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POLICY RATIONALE AND INVESTMENT FALLOUT OF INDIA'S 2025 OVERHAUL ON FOCC DOWNSTREAM INVESTMENT

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Abstract: *Over the years, India has emerged as a favoured foreign investment hub, driven by its robust economic growth and the resulting burgeoning market. Before 2009, Indirect Foreign Investment ("IFI") lacked clear regulatory guidelines, with sector-specific rules limited to the Telecom, broadcasting, insurance, and infrastructure services. The Department of Industrial Policy and Promotion initially introduced the idea of IFI in press notes in February 2009, but it wasn't until the Reserve Bank of India adopted the guidelines in June 2013 that it gained official regulatory status. The Reserve Bank of India and the Central Government had different stances, which caused the delay. Revisions to the framework have been made since the official notification in June 2013. Notably, a series of notifications under the Foreign Exchange and Management Act ("FEMA") were released in 2015-16, significantly improving regulatory clarity. Transaction structure has long been complicated by the regulatory ambiguity surrounding downstream investments made by foreign-owned or controlled entities. Although not all issues were completely resolved by the 2024 and 2025 amendments to the FEM (Non-Debt Instruments) Rules, 2019 ("NDI Rules"), they did offer important clarifications that reinforced the framework for FOCCs and allowed for more strategic investment planning, structure, and execution. Beyond just consolidating recent rule revisions, the 2025 update to the Master Direction on Foreign Investment in India expands on this endeavour by addressing a number of areas that were previously left in legislative silence. It is noteworthy because it provides much-needed clarification on downstream investment, an area that still requires cautious regulatory interpretation. With an emphasis on their effects on downstream investment, this article analyses the reform trajectory through the 2024 and 2025 revisions to the NDI Rules, 2019, as well as important clarifications added in the 2025 Master Directions on Foreign Investment in India.*

Keywords: *Downstream Investment, FEMA, IFI, RBI, FOCC.*

I. INTRODUCTION

In India, both direct and indirect foreign investments are regulated under the Foreign Exchange Management Act, 1999 ("FEMA"), together with subordinate rules and regulations framed pursuant thereto.[1] FEMA vests the Reserve Bank of India ("RBI") with the authority to issue regulations, while conferring on the Central Government the power to prescribe rules.[2] The principal legal framework governing foreign direct investment in India consists of the FEMA, 1999, and the NDI Rules, 2019[3], which together regulate the infusion of foreign equity by non-resident entities into Indian companies. The NDI Rules also set out the framework for regulating indirect foreign investment[4] in Indian entities, it is commonly referred to as downstream

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[1] Foreign Exchange Management Act 1999, Act No. 42, 1999, (India).
[2] Foreign Exchange Management Act 1999, § 46-47.
[3] Foreign Exchange Management (Non-debt Instruments) Rules 2019, F.NO.1/14/EM/2015.
[4] NDI Rules, 2019, Rule 23.

investment.[5] In addition, the RBI issued the 'Master Directions on Foreign Investment in India' ("Master Directions")[6] under FEMA, which provides detailed procedures for conducting foreign exchange transactions in line with the NDI Rules, 2019. Taken together, FEMA, the NDI Rules, and the Master Directions form India's comprehensive framework for regulating Foreign Direct Investment ("FDI"). Notably, the Master Direction on Foreign Investment in India, updated as recently as January 20, 2025, not only consolidated amendments to the NDI Rules but also provides crucial clarifications on previously ambiguous areas, including downstream investment regulations.[7] This article seeks to present a comprehensive account of the regulatory framework governing downstream investments in India, highlighting the recent developments in 2025 marking a deliberate policy pivot with the clarifications released in its favor to facilitate a constructive dialogue for channeling indirect foreign investment/ foreign capital inflows and facilitating cross border mergers and acquisitions (M&A), further streamlining regulatory clearances to enhance India's appeal as a business hub.

