



# **THE CHAMBER OF TAX CONSULTANTS**

3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020  
●Tel.: 2200 1787 / 2209 0423 ●Fax: 2200 2455 ●E-mail: office@ctconline.org  
●Website: [www.ctconline.org](http://www.ctconline.org)

## **Seminar on Recent Developments in Compounding of Offences under FEMA Queries for Panel Discussion on 24.4.2019**

### **(I) Amount, timelines, etc.**

1) The amount of fees in compounding order issued by authorities is based on the working matrix provided under notification. However, in certain cases, it is not possible to reconcile the fees levied with the matrix as per regulation. In case where applicant feels that the compounding fees levied are higher than the working as per the notification matrix, whether any of the below remedy is available to the applicant?

- Whether he can challenge the order?
- Whether he can file for rectification?
- Whether such fees can be revised?
- Whether the applicant has an option to file writ with HC?
- Whether the applicant can demand the working for calculation of compounding fees?

Is there any reason for RBI not providing the working as per the matrix in the compounding order?

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2) If the compounding fees could not be paid within 15 days from the date of the issue of order due to genuine reasons/difficulties and the same is paid thereafter, can it be deemed as contravention of the order?

Whether any remedy is available to the applicant to seek extension?

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3) Where in a case there is a contravention which is known and pending, the banker may not entertain the current transaction which is partly comple

and it shall be halted in middle. This would lead to another contravention which would further lead to multiple contraventions. Whether any remedial measures are available or something like 'protective transaction' (like protective assessment) which AD banker will complete subject to correction of error of earlier transaction by the applicant.

Also, what is the logic behind stopping a business transaction pending the compounding process?

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- 1) Should RBI compound a case where there is delay in reporting which is attributable to AD bank?

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**(II) Other queries:**

**1) Investment under approval route:**

It is stated in regulation as follows:

*“Contraventions relating to any transaction where proper approvals or permission from the Government or any statutory authority concerned, as the case may be, have not been obtained, such contraventions would not be compounded unless the required approvals are obtained from the concerned authorities”*

It is often noticed that such authorities provide post facto approval subject to applicant applying for compounding under particular regulation as may be applicable.

However, there is no time limit provided under the regulations or under such approval. In how much time can the applicant make the application for compounding? Is it fine if the applicant applies after a year from obtaining post facto? Can RBI reject such application on account of delay?

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2) RBI requires regularization of transaction before initiating compounding process. In some cases, for eg. an Indian company has received FDI through money changers and have allotted shares to non-resident. How would one regularize such a transaction? Does it mean you cannot go for compounding in such cases?

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3) In compounding ECB contraventions, we understand that RBI calculates the compounding fees basis a 'gain concept' i.e. basis the interest saved by the Indian company. What is the logic behind this?

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**(III) Stage at which RBI can compound the case if enquiry started by ED:**

1) Where a notice is received from the Enforcement Directorate (ED) enquiring about certain transactions undertaken by the company, whether the company can regularise the offence and opt for compounding before the show cause notice is issued by the ED?  
Can RBI compound a case for which show cause notice has been issued by the ED?  
At what stage does a company have an option to accept and regularise the offence and go for compounding assuming the enquiry is started by the ED based on information available with the ED.

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**(IV) Queries in relation to ODI Regulations:**

1) Why not introduce LSF (late submission fee) for all procedural contraventions?

We understand that the possible reason here is that as of now, only FDI filings are made online by the applicant and other filings (eg. ODI) are still made physically made with the AD bank. But even in such cases, the applicant would always have the acknowledgement for filing the forms with the AD bank which can be used as a base for calculation of LSF. If LSF is introduced, referring of many cases of procedural contraventions to compounding can be avoided.

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2) A Resident individual has sent money to his overseas account through LRS over the years.

- Whether he can use the above funds to pay a non-resident towards acquisition of shares of Indian company, to avoid forex loss/gain.
- Whether he can use the above funds to pay a non-resident towards acquisition of shares of foreign company, to avoid forex loss/gain.

Will above lead to any contravention leading to compounding.

Assuming that the above transaction is completed by the resident from overseas bank account, how will RBI compound the contravention? Since the overseas seller has been paid off and transaction cannot be reversed.

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### 3) **Overseas Direct Investments under Liberalized Remittance Scheme**

#### Facts:

With effect from 5<sup>th</sup> Aug. 2013, a resident is permitted to make Overseas Direct Investment in JV / WOS by utilizing the overall limit prescribed by RBI under LRS provided the conditions specified in Schedule V to FEMA Ntf. 120 are complied with. However, prior to this amendment, residents have

incorporated and invested in foreign companies for various purposes based on the language of the LRS Circulars from time to time as it appeared.

It is learnt that these matters of investment in the overseas companies are subject matter of Compounding.

Issues:

- What is the status of investments in unlisted private companies done under LRS prior to Aug. 2013? Can these investments made pre Aug 2013 be called for compounding given that strictly speaking there was nothing under the law which stopped acquiring overseas companies under LRS?

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4) A foreign company which is set up under ODI proposes to make investments into India. We understand that such acquisition would fall under approval route. Reason cited is that ODI is allowed only for bonafide business activities outside India and accordingly, investment into India would not be regarded as bonafide business activity outside India.

