Firms re-evaluate biz structures for setting up overseas entities

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By Ashley Coutinho

The new regime for overseas direct investment (ODI) is prompting Indian conglomerates to re-evaluate their business structures for setting up overseas entities. Indian startups looking at flipping into overseas structures may also re-evaluate their investment holding structures.

This is being done for a variety of reasons ranging from ease of listing abroad and raising capital to servicing of foreign customers and doing business overseas. However, the investment can flow only into foreign entities carrying on bonafide business activities.

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"Many Indian entities have restarted exploring investment opportunities which were earlier subject to a lot of uncertainty given the extended timeline and extensive information requirement," said Moin Ladha, partner, Khaitan & Co.

"There were ambiguities in the law earlier but many start-ups still implemented offshore holding company structures in the past. Now, entities can do these easily given the relaxations provided by RBI," said Bhavin Shah, deals leader at PwC India.

Indian entities could not invest in foreign entities earlier if they had an India connection and an RBI approval was needed for the same. The apex bank would look into the requests for approvals on a case-to-case basis.

The new ODI rules/directions permit transactions by Indian entities in foreign entities provided they do not have more than two layers of subsidiaries, directly or indirectly. However, such restriction will not apply to banks, systematically important non-registered non-banking financial companies, insurance firms and government companies.

Last week, Sebi allowed outbound investments from Indian alternative investment funds or venture capital funds into foreign entities without an Indian connection.

“The regulatory move has already broadened the scope of investments by Indian entities and individual residents in overseas entities. The new rules have also streamlined the mode of these investments, paving the way for cleaner structures to facilitate investments and raising of funds at a global level,” said Rachna Jain, senior partner, Desai & Diwanji.

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Clarifications on deferred payment as well as indemnity are an added layer of encouragement to interest global investors, added Jain. The purchase consideration of foreign security may be deferred for a definite period as indicated in the agreement, subject to compliance with applicable pricing guidelines and other conditions. The new norms also permit the buyer to seek indemnity from the seller up to such amount as may be mutually agreed upon among themselves subject to compliance with FEMA.

Two tax-friendly jurisdictions – Mauritius and Singapore – along with the US, the UK and the Netherlands are the top five preferred jurisdictions for outbound investments from India, according to Desai & Diwanji.

Clarity awaited

Market watchers believe the government or the RBI is likely to issue an FAQ to clarify certain aspects regarding layering, portfolio investments and pricing guidelines.

“Clarity may be required as to whether foreign entities operating as pure holding company structures could be regarded as carrying on bonafide business activities or be deemed to be engaged in financial services, investment into which has also now been permitted provided the Indian investor entity is making profits for at least three years," said Parul Jain, head of fund formation at Nishith Desai Associates.

An Indian entity not engaged in financial services activity in India can now make ODI in a foreign entity, which is directly or indirectly engaged in financial services activity, except banking or insurance, subject to the condition that such Indian entity has posted net profits during the preceding three financial years. This will allow Indian businesses to access investment opportunities abroad.

"There is clarity needed on the limitation of two layers of subsidiaries. On cashless ESOPs, the RBI may want to specify whether shares can be issued from group entities, where holding-subsidiary relationship does not exist. Lastly, pricing guidelines suggest that the investment has to be at fair value but commercial price will always be different than valuation arrived at by a valuer. The question is whether fair value as per valuation report should be regarded as maximum cap," said Shah.

According to Nishith Desai's Jain, the restriction for two layers of subsidiaries may not apply in the event that the foreign entity has no control over the subsidiary investments. However, this may also need to be clarified further. "The issue of Indian startups flipping into overseas structures also raises questions on how Indian promoters may participate in such foreign holdings, which seems to be a challenge under the new rules," said Jain.

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