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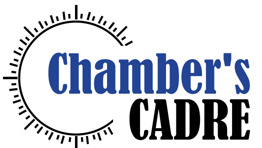

THE CHAMBER'S JOURNAL

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Vol. XI | No. 8 | May 2023

FEMA OVERSEAS INVESTMENT

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Editorial

Dear Readers,

Bharat Ratna Sachin Tendulkar celebrated his 50th Birthday on 24th April 2023 which also marked the 50th anniversary (Golden Jubilee) of the epoch making judgement of the Supreme Court of India in the case of *Kesavananda Bharati vs. State of Kerala (1973) 4 SCC 225*, popularly known as the Fundamental Rights Case and is also regarded as one of the most significant milestone in Indian judicial history.

The hearing of this case commenced on October 31,1972 and concluded on March 23,1973- a total of 66 working days as the case was heard every Tuesday, Wednesday and Thursday. The judgment of 703 pages was a split verdict, delivered on 24th April 1973. By a wafer thin majority of 7:6, a 13 judge bench, the largest ever bench of the Supreme Court, came to one basic conclusion "The Parliament can not alter the basic structure or framework of the Constitution".

Perhaps this judgement which is considered as one of the fundamental decisions upholding the constitutional supremacy is responsible for India continuing as a democracy over the last fifty years. Many articles on this landmark judgement by legal luminaries were published in various newspapers on its 50th anniversary which highlights importance of this judgement. The case on behalf of Kesavananda Bhartati was argued by the great doyen of the legal profession ,Late Shri Nani Palkhivala. His thoughts on constitution have been captured in the book-The Wits and Wisdom of Nani Palkhivala. One quote which is relevant in the context of Keshavananda Bharati's case is quoted below.

"The Constitution represents 'Charters of power granted by liberty' and not 'Charters of liberty granted by power'. Liberty is not the gift of the state to the people: it is the people enjoying liberty as the citizens of a free republic who have granted powers to the legislature and the executive".

This I believe, is an apt occasion to be grateful for the efforts our freedom fighters have taken to make India a free and democratic nation, where the principles of Liberty, Equality and Justice, still hold fort.

One recent development which is being debated and discussed by the professionals is bringing the Chartered Accountants, Company Secretaries and Cost Accountants within the ambit of the Prevention of Money Laundering Act,2002 (PMLA) to harmonise with global norms. It has,

however, kept other intermediaries such as lawyers , outside it's ambit. The abovementioned categories of professionals will now be covered under the ambit of PMLA for five categories of financial transactions ,namely

1. Buying and selling of immovable property.
2. Managing client money, securities or other assets
3. Management of bank, saving or securities account.
4. Creation, operation or management of companies, LLPs , trust and organisation of contribution for them.
5. Buying and selling of business entities.

In performing their attesting and advisory roles, professionals will have to undertake a 'Know Your Customer' exercise (KYC) of all clients entering into these transactions and maintain their records. This measure will change the way professionals will work when they advise their clients on specified transactions. They will have to do due diligence of transactions to examine *inter alia* the source of funds and report irregularity(ies), if any. Going forward the CAs, CSs and CWAs will have to be diligent in selection of clients when they advise them on the specified transactions.

Economically our country has been doing quite well in the last couple of years. More and more foreign companies are setting up facilities in India or investing in India. Similarly more and more Indians and Indian companies have started investing overseas. FEMA is a very important statute for the inbound and outbound investments and is one of the most relevant statute for any practicing professional.

Considering its importance and rising outbound investments, the Journal Committee has designed this issue on FEMA Outbound Investments. My sincere gratitude to the authors for sharing their expert knowledge and sparing their valuable time to write the articles for this issue.

I end with some thoughts of Late Shri Nani Palkhivala on politics:

— *Bacon said, 'Knowledge is power'. A nation progresses gloriously when knowledge and power are combined in the same individuals. It faces a grave crisis when some have knowledge and others have power.*

— *Some minimum qualifications should be prescribed for those who seek election to Parliament .....You need years of training to attend to a boiler or to mind a machine, to supervise a shop floor or to build a bridge, to argue a case in law court or to operate upon a human body. But to steer the lives and destinies of millions of your fellowmen, you are not required to have education or equipment at all!*

VIPUL K. CHOKSI
Editor

From the President

Dear Members,

The cost of tax collection for the Income Tax department in India has dropped to 0.5% of total taxes collected in FY22, the lowest in over two decades. This reduction in cost is attributed to tech-enabled oversight of economic activity and a widening net of taxes deducted at source. The decrease in cost suggests that the Income Tax department is becoming more efficient, which can lead to increased revenue collection, improved compliance, and increased taxpayer satisfaction. However, it is important to consider other factors like fairness, transparency, and accountability to ensure the tax system operates effectively and efficiently.

The Indian government has reported that the introduction of new tracking features has helped widen the tax base, which was identified as a key focus area by the finance minister, along with educating taxpayers and disposal of disciplinary proceedings. The use of these new tracking features, such as data analytics, artificial intelligence, and machine learning algorithms, can help tax authorities better detect cases of tax evasion and fraud by identifying previously unreported income or assets. However, it is important to ensure that the data collected is used responsibly and ethically, with appropriate safeguards in place to protect individual privacy rights

Research indicates that social bias can hinder the success of girls in male-dominated fields like mathematics and science. Girls tend to perform as well as boys in these subjects in early childhood and adolescence, but their representation and success decline in higher education and the workforce due to societal stereotypes and biases about gender roles and abilities. Girls face challenges like being taken seriously, receiving mentorship, being promoted to leadership positions, and balancing work-life expectations. Addressing gender bias and inequality requires efforts to change cultural norms and biases, improve access to education and mentorship, and promote policies that support work-life balance and equality in the workplace. By doing so, girls and women can reach their full potential in all fields, including mathematics and science.

The 6th Dastur National Moot Court Competition 2023, organized by The Chamber in association with The Government Law College, Mumbai, aims to provide students from all over India with an opportunity to improve their oratory and intellectual skills in taxation,

appear before the Hon'ble Members of the Hon'ble Income Tax Appellate Tribunal (ITAT) and the Hon'ble Judges of the Hon'ble Bombay High Court, and motivate them to specialize in taxation. The competition's objective is to expose students to a tax moot problem and encourage them to participate. Members are urged to educate and assist students in participating in the competition.

The Delhi Chapter has been praised for successfully organizing two hybrid programmes in April. The first program was a full-day seminar on FEMA, which covered recent developments on FDI, ODI, ECB, and other related issues. Representatives of the RBI Delhi Regional Office led presentations and discussions, which helped clarify several issues for around 70 physical participants and around 125 virtual participants. The second program was a full-day seminar on Charitable Trust and its related issues, where members actively participated in discussions related to FCRA and CSR compliances of charitable trusts. Honourable ITAT President Shri G. S. Pannu addressed the gathering.

The Direct Tax Committee is conducting an important program on May 13, 2023, on the topic of "Tax and Regulatory Issues in Relation to Self Development and Joint Development Agreement." The program is unique and important as it will provide insights into the perspectives of flat owners and society in relation to tax and regulatory issues that arise in self-development and joint development agreements. The speaker will likely cover topics such as tax implications, compliance requirements, and other regulatory issues related to these agreements. The speaker may also take questions from attendees to provide further clarification on the topic. I urge you all to attend the program in large numbers to benefit from the insights provided.

The International Taxation Committee has announced the 16th RRC which is going to be held in Coimbatore. The committee is putting in a lot of effort to ensure that the event is successful and beneficial for the participants. The conference will feature knowledgeable paper writers who will be sharing their expertise on various topics related to international taxation. Along with the insightful sessions, the conference will also provide an opportunity for the participants to explore the beautiful city of Coimbatore. The speaker sessions coupled with the chance to visit the locales of Coimbatore make the event an excellent opportunity for the members to expand their knowledge and network with other professionals. Therefore, I urge all the members to register in large numbers and take advantage of the valuable learning opportunities offered by the conference.

The current issue of the Journal is on an Important subject of "**FEMA Overseas Investment**". Special thanks to Shri Kirit Dedhia for helping to design the journal. I am sure the contents of the journal will be helpful and serve as a reference on the subject.

I conclude with best wishes to all the readers and wish a happy summer vacation.

Jai Hind

PARAG S. VED
President

CA Paresh Shah

Applicability of FEMA to Outbound Investments

1. Introduction

Indian economy is growing at fast rate and is now significant part of global economy. Hence, Government and RBI thought it fit to liberalise the policy of Indian investment outside India. The revised policy has been announced on 22-8-2022. In this article we will understand the following topics pertaining to FEMA provisions pertaining to Outbound Investments in detail:

i. History pertaining to Out bound Investments and how the regulations have liberalized with time.

ii. Meaning of Capital Account transactions.

iii. Exemptions from applicability of Overseas Investment Rules and Regulations.

iv. Overall Construct of the New OI rules and Regulations.

v. Acquisition and Transfer of Immovable properties outside India.

2. History

Regulations pertaining to Outbound Investments were notified by RBI vide Notification No. Fema 19/RB Dt.3.5.2000 [Notf. 19]. Notification 19 was superseded by Notification No. FEMA 120/RB dt. 7.7.2004. In August 2022, RBI, with effect from August 22, 2022 has combined erstwhile FEMA Notification No. FEMA 120/RB (Transfer or Issue of Foreign Security) Regulations, 2004 ('erstwhile ODI regulations') and FEMA Notification No. 7(R) (Acquisition and Transfer of immovable property outside India) Regulations, 2015 into FEMA (Overseas Investment) Rules, 2022 ('OI Rules') and FEMA (Overseas Investment) Regulations, 2022 ('OI Regulations') and the erstwhile regulations stand superseded.

2.1. Initially only a company incorporated in India could make investments abroad whereas a resident Indian, a partnership firm in India or any other resident entity were not permitted to invest abroad. Proprietary concern engaged in profession was also permitted to invest outside India w.e.f. 1.1.2002. With effect from 7th July, 2005 it was notified that even partnership firm registered under Indian Partnership Act, 1932 would be eligible to invest outside India.

2.2. The financial commitment by Companies, Registered Partnership

firms or a body created under an Act of Parliament, was initially permitted up to 100% of the Net Worth which was later increased to 200% of the Net Worth and later increased to 400% of Net Worth (current limit).

2.3. Resident individuals were permitted to set up a Joint Venture or a Wholly Owned Subsidiary outside India with effect from August 5, 2013 and subject to the terms and conditions stipulated in Notification No. FEMA 263/RB-2013 dated August 5, 2013. The annual permitted limit of Investment at that time was USD 75,000 which has been increased to USD 2,50,000.

3. Capital Account Transactions

3.1. According to Sec 2(e) of FEMA - Capital Account transaction means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6.

3.2. Capital account transactions are generally prohibited unless permitted. Upto 15.10.2019, all capital account transactions were regulated by RBI.

3.3. Prior to its omission w.e.f. 15.10.2019, Section 6(3) contained ten sub clauses covering a wide range of transactions. For each of such categories RBI has issued separate notifications.

No.	Transactions specified under Sec 6(3)	Ntf. No
1	Transfer/Issue of Foreign Security by a PRII	Notf. No.120
2	Transfer/Issue of any Security by a PROI	Notf. No.20(R)
3	Transfer/Issue of Security/Foreign security by branch, office or agency in India by PROI	Notf. No.2
4	Borrowing/Lending in Foreign currency in whatever form or by whatever name called	Notf. No.3(R)
5	Borrowing/Lending in Rupees in whatever form or by whatever name called between a PRII and a PROI	Notf. No.4
6	Deposits between PRII and PROI	Notf. No.5 (R)
7	Export, Import or holding of currency or currency notes	Notf. No.6 (R)
8	Transfer of Immovable property outside India, other than a lease ≤ 5 years, by PRII	Notf. No.7 (R)
9	Acquisition/Transfer of Immovable property in India, other than a lease ≤ 5 years by PROI	Notf. No.21 (R)
10	Giving of a guarantee/surety in respect of any debt, obligation or other liability incurred: 1) By PRII owed to PROI or 2) By PROI	Notf. No.8

It may be noted that Section 6(3) of FEMA has been omitted by the Finance Act, 2015 w.e.f. 15.10.2019. Instead, Section 6(2A) has been inserted by the Finance Act, 2015 to

provide that the Central Government may, in consultation with the Reserve Bank, prescribe any class or classes of capital account transactions, not involving debt instruments, which are permissible. Simultaneously, Section 6(2)(a) has been amended by the Finance Act, 2015 w.e.f. 15.10.2019, by providing that the Reserve Bank may, in consultation with the Central Government, specify any class or classes of capital account transactions, involving debt instruments, which are permissible. Newly inserted Section 6(7) states that "for the purposes of this section, the term "debt instruments" shall mean, such instruments as may be determined by the Central Government in consultation with the Reserve Bank". Thus, the Central Government has the power to regulate capital account transactions other than debt instruments i.e. equity capital whereas the Reserve Bank has the power to regulate capital account transactions involving debt instruments.

3.4. The above-mentioned capital account transactions are also notified through Notification FEMA 1, segregating the transactions of residents and non-residents as Schedule I & Schedule II respectively.

3.5. Only the transactions specified in Schedules I & II are permissible Capital Account transactions under broad heading, any transaction not specified in in Schedules I & II cannot be undertaken by Resident or Non-resident as the case may be.

3.6. Notification No. FEMA 1/2000-RB dated 3rd May 2000 "Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000".

Permissible Capital Account Transactions are as under:

a. Transactions, specified in **Schedule I**, of a person resident in India.

b. Transactions, specified in **Schedule II**, of a person resident outside India.

Since this article deals with FEMA implications on outbound investments, permitted capital account transaction for a PRII has been elaborated below

Schedule I - Classes of capital account transactions of persons resident in India (PRII)

i. Investment by a PRII in foreign securities.

ii. Foreign currency loans raised in India and abroad by a PRII.

iii. Transfer of immovable property outside India by a PRII.

iv. Guarantees issued by a PRII in favour of a person resident outside India.

v. Export, import and holding of currency/currency notes.

vi. Loans and overdrafts (borrowings) by a PRII from a PROI.

vii. Maintenance of foreign currency accounts in India and outside India by a PRII.

viii. Taking out of insurance policy by a PRII from an insurance company outside India.

ix. Loans and overdrafts by a PRII to a PROI.

x. Remittance outside India of capital assets of a PRII.

xi. Sale and purchase of foreign exchange derivatives in India and abroad and commodity derivatives abroad by a PRII.

4. Section 6(4) Exemptions

4.1. Section 6(4) of FEMA: A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

4.2. Foreign Exchange Management Overseas Investment Rules, 2022, and Foreign Exchange Management Overseas Investment Regulations, 2022 does not apply to any acquisition or transfer of any investment made in accordance with Section 6(4) of FEMA. Therefore, the limits of financial commitment, pricing guidelines, RBI compliances or repatriation requirements will not apply to investments made by a person resident in India (PRII) from his/her income earned or investments made while he/she were a person resident outside India (PROI).

4.3. As per AP (DIR Series) Circular No. 90 dated 9th January, 2014, it was clarified that Section 6(4) covers the following transactions:

(i) Foreign currency accounts opened and maintained by such a person when he was resident outside India;

(ii) Income earned through employment or business or vocation outside India taken up or commenced while such person was resident outside India, or from investments made while such person was resident outside India, or from gift or inheritance received while such a person was resident outside India;

(iii) Foreign exchange including any income arising therefrom, and conversion or replacement or accrual to the same, held outside India by a person resident in India acquired by way of inheritance from a person resident outside India.

(iv) A person resident in India may freely utilise all their eligible assets abroad as well as income on such assets or sale proceeds thereof received after their return to India for making any payments or to make any fresh investments abroad without approval of Reserve Bank, provided the cost of such investments and/or any subsequent payments received therefor are met exclusively out of funds forming part of eligible assets held by them and the transaction is not in contravention to extant FEMA provisions.

5. New ODI regulations (Overall construct – Rules, Regulations, Directions)

The new framework of Overseas Direct Investment comprises of the following:

i. Foreign Exchange Management (Overseas Investment) Rules, 2022 ("OI Rules")

Issued by Ministry of Finance on 22nd August, 2022, OI Rules provides the regulatory framework for making of overseas investment covering the permissions,

conditions for making overseas investment, restrictions from making Overseas Direct Investment ('ODI'), pricing guidelines, transfer, liquidation and restructuring of ODI. While the OI Rules have been framed by Ministry of Finance, however, the same will be administered by the RBI as per Rule 3(1):

Rule	Provision
2 to 4	Definitions, Power of RBI to administer and non-applicability of rules
5	Classification of debt and non-debt instruments
6	Continuity of certain investments made as per the Act, Rules or Regulations
7	Rights and Bonus Shares
8	Prohibition on Investments outside India
9	Overseas Investment
10	No Objection Certificate
11 to 15	Manner of making overseas investment by: • Indian Entity (Schedule I & II) • Resident Individual (Schedule III) • Entities other than Resident Individual and Indian Entity (Schedule IV) • PRII in International Financial Service Centre (IFSC) (Schedule V)
16	Pricing Guidelines
17	Transfer or Liquidation
18	Restructuring
19	Restrictions and Prohibitions
20	Requirements to be specified by Reserve Bank
21	Restriction on acquisition or transfer of immovable property outside India
Schedules	Provision
I	Manner of making ODI by Indian Entity (IE)
II	Manner of making OPI by Indian Entity
III	Manner of making OI by Resident Individual (RI)
IV	OI by PRII other than IE and RI
V	OI in IFSC by PRII

ii. *Foreign Exchange Management (Overseas Investment) Regulations, 2022 ("OI Regulations")*

Issued by RBI on 22nd August, 2022, OI Regulations provide only the operational part covering conditions for undertaking Financial Commitment ('FC'), investment in debt instruments, deferred consideration in case of acquisition or transfer of equity capital of a Foreign Entity ('FE'), mode of payment, obligations of Persons Resident in India ('PRII'), reporting requirements, and consequence of delay in reporting.

Regulation	Provision
2	Definitions
3	Financial commitment (FC) by Indian Entity by modes other than equity capital
4	Financial commitment by Indian entity by way of debt
5	Financial commitment by way of guarantee
6	Financial commitment by way of pledge or charge
7	Acquisition or transfer by way of deferred payment
8	Mode of Payment
9	Obligations of PRII
10	Reporting requirements for Overseas Investment
11	Delay in reporting
12	Restriction on further financial commitment or transfer

iii. *Foreign Exchange Management (Overseas Investment) Directions, 2022 ("OI Directions")*

Issued by RBI on 22nd August, 2022, it deals with the implementation aspects of OI Rules and OI Regulations.

Part	Provision
I	Definitions and Associated Details
II	General Provisions • Non Applicability if OI Rules & Regulations • Permission to make OI • Approval from CG/RBI • NOC • Rights & Bonus shares • Acquisition of Foreign Entity through bidding

Part	Provision
	• ODI in startups • Acquisition/Transfer by Deferred Payment • Mode of Payment • Pricing Guidelines • Transfer/Liquidation • Restructuring • Opening of Foreign Currency Account Abroad by Indian Entity • Obligations of PRII • Reporting and Delay in Reporting • Restriction on further financial commitment/transfer • Restrictions and Prohibitions
III	Specific Provisions • FC by Indian Entity • OI by Resident Individual • OI by PRII other than RI and IE • OI by PRII in IFSC • Acquisition or Transfer of Immovable Property outside India
IV	Other operational instructions to AD Banks

iv. ***Master Direction – Reporting under Foreign Exchange Management Act***

Updated by RBI on 22nd August, 2022, it deals with reporting requirements under FEMA, including that relating to ODI.

v. ***FAQ on Purchase of immovable property outside India by Resident Individual***

Updated by RBI on 06th April, 2023, It resolved common queries pertaining to Purchase of immovable property outside India by Resident Individual.

6. Non-Applicability of New OI Rules and Regulations

The New OI Rules and Regulations shall not apply to the following:

i. Any investment made outside India by a financial institution in an IFSC

ii. Acquisition or transfer of any investment outside India made out of Resident Foreign Currency Account

iii. Acquisition or transfer of any investment outside India made out of foreign currency resources held outside India by a person who is employed in India for a specific duration irrespective of length thereof or for a specific job or assignment, duration of which does not exceed three years or

iv. Investment made in accordance with section 6(4) of the Act.

7. Important Definitions as per new OI Rules and key changes arising therefrom

i. Overseas Direct Investment (ODI) *- means investment by way of acquisition of unlisted equity capital of a foreign entity, or subscription as a part of the memorandum of association of a foreign entity, or investment in ten per cent, or more of the paid-up equity capital of a listed foreign entity or investment with control where investment is less than ten per cent. of the paid-up equity capital of a listed foreign entity;*

a. Modes of Acquisition of ODI:

(i) subscription as part of memorandum of association or purchase of equity capital, listed or unlisted;

(ii) acquisition through bidding or tender procedure;

(iii) acquisition of equity capital by way of rights issue or allotment of bonus shares;

(iv) capitalisation, within the time period, if any, specified for realisation under the Act, of any amount due towards the Indian entity from the foreign entity, the remittance of which is permitted under the Act or does not require prior permission or RBI/Central Govt.;

(v) the swap of securities;

(vi) merger, demerger, amalgamation or any scheme of arrangement as per the applicable laws in India or laws of the host country or the host jurisdiction, as the case may be.

b. Modes of Acquisition of ODI in a Listed Foreign Entity:

- Investment in 10% of more of paid up share capital of a listed foreign entity.
- Investment with control in less than 10% of the paid up share capital of a listed foreign entity.

c. Once an ODI, it will always remain an ODI even if the investment falls under 10% in listed foreign entities.

ii. Overseas Portfolio Investment (OPI) *- means investment, other than ODI, in foreign securities, but not in any unlisted debt instruments or any security issued by a person*

resident in India who is not in an IFSC

a. An Indian entity may make OPI which shall not exceed fifty percent of its net worth as on the date of its last audited balance sheet,

b. Listed Indian companies are permitted to make OPI including by way of reinvestment.

c. Unlisted Indian companies however can only acquire equity capital by way of OPI by means of rights/bonus, capitalization of amount due, swap of securities or merger, demerger, amalgamation or any scheme of arrangement as per the applicable laws in India or laws of the host country.

d. Individuals may also make OPI up to the Liberalized Remittance Scheme (LRS) limit.

ODI v OPI:

In the old regime, there was no segregation between a direct investment and a portfolio investment and there was no clear definition of portfolio investment. The new regime, however, has clearly defined ODI and OPI.

The New Regime defines ODI as (a) acquisition of unlisted equity capital or subscription to the memorandum of association of a foreign entity; or (b) investment in 10% or more of the paid-up share capital of a listed company; or (c) acquisition of 'control' (i.e., acquiring management control or 10% or more of voting rights) of a listed company.

OPI, on the other hand, has been defined as investment other than ODI in foreign securities and cannot be made in (i) unlisted debt instruments; (ii) any securities issued by a person resident in India that is not in an international financial services center.

In view of the above definitions, any investment in equity capital of an unlisted company is considered ODI. The only exceptions to this are acquiring shares of less than 10% as qualification shares or under a sweat equity plan or employee benefits scheme. This means that shares acquired by resident individuals in an unlisted company by way of gift will be classified as ODI under the new regime, whereas under the old regime it could have been classified as portfolio investment so long as there was no management participation. Now, as ODI, the attendant conditions (like, investing in financial services, step down subsidiary) will be applicable. Accordingly, resident individuals can no longer explore the gift option to acquire equity in unlisted foreign companies that have subsidiaries. Further, in such instances, several reporting obligations may become applicable to individuals, which is cumbersome.

Further, in case of inheritance of foreign securities, it appears from the provisions of Schedule III of the OI Rules that such overseas

investment would be classified only as ODI even if such inheritance is less than ten per cent of the equity capital, whether listed or unlisted, of a foreign entity without control. This seems to be an inadvertent implication and may be clarified in due course of time by the regulator.

iii. ***Control*** - *means the right to appoint majority of the directors or to control management or policy decisions exercisable by a person or persons acting individually or in concert,* ***directly or indirectly****, including by virtue of their shareholding or management rights or shareholders' agreements or voting agreements that entitle them to ten per cent. or more of voting rights or in any other manner in the entity;*

a. Hence, the term Control

- Means:
- the right to appoint majority of the directors; or
- to control management or policy decisions; or
  - o by persons acting individually or in concert, directly or indirectly
- 10% or more of voting rights (by means of Shareholding, Management Rights, Shareholder Agreement or Voting Agreement)

b. The definition of Control as per Companies Act does not include the 10% voting right threshold. The definition of control is only required to be referred to in case of investment of less than 10% in listed foreign entities.

iv. ***Equity capital*** - *means equity shares or perpetual capital or instruments that are irredeemable or contribution to non-debt capital of a foreign entity in the nature of fully and compulsorily convertible instruments*

a. The above definition does not include optionally convertible instruments. The definition clearly states that only contribution to non-debt capital of a foreign company will be considered as Equity Capital. There is ambiguity whether Compulsory Convertible Debentures can be considered as part of equity capital? It may be noted that Foreign Exchange Management (Non-Debt) Instrument Rules specifically cover a Compulsorily Convertible Debentures into the definition of "equity instruments" of an Indian company.

v. ***Foreign entity*** - *means an entity formed or registered or incorporated outside India, including International Financial Services Centre that has limited liability:*

Provided that the restriction of limited liability shall not apply to an entity with core activity in a strategic sector;

The above definition indirectly clarifies that investment in US LLCs will be permitted as such

entities have limited liability, the erstwhile ODI provisions were not clear whether investment in LLCs is permitted or not

vi. ***Strategic sector*** *shall include energy and natural resources sectors such as oil, gas, coal, mineral ores, submarine cable system and start-ups and any other sector or sub-sector as deemed necessary by the Central Government*

a. The term start up is not defined in the new OI Rules.

b. The term "core activity" has not been defined in the new OI Rules. The erstwhile ODI Regulations defined "core activity" as an activity whose turnover was not less than 50% of the total turnover in the previous financial year.

vii. ***Financial commitment*** - *means the aggregate amount of investment made by a person resident in India by way of Overseas Direct Investment, debt other than Overseas Portfolio Investment in a foreign entity or entities in which the Overseas Direct Investment is made and shall include the nonfund- based facilities extended by such person to or on behalf of such foreign entity or entities;*

viii. ***Indian entity means–***

(i) a company defined under the Companies Act, 2013 (18 of 2013);

(ii) a body corporate incorporated by any law for the time being in force;

(iii) a Limited Liability Partnership duly formed and incorporated under the Limited Liability Partnership Act, 2008 (6 of 2009); and

(iv) a partnership firm registered under the Indian Partnership Act, 1932 (9 of 1932)

Under the old regime, there was the concept of Indian Party which is done away with in the new regime. Now, concept of Indian party (IP)where all the investors from India in a foreign entity were together considered as IP, has been substituted under the new regime with the concept of Indian entity where each investor entity shall be separately considered as an Indian entity.

ix. ***Overseas Investment*** - *means financial commitment and Overseas Portfolio Investment by a person resident in India;*

x. ***Round-tripping –***

Round-tripping/ODI to FDI structure had not been clearly identified or permitted under the previous ODI regime and had been addressed only by way of an FAQ, where a clarification was issued that the RBI will consider such structures on merits under the approval route. RBI FAQs had prohibited an Indian Party to set up an Indian subsidiary(ies) through its foreign WOS or JV and also prohibited an Indian Party to acquire a WOS or invest in JV that already had direct/indirect investment in India under the automatic route. In such cases, the Indian Party was required to approach the Reserve Bank for prior approval through AD Bank which was considered on a case to

case basis, depending on the merits of the case.

Under the new regime, the OI Rules states that investment in any foreign entity is restricted if such foreign entity has a step-down subsidiary in India and such investments results in a structure having more than two layers of subsidiaries. Thus, it permits a combination of overseas investment followed by a foreign direct investment back into India, subject to being restricted to two layers. The exemption is provided to the entities covered under Rule 2 (2) of Companies (Restriction on Number of Layers) Rules,2017. The new OI Rules thus seems to have diluted the stringent norms under the erstwhile provisions.

xi. ***Gift of foreign securities to Resident Individual –***

Under the previous ODI regime, a general permission had been provided to an individual resident in India to acquire foreign securities by way of gift from a person resident outside India.

The new OI Guidelines now state that any gift of foreign securities from a person resident outside India to an individual resident in India may be made only in accordance with the Foreign Contribution (Regulation) Act, 2010 ("FCRA"). This is a key restriction imposed upon investments by resident individuals, especially since there is no clarity on the compliances required to be fulfilled under the FCRA. The FCRA norms are applicable only where such shares may be considered as 'foreign contribution' under the FCRA. The FCRA allows a resident to receive foreign contribution from a relative. Thus, it appears that a gift from a non-resident may be acceptable as long as such non-resident is a relative of the resident individual. A 'relative' in such case shall be as defined under the Companies Act, 2013.

8. Investment in immovable property outside India

The Foreign Exchange Management (Overseas Investment, or OI) Rules, notified by the Reserve Bank of India (RBI) on 22 August 2022, supersedes the erstwhile notification 7(R) governing acquisition and transfer of immovable property outside India. Rule 21 of the OI Rules pertains to Acquisition and Transfer of Immovable Property outside India. Rule 21 provisions does not apply to:

i. Property held by a person resident in India who is a national of a foreign state

ii. Acquired by a person resident in India (PRII) on or before the 8th day of July, 1947 and continued to be held by such person with the permission of the Reserve Bank

iii. Acquired by a person resident in India on a lease not exceeding five years.

8.1. Acquisition of Immovable Property from PRII - a PRII may acquire immovable property outside India by way of inheritance or gift or purchase from a PRII who has acquired such property as per the foreign exchange provisions in force at the time of such acquisition. It may be noted that the transferor PRII may have acquired the

immovable property when he was PROOI as a result of which the acquisition would be in accordance with the foreign exchange provisions in force at the time of acquisition.

As the new OI regime permits PRII to acquire foreign immovable property from another PRII, it appears that payment for the same may be made in INR in India, similar to transfer of ODI assets from one Indian Party to another.

8.2. Acquisition of Immovable Property from PROI – A PRII can acquire immovable property outside India from a PROI through any of the following means:

i. By way of inheritance.

ii. By way of purchase out of foreign exchange held in RFC account.

iii. By way of purchase out of the remittances sent under the Liberalised Remittance Scheme (LRS). Remittance under LRS may be consolidated in respect of relatives, provided the property is jointly held by the relatives.

iv. Jointly with a relative who is a PROI.

v. Out of the income or sale proceeds of the assets, other than ODI, acquired overseas under the provisions of the Act – This was not permitted under Notification 7(R), This means that any income earned by a PRII on investments made via LRS (Eg: Portfolio Investment) can also be used to acquire property outside India.

8.3. Acquisition of Immovable Property by an Indian Entity – An Indian Entity having an overseas office can acquire immovable property for the business and residential purpose of its staff.

8.4. Transfer of Immovable Property

i. A PRII can transfer the property by way of inheritance, gift or sale to a PRII.

ii. A PRII can transfer the property by way of inheritance or sale to a PROI.

iii. A PRII can create charge on such property.

9. Conclusion

The revised framework aims to enhance the ease of doing business in India. The framework introduces some new definitions like Control, OPI, step down subsidiary, startups etc. and provides clarity with respect to various existing definitions e.g., Overseas Investment (OI), Overseas Direct Investment (ODI), Indian entity, etc. It also provides clarity in certain rules to help with the implementation. Additionally, the revised OI Rules and regulations aims to provide clarity on various concepts such as the distinction between ODI and OPI Rules, liberalization of ODI to FDI structure, introduction of arm's-length criteria for issue/transfer of equity capital or debt by a foreign entity, statutory auditor's certificate for undertaking ODI and for Annual Performance Report etc.

The new framework also liberalizes rules pertaining to Disinvestment, Investment in Financial Sectors by Non-financial Indian Entities, reduces need for seeking specific approvals and liberalizes global operations by Indian Corporates.

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Overseas Investment (OI) regulations for Resident Individuals

1. The Reserve Bank for the first time introduced Liberalised Remittance Scheme (LRS) of USD 25,000 for Resident Individuals vide its A.P. (DIR Series) Circular No. 64 dated February 4, 2004. This facility was available for making remittance up to USD 25 ,000 per calendar year for any current or capital account transactions or a combination of both. The said limit has been revised in stages from time to time and with effect from 26 May 2015 the said limit is USD 250000 per financial year.

   Under this facility, it was stated in the said circular that resident individuals will be free to acquire and hold immovable property or shares or any other asset outside India without prior approval of the Reserve Bank. Further, it was stated that the individuals would be able to open, maintain and hold foreign currency accounts with a bank outside India for making remittances under the scheme without prior approval of the Reserve Bank.

   Many individual entrepreneurs invested in shares of foreign entities using the above referred LRS route. Later, the Reserve Bank issued a Notification No. FEMA.263/ RB-2013 dated March 5, 2013. The notification inserted a new Regulation 20A in Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations 2004 (hereinafter referred to as "Old Regime") which provided as under:

   "20A. Acquisition or Setting up of a JV or WOS abroad by resident individual

   A resident individual (single or in association with another resident individual or with an 'Indian Party' as defined in this Notification) satisfying the criteria as per Schedule V of this Notification, may make overseas direct investment in the equity shares and compulsorily convertible preference shares of a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) outside India."

   With introduction of regulation 20A, with effect from 5 August 2013 (date of notification in the Gazette), individuals were permitted to make overseas direct investment by acquisition or setting up of a JV or WOS in overseas jurisdictions.

   Direct investment outside India made by individuals prior to 5 August 2013 were treated as violations of Regulation 5(1)

read with 2 (k) of the Notification No. FEMA 120/RB-2004 dated July 7, 2004 and were subjected to compounding of offences. There are several compounding orders for such violations.

The term "direct investment outside India" was defined in the Old Regime as below:

"Direct investment outside India" means investment by way of contribution to the capital or subscription to the Memorandum of Association of a foreign entity or by way of purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange but does not include portfolio investment.

There was no clarity as to what can be termed as 'portfolio investment'. There was no specific mention of the percentage of equity holding proposed to be bought to qualify as portfolio investment.

2. Amendment to the ODI Regulations in August 2022

The Reserve Bank of India ('RBI') issued new guidelines for overseas investments on August 22, 2022. The regulatory framework for Overseas Investments by Indian residents is summarized in the table below:

Rules/Regulations/Directions	Notified/issued by
Foreign Exchange Management (Overseas Investment) Rules, 2022 ('OI Rules')	Ministry of Finance on 22 August 2022 via Notification No. G.S.R. 646(E)
Foreign Exchange Management (Overseas Investment) Regulations, 2022 ('OI Regulations')	RBI on 22 August 2022 via notification No. FEMA/400/2022-RB
Foreign Exchange Management (Overseas Investment) Directions, 2022 ('OI Directions')	RBI on 22 August 2022 via A.P. (DIR Series) Circular No.12
Master Direction – Reporting under Foreign Exchange Management Act	RBI, updated on 22 August 2022 and thereafter on 30 September 2022
Master Direction – Liberalised Remittance Scheme	RBI, updated on 23 August 2022 and thereafter on 24 August 2022

(Collectively the OI Rules, OI Regulations and the OI Directions read as the "OI Framework" or "New Regime").

Pursuant to the release of the OI Framework, the RBI has also updated the master directions on Liberalized Remittance Scheme ("LRS")[1], which have been significantly amended to align it with the OI Framework. The LRS now categorizes (a) Overseas Direct Investment ("ODI"), and (b) Overseas Portfolio Investment ("OPI"), by an individual resident Indian as permissible capital account transactions, which are required to be carried out in accordance with the OI Framework.

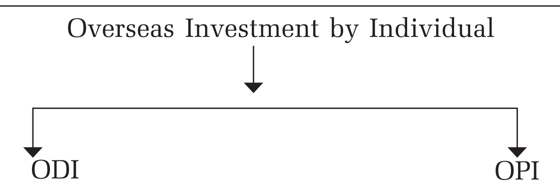
The segregation between 'Rules' and 'Regulations' has its genesis in the amendment made to FEMA vide the

1. FED Master Direction No. 7/2015-16- Updated as on August 24, 2022

Finance Act, 2015. Pursuant to this amendment, the regulatory architecture under FEMA follows an interesting two-tier structure, where the power to frame rules for non-debt instruments vests with the Ministry of Finance ('MoF'); and the power to frame regulations for debt-instruments vests with the RBI. However, RBI has been empowered under Rule 3 of OI Rules to administer the rules framed by the MoF.

The New Regime signifies the Government's attempt to simplify and liberalize the regulatory framework relating to overseas investments by persons resident in India and to promote ease of doing business. Considering the evolving business needs, several relaxations and changes have been introduced.

A resident individual can now make Overseas Direct Investment (ODI) i.e., strategic investment and Overseas Portfolio Investment (OPI) i.e. non-strategic investment and the said investment shall be subject to the overall ceiling under the Liberalised Remittance Scheme of the Reserve Bank (which is at present USD 2,50,000).



3. Grandfathering of Existing Investments

Rule 6 of the OI Rules prescribes that overseas investment made in accordance with the provisions of exchange control regulations prior to the notification of OI Rules and OI Regulations shall be deemed to have been made under the New Regime .

4. Key Changes and its Implications (Relating to Individual as investor)

Some of the important definitions relating to the ODI rules are discussed and analysed below.

"Foreign Entity"[2]

"*Foreign entity*" means an entity formed or registered or incorporated outside India, including International Financial Services Centre that has limited liability:

Provided that the restriction of limited liability shall not apply to an entity with core activity in a strategic sector.

"JV" and "WOS" has now been replaced with 'Foreign Entity' which inter alia means "an entity formed or registered or incorporated outside India." In a welcome move, the New Regime expands the meaning of 'Foreign Entity' and unlike the Draft Rules, 'incorporation' of a Foreign Entity is not a mandatory requirement. This is relevant for LLPs in jurisdictions like the United States, which are registered but not incorporated.

There are two important limbs to the definition of a foreign entity:

i. The entity should be formed or registered or incorporated outside India; and

ii. The entity should have limited liability. This condition is not applicable if the foreign entity is engaged in core activity in a strategic sector.

2. Rule 2(1)(h).

One may infer that investments into foreign limited liability partnerships should also be permitted. Interestingly, in USA, certain states have LLP laws, which are regarded as "partial shield statute". In other words, LLPs incorporated in particular states, may not provide full limited liability to the Partners! One may have to find out the kind of limited liability those LLPs have and assess whether they are fit to be called foreign entity as defined.

An entity in the International Financial Services Centre is a foreign entity. An individual can invest in such a foreign entity in IFSC within the LRS limit.

