Foreign Exchange Management Act, 1999

To facilitate external trade & payments & for promoting the orderly development & maintenance of FOREX market in India

Importance of the chapter at a glance

- Average marks of 10 previous attempts – 13.3 (along with Part-II)
- Revision Priority - IV
- Mostly asked question type – Short Notes & Problem Solving questions
- Most frequently asked topics -
  1) Current account transaction & capital account transaction.
  2) Political party & an organization of political nature.
  3) The power of Central Government to prohibit receipt of foreign contribution.
  4) Transactions require prior approval of RBI.

. FEMA is a chapter in which changes are initiated by the govt. quite frequently so we all need to stay updated, in this chapter I'm going to share all those amendments which are relevant for your upcoming exams.

Important definitions

Capital account transaction - Capital Account is that part of BOP (balance of payment) Account which shows all payments made or received by way of settling old debts or creating new debts. It is a record of inflows and outflows of capital which brings a change in a country's foreign assets and liabilities. Capital account flows consist of investments, loans, commercial borrowings, banking, capital, etc.

Current account transaction - Current Account is that part of Balance of Payment Account which shows all payments made or received in respect of goods and services including payment of interest on past lending and borrowings.

Distinction between current & capital a/c transactions

Current account transaction

Difference shall be recognized by the following components of current account transactions

- Export and import of goods (Visible trade)
- Export and import of services—non-factor and factor services (called Invisible trade)
- Unilateral transfers (Transfer receipts/payments).
- Investment income (Factor income from land, bonds, shares abroad).

Capital account transaction

Difference shall be recognized by the following components of capital account transactions

- **Foreign investment:** This refers to investment to and from the Rest of World.
- **Foreign loans:** These refer to credit granted by foreign governments and international institutions like IME External commercial borrowings are also included.
- **Banking capital and other capital:** Banking capital includes foreign assets and foreign liabilities of banking sector excluding the central bank. Deposits by nonresidents are also included.
- **Monetary movements or changes in foreign exchange reserve:** This reserve keeps on changing depending upon the net balance of other private and official transactions.

Foreign exchange Section 2 (n)

