REGULATING THE DRAGON'S CAPITAL: FDI RESTRICTIONS ON CHINESE INVESTMENT IN INDIA UNDER THE FEMA FRAMEWORK - A STUDY OF PRESS NOTE 3 (2020) AND PRESS NOTE 2 (2026)

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ABSTRACT

Press Note 3 (2020 Series) issued by the Department for Promotion of Industry and Internal Trade under the Foreign Exchange Management Act, 1999 (FEMA) in April 2020[1], is the most impactful change to the FDI regime in India, which made the automatic route a mandatory prior approval route for all investments from and in the Land Bordering Countries. This paper explores the legal architecture established by this instrument as well as its successor in 2026 (Press Note 2), by examining the framework of rules made by the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, the Consolidated FDI Policy[2], and compliance frameworks under SEBI and the Prevention of Money Laundering Act, 2002[3]. Three deals are highlighted as case studies: the split-up of Ant Group's stake in Zomato over a three-year period starting from 2023; the secondary sale of Alibaba's BigBasket stake to the Tata Group in 2021; and BYD's proposed joint venture with Megha Engineering for manufacturing EVs in Telangana. The paper suggests that Press Note 3, issued as an emergency measure, following the People's Bank of China's stake in HDFC Limited, was overly aggressive in its approach as it mandated approval for all investments in LBC, irrespective of the specific sector, without introducing any definition of beneficial ownership or a time frame for the approval. Press Note 2 (2026) has now resolved the definitional problem and brought beneficial ownership under the rubric of PMLA, but it has not addressed the underlying structural conflict between India's FDI security system and its industrial policy goals, most clearly seen in the BYD rejection.

Keywords: Foreign Direct Investment, FEMA, Press Note 3, Press Note 2, Land Bordering Countries, Beneficial Ownership, Chinese Investment, NDI Rules, SEBI, PMLA, Automatic Route, Government Approval Route.

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[1] Press Note No. 3 (2020 Series), Dep't for Promotion of Indus. & Internal Trade, Ministry of Com. & Indus., Gov't of India (Apr. 17, 2020); Foreign Exchange Management Act, No. 42 of 1999, India Code (1999).
[2] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, G.S.R. 796(E) (India); Dep't for Promotion of Indus. & Internal Trade, Consolidated FDI Policy Circular of 2020 (Oct. 15, 2020) (India).
[3] Prevention of Money Laundering Act, No. 15 of 2003, India Code (2002).

1. INTRODUCTION

India and China stand in a rather unique position within the global economic order. Besides being the two most populous countries in the world, sharing along the way a 3,488 kilometre border, and being each other's largest trading partners in the Indo-Pacific region, the relationship between their capital markets, in fact, has been more characterized by mistrust than by integration for almost a decade. India's trade deficit with China was over 116 billion dollars in 2025[4]. Chinese direct investment in India amounts to only a cumulative 2. 51 billion dollars, that is, a mere 0. 32 % of India's total equity inflows since 2000. That imbalance is by no means a coincidence. It is largely a byproduct of law.

This paper reviews the legal structures regulating Chinese investment in India under the Foreign Exchange Management Act, 1999 (FEMA), with a specific reference to the two policy instruments which have defined the structure since 2020: Press Note 3 (2020 Series), released by the Department for Promotion of Industry and Internal Trade (DPIIT) on April 17, 2020[5], and Press Note 2 (2026 Series), issued on March 15, 2026[6]. Both the directives were published as legal provisions via amendments to the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019[7] (NDI Rules). These together are the major changes that have occurred in India's foreign direct investment regime after a long time; a shift that changed a predominantly open FDI system, where automatic approval was normally given; to a regime where prior approval has become compulsory for all investments that originate from or are beneficially owned by entities in, the countries with which India shares a land border.

Through doctrinal analysis, the paper studies major acts like FEMA 1999, the NDI Rules, the Consolidated FDI Policy, and the Press Notes, and secondary compliance systems like SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011[89] SEBI (Prohibition of Insider Trading) Regulations, 2015 and PMLA beneficial ownership setup.

[4] Press Trust of India, India's Trade Deficit with China Widens (2026), cited in AZB & Partners, Changes in FDI Regime on Investments from Countries Sharing Land Border with India (Mar. 2026).
[5] Press Note No. 3 (2020 Series), Dep't for Promotion of Indus. & Internal Trade (Apr. 17, 2020) (India).
[6] Press Note No. 2 (2026 Series), Dep't for Promotion of Indus. & Internal Trade (Mar. 15, 2026) (India); DPIIT Amends Press Note 3 to Ease FDI Norms for Border Countries, Bus. Standard (Mar. 16, 2026).
[7] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, G.S.R. 796(E), r. 6 (India).
[8] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (India).
[9] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 29(2) (India).

The case study part assesses the system with three different transactions: the Ant Group's staggered multi-tranche exit from Zomato (now Eternal) during 2023-2025, which is a great example of how PN3 changed a strategic investor into a staged seller on the public market and what actually the exit compliance architecture required; the Tata Group's taking over of a majority stake in BigBasket (Supermarket Grocery Supplies Private Limited) from Alibaba in 2021, which is a full secondary sale to an Indian resident buyer, the cleanest exit

These three transactions are not selected simply because they are well-known. They represent three analytically distinct scenarios within the PN3/PN2 framework: a listed-company phased exit, an unlisted-company secondary acquisition, and a proposed greenfield joint venture; each of which engages a different subset of the compliance architecture and produces different legal outcomes. In total, they give a fuller understanding of how the system works in reality than either theoretical analysis or any one transaction would alone.

2. PRE 2020 FDI REGIME – THE AUTOMATIC ROUTE ERA

3.1 The Architecture of the Automatic Route

Before April, 2020, Foreign Direct Investment (FDI) in India operated in a simple two-track manner: automatic and government approval routes. These were covered under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 read with the Consolidated FDI Policy Circular 2020[10]. Through the automatic route, foreign investors could invest in Indian companies, without seeking any prior approval from the Government or RBI, provided they adhered to the sectoral investment caps. Such an investment would take place by way of remittances through standard banking channels. The Indian investee company would be required to file a Foreign Currency - Gross Provisional Return (FC-GPR) with the RBI through its Authorised Dealer bank within thirty days. There was no need to communicate to the Department of Promotion of Industry and Internal Trade (DPIIT), no requirement for ministerial examination, and no question of security vetting. Once the return was submitted, there was no need for the Government to interfere and the deal was concluded.

