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**NOVEMBER 2018**

## FEMA FOCUS

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Chartered Accountants

### **(I) Dispensation with requirement to file Form ARF within 30 days of receipt of funds pertaining to share capital from foreign investor**

Earlier all Indian companies receiving share capital from foreign investor were required to file Form ARF within 30 days of receipt of share capital from foreign investor. The said Form ARF has been merged with Form FC-GPR with effect from 1<sup>st</sup> September, 2018 and is required to be filed online through filing of Single Master Form (Form SMF) on the FIRMS database.

RBI has now amended the FDI Regulations governed by **FEMA 20 (R)/2017-RB dated 7<sup>th</sup> November, 2017** and omitted the requirement to file ARF within 30 days of receipt of funds towards share capital. Hence, going forward, with respect to receipt of funds relating to share capital from foreign investor, Form ARF will not be required to be filed separately and its details would be included in Form FC-GPR.

### **(II) Downstream investment**

#### **ERSTWHILE FDI REGULATIONS**

Under earlier FDI Regulations governed by FEMA 20(R), Form DI was required to be filed by Investor Indian company within 30 days of making downstream investment when following conditions were satisfied:

- i) Investor Indian company makes investment in another Indian company; and
- ii) Such Investment qualifies as indirect foreign investment;

'Indirect Foreign Investment' has been defined to mean downstream investment received by an Indian entity from:

(a) *Indian entities (excluding investment vehicle) provided:*

- Such Indian entity (Investor IE) has received foreign investment **and**
- the investor IE is not owned and not controlled by resident Indian citizens or is owned or controlled by persons resident outside India;

(b) *Investment vehicle*

by resident Indian citizens or is owned or controlled by persons resident outside India

It may be noted that Form DI was required to be filed within 30 days of investment even when capital instruments were not allotted by recipient Indian company.

However, Form DI was not required to be filed when either the investor entity or investee entity was not an Indian company.

### **AMENDED FDI REGULATIONS W.E.F. FROM 1<sup>ST</sup> SEPTEMBER 2018**

Under the amended FDI Regulations, Form DI is now required to be filed by investor entity in all situations where downstream investment is being made by an Indian entity having FDI investment irrespective of whether investor or investee entity are Indian companies or not. Further, Form DI is now required to be filed within 30 days of allotment of capital instruments and not within 30 days of making investment.

Thus, care needs to be taken to ensure that Form DI is appropriately filed by Indian investor entities in all cases of indirect foreign investment being made into investee Indian entities. Comparison between applicability of filing of Form DI under different scenarios under old FDI regulations and new FDI regulations are as under:

<b>Scenario</b>	<b>Investor entity making downstream investment</b>	<b>Investee entity</b>	<b>Applicability of Form DI under old FDI regulations</b>	<b>Applicability of Form DI under New FDI regulations</b>
Scenario 1	Indian LLP / Any Indian entity (excluding Indian company)	Indian company	Not applicable	Applicable
Scenario 2	Indian company	Indian LLP / Any Indian entity (excluding Indian company)	Not applicable	Applicable
Scenario 3	Indian company	Indian company	Applicable	Applicable
Scenario 4	Indian investment vehicle	Indian company / Any other Indian entity	Not applicable	Applicable

As per revised reporting format, Form DI needs to be filed online as part SMF. Form DI is yet to be notified. Till notified, Indian investor will have to take care of aforesaid changes.

### **ANALYSIS OF RECENT COMPOUNDING ORDERS**

An analysis of some interesting compounding orders passed by Reserve Bank of India in recent months of June and July, 2018 and uploaded on the website<sup>1</sup> are given below. Article refers to regulatory provisions as existing at the time of offence. Changes in regulatory provisions are noted in comments section.

