

## Social Sector Hotline

September 01, 2023

### ENHANCED SCRUTINY OF FOREIGN FUNDS FOR FCRA-REGISTERED RECIPIENTS

#### GOVT'S APPROVAL NECESSARY TO RECEIVE FOREIGN FUNDS DESPITE PERMANENT FCRA REGISTRATION

- Recent ruling by the Karnataka High Court states that possessing a permanent FCRA registration does not automatically grant organizations the right to receive and credit foreign donations till the validity of the registration. Approval by the Ministry of Home Affairs ("MHA") is still necessary for such donations.
- The ruling reaffirms the MHA's pivotal role in overseeing foreign contributions, emphasizing its control over fund inflows for national security reasons.
- The court's verdict underscores MHA's control over foreign fund inflows and the significance of adherence to regulatory processes for both banks and foreign donation recipients.

The Karnataka High Court ("Karnataka HC") recently held in the case of *MANSA—Centre for Development and Social Action ("Petitioner") v. Managing Director, Development Credit Bank & Others. ("Respondent")*<sup>1</sup> that possessing a permanent FCRA registration certificate issued by MHA under the **Foreign Contribution (Regulation) Act, 2010 ("FCRA Act")** does not automatically guarantee the right to receive and credit foreign donations into the bank account of the NGO/association. The court clarified that MHA has the authority to scrutinize and approve foreign contributions before they can be credited further.

#### BACKGROUND

In recent years, the regulatory landscape in India has undergone significant transformations, particularly regarding funding avenues available to domestic non-profit organizations. Foremost among these regulatory measures is the FCRA Act, an important piece of legislation governing the acceptance and utilization of foreign contributions by individuals, associations and organizations within the country.

The FCRA Act has attracted considerable attention due to recent amendments that have introduced more stringent compliance requirements. These changes pose challenges for non-profit entities in accessing foreign funding sources. According to this law, entities seeking to receive foreign donations must first register per Sections 11<sup>2</sup> and 12<sup>3</sup> of the FCRA Act to legally accept such funds. The present case is regarding the conflict between the Petitioner, seeking release of foreign funds withheld by the Respondent. The central contention in this case revolves around the justification of the Respondent's actions in freezing the Petitioner's funds in alignment with the MHA's directive, despite the Petitioner holding a valid and permanent FCRA registration certificate.

#### CONTENTIONS OF THE PETITIONER

The Petitioner, a Bengaluru-based society holding permanent FCRA registration, had filed a writ petition seeking the release of over ₹29 lakh (\$35,034.90 USD) foreign funds being withheld by the Respondent. Upon investigation, it came to the Petitioner's attention that this action was taken in alignment with the MHA directive to the banks. This directive stipulated that clearance from MHA was a prerequisite for the transfer of funds originating from the 'Dan Church Aid' organization. The Petitioner argued that the Respondent had dishonored its cheques arbitrarily without any justification or prior intimation. It was the contention of the Petitioner that the account in question had funds from multiple organizations and not just from 'Dan Church Aid'.

Furthermore, the Petitioner argued that even in relation to the foreign funds received from the 'Dan Church Aid', the money received for the respective project had been entirely utilized. The associated project had been successfully concluded and officially closed on the 31st of December 2012. Hence, considering these circumstances, the Petitioner emphasized that Respondent's decision to freeze the bank account of the Petitioner was not only arbitrary but also constituted a high-handed approach.

#### CONTENTIONS OF THE RESPONDENT

The Respondent relied on an MHA directive received by them to withhold funds, instructing banks not to credit funds from 'Dan Church Aid' without prior approval from the MHA, in accordance with Section 46 of the FCRA Act<sup>4</sup> and Regulations 35(A) of the Banking Regulation Act, 1949<sup>5</sup>. The Respondent argued that having a permanent FCRA registration certificate under the FCRA Act does not automatically permit an organization to receive foreign donations.

#### JUDGEMENT

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The judgement delivered by Justice KS Hemalekha of the Karnataka HC extensively examined the intricacies of the FCRA Act and its underlying objectives. The court emphasized the government's authority to prohibit the receipt of foreign contributions even for organizations with permanent FCRA registration.

The judgement underlines power of MHA to regulate such inflow of foreign funds in the interest of national security and other considerations.

