

# Foreign Exchange Management Act

The world has become economically inter-dependent. Following the directions of the World Trade Organisation, the participating countries have had to open their borders for trade and commerce. However, each country has its own currency and so, international trade requires an exchange of currencies. This has led to the development of a foreign exchange market, where the currencies of foreign countries can be bought and sold. The foreign exchange market is central to the economy of a country. It bears a relationship with the growth, employment, inflation, trade and stability of the country. Thus, the foreign exchange market needs to be regulated and managed.

The Foreign Exchange Management Act, 1999 (FEMA) provides for the management of foreign exchange. It is a skeletal legislation. It creates a broad framework and delegates the power to fill in the details to the Central Government and the Reserve Bank of India (RBI). The Central Government has made rules on the different aspects of the Act. The rules have been frequently amended through notifications. In addition, the RBI has provided further details. This has resulted in the creation of voluminous documents on the subject. The documents provide schemes, procedures and forms. This chapter will introduce the broad arrangement set out by FEMA, 1999 and the salient features of the details set out by the Central Government and RBI. The chapter is not an exhaustive description of the schemes and plans and must not be taken as a guide.

India has to necessarily import certain goods and thus, it has been perpetually watchful of its foreign exchange reserves. The level of the foreign exchange reserves can be maintained by boosting exports, encouraging remittances and attracting foreign capital. This needs fine balancing and regulation. The Act controls the foreign exchange transactions by providing that only authorised persons can deal in foreign exchange. The Reserve Bank of India has been given the power to appoint and regulate the persons authorised to transact in foreign exchange. The authorised persons are either banks or money changers. The Act also constitutes the category of 'person resident in India'. The provisions of the Act are with reference to this category only. Towards understanding the Act and the details under it, we need to become familiar with the meaning of this category. Section 2(v) defines it as follows:

2(v) "person resident in India" means—

(i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include—

(A) a person who has gone out of India or who stays outside India, in either case—

(a) for or on taking up employment outside India, or

(b) for carrying on outside India a business or vocation outside India, or

c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;

(B) a person who has come to or stays in India, in either case, otherwise than—

- (a) for or on taking up employment in India, or
- (b) for carrying on in India a business or vocation in India, or
- (c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;
- (ii) any person or body corporate registered or incorporated in India,
- (iii) an office, branch or agency in India owned or controlled by a person resident outside India,
- (iv) an office, branch or agency outside India owned or controlled by a person resident in India;

Section 2(w) defines a 'person resident outside India' by exclusion, i.e., as one who is not 'a person resident in India'. The above definition has four sub-clauses-- i, ii, iii and iv. Clause (i) has two further sub-clauses -- A and B. Clause (ii) includes all bodies incorporated in India within the category of 'person resident in India'. Thus, a company incorporated in India or a public sector undertaking is a 'person resident in India'. Clause (i) applies to individuals. The clause begins by making every individual, irrespective of his/her nationality, residing in India for more than 182 days in the preceding financial year, a 'person resident in India'. A financial year begins on the 1<sup>st</sup> of April of a year and ends on 31<sup>st</sup> of March of the next year. However, it excludes an Indian national who has gone out of India for employment, is carrying on any business outside India or intends to stay outside India for an indefinite period. The Act gives the reverse treatment to the foreigners residing in India. A foreigner staying longer than 182 days in a year in India, for employment or for doing a business or vocation, is a 'person resident in India'. Clause (iv) deals with business establishments outside of India of a 'person resident in India'. For example, X Ltd, a company incorporated in India, has a sales office in London. The sales office is a 'person resident in India' even if it is located in London. Let us take the reverse case. A company incorporated in the UK has a sales office in Delhi. Under Clause (iii), the sales office is a 'person resident in India'.

