

FEMA – AN OVERVIEW

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FEMA – AN OVERVIEW

BASIS OF EXCHANGE CONTROL LAW

- An economic legislation
- Legal regulation on scarce resource of ‘foreign exchange’
- Cannot be a static law – but dynamic – Central Government retains power to suspend or relax the law
- How much foreign exchange is sufficient for a country?
- Gulf war of 1990 foreign exchange crisis – a trigger factor
For liberalization in the law, followed by Industrial Policy of 1991

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“CONTROL” TO “MANAGEMENT”

- Change in forex balance – 1991 \$ 500 million to 34 billion in 1999
- Today it has crossed \$ 300 billion!
- Major component is software exports – major concern is crude oil import
- This necessitated shift in focus – from ‘permission’ to ‘promotion’
- ‘Control’ became allergic and the shift was ‘management’
- From Quasi-criminal old FERA to Civil new law FEMA

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SALIENT FEATURES OF FEMA

- Focus of law changed – from accounting & controlling in FERA to orderly development of forex market and, facilitating external payments
- Alignment of certain definitions such as Person, Person Resident in India, similar to Income Tax law
- Transaction regulated according to Nature – Current A/c and Capital A/c Transactions

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SALIENT FEATURES OF FEMA

- **Rigour of penal provisions diluted**
 - quantum of penalty reduced
 - concept of Mens rea abolished
 - No automatic imprisonment. Arrest only if penalty is not paid
 - Penalty subject to Adjudication
 - Compounding made possible
- **Central Government retains residuary power to suspend / relax the law**

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CAPITAL ACCOUNT TRANSACTION U/S 2(e)

- What is Capital A/c for Accounting – Assets (A) or Liabilities, including Contingent liabilities (L) OR simply a Balance Sheet Item, as compared with P&L A/c item.
- Legally there shall be ‘alteration’ – that is, purchase or sale, addition or deletion.

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CAPITAL ACCOUNT TRANSACTION U/S 2(e)

- This can be understood in a logical way: Location of person and A&L
- If the A&L and the person doing the Transaction are located cross-border, then it is a Capital A/c Transaction under FEMA. Otherwise not. E.g. FDI, ODI, Guarantees, ECB, FII, immovable properties in India are all Capital A/c Transactions.

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CAPITAL ACCOUNT TRANSACTION U/S 2(e)

- Capital A/c Transactions include items specified u/s 6(3) as well.
- Capital A/c Transactions continued to be regulated.

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Permissible Capital Account Transactions:-

The FEM (Permissible Capital Account Transactions) Regulations permit various Capital A/c Transactions of Person Resident in India or “residents”.

- Investment in foreign securities or Overseas Direct Investment (ODI)
- Loans raised in foreign security or External Commercial Borrowings (ECB)
- Transfer of immovable property outside India
- Remittance of Capital asset outside India
- Loans by residents to non-residents & vice-versa

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CURRENT A/C TRANSACTION

- Definition u/s 2 (j) is by exclusion. Current A/c Transaction is what is not a Capital A/c Transaction. It expressly includes the following:-
- Payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business

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CURRENT A/C TRANSACTION

- Payments due as interest on loans and as net income from investments
- Remittances for living expenses of parents, spouse and children residing abroad AND
- Expenses in connection with foreign travel, education and medical care of parents, spouse and children.
- Current A/c transactions are free from Regulation– barring a limited prohibition / regulation as per the FEM [Current A/c Transactions] Rules 2000 – regardless of ceiling limits, monetary or percent age wise.

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Prohibited Current Account Transactions:-

The following current account transactions – even though in value terms small are prohibited:-

- Remittance for lottery winnings
- Remittance for income from racing
- Purchase of banned lotteries or magazines
- Payment of commission on exports made towards equity investment in JV / WOS abroad of Indian companies
- Payment related to “call back services” of telephone

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S 2 (u) "Person" includes-

(i) an individual (ii) a Hindu undivided family (iii) a company (iv) a firm (v) an association of persons or a body of individuals, whether incorporated or not (vi) every artificial juridical person, not falling within any of the preceding sub-clauses, and (vii) any agency, office or branch owned or controlled by such person;

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Person Resident in India or residents.

