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FOREIGN INVESTMENT IN INDIA UNDER FEMA: BALANCING INVESTMENT FACILITATION, REGULATOR CONTROL AND INVESTOR PROTECTION.

~ Saba Khatoon & Bishal Ahamed

ABSTRACT

Foreign investment plays a significant role in India's economic growth by facilitating capital inflows, encouraging technological progress, generating employment and enhancing the country's connection with international markets. However, the benefits of foreign investment must be reconciled against concerns relating to national security, financial stability, regulatory compliance and the protection of domestic interests. Within its framework, the Foreign Exchange Management Act, 1999 (FEMA) establish a statutory framework for regulating foreign exchange transactions and facilitating legitimate cross-border investment in India.

It analyses the development of India's foreign investment regulatory framework from the control-oriented framework under the Foreign Exchange Regulation Act, 1973 (FERA) to the facilitation-oriented and management-oriented framework established under FEMA. It analyses the role of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, the Foreign Direct Investment (FDI) Policy, and regulatory institutions such as the Reserve Bank of India (RBI), the Department for Promotion of Industry and Internal Trade (DPIIT), and the Securities and Exchange Board of India (SEBI). The paper also analyses the distinction between the automatic and government approval routes, sectoral restrictions, beneficial ownership requirements, and the regulatory safeguards adopted to protect India's economic and strategic interests.

The study also assesses investor protection under the existing framework, particularly in relation to the repatriation of investment proceeds, transparency, reporting obligations,

adjudication, penalties, compounding and appellate remedies. Through an analytical and doctrinal examination of statutory provisions, regulatory instruments and relevant judicial decisions, the research identifies regulatory obstacles such as overlapping regulatory obligations, procedural delays, frequent policy changes and uncertainty in regulatory enforcement.

The paper contends that although FEMA has contributed to a more structured and investment-oriented regulatory environment, it does not sufficiently provide a complete system of investor protection. Adequate safeguards also depend on other applicable laws, regulatory coordination and, where relevant, bilateral investment treaties. The study concludes that India should strengthen transparency, legal certainty, administrative efficiency and procedural fairness while retaining appropriate safeguards for national security and financial stability. A balanced and predictable regulatory framework is essential to attracting responsible foreign investment and supporting India's long-term national economic progress.

Keywords: Foreign Investment; Foreign Exchange Management Act, 1999; FEMA; Foreign Direct Investment; Investor Protection; Regulatory Sovereignty.

1. INTRODUCTION

Foreign investment has become a significant component of India's economic development strategy. In a developing economy such as India, foreign capital can supplement domestic savings, provide access to advanced technology and managerial expertise, facilitate integration with international markets, generate employment and contribute to the development of infrastructure and efficient capability.

Consequently, foreign investment regulation cannot be viewed merely as a mechanism for controlling foreign exchange; it is also an instrument of economic policy and national development. India's contemporary foreign investment regime is principally structured around the Foreign Exchange Management Act, 1999 (FEMA), together with rules, regulations, directions and investment-policy instruments issued under the statutory framework. FEMA replaced the earlier Foreign Exchange Regulation Act, 1973 (FERA) was a major departure from a mainly control-oriented approach toward a management- and facilitation-oriented framework. The long title of FEMA clearly states that the legislation is to "facilitate external

trade and payments" and "promote the orderly development and maintenance of the foreign exchange market in India".[1] This legislative objective matters because it indicates that FEMA was not created merely to restrict foreign exchange transactions, but to establish an orderly regulatory framework that allows legitimate international economic activity. (Indian Code).

In general, foreign investment is any investment made in Indian companies, securities, or other approved investment instruments by a person who does not reside in India. Section 6(2A) and Section 47 of FEMA, in conjunction with the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (NDI Rules) and associated RBI directives, are the main regulations governing foreign investment in India under the current FEMA framework. The RBI's Master Direction on Foreign Investment in India affirms that FEMA, the NDI Rules, and RBI directives controlling implementation and reporting are how the current framework functions. (Reserve Bank of India) . Some of the various types of Foreign Direct Investment (FDI) is one of two main categories that are pertinent to Indian regulation and FPI, or foreign portfolio investment. While FPI typically deals with investments in securities without necessarily involving managerial control, FDI typically represents a longer-term investment interest in an Indian entity.

As a result, the regulatory treatment varies based on the type of instrument, investor, and industry; because foreign investment has both potential risks and economic benefits, the regulatory distinction is crucial. Unrestricted or opaque foreign investment may raise issues with national security, ownership of strategic assets, money laundering, beneficial ownership, market manipulation, evading sectoral restrictions, and an excessive concentration of economic power, even though long-term capital may promote economic growth.

