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TECHNOLOGY CONTRIBUTIONS AS NON-CASH CONSIDERATION: ISSUANCE OF CONVERTIBLE INSTRUMENTS

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INTRODUCTION

As foreign direct investment in India continues to evolve, movement of technology is becoming increasingly common. In joint ventures, this may involve foreign partners contributing proprietary technology or technical expertise to the joint venture company in exchange for an equity stake, while Indian partners seek to leverage these contributions to build technological capabilities and strengthen the venture's competitive position.

As technology contributions become an increasingly significant component of foreign investment in India, the foreign exchange framework governing the issuance of securities against such non-cash consideration remains open to interpretation. In particular, the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("**NDI Rules**"), read in isolation, raise questions about whether an Indian company may issue convertible instruments, including compulsorily convertible preference shares, against non-cash consideration such as lump-sum technical know-how fees or royalties. This uncertainty has led to divergent interpretations among authorised dealer ("**AD**") banks and practitioners, creating practical challenges in structuring cross-border investments involving technology contributions.

This article traces the evolution of India's foreign exchange framework governing the issuance of shares against non-cash consideration since 2000, examines the source of the current interpretational divergence, and sets out our view on the issuance of equity shares and compulsorily convertible preference shares against eligible non-cash consideration.

I. EVOLUTION OF THE FDI FRAMEWORK

(A) Regulatory Development

The table below traces the evolution of the regulatory framework governing the issuance of securities against non-cash consideration, from the erstwhile Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 ("**TISPRO Regulations**"), through the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 ("**FEMA 20 Regulations**"), to the current NDI Rules. It highlights key amendments concerning permissible forms of consideration under the automatic and government routes and the subsequent changes that have given rise to divergent interpretations.

Year	Development
2000	The TISPRO Regulations permitted the issuance of capital instruments (defined as equity shares, preference shares,[1] convertible preference shares and convertible debentures) only against consideration received through inward remittance via normal banking channels or by debit to an NRE/FCNR account.[2]

[1] For the purposes of this article, references to "preference shares" in the context of periods after May 1, 2007, denote compulsorily and mandatorily convertible preference shares. Optionally convertible preference shares, previously governed by the TISPRO Regulations, are now classified as debt and regulated under the external commercial borrowing framework.

[2] Reserve Bank of India, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000, Notification No. FEMA 20/2000-RB, dated May 3, 2000, available at: https://rbi.org.in/scripts/BS_FemaNotifications.aspx?Id=174, last accessed November 24, 2026.

Year	Development
2004	The amendment to the TISPRO Regulations dated November 27, 2004 introduced sub-paragraph (5) in paragraph 2 of Schedule I (*governing the foreign direct investment scheme),* expressly permitting the issuance of equity and preference shares against technical know-how fees, lump-sum fees and royalties due for payment, and through the conversion of ECBs.[3] A corresponding explanation was inserted in paragraph 8 of Schedule I, which governed the mode of payment for the issuance of shares, to include technical know-how and the conversion of ECBs as permissible forms of consideration.
2008	An amendment dated August 22, 2008 renumbered sub-paragraph (5), inserted in 2004, as sub-paragraph (4) of paragraph 2 of Schedule I (*foreign direct investment scheme*). This procedural change is relevant only for tracking subsequent amendments to the provision.[4]
2012	The amendment to the TISPRO Regulations dated April 23, 2012, added a further limb to paragraph 2 of Schedule I, permitting the issuance of equity and preference shares against the import of capital goods by SEZ units under the automatic route. The amendment also permitted other forms of consideration under the government route, including share swaps, the import of capital goods, machinery and equipment, and the payment of pre-operative or pre-incorporation expenses.[5]
2014	The amendment to the TISPRO Regulations dated July 10, 2014, introduced another limb to sub-paragraph (4) of paragraph 2 of Schedule I (*foreign direct investment scheme*), permitting the issuance of ***only*** equity shares against "*any other funds payable*".[6] In a subsequent circular, the RBI acknowledged that, before the 2014 amendment, the issuance of shares under the automatic route was permitted against only three categories of non-cash consideration: technical know-how fees or royalties, the conversion of ECBs, and the import of capital goods by SEZ units.[7] The "*any other funds payable*" limb was introduced to cover other legitimate dues that did not fall within the categories of non-cash consideration specifically permitted under either the automatic route or the government route under Schedule I.

[3] Reserve Bank of India, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) (Fifth Amendment) Regulations, 2004, Notification No. FEMA 125/2004-RB, dated November 27, 2004, available at: https://www.rbi.org.in/Scripts/BS_FemaNotifications.aspx?Id=2611, last accessed November 24, 2026.

[4] Reserve Bank of India, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) (Second Amendment) Regulations, 2008, Notification No. FEMA 179/2008-RB, dated August 22, 2008, available at: https://www.rbi.org.in/scripts/BS_FemaNotifications.aspx?Id=4863, last accessed November 24, 2026.

