Jus Corpus Law Journal

Open Access Law Journal – Copyright © 2022 – ISSN 2582-7820
Editor-in-Chief – Prof. (Dr.) Rhishikesh Dave; Publisher – Ayush Pandey

FEMA - An Overview and the Role of RBI

Ananya Singh[a]

[a]Jogesh Chandra Chaudhari Law College, University of Calcutta, Kolkata, India

Received 18 April 2022; *Accepted* 08 May 2022; *Published* 14 May 2022

The purpose of this article is mainly to give a conspectus on the "Foreign Exchange Management Act, 1999" along with the contribution and role of the Reserve bank Of India. Foreign Exchange refers to the exchange of currencies of one country for another at prevalent rates. It is important because the prevalent exchange rate vis., the amount of one currency in terms of another, helps to determine the economic condition of a country, hence, the welfare of the people residing in it. This article discusses how after the amendment of the Foreign Exchange Regulation Act in 1993, it was decided that the Act would become the Foreign Exchange Management Act in 1999, as there was a need to remove the draconian provisions under FERA which criminalized any contraventions in foreign exchange policies in India. Thus, as a result of economic liberalization and to relax controls over the foreign exchange market in India, FEMA was adopted. The RBI plays a huge role in monitoring the foreign exchange transactions taking place in India, with the consultations of the Central Government in special cases. The impact of foreign exchange contributes greatly to the Indian business sector and further, the nation's economy. This article gives a detailed purview of the FEMA, as it is considered to be one of the largest liquid markets in the world. Hence, the knowledge and need for the management of the Foreign Exchange market are indispensable.

Keywords: *FEMA, foreign currency, RBI, economy, FERA, exchange.*

INTRODUCTION

'Foreign Exchange' in its literal sense means, the process in which foreign currency- such as Dollar, Yen, or Euro- is traded for domestic currency- for example, the Indian Rupees; and vice versa. Foreign exchanges take place in-between countries daily, thus, it is very vital to keep an account for the same. The Reserve Bank of India has the regulatory power over foreign exchange[1]- to manage and maintain a balance between the inflow and outflow of an international currency in India. The laws related to foreign exchange in India are reserved under the Foreign Exchange Management Act, 1999 (FEMA). The head office of FEMA is situated in New Delhi known as Enforcement Directorate and is headed by a Director. Foreign Exchange Management Act, 1999 was formulated by the Central Government of India "with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India."[2] In 1999, this Act was adopted and it replaced the previous Act which was known as the Foreign Exchange Regulation Act (FERA). FEMA was enacted to put more emphasis on the 'management' rather than the 'regulation' of foreign exchange and several major reforms were made to fill all the drawbacks present in the previous Act, FERA. To have a liberal economy in the d-regularized form in India, FEMA was effectively introduced.

WHAT IS FEMA?

The Foreign Exchange Management Act, of 1999, mainly deals with foreign exchange transactions, cross-border investments, and transactions taking place between residents and non-residents. FEMA replaced the draconian provisions present in the previous act FERA and came into force on June 1st, 2000. The operation of FEMA is akin to any other commercial law. However, FEMA is one of the smallest in comparison to other commercial laws, as there are only 49 Sections divided into seven chapters. According to the provisions of the Act, if the guidelines, rules, conditions, etc., mentioned are followed, a person can undertake a foreign transaction without any prior approval. But if the proposed transaction falls outside the

[1] Foreign Exchange Management Act, 1999, s 3
[2] Foreign Exchange Management Act, 1999, Preamble

guidelines mentioned in the provisions, one will have to obtain prior approvals from the Reserve Bank of India. The consequence of any violence results in a penalty, further, if the said penalty isn't paid within the given period, there can also be a prosecution.[3] Before 1999, in case of any violation of law in the dealings of foreign exchange, was considered a criminal offence; further, FERA in its existing form was gradually becoming more ineffective, as result in the early 1990s it became incompatible with the new liberal reforms in the economic policies. Observing the negative sentiments prevailing against the then law, the Central Government sanctioned a mellower and more 'humane' enactment of the law- FEMA came into being. Thus, the emphasis was shifted from 'regulation' to 'management' of foreign exchange in India.