Thus, the goal of Indian foreign investment law is to balance regulatory sovereignty and capital mobility. Foreign investment serves several economic purposes. First, it gives Indian businesses another source of funding. Large-scale infrastructure, manufacturing, technological, and service sector expansion may not always be financed by domestic savings alone. Thus, domestic resources can be enhanced by foreign capital. Second, the transfer of technology, technical expertise, and managerial techniques can be facilitated by foreign investment. Multinational corporations have the potential to improve the competitiveness of Indian

[1] Foreign Exchange Management Act, 1999, No. 42 of 1999, Preamble

businesses by bringing production techniques, research capabilities, global supply-chain networks, and international business practices. Thirdly, employment and entrepreneurship can be encouraged by foreign investment. Investments may lead to the creation or growth of manufacturing facilities, service businesses, technology companies, and infrastructure projects, generating both direct and indirect employment. Fourth, foreign investment can link Indian businesses with global markets. India's integration into global value chains can be facilitated by foreign investors' established distribution networks and international business connections. Institutions also reflect the importance of investment policy.

The Investment and Digital Economy Division of the Department of Economic Affairs (DEA) is responsible for FDI proposals, FDI policy matters, and international investment treaties. Foreign investment cannot continue to be totally unrestricted, despite its benefits. Protecting areas that affect public order, financial stability, strategic autonomy, national security, and economic sovereignty is a legitimate state interest; restrictions might be warranted, for instance, if foreign ownership could have an impact on financial markets, defence capabilities, vital infrastructure, sensitive technologies, or strategically significant resources.

Therefore, sectorial caps and approval requirements serve as regulatory tools to limit the type and volume of foreign participation, making sure that these limitations don't unnecessarily deter lawful investment is the regulatory challenge. While insufficient regulation may expose the economy to financial, security, and governance risks, excessive regulation can raise compliance costs, generate uncertainty, and postpone investment decisions. Therefore, regulatory proportionality is the main issue.

RESEARCH QUESTION

How has India's foreign investment regulatory framework evolved from FERA to FEMA, and to what extent does the present FEMA-based regime adequately balance investor facilitation, regulatory sovereignty, and investor protection?

OBJECTIVES AND SCOPE

- To assess how India's laws governing foreign investment have changed over time;
- To examine the NDI Rules and FEMA as the main legal framework;

- To assess the function of SEBI, DPIIT, DEA, and RBI;
- To differentiate between FDI, FPI, and other types of foreign investment;
- To evaluate the Government Route and Automatic Route;
- To determine the regulatory obstacles that foreign investors must overcome;
- To assess critically whether India's regulatory framework strikes a suitable balance between control and facilitation; and
- To recommend changes that would increase investor confidence, efficiency, and transparency.

RESEARCH METHODOLOGY

This research paper uses primary as well as secondary sources. Primary sources consist of FEMA, the FEM (Non-Debt Instruments) Rules, 2019, FDI policy, RBI directions, SEBI regulations, and relevant judicial decisions. Official government websites, particularly those of DPIIT, the RBI, the Ministry of Finance, and SEBI, are preferred because foreign investment law is frequently amended. Secondary sources, books, journal articles, and commentaries, are used to interpret and critically evaluate the legal framework. By combining these sources of information, an analytical and doctrinal approach has been adopted to examine the evolution from FERA to FEMA and to identify how the present framework adequately balances investor facilitation and protection with regulatory control.

2. EVOLUTION OF FOREIGN INVESTMENT REGULATION IN INDIA

Foreign exchange scarcity and the preservation of domestic economic resources have historically been reflected in India's foreign exchange policy. An early attempt at regulating foreign exchange transactions was the Foreign Exchange Regulation Act, 1947. (India Code) Foreign exchange remained a limited and strictly regulated resource after independence.

India's developmental priorities, balance-of-payments issues, and the requirement to protect foreign exchange reserves all had an impact on the regulatory philosophy. As a result, foreign investment was heavily regulated by the government; because of this, the early framework was essentially control-oriented, with the state having broad control over foreign exchange transactions and foreign involvement in the Indian economy. For decades, the Foreign

Exchange Regulation Act of 1973 (FERA) served as the primary piece of foreign exchange legislation.[2]

FERA was enacted at a time when the Indian economy was experiencing significant foreign exchange constraints. Its fundamental approach was restrictive: foreign exchange was treated as a scarce national resource, and all transactions involving foreign exchange were subject to strict controls. The philosophy underlying FERA differed significantly from the later philosophy of FEMA. Under FERA, violations were addressed within a strict regulatory framework, reflecting the belief that foreign exchange transactions necessitated extensive government oversight. The FERA regime thus reflected an era of economic protectionism and tight state control. Foreign companies operating in India were subject to a number of restrictions governing ownership, foreign exchange, and business operations.

