

VALUATION INDIA INSIGHT SERIES 2025

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Issued Oct - 2025

***Navigating Strategy, Governance &
Compliance in a Transforming
Business Landscape***

Published by: Valuation India Division of VI Advisors Pvt. Ltd.

Advisory • Valuation • Strategy • Governance

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New FEMA & Income-Tax Trends Shaping Cross-Border Investments Introduction



FEMA

For Indian enterprises with overseas operations or aspirations, 2025 is turning out to be a pivotal year. Recent amendments and evolving interpretations under the **Foreign Exchange Management Act (FEMA)** and **Income-tax Act, 1961** are reshaping the way Indian companies, especially SMEs, structure and manage their cross-border investments.

The new compliance landscape is not merely about restrictions; it offers opportunities for smarter, compliant, and tax-efficient global expansion.

1. The Emerging Regulatory Landscape

Regulatory Area	Recent Change / Focus	Impact on Businesses
Overseas Direct Investment (ODI)	Revised FEMA (Overseas Investment) Rules, 2022 operationalized through RBI clarifications in 2024–25	Clearer framework for round-tripping, step-down subsidiaries, and investment reporting
Taxation of Global Income	Greater emphasis on “Place of Effective Management” (POEM) and Controlled Foreign Company (CFC) principles	Indian entities with overseas control must justify substance and commercial rationale
Repatriation and Dividend Taxation	Shift from Dividend Distribution Tax to shareholder-level taxation	Higher importance of treaty planning and credit optimization
Liberalized Remittance Scheme (LRS)	New digital reporting system and risk filters introduced by RBI	Simplified process, but tighter monitoring of end-use
Transfer Pricing and BEPS 2.0	Alignment with OECD Pillar Two – Global Minimum Tax	Impacts profit allocation for Indian MNCs and subsidiaries abroad

*The key trend: **Regulatory scrutiny is intensifying, but clarity and digitization are enabling compliant cross-border operations.***

2. FEMA: From Restrictive to Strategic

The FEMA framework has evolved from being control-driven to facilitation-oriented. Recent RBI circulars and FAQs under the ODI/FDI rules highlight the following:

a. Round-Tripping & Layering Controls

- Investments where Indian funds circle back to India through multiple jurisdictions are under close watch.
- The RBI now requires “bona fide business intent and commercial substance” in all foreign structures.
- Example: Indian holding companies routing investments via Singapore or Dubai must demonstrate active operations abroad, not just a holding entity.

b. Overseas Step-Down Subsidiaries

- Entities can now have multiple layers of overseas subsidiaries, provided ultimate ownership and control are transparent.
- Each layer must comply with the arm's length and beneficial ownership conditions under FEMA and PMLA norms.

c. Dividend and Disinvestment Rules

- Proceeds from disinvestment must be repatriated to India within 90 days, except where reinvested for strategic expansion.
- Boards must now ensure fair valuation using methods aligned with internationally accepted standards (DCF, NAV, Comparable Approach).

3. Income-Tax: Navigating Cross-Border Complexity

a. Re-examining Tax Residency

The **POEM test**—which determines if a foreign company is effectively managed from India—has become critical. Boards and CFOs must ensure:

- Strategic decisions are demonstrably taken abroad.
- Local directors, meetings, and governance documents support substance.

Failure may trigger global income taxation in India.

b. Controlled Foreign Corporation (CFC) Risk

The tax department increasingly examines **Indian-controlled foreign entities** to identify undistributed passive income. Though India has not yet formally adopted CFC rules, the **GAAR** and **BEPS frameworks** are being used to achieve similar outcomes.

c. Transfer Pricing Vigilance

Cross-border service arrangements, royalty payments, and intra-group loans are under closer scrutiny. Companies are expected to maintain:

- Detailed inter-company agreements,
- Economic substance of pricing, and
- Country-by-country reporting (CbCR) compliance.

4. Strategic Implications for SMEs with Overseas Exposure

SMEs expanding to foreign markets are no longer exempt from complex compliance expectations. Key considerations include:

Area	Strategic Focus	Action Point
Investment Structuring	Ensure commercial substance and transparent ownership	Conduct pre-investment FEMA review
Tax Planning	Optimize treaty benefits; avoid artificial structures	Evaluate tax residency and permanent establishment risks
Funding Routes	Consider ECB vs. equity vs. hybrid instruments	Align with FEMA debt-equity norms
Repatriation	Plan dividend, royalty, or management fee flows efficiently	Utilize DTAA credits and repatriation planning
Governance	Strengthen documentation and board oversight	Maintain local audit and regulatory compliance in host country

5. Practical Insights and Trends

- Shift toward Singapore and GIFT IFSC:** As Mauritius faces scrutiny, firms prefer Singapore or IFSC routes for compliant cross-border vehicles.
- Use of Alternate Investment Funds (AIFs):** AIFs are becoming the preferred vehicle for outbound portfolio investments.
- Digital FEMA Compliance Portals:** RBI's new Foreign Investment Reporting and Management System (FIRMS 2.0) will integrate ODI, FDI, and LRS monitoring.

4. **Global Minimum Tax (GMT) Readiness:** Multinationals must evaluate exposure to 15% global tax under OECD Pillar Two.

6. The Way Forward

Cross-border investment strategy now demands an interdisciplinary approach—combining regulatory knowledge, tax foresight, and valuation logic. Indian SMEs and mid-sized corporates should:

- Engage FEMA and tax experts jointly during deal structuring.
- Adopt fair valuation and transfer pricing frameworks upfront.
- Ensure board-level documentation of overseas investment rationale.

These steps not only safeguard compliance but enhance bankability, investor confidence, and global credibility.

Conclusion

India's new FEMA and Income-tax trends signal a maturing investment environment—transparent, monitored, and globally aligned.

For SMEs with overseas exposure, this is not a challenge but a chance to professionalize cross-border governance. Those who treat compliance as strategy, not an afterthought, will lead India's next wave of outbound growth.

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