



# INDIAN JOURNAL OF LEGAL AFFAIRS AND RESEARCH

VOLUME 3 ISSUE 1

Peer-reviewed, open-access, refereed journal

**IJLAR**

+91 70421 48991  
editor@ijlar.com  
www.ijlar.com

## **DISCLAIMER**

The views and opinions expressed in the articles published in the Indian Journal of Legal Affairs and Research are those of the respective authors and do not necessarily reflect the official policy or position of the IJLAR, its editorial board, or its affiliated institutions. The IJLAR assumes no responsibility for any errors or omissions in the content of the journal. The information provided in this journal is for general informational purposes only and should not be construed as legal advice. Readers are encouraged to seek professional legal counsel for specific legal issues. The IJLAR and its affiliates shall not be liable for any loss or damage arising from the use of the information contained in this journal.

## **Introduction**

Welcome to the Indian Journal of Legal Affairs and Research (IJLAR), a distinguished platform dedicated to the dissemination of comprehensive legal scholarship and academic research. Our mission is to foster an environment where legal professionals, academics, and students can collaborate and contribute to the evolving discourse in the field of law. We strive to publish high-quality, peer-reviewed articles that provide insightful analysis, innovative perspectives, and practical solutions to contemporary legal challenges. The IJAR is committed to advancing legal knowledge and practice by bridging the gap between theory and practice.

## **Preface**

The Indian Journal of Legal Affairs and Research is a testament to our unwavering commitment to excellence in legal scholarship. This volume presents a curated selection of articles that reflect the diverse and dynamic nature of legal studies today. Our contributors, ranging from esteemed legal scholars to emerging academics, bring forward a rich tapestry of insights that address critical legal issues and offer novel contributions to the field. We are grateful to our editorial board, reviewers, and authors for their dedication and hard work, which have made this publication possible. It is our hope that this journal will serve as a valuable resource for researchers, practitioners, and policymakers, and will inspire further inquiry and debate within the legal community.

## **Description**

The Indian Journal of Legal Affairs and Research is an academic journal that publishes peer-reviewed articles on a wide range of legal topics. Each issue is designed to provide a platform for legal scholars, practitioners, and students to share their research findings, theoretical explorations, and practical insights. Our journal covers various branches of law, including but not limited to constitutional law, international law, criminal law, commercial law, human rights, and environmental law. We are dedicated to ensuring that the articles published in our journal adhere to the highest standards of academic rigor and contribute meaningfully to the understanding and development of legal theories and practices.

# **AMENDMENTS TO THE FOREIGN EXCHANGE MANAGEMENT (NON-DEBT INSTRUMENTS) RULES, 2019: AN IN-DEPTH ANALYSIS**

AUTHORED BY - PRATHA PARAS

## **ABSTRACT**

*This paper presents a comprehensive analysis of the recent amendments made by the Government of India to the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 through a notification issued on August 16, 2024. The paper begins with an overview of the Foreign Exchange Management Act, 1999 (FEMA), which serves as the legal framework governing foreign investments in India. Under this Act, the government and the Reserve Bank of India (RBI) are empowered to issue rules and directives that regulate foreign exchange transactions, including foreign investments.*

*The Non-Debt Instruments Rules, 2019, extend the provisions of the parent Act, specifically addressing foreign investment transactions involving non-debt or equity instruments, distinguishing them from transactions involving debt instruments. Unlike debt instruments, which are typically short-term in nature, transactions involving non-debt instruments are generally long-term and often have significant implications on the control, governance, and ownership structures of Indian companies. As such, it is crucial for the government to provide clear and detailed guidelines to regulate these investments in a manner that ensures economic stability, fosters investor confidence, and aligns with national interests.*

*This paper provides an in-depth analysis of the amendments introduced to the Non-Debt Instruments Rules, 2019, comparing them to the original framework. By identifying the inconsistencies and gaps in the previous version, the paper highlights how the recent amendments aim to address these issues. Furthermore, the analysis extends to the broader economic implications of these changes, exploring how the amendments are designed to enhance the*

*regulatory environment for foreign investments and contribute to India's economic growth and development.*