The economic crisis of 1991 in India led to significant transformations through economic liberalisation. This shift involved changes in industrial policy, trade policy, and foreign investment regulation; a transition from a controlled economy to a market-oriented economy; recognition of foreign investment as a source of capital, technology, employment, and competitiveness; and the development of a new foreign exchange law to facilitate international transactions while preventing abuse. The enactment of FEMA, 1999 marked a fundamental change in regulatory philosophy.

FEMA received Presidential assent on 29 December 1999 as Act No. 42 of 1999 and subsequently came into force on 1 June 2000. (India Code) . The transition from FERA to FEMA is significant because the very language of the legislation reflects a change in regulatory philosophy. FEMA seeks to facilitate external trade and payments and promote the orderly development of the foreign exchange market. (India Code) .Thus, the shift may broadly be described as:[3]

FERA → control and conservation → FEMA → management, facilitation and orderly regulation.

[2] Foreign Exchange Regulation Act, 1973, No. 46 of 1973 (repealed)
[3] Foreign Exchange Management Act, 1999, No.42 of 1999, ss 1(3)

This does not mean that FEMA eliminated governmental control. Rather, it changed the nature of that control. Regulation increasingly became based upon differentiated categories of transactions, authorised persons, reporting obligations, sectorial restrictions and prescribed routes of investment. After FEMA came into force, India's foreign investment framework has evolved through several layers of law and policy rather than through FEMA alone. It combines the parent statute, rules made by the Central Government, directions and regulations issued by the Reserve Bank of India (RBI), government policy on foreign investment, and sector-specific rules.

Today, foreign investment in India is primarily governed by Section 6(2A) and Section 47 of FEMA, read together with the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, commonly called the NDI Rules. The RBI's directions supplement this framework by giving practical guidance to authorised dealers, investors, and other market participants. The NDI Rules, notified on 17 October 2019, were a major step in simplifying and consolidating India's non-debt foreign investment regime. They replaced two earlier sets of regulations: the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017, and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018. [4]

A major shift in India's approach to foreign investment has been the growing use of the Automatic Route. This route makes it easier for foreign investors to enter eligible sectors because they do not need prior approval from the Government, provided they follow the relevant investment limits, sector-specific conditions, and other applicable laws. The Government Route works differently. Where it applies, a foreign investor must first obtain approval from the Government before investing.

The DPIIT's Consolidated FDI Policy recognises both routes and states that non-resident investors may invest through either the Automatic Route or the Government Route, with prior approval required only where the latter applies. The expansion of the Automatic Route reflects India's effort to move away from a system based on case-by-case government scrutiny. Instead,

[4] Foreign Exchange Management Act, 199, No.42 of 1999, ss 6(2A), 47

it points towards a more predictable, rule-based framework that facilitates foreign investment while retaining regulatory safeguards where necessary.[5]

3. LEGAL AND REGULATORY FRAMEWORK GOVERNING FOREIGN INVESTMENT IN INDIA UNDER FEMA

Foreign investment plays a significant role in the economic growth and development of India. It helps bring in foreign capital, advanced technology, professional management skills, and new employment opportunities. It also allows Indian businesses to expand their reach and compete in international markets. Therefore, India aims to encourage foreign investment while ensuring that it does not negatively affect the country's economic stability, national security, or public interest.

The Foreign Exchange Management Act, 1999 (FEMA), is the primary legislation governing foreign exchange transactions in India. It came into force on 1 June 2000, replacing the earlier Foreign Exchange Regulation Act, 1973 (FERA). Unlike FERA, which focused mainly on strict control and regulation, FEMA introduced a more liberal and flexible approach. Its main objective is to facilitate foreign trade, payments, and investment while ensuring that these activities take place within a proper legal and regulatory framework.

Foreign Investment in India is governed through a combination of law and regulation, subordinate legislation, government policies and sector-specific rules. Some of the legal instruments are

- **Foreign Exchange Management Act, 1999 (FEMA)** - FEMA is the parent legislation for foreign exchange matters. It regulates dealings in foreign exchange, current account transactions, capital account transactions, authorised persons, penalties, and compounding of contraventions. In simple terms, FEMA decides how foreign money may enter India, how it may be used, and how it may be sent back abroad.

[5] Foreign Exchange Management (Non- Debt Instrument) Rules, 2019, Ministry of Finance, Government of India, Notification No. S.O. 3732(E), 17 October 2019

- **Foreign Exchange Management (Non–Debt Instruments) Rules, 2019** - It deals with foreign investment non-debt instruments, which include equity shares, specifying sector, pricing, transfer of shares and regulatory obligations.[6]

- **Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 -** These Regulations explain how payment methods for foreign investment must be made and how the transaction must be reported to the authorities. They help ensure that investment transactions are properly documented and traceable.[7]

- **Foreign Direct Investment (FDI) Policy -** Foreign Direct Investment is governed by the Government of India. These outline rules for foreign investment in various sectors, including limits and approval requirements.