Strategic sector

"*Strategic sector*" shall include energy and natural resources sectors such as oil, gas, coal, mineral ores, submarine cable system and **start-ups** and any other sector or sub-sector as deemed necessary by the Central Government;

Interestingly, an investment into a start-up is regarded as a strategic sector activity. However, the term 'start-up' has not been defined under the OI Rules. This poses few interesting issues as to whether an ODI can be made into a foreign entity with unlimited liability, which is a so called "start-up" under the general meaning.

"Indian Entity"[3]

"*Indian Entity*" is defined to mean companies, body corporates, LLPs and interestingly, even partnership firms registered under the Indian Partnership Act, 1932 are covered. Indian individual is not included in the definition of Indian Entity. However, Indian individual is one of the recognized investors for which separate rules are prescribed.

It may be noted that the erstwhile ODI regulations permitted "any body created under an Act of Parliament", whereas the new OI Rules specifically refers to a "body corporate" incorporated by any law enacted by the Central or State Government.

"Control"[4]

"*Control*" means the right to appoint majority of the directors or to control management or policy decisions exercisable by a person / persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders' agreements/ voting agreements that entitle them to ten per cent or more of voting rights or in any other manner in the entity.

Hence, the term control is defined to mean:

1. right to appoint majority of the directors; or
2. right to control management or policy decisions, or
3. 10% or more of voting rights

The aforesaid rights could be by virtue of shareholding or management rights or shareholders' agreements or voting agreements or in any other manner

The 10% test assumes relevance whilst determining whether the overseas entity would be regarded as a 'subsidiary' or a 'step-down subsidiary (SDS).

3. Rule 2(1)(j)
4. Rule 2(1)(c)

Under the OI Rules, a subsidiary would be regarded as an entity in which a foreign entity has control. By virtue of the 10% test, a Foreign Entity may be regarded as a subsidiary/ SDS even when it does not meet the 'subsidiary test' under Section 2(87) of the Companies Act, 2013.

***Equity Capital*[5]**

"*Equity capital*" means equity shares or perpetual capital or instruments that are irredeemable or contribution to non-debt capital of a foreign entity in the nature of fully and compulsorily convertible instruments.

Clearly, any optionally convertible instruments, for instance, Optionally Convertible Redeemable Preference Shares into a foreign entity is not regarded as equity capital and not covered within the definition of ODI. However, a Compulsorily Convertible Preference Shares or Compulsorily Convertible Debentures would be regarded as equity capital.

***Overseas Investment*[6]**

"*Overseas Investment*" or "*OI*" means financial commitment and Overseas Portfolio Investment by a person resident in India;

***Financial commitment*[7]**

"*Financial commitment*" means the aggregate amount of investment made by a person resident in India by way of Overseas Direct Investment, debt other than Overseas Portfolio Investment in a foreign entity or entities in which the Overseas Direct Investment is made and shall include the non-fund-based facilities extended by such person to or on behalf of such foreign entity or entities;

Thus, Overseas Investment comprises of:

- Financial Commitment which means
    - o Overseas Direct Investment (ODI)
    - o Debt other than OPI
    - o Non-fund-based facilities to or on behalf of foreign entity
- Overseas Portfolio Investment (OPI)

  Permissible Overseas Investment for the resident individual:

- Overseas direct investment (ODI)
- Overseas Portfolio Investment (OPI)

ODI vs. OPI

In a welcome change, there is now a clear segregation between an Overseas Direct Investment (ODI) and an Overseas Portfolio Investment (OPI).

OI only in "bona fide business activities"

"*Bona fide business activity*" means any business activity permissible under any law in force in India and the host country[8].

Further, the three activities which are prohibited for ODI are:

(i) real estate activity;

5. Rule 2(1)(e)
6. Rule 2(1)(r)
7. Rule 2(1)(f)
8. *Explanation* to Rule 9(1)

(ii) gambling; and

(iii) dealing with financial products linked to the Indian Rupee, without specific RBI approval.

The expression "real estate activity" is defined to mean buying and selling of real estate or trading in Transferable Development Rights but does not include the development of townships, construction of residential or commercial premises, roads or bridges for selling or leasing.

***NOC Requirement*[9]**

A Non-Objection Certificate ('NOC') requirement for making financial commitment has been introduced for any person resident in India who:

- Has an account appearing as NPA; or
- Is classified as a willful defaulter by any bank; or
- Is under investigation by a financial service regulator or by investigative agencies in India, viz, CBI/ED/SFIO.

There is also a deemed approval provision if the concerned agency fails to furnish the certificate within 60 days from the date of receipt of application.

***Pricing Guidelines*[10]**

The pricing for OI should be on an arm's length basis, based on valuation undertaken as per any internationally accepted pricing methodology. The AD banks are responsible for ensuring compliance with arm's length pricing requirements.

Transfer

A person resident in India may transfer equity capital by way of sale to a person resident in India, who is eligible to make such investment under the OI Rules, or to a person resident outside India in accordance with Rule 17 of the OI Rules. The said transfer is subject to compliance with pricing guidelines and reporting requirements under FEMA.

Simplification

Introduction of "Late Submission Fee (LSF)" for reporting delays.

5. Overseas Direct Investment in General

"*Overseas Direct Investment*"[11] or "ODI" means investment by way of acquisition of unlisted equity capital of **a foreign entity**, or subscription as a part of the memorandum of association of a foreign entity, or investment in ten per cent, or more of the paid-up equity capital of a listed foreign entity or investment with **control** where investment is less than ten per cent of the paid-up equity capital of a listed foreign entity;

Thus, ODI is defined to mean the following:

— Acquisition of unlisted equity capital; or

— Subscription to MOA; or

— Investment in 10% or more of paid-up equity capital of a listed foreign entity; or

— Investment with control where investment is less than 10% of paid-up equity capital of a listed foreign entity

9. Rule 10

10. Rule 16

6. Prohibited overseas countries/ jurisdictions[12]

Overseas Investment or transfer of such investment including swap of securities in a foreign entity formed, registered or incorporated in Pakistan or in any other jurisdiction as may be advised by the Central Government from time to time shall require prior approval of the Central Government.

7. Overseas Direct Investment by resident individual

A resident individual may make or hold Overseas Investment by way of ODI in an operating foreign entity not engaged in financial services activity and which does not have subsidiary or step-down subsidiary where the resident individual has control in the foreign entity[13].

To illustrate:

ODI by resident individual is permitted in operating foreign entity only.

ODI by resident individual is not permitted in Special Purpose Vehicle.

ODI by the resident individual shall be subject to the overall ceiling under LRS.

ODI by resident individual is not permitted in a foreign entity engaged in financial services activity.**

ODI by resident individual is not permitted in a foreign entity having a subsidiary or step-down subsidiary where resident individual has control in the foreign entity.**

ODI by resident individual is permitted in a foreign entity having a subsidiary or step-down subsidiary where resident individual does not have control in the foreign entity.

Where a resident individual has made ODI without control in a foreign entity that subsequently acquires or sets-up a subsidiary/SDS, such resident individual shall not acquire control in such foreign entity[14].

In case of resident individuals, ODI in start-ups (start-ups recognized under the laws of the host country/host jurisdiction) is permitted from own funds of such an individual and not out of borrowed funds.

** Resident Individual can do ODI by way of Inheritance; Acquisition of sweat equity shares; Acquisition of minimum qualification shares issued for holding a management post in a foreign entity; Acquisition of shares or interest under Employee Stock Ownership Plan or Employee Benefits Scheme even if foreign entity is engaged in financial services activity or has subsidiary or step-down subsidiary where he has control in the foreign entity[15].

8. Overseas investment in IFSC

A resident individual is permitted to make an ODI in a foreign entity (including an entity engaged in financial services activity, except banking and insurance) in IFSC if such entity does not have a subsidiary or step-down

11. Rule 2(q) of OI Rules
12. Rule 9 of OI Rules
13. Schedule III to the OI Rules
14. Para 22(1) of the OI Directions
15. Schedule III, Paragraph (1), Proviso to sub-clause (2) of OI Rules

subsidiary where the resident individual has control in the foreign entity.

9. ODI in startups[16]

Any ODI in startups in accordance with rule 19(2) of OI Rules shall not be made out of funds borrowed from others. The AD bank, before facilitating the transaction, shall obtain necessary certificate in this regard from the statutory auditors/chartered accountant of the Indian entity/investor.

10. Acquisition or transfer by way of deferred payment[17]

AD bank shall verify the *bona fides* of the transactions from the underlying agreement/documents in case of deferment of payment of consideration. The period of deferment shall be defined upfront. In case the remittance towards acquisition of equity capital is to be made post subscription to Memorandum of Association, the period within which such remittance is to be made shall be defined in the underlying agreement/documents/applicable laws else the remittance shall be made on or before acquisition of/setting up of the foreign entity.

The part of the payment towards consideration deferred by the person resident in India shall be treated as non-fund based financial commitment by such person and shall be reported accordingly. Subsequent payments towards deferred consideration shall be reported in Form FC as conversion of non-fund based financial commitment to equity. The valuation in accordance with pricing guidelines, wherever applicable, shall be done upfront.

11. Overseas Investment by way of Portfolio Investment

"*Overseas Portfolio Investment*" or "OPI" means investment, other than ODI, in foreign securities, but not in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC:

Provided that OPI by a person resident in India in the equity capital of a listed entity, even after its delisting shall continue to be treated as OPI until any further investment is made in the entity[18].

12. Acquisition by way of gift or inheritance[19]

12.1 A resident individual may, without any limit, acquire foreign securities by way of **inheritance** from a person resident in India who is holding such securities in accordance with the provisions of the Foreign Exchange Management Act, 1999 or from a person resident outside India.

12.2 A resident individual, without any limit, may acquire foreign securities by way of **gift** from a person resident in India who is **a relative**[20] and holding such securities in accordance with the provisions of the Foreign Exchange Management Act, 1999.

16. Clause 9 of OI Directions
17. Clause 10 of OI Directions
18. Rule 2(s) of the OI Rules
19. Schedule III, Paragraph (2) of OI Rules
20. "relative" shall have the same meaning as assigned to it in clause (77) of section 2 of the Companies Act, 2013, (18 of 2013);

12.3 A resident individual may acquire foreign securities by way of **gift** from a person resident outside India in accordance with the provisions of the Foreign Contribution (Regulation) Act, 2010 and the rules and regulations made thereunder.

A resident individual may acquire foreign securities		
By way of Inheritance (without any limit)	By way of gift (without any limit)	By way of gift (subject to FCRA)
From a person resident in India or from a person resident outside India*	From a person resident in India who is a relative *	From a person resident outside India in accordance with the provisions of FCRA 2010 *

*Acquisition of foreign securities by way of inheritance or gift in accordance with paragraph 2 of Schedule III of OI Rules shall not be reckoned towards the LRS limit and hence, shall not require reporting under LRS[21].

13. Transfer of overseas investment by way of gift[22]

Resident individuals are not permitted to transfer any overseas investment by way of gift to a person resident outside India.

14. Shares/interest under ESOP/Employee Benefits Scheme

AD banks may allow remittances, towards acquisition of the shares/interest in an overseas entity under the scheme offered directly by the issuing entity or indirectly through a Special Purpose Vehicle (SPV)/SDS. Where the investment qualifies as OPI, the necessary reporting in Form OPI shall be done by the employer concerned in accordance with regulation 10(3) of OI Regulations. Where such investment qualifies as ODI, the resident individual concerned shall report the transaction in Form FC.

Though there is no limit on the amount of remittance made towards acquisition of shares/interest under ESOP/Employee Benefits Scheme or acquisition of sweat equity shares, such remittances shall be reckoned towards the LRS limit of the person concerned.

15. Compliances

15.1 ODI – Form FC

The person intending to make any financial commitment or to do ODI shall fill up the Form FC and submit to the AD Bank.

Any person resident in India having an account appearing as a Non-Performing Asset (NPA) or is classified as willful defaulter by any bank or is under investigation by a financial sector regulator/ investigative agency shall obtain an NOC from the lender bank/regulatory body/investigative agency concerned before making financial commitment or undertaking disinvestment.

21. Clause 17 of ODI Directions

22. Clause 22 (4) of the OI Directions

15.2 OPI

A resident individual investing by way of OPI is not required to report it to any authority. Also, there is no need to submit any documents to the AD bank and not required to do any annual filings.

16. Obligations of person resident in India

Obtain UIN

A person resident in India, through its designated AD bank, shall obtain a Unique Identification Number or "UIN" from the Reserve Bank for the foreign entity in which the ODI is intended to be made before sending outward remittance or acquisition of equity capital in a foreign entity, whichever is earlier.

One AD Bank for all remittances for one foreign entity

A person resident in India making ODI shall designate an AD bank and route all transactions relating to a particular UIN through such AD:

Provided that where more than one person resident in India makes financial commitment in the same foreign entity, all such persons shall route all transactions relating to that UIN through the AD bank designated for that UIN.

Post investment certain documents to be submitted to the AD Bank

A person resident in India acquiring equity capital in a foreign entity, which is reckoned as ODI, shall submit to the AD bank share certificates or any other relevant documents as per the applicable laws of the host country or the host jurisdiction, as the case may be, as an evidence of such investment in the foreign entity within six months from the date of effecting remittance or the date on which the dues to such person are capitalised or the date on which the amount due was allowed to be capitalised, as the case may be.

Earnest money Deposit/Bid Bond Guarantee

A person resident in India who is eligible to make ODI may make remittance towards earnest money deposit or obtain a bid bond guarantee from an AD bank for participation in bidding or tender procedure for the acquisition of a foreign entity:

Provided that in the case of an open-ended bid bond guarantee, it shall be converted into a close-ended guarantee not later than three months from the date of award of the contract.

Realise and repatriate to India all dues receivable from foreign entity

A person resident in India having ODI in a foreign entity, wherever applicable, shall realise and repatriate to India, all dues receivable from the foreign entity with respect to investment in such foreign entity, the amount of consideration received on account of transfer or disinvestment of such ODI and the net realisable value of the assets on account of the liquidation of the foreign entity as per the laws of the host country or the host jurisdiction, as the case may be, within ninety days from the date when such receivables fall due or the date of such transfer or disinvestment or the date of the actual distribution of assets made by the official liquidator.

17. Rights issue and bonus shares[23]

A person resident in India, who has acquired and continues to hold equity capital in a foreign entity may acquire equity capital through exercise of rights or by way of bonus shares.

Rights

The acquisition of equity capital through the exercise of such rights shall be reported in Form FC.

Renouncement of the rights

Where such person does not exercise the rights but renounces such rights in favour of a person resident in India or a person resident outside India, such renouncement shall not require reporting.

Bonus

The acquisition of bonus shares shall not be treated as fresh financial commitment and will not require reporting.

18. Check-list for ODI by resident Individuals

18.1 Due Diligence

A new foreign entity is formed

The foreign entity shall be an operating entity and shall have limited liability. If the core activity of the foreign entity is in a strategic sector, then the requirement of limited liability is dispensed with.

The foreign entity shall be an operating entity and shall have limited liability. If the core activity of the foreign entity is in a strategic sector, then the requirement of limited liability is dispensed with.

A foreign entity is in existence

If the foreign entity is in existence, check if it is an operating entity and whether it has a subsidiary or step-down subsidiary (SDS). Foreign entity where Indian individual has control cannot have subsidiary and or step-down subsidiary.

However, if Indian individual does not have control in the foreign entity, then such a foreign entity can have subsidiary and step-down subsidiary including round tripping.

18.2 Permissible Instruments of investment by Resident Individuals

The permissible instrument of investment by a resident individual is equity capital only. The equity capital includes equity shares, perpetual capital, fully and compulsorily convertible instruments such as compulsorily convertible preference shares, compulsorily convertible debentures etc. Further, a resident individual shall not make financial commitment by way of debt.

18.3 Obtain NOC from the lender bank/ regulatory body/investigative agency if required.

18.4 Obtain valuation certificate

18.5 File Form FC

Form FC shall be submitted along with requisite documents to AD bank for obtaining UIN on or before making initial ODI. The person intending to make any financial commitment shall fill up the Form FC as provided in the "Master Direction – Reporting under Foreign Exchange Management Act, 1999" duly supported by the requisite

23. Rule 7 of OI Rules and Clause 7 of OI Directions

documents and approach the designated AD bank for making the investment/ remittance.

A person resident in India, who has acquired and continues to hold equity capital in a foreign entity in accordance with the OI Rules/Regulations may acquire equity capital through exercise of rights or by way of bonus shares in accordance with rule 7 of the OI Rules.

The acquisition of equity capital through the exercise of such rights shall be reported in Form FC. Where such person does not exercise the rights but renounces such rights in favour of a person resident in India or a person resident outside India, such renouncement shall not require reporting. Further, the acquisition of bonus shares shall not be treated as fresh financial commitment and will not require reporting..

18.6 Post investment in a foreign entity

Evidence of Investment

To submit to the AD bank share certificates or any other relevant documents as per the applicable laws of the host country, as evidence of such investment in the foreign entity within six months from the date of effecting remittance or the date on which the dues to such person are capitalised or the date on which the amount due was allowed to be capitalised, as the case may be.

18.7 Annual Performance Report in case of ODI

	Due date
In General	31st December
Where the accounting year of such foreign entity ends on 31st December	31st December of the next year
Relaxation from filing APR	Filing of APR is not required where: (i) Indian investor is holding less than 10% of the equity capital without control in the foreign entity and there is no other financial commitment other than by way of equity capital or (ii) a foreign entity under liquidation.
Based on Audited Financials	The APR shall be based on the audited financial statements of the foreign entity.
Relaxation from Audited Financials	The APR may be submitted based on unaudited financial statements certified as such by the statutory auditor of the Indian entity or by a chartered accountant where the statutory audit is not applicable provided: (i) the person resident in India does not have control in the foreign entity and (ii) the laws of the host jurisdiction do not provide for mandatory auditing

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CA Darshana Jain CA Nikhil Parab

Overseas Investment regulations for other than Resident Individuals

1. Introduction - Overseas Investments

Keeping with the spirit of liberalization and to promote ease of doing business, the Central Government (‘**CG**’) and the Reserve Bank of India (**‘the RBI’**) have been progressively simplifying the procedures and rationalizing the rules and regulations under Foreign Exchange Management Act, 1999 (‘**FEMA**’). In this direction, a significant step has been taken with introduction of a New Overseas Investment (**‘OI’**) Framework as follows: -

(a) **Foreign exchange Management (Overseas Investment) Rules, 2022 (‘OI Rules’) notified by CG** - Regulating Non-Debt Instruments, OPI and acquisition of overseas immovable property.

(b) **Foreign exchange Management (Overseas Investment) Regulation, 2022 (‘OI Regulations’) notified by the RBI**- Regulating Debt, non-fund-based commitments (Loan/Guarantee/Pledge) and Reporting of OI.

(c) **Foreign exchange Management (Overseas Investment) Directions, 2022 (‘OI Directions’) issued by the RBI**- It mainly covers procedural/ administrative aspects of overseas investments and directions to AD Banks as RBI has administrative powers under the new OI Framework.

New OI Framework vs Erstwhile OI Framework[1]

*The New OI Framework aims to simplify the existing framework for OI by persons resident in India (**‘PRII’**) to cover wider economic activity and significantly reduce the need for seeking specific approvals. This is expected to reduce the compliance burden and associated compliance costs.*

1. Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 (‘FEMA 120’) issued vide Notification No. FEMA.120/RB-2004 dated 7 July 2004 read with Master Direction Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad updated as on 24 June 2021, as amended from time to time.

Under the Erstwhile OI Framework, the powers of regulation / administration were entirely vested with the RBI. Under the New OI Framework, these powers have now been vested between RBI and the Central Government as highlighted above.

2. Routes of undertaking OI

(a) Automatic route

- Under the New OI Framework, OI can be made by a PRII in a foreign entity engaged in a bona fide business activity, directly or through step down subsidiary (‘**SDS**’) or the special-purpose vehicle (‘**SPV**’), subject to the prescribed limits and the conditions.
- ‘Bonafide business activity’ mean any business activity permissible under any law in force in India and the host country or host jurisdiction, as the case may be.

New OI Framework vs Erstwhile OI Framework

The ‘bonafide test’ is one of the most key requirements for undertaking OI both under the New and Erstwhile OI Framework. The Erstwhile OI Framework did not expressly define ‘bonafide business activity’, which resulted to different interpretations. As a result, various investors (including family offices) have received notices / queries from the RBI in the past questioning the bonafides of the OIs.

In a welcome move, the OI Rules now expressly define ‘bonafide business activity’ and states that an activity to be considered bonafide should be permissible under laws in force, both in India and the host country. However, considering certain activities are prohibited in some states within India and permitted in others (such as sale of liquor, gaming, etc.), it remains to be seen whether such activities would qualify the bonafide test under the New OI Framework.

In view of above, it is extremely critical for investors to closely examine the bonafides of the OI and relevant conditions including approval requirements, if any before investing overseas under the ODI route to mitigate any regulatory risks.

(b) *Approval Route*

Under the New OI Framework, approval with respect to investment in restricted geography/ sector (including Pakistan) has to be obtained from the CG, whereas approval for investments beyond the monetary limit has to be obtained from the RBI.

3. Restrictions/Prohibited activities

OI Rules restricts a PRII from making Overseas Direct Investment (‘**ODI**’) in foreign entity engaged in real estate activity[2], gambling in any form and dealing in financial products linked to Indian Rupee (without prior RBI approval).

2. "real estate activity" means buying and selling of real estate or trading in Transferable Development Rights but does not include the development of townships, construction of residential or commercial premises, roads or bridges for selling or leasing [Explanation to Rule 19 of OI Rules]

New OI Framework vs Erstwhile OI Framework
Gambling has been newly inserted under the list of restricted / prohibited activities provided under Rule 19 of OI Rules. Further, the restriction on banking business prevailing under Erstwhile OI Framework has been excluded in Rule 19.

4. Schedules for OI

The New OI Framework has following Schedules governing OI by PRII other than resident individual -

- Schedule I - Manner of making ODI by Indian entity
- Schedule II - Manner of making Overseas Portfolio Investment ('**OPI**') by an Indian entity
- Schedule IV - OI by PRII other than Indian entity and resident Individual
- Schedule V - OI in IFSC by PRII.

4.1 Schedule I - Manner of making ODI by Indian entity

(a) **Modes of ODI:** An Indian entity may make ODI for the purpose of undertaking bonafide business activity as stipulated by way of -

(i) Subscription to memorandum of association or purchase of equity capital (listed/ unlisted).

(ii) Acquisition through bidding or tender process.

(iii) Acquisition of equity capital by way of rights issue or allotment of bonus shares.

(iv) Capitalization of the amount due to the Indian Entity by the Foreign Entity, where such remittance is permitted and does not require prior approval;

(v) Swap of securities;

(vi) Merger, demerger, amalgamation, or any scheme of arrangement.

New OI Framework vs Erstwhile OI Framework
The concept of an 'Indian Party' as defined under the Erstwhile OI Framework has now been substituted with the concept of an 'Indian entity'.

The extant concepts of a 'joint venture' and 'wholly owned subsidiary' have now been subsumed under a single definition of a 'foreign entity' which refers to an entity formed or registered or incorporated outside India including an International Financial Services Centre ('IFSC') in India that has limited liability.

(b) Limit on Financial Commitment ('FC') by an Indian entity

- The total FC made by Indian entity shall not exceed 400 percent of its net worth as per the latest audited balance sheet or as directed by RBI in consultation with Central Government. Such limit shall be subject to an overall limit of USD one billion per financial year as provided in the OI Directions.

New OI Framework vs Erstwhile OI Framework

Under the erstwhile OI regime, net worth was defined as paid up capital and free reserves.

The definition of 'net worth' for an Indian Company has been harmonised with Companies Act, 2013. The new definition shall now allow inclusion of Securities Premium as part of net worth computation. This move is likely to benefit Indian start-ups looking to expand their operations overseas but might not have sufficient free reserves due to losses in early stages.

Further, the computation mechanics of net worth of registered partnership firms and LLP have been additionally laid down in the Rules.

It has also been clarified that 'Last audited balance sheet' shall mean audited balance sheet as on date not exceeding eighteen months preceding the date of the transaction.

The concept of with utilizing net worth of the subsidiary / holding company has been done away with under the New OI Framework.

(c) ODI in Financial service activity

- Under the New OI Framework, Indian entities engaged in financial services in India can make ODI in a foreign entity engaged directly or indirectly, in financial services business, subject to the Indian entity -

  (i) being profitable for three preceding financial years;

  (ii) being registered with or regulated by a financial services regulator in India; and

  (iii) obtaining requisite approvals from regulators in India and the host country

  The OI Rules now provide flexibility for Indian Entity *regulated* by a financial services regulator to make ODI under the automatic route. This is a welcome change as under the Erstwhile OI Framework only Indian entities *registered* with the relevant regulatory authority were permitted to make ODI as prescribed.

- Another significant change introduced under the New OI Framework is that entities not engaged in the financial services sector have been permitted to make ODI in foreign entities engaged in financial service activities, except banking and insurance (unless general insurance is supporting core activity), subject to such Indian entity meeting the profitability condition.

- Further, it is now expressly clarified that a foreign entity is 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.

4.2 *Schedule II - Manner of making OPI by an Indian entity*

An Indian entity may make OPI including by way re-investment upto fifty percent of its net worth as per latest audited balance sheet, subject to below conditions-

- **Listed Indian Company –** Permitted to undertake OPI including by way of reinvestment.
- **Unlisted Indian Company –** Permitted to undertake OPI only in prescribed modes under Schedule II of OI Rules such as right issues, bonus, swap of securities, merger, demerger, etc.

New OI Framework vs Erstwhile OI Framework

The OI Rules have now expressly defined OPI[3] for the first time. Under the Erstwhile OI Framework, the RBI, in a Conference of Authorised Dealers held in the year 2015 provided some guiding principles to help identify / classify an OI as an OPI viz. the investor should not be holding majority stake, should be a passive investor and not managing the affairs of the Company, should not be a promoter of the foreign entity, etc. However, since the term OPI was not specifically defined, it resulted in interpretational issues amongst different stakeholders viz. the RBI, AD Bank, investors, etc.

Further, OI Rules now permits unlisted Indian Companies to undertake OPI in certain specific cases as explained above.

4.3 *Schedule IV - OI by PRII other than Indian entity and resident Individual*

(a) *ODI by Registered Trust or Society*

A registered Trust or a registered Society engaged in the educational sector, or which has set up hospitals in India may make ODI in a foreign entity in the same sector with the *prior approval of the RBI*. The Trust/the Society should have been in existence for at least three financial years before the year in which such investment is made. Further, such ODI shall be subject to approval of government/other authority, as maybe applicable.

3. "Overseas Portfolio Investment" or "OPI" means investment, other than ODI, in foreign securities, but not in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC.

   Provided that OPI by a person resident in India in the equity capital of a listed entity, even after its delisting shall continue to be treated as OPI until any further investment is made in the entity. [Rules 2 (r) of OI Rules]

New OI Framework vs Erstwhile OI Framework
Whilst the provisions for ODI by Trust / Society have largely remained unchanged, the Trust / Societies engaged in manufacturing does not seem to be eligible to undertake ODI under Schedule IV of OI Rules.

(b) OI by Mutual Funds ('MF') or Venture Capital Funds ('VCF') or Alternative Investment Funds ('AIF')

OI by MF/VCF/AIF shall be subject to terms and conditions prescribed by RBI (in consultation with CG) and SEBI including the overall and individual limits. All transactions of purchase and sales to be route through a designated AD Bank. Further, any investment under OI Rules by mutual funds, Venture Capital Funds and Alternative Investment Funds shall be treated as OPI.

New OI Framework vs Erstwhile OI Framework
Under the New OI Framework, investment by MF, VCF and AIF are deemed as OPI. This specific provision was absent under the Erstwhile OI Framework.

(c) OI by Other Parties - Opening of Demat Accounts by clearing corporations of stock exchanges and clearing members, domestic depository, AD bank

The OI by Clearing corporations of stock exchanges and clearing members, domestic depository, AD bank in India shall be as per the subject to prescribed limits and conditions as specified under Schedule V of OI Rules.

4.4 Schedule V - OI in IFSC by PRII

A PRII may make OI in an IFSC in the same manner as laid down in Schedule I/Schedule II/Schedule III/Schedule IV. The key aspects in relation to OI in IFSC are as under -

(i) Time period available to financial service regulator concerned to grant approval stands reduced to forty-five days. The application shall be deemed approval for IFSC investment post expiry of this period.

(ii) An Indian Entity not engaged in financial services activity, in so far as the investee IFSC Entity is not engaging in banking or insurance activity, the three years profitability criteria shall not be applicable

(iii) A PRII may make contribution to an investment fund or vehicle set up in an IFSC as OPI.

(iv) A resident individual allowed to make ODI in a foreign entity, including an entity engaged in financial services activity (except in banking and insurance) in IFSC, if such entity does not have subsidiary or SDS outside IFSC where the resident individual has control in the foreign entity.

New OI Framework vs Erstwhile OI Framework *Under the Erstwhile OI Framework, investment in IFSC was subject to the general conditions applicable to Indian party making ODI. However, under OI Rules, specific schedule with respect to investment by PRII in IFSC has been introduced by way of Schedule V and thus providing greater clarity for making such investments.*
In addition to listed Indian companies and resident individuals, unlisted Indian entities may also make such investment in IFSC. *Host of relaxations introduced for OI in IFSC under the New OI Framework. These provisions are an important step to promote setting up offshore structures in the IFSC with greater speed.*

5. FC by an Indian entity by Debt/Non-fund based commitments

5.1 General conditions

Under the New OI Framework, the Indian entity may lend or invest in any debt instrument issued by a foreign entity or extend non-fund based commitment to or on behalf of a foreign entity (including its overseas SDS) subject to prescribed limits and below conditions:

(i) the Indian entity is eligible to make ODI;

(ii) the Indian entity has made ODI in the foreign entity;

(iii) the Indian entity has acquired control in such foreign entity at the time of making such FC.

New OI Framework vs Erstwhile OI Framework *The New OI Framework has for the first time introduced the concept of control which is primarily relevant for making ODI in listed foreign entity, granting of debt and giving of guarantee as part of financial commitment in the foreign entity.* *An Indian Entity can now provide loans / guarantees to foreign entity only if it has control in such entity. Merely having a nominal equity holding / participation without control would now be a hurdle to Indian entity's ability to undertake such FCs. Under the Erstwhile OI Framework, Indian entities could lend to a foreign entity in which they had any amount of equity participation irrespective of the shareholding.*

5.2 Debt/Loans

The lending/investment in any debt instruments of foreign entity by Indian Entity is now required to be backed by loan agreement and interest charged shall be on arm's length basis.

5.3 Issuance of Guarantees

The guarantees may be issued to or on behalf of the foreign entity or any of its SDS in which the Indian entity has control through foreign entity. The type of guarantees that can be issued by are as under -

(i) Corporate or performance guarantee;

(ii) Corporate or performance guarantee maybe be issued by group company[4] of Indian entity in India

(iii) Personal guarantee by resident individual being promotor of Indian entity.

(iv) Bank guarantee by AD bank which is backed by a counter guarantee or collateral by the India entity or its group entity and issued by a bank in India.

(a) Special considerations - Guarantee by group company and resident individual promoters

- The guarantee is issued by a group company, shall be counted independently towards utilisation of its FC limit.
- Where guarantee is issued by an Individual promotor, such guarantee shall be counted within the limits of Indian entity.
- Where any of the four types of commitment referred above is extended by a group company, any fund based exposure to or from Indian entity shall be deducted from the net-worth of such group company for computing FC.

5.4 Other key aspects

- No guarantee shall be open-ended
- The guarantee, to the extent is invoked, shall cease to be a non-fund commitment and considered as lending.
- Where guarantee is extended by jointly and severally by two or more Indian entities, 100 percent of the amount of such guarantee shall be reckoned towards the individual limits of each of such Indian entities.
- In case of performance guarantee, fifty percent of the amount of guarantee shall be reckoned towards FC.

4. Group company issuing such guarantee shall be a holding company (which holds at least 51 per cent. stake in the Indian entity) or a subsidiary company (in which the Indian entity holds at least 51 per cent. stake) or a promoter group company, which is a body corporate. Further, 'promoter group' shall have the meaning as assigned to it in the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018.

- Roll-over of guarantee shall not be treated as fresh FC where the amount on account of such roll-over does not exceed the amount of original guarantee.

New OI Framework vs Erstwhile OI Framework
Under the Erstwhile OI Framework, FC without equity investment was allowed with the prior approval of the RBI. However, under the New OI Framework, such facility has not been provided.

Under the Erstwhile OI Framework, Indian party was required to obtain approval from the RBI for extending guarantees to SDS in certain cases (Corporate Guarantee to Second level SDS, etc). However, under the New OI Framework, Indian entity is permitted to issue guarantee (as stipulated) to any of its SDS in which it has acquired control through the foreign entity.

5.5 Pledge or charge

- The Indian party may pledge equity capital of the foreign entity outside India or create charge on Indian entity assets or charge on assets of foreign entity outside India for availing fund/non-fund-based facility for itself as well as for foreign entities/SDS outside India subject to prescribed conditions laid down in OI Regulation/OI Direction.
- The fund/non-fund-based facilities for Indian entity shall not be considered towards limit of FC. Further, fund/non-fund-based facilities for any foreign entity/its SDSs outside India, the value of the pledge or the amount of the facility, whichever is less shall be considered towards FC.

6. Other Key changes/aspects

(a) No-objection certificate ('NOC') for Loan defaulters and those under Investigation

Any PRII who, has an account appearing as a non-performing asset; or classified as a willful defaulter; or is under investigation by a financial service regulator/investigative agencies as prescribed, is required to obtain a NOC from the respective lenders/authorities before undertaking any FC/disinvestment of ODI. If these authorities do not give their NOC within sixty days from the date of receipt of such request, then it would be presumed that they have no such objection.

New OI Framework vs Erstwhile OI Framework
Under the Erstwhile OI framework, ODI where investor was under investigation, etc, was subject to RBI approval. In a welcome departure from the Erstwhile OI Framework, the new OI Framework places the onus on the prescribed investigating agency / lender bank to respond to such written applications for an NOC within sixty days. Any failure to furnish such NOC within the stipulated timeline would be construed as a deemed consent to the proposed transaction. This is expected to bring in lot of time efficiencies with respect to the NOC and is a welcomed relief.

(b) Acquisition/Transfer under ODI by way of Deferred Payment

In respect of ODI in equity capital of a foreign entity by PRII (acquisition or issuance), the amount of consideration can be deferred as agreed between the parties subject to period of deferment defined upfront and other prescribed conditions. The part of the payment towards consideration deferred by the PRII shall be treated as non-fund based FC by such person and to be reported accordingly.

New OI Framework vs Erstwhile OI Framework

Significant relaxations have been introduced to permit payment of consideration on a deferred basis for any sale of any equity capital between a resident and a non - resident subject to prescribed conditions.

(c) ODI in strategic sector

Under the New OI Framework, the ODI in strategic sector will be subject to Indian entity obtaining necessary permission from the competent authority, wherever applicable. The restriction of limited liability structure of foreign entity does not apply for entities with core activity in any strategic sector. Accordingly, ODI can be made in such sectors in unincorporated entities as well. Further, an Indian entity is also permitted to participate in a consortium with other international operators to construct and maintain submarine cable systems on co-ownership basis

(d) ODI in start-ups by an Indian entity/resident individual

The OI Rules allows an Indian Entity to undertake ODI in start-ups, recognised under the laws of host country only from its own internal accruals (including accruals of its group/ associate companies in India). Further, in case of resident individuals, such ODI can be made from own funds of such individual.

New OI Framework vs Erstwhile OI Framework

The provisions in relation to ODI in start-ups have been newly introduced in New OI framework.

Considering the new provisions rely on host country / jurisdictions' interpretation of the term start-up, it would be interesting to see how this provision will work in effect, as many host country / jurisdiction may not have a recognition / registration system in place for start-ups.

Further, the restriction on borrowing for Indian investors in undertaking ODI seems to be a step taken to discourage considering the high risk / volatility involved in start-ups investments.

(e) Restructuring of balance sheet of foreign entity including write off of dues

- In a significant liberalisation, OI Rules now permit a PRII who has made ODI in a foreign entity to restructure of the balance sheet by such foreign entity, incurring losses for the previous two years (as per its last audited balance sheets) subject to prescribed conditions and limits. Further, the diminution in the total value of the

outstanding dues towards such PRII on account of investment in equity and debt, after such restructuring shall not exceed the proportionate amount of the accumulated losses.

- In cases where diminution of original investment is more than USD 10 million or where the amount of such diminution exceeds twenty per cent of the total value of the outstanding dues towards the Indian entity/investor, such dimunition shall be certified by registered valuers as prescribed.
- Under the New OI Framework, PRII is also required to realise/repatriate all dues receivable (amount of consideration on disinvestment, other trade receivables, etc) from foreign entity within ninety days from the prescribed date. Whist the New OI Framework is silent on whether any additional approvals would be required for write off/restructuring of outstanding dues other than equity and debt, the PRII may ensure compliance with relevant Current Account Regulations separately (including obtaining of necessary approvals).

New OI Framework vs Erstwhile OI Framework

The Erstwhile OI Framework prescribed a maximum of twenty five percent for restructuring. Further, such restructuring by unlisted Indian Companies was subject to RBI approval

Under the New OI Framework such restructuring can be undertaken by both listed / unlisted entities under automatic route subject to limit and prescribed conditions.

(f) *Tightening of the reporting requirements for domestic entities opting for the ODI route and introduction of Late Submission Fee ('LSF')*

The revised framework has tightened the reporting requirements for overseas investments by restricting any further FC towards the foreign entity or transfer of such ODI till any non-reporting or the delay in reporting is regularized. There is also an introduction of LSF for delays in reporting (as stipulated) which should reduce the time taken to regularize such non-compliances vis-a-vis the traditional compounding route.

A three-year window has also been provided to PRII for regularizing the delays in submission of proof of investment/OI Filings occurring prior to the date of publication of OI Regulations in the Official Gazette by payment of LSF.

7. Analysis of key compounding orders relevant under the New OI Framework

Some of the existing Compounding Orders on key issues relevant under the New OI Framework are as under-

(i) Open-ended corporate and personal guarantees on behalf of the overseas entity [Solkar Solar Industry Limited (CA 4432/2017)].

(a) Issue: Issuance of open ended corporate and personal guarantees on behalf of the overseas entity not permitted under Erstwhile OI Framework.