II. UNDERSTANDING FOCCS AND DOWNSTREAM INVESTMENT: A CONCEPTUAL PRIMER

A downstream investment refers to an investment made by an Indian company that is owned or controlled by a person resident outside India (an "FOCC").[8] According to the NDI Rules, specifically the explanation to Rule 23, which states,

> '*Downstream Investment is an investment made by an Indian entity which has received foreign investment or an Investment Vehicle in the equity instruments or the capital, as the case may be, of another Indian entity.*'[9]

In other words, when an Indian entity owned or controlled by a person resident outside India invests in the equity instruments/ capital of another Indian entity, it constitutes a downstream investment for the person resident outside India ("PROI"), enabling indirect foreign investment through layered ownership structures.[10] Accordingly, downstream investments are governed by the same restrictions and conditions that apply to direct foreign investments.

The ambit of FOCC covers both Indian companies and Limited Liability Partnerships ("LLPs").[11] An Indian company or LLP is considered '*owned*' by persons resident outside India when such persons hold the prescribed ownership interest, and is regarded as '*controlled*' when they possess the right to appoint a majority of directors or control management and policy decisions.[12] Under the NDI Rules, an Indian entity receiving foreign investment is deemed an FOCC if it is either not owned and controlled by resident Indian citizens or is owned or

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[5] *Id*.
[6] Reserve Bank of India, Master Direction - Foreign Investment in India, RBI/FED/2017-18/60, (Issued on January 4, 2018).
[7] Aparna Ravi, Aastha Bhandari, *Updated Master Direction on Foreign Investment in India: Clarifications to the Regulatory Framework*, Taxmann (Sept. 14, 2025), https://www.taxmann.com/research/preview-document?categoryName=fema-banking-insurance&fileId=105010000000026435&subCategory=experts-opinion&searchText=downstream%20investment%20in%20india/
[8] CS Amandeep Singh Oberoi, *Downstream Investments under FEMA - Regulatory and Practical Considerations*, CS Journal, 97, 97 (2024).
[9] NDI Rules, 2019, § Rule 23, Explanation.
[10] Master Direction, para. 9.1.13 (Updated on January 20, 2025).
[11] NDI Rules, 2019, § Rule 23(7)(c).
[12] NDI Rules, 2019, § Rule 23(7)(f).

controlled by PROI.[13] Conversely, suppose an Indian entity receiving foreign investment falls short of the threshold for being '*owned*' or '*controlled*' by a PROI; in that case, its subsequent investment in another Indian entity is treated as a domestic investment.

The guiding principle of the regulatory framework is *"what cannot be done directly, shall not be done indirectly,"*[14] which aligns downstream investments with foreign direct investments in terms of regulatory treatment. Accordingly, downstream investments deemed to be indirect foreign investments must comply with the NDI Rules regarding entry routes, sectoral caps, investment limits, pricing guidelines, and conditionalities.[15] However, ambiguity has historically stemmed from a lack of clarity on the scope of these principles within the FDI regime.[16] In response, the RBI issued a series of FEMA notifications, culminating in the January 20, 2025, update to the Master Directions ("Updated Master Directions"), which introduced significant clarifications.

III. RECALIBRATING THE NDI RULES

As discussed, India's Foreign Investment regime (direct or indirect), governing the terms and conditions under which foreign capital may flow into Indian entities, has its legal backbone in the NDI Rules, 2019. The years 2024 and 2025, together, represent one of the consequential phases of reform since the enactment of the NDI Rules. Through four separate amendments in 2024 and a further one in 2025, the government additionally liberalized entry norms across multiple sectors and also resolved long-standing issues that had undermined investor trust.[17] These reforms have changed the downstream investment scenario for Indian companies[18] categorized as FOCCs, opening new avenues while also, when needed, tightening compliance requirements.

