Managing Risks and Legal Requirements for Indian Entities Investing Overseas
written by King Stubb & Kasiva | February 28, 2023

Indian entities, whether individuals or companies have been increasingly looking to expand their business and investment activities overseas. Overseas investments can offer several opportunities for Indian entities, such as diversification of their portfolio, access to new markets, technology, and resources, and the potential for higher returns. However, overseas investing also comes with its fair share of risks and challenges that must be considered and addressed.

Market Size

The Indian overseas investment market has been growing steadily over the years. As of March 2021, Indian companies had invested around USD 262 billion overseas, with major investments made in the USA, Singapore, and Mauritius. The United States is one of the most popular destinations for Indian overseas investment, with investments totaling approximately USD 60 billion as of

March 2021. Singapore and Mauritius are also popular investment destinations, with investments totaling approximately USD 29 billion and USD 16 billion, respectively. Other countries that have attracted significant investments from Indian entities include the United Kingdom, the United Arab Emirates, and the Netherlands.

The software and services sector is the largest recipient of Indian overseas investments, with investments totaling approximately USD 57 billion as of March 2021. The telecommunications and pharmaceuticals sectors are also significant recipients of Indian overseas investments, with investments totaling approximately USD 24 billion and USD 14 billion, respectively.

The market size for overseas investments by Indian entities is expected to continue to grow in the coming years. Factors such as increasing globalization, the emergence of new markets, and the need for diversification are likely to drive further investments by Indian entities overseas. However, Indian entities must also be prepared to address the risks and challenges associated with overseas investments, such as compliance with local laws and regulations, exchange rate fluctuations, and geopolitical risks.

Legal and Regulatory Framework for Overseas Investments

Indian entities looking to invest overseas must comply with the legal and regulatory framework applicable to overseas investments. The Reserve Bank of India (RBI) is the primary regulator of overseas investments by Indian entities. The RBI has issued several regulations and guidelines, including the Foreign Exchange Management Act (FEMA) and the Overseas Direct Investment (ODI) policy, which govern outbound investments by Indian entities.

The primary legislation and framework(s) with respect to Foreign Investments are:

1. Foreign Exchange Management (Overseas Investment) Regulations, 2022[1]
2. Foreign Exchange Management (Overseas Investment) Rules, 2022[2]

Overseas Direct Investment by Indian Companies

Indian companies looking to make direct investments overseas must comply with the provisions of the ODI policy. The policy mandates that Indian companies can invest up to 400% of their net worth, subject to the approval of the RBI. The investments can be made in the form of equity, debt, or joint ventures.

One of the key risks associated with overseas direct investment is the impact of exchange rates on investments. Fluctuations in exchange rates can have a significant impact on the returns earned by Indian entities. Indian entities can mitigate this risk by hedging their investments against exchange rate fluctuations.

Overseas Real Estate Investment by Indian Entities

Overseas real estate investment has become increasingly popular among Indian entities. However, such investments come with their fair share of legal challenges. Indian entities must comply with the laws and regulations of the host country regarding real estate investments. Additionally, Indian entities must ensure that they have a clear understanding of the title and ownership of the property they are investing in.

Taxation of Overseas Investments in various Instruments

Instrument	Holding Period	Tax Slab & Rate
Equity		
LTCG	Over 24 Months	20% after Indexation
STCG	Less than 24 Months	Slab rate
Dividend Income		Slab rate

Debt Instruments & Mutual Funds		
Dividend Income	NA	Slab rate
LTCG	Over 36 Months	20% after indexation
STCG	Less than 36 Months	Slab rate
Real Estate		
LTCG	Over 24 Months	20% after indexation
STCG	Less than 24 Months	Slab Rate
Rental Income	NA	Slab Rate

Impact & Changes vide New Guidelines notified by RBI

1. The concept of "JV/WoS" under the previous overseas direct investment regime has been replaced by the term "foreign entity." This term now encompasses any entity formed, registered, or incorporated outside of India, including those with limited liability in International Financial Services Centers. If a foreign entity is involved in strategic industries, such as oil, gas, coal, mineral ores, submarine cable systems, start-ups, or any other industry deemed necessary by the Central Government, it is exempt from limited liability. The OI Regime has specifically included the criteria of "limited liability" to ensure that the obligation of the Indian party is clear, identifiable, and limited, even though the concept is similar to the previous definitions of JV/WoS.