(b) **Key Takeaway**: Foreign entities may require guarantees from their Indian Parent for raising funds/working capital overseas. The Indian Entity at the time of providing such guarantee must ensure that period of guarantee in the agreement is for a specific period and not open-ended as the same is also not permitted under New OI Framework.

(ii) Investment in preference shares of JV/WOS without prior equity contribution-[Biocon Limited (CA 3869/2015)].

(c) **Issue:** The Indian entity has made investment in optionally convertible preference shares of the foreign entity without prior equity contribution. The same was undertaken without prior approval of the RBI.

(d) **Key Takeaway**: It is imperative to note that under New OI Framework, the Indian entity can lend or invest in a debt instrument issued of foreign entity only if it is eligible as per Regulation 3 and 4 of OI Regulations viz. Indian Entity has made ODI in the said foreign entity, acquired control in such foreign entity, interest on arm's length pricing, etc.

(iii) Disinvestment of stake in overseas entity without being in operation for one full year-[Sidhartha Gelatines Private Limited (CA 3959/2016)].

(a) **Issue:** The applicant Indian entity had disinvested from foreign entity in less than one year from the date of ODI.

(b) **Key Takeaway**: As per the New OI Framework, Indian entity is required **to stay invested** for at least one year. In case of disinvestment in less than one year, Indian Entity shall ensure to seek necessary approvals as prescribed.

(iv) Providing Loan to WOS through a mode not permitted - [Synfosys Business Solutions Limited (CA 4409/2017)]

(a) **Issue:** In the said order, the Indian entity had remitted some amount abroad into an escrow account for purpose other than ODI and then utilized a portion of such remittance for providing loan to other WOS outside India which is not a permitted mode of payment.

(b) **Key Takeaway**: Any ODI/FC in a foreign entity by an Indian entity should be made through normal banking channels and routed only through the designated AD Bank in India.

(v) ODI in real estate activity [Zodiac Clothing Company Limited (CA No 4533/2017)]

(a) **Issue:** In the instant case, the Indian entity had an ODI in a foreign entity that had set-up a second level SDS engaged in the business of real estate.

(b) **Key Takeaway:** Indian entity should be cautious while making ODI and ensure that restricted activities are not carried on by such foreign entities, directly or indirectly through step-down subsidiary.

Conclusion

The New OI Framework brings in host of changes that has ushered clarity/liberalization in several cases in several cases e.g. OPI, Financial Services sector ODIs, ODIs under the approval route, NOCs in cases of banking defaulters and those under investigation, round-tripping, etc. The new aspects include the concept of control, arms-length criteria, deferred consideration, late submission fees for filing delays, etc.

Under the New OI Framework, there is more clarity on classification of ODI and OPI. The OI that were earlier under the approval route including round tripping/ODI-FDI structures are now liberalized for an Indian entity subject to stipulated conditions.

Considering the evolving economic landscape, New OI Framework will go a long way in expanding Indian footprint in the overseas markets and enhancing the ease of doing business outside India significantly.

Though the RBI has released its Directions on the New OI Framework, the RBI's FAQs on this topic are still awaited and once released they should assist in further clarifying various aspects of the New OI Framework.

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"So fulfil your desire for power and everything else, and after you have fulfilled the desire, will come the time when you will know that they are all very little things; but until you have fulfilled this desire, until you have passed through that activity, it is impossible for you to come to the state of calmness, serenity, and self-surrender."

— *Swami Vivekananda*

"I have always held that it is only when one sees one's own mistakes with a convex lens, and does just the reverse in the case of others, that one is able to arrive at a just relative estimate of the two."

— *Mahatma Gandhi*

CA Tanvi Vora

Reporting Obligations for Overseas Investments

The Central Government (through Ministry of Finance (MoF)) and the Reserve Bank of India (RBI) vide Notification No. G.S.R 646(E) issued Foreign Exchange Management (Overseas Investment) Rules, 2022 and also notified Foreign Exchange Management (Overseas Investment) Regulations, 2022 *vide* Notification No. FEMA 400/2022-RB both on 22nd August, 2022 in supersession of Notification No. FEMA 120/2004-RB dated 7-7-2004 [Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004] and Notification No. FEMA 7(R)/2015-RB dated 21st January, 2016 [Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015.

These new ODI Rules and Regulations have brought about a complete overhaul of the ODI framework which was in place for almost two decades. In this article we have explained the obligations and compliances applicable to persons resident in India undertaking overseas investments.

Abbreviation used

PRI – Person Resident in India; PROI – Person Resident outside India; OI – Overseas Investments; ODI – Overseas Direct Investment; OPI – Overseas Portfolio Investment;RI – Resident Individual; IE – Indian Entity;LSF – Late Submission Fee.

Reporting Compliances under Overseas Investment Rules and Regulations

For ease of understanding, we have divided the forms applicable to different persons at various circumstances of overseas investments i.e. ODI & OPI.

A] Overseas Direct Investment

Form FC

Form FC captures information relating to financial commitment including ODI, restructuring and disinvestment by Indian entities and resident individuals. There are seven different sections provided in Form FC. Brief detail of each section is as follows:

Section A	Details of the Indian entity/ resident individuals/Trust/Society
Section B	Details of the foreign entity/step-down subsidiaries
Section C	Details of transaction/remittance/ financial commitment of the person resident in India
Section D	Declaration furnished by the Indian entity/resident individual, undertaking financial commitment

Section E	Certificate by the Statutory Auditors of the Indian entity (IE)/ group company
Section F	Details to be reported at the time of restructuring of the balance sheet of the foreign entity involving diminution in the total value of the outstanding dues towards the person resident in India on account of investment in equity and debt
Section G	Details to be reported at the time of disinvestment in the foreign entity by way of sale or transfer of equity capital/buyback of equity capital/closure/liquidation/ winding up/merger/amalgamation

i) At the time of overseas investment

Form FC should be submitted along with requisite documents to the AD Bank on or before making remittance. This is an important clarification brought out in the new reporting mechanism that Form FC has to be submitted at the time of making outward remittance or making Financial Commitment, whichever is earlier. Under the erstwhile FEMA 120, until April 2016, the form was allowed to be permitted within 30 days of investment.

The following specific sections are required to be submitted by person resident in India who is making ODI to AD Bank:

Sr. No.	Person making ODI	Relevant sections of Form FC
1	Indian entity making ODI	Section A to E
2	Resident Individual making ODI	Section A to D

Further clarifications with respect to reporting in the following situations:

1. ***Reporting of Rights Issue:*** i) Acquisition of equity capital through exercise of rights is required to be reported in Form FC. ii) In case the rights are renounced in favour of a person resident in India or a person resident outside India, such renouncement does not require any reporting.

2. ***Reporting of Bonus Shares***: Acquisition of bonus shares is not treated as a fresh financial commitment and does not require reporting.

3. ***In case of ODI in Financial Services/ Start-ups:*** Certain portions of Form FC such as core activity details and portions of declarations specifically apply to such cases. Statutory Auditor/ CA certificate to be provided along with the form certifying investment through internal accruals and are not made out of borrowed funds.

4. ***Reporting of financial commitment by way of guarantee:*** i) Guarantee should be reported inForm FC. ii) Roll-over of guarantee shall not be treated as fresh financial commitment. However, such roll-over shall be reported in Form FC. iii) Invocation of guarantee should be reported in Form FC. Any guarantee, to the extent of the amount invoked, shall cease to be a part of the non-fund based financial commitment but will be considered as financial commitment by way of debt. No prior approval from the Reserve Bank shall be needed for remitting the funds from India on account of invocation of a performance guarantee.

5. ***Reporting of acquisition or transfer by way of deferred payment:*** Payment of deferred amount of consideration is permitted for i) equity capital by way of subscription to an issue or ii) by way of purchase from a person resident

outside India or iii) where a person resident outside India acquires equity capital by way of purchase from a person resident in India. Deferment is permitted for a definite period from the date of the agreement. With respect to reporting, i) The part of the payment towards deferred consideration shall be treated as a non-fund based financial commitment by such person and reported accordingly in Form FC. ii) Subsequent payments towards deferred consideration shall be reported in Form FC as conversion of non-fund based financial commitment to equity. iii) The valuation in accordance with pricing guidelines, wherever applicable, shall be done upfront. The foreign securities equivalent to the amount of total consideration shall be transferred or issued upfront by the seller to the buyer.

6. ***Acquisition of foreign securities by way of inheritance or gift by resident individuals*** under Schedule III shall not require LRS reporting but would still require Form FC reporting.

7. ***More than one person resident in India invests in the same foreign entity***: Form FC should be submitted individually by all persons to the same designated AD Bank. This is cumbersome and would require persons to open bank accounts with a designated AD bank in case they do not have an account with them. RBI will allot only 1 UIN to the foreign entity.

General observations and instructions regarding Form FC

1. Legal Entity Identifier (LEI) to those it is applicable, it required to be provided.

2. Networth (as on last audited balance sheet) is required to be provided in case of Indian entities only and not resident individuals. However, a declaration is asked on the sources of funds.

3. Details w.r.t. financial commitment is required to be provided in both foreign currency and Indian rupees.

4. Presence of 'control' of person resident in India is to be answered as yes or no.

5. Method of investment to be selected in Section C and to provide requisite details in that regard such as date of remittance, guarantee, capitalization, conversion, etc as the case maybe.

6. Declaration in Section D has become more onerous, and it is imperative to comply with them all (when applicable) otherwise ODI will not be permitted.

7. Section E is applicable only to ODI by Indian Entities and not applicable to resident individuals. It is to be certified by the statutory auditor of the Indian Company. UDIN is compulsory to be provided for the certificate.

8. For subsequent remittances, Section A and B may not be filled unless there is any change in the details of the person resident in India/foreign entity/SDS/capital structure submitted at the time of previous Form FC.

General list of enclosures to be submitted along with Form FC

By an *Indian entity* making ODI (subscription to MoA):

1. Photocopy of PAN card.

2. Board Resolution of Indian entity

3. MoA of foreign entity

4. Incorporation Certificate of foreign entity

5. Statutory Auditor certificate in Section E of Form FC

6. Any other documents as requested by the bank in their format (may differ from bank to bank).E.g. debit authority letter, customer request letter, project feasibility report.

By an *Indian entity* making ODI (Acquisition through purchase of equity capital/Financial Commitment in Debt/Non-Fund based commitment):

1. Photocopy of PAN card.
2. Share Purchase Agreement
3. Loan Agreement (along with rate of interest on Arm's Length basis)
4. Guarantee Agreement or similar documents
5. Valuation Report.
6. Board Resolution of Indian and foreign entity
7. MOA of foreign entity
8. Statutory Auditor certificate in Section E of Form FC
9. Any other documents as requested by the bank in their format (may differ from bank to bank).E.g. debit authority letter, customer request letter.

By a *Resident Individual* making ODI (MoA Subscription or Purchase):

1. Photocopy of PAN card.
2. Form A2
3. MoA of foreign entity
4. Share Purchase Agreement (in case of acquisition through purchase)
5. Board Resolution of foreign entity (in case of acquisition through purchase)
6. Valuation Report (in case of acquisition through purchase)
7. Any other documents as requested by the bank in their format (may differ from bank to bank).E.g. debit authority letter, customer request letter, LRS form providing details of LRS limit utilized during the year.

No-Objection Certificate

A new requirement of No Objection Certificate (NOC) has been brought in through the OI rules. An NOC is required to be obtained in cases where any person resident in India:

- Has an account which is classified asa NPA
- Is classified as a willful defaulter by any bank.
- Is under investigation by a financial service regulator or CBI or ED or SFIO

In case any of the above is applicable, *the person resident in India* shall obtain an NOC from the respective bank or authority before making any financial commitment or undertake disinvestment.

The saving grace under this new requirement is that in case the certificate is not furnished within 60 days of receipt of application,it may be presumed that there is no objection to the proposed transaction. However, in case where an Indian entity has already issued a guarantee in accordance with the FEMA provisions before an investigation has begun or account is classified as NPA/willful defaulter and subsequently is required to honour such contractual obligation, remittance due to invocation will not constitute fresh financial commitment and hence NOC shall not be required.

It should be noted that the requirement of not being under investigation persisted in the erstwhile FEMA 120 but requirement to obtain an NOC from said investigative agency has now been added. However, the requirement

for NOC from banks in case of NPAs or willful defaulter is newly added. The certificate in Form FC by statutory auditor needs to certifythat the NOC requirement has been complied with. It is not known how an auditor would be able to verify the classification by banks in absence of a database or other details readily available and will need to rely on management representation in many cases.

ii) Post Investment Changes

Sr. No.	Situation	Relevant sections of Form FC
1	Restructuring	Section F

Restructuring

A whole new section has been inserted for restructuring of the balance sheet of the foreign entity involving diminution in the total value of investment including equity and debt. The important part of this section is giving the details of proportionate losses out of total accumulated losses and its impact on the total investment post restructuring captured in the total financial commitment. Form FC Section F is to be submitted within 30 days from the date of restructuring. The diminution value is required to be certified by a registered valuer or CPA or registered valuer in the host country and submitted along with Form FC.

iii) Annual Compliances

There are two annual fillings applicable to a person resident in India who has made overseas direct investments viz. Form APR and Form FLA. The persons to whom the forms are applicable, and the filing deadline are explained below.

Form APR

The performance of the foreign entity is reported to RBI through the AD Bank in Form APR. Form APR formed part of the ODI Form i.e. Form ODI -Part II under the extant FEMA 120 regulations. Under new regulations, Form APR has been separated from Form FC as Form APR.

Form APR is to be submitted by a person resident in India who has undertaken ODI in a foreign entity. However, It is not required to be submitted in the below situations:-

a) if PRI holds less than 10 percent of the equity capital in the foreign entity i.e. having no control and no financial commitment other than equity,

b) where foreign entity is under liquidation,

c) for the part of the year at the time of disinvestment.

Form APR is to be submitted with respect to each foreign entity by 31st December every year. The APR should be filed based on the audited financial statements of the foreign entity.

In case where more than one person resident in India have made ODI in same foreign entity the person holding the highest stake shall be required to submit APR and in case of Joint holding with equal stake any one of them can be authorized to submit the Form APR.

In case the IE/RI has *control* in the foreign entity, the APR must be compulsorily based on audited financial statements. However, in many countries audited financial statements are not required by the host country. In case for APRs that were due in December 2022 banks allowed audited financial statements from an Indian CA. However, it is to be seen if in the upcoming years banks would continue to accept the financial statements of the foreign entity to be certified by Indian CAs.

In case IE/RI does *not have control* and where audit is not mandatory in host country, the APR may be submitted based on unaudited BS certified by the Statutory Auditors of the IE

or CA where statutory audit is not applicable. This is contrary to the exemption provided for non-filing of Form APR in cases where there is no control in the foreign entity. Clarification by RBI in this regard would be helpful.

Interesting, the following post investment changes have been merged within Form APR:

Sr. No.	Situation
1	Setting up of SDS/Acquisition of SDS
2	Winding up of SDS/Transfer of SDS
3	Alteration in shareholding pattern in foreign entity

Accordingly, any of the above changes shall be reported annually in Form APR, which can be extrapolated to mean that reporting in Form FC at the time of change for the same is no longer required. However, in case of step down subsidiaries, the OI directions has clarified that investee entities of foreign entity where the foreign entity does not have control shall not be treated as SDS and therefore need not be reported.

Form FLA

Annual Return on Foreign Liabilities and Assets is required to be filed annually in Form FLA. It is only applicable to Indian entities and not to resident individuals who have undertaken ODI. It is to be submitted on the FLAIR portal of the RBI to the Department of Statistics and Information Management, RBI. It is to be submitted by 15th July every year. The FLA should preferably be based on the audited financial statements of the foreign and Indian entity, but it is not a compulsory requirement. However, it is compulsory for the details to be provided as on 31st March. Accordingly, in cases where the foreign entity follows calendar year, management accounts may need to be prepared for March ending for the purpose of Form FLA. In case the FLA is filed based on unaudited accounts, once the audited numbers are ready, the Indian entities should request for approval on the FLAIR portal to revise the previously filed return to RBI. Once you receive the approval, you can revise the previously filed return with audited numbers and re-submit the same to RBI via FLAIR portal.

iv) At the time of disinvestment

Sr. No.	Case	Form FC
4	Disinvestment	Section G

In case of disinvestment from a foreign entity by way of transfer or liquidation, Form FC Section G is required to be submitted by the PRI within 30 days of receipt of disinvestment proceeds. As explained below, the PRI has a maximum of 90 days to repatriate the disinvestment proceeds to India under Regulation 9 of the FEM (OI) Regulations, 2022.

General list of enclosures to be submitted along with Form FC in case of disinvestment

1. Form FC (Section G).
2. Last audited financials
3. Valuation report
4. Board Resolution of Indian entity and foreign entity
5. Inward remittance advice (to be repatriated within 90 days of disinvestment or distribution by liquidator)
6. Proof of Liquidation/closure/winding up (if applicable)
7. Transfer Agreement (if applicable)

Valuation for Overseas Direct Investments

The pricing guidelines under the new OI framework have been completely changed and, in our view, left many questions unanswered. Valuation would be required at the time of acquisition or transfer of equity capital of a foreign entity by a person resident in India. The issue or transfer may be in the following circumstances:

i) Acquisition NR to R

ii) Transfer – R to R & R to NR

The new pricing guidelines provides that the price should be arrived on an arm's length basis as per any internationally accepted pricing methodology. In comparison to the erstwhile pricing requirement under FEMA 120, the guidelines now require an arm's length basis instead of the fair value requirement followed earlier. The AD banks have been handed the reigns to decide on the matters related to valuation based on the board policy of each bank. The board policy may decide on the documents to be provided and may also provide scenarios where valuation may be insisted upon and where not to be insisted upon. Each bank's board policy has also been permitted to decide additional document requirements such as audited financial statements of the foreign entity etc. that may be taken to ascertain *bona fides* of transactions.

However, it is not notified who can provide the valuation certificate. In FEMA 120, based on USD 5 mn threshold the valuation of shares of foreign entity was required from a merchant banker or investment banker and in other cases by a CA or CPA. This has not been provided under the new OI framework. It seems that this has also been left open to each bank's board policy to decide. This can also create a larger issue if bank policies differ from each other. Although the FEM OI Directions, 2022 required the board policies to be put in place within 2 months, none of the banks have yet provided their policy in the public domain. In our view, valuation guidelines should be uniform across AD Banks. Most banks allow valuation reports of CA/Registered Valuer/Merchant Bankers.

B] Overseas Portfolio Investment

Form OPI

OPI deals with making portfolio investment and transferring such investment by a person resident in India being an Indian Entity or Mutual Fund.

Form OPI is an entirely new reporting obligation entrusted on the person resident in India which needs to be filed within 60 days from the end of every half year in which the investment was made or transferred. i.e. ended March/September.

However, since shares or interest acquired by the resident individuals by way of sweat equity shares or minimum qualification shares or under Employee Stock Ownership Plan (ESOP)/Employee Benefits Scheme up to 10% of the paid-up capital/stock, whether listed or unlisted, of the foreign entity and without control shall also qualify as OPI, the reporting shall be done by

i. the office in India or branch of an overseas entity or

ii. a subsidiary in India of an overseas entity or

iii. the Indian company in which the overseas entity has direct indirect equity holding where the resident individual is an employee or director.

Form OPI has multiple sections as below:

Particulars	Section	(Notes)/Transactions Covered
Details of the Indian Entity	Section A	*Detail of Indian Entity/Mutual fund, such as Name, LEI, PAN, Address, Net worth in INR, Whether IE is Listed, Contact person (Name, Designation, Mobile number, Email id)*
Details of OPI by Indian entity	Section A.(A)	Schedule II of OI Rules; and
Proviso iii of Schedule V of OI Rules		
Details of OPI by a resident individual by way of ESOP/ Employee benefit Scheme (EBS).	Section A.(B)	Para 1(2)(iii)(h) of Schedule III of OI Rules; and Para 3 of Schedule III of OI Rules (Reporting to be done by office/branch/ subsidiary/IE)
Details of OPI by MF	Section A.(C)	Para 2 of Schedule IV of OI Rules
Details of OPI by AIF/VCF	Section B	Para 2 of Schedule IV of OI Rules
Certificate from Indian Entity/ MF/AIF/VCF, as the case may be	Section C	*The form is to be certified by the Indian Entity/ MF/AIF/VCF. Interestingly, the form does not need to be certified/signed by AD Bank as is the case in all other forms explained above.*

An underlier to the whole out bound regime has been the tightening of the noose of noncompliance under FEMA. It has been provided that a PRI who has made a financial commitment in a foreign entity shall not be permitted to make any further financial commitment, whether fund-based or non-fund-based,directly, or indirectly till any delay in reporting is regularized. This is important to note since banks will no longer permit any further investment in foreign entities until regularization as well as LSF payment is complete. This process has been taking anywhere between 2 to 6 months as per recent experiences.

Obligations of a PRI under Overseas Investment Rules and Regulations

Similar to the Regulation 15 of erstwhile FEMA 120, the FEM (OI) Regulations,2022 has formulated Regulation 9 listing the obligations applicable to a person resident in India. These include:

1. ***Evidence of Investment*** – PRI is required to submit to AD bank share certificates or any other relevant documents, as evidence of ODI investment in the foreign entity within six months from the date of effecting remittance or the date on which the dues to such person are capitalised or the date on which the amount due was allowed to be capitalized. While there is no change on the time limit of 6 months in comparison to erstwhile FEMA 120, the words used earlier were, the PRIwas required to 'receive' whereas the new regulation specifies the limit on 'submission' to AD bank. Hence many entities that would receive the certificates but were not aware on the requirement of submission or

inadvertently forgot to do so would be considered in contravention. If the PRI is unable to submit evidence of investment, it is required to repatriate to India the funds remitted overseas within the said 6 months.

2. ***Unique Identification Number*** – PRI should obtain UIN from RBI through AD Bank for the foreign entity in which the ODI is intended to be made before sending outward remittance. This was not included under the obligation regulation under erstwhile FEMA120, but was instead under erstwhile Regulation 10 wherein it specified allotment of a UIN by RBI. Having now included this regulation under the obligation provisions, in our view, the RBI is passing the burden onto the PRI to follow up and ensure that the AD bank files the necessary documents with RBI on the OID application portal which is not available to the public but only AD banks. As explained above, Form FC shall be submitted along with requisite documents to AD bank for obtaining UIN on or before making initial ODI. The PRI should follow-up religiously for swift and timely processing of Form FC as only then they would be able to undertake the remittance and future transactions.

3. ***Designated AD bank***: A PRI making ODI shall designate an AD bank and route all transactions relating to a particular UIN through such AD Bank. In erstwhile FEMA 120 under Regulation 6(2)(v), the requirement was to route everything through the same 'branch' of the AD bank as well. This relaxation from the same branch of AD bank to same AD bank could be due to the fact that sometimes various banks have only one or limited branches that deal with forex transactions.

4. ***Repatriation of due***: Under the erstwhile FEMA 120, all dues receivable from the foreign entity, like dividend, royalty, technical fees etc. were required to be repatriated within 60 days of its falling due. Also, the sale proceeds were required to be repatriated within 90 days from the date of sale. However, under the new regime, the PRI shall realise & repatriate i) all dues receivable with respect to investment in a such foreign entity; ii) consideration received on transfer/disinvestment; iii) net realizable value of assets on account of liquidation, within 90 days of them falling due or date of transfer/ disinvestment or date of distribution upon liquidation. The RBI has therefore provided relaxation on the number of days from 60 days to now 90 days.

Summary of Reporting Requirement

Sr. No.	Form	Who has to file	Transaction entered	
1	Form FC	Person resident in India who has made	i. ii. iii. iv.	ODI Making financial Commitment Undertaking restructuring Undertaking disinvestment
2	Form OPI	Person resident inIndia other than resident individual	i. ii.	Making OPI Transferring OPI.

Sr. No.	Form	Who has to file	Transaction entered
3	Form APR	Person resident in India	who has made ODI
4	Form FLA	Person resident in India other than resident individual	who has made ODI

Timelines for reporting OI

Sr. No.	Overseas Investments	Applicable Form	When to file
1	Financial Commitment by Indian Entity	Form FC Section A to E	At the time of sending outward remittance or making financial commitment whichever is earlier
2	Financial Commitment by Resident Individual	Form FC Section A to D	
3	Restructuring	Form FC Section F	Within 30 days from the date of restructuring
4	Disinvestment	Form FC Section G	Within 30 days from the date of receipt of disinvestment proceeds
5	Overseas Portfolio Investment	Form OPI	within 60 days from the end of the half year in which such investment or transfer is made as of September or march end i.e. 30th November & 31st May
6	Annual Compliances	Form APR	on or before 31st December of the next year.
7		Form FLA	on or before 31st July every year.

Late Submission Fee ('LSF') for Delay in Reporting

Through A.P. (DIR Series) Circular No. 16 dated 30th September 2022, LSF RBI has brought uniformity in imposition of LSF for reporting delays in Foreign Investment (FI), External Commercial Borrowings (ECBs) and Overseas Investment related transactions. The option of LSF is mainly for reporting contraventions/delays and is not applicable for substantive contraventions.

Interestingly, the OI framework has not only permitted LSF option for future reporting delays (however available up to three years from the due date of reporting/submission) but has allowed sort of an amnesty to regularize under LSF option all past reporting delays Notification No. FEMA 120/2004-RB and earlier corresponding regulations, up to three years from the date of notification of Foreign Exchange Management (Overseas Investment) Regulations, 2022 i.e. until 21st August 2025.

The following matrix shall be used henceforth for calculation of LSF in relation to Overseas Investment contraventions, wherever applicable:

Sr. No.	Type of Reporting delays	LSF Amount (INR)
1	Form ODI Part-II/APR, FLA Returns, Form OPI, evidence of investment or any other return which does not capture flows or any other periodical reporting	7500
2	Form ODI-Part I, Form ODI-Part III, Form FC or any other return which captures flows or returns which capture reporting of non-fund transactions or any other transactional reporting	[7500 + (0.025% × A × n)]

Where:

- "n" =number of years of delay in submission in submission rounded-upwards to the nearest month and expressed up to 2 decimal points.
- "A" = Amount involved in delayed reporting

Maximum LSF amount will be limited to 100 per cent of 'A' and will be rounded upwards to the nearest hundred.

Where an advice has been issued for payment of LSF and such LSF is not paid within 30 days, such advice shall be considered as null and void and any LSF received beyond this period shall not be accepted. If the applicant subsequently approaches for payment of LSF for the same delayed reporting, the date of receipt of such application shall be treated as the reference date for the purpose of calculation of "n".

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"We reap what we sow. We are the makers of our own fate. The wind is blowing; those vessels whose sails are unfurled catch it, and go forward on their way, but those which have their sails furled do not catch the wind. Is that the fault of the wind?....... We make our own destiny."

— *Swami Vivekananda*

"Power is of two kinds. One is obtained by the fear of punishment and the other by acts of love. Power based on love is a thousand times more effective and permanent than the one derived from fear of punishment."

— *Mahatma Gandhi*

CA Hinesh Doshi CA Aarti Karwande

Setting up a Branch/Representative Office/ Warehouse overseas by an Indian entity

Introduction

India is primarily a domestic-driven market. With an improvement in the economic scenario and recovery from post-COVID shock, India is relatively well placed as compared to other developing countries of the world. Due to robust economic measures in place, the Indian economy has remained strong which gives Indian businesses an advantage to make investments abroad. This broadens the operational footprint in such other nations.

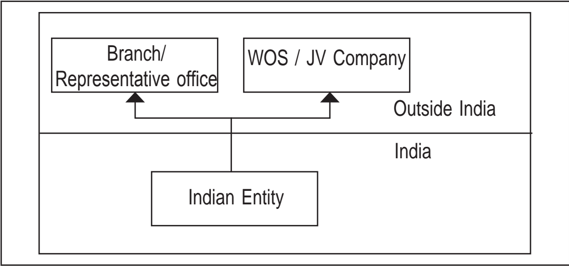
Globalization was once considered to be a flight of fancy. But here we are in the 21st century where the world has become a global village. The liberalisation policy of 1990s gave a head start to India's relations with other countries. In the last decade, India has taken exuberant steps to increase investments in other countries.

The foremost important step to enter the global marketplace is through overseas investment, and recently, India has taken the necessary actions to establish its presence felt in the global arena. If Overseas investment trends over the past ten years are analysed, it is evident that while investment flows were rather slow in the early half of the decade, they increased drastically in the latter half. In the first half of the decade, overseas investments were focused on resource-rich nations like Australia, UAE and Sudan while in the latter half, it was focused on the nations with tax advantages viz., Mauritius, Singapore, the British Virgin Islands and the Netherlands.

According to the Department of Economic Affairs, India's overseas direct investment stood at US$ 17.53 billion in FY 2021-22 whereas in April-September 2022 it was at US$ 9,829 million with 2,849 applications for Overseas Investment (including Guarantee and Loan). Amongst the top investment destination for Indian companies was Singapore followed by the US and Mauritius. It is pertinent to note that India has maintained its spot as the 2nd largest source of foreign direct investment projects for the UK. However, not always Overseas Direct Investment ('ODI') is the preferred option to enter the overseas market. Many times, before establishing a presence through a Joint Venture ('JV')/Wholly Owned Subsidiary ('WOS'), an Indian entity may also evaluate the benefits of this presence in an overseas country by way of a Branch or Representative office in the overseas market.

In India, the Reserve Bank of India ('RBI') controls and regulates all the investments

made by a Resident of India to any other country. A resident of India can enter overseas through a WOS or a JV, a Branch office or Representative Office. In this article, we are going to discuss entering an overseas country through the setting up of a branch office or a representative office or through a Warehouse by an Indian entity.



Benefits of exploring foreign markets

Access to new markets: The most prominent benefit of opening a foreign branch/ representative office is access to new markets. The Indian entity can explore a new set of customers through its presence in another country. It helps in expanding the business globally. The Indian entity has the opportunity of exploring new distribution partners and new networks.

Exposure to Knowledge and technological advancements: Having a foreign existence helps in sharing of knowledge between the two countries. Foreign investments help the Indian entity to access foreign technology, innovations and new marketing strategies. This helps in staying ahead of the competition.

Let us now discuss the provisions related to setting up a Branch office or a Representative office or a Warehouse in a foreign country by an Indian entity:

Branch Office

A branch office mirrors the functions of a parent company. The offices are established to perform similar business operations as the foreign parent company at different locations in a particular country. Branch offices can carry on the same business as the Parent company. They can carry on all the trading activities that a parent country does. It is to be particularly noted that the RBI allows to set up of Branch offices overseas only for permissible activities under Foreign Exchange Management Act ('FEMA').

Representative Office

A representative office is set up primarily to explore and understand the business and investment climate. Representative offices cannot undertake commercial activities. It is usually opened by companies to carry out market research before opening a Branch office/Subsidiary/JV. A representative office can undertake only specific activities which are peculiar to each country. It acts as a communication channel for the Head office and the parties in the country in which it is set up.

Warehouse abroad

The warehouse can also be hired/opened abroad by an Exporters which is subject to conditions to be followed under FEMA. The detailed conditions are covered by us further in this article.

Residential Status of a Branch/Representative office outside India

As per section 2(iv) of FEMA, a person resident in India includes "any office, branch or agency outside India owned or controlled by a person resident in India"

A branch office is a mere extension of the Head office. It acts as a business arm of the head office in another country. Hence, the branch/representative office is considered to be a Resident as per FEMA. Due to its residential status as Resident in India, the overseas branch is subject to all FEMA restrictions as applicable to Person Resident in India.

Capital Account Transactions

All the transactions involving a resident and non-resident are bifurcated as capital account transactions or current account transactions. The method of identifying a transaction as a capital account transaction is that unless a transaction is specifically permitted it is not allowed.

As per section 2(e) of the Foreign Exchange Management Act, Capital account transaction means *"a transaction which alters the assets or liabilities, including the contingent liabilities, outside India of person's resident in India or assets or liabilities in India of person's resident outside India"*.

It is generally seen that all capital Account transactions are prohibited unless they are specifically permitted. For setting up a branch outside India, an Indian entity is required to open a foreign currency bank account outside India. The opening up of a bank account outside India by a person resident in India is considered a capital account transaction and is regulated by Notification No.10R.

RBI has stated the following provisions with regard to capital account transactions by a Branch/Representative office:

- The purchase of office equipment and other assets which are required for the operations of the Branch/ Representative office outside India shall not be considered a Capital account transaction.
- Transfer or acquisition of immovable property outside India, other than by way of lease not exceeding five years, by the overseas Branch/Representative office will be subject to the Foreign Exchange Management (Acquisition and Transfer of Immovable Property outside India) Regulations, 2015.

Opening a Bank Account

To open a Branch office/Representative office outside India the first step is to open a bank account in the foreign country. All the transactions of the office are to be carried through the bank account. Notification 10R enables a firm or a company that is registered or incorporated in India to open, hold or maintain a Foreign currency account in the name of its Branch office or representative office. The Branch/Representative office can be in nature of both trading and non-trading office.

Details of the overseas bank account opened by an Indian entity are to be promptly given to the AD Banker.

Foreign remittance to Branch/Representative office

An entity that has opened a foreign branch office/representative office has to incur initial expenses for set up. The Indian entity has to transfer money to the overseas branch/ representative office to meet its expenses.

To regulate the remittance, RBI has imposed certain conditions and limits that have to be followed with respect to remittance for initial expenses:

- The remittance by an Indian entity to all its foreign accounts shall not exceed:
  - 15% of the average turnover of the Indian entity in the last two financial years OR
  - 25% of the net worth

  whichever is higher.

The Indian entity also needs to send money/remittance for the recurring expenses which are necessary for the daily operational activities and the upkeep of the Branch/ Representative office. The prescribed limits for such recurring expenses is **upto 10%** of the turnover **during its last 2 financial years.**

The above limits however shall not be applicable in the case:

- Where the remittance is made to the account out of the funds held in the EEFC account of the Indian entity
- the overseas branch/office is set up or representative posted by a 100% Export Oriented Unit (EOU) or a unit in Export Processing Zone (EPZ) or in a Hardware Technology Park or in a Software Technology Park, within two years of establishment of the Unit.

To acquire immovable property outside India for its business or residential purpose of the staff, the AD Bankers may also allow remittance by an Indian company to its overseas office, within the above limits.

On-Site/Off-site contracts

In the case of an overseas office of a software exporter company/firm, the overseas office can repatriate 100% of the contract value of each off-site contract while in the case of "on-site" contracts, the profits of such on-site contracts should be repatriated after the completion of the respective contract.

Closure of the overseas bank account

To set up a branch office/project office in a foreign country the Indian entity is required to open a bank account in the respective country. The RBI has stated certain stipulated limits and conditions with respect to maintaining a bank account by an Indian entity in a foreign country which is discussed in earlier para. However, in case of failure to meet such conditions, the Indian entity would be required to close the bank account and remit the money lying in the foreign bank account to India.

The RBI has stated the following conditions under which the bank account of an overseas Branch/Representative office is to be closed:

- The foreign bank account opened by the Indian entity should be closed if the Branch office is not opened within 6 months of opening the bank account
- The Bank account should be closed if the Indian entity fails to appoint a representative to conduct its business.
- The bank account is to be closed within 1 month of the closure of the branch.

Additional conditions to be followed by the Overseas Branch/Representative offices

The Branch/Representative offices have to follow some additional conditions with respect to its activities as mentioned in AP Dir Circular No 54 dated 29th June 2002:

- The branch/representative office is not allowed to create liabilities or contingent liabilities for its head office in India.

- The surplus funds earned by the branch office are to be remitted back to India. They cannot be reinvested in the country without the prior approval of RBI.
- The details of the overseas bank account is to be reported to the AD Banker.

Carrying business outside India without having an existence there

In the above para's we have discussed the option of having a presence through an office outside India. This requires the Indian entity to have an existence in the respective foreign country. However, there are also other options to carry a business outside India without having an existence there. The two options include Consignment sales/Exports and hiring of warehousing abroad. Let us now discuss the two options in detail.

Consignment Exports

In the case of consignment export, an exporter can send goods to a foreign agent/distributor who shall sell the goods on behalf of the exporter. The foreign agent/distributor shall remit the sales proceeds to the exporter in India. He shall remit the amount after deducting various expenses incurred by him e.g. storage charges, distribution charges, handling charges etc. Provisions with respect to consignment exports are given in Regulation C.12 of notification No. 23 FEMA (R):

- The AD Banker shall direct the exporter to send the goods only against trust receipt/undertaking to deliver the sale proceeds by a specific date within the period prescribed for the proceeds of export.
- As discussed above the sale proceeds by the consignee shall be remitted after deducting the expenses incurred by him for the sale.
- The AD Banker is liable to check the account sales given by the consignee.
- All the deductions taken into account shall be supported by valid bills and invoices.
- In case the goods are exported on consignment basis, freight and marine insurance must be arranged in India

Export sales through a Warehouse abroad:

Provisions with respect to this option is given in the Master Direction – Export of Goods and Services issued by RBI vide Para C.13 which are:

- The export outstanding should not exceed 5% of the exports made by exporter during the previous financial year.
- The applicant should have a minimum export turnover of USD 100,000/- during the last financial year.
- The period of realization for export shall be as per respective FEMA Guidelines.
- All the transactions with respect to the warehouse should be routed through the AD Banker only.

The approval for such an application is usually given by the AD Bank only for a period of 1 year. The approval is then renewed every year provided that the exporter meets the given conditions.

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Round-trip Structures

1. Introduction

1.1 In past many years, more and more Indians have opened up to the idea of investing abroad for expanding their business beyond the Indian boundaries. At the same time, considering the market size and the pace with which the Indian economy is growing, foreign investors are increasingly investing by way of equity capital in India.

1.2 This has led to inflow and outflow of investments to and from India. Liberalization on investment to and from India has led to structures where Indians have invested abroad and the same overseas entity has opportunities to invest back into India. Such structures, where an Indian owned entity abroad invests back into India, have been subject matter of discussion and debate with the regulatory authorities.

1.3 Therefore, it has become important to understand as to what are the issues around these structures and the permissibility thereof. This article tries to cover the concepts and also explain the possible structures and implications thereof by way of case studies.

2. Round tripping vs. Round Trip Structure

2.1 'Round tripping' refers to a series of transactions that involves circulation of money across jurisdictions culminating its return to the jurisdiction of origin. Such transactions generally do not have substantial commercial purpose. The term 'Round tripping' has not been defined anywhere under FEMA. However, structures involving remittance of money overseas which flows back into India by way of capital account transaction is generally regarded as round tripping and not permitted.

