Module 6 · Foreign Exchange Management Act, 1999 P13 · Section B · topics 6.1–6.4

SM pp. 297–322 (26 pages). **60 marks in 7 papers.** FEMA swaps with Competition between **Q7(b) and Q8(a)**: one of them comes as a 7-marker almost every paper.

Paper	What was asked	Marks
Jun'23	Q6(a) notes: **prohibited sectors for FDI**; **parking of ECB proceeds** · Q8(b) **unlisted company issues 20% to a foreign investor**: possible? steps? (= SM solved case)	8 + 6
Dec'23	Q8(a) **permitted investments by persons resident outside India**	7
Jun'24	Q3(b) **restrictions on dealing in and holding foreign exchange** (s.3, s.4)	7
Dec'24	Q7(a) **LRS**: eligible persons and purposes	7
Jun'25	MCQ: an Indian company's shares issued to a Singapore resident = **Indian securities** · Q8(a) **late FC-GPR** filing case	2 + 7
Dec'25	MCQ: ECB automatic route limit (**USD 750 million** = SM MCQ 7) · Q8(a) **returning resident's foreign assets**; capital vs current account	2 + 7
Jun'26	Q7(b) **FDI framework**: routes, sectoral caps, reporting	7

HOW IT IS EXAMINED · DEC'26 PREDICTION

- **SM headings become questions**: prohibited sectors (6.2.2), permitted investments (6.2.6), parking of ECB (6.3.3), LRS (6.4), s.3/s.4. Jun'23 Q8(b) is the SM's **solved case**.
- **Strongest Dec'26 FEMA pick: ECB**. It was revised by the **Dec'26 supplementary** (16 Feb 2026) and carried by 3 ICMAI practice papers (conversion of ECB into equity, parking, the limit). Also likely: **capital vs current account** + s.6(4) (Dec'25 repeat); FDI just asked (Jun'26).
- MCQ at (xiii)–(xv): an ECB, LRS or FDI fact; **insurance FDI 100%** and **land-border-country FDI → Government route** (supplementary).

MAP

1. FEMA basics, definitions, s.3–s.6 (6.1) ★★
2. FDI: meaning, prohibited sectors, routes, caps, pricing, reporting (6.2) ★★★
3. ECB and trade credits (6.3) ★★★
4. LRS (6.4) ★★
5. Supplementary changes ★★
6. Model answers · SM exercise · numbers

6.1 FEMA basics, definitions, and the core sections (s.3–s.6)

FROM FERA TO FEMA

- Exchange control began under the Defence of India Act, **1939** → FERA **1947** → FERA **1973** (from 1 Jan 1974). After the **Tarapore Committee** (1997) on capital account convertibility, **FEMA 1999** came into force on **1 June 2000**. [SM 297]
- FEMA has **7 chapters, 49 sections**, with **5 sets of Rules** (CG, s.46) and **23 sets of Regulations** (RBI, s.47), RBI master directions, the DPIIT's FDI policy, and the **Enforcement Directorate**. [SM 297–298]
- It extends to **all of India** and to offices and branches abroad owned or controlled by residents. The **RBI** administers it in consultation with the CG. [SM 297–298]

FERA vs FEMA

FERA	FEMA
regulate and minimise dealings	**manage**; build a liberal forex market
everything specified is controlled	**everything not expressly covered is not controlled**
criminal law: arrest and imprisonment	**civil** law: penalties, not arrest
accused presumed guilty	the **ED must prove** guilt
–	**current account** transactions free unless restricted; **capital account** only as permitted

[SM 298]