[10] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, G.S.R. 796(E) (India); Dep't for Promotion of Indus. & Internal Trade, Consolidated FDI Policy Circular of 2020, ¶ 3.1.1 (India).

The government route applied to investment situations where: (a) the investment in a particular sector exceeded the cap on foreign investment under the automatic route; or (b) the sector itself was under the government route by policy irrespective of investment size. Sectors that were on government routes traditionally included defence (investment beyond 74%), telecommunications, broadcasting content services, print media, multi-brand retail trading, titanium-bearing minerals exploitation, and satellites. Under these, the investor was expected to submit a request via DPIIT through the Foreign Investment Facilitation Portal (FIFP) and after that, the application was passed on to the respective Ministry or Department for processing in collaboration with DPIIT.

A third category involved prohibited sectors, including atomic energy production, lottery and gambling business, Chit Funds, Nidhi companies, real estate trading, and tobacco production. Such kinds of FDI were not permissible regardless of the route or investment size.

The guiding principle of the pre-2020 regime, was its assumption of openness: FDI was generally encouraged in many of the sectors, with only the government route and prohibited categories serving as the very narrowly targeted exceptions to this rule. Almost always, the nationality of the investors was irrelevant in deciding which route was being considered.

3.2 Position For Chinese Investors

Before Press Note 3, the foreign investment regime of India under NDI Rules 2019 was the same irrespective of whether it was a Chinese or a foreign investor. However, the NDI Rules imposed special provisions under Rule 6(b)(ii)[11] upon two categories of foreign investors: citizens of Bangladesh and Pakistan and entities incorporated or registered therein. Pakistan and Bangladesh had to go through the government route for investing in India no matter which sector was targeted. Pakistani investors were further restricted under the NDI Rules as even government approval for investing in defence, space, and atomic sectors was withheld from them.

Contrary to this, Chinese foreign investments had free-flowing access with very minimal barriers. A company incorporated in the People's Republic of China, an entity registered

[11] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, G.S.R. 796(E), r. 6(b)(ii) (India).

in Hong Kong, or a Chinese citizen investing in India was subject to the same rules as a foreign investor from the United States, the United Kingdom, Japan, or Singapore. It could enter eligible sectors through the automatic route, participate in multiple funding rounds, exercise anti-dilution rights, subscribe to rights issues, and transfer its holding to another investor, without any governmental scrutiny on its Chinese origin. The only requirement was the standard reporting obligation applicable to all foreign investment: FC-GPR on issue of capital instruments, and Form FC-TRS on subsequent transfer of shares.

It did not come as surprise that over the last 10 years Chinese capital flowed freely in Indian equity market, particularly through startup and venture capital ecosystem. Alibaba Group, through entities including Alibaba Singapore Holding Pvt. Ltd. and Ali Small and Micro Financial Services (later rebranded as Ant Group), invested across Paytm, Zomato, BigBasket, Paytm Mall, and Snapdeal. Tencent Holdings made investments in Ola, Swiggy, Byju's, Flipkart, and Dream11. ByteDance, through offshore vehicles, invested in VerSe Innovation (Dailyhunt and Josh). By early 2020, estimates placed Chinese-origin capital across 18 of India's 30 unicorns. The combined investment portfolio of Alibaba and Ant Group alone amounted to over $5 billion across more than 20 Indian companies.

3.3 The Triggering Event

The triggering event behind Press Note 3 was specific, public, and legally unremarkable. In the first half of 2020, the People's Bank of China (PBoC), acquired a 1.01 % stake in HDFC Limited, through the automatic route. This purchase was made as a portfolio adjustment since HDFC's share price declined rapidly in the earlier weeks of the COVID-19 pandemic. Besides that, it was clearly in consonance with the NDI Rules as they then stood, entirely lawful.

The take-over by PBoC was made public in April 2020, attracting immediate attention from the Ministry of Finance and the Ministry of External Affairs. India's concern was twofold: first, that a state-owned Chinese financial institution had acquired a meaningful stake in a systemically crucial Indian financial services company during a period of extreme market disruption; and second, that this acquisition had been effected through the automatic route, meaning the Indian government had no prior knowledge of, or a mechanism to review, the transaction before it was completed. Such acquisition, though limited in itself, presented an illustration of a weak link: if a central bank could acquire a stake in HDFC without review, any state-linked Chinese entity could acquire a stake in any automatically-eligible Indian company during the pandemic-induced market crash.

The announcement of Press Note 3 came to be made seventeen days after the PBoC buyout had drawn widespread coverage. The swift regulatory response, from public reporting to a notified amendment of the NDI Rules within three weeks, highlighted both, the effectiveness and the limitations of Press Note 3: it was designed to address an immediate vulnerability by restricting a specific channel of investment, rather than to establish a comprehensive regulatory framework.

3. PRESS NOTE 3 (2020) – THE LEGAL ARCHITECTURE OF RESTRICTION

4.1 The Statutory Instrument and Its Legal Effect

Press Note 3 (2020 Series) (PN3), published by DPIIT on April 17 2020, amended paragraph 3.1.1 of the Consolidated FDI Policy Circular 2020[12]. Yet, the law did not come only from being mentioned in the Press Note. In fact, Press Notes are documents that reflect the executive policy of government and are not laws themselves. The tool of implementing the changes was in effect through Foreign Exchange Management (Non-Debt Instruments) Amendment Rules, 2020 made by the Ministry of Finance and communicated through G.S.R. 272(E) dated April 22, 2020[13]. These regulations revised NDI Rules 2019, Rule 6 to bring in these new restrictions. The separation between a policy tool and a legal tool is not mere difference, it is essentially the reason why PN3 can be executed under FEMA and in reality a violation of the terms in PN3 leads to criminal proceedings by and under FEMA 1999[14].

