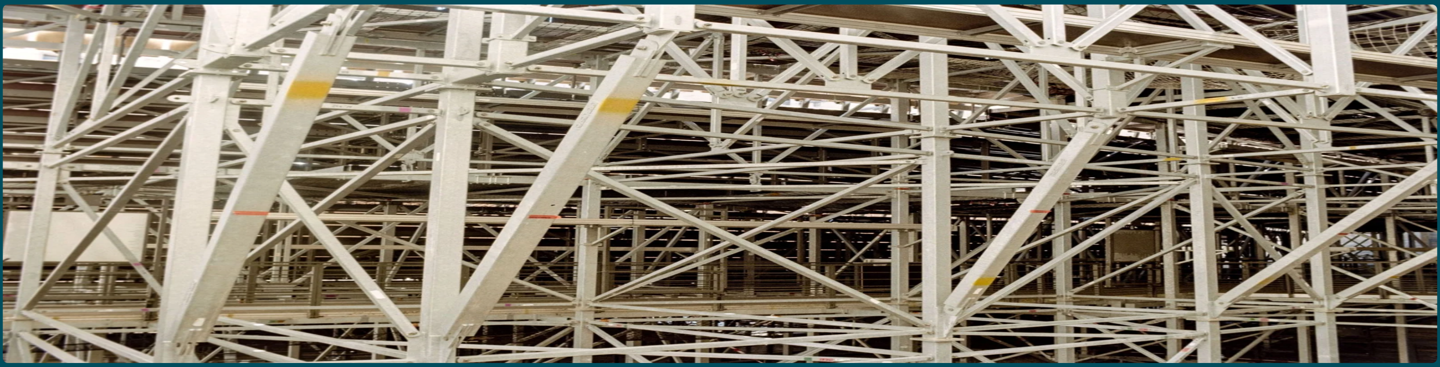
INDIALAW



COMMERCIAL/CORPORATE

Refining the FEMA Framework: An Analysis of the Draft Foreign Exchange Management (Foreign Investment) Rules, 2026

AUTHOR Umang Shirodariya

PUBLISHED 29 July 2026

The Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (the "Existing Rules") currently govern foreign direct investment by persons or entities resident outside India into persons or entities resident in India in non-debt instruments. The Reserve Bank of India has recently proposed a comprehensive overhaul of this framework through the **draft Foreign Exchange Management (Foreign Investment) Rules, 2026** (the "Draft Rules"), which were released for public comments on 21 July 2026.

Once notified, the Draft Rules are expected to substantially reshape the regulatory architecture governing foreign investment in India.

Table of contents

Shift From Investor-Centric to Investee-Centric Classification

A fundamental shift in approach is evident in the structure of the Draft Rules. The Existing Rules organised provisions and compliance obligations primarily by reference to the category of investor, such as a person resident outside India, a non-resident Indian, or an overseas citizen of India.

In contrast, the Draft Rules adopt a classification centred on the **eligible investee entity**. The definition of "eligible investee company" has been broadened to expressly cover:

- Private companies
- Limited liability partnerships
- Partnerships
- Alternative investment funds

This reorientation consolidates and simplifies compliance requirements across diverse corporate and fund structures, reducing fragmentation that previously existed under the investor-centric model.

Clarified Definition of Foreign Controlled Entity

The Draft Rules also introduce a clarified definition of **"foreign controlled entity."** This new definition resolves several long-standing ambiguities present in the Existing Rules regarding the determination of foreign control.

Streamlined Structure and Logical Progression

In terms of architecture, the Draft Rules follow a **logical progression**:

1. Prohibited activities
2. Permitted investments
3. Conditions attaching to such investments

This sequential structure, coupled with the adoption of a single set of common compliance obligations applicable across investor categories, significantly reduces interpretive uncertainty and administrative complexity.

Elimination of Differential Compliance Regimes

Notably, the Draft Rules eliminate the differential and often lengthy compliance regimes that previously applied depending on the nature of the investee entity. Key changes include:

- Removal of the differential compliance regimes based on the nature of the investee entity

- Removal of the restriction applicable to investments involving entities from countries that share a **land border with India**

The overall framework is designed to be both investor- and investee-neutral, establishing uniform compliance standards intended to enable *ease of doing business*.

Retained Principles and Omitted Provisions

While the Draft Rules retain the core principles of **pricing guidelines** and the requirement that investments be undertaken on an arm's-length basis, certain provisions found in the Existing Rules have been omitted.

Omitted Provisions

- The detailed regimes governing downstream investments
- Investments through employee stock option schemes or convertible notes
- The acquisition or transfer of immovable property

Key Takeaway for Stakeholders

Taken together, the Draft Rules represent a deliberate move towards **simplification, consolidation, and greater regulatory clarity**. Stakeholders would be well advised to review the proposals carefully and submit comments within the prescribed window, given the material impact the final rules are likely to have on foreign investment structuring and compliance practice in India.

Public Comments and Deadline

The RBI has called for public comments on the draft rules to be submitted by **August 31, 2026**. The notification and the draft rules can be accessed on the following link:

https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=63204

Related Practice Areas

Corporate Finance | **Foreign Exchange and FDI Compliance**