# FEMA

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# Foreign Exchange Management Act, 1999

- Facilitates external trade and payments
- Promotes orderly development & maintenance of foreign exchange market in India
- Partial Capital Account convertibility
- Current Account convertibility
- Violation under FEMA – Civil offence

# FEMA

| | |
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| Sec.1-2 | Short title, **definitions** |
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| 8 | **Realisation and repatriation** of foreign exchange |
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# FEMA Rules & Regulations

| | |
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| **Sec. 5, 46(2)(a)** | Restrictions for **current account transactions** |
| **FEM (Current Account Transactions) Rules, 2000** | |
| **Sec. 6(2)** | Specification of **permissible capital account transactions** |
| **FEM (Permissible Capital Account Transactions) Regulations, 2000** | |
| **6(3)(a)** | Prohibition/restriction/regulation of transfer or **issue of any foreign security by a person resident in India** |
| **FEM (Transfer or Issue of any Foreign Security) Regulations, 2000** | |
| **6(3)(b)** | Prohibition/restriction/regulation of **transfer or issued of any security by a person resident outside India** |
| **FEM (Transfer or Issue of Security by a Person resident Outside India) Regulations, 2000** | |
| **6(3)(c)** | Prohibition/restriction/regulation of transfer or **issued of any security by any branch, office or agency in India of a person resident outside India** |
| **FEM (Issue of Security in India by a branch, office or a person resident outside India) Regulations, 2000** | |
| **6(3)(d)** | Prohibition/restriction/regulation of any **borrowing or lending in foreign exchange** |
| **FEM (Borrowing or Lending in Foreign Exchange) Regulations, 2000** | |
| **6(3)(e)** | Prohibition/restriction/regulation of any **borrowing or lending in rupees** between a person resident in India and a person resident outside India |
| **FEM (Borrowing and Lending in Rupees) Regulations, 2000** | |
| **6(3)(f)** | Prohibition/restriction/regulation of **deposits between persons resident in India and persons resident outside India** |
| **FEM (Deposit) Regulations, 2000** | |
| **6(3)(g)** | Export, import or **holding of crrency or currency notes** |
| **FEM (Export & Import of Currency) Regulations, 2000** | |

| | |
|---|---|
| **6(3)(h)** | Prohibition/restriction/regulation of transfer of **immovable property outside India** other than short-term lease) by a person resident in India |
| **FEM (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2000** | |
| **6(3)(i)** | Prohibition/restriction/regulation of acquisition or transfer of **immovable property in India** (other than short-term lease) by a person resident outside India |
| **FEM (Acquisition and Transfer of Immovable Property in India) Regulations, 2000** | |
| **6(3)(j)** | Prohibition/restriction/regulation of giving of a **guarantee or surety** |
| **FEM (Guarantees) Regulations, 2000** | |
| **6(6)** | Prohibition/restriction/regulation of **establishment in India of a branch**, office or other place of business by a person resident outside India |
| **FEM (Establishment in India of Branch or Office or Other Place of Business) Regulations, 2000** | |
| **7(1)(a), 7(3)** | Declaration to be furnished by **exporter of goods and services** to RBI in prescribed form and in specified manner |
| **FEM (Export of Goods and Services) Regulations, 2000** | |
| **8,10(6)** | Time-limit for and manner of **realisation and repatriation of foreign exchange** due or accrued to a person resident in India |
| | **Surrender of unutilised foreign exchange** to authorised person within specified period |
| **FEM (Realisation, repatriation and surrender of foreign exchange) Regulations, 2000** | |
| **9(a), 9(e)** | Limits specified by RBI for **possession and retention of foreign currency/foreign coins**/foreign exchange by any person |
| **FEM (Possession and retention of foreign currency) Regulation, 2000** | |

| | |
|---|---|
| **9(b)** | Specification by RBI of resident persons who can hold or operate **foreign currency account**, and limits therefore |
| **FEM (Foreign currency accounts by a person resident in India) Regulations, 2000** | |
| **15(1), 46(2)(b)** | Officers authorised by Central Government for **compounding contravention**, and procedure for such compounding |
| **FEM (Compounding proceedings) Rules, 2000** | |
| **16(1), 46(2)(c)** | Appointment of **adjudicating Authority** and prescribing manner of holding inquiry by adjudicating Authority |
| **17(3), 46(2)(d)** | Form of appeal to **Special Director (appeals)** and fees payable |
| **19(2), 46(2)(d)** | Form of appeal to **Appellate Tribunal** and fees payable |
| **FEM (Adjudication Proceedings and Appeals) Rules** | |
| **39(ii), 46(2)(h)** | Prescribing authority or person competent to **authenticate documents** received for investigation of contraventions, from any place outside India, and manner of authentication |
| **FEM (Authentication of Documents) Rules, 2000** | |
| **46(2)(i)** | **Residual matters** in respect of which **Central Government** may make rules |
| **FEM (Encashment of Draft, Cheque, Instrument and Payment of Interest) Rules, 2000** | |
| **47(2)(h)** | **Residual matters** in respect of which **RBI can make regulations** |
| **FEM (Insurance) Regulations, 2000** | |
| **FEM (Remittance of Assets) Regulations, 2000** | |
| **FEM (Manner of Receipt & Payment) Regulations, 2000** | |
| **FEM (Investment in Firm or Proprietary Concern in India) Regulations, 2000** | |
| **FEM (Foreign Exchange Derivative Contracts) Regulations, 2000** | |
| **FEM (Offshore Banking Unit) Regulations, 2002** | |
| **FEM (Withdrawal of General Permission to Overseas Corporate Bodies (OCBs)) Regulations, 2000** | |