[5] Reserve Bank of India, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) (Third Amendment) Regulations, 2012, Notification No. FEMA 229/2012-RB, dated April 23, 2012, available at: https://rbi.org.in/scripts/NotificationUser.aspx?Id=7711&Mode=0, last accessed November 24, 2026.

[6] Reserve Bank of India, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) (Twelfth Amendment) Regulations, 2014, Notification No. FEMA 315/2014-RB, dated July 10, 2014, available at: https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=9241&Mode=0, last accessed November 24, 2026.

[7] Reserve Bank of India, Foreign Direct Investment (FDI) in India - Issue of equity shares under the FDI Scheme against legitimate dues, RBI/2014-15/234, A.P. (DIR Series) Circular No. 31, dated September 17, 2014, available at: https://rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=9242, last accessed November 24, 2026.

Year	Development
2017	The TISPRO Regulations were superseded by the FEMA 20 Regulations. Schedule I (*governing the purchase/sale of capital instruments of an Indian company by a person resident outside India*) of the FEMA 20 Regulations expressly recognised share swaps, the import of capital goods, and the payment of pre-operative or pre-incorporation expenses as permissible forms of non-cash consideration under the government approval route.[8] It also permitted the issuance of **only equity shares** against "*funds payable*" under the automatic route. However, unlike the erstwhile TISPRO Regulations, Schedule I did not retain the express permission for the issuance of equity and preference shares against technical know-how fees, royalties and the conversion of ECBs. The corresponding provision governing the mode of payment under Schedule I listed only inward remittance, funds payable and share swaps, without separately recognising technical know-how fees, royalties or the conversion of ECBs. Thus, these categories were no longer expressly recognised either in the provision permitting the issuance of instruments against non-cash consideration or in the corresponding mode-of-payment provision, while the permission relating to "*funds payable*" remained expressly limited to equity shares.
2019	The NDI Rules, which superseded the FEMA 20 Regulations, largely retained the approach adopted under those regulations when read with the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 ("**Reporting Regulations**")[9]. The NDI Rules recognised the issuance of equity instruments against "*funds payable*", while the Reporting Regulations prescribed the permissible modes of payment, including inward remittance, funds payable and swaps of equity instruments.

(B) Position under the FDI Policy

The permission introduced in 2004 for the issuance of equity and preference shares against lump-sum technical know-how fees and royalties, and through the conversion of ECBs, has consistently been retained in India's consolidated FDI Policy, subject to the prescribed conditions. Following the 2014 amendment to the TISPRO Regulations and the subsequent RBI circular discussed above, the 2015 FDI Policy introduced a separate category covering "*any other funds payable*", the remittance of which is permitted under the applicable foreign exchange framework. This category was retained in the 2016, 2017 and 2020 FDI Policies. The permission under this category was expressly limited to the issuance of equity shares and remained distinct from the specific provision governing technical know-how fees, royalties and ECB conversion.

II. REGULATORY AMBIGUITY

(A) Conservative Interpretation

[8] Reserve Bank of India, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017, Notification No. FEMA 20(R)/2017-RB, dated November 7, 2017, available at: https://rbi.org.in/scripts/BS_FemaNotifications.aspx?Id=11161, last accessed November 24, 2026.

[9] Reserve Bank of India, Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019, Notification No. FEMA 395/2019-RB, dated October 17, 2019, available at: https://rbi.org.in/scripts/NotificationUser.aspx?Id=11723&Mode=0, last accessed November 24, 2026.

On a literal reading, the FEMA 20 Regulations, the NDI Rules and the Reporting Regulations refer only to the issuance of 'equity shares' against "*funds payable*". Instruments other than equity shares are expressly mentioned only in connection with share swaps, the import of capital goods or machinery, and pre-operative or pre-incorporation expenses. On this reading, royalties, lump-sum fees and amounts outstanding under ECBs may fall within the category of "*funds payable*" under the NDI Rules. The issuance of securities against these amounts, including through the conversion of ECBs, may therefore be construed as restricted to equity shares, to the exclusion of convertible instruments.

(B) Divergent market practice

Market practice reflects this interpretational divergence. Some AD banks permit and process the issuance of convertible instruments against royalties or technical know-how fees, treating compulsorily convertible preference shares as akin to equity shares on account of their compulsory convertibility. Other AD banks adopt a narrower reading of the NDI Rules, taking the view that only equity shares may be issued against such consideration. This conservative approach is also reflected in market interpretations based on a strict reading of the NDI Rules and the Reporting Regulations, although it does not appear to be the dominant view.

III. OUR VIEW: THE CASE FOR BROADER INTERPRETATION

In our view, the framework, read as a whole and in light of its evolution, supports the issuance of convertible instruments against eligible technical know-how fees and royalties, and through the conversion of ECBs. The omission of the earlier express permissions from the NDI Rules should not, by itself, be read as their withdrawal. This interpretation rests on the historical distinction between specified categories of non-cash consideration and the residual category of "*funds payable*", which the FDI Policy continues to recognise.