### **FOREIGN DIRECT INVESTMENT (FDI) COMPOUNDING ORDERS**

#### **A. Phoenix Managed Services (India) Private Limited**

**Date of order: 19<sup>th</sup> June 2018**

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

**Issue:**

- (i) Allotment of shares to Non-Resident investors under its Memorandum & Article of Association, prior to receipt of consideration.
- (ii) Delay in reporting receipt of foreign inward remittance towards share capital;
- (iii) Delay in submission of Form FC-GPR relating to allotment of shares and;
- (iv) Delay in filing 'Annual Return on Foreign Liabilities and Assets' (FLA Return).

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

**Facts:**

Applicant is engaged in the business of software designing and developing and dealing in computer software and solutions etc.

Applicant allotted shares to Non-Resident investors under its Memorandum & Article of Association, prior to receipt of consideration.

Applicant reported receipt of remittances to RBI with a delay ranging from 3 months to 3 years

Applicant filed form FC-GPRs with a delay of 4.5 years. Applicant did not file FLA return for FY 2012-13 to FY 2014-15. Whereas for FY 2015-16 and 2016-17, Applicant filed FLA returns with delay.

**Regulatory provisions:**

Paragraph 8 of Schedule 1 to Notification No. FEMA 20 requires issue of shares within 180 days from the date of receipt of the inward remittance.

Paragraph 9(1)(A) of Schedule 1 to Notification No. FEMA 20 – requires reporting of inward remittance for FDI investment within 30 days from receipt of such remittance

Paragraph 9(1)(B) of Schedule 1 to notification No. FEMA 20 requires filing of Form FC-GPR within 30 days from the date of issue of shares.

Paragraph 9(2) of Schedule 1 to Notification No. FEMA 20 read with A. P. (DIR Series) Circular No. 29 dated 2<sup>nd</sup> February, 2017, requires filing of FLA return on or before the 15<sup>th</sup> day of July each year.

**Contravention:**

Relevant Para of FEMA 20 Regulation	Nature of default	Amount involved (in INR)	Time period of default
Paragraph 8 of Schedule 1	Allotment of shares to Non-Resident investors prior to receipt of consideration	10,06,069	1 year 6 months to 3 years 10 months

Paragraph 9(1)(A) of Schedule 1	Delay in reporting of inward remittances for share capital to RBI	10,06,069	3 months to 2 years & 8 months
Paragraph 9(1)(B) of Schedule 1	Delay in filing of Form FC-GPR	10,00,000	4 years & 6 months
Paragraph 9(2) of Schedule 1	Non-filing / delayed filing of FLA return.	-	5 financial years

**Compounding penalty:**

Compounding penalty of Rs.1,14,732 was levied.

**B. Strides Shasun Limited**

**Date of Order: 28<sup>th</sup> June 2018**

**Regulation: FEMA 20**

**Issue:**

**Issuance of Employee Stock Options (ESOPs) to the person resident outside India in the brownfield pharmaceutical company without obtaining necessary prior approval at a time when the foreign investment in brownfield pharmaceutical sector was under the approval route.**

**Facts:**

Applicant is engaged in pharmaceutical industry, as manufacturer, producer, processor and formulator of proprietary medicine, drugs etc.

In February, 2014, Applicant issued 50,000 ESOPs exercisable/ convertible into 50,000 equity shares to a non-resident employee at an exercise price of Rs.322.30 per share.

In March, 2015, the non-resident employee exercised 10,000 Options and accordingly, 10,000 shares were allotted by the Applicant to the said non-resident employee.

FDI upto 100% under the Automatic route was permitted in the pharmaceuticals sector till November 2011.

Subsequently, with effect from 3<sup>rd</sup> November 2011, above FDI policy was amended. Different criteria was prescribed depending upon whether investment in pharmaceutical sector was greenfield (i.e. investments in new companies) or brownfield (investment in existing companies). FDI upto 100% under the automatic route was permitted only for greenfield investments in pharmaceuticals sector. However, for investment in existing Indian pharma companies (i.e. brownfield investments), FDI upto 100% was brought under the government route.