# Master Circulars - July 01 every year

- Foreign Investment in India
- Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad
- External Commercial Borrowings and Trade Credits
- Acquisition and Transfer of Immovable Property in India by NRIs-PIOs-Foreign Nationals of Non- Indian Origin
- Establishment of Liaison - Branch - Project Offices in India by Foreign Entities
- Opening of Branch-Subsidiary-Joint Venture-Representative office or Undertaking Investment Abroad by NBFCs
- Miscellaneous Remittances from India – Facilities for Residents
- Remittance Facilities for Non-Resident Indians - Persons of Indian Origin - Foreign Nationals
- Export of Goods and Services
- Import of Goods and Services
- Non-Resident Ordinary Rupee (NRO) Account
- Compounding of Contraventions under FEMA

# Frequently Asked questions – FAQs by RBI

- Foreign Investments in India
- Direct Investment by Residents in Joint Venture (JV)-Wholly Owned Subsidiaries (WOS) abroad
- Liberalised Remittance Scheme
- Acquisition and Transfer of Immovable Property in India by a person resident outside India
- Facilities for NRIs and PIOs Features of various Deposit Schemes available to Non-Resident Indians (NRIs)
- Account Opened by Foreign Nationals and Foreign Tourists Forex Facilities for Residents (Individuals)
- Compounding of Contraventions under FEMA, 1999 Exchange Earner's Foreign Currency (EEFC) Account
- Foreign Contribution Regulation Act

# Where to find the law - **Reference/Sources**

- Website of RBI: **rbi.org.in** for Master Circulars every year 1st July, FAQs, Circulars, Notification, Press Release, FEM Act.
- Website of **DIPP**: dipp.nic.in for **Consolidated FDI Policy**, Industrial Policy, policy, Circular, Press Notes/releases/Clarifications on FDI.
- Website of **FIPB**: finmin.nic.in/fipbweb for FIPB related matters.
- **FDI inflows: Subscribe to shakun.com Circulars**
- **ODI outflows: As per monthly release by RBI**

# Current Account Transactions

- Any transaction which is not a capital account transaction and includes:
  - Payment due in connection with **current business, trade, services, short term borrowings & credit facilities in normal course of business**
  - Payment of **interest** on loans
  - **Income/Dividend on investment**
  - Remittance of **living expenses** to parents/spouse/children
  - Expenses in connection with **foreign travel, education, medical etc**.

FEM (**Current Account Transactions**) **Rules**, 2000:

- **Schedule I**: Transactions for which **foreign exchange withdrawal is prohibited** e.g. lottery winnings, racing/riding etc. lottery tickets, banned /proscribed magazines, football pools, sweepstakes, etc. , commission towards equity investment in JVs// WoS abroad of Indian companies, Call Back Services" of telephones.
- **Schedule II**: Transactions **require approval of the Central Government** e.g. Cultural Tours (Ministry of Human Resources Development), hiring charges of transponders (Ministry of I&B)
- **Schedule III**: Transactions **require approval of Reserve Bank of India** – private visits abroad (exceeding US$ 10,000), Gifts, Donations (exceeding US$ 5,000) Going abroad for employment (exceeding USD 100,000), Maintenance of close relatives abroad, Business travel,, medical treatment abroad, Consultancy services, reimbursement of pre-incorporation expenses

FEM (**Export of Goods and Services**) Regulations, 2000

# Capital Account Transactions

- Any transaction:
- which **alters the assets or liabilities outside India of persons resident in India** or
- which **alters assets or liabilities in India of persons resident outside India**
- Including transactions referred to in section 6(3) of FEMA.

**Section 6(3) – RBI may by regulations, prohibit, restrict or regulate:**

- Transfer or issue of any
  - **foreign security** by a person resident in India
  - **security by a person resident outside India**
  - **security or foreign security by any branch, office or agency in India of a person resident outside India**
- Any **borrowing or lending in foreign exchange**
- Any **borrowing or lending in rupees between a person resident in India and a person resident outside India**
- **Deposits** between person resident in Indian and person resident outside India
- Export, import or holding of **currency or currency notes**
- Acquisition and transfer of **immovable property** other than a lease not exceeding five years,
  - **outside India** by a person resident in India
  - **in India** by a person resident outside India
- Giving a **guarantee or surety** in respect of any debt, obligation or other liability incurred
  - **by a person resident in India** and owed to a person resident outside India
  - **by a person resident outside India**

# Prohibited transactions

Para 4 of the FEM (**Permissible Capital Account Transactions**) Regulations, 2000

- For person resident outside India **investment in India**, in any form ,in any company, firm or proprietary concern or any other entity which is or proposed to be engaged in :
  - **Chit fund**
  - **Nidhi co.**
  - **Agricultural and plantation activities**
  - **Real estate business or construction of farm houses**
  - **Trading in TDRs** means certificates issued in respect of category of land acquired for public purpose either by Central or State Government in consideration of surrender of land by the owner without monetary compensation, which are transferable in part or whole**.**

- For person resident in India **investment outside India** in the business of:
  - Banking
  - Real estate.

