EXCHANGE CONTROL LAWS OF INDIA: COMPOUNDING OF CONTRAVENTIONS

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The exchange control laws of India come into play whenever there is an inflow/ outflow of foreign exchange to or from India. The primary legislation which governs the exchange control laws of India is the Foreign Exchange Management Act, 1999 (**"FEMA"**). The Reserve Bank of India (**"RBI"**), i.e., India's central bank, oversees the implementation of FEMA provisions and also has powers to issue rules, regulations, directions, circulars, guidelines from time to time for effective implementation of FEMA provisions. While overseeing the implementation of FEMA, RBI also has powers to compound the contraventions of provisions of FEMA, except those relating to unauthorised dealing in foreign exchange or foreign security or serious contraventions relating to money laundering, terror financing or those which affects the sovereignty of the nation.

India has a complex exchange control regulatory mechanism consisting of several rules, regulations, circulars, directions, guidelines under FEMA which investors often finds difficult to comply with and lands with breaching the provisions of FEMA. Contravention of provisions of FEMA make a person (whether individual or body corporate) liable for a penalty up to thrice the sum involved in the contravention where the amount is quantifiable or up to INR 200,000/-, where the amount is not directly quantifiable. In case of a continuing contravention one is liable for a further penalty which may extend to INR 5,000/- for every day after the first day during which the contravention continues. Further, failure to pay the penalty imposed on a person under FEMA by an adjudicating authority may make such person liable to civil imprisonment.

Compounding refers to the process of voluntarily admitting the contravention, pleading guilty and seeking redressal through payment of monetary penalty in lieu of prosecution. It is a voluntary process in which an individual or a body corporate seeks compounding of an admitted contravention. Compounding is a tool provided under the relevant legislation which helps to avoid a long drawn process of prosecution and minimize both time and cost in exchange of penalty payment.

As a measure of customer service and in order to facilitate the operational convenience, depending upon the nature of contravention, RBI has delegated the compounding powers to its Regional Offices, Foreign Exchange Divisions, CO Cell, New Delhi (**"FED CO Cell"**) and Cell for Effective Implementation of FEMA, RBI, Central Office, Mumbai (**"CEFA"**). The Regional Offices of RBI are empowered to compound contraventions in relation to foreign direct investment in companies in India. The FED CO Cell is empowered to compound contraventions in relation to liaison office/ branch office/ project office in India. The CEFA is empowered to compound all other contraventions of the provisions of FEMA. The matters related to any unauthorised dealing of foreign exchange/ security in India is handled by the Directorate of Enforcement, Government of India (**"DOE"**).

Any person who has contravened the provisions of FEMA can submit an application for compounding of such contravention in a prescribed format along with prescribed documents and fee with the relevant office of the RBI. However, there are various pre-requisite for commencement of the compounding process. For instance, the entity which has contravened the provisions of FEMA is required to first make the default good by obtaining all requisite approvals and completing compliances before seeking compounding of contravention.

As a process, upon receipt of the compounding application, RBI scrutinises the application to verify if the required details and documents furnished by the applicant are prima-facie in order. Applications with incomplete details or where the contravention is not admitted are returned to the applicant. On the admission of application, the RBI examines the application to decide if the contravention is technical, material or sensitive in nature. If technical, the applicant can be issued a cautionary advice. If the contravention is material, it is compounded by imposing an amount after giving an opportunity to the contravener to appear before the compounding authority for a personal hearing. If the contravention is sensitive in nature requiring further investigations, the same is referred to the DOE for further investigation/ action. Once the compounding order is issued by the compounding authority and sum payable for compounding (*as indicated in the compounding order)* is paid by the contravener, the compounding process comes to an end. On realization of the sum for which contravention is compounded, a certificate is issued by the RBI indicating that the applicant has complied with the order passed by the compounding authority. Once a contravention is compounded, there cannot be a second adjudication by any authority on the same contravention. As a legal effect of compounding no proceeding or further proceeding can be initiated or continued against the person in respect of the contravention which has been compounded.

It is pertinent to note that while FEMA permits offenders to get the offence compounded by payment of monetary penalty, it bars repetitive offenders from seeking refuge under the guise of compounding of contravention. FEMA specifically provides that in respect of a contravention committed by any person within a period of three (3) years from the date on which a similar contravention committed by him was compounded, such contraventions would not be compounded and relevant provisions of the FEMA shall apply. However, any second or subsequent contravention committed after the expiry of a period of three (3) years from the date on which the contravention was previously compounded is be deemed to be a first contravention and can be compounded. Essentially, this means that during a period of three (3) years, a person cannot seek compounding of contravention of a similar nature more than once.

To conclude, it can be firmly stated that compounding process is an enabler under FEMA which allow a person to discharge his/ her/ its liability in an honourable manner, however, given the penal provisions and restriction under FEMA with respect to compounding it becomes imperative for companies to adhere to the provisions of exchange control laws of India in true letter and spirit.

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