Hence, as issuance of ESOPs and allotment of shares to non-resident employees in March 2015 was in violation of FDI regulations as amended in November 2011, SSL applied to Department of

Pharmaceuticals, Ministry of Chemicals & Fertilizers (pursuant to abolishment of FIPB) in January 2017.

Department of Pharmaceuticals, Ministry of Chemicals & Fertilizers granted its approval, advising the Applicant to approach RBI for compounding the contravention committed by issuing abovementioned ESOPs, as brownfield investment in pharmaceutical sector was under approval route at the time of issuance of ESOPs, thus requiring prior FIPB approval.

In the compounding application, SSL submitted that ED had asked it to furnish certain information and documents in relation to export / import transactions. Hence, RBI sought comments from ED as to whether offence being compounded by RBI, i.e. issuance of ESOP was being investigated by ED and if it had any objection in compounding the said offence.

ED replied to RBI that its investigation did not pertain to the offence being compounded by RBI and hence, RBI proceeded with this compounding application.

### **Regulatory Provisions:**

FEMA 20 as amended from time to time read with Notification No.FEMA.242/2012-RB dated 19<sup>th</sup> October 2012.

### **Contravention:**

Issuance of ESOPs without prior approval from erstwhile FIPB.

Period of Contravention is approx. 3.9 years.

Amount of Contravention is approx. Rs.1.61 crore.

### **Compounding penalty**

Compounding penalty of Rs.1,54,748 was levied.

### **Comments:**

W.e.f. 3<sup>rd</sup> November 2011 and until December 2016, FDI in existing Indian companies (i.e. brownfield investment) engaged in pharmaceutical sector was permitted upto 100% only under FIPB approval route.

W.e.f. 7<sup>th</sup> December 2016, FDI in brownfield pharmaceutical sector upto 74% is permitted under the Automatic Route and upto 100 % under Approval Route.

Further, existing compounding regulations provide that compounding proceedings can be undertaken only when same offence is not under investigation by ED. Hence, if any applicant is under investigation by ED for specific offence being committed under FEMA regulations, compounding application cannot be filed for same offence but it can be filed for a different offence.

This case demonstrates need for ESOPs plans to be in compliant with extant FEMA regulations.

## **C. Rajasthan Hospitals Limited**

**Date of Order: 19<sup>th</sup> July 2018**

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

**Issue:**

**Availing of loan from NRI without issue of Non-Convertible Debentures (NCDs) made by public offer.****Facts:**

Applicant borrowed Rs. 49.80 lakh from NRI, Dr. Jawahar Lal Taunk, a US resident through wire transfer from USA in March 2017.

This transaction was reversed on 4<sup>th</sup> April, 2018 when the above amount was refunded to the lender.

**Regulatory Provisions:**

Regulation 5 (i) of Notification No. FEMA 4/2000-RB permits Indian Company to borrow in rupees on repatriation or non- repatriation basis from an NRI only by way of issue of NCDs through public offer.

**Contravention:**

Borrowing from NRI was not through issuance of NCDs made by public offer.

Period of Contravention is approx. one year.

Amount of Contravention is Rs.49.80 lakh

**Compounding penalty:**

Compounding penalty of Rs.77,400 was levied.

**Comments:**

Raising debt by Indian Companies from NRIs is highly truncated under extant FEMA regulations.

*NCD Route:* Indian companies may avail loan by way of issuing NCD through a public offer.

*ECB Route:* Indian Company may borrow from NRI, who are its shareholders subject to compliance of ECB regulations viz Indian Company being eligible borrower, end-use restrictions, all-in-cost ceilings etc., and NRI lender being eligible lender.

**D. Vigno Prasath**

**Date of Order: 10<sup>th</sup> July 2018**

**Regulation:**

Notification No. FEMA 20/2000-RB FEMA (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.