# Person resident in India means

(*i*) a person residing in India **for more than one hundred and eighty-two days during the course of the preceding financial year** but does **not include:**

(*A*) a **person who has gone out of India or who stays outside India**, in either case

- (*a*) for or on **taking up employment outside India**, or
- (*b*) for **carrying on outside India a business or vocation outside India**, or
- (*c*) **for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period**;

(*B*) a person **who has come to or stays in India, in either case, otherwise than**

- (*a*) for or on **taking up employment in India**, or
- (*b*) for **carrying on in India a business or vocation in India**, or
- (*c*) **for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period.**

# Person resident in India means

**To be treated as a person resident in India, a person has not only to satisfy the condition of the period of stay (being more than 182 days during the preceding financial year) but has to also comply with the condition of the purpose/intention of stay.**

(*ii*) any person or **body corporate registered or incorporated in India**,

(*iii*) an **office, branch or agency in India owned or controlled by a person resident outside India**,

(*iv*) **an office, branch or agency outside India owned or controlled by a person resident in India**.

# Change of residential status

**Change of residential status from resident outside India to resident in India**

As per section 6(4) of FEMA, a **person resident in India** may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India **or** inherited from a person who was resident outside India.

**Change of residential status from resident in India to resident outside India**

As per section 6(5) of FEMA, a **person resident outside India** may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India **or** inherited from a person who was resident in India.

**Any fresh investments** in shares or expansion of the activities of the companies in which investment is made would be subject to the prevailing sectoral FDI cap and conditionalities. Further, sale proceeds of the assets would have to be deposited in the NRO Account and disposal thereof would be as per the applicable guidelines.

# Options for Foreign Entity/Person for Business Activities/ Investments in India

- **Company** (including section 25 (Not-for-profit) under Companies Act, 1956, as Joint Venture or Wholly of Subsidiary
- Limited Liability Partnership under **LLP** Act
- Partnership **Firm / Proprietary** ship firm.

  **By NRI and PIO:**

  - **On non-repatriation basis**: Not engaged in any agricultural/plantation or real estate business or print media sector
  - **On repatriation basis**: Subject to prior permission of RBI in consultation with the Government of India. **Generally not permitted by FIPB.**

  **Other than NRIs/PIO:**

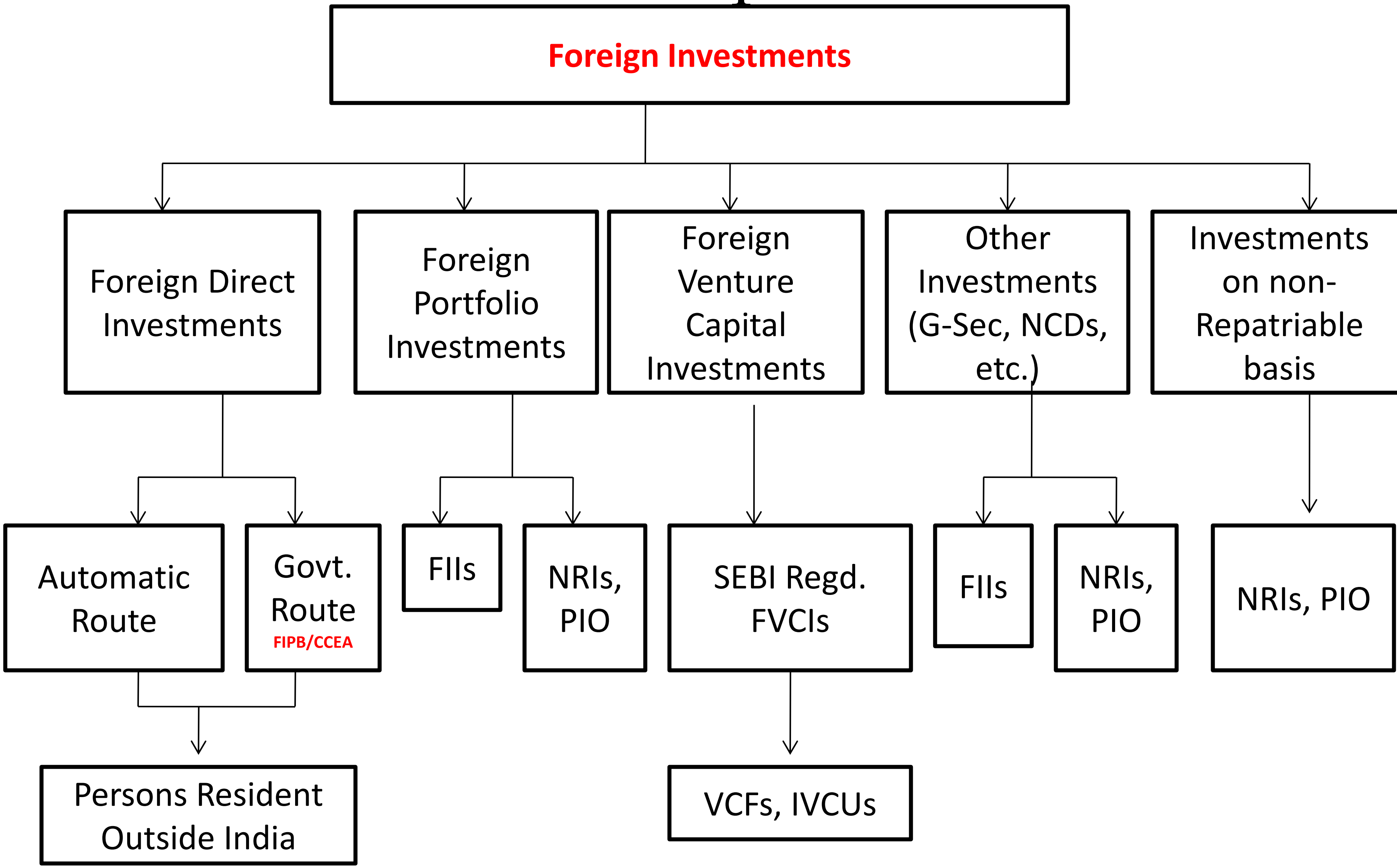
  - Prior approval of Reserve Bank in consultation with the Government of India. **Generally not permitted by FIPB**