(A) Historical and purposive reading

From 2004 until the introduction of the FEMA 20 Regulations, the foreign exchange framework expressly permitted the issuance of equity and preference shares against technical know-how fees and royalties, and through the conversion of ECBs. The introduction of "*funds payable*" in 2014 supplemented these specific permissions with a residual category covering other legitimate dues. Limiting that residual category to equity shares did not displace the existing permissions or narrow the range of instruments available under them. Against this background, the subsequent omission of the specific categories from the FEMA 20 Regulations and the NDI Rules does not, in itself, establish an intention to withdraw those permissions. The framework's evolution therefore supports an interpretation that preserves the distinction between the specified categories of consideration and the residual category of "*funds payable*".

(B) Continuity under the FDI Policy

The FDI Policy reinforces this interpretation by continuing to recognise general permission under the automatic route for the issuance of equity and preference shares against technical know-how fees, lump-sum fees and royalties, and through the conversion of ECBs, subject to applicable conditions. Following the 2014 amendment, the 2015 FDI Policy separately recognised "*any other funds payable*" as a category against which only equity shares could be issued.

This distinction is significant: the FDI Policy treats "*any other funds payable*" as a residual category, rather than as an exhaustive description of all permissible non-cash consideration. Its continued recognition of the specified categories supports the view that their omission from the NDI Rules should not be read as withdrawing the corresponding permissions.

(C) The FDI Policy as an interpretative aid

The NDI Rules prevail over the FDI Policy in the event of any inconsistency. The FDI Policy cannot, therefore, be relied upon to override an express restriction in the NDI Rules. It can, however, inform the interpretation of matters on which the NDI Rules are silent, provided the resulting interpretation is consistent with those Rules. Its relevance here is as an aid to understanding the omission of previously recognised categories of consideration, rather than as a basis for displacing the NDI Rules.

Accordingly, the omission should be considered in light of the framework's evolution and the distinction maintained by the FDI Policy between specified and residual categories of consideration. Taken together, these considerations support the view that the absence of an express reference in the NDI Rules to technical know-how fees, royalties and ECB conversion should not, by itself, be treated as prohibiting the issuance of convertible instruments against such eligible consideration, subject to applicable conditions.

IV. PRACTICAL CONSIDERATIONS

Notwithstanding the interpretation set out above, the issuance of convertible instruments against technical know-how fees or royalties may, in practice, depend on the position adopted by the AD bank processing the transaction. Parties should therefore address this issue at the transaction-structuring stage, rather than defer it until documentation or allotment.

- **Early engagement with the AD bank**: The parties should consult the proposed AD bank early to confirm its position on the issuance of convertible instruments against the relevant technology consideration. The choice of AD bank should align with the proposed transaction structure, and its requirements should be reflected in the transaction documents and implementation timeline.

- **Establishing the underlying consideration**: The underlying technical know-how fees or royalties payable should be genuine and eligible for remittance under the applicable foreign exchange framework. The technology contribution should be documented in a technology licence, know-how transfer agreement or other relevant agreement that clearly specifies the rights granted, the consideration payable and the payment or settlement mechanism. The parties should also ensure compliance with applicable pricing guidelines, sectoral caps, entry-route conditions and other relevant FEMA requirements.

- **Valuation and Companies Act compliance**: The parties should obtain a report from a registered valuer valuing the technology or know-how being contributed and the consideration attributable to it. This is not merely an AD bank documentation requirement. Under the Companies Act, 2013, where securities are allotted for consideration other than cash, a registered valuer's report valuing that consideration is required and must be attached to the return of allotment filed with the Registrar of Companies in Form PAS-3. The AD bank may also require additional documentation in accordance with its internal policies.

CONCLUSION

In our view, the evolution of the foreign direct investment framework, together with the FDI Policy, supports the issuance of compulsorily convertible preference shares against eligible technical know-how fees and royalties, subject to applicable conditions. Regulatory clarification is needed to resolve the ambiguity under the NDI Rules and promote consistency in the practices adopted by AD banks. Until then, early engagement with the AD bank remains essential to the smooth implementation of transactions involving these structures.

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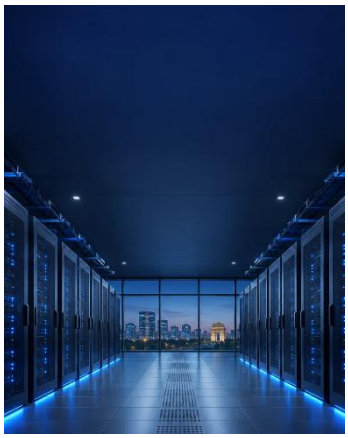

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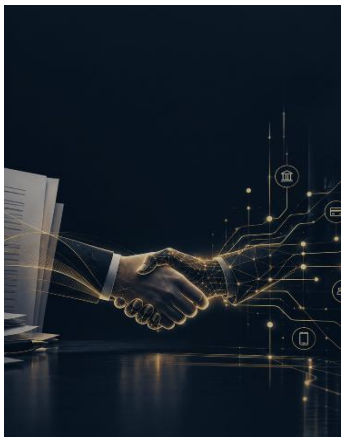

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