

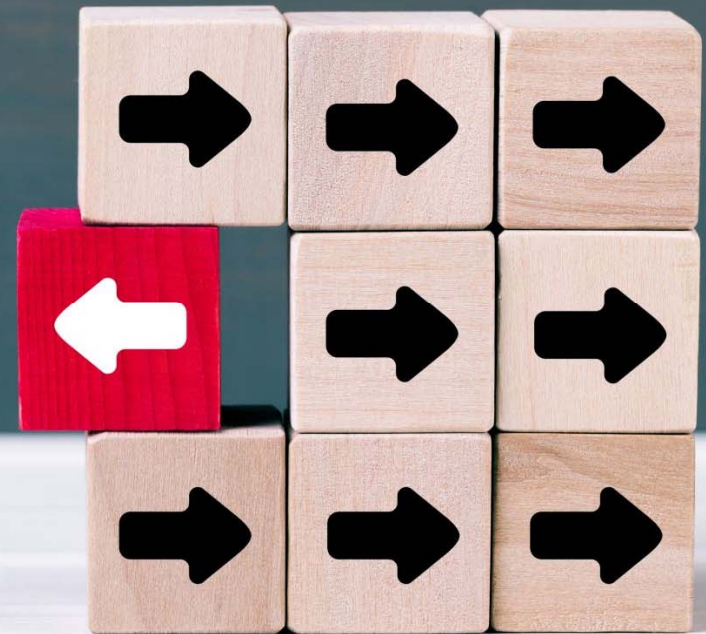


**Important aspects under FEMA
Vadodara Chapter of WIRC of ICSI**

CA HIREN SHAH – AHMEDABAD

Topics covered

-
- Basics
 - Inbound Investment
 - Outbound Investment
 - Compounding Mechanism



Basics

- Background
- Definitions
 - Person
 - Capital Account Transactions & Current Account Transactions
 - Repatriation



Inbound Investment

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Type of the Entity

- **Incorporated Entity**
- **Unincorporated Entity**

Objective



Background



Exit Strategy
[PE, IPO,
Dilution]



Tax Factors
[Structuring the
Investment]