- **Trust** under trust Act. FDI in Trusts other than VCF is not permitted.
- **FDI in other Entities**: Not permitted e.g. HUF, AOPs.
- **Liaison** Office / Representative Office or a **Project Office** or a **Branch Office** to undertake permitted activities.

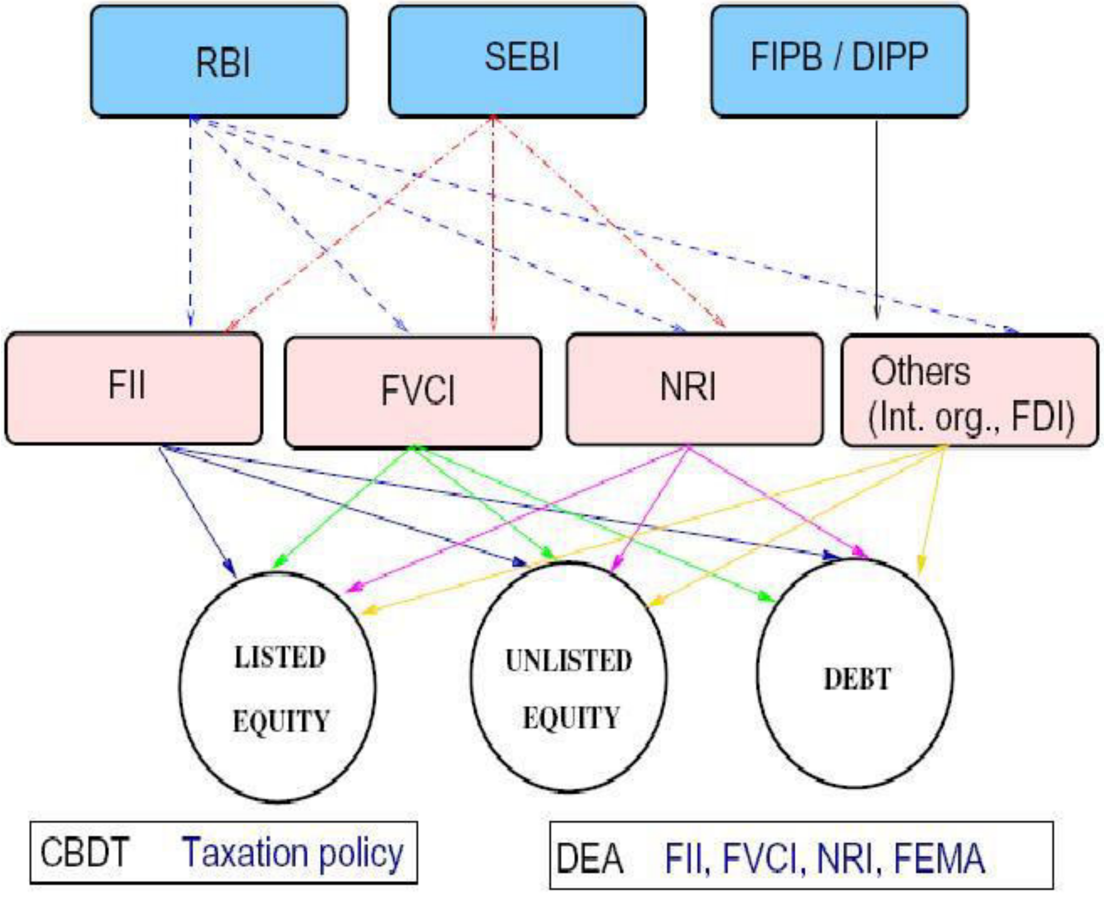
# Legal Forms of Overseas Business Activities/Investments

- **Corporation/** Limited Liability Companies / Limited Life Companies
- Limited Liability Partnership ('LLP') / Partnership Firms /Protected Cell Companies
- **Branch Office/Representative Office abroad**
- **NBFC** under **NBFC (Opening of Braanch/Subsidiary/JV/Representative Office or Undertaking Investment Abroad) Directions 2011**
- **Trusts:** Trust, as an offshore entity, is widely used in **management of private wealth of high net worth individuals** and for **estate planning** (in the countries where estate duty/gift tax/ inheritance tax exists). These are also widely used **for asset protection purposes**. The main characteristic of a trust is that it allows **separation of legal and beneficial ownership** amongst a number of individuals. These individuals are the Settlers who transfer legal ownership (title) of the assets to Trustee who hold and administer the assets solely for the Beneficiaries of the Trust in accordance with instructions from the Settlers as specified in the Written Trust Document. There are several types of Trusts each one having distinct uses e.g. the **Family Trust** (which is sued to maintain a Family' wealth), the **Charitable Trust** (used for charitable purposes), the **Testamentary Trust** (used to distribute assets after one's death), **Asset Protection Trust** (used to protect the assets from potential future claims of creditors) etc. Trust could be **discretionary trust or specific trust**.