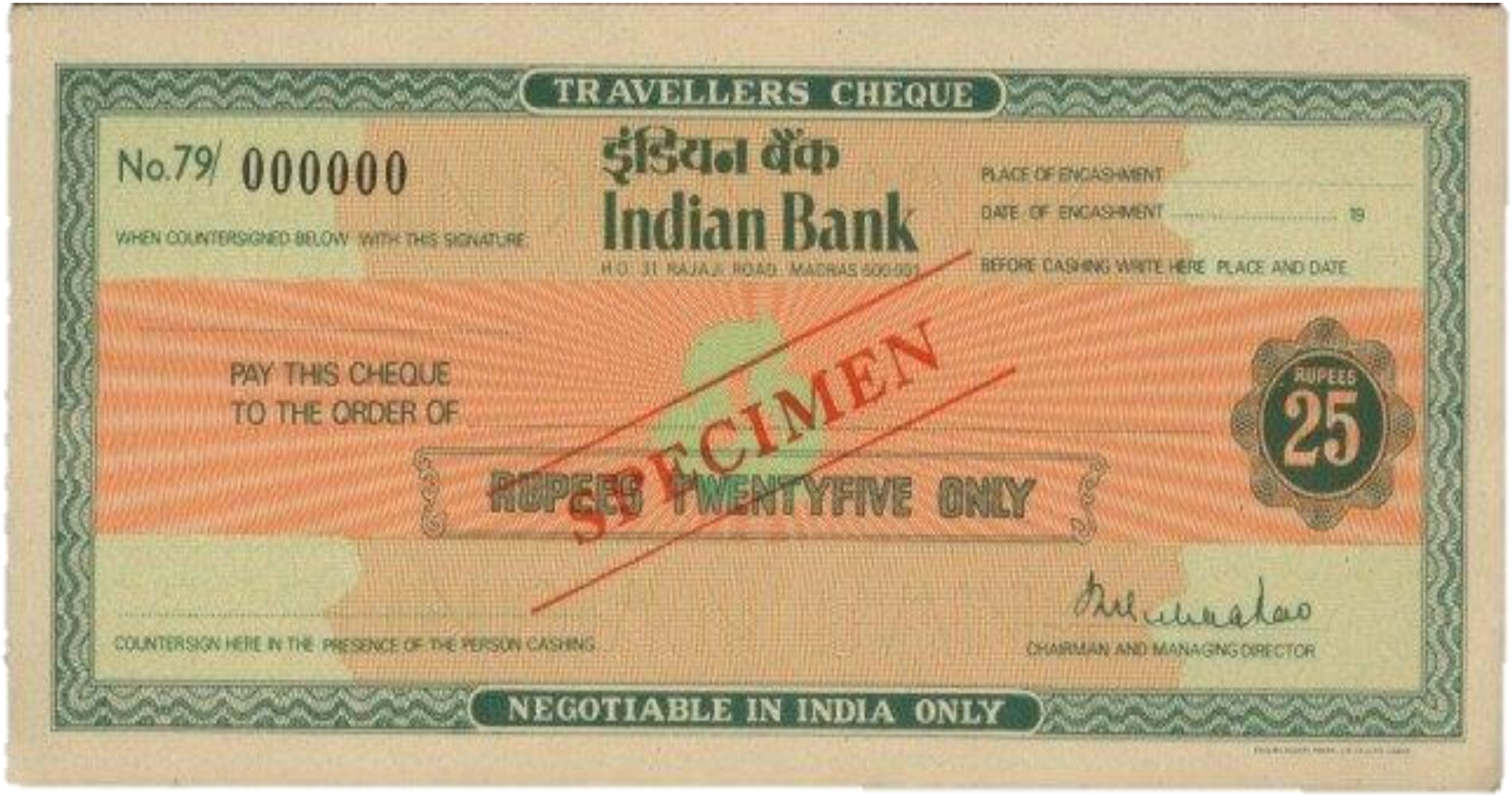
It means foreign currency & includes the following:-

1) Deposits, credits & balance payable in foreign currency.

2) Drafts, travelers cheque, letter of credit, bills of exchange drawn in Indian currency but payable in foreign currency & it also includes the same instruments drawn by any bank, institutions or person outside India but payable in Indian currency.