Towards regulating foreign exchange transactions, the Act makes a distinction between a 'capital account transaction' and a 'current account transaction'. Section 2(e) defines a capital account transaction as follows:

- (e) 'capital account transaction' means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6;

For example, a company incorporated in India, buys a building in London for housing its branch office. This is a capital account transaction as the company is a 'person resident in India', whose assets outside India are being altered. A current account transaction is one which is not a capital account transaction. Section 2(j) defines it follows:

- 2 (j) "current account transaction" means a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes:-

- (i) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business,
- (ii) payments due as interest on loans and as net income from investments,
- (iii) remittances for living expenses of parents, spouse and children residing abroad, and
- (iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children;

Thus, a current account transaction has been defined as one which is not a capital account transaction. If a company incorporated in India and working from India, buys raw material from another country, it would be a current account transaction. Some other examples of current account transactions are a person taking foreign exchange for going abroad for a vacation or a person sending foreign exchange to a foreign country for his son's studies. A company incorporated in India and working from India, buys machinery from abroad for setting up a plant in India. The machinery is a capital asset. However, as the machinery is being brought into India, it is not altering the capital assets of the company outside India. Thus, the transaction is a current account transaction. We can now explore the main provisions of the Act. Section 4 provides:

**4. Holding of foreign exchange, etc.** Save as otherwise provided in this Act, no person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India.

The above section is a general provision, bringing all the aspects of foreign exchange transactions within the folds of the Act. A person resident in India can acquire, hold, own or possess foreign exchange only as authorised under the Act.

### **Current Account Transaction**

Section 5 provides on current account transactions. It states

**5. Current account transactions.** Any person may sell or draw foreign exchange to or from an authorised person if such sale or drawal is a current account transaction:

Provided that the Central Government may, in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as may be prescribed.

This section allows any person to draw foreign exchange from an authorised person for a current account transaction. The limitation on the freedom is only to the extent of the restrictions imposed by the Central Government through its rules, notifications or orders. The Central Government can impose only 'reasonable restrictions'. The Central Government has issued the Foreign Exchange Management (Current Account Transactions) Rules, 2000, imposing certain restrictions. The Rules have since been amended through numerous notifications. The Rules, with all the amendments consolidated in them, constitute the existing law on the subject. It can be a demanding exercise for dealers in foreign exchange to get all the notifications together. To facilitate this, the RBI has been issuing master circulars on different subjects, summarising the existing law. The master circular also carries an expiry period of one year, making it imperative for the RBI to revise the document. The webpage of the RBI is a repository of information and documents on the Act.

The Foreign Exchange Management (Current Account Transactions) Rules, 2000 (with all the amendments) completely prohibit certain current account transactions. These transactions are listed in Schedule 1 of the Rules. Transactions listed in Schedule 2 can be carried out only with the prior permission of the Central Government. Transactions listed in Schedule 3 require prior permission of the RBI. All transactions not covered by the three schedules, require no permission. An authorised dealer is free to issue foreign exchange for such transactions. Further, Rule 3 prohibits withdrawal of foreign exchange for travel to Nepal or Bhutan or for transacting with a person in Nepal or Bhutan. Schedule 1 is as follows:

**Schedule I**

**Transactions which are Prohibited (see rule 3)**

1. Remittance out of lottery winnings.
2. Remittance of income from racing/riding etc. or any other hobby.
3. Remittance for purchase of lottery tickets, banned /proscribed magazines, football pools, sweepstakes, etc.
4. Payment of commission on exports made towards equity investment in Joint Ventures / Wholly Owned Subsidiaries abroad of Indian companies.
5. Remittance of dividend by any company to which the requirement of dividend balancing is applicable.
6. Payment of commission on exports under Rupee State Credit Route, except commission up to 10% of invoice value of exports of tea and tobacco.
7. Payment related to 'Call Back Services' of telephones.
8. Remittance of interest income on funds held in Non-Resident Special Rupee (Account) Scheme.