# Foreign Investment in India- Schematic Representation



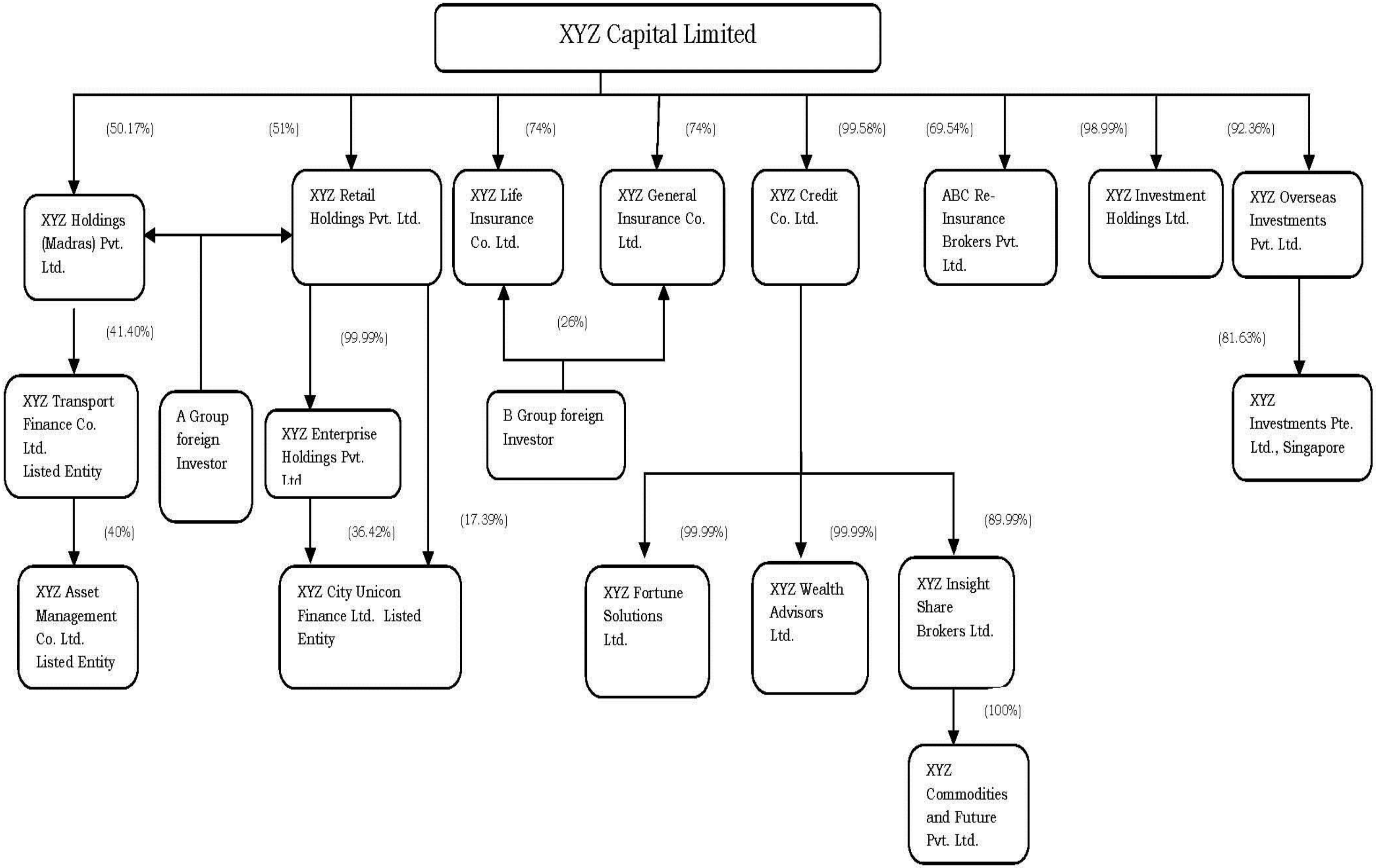
# Administrative jurisdiction



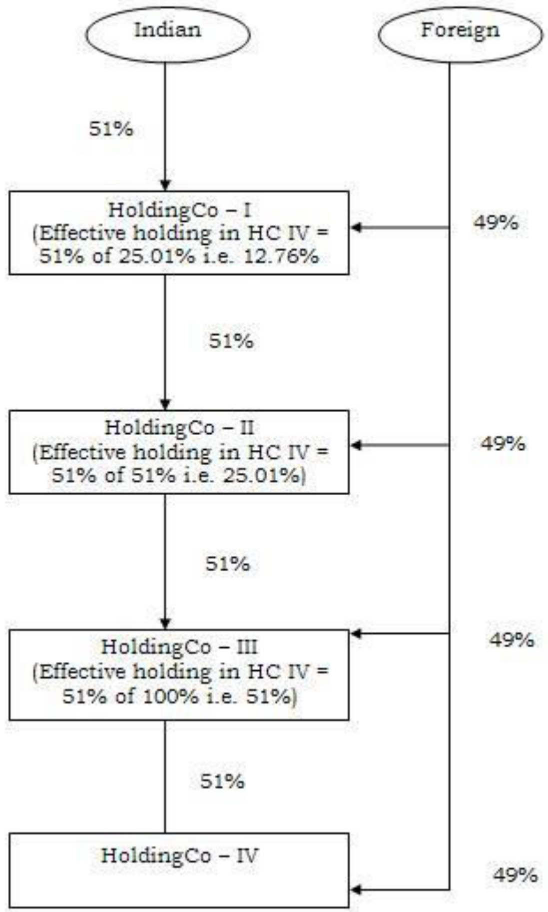
# Inward and Outbound investments
# 4 Indian sample companies by Random