The amended Rule 6 provided for two operative provisions: first, paragraph 3. 1. 1(a) of the revised FDI Policy, stated that any investment into India by an entity of a Land Bordering Country (LBC), or by an entity whose beneficial owner is sitting in, or is a

[12] Dep't for Promotion of Indus. & Internal Trade, Consolidated FDI Policy Circular of 2020, ¶ 3.1.1 (India).
[13] Foreign Exchange Management (Non-Debt Instruments) Amendment Rules, 2020, G.S.R. 272(E) (Apr. 22, 2020) (India).
[14] Foreign Exchange Management Act, No. 42 of 1999, § 13, India Code (1999).

citizen of, a LBC, should only be done via the government route. The second provision, aligned to paragraph 3. 1. 1(b), extended the necessity to existing FDI transfers. Any kind of transfer of ownership of an existing or future FDI interest in an Indian entity, regardless of whether it happens directly or indirectly, resulting in the beneficial owner of the interest becoming an entity or citizen of a LBC, will also involve a prior government approval.

The LBCs designated by PN3 were China, Hong Kong, Pakistan, Bangladesh, Nepal, Myanmar, Bhutan, and Afghanistan. The inclusion of Hong Kong was a deliberate and legal decision. Hong Kong is not even adjacent geographically with India, let alone sharing a land border, but was placed into the category on the justification that the entities of Hong Kong can be assumed to carry out sovereign will of China following the enactment of the National Security Law in June 2020[15].

4.2 Prior Approval Requirement

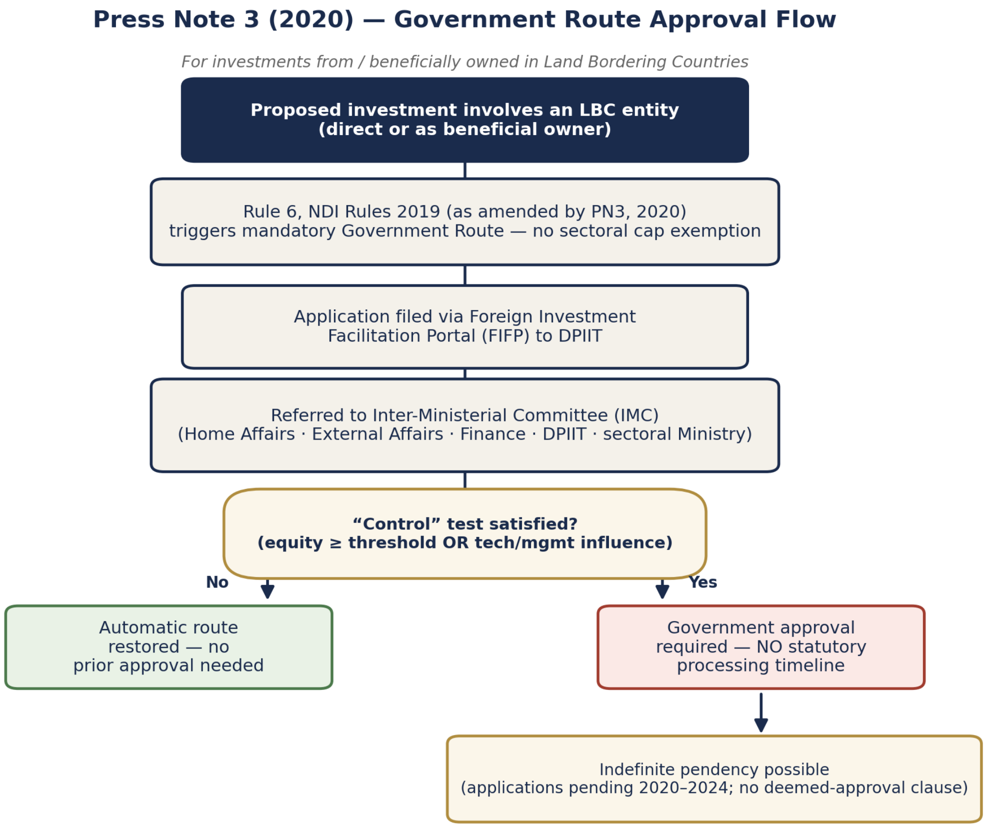
Prior to 2020, government approval was an instrument applicable to sensitive sectors and above-cap investments. PN3 wiped out the sectoral targeting completely for LBC-linked investments. Hence, a Chinese investor that invests in an Indian software company, a sector that allowed 100% FDI through the automatic route, would need the very same pre-clearance from the government as, for example, a Chinese investor wanting to invest in a defence manufacturer. The same stands true of e-commerce, financial services, manufacturing and all kinds of sectors that up to then were completely open.

By removing sector-based distinction between automatic and government route for LBC investments, PN3 transformed a narrow and targeted checking system into a thorough pre-approval for all investments of the category concerned. This category was determined by the origin of country of the investors. The impact of the change was not only felt by new investments but also those subsequent corporate actions affecting existing FDI positions as well, by virtue of paragraph 3.1.1(b). These would include new issue buybacks share allotments with pre-emption rights, secondary sales between LBC-related entities, etc. Anti-dilution adjustment causing an increase of LBC's share of

[15] The Law of the People’s Republic of China on Safeguarding National Security in the Hong Kong Special Administrative Region (2020) (China).

shares is an example of an action which would require prior approval. The investor is blocked from taking new positions, or to put it in a legal sense, the investor is locked in a particular position he has already taken.

4.3 Inter-Ministerial Committee and the Absence of a Processing Timeline



DPIIT mandated an FIFP-based process (Foreign Investment Facilitation Portal), routed through an Inter-Ministerial Committee (IMC) headed by the Home Secretary, for investments requiring government approval. The composition of IMC included representatives of the Ministries of Home Affairs, External Affairs, Finance, DPIIT, and the relevant administrative Ministry for the sector in involved. Applications would be filed through the FIFP portal and awaited comments and security clearance from the relevant Ministries before DPIIT coordinated a final decision.

