

Compounding of Offences under FEMA – Practical Issues and Guidance

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Scope of the presentation

- Compounding and its legal provisions
- Foreign Exchange (Compounding Proceedings) Rules, 2000
- Master Directions on Compounding
- Trends regarding contraventions compounded at RBI
- Guidance matrix on compounding
- Food for thought...



Compounding and its legal provisions



Background

- Foreign Exchange Regulation Act, 1973 (FERA, 1973) was replaced by the Foreign Exchange Management Act, 1999 (FEMA, 1999). FEMA, 1999 brought foreign exchange contraventions within the ambit of civil law (previously treated as criminal violations).
- The Foreign Exchange (Compounding Proceedings) Rules, 2000 empowers RBI to compound all the contraventions of FEMA 1999 except Section 3(a) which deals with money laundering.
- To provide comfort to the citizens & corporate community by minimizing transaction costs, while taking a serious view of the wilful, malafide & fraudulent transactions.



Various Rules and Provisions

- Foreign Exchange Management Act – 1999
 - Sections 13 & 15
- Foreign Exchange (Compounding Proceedings) Rules, 2000
- RBI Master Directions on Compounding



What is compounding of contravention ?

- Exists under Companies Act, the Income Tax Act (limited form) and SEBI laws
- Term not defined under FEMA, Rules and Regulations Webster's Dictionary - "to agree for a consideration not to prosecute an offence"
- Law Lexicon - "settle by mutual concession"
- Black's Law Dictionary - "to settle by a money payment "
- It is a voluntary process in which an individual or a corporate seeks compounding of an admitted contravention. No investigation needs to be made



Statutory Provisions

Foreign Exchange Management Act 1999

13. Penalties.-

(1) If any person contravenes any provision of this Act, or contravenes any rule, regulation, notification, direction or order issued in exercise of the powers under this Act, or contravenes any condition subject to which an authorization is issued by the Reserve Bank, he shall, upon adjudication, be liable to a penalty up to thrice the sum involved in such contravention where such amount is quantifiable, or up to two lakh rupees where the amount is not quantifiable, and where such contravention is a continuing one, further penalty which may extend to five thousand rupees for every day after the first day during which the contravention continues.

(2).....

Explanation.- For the purposes of this sub-section, "property" in respect of which contravention has taken place, shall include- (a) deposits in a bank, where the said property is converted into such deposits; (b) Indian currency, where the said property is converted into that currency; and (c) any other property which has resulted out of the conversion of that property.



Statutory Provisions

Foreign Exchange Management Act 1999

15. Power to compound contravention.-

(1) Any contravention under section 13 may, on an application made by the person committing such contravention, be compounded within one hundred and eighty days from the date of receipt of application by the Director of Enforcement or such other officers of the Directorate of Enforcement and officers of the Reserve Bank as may be authorized in this behalf by the Central Government in such manner as may be prescribed.

(2) Where a contravention has been compounded under sub-section (1), no proceeding or further proceeding, as the case may be, shall be initiated or continued, as the case may be, against the committing such contravention under that section, in respect of the contravention so compounded.



Foreign Exchange (Compounding Proceedings) Rules, 2000



Statutory provisions Foreign Exchange (Compounding Proceedings) Rules 2000

Rule	Particulars
Rule 1	Short Title and commencement
Rule 2	Definitions
Rule 3	Compounding Authority – Authorised by Government < DD / DLA in DoE or AGM of RBI
Rule 4 (1)	<p>If any person contravenes any provisions of the FEMA 1999, except clause (a) of section 3 of that Act</p> <ul style="list-style-type: none">AGM-Rs.10 lakhs and belowDGM-More than Rs.10 lakhs but less than Rs.40 lakhsGM -Rs.40 lakhs or more but less than Rs.100 lakhsCGM-Rs.100 lakhs or more <p>No compounding for non-quantifiable contravention</p>
Rule 4 (2)	<p>Nothing contained in sub-section (1) shall apply to a contravention committed by any person within a period of three years from the date on which a similar contravention committed by him was compounded under these rules.</p> <p>Explanation—For the purposes of this rule, any second or subsequent contravention committed after the expiry of a period of three years from the date on which the contravention was previously compounded shall be deemed to be a first contravention.</p>



