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1. Learning Outcomes

After this module, we shall be able to

- Learn the objectives and need of FEMA;
- Understand the provisions, capital & current A/c transactions;
- Compare FEMA and FERA; and
- Identify the industries which are still under Licensing Act.

2. Introduction

When a company imports goods from other countries, exports its products to them or makes any kinds of investments abroad, it has to deal in foreign exchange. Foreign exchange means 'foreign currency' and includes: -

(i) Deposits, credits and balances payable which are in any foreign currency;

(ii) Drafts, travelers' cheques, letters of credit or bills of exchange, expressed or drawn in the Indian currency but are payable in any foreign currency; and

(iii) Drafts, travelers' cheques, letters of credit or bills of exchange which are drawn by banks, institutions or persons outside of India, but are payable in the Indian currency.

In India, each transaction that includes foreign exchange is to be regulated by Foreign Exchange Regulations Act (FERA), 1973. As a distant impact of economic reforms along with the liberalized scenario, FERA was needed to be replaced by the Act called the Foreign Exchange Management Act (FEMA), 1999. FEMA is an Act of the Parliament of India to merge and modify the law relating to the foreign exchange with the aim of facilitating the external trade and payments and promotion of the orderly development and maintenance of the foreign exchange market in India.

The act came into effect from January, 2000, which is applicable to whole of India and on all the branches, offices, and agencies outside India, owned and controlled by person resident of India.

3. Objectives and Need for FEMA

The foremost object of FERA was management and smart use of the foreign exchange resources of the country. It also aimed to the controlling of certain aspects to the conduct of business outside the country by the Indian companies and in India by other foreign companies. It has been considered as a draconian legislation as it is meant that its violation would lead to imprisonment and payment of hefty penalties. It had many restrictive clauses which discouraged foreign investments. After the changed scenario of economic reforms since 1991, some amendments were made in FERA in 1993.

There was lot of pressure from those dealing in foreign exchange to modify these regulations and FEMA was enacted in 1999, which became operational since January, 2000.

Broadly, the objectives of FEMA are:

- Facilitating external trade and payments; and
- Encouraging methodical development and maintenance of the foreign exchange market. The Act has been assigned as a significant factor to the Reserve Bank of India (RBI) in the administering FEMA.

These rules, regulations and norms which are related to various sections of the Act, are laid-down by the RBI after the discussion with Central Government.

4. Provisions, Current and Capital Account Transactions

4.1 Restrictions in dealing in Foreign Exchange

Section 3 of FEMA permits only an authorized person to deal in the foreign exchange or foreign security. Such person authorized, under the Act, means authorized dealer, money changer, off-shore banking unit or any other person for that time approved by Reserve Bank. No person shall:-

- Dealing in or transferring of any foreign exchange or foreign security to any person not being an authorized person;
- Make any such payment to or for the credit as of any person who is a resident outside of India in any way,
- Receive otherwise through any authorized person, a payment by an order or on behalf of any person who is a resident outside India in any manner;
- Entering into any monetary transaction which in India is considered for or in association with acquisition or construction or transfer of a right to acquire, any asset outside India by any person is resident in India which is to acquire, hold, own, possess or to transfer any foreign exchange, foreign security or any immovable property situated outside of India.

4.2 Holding of Foreign exchange

Section 4 of the act states:

Save as otherwise which is as mentioned in this Act is that, no person who is an Indian resident shall be acquired, held, own, possess or transfer any foreign exchange, foreign security or any immovable property which is situated outside of India.

The Act deals with two types of foreign exchange transactions.

1. Current Account Transactions
2. Capital Account Transactions

4.3 Current Account Transactions

In the Act the term 'current account transaction' is defined as a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes:

Payments due in connection with

- Foreign trade,
- Other current business
- Services, and
- Short-term banking and credit facilities in the ordinary course of business;

Payments due as

- Interest on loans and
- Net income from investments

Remittances for living expenses of parents, spouse and children residing abroad, and

Expenses in connection with

- Foreign travel
- Education and
- Medical care of parents, spouse and children

As a general rule, any person may sell or draw foreign exchange if such sale or drawl is a current account transaction. Under the Act, Central Government may, in public interest and in consultation with the Reserve Bank, impose such restrictions which are reasonable for current account transactions as prescribed.

4.4 Capital Account Transactions

Capital account transaction as a transaction is defined in which:-

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- Alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India. In other words, it includes those transactions which are undertaken by a resident of India such that his/her assets or liabilities outside India are altered (either increased or decreased). For example:- (i) a resident of India acquires an immovable property outside India or acquires shares of a foreign company. This way his/her overseas assets are increased; or (ii) a resident of India borrows from a non-resident through External commercial Borrowings (ECBs). This way he/she has created a liability outside India.

