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FEMA FOCUS

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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 months from November, 2018 to March, 2019 and uploaded on the website[1] are given below. The article refers to regulatory provisions as existing at the time of offence. Changes in regulatory provisions are noted in the comments section.

BORROWING OR LENDING IN FOREIGN EXCHANGE

A. Respoint Shoes Private Limited

Date of Order: 11th October, 2018

Regulation: FEMA 3/2000-RB Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000

ISSUE

- 1) Loan proceeds were used to meet company formation and related expenses, which were not permitted end-uses;
- 2) Drawdown of proceeds before obtaining Loan Registration Number (LRN);
- 3) Reporting guidelines not met.

FACTS

The applicant company received Euros 5,000 (Rs. 2,88,600) from Hollre B.V., its parent company situated in the Netherlands.

Out of the said amount of Rs. 2,88,600, the applicant accounted for Rs. 1,00,000 towards issuance of 10,000 equity shares of Rs. 10 each and treated the remaining Rs. 1,88,600 as external commercial borrowing (ECB) from its parent company.

The said amount was utilised towards company formation and related expenses.

Regulatory provisions

As per Regulation 6 of Notification No. FEMA 3/2000-RB, a person resident in India may raise in accordance with the provisions of the Automatic Route Scheme specified in Schedule I, foreign currency loans of the nature and for the purposes as specified in that Schedule.

Paragraph 1(iv) of Schedule I to FEMA Notification No. FEMA 3/2000-RB provides the end-uses for which ECB is permitted. However, loan towards 'company formation and related expenses' is not a permitted end-use route.

Paragraph 1(xi) of Schedule I to FEMA Notification No. FEMA 3/2000-RB states that drawdowns of borrowing in foreign exchange shall be made strictly in accordance with the terms of the loan agreement only after obtaining the loan registration number from the Reserve Bank.

Paragraph 1(xii) of Schedule I to FEMA Notification No. FEMA 3/2000-RB states that the borrower shall adhere to the reporting procedure as specified by the Reserve Bank from time to time.

Contravention

Relevant Para of FEMA 3 Regulation	Nature of default	Amount involved (in Rs.)	Time period of default

Regulation 6 of Notification No. FEMA 3/2000-RB read with Paragraphs 1(iv), (xi) and (xii) of Schedule I to this Regulation	<p>Issue 1: Loan proceeds were used to meet company formation and related expenses, which were not permitted end-uses</p> <p>Issue 2: Drawdown of proceeds before obtaining Loan Registration Number (LRN)</p> <p>Issue 3: Reporting guidelines not being met</p>	Rs. 1,88,600	April, 2007 to July, 2018
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Compounding penalty

Compounding penalty of Rs. 51,415 was levied.

Comments

Under provisions of Notification No. FEMA 20(R)/2017-RB, if capital instruments are not allotted by the Indian company within 60 days of receipt of consideration, the amount can be refunded to the foreign company within 15 days of completion of the 60 days' limit and subject to satisfaction of the AD Bank.

Alternatively, equity shares can also be allotted against pre-incorporation expenses incurred by the holding company subject to fulfilment of certain conditions.

It is relevant to note that under the new ECB Regulations notified vide Notification No. FEMA 3R/2018-RB dated 17.12.2018 there is a negative list of end-uses for which ECB cannot be utilised. The said negative end-use list specifies that ECB cannot be utilised for general corporate purposes except if it's raised from foreign equity holder. However, this would not cover cases where ECB is raised along with or prior to the issue of equity to the foreign investor.

B. Glenmark Life Sciences Limited

Date of Order: 7th December, 2018

Regulation: FEMA 4/2000-RB Foreign Exchange Management (Borrowing and Lending in Rupees) Regulations, 2000

ISSUE

Borrowing by Indian company without issuance of Non-Convertible Debentures (NCDs) and non-compliance with reporting requirements.

FACTS

The applicant company's NRI Director and shareholder remitted Rs. 38,00,000 out of his NRE account. Out of the above amount, Rs. 33,330 was utilised towards allotment of shares and the balance amount of Rs. 37,66,670 was treated as loan in the books of the applicant company.

The applicant neither issued any NCDs to the NRI lender nor complied with the reporting requirements. However, the applicant reversed the transaction and remitted the amount of Rs. 37,66,670 to the NRI.

Regulatory provisions

In terms of Regulation 5(1) of Notification No. FEMA 4/2000-RB a company incorporated in India may borrow in rupees on repatriation or non-repatriation basis from a non-resident Indian or a person of Indian origin resident outside India by way of investment in non-convertible debentures (NCDs) subject to the conditions specified therein.