2.2 An Indian Resident investing abroad into a foreign entity and such foreign entity investing back into India (without rotation of funds) is generally not considered as round tripping. However, the Reserve Bank of India ('RBI') started questioning such structures in 2013-14 on the basis of language of Regulation 6(2)(ii) of FEMA 120 which allowed direct investment in overseas wholly owned subsidiary or joint venture engaged in '*bona fide* business activity'. Although the term '*bona fide* business activity' was not defined, RBI in the

case of Binani Industries Ltd., Mumbai, dated 3 June, 2016 compounded the case on the grounds that receipt of Foreign Direct Investment ('FDI') under an Overseas Direct Investment ('ODI') entity should not be regarded as a '*bona fide* business activity'. RBI had given post-facto approval and compounded the contravention of Regulation 6(2)(ii) of FEMA 120. Since then such structures where an ODI entity invests back into India started being referred to as round trip structures which became permissible only under approval route.

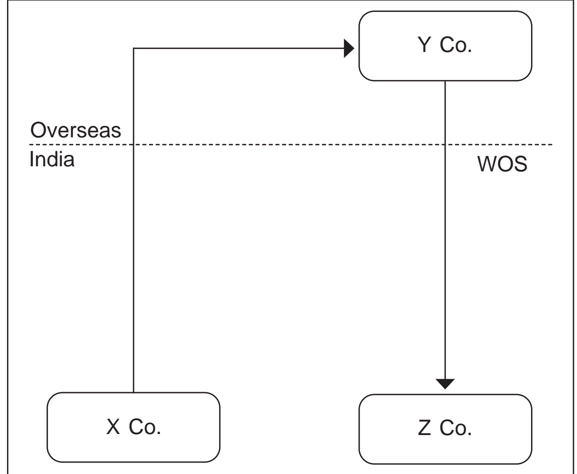
2.3 In 2019, the restriction relating to round trip structures was sought to be further clarified by RBI by way of Q. 64 of frequently asked questions ('FAQ 64') released by RBI which read as follows:

> "***Q. 64*** *Can an Indian Party (IP) set up a step-down subsidiary/joint venture in India through its foreign entity (WOS/JV), directly or indirectly through step-down subsidiary of the foreign entity?*
>
> *FEMA 120 do not permit an IP to set up Indian subsidiary(ies) through its foreign WOS or JV nor do the provisions permit an IP to acquire a WOS or invest in JV that already has direct/indirect investment in India under the automatic route. However, in such cases, IPs can approach the Reserve Bank for prior approval through their Authorised Dealer Banks which will be considered on a case-to-case basis, depending on the merits of the case*"

2.4 Recently, Central Government and RBI issued new rules and regulation for ODI which permit Indian entities to invest in foreign entities which invests back in India under automatic route provided the investment does not result in a structure with more than two layers of subsidiaries. This has been discussed in detail, later in this article.

3. Case studies on structures under FEMA 120, the erstwhile overseas investment regulations (prior to 22 August, 2022)

Case study 1 – (Indirect India Investment)



Facts

1. X Co, a private limited company incorporated under the provisions of Companies Act, 2013 has made an outbound investment of ₹ 1 crore in foreign company, Y Co.

2. Y Co intends to incorporate a wholly owned subsidiary in India say Z Co.

Issues

1. Whether investment by Y Co in Z Co shall be permissible if the funds invested by X Co are utilised for investment in Z Co?

2. Whether investment would be permissible if Y Co borrows a loan of

₹ 1 crore in its local currency and invests in Z Co?

3. Whether investment would be permissible if Y Co invests in Z Co from Internal accruals?

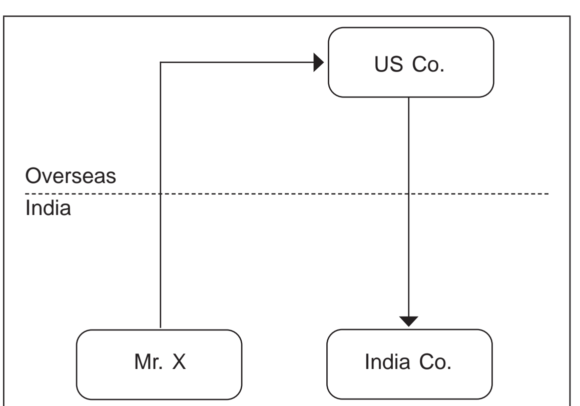
Comments

1. Issue 1 was a clear case of round tripping since the funds utilized for the purpose of Foreign Direct Investment by Y Co into Z Co, are out of the proceeds of overseas direct investment made by X Co. and therefore, not permissible.

2. With respect to issue 2 and issue 3, FAQ 64 to FEMA 120, as specified above, did not permit Y Co to incorporate Z Co even though the investment made by Y Co are not out of the funds remitted as overseas direct investment by X Co to Y Co. Consequently, the said structures would fall under approval route.

3. Some of the select cases which have been compounded by the RBI are discussed towards the end in this article.

Case study 2 – Structure when Non Resident individual changes his status to Resident



Facts

1. Mr. X, resident of United States of America started a business of artificial intelligence and software development by incorporating a company in United States of America ('US Co.').

2. Further, the US Co. has acquired 99.99% stake in an Indian Company ('India Co.') by infusion of funds when Mr. X continued to be a non-resident.

3. Mr. X for certain reasons moves with his family to India and settles in India and now has become resident of India.

Issues

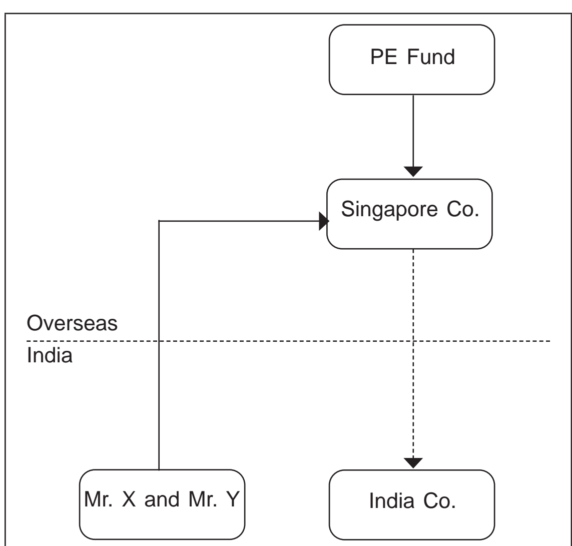
1. Considering the above factual background, whether the structure can be continued considering that Mr. X is now a resident of India having investment in US Co. which in turn has investment in India Co.?

Comments

1. As per section 6(4) of Foreign Exchange Management Act, 1999 ('FEMA'), a person resident in India may hold or own investment in foreign securities if such securities were acquired, held or owned by such person when he was resident outside India.

2. Considering the above, it was a pure section 6(4) structure and should have been permissible under FEMA 120 even though it leads to being a round trip structure post Mr. X turning a resident.

Case study 3 – Structure using NR funds



Facts

1. Mr. X and Mr. Y two Indian residents started with the business of IT software development in Singapore by incorporating a company in Singapore ('Singapore Co.') with a nominal capital of SGD 100.

2. Capital was infused by the promoters using their overseas funds earned when they were non-residents and retained abroad.

3. Further, Private Equity ('PE') fund invests into Singapore Co. to acquire 25% stake in the Singapore Co.

4. Considering the dynamics of Indian economy, Singapore Co intends to create its presence in India by incorporating a company ('India Co.')

Issues

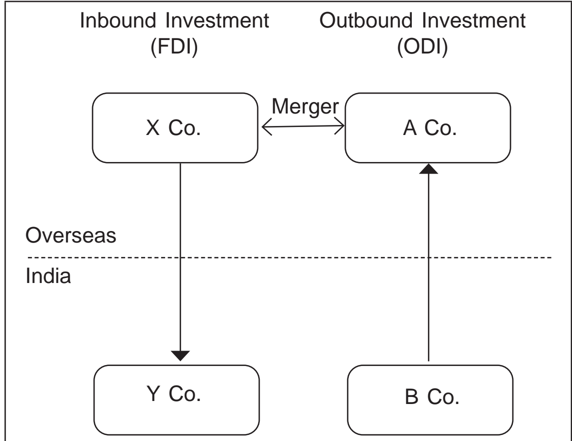
1. Whether the investment by Singapore Co. in India Co. would be permissible?

Comments

1. There was a possible argument under erstwhile regulations that investment in Singapore Co. is made out of the income earned and retained in bank account held outside India. Consequently,the investment doesn't attract the provisions of FEMA 120 as it is made out of funds retained abroad under section 6(4) of the FEMA.

2. Accordingly, by virtue of above, FEMA 120 read with FAQ 64 should not have applied given the facts of the case.

Case study 4 – Merger of overseas entity



Facts

1. B Co. engaged in the business of information technology has made an outbound investment in the company incorporated in UAE, say A Co.

2. Another company (unrelated) also engaged in the business of information technology, say X Co., has made foreign direct investment in an Indian company, say Y Co.

3. Considering the future economic growth and creation of enhanced value for shareholders, the management of both

groups decided to merge X Co. with A Co.

4. As a result of merger, Indian entity B Co. will have indirect investment in Y Co., through merged entity.

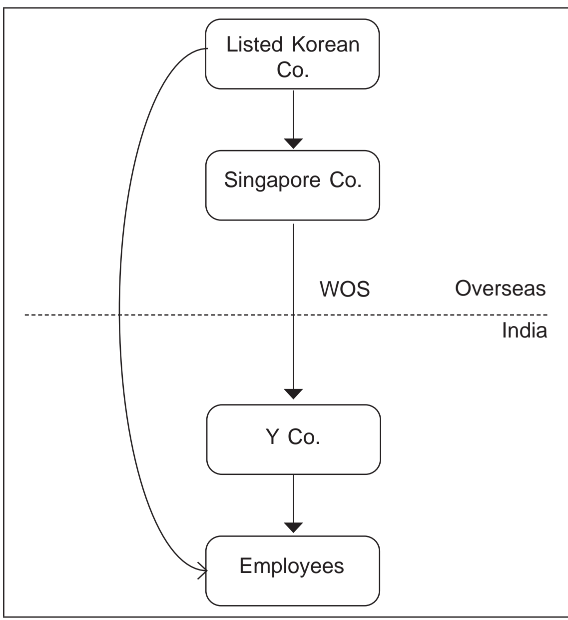
Issue

1. Whether RBI approval would be required for holding such investments even if Y Co is engaged in a sector where investment is allowed under automatic route?

Comments

1. Considering the FEMA 120 read with FAQ 64, the present structure falls under approval route. B Co. had to approach RBI for approval prior to giving consent to the merger, as the proposed merger results into an ODI-FDI structure which was allowed subject to RBI approval.

Case study 5 – Employee Stock Option Plan ('ESOP')



Facts

1. Koran Company (Korean Co.) is engaged in the business IT software development. Korean Co. has a wholly owned subsidiary in Singapore (Singapore Co.) which acts as a marketing agent for Korean Co in Singapore.

2. Further, Singapore Co. has a wholly owned subsidiary in India (India Co.). India Co. to incentivize and retain the right talent in the company, has offered employee stock options ('ESOPs') to certain employees of the Korean Co.

Issue

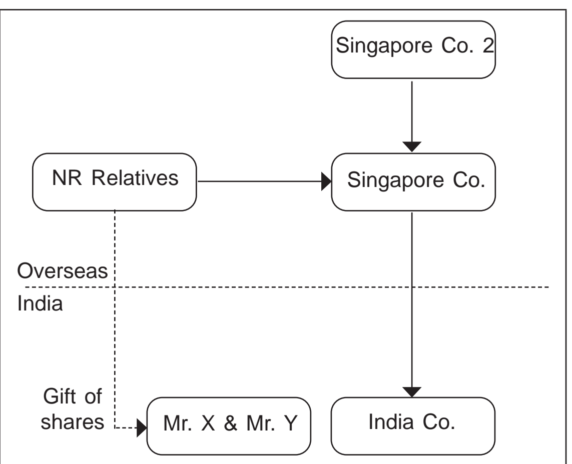
1. Whether the employees are eligible to subscribe to ESOPs offered by the India Co.

Comments

1. In the erstwhile regulations of FEMA 120, ESOP were permissible subject to fulfillment of conditions. Hence, employees should have been eligible to subscribe to the shares of Korean Co. under ESOPs even though it leads to a structure where Indian residents were holding shares of overseas company which was indirectly holding foreign direct investment in India.

2. India Co. was liable to comply with filing requirements for the ESOPs offered to its employees.

Case Study 6 – Structure using gift from NRIs



Facts

1. Singapore Co. incorporated by non-resident Indian relatives of two individuals Mr. X and Mr. Y who are Indian residents with a nominal capital of SGD 100.

2. Singapore Co. 2 is another company incorporated in Singapore which had subsequently invested to acquire a stake in Singapore Co.

3. Singapore Co. has acquired 99.99% stake in the India Co. by infusion of funds

4. The non-resident relatives proposes to gift the shares of Singapore Co. to Indian residents Mr. X and Mr. Y.

Issues

1. Is gift of shares by non-resident relatives to Mr. X and Mr. Y were permissible?

2. Can non-resident relatives gift the shares to Mr. X and Mr. Y given that Singapore Co. has investments in India Co.?

Comments

1. As per regulation 22 of FEMA 120 general permission had been granted to a person resident in India to acquire foreign securities by way of gift from person resident outside India.

2. Regulation 22 is reproduced below:

   "22. Permission for purchase/acquisition of foreign securities in certain cases

   (1) A person resident in India being an individual may acquire foreign securities:-

   (i) by way of gift from a person resident outside India"

3. However, under FEMA, what cannot be done directly should not be allowed to be done indirectly as well. Applying this principle, it was better to seek guidance from RBI prior to executing such a structure as it ultimately leads to a structure where Indian resident is holding shares in overseas entity which in turn is holding shares in an Indian company.

4. Draft New Overseas Investment Rules and Regulations

4.1 Initially the Central Government had released draft Foreign Exchange Management (Overseas Investment) Rules and draft Foreign Exchange Management (Overseas Investment) Regulations for public comments on 9th August, 2021 according to which, person resident in India were permitted to make financial commitment in a foreign entity that had invested into India, at the time of making financial commitment or at any time thereafter, either directly or indirectly, provided

the structure was not designed for the purpose of tax evasion/tax avoidance by such person.

4.2 Thereafter, various representations were made to the Central Government to provide clarity as to what would be the benchmark for RBI to decide whether a structure is designed tax evasion/avoidance or not.

4.3 Considering the representation made to RBI, in the final set of Overseas Investment Rules and Overseas Investment Regulations (22 August, 2022), the language of this rule was amended and the new language has been discussed in detail in para 5 of this Article below.

5. Position post to 22 August, 2022

5.1 The Ministry of Finance *vide* its notification issued on 22 August, 2022, introduced new rules and regulations for Overseas Investment viz. Foreign Exchange Management (Overseas Investment) Rules, 2022 ('OI Rules') and Foreign Exchange Management (Overseas Investment) Regulations, 2022 ('OI Regulations') which superseded the erstwhile regulations, Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 – FEMA 120.

5.2 The preface to the notification implies that RBI, in consultation with Central Government, has introduced more simplified regime for overseas investment with an aim to simplify the existing framework, promote ease of doing business and considering the current business and economic dynamics.

5.3 In the new OI Rules and OI Regulations, clarity on ODI and Overseas Portfolio Investment has been brought in and various overseas investment related transactions that were earlier under approval route are now under automatic route, significantly enhancing "Ease of Doing Business".

5.4 One of the example is round trip structures,which under the erstwhile regulations i.e. FEMA 120,were permitted under approval route, are now permitted under automatic route as per new rules [refer Rule 19(3) of the OI Rules]. This is subject to the condition that investment does not result in a structure with more than two layers of subsidiaries. Rule 19(3) of OI Rules is reproduced below for ready reference:

19. Restrictions and prohibitions.–

(3) No person resident in India shall make financial commitment 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, resulting in a structure with more than two layers of subsidiaries:

Provided that such restriction shall not apply to the following classes of companies mentioned in sub-rule (2) of rule 2 of the Companies (Restriction on Number of Layers) Rules, 2017 as may be amended from time to time, namely:-

(a) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(b) *a non-banking financial company as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934) which is registered with the Reserve Bank and considered as systematically important non-banking financial company by the Reserve Bank;*

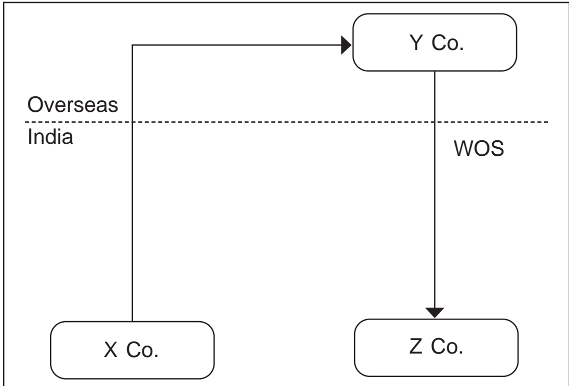
(c) *an insurance company being a company which carries on the business of insurance in accordance with provisions of the Insurance Act, 1938 (4 of 1938) and the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999); and*

(d) *a Government company referred to in clause (45) of section 2 of the Companies Act, 2013 (18 of 2013).*

5.5 However, the language in the OI Rules is not clear as to how the two layers of subsidiary should be counted. Some of the case studies along with issues in relation to the language of the new rules are discussed below.

Case studies

Case study 1 – (India Foreign India)



Facts

1. X Co is a private limited company incorporated under the provisions of Companies Act, 2013 and is engaged in the business of IT software development.

2. X Co has made an outbound investment and incorporated a company, Y Co, in USA with a nominal capital of USD 100. Y Co has developed a software for which it requires technical support from Indian employees.

3. In order to obtain the technical support from Indian employees, it proposes to incorporate a new company, Z Co in India and hire the Indian employees in Z Co.

Issue

1. Whether XCo would be allowed to continue to hold the investment in Y Co, given the fact that Y Co is proposing to set up Z Co in India?

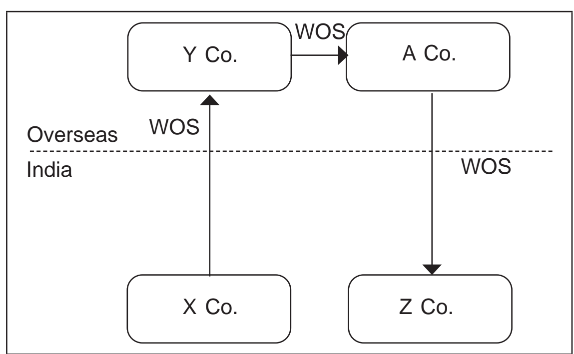
Comment

1. As per the erstwhile regulation, FEMA 120, the above structure was permitted under approval route, by virtue of clarification under FAQ 64, as it results into ODI-FDI structure.

2. However, as per Rule 19(3) of the new OI Rules, RBI has now allowed Indian entities which have made financial commitment in foreign entity that has invested or proposes to invest into India. The only condition is that the structure should not result in more than two layers of subsidiaries.

3. Present structure does not result into more than two layers of subsidiaries. Therefore, X Co. should be allowed to continue to hold the overseas investment in Y Co which now proposes to make an investment in Z Co.

Case Study 2 –(India Foreign Foreign India)



Facts

1. Considering the facts given in case study 1 above, instead of Y Co incorporating Z Co in India, Y Co first incorporates a company in Singapore say A Co and A Co in turn incorporates Z Co, a new company in India.

Issue

1. Whether X Co would be allowed to continue to hold the investment in Y Co, given the fact that Y Co is proposing to set up A Co in Singapore and in turn A Co is proposing to incorporate Z Co in India?

2. How will the two layers of subsidiary for the purpose of Rule 19(3) of OI Rules be counted?

Comments

1. As per Rule 19(3) of OI Rules read with para 20 of Foreign Exchange Management (Overseas Investment) Directions, 2022 ('OI Directions'), RBI has now allowed Indian entities which have made financial commitment in foreign entity that has invested or proposes to invest into India. The only condition is that the structure should not result in more than two layers of subsidiaries.

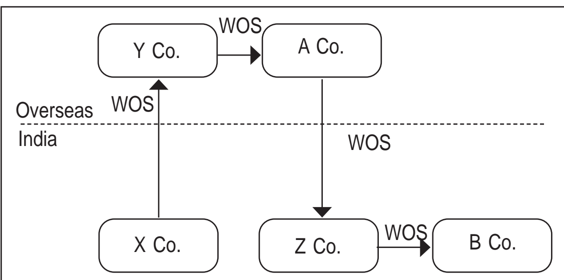
2. Further, a note has been added below para 20 of OI Directions according to which subsidiary should have the meaning as provided in OI Rules.

3. As per Rule 2(1)(y) of OI Rules, subsidiary or step down subsidiary of a foreign entity means an entity in which the foreign entity has control.

4. Given that the definition of 'subsidiary' under Rule 2(1)(y) also mentions step-down subsidiary and such definition is limited to a subsidiary of a foreign entity, a plausible interpretation would be that, the permitted layers of subsidiaries should be determined with reference to the foreign entity receiving financial commitment (Y Co in the present case).

5. Consequently, investment by Y Co. in A Co should be counted as first layer and in turn investment by A Co in Z Co should be counted as second layer. Therefore, the structure should be covered within the permissibility of Rule 19(3) of OI Rules. Consequently, X Co should be permitted to continue to hold investment in Y Co. even when Y Co. sets up A Co (in Singapore) and A Co. in turn sets up Z Co. in India.

Case study 3 - (India Foreign Foreign India India)



Facts

1. Further to the facts given in case study 2 above, after A Co incorporates Z Co., Z Co. further incorporates a WOS in India say B Co.

Issue

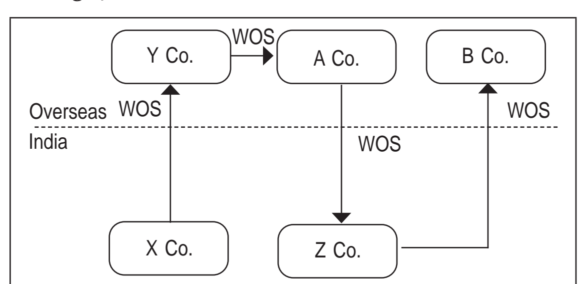
2. Whether Z Co. will be permitted to further incorporate a WOS in India?

Comments

1. As discussed above, upto incorporation of Z Co. in India should be permissible under Rule 19(3) of the OI rules.

2. Incorporation of B Co., very technically, would lead to a third layer of subsidiary. Consequently, incorporation of B Co. may not be permitted if we go by the strict reading of Rule 19(3). However, a question would arise as to whether RBI should restrict setting up of entities within India under Z Co. Logically, once the structure has come back to India, overseas investment regulations should not have control since Z Co. is an Indian Company and should be allowed to set up another company in India. Representations have been made seeking a clarification on the above issue. Till the time there is any clarification issued on the above, it would be better to seek guidance from RBI prior to executing this structure.

Case study 4 - (India Foreign Foreign India Foreign)



Facts

1. As a modification to the facts in case study 3 above, Z Co. proposes to incorporate a new entity B Co. in an overseas country instead of India.

Issue

1. Whether Z Co. should be permitted to make fresh outbound investment in B Co?

Comments

1. As discussed above, upto incorporation of Z Co. in India should be permissible under Rule 19(3) of the OI rules.

2. Incorporation of B Co., very technically, would lead to a third layer of subsidiary. Consequently, incorporation of B Co. may not be permitted if we go by the strict reading of Rule 19(3). However, a question would arise as to whether RBI should restrict Z Co. in making further ODI outside India if it is otherwise compliant with the OI Rules. Logically, setting up of B Co. under Z Co. would separately get covered and regulated under the OI Rules separately. Consequently, there could be a possible view that a fresh ODI by Z Co. should be permissible. Representations have been made seeking a clarification on the above issue. Till the time there is any clarification issued on the above, it would be better to seek guidance from RBI prior to executing this structure.

6. Is round tripping now permissible under new regulations?

6.1. Round tripping of funds was never permitted nor encouraged from regulatory perspective.

6.2. However, the new OI Rules permits person resident in India to make financial commitment in foreign entity that has made financial commitment or propose to make financial commitment in India, either directly or indirectly provided the structure does not result in more than two layers of subsidiaries.

6.3. The language of Rule 19(3) of OI Rules is permitted only subject to a condition that the structure should not result in more than two layers of subsidiaries. The language does not restrict rotation of funds, sent from India to overseas entity, back into India. Consequently, it appears that round tripping of funds from India to an overseas entity and back in to India ought to be permitted subject to satisfaction of OI Rules, as long as the structure doesn't result in more than two layers of subsidiaries.

7. Compounding orders passed by RBI under FEMA 120

7.1 Subhkam Ventures (I) Private Limited

- The applicant was engaged in the business of managing public issue of shares and securities in all its branches and carries out the business of an investment company.
- A Wholly Owned Subsidiary ('WOS') of the applicant company, namely, Subhkam Overseas Limited was incorporated in British Virgin Islands on April 15, 2008, to carry out the *bonafide* activity of software supply services.
- On July 29, 2010 the applicant remitted USD 12,33,000 to its WOS, out of which USD 12,25,000/- was invested back by the WOS in India, to make payment for the shares purchased by it of an Indian entity viz. Usha Communication Technology Limited, Kolkata.
- As this was not a *bona fide* activity of the WOS, the abovementioned transaction was in contravention of Regulation 6 (2) (ii) of Notification No. FEMA 120/2004-RB. The unwinding process was completed and had been taken on record on July 12, 2016. The Annual Performance Reports (APRs) for the years 2008-09, 2009-10 and 2010-11 were submitted with a delay beyond the stipulated time period.

7.2 Jasper Infotech Private Limited

- The applicant, Jasper infotech Private Limited (JIPL), was incorporated under the Companies Act, 1956.
- Another Indian company *viz*. Accelyst Solutions Private Limited (ASPL) was incorporated on July 29, 2008 with a paid-up capital of ₹ 100,000/- and as on March 31, 2011. 50% of ASPL's equity was held by Shri Kunal Shah and 50% by Tancom Electronics Pvt Ltd (an Indian company).
- Accelyst Pte Ltd (APL) was incorporated under the laws of Singapore on September 27, 2011 which was stated to be a Holding Company in Form ODI. In November 2011 Mr. Kunal Shah, Mr. Sandeep Tandon and Ms. Gauri Tandon (erstwhile promoter/shareholders) acquired 10,500 shares, 2100 shares and 8400 shares (these shares were split in the ratio of 1:1000 on February 11, 2014) of APL, Singapore respectively for a total amount of USD 21,000 from other non-resident individuals/entities.
- During the period December 2011 to March 2015 APL, Singapore raised an amount of USD 116,690,263 through issuance of 7,36,92,097 optionally convertible preference shares (OCPS) to non-resident investors. In November 2011, APL acquired 9,999 shares (99.99% stake) in ASPL (one share continued to be held by Tancom Electronics Pvt Ltd) for ₹ 100/- per share (against valuation of ₹ 92.20 per share) and thus ASPL became JV of APL, Singapore. Out of the funds raised through issuance of OCPS by APL, Singapore, ₹ 3,62,06,35,706/-, were invested into ASPL during the period April 2012 to July 2015, in the form of compulsorily convertible debentures (CCDs) issued by ASPL which were later converted to equity shares.
- In March 2015, JIPL acquired, through a secondary purchase transaction, shares of Accelyst Pte Ltd (APL) from the resident individuals and non-resident entities for a total amount of USD 339,368,176.07 (₹ 2118,71,43,413.45/-) at a time when APL already had a JV in India i.e. ASPL
- Thus, the acquisition of APL by JIPL resulted in an ODI-FDI structure, resulting in contravention of Regulation 5(1) read with Regulation 6(2)(ii) of Notification No. FEMA 120/2004-RB on the part of JIPL.

7.3 RIR Enterprises – II

- The applicant, RIR Enterprises – II, was registered as a partnership firm on 27 November, 2007, with the Registrar of Firms, Andhra Pradesh. The partners were Mr. Tikkavarapu Venkatram Reddy, Mr. Tikkavarapu Vinayak Ravi Reddy and Mr. P K Iyer. The applicant is engaged in the business of making writing notebooks, including buying paper, cutting and binding.

- A Wholly Owned Subsidiary ('WOS') of the applicant namely, RRI International Limited, was incorporated in Mauritius on December 05, 2007. The applicant issued corporate and personal guarantees to the extent of USD 300 and USD 38.7 million respectively, on behalf of its WOS, to ICICI Bank, Bahrain, to enable the WOS to raise a loan of USD 30 million.
- M/s RRI International Limited, Mauritius, invested the loan proceeds in Compulsorily Convertible Preference Shares of Indian Company, Sieger Solutions Limited which was incorporated on July 6, 2006.
- It was concluded that the above activity of the WOS was not a *bonafide* activity, and hence, a contravention of Regulation 6(2)(ii) of Notification No. FEMA 120/2004-RB.

Conclusion

1. To summarize,under the erstwhile regulation, Round Trip Structures, with bona fide activities, were permitted subject to prior RBI approval.
2. With new OI Rules and OI Regulations, round trip structures are now permitted under automatic route provided it does not result into more than two layers of subsidiaries.
3. Though the new OI Rules and Regulations seek to provide clarity on lot of open issues in the erstwhile regulations, especially in respect of Round Trip Structures, the language of the new rules and regulations itself has left a few questions unanswered. This article tries to provide an overview of the position under erstwhile regulation and the new rules along with highlighting these issues for the benefit of the reader.

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"If money help a man to do good to others, it is of some value; but if not, it is simply a mass of evil, and the sooner it is got rid of, the better."

— *Swami Vivekananda*

"As human beings, our greatness lies not so much in being able to remake the world - that is the myth of the atomic age - as in being able to remake ourselves."

— *Mahatma Gandhi*

CA Manoj Shah

Open issues under new Overseas Investment Regime

Authority to make provisions for Capital Account Transaction (CAT) was shifted from Reserve Bank of India (RBI) to Central Government since 2015 by introducing Sec 6(2A) to Foreign Exchange Management Act (FEMA). In the year 2019, under this change, the Rules pertaining to Foreign Investment in India (including investment in immovable properties) were pronounced. Come, year 2022, and the much awaited, Overseas Investment (OI) Rules have been pronounced.

The Rules have cured many deficiencies that were present in the erstwhile Notifications No.120/RB FEM (Transfer or issue of any foreign security regulations) 2004.

Few of such noteworthy changes -

- The most sought after ODI (Overseas Direct Investment) to FDI structure (Foreign Direct Investment), colloquially known as Round Tripping, which needed RBI approval under old regime has now found its place with certain conditions under automatic route.
- Also the definition of 'Net Worth' now brings certainty to inclusion of 'share premium' in computing it.
- Clarity on remittance towards incorporation expenses of Overseas Entity. Such remittance can be either capitalized by treating it as Financial Commitment (FC) or by treating it either as can be treated as Receivables. If not capitalized, same would not be considered as part of FC.
- An unexpected liberalization measure is to permit non Financial Services company to venture overseas in Financial Services sector (subject to certain conditions).
- Opportunity to regularize non reporting/ delayed reporting of past contraventions with payment of Late Submission Fees (LSF) with a three year window (which shall end on 21.08.2025). This will do away with need to undergo compounding process.

While there are many changes which facilitate OI with much needed ease under new OI Rules, there still remain few areas which require clarifications.

The Article attempts to list down few such areas:

- **'Real Estate Activity' Definition**: Overseas Direct Investment is not permissible in foreign entity which is engaged in Real Estate activity. The

issue is whether buying of property for leasing is permissible activity or not. Explanation to Rule 19(1) defines 'Real Estate Activity'. The definition reads as under-

"For the purpose of this sub-rule, the expression 'real estate activity' means buying and selling of real estate or trading in TDRs but does not include the development of townships, construction of residential or commercial premises, roads or bridges for selling or leasing"

As can be seen, the definition leaves a possible interpretation that, what is prohibited is direct buying and selling but since 'leasing' is a permissible activity, it gives impression whether buying and leasing could be an activity which is outside the scope of 'real estate activity'.

While intention seems to be that leasing should be permissible which is preceded by construction. Also philosophy of OI Rules, is that , ODI is meant for business activity and not merely for holding of asset for passive incomes.

- **Cashless ESOPs**: Under erstwhile Notification No.120, Regulation 22(1)(ii) specifically permitted acquisition of foreign securities under cashless ESOPs scheme. Under new Rules, there is no specific mention of Cashless ESOP. Though ESOP as such is included in Schedule III (manner of making OI by resident individual). There is also a reference to reporting by Indian company (subsidiary or JV Co) or Indian branch or office of a foreign company in respect of ESOP acquired by employee or director (Regulation 10), however since there was no reporting for cashless ESOP under old regime, it further raises doubt how to bring on record cashless ESOP. Since there is no outward remittance, clarification in this regard from RBI is needed.

- **Arm's Length Price (ALP) as a basis for Pricing Guidelines:** Rule 16 now prescribes issue or transfer of equity capital from Non Resident to Resident or vice versa at a price which is arrived on an ALP. Further, AD shall ensure compliance with ALP taking into consideration the valuation as per any internationally accepted pricing methodology for valuation. The issue under ALP concept would be that – valuer will not be certifying ALP but his report would be for fair value and thereafter it is left to discretion of AD to ensure what is ALP. In case of acquisition of shares of existing company (where transaction is between unrelated parties) it is quite possible that transaction may take place at a price which is below fair value and in fact such price is always an ALP as parties are unrelated. Whether such transfer would be considered in compliance with Rules by AD is an open issue. ALP concept needs to be followed even in case of Restructuring where diminution in value needs to be "certified" on an arm's length basis by a registered valuer or valuer of host country jurisdiction.

- ***Bonafide* business Activity**: Rule 9 mandates Overseas Investments in Foreign entity which is engaged in *bonafide* business activity. Further *bonafide* business activity is defined in Explanation to Rule 9(1) as under- "For the purpose of this sub-rule *bonafide* business activity shall mean

any business activity permissible under any law in force in India and the host country or host jurisdiction, as the case may be". Inference is, activity should be within the framework of law of both in India and overseas jurisdiction and further it applies to both i.e. Overseas Direct Investment as well as to Overseas Portfolio Investment (OPI). The issue that arises is what if an activity is prohibited in certain states of India (say online lotteries) but not in all states and hence what should the view be taken. Further, even for OPI one will have to be careful, if activities of listed overseas company are not permissible under Indian laws, even OPI would not be eligible.

- **Start up**s: ODI in start ups is subject to conditions (1) it should be made out of internal accruals of Indian entity or group or associate companies and in case of resident individuals from own funds and (2) start ups should be recognised under the laws of the host country/jurisdiction. Intention is fairly clear with respect to internal accruals, that only surplus funds to be invested and even company's own funds raised through equity etc are not eligible. The second condition however may pose practical challenge, as host country may not have law or policy to recognise specifically 'start ups', like India has.

- **Acquiring qualification shares as subscriber to MoA:** Many jurisdictions require first director to be subscriber to MoA. In such cases, even if they hold bare minimum say, just one share, however, the same may be considered as ODI and hence even such individual will have to comply with entire compliance of ODI. Schedule III dealing with manner of making OI by resident individuals, considers- acquisition of minimum qualification shares – as OPI, however, if such individual is subscriber to MoA, the same may get characterized as ODI. In substance it is certainly not ODI but in form it may tantamount to ODI.

- **Deferred consideration recognised but not variable consideration**: Regulation 7 of FEM ((Overseas Investment) Regulations, 2022 does recognise and permit deferred consideration in case of sale of ODI by person resident in India. Such deferred consideration can be deferred for a definite period (no upper time limit given as in case of FDI- where it is 18 months). However, many a times, deals get closed with fixed consideration plus a variable component, either based on near term future profits/recovery of dues which are determined on a valuation date etc., such variable portion, would still require RBI approval. A limit of certain percentage say 10% which could be kept as variable component (plus or minus) to fixed consideration as process to expedite deal closure.

- **Gift of foreign security received by Resident Individual**: Resident Individual may acquire foreign securities by way of gift from a Person Resident Outside in India in accordance with the provisions of the Foreign Contribution (Regulation) Act, 2010 ("FCRA, 2010") [Para 2(3) of Schedule 2 of OI Rules,2022].

  As per the provisions of FCRA, 2010, there is no prohibition to accept foreign contribution unless you are specifically prohibited under section 3 which includes candidate for election, public servant, member of any legislature etc.

Section 4(e) exempts persons specified in Section 3 if Foreign contribution (FC) is from relative. However, there appears to be no embargo on resident individual (other than those covered in Section 3) from receiving gift of foreign security from Non-Residents.

The confusion however emerges from Rules and related Form for registration which recipient of gift has to file under FCRA.

As per the Rule 17(4) of Foreign Contribution (Regulations) Rules, 2011-

"*If the foreign contribution relates to foreign securities, the intimation shall be submitted in Form [FC-1]*"

While filing form FC-1, the language of the subject creates an ambiguity - whether the FC can be accepted from a non relative.

"***Subject***: – *Intimation to the Central Government of receipt of foreign contribution by way of gift from relative by an individual/foreign contribution in the form of articles/securities/by a candidate for election [section 21 of the Foreign Contribution (Regulation) Act, 2010 (42 of 2010)]*"

Receipt of foreign contribution by way of gift from relative	☐ Y es/No
Foreign contribution (articles) account	☐ Yes/No
Foreign contribution (securities) account	☐ Yes/No
Receipt of foreign contribution by a candidate for election	☐ Yes/No

But the same has been cleared out in the table provided under the subject, which clearly segregates the head, "FC(Securities) account" and gives an option to strike off if gift of foreign security is from non relative.

- The literal interpretation of subject therefore creates confusion which may be settled by Ministry of Home affairs through a clarification.

- **Restriction on further financial commitment or transfer:** The Regulation makes it mandatory to regularise delayed reporting first before embarking upon fund or non fund based investment or even transfer. So it would be imperative for all Indian entities or resident individuals who have made OI to get FEMA health check up done to identity if there are any lapses in either non reporting or delayed reporting and take immediate action to get it regularised with payment of LSF till 21.08.2025.

Overseas Investment Rules, to a considerable extent, are an improvised version as compared to its predecessor Notification No.120. However, there are still certain issues which need clarifications from Reserve Bank, as an implementing agency of Central Government. FAQs are one of the ways to clear the issues and the same is eagerly awaited.

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Case Studies on Outbound Investments – FEMA & Income Tax

Overseas investments from India have increased in recent years, as persons resident in India expand their worldwide footprint and enter new markets. Overseas investment is a type of foreign investment in which Indian entities/individuals invest in enterprises and assets located outside of India in order to gain access to new markets, technologies, and resources. By investing abroad, Indian entities/individuals not only get access to new markets and resources, but they also contribute to the global economy's growth and development. Hence, a comprehensive policy structure should be in place to direct and regulate any offshore investments.

