CONTRAVENTION, PENALTY AND PROSECUTION UNDER FEMA

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The current issue of the CVO CA's News & Views covering the subject of Contraventions, Offences, Penalties and Prosecution is an excellent endeavour in appraising the business community as well as enlightening the professionals on the impact of penal consequences if there is negligence in complying with stringent provisions under various Laws and Regulations in India.

In this article, we are going to cover the Contraventions, Offences, Penalties and Prosecution under the Foreign Exchange Management Act, 1999 (FEMA).

Any legislation demands strict observation of its provisions by the concerned parties whom it regulates in light of the spirit and philosophy of the said legislature. Hence, any legislature without penal provisions is like a lion without teeth or a snake without poison. The penal provisions deter the accused from repeating the offences in future and also give a warning for the others not to follow the same path of any violation under the law.

As we all understand that the philosophy of FEMA is to regulate the foreign exchange transactions and protect the foreign exchange reserves of the country. The objective of FEMA is to dissuade the Resident Indians and Entities from aggressively spending the foreign exchange or investing in foreign ventures with unlimited liability exposure in foreign exchange. It also regulates the inflow of foreign investment in India in a manner to encourage investment in the Indian economy and at the same time monitors such investments to prevent sudden exit from the investments disturbing the forex position of the country.

The shift from Foreign Exchange Regulation Act, 1974 (FERA) to Foreign Exchange Management Act 1999 (FEMA) was certainly a very welcome move for Indians and the Indian economy which liberalised the investment and expenditure regime for Indians substantially to go global. The most important comfort is that FEMA is a civil law as against FERA which was a criminal Law.

Many a time business expediency demands quick solutions to the regulatory restrictions due to which people try to find a suitable interpretation of the presence or absence of explicit provisions and take aggressive calls on the permissibility of capital account and current account transactions. At times it is ignorance or carelessness in following the regulations while entering into transactions which are not permissible and at times there are willful defaults. Such actions result in contraventions under FEMA attracting the penal provisions which we have dealt with in this Article.

In legal terminology, a 'mistake' is referred to as “contravention”. Contravention of FEMA occurs when any person acts contrary to the provisions of FEMA or any rule, regulation, notification, direction or order issued in exercise of the powers under FEMA or any condition subject to which an authorization is issued by RBI.

Before we get into the analysis of the provisions dealing with the contraventions and penalties let us have a look at some instances which are considered a contravention under FEMA. The contraventions can be purely procedural or arising out of technical defaults or even the outcome of willful defaults.

Few common instances of contravention under FEMA:

- Delay in submission of Form FC-GPR to the Reserve Bank after issue of shares to a person resident outside India.
- Delay in the submission of Form ODI and Annual Performance Reports
- Gift of shares of an Indian company from Resident to Non-resident without prior RBI approval
- Utilization of ECB proceeds towards non-permissible end use
- Acquisition of agricultural land in India by Non-Resident Indian without prior RBI approval
- Remittance as a gift under the LRS from a person resident in India to a foreign currency account of another person resident in India which is not permitted under the Liberalised Remittance Scheme
- Making a total financial commitment in overseas JV/WOS in excess of 400% of net worth
- Extending loans to overseas Joint Venture (JV) without any equity participation in it.
- Disinvestment of stakes in overseas Wholly Owned Subsidiary with outstanding dues.
- Undertaking Overseas Direct Investment without prior approval of RBI when the Indian Party was being investigated by the Directorate of Enforcement under the Prevention of Money Laundering Act, 2002

The above list is illustrative and there can be many more instances of transactions undertaken by a person which are in contravention of the FEMA. Such contraventions may attract late submission fees or penalties under the penal provisions of the FEMA which can be followed by the other severe consequences of recovery proceedings and imprisonment too.