Statutory provisions Foreign Exchange (Compounding Proceedings) Rules 2000

Rule	Particulars
Rule 4(3)	Every officer specified under sub-rule (1) of rule 4 of the Reserve Bank of India shall exercise the powers to compound any contravention subject to the direction, control and supervision of the Governor of the Reserve Bank of India.
Rule 4(4)	Every application for compounding any contravention under this rule shall be made in Form to the Reserve Bank of India.
Rule 5	Powers to DoE –If any person contravenes provisions of Section 3 (a) of FEMA...
Rule 6	Where any contravention is compounded before the adjudication of any contravention under section 16, no inquiry shall be held for adjudication of such contravention in relation to such contravention against the person in relation to whom the contravention is so compounded. The Foreign Exchange (Compounding Proceedings) Rules, 2000



Statutory provisions Foreign Exchange (Compounding Proceedings) Rules 2000

Rule	Particulars
Rule 7	Where the compounding of any contravention is made after making of a complaint under sub-section (3) of section 16, such compounding shall be brought by the authority specified in rule 4 or rule 5 in writing, to the notice of the Adjudicating Authority and on such notice of the compounding of the contravention being given, the person in relation to whom the contravention is so compounded shall be discharged.
Rule 8	<p>Procedure for compounding.—</p> <p><u>(1)</u> The Compounding Authority may call for any information, record or any other documents relevant to the compounding proceedings.</p> <p><u>(2)</u> The Compounding Authority shall pass an order of compounding after affording an opportunity of being heard to all the concerned as expeditiously as possible and not later than 180 days from the date of application.</p> <p>“Provided that with respect to any proceedings initiated under Rule 4, the Enforcement Directorate is of the view that the said proceedings relates to a serious contravention suspected of money laundering, terror financing or affecting the sovereignty and integrity of the nation, the Compounding Authority shall not proceed with the matter and shall remit the case to the appropriate Adjudicating Authority for adjudicating contravention under Section 13”</p>



Statutory provisions

Foreign Exchange (Compounding Proceedings) Rules 2000

Rule	Particulars
Rule 9	Payment of amount compounded.—The sum for which the contravention is compounded as specified in the order of compounding under sub-rule (2) of rule 8, shall be paid by demand draft in favour of the Compounding Authority within fifteen days from the date of the order of compounding of such contravention.
Rule 10	In case a person fails to pay the sum compounded in accordance with rule 9 within the time specified in that rule, he shall be deemed to have never made an application for compounding of any contravention under these rules and the provisions of the Act for contravention shall apply to him.



Statutory provisions Foreign Exchange (Compounding Proceedings) Rules 2000

Rule	Particulars
Rule 11	No contravention shall be compounded if an appeal has been filed under section 17 or section 19 of the Act.
Rule 12	Contents of the order of the Compounding Authority.— <u>(1)</u> Every order shall specify the provisions of the Act or of the rules, directions, requisitions or orders made thereunder in respect of which contravention has taken place alongwith details of the alleged contravention. <u>(2)</u> Every such order shall be dated and signed by the Compounding Authority under his seal.
Rule 13	Copy of the order.—One copy of the order made under rule 8 (2) shall be supplied to the applicant and the Adjudicating Authority as the case may be.



Master Directions on Compounding



Procedure for applying for compounding

- The form given as [Annex – I](#) to the A.P.(DIR Series) Circular No. 56 dated June 28, 2010 issued by the Reserve Bank of India, can be used for applying for compounding.
- The application in the prescribed format accompanied with necessary documents and a demand draft for Rs. 5000/- drawn in favour of the “Reserve Bank of India” should be submitted alongwith compounding application.
- Along with the application in the prescribed format, the applicant may also furnish the details as per the Annexes- relating to [Foreign Direct Investment](#) / [External Commercial Borrowings](#) / [Overseas Direct Investment](#) / [Branch Office](#) / [Liaison Office](#), as applicable, (attached to the A.P. (DIR Series) Circular No. 20 dated August 12, 2013) along with an undertaking that they are not under investigation of any agency such as DOE, CBI, etc., a copy of the Memorandum of Association and latest audited balance sheet while applying for compounding of contraventions under FEMA, 1999. The applicant has to give PAN details, NEFT details and ECS mandate.
- The latest forms etc. are also available on Bank’s website in Master Direction No. 18.