A. Foreign Exchange Management (Non-Debt Instruments) Amendment Rules 2024

The first amendment of 2024 introduced the Direct Listing of Equity Shares of Companies Incorporated in India on International Exchanges Scheme[19], marking the start of the reform wave. By creating a new chapter X[20] and Schedule XI[21], the amendment enabled Indian public companies to list their equity shares directly on the notified international exchanges. It signaled India's readiness to integrate with global capital markets and lessen its reliance on antiquated instruments such as American Depository Receipts ("ADRs") or Global Depository Receipts ("GDRs"). With respect to FOCCs, this indirectly facilitated downstream investment by enhancing the capital-raising capacity of Indian companies in which they hold stakes.[22] The

[13] *Supra note* 8.
[14] Master Direction, para. 9 (Updated on January 20, 2025).
[15] Master Direction, para. 9.2 (Updated on January 20, 2025).
[16] Anindya Ghosh, Anantha Krishnan Iyer, Jaidrath Zaveri, Shubham Tiwary, *A Nod for SWAPS and Deferred Consideration in Downstream Investment: Unlocking the Foreign Investment Regime in India*, Argus Partners (Aug. 2, 2025), https://www.argus-p.com/papers-publications/thought-paper/a-nod-for-swaps-and-deferred-consideration-in-downstream-investment-unlocking-the-foreign-investment-regime-in-india/
[17] *Supra note* 7.
[18] Master Direction (Updated on January 20, 2025).
[19] Foreign Exchange Management (Non-Debt Instruments) Amendment Rules, 2024.
[20] Foreign Exchange Management (Non-Debt Instruments) Amendment Rules 2024, Ch X, Rule 34.
[21] Foreign Exchange Management (Non-Debt Instruments) Amendment Rules 2024, Schedule XI.
[22] *Supra note* 7.

amendment carefully restricted participation to '*permissible holders'*.[23] It also linked eligibility to anti-money laundering norms, ensuring that while global capital was welcomed, it did not compromise regulatory integrity.[24] The amendments thus laid the groundwork for a more globally connected capital-raising environment that FOCCs could leverage in their downstream strategies.

B. Foreign Exchange Management (Non-Debt Instruments) (Second Amendment) Rules 2024

The second amendment of 2024 tackled a narrow yet critical issue. Through this amendment, the legislation expanded the scope of *'unit'* by including partly paid-up units[25], subject to SEBI regulations framed in consultation with the Government of India, addressing the uncertainties relating to the phased funding models, i.e., the investment not paid in full at once but in parts (tranches). Before this clarification, questions arose as to whether subsequent calls on such units constituted fresh foreign investment, thereby requiring separate compliance. For FOCCs investing downstream through such vehicles, this created an unnecessary compliance burden and heightened regulatory scrutiny. The amendment attempts to resolve this issue by aligning FEMA with SEBI's established practices, providing certainty that phased funding structures are permissible. It shall greatly benefit FOCC-backed entities looking to invest in capital-intensive sectors without risking inadvertent non-compliance.

C. Foreign Exchange Management (Non-Debt Instruments) (Fourth Amendment) Rules 2024

The Fourth Amendment of 2024[26] stands out as the most comprehensive of the year, extending across definitional changes, investment eligibility, sectoral caps, and new entry routes. The first major change was the harmonization of the definition of *'control'* with that in the Companies Act, 2013.[27] This new uniform standard shall ensure consistency and predictability, which is vital for FOCCs structuring downstream investments through layered shareholding arrangements, as the differing definitions across statutes have led to confusion about when an Indian entity would be considered foreign-controlled or owned.[28] In the case of LLPs, *'control'* is now explicitly tied to the right to appoint a majority of designated partners who possess exclusive authority over policy decisions.[29] Equally significant was the insertion of Rule 9A, which formally permitted the swap of equity instruments between residents and non-residents and the swap of equity capital of foreign companies, provided the transactions complied with the FEMA and the Overseas Investment Rules, 2022.[30] This reform addressed a long-standing demand of industry stakeholders, as earlier share swap transactions required case-by-case approval from the RBI, creating delays and uncertainty.[31] The amendment facilitates cross-border mergers and acquisitions by codifying the process, making complex downstream