The schedule prohibits remittances out of lottery winnings, racing or similar hobbies. It prohibits remittances for the purchase of lottery tickets or football pools and sweepstakes. Football pools and sweepstakes are forms of gambling. The schedule prohibits any remittance for buying banned magazines. The other items in the list have been included as benefit has been given to the parties in specific schemes. Rule 4 requires the prior approval of the Government of India for a foreign exchange transaction included in Schedule 2. Schedule 2 reads:

**Schedule II**

**Transactions which require prior approval of the Central Government (see Rule 4)**

Purpose of Remittance	Ministry / Department of Govt. of India whose approval is required
1. Cultural Tours	Ministry of Human Resources Development, (Department of Education and Culture)
2. Advertisement in foreign print media for the purposes other than promotion of tourism, foreign investments, and international bidding (exceeding USD 10,000) by a State Government and its Public	Ministry of Finance, (Department of Economic Affairs)

Sector Undertakings	
3. Remittance of freight of vessel chartered by a PSU	Ministry of Surface Transport, (Chartering Wing)
4. Payment of import through ocean transport by a Govt. Department or a PSU on c.i.f. basis (i.e. other than f.o.b. and f.a.s. basis)	Ministry of Surface Transport, (Chartering Wing)
5. Multi-modal transport operators making remittance to their agents abroad	Registration Certificate from the Director General of Shipping
6. Remittance of hiring charges of transponders by	Ministry of Information and Broadcasting
(a) TV Channels	Ministry of Communication and Information Technology
(b) Internet Service providers	
7. Remittance of container detention charges exceeding the rate prescribed by Director General of Shipping	Ministry of Surface Transport (Director General of Shipping)
8. omitted	
9. Remittance of prize money/sponsorship of sports activity abroad by a person other than International / National / State Level sports bodies, if the amount involved exceeds USD 100,000.	Ministry of Human Resources Development (Department of Youth Affairs and Sports)
10. Omitted	
11. Remittance for membership of P&I Club	Ministry of Finance (Insurance Division)

Most of the above provisions relate to spending by the government departments.

### Current Account Transactions- Individuals

Rule 5 requires prior approval of the RBI for a transaction included in Schedule 3. Some of the relevant provisions for resident individuals are:

2. Release of exchange exceeding US\$ 10,000 or its equivalent in one financial year, for one or more private visits to any country (except Nepal and Bhutan).
5. Exchange facilities exceeding USD 100,000 for persons going abroad for employment.
6. Exchange facilities for emigration exceeding USD 100,000 or amount prescribed by country of emigration.
8. Release of foreign exchange, exceeding USD 25,000 to a person, irrespective of period of stay, for business travel, or attending a conference or specialised training or for maintenance expenses of a patient going abroad for medical treatment or check-up abroad, or for accompanying as attendant to a patient going abroad for medical treatment/check-up.
9. Release of exchange for meeting expenses for medical treatment abroad exceeding the estimate from the doctor in India or hospital/doctor abroad.
10. Release of exchange for studies abroad exceeding the estimate from the institution abroad or USD 100,000, per academic year, whichever is higher.

The provisions are self-explanatory. All the provisions above refer to a limit. No permission of the Reserve Bank is needed for release of foreign exchange within the limit. A dealer in foreign exchange can release foreign exchange on adequate documentation. The dealer has to take the permission of the RBI only if the

amount exceeds the mentioned limit. Thus, for a private visit abroad, other than to Nepal and Bhutan, a resident can obtain foreign exchange up to an aggregate amount of USD 10,000, from an Authorised Dealer, in one financial year. For a business trip abroad, other than to Nepal and Bhutan, a person can avail of foreign exchange up to USD 25,000 per visit. Visits in connection with an international conference, seminar, specialised training, study tour and apprentice training are treated as business visits. A person going abroad for employment can draw foreign exchange up to USD 100,000 from any Authorised Dealer in India, on the basis of self-declaration. A student studying abroad can draw the higher of the two, the estimate received from the institution abroad or USD 100,000, per academic year.

Use of International Credit Cards (ICCs) can also be made for travel abroad. Rule 7 states:

**7. Use of International Credit Card while outside India:** Nothing contained in Rule 5 shall apply to the use of International Credit Card for making payment by a person towards meeting expenses while such person is on a visit outside India.

