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August 23, 2021

Mr. Yogesh Dayal
Chief General Manager
Reserve Bank of India
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Respected Sir,

Sub.: - Feedback on draft Overseas Investment rules & regulations

This has reference to following two documents placed on RBI's website for comments:

1. Draft Foreign Exchange Management (Non-debt Instruments - Overseas Investment) Rules, 2021; and
2. Draft Foreign Exchange Management (Overseas Investment) Regulations, 2021

As called for by way of Press release dated 9th August 2021, we take this opportunity to make certain important suggestions to the above-mentioned drafts for clarifying certain ambiguities so that the revised Overseas Investment Regulations meet the intended objectives of the Government.

There are many path-breaking amendments and liberalisations. There are hence a few suggestions to be provided too. However, considering the short 15 day period provided for feedback, we request RBI to extend the deadline and provide another 15 days for providing more suggestions on the draft regulations.
Alternatively, a revised draft considering suggestions received till 23rd August should be provided for public feedback to ensure full implementation of Government and RBI's intentions.

Further, under the existing Overseas Direct Investment regulations, RBI has issued several FAQs addressing various queries of stakeholders. We humbly suggest to issue draft FAQs and draft format of applicable Forms under the proposed regulations for public feedback before issuing final Rules and Regulations.

We sincerely request a personal meeting – physical or virtual - to explain the suggestions put forth in the document.

For **Bombay Chartered Accountants' Society,**

Sd/-
CA Abhay Mehta
President

For **The Chamber of Tax Consultants,**

Sd/-
CA Ketan Vajani
President

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Representation on Draft FEM (Non-debt instruments – Overseas Investment), Rules 2021 ('ODI Rules') and Draft FEM (Overseas Investment) Regulations, 2021 ('OI Regulations)

Sr. No.	Heading	Relevant clause of Rules / Regulation	Provision and Issues	Rationale and suggestion
1.	**Definition Overseas Direct Investment read with Schedule III**	Rule 2(vii) under Chapter I of ODI Rules	**Provision (Extract)** **"Overseas Direct Investment (ODI)" means** investment by way of acquisition of equity capital of an unlisted foreign entity, or subscription to the Memorandum of Association of a foreign entity, or investment in ten percent or more of the paid-up equity capital of a listed foreign entity, or where the person resident in India making such investment has or acquires control, directly or indirectly, in the foreign entity…… Schedule III	**Rationale:** The first part of the definition of ODI can be split into the following four limbs: (1) investment by way of acquisition of equity capital of an unlisted foreign entity, or (2) subscription to the Memorandum of Association of a foreign entity, or (3) investment in ten percent or more of the paid-up equity capital of a listed foreign entity, or (4) where the person resident in India making **such** investment has or acquires control, directly or indirectly, in the foreign entity. As can be seen from above, limb (4) has two conditions for an investment to qualify as an ODI. A person resident in India should be making **such** investment and in addition should acquire control,

			Overseas Investment by Resident Individuals 2. A resident individual may make or hold Overseas Investment in a foreign entity by way of: (i) ODI only in an operating foreign entity not engaged in financial services activity, provided such individual **also acquires control, directly or indirectly**, in such foreign entity. No subsidiary/SDS shall be acquired or set up by such foreign entity; **Issue** 1. Fourth limb of the definition becomes redundant. 2. Anomaly with regards to impermissibility of investment for resident individuals without control.	directly or indirectly, in the foreign entity. If one was to give a meaning to the words **such investment,** it would mean investment as referred under limbs (1), (2) and (3) above. In case such an interpretation is adopted, an investment falling within (1), (2) and (3) already qualifies as an ODI (with or without control). Accordingly, limb (4) becomes redundant. Further, a plain reading of limb (1) suggests that acquisition of equity capital (from Zero to 100%) of unlisted foreign entity would be regarded as ODI. If this is read with Schedule III – Clause (2)(i), a resident individual would not be allowed to make any investment in a foreign entity if he does not acquire control in such foreign entity (except in case of acquisition of less than 10% stake in a listed entity). This seems to override the permissibility of making portfolio investments into foreign entities which is presently available to resident individual under the Liberalised Remittance Scheme. **Suggestion** Exclude equity stake upto 10%, without acquiring control, from the definition of ODI. Consequently, equity stake upto 10% (without acquisition of control) can get included under the definition of