**Issue:**

**Transfer of shares of an Indian company to a person resident outside India without filing form FC-TRS.**

**Receipt of sale consideration for transfer of shares on deferred payment basis.**

**Receipt of sale consideration through third parties.**

**Facts:**

Applicant is a resident individual being one of the shareholders holding equity shares of Sathya Auto Private Limited (SAPL) an unlisted private Indian company;

Applicant transferred shares held by it in SAPL to a non-resident Indian (NRI);

Sale consideration was paid by NRI as follows

Sr No	Date of payment	Mode of payment	Amount (INR)
1.	17 <sup>th</sup> March 2007	NRI transferred funds from his NRE A/c to its Indian company, AHPL which in turn made payment to Applicant	12,50,000
2.	4 <sup>th</sup> April 2007		12,50,000
3.	16 <sup>th</sup> October 2007		33,50,000
4.	23 <sup>rd</sup> April 2008	Funds transferred from AHPL to SAPL, which in turn made the payment to applicant	182,329

As can be seen from above, whilst shares of SAPL were sold to NRI consideration was received through the third parties namely, AHPL and SAPL.

Also, part of sale consideration was received by the Applicant on a deferred payment basis over a period of one year without obtaining RBI approval.

Form FC-TRS relating to transfer of shares was filed with delay of around 4 years.

#### Regulatory Provisions:

Para 8 of schedule 1 to FEMA 20 – Lays down 2 permitted modes of payment of sale consideration: (1) inward remittance through normal banking channels or (2) debit to NRE / FCNR account of the person concerned;

Regulation 10A(b)(iii) of FEMA 20 - Requires submission of declaration in Form FC-TRS at the time of transfer of shares.

Regulation 10A(b)(iii) of FEMA 20 (as it stood at the time of transfer) - Requires prior approval of RBI for receipt of deferred consideration.

#### Contravention:

Relevant Para of FEMA 20 Regulation	Nature of default	Amount involved (in INR)	Time period of default

Regulation 10A(b)(iii) read with Paragraph 8 of Schedule 1	Receipt of sale consideration by the applicant through third parties, not being a permitted method of payment under FEMA Regulations	59,50,000	8 years & 7 months to 9 years & 8 months
Regulation 10A(b)(iii)	Receipt of sale consideration by the applicant on deferred payment basis	34,50,000	9 years & 8 months
Regulation 10A(b)(iii)	Transfer of shares by the applicant without filing Form FC-TRS	59,50,000	Approx. 4 years

#### Compounding penalty:

Compounding penalty of Rs. 1,59,175 was levied.

#### Comments:

Share transfer by a resident buyer to a non-resident seller on a deferred payment basis was not allowed under the extant FDI Regulations and therefore required prior RBI approval.

However, RBI vide Notification No. FEMA 386/2016 dated 20<sup>th</sup> May, 2016 FEMA (Transfer or Issue of Security by a Person Resident Outside India) (Seventh Amendment) Regulations, 2016, permitted transfer of shares between resident buyer and non-resident seller on deferred payment basis subject to the following conditions:

- i. *Not more than 25% of the total consideration can be paid by the buyer on a deferred basis*
- ii. *Consideration can be deferred for not more than 18 months from the date of the transfer agreement*
- iii. *Consideration can be settled through an Escrow Arrangement between the Buyer and Seller for a period not exceeding 18 months from the date of transfer agreement*

*If total consideration has been paid by the buyer to the seller, sale consideration can be indemnified by the seller for a period not exceeding eighteen months from the date of payment of full consideration.*

Further, apart from Applicant, i.e. Mr. Vigno Parsath, there were three other shareholders of SAPL who had also sold their shares to non-resident and wherein all above contraventions had taken place.

As facts were similar, RBI levied similar penalty of Rs. 1.59 lakh in all other cases.