Contravention

Relevant Para of FEMA 4 Regulation	Nature of default	Amount involved (in Rs.)	Time period of default
Regulation 5(1)	Borrowing undertaken by the applicant company without issuance of NCD	Rs. 37,66,670	Two years five months to six years ten months, approximately.

Compounding penalty

A compounding penalty of Rs. 75,300 was levied.

Comments

This case reflects one common violation wherein an Indian company obtains loan from an NRI director to meet short-term funds. Such loan is permissible under the Indian Companies Act but is in violation of FEMA provisions. Schedule 4 of FEMA 20(R) which deems investment by an NRI to be domestic investment at par with the investment made by residents, is restricted to capital instrument or convertible notes. Borrowing and lending regulations are yet to be liberalised resulting in limited

avenues for an Indian company to raise finance from outside India. The conclusion would have been similar even if the loan was lent from an NRO account, subject to the provisions of Schedule 7 as contained in Notification No. FEMA 5(R)/2016-RB.

RETENTION OF ASSETS ABROAD

C. Pradeep Khemka

Date of Order: 1st October, 2018

Regulation: FEMA 348/2015-RB of Foreign Exchange Management (Regularisation of assets held abroad by a person resident in India) Regulations, 2015

ISSUE

Retention of assets abroad that were declared under the Black Money Act (BMA) beyond 180 days from the date of declaration without prior approval of Reserve Bank.

FACTS

The applicant, a resident Indian, declared foreign assets (Seaworld Foundation, Liechtenstein, of which he was the settlor and first beneficiary) to the extent of US \$ 30,46,861 on 26.09.2015 under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BMA) and paid a tax of Rs. 11,57,19,780 on 28.12.2015 on the same.

The applicant received an amount of \$ 29,71,165.38 on 13.10.2015 after liquidation of his foreign assets. However, the balance amount of \$ 89,369.04[2] was not remitted to India within the specified period of 180 days, as prescribed under Regulation 4 of FEMA 348.

No approval was sought from RBI by the applicant for retaining the amount beyond the period of 180 days as required in terms of Regulation 4 of FEMA 348 read with para 3(c) of A.P. (DIR Series), Circular No. 18 dated 30.09.2015.

Regulatory provisions

FEMA 348 provided immunity from FEMA violation in respect of declaration made by the resident person under amnesty scheme of BMA.

Proviso to Regulation 4 of FEMA 348 permitted the resident person to hold declared asset outside India beyond 180 days from date of declaration after obtaining specific permission from RBI.

If aforesaid permission is denied, regulation mandates bringing back of proceeds within 180 days from date of refusal of permission.

Contravention

Relevant Para of FEMA 348 Regulation	Nature of default	Amount involved (in Rs.)	Time period of default
Regulation 4	Retention of assets abroad that were declared under the BMA beyond 180 days without prior approval of Reserve Bank	Rs. 58,08,988	2 years approximately

Compounding penalty

Compounding penalty of Rs. 81,949 was levied.

Comments

Regulation 348 is applicable only to person making declaration under amnesty scheme of BMA. It was a one-time relaxation provided by the government to encourage people to declare undisclosed assets held abroad and absolve themselves from draconian consequences of BMA.

ACQUISITION AND TRANSFER OF IMMOVABLE PROPERTY

D. Mrs. Rajini Kodeswaran

Date of Order: 28th August, 2018

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 a Sri Lankan citizen without RBI permission.

FACTS

The applicant, a Sri Lankan citizen, had acquired an immovable property in the year 2008 without obtaining prior permission from the Reserve Bank of India. Subsequently, she constructed a flat on the same property.

The immovable property was acquired for total consideration of Rs. 6,84,000; the cost of construction of the flat is Rs. 32,97,085, aggregating to Rs. 39,81,085.

Regulation 7 of FEMA 21/2000 prohibits Sri Lankan citizens from acquiring immovable property without prior permission of RBI. Since no prior permission was obtained, the applicant was asked to immediately sell the property to a person resident in India.

Pursuant to the aforesaid direction, the property was sold by the applicant for Rs. 44,00,000.

Regulatory provision

As per Regulation 7 of Notification No. FEMA-21/2000, no person being a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal, Bhutan, Macau or Hong Kong shall acquire or transfer immovable property in India, other than lease, not exceeding five years without prior permission of the Reserve Bank.