In exercise of the powers granted by the Foreign Exchange Management Act, 1999 ('FEMA'), the Central Government notified the Foreign Exchange Management (Overseas Investment) Rules, 2022 ['OI Rules'] dated 22nd August 2022, in suppression of the Foreign Exchange Management (Transfer or Issue of Any Foreign Securities) Regulation, 2004 [Notification No. FEMA 120] and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015 2004 [Notification No. FEMA 7(R)]. The Reserve Bank of India ('RBI') issued the Foreign Exchange Management (Overseas Investment) Regulations, 2022 on August 22, 2022, in order to control the OI Rules. Separately, the detailed operational guidelines in this regard have been issued vide A. P. DIR Series Circular in the form of Foreign Exchange Management (Overseas Investment) Direction, 2022, dated 22nd August 2022.

Since the framework is fairly new there are numerous interpretational issues, however, in this article we have restricted the discussion into the subject with 09 practical and live case studies which can be of importance in day to day practice, including ramifications under the Income Tax Act of 1961 ('ITA') wherever applicable.

Case Study 1: Financial Services Activity [Paragraph 2 of Schedule I of OI Rules]

Case Study

Indian HNIs are investing in stocks and ETFs listed on the NASDAQ through a worldwide investment platform owned and run by Big Bull Inc., a US-based corporation. Big Bull Inc. provides model

portfolios, however, it does not make any investment recommendations as client is solely responsible for their investment decision. Big Bull Inc. charges its clients an access fee for its model portfolio. An Indian corporation, ABC Private Limited ('ABC'), is negotiating to buy 25% of Big Bull Inc.'s share capital. Please take note that, ABC has incurred losses for the past five years in a row.

Issue

Whether ABC is permitted to acquire shares of Big Bull Inc.?

Analysis

Whether Big Bull Inc. can be considered to be involved in financial services activity or not is a moot question that needs to be addressed in this case. It should be noted that, an Indian entity not engaged in financial services activity in India is allowed to invest overseas in a foreign entity that is directly or indirectly involved in financial services activity, excluding banking or insurance, provided that the Indian entity has reported net profits over the previous three financial years. If a foreign entity performs an activity which if performed by an entity in India, would require registration with or be subject to regulation by a financial sector regulator in India, it is deemed to be engaged in the business of financial services activity. As a result, if it was to claim that Big Bull Inc. is engaged in financial services activity, ABC would not be allowed to invest in Big Bull Inc. as ABC had incurred losses for the preceding five years in a row.

Although Big Bull Inc. provides model portfolios on its platform, it does not offer recommendations on which model portfolios HNIs should invest. Additionally, Big Bull Inc. would bill its clients as platform access fees. Big Bull Inc. is also not offering its clients with investment advisory services in the traditional sense as it does not advise them on which model portfolio to be selected from the assortment of model portfolios. Additionally, clients would be solely responsible for making any investment choices and for purchasing any securities through the Big Bull Inc. platform. Since Big Bull Inc. does not advise the clients on their investment decision, they will not be covered within the purview of the Securities Exchange Board of India (Investment Advisers) Regulations, 2013 as amended from time to time. As a result, Big Bull Inc. is considered as a tech-enabled business company and does not, in fact, offer any financial services. This leads to the conclusion that ABC would be permitted to make an investment into Big Bull Inc.

Under ITA, in Income Tax Return ('ITR') to be filed, ABC would be required to disclose the details of the investment made and the resultant income, if any in Big Bull Inc. under the Foreign Asset schedule ('Schedule FA'). The Schedule FA is a schedule of the ITR that is required to be filled out by resident Indian taxpayers who hold foreign assets. The schedule is a declaration of all foreign assets held by the taxpayers, including bank accounts, immovable property, financial assets, and other assets located outside of India. The schedule requires taxpayers to provide details of their foreign assets, including the country of location, description of the assets, mode of acquisition, cost of acquisition, and the current market value. Taxpayers are also

required to report any income earned from these foreign assets, including interest, dividends, and capital gains. It is to be noted that the details of investment made needs to be given for the calendar year wise whereas details of resultant income should be for the financial year wise.

Case Study 2: Real Estate Activity Definition [Rule 19 of OI Rules]

Case Study:

An unlisted British company called Builder Limited ('BL') is in the business of purchasing and renting out commercial premises close to the Manchester area. An Indian company, Developers Private Limited ('DPL'), which is engaged in a similar business activity in India is considering investing 44% into share capital of Builder Limited.

Issue

Whether Developers Private Limited is permitted to acquire shares of Builder Limited?

Analysis

In this case, the moot question is whether BL can be considered to be involved in the real estate activity and, as a result, whether DPL's investment in BL is prohibited under Rule 19 of OI Rules? The definition of real estate activity as given under Rule 19 of OI Rules is reproduced as follows for ease of reference: *"For the purposes of this sub-rule, the expression "real estate activity" means **buying** and selling of **real estate** or trading in Transferable Development Rights **but does not include** the development of townships, construction of residential or commercial premises, roads or bridges for selling **or leasing**."* (Emphasis supplied)

Reader 1: "*real estate activity*" *means **buying** and selling of **real estate** or trading in Transferable Development Rights of real estate **but does not include.....leasing**.*

Reader 2: "*real estate activity*" *means **buying** and selling of **real estate** or trading in Transferable Development Rights of real estate **but does not include** the **development of townships**, construction of residential or commercial premises, roads or bridges **for selling or leasing**.*

Based on the above, reader 1 can contend that buying and leasing real estate does not constitute real estate activity based on a literal reading of the definition and thus, the investment by DPL into BL is ought to be permitted whereas as per reader 2, buying & leasing is not permitted. However, the phrasing 'real estate activity' does contain some ambiguity in terms of the language used therein. Therefore, for better interpretation of the Rules, one can refer to the Hindi version of the Rules[1], which helps in interpretation. For convenience, the relevant extract from the Rules is given below in Hindi:

1. Even in case where Hindi version of the text is translated from English version, as per Section 5(1) of Official Language Act, 1963 as amended from time to time, Hindi version of the text is deemed to be authoritative text.

स्पष्टीकरण: इस उप-नियम के प्रयोजनों से, अभिव्यक्ति स्थावर संपत्ति क्रियाकलाप का अर्थ स्थावर संपत्ति की खरीद और बिक्री या हस्तांतरणीय विकास अधिकारों में व्यापार है, लेकिन इसमें बेचने या पट्टे पर देने के उद्देश्य से विकसित की जानेवाली टाउनशिप, आवासीय या वाणिज्यिक परिसरों, सड़कों या पुलों का निर्माण शामिल नहीं है।

The Hindi version of the Rules makes it clear that developing real estate and leasing does not fall under the definition of real estate activities. But purchasing real estate and leasing the same is unquestionably included in the definition of real estate activity. Therefore, in our view, it is reasonable to conclude that DPL would not be permitted to invest in BL as BL would be construed to be engaged in the real estate activity.

Case Study 3: Investment by Resident Individuals [Paragraph 2 of Schedule III of OI Rules]

Case Study

Mr. Investor, a resident of the USA, formed Advisory Inc., a business that offers investment advisory services and was registered in the USA. In addition, Advisory Inc. established MPL as a wholly owned subsidiary in India to offer global investment advisory support services to Advisory Inc. Mr. A, an Indian resident and close friend of Mr. Investor, is contemplating buying 5% of the equity shares in Advisory Inc.

Issue

Whether Mr. A is permitted to acquire equity shares of Advisory Inc.?

Analysis

As per Securities and Exchange Board of India (Investment Advisers) Regulations, 2013 [Last amended on February 07, 2023], 'investment adviser' means any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called. Further, investment advice has also been defined to *inter alia* mean advice relating to investing in, purchasing, selling or investment portfolio containing securities or investment products. Thus, investment advisory services will fall under the category of financial services activity since it is regulated by financial sector regulator in India. Thus, Advisory Inc. is considered to be involved in the financial services business. The relevant extract of Rule 2(1) of Schedule III to OI Rules which is applicable to the facts of this case is reproduced as follows: *A resident individual may make or hold Overseas Investment by way of, inter alia, ODI in an operating foreign entity not engaged in financial services activity and which does not have subsidiary or step-down subsidiary where the resident individual has control in the foreign entity.* (Emphasis supplied)

On a plain reading of the definition, foremost, the foreign company is required to be an operating entity. Secondly, one can contend that in case an individual does not have control over the foreign entity, such foreign entity can have a step-down subsidiary. Thirdly, irrespective of control, investment by an individual in a foreign entity engaged in financial service activity is not permitted as under which scenario

(financial service activity v/s Subsidiary) control criteria should be applicable has not been mentioned expressly in the absence of appropriate punctuation mark in the sentence. Accordingly, it can be argued that regardless of whether Mr. A has control over Advisory Inc. or not, Mr. A is not allowed to invest in Advisory Inc. because it is engaged in financial services activity in view of the fact that the cumulative condition as mentioned above needs to be fulfilled.

However, it is clear from the Hindi version of the Rules that investments by residents in foreign company operating in the financial services sector is permitted when such individual does not have control over the subject foreign company. Therefore, in our view, even though Advisory Inc. is engaged in the financial service activity, Mr. A would be allowed to invest in Advisory Inc. because he plans to acquire 5% of the equity capital of Advisory Inc., without having any control. The relevant extract of the Rules in Hindi is reproduced below for easy reference:

(२) कोई निवासी व्यष्टि निम्नलिखित के माध्यम से पारदेशीय निवेश कर सकता है या बनाए रख सकता है-

(१) किसी परिचालनरत विदेशी संस्था में ओडीआई, जो वित्तीय सेवा क्रियाकलाप में संलग्न नहीं है, और जिसकी कोई अनुषंगी या उप-अनुषंगी नहीं है, जहाँ निवासी व्यष्टि का नियंत्रण उस विदेशी संस्था में हो।

Under ITR, Mr. A would be required to disclose the investment made and resultant income in Schedule FA. Also, while making remittance under Liberalised Remittance Scheme ('LRS') of RBI, from 01st July 2023, authorised dealer will collect tax at source ('TCS') @ 20% without any monetary threshold limit. TCS on remittances prior to 01st July 2023 will be @5% if remittance is > Rs. 7 lakhs.

Case Study 4: Valuation Conundrum [Rule 16 of OI Rules]

Case Study

On 01st April 2023, India Limited invested in equity shares of US Inc. for USD 80 per share. On 15th January 2023, Mr. Valuer, a registered valuer in India, issued his valuation report as on 15th December 2022, which stated that US Inc.'s fair value ranges from USD 70 to USD 90 per share.

Issue

Is this investment permitted under the OI Rules?

Analysis

The OI Rules with regard to pricing guidelines state that a price determined on an arm's length basis must be used for the issue or transfer of equity capital of a foreign entity from a person resident outside India or from a person resident in India ('PRI') to PRI who is eligible to make such an investment. However, there are certain crucial issues relating to valuation norms which are: (i) Who can perform the valuation is not specified in the OI Rules[2]- whether a registered valuer is now eligible

2. As per our practical experience, few banks are still considering the threshold limit given under erstwhile notification no. FEMA 120 concerning who can do the valuation for overseas direct investment

to issue a valuation certificate? (ii) What does the phrase 'arms-length principle' mean? (iii) How long is a certificate of valuation valid once it is issued?[3] (iv) Given that the Rule only mentions ALP and makes no reference to valuation principles for transfer or issue, whether range specified in the valuation report for fair value is implicitly permitted?

RBI in OI Direction has stated that the AD is required to put in place a board-approved policy within 2 months from the date of direction. In a nutshell, major pointers relating to the valuation principles are left to the discretion of the AD Banker, which occasionally may jeopardise the principle of legal certainty in a case where various banks adopt different viewpoints or approaches on valuation.

Case Study 5: Cashless ESOP [Paragraph 3 of Schedule III of OI Rules]

Case Study

An overseas parent company of the Indian subsidiary company has granted a cashless employee stock option plan to Ms. P, a resident of India who works in Indian subsidiary company.

Issue

Whether cashless ESOP is permitted under OI Rules?

Analysis

The moot question in this case study is whether cashless ESOP scheme granted to Indian employee by an overseas parent company is permitted under OI Rules or not. In this regard, Regulation 22 of the erstwhile FEMA Notification No. 120 clearly stated that a person residing in India who is an individual may purchase foreign securities issued by a company incorporated outside of India under a cashless employee stock option plan as long as it does not involve any remittance from India. However, OI Rules regarding the acquisition of shares or interests under Employee Benefit Schemes ('EBS') or Employee Stock Ownership Plans ('ESOP') state that a resident individual is permitted to acquire shares or interests under EBS or ESOP without specifically stating that even cashless employee stock option schemes are permitted.

Cashless ESOP scheme, sometimes called a same-day sale, allows an employee to exercise his stock options without having to pay cash to cover the exercise price. In Paragraph 3 of Schedule III of OI Rules, EBS has been defined as 'any compensation or incentive given to directors or employees of any entity which gives such directors or employees an <u>ownership interest</u> in an overseas entity through ESOP or any similar scheme'. Thus, because an employee receives ownership interest in the equity shares of parent company and is allotted equity shares upon exercise under the cashless ESOP scheme, it can be said that cashless ESOP is covered within the purview of EBS as defined in OI Rules. As

3. As per our practical experience, few banks are considering 90 days timeline for validity of valuation report

a result, cashless ESOPs are permitted under OI Rules as well.

Under ITA, since benefit arising from grant of foreign ESOPs is considered to be comparable to the ESOP perquisite arising u/s 17(2)(vi), tax becomes chargeable upon allotment of foreign shares pursuant to ESOP scheme. Further, the Fair Market Value of foreign shares too would have to be determined by a merchant banker for this purpose. Also, Since the perquisite arising upon allotment of foreign shares is considered to be salary income arising in India, consequently the Indian company should be treated as the 'person responsible for paying' such income which is chargeable to tax in India. Thus, TDS obligation will rest upon Indian employee company. It is to be noted that deferment of tax provision would not be possible since foreign company may not qualify as an 'eligible start up' u/s 80IAC. However, Double Taxation Avoidance Agreement ('DTAA') may shield an Indian employee from taxation in the country of tax residence of the foreign company if such employee would have served employment in India during the vesting period. In ITR, Ms. P would be required to disclose right in shares of the foreign company at the time of vesting as well as the shares allotted upon exercise, and resultant income in Schedule FA.

Case Study 6: Overseas Portfolio Investments [Rule 2(s) of OI Rules]

Case Study

Mr. B, a resident Indian is of the view that the interest rates will fall in the near future resulting in an increase in the prices of bonds. With this investment belief, he has already invested into bonds of HUDCO, REC, NTPC, and SBI that are listed in India. Adopting the same belief, now he wants to invest abroad. He plans to take exposure in overseas bonds as follows:

A. Bonds issued by SBI (London Branch), Bank of Baroda (London Branch) listed outside India

B. Investments in the listed overseas funds which will in turn invest in above overseas bonds

C. Investments in overseas funds (not listed) which will in turn invest in above overseas bonds

Issue

Whether Mr. Bond is permitted to invest in above capital assets?

Analysis

Unlike the erstwhile provision of Notification No. FEMA 120, OI Rules have now defined the expression 'Overseas Portfolio Investment' as investment, other than ODI, in foreign securities, but not in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC. On the perusal of the definition, it seems evident that portfolio investment is not permitted in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC. The above two exclusions are also separately given under FEM (Overseas Investment) Directions, 2022. Given the foregoing, permissibility of investment in aforesaid capital asset by Mr. B would be as under:

A. Bonds issued by SBI (London Branch), Bank of Baroda (London Branch) listed outside India: Mr. B will not be able to make investment in these bonds because even listed debt instruments issued by a person resident in India (as overseas branch of Indian bank is considered as a person resident in India) who is not located in an IFSC are not permitted.

B. Investments in the listed overseas funds which will in turn be investing in above overseas bonds: Mr. B will be able to make investment in these funds because investment in listed foreign funds issued by person other than a person resident in India who is not located in an IFSC falls under the umbrella of overseas portfolio investments.

C. Investments in overseas funds (not listed) which will in turn be investing in above overseas bonds: OI Direction specifically states that investment in units of any investment fund overseas duly regulated by regulator for the financial sector in the host jurisdiction is considered as overseas portfolio investment. Hence, Mr. B will be allowed to invest in these unlisted funds if it is regulated by the regulator for the financial service sector in the host jurisdiction.

Under ITR, Mr. B would be required to disclose the investment made and resultant income in Schedule FA. Also, tax will be collected at source as applicable.

Case Study 7: Equity Capital [Rule 2(e) of OI Rules]

Case Study

Artificial intelligence, machine learning, and other cutting-edge technologies are the focus of AI Inc., a US-based corporation. Mr. Developer, an Indian resident with a significant interest in these types of companies, is contemplating acquiring SAFE Notes of AI Inc. that would offer him the right to acquire shares of the company in the future. In this arrangement, the SAFE Note will automatically be converted into shares of AI Inc. if there is an equity financing round. However, in the occurrence of any liquidity event, such as a change of control or IPO event, Mr. Developer will receive the cash-out amount and the SAFE Note will stand cancelled.

Issue

Whether Mr. Developer is permitted to invest in such an instrument issued by AI Inc.?

Analysis

SAFE (or simple agreement for future equity) notes is typically issued by start-up companies to raise the seed capital. SAFE note formally acts as a legally binding promise to allow an investor to purchase a specified number of shares for an agreed price at a future point of time, usually when the start-up company subsequently raises the funding. The cash-out amount typically means the amount of money that founders or investors receive when they sell their shares or exit the company. The cash-out amount can vary widely depending on a variety of factors, including the stage of

the start-up, the valuation of the company, the terms of any funding rounds, etc. Considering the above, the question is whether overseas direct investment in SAFE Note is permissible under OI Rules?

Firstly, 'overseas direct investment' which is defined in OI Rules permits investment into equity capital of an unlisted foreign entity. Thus, it is crucial to understand the meaning of the term 'equity capital'. The term 'equity capital' has also been defined in OI Rules as: *equity shares or perpetual capital or instruments that are irredeemable or contribution to non-debt capital of a foreign entity in the nature if fully and compulsorily convertible instruments.*

As per the facts of the case, since Mr. Developer will receive the cash-out amount on occurrence of liquidity event (such as a change in control or an IPO), SAFE Note cannot be considered as either equity shares, irredeemable instruments, or fully and compulsorily convertible instruments. As a result, Mr. Developer is prohibited by OI Rules from making an overseas direct investment in AI Inc.

Additionally, although Mr. Developer is prohibited from making investments, provision concerning remittance out of the own funds of an Individual in case of ODI in a start-up will not be applicable since there is no specific regulation in the USA that defines start-up.

Case Study 8: Transfer of Equity Investment [Rule 17 of OI Rules]

Case Study

ABC Private Limited ('ABC'), an Indian company had made investment in the year 2015 of USD 15 million for acquiring 100% share capital of XYZ GmbH ('XYZ'). However, XYZ continuously incurred losses since the incorporation. Apart from the equity investment, ABC had granted loans to XYZ on which interest to the tune of USD 5,000 is still outstanding which is expected to be repaid in 2 months. Also, ABC is yet to realise export proceeds to the tune of USD 4,40,000 from XYZ which is expected to be realised in 4 months. ABC has regularly submitted Form APR for investment into XYZ. PQR Inc., one of the buyer, has informed ABC of its desire to purchase XYZ for USD 8 million. It has claimed that it does not want to prolong the deal, thus, it will pay ABC's o/s receivables by implicitly increasing the purchase price. Another buyer, LMN Inc., is willing to wait until all o/s receivables are realised and has expressed its interest in purchasing XYZ for USD 8 million. Transaction price in both the cases is in accordance with FMV of shares of XYZ.

Issue

Whether ABC should transfer shares to PQR Inc. or LMN Inc.?

Analysis

As per the OI Rules, Where the disinvestment by a person resident in India pertains to ODI–

- ✓ the transferor, in case of full disinvestment other than by way of liquidation, shall not have any dues outstanding for receipt, which *such transferor is entitled to receive from the foreign entity as an investor in equity capital and debt;*

- ✓ the transferor, in case of any disinvestment, must have stayed invested for at least one year from the date of making ODI:... (emphasis supplied)

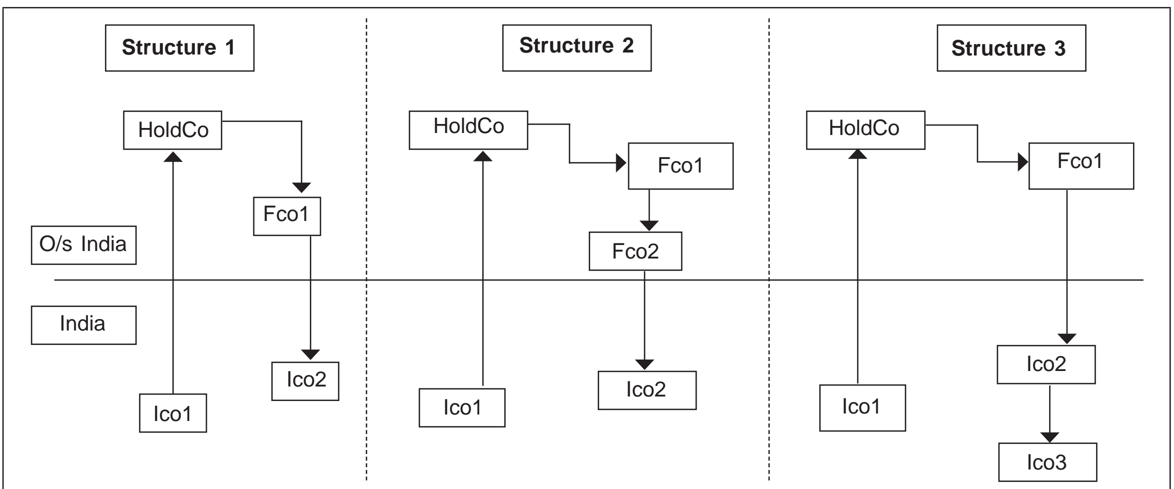
In addition to the aforementioned, OI Regulations states that a person residing in India would not be allowed to transfer such investments or make any further financial commitments until any reporting delays are resolved.

As per the facts of the case, ABC has outstanding receivables from XYZ in the nature of export proceeds as well as interest on loan. As per OI Rules, one of the prescribed condition for write-off permissibility is that the ABC should not have any outstanding dues as an investor in equity capital or debt. As a result, even though ABC is yet to realise export proceeds from XYZ, ABC must first realise outstanding loan interest before being allowed to transfer its equity investment in XYZ. Further, the contention of PQR Inc. that they will pay o/s dues to ABC by jacking up the purchase price will not be permitted under FEMA. As a result, ABC should transfer shares to LMN Inc. after realising o/s interest on loan. It is to be noted that unlike erstwhile FEMA Notification No. 120, OI Rules or Regulation do not prescribe any monetary threshold for write-off of equity capital by an unlisted Indian company.

Under ITA, when ABC transfers shares of XYZ, long term capital loss will arise since ABC has held shares of XYZ for > 24 months and transfer will happen at a price < its cost of acquisition. ABC is also required to adhere to the valuation norms outlined u/s 50CA. The ITA implication will remain same whether ABC transfers shares of XYZ to PQR Inc. or LMN Inc. Also, while investment is in subsistence, details of the same and the resultant income is required to be filled in Schedule FA.

Case Study 9: Round Tripping of Investment [Rule 19(3) of OI Rules]

Case Study



Issue

Whether above structures are permitted?

Analysis

Under the erstwhile provisions of the Notification No. FEMA 120, FAQ No. 64 issued by the RBI did not permit Indian companies to set up Indian subsidiary(ies) through its foreign wholly owned subsidiaries (WOS) or joint venture (JV) nor permitted an Indian company to acquire a WOS or invest in JV that already has direct/indirect investment in India. This arrangement was not considered as engaging in a bonafide business activity and was commonly referred to as "round tripping of investment."

The OI Rules, however, specifically state that no person residing in India shall make a financial commitment in a foreign entity that has invested or invests into India at the time of such financial commitment or at any time thereafter, either directly or indirectly, resulting in a structure with more than two layers of subsidiaries. Round-tripping of investments is thus now allowed, but the arrangement should not include more than two layers of subsidiaries. Consequently, the question has arosen as to from which layer the counting of subsidiaries is to be considered? Does the number starts from an overseas holding company or an Indian company making investment?

The definition of **subsidiary/step-down subsidiary** of a foreign entity means an entity in which the foreign entity has control. Therefore, it is evident from a cursory reading of the definition of 'subsidiary' that this term refers to a company in which the foreign entity has the control. Hence, the starting point for counting of number of layers will be the overseas holding company. Considering the same, structure 1 will be permitted whereas structure 2 and structure 3 will not be permitted since it has more than 2 layers of subsidiaries and considering the fact that step-down sunbsidiary has also defined to mean entity in which foreign entity has control.

Apart from the FEMA implications, Income Tax implications can also arise specifically on the count of applicability of General Anti-avoidance provisions ('GAAR'). The GAAR provisions were introduced in the Income Tax Act, 1961 by the Finance Act, 2012, and they became effective from April 1, 2017. The GAAR empowers the tax authorities to investigate and deny tax benefits to any transaction or arrangement that is considered to be an 'impermissible avoidance arrangement'. GAAR provisions were introduced to provide a deterrent to aggressive tax planning and to ensure that taxpayers do not misuse the provisions of the tax laws. Thus, before creation of any structures, GAAR provisions should be taken into consideration. GAAR can be applied where taxpayers intentionally misuse or abuse the tax laws to achieve a tax advantage that was not intended by the legislature. Tax advantage in structuring can arise by (i) taking advantage of double tax avoidance treaties between countries by creating structures that allow the profits to be taxed in a country that offers a lower tax rate including artificially creating entities in tax haven jurisdictions to reduce their tax liabilities in India. (ii) routing domestic funds through offshore entities in order to avoid taxes (iii) misuse tax exemptions and deductions by artificially creating situations that qualify for such benefits. GAAR is a set

of rules designed to prevent tax avoidance schemes in India. The tax authorities may examine the business purpose or economic substance of the transaction or arrangement to determine whether it has a valid commercial purpose beyond tax avoidance. The tax authorities will assess whether the transaction or arrangement is an artificial or contrived arrangement that has no real economic substance or commercial purpose, and is designed solely to obtain the tax benefit.

Akin to the GAAR provisions in the domestic tax law of India, many of the DTAA entered into by India includes the provisions of Principle Purpose Test ('PPT'). PPT is a key feature of the Base Erosion and Profit Shifting ('BEPS') initiative led by the Organisation for Economic Co-operation and Development ('OECD'). The PPT is designed to prevent treaty abuse by denying treaty benefits to taxpayers who engage in transactions that are primarily motivated by obtaining those benefits. In other words, the PPT requires a tax authority to examine the facts and circumstances surrounding a transaction or arrangement to determine if one of the principal purposes was to obtain treaty benefits, rather than to conduct genuine business activities. If such a purpose is found, the treaty benefit can be denied, subject to the exception for situations where granting the benefit would be in accordance with the object and purpose of the relevant treaty provisions.

Concluding remark

The new regime simplifies the existing framework for overseas investment by person resident in India to cover wider economic activity and significantly reduces the need for seeking approvals. This will reduce the compliance burden and associated compliance costs. However, clarifications from the regulator on some contentious issues would be a welcome step and well-received by India Inc.

Overall, ODI from India is expected to continue to grow in the coming years, as Indian companies seek to expand their global presence and tap into new opportunities. The government's continued support for ODI, coupled with efforts to improve the ease of doing business in India, are likely to further facilitate this trend and help Indian companies to become more globally competitive.

■●■

"the mind is in three states, one of which is darkness, called Tamas, found in brutes and idiots; it only acts to injure. No other idea comes into that state of mind. Then there is the active state of mind, Rajas, whose chief motives are power and enjoyment. "I will be powerful and rule others." Then there is the state called Sattva, serenity, calmness,"

— *Swami Vivekananda*

Ms. Varsha Galvankar

CA Niraj Chheda

Overseas Investment - Income Tax Issues

In recent years, India's overseas investments have evolved radically, not only in terms of volume but also in terms of regulatory framework. With significant changes and relaxations brought in for investments in foreign countries by the new framework in August 2022, Indian entities and individuals are actively venturing out for investment opportunities globally. This coupled with changing market landscape may result in increasingly complex structures, with different kinds of investment modes available and varied types of investment instruments.

Apart from compliance under the Foreign Exchange Management Act ('FEMA') provision, it is also important to consider tax aspects and disclosure requirements while undertaking overseas investment. This article throws light on a few peculiar tax issues faced in the case of overseas investment and its reporting under Indian Income tax law.

Requirements for filing return of income

Section 139(1) of the Income Tax Act, ('the Act') requires every person, other than a company, to file the return of income if his total income exceeds the maximum amount not chargeable to tax. However, the fourth proviso to Section 139(1) requires a resident and ordinarily resident ('ROR') to file the return of income in the case where the beneficial owner holds any asset including any financial interest in any entity located outside India or has signing authority in any account outside India or is a beneficiary of any asset located outside India at any time during the previous year.

Thus, the beneficial owner/beneficiary of foreign assets is required to file an income tax return irrespective of taxable income. Relaxation from filing an income tax return is provided in the case of a beneficiary if the income arising from such asset is includible in the hands of the beneficial owner.

All persons have to mandatorily disclose all foreign assets and incomes from any source outside India in Schedule Foreign Assets and Incomes ('Schedule FA') forming part of the Return of Income, failing which there can be severe penal and other consequences, including those under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (commonly referred to as 'Black Money

Act'). In the case of individuals, such reporting is required only if he is a ROR. The reporting is required even in cases where the individual is merely a signing authority of a bank account even though such a person is not the beneficial owner/ beneficiary of such bank account. Thus, the bank account of an overseas company where the individual is a signing authority is also required to be disclosed in his tax return.

ROR and all other persons undertaking overseas investments should ensure that accurate reporting of such investments and income is done in Schedule FA. This may also extend to people who are joint holders in overseas investment.

Investment by minor and disclosure requirements

Recently, minors have received income tax notices for foreign remittances made from their bank account under Liberalised Remittance Scheme ('LRS'). Under LRS, all resident individuals, including minors, are allowed to freely remit up to USD 2,50,000 per financial year (April – March) to acquire stocks/equity shares, immovable properties and hold bank accounts. Since there is an upper cap on the funds that can be remitted outside India, money is pooled from the bank accounts of other family members including those of minors.

India has signed agreements for the Exchange of Information with various jurisdictions which may also provide information about foreign assets to the concerned authorities in India. The said notices might have been issued to verify the source of income for the remittances and whether or not any assets held outside India have been disclosed by them or their parents.

In most cases, money is gifted to minors in their Indian bank account and from which the remittances are made to acquire the asset. The income earned on such investment is clubbed in the hands of the parent and offered to tax accordingly. However, at times there may be a lapse in disclosing the foreign assets held by a minor.

In such cases where a minor is a beneficial holder of foreign assets, income tax authorities may contend that the fourth proviso to Section 139(1) is applicable and the minor should have filed an income tax return and disclosed the foreign assets irrespective of income. In a case where the parent has disclosed the foreign asset held by the minor in his tax return, one may contend that penal provisions should not apply as foreign assets have been disclosed albeit in the tax return of the parent. Even where a minor has disclosed foreign assets in his tax return, parents would be required to disclose the bank account since in most cases they would be signatories to the bank account.

Impact of TCS on overseas investment

The Finance Act, 2023 hiked tax collection at source ('TCS') for remittances under LRS with effect from 1st July, 2023 to 20% without any threshold limit for other than specified cases, which include overseas investment by an individual. Earlier TCS for such cases was 5% for remittances in excess of INR 7 Lakhs. Though TCS can be claimed as a credit against the tax liability, it can result in blockage of funds in the absence of sufficient tax liability.

In case, the minor's bank account is used to remit the fund outside India under LRS, TCS will be collected and deposited under the minor's PAN.

In the case of TDS, Rule 37BA provides a mechanism whereby the deductee can file a declaration with the deductor to credit TDS in favour of another person in whose hands the income is assessable. However, no such corresponding provisions are expressly provided in the case of TCS. Further Rule 37-I expressly mentions that credit for TCS shall be given to the person from whom the tax has been collected.

In the above case, a question arises whether a minor can claim a refund while filing the return of income even if the corresponding income is offered in the parent's tax return.

Issues around the taxability of Capital Gains

Rule 115 of the Income-tax Rules provide an exchange rate for the conversion of income earned into foreign currency. In case of capital gains, the telegraphic transfer buying rate of such currency on the last day of the immediately preceding month of transfer has to be used for conversion into Indian rupees.

Rule 115 requires capital gains to be converted into Indian rupee as per the exchange rate specified. Hence, it is possible to contend that capital gains should be computed having regard to the provisions of the Act and the gains so computed in foreign currency should be converted in accordance with the Rule. Thus for example, suppose a resident individual has purchased a stock at USD 100 in 2010 when the exchange rate was say 45 and sold it for USD 250 in 2022 when the exchange rate is say 75, individual may calculate capital gains in foreign currency including indexation benefit and the capital gains so computed would be converted into INR.

Particulars	***in USD***	***in INR****
Sale Consideration (A)	250	18,750
Cost of Acquisition (B)	100	4,500
Indexed Cost of Acquisition [C =B *331/148]	224	10,064
Capital Gains (D = [A-C])	26	8,686
Specified Exchange Rate	75	
Capital Gains in INR	1,976	8,686
* assuming exchange rate as on date of transaction		

In the above case, it is possible to contend that capital gains chargeable to tax is INR 1,976. This view can be supported by relying on the decision of the Mumbai Tribunal in the case of ***DCIT vs. Hollandsche Aanneming Maatschappij (107 TTJ 268)***, whereby the Tribunal had held in the context of Profit and Gains of Business and Profession that "*In our considered views, it is not the mandate of the IT Act that computation of income under the head Profits and gains of business or profession should necessarily be done in Indian rupee. If any foreign company is working in India and is receiving foreign exchange, spending money in foreign exchange, then computation of income can be done in such foreign exchange and in the process, allowance as per IT Act has to be allowed in terms of that foreign exchange only. The income so finally worked out will then be converted into Indian*

rupee at the exchange rate on the specified date which is the last day of the accounting period. But where foreign exchange has already been received by the assessee in its Indian bank account, then this rule would not be applicable as per the decision of the Hon'ble Supreme Court in the case of Chowgule & Co. Ltd. (supra)." However, this view may not be free from litigation.

This is in stark contrast to inbound investment by a non-resident in shares of an Indian company, where the first proviso to Section 48 read with Rule 115A specifically provides for computation of capital gains in foreign currency and re-conversion into Indian rupees without the benefit of indexation.

It is possible that the taxability of capital gains on foreign mutual funds invested by resident individuals under LRS may be affected by the provisions of newly inserted Section 50AA vide Finance Act, 2023. Capital gains from specified mutual funds i.e. those not investing more than 35% in equity shares of domestic companies shall be deemed as short-term capital gains irrespective of their period of holding. Since foreign mutual funds would not satisfy this condition, capital gains arising from the sale of such mutual funds can be deemed as short-term capital gains in the hands of investors and taxable at slab rates without any indexation benefit which may or may not be the intention of the Government. Individuals may explore exemptions under Section 54F in such cases.

Disclosure of Foreign Equity Shares in ITR Form

Assessee has to report unlisted equity shares held any time during the relevant previous year in the income tax return. When it comes to overseas investment, equity shares of foreign unlisted companies are also required to be reported even if reported under Schedule FA. However, it is important to note that reporting under this clause for equity shares is required as per the relevant previous year, unlike the calendar year followed in schedule FA. In the case of Form ITR-6 (applicable to Companies other than companies claiming exemption u/s 11), the unlisted equity shares disclosure requirement forms part of Schedule Assets and Liabilities ('Schedule AL').

Usually, equity shares listed on a stock exchange outside India are treated as unlisted shares for the purpose of tax computation. However, Instructions to ITR forms have clarified that equity shares of companies listed on a recognised stock exchange outside India are not required to be reported under the unlisted equity clause.

The ITR forms and instructions, do not expressly specify any conversion/exchange rate to value foreign unlisted equity shares for reporting. Since the disclosure requires reporting of the cost of acquisition and/or sales consideration, one may take reference from Instructions to Schedule FA and use the telegraphic transfer buying rate of the foreign currency as on the transaction date to report the values in INR as required in the case of Schedule FA. A similar view can be taken for the conversion of foreign currency assets while filling Schedule AL.

Instructions to ITR forms have clarified that the details provided under this clause are not relevant for the purpose of computation of total income or tax liability.

It is important to note that Resident but Not Ordinarily Resident Individuals who are not required to disclose their foreign assets or income, also need to disclose their unlisted foreign shares under this clause.

Issues around Foreign Tax Credit (FTC)

Residents can claim credit for the taxes paid in the foreign state by filing Form 67 with the Income Tax Department. The due date of filing Form 67 has been extended (end of relevant Assessment Year) to address the issue faced by several assessees in claiming FTC in cases where their foreign tax returns were not finalized by the due date of Indian tax return filing.

- ***Income from Different Countries***

Assume an individual has capital gains from Country A and India and capital loss from Country B. Question arises is there any specific priority in which the loss can be set off to optimise the foreign tax credit.

Particulars	Country A	Country B	India	Total in India
Capital Gains/Capital loss	100	-50	100	150
Tax Rate in respective country	10%	10%	20%	20%
Gross Tax				30
FTC that can be claimed	10	0	NA	10
Net Tax				20

In the above case, if the loss of country B is first adjusted with the gain of country A, then FTC would be proportionately reduced to the extent of doubly taxed income (FTC in this case would be 5). On the contrary, if the loss of country B is adjusted with gains in India first, full FTC (of 10) can be claimed thereon. This continues to be an open question whether the assessee can set off losses in a manner that is beneficial to him.

- ***Claim of FTC and deduction under Section 80M***

In case a foreign company distributes profits by way of dividend to its parent company in India, which in turn upstreams the income earned by way of dividend to its shareholders before the specified date, the Indian company can claim a deduction u/s 80M for the dividend income to the extent distributed further.

It would be interesting to note, whether an Indian company can claim FTC along with a deduction under section 80M for the dividend distributed further. One may take a view that an Indian company may not be able to claim FTC for taxes paid outside India if the entire dividend income included in its gross total income is claimed as a deduction under section 80M since such income may not be considered as a doubly taxed income.

