

## Updates to the Master Direction on Foreign Investment in India

The Reserve Bank of India (“**RBI**”) has introduced updates to the Master Direction – Foreign Investment in India (FED Master Direction No.11/2017-18) on January 20, 2025 (“**Updated Master Directions**”). The master directions supplement the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (“**FEM NDI Rules**”) and the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019.

The Updated Master Directions, *inter alia*, have provided the following key clarifications:

### 1. Extension of pricing guidelines to unsubscribed portion of rights issue

The FEM NDI Rules lay down detailed pricing guidelines applicable to various modes of issuance/transfer between residents and non-residents. In relation to rights issue by an unlisted Indian company, Rule 7 of the FEM NDI Rules provides that the price should not be less than the price offered to resident shareholders.

The Updated Master Directions have clarified that specifically in relation to the unsubscribed portion of the rights issue, wherein the board of directors decide the manner of disposal of the unsubscribed shares (in a manner not dis-advantageous to the shareholders and the company), the pricing guidelines must apply i.e., the unsubscribed portion should be priced at the fair market value as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a Merchant Banker registered with the Securities and Exchange Board of India or a practising Cost Accountant, in case of an unlisted Indian Company.

### 2. Deferred consideration and other options for Foreign Owned and Controlled Companies

Rule 9(6) of the FEM NDI Rules provides that in the event of transfer of equity instruments between a resident and a non-resident, the 25% of the consideration may be:

- a) paid on a deferred basis within a period not exceeding 18 (eighteen) months from the date of the transfer agreement;
- b) settled through an escrow arrangement between the buyer and the seller for a period not exceeding 18 (eighteen) months from the date of the transfer agreement; and
- c) indemnified by the seller for a period not exceeding 18 (eighteen) months from the date of the payment of the full consideration, if the total consideration has been paid by the buyer to the seller.

The Updated Master Directions expressly clarify that these arrangements will also be available for the purpose of downstream investment by Foreign Owned and Controlled Companies (“**FOCCs**”). It is to be noted that FOCCs have generally been prevented from using such structures as it was not clear if FOCCs could also structure their transactions to provide for deferred consideration subject to the above conditions. This update significantly broadens the scope of structuring of transactions involving FOCCs, subject to the scope of restrictions applicable to downstream investments as imposed under Rule 23 of the FEM NDI Rules.

### 3. **Reporting in Form DI pursuant to reclassification**

The Updated Master Directions have widened the scope of filing Form DI. The Updated Master Directions have clarified that investment by resident investors who have subsequently become owned and/or controlled by persons resident outside India, is reckoned as downstream investment from the date on which the investor entity is owned and/or controlled by persons resident outside India. Such downstream investment should be reported in Form DI by the investor entity within 30 (thirty) days from the date of such reclassification. This reporting requirement is different from the general requirement under Rule 23(6) of the FEM NDI Rules which places the obligation on the first level Indian company making the downstream investment.

### 4. **Foreign investment to fulfil Net-Owned Funds (“NOF”) requirements**

The FEM NDI Rules lays down that investment in companies operating in the financial sector requires prior approval of the RBI, as detailed thereunder. However, the RBI has clarified that an Indian investee company whose proposed activities are regulated by a financial sector regulator, may receive foreign investment to comply with the criteria of minimum net owned funds prescribed by such regulator. The RBI has expressly clarified that such investment should only be utilised for the sole purpose of complying with the NOF requirements and not for any other purposes or activities.

Further, in the event that the registration/license is not granted by the respective regulator the investment amount should be repatriated to the investor. This clearly lays down the intention of the regulator to ensure that the companies do not misuse the provision which was provided to further facilitate companies to meet the NOF requirement.

This relaxation significantly assists such companies to meet the NOF requirement by means of foreign capital.

### 5. **Treatment of inherited assets**

The RBI has clarified that non-resident legal heirs inheriting equity instruments held by a resident individual must inherit the same on non-repatriation basis and no reporting is required in this regard. Further, the RBI has clarified that change in residential status of a holder from a resident to a non-resident would deem the investment held to be on a non-repatriable basis.

### 6. **Issue of Employee Stock Option Plan (“ESOPs”), sweat equity shares and share based employee benefits**

The resident companies are required to adhere to the sectoral foreign investment limits applicable on such companies while granting ESOPs, sweat equity shares and share based employee benefits. The RBI has further clarified that the percentage of foreign investment should be calculated on fully diluted basis, upfront, at the time of issuance/grant of employee stock options, sweat equity shares and share based employee benefits to persons resident outside India. Resident companies should be mindful of this requirement while drafting and adopting the underlying documents in relation to these schemes.

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**This Prism has been prepared by:**



**Archana Tewary**  
Partner



**Naveen Kumar**  
Associate

		
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For more details, please contact [km@jsalaw.com](mailto:km@jsalaw.com)

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