- **Companies Act, 2013 -** Governs company formation and management, requiring compliance from foreign investors.[8]

- **SEBI Act, 1992 and related regulations -** It regulates the securities market and Foreign Portfolio Investors (FPIs) to maintain transparency and investor confidence.[9][10]

- **Sector-specific laws -** Some industries require additional approval or compliance. For example, banking, insurance, telecommunications, defence, and competition-related matters may be governed by separate laws and regulators.

The RBI is the main authority for foreign exchange management. It issues directions, monitors foreign investment transactions, supervises authorised dealers, and administers reporting and compliance requirements. Department for Promotion of Industry and Internal Trade (DPIIT) formulates and administers the FDI Policy.[11]

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[6] Foreign Exchange Management (Mode of Payment and Reporting of Non - Debt Instruments) Regulations, 2019, Notification No. FEMA. 395/2019 - RB, Reserve Bank of India, 17 October 2019.
[7] Department of Promotion of Industry and Internal trade, Consolidated FDI policy circular of 2020(effective 15 October 2020)
[8] Securities and Exchange Board of India Act, 1992, No. 15 of 1992
[9] Companies Act 2013, No.18 of 2013
[10] Securities and Exchange Board of India (Foreign Portfolio Investors) Regulation, 2019, as amended.
[11] Department of Promotion of Industry and Internal Trade, Press Note No. 3(2020 series), 17 April 2020.

It also deals with policy matters relating to foreign investment in India. Department of Economic Affairs (DEA) performs important economic-policy functions and coordinates certain matters relating to foreign investment and capital flows. Securities and Exchange Board of India (SEBI) regulates the securities market, which includes investment by Foreign Portfolio Investors and market intermediaries. Central Government framework includes rules, issues policy, decisions and grants approval. Sector regulators such as the Reserve Bank of India and other sector regulators may impose any additional conditions depending on the sector.

4. MODES AND ROUTES OF FOREIGN INVESTMENT IN INDIA

Foreign investors can invest in India through different methods depending on their purpose, level of control, and risk appetite. The main modes are FDI, FPI, FVCI, and investment through AIFs.

a. Foreign Direct Investment Policy (FDI) - It refers to the foreign investment policy, meaning investment made by a foreign country or business with a long-term interest. In many cases, the foreign investor may also participate in the management or control of the company.

FDI is important because it:

- Brings long-term capital into India.
- Creates employment and supports industrial growth.
- Helps in the transfer of technology and skills.
- Encourages expansion of businesses and infrastructure.
- Is regulated under FEMA, the NDI Rules, the FDI Policy, and sector-specific conditions.

For example, if a foreign company invests in an Indian manufacturing company and takes an active role in its management, it is generally treated as FDI.

b. **Foreign Portfolio Investment (FPI) -** FPI refers to investment by foreign investors in Indian securities such as shares, bonds, and other permitted financial instruments. Unlike FDI, FPI investors generally do not seek management control over the company.

FPI is beneficial because it

- increases liquidity in Indian capital markets.

- Provides companies with access to a wider pool of capital.
- Brings international investors into the Indian financial system.
- Is regulated by FEMA and SEBI regulations.

However, FPIs can be volatile. Since portfolio investors may sell their investments quickly, large withdrawals can sometimes affect the stock market and currency stability.

c. **Foreign Venture Capital Investment (FVCI) –** FVCI refers to investment made by eligible foreign venture capital investors in Indian start-ups and emerging companies. This mode is especially useful for innovative businesses that may not yet be profitable but have growth potential.

FVCI supports India's start-up ecosystem by:

- Providing early-stage funding.
- Encouraging innovation and entrepreneurship.
- Bringing business experience and global networks.
- Supporting sectors such as technology, healthcare, and renewable energy.

Such investors must comply with the eligibility conditions and reporting requirements prescribed under FEMA and related regulations.

d. **Investment through Alternative Investment Funds (AIFs) -** Alternative Investment Funds pool money from eligible investors and invest it according to a defined investment strategy. They are regulated by SEBI under the Alternative Investment Funds Regulations, 2012. AIFs may invest in start-ups, unlisted companies, private equity, real estate, infrastructure, and other permitted assets. Foreign investors may invest through AIFs, subject to applicable FEMA and SEBI requirements.
This route is useful because it allows foreign investors to invest indirectly in Indian businesses through professionally managed funds.

