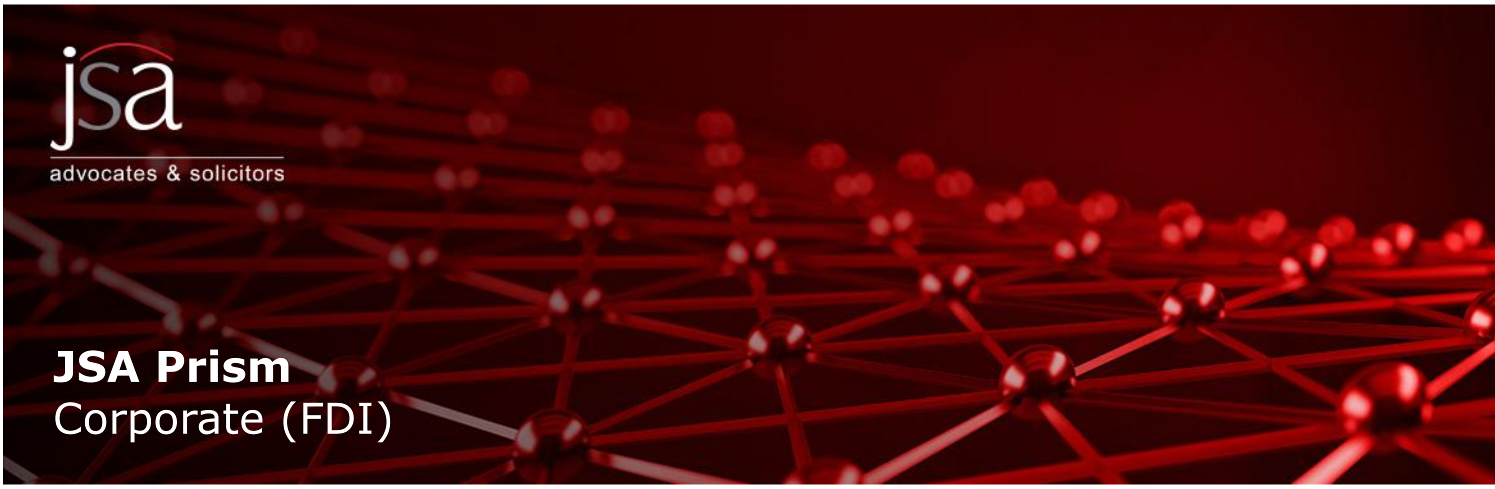

July 2026

Simplifying foreign investments in India: analysis of the draft Foreign Exchange Management (Foreign Investment) Rules, 2026

The Reserve Bank of India ("**RBI**"), on July 21, 2026, has published the draft Foreign Exchange Management (Foreign Investment) Rules, 2026 ("**Draft FI Rules**"), and invited comments on the same by August 31, 2026. The Draft FI Rules, upon being made effective, will supersede the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 ("**NDI Rules**").

The intention of the RBI to simplify the framework for foreign investment in India is appreciable and much needed. However, in the process of simplifying the framework and rules, it appears that some long-established principles for such foreign investment may be compromised or impacted unless the drafting of the Draft FI Rules is suitably revised. It is therefore imperative that all stakeholders provide their comments on the consultation paper to ensure that the final version of the Draft FI Rules acts as a positive catalyst to improve the ease of doing business in India.

Grandfathering provisions

As a preliminary observation, the Draft FI Rules contain grandfathering provisions which preserve and validate all acts undertaken under the erstwhile NDI Rules upon supersession of the same. This provision preserves the actions previously undertaken and enables continuity and preservation of past actions taken by stakeholders.

Applicability

The Draft FI Rules, upon implementation, will apply to "*any foreign investment in equity of an eligible investee entity by a person resident outside India or transfer thereof*". The applicability of the Draft FI Rules contains a carve-out and accordingly, the Draft FI Rules would not apply to investments made by a person resident outside India in a financial institution set up or incorporated in an International Financial Services Centre.