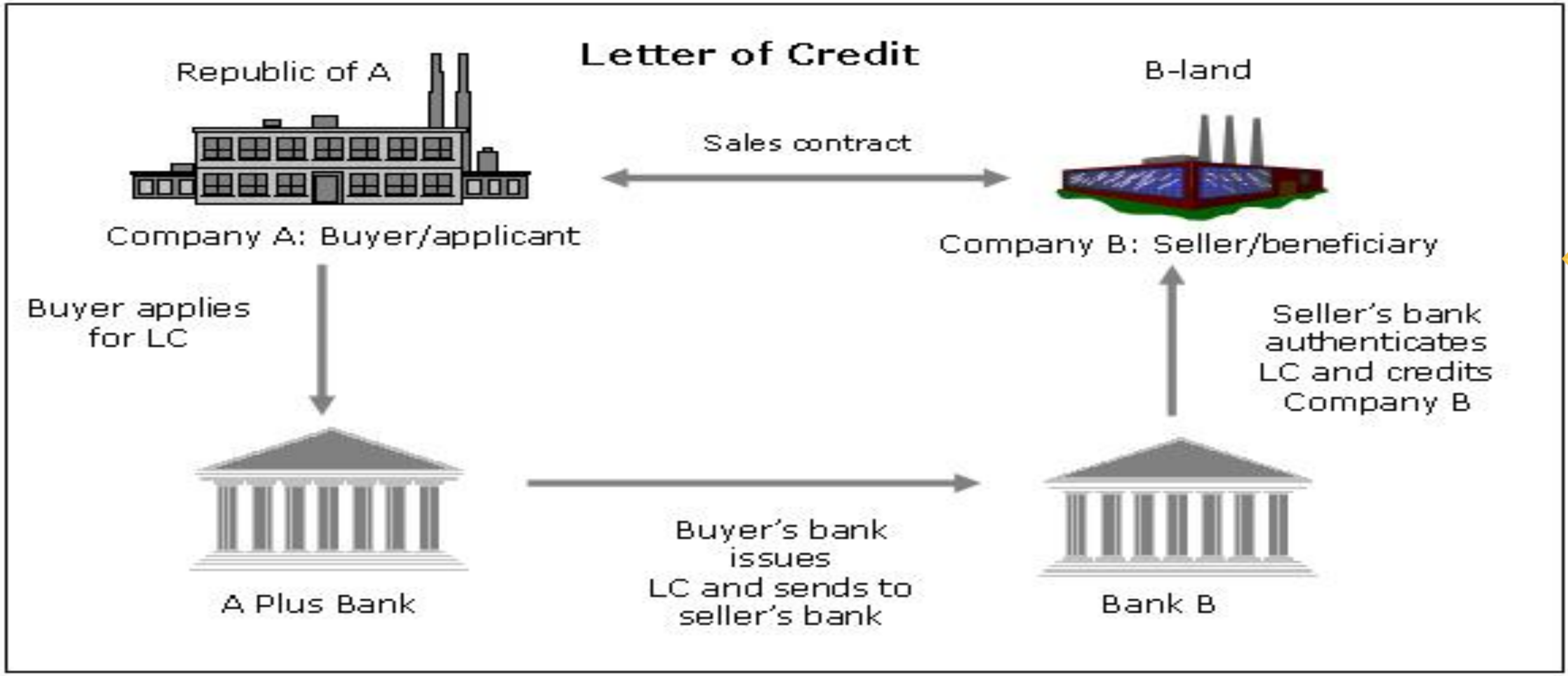
Foreign security Section 2 (o)

It means any security (shares, stock, bond, debentures or any other instrument) denominated or expressed in foreign currency & also includes the same type of security whose redemption or any other return as interest or dividend is payable in Indian currency.



Specimen of traveler's cheque

Traveler's cheque is a cheque for a fixed amount that may be cashed or used in payment abroad after endorsement by the holder's signature



Like this transactions are completed by way of letter of credit

Letter of Credit

A **letter of credit** is a document from a bank guaranteeing that a seller will receive payment in full as long as certain delivery conditions have been met. In the event that the buyer is unable to make payment on the purchase, the bank will cover the outstanding amount.

Section 3 of FEMA,1999 (Prohibitive Section)

Section 3 implies that only authorized person can deal or transfer any foreign exchange or foreign security to any other person. If anyone wants to make any such deal he can make it only through such authorized person.

Further Section 3 (d) implies that nobody can get enter into any financial transaction for acquisition/creation/transfer of a right to acquire in any asset outside India, except as otherwise prescribed in the Act & rules or regulations made thereunder .

This Section has prohibited drawal of foreign exchange for the purpose of transaction specified in the Schedule I or to travel Nepal & Bhutan or transaction with a person resident in those two countries.

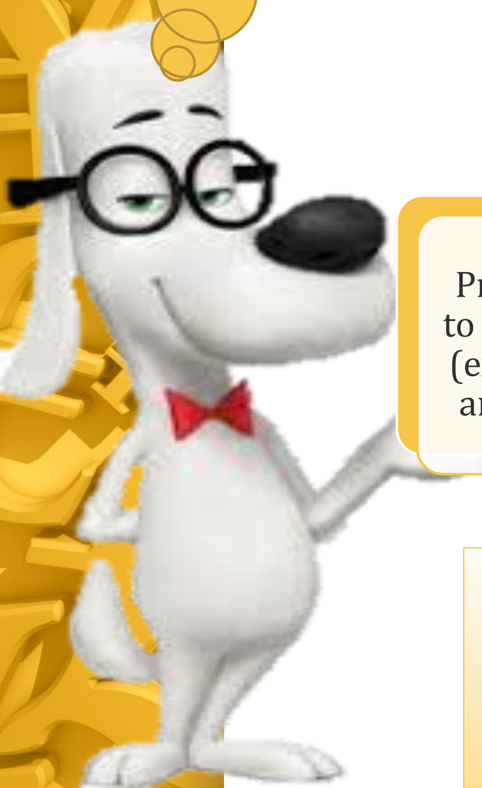
What is the logic behind casting prohibition on drawal of Forex in Nepal & Bhutan?