**Non- Tax
Factors**



Incorporated Entity

- Governed under the respective Laws

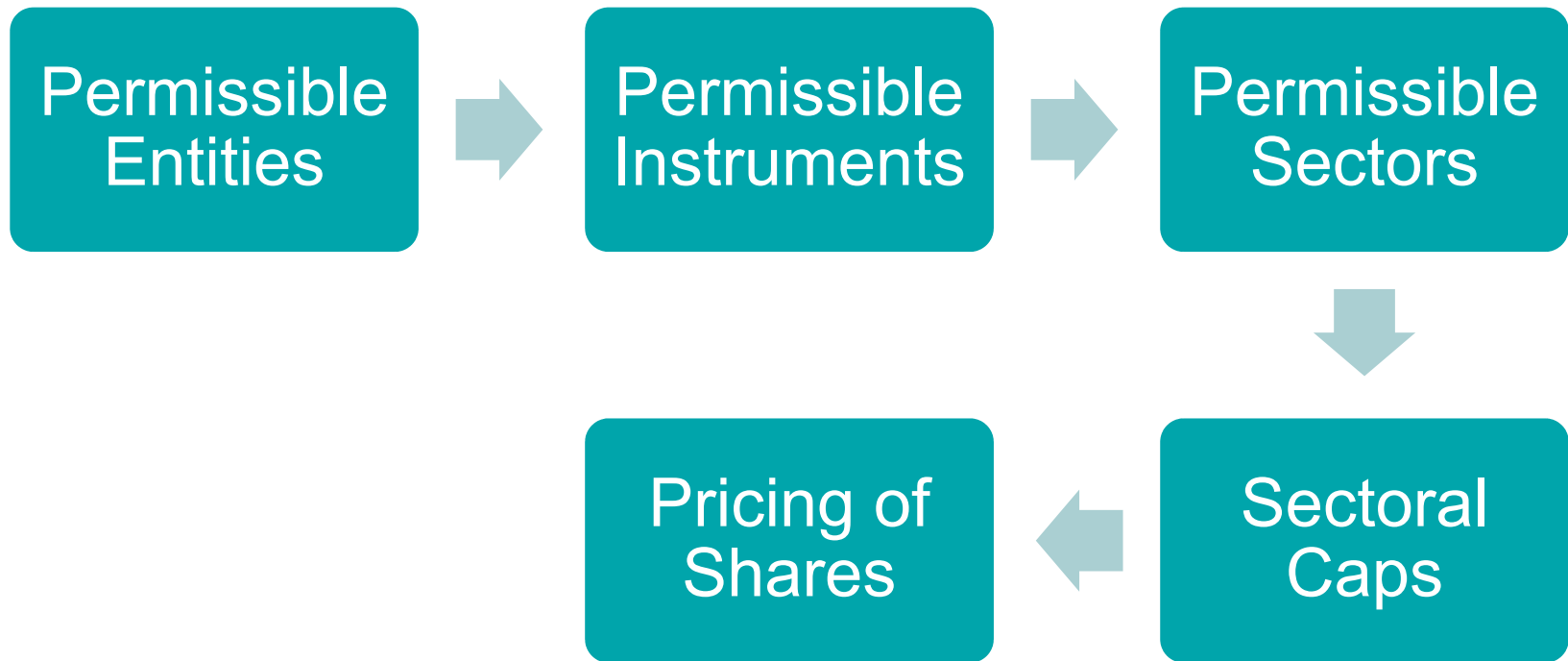


Repatriation Benefits

FDI Guidelines

Permissible
Capital Account
Transactions

Check Points



Pricing of Shares

- New Entity vis-à-vis Existing Entity
- Valuation of Shares
- Right Offer and Bonus Issues



Capital Structure



EQUITY



QUASI EQUITY [
CONVERTIBLE EQUITY]



EXTERNAL COMMERCIAL
BORROWINGS

Restructuring of the Equity

- **Transfer between Person resident in India vis-à-vis Person resident outside India subject to guidelines under FEMA regulations**
- **Buy- Back subject to Company Law guidelines**
- **Listed entity subject to SEBI guidelines [Overall Permissible Limited for NR Holding]**

Cash Out – Tax Factors



**SHARE OF
PROFIT**



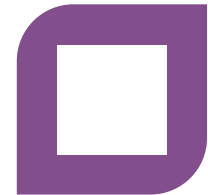
**DIVIDEND
INCOME**



**IRP
INCOME**



BUY-BACK



**ECB
REPAYMENTS**

OVERVIEW OF TAX IMPLICATION

Withholding Tax on Cash out [Source Country Tax]

Taxation in the Country of Resident

Elimination of tax in the Country of Residence

Transfer Pricing Applicability for Cross Border Services between the Indian entity and JV Partner or any of their affiliated entities

Unincorporated Entity

- Permissible entities [BO/LO/PO]
- Permissible Sectors
- Compliances under the Companies Act
- Tax Treatment

Practical Difficulties



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Concerns

- **Online Reporting Portal practical issues [FIRM]**
- **AD Bank approach**
- **Reporting through AD Bank**
- **Advice & Guidance**