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[23] Foreign Exchange Management (Non-Debt Instruments) Amendment Rules 2024, Rule 2(ak).
[24] *Id*.
[25] Foreign Exchange Management (Non-Debt Instruments) (Second Amendment) Rules 2024, § Rule 2(aq).
[26] Foreign Exchange Management (Non-Debt Instruments) (Fourth Amendment) Rules, 2024.
[27] Foreign Exchange Management (Non-Debt Instruments) (Fourth Amendment) Rules 2024, § Rule 23(7)(d); Companies Act, 2013, § 2(27).
[28] *Supra note* 8.
[29] Foreign Exchange Management (Non-Debt Instruments) (Fourth Amendment) Rules 2024, § Rule 23(7)(d).
[30] Foreign Exchange Management (Non-Debt Instruments) (Fourth Amendment) Rules 2024, § Rule 9A.
[31] Master Direction (Updated on January 20, 2025).

structuring more feasible for FOCCs.[32] The amendment also makes an important clarification in the context of indirect foreign investment. The rules remove a longstanding irritant by providing that investments made on a non-repatriation basis by entities owned and controlled by Non-Resident Indian ("NRIs") or PROIs (including companies, trusts, and partnerships) shall not be considered in calculating indirect foreign investment. For FOCCs, this relaxation translated into the structuring of downstream investments without the risk of technical non-compliance.[33]

D. Foreign Exchange Management (Non-Debt Instruments) (Amendments) Rules 2025

The 2025 reform[34], aimed at resolving a long-standing compliance ambiguity in India's FDI regime. The amendment authorizes Indian companies operating in FDI-prohibited sectors or activities to issue bonus shares to their pre-existing non-resident shareholders, subject to the condition that such issuances do not alter the existing shareholding pattern. By inserting sub-rule (2) under Rule 7, the reform directly addresses concerns that bonus share issuances, though not involving any inflow of fresh foreign capital, might nevertheless be construed as violating FEMA restrictions.[35] The FEMA has incorporated that bonus share issuances to non-resident shareholders in FDI-prohibited sectors would be permissible, provided there was no alteration to the shareholding structure.[36]

IV. DECODING THE 2025 MASTER DIRECTION

The January 2025 update to the Master Direction on Foreign Investment[37] introduced a series of clarifications and definitions aimed at closing interpretive gaps and improving procedural certainty, particularly in the context of downstream investment by Foreign Owned or Controlled Companies. A foundational clarification asserts that in case of inconsistency between this Master Direction and notifications issued under FEMA, the latter will prevail, thereby reaffirming the primacy of statutory instruments over guidance documents.[38] This edition of the Master Direction also addressed the long-uncertain treatment of inherited securities and changes in residential status.[39] Where equity instruments are inherited by a non-resident from a resident Indian, they are to be held on a non-repatriation basis and are exempt from reporting.[40] Similarly, when a resident investor becomes a non-resident, any existing investments will retain non-repatriable character.[41]

Further refinements were made to terminologies that directly affect employee-linked capital instruments. The terms Employee Stock Option Plans ("ESOP"), '*sweat equity shares*', and '*Share Based Employee Benefits*' are now clearly defined in reference to the Companies Act and

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[32] Prateek Lala, Ritwik Mukherjee, *Downstream investments by FOCCs: Practical challenges and conundrums*, Trilegal (Aug. 10, 2025), https://trilegal.com/magazine/downstream-investments-foccs-practical-challenges-and-conundrums-insights-issue-11.html
[33] *Id*.
[34] Foreign Exchange Management (Non-Debt Instruments) (Amendments) Rules, 2025.
[35] Foreign Exchange Management (Non-Debt Instruments) (Amendments) Rules 2025, § Rule 7(2).
[36] *Id.*
[37] Master Direction (Updated on January 20, 2025).
[38] Master Direction, para. 1.1 (Updated on January 20, 2025).
[39] Master Direction, para.1.3 (Updated on January 20, 2025).
[40] NDI Rules, 2019, § Rule 6(2).
[41] Master Direction, para. 1.3 (Updated on January 20, 2025).