Let us also set the tone for the understanding of these provisions with the background of following

SALIENT FEATURES OF PENAL PROVISIONS UNDER FEMA

- FEMA is a civil law
- Authorities under FEMA are Government / RBI / Directorate of Enforcement (DoE)
- Penal provisions are exercised in two ways – Compounding (Voluntary)under Foreign Exchange (Compounding Proceedings) Rules, 2000 & Adjudication (Government) under Foreign Exchange Management (Adjudication Proceedings and Appeal) Rules, 2000
- Investigation & Adjudication are segregated
- Prosecution needs to prove the guilt of the contravener -Absence of '*mens rea*'
- No arrest except for non-payment of penalty and in some exceptional cases
- Time-bound disposal
- Maximum penalty prescribed

Broad overview of the provisions under FEMA dealing with this subject are as under:

Section	Coverage
13(1)	Penalty for contravention levied by the Adjudicating Authorities.
13(1A) to 13(1D)	Penal provisions in respect of foreign exchange, foreign security and foreign immovable property above the prescribed threshold
13(2)	Confiscation of the assets in respect of which contravention has taken place
14	Enforcement of the orders of Adjudicating Authority
14A	Recovery of arrears of penalty
15	Compounding of Contraventions
16 to 19	Adjudication & Appeal related provisions

The powers to implement the provisions of sections 13 to 14 are with the Adjudicating Authorities whereas the compounding provisions are largely implemented by the Reserve Bank of India and by the Enforcement of Directorate in some cases as stated above.

Lastly, we shall also look into the fees for late filing of certain procedural forms which are covered under Master Direction on Reporting under FEMA.

With this background let us look into various penal provisions under FEMA.

I) Levy of Penalty [Section 13(1)]

In terms of section 13(1) of FEMA, the person committing contravention is liable to a penalty upon adjudication. The person contravening may be liable to a penalty of up to **thrice the sum involved** in such contravention where such amount is quantifiable, or **up to INR 200,000** where the amount is not quantifiable. Further, if such contravention is a continuing one, a penalty which may extend to **INR 5,000 for every day** after the first day during which the contravention continues may also be levied.

- As per the language of the section, the Act not only covers the cases where foreign exchange is involved but also contraventions involving any sum in rupees.
- The quantum of the penalty is based on the sum involved in the contravention and the continuity of the contraventions. However, where the impact of the contravention cannot be quantified e.g. carrying on business from a place of business in India in contravention of the regulations governing the establishment of branch/office, the maximum penalty up to INR 200,000 can be levied in such cases as the quantum of the sum involved cannot be determined.
- In addition to any contravention of the Act, Rules Regulations etc., even contravention of any condition subject to which any authorisation was given by the RBI also attracts the above penalty.

II) Confiscation of the assets in respect of which contravention has taken place [Section 13(2)]

- The Adjudicating Authority is also empowered to direct confiscation of any currency, security or any other money or property in respect of the contravention that has taken place

- Confiscation of the assets in respect of which contravention is made would be in addition to the penalty which can be directed by the Adjudicating Authority.
- Under this:

a. Any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated by the Central Government.

b. The foreign exchange holdings if any of the persons committing the contravention or any part thereof shall be brought back into India or shall be retained outside India in accordance with the directions.

For this purpose, deposit in bank or Indian currency or any other property into which the impugned property has been converted would also be liable for confiscation.

- The powers of confiscation are discretionary and lie only with the Adjudicating Authority. However, the process is not automatic and needs conscious application of mind on the part of the Authority to the relevant fact and factors. It should be on some justifiable grounds and when the nature of the transaction does not involve any conscious wrongdoing on the part of the contravener, confiscation may not be justified.
- It is essential that the items to be confiscated have nexus with the contravention.