Need of an Hour

Structure based on Objectives

Appropriate Structure

Free Cash Flow – Easy Exit

Evolve Tax Efficient Structure



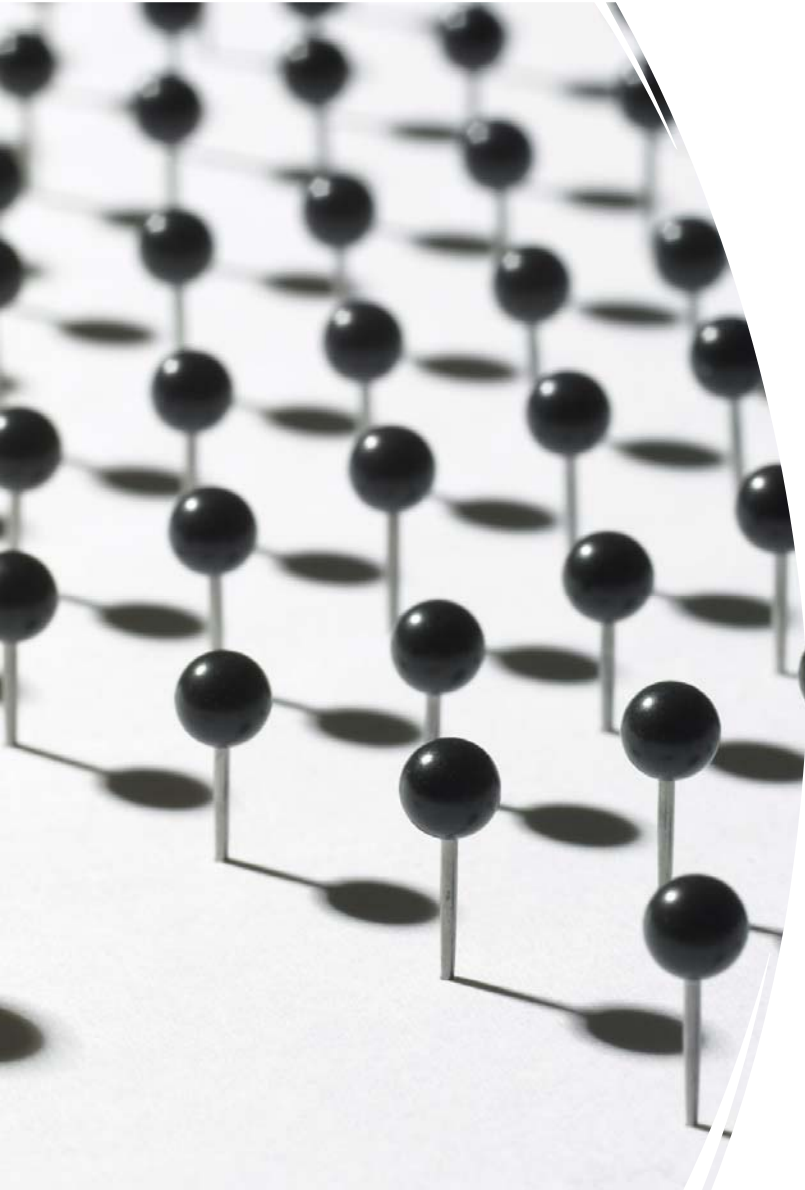
Outbound Investment

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Objectives

- **Vertical Expansion**
- **Value Creation**
- **Migration to be linked up with an Opportunity**



Type of the Entities

-
- **Incorporated Entity**
 - **Unincorporated Entity**



Overview

-
- **Permissible Entity**
 - **Permissible Limits [Financial Commitment]**
 - **Individuals**
 - **Other than Individuals**
 - **Permissible Sector**



Capital Structure

- **Infusion of Fund Pattern**
- **Entry / Exit Strategy**
- **Financial Leverage**

Cash Out



Pass through Income



Deemed Income - CFC Provisions



Dividend Income



Capital Gain



Repayment of Loan



IPR Income



Factors for Outbound Investments

- **Tax Factors**

- **Non- Factors**



Tax Factors

- Test of Residence for Overseas entity
- Implication for residential status
- Check up Point [Entity Level]
- Caution
- Treaty Network
- Transfer Pricing