*Through this detailed examination, the paper aims to provide its readers with a deeper understanding of the amendments, their rationale, and their potential impact on the Indian economy. In doing so, it offers valuable insights into how these regulatory changes are likely to shape the landscape of foreign investments in India, fostering a more transparent, robust, and investor-friendly environment.*

## I) BACKGROUND

The Foreign Exchange Management Act (FEMA), which came into force on June 1, 2000, replaced the earlier Foreign Exchange Regulation Act (FERA) of 1999. FEMA aimed to simplify and streamline export-import trade and payments, regulate foreign exchange markets, and eliminate inconsistencies in foreign exchange transactions. As a commercial law, FEMA consolidates and amends the foreign exchange policies in India, facilitating smoother capital account transactions. The Finance Act of 2015 proposed a significant shift in the governance structure for capital account transactions involving debt and non-debt instruments<sup>1</sup>. However, the initial legal framework lacked clear definitions for "debt" and "non-debt" instruments, which were later addressed through the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (hereafter referred to as "Rules 2019"). These rules replaced the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 (TISPRO) and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018.

The Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 [referred to as Non-Debt Instruments Rules, 2019 from hereafter] were introduced to regulate foreign exchange transactions involving non-debt instruments, such as equity shares and convertible instruments like share warrants, debentures, and preference shares. These rules were designed to provide a framework for

---

<sup>1</sup> ALMT Legal, *Debt and Non-Debt Instruments* (2023) <https://almtlegal.com/articles-pdf/Debt%20and%20Non-%20Debt%20Instruments.pdf> accessed on 17<sup>th</sup> December, 2024.

facilitating and regulating foreign investments in India, ensuring compliance with national economic policies while encouraging long-term investments. However, as with any evolving legal framework, periodic amendments are required to address changing economic realities and market dynamics.

## II) INTRODUCTION

The Non-Debt Instruments rules, 2019 regulate transactions involving equity instruments, which are typically long-term in nature, ensuring that foreign investments align with national priorities. For example, if an Indian company raises funds by selling equity shares to a foreign investor, the transaction needs to be disclosed to the Reserve Bank of India (RBI) as it involves foreign direct investment (FDI). This foreign investment can lead to the acquisition of voting rights, thus providing the investor with some degree of influence over the company's decision-making. To support and regulate these types of investments, the government introduced the Non-Debt Instruments Rules, 2019, with an aim to provide a clear and transparent regulatory framework for the flow of foreign investments into India.

## III) RECENT AMENDMENTS: ANALYSIS

The Foreign Exchange Management, 1999 confers powers on the Government of India and RBI to issue rules and regulations for regulating the foreign investment involving non-debt instruments and introducing amendments thereon. On the basis of the powers conferred under Section 46 of the Foreign Exchange Management Act, 1999, the Government of India introduced the Foreign Exchange Management (Non-Debt Instruments) (Fourth Amendment) Rules, 2024<sup>2</sup>. The key amendments to the Rules 2019 are as follows:

### A. *Rule 2: The amendment introduced new definitions:*

(da): Control must be interpreted as per the definition under the Companies Act, 2013 (Section 2(27)), except for Limited Liability Partnerships where control means the right to appoint the majority of the designated partners having control over the policies of the LLPs.

---

<sup>2</sup> Government of India. "Department of Economic Affairs amends Foreign Exchange Management (Non-debt Instruments) Rules, 2019 in pursuance of Union Budget 2024-25 announcement". Press Information Bureau, [August 16<sup>th</sup>, 2024]. Available at: <https://pib.gov.in/PressReleasePage.aspx?PRID=2046086> [Accessed: 18th December 2024].

Under Section 2(27) of the Companies Act, 2013; Control refers to the right to appoint the majority of the directors to the companies' board or holding more than 50% of the voting rights thus acquiring influence in companies' decision making or having management rights or influence like the power to appoint key managing personnel (KMPs) or control via agreement or other mechanisms.

This definition was originally under Rule 23(7)(d) of the Non-Debt Instruments rules, 2019 and has been simply shifted to Rule 2(da) aligning it with definition of control under the Companies Act with the purpose of ensuring a standard definition of control across all laws and acts to ensure consistency.