SEBI regulations.[42] Importantly, the scope of Share-Based Employee Benefits has been extended to allow Indian companies to issue equity instruments to non-resident employees or directors of their overseas subsidiaries, joint ventures, or parent entities.[43] These instruments must comply with sectoral caps and applicable laws, and prior government approval is necessary where FDI approval routes apply or when recipients are citizens of Bangladesh or Pakistan. Notably, sweat equity has been permitted since June 2015[44], while other share-based benefits for non-residents have been allowed since April 2022, marking progressive liberalization in this area.[45] To eliminate ambiguity in language, it has been clarified that any undefined term used in the Master Direction will carry the same meaning as assigned in FEMA and associated rules.[46] Moreover, the expression "banking channels" now formally includes rupee vostro accounts held by non-residents, including Special Rupee Vostro Accounts recognized under the FEMA Deposit Regulations, 2016.[47]

The revised direction also retains restrictions on investment from countries sharing land borders with India, with a narrow exception made for multilateral banks or funds of which India is a member. These entities are no longer treated as originating from a specific country, nor is any nation deemed the beneficial owner of their investments.[48] Instruments like convertible debentures and preference shares are now recognized under strict conditions. Only fully paid and mandatorily convertible debentures and preference shares qualify, with the pricing or conversion formula required to be fixed at the time of issue. The conversion value must not fall below the fair market value assessed at issuance, thereby preventing backdoor underpricing or misuse of hybrid instruments.[49] Any amendment to the tenor of these instruments must also conform to the Companies Act and related rules.

To manage exposure in sensitive sectors, the Direction has placed a ceiling of twenty-four per cent on foreign portfolio investment in sectors where FDI is otherwise prohibited.[50] This serves to curb indirect control through passive investments. In sectors that prescribe minimum capitalization, it is clarified that only the amount received at the time of issue, comprising face value and premium, will be counted. Any subsequent premium paid in a secondary transfer will not qualify for this computation.[51] A vital clarification has also been provided for companies in the financial sector. Where a regulator prescribes minimum net owned funds as a licensing requirement, such entities may receive foreign investment strictly for the purpose of meeting this criterion[52] however, if the registration is not granted, the investment must either be returned or restructured to comply with norms applicable to non-operational entities receiving FDI.

[42] Master Direction, para. 2.15, 2.16 (Updated on January 20, 2025); Companies Act, 2013 § 2(88); SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021.
[43] Master Direction, para. 2.17 (Updated on January 20, 2025).
[44] Reserve Bank of India, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Fourth Amendment) Regulations, FEMA.344/2015 RB, (Issued in June 11, 2015).
[45] Master Direction, para. 6.13.1 (Updated on January 20, 2025).
[46] Master Direction, para. 2.28 (Issued on January 4, 2018).
[47] Master Direction, para. 2.28, Explanation (Updated on January 16, 2025).
[48] Master Direction, para. 3.2 (Updated on March 17, 2022).
[49] Master Direction, para. 4.6.1 (Updated on January 20, 2025).
[50] Master Direction, para. 5.4.1 (Updated on January 20, 2025).
[51] Master Direction, para. 5.2.5 (Issued on January 4, 2018).
[52] Master Direction, para. 5.2.7, note (Updated on January 20, 2025).

