

August 2024



Note on key amendments to the Foreign Exchange Management (Non-debt Instruments) Rules, 2019

Background

In furtherance of the announcements made by the Union Minister of Finance and Corporate Affairs in the Union Budget 2024-25 to simplify the rules and regulations governing foreign investment, the Department of Economic Affairs, Ministry of Finance, Government of India has amended the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (“**NDI Rules**”), through the Foreign Exchange Management (Non-debt Instruments) (Fourth Amendment) Rules, 2024 (“**Amendment Rules**”) which were notified on August 16, 2024.

In brief, these amendments aim to: (i) simplify cross-border share swaps and provide for issuance or transfer of equity instruments of Indian companies in exchange for equity capital of foreign companies; (ii) bring clarity on the treatment of downstream investments made by entities which are owned and controlled by overseas citizens of India (“**OCI**”) on a non-repatriation basis, thereby aligning it with the treatment of investments made by entities which are owned and controlled by non-resident Indians (“**NRI**”); (iii) standardising the definition of “control” to bring consistency with other legislations; (iv) enable foreign direct investment (“**FDI**”) in white label ATMs to boost financial inclusion in India; and (v) harmonise the definition of a “startup company” with the definition contained in the notification issued by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India (“**DPIIT**”), on February 19, 2019.

These amendments have been brought about with the aim of facilitating global expansion of Indian companies via mergers, acquisitions and other strategic initiatives which would enable them to reach new markets.

Summary of the key changes introduced through the Amendment Rules

Standardizing definition of the term “control”

The definition of the term “control” as provided under Explanation (d) to Rule 23 (*Downstream Investments*) of the NDI Rules has been omitted and a new definition of such term has been inserted under Rule 2 of the NDI Rules, as follows:

Previous Definition (As provided under Explanation (d) to Rule 23 of the NDI Rules)	New Definition (As inserted in Rule 2 of the NDI Rules)
“control” shall mean the right to appoint majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreement or voting agreement and for the purpose of LLP, “control” shall mean the right to appoint majority of the designated partners, where such designated partners, with specific exclusion to others, have control over all the policies of an LLP.	“control” shall have the same meaning as assigned to it in the Companies Act, 2013 and for the purposes of Limited Liability Partnership, shall mean the right to appoint majority of the designated partners, where such designated partners, with specific exclusion to others, have control over all the policies of an LLP.

Analysis and key changes: The definition of the term “control” as provided under Explanation (d) to Rule 23 of the NDI Rules has been omitted and a new definition of such term has been inserted under Rule 2 of the NDI Rules. The introduction of such new definition of the term “control” is clarificatory in nature and there is no change in the construct of the scope of the definition, except that the new definition makes reference to the definition of the term “control” for a company as provided under the Companies Act, 2013. Further, no change has been made vis-à-vis “control” of a limited liability partnership.





Harmonizing the definition of the term “startup company”

The definition of the term “startup company” as provided under Rule 2 (an) of the NDI Rules has been amended, as follows:

Previous Definition	New Definition
“startup company” means a private company incorporated under the Companies Act, 2013 and identified under G.S.R. 180(E), dated the 17 th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry.	“startup company” means a private company incorporated under the Companies Act, 2013 (18 of 2013) and identified as “startup” under G.S.R. 180(E), dated the 17th February, 2016 the notification of the Government of India number G.S.R. 127 (E), dated the 19th February, 2019 issued by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, as amended from time to time.

Analysis and key changes: The definition of the term “startup company” has been amended to align the same with the latest notification issued by DPIIT on February 19, 2019, which provided key changes in relation to the criteria for recognizing a company as a “startup company”, which included an increase in the turnover threshold for a company from INR 250 million to INR 1 billion for any of the financial years since its incorporation and also an increase in the time period for recognition as a “startup” from five years to ten years from the date of its incorporation.

Requirement of prior government approval

The existing proviso (i) to Rule 9 (1) of the NDI Rules has been amended, as follows:

Language under previous provision	Language under new provision
prior government approval shall be obtained for any transfer in case the company is engaged in a sector which requires government approval.	prior Government approval shall be obtained for any transfer in case the company is engaged in a sector which requires transfer in all cases wherever Government approval is applicable.