(an): Startup Company is a private company as defined under Companies Act, 2019 and was redefined based on the Government's updated criteria, which were clarified in G.S.R. 127 (E), dated 19th February 2019.

Section 2(68) of the Companies Act defines a private company as having a minimum paid-up share capital as may be prescribed and which by its Article of Association restricts the right to transfer its shares; limits the number of members to two hundred except in cases of One person company and restricts the public from subscribing to its shares and debentures.

The Government notification dated 19<sup>th</sup> February 2019 defines a 'startup' as a company that has completed less than ten years from its inception or registration whether it be a private company, a limited liability partnership or a partnership firm, the turnover of the company for any financial year not exceeding hundred crores since its inception or registration, and is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation. The proviso to the notification provides that the company must not be formed by splitting up or restructuring of an existing company, for it to be considered as a startup.

Previously a startup company was a private company as incorporated under Companies Act, 2013 and identified as an 'startup' under G.S.R. 180(E), dated 17th February, 2016<sup>3</sup> issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, which defined a 'startup' as an entity having completed upto five years from the date of incorporation or registration, the turnover of the company not exceeding twenty five crores for any financial year

---

<sup>3</sup> Government of India. Ministry of Commerce and Industry, 'Startup India' (17<sup>th</sup> February, 2016). Available at [https://www.startupindia.gov.in/content/dam/investindia/Templates/public/notification/Overall/2.%20notification\\_Startups\\_Notification\\_17\\_02\\_16.pdf](https://www.startupindia.gov.in/content/dam/investindia/Templates/public/notification/Overall/2.%20notification_Startups_Notification_17_02_16.pdf) [Accessed on 18<sup>th</sup> December, 2024]

and is working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property; given it's not formed by splitting up or restructuring of a company already in existence.

*B. Rule 9: Several modifications, including:*

The substitution of the proviso in Rule 9(1)(i) to provide clarity on foreign investment in Indian companies. Previously government approval was mandatory if the company is engaged in sectors that requires for prior government approval. However, the amendment makes it mandatory for the companies to seek prior government approval in all cases wherever it's required by law irrespective of the sector that the company is engaged in, whether it's one or more than one sector.

The insertion of Rule 9A, governing the transfer of equity instruments and equity capital between Indian residents and non-residents. In case of the former the swap must follow the guidelines laid down by central government such as Foreign Exchange Management (Overseas Investment) Rules, 2022, must adhere to pricing guidelines, require valuation by a registered merchant banker, and be reported to the Reserve Bank of India ("RBI"). In case of swap of equity capital of a foreign company the transfer must comply with the rules laid down central government Foreign Exchange Management (Overseas Investment) Rules, 2022, and the regulations specified by the RBI through Master Direction on Foreign Investment in India.

A proviso to this rule requires prior government approval in circumstances that provides for the same.

Previously Indian companies could issue equity instruments to non-residents in exchange for the shares held by them in Indian companies. However, now Indian companies could swap equity instruments for non-resident's equity capital in foreign company as long as it complies with the Overseas investment rules.

*C. Rule 23: Omission and Refinement:*

Sub-rule (7)(d) was omitted, which addressed the definition of "control" which has been shifted to Rule 2(da).

Sub-rule (7)(i) saw a substitution in the explanation, refining the earlier interpretation of indirect foreign investments. Investment made by an Indian entity controlled and owned by Non-Resident Indian ("NRI") or an Overseas Citizen of India ("OCI"), including companies, trusts, and

partnership firms incorporated outside India will not be included under the indirect foreign investment given its on non-repatriation basis and complies with schedule IV of the Foreign Exchange Management Non-Debt rules. This would prevent false inflation in the Calculation of foreign investment given these are entities which are controlled by individuals who have strong connections with India even though they are outside India. This would also boost investments from NRIs and OCIs.

