
LEGAL FRAMEWORK FOR OUTBOUND INVESTMENT BY INDIAN ENTITIES: REPORTING OBLIGATIONS AND PROCEDURAL CHALLENGES IN FDI TRANSACTIONS

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ABSTRACT

The proliferation of Indian businesses in the globe has given birth to a surge of outward investments which necessitate the full understanding of the legal frame of reference enjoying of outward investments. For Foreign Direct Investment (FDI) transactions, this paper discusses the regulatory landscape for outbound investments by Indian entities which have reporting obligations and procedural issues. The Foreign Exchange Management Act (FEMA), RBI guidelines and role of the Department for Promotion of Industry and Internal Trade (DPIIT), which oversee these investments, are analysed. The paper also further examines the procedural complications that plague Indian companies when trying to move through approval processes, the compliance and disclosure norms. The study further explores legal limitations and trials based on case studies which demonstrate the practical problems that Indian entities face in documenting, timelines, and coordination between regulation bodies. It also pinpoints gaps and inconsistencies in the current framework and makes suggestions on how to enhance transparency, speed and ease of doing business in outbound FDI transactions. In the context of this research, I aim to contribute towards the broader discourse surrounding the international investments and also offer many useful insights to the policymakers, business, and legal practitioners who deals with the cross border financial transactions.

Keywords: Outbound Investment, Indian Entities, Reporting Obligations, Foreign Direct Investment (FDI), Foreign Exchange Management Act (FEMA), Reserve Bank of India (RBI), Department for Promotion of Industry and Internal Trade (DPIIT), Compliance, Cross-Border Transactions

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INTRODUCTION

Indian businesses over the past few years have been going beyond domestic markets to exploit growth opportunities in international markets. A series of regulatory reforms around supporting global competitiveness have facilitated the practice of outbound investing, by Indian entities. But the legal and procedural framework regulating these investments can be complex and difficult for businesses to navigate. To deficit this need for balancing in outward foreign direct investment (FDI), the Indian government has established a hierarchy of regulatory regimes through the Reserve Bank of India (RBI), Ministry of Finance together with the Department for Promotion of Industry and Internal Trade (DPIIT).

The rules by which Indian entities invest abroad are dealt with primarily under the Foreign Exchange Management Act (FEMA), its related guidelines and foreign direct investment (FDI) regulations. According to these regulations, the reporting requirements and how to get approval or other matters — both for protection of the client and society — will vary depending on the size and kind of the investment. While these legal frameworks are in place there are challenges relating to compliance with reporting obligations, obtaining the required approval, and working with international tax regimes and bilateral agreements generally.

The objective of this paper is to analyze in detail the legal framework applicable to outbound investments by Indian entities with a special focus on the reporting obligations and procedural hurdles undertaken by entities during FDI transactions. This study attempts to deepen the understanding of the challenges resulting from outbound investment by analyzing existing legal provisions and helping to fill the existing gaps and inconsistencies in the regulatory structure as well as by demonstrating the practical difficulties business encounter in this area. Additionally, it suggests suggestions that would simplify the procedural component and meet the objective of improving the operational phase of the existing regulation by delivering a more transparent and business friendly climate to outbound investors.

What is an Outbound Investment?

Capital which is put into a foreign entity by an individual or organization is called outbound investment. One way of doing this is by going on the entity's memorandum, investing in it by subscribing its capital or purchasing its existing shares through private placement, market

purchase or on the stock exchange. The investment made here is long term and in a foreign entity, which can be either wholly owned subsidiary or a joint venture abroad. Purchasing financial instrument of foreign companies does not mean that outbound investments are done though; they ought to stick to applicable laws and regulation.

Therefore, outbound investments are that the capital that individuals, companies, or companies make available in companies and also assets positioned outdoors their house country. Typically, these investments mean a long term financial interest in foreign entities, for example, wholly owned subsidiaries, joint ventures, or other international ventures. There are many ways through which a company can achieve foreign investment including direct investment through buying of shares or equity in foreign companies, setting up subsidiaries or branch in foreign land, and joint venture with foreign partners. Outbound investments can include the purchase of a company's physical or intellectual assets and the investment in bonds or securities that were issued by certain foreign entities. These investments allow businesses and private persons to obtain new markets, expand on the richness of the portfolio, and enhance business efficiency through global risks. They, however, are regulated to maintain the alignment with policies of the home country financial and economic policies.¹ Various major corporations, such as Tata, Reliance, and Infosys have been engaging in mergers, acquisition and joint venture to expand their business globally.

Much of India's outbound investments has been through wholly owned subsidiary and joint venture projects aimed at markets with created of offering growth and diversification opportunities. Around 60 percent of India's total ODI in FY 2022-23 was in equity investments, while the rest was in loans and guarantees.² Out of \$118 billion total investments, it has been seen that U.S. and Singapore are among the most important sources of Indian ODI. It has indicated the growing internationalisation of India economy and capacity to contribute to the global economy.³

Legal Framework under FEMA

Export capital investments are controlled under FEMA 1999 and regulations published by the RBI to that effect. The policies governing such a type of investment are Foreign Exchange Management (Overseas Investment) Regulations of 2004, with updates of 2022. These

¹ Reserve Bank of India (RBI), *Overseas Direct Investment Data, FY 2022-23*.