2

- Alters the assets or liabilities in India of persons resident outside the India. In other words, it includes those transactions which are undertaken by a non-resident such that his/her assets or liabilities in India are altered (either increased or decreased). For example, (i) a non-resident acquires immovable property in India or acquires shares of an Indian company or invest in a Wholly Owned Subsidiary or a Joint Venture with a resident of India. This way his/her assets in India are increased; or (ii) a non-resident borrows from Indian housing finance institute for acquiring a house in India. This way he/she has created a liability in India.

- The Act also contains a list of some of the most common capital account transactions:-

(i) Transfer or issue of any foreign security by a person resident in India;
(ii) Transfer or issue of any security by a person resident outside India;
(iii) Transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
(iv) Any borrowing or lending in rupees in whatever form or by whatever name called;
(v) Any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;
(vi) Deposits between persons resident in India and persons resident outside India;
(vii) Export, import or holding of currency or currency notes;
(viii) Transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India;
(ix) Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
(x) Giving of a guarantee or surety in respect of any debt, obligation or other liability incurred-

(a) By a person resident in India and owed to a person resident outside India; or
(b) By a person resident outside India.

The Act has empowered the Reserve Bank of India (RBI) to specify, with the consultation of the Central Government, the permissible capital account transactions besides the limits up to which foreign exchange may be drawn for such transactions. Nonetheless it shall not force any restraint on the drawl of foreign exchange for expenses due on account of remuneration of loans or for depreciation of direct investments in the regular course of business.

4.5 Export of Goods and Services

Section 7 of Chapter II –

(1) Every exporter of goods shall:

- (a) Provide to the Reserve Bank or to such other authority a declaration in such form and in such way as may be definite, comprising true and correct substantial details, as well as the amount representing the complete export value or, if the complete export value of the commodities is not ascertainable at the time of export, the value which the exporter, obligating regard to the prevailing market conditions, supposes to admit on the sale of the goods in a market outside India;
- (b) the exporter needs to furnish to the Reserve Bank any other such info as may be obligatory by the Reserve Bank for the determination of safeguarding the recognition of the export proceeds by such exporter.

(2) The Reserve Bank may, for the determination of safeguarding that the full export value of the goods or such condensed value of the goods as determined by the Reserve Bank, obligating regard to the prevalent market circumstances, is expected without any delay, direct any exporter to obey with such necessities as it deems fit.

(3) Each exporter of services shall provide to the Reserve Bank or to such other authorities a declaration in such form and in such a way as may be specifically mentioned, comprising the true and correct material particulars in relation to payment for such services.

4.6 Realization and Repatriation of Foreign Exchange

Section 8 says that-
Save as anything other as mentioned in this Act, where any other sum of foreign exchange is outstanding or has ensued to any person who is a resident in India, such a person shall take all rational steps to recognize and repatriate to India such foreign exchange within such period and in such manner as may be specified by the Reserve Bank.

4.7 Exemption from realization and repatriation in certain case

Sections 4 and 8 shall not be applicable to the following, namely:-

(a) Control over foreign currency or foreign coins by any person up to such extent as may be specified by the Reserve Bank;

(b) Foreign currency account held or operated by any such person or class of persons and to the extent up to which is specified by the Reserve Bank;

(c) Foreign exchange acquired or received before the 8th day of July, 1947 or any other income arising or accruing thereon which is held outside India by any person in pursuance of a general or special permission is to be granted by the Reserve Bank;

(d) Foreign exchange held by a person resident in India up to such limit as the Reserve Bank may specified, if such foreign exchange was acquired by way of gift or inheritance from a person referred to in clause (c), including any income arising there from;

(e) Foreign exchange attained from employment, business, trade, vocation, services, honorarium,

gifts, inheritance or any such other legitimate means up to such limit as may be specified by the Reserve Bank; and

(f) Such other receipts in foreign exchange as may be specified by the Reserve Bank.

4.8 Contravention and Penalties

Section13 says that-

If any person contravenes any of the provision of this Act, or contravenes any rule, regulation, notification, direction or order that are dispensed in exercise of the authority under this Act, or contravenes any condition subject to which an authorization is delivered by the Reserve Bank, he shall, upon adjudication, be accountable to a penalty up to three time, the sum involved in such contravention where such amount is measureable, or up to two lakh rupees where the amount is not computable, and where such contravention is a continuing one, moreover penalty which may be extending to five thousand rupees for every day after the first day for the duration of which the contravention continues.

If the person fails to pay the fine within ninety days from the date of the notice aided and after the formalities of show cause notice and personal hearing, he will be liable for civil imprisonment after serving warrant of arrest.