- What are the key criteria looking at which RBI grants approval to such cases?
- Will an Indian company acquiring global structure of a group (involving say 10 entities) where 1 entity is situated in India satisfy the rational for approval?
- Does RBI look at rotation of funds? Could approval be granted to Indian investments made by the ODI entity out of internal accruals or out of overseas borrowings?
- Can an overseas pooling vehicle which has Indian Sponsor's investment under ODI be allowed to make investments into India?

There is nothing strictly in the regulations which was stopping this. In such a situation, should RBI compound these cases?

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**5) Filing of Form ODI / APR in case of acquisition without remittance**

Facts:

Under Regulation 6(2) of FEMA Ntf. 120, direct investment may be made by an Indian Party under the automatic route in accordance with the prescribed conditions including filing Form ODI at the time of remittance. Form APR is also required to be filed by way of periodic compliance to enable further investment under the automatic route.

However, there may be events where a PRII acquires foreign security without making remittance such as acquisition by way of (i) gift from PROI or by way of inheritance from PRII or PROI, or (ii) cashless ESOP Scheme.

Issues:

- Is such a recipient / donee of the foreign securities required to file Form ODI or Form APR, especially if the securities in question were acquired by way of overseas direct investment under Regulation 6(2) by the original holder?
- In case of acquisition of foreign securities under the LRS scheme, as there is no requirement for filing Form ODI / Form APR / Divestment report, how does the RBI keep track of the holders of such securities in case of transfers by way of sale / gift / inheritance?
- In case he has not filed Form ODI, can he be compounded?

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- 6) Form APR (Annual Performance Report) is provided for annual reporting by Indian Investor company towards the investment made in overseas JV/WOS. The form includes 'Reporting requirement of repatriation from JV/WOS '. Under which point (x) provides "FDI by JV/WOS/SDS into India". However, this would lead to round tripping of funds invested through ODI.

What is intention behind such entry? If an ODI applicant has FDI in India and there is repatriation, would it not lead straight to contravention?

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**(V) Queries in relation to compounding orders:**

- 1) Which date is to be considered as policy decision coming into effect for the purpose of levying compounding penalty?

Please refer to two compounding orders.

C.A. HYD 307 in case of Alphamed Formulations Private Limited and CA No 4656 / 2018 in case of Raks Pharma Private Limited. Both deal with investment in brownfield pharmaceutical sector. Previously brownfield pharma was under automatic route and subsequently, investment could have been made only under approval route. In case of Alphamed, RBI has considered contravention to have begun from date of issuance of Press note 3 of 2011 viz. 08.11.2011 whereas in case of Raks Pharma, RBI has adopted 19/10/2012 when Notification No. FEMA 242/2012-RB was issued.

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- 2) Under what circumstances does RBI compounding authority invoke Sec. 42(1)? CA No. 4767/2018 in case of K. Shanmugam, contraventions by company were (a) delay in reporting foreign inward remittance; (b) delay in reporting allotment of shares; (c) issue of CPPS without determining price or conversion formula upfront. Penalty amount of Rs. 3,63,000/- was levied previously on the company under Compounding Order CA No. MCO3870 dated June 07, 2016 for these contraventions. Vide CA No. 4767/2018, penalty of Rs. 36,300/- has been levied on Managing Director of the company - K. Shanmugam for the same contravention.

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- 3) What if transfer from Resident to Non Resident has been made in contravention of FERA regime. RBI mentions in the order that it cannot be compounded. Then what happens to those contraventions? Refer Abicor Binzel Production (India) Pvt Ltd. CA. No.4517/2017.

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**(VI) Export of Goods and Services:**

1) If a supplier has received advance against export for jewellery in India from a Non-resident. Subsequently the NR visits India and collects the jewellery personally. The supplier has informed its bankers about the advance for export, however there are no shipping documents since there was direct delivery to customer in India.

Whether this will amount to compounding proceedings as the applicant is required to submit relevant documents to the bank in order to enable the bank to close the transaction?

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2) Write back of export advances received – What is the remedial measure in EDPMS (Export Process Data Management System)/IDPMS (Import Process Data Management System).

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**(VII) Transfer of Immovable property outside India by way of inheritance from Resident to Resident**

1) Facts:

Under erstwhile Regulation 5(2) of FEMA Ntf. 7, a person resident in India (PRII) who had acquired immovable property outside India either (a) by way of gift or inheritance from a PROI referred to in Section 6(4) of the Act, or (b) by way of purchase out of foreign exchange held in RFC account, was permitted to transfer the same by way of gift to his relative who is PRII. However, transfer by way of inheritance was not provided for.

The amended FEMA Ntf. 7(R) now covers such a situation in amended Regulation 5(2) which states that a PRII may acquire immovable property outside India by way of inheritance or gift from a PRII who has acquired such property in accordance with foreign exchange provisions in force at the time of such acquisition.



Issues:

For events of inheritance of immovable property outside India held by a PRII to another PRII on the event of the former's death, as the erstwhile FEMA Ntf. 7 did not provide for general permission, whether such a transfer is deemed to be a violation of FEMA?

There may be a view that constitutional rights of Indians provides for automatic inheritance as per personal law and FEMA cannot override or restrict such operation of personal law protected by the Constitution of India. Is this understanding correct, else what are the implications under FEMA as prevalent under erstwhile Ntf. 7 as there may be many such cases of inheritance of foreign immovable property?

Can such a case be selected for compounding for the recipient of the property continuing to hold the immovable property?

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***This is the end of Queries***