

Cross-border share swaps made easier through amendments to India's foreign exchange regulations

By: Rukshad Davar, Rahul Datta and Bhavya Solanki, Majmudar & Partners, India

The Indian government has recently notified the Foreign Exchange Management (Non-Debt Instruments) (Fourth Amendment) Rules, 2024 (the “**Amendment Rules**”) to amend the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (the “**NDI Rules**”). This update delves into some important changes on share swaps and clarifications introduced by the Amendment Rules.

Key changes

- (i) Equity swaps by way of transfers: Rule 9A has been newly introduced in the NDI Rules to regulate equity swaps in the context of a transfer of shares. Under this Rule, the transfer of equity instruments of an Indian company between a resident and a non-resident (“**NR**”) may occur via a swap of either, equity instruments of an Indian company, or equity capital of a foreign company. Both types of swaps are subject to compliance with the rules and regulations prescribed by the Central Government and the Reserve Bank of India (the “**RBI**”) (“**Applicable Law**”). In simple terms, the NDI Rules now permit the following transfers:
 - (a) A resident holding equity instruments in an Indian company can transfer such instruments to an NR in exchange for equity instruments held by the NR in another Indian company;
 - (b) An NR holding equity instruments in an Indian company can transfer such instruments to a resident in exchange for equity instruments held by the resident in another Indian company;
 - (c) A resident holding equity instruments in an Indian company can transfer such instruments to an NR in exchange for the equity capital held by the NR in a foreign company, subject to compliance with Applicable Law; and
 - (d) An NR holding equity instruments in an Indian company can transfer such instruments to a resident in exchange for the equity capital held by the resident in a foreign company, subject to compliance with Applicable Law.
- (ii) Equity swaps for primary issuance of shares: The Amendment Rules have also introduced changes to Paragraph (1)(d) of Schedule I to the NDI Rules, which deals with issuance of equity instruments by an Indian company. Previously, Indian companies were permitted to issue equity instruments to an NR in exchange for equity instruments held by the NR in another Indian company. The Amendment Rules have introduced a new clause that explicitly permits Indian companies to issue new equity instruments to an NR in exchange for equity capital held by the NR in a foreign

company, subject to compliance with the OI Rules. This change will facilitate cross-border share swaps for Indian companies and may result in more businesses opting for reverse flipping and simpler share-swap based structures for mergers, acquisitions, and restructuring across borders, subject to compliance with Applicable Law, including tax law.

- (iii) Definition of “control”: Rule 23 of the NDI Rules govern downstream (or indirect) foreign investments in India (“DI”) made by foreign investors through entities “owned” or “controlled” by those foreign investors (“FOCCs”). Previously, the NDI Rules defined “control” under Explanation (d) to Rule 23(7) as: (a) for companies, the right to appoint a majority of the directors or to control the management or policy decisions, including by virtue of shareholding, management rights, shareholders’ agreements, or voting agreements; and (b) for limited liability partnerships (“LLP”), the right to appoint a majority of the designated partners, where those designated partners, with specific exclusion to others, held control over all the policies of the LLP.

The Amendment Rules have now removed the foregoing definition and have added a new definition under Rule 2 of the NDI Rules. Pursuant to this change, “control” for companies is now defined to have the meaning assigned to it in the Companies Act, 2013 (the “Companies Act”), while the definition of “control” for LLPs remains the same as before. Additionally, the explanation on the definition of “control” under Schedule II(1)(a)(ii) of the NDI Rules, which applied to Foreign Portfolio Investors (“FPI”), has been removed. Under the Companies Act, the definition of “control” is largely similar to the erstwhile definition in the NDI Rules but also expressly states that control can be exercised, directly or indirectly, by a person or persons acting individually or in concert. Given the foregoing, in our view, the change has been introduced to harmonize the definition of “control” across various laws in India and is largely clarificatory in nature.

- (iv) DI by FOCCs owned by Overseas Citizens of India (“OCIs”): The Amendment Rules state that any DI made by an Indian entity (including a company, trust or partnership firm) owned and controlled by Overseas Citizens of India (“OCIs”) on a non-repatriation basis under Schedule IV of the NDI Rules will not be considered as indirect foreign investment. Pursuant to the change, the treatment of investments made by OCIs on a non-repatriation basis has been expressly clarified to be at par with the treatment of investments made by non-resident Indians (“NRIs”) on a similar basis. The provision on treatment of investments by NRIs on a non-repatriation had been introduced in India’s foreign exchange regulations by way of [Press Note 1 of March 2021](#). The NDI Rules, under Schedule IV(A)(1)(a) read with Schedule IV(A)(1)(b) already stated that an NRI or an OCI, including a company, trust, partnership firm incorporated outside India and owned and controlled by NRIs or OCIs, may make specified investments on a non-repatriation basis, and these investments will be deemed to be domestic investments at par with the investments made by Indian residents. Given this, in our view, the changes are clarificatory in nature.

- (v) Definition of “startup company”: The Amendment Rules have updated the definition of “startup company” to align with the latest notification on India’s Startup Action plan issued by the Department for Promotion of Industry and Internal Trade on February 19, 2019 ([G.S.R. 127\(E\)](#)). The changes are intended to harmonize the definition of startup companies under Indian laws.

- (vi) Transfers: Rule 9 of the NDI Rules regulates the transfer of equity instruments of Indian companies by or to NRs. Previously, Proviso (i) of Rule 9(1) required prior government approval for transfers between two (2) NRs if the Indian company was engaged in a sector requiring such government approval. The Amendment Rules replace the foregoing clause with a broader requirement of obtaining prior government approval for transfers in all cases where government approval is required. This change clarifies that all necessary approvals under law, whether sector-specific or sector agnostic (for instance, acquisitions under [Press Note 3 of 2020](#), which require government approval when the transferee is in a country sharing land border with India or has a beneficial owner who is situated in or is a citizen of such country), or from other regulators, will be required for transfers between two (2) NRs.

- (vii) FPI: In Schedule I of the NDI Rules, Paragraph 3(a) outlines the foreign investment entry routes into India, namely the automatic route, the government route, and the FPI route. Previously, under the FPI Route, aggregate FPI of up to either: (a) 49% of the Indian company’s fully diluted paid-up capital; or (b) the sectoral or statutory cap, whichever was lower, did not require government approval or compliance with sectoral conditions; provided, that, the FPI did not result in transfer of ownership and control of the Indian company from resident Indian citizens to NRs.

The Amendment Rules omit the 49% threshold and now permit FPI up to the sectoral or statutory cap under the automatic route. However, the Amendment Rules continue to specify an approval requirement if the acquisition by the FPI results in a transfer of ownership and/or control of the Indian company from a resident to an NR. While the removal of the 49% threshold is welcome, the extent of the impact of this change is currently unclear as any transfer of ownership of the Indian company will continue to require government approval.

- (viii) White Label ATM: The Amendment Rules now incorporate White Label ATM (“**WLA**”) operations in the NDI Rules to align them with Paragraph 5.2.25 (White Label ATM Operations) of the Consolidated Foreign Direct Investment Policy (effective from October 15, 2020). Now, the NDI Rules also reflect that 100% FDI is permitted in WLA operations through the automatic route, subject to attendant conditions.