Definition	Meaning
Capital account transaction s.2(e)	alters **assets or liabilities** (contingent included) **outside India of residents**, or **in India of non-residents** [SM 299]
Current account transaction s.2(j)	any transaction **other than** a capital account one: foreign trade and services payments, short-term banking credit, interest and net investment income, family maintenance abroad, travel, education, medical care [SM 299]
Foreign exchange s.2(n)	foreign currency, incl. deposits and balances in foreign currency; drafts, TCs, LCs, bills drawn in rupees but payable in foreign currency, or drawn abroad but payable in rupees [SM 299–300]
Foreign security s.2(o)	shares, bonds, debentures and other instruments **denominated in foreign currency**, even if returns are paid in rupees [SM 300]
Person resident in India s.2(v)	resident for **more than 182 days** in the preceding FY, except a person who left (or came) for employment, business or an uncertain stay. Also any person or body corporate registered in India, and offices or branches in or outside India controlled by residents (or non-residents) [SM 300–301]
Others	**Authorised person** (AD, money changer, offshore banking unit) · **FCCB** · **FDI** (in the DPIIT policy, not the Act) · **FII / FPI / FVCI** (SEBI-registered) · **PIO** (not Pakistan or Bangladesh) · repatriable investment [SM 298–300]

s.3 · s.4: RESTRICTIONS (Jun'24 Q3(b))

s.3: no person shall (i) deal in or transfer foreign exchange or foreign securities **except through an authorised person**; (ii) make any payment to or for a non-resident; (iii) receive a payment on a non-resident's behalf other than through an authorised person; (iv) enter into a financial transaction in India as consideration for acquiring an **asset outside India**. [SM 301]

s.4: no resident shall acquire, hold, own, possess or transfer foreign exchange, foreign securities or **immovable property outside India**, except as the Rules permit: property held by a **foreign citizen** resident in India; property acquired on or before **8 July 1947** with RBI permission; **gifts or inheritance** from them; property bought from an **RFC account**. [SM 301]

s.5 · s.6: CURRENT AND CAPITAL ACCOUNT

s.5 (current account): free, except under the CAT Rules 2000: **Schedule I prohibited**, **Schedule II** needs Government/RBI approval, **Schedule III** has ceilings. [SM 301–302]

s.6 (capital account): through an authorised person, as RBI permits (classes and limits); no restriction on amortisation of loans or depreciation of direct investment. **s.6(4): a resident may keep, hold and invest foreign currency, securities or property acquired while he was resident outside India, or inherited from a non-resident** (the Dec'25 answer). Exporters must realise full export value; service exporters declare. [SM 302]

Possession: foreign **coins** without limit; currency within notified limits; a person not permanently resident may keep currency brought in and declared to customs without limit. **Foreign company's options:** a JV or WOS company, or a liaison, project or branch office. [SM 302–303]

6.2 Foreign Direct Investment (FDI) · Dec'23 Q8(a), Jun'23 Q6(a), Jun'26 Q7(b)

WHAT IT IS The FDI policy is set by the **DPIIT** (Ministry of Commerce and Industry) in a yearly **Consolidated FDI Policy**, under FEMA. The FEMA rules govern the mode, pricing and reporting. **FDI** = investment through capital instruments by a non-resident in an **unlisted** Indian company, or in **10% or more** of a **listed** company's post-issue paid-up equity (fully diluted). Below 10% in a listed company = **Foreign Portfolio Investment**; once FDI, it stays FDI even if it later falls below 10%. [SM 304]

PROHIBITED SECTORS / PERSONS (Jun'23 Q6(a)(i))

1. **lottery** (Government, private, online)
2. **gambling and betting**, casinos
3. **chit funds** (except NRI/OCI on a non-repatriation basis)
4. **Nidhi** companies
5. trading in **TDRs**
6. **real estate business** and farm houses (not townships, residential or commercial construction, roads, bridges or REITs)
7. **cigars, cheroots, cigarillos, cigarettes** of tobacco or substitutes
8. sectors closed to private investment: **atomic energy**, **railway operations** (other than permitted)
9. citizens or entities of **Bangladesh or Pakistan**: only with **Government approval**; Pakistan never in defence, space or atomic energy

[SM 304–305]