Non-tax Factor

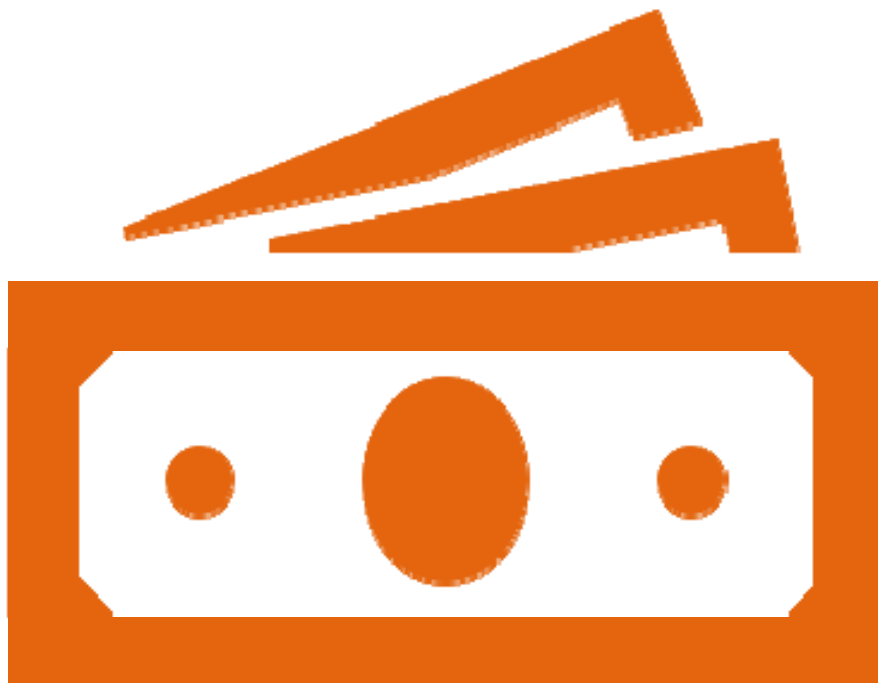
Stable Economy

Political System

Migration Policy

Substance

Political relations



Legal Compliances

- Under FEMA
- Under Company Law
- Under Income Tax

Compounding Mechanism

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Compounding Law

- **Section 13** of FEMA covers penalties in respect contraventions which are compounded.
- **Section 14** of FEMA Enforcement of order of adjudication Authority.
- **Section 15** of FEMA 1999 covers powers to compound contraventions and empowers the Compounding Authority to compound the contraventions
- Master Direction – Reporting under Foreign Exchange Management Act, 1999 (Updated as on April 04, 2019)
- Master Direction- Compounding of Contraventions under FEMA, 1999 (Updated as on April 04, 2019)
- Foreign Exchange(Compounding Proceedings) Rules, 2000 (the Rules) as amended time to time, lay down the basic framework for compounding process.



Compounding Law

- Compounding rules were amended with effect from 13.09.2004.
- RBI issued A.P. Circular No. 31 dated 1.2.2005.
- RBI has powers to compound all contraventions - except those of S.3(a).

Compounding law

ED can compound contravention u/s. 3(a) only.
[Deal in or transfer any foreign exchange or foreign security to any person other than Authorised Dealers – Hawala transactions.]

From 2005, compounding process started in true sense.

RBI was empowered to provide comfort to people to minimise transaction cost.

Compounding - meaning

Compound means to admit a violation and pay up the penalty.

It is a quick settlement system. One does not have to go through the legal process of adjudication, appeal, etc.

FEMA violation is not a scheduled offence under PMLA.

Compounding application

- Application can be filed:
 - Suo moto, or
 - on advice of RBI.
- Advisable to file once RBI advises.

Compounding application

Responsibility is normally on the Indian resident – as investee (for FDI), as borrower (ECB), as investor (JV/ WOS abroad).

Non-Resident is responsible for liaison office, branch, etc. in India.

Benefits of Compounding

Simplified process.

Quick completion of process.

Multiple/ Related offences can be compounded under one application.

Fastest way to clean the past.

Once over, there is no “pending investigation”.

After compounding, no further proceeding can be initiated or continued.

Key features of Compounding



It is a voluntary process – unlike adjudication where a person can be charged with an offence.



Person has to admit the offence.



Not a forum for arguing your case.



Compounding possible only if amount involved is quantifiable.