MAIN FEATURES OF FEMA[4]

- FEMA applies to only people residing in India for "more than 182 days" in the preceding financial year. It does not apply to Indian citizens residing outside India.
- All foreign exchange or foreign security dealings can only be done through an "Authorized Person" if permitted by FEMA.
- This Act has classified foreign transactions into two groups, that is, the capital account transactions and the current account transactions.
- The application of this Act is more transparent, as it specifies provisions under which special permissions are required from the RBI/ The Government of India on the acquisition or holding of foreign exchange.
- This Act empowers RBI to restrict, prohibit, or regulate financial transactions even if they are carried by an authorized person.
- It gives power to RBI and the Central Government, in consultation with each other, to specify the classes of capital account transactions and the limit to which such forex are admissible, along with any conditions which may be placed for making such transactions.

[3] 'Foreign Exchange Management Act' (*Bombay Chartered Accountants Society*) <https://www.bcasonline.org/referencer2015-16/other%20laws/fema.htm> accessed 10 April 2022
[4] Hemant Singh, 'Features of FERA & FEMA in India' (*Jagran Josh*, 29 March 2019) <https://www.jagranjosh.com/general-knowledge/fera-fema-in-india-1448706242-1> accessed 10 April 2022

- FEMA also allows Indians residing in India, to carry out international trade transactions, forex, and overseas security dealings or the freedom to keep or own immovable property in the foreign country, provided that it has been acquired or owned when the person was residing outside the country or inherits from a person residing outside the country.
- This Act is considered Civil law, and the contraventions in this Act provided for arrests are only in exceptional cases.

HISTORICAL BACKGROUND

- ***Foreign Exchange Regulation Act, 1973 (FERA)***

Foreign Exchange Regulation Act or FERA was a set of laws for leading foreign investments in India as well as laws related to the rules and regulation of foreign exchange in India. It also had laws that enforced strict restrictions on certain cross-border trade transactions, certain forms of payments, and securities and exchanges that indirectly had an impact on the foreign exchange currencies in India. In 1947, Foreign Exchange Regulation Act was enacted as a temporary measure and later was made permanent in the year 1957. After the independence, there was an initiation of the process of industrialization all over the country, and India felt a keen need of conserving foreign exchange. Due to the prevailing inflation thereafter, Foreign Exchange Regulation Act (FERA) was amended in 1973, with 81 draconian sections divided into seven chapters. Naturally, as it was a crisis-driven regulation, provisions under it were harsh and any offence under FERA was considered to be a criminal offence liable for imprisonment.

- ***Progression from FERA to FEMA***

In the early 1990s, there was a new approach toward trade, and several major economic reforms were made. FERA, in its existing form since 1973, did not succeed in regulating and restricting activities like the escalation of Transnational Corporations (TNCs) or Multinational Corporations (MNCs) in India. The modifications that were done to FERA from 1990 to 1993, only made it obvious that FERA was on the verge of becoming superannuated and redundant. After the amendment of FERA in the year 1993, it was agreed that the Act would be called

FEMA. This was done in consideration of making the Act dealing with foreign exchange less aggressive and compatible with the new era of economic liberalization.[5] FEMA has brought about a radical change in the regard to the concept of 'management' rather than 'control or regulation' of foreign exchange in India, with its transition from FERA to FEMA. Transactions in the foreign exchange market, that is, from buying and selling of currencies or any securities to other debt instruments by the individuals, the government, or businesses take place too often. The foreign market is not only competitive but also one of the largest and most liquid markets in the world and India as well. Thus, management of this market is essential to mitigate the chances of risks. Be it under FERA or FEMA, the need for the management of FOREX markets is absolutely necessary.