Contravention

Relevant Para of FEMA 21/2000 Regulation	Nature of default	Amount involved (in Rs.)	Approx. Time period of default
Regulation 7	Purchase of immovable property by Sri Lankan citizen without RBI permission	Rs. 39,81,085	9 years 2 months 25 days

Compounding penalty

Compounding penalty of Rs. 18,78,208 was levied.

Comments

It was represented based on a valuation report that the value of land appreciated to Rs. 24,82,350. Accordingly, undue gain was computed at Rs. 17,98,350 (difference between cost of land Rs. 6,84,000 and value appreciation of property). Period of default was computed from date of acquisition of immovable property till date of disposal, i.e., regularisation. 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 holders[3].

FOREIGN DIRECT INVESTMENT (FDI)

E. ND Callus Info Services Pvt. Ltd.

Date of Order: 13th December, 2018

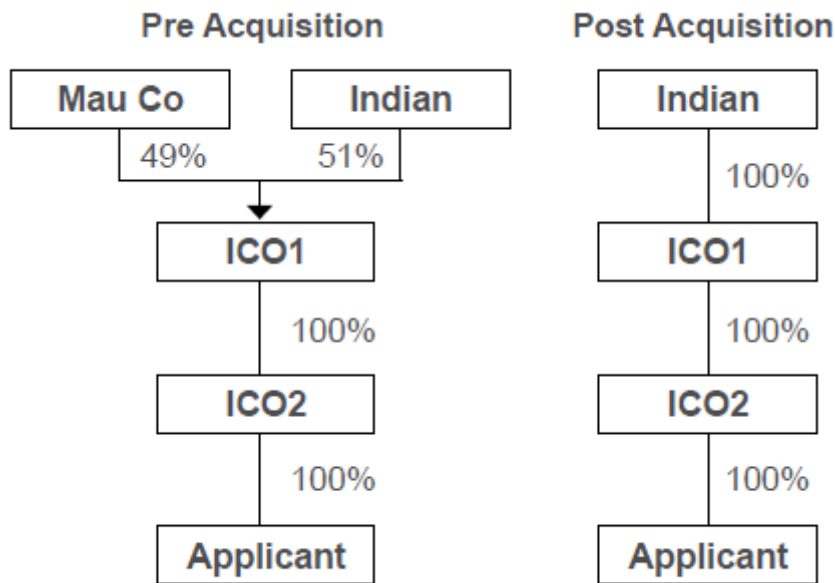
Regulation: FEMA 20/2000-RB Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000

ISSUE

Downstream investment by a foreign-owned and controlled company in an Indian company engaged in core investment activity without seeking FIPB approval.

FACTS

The applicant company is engaged in investment activities as a core investment company. Shareholding structure of applicant pre- and post-acquisition is as under:



The Mau Co acquired the remaining 51% stake from Indian shareholders and accordingly ICO1, ICO2 and the applicant became directly and indirectly foreign-owned and controlled companies. The applicant did not take government / erstwhile FIPB approval as was required since the applicant was engaged in core investment activities.

The applicant became part of Vodafone group which acquired control over Hutchison group through indirect transfer.

Regulatory provision

Regulation 14(6)(ii) of Notification No. FEMA 20/2000-RB states that foreign investment in an Indian company, engaged only in the activity of investing in the capital of other Indian company/ies, will require prior government / FIPB approval, regardless of the amount or extent of foreign investment.

Contravention

The amount of contravention is Rs. 508,31,13,300 and the period of contravention is 4 years and 3 months approximately.

Compounding penalty

Compounding penalty of Rs. 3,56,31,793 was levied.

Comments

This case reveals the care and precaution to be taken at the time of increase in stake by a foreign investor in an Indian company. Not only FEMA compliance needs to be undertaken by Target company but also by downstream investment held by the Target company. Regulations are not only applicable at the time of making downstream investment, but also on account of subsequent change in holding company shareholding making regulations applicable to investment already made by the Indian company.

Under revised FEMA 20(R)/2017-RB as amended from time to time, a core investment company is covered under other financial services under which 100% foreign investment is permitted under the automatic route subject to compliance of applicable RBI regulations.

[1] <https://www.rbi.org.in/scripts/Compoundingorders.aspx>

[2] *Initially balance amount was declared as \$ 75,695.62 but this increased to \$ 89,369.04 due to increase in market value as per submissions of the applicant*

[3] *FAQ No. 4 on purchase of immovable property in India by non-resident individuals*
<https://m.rbi.org.in/Scripts/FAQView.aspx?Id=117>

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