De Jure

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Compounding – Beat the Breach

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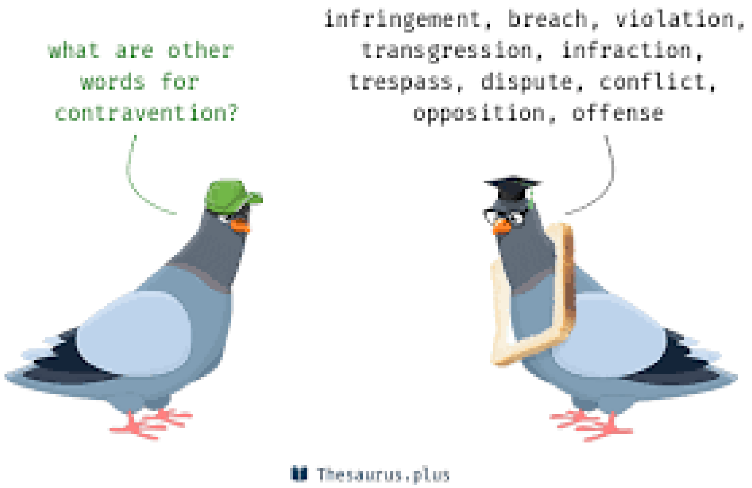
The emphasis of erstwhile Foreign Exchange Regulation Act (**FERA**), as the name implies, was to regulate foreign exchange and even small infractions under FERA was a criminal offence, punishable with imprisonment. This was too draconian. With the onset of liberalization, need was felt to replace FERA with liberal set of foreign exchange management regulations

Foreign Exchange Management Act (**FEMA**), 1999 was introduced with the aim to consolidate and amend the laws relating to foreign exchange with the objective to facilitate external trade and payments and to promote the orderly development and maintenance of foreign exchange market in India.

In today's world, the chances of individuals and business enterprises dealing in foreign exchange either directly or indirectly is high. The provisions of FEMA triggers when an individual or business enterprise imports from or exports to other countries goods and/or services or makes investments abroad or deals in foreign exchange. It is therefore essential to understand what constitutes foreign exchange. The term has been defined in FEMA to mean foreign currency and to include, deposits, credits and balances payable in any foreign currency, drafts, travellers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency or drawn by banks, institutions or persons outside India, but payable in Indian currency.



The term contravention though not defined in FEMA is generally understood as any breach of the provisions of FEMA, the rules, regulations, notification, orders, directions, circulars issued thereunder.

This technically means that one should ideally have a fair understanding of provisions of FEMA, the rules, regulations, notification, orders, directions, circulars which are issued from time to time under FEMA, in order to be FEMA compliant. A close look at the provisions of FEMA read together with the Rules, Regulations, Circulars, Notifications reveal the enormity and complexity of procedural compliance, which the business entities may not be even aware of.

As far as entity dealing in foreign exchange is concerned, the exchange management laws in India requires such entity to adhere to various provisions and compliances prescribed thereunder. While some of these are one time compliances (*like taking approvals of the statutory authority, fulfilling the conditions prescribed at the time of granting of approvals, intimation requirements and filing of prescribed forms*), few other compliances are required to be done on periodical or annual basis (*like filing of annual performance report, annual activity certificate, approvals from time to time*). There are also certain compliances which are transaction based compliances.

In the event, an entity is, knowingly or unknowingly, in contravention of the provisions of the exchange management laws in India (*including notification, circular, conditions set out in the approval letter*), then the RBI is vested with powers to initiate proceedings against such entity and levy penalty. The penalty can be levied is almost 3 times the amount involved in the contravention.

From the data available in public domain it is observed that a majority of the cases of contraventions are in relation to advance reporting. Delay in filing or non-filing of AAC, APR, FC-GPR, FC-TRS, non-submission of ECB statements, non-reporting or delay in reporting of acquisition, setting-up of subsidiaries or step down subsidiaries or change in the shareholding pattern, non-allotment of shares or allotment or refund after the stipulated time period are few contraventions under FEMA.

While FEMA contraventions are dealt with under the civil law procedure and the Reserve Bank of India (**RBI**) is authorized to compound contraventions under all the sections, except contraventions under Section 3(a) of FEMA.

Compounding refers to the process of voluntarily admitting the contravention, pleading guilty and seeking redressal. Compounding is not a legal proceeding. It is more like voluntary disclosure which helps in regularizing the contravention for a lesser compounding fee as against the penalty for the contraventions which can be upto three times the sum involved in such contravention where the amount of contravention is quantifiable. Where the amount is not quantifiable up to two lakh rupees, and where such contravention is a continuing one, further penalty can be levied till the contravention continues.

A person can *suo moto* file a Compounding Application with the relevant authority or on being notified of any contravention either by the RBI and/or any other statutory authority, provided a similar contravention has not been compounded in the last three years. Wilful, mala fide and fraudulent transactions or contravention suspected of money laundering, terror financing, serious infringement of the regulatory framework or issues affecting sovereignty and integrity of the nation are also not compounded by the RBI.

After the application is submitted, the Competent Authority decides whether the contravention is of a technical, material or sensitive nature. The applicant gets an opportunity to appear in person for a hearing before the adjudicating authority. While the RBI encourages the applicant to appear for the personal hearing, the same is completely discretionary. Even if the applicant does not appear for personal hearing, this does not adversely affect the decision of the adjudicating authority while determining the penalty.

Once the adjudicating authority passes the Compounding Order, the applicant is required to pay the compounding fees within a period of 15 days from the date of the order. In case, the applicant cannot or fails to pay the compounding fees, the matter may then be referred to the Directorate of Enforcement.

FEMA requires all capital account and current account transactions to be routed through the Authorized Dealers (ADs). While the AD has an important role to play in relation to foreign exchange transactions, the role of every person who, at the time the contravention was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company is also essential. In the event such persons are found guilty of the contravention, proceedings can be initiated against then and they can be punished accordingly.

By taking certain timely steps the contraventions can be regularized and also the repercussions of the contraventions and the quantum of penalty to an extent can be reduced.

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