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UNDERSTANDING INDIA'S LEGAL FRAMEWORK FOR FOREIGN DIRECT INVESTMENT

~Bhumika Singh

INTRODUCTION

FDI or Foreign Direct Investment is a crucial financial resource that substantially helps in India's development by adding long-term sustainable capital, technology, and skills to the Indian economy. The recent amendments to Press Note No. 3 have brought India's FDI policy into the spotlight. While the debate is over foreign investment from neighbouring countries especially China, it is important to know the fundamentals of FDI and how it is regulated in India in order to understand the recent developments. Therefore, this blog explains the fundamental legal framework that regulates FDI in India.

WHAT IS FDI?

Foreign Direct Investment, under the 2019 rules, is defined as an investment through equity instruments 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.[1] In simple terms, it means that an investment in an Indian company by a person or entity living outside India can be referred to as FDI and in return that person or entity obtains ownership interest and, in many cases, some degree of control over the company invested in. In case of India, the total stakes should amount to at least 10% of the listed company to be called FDI.

The reason FDI is welcomed into countries is due to the long-term growth and financial support that it brings along. It is often accompanied by new technology, better machinery,

[1] Foreign Exchange Management (Non-debt Instruments) Rules, 2019, Notification no. S.O. 3732(E) (Oct. 17, 2019) rr. 2(r)-(t).

jobs, global business practices, and international markets that are essential for development of a country.

FDI VS. FPI

Investments from a foreign source can be of two types namely – Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). The key differences between the two lies in control and the investment threshold. While FDI is made in both listed and unlisted companies, FPI is made only in the listed ones. In the listed companies, if the investment is 10% or more of the equity, then it would be considered FDI, while if it is less than 10%, it would be referred to as FPI.[2] While FDI also gives part ownership and control over the company's decisions, FPI does not.

THE LEGAL FRAMEWORK

The legal framework surrounding FDI is not derived from a single document but from a multi-layered "edifice" that is built upon four principal pillars. These pillars are described as follows:

1. FEMA - The Foreign Exchange Management Act, 1999, is a legislation enacted by Parliament that acts as the primary statute governing all foreign exchange transactions. It empowers the Central Government and RBI to frame rules and regulations for regulating foreign exchange and capital account transactions. While the RBI handles all the debt-related transactions (like loans), the central government decides rules for non-debt related transactions (like FDI) in consultation with the RBI.[3]
2. The Rulebook - The central government has framed a subordinate legislation that provides the granular legal requirements for investments. It is called the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, often known as the NDI Rules of 2019.[4]
3. The Policy guide - The Consolidated FDI Policy issued by the Department for Promotion of Industry and Internal Trade (DPIIT) under the Ministry of Commerce and Industry brings together sector-wise conditions, entry routes, eligibility and other

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[2] Id. r. 2(t).
[3] Foreign Exchange Management Act, No. 42 of 1999, INDIA CODE (1999).
[4] Foreign Exchange Management (Non-debt Instruments) Rules, 2019, supra note 1.

provisions related to FDI in one document. It is an executive policy document that operates within the framework of FEMA.[5]

4. Press Notes - DPIIT issues Press Notes that announce amendments to the FDI policy. The press note may be issued but it does not imply completion of the legal process. As stated in each of the press note, the decision "will take effect from the date of FEMA notification"[6], meaning that the actual amendments to the NDI rules are necessary to give the policy a legal effect.

These four together regulate the foreign exchange matters in India while providing mechanisms for compliance through penalties and hold the company and its major decision makers accountable.

THE 2 ENTRY ROUTES

The Investments made in an Indian company come via either of the two routes namely – the automatic route and the government route. The Automatic Route is the entry route that does not require the prior approval of the central government. On the other hand, the Government Route needs prior government approval for investment.[7]

Which route applies depends on the sector and specific policy conditions which are mentioned in the NDI rules of 2019 along with sectoral caps[8] that limit the maximum percentage of foreign ownership through investment. The distinction itself is primarily constructed due to national security concerns. For example, sectors such as defence and space are considered "sensitive sectors" and any foreign investment is permitted through the Government Route.

WHY PRESS NOTE 3 BECAME IMPORTANT?

Press Note No. 3 was issued in 2020 during the Covid-19 pandemic to curb "opportunistic takeovers"[9] of Indian companies while valuations were comparatively low. It mandated that any investment from a neighbouring country sharing land border with India would have to compulsorily seek prior government approval and enter via the government route regardless

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[5] Dep't for Promotion of Indus. & Internal Trade, Ministry of Com. & Indus., Gov't of India, Consolidated FDI Policy, 2020 (Oct. 15, 2020).

[6] Dep't for Promotion of Indus. & Internal Trade, Ministry of Com. & Indus., Gov't of India, Press Note No. 3 (2020 Series): Review of Foreign Direct Investment (FDI) Policy for Curbing Opportunistic Takeovers/Acquisitions of Indian Companies Due to the Current COVID-19 Pandemic (Apr. 17, 2020).

[7] Consolidated FDI Policy, 2020, supra note 5 ¶ 3.4.

[8] Foreign Exchange Management (Non-debt Instruments) Rules, 2019, supra note 1, r. 2(am).

[9] Press Note No. 3 (2020 Series), supra note 6.

of the sector. It was widely considered as being aimed at China amid concerns over opportunistic acquisitions during pandemic.[10] Although this kept the investments in check, it slowed down the process and also did not help in decreasing the trade deficit with China.

Recently, the government relaxed this rule through another press note. The 2026 amendment revised the beneficial ownership criteria for investments from neighbouring countries, therefore relaxing certain restrictions introduced by Press Note 3 while retaining government scrutiny in specified cases.[11] It has become a subject of discussion as it may permit certain investments involving neighbouring countries through the Automatic Route, subject to the revised beneficial ownership criteria and other applicable conditions.

CONCLUSION

The four pillars formulate an edifice that governs the FDI in India in a secure and systematic manner. The flexibility of the system, especially the press notes, allows the legal framework around FDI to be constantly evolving according to the needs of the time which allows it to remain adaptable. The recent developments like the amendment announcements through press notes are proof to this premise.

[10] Konark Bhandari, *India's Press Note 3 Gamble: Opening the FDI Door to China*, Carnegie India (Apr. 28, 2026), https://carnegieendowment.org/india/research/2026/04/indias-press-note-3-gamble-opening-the-fdi-door-to-china.

[11] Dep't for Promotion of Indus. & Internal Trade, Ministry of Com. & Indus., Gov't of India, Press Note No. 2 (2026 Series): Review of FDI Policy on Investments from Countries Sharing Land Border with India (Mar. 15, 2026).