Analysis and key changes: Prior to the amendment, the proviso (i) to Rule 9 (1) of the NDI Rules provided, amongst others, that prior government approval was required for any transfer of equity instruments from any person resident outside India to another person resident outside India, in case the Indian target company was engaged in a sector that required government approval.

While this amendment specifically confirms that government approval will still be required for the relevant cases irrespective of the sector in which the Indian target company is engaged, based on past precedents, we believe that this amendment will have no impact on the requirement of obtaining prior government approval, including pursuant to the provisions of Rule 6 of the NDI Rules read with Press Note 3 of 2020 (“**Press Note 3**”), and that such requirement is already covered under Rule 9. Therefore, we believe that this amendment is merely clarificatory in nature. As per Rule 6 of the NDI Rules read with Press Note 3, for transfer of equity instruments of an Indian target company to an entity situated in / an individual who is a citizen of a country sharing a land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, prior government approval is required. Even after the aforementioned amendment, such requirement of obtaining prior government approval will continue irrespective of the sector in which the Indian target company is engaged and irrespective of the transferor or transferee being non-residents.

New Rule 9A in relation to swap of equity instruments and equity capital

a. A new Rule 9A relating to swap of equity instruments has been inserted in the NDI Rules as follows:

“Swap of equity instruments and equity capital. – The transfer of equity instruments of an Indian company between a person resident in India and a person resident outside India may be by way of –

- (i) swap of equity instruments, in compliance with the rules prescribed by the Central Government and the regulations specified by the Reserve Bank from time to time;
- (ii) swap of equity capital of a foreign company in compliance with the rules prescribed by the Central Government including the Foreign Exchange Management, (Overseas Investment) Rules, 2022, and the regulations specified by the Reserve Bank from time to time:

Provided that prior Government approval shall be obtained for transfer in all cases wherever Government approval is applicable.

Explanation. – For the purposes of this clause, the expression “equity capital” shall have the same meaning as assigned to it in the Foreign Exchange Management, (Overseas Investment) Rules, 2022, as amended from time to time.”



- b. Pursuant to the introduction of Rule 9A under the NDI Rules, Paragraph (1)(d) of Schedule I of the NDI Rules has also been amended to allow issuance of equity instruments by an Indian target company to a person resident outside India against swap of equity capital of a foreign company.

Analysis and key changes: Prior to introduction of Rule 9A, Rule 21 (Pricing Guidelines) read with Schedule I of the NDI Rules made provision for, amongst others, issuance of equity instruments by an Indian company to a person resident outside India against swap of equity instruments of another Indian company. Pursuant to this amendment, a new Rule 9A has been inserted under the NDI Rules which makes provision for transfer of equity instruments of an Indian company between a person resident in India and a person resident outside India, against: (i) swap of equity instruments of another Indian company; (ii) swap of equity capital of a foreign company. This amendment is expected to provide an impetus to the investors for entering into more cross-border share swap arrangements. It has been further provided that the requirement of obtaining prior government approval will apply for transfer of equity instruments in such share swap arrangements, wherever government approval is required under law.

Clarity on downstream investments

Under Rule 23, after sub-rule (7), the explanation provided in sub-clause (i) has been amended, as follows:

Language under previous provision	Language under new provision
An investment made by an Indian entity which is owned and controlled by NRI(s), on a non-repatriation basis, shall not be considered for calculation of indirect foreign investment.	An investment made by an Indian entity which is owned and controlled by NRI(s) a Non-Resident Indian or an Overseas Citizen of India including a company, a trust and a partnership firm incorporated outside India and owned and controlled by a Non-Resident Indian or an Overseas Citizen of India , on a non-repatriation basis in compliance with Schedule IV of these rules , shall not be considered for calculation of indirect foreign investment.

Analysis and key changes: Pursuant to this amendment, investments by entities owned and controlled by OCIs will now be treated at par with investments by entities owned and controlled by NRIs. Such investments will not be considered for calculation of indirect foreign investment. This amendment is expected to encourage more OCIs to invest in India through the entities owned and controlled by them.