Rule 5 creates Schedule 3, which includes transactions in foreign exchange that require prior permission of the RBI. An ICC can be used for all the items listed in Schedule 3, including those for which prior permission of the RBI is needed. Thus, there seems to be no limit on the use of credit cards for meeting expenses while on travel abroad. Further, one can use ICCs on internet for any purpose for which exchange can be purchased from an Authorised Dealer in India, e.g. for import of books, purchase of downloadable software or import of any other item permissible under Foreign Trade Policy (FTP). There is no aggregate monetary ceiling prescribed separately for the use of ICCs through internet. However, ICCs cannot be used on internet or otherwise for the purchase of prohibited items, like lottery tickets, banned or proscribed magazines, participation in sweepstakes or payment for call-back services, since foreign exchange is not permitted for such items/activities.

The Government of India has provided on the availing, holding and surrendering of foreign exchange. Travellers are allowed to purchase foreign currency notes/coins only up to USD 3,000. The balance amount can be carried in the form of travellers' cheques (TCs) or bankers' drafts. Permissible foreign exchange can be drawn 60 days in advance of the travel. In case it is not possible to use the foreign exchange within the period of 60 days, it should be immediately surrendered to an authorised person. However, residents are free to retain foreign exchange up to USD 2,000, in the form of foreign currency notes or TCs, for future use.

A person coming into India from abroad, can bring with him, any amount of foreign exchange. However, if the aggregate value of the foreign exchange in the form of currency notes, bank notes or travellers' cheques brought in exceeds USD 10,000 or its equivalent and/or the value of foreign currency alone exceeds USD 5,000 or its equivalent, it should be declared to the Customs Authorities at the Airport, on arrival in India. On returning from a foreign trip, travellers are required to surrender the unspent foreign exchange held in the form of currency notes and travellers' cheques, within 180 days of their return. However, they are free to retain foreign exchange up to USD 2,000 in the form of foreign currency notes or TCs, for future use.

## Current Account Transactions- Businesses

The important entries in Schedule 3 on business transactions are as follows:

15. Remittances exceeding US\$ 10,000,000 per project for any consultancy services in respect of infrastructure projects and US\$ 1,000,000 per project, for other consultancy services procured from outside India.

Explanation:- For the purposes of this item number 'infrastructure project'

is those related to –

- (i) Power,
- (ii) Telecommunication,
- (iii) Railways,
- (iv) Roads including bridges,
- (v) Sea port and airport,
- (vi) Industrial parks, and
- (vii) Urban Infrastructure (water supply, sanitation and sewage) ...

17. Remittances exceeding five per cent of investment brought into India or US\$ 1,00,000 whichever is higher, by an entity in India by way of reimbursement of pre-incorporation expenses.

For all other current account business transaction, the permission of the RBI is not needed for the authorised dealer to release foreign exchange. Of course, for importing goods or services, the resident would need to have the license, if the import requires a licence or approval of the Government.

## Foreign Currency Accounts

Provisions have been made for different kinds of foreign exchange accounts, for the benefit of the residents. An overview of the different kinds of accounts is as follows:

1. **Exchange Earners' Foreign Currency Account** : An Exchange Earners' Foreign Currency Account (EEFC) is an account maintained in foreign currency with an Authorised Dealer, for example, with a bank dealing in foreign exchange. It is a facility provided to foreign exchange earners. This can be an individual or a company resident in India. The foreign exchange earner can credit all the foreign exchange earnings to the account. The person can then make eligible expenditures from the account. Thus, the person does not have to convert the foreign exchange into Rupees and vice-versa. This reduces the transaction costs.

2. **Resident Foreign Currency Accounts** : Only an individual returning to India can create a Resident Foreign Currency (RFC). Foreign currency assets by the person residing outside can be credited to the account. The other sources for credit to the account can be pension, superannuation or other monetary

benefits from the employer outside India, gift or inheritance from a person residing outside India or the proceeds of a life insurance policy in foreign currency. The funds in an RFC account are free from all restrictions regarding utilisation of foreign currency balances, including any restriction on investments outside India. This is a very significant aspect of the account.