The flaw in this structure was not its composition, but rather the absolute lack of any defined processing timeline. The Government was not obligated to decide an application within any particular period. PN3 and the NDI Rules provided no provisions of a deemed approval; no longstop date; and no right of the applicant to seek a mandamus due to delay. Applications filed in 2020 remained pending in 2022 and, in sometimes, in 2024. The economic fallout was severe: a transaction dependent on LBC FDI approval could not be closed or abandoned until the application was under consideration.

4.4 Compliance Obligations created by Press Note 3

For new investments following the government route, the investee company was required to obtain IMC approval before the funds were remitted, file FC-GPR with the RBI within thirty days of the issue of capital instruments, and maintain records of the approval and all supporting documentation. The onus of compliance rested with the Indian investee company, not the foreign investor, under paragraph 5.2(i) of the Consolidated FDI Policy[16]. This was a provision of considerable significance since it exposed the investee company to FEMA penalties for violations by its own shareholders.

When it comes to exits, for the divestment by an LBC entity of its existing holding to a non-LBC buyer, the position under PN3 was, and remains, that the transaction does not trigger the prior approval requirement because beneficial ownership is being reduced instead of being created. The compliance obligations applicable to such transactions instead arise from FEMA and SEBI. Form FC-TRS must be filed on the RBI FIRMS portal within sixty days of the date of transfer or receipt of consideration, through the Authorised Dealer bank. Late filing attracts Section 15 of FEMA, with penalties of up to three times the sum involved[17]. FEMA pricing rules require that the consideration not exceed independently certified fair value in the case of a non-resident selling to a resident. For listed companies, SEBI's block deal window applies: the transaction must be executed within the designated window, at a floor price within one percent of the previous day's volume-weighted average price. SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 require disclosure of every crossing of a threshold holding within two days under Regulation 29(2). For listed-company block deal exits, a ninety-day lock-in between successive tranches applies, and all sales must be executed within SEBI's designated open trading windows and not during blackout periods around quarterly results.

[16] Dep't for Promotion of Indus. & Internal Trade, Consolidated FDI Policy Circular of 2020, ¶ 5.2(i) (India).
[17] Foreign Exchange Management Act, No. 42 of 1999, § 15, India Code (1999).

4.5 The Framework's Fundamental Tension

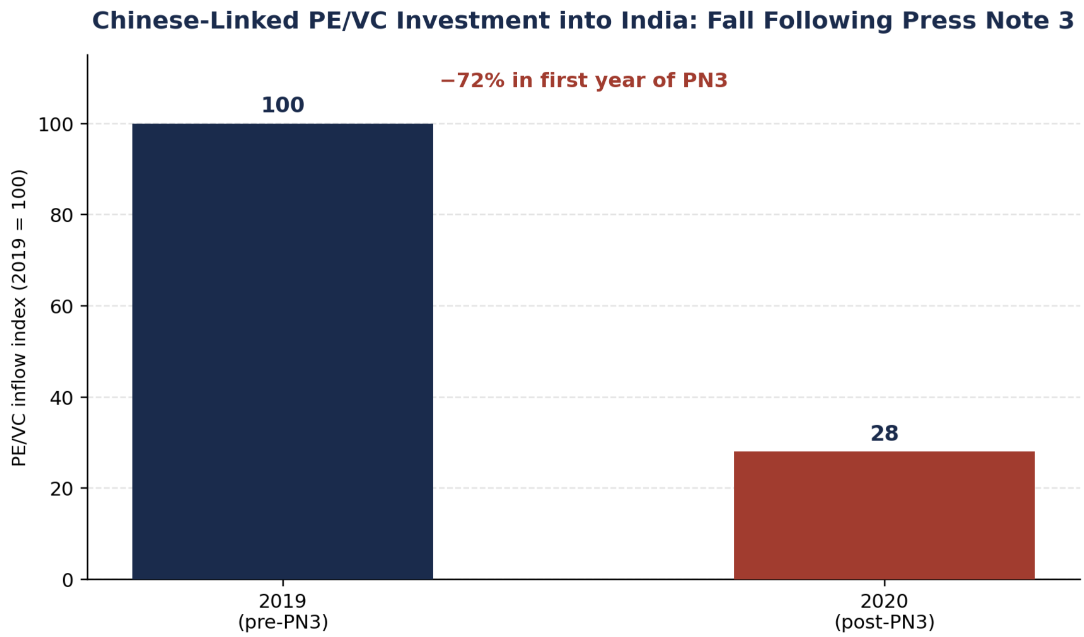
PN3 was framed to handle a genuine and specific issue, that of Chinese state-linked capital acquiring sensitive positions in Indian companies during the pandemic period, when companies were undervalued. The PBoC-HDFC acquisition demonstrated a genuine vulnerability in the pre-2020 framework, and it was not unreasonable for the Government to respond.