Amendment to Paragraph 3(a)(iii) of Schedule I of the NDI Rules

Paragraph 3(a)(iii) of Schedule I of the NDI Rules has been amended, as follows:

Language under previous provision	Language under new provision
Aggregate foreign portfolio investment up to forty-nine percent of the paid-up capital on a fully diluted basis or the sectoral or statutory cap, whichever is lower, shall not require Government approval or compliance of sectoral conditions as the case may be, if such investment does not result in transfer of ownership and control of the resident Indian company from resident Indian citizens or transfer of ownership or control to persons resident outside India and other investments by a person resident outside India shall be subject to the conditions of Government approval and compliance of sectoral conditions as laid down in these rules.	The aggregate foreign portfolio investment up to forty-nine percent of the paid-up capital on a fully diluted basis or the sectoral or statutory cap, whichever is lower , shall not require Government approval or compliance of sectoral conditions as the case may be, if such investment does not result in transfer of ownership and/ or control of the resident Indian company from resident Indian citizens to persons resident outside India and other investments by a person resident outside India shall be subject to the conditions of Government approval and compliance of sectoral conditions as laid down in these rules.

Analysis and key changes: Prior to this amendment, a prior government approval was required in the event the aggregate foreign portfolio investment exceeded either 49% of the paid-up capital on a fully diluted basis or the sectoral or statutory cap, whichever was lower, and if such investments resulted in change of ownership and/ or control of the resident Indian company from resident Indian citizens to persons resident outside India. However, this amendment has now omitted the threshold of 49% and provides that if the aggregate foreign portfolio investment is up to the sectoral or statutory cap and it does not result in transfer of ownership and/ or control of the resident Indian company from resident Indian citizens to persons resident outside India, no government approval will be required for the same.

Entry in Schedule I regarding FDI in White Label ATM Operations sector

A new entry F:11 has been inserted under the table in Schedule I of the NDI Rules in relation to FDI in White Label ATM Operations' sector. It provides that FDI upto 100% under the automatic route is permitted in such sector, subject to specified conditions.



Analysis and key changes: This amendment has been introduced to align with Paragraph 5.2.25 (White Label ATM Operations) of the Consolidated FDI Policy (effective from October 15, 2020).

Amendment to Explanation to Paragraph (1)(a)(ii) of Schedule II

Explanation to Paragraph (1)(a)(ii) of Schedule II of the NDI Rules has been amended, as follows:

Language under previous provision	Language under new provision
In case, two or more FPI's including foreign Governments/their related entities are having common ownership, directly or indirectly, of more than fifty percent or common control, all such FPI's shall be treated as forming part of an investor group. Control includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of shareholding or management rights or shareholders agreements or voting agreements or in any other manner.	In case two or more FPI's including foreign Governments or their related entities are having common ownership, directly or indirectly, of more than fifty percent or common control, all such FPI's shall be treated as forming part of an investor group. Control includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of shareholding or management rights or shareholders agreements or voting agreements or in any other manner

Analysis and key changes: This amendment is clarificatory in nature. Given that this Explanation contained the previous definition of term "control" which has now been omitted from the NDI Rules, such previous definition has now been omitted from this Explanation.

Amendment to Schedule VII

Paragraph (1)(iii) of Schedule VII of the NDI Rules has been amended, as follows:

Language under previous provision	Language under new provision
Subject to the terms and conditions as may be laid down by the Central Government, a Foreign Venture Capital Investor (FVCI) may purchase: xxxxx..... equity or equity linked instrument or debt instrument issued by an Indian 'start- up' irrespective of the sector in which the start-up is engaged. The definition of 'start- up' shall be as per Department for Promotion of Industry and Internal Trade's Notification No. G.S.R. 364(E), dated the 11 th April, 2018. Provided that if the investment is in equity instruments, then the sectoral caps, entry routes and attendant conditions shall apply.	Subject to the terms and conditions as may be laid down by the Central Government, a Foreign Venture Capital Investor (FVCI) may purchase: xxxxx.... equity or equity linked instrument or debt instrument issued by an Indian startup company irrespective of the sector in which the startup company is engaged. The definition of 'start- up' shall be as per Department for Promotion of Industry and Internal Trade's Notification No. G.S.R. 364(E), dated the 11 th April, 2018. Provided that if the investment is in equity instruments, then the sectoral caps, entry routes and attendant conditions shall apply.

Analysis and key changes: This amendment is clarificatory in nature. Given that the latest notification G.S.R. 127 (E), dated February 19, 2019, issued by DPIIT, provides an updated definition for the term "startup", reference to the previous notification which provided a definition for the term "startup" has now been omitted.

Please feel free to address any further questions or request for advice to:

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