Powers with Regional Offices of RBI

- Delay in reporting inward remittance in case of FDI.
- Delay in filing Form FC-GPR after allotment of shares.
- Delay in issue of shares beyond 180 days of receipt of funds.
- Mode of receipt of funds



Powers with Regional Offices of RBI

- Violation of pricing guidelines for issue of shares.
- Issue of ineligible instruments - optionally convertible debentures, etc.
- Issue of shares without FIPB approval.
- Transfer of shares from resident to non-resident and vice-versa; and transfer of shares in the investee company's record.
- Delay in filing FLA returns by companies which have received Foreign Direct Investment.

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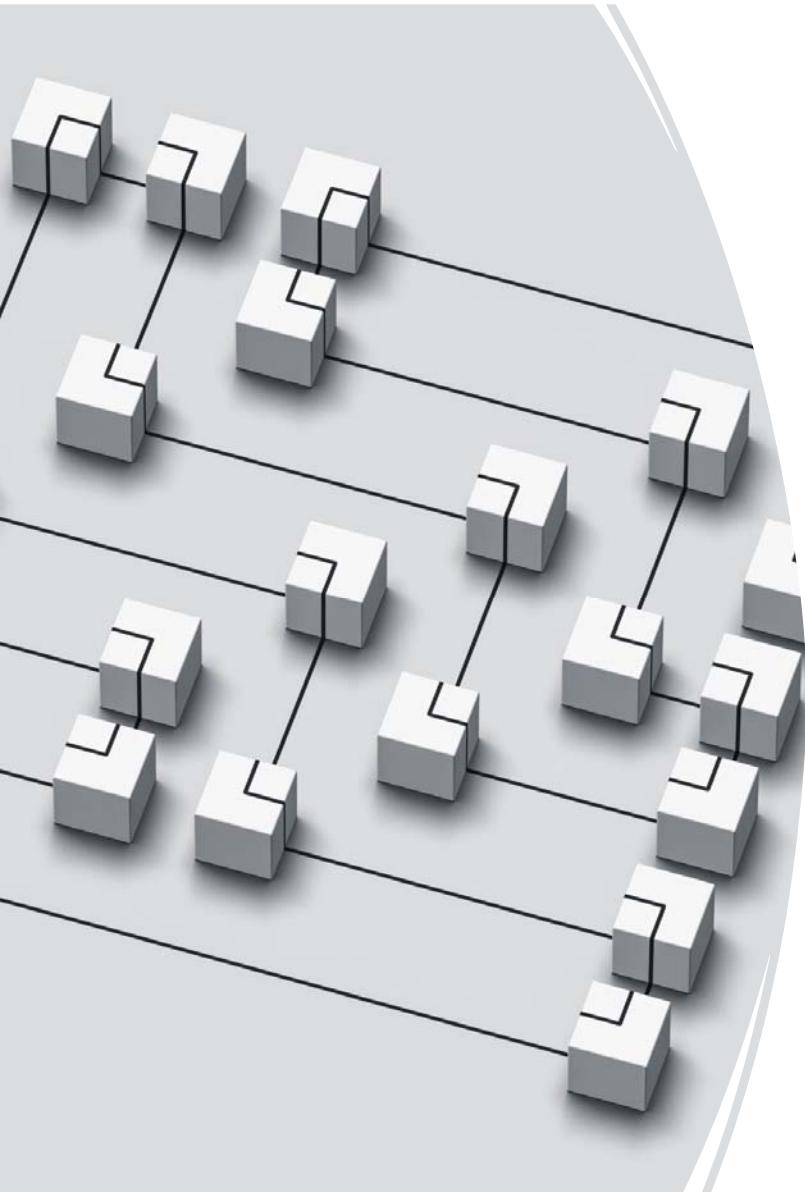
Powers with Delhi office of RBI

Immovable property abroad by residents.

Immovable property in India by non-residents.

Establishment of Branch, Liaison or Project office.

Contravention of Deposit regulations (FCNR / NRE / NRO and other non-resident accounts and deposits from non-resident by Indian entities)



Before the Compounding

- Administrative procedure should be completed before compounding can be done.
- Set right the contraventions before compounding.
- If transactions can't be set right, compounding may not be done.
- If administrative process is not complete, within 180 days of compounding application, application is returned with the application fee.