An alternative view can be that the foreign dividend income is included in the

Gross Total Income and subsequently, the deduction is claimed under Chapter VI-A. However, the deduction may not mean that the corresponding income has not been charged to tax. A possible argument can be Section 80M(2) provides a deduction in respect of dividends distributed by the Indian company capped to the amount of dividend income included in gross total income. If this view is adopted, one may claim FTC. However, the first view seems to be plausible.

- ***Issues around income characterisation***

There may be some challenges in claiming FTC in cases where countries characterise income differently. For example, if the buyback of foreign shares is treated as capital gains in the foreign country while in India to the extent of accumulated profits may be treated as a dividend.

Transfer Pricing Issues

- ***Investment in shares***

Indian transfer pricing regulations define the term 'international transactions' in an inclusive manner which includes capital financing transactions. However, the Hon'ble Bombay High Court, in the landmark case of Vodafone India Services (P.) Ltd . has principally held that investment in shares is on capital account and does not give rise to any income to trigger the provisions of Chapter X of the Act. This has been followed in case of outbound investment by, the Hon'ble Bombay High Court, in the case of PMP Auto Components (P.) Ltd.

However, with respect to reporting requirements in Form 3CEB, it is pertinent to note that in the case of BNT Global (P.) Ltd. , a penalty was imposed u/s 271BA for non-furnishing of Form 3CEB with respect to issuing shares at a premium to a non-resident director. The Mumbai ITAT distinguished this case from Vodafone judgement (supra) stating that the facts of the case were different and AO neither attempted nor made any adjustment to the ALP for the issue of equity shares at a premium to its NRI Director and solely intended to raise penalty u/s 271BA for non-reporting of transaction in Form 3CEB. It was concluded that the assessee had entered into an international transaction and non-reporting was a clear violation of section 92E and thus penalty was levied u/s 271BA.

Thus, the acquisition of shares in a foreign company must be duly reported in Form 3CEB and supported with a valuation report in cases other than a subscription of the memorandum.

- ***Corporate Guarantee (Financial Commitment)***

Increasing outbound investments have resulted in an increase in financial transactions between Indian and foreign companies.

In the past, there were controversies about whether the corporate guarantee is an international transaction in the absence of bearing on profits, income, losses, or assets of the enterprise. However, this seems to be now settled with the specific inclusion of guarantee under capital financing transaction in the explanation (i)(c) to section 92B [Inserted by Finance Act, 2012] in relation to the definition of International Transaction.

Guarantee has been one of the most debatable issues with divergent views from taxpayers and tax officers. The

issues surround the arm's length rate for guarantee fees and whether the guarantee is a shareholder function for the furtherance of its own business.

The transfer pricing officers tend to consider bank rates, open rates on the bank website as comparable for corporate guarantee fees without factoring in the nature, mutual understanding between the parties, terms and conditions of the guarantee, risk profile, quantum etc. The Tribunals in various cases after considering relevant factors have upheld corporate guarantee fees in the range of 0.3% to 0.5% as arm's length. Even the Transfer Pricing Safe Harbour provisions have rationalised the commission/fee rate to 1% p.a. on the amount guaranteed in case of corporate guarantee, which may still be higher.

Conclusion

With enhanced use of technology, integration of systems and active exchange of information amongst countries, the Income Tax Department now is equipped to keep a tab on taxation and reporting of overseas investment. This is evident from tax notices issued to assessees having foreign investment and/or income thereon.

Valuation and reporting of overseas investments are of importance not only under FEMA regulations but also under Indian tax and transfer pricing law. With this in the backdrop, a taxpayer needs to be extra cautious and has to ensure correct disclosure and taxability of such investment, to not attract any consequences under the Income Tax or Black Money Act. Indian entities and individuals undertaking overseas investment should ensure adequate substance outside India and take due care in establishing an appropriate management body to mitigate POEM exposure for foreign companies in India.

This Article focuses on issues currently faced which will keep on evolving and get complex as we see a rise in outbound investments.

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"Take up one idea. Make that one idea your life - think of it, dream of it, live on that idea. Let the brain, muscles, nerves, every part of your body, be full of that idea, and just leave every other idea alone. This is the way to success."

— *Swami Vivekananda*

"you should work like a master and not as a slave; work incessantly, but do not do slave's work."

— *Swami Vivekananda*

Keshav B. Bhujle
Advocate

DIRECT TAXES
Supreme Court

1 ***ACIT vs. Godrej and Boyce Manufacturing Co. Ltd.; [2023] 453 ITR 14 (SC): Dated 02/01/2023***

Reassessment — Notice u/s. 148 — Sanction of prescribed authority — Principal Commissioner himself earlier dropping revision proceedings on ground on which reassessment proposed — Sanction given without application of mind — Notice not valid: Ss. 147, 148, 151 and 263 of ITA 1961: A. Y. 2012-13

For the A. Y. 2012-13 the Assessing Officer issued notice u/s. 148 of the Income-tax Act, 1961. The assessee filed writ petition and challenged the notice. The Bombay High Court allowed the petition and held as under:

"i) The sanctioning authority u/s. 151 of the Income-tax Act, 1961 is duty bound to apply his or her mind to grant or not to grant approval to the proposal put up before him to issue notice u/s. 148 to reopen an assessment u/s. 147 to the material relied upon by the Assessing Officer for reopening the assessment. Such power cannot be exercised casually in a routine and perfunctory manner.

ii) One of the reasons recorded for reopening the assessment u/s. 147 of the Income-tax Act, 1961 being the claim for deduction of the diminution in the value of investment in a subsidiary, had already been considered by the Principal Commissioner, who in his revision order u/s. 263 had dropped the proceedings initiated accepting the reply of the assessee and rejecting the audit objection. The Principal Commissioner had accorded the approval u/s. 151 which showed non-application of mind by the Principal Commissioner while according approval for reassessment without considering all documents including his own earlier order passed dropping proceedings u/s. 263.

iii) The notice u/s. 148 and the order passed on the objections of the assessee were quashed and set aside."

The Supreme Court dismissed the Special Leave Petition fields by the Revenue and held as under:

"We are not inclined to interfere with the judgment and order impugned in this petition. The special leave petition accordingly stands dismissed."

2 *Anil Minda vs. CIT; [2023] 453 ITR 1 (SC): Dated 24/03/2023:*

Search and seizure — Block assessment — Limitation — To be reckoned from date of last panchnama, not date of last warrant of authorisation

During the execution of a search warrant dated March 13, 2001, the Income-tax authorities got information about a locker belonging to the assessee in a bank. Therefore on March 26, 2001, a second authorisation was issued for searching the locker and the search was executed on March 26, 2001 itself. Notice u/s. 158BC was issued for block assessment. The assessee filed his return and the assessment was completed in April, 2003. Similar assessment orders were passed in the case of other assessees.

The assessees filed appeals challenging the assessment orders, inter alia, on the ground that the assessment was time barred, contending that the two-year period as prescribed u/s. 158BE(b) of the Act from the date of the panchnama drawn on March 26, 2001, came to an end by March, 2003 and the assessment order was passed in April, 2003. The Commissioner (Appeals) dismissed the appeals. However, the Tribunal held that the assessment orders were barred by limitation.

On appeal by the Revenue, the Delhi High Court held that as the last panchnama though related to search authorisation dated March 13, 2001 was executed on April 11, 2001, limitation of two years was to be computed from April 11, 2001 and the assessments were within time.

The Supreme Court dismissed the appeals filed by the assessee, and held as under:

"i) The relevant date from which limitation for a block assessment pursuant to a search operation is to be reckoned, would be the date on which the panchnama is drawn and not the date on which the authorisation is issued. Block assessment proceedings are initiated on the basis of the entire material collected during the search and on the basis of the respective panchnama drawn. Therefore, the date of the panchnama last drawn can be said to be the relevant date and can be said to be the starting point of limitation of two years for completing the block assessment proceedings. If the date of the last authorization were considered for the purpose of starting point of limitation of two years, the entire object and purpose of Explanation 2 to section 158BE of the Income-tax Act, 1961 would be frustrated. There may be a number of searches. Thus, the date of the panchnama last drawn would be the relevant date for considering the period of limitation of two years and not the last date of authorization.

ii) The view of the High Court was right."

■●■

Jitendra Singh
Advocate

Radha Halbe
Advocate

Harsh Shah
Advocate

DIRECT TAXES

High Court

Business expenditure - Section 37(1) of the Income-tax Act, 1961 - expenditure though related to earlier period got crystallized during year under consideration - thus was incurred wholly and exclusively for carrying on business and hence deductible expenditure. [S. 145]

Facts

1. The assessee had claimed Rs 4.08 crore as prior period expenditure on account of same having crystallised during the year though it related to earlier years.

2. The AO while finalizing the assessment disallowed the same by observing that according to the accounting standard, the expenses are debited to the profit and loss account on accrual basis and the unpaid expenses are made provisions in the balance sheet and any expenses accrued but not settled during any year are debited in the year of accrual and any deviation on settlement is charged in the profit and loss account as income or expenses as applicable in the following years. Thus, assessee having not followed the mercantile system of accounting in respect of prior period expenses debited in the profit and loss account for the current year the same is not allowable expenditure.

3. On appeal the first appellate authority allowed the claim of the assessee on the ground that the Ld. CIT(A) has allowed the claim in earlier assessment years. On further appeal by the department, the Appellate Tribunal also upheld the order of the Ld. CIT(A). The department being aggrieved by the order of the Appellate Tribunal filed an appeal before the Hon'ble Calcutta High Court under section 260A of the Act.

Arguments of the assessee

4. The assessee referring to Section 145 of the Act, submitted that the said provision is a mandatory provision which compels the department to accept the system or method of accounting regularly employed by the assessee for ascertaining the profits from the business or profession carried on by him or the income from other source subject to its being the proper method of reflecting the true or correct profits. After referring to the item No. 7 of Accounting Standards- II (AS II), it was stated that the statute itself prescribes

the manner of disclosure of expenses relating to prior period, which arises in the previous year as a separate item. Thus, the expenses are claimed by the assessee are allowable.

Arguments by the department

5. The department contended that the Appellate Tribunal while allowing the claim of the assessee has not verified the facts. Hence, the claim of the assessee is not allowable.

Hon'ble Court's ruling

6. Hon'ble Calcutta High Court after considering the facts of the case and decisions cited held that the tribunal correctly allowed the claim of deduction on account of prior period expenditure as it crystallised during the year.

PCIT vs. Balmer Lawrie & Co. Ltd. [2023] 149 taxmann.com 286 (Calcutta)

Refunds - Section 241A, read with section 143 of the Income-tax Act, 1961 – withholding of refund due as per intimation order passed under section 143(1) without giving details of issues which requires examination during the assessment proceedings- unjustified. [S. 143(1)]

Facts

1. The assessee filed a return of Income Tax for AY 2020-2021 declaring a loss of ₹ 16,13,83,22,476/- and claimed a refund of ₹ 31,46,26,494/- on account of tax deducted at source under Section 139 of the Income Tax Act, 1961. Pursuant to a de-merger and to give effect to the Scheme of Arrangement, the Assessee filed a revised return of Income Tax for AY 2020-2021 on 27.03.2021 [hereinafter "Revised Return"] declaring a loss of ₹ 16,70,16,05,998/- and claiming a refund of ₹ 43,91,40,294/-.

2. The return filed by the Assessee was selected for scrutiny assessment by issuing the statutory notices under section 143(2) and 142(1) of the Act. The Assessee submitted a response to the same on 27.12.2021. On the same day, the Assessee received an intimation under Section 143(1) of the Act which stated that a refund of ₹ 33,05,84,840/- (inclusive of interest) has been calculated as due to the Assessee [hereinafter "Refund Intimation"]. The Refund Intimation also stated that the refund shall be credited within a period of 15 days from that date.

3. However, despite the lapse of several months after the passing of the Refund Intimation, no refund was received by the Assessee. Aggrieved by the inaction of the Respondents, the Assessee filed online complaints on the Income Tax Portal on 14.05.2022 and 16.06.2022 seeking disbursal of the refund amount as determined under the Refund Intimation. This was followed by detailed letters dated 06.09.2022 and 21.09.2022 sent to the Respondents seeking disbursal of the refund amounts.

4. Since no response was received, the Assessee requested an inspection of the file and records of AY 2020-2021 and asked for a copy thereof by its letter dated 11.11.2022. In response thereto, the Revenue by an email of even date, informed the Assessee that its refund has been withheld in view of a letter dated 07.06.2022 received from the Faceless Assessment Unit of the

Respondent. The letter dated 07.06.2022, however, did not contain any enclosures or reasons for the withholding of the refund of the Assessee.

5. The assessee being aggrieved by the inaction of the department in not issuing the refund approached the Hon'ble Delhi High Court.

Hon'ble Court's ruling

6. Hon'ble Delhi High Court allowed the claim of the assessee by observing that the power to withhold a refund can be exercised under Section 241A of the Act. A refund may be withheld subject, however, to reasons being recorded in writing on how the grant of refund in the opinion is "likely to adversely affect revenue". It is well settled that a refund cannot simply be withheld if an Assessee is selected for scrutiny assessment or where a notice has been issued under sub-section (2) of Section 143 of the Act. In the present case, there were no worthwhile reasons recorded in writing. The reasons for withholding the refund are simply that the case was selected under CASS with a large number of "issues" to be examined. However, no details of any issue which requires examination has been set forth. There is then a passing mention of the fact that "it is also referred to transfer pricing", however, what has been referred, is absent. No other details are given either. The High Court held that Merely because a notice has been issued under Section 143(2) of the Act, it is not a sufficient ground to withhold the refund under the provisions of the Act. Thus, where Assessing Officer by impugned order withheld refund of TDS requested by assessee, a well-reputed company with a large net worth running into several billion, on mere ground that assessee's case was selected for scrutiny with numerous issues to be examined, since said reasons nowhere mentioned details of any such issue which required examination, impugned order is to be set aside.

OYO Hotels & Homes (P.) Ltd. vs. Dy ACIT [2023] 148 taxmann.com 410 (Delhi)

Immunity from levy of penalty – Section 270AA of the Income Tax Act – Order passed without providing an opportunity of being heard before rejecting immunity application under Section 270AA is void ab initio. [S. 270A of the Act]

Facts

1. The assessee before the Hon'ble Delhi High Court is an individual and had filed his return for the assessment year 2020-2021 on 16.12.2020 declaring a total income of ₹ 1,73,72,262/-. The return was picked up for scrutiny under section 143(3) of the Act.

2. The AO finalised the assessment vide order dated 23.09.2022 under section 143(3) of the Act. In the said assessment order the AO made disallowance of ₹ 22,08,857/- by treating certain expenditures to be personal expenses of the assessee.

3. Pursuant to the assessment order:

   (ii) the AO issued a notice of demand dated 23.09.2022, raising a tax demand of ₹ 9,37,329/- which was duly paid by the assessee on 24.09.2022

(iii) the AO also called upon the taxpayer to show cause why penalty under section 270A of the Act should not be levied. The said penalty notice was followed by another notice dated 14.12.2022.

4. The assessee filed an application under section 270AA(2) on 19.12.2022 seeking immunity from penalty proceedings. The application filed by the assessee was rejected without providing an opportunity of being heard. The assessee being aggrieved by the said order, challenged the same before the Hon'ble Delhi High Court.

Assessee's arguments

5. The assessee contended before the Hon'ble Delhi High Court that he had substantially complied with all conditions for availing the immunity under section 270AA of the Act. The assessment order was accepted, the demand was discharged and an appeal against the said assessment order was also not filed. Though, the application was filed after the delay of 48 days, the delay in filing of the application under section 270AA of the Act was on account of some technical glitches in the portal which prevented the said application from being uploaded within time. The assessee further contended that his application was rejected without providing any opportunity of hearing and while considering an application under section 270AA, the concerned authority has the power to condone delay.

Departments arguments

6. The department on the other hand supported the order passed by the lower authorities.

Hon'ble Court's ruling

7. Hon'ble High Court set aside the order passed under section 270AA of the Act by observing that the proviso to sub-section(4) of section 270AA of the Act makes it amply clear that before an application is rejected, the applicant must be given an opportunity of being heard. In the present case, there is no dispute that the assessee was not afforded the said opportunity. Thus, the impugned order is set aside as the same has been passed without following the procedure as set out in section 270AA(4) of the Act and the matter is remanded back to consider the assessee's application under section 270AA of the Act afresh. (AY 2020-21)

Rohit Kaput vs. Pr. CIT [2023] 148 taxmann.com 397 (Delhi)

Statutory defects in Assessment order – section 292B of the Income Tax Act, 1961 – object of Circular No. 9 of 2019 is to have an audit trail on the communications relating to assessments, appeals, orders, etc. - Hence, manual assessment orders passed without DIN, can have no standing in law

Facts

1. In the present case, final assessment order was passed by the Assessing Officer (AO) on 15.10.2019, under Section 147/144(C)(13)/143(3) of the Act which did not bear a Document

Identification Number (DIN) in terms of Circular No. 19 of 2019 issued by Central Board of Direct Taxes (CBDT).

2. The assessee challenged the legal validity of the same before the Hon'ble Appellate Tribunal. The Appellate Tribunal allowed the ground of the assessee and quashed the assessment order passed without having DIN.

3. The department being aggrieved by the order of the Appellate Tribunal filed an appeal before the Hon'ble Delhi High Court under section 260A of the Act.

Arguments of the Assessee

4. The assessee contended before the Hon'ble Delhi High Court that the Circular No. 9 of 2019 issued by the CBDT is binding on the revenue authorities. Thus, any assessment order passed without DIN suffers from jurisdictional error which cannot corrected taking recourse to section 292B of the Act.

Arguments of the Department

5. The department contended that circular only applies to the communications emanating from the revenue, and not vis-à-vis the substantive orders passed qua the assessee. Thus, failure to generate and allocate DIN in the present case is a mistake or at best, a defect and/or an omission, which ought not to invalidate the assessment proceedings.

Hon'ble Court's ruling

6. The Hon'ble Delhi High Court dismissed the appeal of the department by observing that the CBDT issued a Circular No. 19 of 2019 dated 14.08.2019 setting out the requirement to generate a DIN while communicating a notice, order, summon, letter and any correspondence issued by the Income Tax Department, i.e., the Revenue.

7. Hon'ble Delhi High Court further observed that the object and purpose of allocating DIN to the communications, such as notices, orders, summons, letters and/or any correspondence emanating from the revenue was to maintain a proper audit trail. Therefore, the CBDT, in exercise of its powers, mandated that no communication shall be issued by any income tax authority relating to assessment, appeals, orders, statutory or otherwise, exemptions, enquiry, investigation, verification of information, penalty, prosecution, rectification, approval etcetera, to the assessee or any other person, on or after 01.10.2019 unless it is allotted a computer-generated DIN. Further, there is a specific requirement under the 2019 Circular to quote the DIN in the body of any such communication.

8. The Hon'ble Court also observed that the 2019 Circular sets out certain circumstances in which exceptions can be made:

(ii) when there are technical difficulties in generating/allotting/quoting the DIN and issuance of communication electronically

(iii) when communication regarding enquiry, verification etc. is required to be issued by an income-tax authority, who is outside the office, for discharging his official duties

(iv) when due to delay in PAN migration, PAN is lying with non-jurisdictional Assessing Officer

(v) when PAN of assessee is not available and where a proceeding under the Act (other than verification under section 131 or section 133 of the Act) is sought to be initiated

(vi) When the functionality to issue communication is not available in the system

Insofar as the exceptions given in (i), (ii) and (iii), the authority is required to take steps to regularise the failure to quote DIN within fifteen working days. In case of exception (v) an intimation of issuance of manual communication shall be sent to the Principal Director General of Income-Tax (Systems) within seven (7) days from the date of its issuance.

9. The Hon'ble Court also observed that the 2019 Circular mandates alignment of all pending assessment proceedings, where notices were issued manually, prior to the issuance of the said circular, by having them uploaded in the system by 31.10.2019.

10. In the case before the Hon'ble Court there was nothing on record to show that, according to the revenue, failure to allocate DIN arose out of the five "exceptional circumstances". The case of the revenue was that failure to allocate DIN was a mere mistake and that the mistake can be corrected by taking recourse to Section 292B of the Income Tax Act, 1961. It was also urged on behalf of the revenue that the circular only applies to the communications emanating from the revenue, and not vis-à-vis the substantive orders passed qua the assessee.

11. In such circumstances, the Hon'ble Court held that the final assessment order did bear the mandatory DIN and further there was nothing on record to show that such absence of DIN was on account of any one of the five allowed exceptions. Accordingly, in terms of the 2019 Circular, any communication does not bear the DIN shall be treated as invalid and shall be deemed to have never been issued. The 2019 Circular communication of assessment order, in the category of communication which are non-est in law. No recourse can be taken to Section 292B of the Act having regard to the phraseology used in paragraph 4 of the 2019 Circular. (AY 2011-12)

CIT vs. Brandix Mauritius Holdings Ltd. [ITA No. 63 of 2023, dated 20th March 2023, Delhi High Court]

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"Do not criticise others, for all doctrines and all dogmas are good; but show them by your lives that religion is no matter of books and beliefs, but of spiritual realisation."

— *Swami Vivekananda*

Tanmay Phadke
Advocate

CA Viraj Mehta

CA Kinjal Bhuta

DIRECT TAXES

Tribunal

1 *Ajay Kothari vs. ITO [ITA No. 2823/Mum/2022 dt. 03/04/2023 (Mum)(Trib.) (AY 2013-2014)*

Section 56 – Income from Other Sources – Rent Received from builders on account of redevelopment for alternate accommodation – Hardship allowance – Not taxable as income from other sources

Facts

During the assessment proceedings, AO observed from the capital account that assessee has shown a receipt of of ₹ 3,73,191/- as a capital accounts receipt from the builders. It was submitted that such amount is a monthly rental compensation from the builder for rent of alternate accommodation as his building has gone for redevelopment. AO observed that rent received is a revenue receipt in the form of alternate accommodation rent provided by the builder for development of his residences. Further, assessee has not utilized any amount of its receipt for his alternate accommodation. Accordingly, he treated the above amount as income of the assessee and taxed under the head "income from other sources". CIT (Appeals) confirmed the action of AO. Being aggrieved with the same, appeal before ITAT is filed.

Held

Assessee has received ₹3,73,191/- from the builder for alternate accommodation. However, assessee has not utilized these funds for any accommodation. However, he adjusted and lived with his parents. It clearly indicates that even though assessee has not utilized the rent received for his accommodation, however, assessee has faced hardship by vacating the flat for redevelopment and also adjusted himself during the period. Coordinate Bench in case of ***Smt. Delilah Raj Mansukhani vs. ITO (ITA No. 3526/Mum/2017)*** was also relied upon. It was concluded that receipt of compensation for hardship is in the nature of capital receipt and accordingly addition was deleted.

2 *Manohar M Paliwal vs. ITO [ITA No. 51/Mum/2023 dt. 31/03/2023 (Mum) (Trib.)(AY 2018-2019)*

Section 56(2)(viib) – Income from Other Sources – Property Purchased – Agreement

Value less than Stamp Duty Value – No reference to DVO – Not valid – Addition to be deleted

Facts

Assessee has purchase a property of ₹ 19,50,000/-. The AO noted that the circle rate of the flat in question (as per the Stamp Valuation Authority) was ₹ 41,34,330/-. Hence, assessee was required to submit reasons as to why the difference should not be brought to tax as per the Section 56(2)(vii)(b) of the Act. Assessee replied that he has only parted with the agreed sale consideration of ₹ 19,50,000/- and the flat was situated in a Slum Area (Slum Rehabilitation flat). It was also submitted that the fair market value/circle rate as determined by the Stamp Valuation Authority was unreasonably high. According to AO, assessee should have contested the valuation at the time of registration of the property and since assessee has not done so, assessee cannot contest the circle rate during assessment proceedings before him. Therefore, AO added the difference of ₹ 21,84,330/- (₹ 41,34,330/- minus ₹ 19,50,000/-). Aggrieved, the assessee preferred an appeal before the Ld. CIT(A) who confirmed the addition. Aggrieved, the assessee is before this Tribunal.

Held

The Ld. AR submitted that the flat in question is situated in a slum area and the flat has been constructed as a slum rehabilitation project. Rate of flats cannot be compared with that of assessee because it is located in slum area; and even if other flats of nearby locality may fetch higher price that doesn't mean that assessee has purchased the flat in question at a higher price and therefore circle rate cannot be applied in assessee's case. Copy of the report from registered valuer of the flat was also submitted. Before making addition applying provision of section 56(2)(vii)(b) of the Act, AO ought to have referred the matter to the Valuation Officer (DVO), since the Assessee objected for the value to be taken according to the stamp valuation authorities. AO has made addition under section 56(2)(vii)(b) without making reference to the valuation officer as required by proviso under sub clause (c) of section 56(2)(vii)(b) of the Act. We cannot accept the Ld DR's request to restore the matter back to AO for referring the valuation of flat to DVO because that will tantamount to condoning the erroneous action of AO and consequently allowing a second inning for no fault of assessee and would tantamount to breathing fresh life to an order which on the facts on records exposes the arbitrary and whimsical action of AO and so is unsustainable in law. Therefore, the addition made by AO to the tune of ₹ 21,84,330/- u/s 56(2)(vii)(b) is directed to be deleted.

3 ***Manoj Kumar Chandrama Prasad Pande vs. ITO (ITA No: 191/Mum/2023)***

Section 69B – Addition on account of cash payment cannot sustain because opportunity to cross-examination was not given to the assessee

Facts

Assessee is a NRI and had filed a nil return of income. During the year on money cash was paid to builder for purchase of residential flat. The case was re-opened based on the report of Directorate Investigation Wing. Summons was issued to assessee and the builder u/s. 131(1). The assessee could not be present for summons as he was working in Merchant Navy. The builder also did not respond. The assessment order was finalized making

addition u/s. 69B on basis of investigation report and assuming that assessee is one of the beneficiaries of on money cash payments. CIT(A) also confirmed the additions and dismissed the appeal of the assessee.

Held

Before the ITAT, the assessee claimed that opportunity to cross-examination was not given to the assessee. The AO contended that the opportunity was given to the assessee however the same was not availed and also that all the documents based on which assessment was based, were given to the assessee and therefore opportunity to cross examination was not required. It was observed by the ITAT that when the person on whose statements, the re-assessment was framed, did not reply on the summons issued and did not give any explanation of cash received, then assessee did not avail cross-examination was just an empty formality. The Hon'ble ITAT relying on the Apex Courts decisions in case of Andaman Timber Industries and I.C.D.S Limited, held that when the issue is regarding the cross-examination, the matter needs to be set aside to the file of the AO to frame the assessment de-novo after providing the assessee all documents which were relied upon during the assessment. The AO was directed to grant opportunity to cross-examine and assessee is allowed to file any documents in support of his contentions.

4 ***Govind Gidomal Lulla vs. ITO [ITA No. 2285/Mum/2022 dt. 11/04/2023 (Mum)(Trib.) (AY 2019-2020)***

Section 69 – Undisclosed Investment – Excess Stock found during course of Survey – Taxable as business income and not as undisclosed income

Facts

Survey action 133A of the Act was carried out on the business premises. AO in assessment noted that, during the course of survey proceedings, inventory of stock was prepared and as on the date of survey, in books of account the stock was shown at ₹ 2,82,400/-. However, the stock as per the physical inventory was arrived at 25,21,196/- Thus, there was stock discrepancy of ₹ 22,38,769/-, which assessee accepted and offered for taxation as business income. However, AO taxed the excess stock as undisclosed investment u/s 69 and subsequently u/s 115BBE. CIT(A) confirmed the action of AO. Being aggrieved with the same, appeal before ITAT is filed.

Held

There was difference of stock in books and the physical stock found during the survey and such difference was Rs. 22,38,769/-. Assessee offered the difference for taxation as business income, because the excess stock was said to be purely purchase of material for making sweets during the course of the business. If assessee is carrying on business and has some undisclosed stock then same is taxable as an undisclosed business income. It cannot be held it is a case of undisclosed investment. Neither during the course of survey neither in the statement it was found nor has assessee ever stated that there is some undisclosed investment representing in the form of undisclosed assets. It is a case of excess stock found during the carrying of the business and stock is generated out of business income and therefore, the provision of section 69 on the facts of the case has no applicability.

5 *Marudhamalai Sri Dhandapani Spinning Mills vs. DCIT, CPC [ITA No. 11/Chny/2023]*

Section 80IA- Deduction to be allowed even if the Form 10CCB not filed with return of income. The filing of form is directory and not mandatory.

Facts

The appellant filed return for AY: 2017-18 after claiming deduction u/s. 80IA of the Act. The Tax Audit report and Income Tax return were filed within the due dates, however the report of accountant as required u/s. 80IA – Form no. 10CCB was e-filed late after the due date. Intimation issued u/s. 143(1) did not allow the deduction u/s. 80IA, as form 10CCB was not filed before filing the return of income. Before the CIT(A), the assessee argued that deduction should not be disallowed merely because of procedural lapse, however the order of AO was upheld.

Held

In appeal before the Tribunal, the assessee argued that filing of Form 10CCB was not mandatory but directory and if the form is filed before the completion of assessment, then deduction cannot be denied. The DR argued on the basis of section 80AC, that for claiming deductions under Chapter VIA, filing return of income before time limit is essential and that return is considered valid only if it is accompanied by the audit report required under the statute. The Hon'ble ITAT relied upon the decision of Apex Court in case of ***GM Knitting Industries Pvt Ltd. (376 ITR 456)*** where it has been held that that even if the form is not filed with return, but if it is filed before the completion of assessment proceedings, the deduction should be allowed. Based on this decision and various other decisions at HC and ITAT level, the appeal was allowed in favour of the assessee ruling that deduction should be allowed even if the form has not been filed along with return of income.

6 *Smt. Bhawna Nagori vs. The ITO Ward-4 Bhilwara (379/Jodh/2019)*

Section 234A - AY 2010-11- If any assessment is made for the first-time u/s 147 then the assessee cannot be made to pay interest for the period during which it was not possible on the part of the assessee to file return

Facts

The AO had revised the amount of interest charged u/s 234A to ₹ 97,493/- from ₹ 8,296/- vide rectification order. The AO had computed the interest u/s 234A for the period of 47 months for the period August 2010 to June 2014. The rectification order of the AO was confirmed by CIT (A). The Assessee filed an appeal before the ITAT.

Held

The ITAT referred to the decision in the case of ***Priti Pithawala vs. ITO (2003) 129 Taxman 79*** wherein it was observed that a belated return could not be submitted after the expiry of one year from the end of the assessment year and thus, the Assessee could not be fastened with a liability for which he was not able to file a return . The assessment was made for the AY 2010-11. The ITAT observed that the AO erred in rectifying the order for charging the interest for a period for which the assessee could not file his return. The ITAT allowed the appeal of the assessee and reversed the action of the AO and CIT(A).

7 *M/s. Panalpine World Transport India Pvt. Ltd. vs. Addl. CIT, Special Range-7, New Delhi (ITA No.2168/Del/2019)*

Section 253 and Rule 4 of the Income Tax (Appellate Tribunal) Rules, 1963- The jurisdiction of the Bench which can decide the appeal is to be determined by the location of the AO

Facts

The AO situated in Mumbai passed the assessment order and the appeal was filed before CIT(A). The jurisdiction of the AO was transferred from Mumbai to Delhi and thus, subsequently, the CIT(A) delhi decided the Appeal and passed the order which was challenged before the ITAT Delhi bench. The issue of maintainability arose and the ITAT held as under:

Held

The ITAT noted the facts and perused the Rule 4 of the Income Tax (Appellate Tribunal) Rules, 1963 and paragraph 4 of Notification No. F.No.63-AD(AT/97), dated 16/09/1997 as amended from time to time. The ITAT noted that the jurisdiction of the Bench which can decide the appeal is to be determined by the location of the Assessing Officer passing an assessment order. The ITAT observed that since in the present case, the location of the AO in the instant proceeding was at Mumbai, the appeals, necessarily, should have been filed before Mumbai Benches and not in Delhi Benches. The reference was made to the view expressed by the SC in case of ***PCIT vs. ABC Papers Ltd., [2022] 289 taxmann 150(SC).*** The ITAT held that the appeal before the Delhi bench was not maintainable. However, since the Appellant was filed under the bona fide belief, the ITAT delhi bench granted liberty to the assessee to file an appeal before the Mumbai bench.

8 *Mr.Gopal Soundararaj vs. PCIT [ITA No. 181/Chny/2023]*

Section 263: Revision cannot be done only because the assessing officer has not dealt the satisfaction in writing in the assessment order. Sufficient enquiries were taken and so order cannot be considered as erroneous or prejudicial

Facts

The case of the assessee was selected for scrutiny under CASS for mismatch in interest income offered to tax and reported in form 26AS. The assessment order was passed u/s. 143(3) by making some addition of interest income on Fixed Deposits. The cash deposited was also discussed in the assessment order. Penalty notice was also issued u/s. 270A for under reporting of income after passing the assessment order. Notice u/s. 263 was issued by PCIT to assesssee on the grounds that since AO has not recorded any reasons for initiation of penalty u/s. 270A, the order is prejudicial to the interest of revenue. The penalty later on was not levied u/s. 270A. Another reason quoted was that the source of fixed deposit was not examined. The jurisdiction and validity of revision proceedings u/s. 263 was challenged before the ITAT.

Held

The jurisdiction under section 263 was assumed on two grounds, one that the AO has not mechanically issued notice u/s. 270A without recording reasons in the assessment

order and second that the source of Fixed deposits with two banks was not questioned upon during the assessment. It was held by the ITAT that on grounds of penalty u/s. 270, the notice was very clear so as to mention as to why there should be no penalty levied for under -reporting of income. Therefore, it could not be said that there was no proper satisfaction in initiating the penalty proceedings. On the second issue for source of FDs, it was held that very purpose of assessee was to verify interest income. The AO has verified the interest income and made addition on interest income. Though the AO has not specifically not discussed about the source of fixed deposits in its assessment order, however the details of source were submitted during the assessment proceedings and the same were accepted by the AO. There was abundant enquiry made by the AO, only the same not being recorded in the assessment order, cannot be reason to presume jurisdiction u/s. 263 to invoke revisionary provisions. It was held that the assessment order was not prejudicial or erroneous and the jurisdiction u/s. 263 was set aside and quashed.

9 *Bhawani Shankar Gupta vs. ITO Ward 4(1), Jaipur (ITA. No. 43/JP/2023)*

Section 271B Penalty- once the penalty is levied for non-maintenance of book of accounts, there cannot be further default for not getting the same audited u/s 44AB of the Act

Facts

Penalty proceedings u/s 271B was initiated for violation of Sec 44AB against the assessee while finalizing the assessment proceedings and show cause notice was issued. Assessee filed his reply. However, the AO without appreciating the same levied the penalty of ₹ 53,518/-. The assesse preferred an appeal before the NFAC/ CIT(A). The CIT(A) confirmed the levy of the penalty holding that the assessee was not covered under the any reasonable clause. Since the assessee did not comply with the statutory provisions, the action of levy of penalty was confirmed by CIT(A). The Assessee challenged the said order before the ITAT.

Held

The ITAT considered the submissions and noted that there was no dispute regarding the fact that the assessee had not maintained books of account. The ITAT perused the decisions of coordinate benches on the issue and observed that a consistent view has been taken that no penalty is leviable u/s 271B of the Act when books of accounts are not maintained. The ITAT allowed the appeal of the assessee and deleted the penalty.

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"There is nothing holier in the world than to keep good company, because the good impressions will then tend to come to the surface."

— *Swami Vivekananda*

CA Naresh Sheth

CA Jinesh Shah

INDIRECT TAXES
GST – Recent Judgments and Advance Rulings

A. DECISIONS BY HIGH COURT

1 *Ernst and Young Limited – Delhi High Court [W.P.(C) 8600/2022]*

Facts and issue involved

Petitioner is an Indian Branch Office of M/s Ernst & Young Limited, a company incorporated under the Laws of United Kingdom ('EY-UK'). Petitioner has entered into and has provided professional consultancy services in terms of the service agreements to its overseas entities (EY Entities). Broad scope of services provided by petitioners are assurance and business advisory services, technical assistance and advise in relation to the expatriate tax compliance, business tax compliance, technical assistance and advise with respect to the audit process. Nature of services described on the invoices raised by petitioner on EY entities is 'Professional fees for services'. Consideration for services were received in convertible foreign exchange.

Petitioner had applied for refund of ITC used for export of services for the period December 2017 to March 2020. Adjudicating authority held that petitioner is engaged in providing intermediary services and hence place of supply of the said services is location of supplier of services u/s 13(8)(b) of IGST Act.

Aggrieved by the adjudication order, appellate preferred the appeal to Appellate authority who upheld the adjudication order. Petitioner has challenged the said appellate order by way of present writ petition.

Petitioner's submissions

Services provided by petitioner are in the nature of management consultancy/ professional consultancy services. It had provided services directly to EY entities located outside India in terms of service agreements entered into EY Limited with respective EY entities. The consideration for said services was received in convertible foreign exchange.

Petitioner relied on the order passed by service tax authorities wherein it was held that petitioner is not an intermediary. Relying on the said order, petitioner contended that the concept of intermediary under GST is same as that was prevailing under erstwhile service tax law.

Department's submissions

Adjudicating Authority held that petitioner is engaged in promoting technical or financial

collaboration between Indian companies and parent company, representing the parent company in India and acting as buying/selling agents in India.

Adjudicating authority referred to the letter dated 04.04.2008 issued by RBI to EY-UK to establish a branch office in India and noted that the activities that could be carried out by petitioner included representing the parent company in India and acting as buying/selling agent.

Observations and Discussion by Court

Intermediary merely arranges or facilitates supply of goods and/or services. It is obvious that person who supplies the services is not an intermediary. In the present case, there is no dispute that the petitioner does not arrange or facilitate services to EY entities from third parties. Petitioner renders services to them. The petitioner had not arranged the said supply from any third party. Adjudicating authority had also accepted that the petitioner had provided the services. A person who provides services, as opposed to arranging or facilitating, is not an intermediary with the definition of section 2(13) of IGST Act.

There may be services which may entail outsourcing some constituent part to a third party. But that would not be construed as intermediary services if the service provider provides services to the recipient on his own account as opposed to merely putting the third party directly in touch with the service recipient and arranging for the supply of goods or services.

Even if it is accepted that the petitioner has rendered services on behalf of a third party, the same would not result in the petitioner falling within the definition of 'intermediary' under Section 2(13) of the IGST Act as it is the actual supplier of the professional services and has not arranged or facilitated the supply from any third party.