ROUTES · CAPS · INSTRUMENTS

- **Automatic route**: no prior approval of **RBI or Government** (SM MCQ 1). **Government route**: prior approval of the concerned ministry. [SM 305]
- **Sectoral caps**: up to **100% automatic** in sectors not listed in Regulation 16 of FEMA 20(R) and not prohibited. Minimum capitalisation counts premium received on issue only. Investing companies not registered as NBFCs (CICs) need Government approval; NBFC-registered ones are 100% automatic. [SM 305–306]
- **Capital instruments**: equity shares, **fully, compulsorily and mandatorily convertible** debentures and preference shares, share warrants. Partly paid shares: **25%** upfront, the balance within **12 months**. [SM 305]
- Debt converted into equity counts towards the cap; FCCBs and DRs with debt underlying do not. Downstream investment is counted at every stage. [SM 304–307]
- **Start-up convertible notes**: a non-resident may invest **₹25 lakh**; repayable or convertible within **5 years**. [SM 306–308]

PERMITTED INVESTMENTS BY NON-RESIDENTS (Dec'23 Q8(a)): THE 10 ANNEXES

1. subscribe, purchase or sell capital instruments of an Indian company
2. **FPIs**: listed shares on a stock exchange
3. **NRI/OCI**: listed shares on the exchange, **repatriable**
4. **NRI/OCI**: shares, LLP, firm or proprietorship, **non-repatriable**
5. securities other than capital instruments
6. investment in an **LLP**
7. **FVCI** investment
8. **investment vehicles** (REITs, InvITs, AIFs; not VCFs)
9. issue or transfer to a foreign depository for **depository receipts**
10. **IDRs** of companies resident outside India

Also: rights and bonus issues; **ESOPs and sweat equity** to non-resident employees or directors; shares on merger or demerger; MOA subscription at **face value**. [SM 306–307]

PRICING · EXIT

- **Issue price not less than:** the **SEBI-guideline price** (listed), or a **fair value by an internationally accepted method**, certified by a CA, SEBI merchant banker or **practising cost accountant** (unlisted). For convertibles, fix the formula upfront; the conversion price is not below the fair value at issue. [SM 307]
- **LLP**: not below fair value certified by a CA, practising cost accountant or approved valuer. [SM 307]
- **Exit**: the Indian partner has the first right of refusal; valuation and capital-gains tax apply. Transfers by foreign-owned Indian companies: to a non-resident (report in **FC-TRS**; no pricing rule) or a resident (pricing rule). [SM 308]

⚠ REPORTING TIMES (Jun'25 Q8(a), Jun'26 Q7(b)): NOT IN THE SM

Under the FEMA (NDI) reporting rules: **FC-GPR** within 30 days of **issue** of the shares; **FC-TRS** within 60 days of a transfer or receipt of consideration. Filed on the RBI's **FIRMS** portal after an **Entity Master** registration. Late filing is regularised by paying a **Late Submission Fee**; otherwise it is a contravention (compounding or penalty). The **Jun'26 supplementary** moved **all reporting to FIRMS**, electronic only, with harmonised timelines.

6.3 External Commercial Borrowings (ECB) and Trade Credits · Jun'23 Q6(a)(ii), Dec'25 MCQ, PTP Q8(a)

WHAT IT IS **ECB** = commercial loans raised by **resident entities from recognised non-resident lenders**, within limits on **minimum maturity, end-use and all-in-cost**, which apply **together**. Governed by s.6 FEMA. [SM 310]

Parameter	Rule (SM)
Forms	**FCY ECB**: loans, floating or fixed-rate notes, bonds, debentures (not fully and compulsorily convertible), trade credits beyond **3 years**, FCCBs, FCEBs, financial lease. **INR ECB**: the same plus preference shares and **rupee-denominated bonds issued overseas (masala bonds)** [SM 310]
Eligible borrowers	**all entities eligible to receive FDI**; INR ECB also micro-finance and non-profit organisations [SM 310]
Lenders	residents of a **FATF or IOSCO-compliant** country; multilateral and regional institutions; individuals; foreign branches and subsidiaries of Indian banks (FCY ECB only, not FCCB/FCEB) [SM 311]
Minimum average maturity	**3 years** [SM 311]
Negative end-uses	**real estate** · **capital market** · **equity investment** · working capital, general corporate purposes, repaying rupee loans (with listed exceptions) · on-lending for these [SM 311]
Limit	**USD 750 million** (or equivalent) per FY under the **automatic route** (SM MCQ 7 = Dec'25 MCQ). ECB from a **direct foreign equity holder**: ECB liability to equity ≤ **7:1**, unless all ECB is ≤ **USD 5 million** [SM 311]
Special cases	ECB to repay domestic capex loans classified **SMA-2/NPA** under a one-time settlement; resolution applicants under the IBC repaying the target's rupee loans (**approval route**) [SM 310]

