EXECUTIVE SUMMARY

# What Foreign Investors Must Know About India's Policy Changes — FY 2026–27

Including China-Linked Investment Risk Overlay

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| **Issued by** | R. Mahesh & Associates, Chartered Accountants |
| **Coverage Period** | Financial Year 2026–27 (April 2026 – March 2027) |
| **Subject** | FDI Policy · FEMA · Income Tax Act 2025 · RBI · GST |
| **Audience** | Foreign Investors, FDI Structuring Teams, In-house Counsel |
| **Classification** | Client Advisory — For Circulation |

## 1. THE REGULATORY SHIFT — WHAT THIS YEAR IS ABOUT

FY 2026–27 is not primarily a year of new policy liberalisation. It is a year of **enforcement integration and structural reform**. The major frameworks — the new Income-tax Act 2025, the RBI's enhanced KYC norms, and GST's system-driven compliance — are now operational. For foreign investors, this means India's regulatory environment has moved from one of principled permissions to one of **verified substance and traceable ownership**.

The central theme across all frameworks this year is: **substance prevails over form**. Jurisdictional routing, layered ownership structures, and treaty-based positions without economic substance face significantly higher scrutiny.

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# 2. FOUR REGULATORY PILLARS — KEY CHANGES FOR FDI

## 2.1 FDI POLICY & FEMA

Press Note 3 (2020) continues in full force. The regulatory emphasis has shifted decisively from jurisdiction of incorporation to beneficial ownership and control. Multi-layer investment structures face enhanced documentation requirements. The 'FOCE' (Foreign Owned or Controlled Entity) concept now governs downstream investment classification — a critical point for holding company structures.

- Shift: jurisdiction-based → ownership/control-based classification
- Form FC-GPR must be filed within 30 days of receiving investment
- Downstream investments by Indian companies with foreign capital require separate FEMA compliance
- Valuation cannot be below FMV determined by SEBI-registered merchant banker

## 2.2 RBI — RISK & CAPITAL TRANSPARENCY

The RBI's Expected Credit Loss (ECL) framework becomes effective April 2027, but banks are already adjusting credit behaviour. Enhanced KYC and UBO (Ultimate Beneficial Owner) verification norms are in force. Cross-border funding flows face greater traceability requirements at the banking level.

- ECL framework operationalises April 2027 — banking relationships affected now
- UBO verification: chains of ownership beyond 25% threshold require disclosure
- Opaque funding structures face delays and rejections at account-opening stage
- Capital traceability is now a banking-level requirement, not just regulatory

## 2.3 INCOME TAX ACT, 2025 — STRUCTURAL REFORM

The new Income-tax Act, 2025 governs all transactions from FY 2026–27. Key structural changes include a single 'Tax Year' replacing Assessment Year/Previous Year distinctions, a simplified filing framework, and continued application of GAAR and transfer pricing provisions. For foreign investors, the critical change is greater alignment between legal ownership, economic substance, and tax treatment.

- New ITR forms under Act 2025 apply from FY 2026–27 onwards
- GAAR applies where tax benefit exceeds ■3 crore — treaty positions must have substance
- Transfer pricing documentation requirements unchanged but enforcement more data-driven
- Round-tripping and treaty shopping structures face heightened AI-driven scrutiny
- Start-up tax holiday turnover limit raised to ■300 crore (DPIIT-certified entities)

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### 2.4 GST — SYSTEM-DRIVEN ENFORCEMENT

The GST system has matured from a compliance framework to an enforcement one. E-invoicing, ITC matching, and cross-border service taxation clarifications are now operating through automated systems. For foreign investors with Indian subsidiaries providing or receiving cross-border services, this creates direct compliance obligations.

- E-invoicing mandatory for cross-border service providers above threshold
- ITC claims auto-reconciled against counterparty GSTR-1 filings
- Cross-border OIDAR (digital) services: registration and GST payment obligations
- Inter-company transactions face system-level scrutiny for arm's-length pricing

## 3. CHINA-LINKED FDI — RISK OVERLAY

Investments from China and other land-border nations continue under **Press Note 3 (2020)**, which requires government approval for all FDI from these jurisdictions regardless of route. In FY 2026–27, there has been limited relaxation for passive minority exposure, but the core restriction on controlling stakes and sensitive sector investments remains unchanged.

| SCENARIO | REGULATORY TREATMENT | KEY RISK |
|---|---|---|
| Passive minority stake (<10%, non-controlling) | Case-by-case review<br>May qualify for some relief | Beneficial ownership still scrutinised for Chinese UBO |
| Controlling stake or board influence | Government Approval Route mandatory — no automatic route | Approval timelines: 3–9 months<br>Sector restrictions apply |
| Layered / opaque ownership structure | Heightened scrutiny<br>Likely delays at multiple levels | UBO tracing required across all intermediate entities |
| Sensitive sectors (defence, media, telecom) | Restricted / prohibited regardless of stake size | Exposure may be deemed non-compliant ab initio |

### 4. WHEN DOES CHINA-LINKED EXPOSURE TRIGGER SCRUTINY?

- Beneficial ownership is Chinese — directly or through intermediate entities
- Control or significant influence is established regardless of legal ownership percentage
- Ownership structures are layered across multiple jurisdictions to obscure origin
- Funding source lacks documentable transparency (no clear trail to original source)
- The Indian entity operates in or adjacent to sensitive sectors
- Round-tripping structures route Indian capital through third-country Chinese-controlled entities

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## 5. PRACTICAL ADVISORY CHECKLIST FOR FOREIGN INVESTORS

### ■ OWNERSHIP DOCUMENTATION

- ✓ Prepare UBO declaration identifying all beneficial owners above 10% threshold
- ✓ Map ownership through all intermediate entities — jurisdictional routing will be traced
- ✓ Obtain apostilled/notarised foreign entity documents for FIRMS/RBI portal filings

### ■ PRE-INVESTMENT TAX PLANNING

- ✓ Confirm that treaty position has genuine economic substance in treaty jurisdiction
- ✓ Review for GAAR applicability — particularly if tax benefit exceeds ■3 crore
- ✓ Ensure transfer pricing documentation is contemporaneous (not retrospective)

### ■ FEMA COMPLIANCE TIMELINE

- ✓ FC-GPR filing: within 30 days of receiving investment — cannot be delayed
- ✓ Annual Return on Foreign Liabilities & Assets (FLA): file by July 15 each year
- ✓ Downstream investment reporting: file FC-TRS on any subsequent share transfers

### ■ BANKING & FUNDING TRACEABILITY

- ✓ Ensure inward remittance clearly identifies purpose code and remitter details
- ✓ KYC documentation for UBO should be prepared in advance of account opening
- ✓ Foreign currency loans: comply with ECB guidelines including end-use restrictions

### ■ CHINA-LINKED SPECIFIC STEPS

- ✓ Apply for DPIIT/RBI government approval before any capital commitment
- ✓ Engage legal counsel to prepare Press Note 3 compliance filing
- ✓ Build in 3–9 month approval timeline for controlling stake investments

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## 6. CONCLUSION

FY 2026–27 represents India's regulatory maturation — from aspirational frameworks to integrated enforcement. **FDI continues to be welcomed and encouraged**, but on terms of transparency, verified substance, and documented ownership.

For investors with no China-linked exposure, the key actions are: verify your UBO chain, ensure FC-GPR timelines are met, align treaty positions with genuine substance, and prepare for GST's system-driven environment.

For investors with China-linked exposure, the actions are additionally: file government approval applications early, build in extended timelines, and ensure beneficial ownership documentation is irrefutable.

### For Transaction-Specific Advisory

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