Administrative procedure

- File forms where they have not been filed.
- Obtain RBI approval if not obtained.
- Obtain FIPB approval for FDI not covered under automatic route.

Administrative procedure

RBI can decide whether an offence is:

technical/minor and only administrative procedure / cautionary advice is required.

material and requires compounding.

Serious to be referred to Enforcement Directorate.



If application is filed suo moto, compounding has to be done. Offence cannot be considered technical/minor.

Setting right - means what

-
- Setting right - may involve - reversing the transaction; unwinding investments.
 - Investment under LRS - unwind; or transfer shares to Indian company (except if it is under notification no. 263 dated 5.3.2013).
 - ECB - repay the loan/ convert into equity.
 - There cannot be a situation, where - the incorrect transaction continues, & it is compounded.

Procedure in brief

- File application form with full details.
- State clearly:
 - Nature of violation.
 - Specific section, rule, regulation.
 - Date from which violation has determine the **period of violation**).
 - **Amount involved**.

Procedure in brief



Specific list of requirements have been prescribed for – FDI, ECB, ODI & Liaison / branch office.



Undertaking to be given that there is no pending investigation.



Attach Demand draft of Rs. 5,000/- for application fee.



Pending investigation

- If investigation is pending against applicant, group company, promoter, etc. state it.
- RBI will write to ED asking if they have any objection.
- If ED gives NOC, RBI will compound.