PARKING OF ECB PROCEEDS (Jun'23; postal Q5(b); SM essay)

- **Abroad:** only proceeds meant for **foreign-currency expenditure**, pending use, invested in specified **liquid assets**. [SM 312]
- **In India:** proceeds for **rupee expenditure** are repatriated **immediately** to rupee accounts with **AD Category I** banks, or kept in **term deposits** with them for at most **12 months** cumulatively. [SM 312]

Procedure: automatic route if within the parameters; otherwise apply to the RBI. **Reporting:** monthly **ECB-2 Return**. An entity unreachable for **2 quarters**, or without an auditor's certificate for **2 years**, becomes an "**untraceable entity**": no fresh ECB, the ED is informed, no remittance under the automatic route. [SM 312]

Refinancing: allowed if the maturity is not reduced and the all-in-cost is lower; Indian banks only for **AAA** companies and Maharatna/Navratna PSUs. [SM 312]

CONVERTING ECB INTO EQUITY (ICMAI PTP Q8(a))

1. the activity is under the **FDI automatic route**, or **Government approval** is obtained
2. with the **lender's consent**, at no extra cost, and without breaching the **sectoral cap**
3. **pricing guidelines** complied with
4. **reporting**: partial conversion in **FC-GPR** + ECB-2 marked "partially converted"; full conversion in FC-GPR + ECB-2 "fully converted" (then no more ECB-2); in phases, phase by phase
5. prudential norms of Indian lenders complied with; other lenders' consent or information
6. exchange rate: that on the **agreement date** (or lower, if the lender agrees); fair value as on the **conversion date**

[SM 312–313]

TRADE CREDITS (TC)

- Buyers' or suppliers' credit for **imports**. Automatic route up to **USD 150 million** per import (oil and gas, airlines, shipping) or **USD 50 million** for others. [SM 313–314]
- Period: up to **3 years** (capital goods); **1 year or the operating cycle**, whichever is less (non-capital goods; shipyards 3 years). [SM 314]
- All-in-cost: benchmark + **300 bps** (new FCY TC), + **350 bps** (old LIBOR-linked), + **250 bps** (INR TC). [SM 314]
- AD reporting: monthly in **Form TC**; quarterly bank-guarantee data on **XBRL**. The **AD ensures compliance**, avoids double financing, and checks the TC period (the role of ADs, an SM essay). [SM 315–316]

OTHER

- **Security**: ADs may allow charges on assets and guarantees in favour of the overseas lender; entities under restructuring or CIRP only if the resolution plan permits. Entities under FEMA investigation may still raise ECB if otherwise eligible. [SM 313]
- Rupee borrowing between residents is outside FEMA, until a **non-resident guarantee** is invoked. [SM 316]
- **Credit enhancement** by multilateral institutions or foreign equity holders is allowed for rupee bonds of borrowers eligible for automatic-route ECB. [SM 316]

DEC'26 SUPPLEMENTARY: REVISED ECB FRAMEWORK (FEMA BORROWING AND LENDING AMENDMENT REGS, 2026 · EFFECTIVE 16 FEB 2026)

Simplified and broadened: **all entities eligible to receive foreign investment** may raise ECB · **recognised lenders** realigned · **foreign currency or rupees** · minimum average maturity **generally 3 years** (specific categories differ) · separate cost ceilings rationalised into one **all-in-cost** framework · a **broader permitted end-use**, with specified activities still prohibited. **ICMAI's examination point:** eligible borrowers, recognised lenders, currency, MAMP, all-in-cost, end-uses. [Supp Dec'26 p.7]

The supplementary gives no new limit figure, so the SM's **USD 750 million** remains the figure ICMAI asked (Dec'25, MQP).