Compounding Essentials

- The applicant must voluntarily admit the contravention.
- The contravention is crystallized i.e. **P**eriod of contravention, **A**mount of contravention and **R**egulation contravened. (**PAR**)
 - In case the contravention cannot be quantified, it cannot be compounded.(Rule 4(1))
- The application must be accompanied with a fee of Rs.5000/- by way of a Demand Draft drawn in favour of RBI.
- The whole process is to be completed within 180 days (Rule 8(2)).
- The process is deemed to be completed when the certificate is issued to the applicant upon payment of the amount imposed in a compounding order (Rule 9).
- Once a contravention is compounded, no further prosecution for the same contravention. (Rule 6 – Compounding Rules)



Pre-requisites for Compounding

- No similar contravention should have been committed in the last 3 years. (Rule 4 (2) – Compounding Rules)
- Any second or subsequent contravention committed after the expiry of a period of three years from the date on which the contravention was previously compounded shall be deemed to be a first contravention.
- Contraventions should have been duly regularized
 - Approvals / permissions granted
 - Excess amounts refunded etc.
- Serious contraventions - Proviso added to Rule 8(2) of Compounding Rules February 20, 2017 - (money laundering, terror financing, affecting sovereignty and integrity of the nation) including non-payment of penalty in the compounding order
 - Cases referred to DoE



Classification of contraventions

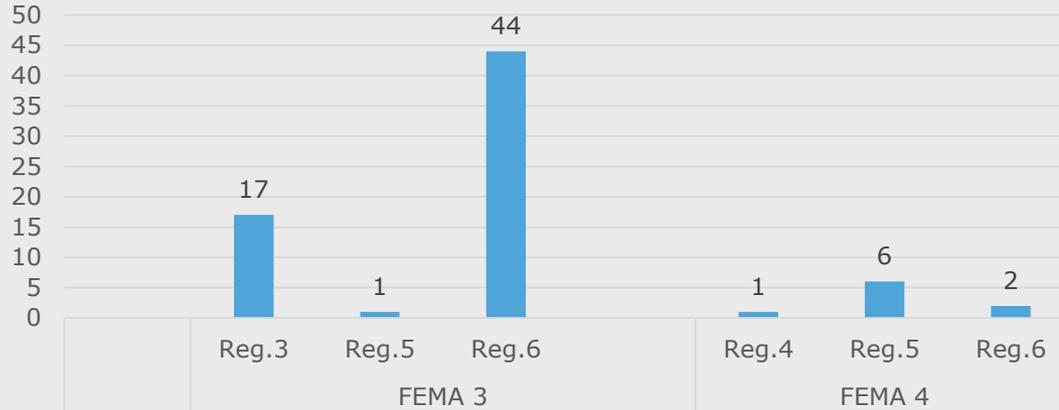
- Material: Non-compliance with regulatory requirements – Compounding
- Sensitive: Case referred to DoE under Section 37