OBJECTIVE OF FEMA

The main prospect for introducing Foreign Exchange Management Act, 1999, in India, was "to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India"- as stated in its preamble. There are two categories of transactions that constitute the fundamental concept of FEMA which are classified into- "Capital account transactions" and "Current account transactions". All the formalities and procedures for the dealings of all cross-border transactions are highlighted in the FEMA.

Therefore, with the regulation of the two accounts- Capital Account and Current Account, the balance of payments of the country are monitored. Capital Account comprises all capital transactions such as investment in equity shares or acquiring an immovable property outside India, etc. Whereas, Current Account comprises all transactions other than capital account transactions, that is, the transactions in the trade of merchandise. As the current account transactions involve the inflow and outflow of currencies to and from country/countries during a year, due to trading/rendering of goods, commodities, services, and income - it determines the economic status of the country. Thus, in the Balance of Payments comprising

[5] Kaustubh Barve, 'Progression of FERA to FEMA has facilitated development of FOREX markets in India' (2015) 4 <https://www.academia.edu/11232352/Progression_of_FERA_to_FEMA_and_its_imp> accessed 10 April 2022

the capital and current account, the remainder of it is the capital account which consists of "the movement of capital in the economy due to capital receipts and expenditure". Capital account recognizes the domestic investment in foreign assets and foreign investment in domestic.[6]

APPLICABILITY OF FEMA

Foreign Exchange Management Act, 1999 "extends to the whole of India". It also "applies to all branches, offices, and agencies situated outside India", which are controlled and owned by a person resident in India. Any contraventions committed by these entities outside India are also covered by this Act, concerning this, FEMA can be said to acquire extra-territorial jurisdiction.[7] In this Act, we observe that the residential status is the most important criterion for determining the applicability of the Act. Generally, there are three categories of 'persons' included in FEMA which are dealt with differently Person resident in India, Non-resident Indian (NRI), a person resident outside India, Persons of Indian Origin (PIO), and Overseas Corporate Body (OCB).

- As per the Definitions mentioned in the Foreign Exchange Management Act, 1999, a "person resident in India" refer to -

1. "A person residing in India for more than 182days during the preceding financial year". But it does not include- a person who has "gone out" of India or who has "come" to India, in either case, such as, for employment, for business or vocation, or for any other purpose which indicates his stay outside/in India uncertain for a period;
2. Any person or body incorporated or registered in India;
3. An office, branch, or agency in India or outside India is owned or controlled by a person residing outside India or in India respectively.

- "A Non-Resident Indian (NRI) means a person who is a citizen of India or is a person of Indian origin, residing outside India". These persons are called non-resident citizens, as their visit or stay in India for a temporary or uncertain period.

[6] 'Foreign Exchange Management Act – FEMA' (*Clear Tax*, 7 December 2021) <https://cleartax.in/s/fema-foreign-exchange-management-act> accessed 12 April 2022
[7] Foreign Exchange Management Act, 1999, s 1(3)

- Person of Indian Origin means a citizen of any country other than Pakistan and Bangladesh-

(a) only if he at any time held an Indian passport;

(b) by the constitution of India or the Citizenship Act, 1995 he or either of his parents or any of his grandparents were Indian citizens;

(c) the person is a spouse of an Indian citizen or a person referred to in the above sub-clauses (a) or (b).

- Overseas corporate body means a company, society, partnership firm, and other corporate body owned either directly or indirectly to the extent of at least 60% by non-resident Indians and also includes "overseas trust in which not less than 60% beneficial interest is held by NRIs directly or indirectly but irrevocably."[8]

RBI'S ROLE IN REGULATING FOREIGN EXCHANGE

Following the Reserve Bank of India Act, 1934, the central bank of India which is known as the Reserve Bank of India (RBI) was established and commenced its operations on 1st April 1935. It issues and supplies the Indian Rupee. RBI is responsible for the regulation of currencies and the Indian banking system in the country, under the ownership of the Ministry of Finance, Government of India. The RBI analyses the economic conditions in the country and alters various policies to regulate credit control, to maintain financial stability in the country. It also monitors and prepares various banking policies and norms for the banking sector of the nation. These are the few functions out of all the responsibilities of RBI as a central bank of the country. The Reserve bank of India also is responsible for the regulation of Foreign Exchange in India under the Foreign Exchange Management Act, 1999.

