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ANALYSIS OF RECENT COMPOUNDING ORDERS

An analysis of some interesting compounding orders passed by the Reserve Bank of India in the period March to June, 2019 and uploaded on the website¹ is given below. This article refers to regulatory provisions as existing at the time of offence. Changes in regulatory provisions are noted in the comments section.

FOREIGN DIRECT INVESTMENT (FDI)

A. M/s. Shri Naveen Trehan

Date of order: 1st March, 2019

Regulation: FEMA 20/2000-RB Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000

ISSUE

1. Purchase of equity shares of an Indian company by an NRI through a resident savings bank account.

FACTS

The NRI acquired equity shares of an Indian company from an individual resident in India.

On 28th January, 2016 the NRI buyer issued a cheque drawn on HDFC Bank in favour of Indian resident individuals towards payment of the sale consideration.

The said amounts were paid through the resident savings bank account of the NRI maintained with HDFC Bank.

However, the NRI got converted his ordinary resident savings account into an NRO account; the Foreign Investment Division (FID) of FED advised the AD Bank to let the NRI know that his investment is being treated as non-repatriable.

Regulatory Provisions

Paragraph 3 of schedule 4 of Notification No. FEMA 20/2000-RB states that the amount of consideration for purchase of shares or convertible debentures of an Indian company on non-repatriation basis shall be paid by way of inward remittance through normal banking channels from abroad or out of funds held in NRE/FCNR/NRO/NRSR/NRNR account maintained with an authorised dealer or as the case may be with an authorised bank in India.

Regulation 5(3) (ii) of Notification No. FEMA 20/2000-RB states that a non-resident Indian or an overseas corporate body may purchase shares or convertible debentures of an Indian company on non-repatriation basis other than under Portfolio Investment Scheme, subject to the terms and conditions specified in schedule 4.

Contravention

| Relevant para of FEMA 20 Regulation | Nature of default | Amount involved (in rupees) | Time period of default |
|--|--|-----------------------------|--|
| Para 3 of schedule 4 read with regulation 5(3) (ii) of this regulation | Purchase of equity shares of an Indian company by an individual pursuant to becoming a Non-Resident Indian (NRI) through a resident savings bank account | Rs. 39,00,000 | 15 th April, 2015 to 26 th April, 2018 |

Compounding penalty

A compounding penalty of Rs.75,350 was levied.

Comments

Under provisions of FEMA, once an Indian resident becomes non-resident, his Indian savings bank account will be designated as NRO bank account. However, the balance lying in this NRO bank account cannot be utilised for buying shares of an Indian company either on repatriation or non-repatriation basis.

The said funds can be utilised for undertaking permissible transactions in the nature of local payments, transfers to another NRO account, remittance of current income outside India net of applicable taxes, etc., as permitted by the Foreign Exchange Management (Deposit) Regulations, 2016.

B. M/s. Celon Laboratories Private Limited

Date of order: 15th March, 2019

Regulation: FEMA 20/2000-RB Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000

ISSUE

1. Received consideration amount from third party for the allotment of shares to NRI on non-repatriation basis.
2. Transfer of repatriable shares issued to non-resident to another non-resident on non-repatriation basis.

FACTS

The applicant, an NRI, was allotted equity shares on non-repatriation basis, whereas the consideration of those shares was received from DNA Biotec Limited, a resident Indian company on behalf of the NRIs.

Further, NRIs were also allotted equity shares of an Indian company on repatriation basis. These shares were subsequently transferred to another NRI without any consideration and on non-repatriation basis.

Regulatory Provisions

Regulation 4 of Notification No. FEMA 20/2000-RB which states that remittance has to be received from the same person to whom shares are to be allotted.

Once shares are issued on repatriation basis, the same cannot be converted into non-repatriation basis.