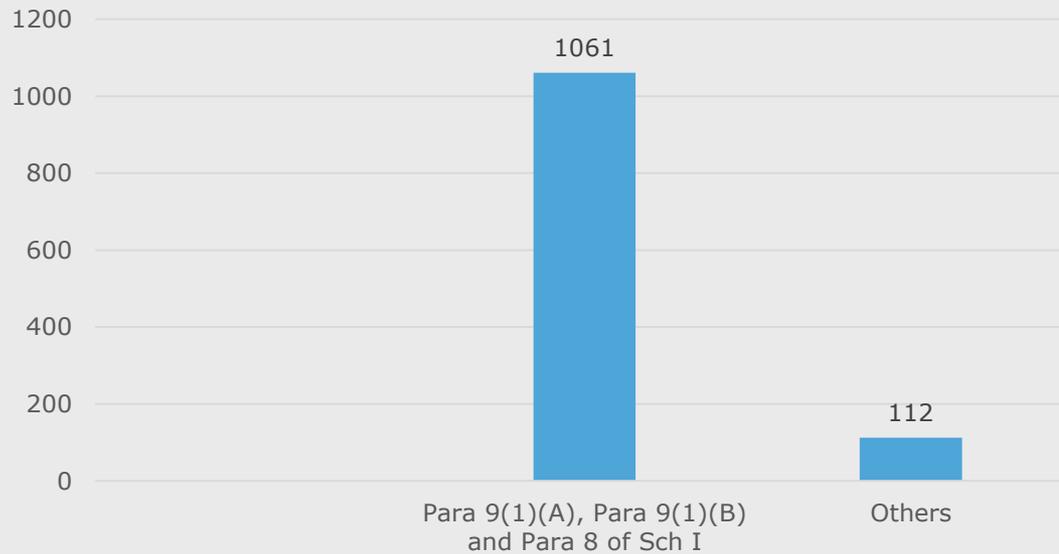
Trends regarding contraventions compounded at RBI