In case of Nepal- You can use Indian currency over there very easily. Back in the history, until 1951 Nepal had very little contact with countries other than India, Tibet, and Britain. Movement of goods or people from one part of the country to another usually required passage through India, making Nepal dependent on trade with or via India. Nepal's economy is irrevocably tied to India & Nepalese rupee was linked to the Indian rupee. Before 1960, Nepal had little control over its foreign currency holdings. **Indian rupees were the prevalent medium of exchange in most parts of the country**. Nepalese currency was used mostly in the Kathmandu and the surrounding hill areas.

In case of Bhutan- The financial sector in Bhutan has begun to develop recently. It opened to the outside world in 1961, Bhutan did not have its own bank notes, but transactions were no longer confined to barter. India provided both financial and technical assistance to initiate development activities. Through this assistance, **Indian rupees began to circulate in Bhutan** & the rupee has been legal tender in Bhutan i.e. Indian Rupee can be used there easily.

Prior approval of RBI for certain transactions (most wanted topic for problem solving questions)

Congratulations! Central govt. has been facilitated this intricate topic for you by amending it & these amendments are discussed here



- Facilities for
  - Individual
    - Remittance more than US$ 250,000
      - Private visits to any country (except Nepal and Bhutan)
      - Gift or donation.
      - Going abroad for employment
      - Emigration & Maintenance of close relatives abroad
      - Expenses in connection with medical treatment abroad
      - Studies abroad
      - Any other current account transaction
  - Person other than individual
    - See chart below

. Business trip/ attending a conference/specialized training/maintenance of expenses of a patient going abroad for medical treatment or check-up or accompanying that person as an attendant – Release of Forex exceeding US$ 250,000.

For Individuals – Provided that for the purposes of emigration, expenses in connection with medical treatment abroad and studies abroad, the individual may avail of exchange facility for an amount in excess of the limit prescribed under the **Liberalised Remittance Scheme (inserted by amendment)** as provided in regulation 4 to FEMA, if it is so required by a country of emigration, medical institute offering treatment or the university, respectively

Provided further that if an individual remits any amount under the said Liberalised Remittance Scheme in a financial year, then the applicable limit for such individual would be reduced from US$ 250,000 by the amount so remitted e.g. Rohit has remitted US$ 150,000 under the Liberalised Remittance Scheme in September 2015 so the limit applicable on him shall be US$100,000 (US$ 250,000 – US$ 150,000) for 2015-2016

Provided also that for a person who is **resident but not permanently resident in India** and
(a) is a citizen of a foreign State other than Pakistan; or
(b) is a citizen of India, who is on deputation to the office or branch of a foreign company or subsidiary or joint venture in India of such foreign company, **may make remittance up to his net salary (after deduction of taxes, contribution to provident fund and other deductions).**

Explanation: For the purpose of this item, a person resident in India on account of his employment or deputation of a specified duration (irrespective of length thereof) or for a specific job or assignments, the duration of which does not exceed three years, is a resident but not permanently resident:

Facilities for person other than individuals

- 1. Donations exceeding one per cent. of their foreign exchange earnings during the previous three financial years or US$ 5,000,000, whichever is less, for-
  - creation of Chairs in reputed educational institutes,
  - contribution to funds (not being an investment fund) promoted by educational institutes; and
  - contribution to a technical institution or body or association in the field of activity of the donor Company.
- See below for more points

Nota Bene – A person other than an individual may also avail of foreign exchange facility, mutatis mutandis, within the limit prescribed under the said Liberalised Remittance Scheme for the purposes mentioned herein above.