III) Contravention in respect of the foreign exchange or foreign security or foreign immovable property [Section 13(1A) to (1D)]

Sub-Sections 1A to 1D were introduced in section 13 w.e.f 9th September, 2015. The same is applicable if the aggregate value of these assets exceeds the threshold prescribed under section 37A(1)which currently is INR 1 Crore. The penal provisions for these contraventions are as under:

- If any person is found to have acquired any foreign exchange, foreign security or immovable property, situated outside India, of the aggregate value exceeding the prescribed threshold limit, **he shall be liable to a penalty up to three times the sum involved in such contravention and confiscation of the value equivalent, situated in India, the foreign exchange, foreign security or immovable property.**
- The Adjudicating Authority can recommend initiation of prosecution against the defaulting party. He can also direct prosecution by filing a criminal complaint against a guilty person. The criminal complaint shall be filed by an officer, not below the rank of Assistant Director.
- In addition to the penalty imposed and confiscation under section 13(1A), the guilty shall also be exposed to the punishment of imprisonment for a term which may extend up to 5 years and with a fine.
- Under Section 13(1D), the Court shall take cognizance of an offence only upon a complaint in writing by an officer, not below the rank of Assistant Director.
- The provisions under this set of sections are harsher in terms of the directions to be given for prosecution by filing a criminal complaint against the guilty person.

The liability of penalty covered under section 13 is not automatic and can be determined only after adjudication under the Adjudication Proceedings.

Certain principles and guidelines arising out of various judicial decisions on the levy of penalty:

Taking guidance from various decisions held under FERA Regime it can be held that 'mens rea'may not be required for levying the penalty for the above contravention and a person can be held liable for the penalty notwithstanding the fact that he was not aware of the statutory provisions.

However, penalty cannot be based on conjecture or surmise and there needs to be some material on the basis of which a reasonable conclusion is possible.

The powers conferred upon the officers are quasi-judicial powers and hence they need to act judicially and consider all the circumstances as the liability to penalty under these sections does not arise merely on default being proved. **Since the powers conferred on the officers are quasi-judicial various principles set in the landmark Supreme Court decision in the case of Hindustan Steel Ltd (83 ITR 26) would also hold good in the penalty matters under these provisions of FEMA**

Under the FERA Regime, the adjudicating officers could order court prosecution in cases where the offences would be of such gravity that a mere penalty would not be adequate. However, under FEMA, the prosecution is confined to the cases where the penalty is not paid within the specified time except in cases covered under Section 13(1A) to 13(1D) dealing with contraventions in respect of foreign exchange-security and property.

IV) Once the penalties are determined by the Adjudicating Authorities, power for the enforcement of the said penalty and recovery thereof are covered as under:

A. <u>Enforcement of the order of the Adjudication Authority [Section 14]</u>

Section 14 provides for a mechanism for enforcement of the penalty imposed on the person and the important provisions are:

- The person on whom the penalty is imposed is required to pay the full penalty within 90 days from the service of the notice.
- If the payment is not made within 90 days such person is liable for civil imprisonment
  - ➢ Up to 6 months -if demand is upto INR 1 crore
  - ➢ Up to 3 years - if demand is more than INR 1 crore
- Such detention can be made in any part of India as per the Code of Criminal Procedure; 1973.Person detained shall be released from such detention on payment of the amount mentioned in the warrant for his detention to the officer-in-charge of the civil prison.
- Such imprisonment cannot be done unless a show cause notice is issued to such person and an opportunity is given to him to explain why he should not be put to prison. The Adjudicating Authority has to record reasons in writing that the defaulter has concealed or parted with his property after issuance of notice to obstruct recovery or does not pay the arrears despite the means available for payment.
- However, no Show cause notice would be required, if the Adjudicating authority is satisfied that the defaulter is likely to abscond or leave the local limits of the jurisdiction of the Adjudicating Authority.

- Further, where an appearance is not made pursuant to a notice issued and served under sub-section (1), the Adjudicating Authority may issue a warrant for the arrest of the defaulter. The defaulting person has to be immediately released if he pays the amount due in the arrest warrant along with the cost of the arrest.

  The proceedings under these provisions are very strict and stringent. Considering the gravity of the defaults that can take place under the Act, there is very less time available for the payment of the penalty and its non-payment would attract imprisonment.

  The process has to be carried out judiciously before initiating imprisonment. However, exceptional powers to fast track the process are provided in cases where there are chances of the defaulter playing mischief with the law or willfully avoiding the payment of penalty or can abscond to avoid the payment of penalty.