ECB Contraventions

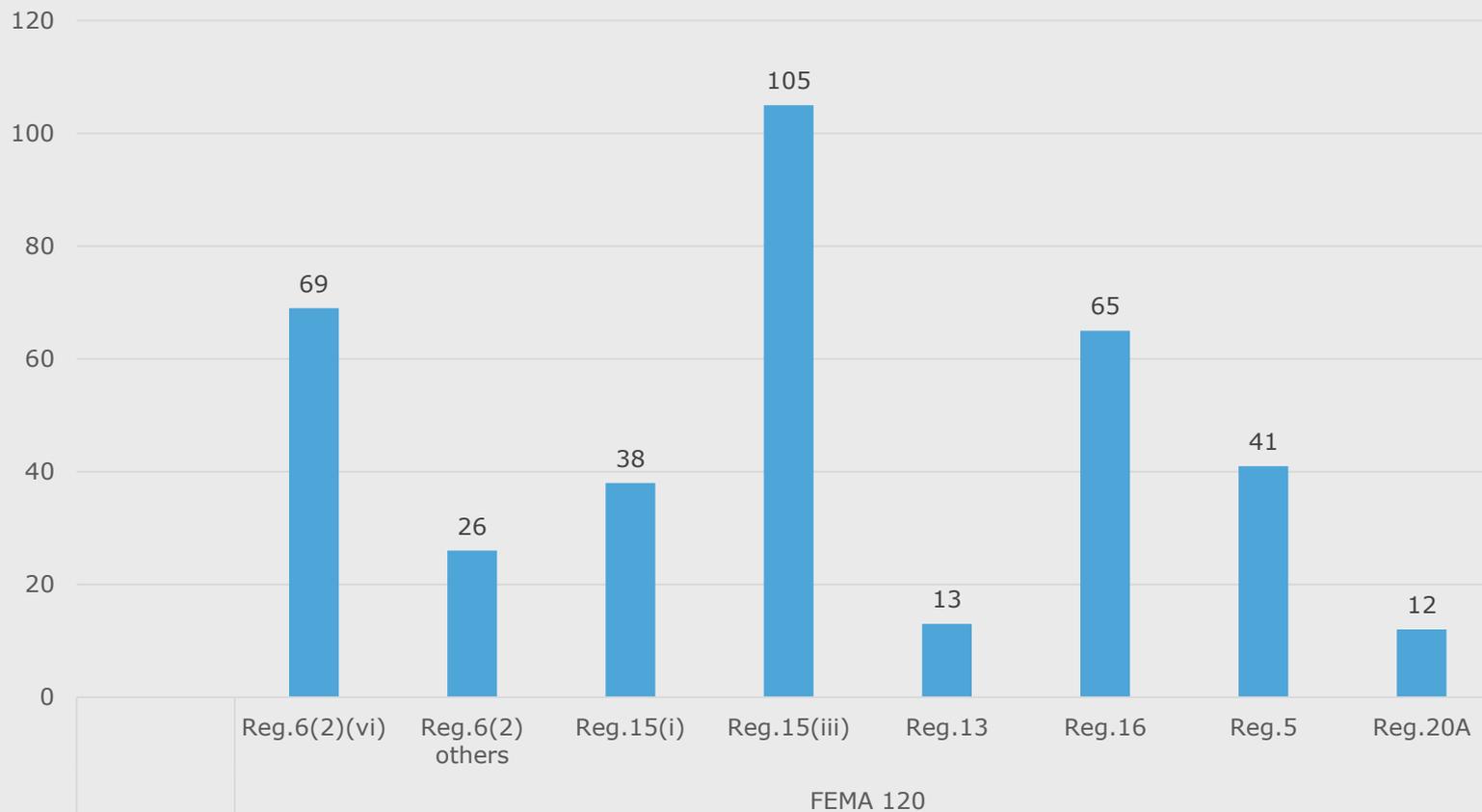


Foreign Investment Contraventions





OID Contraventions





Guidance matrix on compounding



I. Guidance Note on Computation Matrix

Type of contravention	Existing Formula
1] Reporting Contraventions A) FEMA 20 Para 9(1)(A), 9(1)(B), part B of FC(GPR), FCTRS (Reg. 10) and taking on record FCTRS (Reg. 4) B) FEMA 3 Non submission of ECB statements C) FEMA 120 Non reporting/delay in reporting of acquisition/setup of subsidiaries/step down subsidiaries /changes in the shareholding pattern D) Any other reporting contraventions (except those in Row 2 below)	Fixed amount : Rs10000/- (applied once for each contravention in a compounding application) + Variable amount as under: Up to 10 lakhs : 1000 per year Above Rs.10 lakhs & below Rs. 40 lakhs : 2500 per year Rs.40 lakhs or more & below Rs. 100 lakhs: 7000 per year Rs.1-10 crore : 50000 per year Rs.10 -100 Crore : 100000 per year Above Rs.100 Crore : 200000 per year
E) Reporting contraventions by LO/BO/PO	As above, subject to ceiling of Rs.2 lakhs. In case of Project Office, the amount imposed shall be calculated on 10% of total project cost.
2] AAC/ APR/ Share certificate delays In case of non-submission/ delayed submission of APR/ share certificates (FEMA 120) or AAC (FEMA 22) or FCGPR (B) or FLAR Returns (FEMA 20) or FLA Returns - FEMA 20 / FEMA 20 (R) / FEMA 120	Rs.10000/- per AAC/APR/FCGPR (B)/FLAR Return delayed. Delayed receipt of share certificate – Rs.10000/- per year, the total amount being subject to ceiling of 300% of the amount invested.
3] A] Allotment/Refunds Para 8 of FEMA 20/2000-RB (non-allotment of shares or allotment/ refund after the stipulated 180 days) B] LO/BO/PO (Other than reporting contraventions)	Rs.30000/- + given percentage: 1 st year : 0.30% 1-2 years : 0.35% 2-3 years : 0.40% 3-4 years : 0.45% 4-5 years : 0.50% >5 years : 0.75% (For project offices the amount of contravention shall be deemed to be 10% of the cost of project).



4] All other contraventions except Corporate Guarantees but including all contraventions of FEMA 20(R)/2017-RB dated November 07, 2017 other than FLA Returns

Rs.50000/- + given percentage:

1st year : 0.50%
1-2 years : 0.55%
2-3 years : 0.60%
3-4 years : 0.65%
4-5 years : 0.70%
> 5 years : 0.75%

5] Issue of Corporate Guarantees without UIN/ without permission wherever required /open ended guarantees or any other contravention related to issue of Corporate Guarantees.