2. Commission to agents for sale of residential flats/commercial plots in India – Higher of the following -

a) Exceeding US$ 25,000

b) Exceeding 5% of the inward remittance per transaction

3.Consultancy services procured from abroad -

a) For infrastructure - Exceeding US$ 10,000,000 per project.

b) For other consultancy services – Exceeding US$ 1,000,000 per project

4. Payment of pre-incorporation expenses by way of reimbursement by an entity in India - exceeding US$ 100,000

Nota bene - This rule shall not apply where the payment is made out of funds held in Resident Foreign Currency Account of the remitter.

Domanda nella mia mente

1. What is Liberalised Remittance Scheme (LRS)?
Answer – The government is wary of excessive outflows of foreign exchange draining its reserves and destabilising the rupee. The window that is opened up for individuals to remit money across the border, without seeking specific approvals, called the Liberalised Remittance Scheme (LRS).
2. What are non-permissible remittances under LRS?
Answer – The rules do not allow remittances for trading on the foreign exchange markets, margin or margin calls to overseas exchanges and counterparties and the purchase of Foreign Currency Convertible Bonds issued by Indian companies abroad. Sending money to certain countries and entities is also barred. Under LRS, people can't send money to countries identified as 'non cooperative' by the Financial Action Task Force.
3. Why is it important?
Answer -The LRS represents India's baby steps towards dismantling controls on foreign exchange movements in and out of the country. It has allowed large numbers of Indians to study abroad and diversify their portfolios from purely *desi* stocks and property. Ideally speaking, capital controls in any form have no place in a liberalised economy. But for India, which is heavily dependent on imports of critical goods and perpetually spends more foreign exchange than it earns, it is difficult to free up remittances because of the havoc this can wreak on exchange rates. This is why, having opened up the LRS to Indian residents, the RBI has tweaked the rules with an eye on the exchange rate situation. For example, in mid 2013, when the country was faced with a large current account deficit and there were murmurs of a run on the rupee, the LRS limit was slashed to $75,000. This has since been hiked again in phases.

4. What are the benefits of LRS?

Answer – The LRS gives you the freedom to put your money to work anywhere in the world. Until India is ready to free all capital controls (and that day may be a long way off), the LRS remains the most viable way for individuals to legally remit money overseas.

5. Who are the biggest users of this window?

Answer – Parents who have sent their wards abroad for studies are the largest users of the LRS, using this window both to pay the fees and regularly meet the student’s living expenses.

6. What are the permissible capital account transactions under LRS?

Answer – The following transactions are permitted capital a/c transactions under LRS –
i) opening of foreign currency account abroad with a bank;
ii) purchase of property abroad;
iii) making investments abroad;
iv) setting up Wholly owned subsidiaries and Joint Ventures abroad;
v) extending loans including loans in Indian Rupees to Non-resident Indians (NRIs) who are relatives as defined in Companies Act, 2013.

Permissible capital account transactions

Person resident in India

i. Investments in foreign securities
ii. Foreign currency loans raised in India & abroad.
iii. Transfer of immovable property outside India.
iv. Guarantees issued in favour of a person resident outside India.
v. Export, import & holding of currency/currency notes.
vi. Loans & overdrafts from a person resident outside India.
vii. Maintenance of foreign currency a/c in & outside India.
viii. Taking out of insurance policy from insurance co. outside India.
ix. Loans & overdrafts to a person resident outside India.
x. Remittance of capital assets outside India of person resident in India

Person resident outside India

i. Acquisition & transfer of immovable property in India.
ii. Guarantee by a person resident outside India in favour of, or on behalf of person resident in India.
iii. Import & export of currency/currency notes into or from India.
iv. Deposits between a person resident in & India & outside India.
v. Foreign currency a/c in India.
vi. Remittance outside India of capital assets in India .
vii. Investment In India in securities issued by a body corporate. Investment by way of contribution to the capital of a firm or a proprietorship concern or an association of persons in India.

FDI Policy, 2015

Amendment to the section incorporated.

1. ‘Control’ shall include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.