| Company Name | | Holding %age | Domestic Subsidiaries + Overseas Subsidiaries |
|---|---|---|---|
| **Infosys Ltd** | Foreign holding: % | | 3 + 11 |
| | Under FDI Scheme | Nil | |
| | Under Portfolio Investment Scheme - FIIs, NRIs | 43.45 | |
| | others | Nil | |
| **Mahindra & Mahindra Ltd.** | Foreign holding: % | | 55 + 56 |
| | Under FDI Scheme | 0.12 | |
| | Under Portfolio Investment Scheme - FIIs, NRIs | 25.54 | |
| | others | 3.41 | |
| **Ranbaxy Laboratories Ltd.** | Foreign holding: % | | 8 + 38 |
| | Under FDI Scheme | 64.88 | |
| | Under Portfolio Investment Scheme - FIIs, NRIs | 9.02 | |
| **Crompton Greaves Ltd.** | Foreign holding: % | | 4 + 31 |
| | Under FDI Scheme | Nil | |
| | Under Portfolio Investment Scheme - FIIs, NRIs | 21.68 | |
| | others | 1.24 | |

# Annexure 4
## Structure chart of the Indian Company and Subsidiaries of the Indian Company

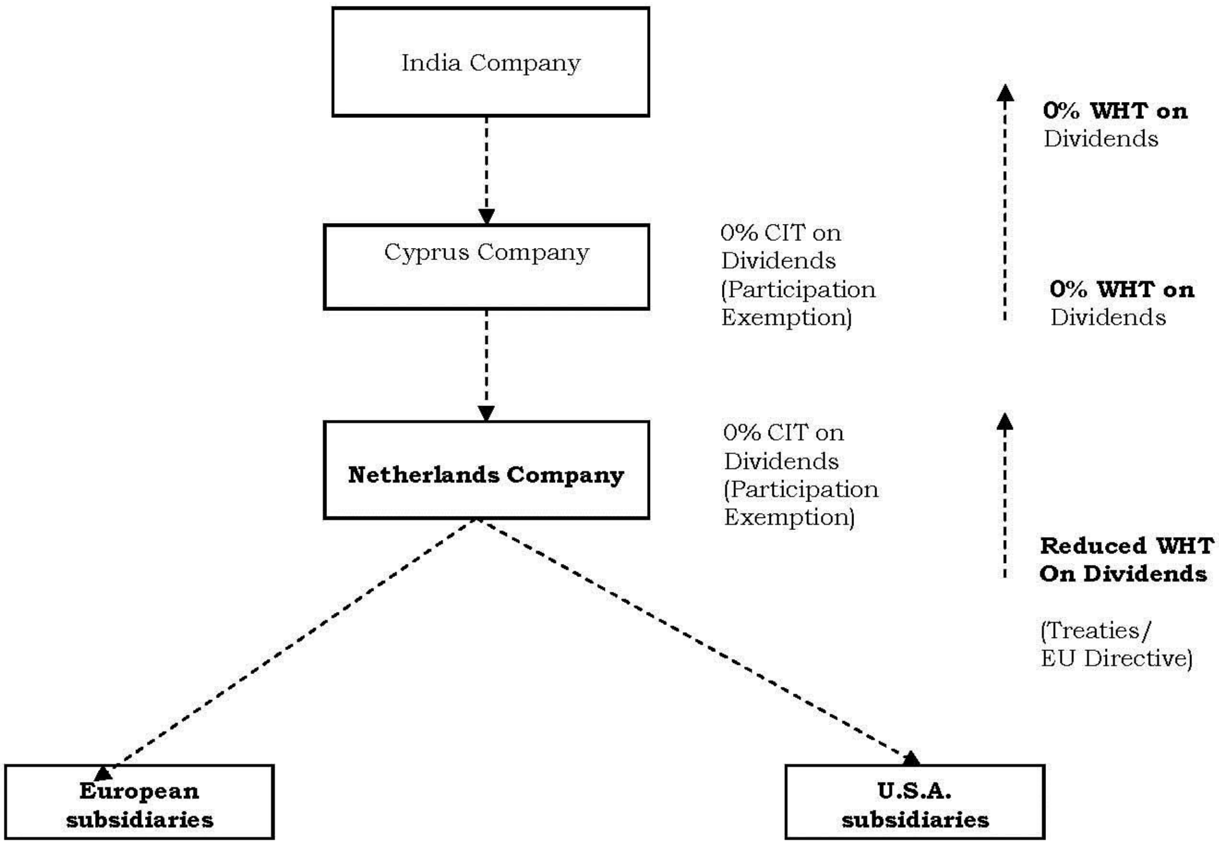


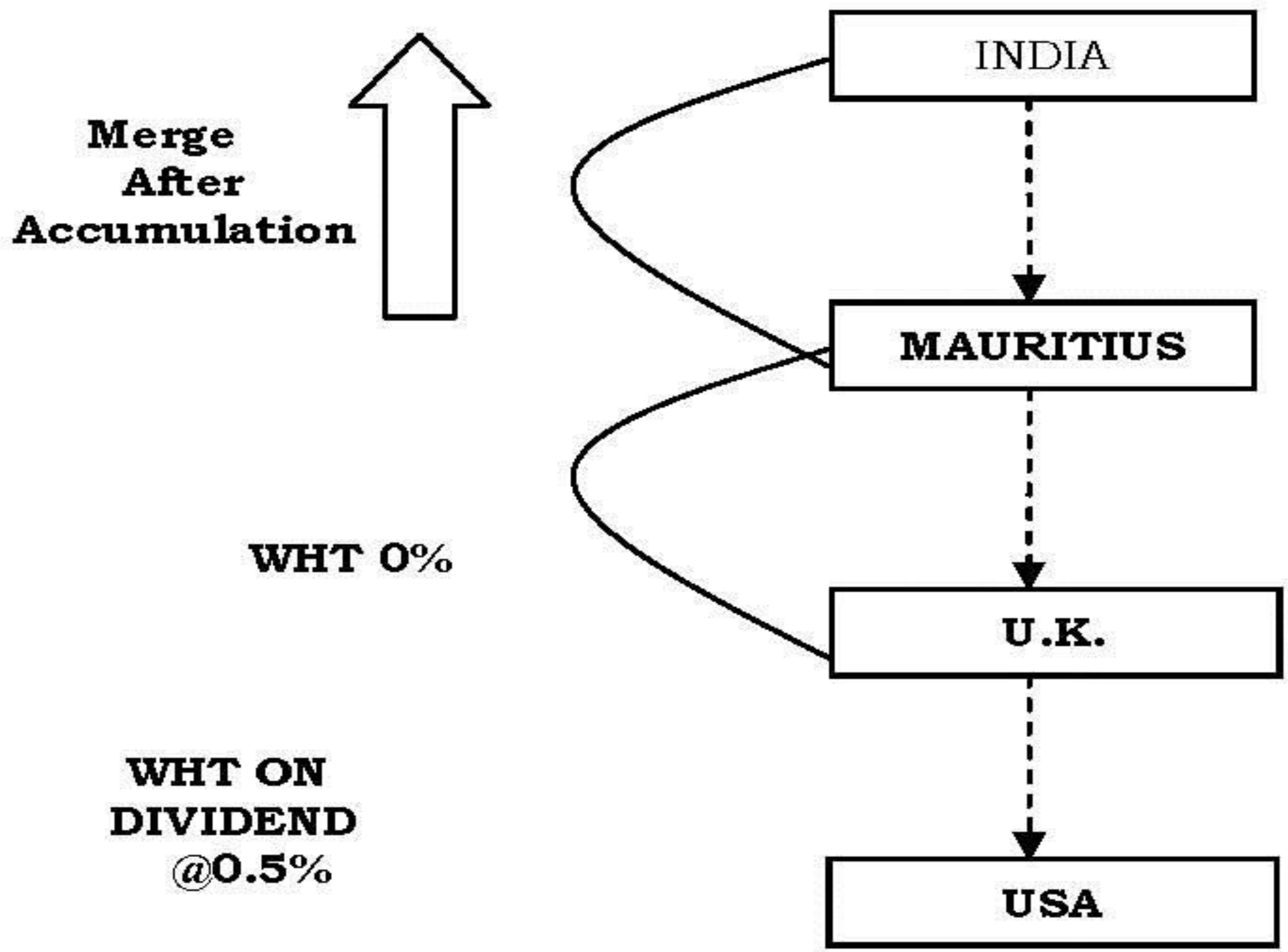
# Illustration
# Four layered foreign holding



**Effective foreign holding in HC-IV through:**

| | | |
|---|---|---|
| HoldingCo IV | (49% of 100%) | 49.00% |
| HoldingCo III | (49% of 51%) | 24.99% |
| HoldingCo II | (49% of 25.01%) | 12.25% |
| HoldingCo I | (49% of 12.76%) | 6.25% |
| Total effective foreign: Holding in HoldingCo -IV | | 92.49% |


India Company
Cyprus Company
Netherlands Company
European subsidiaries
U.S.A. subsidiaries
0% CIT on Dividends (Participation Exemption)