**3. Resident Foreign Currency (Domestic) Account :** Only a resident individual can open and maintain a Resident Foreign Currency (Domestic) Account. The account can be credited with foreign exchange acquired in the form of currency notes, bank notes and travellers' cheques as payment for services rendered abroad, or as an honorarium or gift. The account may also be credited with foreign exchange earned from abroad through export of goods and services, royalty etc. Gifts received from close relatives and repatriated to India through normal banking channels can also be credited to the account. The account can be debited for payments made towards permissible current and capital account transactions.

### Capital Account Transactions

Section 6 provides on availing foreign exchange for capital account transactions. It reads:

**6. Capital account transactions.** (1) Subject to the provisions of sub-section (2), any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction.

(2) The Reserve Bank may, in consultation with the Central Government, specify

(a) any class or classes of capital account transactions which are permissible;

(b) the limit up to which foreign exchange shall be admissible for such transactions ...

Section 6 allows the release of foreign exchange for the capital account transactions that are allowed by the RBI under Section 6(2). The difference between the provision on current account transactions and that on capital account transactions is that all current account transactions are allowed without permission, unless restricted, while a capital account transaction can be taken up only if it is allowed under Section 6. We can study capital account transactions for individuals and corporate bodies, separately. Further, capital account transactions can be inward or outward.

### Outward Capital Account Transactions- Individuals

The RBI issued a circular in February 2004, announcing a 'Liberalised Remittance Scheme (the Scheme)'. The Scheme was on capital account transactions for persons resident in India. The scheme, since, has been amended. It is open only for resident individuals. Under this scheme, a resident individual can remit up to USD 200,000 per financial year, for any permitted capital or current account transaction, or for a combination of both. Further, a resident individual can acquire and hold immoveable property or shares or debt instruments or any other assets outside India, without prior approval of the Reserve Bank of India. An individual can also open, maintain and hold foreign currency accounts with banks outside India, for carrying out transactions permitted under the scheme. The scheme specifically mentions:

It is further clarified that the facility under the scheme is in addition to those already available for private travel, business travel, gift remittances, donations, studies, medical treatment etc as described in Schedule III of Foreign Exchange Management (Current Account Transactions) Rules, 2000.

The remittance facility under the above scheme is not available for remittances mentioned in Schedule 1 and Schedule 2 of the Foreign Exchange Management (Current Account Transactions) Rules, 2000. In addition, the following remittances are not allowed under the scheme:

1. Remittance from India for margins or margin calls to overseas exchanges / overseas counterparty;
2. Remittances for purchase of FCCBs issued by Indian companies in the overseas secondary market;
3. Remittance for trading in foreign exchange abroad;
4. Remittance by a resident individual for setting up a company abroad;
5. Remittances directly or indirectly to Bhutan, Nepal, Mauritius and Pakistan;
6. Remittances directly or indirectly to countries identified by the Financial Action Task Force (FATF) as “non co-operative countries and territories”, from time to time; and
7. Remittances directly or indirectly to those individuals and entities identified as posing significant risk of committing acts of terrorism as advised separately by the Reserve Bank to the banks.

The Central Government has also made the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004. General permission has been granted to persons resident in India for purchase or acquisition of securities as follows:

- a. Out of funds held in the RFC account;
- b. As bonus shares on existing holdings of foreign currency shares;
- c. When not permanently resident in India, from the foreign currency resources outside India.

Further, a resident individual can acquire foreign securities without prior approval, if they are in the form of a gift from a person outside India, an inheritance from a person whether resident in or outside India or by way of Employee Stock Options offered by a foreign company.

### **Outward Capital Account Transactions- Legal Persons**

Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 provide on capital account transactions. Outward capital account transactions can take two forms. An Indian entity can set up a joint venture or a wholly owned subsidiary company in another country. This is called direct investment. Alternatively, an entity can buy securities in another country. Direct investment refers to a contribution to the capital or subscription to the Memorandum of Association of a foreign entity, signifying a long-term interest. This can take the form of a Joint Venture (JV), where a partial stake is taken up, or a Wholly Owned Subsidiary (WOS), where an existing company is fully acquired. For some kinds of direct investments, prior permission of the RBI is not needed. These investments are referred to as the automatic

route. For investment in certain sectors, prior approval of the RBI is needed. These are called approval route.