2. ‘Foreign Portfolio Investor’(FPI) means a person registered in accordance with the provisions of Securities and Exchange Board of India (SEBI) (Foreign Portfolio Investors) Regulations, 2014, as amended from time to time.

3. ‘Group Company’ means two or more enterprises which, directly or indirectly, are in a position to:
(i) exercise twenty-six percent or more of voting rights in other enterprise; or
(ii) appoint more than fifty percent of members of board of directors in the other enterprise.

4. ‘Limited Liability Partnership’ means a Limited Liability Partnership firm, formed and registered under the Limited Liability Partnership Act, 2008.

5. ‘Portfolio Investment Scheme’ means the Portfolio Investment Scheme referred to in Schedules 2, 2A & 3 of FEMA (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.

6. ‘A Qualified Foreign Investor’ (QFI) means a non-resident investor (other than SEBI registered FII and SEBI registered FVCI) who meets the KYC requirements of SEBI for the purpose of making investments in accordance with the regulations/orders/circulars of RBI/SEBI.

Who can invest in India?

1. Non-resident entity – Yes but subject to the FDI Policy except in those sectors/activities which are prohibited.

2. A citizen of Bangladesh or an entity incorporated in Bangladesh – Only under the Government route.

3. A citizen of Pakistan or an entity incorporated in Pakistan - Only under the Government route, in sectors/activities other than defence, space and atomic energy and sectors/activities prohibited for foreign investment.

4. NRIs resident in Nepal and Bhutan as well as citizens of Nepal and Bhutan – In the capital of Indian companies on repatriation basis, subject to the condition that the amount of consideration for such investment shall be paid only by way of inward remittance in free foreign exchange through normal banking channels.

5. FII/FPI -in the capital of an Indian company under the Portfolio Investment Scheme which limits the individual holding of an FII/FPI below 10% of the capital of the company and the aggregate limit for FII/FPI/QFI investment to 24% of the capital of the company. This aggregate limit of 24% can be increased to the sectoral cap/statutory ceiling, as applicable, by the Indian company concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body and subject to prior intimation to RBI. The aggregate FII/FPI/QFI investment, in the FDI and Portfolio Investment Scheme, should be within the above caps.

6. SEBI registered Foreign Venture Capital Investor (FVCI) – May contribute up to 100% of the capital of an Indian Venture Capital Undertaking (IVCU) and may also set up a domestic asset management company to manage the fund. All such investments can be made under the automatic route in terms of Schedule 6 to Notification No. FEMA 20. A SEBI registered FVCI can invest in a domestic venture capital fund registered under the SEBI (Venture Capital Fund) Regulations, 1996. Such investments would also be subject to the extant FEMA regulations and extant FDI policy including sectoral caps, etc. SEBI registered FVCIs are also allowed to invest under the FDI Scheme, as non-resident entities, in other companies, subject to FDI Policy and FEMA regulations.

Further, FVCIs are allowed to invest in the eligible securities (equity, equity linked instruments, debt, debt instruments, debentures of an IVCU or VCF, units of schemes/funds set up by a VCF) by way of private arrangement/purchase from a third party also, subject to terms and conditions as stipulated in Schedule 6 of Notification No. FEMA 20 / 2000 –RB dated May 3, 2000 as amended from time to time. It is also being clarified that SEBI registered FVCIs would also be allowed to invest in securities on a recognized stock exchange subject to the provisions of the SEBI (FVCI) Regulations, 2000, as amended from time to time, as well as the terms and conditions stipulated therein.

7. Qualified Foreign Investors (QFls) -QFls are permitted to invest through SEBI registered Depository Participants (DPs) only in equity shares of listed Indian companies through recognized brokers on recognized stock exchanges in India as well as in equity shares of Indian companies which are offered to public in India in terms of the relevant and applicable SEBI guidelines/regulations. QFls are also permitted to acquire equity shares by way of right shares, bonus shares or equity shares on account of stock split/consolidation or equity shares on account of amalgamation, demerger or such corporate actions subject to the prescribed investment limits. QFIs are allowed to sell the equity shares so acquired subject to the relevant SEBI guidelines.