				Overseas Portfolio Investment (OPI). This will resolve the issue of the fourth limb becoming redundant and also treat an investment of up to 10% in a foreign entity (without control) as OPI and be permissible freely. Below is a possible suggestion for drafting the revised clause: **"Overseas Direct Investment (ODI)" means** investment by way of acquisition of 10% or more of the equity capital of an unlisted foreign entity, or subscription to the Memorandum of Association of a foreign entity, or investment in ten percent or more of the paid-up equity capital of a listed foreign entity, or where the person resident in India making investment in a foreign entity has or acquires control, directly or indirectly, in the foreign entity……
2	**Definition of foreign entity**	Rule 2(vii) under Chapter I of ODI Rules	**Provision:** *"Foreign Entity" means (a) an entity* ***incorporated and registered*** *outside India under the laws of the host country, or (b) an unincorporated entity engaged in a strategic sector and formed under the laws of the host country;*	**Recommendations:** • Kindly replace the word 'and' with 'or' so as to align it with the existing understanding. **Rationale:** With the proposed definition, popular form of entities like LLC in United States of America and LLP in other countries which are formed and

			Provided that in case of any ODI in an unincorporated entity engaged in a non-strategic sector and existing as on the date of notification of these rules, no further investment shall be made after six months from the date of notification unless the structure of the foreign entity is modified in compliance with these rules. **Issue:** The proposed definition of the foreign entity has restricted the scope of the entities in which Person resident in India can make overseas direct investments. It now allows investment to be made only in entities which are incorporated and registered which is far restrictive than the understanding under the existing regulations. Under the existing regulations, as explained by FAQ no. 5 on Overseas	registered but not incorporated would become ineligible for receiving overseas direct investment from person resident in India. .

			Direct Investment an Indian Party / Resident Indian can invest in a JV / WOS which is either formed, registered or incorporated in accordance with the laws and regulations of the host country. The definition of the foreign entity is also not in sync with the definition of host country / jurisdiction. Host country / Jurisdiction covers all the countries where the foreign entity is either formed, registered or incorporated, which is also in alignment with the existing regulations.	
3.	**Definition of Step Down Subsidiary**	Rule 2(xxv) under Chapter I of ODI Rules	**Provision:** "*Step Down Subsidiary (SDS)" means a subsidiary of a foreign entity having ODI and in a case where the Indian entity has control in the foreign entity at the time of the creation of SDS, the structure of such*	• **Rationale:** The definition states that SDS means a "subsidiary of a foreign entity…". The word "Subsidiary" however has not been defined. Under company law and in general, the normal meaning of subsidiary in relation to any other company, means a company in which the holding company— (i) controls the composition of the Board of Directors; or

			SDS shall comply with the requirements of a foreign entity as prescribed in rule 2(vii). *Explanation:* *(a) For this clause, a subsidiary would not include an entity in which the foreign entity holds equity capital in the nature of listed securities and not exceeding 10% of the paid-up capital of the investee entity.* *(b) A subsidiary of an SDS will also be an SDS.* **Issue** The definition in the draft OI Rules means that if the foreign entity has invested less than 50% and does not have control, it does not have to comply with ODI rules.	(ii) exercises or controls **more than one-half** of the total share capital either at its own or together with one or more of its subsidiary companies: In practice, under the existing regulations, if the foreign entity which has ODI, invests in a Step down entity, FEMA compliance has to be undertaken. Step down entity need not be a subsidiary. This was clear from the use of the terminology "Joint Venture" as distinguished from a "Wholly Owned Subsidiary". These terms do not find place in the draft OI Regulations and hence the concern regarding the use of the word 'subsidiary'. The definition in the draft OI Rules means that if the foreign entity has invested less than 50% and does not have control, it does not have to comply with ODI rules. Consider a case where Indian resident has Overseas investment in a foreign company. The foreign company further invests only 25% in the step down entity. Such an entity does not fall within meaning of 'subsidiary' and hence is not a 'step down subsidiary' as per draft