Contravention

| Relevant para of FEMA 20 Regulation | Nature of default | Amount involved (in rupees) | Time period of default |
|--|--------------------------|------------------------------------|-------------------------------|
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|-----------------|---|---|---|
| Regulation 4 | <p>Issue 1: Receiving consideration amount from third party for the allotment of shares to resident outside India on non-repatriation basis</p> <p>Issue 2: Transfer of shares to non-resident under non-repatriation, which were originally held on repatriation</p> | <p>Issue 1: Rs. 1,07,25,000</p> <p>Issue 2: Rs. 71,68,340</p> | <p>Issue 1: 10 years, 3 months, 7 days approximately</p> <p>Issue 2: 8 years, 6 months, 1 day approximately</p> |
|-----------------|---|---|---|

Compounding penalty

A compounding penalty of Rs. 2,15,470 was levied.

Comments

Under provisions of FEMA, extreme care needs to be taken that entity / person to whom shares are issued is the same as the one who has paid consideration and shares cannot be issued on behalf of anyone. Care also needs to be taken for ensuring that once shares are issued on repatriation basis, the same cannot be transferred on non-repatriation basis.

C. M/s. Ibiz Consultancy Services India Pvt. Ltd.

Date of order: 13th March, 2019

Regulation: FEMA 20/2000-RB Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000

ISSUE

Taking on record the transfer of shares in the books of the company without certified FC-TRS.

FACTS

The company has taken the transfer of 40,000 shares on record without certified Form FC-TRS.

Form FC-TRS was submitted for certification to the AD Bank on 14th August, 2015, whereas the company has taken the transfer of shares on record 18 days prior to filing of Form FCTRS with AD Bank

Regulatory Provisions

Regulation 4 of Notification No. FEMA 20/ 2000-RB which states that Indian company will record share transfer only upon receipt of Form FC-TRS acknowledged by AD Bank

Contravention

| Relevant para of FEMA 20 Regulation | Nature of default | Amount involved (in rupees) | Time period of default |
|-------------------------------------|--|-----------------------------|------------------------|
| Regulation 4 | Taking on record the transfer of shares in the books of the company without certified FC-TRS | Rs. 4,00,000 | 18 days approximately |

Compounding penalty

Compounding penalty of Rs. 10,080 was levied.

Comments

Any Indian company having non-resident shareholders should ensure that any share transfer between resident and non-resident is not taken on record without receiving Form FC-TRS duly acknowledged by AD Bank.

D. Vijay P Uttarwar

Date of order: 12th April, 2019

Regulation: FEMA 20/2000-RB Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000

ISSUE

Transfer of shares of Indian company by way of gift by a resident to non-resident without RBI approval.

FACTS

An Indian resident individual transferred 2,50,000 equity shares of Re. 1 each of an Indian company as gift to a non-resident on 31st March, 2016 without obtaining prior RBI approval.

Post-facto approval was granted by RBI on 12th March, 2018.

Regulatory Provisions

Regulation 10A(a) of Notification No. FEMA20/2000-RB which provides that transfer of shares by way of gift from resident to non-resident is subject to prior RBI approval.

Contravention

| Relevant para of FEMA 20 Regulation | Nature of default | Amount involved (in rupees) | Time period of default |
|-------------------------------------|--|-----------------------------|------------------------|
| Regulation 10A(a) | Transfer of shares by way of gift by a resident to non-resident without RBI approval | Rs. 2,50,000 | 2 years approx. |

Compounding penalty

Compounding penalty of Rs. 51,375 was levied.

Comments

Transfer of shares by an Indian resident to non-resident by way of gift requires prior RBI approval both under earlier FEMA 20 regulation as well as revised FEMA 20(R), dated 7th November, 2017.

E. Ramasubramanian Balasubramanian

Date of order: 12th April, 2019

Regulation: FEMA 20/2000-RB Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000

ISSUE

Transfer of shares by way of gift by a resident to a non-resident without RBI approval.

FACTS

The applicant is an NRI and is also a promoter / director of an Indian company, viz., IBIZ Consulting Services India Pvt. Ltd.

The applicant transferred 40,000 shares held by him in the Indian company to IBIZCS Group Pte. Ltd, Singapore (a non-resident entity) for a consideration of Rs. 4,00,000 on 9th July, 2015.

Transfer of shares by an NRI to an NR was not a permitted transaction under automatic route during the said period.