*D. Schedule I: Swap of Equity instruments and Equity capital & Introduction of a new category:*

Para 1(d) and Para 3(a)(iii) were substituted to improve clarity regarding sector-specific guidelines. Para 1(d) allows an Indian company to issue equity instruments to non-resident in return for equity instruments or capital goods, machinery or equipment excluding second hand machinery or pre-operative or pre-incorporation expenses or equity capital of a foreign company give it complies with the rules prescribed by the Central Government including Foreign Exchange Management, (Overseas Investment) Rules 2022, and the regulations specified by the Reserve Bank. However prior government approval must be obtained in the manner prescribed by central government in cases where approval is applicable. Therefore, it now allows Indian companies to issue equity instruments like that of shares to non-residents given it complies with the central government and RBI rules and regulations.

Para 3(a)(iii) provides that the foreign investors investing in Indian companies does not require prior government approval until and unless the investment exceeds the sectoral gap or statutory gap for the particular sector or that is results in the foreign investors taking ownership or control of the Indian company. The company must follow the sectoral conditions or specific rules related to the foreign investment in that particular sector.

New entries F.11 and F.11.1 were added to clarify procedures for certain types of foreign investments. A new category has been introduced for "White Label ATM Operations" ("WLAO"). This entry establishes a sectoral cap of 100% and an automatic entry route for investments. To set up White Label ATMs, a non-bank entity must have a minimum net worth of rupees hundred crores (Rs. hundred crores), as reflected in their latest audited balance sheet. Additionally, if the entity is involved in any "Other Financial Services," foreign investment must comply with the minimum capitalisation norms applicable to those services. Furthermore, Foreign Direct Investment ("FDI")

in WLAO will be subject to specific criteria and guidelines issued by the RBI under the Payment and Settlement Systems Act, 2007. This update simplifies the process for foreign investment in WLAO, encouraging investment in the sector while ensuring that entities maintain financial stability.

*E. Schedule II: Foreign Investors as part of same investor group*

The substitution of Para 1(a)(iii) further clarified the rules related to foreign investments in certain sectors. In case where two or more foreign investors which includes foreign government and entities having common ownership or control over more than 50% of the same investment or company then they will be considered as part of the same investor group.

*F. Schedule VII: Foreign Venture Capital Investors and Equity & Debt instruments*

Changes to Para 1(iii) updated the conditions under which foreign venture capital investors may acquire equity instruments in Indian companies. It has been amended to provide that a foreign venture capital investor may purchase equity or equity linked instrument or debt instrument issued by an Indian company irrespective of the sector in which the Indian startup company is engaged. A proviso to this amended rule requires that in case of investment in equity instruments sectoral caps, entry routes and attendant conditions shall apply.

#### **IV) REASON FOR THE AMENDMENTS**

*A. Control (Rule 2)*

The amendment aligns the definition of control with the Companies Act, 2013 (Section 2(27)), recognizing the ability to influence company decisions through majority voting rights, the appointment of key management personnel, or other mechanisms. This formalization ensures consistency with existing corporate governance laws and aids in determining the scope of foreign influence in Indian businesses. It is crucial for determining the ownership structure, particularly in cases of cross-border mergers and acquisitions.

*B. Definition of Startup Company (Rule 2)*

The redefinition of startup company clarifies that a startup is a private company or partnership firm

less than 10 years old with an annual turnover of less than hundred crores. It must be focused on innovation or scalability. This updated definition expands the scope of eligible companies for venture capital and foreign investment, promoting entrepreneurship. By encompassing more companies under its purview, it extends the tax and several other benefits provided under this section thus encouraging companies to grow and contribute to the country's economy by simultaneously attracting foreign investments. The proviso that the startup must not be formed by splitting or reconstituting an existing company ensures that the benefits are targeted at genuinely new ventures, rather than restructured firms.

*C. Broader Government Approval {Rule 9(1)(i)}*

The amendments to Rule 9A broaden the scope of transactions requiring government approval. Previously, approval was only required for investments in sensitive sectors. Now, government approval is required more universally for any transactions exceeding certain thresholds or involving foreign control, enhancing regulatory oversight. This ensures that no transactions detrimental to the country's growth goes unnoticed. By keeping track of such transactions, the government can prevent any harmful activities that might impede economic progress and focus on advancing the nation's prosperity.