- The definition of "overseas portfolio investment" has been clearly and precisely defined, which has resolved the long-standing ambiguity between portfolio investments and overseas direct investments made by Indian entities. An overseas portfolio investment is any foreign investment that is not considered an overseas direct investment, except for investments in unlisted debt instruments and securities issued by Indian residents who are not located in an International Financial Services Center. Previously, only listed companies were permitted to make portfolio investments under the ODI Regime. However, under the new regulations, unlisted Indian enterprises, local individuals, mutual funds, alternative investment funds, and venture capital funds are now eligible to invest in overseas portfolio investments.
- Resident individuals (RIs) were previously allowed to purchase shares in foreign companies through various channels such as LRS, ESOPs, and donations under the former ODI Regime. However, there were no established procedures or regulations in this area. The OI Regime has now addressed this issue by outlining specific procedures and rules for overseas investments by RIs. RIs can acquire shares through various methods, including OPI and ODI in an operational firm without a subsidiary if the RI has control over such foreign organization, inheritance, ESOPs, purchase of sweat equity shares, and gift. The investment by the RI must comply with the OI Regime, and the provisions of the liberalized remittance scheme will not apply.
- Under the former ODI regime, gifting of foreign securities was generally permitted, which caused confusion regarding compliance requirements for the gifting of securities by non-residents to resident Indian entities or individuals, especially if the non-resident was not related to the resident Indian. The Foreign Contribution (Regulation) Act of 2010 requires compliance when gifting foreign securities from a person residing outside of India. The OI Regime permits RIs to acquire shares through inheritance from a resident of India or through a gift from relatives who are residents of India. However, this imposes a significant restriction on RIs as compliance conditions under FCRA are currently unclear.

Conclusion

In conclusion, the Overseas Investment Regime has brought significant changes to the Indian overseas investment landscape. It has provided clear definitions, procedures, and regulations for Indian entities investing abroad, addressing several ambiguities and uncertainties that existed under the previous regime. Indian entities now have greater flexibility and scope for investment opportunities in strategic industries, real estate, and other sectors globally.

However, they must also navigate various legal and regulatory challenges, such as compliance with FCRA when gifting foreign securities and managing the impact of exchange rates on overseas investing. To set up a business entity for overseas investment, Indian entities must carefully consider the legal requirements and procedures of the host country. Overall, the OI Regime has created opportunities and risks for Indian entities investing overseas, requiring them to balance their investment goals with compliance requirements and risk management strategies.

FAQs

What are the risks associated with overseas investing for Indian entities?

There are several risks associated with overseas investing for Indian entities. Some of the common risks include:

1. Political and Economic Instability
2. Currency Fluctuations
3. Regulatory Compliance
4. Cultural Differences
5. Legal Challenges

Overall, Indian entities must carefully consider these risks before investing overseas and take appropriate measures to mitigate them.

What are the legal requirements for Indian entities looking to invest overseas?

Indian entities looking to invest overseas must comply with various legal requirements, which may vary depending on the country of investment. Some of the common legal requirements for Indian entities looking to invest overseas include:

1. Obtain Necessary Approvals
2. Transfer of Funds
3. Compliance with Tax Laws
4. Compliance with Anti-Corruption Laws

Overall, Indian entities must be aware of the legal requirements and regulations in the host country where they plan to invest and seek professional legal advice to ensure compliance with these requirements.

How can Indian entities mitigate the risks associated with overseas investing?

Indian entities can mitigate the risks associated with overseas investing by conducting thorough due diligence, seeking expert advice, diversifying their investments, having a clear exit strategy, maintaining good communication with local partners, and continuously monitoring and evaluating their investments.

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[1]https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12380&Mode=0

[2]https://rbidocs.rbi.org.in/rdocs/content/pdfs/GazetteRules23082022.pdf

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