B. <u>Power to recover arrears of penalty[Section 14A]:</u>

- Adjudicating Authority in writing can authorize an officer of Enforcement not below the rank of Assistant Director to recover any arrears of penalty from any person who fails to make full payment of the penalty imposed on him under section 13 within the period of ninety days from the date on which the notice for payment of such penalty is served on him.

- The recovery procedure shall apply in the same manner as laid down under the Second Schedule to Income Tax Act, 1961.

Considering the powers for Enforcement of the penalty order and the recovery of penalty arrears as provided under Section 14 and Section 14A, any person charged with the penalty can face a difficult time as a consequence of non-payment of the penalty within 90 days.

Provisions under section 14 dealing with enforcement of the orders of the Adjudicating Authority provide for imprisonment if the full payment of the penalty is not made within 90 days from the date on which the notice for payment of such penalty is served on such defaulter.

Civil imprisonment covered under Section 14(1) is subject to the provision of section 19(2) of the Act which deals with the filing of appeals against the orders of the Adjudicating Authorities / Special Director (Appeals) with the Appellate Tribunal. The question is whether it means that once the appeal is filed with the Appellate Tribunal, actions cannot be taken under section 14 for recovery of the arrears? That does not seem to be the intention and hence there is a dilemma as regards the relief that can be obtained against payment of penalty when the defaulter is in Appeal before the Appellate Tribunal. This puts the defaulter in real hardship if he cannot make the payment of the full payment of the penalty since the consequences of imprisonment would follow in such a case.

Apparently, there are no specific remedies for the stay of demand. However, when an appeal is to be filed with the Appellate Tribunal, there is a prerequisite of deposit of the penalty amount with the Appellate Tribunal. And proviso to Section 19(1) provides that, in case the Appellate Tribunal is of the opinion that the deposit of penalty would cause undue hardship, the Tribunal may dispense with such deposit as it may deem fit.

In light of this position let us look at the possible reliefs that can be obtained under the Appellate provisions:

V. Appeals against the orders of the Adjudicating Authorities:

- The appeal against the order of the Adjudicating Authority can be filed with either the Special Director (Appeals) or Appellate Tribunal depending upon the rank of the adjudicating officer.
- Further, an appeal against the order of the Special Director can also be filed with the Appellate Tribunal.
- The appeal can be filed within 45 days from the date on which the order is received by the aggrieved person. Condo nation for the delay in filing an appeal beyond 45 days can be considered if there is a sufficient cause of delay.
- As mentioned above the Appellate Tribunal can wave the deposit of the penalty amount in a case where it would cause genuine hardship to the defaulter
- The Appellate Tribunal can call for records of any proceedings before the Adjudicating Authority for examining the legality, propriety or correctness of any order made by the Adjudicating Authority and make such order as it deems fit. Thus there are powers of revision of the order of the Adjudicating Authority with the Appellate Tribunal.
- The civil court does not have jurisdiction to entertain any proceeding in respect of any matter before the Adjudicating Authority or Appellate Tribunal or Special Director (Appeals).
- Appeal to High Court can be filed only on a question of law and within 60 days. High Court does not have jurisdiction to condone delay beyond 60 days.
- There is no specific provision for appeal to Supreme Court. However, considering Article 136(1) of the Constitution, the aggrieved party has a right to prefer an appeal to the Supreme Court if such appeal is otherwise maintainable.

As we understand from the above analysis of the penal provisions and the relief under the Appellate provisions, it is clear that once a person is adjudicated as a defaulter and penalties are levied, the path ahead for a stay of the demands, relief from imprisonment and seeking relief at higher levels is a very long, strenuous and uncertain.

It is therefore very important that one is aware of the more straightforward option of going for compounding of contravention as provided under section 15 of the FEMA

VI. Compounding of Contravention by the Reserve Bank of India [RBI] and Directorate of Enforcement [DOE](Section 15)

Quite often, a contravention happens and the person contravening himself realizes that the contravention has happened. Normally, there is no remedy in such cases and the consequences are as severe as those in case of willful contravention.

Section 15 of FEMA deals with and provides for compounding of offence in such cases. The person contravening the provision is required to make an application for compounding. The authority dealing with compounding is required to compound the offence within a certain prescribed time limit from the date of making the application.