² Ministry of Finance, Government of India, *Annual Report on Overseas Direct Investment*

³ EY Report, *India's Global Expansion: ODI Trends and Opportunities*, August 2023.

regulations apply to Indian entities as well as individuals, to list down the procedures followed to identify who can invest where and whom and which areas or sectors investment is allowed or restricted.⁴

FEMA also applies on the subsequent entities: an Indian company; a Limited Liability Partnership (LLP); or an individual residing in India. Currently, Indian companies can commit up to 400 percent of their net worth for overseas investment for equity and loan, guarantee, and other exposures. For individuals the LRS scheme has been arranged to enable them remit up to two hundred and fifty thousand US dollars each financial year for investment. Investment can be made in stock, bonds, and properties and can cover a wholly owned unit, a joint venture or a foreign company. Nevertheless, the business is restricted to investing in sectors like defence, banking and real estate sectors except being used for business purposes.

The procedures for outbound investments are divided into two categories: Automatic approval, where investing is possible without the RBI's prior approval, and the approval route, where the investor needs the RBI's permission when the investment exceeds specific amounts or falls into specific sensitive sectors. The investors must fill up the form ODI with their authorized dealer banks for this purpose and they must also file Annual Performance Report (APR) to RBI in order to trace the performance of such investment. Section 6(3) of FEMA specifies the legal and permitted transactions in foreign exchange while Section 47 explains the consequences that accompanies violation of FEMA. n overseas ventures, including equity, loans, guarantees, and other commitments. For individuals, the Liberalized Remittance Scheme (LRS) allows them to remit up to USD 250,000 per financial year for investments abroad. Investment can be made in the form of equity, debt instruments, or real estate, and may involve wholly owned subsidiaries, joint ventures, or foreign companies. However, investments in sectors such as defense, banking, and real estate (except for business purposes) are prohibited.

The procedures for outbound investments are divided into two categories: the automatic route, where investments are allowed without prior RBI approval, and the approval route,

⁴ Enterslice. (n.d.). *Outbound Investment under FEMA* – Enterslice. ENTERSLICE PRIVATE LIMITED
<https://enterslice.com/outbound-investment-under-fema>

which requires RBI permission for investments exceeding certain limits or falling under sensitive sectors. Investors must submit Form ODI to their authorized dealer banks, detailing the investment, and must also submit an Annual Performance Report (APR) to the RBI to track the investment's progress. Key provisions under FEMA, such as Section 6(3), outline the permissible foreign exchange transactions, and Section 47 establishes penalties for non-compliance with the regulations.

Changes made that went into effect in 2022 sought the increase of freedom, primarily in investing in foreign start-ups and emerging markets. The changes permit the participation in the overseas sectors of financial services to a certain extent especially in insurance and mutual fund segments. Such regulations in combination with sections like the Regulation 9 and the Rule 5 contained within FEMA 2000 Regulations maintain heightened vigilance over outward investment and foster Indian organization and individual's international business ventures. In sum, the legal system as is set out to help India integrate with world economy while having certain checks on capital mobility and foreign exchange as well as interests of the nation.

Who are the Eligible Investors & Investees?

Under the framework of the Foreign Exchange Management Act (FEMA), several categories of investors and investees are eligible for outbound investments. The regulations define who can invest abroad and where these investments can be directed, based on the type of investor and the destination of the investment. Below are the eligible investors and investees for outbound investments:

Eligible Investors

According to FEMA having classified the investors and investees several categories are allowed to invest abroad. The regulations capture the kind of investment that can be made in a foreign country and to which kind of investor, depending on the characteristics of the country of destination. Below are the eligible investors and investees for outbound investments:

1. Indian Companies (Private and Public)

- **Private Limited Companies:** These entities can directly invest in matters such as subsidiary based overseas companies, joint operations or other overseas business.
- **Public Limited Companies:** Public companies can also invest outwards so long they are within the stipulated financial guidelines stated by FEMA. The regulation regarding minimum net worth which is mandated for companies to meet for having investments overseas applies to all public companies.
- **Limited Liability Partnerships (LLPs):** Another important factor is that LLPs are also allowed to invest overseas but within the same restrictions as private and/or public companies.

2. Resident Individuals

- Under the Liberalized Remittance Scheme (LRS): Every year Indian individuals can invest up to \$ 250000 for different purposes like investing in foreign shares, mutual funds, properties and other. This scheme helps those individual investors who are willing to invest in foreign portfolio but as per some conditions like the types of investment or the country they are willing to invest.