[8] Raj Kumar S. Adukia, 'Applicability of FEMA' (*CAAA*) <http://www.caaa.in/Image/fema2011.pdf> accessed 13 April 2022

With a liberalized approach, the major functions authorized to RBI under FEMA, 1999 are[9]-

- RBI is responsible for the regulation and management of Foreign Exchange transactions in the country.
- All transactions of FOREX can only be carried out through an "authorised person" registered by the RBI, i.e., The Reserve Bank issues licences to banking institutions to act as Authorised Dealers in the market of foreign exchange.
- To keep moving toward liberalisation, the Reserve Bank has taken up a significant "elimination of licensing, quantitative restrictions and other regulatory and discretionary controls."
- Apart from easing restrictions on foreign exchange transactions in terms of procedures, the Reserve Bank of India has also laid out the exchange facility for liberalised travel abroad for reasons, such as organizing business, participating in international conferences, managing technical study tours, conducting joint ventures abroad, "negotiating foreign collaboration, pursuing higher studies and training, and also for medical treatment."
- The Reserve Bank has also permitted to hold foreign currency to the residents up to a maximum of USD 2,000 or its equivalent. Now, "residents can also open foreign currency accounts in India and credit specified foreign exchange receipts into it."
- The Reserve Bank's exchange rate policy significantly focuses on ensuring meticulous governance in the foreign exchange market. For this purpose, RBI closely inspects the developments in the financial markets domestic as well as abroad. When it seems necessary, RBI also intervenes in the market by "buying or selling" foreign currencies. The market operations and regulations are undertaken either directly or through public sector banks.
- Furthermore, the "traditional instruments like forward and swap contracts, the Reserve Bank has facilitated increased availability of derivative instruments in the foreign exchange market". It has permitted "trading in Rupee-foreign currency swaps, foreign

[9] 'Reserve Bank of India: Functions and Working' (*RBI*) <https://rbidocs.rbi.org.in/rdocs/Content/PDFs/FUNCWWE080910.pdf> accessed 13 April 2022

currency-Rupee options, cross-currency options, interest rate swaps and currency swaps, forward rate agreements, and currency futures.”

- In addition, by issuing rules under FEMA, RBI can also regulate, prohibit, and restrict transactions in foreign exchange in consultation with the Central Government. Under FEMA, the roles of RBI and The Central Government have been made distinct. Thus, as observed RBI has been vested with the power to manage and make regulations to carry out operations in the foreign exchange market solely in India under section 47[10] of the FEMA, 1999.

CONCLUSION

As we observe, it has been more than a decade since the Foreign Exchange Management Act, 1999 functioning in the Indian financial sector, regulating the foreign exchange market efficiently. The foreign exchange market not only has brought a good economic environment but also developed with time at a huge scale. With the liberalisation of the foreign exchange, and monitoring the operations properly from time to time, has reduced the risks of financial uncertainty in the FOREX market. Though there are some strict provisions of RBI in regulating FEMA, it seems necessary to impose such operations by the central bank so that no contravention arises and the procedures are efficiently systematic. FEMA has not only impacted the Indian business sector but also encouraged the Indian economy to move rapidly towards capital account transactions. A well incorporated foreign market should be of utmost importance as it affects the development of the country, hence in the FOREX market, the inflow and outflow of foreign currencies from the import and export trade sector are also emphasized greatly globally. The metamorphosis of FEMA from FERA, aided in filling up the gaps and defects which was affecting the Indian economy. In the end, we can conclude, that the legislation of FEMA did help to give a shape to the economy and the business sector conditions in the nation, and tremendously influenced the residents inside and outside India to invest more in the foreign exchange market under the proficient management of RBI throughout.

[10] Foreign Exchange Management Act, 1999, s 47