RBI letter dated 04.04.2008 (as relied by adjudicating officer) containing activities which a branch office (i.e. petitioner in the present case) included export-import of goods; rendering professional or consultancy services, carrying out research work in which the parent company is engaged, promoting technical or financial collaboration between Indian companies and parent or overseas group companies and representing the parent company in India and acting as a buying or selling agent in India. However, merely because one of the activities that could be carried on by the petitioner is to act as buying/selling agent in India does not mean that the petitioner had carried on such activities and the invoices raised were for services as a buying/selling agent.

Definition of intermediary under erstwhile service tax law is similar to the definition under GST. Circular No. 159/15/2021-GST dated 20.09.2021 also acknowledges that there is broadly no change in the scope of intermediary services in GST vis-a-vis service tax regime. Services rendered by petitioner prior to roll out of GST was considered as export of services. ITC refund application filed after March 2020 were also accepted by adjudicating authority.

Since services provided by petitioner are not held to be intermediary services, the place of supply shall be determined as per the location of recipient of services. Since recipient of services is outside India, professional services rendered by petitioner qualifies to be export of services u/s 2(6) of IGST Act.

Decision of High Court

High Court allowed the writ petition preferred by the petitioner.

B. RULINGS BY APPELLATE AUTHORITY OF ADVANCE RULING

1 *Puranik Builders Limited - Maharashtra AAAR [MAH/AAAR/DS-RM/19/2022-23]*

Facts and Issue involved

Appellant is engaged in construction and sale of residential premises. It discharges GST on residential units sold prior to receipt of Occupancy certificate. Construction services provided by appellant are classifiable under SAC 9954 and is taxable under Entry 3 of Notification No. 11/2017-CT(R) dt. 28.06.2017. The taxable value is determined after reducing the land rebate of one third of total consideration received by appellant.

As a part of agreement for sale, appellant also provides following other services for which consideration is collected under the respective heads:

Description of charges	*Brief Explanation*
Electric meter installation and deposit for meter	Paid by appellant to Electricity Board for each unit at construction stage and later reimbursed from the customer.
Water connection charges	Paid by appellant for each unit at construction stage and later reimbursed from the customer.
Share of municipal taxes	Pertains to property tax required to be paid for period post receipt of Occupancy Certificate. The amounts are used for paying such tax.
Advance maintenance and club house maintenance	Collected on behalf of society yet to be formed. These amounts are used for maintenance till the time society is formed and upon formation of society, any unspent amount is transferred to the society.
Development charges	Additional charges for development of the project computed based on premium paid to the Municipal Corporation for project and various other factors
Share money, application and entrance fees of the organization	Charges of making application for allotment, share money for future society of residents etc.
Formation and registration of the organization and legal charges in connection therewith	Charges in respect of formation of future society of residents and associated legal costs.
Infrastructure charges	Additional charges for development of common area infrastructure
Legal fees	Charges of legal cost of the transaction of sale of residential apartments.

Currently, appellant discharges GST at 18% on above other services.

Appellant had sought advance ruling on whether other services provided by appellant is classifiable under SAC 9954 along with the main residential construction services.

Advance Ruling Authority held that 'other charges' will not be treated as a consideration for construction services and will be treated as consideration received against supply of independent services of the respective heads.

Appeal to AAAR and appellant's contentions

Aggrieved by ruling, appellant preferred an appeal to AAAR. Appellant submitted that supply of construction services and consideration received in respect of other charges is composite supply on following grounds:

i. Supply of construction services and other services are supply of two taxable supplies;

ii. Construction services and other services are naturally bundled supplies in light of following factors laid down by CBEC Education Guide:

   a. Perception of the service receiver;

   b. Majority of the service providers provide similar bundle of services;

   c. They are advised as single package; and

   d. It is claimed that they are not available separately.

Appellant relied on 'dominant intention test' laid down by Hon'ble Supreme Court in case of ***BSNL vs. Union of India (2006) 145 STC 91 (SC)*** and held that the primary dominant intent of the customer is to purchase the residential apartment. All other facilities/ services are incidental to the main supply of construction of residential apartment.

Appellant also relied on similar advance ruling pronounced in case of M/s. Joyville Shapporji Housing Private Limited.

Discussions by and observations of AAAR

Perception of the consumer or the service receiver is an important factor in determining whether the services provided are bundled or not. In the construction of residential apartment sector, services in relation to water supply connection charges, electricity meter installation and security deposit for meter, development charges paid to local or Governmental authorities, legal fees for transaction of sale of residential apartments can reasonably be expected to be supplied by the builder/developer/promoter or a residential project. They are inextricably linked to a residential apartment or dwelling. Without these aspects, the property may not be used. These charges shall be liable to GST at the rate applicable to construction services in respect of residential premises.

Certain other charges like advance maintenance, club house maintenance, infrastructure charges, share money application and entrance fee of the organization are not expected by every consumer. These are not inextricably linked to the construction services in respect of residential projects. These charges does not fulfill the following illustrative indicators laid down under the CBEC Education guide:

- All the aspects may or may not be advertised as a package;
- There is a single price or the customer pays the same amount, no matter how much of the package they actually receive or use in the present case;
- Different element of the transaction are available separately. The type of

supplies or the charges received in this case are independent from construction services;

- Even though any one or all of them is removed from the contract, the supply of service of construction of residential apartment/dwelling goes unabated.

The property in the common areas such as road club house, garden utility areas are not transferred to the buyers. Buyers would not have any claims in such common areas. Even the benefits arising out of building shall belong to the appellant. Hence these charges fail to satisfy the dominant intention test laid down by Hon'ble Supreme Court in BSNL's case.

In light of above, water supply connection charges, electricity meter installation and security deposit for meter, development charges paid to the Government/local authority, legal fees for transaction of sale of residential apartments are inextricably linked with construction services. However, charges such as club house maintenance, advance maintenance, share of municipal taxes, formation and registration of the organization and legal charges in connection there with, share money, application and entrance fees of the organization, infrastructure charges are independent supplies and would be liable to GST at respective rates mentioned in the rates notification.

Ruling of AAAR

12% rate charged on other charges which inextricably linked to construction of apartments as these charges are part of composite supply and other charges which are not inextricably linked are supply of independent services liable to GST at respective rates applicable thereon.

C. RULINGS BY AUTHORITY OF ADVANCE RULING

1 *Kedaram Trade Centre – Gujarat AAR [2023-TIOL-53-AAR-GST]:*

Facts and Issue involved

Applicant is engaged in business of constructing immovable properties. Gujarat Government, vide Gujarat State Road Transport Corporation ('GSRTC') decided to develop the area, admeasuring 58,370 sq.mt. through private sector participant on commercial build, operate and transfer basis.

Vide concession agreement dated 12.5.2011, GSRTC granted development rights to Hubtown Bus Terminal (Ahmedabad) P Ltd ('Hubtown'). Out of the development rights for the total area of land, Hubtown further transferred the development rights pertaining to land admeasuring 1670 sq.mt. to the applicant vide deed of assignment dated 3.3.2021.

Upon completion of the project, Ahmedabad Municipal Corporation issued BU permission dt. 25.05.2022 to the applicant. Applicant wishes to allot the developed units to prospective buyers on a long term lease basis of 90 years. Applicant has received booking for certain units and has discharged GST at applicable rate on the entire consideration received by it. Lease deed shall be entered by and between the following parties:

1. GSRTC – Lessor;
2. Prospective buyer – Lessee;
3. Hubtown – Confirming party No. 1;
4. Applicant – Confirming party No. 2.

On expiry of lease period, the lease shall end and lessee shall handover possession of the leased premises to the lessor. Lessee shall pay one time premium of Rs. 13 lacs to the applicant as a consideration for allotment of commercial units on long term lease basis. Additionally, the lessee shall also pay annual leased rentals to the lessor i.e. GSRTC.

Applicant has sought advance ruling on taxability of one time lease premium received by it from prospective buyers.

Discussions by and Observations of AAR

In terms of agreement executed between applicant and Hubtown, applicant has been assigned right to construct commercial premises, right to market and promote the said units and right to execute lease deed as confirming party and obtain premium from the third party lessee for lease of 90 years.

Since applicant does not hold title in the immovable property, they cannot execute sale thereof and allotment of commercial premises by applicant of long-term lease basis of 90 years shall not be covered under the ambit of Clause 5 of Schedule III to CGST Act.

Lease is not defined under GST law and hence reference is made to definition of lease under Transfer of Property Act, 1882 which states that a lease can be of perpetuity. Hence, contention of the applicant that lease of 90 years is akin to sale is not tenable.

As is evident, from the lease deed we observe that the agreement made between the applicant, GSRTC, Hubtown and the lessee for 90 years can by no stretch of imagination be termed as a sale but in fact is a lease, as the nomenclature suggest with many restrictions.

When a person purchases a commercial plot/unit, he becomes an absolute owner of the plot/unit and there is sale deed between seller and purchaser. On purchase of commercial plot/unit, there is no requirement of renewal or extension of the sale after a certain period. The purchaser of the commercial units is also not required to pay any type of annual lease premium for the commercial units so purchased. Also the purchaser/owner is under no restriction as far as sale of the commercial units is concerned. In the present case, lessee is required to pay annual lease rent to GSRTC. In light of above, lease of plot for 90 years is not akin to sale and hence is not covered under Clause 5 of Schedule III to CGST Act. Lease of commercial units on payment of one time lease premium and annual lease rent is a supply liable to GST.

Reliance is placed on Hon'ble Bombay High Court judgement in case of ***M/s. Builders Association of Navi Mumbai [2018-TIOL-2767-HC-MUM-GST]*** wherein it was held that lease of land for one time premium is supply of services liable to GST.

Services by way of granting lease of commercial units for 90 years is a supply of services classifiable under SAC 9972 and liable to GST @ 18%.

Ruling of AAR

Allotment of commercial units on long term lease basis of 90 years is a supply of services classifiable under SAC 9972 and liable to GST at 18%.

2 ***AP Power Development Company Limited – Andhra Pradesh AAR [2023-TIOL-47-AAR-GST]***

Facts and issue involved

Applicant has entered into an agreement with Chettinad Logistics Private Limited ('service provider') for supply of services

(including co-ordination, loading, unloading, handling services etc.). In the event of failure in performance of job assigned to the service provider, applicant will collect liquidated damages for increase in moisture of raw coal over the loading end, for increase in ash percentage, penalties for late transportation of coal and penalty for short supply of coal. Applicant seeks advance ruling on taxability of above liquidated damages along with its classification and GST rate.

Applicant's submissions

Section 73 and 74 of the Contract Act, 1872, entitles applicant to receive compensation for loss in the event of breach of contract. The compensation is not consideration for any independent activity.

Section 7 of the CGST Act includes all forms of supply of goods/services for consideration by a person in the course and furtherance of business. There must be agreement to tolerate an act to attract provision of Para 5(e) of Schedule II to CGST Act. Liquidated damages arise on mutual acceptance of both parties on account of an 'unintentional occurrence' which both parties actually intend to avoid. Liquidated damages cannot be said to be a consideration received for tolerating the breach or non-performance of contract rather they are payments for not tolerating the breach of contract.

Clause of liquidated damages in the agreement between applicant and service recipient was provided with an intent to ensure due performance of an agreement or to further obedience of the law. Payment of liquidated damages is stipulated in a contract to ensure performance and to deter non-performance, unsatisfactory performance or delayed performance. Liquidated damages or penalties are not the desired result or intended to be a source of revenue for applicant but are paid to compensate for loss suffered by applicant, upon the occurrence of an unintended event.

Applicant also placed reliance on Circular No. 178/10/2022 – GST dated 03.08.2022 wherein it was clarified that liquidated damages are not liable to GST.

Discussions by and Observations of AAR

As per Section 2(31), the meaning of the word 'consideration' includes any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for inducement of supply of goods or services.

The amount so paid is neither ad-hoc, unconditional nor at the whims of service provider or the applicant. There is a clear mathematical formula as to calculation of such amount and the conditions/scenarios contingent upon which the amounts are payable are clearly narrated in the agreement itself. It is simply inconceivable that any prudent business will pay amounts for no merit and benefit. It is certain that the service provider is paying the said amount only for certain advantage derived or to ward off any disadvantage incurred. Hence it is only in response to something done by the appellant. It is inconsequential whether the payment is for tolerating the mistake or not-tolerating.

The circular relied upon by the applicant is not universal and absolute. The circular is only meant to clarify the position of law and shall be applied reasonably having regard to the facts of the case. The circular had clearly mentioned, inter alia, vide para 7.1.6 that "Therefore, such payments, even though they may be referred to as fine or penalty, are actually payments that amount to consideration for supply, and are subject to GST, in cases where such supply is taxable.

Thus the circular said payment towards damages are incidental to the main supply and if the main supply is taxable they shall also be taxable and if the principal supply is exempt then the incidental shall also be exempt. Thus the circular shall be understood in the proper context.

Liquidated damages paid by service provider to the applicant for tolerating an act of non-performance or breach of contract have to be treated as consideration for tolerating and act and hence is a supply liable to GST at 18%.

Ruling of AAR

Liquidated damages paid by service provided to the applicant is a supply classifiable under SAC 9997 and liable to GST at 18% under Entry 35 of rate Notification No. 11/2017-Central Tax (Rate) dt. 28.06.2017.

3 *Brandlx Apparel India Private Limited – Andhra Pradesh AAR [2023-TIOL-48-AAR-GST]*

Facts and issue involved

Applicant is engaged the business of manufacture of apparels and export of the same outside India. He has hired two separate third-party contractor to provide canteen and transport services respectively to the employees in the factory. Third-party contractors raises invoice on the applicant for services rendered by them. Applicant recovers part of the amount from employees and balance is borne by them.

Applicant has sought advance ruling on taxability of the amounts recovered from employees towards canteen and transport facility provided to them.

Applicant's submissions

Supply u/s 7 of CGST Act includes-all forms of supply of goods or services or both such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business.

For a transaction to qualify as supply, it should be made in the course or furtherance of business. The term business broadly means any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity whether or not it is for pecuniary benefit. Applicant is in the business of manufacturing apparels and not in the business of providing canteen facility. Canteen services are not connected to apparel manufacturing. He further submits that the services are not falling in the ambit of supply, hence the same shall neither be treated as goods nor services.

Applicant is not a provider of canteen facility but a receiver of such services and no profit element in the recovery of charges from employees. Applicant has arranged a canteen for its employees which is run by a third-party canteen service provider. As per the arrangement, part of the canteen charges is borne by the employees of the company. The said employees' portion of the canteen charges Is collected by the applicant and paid to the canteen service provider without retaining any profit margin and it is a pure reimbursement of the employees' portion of canteen charges.

Food is supplied by applicant to comply with the mandate under Factories Act, 1948.

Applicant relies on following advance ruling in support of its contentions:

- ***M/s Emcure Pharmaceuticals Limited [2022-TIOL-10-AAR-GST];***
- ***M/s. Cadila Healthcare Limited [ADVANCE RULING NO. GUJ/GAAR/R/2022/19];***

- ***M/s. Bharat Oman Refineries Limited [2021-TIOL-36-AAAR-GST];***
- ***M/s. Amneal Pharmaceuticals Private Limited [Order No. GUJ/GAAAR/APPEAL/2021/71];***
- ***M/s. Dishman Carbogen Amcis Ltd. [GUJ/GAAR/R/22/2021];***
- ***M/s. Tata Motors Limited [2021-TIOL-197-AAR-GST].***

Partial cost towards bus facility which is recovered from the employees is in the course of employment, hence the same will not be liable GST in view of Section 7(2)(a) read with Schedule III to the CGST Act.

Applicant relies on following advance ruling in support of its contentions:

- ***M/s Tata Motors Limited [2020-TIOL-245-AAR-GST];***
- ***M/s North Shore Technologies Pvt Ltd. [Order No. 59 dated 29 June 2020];***
- ***M/s Integrated Decisions and Systems India Pvt. Ltd. [2022-TIOL-06-AAR-GST];***

Discussions by and observations of AAR

Requirements of Factories Act, 1948 stipulates for a canteen facility with work force of more than 250. Applicant's work force is well over 11000 and therefore they are mandated to provide the canteen facility as per the Factories Act, 1948. It is clearly seen that the provision of service of canteen is by the third party to the applicant and not by the applicant to their employees.

As per section 7 of the CGST Act, supply includes all forms of supply of goods or services for consideration by the person in the course or furtherance of business. Applicant is involved in the supply of manufacture of apparel and not in the activity of provision of canteen service or bus transportation facility. In fact, the canteen services/bus transport facility are being received by the applicant from the third-party providers. Therefore, it can be concluded that the provision of canteen facility or bus transport facility by the applicant to the employees is not a supply as it is not in the course or furtherance of business.

GST Circular No. 172/04/2022-GST dated 6th July 2022 clarifies that any perquisites provided by the employer to its employee are in lieu of the services provided by the employee to the employer in relation to the employment and therefore the perquisites provided by the employer to the employee will not be subjected to GST.

Ruling of AAR

AAR held that GST is not applicable for the recoveries from the employees for the canteen services and transportation services provided to them.

■●■

"Experience is the only teacher we have We may talk and reason all our lives but we shall not understand a word of truth until we experience it ourselves"

— Swami Vivekananda

CA Rajiv Luthia CA Keval Shah

INDIRECT TAXES

Service Tax – Case Law Update

1 *M/s Cords Cable Industries Limited vs. CCE, Jaipur (Rajasthan) 2023 (4) TMI 441 – CESTAT New Delhi*

Background and Facts of the Case

- The M/S CORDS CABLE INDUSTRIES LIMITED (hereafter referred as "appellant") is engaged in the manufacture of instrumentation/power cable. The directors of the appellant had set up their registered office in the premises owned by two directors.
- The Directors had raised invoices to the appellant wherein service tax under forward charge was collected and deposited with the Revenue.
- SCN was issued for recovery of service tax on the rent paid by the company to the directors under Reverse Charge mechanism.

Arguments put forth

The Appellants submitted as under:

- The taxable service of 'renting of immoveable of property' has been provided by Naveen Sawhney and D.K. Prashar as owners/landlord of the premises and not in the capacity of Directors of the appellant, thus no service tax under reverse charge mechanism is applicable for the said transaction.
- As the rent was collected by Naveen Sawhney and D.K. Parashar as the owners/landlord of the premises, the service tax was included in the invoices raised on the appellant and was also deposited; In any case, no extended period could not be invoked since Service tax was already discharged under Forward charge.
- The Ld. Chartered Accountant also stated that Mr. Naveen Sawhney and Mr. D.K. Prashar are providing service of renting of immovable property in their individual capacity as owners of the premises and not as Directors of the appellant.
- The appellant, in such a situation, could not have been asked to pay service tax on a reverse charge mechanism.

What needs to be further noticed is that service tax had been deposited on the rent received by Naveen Sawhney and D.K. Prashar from the appellant.

The Respondents Submitted as under:

- The AR for the respondents supported the impugned Order and submitted that the appellants' were required to pay service tax under RCM since the rent was collected by the directors of the appellant.

Decision

- The Hon'ble CESTAT held that the premises which were let out to the appellant are owned by Naveen Sawhney and D.K. Prashar in their individual capacity and it is not the case of the department that the properties were owned by them as Directors of the appellant. In such a situation, rent was collected by them in their individual capacity and merely because they also happen to be the Directors of the appellant would not mean that they had collected rent as Directors of the appellant.
- The Commissioner (Appeals) assumed that Naveen Sawhney and D.K. Prashar are providing service of renting of immovable property as Directors of the appellant, whereas they are providing the said service in their individual capacity as owners of the premises and not as Directors of the appellant.
- The appellant, in such a situation, could not have been asked to pay service tax on a reverse charge mechanism. What needs to be further noticed is that service tax had been deposited on the rent received by Naveen Sawhney and D.K. Prashar from the appellant. Thus, for all the reasons stated above, the order dated 07.05.2018 passed by the Commissioner (Appeals) cannot be sustained and is set aside. The appeal is, accordingly, allowed.

2 ***M/S SAAVN MEDIA PRIVATE LIMITED vs. COMMISSIONER OF CENTRAL GOODS & SERVICE TAX (MUMBAI EAST) 2023 (4) TMI 767 - CESTAT MUMBAI***

Background and Facts of the Case

- Appellants are engaged in export of service and they avail the CENVAT Credit of Service Tax paid on the input Services availed by them.
- Refund applications were filed for unutilized accumulated CENVAT credit in view of Notification No. 27/2012- CE dated 18th June, 2012 and Rule 5 of CENVAT Credit Rules, 2004. Certain amounts were allowed and part of the refund was rejected. Appeals were filed before the Ld. Commissioner (Appeals) wherein part relief was allowed and part was rejected.
- The Present appeal is in relation to the rejected portion of both the refund appeals.

Arguments put forth

The Respondents Submitted as under:

- The respondent agreed with the impugned order and made no further submissions.

The Appellants submitted as under:

- That out of above stated amounts reflected in two appeals one is CENVAT Credit of Service Tax paid on Event Management Service and the other one is the Service Tax paid on Renting of Immovable Property.
- He further submitted that they were issued with deficiency memo but there was no issue of show cause notice for rejection of refund. The reason for rejection was that the premises in respect of which the rent was paid was not included in the Service Tax registration by the appellant.

Decision

- It is now settled law that unless the CENVAT Credit availed by the appellant has not been recovered by way of issue of show cause notice invoking Rule 14 of CENVAT Credit Rules, 2004, the CENVAT Credit available on the books of account cannot be rejected when it is accumulated on account of export of Service.
- In the present case, the above stated amounts of CENVAT Credit were not disallowed by way of invoking Rule 14 of CENVAT Credit Rules, 2004.
- Therefore, the said amounts are available in the account of the appellant and the refund of the same cannot be rejected. Thus, the appeal is allowed.

■●■

"If you are pure in your heart and strong in your decisions, you are equal to the whole world, you will be a one man army."

– Swami Vivekananda

"Ethically they had arrived at the conclusion that man's supremacy over the lower animals meant not that the former should prey upon the latter, but that the higher should protect the lower, and that there should be mutual aid between the two as between man and man."

– Mahatma Ghandi

"We are in a good state with respect to generation of wind energy. Within the last decade, we have reached a capacity of generating over 11,000 MW through large scale wind farms. With this experience, it is possible to enhance our capacity to 45,000 MW by using low wind energy windmills by 2030."

– A.P.J. Abdul Kalam

CS Makarand Joshi

CORPORATE LAWS
Case Law Update

Companies Act

1. In the matter of TEQ GREEN POWER PRIVATE LIMITED (petitioner) versus REMC LIMITED (respondent), Delhi high court order dated 21st March 2023.

Facts of the case

- The Petitioner, TEQ Green Power PVT. Ltd (WOS of O2 Power SG PTE. LTD, Singapore Company) is primarily engaged in generation and supply of power for the purposes of procurement by various nodal agencies and distribution companies.
- The Respondent is the nodal agency of the Indian Railways for implementation of renewable energy projects which is a Joint Venture company between Ministry of Railways and Rites Limited.
- On 14.07.2022, respondent issued a notice inviting tender for selection of project developers for certain power projects. requisite eligibility criteria to be fulfilled by prospective applicants issued along with tender.
- The Petitioner submitted the relevant documents along with the technical bid and financial bid.
- The Respondent opened the technical bids submitted by the applicants. The Petitioner thereafter discovered that other bidders had received advance intimation to participate in the reverse auction and it had not received any intimation regarding the same. Therefore, the Petitioner wrote to the Respondent communicating the same and accordingly requested that the reverse auction be deferred until the said issue resolved.
- The Petitioner, aggrieved of being excluded from the bidding process without being assigned any reasons for such exclusion, proceeded to file a Writ Petition which was disposed of with the following directions to the Respondent:

  "the respondent shall communicate its decision to the petitioner and in the meanwhile, e-reverse auction (e-RA) will remain in abeyance till expiry of one week commencing from the communication of the said decision to the petitioner."
- In furtherance of the directions of the high court, the respondent issued the impugned decision, inter alia

communicating that the Petitioner's bid stood excluded on the grounds that it "…is disqualified at Technical Stage based on the Net Worth of the Parent company is less than the required criteria after exclusion of redeemable preference shares in net worth calculation…".

- Challenging the decision of the Respondent disqualifying the Petitioner from further stage of the tender process, the Petitioner approached this Court by filing the instant petition.

Question of law

Whether the value of preference shares can be included while computing net-worth and accordingly whether the respondent erred in declaring the petitioner ineligible to participate in the tender process in terms of request for selection.

Petitioner's contentions

Learned Senior Advocate for the Petitioner contended that:

- Section 2(57) of the Companies Act the definition of net worth uses the expression "paid-up share capital" which is defined under Section 2(64) of the Companies Act to mean that the paid up share capital is the aggregate amount of money credited as paid up capital and is equivalent to the amount received as paid up capital in respect of shares issued including the amount credited as paid up capital in respect of shares of the company.
- Section 43 of the Companies Act states that the share capital includes equity share capital and preference share capital.
- Second proviso to sub-Section (2) of Section 55 clarifies that the shares cannot be redeemed except out of the profits of the company or out of the proceeds paid from issue of shares made for the purposes of such redemption.
- Preference shares cannot be redeemed from the existing share capital. Therefore, the decision of the Respondents to exclude preference shares from the definition of net worth is contrary to the mandate of law.
- The preference shares issued are redeemable only on the option of the issuer and there is no tenure attached to the shares. Equity share capital of the company is included in the net worth than there is no reason as to why preference shares must be excluded more so if the redemption is only at the instance of the company.
- Further states that here is no correlation between the balance sheet and the net worth. Further contends that for the purpose of balance sheet, both equity share capital and preference share capital are shown as liabilities and, therefore, to arrive at the net worth of the company through accounting classification in a balance sheet only excluding preference capital is illogical.
- The judgment of the Hon'ble Supreme Court in ***JK Industries vs. Union of India, (2007) 13 SCC 673***, states that balance sheet is not an indicator of the net worth of a company.
- Where redeemable preference shares are issued but not honoured when they are ripe for redemption, the holder of those shares does not automatically assume the status of a "creditor". Therefore,

the accounting standards relied upon by the Respondent are inapplicable to the present case since they pertain to preparation of the balance sheet, not computation of net worth.

- In terms of AG 25 of Accounting Standard 32, the test applicable to determine whether preference shares are to be treated as a financial liability or an equity instrument is whether it is redeemable at the option of the holder, as opposed to the issuer and also whether such shares are redeemable at a fixed term or tenure.
- The preference shares in question do not have any term/expiry and are redeemable solely at the option of the issuer as noted in the financial statement submitted as part of the bid. Therefore, even if accounting standards were applicable, the shares in question cannot be treated as a liability.

Respondent's contentions

Learned Senior Advocate for the respondent, submitted that:

- Courts must exercise restraint and caution while dealing with tenders. Further states that the judicial review on administrative action is only intended to prevent arbitrariness, irrationality, unreasonableness, bias and *malafide* and the purpose is only to check whether the decision is made lawfully.
- If the decision taken by the tender issuing authority is made applicable across the board and when there is no evidence of the tenderer adopting the policy of pick and choose, then Writ Courts must not interfere exercising its jurisdiction under Article 226 of the Constitution of India.
- Reliance was placed on Section 129 of the Companies Act read with Schedule III Clause 9 under which a preference share is classified as a liability and redeemable preferences are classified under non-current borrowings or liabilities.
- Further contended that applying the said principles, preference shares are liabilities and, therefore, the decision to exclude preference shares from the definition of the net worth of the company cannot be faulted with
- A balance sheet is required to be prepared in terms of Section 129 of the Companies Act and Accounting Standards notified in terms thereof, and neither Section 129 nor extant accounting standards refer to "net worth" of a company per se.

Held

Court observed the relevant provisions of Companies Act, 2013 as contented by petitioner and observed that:

- Clause 4.3.1 (c) of the tender states that net-worth is to be considered in accordance with the Companies Act, 2013. Further, the tenderer has not specifically excluded preference shares from the definition of net-worth.
- Further court observed that the preference shares in question are preference shares redeemable at the instance of the issuer without any fixed term or tenure attached to these shares.
- Considering the provisions of Companies Act, 2013, it is amply clear that such shares would form part of paid-up share capital which in turn is a component of net-worth

- Therefore, the shares in question can form a part of the net worth within the scheme and mandate of the Companies Act.
- Further court referred the case quoted by petitioner and observed that It is well settled that if the preference shares are not redeemed, the holder of the preference shares does not assume the status of a creditor.
- Further observed that even if O2 Power SG PTE. LTD is governed by the Indian Companies Act (which is actually not as it is a company incorporated in Singapore and is governed by the laws of Singapore), the preference shares issued by O2 Power SG PTE. LTD are not redeemable at the option of shareholders, and therefore, cannot be categorized as a debt.
- Court held that that the mode of calculation of net worth which has been adopted by the Respondents to exclude the Petitioner from further stages of the tendering process is contrary to the Sections of the Companies Act.
- Respondents cannot be permitted to adopt a method which runs contrary to the provisions. Even though there are no allegation of mala fides or that the method has been calculated to favour any particular party, since the decision has been arrived at in violation of the statute, this Court cannot be a party to uphold any decision which is contrary to the plain reading of the statute.
- Even if it were the case that the legality of the Impugned Decision was to be tested within directions laid down by Accounting Standard 32, it has been correctly pointed out by Mr. Mehta that in terms of AG 25 of the standards, the preference shares in question would be treated as a liability only in certain circumstances and not always.
- The Apex Court in a catena of Judgments has held that the scope of interference by the Courts in exercising jurisdiction under Article 226 of the Constitution of India in contractual matters is extremely limited. The Court interferes in contractual matters only when the decision-making process is faulty or that the decision arrived at by tenderer is calculated to favour somebody or that the decision is so irrational that no man of prudence would have come to that conclusion. In the facts of the present case, it cannot be said that the decision that has been arrived at by the Respondent is to favour somebody yet the method adopted by the Respondent for calculating net worth is contrary to the definition of net worth given under the Companies Act.
- The tenderer has decided to exclude preference shares from the definition of net worth on a wrong notion that preference shares is a liability which is contrary to the Sections in Companies Act.
- The Respondent is directed to re-work the net-worth of the Petitioner herein by including the preference shares while calculating its net-worth and take a decision as to whether the Petitioner's financial bid can be considered or not.
- The writ petition is allowed. Pending application(s), if any, are disposed of.

SEBI

Order of the SEBI Adjudicating Officer

Name of the Case: Adjudication order in the matter of Shilpi Cable Technologies ltd.

Facts of the case

The Shilpi cable technologies ltd. (hereinafter referred to as "SCTL") was listed on Bombay stock exchange (hereinafter referred to as "BSE") and National stock exchange (hereinafter referred to as "NSE"). The Company came out with an Initial Public Offer ("IPO") for issuance of 80,98,145 equity shares of face value ₹ 10/- each through 100% book building process at a price of ₹ 69/- per fully paid-up equity share (including a premium of ₹ 59/- per equity share) and aggregating to approximately ₹ 55.87 crore. On the day of listing i.e., 08th April 2011, on BSE scrip opened at ₹ 78.35/- and touched a high of ₹ 84.65 before closing at ₹ 47.60, registered a fall of 39.25. On NSE, it opened at ₹ 78.00/- and touched a high of ₹ 84.70/- before closing at ₹ 48.05/- and thereby registered a fall of 38.4% from the opening price. **SEBI had observed 19 such IPO in the year 2011 and SCTL was one of such 19 companies.**

Accordingly, Securities and Exchange Board of India ("SEBI") **Suo moto**-initiated investigation in the matter of IPO of the Company relating to bidding analysis, listing day analysis, trading analysis, utilization of IPO proceeds, deviation from objects mentioned in the final prospectus/ Red Herring Prospectus ("RHP") and violations of corresponding regulatory requirements by the Company. SCTL in its quarterly financial results to exchanges had disclosed IPO utilisation on quarterly basis. From transactions and SCTL's reply it was observed that IPO proceeds were utilised towards payment to 17 entities including Salasar Trading Company Limited ("Noticee No. 1" or "Salasar"), King Empire Tradexim Pvt. Ltd. ("Noticee No. 2" or "King Empire") and King Power Industries Pvt. Ltd. ("Noticee No. 5" or "King Power"), payment of IDBI Term Loan, Fixed Deposit Receipt with PNB and Other Expenses/ Payments. SEBI noted that **substantial portion of the IPO proceeds** were used to repay unsecured creditors, advances to a group entity – Shilpi Communications Pvt. Ltd, to the vendors who were subsequently selected by the Company to replace the vendors mentioned in the prospectus and working capital requirement.

SEBI observed that there has been **a stark deviation in the actual utilization of IPO proceeds** to that mentioned in the final prospectus. SCTL had deviated from the objects of the IPO by approx. **₹ 50 Crore**. Further, it was noted that **payments from the entire IPO proceeds** have been made during the period **April 07, 2011 to April 18, 2011**.

Pursuant to this examination Securities Exchange Board of India (hereinafter referred to as "SEBI") carried out investigation and observed that **businesses of the three entities** – Salasar, King Power and King Empire **are questionable**. Further, King Empire and King Power being incorporated in 2010 only and their revenue and sales did not commensurate with their meagre fixed assets, employee costs, etc. Since it is a fact that a **company** being a juristic person, **acts through its board of directors**, who individually and collectively hold the position of trust and have fiduciary duties towards the company, the shareholders and other stakeholders, Mr. Manoj Kumar Garg proprietor of Salasar, Mr. Om Raj Garg (Noticee No. 3) and Mr. Chandan Gupta (Noticee No. 4) of King Empire and Mr.Avnish (Noticee No .6) and Mr. Arvind Poddar (Noticee No. 7) of King Power being **directors , were also charged for violation of regulation**.

Charges levied

Noticees 1 to 7 have violated the provisions of Section 12A(c) of the SEBI Act, 1992 read with Regulation 3(d) and 4(1) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (hereinafter to be referred as "PFUTP Regulations"

Arguments by Noticee

- **Arguments about King power and Shri Avnish (Director):** Vide Summons, information was sought from King Power and its directors viz. Shri Avnish Bhatnagar (Noticee No. 6) and Shri Arvind Poddar (Noticee No. 7). According to submission by Shri Avnish, Mr. Manoj Garg's office misused his DIN and digital signatures without his prior consent and appointed him director in King power. The Contention of King Power was that he was not part of the fraud.

- **Arguments about King Empire:** Vide Summons, information was sought from King Empire and its directors Shri Chandan Gupta and Shri Om Raj Garg. However, letters sent to King Empire, Rrjr Trading Pvt Ltd and Shri Om Raj Garg were returned with the reason "Unclaimed." While, the letter to Shri Chandan Gupta returned with the reason "Addressee Moved."

- **Arguments of Shri Garg of Salasar Trading Company Ltd:** With regards to Shri Garg, he contended that he had never been associated or dealt with King Power, King Empire, Silver Jubliee Tradeexim Pvt Ltd, Western Alliance Tradeexim Pvt Ltd, Ford Asia Trading Pvt. Ltd. and Golden Jubilee Sales Pvt Ltd during the financial year 2010-2011 and 2011-2012. Mr Garg further contended that he was concentrating on his overseas business since 2007 so he was not fully aware of his business activities in India.

Contention of SEBI

- **SEBI's contention on arguments about King power and Shri Avnish (Director):** Regarding King Power, it was apparent from financial statements that it did not have any major fixed asset and it had an abnormally high level of inventory turnover. The Overall, the per unit price for the item of cable purchased by SCTL from King Power increased by almost 80% within a span of 6 months and also King Power was incorporated in April 2010 only, still SCTL placed substantial portion of its purchases with King Power during the period 2010-2012, which is suspicious in itself. With regards to Mr. Avnish, Noticee No. 6, who denied the fact of being director of the King Power. Instead, he had submitted that his DIN and digital signature, submitted for appointment as executive director of Frisco, has been misused by Mr. Manoj and his associates for appointing him as a director of their associate companies. In this regard, SEBI noted that the basis of association of Mr. Avnish with King Power is his signature on AOF of Axis Bank and the PoA submitted under his signature in favour of Mr. Manoj Kumar Mandal. Further, Mr. Avnish was a signatory to both the documents and a subscriber to the MoA and AoA of King Power and therefore, SEBI alleged that he was cognizant of his association with King Power.

- **SEBI's contention on arguments about King Empire:** With regards to King Empire which was incorporated in April 2010 which did not have any

major asset and had an abnormally high level of inventory turnover. Its ledger statement showed that SCTL and Shilpi Cabletronics had purchased goods worth ₹ 11.53 crore and ₹ 16.8 crore, respectively, and aggregating to ₹ 28.3 crore. Due to which SEBI inferred that SCTL and Shilpi Cabletronics were the only customers of King Empire during the FY 2010-11. There was also a lot of fluctuation in per unit price for connector purchased by SCTL from King empire within span of 6 months.

- **SEBI's contention on arguments of Shri Garg of Salasar Trading Company:** With regards to Salasar, it was a sole proprietorship hence no data was available in public domain However SEBI investigated ledger statements of Salasar and found that it had regular transactions with King Power, King Empire, Silver Jubliee Tradeexim Pvt Ltd, Western Alliance Tradeexim Pvt Ltd, Ford Asia Trading Pvt. Ltd. and Golden Jubilee Sales Pvt Ltd during the financial years 2010-11 and 2011-12. Also Mr. Garg's contention that he was not concentrating on business affairs in India and not in possession of any of the records sought relating to the transactions between Salasar and other entities to which SEBI informed him that **several financial transactions** were observed between him and the aforesaid entities during 2010-11 and 2011-12. Accordingly, SEBI asked him to provide details with respect to his relation with the entities and submit corroborating documents for such transactions for which he never replied. SEBI further contended that SCTL and Shilpi Cabletronics had transactions worth more than ₹ 100 Crore with Salasar, however, they **failed to provide the complete contact details of the employees from both parties who had dealt with such transactions**. Thus, SEBI took view that SCTL had deliberately not disclosed the complete details of such employees in order to prevent SEBI from contacting employees and to conceal such dubious transactions. Also, there was **commonality of email-ids** between Golden Jubilee Sales, Salasar, King Power and King Empire. SEBI observed that Salasar, King Empire and King Power are run by the same set of entities and connected to each other. Further, it is observed Shri Manoj Kumar Garg who is the sole proprietor of Salasar and was the promoter director of Golden Jubilee Sales. Also, during the financial year 2011-12, it is observed that **Golden Jubilee Sales had infused Rs. 99 lacs each in the share capital of King Empire and King Power**.