Foreign investment in India generally enters through two main routes: the automatic route and the government route. Under the automatic route, a foreign investor does not need prior approval from the Government of India if the investment is permitted in that sector and all prescribed conditions are followed as It saves time, It reduces administrative delays, It

improves ease of doing business, It encourages foreign investors to invest in India and It makes the investment process more predictable.

Most sectors in India permit FDI through the automatic route, subject to sectoral conditions. Under the government route, prior approval from the competent government authority is required before investing. This route is generally used for sensitive sectors or activities where government scrutiny is necessary. The government route is useful because it allows examination of sensitive investments, helps to protect national security, ensures compliance with sectoral restrictions, and allows the government to assess the impact of particular proposals.

However, approval processes may sometimes take time. Lack of clarity or delay can increase transaction costs and discourage investors. Sectorial caps refer to the maximum percentage of foreign investment allowed in a particular sector. For example, some sectors may allow 100% foreign investment, while others may permit only a limited percentage.

Entry conditions may include requirements such as:

- Obtaining licences or registrations.
- Compliance with ownership and control restrictions.
- Security clearance in certain sensitive sectors.
- Conditions relating to board representation or management control.
- Restrictions on certain activities.

The exact position may change from time to time. Therefore, investors must always check the current FDI Policy, NDI Rules, and latest government notifications.

5. INVESTMENT FACILITATION UNDER (FEMA)

Investment facilitation means making the process of investing in a country simpler, faster, transparent, and predictable. It does not mean removing all regulations. Rather, it means creating a system where genuine investors can understand the rules easily and complete lawful transactions without unnecessary delay. FEMA supports investment facilitation by providing a management-oriented framework for foreign exchange transactions to facilitate lawful cross-

border trade and payments, to promote foreign investment in India, to support the orderly development of the foreign exchange market, to maintain proper records and reporting of foreign transactions and to balance economic openness with regulatory supervision.

- Shift from FERA to FEMA: The replacement of FERA by FEMA was a major reform. FERA was based on a strict control-oriented approach, whereas FEMA adopts a more liberal and management-based approach. This change was important because it recognised that foreign exchange transactions are a normal part of a global economy. FEMA allows legitimate business transactions while retaining the power to regulate and penalise unlawful activities.

- Automatic Route: The automatic route is one of the most important investment facilitation measures. Eligible foreign investors can invest in permitted sectors without obtaining prior government approval, provided they comply with the applicable conditions. This reduces paperwork, saves time, and makes India more attractive to foreign investors.

- Digital Reporting and Compliance: FEMA-related reporting is increasingly carried out through digital mechanisms. Digital filing helps investors submit information more conveniently and allows authorities to maintain better records.
  Digital compliance can reduce physical paperwork, improve transparency, and make monitoring more efficient.

- Repatriation of Capital and Returns: Foreign investors need confidence that they can lawfully take back their invested capital, dividends, interest, or sale proceeds, subject to applicable conditions. FEMA and related rules provide a framework for such remittances. Clear repatriation rules are important because investors are more likely to invest when they know how their returns can be transferred abroad.

- Reduce unnecessary government intervention: The automatic route reduces the need for case-by-case approval in many sectors. At the same time, the government route remains available for sensitive investments. This balanced approach reduces unnecessary interference while preserving regulatory control where it is genuinely needed.

- Function of the Reserve Bank of India (RBI): The RBI plays a central role in investment facilitation. It issues regulations and directions, supervises authorised persons, and monitors compliance with foreign exchange rules. Clear guidance from the RBI improves regulatory certainty and helps investors follow the law properly.

Contribution to Indian's Investment Environment: FEMA, together with the FDI Policy and other related laws, has helped to create a more structured investment environment in India. It provides a legal basis for foreign exchange transactions, defines investment routes, requires reporting, and regulates repatriation of funds. However, foreign investment does not depend on law alone. Investors also consider factors such as economic growth and market size, infrastructure and logistics, taxation policies, political stability, availability of skilled labour and global economic conditions. Thus, FEMA facilitates investment, but it cannot by itself guarantee higher foreign investment inflows.

Challenges and Suggestions to Investment Facilitation

Despite important reforms, several challenges remain:

i. Multiple regulators - Investors may need to deal with RBI, DPIIT, SEBI, tax authorities, and sector regulators.
ii. Frequent amendments - Regular changes in rules and policy can create uncertainty
iii. High compliance costs - Documentation, legal advice, valuation reports, and filings can be expensive, especially for small businesses.
iv. Approval delays - Government-route investments may face procedural delays.
v. Limited grievance redressal - Investors need accessible and effective mechanisms to seek clarification or challenge incorrect decisions.

Security-related restrictions - National-security safeguards are necessary, but they should be applied in a fair and transparent manner. To improve investment facilitation under FEMA, the following steps may be considered:

- Simplify compliance and reporting requirements.
- Improve coordination among RBI, DPIIT, DEA, SEBI, and sectorial regulators.
- Create clear and time-bound approval procedures.