				rules. No compliance would be required for such step down investment. • **Recommendation:** We suggest that the definition should be of "Step Down Entity (SDE)" instead of "Step Down Subsidiary". The redrafted definition could read as under: SDE means an entity in which another foreign entity having ODI has invested, and in a case where the Indian entity has control in the entity at the time of the creation of SDE, the structure of such SDE shall comply with the requirements of a foreign entity as prescribed in rule 2(vii) if applicable.
4.	**Definition of write-off**	Rule 2(xxx) under Chapter I of ODI Rules	**Provision** *"Write-Off" means any shortfall in the amount of consideration received by a person resident in India against the proportionate amount of equity capital at*	**Rationale:** It seems the intention behind defining the term write-off (much wider than understood currently) is to liberalize the regulations and allow disinvestment involving write-off under automatic route. Currently its under approval route subject to some conditions and limits. The

			the time of partial disinvestment in the foreign entity and in case of full disinvestment, such short fall includes the amount of consideration received against the investment in equity capital and debt as due and outstanding on the date of such disinvestment from the foreign entity or the amount of diminution in the capital and other receivables on account of restructuring of the balance sheet of the foreign entity. **Issue** While the term "write-off" have been defined, the same is not referred in either the ODI Rules or OI Regulations	intention also draws support from the fact that now Restructuring of foreign entity involving diminution (though not defined) is allowed under automatic route with up to certain limits. Without giving reference to the said term in the rules and regulations would unnecessarily make such liberalization a point of debate and various interpretations. **Recommendation:** The said term write-off should be referred to in Regulation 5(B) so as to align the regulations with the intent and avoid any confusion in interpretation. The term write off should also be included in Regulation 5(C) alongwith the phrase diminution in value otherwise it would have narrow meaning than what the intent suggest.
5.	**Acquisition of immovable property outside India**	Rule 10(2)(iv) under Chapter III of ODI Rules	**Provision** *"(2) A person resident in India who is an individual may acquire immovable property*	**Rationale:** From plain reading of the provision, it appears that an individual resident in India cannot fund any amount when he is purchasing the immovable property jointly with his relative.

			outside India from a person resident in India: *(i) ....* *(ii) ....* *(iii) ....* *(iv) Jointly with a relative who is a person resident outside India, provided there is no outflow of funds from India;* *(v) ....."*	**Recommendation** The starting para may read as under: "(2) A person resident in India who is an individual may acquire immovable property outside India from a person resident in India in any one or more of the following manners:
6	**Explanation of Bonafide Activity**	Explanation to Rule 4(A) of ODI Rules.	"For these rules, bona fide business activity shall mean any business activity legally permissible both in India and host jurisdiction."	**Rationale:** The Explanation refers to business activity legally permissible. How legally permissible is to be determined has not been stated - there are several activities where Central Government and State Government laws apply. Or only State Government law applies. For example, liquor sale is permitted in Maharashtra, but not in Gujarat. Can such a person undertake liquor business abroad (assuming that the Indian investor is in Gujarat.) **Recommendation:**