5. Difference between FERA and FEMA

Table 1: Comparison between FERA and FEMA

FERA	FEMA
1. It was larger Act with 81 Sections.	It was smaller Act with 49Sections.
2. The Act applied to all citizens of India and to branches and agencies outside India.	The Act applies to all branches, offices and branches outside India owned and controlled by a person resident of India.
3. It became incompatible with the pro-liberalization policies of the Government of India	It is consistent with pro-liberalization era and emerging framework of the World Trade Organization.(WTO)
4. It was for the regulation of foreign exchange.	It is for the management of foreign exchange.
5. Everything that has to do with forex is regulated.	Only the specified act relating to forex is managed.
6. This act was less transparent.	This act is more transparent.
7. The main aim of this act was to conserve forex and to prevent misuse of forex.	The main aim of this act is to facilitate trade and develop forex market to promote the orderly development and maintenance of forex market.
8. Violation of FERA was a criminal offence.	Violation is a civil offence.
9. Offences under this act were compoundable.	Offences are compoundable.
10. Citizenship was a criteria to determine the residential status of a person under this act.	Stay of more than 182 days in India is the criteria to determine the residential status under this act.
11. It was Draconian Police Law. The penalty was five times the sum involved plus imprisonment in most cases.	It is a civil law. Penalty is limited to three times the sum involved if it is quantifiable.
12. It was safe to presume that any transaction in forex or with non-resident was prohibited unless it was generally or specifically permitted.	It adopts two golden rules: a) All current account transactions are permitted unless otherwise prohibited. b) All capital account transactions are prohibited unless otherwise permitted.

6. The New Licensing Policy

Prior to the Industrial Policy announced in July 1991, licensing was governed by Industrial (Development and Regulation) Act, 1951. The licensing was meant to help achieve some of the objectives of economic policy such as designed pattern of industrial dispersal, encouraging new entrepreneurs, protection and development of small-scale sector, regulation of foreign capital and technology and so on. Industrial Policy, 1991 has abolished industrial licensing except for certain industries relating to security and strategic considerations and environmental importance.

Projects were exempted from licensing on the basis of level of investment. This limit was revised upwards periodically.

6.1 List of industries with compulsory licensing:

Industrial licensing is obligatory for the following industries:

Large and Medium Industries: Items reserved for the Small Scale Sector

All Industries:

- All items of electronic aerospace and defense equipment, whether specifically mentioned or not in this list.
- All items related to the production or use of atomic energy including the carrying out of any process, preparatory or ancillary to such production or use, under the Atomic Energy Act, 1962.

Comprehensive list for which industrial licensing is obligatory is as below:

Coal and lignite
Petroleum (other than crude) and its distillation products.
Distillation and brewing of alcoholic drinks
Sugar
Animal fats and oils, partly or wholly hydrogenated
Cigars and cigarettes of tobacco and manufactured tobacco substitutes
Asbestos and asbestos-based products
Plywood, decorative veneers, and other wood-based products such as particle board, medium density fiber board, and black-board
Raw hides and skins, leather chamois and patent leather
Tanned or dressed furskins
Motor cars
Paper and Newsprint except bagasse-based units (*i.e.* except units based on minimum 75% pulp from agricultural residues, bagasse and other non conventional raw materials)
Electronic aerospace and defence equipment: all types
Explosives including detonating fuses, safety fuses, gunpowder, nitrocellulose and matches
Hazardous chemicals
Drugs and Pharmaceuticals (according to Drug Policy)
Entertainment electronics (VCR's, color TV's, CD players, tape recorders)
White goods (domestic refrigerators, domestic dishwashing machines, programmable domestic washing machines, microwave ovens, air conditioners)

7. Summary

Earlier all the transactions which would include a foreign exchange were to be regulated by the Foreign Exchange Regulations Act (FERA), 1973. The economic reforms and the liberalized scenario in the light of FERA was substituted by a new Act of the Foreign Exchange Management Act (FEMA), 1999, which provides more of facilitating and managing foreign trade.

The object of FEMA is to facilitate external trade and payments along with promotion of the orderly development and maintenance of foreign exchange market. The Act has been assigned as a vital role to the Reserve Bank of India (RBI) in the management of FEMA.

There are certain provisions of FEMA which permits only the authorized person to deal in foreign exchange or foreign security. No person who is a resident in India shall acquire, hold, own, possess or even transfer any foreign exchange, foreign security or any immovable property which is locality outside India.

The act defines the term Capital Account and Current Account Transaction and adopts two golden rules concerning it:

- (a) All current account transactions are to be permitted unless otherwise barred.
- (b) All capital account transactions that are prohibited shall not take place unless otherwise permitted.

If any person contravenes any of the provisions of this Act, or contravenes any rule, regulation or order, he is to be made liable for a penalty which is up to thrice the sum involved in any such contravention where such amount is quantifiable, or is up to two lakh rupees where the amount is not quantifiable, and where such contraventions are a continuing one, further penalty which may exceed the limit of five thousand rupees for every day after the first day during which the contravention continues.

Prior to the Industrial Policy announced in July 1991, licensing was governed by Industrial (Development and Regulation) Act, 1951. This act has been eliminated for the industrial licensing except for certain industries which is concerning to security, strategic consideration, and environmental importance also.