Focus on equity instruments

Interestingly, while the title of the existing NDI Rules refers to 'non-debt instruments', the Draft FI Rules propose to reduce the complication with the usage of the term 'foreign investments'. Given that the regime in this regard was always applicable to equity instruments, the change in terminology will simplify the understanding surrounding the rules further.

Further, the Draft FI Rules directly define the term 'equity'. This is a departure from the existing NDI Rules which define the term 'non-debt instruments' and the definition of 'equity instruments' was derived by carving out the definition of 'debt instruments'. This complication would be done away with by the introduction of a clear definition of 'equity'.

Equity has been defined to include the following:

1. instruments classified as equity by the eligible investee entity, other than an investment vehicle, as per applicable accounting standards;
2. unit of an investment vehicle as per the respective the Securities and Exchange Board of India ("**SEBI**") regulations;
3. 'Participating interest or right' in oil fields or mines of an Indian company or a Limited Liability Partnership ("**LLP**").

The definition of 'equity' in the first limb of the above definition under the Draft FI Rules is tied to the 'applicable accounting standards' (primarily, Indian Accounting Standard 32 ("**Ind AS 32**")). Under the Ind AS 32, an instrument qualifies as equity only if it satisfies certain criteria, including the 'fixed-for-fixed' test, i.e., a fixed number of shares for a fixed amount of consideration. Compulsorily convertible instruments (compulsorily convertible debentures, compulsorily convertible preference shares) and share warrants with fixed conversion ratios should qualify, but instruments with variable conversion ratios or mandatory cash payout obligations (such as interest payable) may be classified as financial liabilities.

Due to the definition of equity, it remains unclear as to whether simple agreement for future equity (SAFE) notes and convertible notes issued by startups would fall under this category.

Linking the definition to accounting standards could also lead to an increased role for accountants/auditors in determining whether an instrument qualifies as equity, specifically in cases where the terms of the instrument are not standard.

Further, the Draft FI Rules will expand the third limb to include LLPs, which were not expressly provided under the definition of 'equity instruments' in the NDI Rules.

Introduction of the concept of 'Eligible Investee Entity'

The Draft FI Rules have introduced the concept of 'Eligible Investee Entity'. The Draft FI Rules will apply to foreign investments into equity instruments of such 'Eligible Investee Entities'. An 'Eligible Investee Entity' includes the following:

1. a company as defined in the Companies Act, 2013;
2. a body corporate established or constituted by or under any Central or State Act, which is incorporated in India;
3. an LLP registered as such under the Limited Liability Partnership Act, 2008;
4. an investment vehicle registered with the SEBI and includes: (a) real estate investment trusts; (b) infrastructure investment trusts; (c) alternative investment funds; (d) venture capital funds; (e) mutual funds or exchange-traded funds; or any other investment vehicle which invests more than 50% in equity which are registered and regulated under the respective SEBI regulations;
5. a partnership firm registered under the Indian Partnership Act, 1932; and
6. a proprietary concern registered under the applicable domestic laws.

The definition expressly excludes societies and trusts (which should be read as trusts, other than those specifically identified in sub-para (d) above regarding investment vehicles).

The definition expressly captures any investment vehicle investing more than 50% in equity that is registered and regulated under the SEBI regulations. This will represent a minor liberalisation, as the scope is now limited to the equity investment threshold rather than an exhaustive enumeration along with the investment threshold under the NDI Rules.

It will expand the scope of investee entities to include ‘partnership firms’ registered under the Indian Partnership Act, 1932 and ‘proprietary concerns’, a change from the NDI Rules, which currently permit Non-Resident Indian (“**NRI**”) or Overseas Citizen of India (“**OCI**”) capital contributions only on a non-repatriation basis.

Partnership firms registered under the Indian Partnership Act, 1932 are registered with the Registrar of Firms at the state level. Registration itself is optional and unregistered partnerships (which are very common in India) would be excluded from foreign investment (which was earlier permissible for OCI and NRI investments). Reporting mechanisms will require review given the minimal regulatory reporting under the Indian Partnership Act, 1932 and the practical difficulties of registering existing firms under the Indian Partnership Act, 1932 in order to become eligible to receive foreign investment.