BENEFITS OF COMPOUNDING

- ✓ Absolutely transparent process providing comfort to citizens and corporate community.
- ✓ Time-bound disposal (180 days).
- ✓ Simple and hassle-free procedure.
- ✓ Mandatory personal hearing opportunity.
- ✓ No proceedings or further proceedings initiated or continued.
- ✓ Public disclosure of the guidelines on the amount imposed during the compounding.
- ✓ No arrest except non-payment of penalty.
- ✓ Maximum penalty prescribed.

The Framework of the Compounding Proceedings is provided under Master Direction on No.4/2015-16 - Compounding of Contraventions under FEMA, 1999:

Compounding of contravention means settlement of an offence committed by the contravener through the imposition of a monetary penalty without going in for litigation after the contravener acknowledges voluntarily of having committed the contravention.

Detection of contravention can be through any of the modes such as voluntary disclosure, information from ADs, analysis of data, market Intelligence, RBI's inspections; others – media reporting/complaints, etc.

Power to Compound to RBI	Power to Compound to DOE
✓ Sec.3 – Dealing in Foreign Exchange except section 3(a) of FEMA ✓ Sec.4 – Holding of foreign currency ✓ Sec.5 – Current account transactions ✓ Sec.6 – Capital account transactions ✓ Sec.7 – Export of goods and services ✓ Sec.8 – Realization and repatriation of Foreign exchange ✓ Sec.9 – Exemption from realization & repatriation ✓ Sec.10– Mis-utilization of Foreign Exchange ✓ Third Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000	✓ Sec 3(a): dealing in or transfer of any foreign exchange or foreign security to any person not being an authorized person. ✓ Sec 37(A) relating to assets held outside India in contravention of Section 4 of FEMA. If the compounding proceedings relate to a serious contravention suspected of money laundering, terror financing or affecting the sovereignty or integrity of the nation, RBI forwards the application to the Directorate of Enforcement.

Circumstances under which Compounding cannot be done by RBI

- If an appeal under Sec. 17 of FEMA has been filed with Special Directorate (Appeals)
- If an appeal under Sec. 19 of FEMA has been filed with Appellate Tribunal
- Contraventions relating to any transaction entered into without proper approval or permission from the concerned Govt. or any Statutory Authority i.e., the requisite approval not obtained
- A contravention, prima facie, involving money laundering, terror financing or affecting sovereignty of the country and needs investigation
- Amount involved in the contravention is not quantifiable
- Contravention committed by any person within a period of 3 years from the date on which similar contravention committed by him was compounded

Powers delegated to the Compounding Authority in RBI to compound are as under:

Amount involved in the contravention	Compounding Authority in RBI
INR 10 lakhs or below	Assistant General Manager
More than INR 10 lakhs but less than INR40 lakhs	Deputy General Manager
INR 40 lakhs or more but less than INR 100 lakhs	General Manager
INR 100 lakhs or more	Chief General Manager

The detailed mechanism for the compounding process, computing the compounding fees, and related guidance are mentioned in Master Direction on No.4/2015-16 - Compounding of Contraventions under FEMA, 1999.

Once a contravention has been compounded by the Compounding Authority, no proceeding or further proceeding will be initiated or continued, as the case may be, against the contravener.

In case of failure to pay the sum compounded within the time specified, it shall be deemed that the contravener had never made an application for compounding of any contravention under these Rules.

VII. Regularization of Reporting Delays

With this, we shall now deal with the process of regularization of reporting delays under FEMA which is the last section of this article.