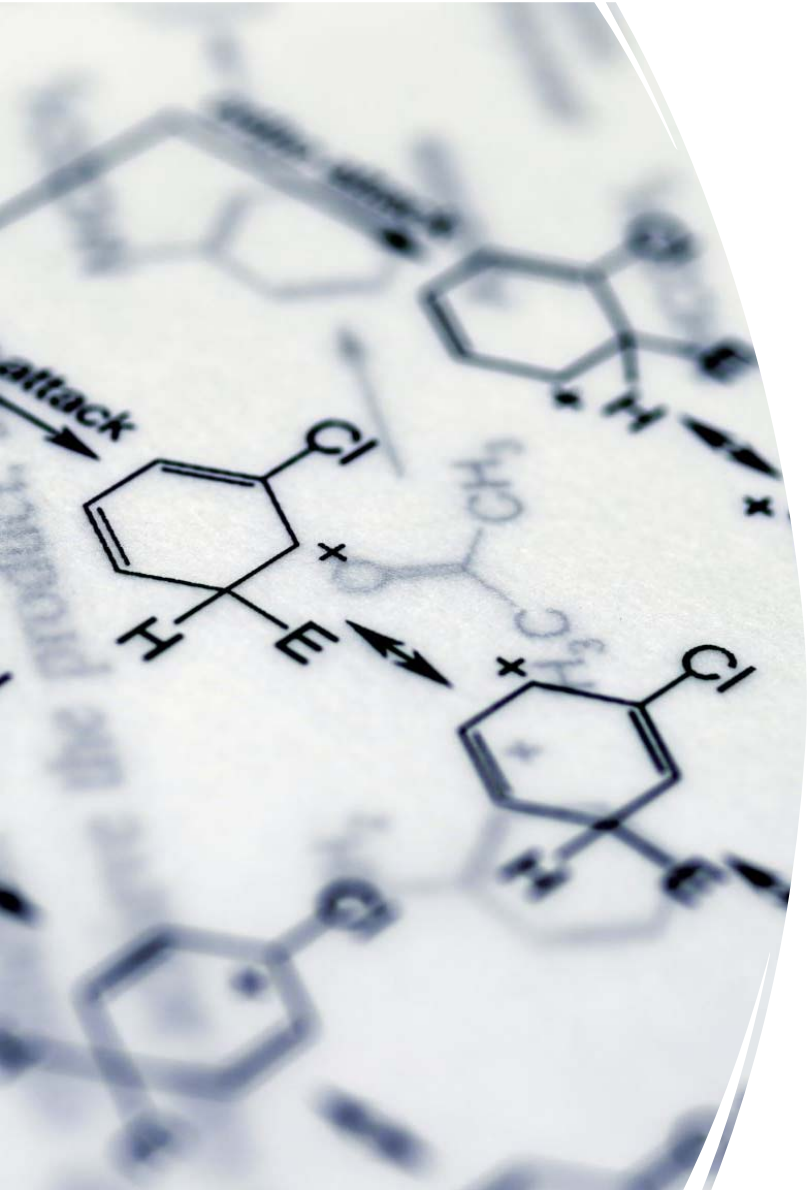
Post filing of application

- RBI will ask queries if any.
- Opportunity of hearing is given. Applicant need not appear. If appearance is to be made, direct appearance of applicant is preferred.
- Opportunity to add more violations if one comes across the same.
- Compounding order within 180 days.



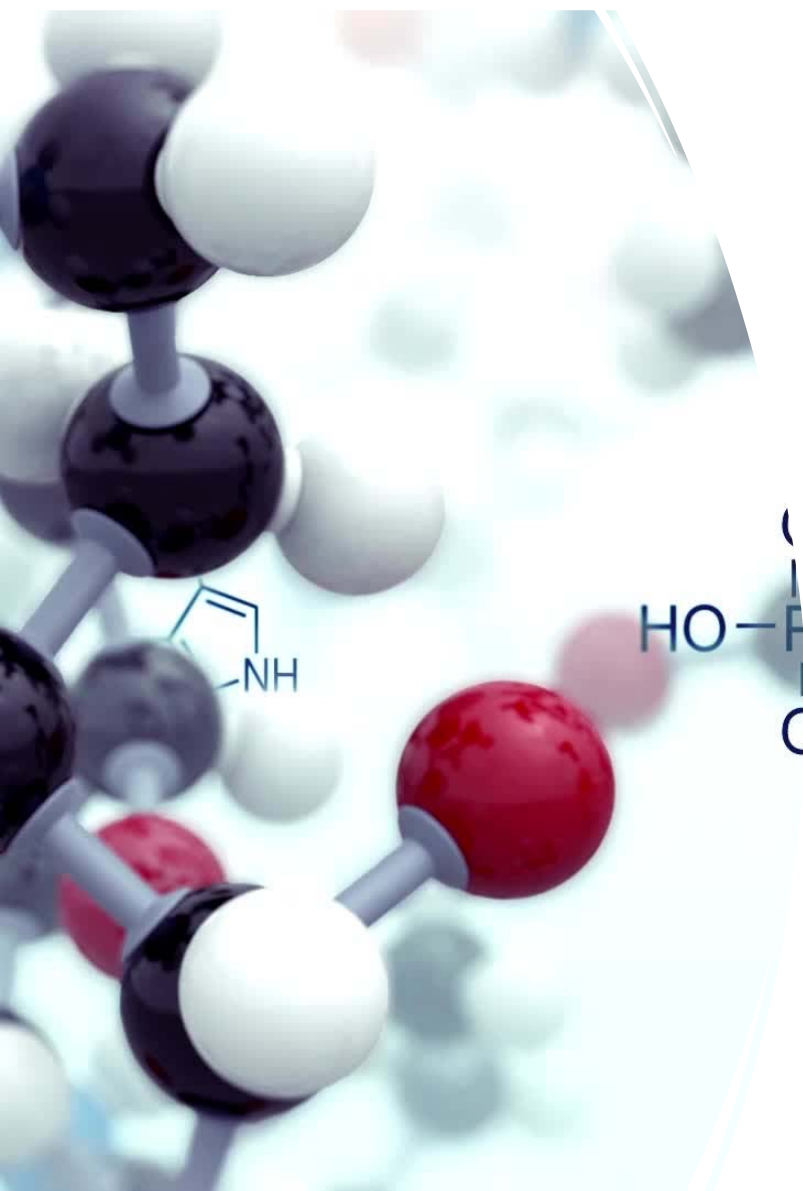
Compounding order

- **Compounding order is issued based on the merits of the case. It takes into account:**
 - period of violation.
 - amount involved.
 - amount of gain wherever quantifiable.
 - loss caused to exchequer.
 - contravener's conduct.
 - etc.