0% CIT on Dividends (Participation Exemption)
0% WHT on Dividends
0% WHT on Dividends
Reduced WHT On Dividends
(Treaties/ EU Directive)


Merge
After
Accumulation
WHT 0%
WHT ON
DIVIDEND
@0.5%
INDIA
MAURITIUS
U.K.
USA

# Annual statement of assets & Liabilities

- Capture the statistics relating to Foreign Direct Investment, **both inward and outward**
- Submitted by **July 15 of every year** to the Reserve Bank of India, Mumbai
- To be submitted by all Indian companies which have **received FDI and/or made FDI abroad** in the **previous year(s) including the current year**
- **Coverage:**
  - **Methodology for valuation of foreign liabilities and foreign assets**
  - **Nature of activities principal line of business as %, with NIC code**
  - **Name & country of non-resident investor under FDI**
  - **Financial derivatives, Money market instruments**
  - **Trade credits, loans, Bonds and notes**
  - **ODI and Portfolio investment overseas**
  - **Contingent foreign liabilities**
  - **Disinvestments in India and Abroad**

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# RBI Complains After Getting Lost in Foreign Arms Maze

## Asks govt for a clear overseas investment policy, says multi-layered structure a concern

**DEEPSHIKHA SIKARWAR**
NEW DELHI

The Reserve Bank has asked the government to frame a policy on overseas investments to prevent Indian companies from setting up operations in tax havens through a complex maze of subsidiaries.