Rs.500000/- + given percentage:

1st year : 0.050%
1-2 years : 0.055%
2-3 years : 0.060%
3-4 years : 0.065%
4-5 years : 0.070%
>5 years : 0.075%

In case the contravention includes issue of guarantees for raising loans which are invested back into India, the amount imposed may be trebled.

****The contraventions of FEMA 20 existing and continuing as on November 07, 2017 (i.e. the starting date of contraventions prior to November 07, 2017) will be compounded as per 1(A) above.***



- II. The above amounts are presently subject to the following provisos, viz.
- i. the amount imposed should not exceed 300% of the amount of contravention
 - ii. In case the amount of contravention is less than Rs. One lakh, the total amount imposed should not be more than amount of simple interest @5% p.a. calculated on the amount of contravention and for the period of the contravention in case of reporting contraventions and @10% p.a. in respect of all other contraventions.
 - iii. In case of paragraph 8 of Schedule I to FEMA 20/2000 RB contraventions, the amount imposed will be further graded as under:
 - a) If the shares are allotted after 180 days without the prior approval of Reserve Bank, 1.25 times the amount calculated as per table above (subject to provisos at (i) & (ii) above).
 - b) If the shares are not allotted and the amount is refunded after 180 days with the Bank's permission: 1.50 times the amount calculated as per table above (subject to provisos at (i) & (ii) above).
 - c) If the shares are not allotted and the amount is refunded after 180 days without the Bank's permission: 1.75 times the amount calculated as per table above (subject to provisos at (i) & (ii) above).
 - iv. In cases where it is established that the contravenor has made undue gains, the amount thereof may be neutralized to a reasonable extent by adding the same to the compounding amount calculated as per chart.
 - v. If a party who has been compounded earlier applies for compounding again for similar contravention, the amount calculated as above may be enhanced by 50%.

III. For calculating amount in respect of reporting contraventions under para I.1 above, the period of contravention may be considered proportionately {(approx. rounded off to next higher month ÷ 12) X amount for 1 year}. The total no. of days does not exclude Sundays/holidays.



Amount imposed under compounding

- Quantum, generally decided based on
 - The amount of contravention
 - The period of contravention
 - Amount of gain or unfair advantage
 - Amount of loss to any authority, agency, exchequer
 - Economic benefits accruing to the contravener from delayed compliance
 - The repetitive nature of the contravention
 - Maximum of 3 times the amount of contravention



Food for thought...



1. Compounding within a period of three years for similar contraventions:

Investments from non-residents under FDI is an ongoing process until permitted sectoral cap, if any, is reached. As investment takes place in a phased manner, there may be multiple instances of delay in reporting inflow of funds / allotment of shares.



2. Can a compounding application be returned if matter is under DoE investigation?

- **Asrani Inns & Resorts Private Limited -**
Contravention - related to availing ECB from shareholders for purchasing land and construction of hotel - loan not adhering to ECB guidelines under automatic route
- RBI returned application on the ground that the matter was under DoE investigation (action as advised by the DoE).
- **Writ Petition before HC of Bombay** – Court upheld the Petition. RBI was directed to process the compounding application and take a considered decision in accordance with the law. DoE directed not to pursue the adjudication proceedings for a specified period, to enable completion of compounding proceedings.



3. Can the amount imposed under compounding order be reviewed?

➤ **JVL Agro Industries private Limited** –

Contraventions under FEMA 120 – Delay in obtaining UIN, delay in submission of APRs and delay in reporting issue of Corporate Guarantee.

- Aggrieved with the amount imposed, the applicant did not pay the penalty within the prescribed time period
- Matter was referred to DoE for investigation
- Applicant's plea in the Writ Petition:
 - i)contravention was not quantifiable and
 - ii)proper reasons were not stated in the Order to conclude that the contraventions had been committed.
- The WP was rejected by the Court and the applicant was directed to abide by the terms of the Compounding Order.



3. Can the amount imposed under compounding order be reviewed?

➤ **Gati Limited**

Contraventions: Company issued FCCBs for refinancing old FCCBs issued earlier. Company is engaged in the services sector and as per extant ECB guidelines, companies engaged in the services sector were not eligible for raising ECB under auto route.