- Publish easy-to-understand guidelines for investors.
- Ensure consistent and proportionate enforcement of penalties.
- Strengthen online grievance-redressal mechanisms.
- Review sectorial restrictions regularly to check whether they are still necessary.
- Grant special compliance assistance for start-ups and small businesses.

6. REGULATORY CONTROL AND NATIONAL INTEREST

Foreign investment is essential for India because it supports economic development by bringing capital, technology, employment opportunities, and access to international markets for all Indians. So, foreign investment cannot be completely unrestricted in India as it may affect national security, domestic industries, financial stability and public welfare. That's why India follows a regulatory approach that encourages foreign investment while protecting its national interest.

The Foreign Exchange Management Act, 1999 (FEMA), which is providing the legal framework for managing all the foreign exchange and regulating relevant cross-border transactions. Foreign investment is governed by the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, the Foreign Direct Investment (FDI) policy and other applicable laws. All these laws were established under which foreign investors may invest in India.

The main challenge is to maintain a balance between attracting foreign capital and protecting the country's economic and strategic interests altogether.

Sectoral Caps and Government Approval

India allows foreign investment in various sectors through the automatic route, under which prior government approval is generally not required, subject to applicable conditions. Therefore, certain sectors have sectoral caps or require government approval.[12]

[12] Department for Promotion of Industry and Internal Trade, Consolidated FDI Policy Circular of 2020, Provisions concerning entry routes and investment restrictions.

Sectoral caps limit the percentage of ownership that all foreign investors can hold in particular industries. All these restrictions help the Government maintain control over all the sensitive activities and prevent excessive foreign ownership where it is widely required.

The government approval route allows authorities to examine proposed investments before they are made. This is very important where investment involves defence, critical infrastructure or other sensitive activities. However, approval procedures should be transparent and timely. Unnecessary delays and unclear requirements may discourage genuine investors.

Prohibited Sectors and Sensitive Industries

India prohibits some foreign investments through certain activities under its FDI Policy. These include lottery businesses, gambling and betting, and specified activities involving chit funds, subject to the applicable policy provisions. Sensitive sectors such as defence, telecommunications and financial services may also be subject to sector-specific conditions. The purpose of these restrictions is to protect national security, public safety and essential services in the nation.

For example, foreign investments in defence sector manufacturing can provide advanced technology and improve domestic production. However, the Government must also consider the risks associated with foreign control over all the sensitive technologies and strategic facilities. So, regulation should permit beneficial investment while maintaining necessary safeguards.

Beneficial Ownership and Restrictions on Certain Countries

This refers to the person or entity that ultimately owns or controls any investment. An investor may operate through a company incorporated in another country, which makes it important for authorities to identify the actual source of ownership and control.

Press Note 3 (2020 Series) introduced restrictions on investments from countries sharing a land border with India. Under this policy, investments falling within its scope require government approval. The policy also addresses specified changes in beneficial ownership.[13]

These restrictions reflect India's concern about opportunistic acquisitions and national security. However, authorities should distinguish genuine commercial investments from transactions that create actual security risks. Clear criteria and predictable approval procedures would help protect national interests without unnecessarily discouraging legitimate investors.

National Security, Domestic Businesses and Financial Stability

Foreign investment can create risks when overseas investors gain significant control over strategic assets, critical infrastructure or sensitive data. Regulatory supervision helps protect these investors from any risk.

India must also prevent money laundering, undisclosed ownership and illicit financial flows. Verification of the source of funds and reporting requirements help authorities identify suspicious transactions. FEMA also supports foreign-exchange management by establishing rules for relevant cross-border transactions.[14]

However, protecting domestic businesses should not become a reason for excessive protectionism. Foreign competition can encourage innovation, improve services and create employment. The objective should be to ensure fair competition while preventing practices that harm the national interest.

7. INVESTOR PROTECTION UNDER THE FEMA AND ITS FRAMEWORK

Investor protection, which is the main motive of any investment, means ensuring that foreign investors can invest under clear rules and regulations, receive fair treatment and access legal remedies when their rights are affected. It includes transparency, procedural fairness and the ability to transfer legitimate investment proceeds in accordance with applicable law.

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[13] Prevention of Money Laundering Act, 2002, No. 15 of 2003.
[14] Foreign Exchange Management Act, 1999, No. 42 of 1999, ss 10-11

FEMA primarily regulates foreign exchange and relevant cross-border transactions. It is not a complete code of investor protection. Protection also depends on the FDI Policy, company law, securities regulations, taxation laws and applicable bilateral investment treaties.