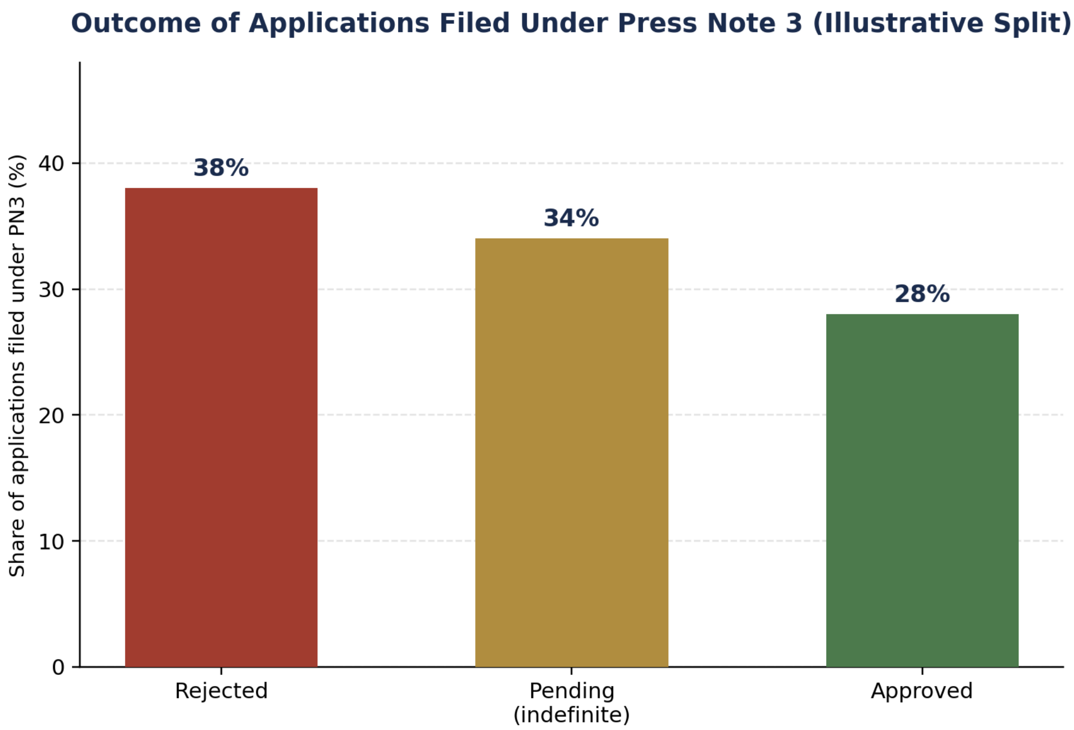
However, the measure actually led to a setup that was somewhat at odds with itself. On one hand, the policy aimed at restricting strategic acquisitions by Chinese state actors. On the other hand, the restriction to all LBC-beneficial ownership without definition, threshold, or timeline, meant that the regulation affected a very large set of investors and transactions which had nothing in common with the legitimate national security issue that the policy intended to address. A Chinese venture capital fund with a minority position in an Indian software startup presented no strategic acquisition risk of the kind the PBoC-HDFC transaction had raised. A global fund with two percent Chinese limited partner capital did not become a vehicle for state-linked acquisition by virtue of that two percent stake. Yet both were treated identically under PN3, subject to the same prior-approval requirement and the same indefinite processing timeline, as a Chinese central bank acquiring a stake in a systemically important lender.

This tension between the policy's intended purpose and its operative scope is not merely an observation. It is the explanation for why over 70 % of applications filed under Press Note 3 were either rejected or remained pending[18], why PE and VC inflows from Chinese-linked capital fell by over 72 % in the first year of the policy's operation[19], and why the Government ultimately found it necessary to issue Press Note 2 (2026) to address the disparities the original instrument had created. The story of PN3's reform is, in significant measure, the story of a regulation that overcorrected and then had to be recalibrated.

[18] Indian Government Has 54 Chinese Investment Proposals Pending: FM Sitharaman, Deccan Herald (Mar. 22, 2023).

[19] PE/VC Investments into India from China, Hong Kong Fall 72% in CY20, Bus. Standard (Dec. 30, 2020).





4. CASE STUDIES

5.1 Case Study I: Ant Group and Zomato: The Five-Tranche Exit

4.1.1. The Investment

Ant Group, the fintech affiliate of Alibaba Group, invested in Zomato through two

Singapore-incorporated entities: Antfin Singapore Holding Pte. Ltd. and Alipay Singapore Holding Pte. Ltd[20]. Although these two shell companies were incorporated in Singapore, Chinese individuals and institutions benefited from the investment, thereby falling within the definition of LBC-linked investors under PN3.

As a part of the automatic route, Ant Financial initially acquired 14.7% equity share in Zomato in 2018. Then in 2019, the holdings of Antfin and Alipay altogether went up to nearly 23% still via the automatic route and FC-GPR standard filings were made by RBI for both investments separately. Further, in January 2020, Zomato entered into an agreement with Antfin for a further investment of up to $150 million, valuing the company at a pre-money valuation of $3 billion[21]. The first tranche of $50 million under this agreement was received before April 2020.

4.1.2. Impact of PN3

Before the second tranche of $100 million could be committed, PN3 came into force. Antfin, being an LBC-linked investor, could no longer remit the committed capital through the automatic route. An application was made to the IMC for prior approval of the tranche but it was never cleared.

Between 2020 and Zomato's IPO in July 2021, Zomato raised multiple rounds, all through the automatic route. Without prior government approval, Antfin and Alipay could neither participate in any of these rounds nor exercise their anti-dilution rights. The result was involuntary dilution: by the time Zomato listed in July 2021, the combined stake of Antfin and Alipay had been diluted from approximately 23 % to approximately 16.6 %.

The SEBI-mandated one-year lock-in for pre-IPO investors, meant that the earliest any block deal exit was possible was July 2022[22]. For an investor whose commercial rationale for holding had been fundamentally altered by PN3 and who

[20] Zomato to Raise $150 Million from Ant Financial at $3 Billion Valuation, Bus. Today (Jan. 15, 2020).
[21] Zomato to Raise $150 Million from Ant Financial at $3 Billion Valuation, Bus. Today (Jan. 15, 2020).
[22] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, reg. 8 (India) (one-year lock-in for pre-IPO allottees).

could not add to, rebalance, or protect its position, the listed market became the only possible exit route.

4.1.3. The Exit

Antfin Singapore and Alipay Singapore exited in four confirmed tranches between November 2023 and August 2025, through SEBI's block deal window on NSE and BSE.

In November 2023, the first tranche was carried out by Alipay, resulting in its complete exit from Zomato. It sold 3.44 % of Zomato's equity[23]. The buyers included Vanguard, Goldman Sachs, Fidelity, Morgan Stanley, the Abu Dhabi Investment Authority, the Government of Singapore, and the Government Pension of Norway[24], etc.

In March 2024, Antfin conducted the second exit, representing about 2.1 % of Zomato's equity. Morgan Stanley Asia (Singapore) had bought about 0.65 % of the total shares. The third tranche was in August 2024,where Antfin sold around 2.14%[25]. The fourth and fifth tranche was concluded in August 2025 where Antfin[26] sold the remaining stake of 1.9 % at a five percent discount to the market price. With this, Ant Group's presence in Zomato's capital table, which had begun in 2018 with a $210 million investment, was wiped out completely.