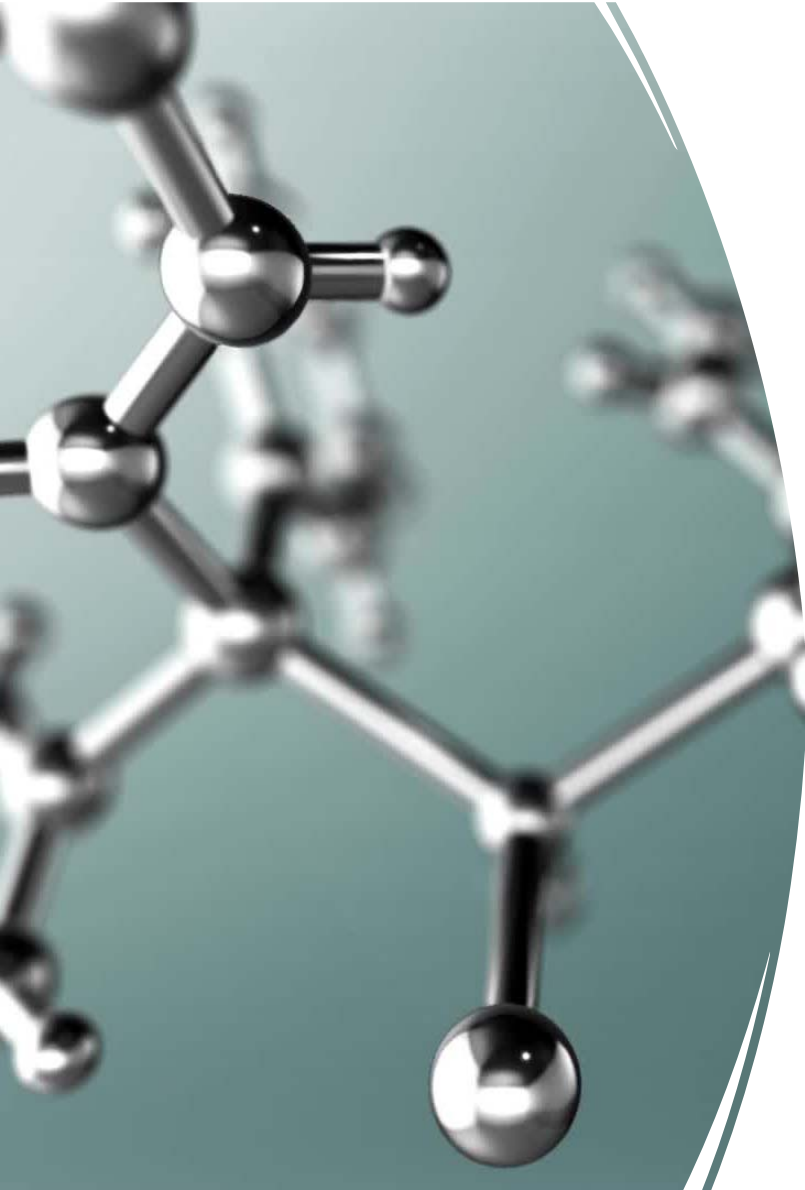
Compounding order

- Compounding sum is determined and stated in the order.
- It has to be paid within 15 days from the date of compounding order.
- If the compounding sum is not paid within 15 days, it will be considered that application was never made. RBI may refer the matter to ED.



Compounding order - some issues

- No appeal against Compounding Order (CO) is possible.
- No review of CO.
- No withdrawal of CO.
- No rectification of CO.



Effect of Compounding

-
- There does not remain a violation of the matter compounded.
 - Any violation of the same kind within 3 years of the Compounding, cannot be compounded.
 - Automatic route would become open to the person concerned.

Challenges

Professional Interest [Hard Core Preparation]

Compliances hurdles

AD Response

RBI divert the issue to AD

No access to RBI

Need transparent Portal like Tax return

Advance ruling System

Appreciate Interaction



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