- The company failed to pay the compounding penalty within the prescribed time period.
- Matter was referred to DoE for investigation.
- The company filed a Writ Petition challenging the amount imposed in the compounding order.
- Court directed the applicant to deposit the full penalty amount with RBI, pending a final decision of the Court in the matter.



4. Can the amount imposed be accepted after 15 days of date of the Order?

- Rule 9 of the Foreign Exchange (Compounding Proceedings) Rules, 2000 provides that the amount imposed in the compounding order should be paid within 15 days of the date of the order, failing which it shall be deemed that the compounded application was never made.
- As an exception, however, in the matter of JVL Agro Industries Private Limited, the Court was of the view that as the petitioner had shown an unconditional willingness to comply with the compounding order, the ends of justice would be met if the Compounding Authority considered the request of the petitioner to pay the penalty even after the expiry of the prescribed period, subject to costs.



5. Is it mandatory for RBI to compound?

Krishiraj Trading Limited and 3 others

Contravention under FEMA 120-The company, along with three others, made joint investment in a JV abroad. However, prior to making remittance towards investment in equity shares of the JV, a corporate guarantee was issued by the applicant and other joint investors to secure a credit facility for the JV from an overseas branch of an Indian bank. The JV used the proceeds to invest in the Indian group companies.

- The company filed an application for compounding but later withdrew the application stating that no contravention existed.
- RBI referred the matter to DoE for investigation.
- The applicant again filed compounding application with RBI which were returned on the ground that the matter was under investigation of DoE.
- After the DoE passed an adjudication order imposing penalty, the applicant moved the Bombay High Court citing wrongful return of compounding application by RBI and seeking directions to RBI to compound their application.



5. Is it mandatory for RBI to compound?

- The Court noted that the compounding application could not be filed only in case an appeal against an adjudication order has been filed. In this case therefore, there was no embargo on RBI from considering the compounding applications, subject to completion of administrative requirements.
- Accordingly, the RBI processed the compounding applications and passed the orders. The four applicants did not, however, pay the amount imposed. As no payment was received within 15 days, the matter was referred to DoE and the approvals granted subject to compounding were treated as withdrawn.



5. Is it mandatory for RBI to compound?

Brentfield Travels Company Private Limited –

Contravention : Shares were issued by the company to two non-residents against which, inward remittance was directly received in the NRO account of resident investor and not in the account of the Company. The amount was not received through normal banking channels. The money was utilized for purchase of immovable property.

- Matter was referred to DoE for further investigation and compounding application was returned.
- Aggrieved, the company filed a Writ Petition in the HC at Bombay.
- The Court accepted the plea that where a contravention is of sensitive nature and, prima facie, involves money laundering, national and security concerns involving serious infringements of the regulatory framework, RBI may recommend the matter to DoE for further investigation. This is a reasonable and bonafide exercise of power.



5. Is it mandatory for RBI to compound?

NDTV Limited –

Background : Foreign Exchange (Compounding Proceedings) Amendment Rules, 2017 notified on February 20, 2017

- Proviso to Rule 8(2): [Provided that with respect to any proceeding initiated under rule 4, if the Enforcement Directorate is of the view that the said proceeding relates to a serious contravention suspected of money laundering, terror financing or affecting sovereignty and integrity of the nation, the Compounding Authority shall not proceed with the matter and shall remit the case to the appropriate Adjudicating Authority for adjudicating contravention under section 13.]



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- Restrictions imposed on the compounding powers of the Reserve Bank under rule 4 are limited to only the specific grounds
- In the similar matter of New Delhi Television Limited Vs. Reserve Bank of India & others (Writ petition No. 2026 of 2017) the Bombay High Court in its judgement dated June 26, 2018 held that: *‘Thus, on such a vague and general materials, as are contained in the original record, the court do not find that it should allow the Enforcement Directorate to interdict the compounding proceedings in the present case.’ (Paragraph 105 of the judgment)*



Questions ??



Thank you