The individual and aggregate investment limits for the QFls shall be 5% and 10% respectively of the paid up capital of an Indian company. These limits shall be within FPI aggregate limits. Further, wherever there are composite sectoral caps under the extant FDI policy, these limits for QFI investment in equity shares shall also be within such overall FDI sectoral caps.

Dividend payments on equity shares held by QFls can either be directly remitted to the designated overseas bank accounts of the QFIs or credited to the single non-interest bearing Rupee account.

Entities into which FDI can be made

FDI can be made into following entities:-

1. Indian Company

2. Partnership Firm/Proprietary Concern (on non-repatriation basis, provided the firm or proprietary concern is not engaged in any agricultural/plantation or real estate business or print media sector and subject to such other conditions as maybe specified. Investments with repatriation option is available subject to prior approval of RBI)

3. Venture Capital Fund (VCF) (VCF set up as a trust is subject to approval of the FIPB and VCF set up as is under the automatic route of FDI Scheme, subject to the pricing guidelines, reporting requirements, mode of payment, minimum capitalization norms, etc.

4. Trusts (FDI in Trusts other than VCF is not permitted)

5. Limited Liability Partnerships (LLPs)

6. FDI in other Entities (FDI in resident entities other than those mentioned above is not permitted.)

Types of instruments

Equity

Equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares

Conditions

a) There is a minimum lock-in period of one year which shall be effective from the date of allotment of such capital instruments.

(b) After the lock-in period and subject to FDI Policy provisions, if any, the non-resident investor exercising option/right shall be eligible to exit without any assured return, as per pricing/valuation guidelines issued by RBI from time to time.

Debt

Other types of Preference shares/Debentures i.e. non-convertible, optionally convertible or partially convertible for issue of which funds have been received on or after May 1, 2007

The inward remittance received by the Indian company vide issuance of DRs and FCCBs are treated as FDI and counted towards FDI.

Prior permission of RBI in certain cases for transfer of capital instruments

1. Transfer of capital instruments from resident to non-residents by way of sale.

2. Transfer of any capital instrument, by way of gift by a person resident in India to a person resident outside India.

3. Transfer of shares from NRI to non-resident.

In the following cases, approval of RBI is not required

1. Transfer of shares from a Non-Resident to Resident under the FDI scheme where the pricing guidelines under FEMA, 1999 are not met

Transfer of shares from Resident to Non-Resident, where the transfer of shares

Requires the prior approval of the Government conveyed through FIPB

a) the requisite approval of the FIPB has been obtained; and

b) the transfer of shares adheres with the pricing guidelines and documentation requirements as specified by the Reserve Bank of India from time to time.

Attract SEBI (SAST) Regulations subject to the adherence with the pricing guidelines and documentation requirements as specified by Reserve Bank of India from time to time.

Does not meet the pricing guidelines under the FEMA, 1999 provided that,

SEE BELOW

Where the investee company is in the financial sector provided that:

SEE BELOW

Does not meet the pricing guidelines under the FEMA, 1999 provided that,

a) The resultant FDI is in compliance with the extant FDI policy and FEMA regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, etc.), reporting requirements, documentation etc.;
b) The pricing for the transaction is compliant with the specific/explicit, extant and relevant SEBI regulations/guidelines (such as IPO, Book building, block deals, delisting, exit, open offer/substantial acquisition/SEBI SAST); and
c) Chartered Accountants Certificate to the effect that compliance with the relevant SEBI regulations/guidelines as indicated above is attached to the form FC-TRS to be filed with the AD bank.

Where the investee company is in the financial sector provided that:

a) Any ‘fit and proper/due diligence’ requirements as regards the non-resident investor as stipulated by the respective financial sector regulator, from time to time, have been complied with; and
b) The FDI policy and FEMA regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, pricing, etc.), reporting requirements, documentation etc., are complied with.

That's all folks

Good Luck for Examinations

Regards,

Ilma Shuza