The central bank, which decides on overseas investments in investing companies on a case-by-case basis, has written to the North Block, highlighting its concern after an exhaustive study of overseas investments of Indian companies.

"The RBI is concerned about multi-layered structures as they make tracking funds flow very difficult," a source said.

The central bank has raised two objections, both related to setting up of special purpose vehicles, or SPVs, which are used to make onward investments in other countries. One, these SPVs float opaque structures, such as trusts, in tax havens. Two, they leverage domestic assets to give guarantees without informing RBI as required under the Foreign Exchange Management Act, or FEMA. There have also been cases where the Indian parent gave guarantees to its subsidiary abroad to enable it to borrow from foreign banks. Such unmonitored borrowings can create systemic risk, the RBI says.

The central bank, therefore, wants the government to restrict SPVs that have multiple tiers below them. Sources said the central bank has already become strict with companies when they come for approval to invest overseas. In a specific case, it told a company to collapse its multi-layered structure into two tiers before approving its proposal.

Indian companies can invest up to 400% of their net worth in overseas subsidiaries. RBI's approval is not required if the second-level entity is an operating company. In May, the RBI had mandated that the parent company should own more than half of step-down operating subsidiary to be able to offer guarantee. But a number of companies have tried to get around the rule by floating SPVs, or holding companies, instead of operating company.

"Having a multi-tiered structure overseas helps in better planning of taxes in overseas jurisdictions, as it improves valuations for Indian shareholders. Therefore, the RBI and the government should consider creating a more enabling environment," said Akash Gupt, partner, PwC.

The new companies bill seeks to bar investment companies from having more than two tiers of subsidiaries, but it is not clear if this proposal will apply overseas.

Multi-layered structures, especially through SPVs in tax havens, have come under the scanner, particularly after the inquiry into the Indian Premier League revealed a complex web of companies to route funds.

Tax authorities fear these opaque structures may be used to take Indian funds out and bring them back into India through tax havens to avoid tax.

The central board of direct taxes, or CBDT, has proposed a new regime called Controlled Foreign Corporations in the new Direct Taxes Code to ensure that tax due to the exchequer is not lost.

Under this regime, the undistributed dividends of foreign corporations controlled or owned by Indian companies will be added to the parent's income and taxed in India.

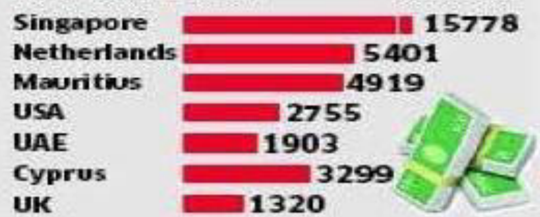
### Foreign Journey So Far

**Indian companies** are allowed to invest overseas 400 times their networth

**Subject to** conditions they can leverage assets in India to borrow overseas

**Investments are** routed through SPVs or subsidiaries

**Overseas investments by Indian cos**
(2007-08 to 2009-10) ($ million)



# Penalties/ Compounding

- Up to **thrice the sum involved** in such contravention where such amount is **quantifiable**, or up to **two lakh rupees where the amount is not quantifiable**, and where such contravention is a **continuing o**ne, further penalty which may extend to **five thousand rupees for every day** after the first day during which the contravention continues.

- **Compounding of Contraventions under FEMA, 1999:** Contravention of FEMA Act, and rules/ regulations/ notification/ orders/ directions/ circulars issued there under.
- A **voluntary process** of **an admitted contravention.**
- **Willful, malafide and fraudulent transactions are, however, viewed seriously, which will not be compounded by the Reserve Bank.**
- When: Made aware by **RBI or FIPB or any other statutory authority or the auditors or suo moto**.

- Procedure: Apply in prescribed form. Completed submitted to the Chief General Manager, **CEFA**, Reserve Bank of India, Mumbai along with demand draft for **Rs. 5000** favouring "Reserve Bank of India" payable at Mumbai.

- **Delegated powers to the Regional Offices of the RBI** to compound the contraventions of FEMA involving (i) delay in reporting of inward remittance, (ii) delay in filing of form FC-GPR after allotment of shares and (iii) delay in issue of shares beyond 180 days (viz. paragraphs 9(1)(A), 9(1)(B) and 8, respectively, of the Schedule I to FEM 20 RBI Circular 57 dated 13.12.2011.

# Penalties/ Compounding

- Where case is pending under the investigation of the Directorate of Enforcement or the authority instituted under Prevention of Money Laundering Act, 2002, no compounding.

- **All requisite approvals should be obtained and compliances should be completed before seeking compounding of contravention.**

- Compounding can be done only after rectifying the records by way of obtaining **post-facto approvals or unwinding the transactions in cases where such transactions are not permissible under FEMA, 1999.**
- The Reserve Bank (CEFA) makes a **prima-facie scrutiny**. Applications with **incomplete details** or **where the contravention is not admitted will be returned to the applicant.**

- If contravention is **technical, material** or **sensitive in nature: Issue a cautionary advice.**

- If the contravention is **material: Imposing a penalty**.

# Thank You

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