6.4 Liberalised Remittance Scheme (LRS) · Dec'24 Q7(a)

WHO · HOW MUCH · WHAT FOR

- **All resident individuals, including minors**, may remit up to **USD 2,50,000 per financial year** (April–March) for permitted **current or capital account** transactions. **Not for** companies, firms, HUFs or trusts. It started on **4 Feb 2004** with USD **25,000**. [SM 317]
- **Purposes:** private visits (not Nepal or Bhutan) · gifts and donations · going abroad for employment · emigration · maintenance of close relatives · business travel, conferences, training, medical check-ups or as an attendant · medical treatment · studies · other current account transactions. [SM 317]
- **Family members** may club remittances, but not for capital account items unless they are co-owners. No limit on the number of remittances, but once USD 2.5 lakh is used, nothing more that year. [SM 318]
- **Remitter:** designate one AD branch; a bank account of at least **1 year**; the AD checks the source of funds; any freely convertible currency. [SM 318]
- A **sole proprietor** has **one** LRS limit, personal and business together. [SM 318–319]

PROHIBITED · OTHERS

- **Prohibited:** Schedule I items (lottery, sweepstakes, banned magazines) or Schedule II items · **margins** on overseas exchanges · buying **FCCBs** of Indian companies in the secondary market · **forex trading** abroad · capital remittances to **FATF non-cooperative** countries · remittances to persons posing a **terror** risk. [SM 317]
- **Rupee loan to an NRI/PIO close relative:** interest-free, at least **1 year**, within the LRS limit, credited to the **NRO** account, for personal or business use in India, not remitted abroad, and repaid through banking channels. A **rupee gift** to a close NRI relative also counts within the limit. [SM 319]
- **Entities (non-individuals):** donations up to **1%** of forex earnings of the last **3 years** or **USD 5 million** (lower) · commission on property sales **USD 25,000** or **5%** · consultancy **USD 10 million** per infrastructure project, **USD 1 million** others · pre-incorporation expenses **5%** or **USD 100,000** · Schedule III items up to **USD 250,000** a year. More needs **RBI approval**. [SM 319]

OTHER SUPPLEMENTARY CHANGES (MCQ MATERIAL)

- **FEMA (Guarantees) Regulations, 2026** (6 Jan 2026): a resident generally may **not guarantee a non-resident's debt** except as specifically permitted or with **RBI approval**. The rules set out when Indian entities and non-residents may give guarantees, and how invocation is paid. [Supp Dec'26 p.6]
- **Land-border countries** (1 May 2026): investment where the investor **or its beneficial owner** is in, or a citizen of, a country sharing a land border with India stays on the **Government route**. [Supp Dec'26 p.8]
- **Insurance FDI up to 100%** (2 May 2026), aligned with the insurance-law amendment (see Module 8). [Supp Dec'26 p.8]
- **Jun'26: FIRMS**: all foreign-investment reporting (issue, transfer, downstream) is **electronic on FIRMS**, with harmonised timelines and simpler late-fee regularisation; the investing Indian entity reports downstream investment. [Supp Jun'26 p.7]

5 Model answers

MODEL ANSWER 1 · ISSUING 20% TO A FOREIGN INVESTOR (JUN'23 Q8(b) = SM SOLVED CASE; ALSO ICMAI POSTAL)

Facts: an unlisted company (capital ₹23 crore) in the technology sector, with no foreign-investment cap, plans to issue fresh shares for a **20%** stake to a foreign investor. (i) Is it possible? (ii) What are the steps?