Regulatory Provisions

Regulation 9(2)(ii) of Notification No. FEMA 20/2000 states that an NRI can transfer shares of an Indian company by way of gift or sale only to another NRI.

Hence, NRI cannot transfer shares of an Indian company to another person resident outside India.

Contravention

| Relevant para of FEMA 20 Regulation | Nature of default | Amount involved (in rupees) | Time period of default |
|--|--|-----------------------------|------------------------|
| Regulation 9(2)(ii) read with Regulation 3 of FEMA 20. | Transfer of shares by way of gift by an NRI to non-resident without RBI approval | Rs. 4,00,000 | 2 years and 4 months |

Compounding penalty

Compounding penalty of Rs. 52,400 was levied.

Comments

It is interesting to note that earlier Notification No. FEMA 20 provided that NRI could transfer shares only to another NRI and not to any other person resident outside India without prior RBI approval. The revised Notification No. FEMA 20(R) permits an NRI to transfer shares to any other person resident outside India, including an NRI.

OVERSEAS DIRECT INVESTMENT (ODI)**F. Aricent Technologies (Holdings) Limited****Date of order: 15th April, 2019****Regulation: FEMA 20/2000-RB Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2004****ISSUE**

Making Overseas Direct Investment (ODI) in an entity with an already existing Foreign Direct Investment (FDI) structure.

FACTS

The applicant, an Indian company, acquired the shares of a Mauritian company, Aricent Mauritius Engineering Services PCC (Aricent Mauritius), from its existing shareholders.

The total amount remitted by the applicant to the existing shareholders for acquiring equity participation of 50.28%, amounted to USD 9,00,00,000 (Rs. 572,58,60,000).

However, Aricent Mauritius was already holding investment in an existing Indian company, Aricent Technologies Private Limited, India (Aricent India) when ODI was made by the applicant Indian company.

The resultant structure amounted to making ODI in an entity with pre-existing FDI, which is not permitted without the prior approval of RBI.

The entire structure, i.e., FDI and ODI, was unwound before compounding application was filed.

Regulatory Provisions

Regulation 5(1) read with Regulation 13 of Notification No. FEMA 120/2004-RB ('FEMA 120').

Contravention

| Relevant para of FEMA 120 Regulation | Nature of default | Amount involved (in rupees) | Time period of default |
|--------------------------------------|-------------------|-----------------------------|------------------------|
| | | | |

| | | | |
|--------------------|--|----------------------|------------------------------|
| Regulation 5(1) | Making Overseas Direct Investment (ODI) in a company with an already existing Foreign Direct Investment (FDI) structure | Rs. 572,58,60,000 | Three years, one month |
|--------------------|--|----------------------|------------------------------|

Compounding penalty

Compounding penalty of Rs. 3,72,68,090 was levied.

Comments

It is interesting to note that existing Regulation FEMA 120 governing outbound investment does not specifically mention that ODI is not allowed in an entity which has FDI structure. Further, in the instant case, RBI has specifically mentioned in the compounding order that the entire structure, i.e., both FDI and ODI, was wound up before compounding application was considered indicates that if both FDI and ODI are existing in one structure, RBI may not compound the same unless it is unwound. Besides, in the revised FAQs on ODI published by RBI in May, 2019, a specific answer has been provided that FDI and ODI in one structure is not permissible under existing ODI regulations.

Hence, care needs to be taken to ensure that even in cases where an Indian entity is buying stake from existing investors of a foreign company, the foreign company should not have any FDI in India to avoid FDI and ODI in one structure.

ACQUISITION AND TRANSFER OF IMMOVABLE PROPERTY

G. Mr. Sha Mathew

Date of order: 8th March, 2019

Regulation: FEMA 21/2000-RB Foreign Exchange Management (Acquisition and Transfer of Immovable property in India) Regulations, 2000

ISSUE

Acquisition of immovable property in India by an NRI without RBI permission.

FACTS

The applicant, Mr. Sha Mathew, an NRI, acquired two agricultural properties in Kerala in the year 2012 without obtaining prior permission from the Reserve Bank of India.