Direct investment in real estate and the banking business is prohibited. However, Indian banks can set up JVs or WOS by getting prior permission from the RBI. An 'Indian Party' is eligible to make an overseas direct investment under the automatic route. An Indian Party is a company incorporated in India or a body created under an Act of Parliament or a partnership firm registered under the Indian Partnership Act, 1932. Under the automatic route, an Indian Party does not require any prior approval from the Reserve Bank for the setting up of a JV/WOS abroad. The Indian Party can directly go to an Authorised Dealer for making the remittances towards such investments. The Indian Party can invest up to 400% of its net worth in a JV / WOS for any lawful activity permitted by the host country. The ceiling of 400% of the net worth will not be applicable where the investment is made out of balances held in the EEFC account of the Indian party or out of funds raised through ADRs. The India Party has to repatriate to India, all dues receivable from the foreign entity, like dividends, royalty and technical fees.

After the report of the first remittance is received by the Reserve Bank, from the designated Authorised Dealer, a Unique Identification Number (UIN) for that particular JV/WOS is issued. The Indian Party has to submit to the RBI, the Annual Performance Report of the JV/WOS.

A listed Indian company can invest up to 50% of its net worth in shares of overseas companies, listed on a recognised stock exchange, or in rated debt securities issued by such companies. Mutual Funds registered with the SEBI are also permitted to invest abroad subject, to certain limits and conditions.

### **Foreign Direct Investment (FDI)**

Foreign investment in India, by legal persons, can take two forms. One, Foreign Direct Investment (FDI), where a company incorporated outside India, forms a joint venture or a wholly owned subsidiary company in India. Two, acquisition of securities of an existing Indian company, by such a company. A foreign company can invest in India by getting into a joint venture or by forming a wholly owned subsidiary in India. There are some sectors where FDI is prohibited. These sectors are:

- i) Retail Trading (except single brand product retailing)
- ii) Atomic Energy
- iii) Lottery Business
- iv) Gambling and Betting
- v) Business of Chit Fund
- vi) Nidhi Company

vii) Agricultural (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors) and Plantations activities (other than Tea Plantations)

viii) Housing and Real Estate business (except development of townships, construction of residential/commercial premises, roads or bridges to the extent specified in Notification No. FEMA 136/2005-RB dated July 19, 2005).

ix) Trading in Transferable Development Rights (TDRs).

x) Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

For all other sectors, there are two routes for FDI, the automatic route and the government route. FDI of up to 100 per cent is allowed under the automatic route in all activities/sectors except where the provisions of the consolidated FDI Policy and sectoral caps in terms of the paragraph on 'Entry Routes for Investment' issued by the Government of India from time to time, are attracted. FDI in sectors /activities, to the extent permitted, under the automatic route, does not require any prior approval, either of the Government or the Reserve Bank of India. Whether the investment is under the automatic route or the government route, the Indian company has to report to the RBI on several aspects of the receipt of the funds and its deployment. FDI in activities not covered under the automatic route, requires prior government approval and it is considered by the Foreign Investment Promotion Board (FIPB). The list of activities or items for which the automatic route for foreign investment is not available, include the following:

- Banking
- NBFC's Activities in Financial Services Sector
- Civil Aviation
- Petroleum, Including Exploration/Refinery/Marketing
- Investment in the housing & Real Estate Development Sector, from persons other than NRIs/OCBs.
- Venture Capital Fund and Venture Capital Company
- Investing Companies in Infrastructure & Service Sector
- Atomic Energy & Related Projects
- Defence and Strategic Industries
- Agriculture (Including Plantation)
- Print Media
- Broadcasting
- Postal Services

The second means for direct investment by a company outside India is through buying of securities of an existing Indian company. A person resident in India may transfer by way of sale, to a person resident outside India, shares of an Indian company whose activities fall under the automatic route of the FDI Scheme. The parties have to comply with the FDI sectoral limits, pricing guidelines, documentation and reporting requirements for such transfers, as specified by the Reserve Bank of India. In case of listed

entities, the transfer of shares should not be in violation of the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, as amended from time to time.