## **OVERSEAS DIRECT INVESTMENT (ODI) COMPOUNDING ORDERS**

### **E. PC Jeweller Limited**



**Date of Order: 12<sup>th</sup> July, 2018**

**Regulation:**

**FEMA 120/2004-RB Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 (FEMA 120)**

**Issue:**

**Making outward remittances to the overseas entity without submission of Form ODI.**

**Making outward remittances to the overseas entity under the automatic route when the same was permitted only with prior approval.**

**Facts:**

The applicant set up a wholly-owned subsidiary (WOS) viz. P. C. Jeweller Global DMCC in UAE in June, 2016 and made remittances amounting to USD 2,00,00,500 to the overseas WOS.

The remittances were reported in form ODI-Part-I within the prescribed time except in one instance of USD 500 wherein applicant reported the remittance with delay beyond the prescribed time.

Applicant had to remit USD 500 to compensate for shortfall in first remittance on account of deduction of bank charges.

Applicant was under investigation by Directorate of Revenue Intelligence (DRI) which was concluded in July 2014 and a show cause notice (SCN) dated 8<sup>th</sup> July, 2014 was issued to the applicant. Applicant had filed an appeal against the SCN to Commissioner (customs) Imports in January 2015 which is pending till date.

Accordingly, as DRI's investigations were pending, Applicant was not eligible to undertake overseas direct investment (ODI), under automatic route pending disposal of the appeal. Hence, prior approval of RBI was required before making ODI.

Further, RBI had asked ED to submit whether contravention sought to be compounded was under ED's investigation or not. However, as ED did not reply, RBI proceeded with the compounding process

**Regulatory Provisions:**

Regulation 6(2)(vi) of FEMA 120 requires an Indian Party making direct investment in a JV/WOS outside India to submit Form ODI Part-I, the Authorised Dealer within 30 days of making such investment

Regulation 6(2)(iii) of FEMA 120 - Indian Party may make direct investment in a JV/WOS outside India subject to the condition that the Indian Party is not on the Reserve Bank's exporters' caution list / list of defaulters to the banking system circulated by the Reserve Bank and/or is not under investigation by any investigation / enforcement agency or regulatory body.

**Contravention:**

Delay in filing of Form ODI beyond the prescribed period of 30 days from the date of making investment.

Period of contravention is 1.4 years and amount of contravention is INR 33,745.

Making ODI investment pending investigation by Directorate of Revenue Intelligence.

Period of contravention is approx. 1.6 years and amount of contravention is approx Rs.133.86 crore.

### **Compounding penalty**

Compounding penalty of Rs. 74,13,478 was levied.

### **Comments:**

Indian Entities to be careful during pending any investigation by any regulatory body and refrain from making any ODI Investments without prior approval during the pendency of such investigation

### **F. Endurance Technologies Limited**

**Date of Order: 21<sup>st</sup> June 2018**

### **Regulation:**

FEMA 120/2004-RB - Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004

### **Issue:**

**Delay in filing Form ODI beyond the stipulated time period.**

**Funding of overseas investment through a mode other than the permitted modes.**

**Non-submission of Annual Performance Reports (APR) within stipulated time period.**

### **Facts:**

Applicant is engaged in the manufacturing of the automotive components, suspension products, transmission products and brake systems.

Overseas investment was made by Applicant under the automatic route in an Italian SPV in May 2007.

Form ODI in relation to the said investment was filed with a delay.

Initial share capital amounting to Euro 10,000 and the incorporation expenses amounting to Euro 500 were paid by Applicant's German subsidiary namely, Endurance Amann GmbH which were reimbursed by the Applicant in 2017

Applicant had extended loans to its Italian SPV and the interest accrued on the loans was capitalised.

There was a delay in reporting such capitalisation of interest

The APRs for two years i.e. from the year ended 31<sup>st</sup> March, 2015 to the year ended 31<sup>st</sup> March, 2016 were submitted with delay.

### **Regulatory provisions:**

Regulation 6(2)(vi) of FEMA 120 – requires filing of Form ODI in case of overseas investment by Indian Entities

Regulation 6(3) of FEMA 120, provides the list of permitted methods of funding of overseas investment.

Regulation 15 (iii) of FEMA 120, requires annual filing of an Annual performance Report (APR) on or before a specified date in respect of each JV or WOS outside India.