1. **Possible:** yes. Technology is under the **automatic route** with no sectoral cap, so **no prior approval of the Government or RBI** is needed. 20% is within the limit. As the company is unlisted, SEBI's issue regulations do not apply, but **FEMA** does. [SM 305–322]
2. **Price:** not less than **fair value** by an internationally accepted method, certified by a CA, SEBI merchant banker or **practising cost accountant**. [SM 307]
3. **Steps:** Board approval and a **special resolution** for preferential allotment (Companies Act) → receive the money **through banking channels** → allot the shares (**dematerialised**) → **report to RBI** (FC-GPR on FIRMS; ⚠ within 30 days of issue) → same voting rights as others; dividends repatriable after tax. [SM 322]

MODEL ANSWER 2 · RETURNING RESIDENT'S FOREIGN ASSETS (DEC'25 Q8(a))

Facts: Mr Soni lived in the USA from 2010 to 2024, bought a flat and shares there (USD 100,000), and inherited his wife's US properties (USD 50,000). He returned to settle in India on 1 Jan 2025. May he keep them?

1. **Capital vs current account:** holding a foreign flat and shares is a **capital account** matter, as it concerns a resident's assets outside India (s.2(e)). Current account transactions are trade, services, interest, travel and family maintenance (s.2(j)). [SM 299]
2. **Status:** on returning to settle, he becomes a **person resident in India** (s.2(v)), so s.4 would normally bar holding foreign property. [SM 300–301]
3. **But s.6(4):** a resident may **hold, own, transfer or invest** in foreign currency, foreign securities or **immovable property outside India acquired while he was resident outside India, or inherited from a person resident outside India**. [SM 302]
4. **Conclusion:** he may **keep both**: the flat and shares (acquired while he was non-resident) and the inherited properties (inherited from his wife, a non-resident). Income on them may also be retained, and he may sell or transfer them, **without RBI permission**.

The SM's own exercise for FEMA (SM 320–322)

1 automatic route means no prior permission of	**RBI or Central Govt**	7 ECB, automatic route ★	**USD 750 million**
2 FIIs registered with	**SEBI**	8 LRS maximum a year	**USD 2,50,000**
3 DPIIT comes under	**Industry and Commerce**	9 prohibited remittances	**all of the above**
4 a resident selling shares to a non-resident	**capital account**	10 UK company's shares to a UK citizen	**key: none of the above** ⚠
5 FDI prohibited in (lottery, gambling, chit funds)	**all of the above**	11 FEMA … foreign currency transactions	**restricts**
6 LRS purposes	**all of the above**		

⚠ MCQ 10: the SM key says "none of the above", but its own fill-in 2 says a security issued by a foreign entity is a **foreign** security (s.2(o)). Prefer "foreign security" if asked. Jun'25 asked the reverse: an Indian company's shares issued to a Singapore resident are **Indian securities**.

Fill-ins: FEMA replaced **FERA** · a foreign entity's security is **foreign** · a resident buying a London house is a **capital** account transaction · FEMA is regulated by the **RBI** · WOS = **wholly owned subsidiary** · master directions by the **RBI** · non-capital = **current** account · FCCB converts into the **Indian** company's shares · FPI · RFC = **Resident Foreign Currency** account.

R Revision: every number in FEMA

Rule	Number
FERA / FEMA in force	1 Jan 1974 / 1 Jun 2000
FEMA chapters / sections	7 / 49
Rules (s.46) / Regulations (s.47)	5 / 23
resident: days in preceding FY	> 182
property held with RBI permission since	8 July 1947
FDI vs FPI (listed company)	≥ 10% / < 10%
partly paid: upfront / balance within	25% / 12 months
start-up convertible note / within	₹25 lakh / 5 years
FC-GPR after issue ⚠ (not SM)	30 days

Rule	Number
ECB automatic route a year	USD 750 mn
ECB MAMP / TC beyond … = ECB	3 yrs / 3 yrs
ECB-equity (direct holder) / exempt up to	7:1 / USD 5 mn
parking in India (term deposit)	12 months
untraceable: no reply / no certificate	2 quarters / 2 years
TC per import: oil, air, shipping / others	USD 150 / 50 mn
TC period: capital / non-capital	3 yrs / 1 yr
TC all-in-cost spreads	300 / 350 / 250 bps
LRS a year / start (2004)	USD 2,50,000 / 25,000
LRS account age / NRI loan maturity	1 yr / ≥ 1 yr
entity donations	1% of 3 yrs or USD 5 mn
consultancy: infra / other	USD 10 / 1 mn