				We suggest that reference to legally permissible should be only to Central Government laws to determine whether the activity is a bonafide business activity or not. Thus, if the activity is permitted under the Central Government laws of India and foreign country, it will be considered as a bonafide business activity.
7.	**"No Objection Certificate (NOC)" from the Lender Bank(s)/Regulatory Body/Investigative Agency** **Where a person resident**	Explanation to Rule 4(D) of ODI Rules.	Where a person resident in India making any financial commitment or undertaking disinvestment of such financial commitment under these rules or the FEM (OI) regulations has an account appearing as a Special Mention Account- category 1/ Special Mention Account- category 2 /Non-Performing Asset (NPA)/wilful defaulter as per the information available with a Credit Information Company (CIC) registered under Credit Information Companies (Regulation) Act, 2005, or is under investigation by a regulatory body, viz., SEBI, Insurance Regulatory and Development Authority (IRDA) or Pension	**Rationale:** The term "under investigation" may have been defined differently under different Statutes and may lead to different interpretations, especially, in the context of Income-tax Act, 1961 (IT Act) where the term "under investigation" is not defined and even a routine scrutiny assessment or an enquiry may be considered as investigation. **Recommendation:** Therefore, in order to bring clarity, the term "under investigation" should be defined or elaborated upon.

			Fund Regulatory and Development Authority (PFRDA) or National Housing Bank (NHB) or any other regulator as may be prescribed by the Central Government, or is under investigation by investigative agencies in India, viz., Central Bureau of Investigation or Directorate of Enforcement or Income-tax Department or Serious Frauds Investigation Office or any other agency as advised by the Central Government, an NOC shall be obtained from the lender bank(s)/regulatory body/investigative agency concerned before making financial commitment or undertaking disinvestment of such financial commitment provided such financial commitment is in compliance with other provisions of these rules and FEM (OI) regulations.	

8.	**Round Tripping**	**Rule 6(3) of OI Rules**	"The Financial Commitment by a person resident in India in a foreign entity that has invested or invests into India, at the time of making such Financial Commitment or at any time thereafter, either directly or indirectly, **which is designed for the purpose of tax evasion/ tax avoidance by such person** is not permitted and any contravention under this rule shall be considered to be a contravention of serious/sensitive nature."	**Rationale:** At the outset, the proposal from the RBI to not explicitly prohibit round-tripping of investments is welcome. It is in line with the current business outlook and will benefit Indian businesses. Also, "tax-evasion" is a legitimate concern from the RBI and is now well addressed (compared to previous decade) due to the following significant changes - a) Introduction of General anti-avoidance rules in India since 2017; b) Modification of Indian tax treaties (such as Mauritius, Cyprus, Singapore) from 2017 due to which capital gains would be taxable in India; c) Implementation of BEPS Minimum Standards by India pursuant to OECD's global efforts since 2020; d) Likely introduction of Global Minimum tax under OECD's Pillar 2 proposals wherein India is actively participating (likely from 2021) e) Introduction of automatic exchange of information wherein India is an active party.

				Determination of "tax evasion/ tax avoidance" (unless reported by the Investor itself) is a very subjective and long-drawn process involving tax authorities and Courts. At the same time, the business needs to have certainty while making an ODI about feasibility under FEMA. What is tax avoidance and tax evasion can be determined by the Income-tax department only after the transaction takes place and income-tax assessment has happened. At the time of undertaking the transaction, it is not possible to conclude whether the transaction is for tax avoidance or evasion. Recommendation: **Kindly note we are not supporting income-tax evasion and avoidance. We are only stating that for violation of tax law only income-tax department may be the regulator.** In order to provide more certainty and clarity at the time of making a decision for outbound investment, we suggest that RBI may issue an FAQ on the same lines as provided in the Standard Operating Procedure of DPIIT:

				"Claim of any tax relief under the Income-tax Act, 1961 or the relevant DTAA will be **examined independently by the tax authorities** to determine the eligibility and extent of such relief and the approval of ABC Deptt. by itself will not amount to any recognition of eligibility for giving such relief." As an alternative to our suggestion in para 1.3.1, we suggest that if there is any Round Tripping investment, the **Indian investor should report the same to RBI,** and RBI may report the matter to Income-tax department. Then let income-tax department decide whether it wants to investigate further.