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Pricing Guidelines Under FEMA

Presentation

By

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Why pricing guidelines under FEMA?

- In FEMA, India's capital control framework, is designed to manage foreign exchange reserves and prevent speculative capital flows.
- The pricing guidelines reflect a macroeconomic policy objective for:
 - ensuring that foreign investment flows occur at fair market rates,
 - preventing both undervaluation that facilitates capital flight and overvaluation that might mask disguised external commercial borrowings.

Pricing aspects under FEMA

- **Capital Account Transactions**

- Section 6(2A) read with Section 46 (2)(ab) of FEMA, 1999

- **Foreign Investment in India**

- FEM (Non-debt Instruments) Rules, 2019.
- FEM (Mode of Payment and Reporting of NDIs) Regulations, 2019

- **Overseas Investment by Indian Residents/Resident entities**

- FEM (Overseas Investment) Rules, 2022.
- FEM (Overseas Investment) Regulations, 2022

- **Master Directions**

- On Foreign Investment in India (No.11/2017-18)
- On Overseas Investment (No.15/2024-25)

Pricing Guidelines in NDI Rules for Equity Instruments

- **Rule 21** prescribes specific pricing guidelines for the issue and transfer of **equity instruments** involving non-residents. (**Chapter VIII- General Provisions**) .
- These pricing guidelines are not applicable for any transfer by way of sale done in accordance with SEBI Regulations where the pricing is specified by SEBI. (**Refer SEBI(Substantial Acquisition of shares and Takeovers) Regulation, 2011**)
- These pricing guidelines also not applicable for investment in equity instruments by a person resident outside India on a non-repatriation basis.
- **Rule 23:** In case of Downstream investment, the pricing guidelines shall be applicable. ***“What cannot be done directly, cannot be done indirectly.”***

Pricing Guidelines in NDI Rules for Equity Instruments- unlisted company

- Issue Price of Equity Instruments- Rule 21(2)(a)
- Issue price of convertible equity instruments- Expl. to Rule 21(2)
- Shares subscribed as promoter- Rule 21(2)(c)(v)
- Issue price of share warrants.- Rule 21(2)(c)(vi)

SEBI Guidelines –ICDR Regulation, 2018- for Issue Price of Equity Instruments

Initial Public Offer (Reg. 27-30):

An issuer may determine the price of specified securities in consultation with the lead merchant banker or through the book building process.

Right Issue (Reg. 73):

The issue price shall be determined in consultation with the designated stock exchange.

Further Public Offer (Reg. 125- 128):

The issuer may determine the price of equity share and in the case of convertible securities, the coupon rate and the conversion price, in consultation with the Lead manager or through the book building exercise specified in Schedule XIII.

SEBI Guidelines for Issue Price of Equity Instruments

- Preferential Issue- Frequently traded (Reg.164).
- Infrequently traded shares (Reg.165).

Pricing guidelines for transfer of Equity Instruments

- Equity instruments of an Indian company (listed and unlisted) :
 - Transfer from a resident in India to a person resident outside India- Rule 21(2)(b)
 - Transfer by a person resident outside India to a person resident in India- Rule 21(2)(c) (I, ii, iii).
- Valuation in case of swap of equity instruments- Rule 21(2)(c)(vi)

Downstream investment - Indian entity which as received indirect foreign investment

- Rule 23 – Required to comply with the entry route, sectoral caps, pricing guidelines and other attendant conditions as applicable for foreign investment.

Investment in LLP – Rule 6(b) - Schedule VI- (f)

- Investment in a LLP either by way of capital contribution or by way of acquisition or transfer of profit shares, should not be less than the fair price worked out as per any valuation norm which is internationally accepted or adopted as per market practice and a valuation certificate to that effect shall be issued by the Chartered Accountant or by a practising Cost Accountant or by an approved valuer from the panel maintained by the Central Government.

Transfer with reference to LLP-Rule 6(b)-Schedule VI-(g)

- In case of transfer of capital contribution or profit share from a person resident in India to a person resident outside India, the transfer shall be for a consideration **not less than the fair price** of capital contribution or profit share of a LLP.
- Further, in case of transfer of capital contribution or profit share from a person resident outside India to a person resident in India, the transfer shall be for a consideration which **is not more than the fair price** of the capital contribution or profit share of an LLP.

Overseas Investment- Pricing Guidelines for shares of a foreign entity

- Issue of share of a new company – through subscription
- Issue of shares of an existing company
 - When investment is more than \$5Million
 - Other cases
- Transfer of shares of a foreign entity
 - By person resident outside India to person resident in India
 - By person resident in India to person resident in India
 - By person resident in India to person resident outside India
- Acquisition through swap
- Conversion of ADR/GDR

Overseas Investment- Basic Pricing guidelines

- (1) The issue or transfer of equity capital of a foreign entity from a person resident outside India or a person resident in India to a person resident in India who is eligible to make such investment or from a person resident in India to a person resident outside India shall be subject to a price arrived on an arm's length basis.
- (2) The AD bank, before facilitating a transaction shall ensure compliance with arm's length pricing taking into consideration the valuation as per any internationally accepted pricing methodology for valuation.

Valuation of shares to be acquired of an existing foreign company

- For the purposes of investment, by way of remittance from India, in an existing company outside India, the valuation of shares of the company outside India shall be made:
 - where the investment is more than USD 5 million, by
 - a Category I Merchant Banker Registered with Securities and Exchange Board of India (SEBI), or
 - an Investment Banker/Merchant Banker outside India registered with the appropriate regulatory authority in the host country.
 - in all other cases, by a Chartered Accountant or a Certified Public Accountant.

Transfer of shares of a foreign entity by an Indian entity to another Indian Entity

- An Indian party may transfer by way of sale to another Indian party, share or security held by him in a Joint Venture or Wholly Owned Subsidiary outside India **Provided that**
 - The sale does not result in any write-off of the investment made;
 - the sale is effected through a stock exchange where the shares of the overseas Joint Venture or Wholly Owned Subsidiary are listed;
 - if the shares are not listed on the stock exchange, and the shares are disinvested by a private arrangement, the share price is not less than the value certified by a Chartered Accountant /Certified Public Accountant as the fair value of the shares based on the latest audited financial statements of the Joint Venture or Wholly Owned Subsidiary.

Valuation of shares under the IT Act, 2025 and FEMA, 1999- differences

- Conflict between pricing guidelines under FEMA and Rule 11UAA of the Income Tax Act, 1961(Rule 57 of Income Tax Rules, 2025) also stems from their fundamentally different objectives.
- FEMA aims at preventing capital flight while IT Act aims at preventing tax evasion.
- Rule 11UAA mandates a historical NAV method for transfers, whereas FEMA permits forward looking DCF.
- Companies frequently prepare two reports considering Safe Harbour Rule with 10% threshold.

Differences of valuation of shares under the CA,2013 and FEMA, 1999

- The objectives of pricing guidelines under FEMA are to prevent both undervaluation that facilitates capital flight and overvaluation that might mask disguised commercial borrowings.
- On the other hand, the Companies Act views the same transaction through a microeconomic lens, focusing on the impact on existing shareholders and corporate governance within the specific company.
- FEMA accepts internally recognised methods, the Companies Act valuation rules which require adherence to specific Indian valuation standards which may not perfectly align with international practices.

Differences of valuation of shares under the CA,2013 and FEMA, 1999

- If the two separate valuations produce different fair value conclusions, companies may face legal uncertainty which increase deal risk.
- Valuers have to intelligently prepare reports satisfying both regulatory frameworks simultaneously.
- This valuation paradox is real.

Thank You.

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