The immovable properties were acquired for a total consideration of Rs. 16,38,700.

Regulatory Provisions

Regulation 8 of Notification No. FEMA-21/2000-RB dated 3rd May, 2000 provides that an NRI is not eligible to purchase any agricultural property in India. Accordingly, the NRI was advised to transfer the property to any resident person within six months and not to repatriate the sale proceeds outside India without prior permission of the RBI.

Contravention

| Relevant para of FEMA 21/2000 Regulation | Nature of default | Amount involved (in rupees) | Approx. Time period of default |
|--|---|-----------------------------|--|
| Regulation 8 | Purchase of immovable property, being agricultural land, by an NRI without RBI permission | Rs. 16,38,700 | 05 years, 10 months, 04 days, i.e., from 13 th July, 2012 to 17 th May, 2018 |

Compounding penalty

Compounding penalty of Rs. 24,53,590 was levied.

Comments

In the instant case, based upon the RBI's letter to transfer the immovable property to a resident in India, the applicant transferred the property in favour of his son, who was resident in India. However, RBI determined the value of land at Rs. 40,30,000 based on a valuation report as on the date of filing the compounding application. Accordingly, undue gain was computed at Rs. 23,91,300 (difference between value as per valuation report, i.e., Rs. 40,30,000 minus Rs. 16,38,700, being cost of land). Hence, the compounding penalty of Rs. 24,53,590 was levied through which the entire undue gain derived by the NRI on purchasing agricultural land was neutralised. The quantum of penalty reflects the stringent view taken by RBI on purchase of immovable property by citizens from select countries. The said restriction is not applicable if such nationals are OCI card-holders².

OPENING AND MAINTAINING ORDINARY SAVINGS ACCOUNT**H. Mr. Thakorbhai Dahyabhai Patel****Date of order: 18th March, 2019****Regulation: FEMA5/2000-RB Foreign Exchange Management (Deposit) Regulations, 2000****ISSUE**

Transfer of funds from NRE account to ordinary savings account.

FACTS

The applicant, Mr. Thakorbhai Dahyabhai Patel, was an OCI and a person non-resident in India in terms of section 2(w) of FEMA.

The applicant had opened and maintained an ordinary savings bank account with ICICI Bank and Prime Co-operative Bank Limited.

Being a non-resident, he was not eligible to open and maintain an ordinary savings account as per extant FEMA guidelines.

The applicant had granted a loan of Rs. 1,39,01,100 to his friend, Mr. Narendra V. Solanki, a person resident in India, in five tranches starting from 1st April, 2013 to 4th September, 2013, from his ordinary savings account maintained with ICICI Bank.

He had also charged interest at the rate of 6% per annum on the above loan.

The amount given as loan represented either transfer of funds from his NRE Account maintained with HDFC Bank or amount received from LIC on his father's death.

For this purpose, the applicant has transferred Rs. 85,01,100 from his NRE Account maintained with HDFC Bank to his ordinary savings account maintained with ICICI Bank.

The loan was subsequently repaid in FY 2017-18.

Regulatory Provisions

Regulation 4(C) of schedule 1 to Notification No. FEMA.5/2000-RB states that permissible debit of NRE account is transfer to NRE / FCNR (B) accounts of the account holder or any other person eligible to maintain such an account.

Regulation 4(i) and (ii) of Notification No. FEMA.4/2000-RB regulates borrowing and lending in rupees between a person resident in India and a person resident outside India.

Contravention

The amount of contravention is Rs. 85,01,100 and the period of contravention is five years, seven months and six days from 4th January 2013 to 10th August, 2018.

Compounding penalty

A compounding penalty of Rs. 1,13,758 was levied in the case.

Comments

This case reflects a common violation wherein persons resident outside India, specifically NRIs and OCI card-holders, open savings bank accounts even when they are not resident in India. Once a person becomes non-resident, he / she cannot open savings bank accounts and can transact only through NRE / NRO Account in the manner which is permissible. Further, if an Indian resident individual becomes non-resident, all his existing savings accounts would be converted into NRO accounts and hence he cannot operate his old savings account without changing its status to NRO account.

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