Under Section 62(1)(a)(iii) of the Companies Act 2013, Indian companies may issue rights shares to non-residents, subject to compliance with all applicable FEMA conditions, including sectoral caps, entry routes, and pricing norms.[53] This ensures parity between primary and follow-on capital issuances, even in cross-border shareholder structures. In cases of mergers, demergers, or amalgamations approved by the NCLT or any other competent authority, the transferee or resulting company may issue equity instruments to non-resident shareholders of the transferor entity. Such transactions must conform to prescribed entry routes, sectoral limits, and require reporting under the *FC-GPR* or *FC-TRS* formats.[54] The update also lays out safeguards for instances where an FPI's acquisition results in a temporary breach of investment caps. If this occurs, the FPI must divest the excess to an eligible resident within five trading days after settlement. Provided the transaction is resolved within this timeframe, no contravention under the NDI Rules will be recorded. Reclassification of FPI investment into FDI must follow the RBI's 2024 framework,[55] thereby standardizing such transitions.[56]

Transactions involving deferred payments, indemnities, or escrow arrangements must now be contractually recorded in the relevant share purchase or transfer agreement. This strengthens legal enforceability and ensures such mechanisms are not used to circumvent regulatory conditions. The Direction also permits swap of equity instruments between residents and non-residents, including swaps involving foreign company equity capital, provided they adhere to FEM (Overseas Investment) Rules, 2022[57] and RBI regulations notified for the same. The term "*equity capital*" used in this context retains the meaning prescribed under the latter rules, ensuring consistency in terminology.[58] Downstream investment continues to follow the principle that indirect investment must mirror the compliance standards of direct investment. Accordingly, downstream transactions must adhere to entry routes, pricing guidelines, and sectoral caps.[59] It has also been clarified that structures permissible for direct investment, such as equity swaps and deferred consideration mechanisms, are likewise permitted in downstream investments, so long as they do not violate provisions of Rule 23,[60] including the restriction on use of domestic borrowings.

Where the original investment in an Indian entity was made by a resident but the investing entity later becomes foreign-owned or controlled, the investment is to be treated as indirect foreign investment from the date of such change. The investing entity must report the transaction within 30 days and ensure compliance with the relevant sectoral norms.[61] At the same time, investments made on a non-repatriation basis by NRIs or PROIs, including those made through companies, trusts, or partnerships incorporated abroad, are not treated as foreign investment. This distinction allows FOCCs to structure certain downstream transactions outside the indirect FDI net, provided they remain within the bounds of Schedule IV.[62] Lastly, Indian companies are

[53] Master Direction, para. 6.12.3 (Updated on January 20, 2025).
[54] Master Direction, para. 6.15.1 (Updated on March 17, 2022).
[55] Reserve Bank of India, Operational framework for reclassification of Foreign Portfolio Investment to Foreign Direct Investment (FDI), RBI/2024-25/90, (Issued November 11, 2024).
[56] Master Direction, para. 7.1.4 (Updated on January 20, 2025).
[57] Foreign Exchange Management, (Overseas Investment) Rules, 2022, No. FEMA 400/2022-RB.
[58] Master Direction, para. 7.14 (Updated on January 20, 2025).
[59] Master Direction, para. 9 (Updated on March 17, 2022).
[60] NDI Rules, 2019, Rule 23.
[61] Master Direction, para. 9.1.15 (Updated on January 20, 2025).
[62] *Id.*

permitted to issue equity instruments to non-residents in exchange for equity of foreign companies. These transactions must comply with Central Government rules and RBI regulations, including the Overseas Investment Rules, 2022.[63] The term "*equity capital*" used in such swap arrangements will carry the meaning assigned under the same rules, ensuring uniform regulatory interpretation across domestic and cross-border structures.