### **Contravention:**

The overseas investment made by Applicant in the Italy SPV was reported with delay in Form ODI-Part-1. Period of contravention is approx. 9 years and 9 months and amount of contravention is approx. Rs 3.35 lakh.

Funding of the overseas investment was done through a mode other than that permitted under regulation 6(3) of FEMA 120. Period of contravention is approx. 10 years and amount of contravention is approx. Rs 8 lakh.

APRs for two years i.e. year ended 31<sup>st</sup> March, 2015 and 31<sup>st</sup> March, 2016 were submitted with delay.

### **Compounding penalty:**

Compounding penalty of Rs. 6,74,942 was levied.

### **Comments:**

Indian entities to ensure that funding of overseas investments is done only via permitted modes under FEMA. Further, in case of conversion of loan into equity it is necessary that due process prescribed by law is followed. This involves intimation to AD banker by filing prescribed form, obtaining share certificate within prescribed time lines, etc.

In a similar case of CI Global Technologies Pvt Limited<sup>2</sup>, Indian Company made payment for ODI Investment by way of Travellers Cheque, which is not a permitted mode of funding. Compounding Penalty was levied in this case as well. \_\_\_\_\_

2 CA No 4634 / 2018 dated 8th June 2018

## **G. Anand Rathi Wealth Services Limited**

**Date of Order: 24<sup>th</sup> April, 2018**

**Regulation: FEMA 120 / RB-2004 Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004**

### **Issue:**

Non-submission of Annual Performance Reports (APRs) for the period 2006 to 2009.

Write off of entire amount of ODI under automatic route without obtaining fair valuation certificate and without submitting APRs.

### **Facts:**

Applicant is engaged in the business of funds management and venture capital, financial advisor, wealth management etc., in India.

Applicant invested USD 30,000 in October, 2005 in an overseas WOS viz. Anand Rathi India Realty Fund in Mauritius. The overseas WOS was unable to commence operations and therefore Applicant decided to close the overseas WOS in May, 2008.

The name of the Overseas WOS company was removed from the Registrar of Companies in Mauritius w.e.f. 6<sup>th</sup> August, 2009.

Applicant did not submit annual performance reports (APRs) for the period 2006 to 2009.

The applicant had written off entire amount of ODI under automatic route without obtaining fair valuation certificate and without submitting APRs.

### **Regulatory Provisions:**

Regulation 16(1)(iii) of FEMA 120 – Shares of an unlisted company held by any Indian Party in a JV or WOS outside India may be transferred, by way of sale to another Indian Party only after obtaining a Valuation Certificate from Chartered Accountant / Certified Public Accountant determining the fair value of such shares.

Regulation 16(1)(v) of FEMA 120 - Shares of an Overseas entity may be sold only if such overseas concern has been in operation for at least one full year and APR together with the audited accounts for that year has been submitted to RBI.

Regulation 15(iii) of FEMA 120 - Indian Party making ODI Investments to submit to RBI, every year on or before a specified date, an Annual Performance Report (APR) in respect of each JV or WOS outside India.

**Contravention:**

Relevant Para of FEMA 120 Regulation	Nature of default	Amount involved (in INR)	Time period of default
Regulation 16(1)(iii)	Write off of the amount of ODI under automatic route without obtaining fair valuation certificate and without submitting APRs	Rs. 13.67 lakh	8 years & 7 months
Regulation 16(1)(v)	Disinvestment of stake in overseas WOS even though the same was not in operation during the previous year.	Rs. 13.67 lakh	8 years & 7 months
Regulation 15(iii)	Non-submission of APR annually	Rs. 13.67 lakh	8 years & 7 months

**Compounding penalty**

Compounding penalty of Rs. 2,10,510 was levied.

**Comments:**

Indian entities need to take care of various FEMA compliances before closing down or disinvesting stake in their overseas WOS as non-compliance of the same would invite compounding penalty.

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**PAST ISSUES**