Additionally, the changes proposed raise interpretive questions since India lacks a uniform registration framework for proprietary concerns. Therefore, clarification on what constitutes valid ‘registration’ for a proprietary concern would be required.

The definition of equity will bring clarity regarding the entities in which foreign investment will be allowed, which was otherwise required to be deduced under the NDI Rules from the notes and explanations to associated definitions. Notably, several provisions of the Draft FI Rules do not use this defined term and instead use ‘a company or an LLP’, thus indicating that the expanded scope of this term will not be applicable in all situations. However, it is useful to flag that the definition of company would include a Section 8 company under the Companies Act, 2013, and considering the expanded scope, it will be interesting to see if Section 8 companies limited by guarantee can receive foreign investment.

Unified definition of ‘foreign investment in equity’

The Draft FI Rules define ‘foreign investment in equity’ as investment in equity of an eligible investee entity by a person resident outside India, whether made directly or indirectly through a Foreign Controlled Entity (“**FCE**”) or any other offshore entity under common ownership or control with the direct investor. This marks a departure from the NDI Rules, which defined ‘foreign investment’ more narrowly as investment made ‘on a repatriable basis’ in equity instruments of an Indian company or the capital of an LLP, with indirect investment dealt with separately through the concept of ‘indirect foreign investment’ in the downstream investment context.

The Draft FI Rules consolidate these into a single unified definition and remove the repatriation-basis qualifier altogether, treating non-repatriable investment as ‘foreign investment’ from the outset and addressing repatriation only as a conditions-based carve-out. Interestingly, the definition of sectoral cap introduced under the Draft FI Rules is the maximum aggregate amount of foreign investment on a repatriation basis.

A key change would be the ‘control’ test embedded in this definition, which now captures shareholders' or voting agreements that entitle the holder to 10% or more of voting rights. This threshold is considerably lower than the NDI Rules’ tests, which define ‘control’ for companies by reference to the Companies Act, 2013 and for LLPs by reference to the right to appoint a majority of designated partners, with no fixed voting percentage. Crucially, any entity with 10% foreign shareholding will be considered an FCE (explained below), and will have to comply with applicable requirements, including in relation to downstream investments made by it in India. If implemented as is, this threshold for control would require several foreign investors to re-evaluate the manner of their investments in Indian investee entities.

Introduction of FCE concept

The Draft FI Rules propose to introduce FCE as a standalone concept, defined as a resident company, LLP or investment vehicle that is 'owned or controlled' by a person resident outside India. This will replace the NDI Rules' more fragmented approach, which built the same idea indirectly through the downstream investment framework using multiple interlocking definitions. While the FCE concept will be a welcome simplification in drafting, it does not carry forward the specific downstream compliance mechanics from the NDI Rules, such as board approval, funding-source restrictions and statutory auditor certification for first-level Indian companies. However, downstream investments by FCEs (the scope of which is intended to be expanded, as mentioned above) will have to comply with the entire framework applicable to foreign investments. It will be interesting to see if reporting obligations for investment by FCEs will be modified to take into account the proposed changes in the framework.

Simplification of investments by way of gift and pledge

The Draft FI Rules propose to permit foreign investment by way of gift between natural persons, but only address gifts made on a repatriation basis by a person holding on a non-repatriation basis, requiring the donee to be a 'close relative' under the Companies Act, 2013 and the value transferred to be within the liberalised remittance scheme limits. While the Companies Act, 2013 defines a 'relative', it will be interesting to see if a more narrowed definition for 'close relative' is proposed as part of clarifications to the Draft FI Rules. It is important to note that the Draft FI Rules contemplate gifting only between natural persons.

The above differs materially from the NDI Rules' comprehensive gift regime for resident-to-non-resident transfers, which include a 5% paid-up capital cap (cumulative, person to person), a USD 50,000 (US Dollars fifty thousand) annual ceiling, a requirement that donor and donee be 'relatives' under Section 2(77) of the Companies Act, 2013, mandatory prior RBI approval, and sectoral cap confirmation.