To further streamline the regulatory framework governing foreign investment, the Reserve Bank of India introduced the *Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) (Third Amendment) Regulations, 2025.*[64] These amendments primarily address procedural aspects related to the mode of payment and remittance for various categories of foreign investment, with a focus on aligning them with the *Foreign Exchange Management (Deposit) Regulations, 2016*.[65] Under the revised provisions applicable to Schedule I transactions involving the purchase or sale of equity instruments of an Indian company by a person resident outside India, consideration for equity instruments issued to non-residents must be brought in through inward remittance or from repatriable accounts held in accordance with the Deposit Regulations.[66] The scope of permissible consideration has been expanded to include dues owed by the issuing company and equity swaps. Shares must be allotted within sixty days from receipt of consideration, or else the funds must be refunded within fifteen days. Partly paid shares follow the same timeline for each instalment. Issuers may also open foreign currency accounts with authorized dealers for these purposes.

Similar clarifications have been made across other schedules. For FPIs (Schedule II), FVCIs (Schedule VII), LLPs (Schedule VI), and investment vehicles (Schedule VIII), the payment and repatriation routes must comply with permitted banking channels or repatriable accounts. In each case, sale or maturity proceeds may be credited to these accounts, net of taxes.[67] In the case of investment in Indian Depository Receipts under Schedule X, NRIs and PROIs may invest through NRE or FCNR(B) accounts, while FPIs must use foreign currency or Special Non-Resident Account (SNRR) accounts.[68] Redemption or conversion into underlying equity shares must follow the Overseas Investment Rules, 2022.[69] The treatment of convertible notes issued by Indian start-ups has also been updated. Consideration must be received through authorized channels, and exit proceeds may be remitted or credited to designated accounts. Additionally, it has been clarified that the term "banking channels" includes rupee vostro accounts, including Special Rupee Vostro Accounts permitted under the 2016 Deposit Regulations.[70]

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[63] Master Direction, Annex 1, para. 1.4 (Updated on January 20, 2025).
[64] Reserve Bank of India, Foreign Exchange Management (Mode of Payment and Reporting of Non- Debt Instruments) (Third Amendment) Regulations, 2025, FEMA 395(3)/2025-RB (Issued in January 14, 2025).
[65] Foreign Exchange Management (Deposit) Regulations, 2016, Notification No. FEMA 5(R)/2016-RB.
[66] Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019, para. 3.1, Schedule I.
[67] Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019, para. 3.1, Schedule II, Schedule VII, Schedule VI & Schedule VIII.
[68] Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019, para. 3.1, Schedule X.
[69] Foreign Exchange Management (Overseas Investment) Rules, 2022.
[70] Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019, para. 3.2.

V. BEHIND THE REFORMS: AN ANALYSIS

The 2025 reforms represent a decisive turning point in the regulatory approach to downstream investments by FOCCs, placing greater weight on predictability, procedural clarity, and alignment with international standards.[71] The NDI Rules, originally framed in 1990 and subsequently amended in 2024 and 2025, reflect a shift from a fragmented, sector-based liberalization model towards a more coherent regulatory architecture, aimed at resolving ambiguities that had long impeded the ability of FOCCs to undertake compliant downstream investments.[72] The amendment aligns the definition of 'control' with the Companies Act, thereby resolving interpretive ambiguities that might otherwise have persisted in assessing downstream investments as indirect foreign investment. For FOCCs operating through multi-tier structures, this clarity offers a significant compliance advantage. The relaxed treatment of non-repatriable investments by NRI and PROI-controlled entities marks a significant policy shift, as the government draws a clear distinction between foreign capital and diaspora-held resources that remain non-repatriable.

The introduction of Rule 9A in the NDI Rules[73] formalises swap-based transactions and provides a clear legal authorisation to the transactions related to equity swaps and cross-border mergers, with no necessity to seek case-to-case authorization of the transaction by the RBI. Rule 9A places strategic acquisitions involving FOCCs within a closed rule-based framework, leaving little scope for regulatory discretion in the decision-making process. A similar justification can be found in the recent amendment, which should permit issuances of bonuses of concerned sectors not opened to FDI inflows, but as long as the basic underlying ownership structure would not change, tackling an obstacle present long ago in FOCC-dominated enterprises. The revised Master Direction crystallises this form of regulatory revision by providing detailed guidance on reporting obligations, permissible instruments, and mechanisms for ensuring valuation protection. The clarification that any change in investor classification mandates fresh downstream compliance compels FOCCs to continuously monitor shifts in corporate control, thereby reinforcing adherence to the regulatory framework.