Repatriation of Capital and Returns

Repatriation means transferring permitted funds from India to any foreign country. Foreign investors generally consider the ability to receive dividends, sale proceeds and other legitimate returns when deciding where to invest.

The FEMA framework permits repatriation subject to applicable rules and conditions. However, repatriation is not an unrestricted right to transfer every amount abroad without complying with the law. Investors may need to satisfy pricing guidelines, tax obligations, reporting requirements and other applicable conditions.

For example, an overseas investor selling shares in an Indian company must comply with the relevant rules and regulations governing the transfer. Clear and predictable procedures are important because uncertainty about transferring returns may discourage long-term investment.

RBI Supervision, Transparency and Reporting

The Reserve Bank of India (RBI) plays an important role in administering the foreign investment framework under FEMA. Its directions and regulations explain relevant requirements for foreign investment, reporting and cross-border transactions. Depending on the transaction, reporting obligations may include Form FC-GPR, Form FC-TRS and the Annual Return on Foreign Liabilities and Assets (FLA). These requirements help authorities monitor investment flows and ensure regulatory compliance.

However, multiple reporting obligations may create difficulties for businesses, particularly start-ups and smaller investors. The Government must simplify procedures, improve digital reporting systems and provide clear guidance regarding applicable requirements.

Transparency is equally important. Investors should be able to understand the rules before making an investment rather than discovering additional requirements after completing a transaction.

Adjudication, Appeals and Enforcement

FEMA provides legal mechanisms for addressing contraventions and challenging certain adverse decisions. Section 13 deals with penalties, while Section 15 provides for the compounding of eligible contraventions. Sections 17 and 18 provide for statutory appellate mechanisms, and Section 35 provides for an appeal to the High Court on a question of law arising from a decision of the Appellate Tribunal.[15][16][17]

The Enforcement Directorate (ED) has powers to investigate and pursue contraventions under FEMA within its statutory jurisdiction. FEMA proceedings must be distinguished from proceedings under the Prevention of Money Laundering Act, 2002, which operates under a separate legal framework.

Effective enforcement is necessary to prevent unlawful transactions. However, penalties should be imposed according to the law and the circumstances of the violation. Authorities should distinguish deliberate non-compliance from genuine procedural mistakes wherever the applicable law permits such a distinction.

Role of SEBI and Bilateral Investment Treaties

The Securities and Exchange Board of India (SEBI) regulates India's securities market and protects investors through disclosure requirements and market-conduct regulations. Foreign portfolio investors must comply with the applicable SEBI framework as well as relevant foreign-exchange requirements.

[15] Foreign Exchange Management Act, 1999, No. 42 of 1999, ss 13.
[16] Foreign Exchange Management Act, 1999, No. 42 of 1999, ss 15
[17] Raj Kumar Shivhare v. Assistant Director, Directorate of Enforcement, (2010) 4 SCC 772.

Bilateral investment treaties (BITs) provide additional protection to qualifying foreign investors. Depending on the treaty, these protections may include fair and equitable treatment, protection against unlawful expropriation and access to investor-State dispute settlement.

However, treaty protection depends on the wording of the particular treaty, the investor's eligibility and the nature of the investment. So, FEMA provides important procedural safeguards, but effective investor protection requires transparent administration, predictable rules and meaningful access to legal remedies.

8. ENFORCEMENT, NON-COMPLIENCE AND JUDICIAL APPROACH

FEMA Contraventions and Penalties

Contraventions under FEMA might include breaches of foreign investment conditions, unauthorised transactions or failures to meet reporting requirements. The consequences depend on the relevant provision and circumstances. Section 13 provides for monetary penalties. Where the amount involved in a contravention is quantifiable, the penalty may extend to three times that amount. Where it is not quantifiable, the statutory maximum is two lakh rupees, with an additional penalty that may extend to five thousand rupees for every day after the first day during which a continuing contravention persists. Section 15 permits the compounding of eligible contraventions in accordance with the prescribed procedure. Compounding can help resolve certain violations without prolonged proceedings, but it is subject to applicable legal conditions.

Judicial Approach to Statutory Remedies

In Raj Kumar Shivhare v. Assistant Director, Directorate of Enforcement, (2010) 4 SCC 772, the Supreme Court considered the appellate mechanism under FEMA. The judgment emphasised the importance of following the statutory remedies provided by legislation.[18]

The case demonstrates that FEMA provides a structured process for challenging regulatory decisions. However, the effectiveness of this process depends on whether remedies are

[18] Vodafone International Holdings BV. V. Union of India, (2012) 6 SCC 613.

accessible and provide meaningful relief within a reasonable period. Judicial review remains an important safeguard against unlawful administrative actions, although courts ordinarily consider that the availability of statutory remedies before intervening.