Similarly, the Draft FI Rules propose to permit investment by way of pledge subject only to general conditions applicable to foreign investment, which will replace the NDI Rules' detailed pledge regime that separately addresses promoter pledges securing external commercial borrowings (including statutory auditor end-use certification and authorised dealer no-objection requirements) and pledges in favour of Indian banks, overseas banks or registered non-banking financial companies.

Pricing guidelines

The Draft FI Rules seek to restate pricing guidelines in a very condensed 3 (three) limb format, requiring the foreign investment to be made at a price:

1. determined in accordance with the SEBI regulations for listed companies and investment vehicles;
2. determined in accordance with conditions provided in Annexure – I of the Draft FI Rules for companies listed on an international stock exchange; and
3. determined, in all other cases, at arm's length valuation under an internationally accepted methodology certified by a chartered accountant, merchant banker or cost accountant. The pricing guidelines do not apply to rights-based subscriptions (such as rights issuance).

The key issue with the above formulation is that for transfers covered by the third limb above, it seems to suggest that all transfers, irrespective of whether the transfers are resident to non-resident or *vice versa*, must be conducted at the fair market value of the securities. This formulation lacks the nuanced approach set out in the NDI Rules, which had set out separate pricing formulae for issuances, resident to non-resident transfers and *vice versa* (with a base and ceiling approach). It sets out an explicit rule that convertible instrument conversion prices must be fixed upfront and cannot at conversion be lower than the fair value at issuance, and a merchant-banker valuation requirement for swaps. This provision should be significantly revised to provide for a clear framework for such transfers, including a nuanced clarification for how the pricing will apply where the buyer is an FCE (this is currently a significant challenge when structuring transactions where the FCE is purchasing shares of an Indian company from both resident and non-resident sellers). The current formulation will also require companies to issue shares to investors at fair value, and not at a price exceeding fair value.

It is also noteworthy that foreign investment on a non-repatriation basis will not require compliance with pricing guidelines.

Reporting obligations

The Draft FI Rules propose to place the 'onus of compliance' jointly on "*the foreign investor and the eligible investee entity or transferor and transferee in a foreign investment*". This will represent a significant expansion of compliance responsibility compared to the NDI Rules. Under the NDI Rules, the onus of compliance was placed on the company receiving foreign investment. In the case of downstream investments, this responsibility is on the first level Indian company making downstream investment while in the case of a transfer, the obligation is on the resident. The Draft FI Rules propose to broaden the compliance framework by extending accountability to the foreign investor. and, in the case of transfers, to both the transferor and transferee. This marks a significant shift that may require foreign investors to reassess their compliance frameworks and due diligence practices. As a practical matter, it is not clear how this can be enforced against a foreign investor; for example, if the foreign investor were to exit and have no other presence in India after a given transaction.

Miscellaneous

The following significant provisions of the NDI Rules, *inter alia*, have not been expressly carried forward in the Draft FI Rules: (a) the deferred consideration, escrow and indemnity-holdback mechanisms for share transfers; (b) the express rule governing equity issuances in National Company Law Tribunal-approved schemes of merger, amalgamation and demerger; (c) the employee stock ownership plan, sweat equity and share-based employee benefit regime; and (d) the specific convertible note framework for startups. Further clarity may be required on whether these are intended to be reintroduced through subordinate RBI directions or are proposed to be discontinued.

Conclusion

The proposed Draft FI Rules will represent a significant step towards liberalising and streamlining India's foreign investment regime. The Draft FI Rules propose to introduce several notable reforms, including an expanded definition of 'eligible investee entity', a new framework for FCEs, and joint responsibility for regulatory compliance. However, a number of issues remain unresolved, including ambiguities in the Draft FI Rules, the status of provisions omitted from the existing NDI Rules, and the manner in which the Draft FI Rules will operate alongside the RBI directions expected to be issued separately.

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