An Indian company may now issue ESOPs, sweat equity shares, or other share-based benefits to non-resident employees or directors of its holding company, joint venture, or overseas subsidiaries, subject to SEBI and Companies Act regulations, sectoral caps, and approval requirements under the FDI regime. These changes enhance the flexibility of FOCCs to structure employee equity allocations within the regulatory framework. Procedural discipline has now found its platform in the centre of payment operations through the Third Amendment to the FEMA Regulations that provides strict time constraints and performs specifications of channels to be used, limiting the vostro arrangements and swap transactions. For FOCCs, these changes recalibrate regulatory expectations, liberal in scope yet stringent in compliance. The result is a framework that provides legal clarity and structural flexibility, while holding FOCCs to high standards of transactional discipline.

[71] Vinod Kothari Consultants, *Downstream investment to be treated at par with FDI* (Sept. 12, 2025) https://vinodkothari.com/2025/01/downstream-investment-to-be-treated-at-par-with-fdis/
[72] *Supra note* 33.
[73] Foreign Exchange Management (Non-Debt Instruments) (Fourth Amendment) Rules 2024, Rule 9A.

VI. CONCLUSION

The revision of the foreign investment regime that India plans in 2024-25 is to enable a clear and predictable post-entry business environment coverage to downstream investors. However, the effectiveness of this agenda of reforms will rest on the manner in which it shall be interpreted and applied to the practice. The series of NDI Rule amendments, coupled with the detailed guidance provided by the 2025 Master Direction on Foreign Investment, has resolved several longstanding gaps, particularly in relation to equity swaps, the definition of control, and the exclusion of certain NRI/PROI-backed investments from indirect foreign investment calculations. Nevertheless, significant challenges remain, foremost among them the lack of legislative clarity on the transfer of equity instruments to or within an FOCC. The rules explicitly specify the applicability of pricing guidelines and reporting obligations when an FOCC acts as the transferor. However, they remain silent on the corresponding obligations when equity instruments are transferred to an FOCC, whether from a non-resident or a resident entity. The existing uncertainty on the scope of relevant and cross-border trade in terms of applying fair value caps and certain reporting is also unclear, and hence, this can result in dissimilar interpretations among authorised dealer (**"**AD**"**) banks, and allow dissimilarity in compliance efforts across jurisdictions.

The easing of restrictions on equity swaps in secondary transfers parallels the relaxation of rules governing direct equity investments. Under the revised regulatory framework, Rule 9A[74] allows the exchange of securities as valid consideration, permitting the use of equity instruments of another Indian company or the equity capital of a foreign company in place of fresh issuances. Paragraph 9 of the updated Master Directions on Foreign Investments 2025 explicitly extends the availability of equity swaps to downstream transactions that comply with FDI regulations, yet market practice in this regard remains nascent. A closer look at the new FOCC regulations[75] confirms what appears to be a dual direction concerning the future of the foreign investment. On one hand, companies gain an expanded scope for transactions; on the other, they must remain vigilant to ensure regulatory compliance. The current approach of India might be described as a calculated balance, or entry of capital and incorporation of novel deal structures is welcome, but regulation and retaining macroeconomic independence are of utmost importance. If existing uncertainties are resolved through strict regulatory interpretation and proactive enforcement, these reforms could render FOCC-led downstream investments both compliant and strategically advantageous, thereby further integrating India into global investment networks.

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[74] *Id*

[75] Master Direction (Updated on January 20, 2025).