4.1.4. The Compliance Architecture

Each tranche followed the same regulatory framework. Under SEBI's block deal rules, all transactions took place through the designated block deal window at floor prices within the allowed range. According to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, each time a threshold holding was crossed, at two percent, five percent, and then every two percent, it was reported to BSE and NSE within two trading days under Regulation 29(2). Under SEBI

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[23] Alipay to Sell 3.44% Stake in Zomato, Bus. Standard (Nov. 28, 2023).
[24] Vanguard to Goldman Sachs, Global Firms Rush to Buy Alipay's Zomato Stakes, Bus. Standard (Nov. 29, 2023).
[25] Antfin Singapore Holding Divests 2.1% Stake in Zomato for Rs 4,771 Crore, Bus. Standard (Aug. 20, 2024).
[26] Antfin to Sell Entire Stake in Eternal (Formerly Zomato) via Block Deal, Bus. Standard (Aug. 6, 2025).

(Prohibition of Insider Trading) Regulations, 2015[27], all sales occurred within the set open trading windows and not during the blackout periods around Zomato's quarterly results. A ninety-day lock-in period between successive block deal tranches applied, which explains the spacing between the four exits. Under FEMA, Form FC-TRS had to be filed on the RBI FIRMS portal within sixty days of each transfer, verified by the Authorised Dealer bank. Since the buyers in each tranche were non-residents, this was a non-resident to non-resident transfer which is allowed under Rule 9(5) of the NDI Rules without needing the PN3 prior approval[28].

4.1.5. Significance

This case study highlights three main claims of this paper. Firstly PN3 did not block the exit; it simply turned the continuous holding into a commercial issue, transforming a long-term strategic investor into a staged seller in the public market. Secondly, separating entry (regulated by PN3) from exit (regulated by FEMA and SEBI) is crucial to the framework and not an oversight. Thirdly, listed company exits require compliance that is much more thorough than the entry compliance that is already in place.

5.2 Case Study II: Alibaba and BigBasket

5.2.1 The Investment

Alibaba Group had invested in BigBasket through Alibaba Singapore Holding Pte. Ltd since 2017 and had increased its shareholding to about 27-30% till the beginning of 2020. This investment had been made under the automatic route and FC-GPR has been filed to RBI for each investment.

5.2.2 PN3 Impact

PN3 put Alibaba in a similar position as Ant Group in Zomato, that is, unable to take part in new rounds, exercise anti-dilution rights, or sell off its holdings to another LBC-linked entity, without the government approval. BigBasket,

[27] Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 (India).
[28] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, G.S.R. 796(E), r. 9(5) (India).

being an unlisted entity meant that the path of the public market exit that Ant had for Zomato was not open for Alibaba. The only feasible commercial exit was a negotiated sale of shares to a non-LBC buyer.

5.2.3 The Transaction

In February 2021, Tata Digital Limited, subsidiary of Tata Sons Private Limited, entered into an agreement to acquire a 64.3 % majority stake in BigBasket[29] through a mix of issuing new shares and acquiring existing ones. This transaction included the purchase of Alibaba's entire shareholding, alongside the stakes of Actis LLP, Ascent Capital, IFC[30], and other existing investors. The transaction valued BigBasket at approximately ₹13,500 crore ($1.85 billion).

5.2.4 Compliance Architecture

This transaction was governed by three different setups. First, the CCI approval was needed under Section 5 and 6 of the Competition Act, 2002[31]. Secondly, the rules of FEMA mandated compliance with the selling of shares of Alibaba, a secondary selling. Since the transaction was a non-resident to Indian resident transfer, it had to be conducted in accordance with the pricing rule laid down by FEMA in the NDI Rules (Rule 21)[32]. Thirdly, the general compliances done are: Signing of Share Purchase Agreement, Stamping of the Share Purchase Agreement under the Stamp Act applicable to the transaction, Transfer of shares (execution of Form SH-4), Change of Register of Members, Filing of the New Pattern of Shareholding with the Ministry of Corporate Affairs.

This particular transaction did not trigger PN3's prior government approval obligation because the transaction was the removal of the LBC linked company's beneficial ownership in BigBasket (and not the creation of it). This is the legalistic approach that paragraph 3.1.1(b) requires if the transfer leads to the beneficial ownership of the assets falling under the LBC restriction, and it

[29] Tata Group Reaches Agreement to Buy Majority Stake in BigBasket, TechCrunch (Feb. 16, 2021).
[30] Roshan Santhalia & Parisa Dumasia, Re-Evaluating Press Note 3 of 2020, Lexology (Apr. 2024).
[31] Competition Act, No. 12 of 2003, §§ 5–6, India Code (2002).
[32] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, G.S.R. 796(E), r. 21 (India).

is not the case if the ownership is removed.

5.2.5 Significance

BigBasket's transaction is an excellent example of the most economically-efficient Indian exit structure available under PN3 setup. A full secondary sale to Indian resident buyer. This showcases PN3 functioning asymmetrically in between the entry and exit processes. Alibaba's entry in 2017 required no governmental involvement beyond an FC-GPR filing. But for the exit in 2021, they needed multiple steps: CCI approval, FEMA pricing certification, FC-TRS filing, and complete corporate law documentation for the transfer, a much higher burden of compliance. Besides, this transaction demonstrates that, when a Chinese Investor exits into the hands of an Indian resident, Competition Act is the first regulatory point that needs to be dealt with, because PN3 by itself is not activated.

5.3 Case Study III: BYD and Megha Engineering: The Blocked Entry

5.3.1 The Proposal

In 2023, BYD applied to DPIIT for the establishment of an electric vehicle manufacturing and battery plant in Telangana[33] with an investment of around Rs 8,200 crore along with Megha Engineering and Infrastructures Limited (MEIL), a Hyderabad-based infrastructure conglomerate. Under the proposed arrangement, MEIL would bring capital, while BYD would bring manufacturing technology, intellectual property rights and know how to run the business in exchange for a minority equity stake.

5.3.2 Regulatory Position

As per FDI Policy for the automobile industry, 100 % FDI is allowed under the automatic route. In pre-PN3 days, BYD's investment would not have needed any government authorization. With PN3, however, things were different. BYD is a PRC incorporated company (LBC). For any sector not automatically

[33] Majmudar & Partners, Scrutiny of Chinese Investments in India: Impact Decoded (2026).

eligible, a prior government approval was required. This application was submitted to DPIIT, passed through IMC, and considered by the Ministries of Home Affairs, External Affairs and Heavy Industries.