- **SEBI's Conclusion:** Hence SEBI concluded that the business credentials of Salasar, King Power and King Empire, with whom the SCTL was substantially purchasing the products during FY 2010-11 and 2011-12 is highly suspicious and dubious and whose credentials are questionable. Further, the funds through a series of transactions, were routed to outside of the country and in absence of any material stating otherwise on record, SEBI alleged that Salasar, King Power and King Empire acted as conduits for the transfer of IPO proceeds and being party to dubious transactions.

Penalty

Noticee	*Amount of Penalty*
Salasar Trading Company Limited (Proprietor - Manoj Kumar Garg)	15,00,000/- (Rupees Fifteen Lakh Only)
King Empire Tradexim Pvt. Ltd.	2,00,000/- (Rupees Two Lakh Only)
Mr. Om Raj Garg	2,00,000/- (Rupees Two Lakh Only)
Mr. Chandan Gupta	2,00,000/- (Rupees Two Lakh Only)
King Power Industries Limited	2,00,000/- (Rupees Two Lakh Only)
Mr. Avnish Bhatnagar	1,00,000/- (Rupees One Lakh Only)
Mr. Arvind Poddar	2,00,000/- (Rupees Two Lakh Only)

IBC

In the matter of *M/s. Punjabi Accessoriezz Private Limited (Applicant / Operational Creditor) vs. M/s. Kredo Beauty Private Limited (Respondent)* at National Company Law Tribunal (NCLT) New Delhi Bench dated 17th March 2023.

Facts of the Case

- M/s. Punjabi Accessoriezz Private Limited – Operational Creditor (OC) filed an application u/s 9 of the Insolvency and Bankruptcy Code, 2016 (IBC) for initiation of Corporate Insolvency Resolution Process (CIRP) against the Kredo Beauty Private Limited – Corporate Debtor (CD).
- The application was admitted by NCLT vide order dated 16th January 2020 and Mr. Ravi Bansal was appointed as the Interim Resolution Professional (IRP), who was further confirmed as the Resolution Professional (RP) of the CD.
- IRP constituted the Committee of Creditors (CoC). On comparison of the existing shareholding pattern of the CD with the Composition of CoC, it was found that the CoC members namely, Crickxon Trade & Export Private Limited and Swift Builders Limited were the shareholders of the CD.
- The application was filed by the RP of CD for approval of the resolution plan submitted by Ms. Vanshika Raheja jointly with Ms. Mridula Mangla - Resolution Applicants- (RA).
- The total claims of creditors/stakeholders admitted were to the tune of Rs. 382.98 Lakhs, against which the Successful Resolution Applicant (SRA) had proposed to pay Rs. 4.07 Lakhs only.
- The Financial Creditors (FC) were paid 0.99% only of their claim amounts.
- The Resolution Plan involved a haircut of 99% plus for the FC.
- The entire CoC of the CD consisted of its shareholders only. From the compliances in "Form-H", it wad observed that none of the two FC or the members of the CoC names are reflected under the category of "Unsecured Creditors in Column 2(a)", which meant that they were not considered as "related party" and therefore, they were not been debarred from the voting rights u/s 21(2) of the IBC.

- With this background - it was required to be examine that, if the CoC members, namely, M/s Crickxon Trade and Exports Private Limited and Swift Builders Limited, were unrelated parties of the CD.

Noting of the NCLT

- It was noted that the two CoC members hold a 19% voting share each. Therefore, individually they are not related parties to the CD in terms of Section 5(24)(j) of the IBC [*where related party in relation to a corporate debtor, means any person who controls more than 20% of voting rights in the corporate debtor on account of ownership or a voting agreement*]. However, in order to pass the test of being unrelated parties, the members of the CoC would have sail through all the criteria stipulated u/s 5(24) of IBC. Therefore, it is required to be examined if they are a related party under any of the other criteria stipulated u/s 5(24) of IBC.
- Another criterion to be considered for declaring a person as a related party to the CD, is stipulated u/s 5(24)(l) of IBC [i.e. *related party in relation to a corporate debtor, means any person who can control the composition of the board of directors or corresponding governing body of the corporate debtor*].
- The aforesaid criterion implies that any person, who can control the composition of the board of directors of the CD is a related party to the CD. When it is said controlling the composition, it includes the appointment and removal of directors. In view of the above, NCLT examined, whether the two Shareholders/CoC members were in a position or legally capable to appoint or remove a director in the CD.
- To adjudicate removal and appointment of a director passing resolution by voting by show of hands NCLT examined the provisions regarding the removal and appointment of a director. First, it can be inferred from Section 169(1) of the Companies Act, 2013 (the Act) that an Ordinary Resolution is required to be passed by the Members/ Shareholders of the Company for the removal of a director.
- Similarly, the provisions for appointing directors are given u/s 152(2) read with 102 of the Act. The appointment of directors in place of those who are retiring is not considered a special business at the Annual General Meeting of the Company. In other words, the appointment of directors in place of those retiring is considered “an ordinary business”, and an ordinary resolution is required to be passed for its approval.
- In order to perform various functions in a Company including appointment and removal of directors, the approval of shareholders is required in the form of an ordinary resolution or special resolution, as the case may be. The criteria for passing ordinary and special resolutions are stipulated under Section 114 of the Act.
- In order to pass an ordinary resolution, the assent of more than 50%, of members/shareholders of a company is required and for passing a special resolution, the assent of at least 75% of members/shareholders is needed. Section 114 of the Act further recognizes the terms “show of hands” and ‘poll’ as the voting criteria.
- In the normal course, the voting has to be done through the show of hands only, unless a Poll is demanded under

Section 109 of the Act, or the voting is carried out electronically.

- On comparison of the provisions relating to voting by poll with the voting by show of hands, it can be inferred that a voting by poll has to be specifically demanded u/s 109, and if voting through a poll was conducted, then in that situation, the votes of a member shall be in proportion to the paid-up capital held by them. In other words, the higher the paid-up capital held by a member/shareholder in comparison to other members, the higher would-be voting share. In contrast, voting by show of hand works on the principle of one member – one vote, irrespective of the percentage of paid-up capital held by the member in the Company.

- When NCLT revisited the section 114 of the Act, it was found that both voting by show of hands and voting by poll are recognized for passing of Ordinary and Special Resolutions. It goes without saying that the criteria of voting by show of hands is not excluded for the purpose of passing the resolutions.

Analysis of the NCLT

- NCLT analysed that:

  — There are only 4 shareholders in the CD and both the Members of the CoC are from amongst them.

  — To appoint or remove a director, an ordinary resolution is required to be passed.

  — Voting by show of hands, is not excluded as a mode of voting for an ordinary resolution for either appointing or removing a director of the board.

  — To pass an ordinary resolution by a show of hands, approval of more than 50% of the shareholders in number is required, which in the present case comes to 3.

Held

- If voting by show of hands would have taken place for passing an ordinary resolution for the appointment or removal of a director in the CD then the same would not have been possible without the participation of any of the CoC members.

- Therefore, the said two shareholders, who are also the members of the CoC of the CD, were capable of controlling the composition of the board of directors of the said CD. Hence, by virtue of their capability of controlling the composition of the board of directors of the CD, NCLT concluded that both the CoC members/CoC as a whole comprised of “related parties” to the CD in terms of Section 2(l) of IBC and therefore, the entire constitution of CoC was erroneous in the eyes of law.

- A resolution plan passed by a CoC, which is comprised of related parties of the CD, is void ab initio as it violates Section 21(2) read with Section 30(2)(e) of IBC.

- Accordingly, the application was dismissed. And since the maximum permissible period of the CIRP period has elapsed, the Liquidation of the CD was ordered.

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CA Hardik Mehta　　CA Tanvi Vora

OTHER LAWS

FEMA – Update and Analysis

In this article, we have discussed recent amendments made in FEMA through Notifications, Circulars and Press Notes & Press Releases.

A. Update through Frequently Asked Questions

1. Liberalised Remittance Scheme

The RBI has updated the FAQs on Liberalised Remittance Scheme on 6th April 2023 and can be accessed on https://www.rbi.org.in/scripts/FS_FAQs.aspx?Id=115&fn=5. The FAQs on LRS were last updated on 21st October 2021.

(Comments: RBI recently amended the Master Direction on LRS which brought in relevant changes to align the scheme with Foreign Exchange Management (Realisation, repatriation and surrender of foreign exchange) Regulations, 2015 [Notification No. FEMA 9(R)/2015-RB] & Foreign Exchange Management (Overseas Investment) Rules, 2022, Foreign Exchange Management (Overseas Investment) Regulations, 2022 and Foreign Exchange Management (Overseas Investment) Directions, 2022. The updated FAQs below therefore provide further clarifications on the changes made above and provide clarifications to questions that were not clear earlier.

RBI vide **FAQ 2** has clarified the expansion of the prohibited transactions under LRS to include **"Gifting by a resident to another resident, in foreign currency, for the credit of the latter's foreign currency account held abroad under LRS"**. Permitted gifts under LRS includes resident individual (upto USD 250,000) undertake gift to a person residing outside India & resident individual can make a rupee gift to a NRI/PIO who is a relative of the resident individual within USD 250,000 subject to conditions.

RBI has amended **FAQ 4 dealing with the requirement to repatriate the income earned on investments abroad has been amende**d. The new answer provided by RBI is brought in line with relevant changes under Foreign Exchange Management (Realisation, repatriation and surrender of foreign exchange) Regulations, 2015 [Notification No. FEMA 9(R)/2015-RB]. The RBI has clarified that income earned from funds remitted under LRS can be retained and reinvested the received/realized/unspent/unused foreign exchange, **unless reinvested**, shall be repatriated and

surrendered to an authorized person within a period of 180 days from the date of such receipt/realisation/purchase/acquisition or date of return to India. In case of ODI investments, the time limit thereunder is to be adhered.

RBI has aptly updated **FAQ 5** dealing with consolidation of LRS facility for family members. Other regulations remaining same, the FAQ is updated in line with the amendment to the scheme bright in vide acquisition of immovable property abroad, Overseas Direct Investment (ODI) and Overseas Portfolio Investment (OPI), in accordance with the provisions contained in Foreign Exchange Management (Overseas Investment) Rules, 2022, that, **"Remittances for acquiring immovable property outside India from a person resident outside India, may be consolidated in respect of relatives if such relatives, being persons resident in India, comply with the terms and conditions of the Scheme"**)

RBI *vide* **FAQ 15** has continued to hold that no ratings or guidelines are prescribed under LRS however has clarified now that the investments should now be in accordance with with Overseas Investment Rules and Regulations, 2022 and the directions made thereunder)

2. Purchase of Immovable Property

The RBI has updated the FAQs on Purchase of Immovable Property on 6th April 2023 and can be accessed on https://www.rbi.org.in/scripts/FS_FAQs.aspx?Id=117&fn=5. The FAQs on LRS were last updated on 21st October 2021.

(Comments: The FAQs on Purchase of Immovable Property is divided into two parts dealing with Purchase of immovable property outside India by Resident Individuals (Part I) and Purchase of immovable property in India by Non-Resident Individuals (Part II). RBI recently overhauled the Overseas Investment rules and regulation in August 2022 and also merged into it, Notification 7(R)/2015-RB that dealt with purchase of immovable property outside India by residents. The Foreign Exchange Management (Overseas Investment) Rules, 2022 and Foreign Exchange Management (Overseas Investment) Directions, 2022 dated August 22, 2022 brought in the relevant changes. Further, in case of Purchase of immovable property in India by Non-Resident Individuals, minor referencing to Foreign Exchange Management (Non-Debt Instrument) Rules, 2019 has been amended while the FAQs remain the same.

The updated FAQs below therefore provide clarifications on the changes made above and provide clarifications to questions that were not clear earlier.

Part I: Purchase of immovable property outside India by Resident Individuals

RBI *vide FAQ 2* has clarified regarding the consolidation of LRS for purchase of property outside India. The FAQ has been amended to provide that **"the remittance under the Liberalised Remittance Scheme may be consolidated in respect of relatives if such relatives, being persons resident in India, comply with the terms and conditions of the Scheme"**. Earlier the FAQ only provided that those family members who pool their LRS remittances, then all their names should be in the ownership of said property.

FAQ 4 has been rephrased and updated to provide list of ways in which a resident can acquire immovable property outside India.

The rule and FAQ has been divided into three heads i) acquisition by resident from another resident, ii) acquisition by a resident from a person resident outside India and iii) entities having an overseas office.

In case of R to R, inheritance/gift/purchase are all permitted provided that the property was acquired by the transferor in compliance with the FEMA regulations at the time. While inheritance and gift was clearly indicated in the old rules, reference to R to R purchase of immovable property outside India is clearly clarified and permitted. Although there may be some practical difficulties to banks w.r.t. tracking such sales/purchases since the payment would be in INR. In case of NR to R, certain permitted modes have not changed, while few have been amended, deleted or inserted. It should be remembered that as per the new rule, acquisition by way of Gift from a person resident outside India is not permitted. It was earlier permitted to acquire immovable property outside India "Jointly with a relative provided there are no outflow of funds from India." which is now updated to "jointly with a relative who is a person resident outside India". This would mean that the no outflow condition has been deleted but also further clarifies that it should be with a non-resident relative. It is also newly inserted that a resident can also acquire immovable property outside India from a PROI out of the income or sale proceeds of the assets, other than ODI, acquired overseas under the provisions of the Act.

Part II: Purchase of immovable property in India by Non-Resident Individuals

FAQ 6 & 7 have been updated to change reference from Notification FEMA 21(R) to Foreign Exchange Management (Non-Debt Instrument) Rules, 2019 as the current prevailing rule applicable to Purchase of immovable property in India by Non-Resident Individuals.

B. Update through A. P. (DIR Series) Circulars

1. Authorised Dealers Category-II - Online submission of Form A2

The RBI has decided to permit AD Category-II entities also to allow online submission of Form A2. AD Category-II entities shall frame appropriate guidelines with the approval of their Board within the ambit of extant statutory and regulatory framework.

The terms and conditions mentioned in aforesaid A.P. (DIR Series) Circular No. 50 dated February 11, 2016 shall continue to apply, as hitherto, to all Authroised Dealers. The relevant provisions of FEMA 1999, and 'Master Direction – Know Your Customer (KYC) Direction, 2016' as updated from time to time, issued by the Department of Regulation, RBI, have to be complied with by the ADs, for all transactions.

(Source: A. P. (DIR Series) Circular No. 2 dated 12th April 2023)

(Comments: RBI has broadened the online filing of Form A2 to AD Category-II entities which as per its definition include a) upgraded Full Fledged Money Changers (FFMCs), b) selected Regional Rural Banks (RRBs), d) Urban Cooperative Banks (UCBs) and other entities. RBIs integration with technology leading to ease of doing business it commendable. RBI has in a separate circular [A. P. (DIR Series) Circular No. 1 dated 12th April 2023] moved the applicable process for Full Fledged Money Changers

and non-bank Authorised Dealers Category-II to an online module – APConnect.)

2. Remittances to International Financial Services Centres (IFSCs) under the Liberalised Remittance Scheme (LRS)

With an objective to align the LRS for IFSCs set up under the International Financial Services Centres Authority Act, 2019 vis-à-vis other foreign jurisdictions, RBI has decided to amend the directions applicable to Resident Individuals for opening a Foreign Currency Account (FCA) in IFSCs under LRS."

As per the circular, the condition of repatriating any funds lying idle in the account for a period up to 15 days from the date of its receipt is withdrawn with immediate effect, which shall now be governed by the provisions of the scheme as contained in the aforesaid Master Direction on LRS.

(Source: A. P. (DIR Series) Circular No. 3 dated 26th April 2023)

(Comments: Through this circular RBI is aligning the time limit for repatriation of idle funds lying in foreign currency accounts maintained in IFSCs with that of accounts maintained with banks in foreign countries. Effectively, the time limit increases from 15 days to 180 days as per paragraph 16 of the Master Direction on LRS which reads as follows "Investor, who has remitted funds under LRS can retain, reinvest the income earned on the investments. The received/realised/unspent/unused foreign exchange, unless reinvested, shall be repatriated and surrendered to an authorised person within a period of 180 days from the date of such receipt/realisation/purchase/acquisition or date of return to India.")

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"To me the very essence of education is concentration of mind, not the collecting of facts. If I had to do my education over again, and had any voice in the matter, I would not study facts at all. I would develop the power of concentration and detachment, and then with a perfect instrument I could collect facts at will."

— *Swami Vivekananda*

"I believe in the Hindu theory of Guru and his importance in spiritual realisation. I think there is a great deal of truth in the doctrine that true knowledge is impossible without a Guru."

— *Mahatma Gandhi*

Rahul Hakani
Advocate

Niyati Mankad
Advocate

Best of The Rest

SHILPA SAILESH VS. VARUN SREENIVASAN – ORDER DT. 01/05/2023 PASSED IN TRANSFER PETITION (CIVIL) NO. 1118 OF 2014 AND ORS. [SUPREME COURT]

Article 142 of Constitution of India and Section 13- B of Hindu Marriage Act, 1956 - Supreme Court has power to invoke Article 142 of Constitution of India to dissolve a marriage between consent parties without referring them to the family court to wait for the mandatory prescribed period of 6 months - on the ground of irretrievable breakdown - subject to requirements and conditions as specified in the case of ***Amardeep Singh vs. Harveen Kaur [(2017) 8 SCC 746]*** and ***Amit Kumar vs. Suman Beniwa [(2017) 8 SCC 746]*** are met.

Facts and Issues

The issues before the Constitution Bench, arise primarily from the Order dt. 12.05.2010 passed in T.P.(C)/899/2007, ***Neeti Malviya vs. Rakesh Malviya*** wherein a bench of two judges had doubted the view expressed in ***Anjana Kishore vs. Puneet Kishore [(2002) 10 SCC 194, rendered by 3 Judge Bench],*** and ***Manish Goel vs. Rohini Goel [(2010) 4 SCC 393]*** that this Court, in exercise of the power under Article 142 of the Constitution of India, cannot reduce or waive the period of six months for moving the second motion as stipulated in Section 13-B(2) of the Hindu Marriage Act, 1956.

Noticing that the Apex Court, some High Courts and even family courts in some States had been dispensing with or reducing the period of six months for moving the second motion when there was no possibility whatsoever of the spouses cohabiting, accordingly the question was referred to a three judges' bench for a clear ruling and future guidance. However, the question was never decided, since T.P.(C)/899/2007 was rendered infructuous as the parties, subsequent to the order of reference, had dissolved their marriage by mutual consent.

Thereafter, in the present T.P. (C)/1118/2014 (tagged with other petitions), a bench of two judges, vide the order dated 06.04.2015, issued notice to the Attorney General for India for addressing arguments on issues mentioned therein. The Attorney General for India also suggested two additional questions of law.

T.P. (C)/1118/2014 and Ors. were effectively disposed of vide the order dated 06.05.2015 dissolving the marriage by grant of divorce by mutual consent with the two judges' bench

exercising jurisdiction under Article 142 of the Constitution of India. However, in view of the conflicting ratio of the judgments of the Apex Court on the applicability of the power and jurisdiction of the Apex Court under Article 142 of the Constitution of India, the two judges' bench of this Court deferred the transfer petition to remain pending for statistical purposes, and formulated questions of law to be decided by a three judges' bench.

Thereafter, vide the Order dated 29.06.2016, another bench of two judges of the Apex Court, on examining the questions formulated in T.P. (C) No. 1118 of 2014, referred to Article 145(3) of the Constitution of India, and relying on ***Pradip Chandra Parija and Ors vs. Pramod Chandra Patnaik and Ors [(2002) 1 SCC 1]***, accepted the submission made by the Attorney General for India to refer the questions formulated in T.P.(C)/1118/2014 for consideration of the Constitution Bench

Accordingly, in the present case, the 5 Judge Bench of the Supreme Court was referred for their consideration on the following substantial questions of law:

(i) The scope and ambit of power and jurisdiction of the Apex Court under Article 142(1) of the Constitution of India;

(ii) In view of, and depending upon the findings on the first question, whether this Court, while hearing a transfer petition, or in any other proceedings, can exercise power under Article 142(1) of the Constitution of India, in view of the settlement between the parties, and grant a decree of divorce by mutual consent dispensing with the period and the procedure prescribed under Section 13-B of the Hindu Marriage Act, and also quash and dispose of other/connected proceedings under the Protection of Women from Domestic Violence Act, 2005 , Section 125 of the Code of Criminal Procedure, 1973, or criminal prosecution primarily u/s 498-A and other provisions of the Indian Penal Code, 1860?

(iii) If the answer to Question 2 above is in the affirmative, in which cases and under what circumstances should this Court exercise jurisdiction under Article 142(1) of the Constitution of India? and

(iv) Whether this Court can grant divorce in exercise of power under Article 142(1) of the Constitution of India when there is complete and irretrievable breakdown of marriage in spite of the other spouse opposing the prayer?

Held

The Apex Court answered the aforesaid questions as under:

Issue (i)

After referring to various decisions of the Apex Court such as M. Siddiq (Dead) Through Legal Representatives (***Ram Janmabhumi Temple Case) vs. Mahant Suresh Das and Ors [(2020) 1 SCC 1***]; ***I. C. Golak Nath and Others vs. State of Punjab and Another [AIR 1967 SC 1643] Union Carbide Corporation and Others vs. Union of India and Others [19 (1991) 4 SCC 584] and Supreme Court Bar Association vs. Union of India and Anr [(1998) 4 SCC 409]***, the Apex Court held that it can depart from the procedure as well as the substantive laws, as long as the decision is exercised based on considerations of fundamental general and specific public policy. While deciding whether to exercise discretion, this Court must consider the substantive provisions as enacted and not ignore the same, albeit this Court acts as a problem solver by

balancing out equities between the conflicting claims. This power is to be exercised in a 'cause or matter'.

[Article 142(1) provides that the Supreme Court in the exercise of its jurisdiction may pass such decree or make such order as is necessary for doing **complete justice in any cause or matter** pending before it, and any decree so passed or orders so made shall be enforceable throughout the territory of India in such manner as may be prescribed by or under any law made by Parliament and, until provision in that behalf is so made, in such manner as the President may by order prescribe.]

Issue (ii)

In view of the findings on the first question, the question was answered in affirmative, inter alia, holding that the Apex Court, in view of settlement between the parties, has the discretion to dissolve the marriage by passing a decree of divorce by mutual consent, without being bound by the procedural requirement to move the second motion. The Court held that this power should be exercised with care and caution, keeping in mind the factors stated in ***Amardeep Singh vs. Harveen Kaur [(2017) 8 SCC 746]*** and ***Amit Kumar vs. Suman Beniwa [(2017) 8 SCC 746]***. The Court further held that it can also, in exercise of power under Article 142(1) of the Constitution of India, quash and set aside other proceedings and orders, including criminal proceedings.

Issue (iii)

This question was also answered in the affirmative, inter alia, holding that the Apex Court, in exercise of power under Article 142(1), has the discretion to dissolve the marriage on the ground of its irretrievable breakdown. This discretionary power is to be exercised to do 'complete justice' to the parties, wherein this Court is satisfied that the facts established show that the marriage has completely failed and there is no possibility that the parties will cohabit together, and continuation of the formal legal relationship is unjustified. The Court, as a court of equity, is required to also balance the circumstances and the background in which the party opposing the dissolution is placed.

PALMVIEW INVESTMENTS OVERSEAS LIMITED PORTCULLIS TRUSTNET (BVI) LTD. VS. RAVI ARYA & ORS. - ORDER DATED 2/5/2023 PASSED IN COMMERCIAL APPEAL (L) NO. 36947 OF 2022 [BOMBAY HIGH COURT]

Section 19 of The Arbitration and Conciliation Act, 1996 – Procedure in Arbitral proceedings - Invalidity of Board Resolution is a Procedural and Curable Defect, cannot lead to rejection of claims and termination of Arbitral Proceedings.

Facts

In this case, Bombay High Court was dealing with Appeal filed by Palmview Investments Overseas Limited Portcullis Trustnet (Bvi) Ltd u/s 37 of the Arbitration and Conciliation Act 1996 (**"the Act"**). The Parties had entered into a shareholder's agreement dated 25.03.2009 by which the Appellant got 49% shares in the Respondent No. 6 (company) i.e. Arya Iron and Steel Co Pvt Ltd and the remaining 51% was held by the remaining Respondents. In consideration thereof, the Appellant invested an amount of Rs. 80 crores in the company.

One Mr. Sunil Jain was nominated by the Appellant as the nominee director on the Board of the company. A dispute arose between the parties which accordingly was referred to arbitration before an arbitral tribunal consisting of three members. Mr. Sunil Jain verified the statement of claim on behalf of the appellant and also appeared

as CW-1. However, before the arbitration proceedings could reach an outcome, the Respondents filed an Application u/s 31(6) r/w 32 of the Act for the rejection of the claims and termination of the arbitral proceedings on the ground that Mr. Sunil Jain did not have the requisite authority to invoke arbitration on behalf of the Appellant or depose as witness as the board resolution that he has relied upon is not a valid document. According to Mr Sunil Jain, he was validly authorised by Board Resolution dated 16/7/2018.

The Arbitral Tribunal held that the board resolution was invalid. However, Mr. Jain was given 2 weeks' time by the Tribunal to file fresh Resolution to prove the validity of the Board Resolution by which he was authorised or produce fresh resolution ratifying his authority.

The Respondents approached the High Court u/s 34 of the Arbitration and Conciliation Act, 1996 in order to set aside the interim award for the same reasons. The High Court allowed the Arbitration Application and held that Interim Award permitting rectification of the defect was bad in law.

Issue

Whether the Petition u/s 34 of the Act was maintainable?

Whether authority derived from invalid board resolution is a curable defect?

Held

The Court held that the Petition u/s 34 of the Act was maintainable and relied on the Judgment of the Supreme Court in ***Indian Farmers Cooperative Ltd vs. Bhadrq Products (2018) 2 SCC 534*** and its own judgment in ***MSEDCL vs. Godrej and Boyce, 2019 SCC OnLine Bom 3920***, to hold that the decision of the arbitrator on the issue whether a person is authorised to file the claim or on the issue of validity of the invocation of the arbitrator is an interim award challengeable under Section 34.

Next, the Court examined the issue whether the invalidity of the board resolution is a curable defect. The Court held that requirement of a board resolution authorizing a person to take legal action on behalf of a company is a procedural requirement and any defect in such a resolution would only be a procedural irregularity and thus, it cannot be allowed to defeat a substantive right of a party.

The Court held that in view of Section 19 of the Act which deals with procedure of arbitration, an arbitrator is not bound by the Code of Civil Procedure, 1909 (CPC) but can go beyond the CPC in order to protect the principles of natural justice. The principles enshrined in CPC could also be applied to Arbitration proceedings. There were several decisions in the context of Suits wherein it was held that Suits filed by Companies pursuant to invalid board resolution or no board resolution was a curable defect. It was held that those ratios would apply even to Arbitration proceedings.

The interim award of arbitral tribunal was upheld.

DATTANI SHELTER COOPERATIVE HOUSING SOCIETY LIMITED & ANR. VS. THE SLUM REHABILITATION AUTHORITY & ORS. WP (ST) 25625 OF 2022 DATED 27/4/2023 (BOMBAY HIGH COURT)

Article 226 of the Constitution of India, 1950 – Writ Petition cannot be entertained if there are serious disputes about consent given to developer for additional construction, structural stability etc – Correct course to file substantive suit – Developer to continue construction

at own risk till society file suit and obtain protective order.

Facts

Writ Petition was filed by the Petitioner-Society against the order of Competent Authority permitting the developer to construct additional 9 floors over a building of 12 floors.

It was the case of the Authorities-Respondent that plinth plus 3 floors were constructed with a view to construct 38 floors. Subsequently, revised permission was sought and number of floors were reduced to 12 floors due to CRZ restrictions.

The building is thereafter completed upto 12 floors in the year 2006. According to the Petitioner, 12 floors A wing was constructed in the year 2007 and B wing was constructed in the year 2012.

Later, the Respondent/authority has sanctioned permission to construct 9 more floors above the 12 floors. The Society took an apprehensive view about the additional structure whereby the Report submitted by the Authorities is unclear as to exact mode of test taken for determining the structural liability.

The Petitioner- Society also disputed the right of the developer to put construction. According to the Developer, the buildings did not have part or full Occupation certificates. Further the buyers had consented to the developer for additional constructions. The Petitioner- society had disputed the validity of the consents.

Society- Petitioner filed a Civil suit only for injunction. Later on, it withdrew the suit with liberty to file a substantive suit as per legal advice. It also received the advice to file Writ Petition. Thus, Society filed the Writ Petition.

Issue

1. Whether the Writ Petition is maintainable?

2. Whether developer can continue construction of additional floors?

Held

One of the main disputes raised by the Society pertained about structural stability of the building to withstand 21 floors/ the capacity of existing structure to take load of the additional floors.

The expert report obtained from VJTI during the pendency of the Writ Petition held that the additional construction was suitable.

It was held that the principle of law suggests that there are multiple facets of the case such as proceeding with additional floors on recommendation of VJTI Report, authenticity of VJTI Report, contents of the Sale agreements or challenging letter of intent, etc., are seriously disputed questions of fact and are thus, not within the scope of Writ Jurisdiction. The correct course for the Society was filing a substantive Civil Suit before Competent Civil Jurisdiction by institution of appropriate Civil proceedings and/or seeking protection along-with such proceedings.

The Hon'ble Bombay High Court held that the developer can continue the construction at their own risk and without claiming equities till the Society files a substantive suit and obtains protective orders within a period of seven weeks. If the Society does not file suit and obtain protective order within seven weeks then the developer will no longer carry on construction at their own risk and would be entitled to claim equities.

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CA Vijay Bhatt
Hon. Jt. Secretary

CA Mehul Sheth
Hon. Jt. Secretary

THE CHAMBER NEWS

Important events and happenings that took place online/physical between **1st April, 2023 to 30th April, 2023** are being reported as under:

I. ADMISSION OF NEW MEMBERS

The details of new members who were admitted in the Managing Council Meeting held on 28th April, 2023 are as under:

Type of Memberships	No. of Members
Life Member	43
Ordinary Member	51
Student Member	26
Associate Member	01
Total	**121**

II. PAST PROGRAMMES

Sr. No.	*Date*	*Topic*	*Speaker*
DELHI CHAPTER			
1.	11.04.2023	Study Circle Meting on Case Law Discussion	*Chairman* Mr. Chandra Mohan Garg - *Hon'ble Member ITAT, New Delhi* *Moderator* CA Vijay Goel *Speakers* Ishita Farsiya, *Advocate* CA Prakash Sinha

Sr. No.	Date	Topic	Speaker
2.	The Delhi Chapter had planned a webinar series on "Full Day Seminar on FEMA". The session-wise detail of the program is as under:		
a.	21.04.2023	Recent development on FEMA on FDI, ODI, ECB etc	Mr. Adarsh Kumar, *Asst. General Manager* & Ms. Mahua Nandi, *Manager, RBI Delhi Regional Office*
b.		Presentation and Discussion by RBI officers • Overview of Foreign Investment Regulations • Reporting requirements and FIRMS 2.0 • Compounding, Late submission Fee and its related issues • Caution Listing of Importers, Exporters • International trade related observations – Some case studies	Mr. Adarsh Kumar, *Asst. General Manager* & Ms. Mahua Nandi, *Manager, RBI Delhi Regional Office*
c.		Recent issues- Bankers' perspective • LRS issue on FD held outside India • Remittance of money outside India for share of profit as capital account transaction • Advances and exports from different Banks • Merchant trade adjustments • EDPMS and IDPMS issues • Postal exports and courier exports in their names • Other LRS Issues	Mr. Harjeet Singh, *Trade Finance Product Solutions, Processes and Compliance* & Mr. Noor Ibraheem, *Retail Outward Remittances - ICICI Bank*
d.		Overseas Investments under ODI and LRS Issues and its related compliance and Issues	CA Naresh Ajwani
e.		Panel discussion covering various issues with Q & A session. Covering issues related to FDI. BO, PO and LO issues, LRS, NRI /OCI transactions related Immovable property, Loan, Gift etc and vice versa. Issues related to Import & Export transaction, Merchant exporter issues, Set off & various other transactions.	*Panellist* CA Naresh Ajwani, CA Hinesh Doshi, CA Vijay Gupta, CA Deepender Aggarwal *Moderator* Adv. (CA) Prakash Sinha

Sr. No.	Date	Topic	Speaker
3.	The Delhi Chapter had planned a webinar series on "Full Day Seminar on Charitable Trust and its related issues". The session-wise detail of the program is as under:		
a.	29.04.2023	Broad overview of the provision under Income Tax act for the charitable Trust recent amendment	V. P. Gupta, *Advocate*
b.		**FCRA & CSR Compliances of Charitable Trust.** Discussion regarding FCRA new Amendment Act, 2020. Discussions on procedural aspects under The Foreign Contribution (Regulation) Act, 2010 and Amendment Act, 2020	Nabin Ballodia, *Advocate*
c.		Direct Recent Judgement of Supreme Court and its ramification	Dr. Rakesh Gupta
d.		Panel Discussion and Q & A on the important issues of Charitable Trust	Nabin Ballodia, *Advocate* V. P. Gupta, *Advocate* Dr. Rakesh Gupta, CA Prakash Sinha
HYDERABAD STUDY GROUP			
1.	29.04.2023	Applicability of Various Labour Laws in Modern Day Business	Mr. S.V. Ramachandra Rao, *Labour Laws Expert*
INDIRECT TAXES			
1.	18.04.2023	Evidence Law and its relevance in GST	Sriram Sridharan, *Advocate*
INTERNATIONAL TAXATION			
1.	17.04.2023	Acquisition and Transfer of Immovable Property under FEMA — Part - II	Ms. Pooja Desai
2.	19.04.2023	Lecture Meeting on Recent Amendment to the International Taxation	CA Bhaumik Goda
PUNE STUDY GROUP			
1.	28.04.2023	Development & Redevelopment Agreements – Tax Implications	Dharan Gandhi, *Advocate*
STUDY CIRCLE & STUDY GROUP			
1.	13.04.2023	Recent judgements under Income Tax	Vipul Joshi, *Advocate*
2.	20.04.2023	Cash Transactions - Impact on Section 68 to 69D	CA Ketan Vajani

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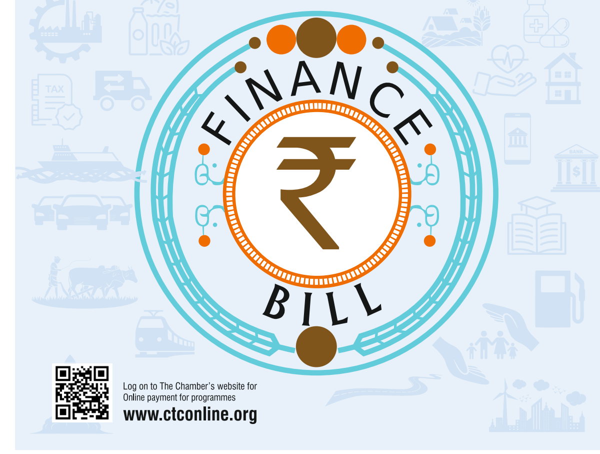

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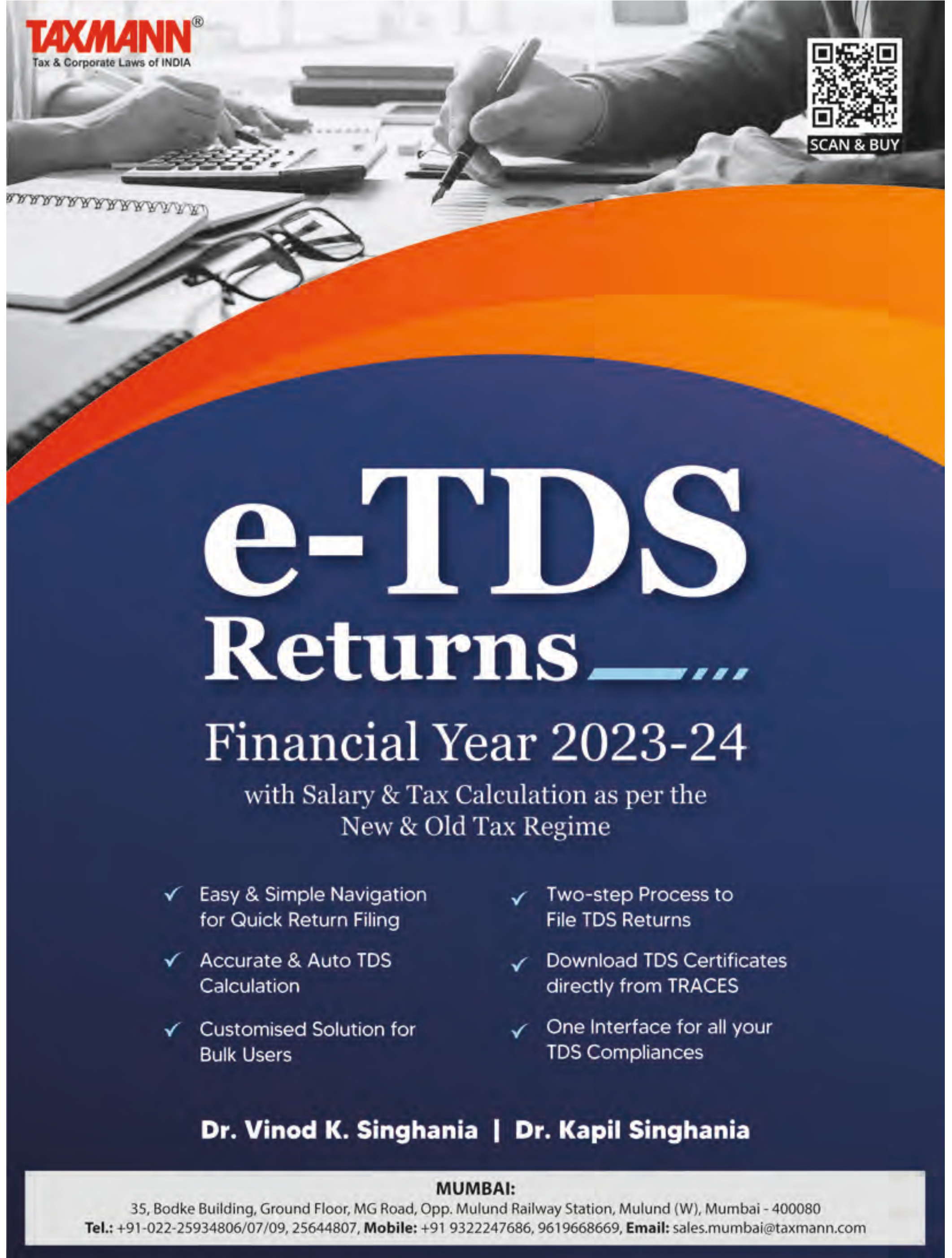

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