*D. Equity Instrument Swap (Rule 9A)*

The introduction of Rule 9A provides for the transfer of equity instruments between residents and non-residents, particularly in the context of equity swaps. Indian companies can now exchange equity instruments for capital goods, machinery, or equipment (subject to central government guidelines). This change is beneficial for sectors requiring significant capital investment and infrastructure, and facilitates foreign investment in key industries like manufacturing.

*E. Indirect Foreign Investment (Rule 23)*

The updated rules now exclude investments made by NRIs or OCIs in Indian companies from the calculation of indirect foreign investment. This exclusion is a critical development as it prevents inflated foreign investment figures, ensuring more accurate reporting and safeguarding against potential misuse. This provision also encourages investments from Indian nationals living abroad without being subject to foreign investment regulations.

*F. White Label ATM Operations (Schedule I)*

A new provision for White Label ATM Operations (WLAO) has been introduced, setting a 100% FDI limit with an automatic approval route. This is a significant move to streamline foreign investment in the financial technology sector, particularly in the setup of ATMs by non-bank entities. The requirement of a minimum net worth of hundred crores ensures that only financially sound entities can enter this space, while compliance with RBI guidelines ensures that foreign investments align with broader financial system regulations.

*G. Foreign Venture Capital (Schedule VII)*

The amendment to Schedule VII allows foreign venture capital investors to acquire equity or equity-linked instruments in Indian startup companies across sectors. However, sectoral caps and entry routes will still apply, ensuring that such investments do not violate existing limits for foreign direct investment. This flexibility will promote venture capital inflows, especially in sectors like technology and innovation, without compromising regulatory standards.

## **V) CONCLUSION**

The Foreign Exchange Management (Non-Debt Instruments) (Fourth Amendment) Rules, 2024 represent a substantial update to the existing regulatory framework governing foreign investments in India. The amendments broaden the scope of foreign investment opportunities, enhance government oversight, and clarify important definitions, such as control and startup companies. They address key concerns in the regulatory landscape, including the calculation of indirect foreign investments and the conditions for equity swaps between residents and non-residents.

These changes aim to improve transparency, encourage long-term foreign investment, and ensure that foreign capital flows align with India's broader economic goals. By adapting to changing market conditions, these amendments not only support the growth of startups and emerging sectors but also promote greater regulatory clarity, ultimately contributing to India's economic development.

## References

1. *Foreign Management Act, 1999 pdf. Available at [https://enforcementdirector.gov.in/sites/default/files/Act%26rules/FEMA\\_ACT\\_1999.pdf](https://enforcementdirector.gov.in/sites/default/files/Act%26rules/FEMA_ACT_1999.pdf)*
2. *Foreign Exchange Management (Non-debt Instruments) Rules, 2019 pdf. Available at [https://enforcementdirector.gov.in/sites/default/files/Act%26rules/Foreign%20Exchange%20Management%20%28Non-Debt%20Instrument%29%20Rules%2C%202019%20-%20without%20amendment\\_2.pdf](https://enforcementdirector.gov.in/sites/default/files/Act%26rules/Foreign%20Exchange%20Management%20%28Non-Debt%20Instrument%29%20Rules%2C%202019%20-%20without%20amendment_2.pdf)*
3. *Foreign Exchange Management (Non-debt Instruments) (Fourth Amendment) Rules, 2024 pdf. Available at <https://static.pib.gov.in/WriteReadData/specificdocs/documents/2024/aug/doc2024816377701.pdf>*
4. *“Foreign Exchange Amendments: Transforming Cross-Border Investment Dynamics” article. Available at <https://www.arbitrationcorporatelawreview.com/post/foreign-exchange-amendments-transforming-cross-border-investment-dynamics#:~:text=The%20Fourth%20Amendment%20modifies%20the%20Foreign%20Exchange%20Management,far-reaching%20implications%20for%20both%20domestic%20and%20foreign%20businesses>*
5. *GOI ‘Startup India’ notification by Ministry of Commerce and Industry. Available at [https://www.startupindia.gov.in/content/dam/invest-india/Templates/public/notification/Overall/2.%20notification\\_Startups\\_Notification\\_17\\_02\\_16.pdf](https://www.startupindia.gov.in/content/dam/invest-india/Templates/public/notification/Overall/2.%20notification_Startups_Notification_17_02_16.pdf)*