For ease of regularizing **reporting delays**, RBI has introduced the levy of Late Submission Fees (LSF) as an option to regularize such delays without undergoing the compounding procedure. In case of procedural delay, reporting is conditionally acknowledged by RBI subject to payment of LSF. These delays are mainly pertaining to three types of reporting requirements namely FDI,ECB and ODI transactions. The matrix provided for calculating the late submission fees for these transactions is as under:

a. In the case of FDI

In case of reporting delays for FDI transactions,

Amount involved (in Rs.)	LSF as % of amount involved *	Maximum amount of LSF applicable
Up to 1 crore	0.05%	Rs.10 lakhs or 300% of the amount involved, whichever is lower
More than 1 crore	0.15%	Rs.1 crore or 300% of the amount involved, whichever is lower

* LSF % will be doubled every 12 months. The minimum LSF amount will be Rs. 100.
The period of contravention shall be considered proportionately (approx. rounded off to next higher month ÷ 12) X Amount for 1 year.

b. In the case of the ECB

Any borrower, who is otherwise in compliance with ECB guidelines, can regularise the reporting delay in the drawdown of ECB proceeds before obtaining LRN or delay in submission of Form ECB 2 returns, by payment of LSF as detailed in the following matrix:

Type of Return/Form	Period of delay from due date of submission/date of drawdown	Applicable LSF
Form ECB 2	Up to 30 calendar days	INR 5,000
Form ECB 2/ Form ECB	Up to 3years	INR 50,000 per year
Form ECB 2/ Form ECB	Beyond 3years	INR 1,00,000 per year

c. In the case of ODI

The LSF for the delay in reporting overseas investment-related transactions shall be calculated as per the following matrix:

Type of Reporting	LSF Amount (INR) per return*
Form ODI Part-II/ APR, FLA Returns, Form OPI, evidence of investment or any other return which does not capture flows or any other periodical reporting	7,500
Form ODI-Part I, Form ODI-Part III, Form FC, or any other return which captures flows or returns which capture reporting of non-fund-based transactions or any other transactional reporting	7,500 + (0.025% × A × n)

***A = Amount involved in the delayed reporting, n = Number of years of delay in submission rounded-upwards to the nearest month and expressed up to 2 decimal points.**

CONCLUSION

- FEMA has a very defined set of regulations for levy of penalties in case of contravention and the powers are with the Adjudicating Authority to levy penalties. Non-payment of the penalties may attract civil imprisonment subject to show cause notice and opportunity of hearing before the concerned authorities. Such show cause notices may not be required in certain grave situations.

- Penalty provisions are stricter in case of contraventions pertaining to foreign exchange / foreign securities and immovable properties outside India. At times, levy of penalties and confiscation of assets can be done simultaneously.

- The provisions for enforcement of penalties levied by adjudicating authority provide for a stay of payment of penalties in case an appeal is filed against the order of the Adjudicating Authority. However, such waiver cannot be taken for granted unless the Tribunal grants such waiver of pre-deposit of penalty while admitting the appeal. The proceedings before the Adjudicating Authorities and the Appellate Authorities are civil in nature.

- Compounding of contravention could be a better remedy at times as against orders of the Adjudicating Authority. However, compounding remedy after receipt of the order of the Adjudicating Authority sounds a difficult proposition.

- The order of the Adjudicating Authority can be appealed against within 45 days from the date of receipt of the notice. Payment of the penalty levied by Adjudicating Authority is to be made within 90 days. Beyond 90 days, the recovery provisions may get initiated including imprisonment. To put such proceedings on hold one has to file the appeal with Appellate Authorities. Further, remedy for compounding of contravention cannot be sought for an order against which an appeal has been filed under section 17 or 19 of FEMA.

So, it is always advisable for any person who realises of any contravention under FEMA to immediately initiate the steps for regularisation of the contravention with the RBI and apply for compounding of the said contravention which is civil in nature, with time-bound results and well determined procedures.

References Material:

- Foreign Exchange Management Act, 1999

- FED Master Direction No. 4/2015-16 dated 1.1.2016 - Compounding of Contraventions under FEMA, 1999 [Updated as on 24.5.2022]

- FED Master Direction No. 18/2015-16 dated 1.1.2016 - Reporting under Foreign Exchange Management Act, 1999 [Updated as on 22.8.2022]

- Foreign Exchange Management (Adjudication Proceedings and Appeal) Rules, 2000 as amended from time to time

- Foreign Exchange (Compounding) Rules, 2000 as amended from time to time