred payment of consideration for issue/transfer of foreign security	Not permitted	Permitted for definite period as provided in the agreement subject to conditions.
21	Repatriation of dues	- Repatriate to India all dues receivable from the foreign entity, like dividend, royalty,	Repatriate to India all dues receivable from the foreign entity with respect to investment in such foreign entity, disinvestment proceeds within 90 days.

Sr. No.	Particulars	Erstwhile ODI law	New ODI law
		<p>technical fees etc., within 60 days of its falling due.</p> <p>- Repatriate sale proceeds within 90 days from the date of sale.</p>	<p>It has been clarified that where the transferor is required to repatriate all the dues before disinvestment, such requirement shall not apply to the dues that do not arise on account of investment like export receivables, etc.</p>
22	Lock-in period before disinvestment	The overseas concern has been in operation for atleast one full year.	The investment was held for atleast one year from the date of making ODI.
23	Exemption from filing Annual Performance Report (APR)	No exemption from filing APR	A specific exemption has been provided in situations where the person resident in India holds less than 10% equity without control in the foreign entity and equity capital is the only financial commitment or if the foreign entity is under liquidation.
24	Late Submission Fees (LSF)	Not prevalent in old ODI law	The concept of LSF was introduced first for FDI and has now been included in ODI compliances too. It is available for a maximum of three years from the due date of filing.

**Note: Investments made in erstwhile regulations will be deemed to be made under the new law.**

After opening the draft ODI rules for stakeholders' comments, the much awaited rules were published which were required in the current dynamic times. The new ODI rules in many ways appear to be more progressive in nature than the earlier rules. However, it is to be seen how the rules are implemented in situations where there are interpretational issues. This proactive step is certainly worthy of acknowledging the Government and RBI's efforts for better policymaking.

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## KEY CHANGES IN OVERSEAS INVESTMENT BY AIF & VCF

Domestic Alternative Investment Funds (“AIFs”) and Venture Capital Funds (“VCFs”) are permitted to make Overseas investments in **equity and equity linked instruments** of unlisted foreign company (“**Offshore Venture Capital Undertaking**”) as per the Securities and Exchange Board of India (“SEBI”) guidelines. Such overseas investment requires prior approval of the SEBI for allocation of limits for overseas investment to an AIF/VCF. At present<sup>1</sup>, the overall investment limit for overseas investments by AIFs and VCFs is **USD 1,500 Million**, and these limits are allocated on a **first cum first serve basis** subject to a cap of **25% of the investible funds** of a scheme of an AIF/VCF.

The SEBI recently issued the guidelines for overseas investment by AIFs and VCFs (“**New Guidelines**”) on August 17, 2022 for regulating overseas investments by AIFs and VCFs. The New Guidelines are in addition to the earlier guidelines dated October 1, 2015 issued by the SEBI and it also modifies certain conditions of the earlier guidelines.

### IMPORTANT CHANGES AS PER NEW GUIDELINES OF THE SEBI FOR OVERSEAS INVESTMENT BY AIF/VCF

#### No need of Indian connection of Overseas Investee Company

Earlier for making investment in overseas investee company by AIF/VCF, such overseas investee company was required to have an ‘Indian connection’ (i.e., the

offshore companies which had back-office operations in India). Now, such condition has been done away with.

**Eligibility criteria for overseas investee company** As per the New Guidelines, AIFs and VCFs can invest in overseas investee companies only if such companies are entities incorporated in countries:

- whose securities market regulator is a signatory to the International Organization of Securities Commissions’ multilateral MOU or a signatory to the bilateral MOU with the SEBI; and
- which are not identified by the FATF<sup>2</sup> as: (i) a jurisdiction having a strategic anti-money laundering/combating the financing of terrorism deficiencies to which counter measures apply, or (ii) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with FATF to address the deficiencies.

#### Revised Reporting Requirements

- The New Guidelines have introduced a more detailed application format for applying to the SEBI for allocation of overseas investment limits along with undertakings to be provided by the trustees and investment managers of the AIF.

<sup>1</sup> August 2022

<sup>2</sup> Financial Action Task Force

- Now, AIF/VCF is required to report any sale/disinvestment of offshore entities within 3(three) working days to the SEBI. Also, AIF/VCF is required to do one-time reporting of their **previous sales/disinvestment** in offshore entities till date by September 16, 2022 to the SEBI.

#### **Re-investment of sale proceeds:**

- The New Guidelines also clarify that sale proceeds received by an AIF or VCF from liquidation of its offshore investee companies would be available for re-investment.

#### **IMPORTANT CONTINUING CONDITIONS OF OVERSEAS INVESTMENT BY AIF/VCF**

- AIFs shall not invest in Joint venture/Wholly Owned Subsidiary while making overseas investments. It is pertinent to note that the new ODI Rules, explicitly provides that any overseas investment by AIF/VCF shall be treated as **Overseas Portfolio Investment**.
- AIFs shall adhere to extant FEMA Regulations/ guidelines with respect to round tripping.
- Overseas investments by AIF/VCF shall also be subject to the applicable extant FEMA regulations/rules.
- The overall investment limit for overseas investments by AIFs and VCFs is **USD 1,500 Million**, and these limits are allocated on a **first cum first serve basis** subject to a cap

of **25% of the investible funds** of a scheme of an AIF/VCF.

The New Guidelines liberalises the overseas investment regime for AIF/VCF by increasing accountability of the governing bodies and managers of AIF.



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## INTERNATIONAL TAX REGULATORY UPDATES

### EXTENDED TIME LIMIT TO FILE FORM NO. 67 FOR FOREIGN TAX CREDIT (FTC)

Earlier Form No. 67 for claiming Foreign Tax Credit (FTC) had to be furnished on or before the due date of filing the original income tax return. This led to practical difficulties for the taxpayers to compile the necessary details/documents within the prescribed time limit.

With the CBDT notification, Form No. 67 can now be filed on or before the end of relevant assessment year in which foreign sourced income is offered/assessed to tax in India and the Income Tax Return is filed within the specified time limit for original/delated return. For an updated return, Form No. 67 shall be furnished on or before filing the updated return.

This amended rule shall be effective from 1<sup>st</sup> April 2022 and shall also apply to all claims for financial year 2021-22 and subsequent years.

Recently there have been few conflicting judicial decisions on the allowability of FTC in cases where Form No. 67 has not been filed on or before filing the income tax return. It is to be seen whether this amendment can have any persuasive value and offer relief where there has been a delay in furnishing Form No. 67 for earlier years.

### E-FILING FORM 10F FOR AVAILING DTAA BENEFIT

Taxpayers claiming relief under DTAA are required to furnish Tax Residency Certificate (TRC) of their Country of Tax Residence. If certain information like status, nationality, address, TIN, residency period is not available then taxpayer is required to provide the necessary information in Form 10F as a self-declaration.

Recently, CBDT has notified online filing of Form 10F along with TRC which led to apprehensions amongst foreign entities/individuals. This indirectly mandates non-resident tax payers to obtain the Indian Identification Tax Number (PAN) to file Form 10F online. However, this may create unnecessary compliance burden.

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