5.3.3 The Outcome

The proposal was turned down. Commerce and Industry Minister Piyush Goyal stated publicly in April 2024[34]: “We need to be convinced that they will play by the rules of the land. As of now, it's a no for BYD.” The rejection stemmed from national security considerations relating to Chinese investment generally, but its specific legal basis rested on a reading of PN3's “control” concept.

DPIIT's PN3 framework states: even if an LBC entity holds a 1 % stake in an Indian entity[35], in addition to technology transfer or management arrangements that allow the LBC entity to exercise influence over the Indian entity, constitutes “control” and thus activates the government route. Accordingly, the inclusion of manufacturing technology and IP by a Chinese company was a way to give it effective control over the JV's key operating parameters. So basically, it was a car that was going to be made in a major Indian denomination and would be a BYD licensed car. The IMC discovered such dependency to be a form of control, sufficient to keep PN3 in play.

5.3.4 Significance

The BYD case highlights two things. First, it recognizes that the PN3 framework may be more than just equity ownership. Hence, control exercised through dependence on technology, contractual arrangements, or management influence is a sufficient basis for the approval requirement. Second, it represents the conflict between the FDI security regime and the industry-policy goals of India. The kind of technology-transfer type JVs that PN3, as understood in BYD, is likely to target is just what India's PLI scheme and its EV manufacturing targets are most likely to need. The car industry has opened automatic route with 100

[34] BYD Hits a Dead End in India as Piyush Goyal Says “No” to Chinese EV Maker, Fortune India (Apr. 8, 2025).
[35] Dep’t for Promotion of Indus. & Internal Trade, Consolidated FDI Policy Circular of 2020, ¶ 3.1.1(a), Explanation (India).

% FDI limit that has been meant to draw manufacturing investment but that is completely restricted by the provision of PN3 if the company is LBC-linked. The framework which both, encourages manufacturing investment and simultaneously bans technology partnerships, is not the one which has resolved its own internal contradiction.

6 PRESS NOTE 2 (2026) – REFORM, SCOPE AND LIMITATIONS

6.1 The Reform

DPIIT had issued Press Note 2 (2026 Series) (PN2) on March 15, 2026 to amend the Consolidated FDI Policy paragraph 3.1.1[36]. The legal effect had been granted under the Foreign Exchange Management (Non-Debt Instruments) (Second Amendment) Rules, 2026[37].

The objective behind this reform was three-fold: to enable FDI inflows to startups and deep-tech sectors that were deterred by the definition of beneficial ownership; to enhance ease of doing business for investment funds from around the world with incidental LBC exposure; and to provide commercial certainty for transactions in the processing timeframes for certain manufacturing sectors.

6.2 The Core Amendment

The most important amendment that PN2 introduced was the definition of "beneficial owner". What was left undefined by PN3 for five years and had created massive uncertainty was finally brought to existence by Section 2(1)(fa) of the Prevention of Money Laundering Act, 2002[38], read with Rule 9(3) of the Prevention of Money Laundering (Maintenance of Records) Rules, 2005. Through this definition, "controlling ownership interest" means ownership of, or entitlement to, more than 10 % of the shares, capital, or profits of a company.

This change meant that a foreign entity incorporated outside any LBC jurisdiction, say, Singapore, Cayman Islands, or the United States, in which an LBC entity held passive-

[36] Press Note No. 2 (2026 Series), Dep't for Promotion of Indus. & Internal Trade (Mar. 15, 2026) (India).

[37] Finance Ministry Notifies FDI Easing for Foreign Firms with up to 10% Chinese Stake under FEMA, The Hindu (May 3, 2026).

[38] Prevention of Money Laundering Act, No. 15 of 2003, § 2(1)(fa), India Code (2002).

non controlling stake of up to 10 %, could now invest in India through the automatic route, whilst being subjected to applicable sectoral caps and a new DPIIT reporting obligation. This reporting obligation applies to the Indian investee company, in accordance with the reporting requirements under paragraph 5.2 (i) of the FDI Policy[39], requiring them to inform DPIIT of any LBC beneficial ownership in the investor entity.

6.3 The Processing Window

For investments falling under the government route, PN2 mandated a 60-day processing window[40]. This compulsory processing timeline specifically addressed seven manufacturing sectors, namely: capital goods, electronic capital goods, electronic components, polysilicon and ingot-wafer manufacturing, advanced battery components, rare earth permanent magnets, and rare earth processing. Such a timeline helped to remove the structural deficiency of PN3, that is, the absence of any timeline, leaving investors and investee companies in an indefinite holding pattern.

Still, this 60-day window has its limits too. It only covers seven manufacturing sectors. The remaining parts of the economy, including information technology, financial services, consumer internet, fintech, and e-commerce, which together account for the majority of Indo-Chinese venture capital deals are excluded. Applications in these sectors continue to be handled by the IMC without any set outer limit.

6.4 What Did Not Change

Although PN2 brought about meaningful changes, it must be noted that a large category of restrictions still remain unchanged.

For instance, the 10 % threshold, introduced by PN2, applies solely to non-LBC entities carrying passive LBC ownership[41], thereby leaving direct LBC investors outside its ambit. This means that a Chinese company wanting to invest in electric vehicles, software, financial services, or any other sector, is still mandated to follow the government route as established by PN3.

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[39] Dep't for Promotion of Indus. & Internal Trade, Consolidated FDI Policy Circular of 2020, ¶ 5.2(i) (India).
[40] India Sets 60-Day Timeline for FDI Proposals from Land Border Countries, Bus. Standard (Mar. 11, 2026).
[41] FDI Easing Only for Non-LBC Firms with Minority Chinese Holding: Official, Bus. Standard (Mar. 11, 2026).

Furthermore, the "control test" remains similarly unchanged. DPIIT expressly states that even a 1 % stake will trigger the government route if the LBC ownership has the ability to influence the Indian entity through technology transfer, board representation or management arrangements. The 10 % threshold determines whether a passive financial stake in a non-LBC entity constitutes "controlling ownership interest" however, it fails to determine whether a minority operational stake in an LBC-technology partnership constitutes "control" in the broader sense that attracts the approval route.