A person resident outside India cannot buy immovable property in India. The only exceptions to this are Non Resident Indians (NRIs) and Persons of Indian Origin (PIOs). However, a foreign company which has established a branch office or other place of business in India, can acquire immovable property in India, as is necessary for or incidental to carrying on of such activity. This has been facilitated by the Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations, 2000. The payment for acquiring such a property should be made by way of foreign inward remittance, through proper banking channels. Further, acquisition of immovable property by entities incorporated in Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal and Bhutan, who have set up branch offices in India, would require prior approval of the Reserve Bank.

### **Foreign Portfolio Investment**

SEBI has made regulations for the registration of Foreign Institutional Investors (FIIs). FIIs registered with SEBI, under the regulations, are treated differently. The FIIs include asset management companies, pension funds, mutual funds, investment trusts, incorporated portfolio managers and institutional portfolio managers. Investment by an FII cannot exceed 10% of the paid-up capital of an Indian company. Further, FIIs as a whole, cannot acquire more than 24 per cent of the paid-up capital of an Indian company. An Indian company can raise the 24% ceiling by passing a Special Resolution in a General Body Meeting. The Indian company has to intimate the raising of the FII limit to the RBI for the RBI to notify the same on its website, for the purpose of public dissemination. FIIs can buy other securities on a repatriation basis. The investment limit for the FIIs as a group, in government securities, currently, is USD 10 billion and in corporate debt, it is USD 20 billion.

NRIs and PIOs can purchase or sell shares on the stock exchanges in India under the Portfolio Investment Scheme. The NRI/ PIO has to apply to a designated branch of a bank, which deals in Portfolio Investment. Then, he/she can purchase shares up to 5% of the paid-up capital of an Indian company. All NRIs/PIOs taken together, cannot purchase more than 10% of the paid-up value of a company. This limit can be increased by the Indian company to 24%, by passing a General Body resolution. NRIs, but not PIOs, can also buy other securities like government securities, treasury bills and corporate debt instruments. The purchase can be on a repatriation or non-repatriation basis. NRIs and PIOs can purchase immovable property in India, other than agricultural land. However, other individuals, resident outside India, cannot buy immovable property in India. Foreign nationals resident in India can buy immovable property in India, subject to conditions.

A contravention of the Act or the rules, notifications and orders passed under the Act, can be compounded by making an application to the RBI. 'Compounding' is a compromise where the authority agrees to not initiate a proceeding or drop a proceeding on the payment of a compounding fee. Wilful, malafide and fraudulent transactions are viewed seriously and not compounded by the Reserve Bank. Further, offences like money laundering and activities raising national security concerns cannot be compounded and would be investigated further by the Enforcement Directorate. The provision of compounding is in sharp contrast

and relief to the now repealed Foreign Exchange Regulation Act, 1973, which provided for imprisonment as the punishment for any violation of the Act. The Prevention of Money Laundering Act, 2002, however, has brought in the possibility of criminal proceedings and punishment if it is suspected that there is a nexus between the transaction and certain specified crimes.

## Summary

1. Foreign Exchange Management Act, 1999 (FEMA) provides for the management of foreign exchange. It is a skeletal legislation.
2. It gives extensive powers to the Central Government and Reserve Bank of India to provide the details.
3. Person resident in India is a key concept for the application of the Act.
4. The Act makes a distinction between current account transaction and capital account transaction.
5. The Central Government has made the Foreign Exchange Management (Current Account Transactions) Rules, 2000 for facilitating and regulating current account transactions.
6. The Central Government has made regulations and notifications and the Reserve Bank of India circulars providing the details under the Act.

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McGraw  
Hill