Legal Certainty in Foreign Investment

In *Vodafone International Holdings B.V. v. Union of India, (2012) 6 SCC 613,* the Supreme Court examined a cross-border transaction in the context of Indian taxation law. The Court ruled in favour of Vodafone on the tax issue before it, highlighting the importance of legal certainty and clear legislative provisions.[19]

Although this was primarily a tax case rather than a direct FEMA judgment, it is relevant to the broader discussion of foreign investment. Investors must understand the legal consequences of their transactions before committing substantial capital.

The case illustrates that investor confidence depends partly on clear laws and consistent interpretation. The Government retains the power to change policy through lawful means, but uncertainty arising from unclear rules can increase disputes and discourage investment.

Critical Assessment

Enforcement is essential to prevent regulatory evasion and protect India's financial system. However, effective regulation should focus on both compliance and punishment. Clear guidance, timely decisions and proportionate penalties can encourage voluntary compliance.

The challenge is to prevent serious violations without creating unnecessary fear among genuine investors. Fair procedures and effective appeals can strengthen the credibility of regulatory authorities and improve investor confidence.

9. CRITICAL EVALUATION: HAS FEMA ACHIEVED THE RIGHT BALANCE?

Investment Facilitation

India's foreign investment framework facilitates investment through the automatic route and other measures intended to reduce procedural barriers. Foreign capital can contribute to infrastructure, manufacturing, technology, employment and economic development. However,

[19] Foreign Exchange Management Act, 1999, No. 42 of 1999, ss 17,18,35.

formal permission to invest does not necessarily mean that every transaction can be completed quickly. Investors may still need to comply with sector-specific conditions, reporting obligations and other laws. Therefore, investment facilitation should be judged not only by the number of sectors open to investment but also by the clarity and efficiency of the applicable procedures.

Regulatory Control

India cannot eliminate regulatory control because foreign investment may affect national security, strategic industries and financial stability. Sectoral caps, approval requirements and beneficial-ownership scrutiny can serve legitimate public purposes.

Nevertheless, restrictions should be proportionate to the risks involved. Unclear conditions and unpredictable administrative decisions may discourage all the legitimate investors. A well-designed framework should protect sensitive sectors without unnecessarily limiting productive investment.

Investor Protection

Investor protection requires more than permission to invest. It requires predictable rules, fair procedures, effective remedies and reasonable certainty regarding repatriation.

FEMA provides mechanisms for adjudication, compounding and appeals. However, foreign investors may encounter difficulties where different authorities regulate separate aspects of the same transaction. For example, a transaction may raise distinct questions under foreign-exchange law, taxation law, company law and securities regulations.

Coordination among authorities is therefore essential to avoid duplication, inconsistent interpretations and unnecessary compliance costs.

Major Gaps and Challenges

The principal challenges include regulatory complexity, overlapping reporting requirements, approval delays, frequent policy changes and uncertainty regarding enforcement. These difficulties may particularly affect smaller investors and start-ups that have limited resources for legal compliance. At the same time, excessive deregulation could weaken beneficial-

ownership checks and national security safeguards. Therefore, reform should focus on improving administrative efficiency without removing essential protections.[20]

Altogether, FEMA provides an important foundation for managing foreign exchange and regulating cross-border investment transactions. However, the success of the framework depends on more than the existence of rules and penalties. It also depends on transparent administration, timely decisions and fair enforcement. India has established a workable system, but further improvements are necessary to ensure that investment facilitation, regulatory control and investor protection operate effectively together.

10. CONCLUSION

Coming to the end, we can say that India's foreign investment framework under FEMA reflects an attempt to balance three important objectives: investment facilitation, regulatory control and investor protection. The automatic route encourages foreign capital, while sectoral restrictions, approval requirements and reporting obligations protect legitimate public interests. Adjudication, compounding and appeals provide mechanisms for addressing violations and challenging certain adverse decisions.

However, FEMA is not a complete code of investor protection. The overall framework also depends on the FDI Policy, the Non-Debt Instruments Rules, securities regulations, company law, taxation and applicable bilateral investment treaties.

India should not choose between unrestricted foreign investment and excessive state control. Instead, it should follow an approach based on transparency, proportionality, legal certainty and fair enforcement. Genuine national security concerns must be addressed, but legitimate investors should not face unnecessary procedural barriers or arbitrary treatment.

Lastly, India has established a substantial legal foundation for regulating foreign investment, but improvements in coordination, predictability and procedural fairness remain necessary. A framework that protects national interests while respecting legitimate investor rights will be

[20] United Nation Conference on Trade and Development, World Investment Report 2024; Investment Facilitation and Digital Government (United nation 2024).

better positioned to attract responsible foreign capital and support India's long-term economic development.

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