Lastly, the exit framework is still governed by FEMA and SEBI. The compliance architecture applicable to listed and unlisted exits remain unchanged.

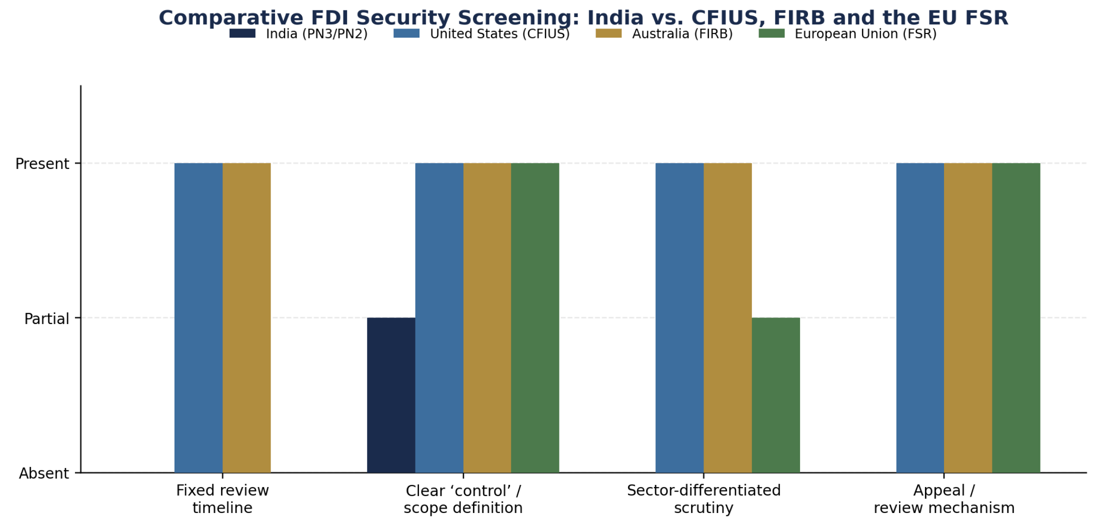
6.5 Assessment

PN2 can best be seen as a specific measure to correct the operational shortcoming of PN3, which is the lack of definition of the beneficial owner, and not as a restructuring of the policy. It provides a number with which to work the framework: 10 %. As it was not introduced five years ago, it does not undo the effects of that absence, that is, the 72 % fall in Chinese-related investment in PE and VC over 2020, and the 526 applications of IMC in 2020[42], with high rejection and pendency rates, however, it does provide a basis to structure and evaluate future transactions.

What PN2 does not do is answer the structural tension that exists between a security-based prior approval model and an industrial policy model that calls for technology transfer partnerships, such as the BYD case. Indian manufacturing technology cannot be done without Chinese manufacturing technology. The PLI scheme and EV manufacturing targets in India are reliant on Chinese manufacturing technology. Through the BYD case, and as captured by PN2, the equity-for-technology joint venture structure (the main vehicle for transferring such technology) is the most difficult type of transaction to approve. What a 10 % beneficial ownership threshold does not do is solve that tension since the BYD problem is not one of thresholds of beneficial ownership, it is one of whether dependence on technology is control. PN2 doesn't say anything about that question.

[42] Indian Government Has 54 Chinese Investment Proposals Pending: FM Sitharaman, Deccan Herald (Mar. 22, 2023).

7 COMPARATIVE ANALYSIS



Indian policy for investment from a country with strategic sensitivity is not extraordinary. Actually, the United States, Australia, and the European Union all have mechanisms in place to assess the foreign investments to protect national security.

The Committee on Foreign Investment in the United States (CFIUS) reviews[43] "covered transactions" where foreign entities acquire US businesses due to national security concerns. Transactions such as those involving critical technology, critical infrastructure, or sensitive personal data, require mandatory filing. The key aspect of CFIUS is its procedural clarity, having an initial 30-day review, which may be followed by a 45-day investigation if necessary. This process includes defined extension provisions and a clear outcome at the end.

Australia's Foreign Investment Review Board (FIRB) follows a similar pattern under the Foreign Acquisitions and Takeovers Act, 1975[44]. It also has a 30-day review window that can be extended by a minister's notice but includes a longstop approval mechanism. Both systems differentiate by sector: they apply stricter examinations for critical infrastructure, defense, and sensitive technology, while they use a lighter review process for commercial investments that do not have strategic importance.

[43] 50 U.S.C. § 4565 (2018) (Defense Production Act of 1950, as amended by FIRRMA).
[44] Foreign Acquisitions and Takeovers Act 1975 (Cth) (Austl.).

The European Union's Foreign Subsidies Regulation, 2023[45], deals with a different issue, that is, the impact of state-backed foreign subsidies on the EU's internal market. This regulation is not a direct investment screening tool, but it highlights a key trend. Worldwide, the regulatory approach is shifting towards focused, intelligence-led screening systems that target state-linked funding rather than treating all capital from a particular region the same. PN2 (2026) makes a small step in this direction by introducing a threshold-based ownership test and a specific timeline for processing in certain sectors. However, it does not fully accomplish this goal. A complete framework is still needed, one that includes set review timelines across all sectors, a clear definition of "control" to differentiate between passive ownership and active influence, and a way to appeal rejected applications.

8 CONCLUSION

An emergency measure adopted after the acquisition of a stake in HDFC by the PBoC, led to a regulatory structure which was broad enough to be more than what was originally intended to block, freezing existing investors to their positions, blocking industrial partnerships that India's own manufacturing policy required, while also creating a pendency backlog that took years to partially clear. The structural imbalance between India's FDI security framework and industrial interest, highlighted by the BYD case, has not been resolved yet, and will not be until India builds a framework which is proportionate in scope, procedure transparent and has the capacity to differentiate the investments it does want to block from those it simply cannot afford to deter.

[45] Regulation (EU) 2022/2560 of the European Parliament and of the Council of Dec. 14, 2022 on Foreign Subsidies Distorting the Internal Market, 2022 O.J. (L 330) 1.

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