FEMA & FDI RULES QUICK REFERENCE GUIDE

Essential Foreign Investment Rules for Deal Lawyers

This guide covers the key FEMA and FDI rules you'll encounter in cross-border transactions, from investment structures to pricing guidelines.

BASIC DEFINITIONS

What is Foreign Direct Investment (FDI)?

FDI means investment by a person resident outside India:

In an unlisted Indian company; **OR**

In 10% or more of the post-issue paid-up equity capital (on a fully diluted basis) of a listed Indian company

What are 'Downstream Investment' and 'Indirect Foreign Investment'?

Downstream Investment: Investment made by an Indian entity (which has received foreign investment) into another Indian entity

Indirect Foreign Investment: Downstream investment made by an Indian entity that is owned or controlled by persons resident outside India (also called '**FOCC**' - Foreign Owned or Controlled Company)

An entity is '**OWNED**' by foreign residents when: More than 50% of equity is held by persons resident outside India

An entity is '**CONTROLLED**' by foreign residents when: 'persons resident outside India' have the right to appoint the majority of directors OR control management/policy decisions

Note*: Indian entities with indirect foreign investment must comply with FDI entry routes, sectoral caps, pricing guidelines, and all other conditions*

PERMISSIBLE INVESTMENT INSTRUMENTS

What instruments can foreign investors use for FDI?

Equity shares (partly or fully paid)

Fully and mandatorily convertible debentures (CCDs)

Fully and mandatorily convertible preference shares (CCPS)

Share warrants

***Conditions for Partly Paid Equity Shares*:**

Must be fully called-up within 12 months of issue

At least 25% of the total consideration (including premium) must be received upfront

Can foreign investors invest in Indian LLPs?

Yes, BUT only if:

The LLP operates in sectors where 100% FDI is permitted under the automatic route; **AND**

There are no FDI-linked performance conditions

Example*: FDI in LLPs operating in the construction and development sector is NOT permitted*

ENTRY ROUTES & RESTRICTIONS

What are the FDI entry routes?

Automatic Route: Investment does **NOT** require prior Government approval

Government Route: Investment **REQUIRES** prior Government approval and must comply with the conditions stipulated in the approval

Important*: Besides entry route compliance, investors must also comply with all relevant sectoral laws, regulations, security conditions, and state/local laws*

What restrictions apply to investors from land-bordering countries?

If any entity, its beneficial owners, or individual investor is situated in **OR** is a citizen of a land-bordering country, then:

Prior Government approval is **REQUIRED**

This applies to:

New FDI investment in India; **OR**

Any transfer that results in such investor holding FDI in India

Land-Bordering Countries: Pakistan, Afghanistan, China (including Hong Kong, excluding Taiwan), Nepal, Bhutan, Bangladesh, Myanmar

PRICING GUIDELINES FOR UNLISTED COMPANIES

Fair Market Value (**FMV**): Value determined by a chartered accountant or merchant banker or cost accountant using any internationally accepted pricing methodology on an arm's length basis

Non-residents (NR): persons resident outside India or entities incorporated outside India

Indian Resident: persons resident in India and entities incorporated in India

SCENARIO 1: Issuance on Private Placement Basis

Rule: Price must **NOT** be less than FMV

SCENARIO 2: Issuance on Rights Issue Basis

Base Rule: Price must **NOT** be less than the price offered to Indian residents

Exception - *Excess Shares: If a foreign investor acquires **MORE** than their pro-rata share (through renunciation or company disposal), the excess shares **CANNOT** be issued below FMV*

SCENARIO 3: Issuance of Convertible Instruments (CCPS/CCDs)

Critical Rules:

Price AND conversion formula must be determined UPFRONT

Price at conversion cannot be **LESS** than the FMV determined at the time of issuance

SCENARIO 4: Transfer from Non-Resident to Indian Resident

Rule: Sale price, per share must **NOT** be **MORE** than FMV

SCENARIO 5: Transfer from Indian Resident to Non-Resident

Rule: Sale price, per share must **NOT** be **LESS** than FMV

SCENARIO 6: Transfer from Non-Resident to Non-Resident

Rule: Pricing guidelines **DO NOT APPLY** (parties can agree on any price)

SCENARIO 7: Transfer from FOCC to Non-Resident

Rule: Sale price, per share must **NOT** be **LESS** than FMV

SCENARIO 8: Transfer from FOCC to Resident

Rule: Sale price, per share must **NOT** be **MORE** than FMV

QUICK REFERENCE: PRICING RULES SUMMARY

Private Placement to NR: Price ≥ FMV

Rights Issue (Pro-rata) to NR: Price ≥ Price to Indian Residents

Rights Issue (Excess Shares) to NR: Price ≥ FMV

CCPS/CCDs to NR: Conversion Price ≥ FMV at issuance

Transfer NR → Resident: Price ≤ FMV

Transfer Resident → NR: Price ≥ FMV

Transfer NR → NR: No pricing restrictions

Transfer FOCC→ NR: Price ≥ FMV

Transfer FOCC→ Resident: Price ≤ FMV

KEY TAKEAWAYS

FMV must be determined by a certified chartered accountant, a SEBI registered merchant banker, or a practicing cost accountant using internationally accepted methods

Land-bordering country restrictions require Government approval regardless of the sector

Convertible instruments must have upfront pricing - no reset mechanisms below initial FMV

Different pricing rules apply for transfers INTO India vs. OUT OF India vs. between non-residents

LLP investments have restricted sectoral access compared to companies

Indirect foreign investment (through FOCC) triggers the same compliance as direct FDI