3. Indian Financial Institutions

- **Banks and Financial Institutions:** They may invest directly in these foreign counterparts or may offer loans and guarantees to their overseas affiliated companies. These investments are strictly UIBarossed and require clearance from the central bank of India, the Reserve Bank of India (RBI), in some cases.

4. Indian Pension Funds and Insurance Companies

- They may also engage in outward investment as allowed under FEMA and clearance of RBI or the Insurance Regulatory and Development Authority of India.

5. Other Bodies Approved by the RBI

- This together with other business entities as per the RBI regulations that are allowed to invest in overseas, with certain conditions and restrictions including those entities carrying out business in certain sectors like insurance firms or mutual funds.

Eligible Investees

1. WHOLLY OWNED SUBSIDIARY (WOS)

- Indian companies can even open their offices in foreign countries as wholly owned subsidiaries. Such entities are wholly owned subsidiaries of the Indian parent and they can undertake the same business as the parent or venture into other businesses in different locations.

2. Joint Ventures (JVs)

- Cross-border involvement may occur through a joint venture where equity ownership is divided between the Indian entities and foreign firms. The joint venture could be in any foreign sector that country laws permit.

3. Foreign Companies

- Indian entities can also invest inward directly through Computer Related Integration of India Purchase Committee, limited by the regulation of FEMA through bought shares or equity in existing firms or through otherwise by the use of bonds and debentures.

4. Foreign Financial Instruments

- Investments can also take the form of foreign securities like common equity, mutual funds, ETF's, and both domestic and foreign bonds traded in overseas stock markets.

5. Property investment in Real Estate

- Companies or residents of India may also acquire interest direct in real estate outside India for establishment of business such as production plants or business outlets. But direct investment in foreign real estate is limited and these are essentially allowed only for business

purposes.

6. Foreign Branches

- Indian companies can also open branches for business outside the country, with the business venture following the laid down legal provisions as well as reporting norms. These branches can perform activities like those of Indian branches provided legal frameworks permit it.

7. Foreign Debt Instruments

- The debt securities such as bonds, debentures, or any other credit instruments which can be owned by Indian entities are bonds, debentures issued by foreign governments or private bodies.

8. Small Business and New Economies

- Holding current licence the Indian entities are now able to invest in overseas start-ups and emerging markets. This consists of capital expenditure on sectors such as technology, healthcare and the growth sectors.

Challenges faced by Indian Entities

Some of the major challenges that Indian entities encounter while undertaking Overseas Direct Investment are regulatory, reporting issues and environment factors. The regulatory and compliance issues form one of the most complex areas of consideration because FEMA involves so many compliances and reports such as form ODI and Annual performance reports to the RBI. The above reporting requirements are important in as much as they enhance transparency, but they can be onerous more so to firms with many abroad investments or subsidiaries. Any regulatory compliance required in high-security areas such as banking, defense, or real estate entails a lot of time hence being an uncertain factor that elongates the time taken to make investment decisions. Also, the measures of check and balance including 400 percent ceiling on net worth of an entity may hamper expansion, especially for the large or capital-intensive house that may wish to expand aggressively in foreign markets. Foreign currency risks and exchange rates also add more complexity in investments since exchange fluctuation can either reduce the value of the returns, or increase the cost of overseas operations. Another problem is regulatory issues, legal and tax requirements across borders

since they continue to be subjected to both Indian and foreign laws governing tax treaties and transfer pricing legislation and local business laws governing the country of operation. Further, it is also rather complex to learn and comprehend the particular rules of the distinct jurisdiction, particularly, if the systems are dissimilar. FEMA regulations change quite often, and the regulatory environment may differ across countries, meaning that businesses must set aside time and money to monitor FEMA regulations and, where necessary, obtain professional advice. These challenges make overseas expansion a rigid and capital intensive affair for Indian organizations that require strategic planning, efficient risk management and appropriate legal and financial infrastructure in order to overcome the challenges of global investment.

CONCLUSION

In conclusion, FEMA under its provision of regulation of outbound Investments offer Indian entities a fairly structured and legal approach to going global. However, apart from achieving the objectives of aligning the investments with the FDI policies of India along with protection of the economic interests of the country, the regulations also put forward certain reporting requirements and procedural concerns that are to be faced by the entities. These reporting necessities for instance; Form ODI, Annual Performance Reports (APR) and Annual Return on Foreign Liabilities and Assets (FLA) are important in sustaining the transparency and tracking of investment flows. But compliance remains conservative, complicated by sector-by-sector approval, and foreign exchange risks as vital factors challenging business. However, I have failed to incorporate following factors: Firstly, the regulatory changes are quite common in the financial markets, and secondly, cross border legal complexities make the management even more challenging. Nonetheless, the legal structure of outbound investments still continues to be an effective instrument in the expansion of Indian business to international markets. For getting a better control on the function and avoiding fraudulent, Indian Business firms have to create conformity framework and consult with professional who deal in this field and still they have to read different policies that are changed frequently. If tackled appropriately, outbound international business investments can turn the challenges above into opportunities for improving the firms' competitiveness in the global economy.

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