S 2 (v) states a person residing in India for more than 182 days during the course of preceding financial year,

Excluding

- (A) Person who has gone out of India or who stays outside India, in either case— (a) For employment outside India (b) For carrying business or vocation outside India (c) Where intention to stay outside India is for uncertain period
- (B) Person who has come to or stays in India, otherwise than (a) For employment outside India (b) For carrying business or vocation outside India (c) Where intention to stay outside India is for uncertain period

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Authorised Person: S 2 (c) AP include an

- **Authorised dealer**
- **money changer**
- **offshore banking unit or**
- **any other person**

Who is authorised to deal with foreign currency or foreign securities. RBI may authorise any applicant to be authorised person. RBI may also revoke (cancel) the license for any violation of the terms of license. RBI may impose certain directions and has the requisite power to inspect AD. Failure to comply with directions may involve penal consequences.

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Foreign Security S 2 (o) means security, in the form of shares, stock, bonds, debenture or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency but where redemption or any form of return interest or dividend is payable in Indian currency

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Export of Goods and Services S 7

- Every exporter is required to furnish to RBI or other authority the true and correct particulars including the full export value, if ascertainable, and expected value, if value not ascertainable.
- In order to receive the export proceeds in full without delay RBI may require exporter to comply with such requirements as it may deem fit.
- Exporter of Services also is required to furnish such particulars relating to export of services.
- S 8 requires the exporter of goods & services to take all reasonable steps to realise and repatriate foreign exchange due to India.

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Right Issue to Person resident outside India Two conditions:-

- The price at which rights share will be issued to person resident outside India shall not be less than the price at which rights are offered to residents.
- The post-rights equity shareholding shall comply with FDI Policy for foreign equity holding.

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Issue of shares under ESOP [Employees Stock Option] Scheme to Person Resident outside India

Subject to regulation issued by SEBI Act, 1992, an Indian Company may issue shares under ESOP to Person resident outside India being (i) its own employees (ii) employees of joint venture (iii) employees of wholly owned subsidiary abroad. There are two conditions to such ESOP to non-residents:-

- Face value of shares allotted should not exceed 5% of paid up capital of the issuing Company
- A report containing details about number and name along with Certificate from the Company Secretary is to be filed with RBI within 30 days from issue of shares

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Exemption from provisions relating to Holding, Realisation and Repatriation of Foreign Exchange – S 9

- Foreign exchange (FE) acquired before July 8, 1947
- FE acquired as gift within limits allowed by RBI
- FE earned out of Business or employment allowed by RBI
- Possession of foreign coins as permitted by RBI
- Operating Foreign Currency Account in compliance with RBI norms

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Acquisition and Transfer of Immovable Property outside India

A person Resident in India is prohibited from acquiring or transferring immovable property outside India, unless a General or Special permission is obtained from RBI. There are five exceptions to this rule:-

- Immovable property acquired by person resident in India who is also foreign national
- Property acquired by resident as gift or inheritance from Person resident outside India
- Property acquired from out of RFC (Resident Foreign Currency) Account
- Company formed outside India having overseas office may be permitted to acquire immovable property for the purpose of business as permitted by RBI.

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PENALTY PROVISIONS

- Not without adjudication
- Quantum: Thrice where quantifiable. Where not quantifiable max. Rs. 2 lakhs.
- Order of Adjudicating officer could be appealed to SD or Tribunal
- Arrest, only if penalty is not paid within 90 days or appealed against
- From February 1st 2005, most of the contraventions are compoundable

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CENTRAL GOVERNMENT POWER

- The Central Government retains power to suspend / relax based on National Interests

SUMMING UP:-

Dissect any proposed Transaction as to its Nature: - Current A/c or Capital A/c.

- If current A/c, one can do it through banking system itself.
- If Capital A/c, it is still regulated. One has to comply with procedures, as to ceilings, forms, approval, and other procedures. Most of the Capital A/c Transactions are also progressively getting liberalised.