Additionally, a mention was made of Section 9 of the FCRA Act<sup>6</sup> which pertains to the authority of the central government to restrict the receipt of foreign contributions in specific cases. Under this provision, the central government is empowered to prohibit or mandate any individual or group, regardless of whether they possess permanent registration, to seek prior permission from the Central Government prior to accepting any foreign contribution. The court also relied on sections 3, 4, 11, 12, and 17 of the FCRA Act<sup>7</sup> which pertain to registration, issuance of certificates and the receipt of funds in designated FCRA account. This was done to highlight the authority of the central government in regulating the inflow of foreign funds into India.

The court further, went on to closely examine the MHA directive that categorized foreign donors as falling under the "Prior Reference/Permission Category" ("PRC"), which required banks not to credit foreign funds until clearance was obtained from MHA. This directive was informed by inputs received against 'Dan Church Aid' and had led to instructions to banks to notify MHA before crediting funds from this organization. The court in the present case held, that Respondent's actions were not arbitrary, as it had followed the MHA directive. The court observed that the decision to categorize foreign donors was based on inputs from field and security agencies and found since, the Petitioner had indeed received inward remittances from 'Dan Church Aid'. Therefore, considering the adverse inputs and directive from the MHA, the court dismissed the Petitioner's claim. It was asserted by the court that possessing a permanent FCRA registration did not automatically entitle them to receive and credit foreign donations. The court emphasized that even with such registration, MHA's clearance was a prerequisite for receiving foreign contributions.

However, in the present case, the court has possibly overlooked the failure of the Respondent to inform the Petitioner of the categorization of "Dan Church Aid" under PRC, which could potentially lead to a breach of administrative law principles.<sup>8</sup> Such a failure to provide due process and transparency infringes upon the Petitioner's right to be informed<sup>9</sup> and their entitlement to receive pertinent information and notice before any administrative decision, such as the freezing of funds, as executed by the bank. This abrogation of core procedural requirements violates the right to a fair hearing protected under Article 21<sup>10</sup>.

Following the landmark judgment in *Maneka Gandhi v. Union of India ("UOI") and Ors.*,<sup>11</sup> procedural fairness is prioritized over outcomes. This perspective holds that non-compliance with fair procedures renders the process procedurally unfair and unreasonable, regardless of its impact on the outcome. The case of *Madhyamam*

*Broadcasting Limited v. UOI*<sup>12</sup> further solidifies this position by emphasizing that the failure to provide a reasoned order, disclose relevant material and ensure open justice violates the right to a fair hearing.

While upholding MHA's authority, the judgment also raises the question of balancing national security concerns with constitutional rights. It draws from the case of *Madhyamam Broadcasting Limited v. UOI*<sup>13</sup>, asserting that even in matters of national security, due process and procedural fairness must be upheld and it is the duty of the court's to examine the threshold question whether in a constitutional democracy, a fundamental right can be limited to realize the purpose underlying the law or action.

## CONCLUSION

The recent judgment by the Karnataka HC highlights the significant role of the MHA in regulating foreign contributions, irrespective of an entity's permanent FCRA registration status. The ruling reinforces the need for MHA approval before crediting foreign donations, especially those categorized under PRC. However, when assessing the constitutionality of this ruling, it is imperative to strike a delicate balance between the government's legitimate concerns related to national security and the fundamental rights of organizations to receive foreign funding as enshrined in Article 19(1)(g) of the Constitution of India.<sup>14</sup>

Drawing upon the precedent set by the case of *Madhyamam Broadcasting Limited v. UOI*<sup>15</sup>, where the Court observed the need for due process even in cases involving national security, the principle of natural justice and procedural fairness must not be compromised, even in circumstances necessitating adjustments for security reasons. The Court has emphasized that while respecting the State's judgment on matters of national security, it is still the Court's duty to ensure that actions taken by the State are well-justified, supported by cogent material and aligned with the principles of fairness.

This judgment carries significant implications for organizations seeking foreign contributions within India's regulatory framework. While reinforcing the importance of adhering to MHA guidelines and obtaining requisite clearances, it also signals the need for the government to balance its oversight of foreign funding with the constitutional rights of organizations. By fostering stricter adherence to regulatory processes, the ruling encourages a more accountable handling of foreign donations by both financial institutions and recipients alike. As the legal landscape continues to evolve, it is essential that legal experts, scholars and the judiciary maintain a vigilant approach to ensure that regulatory measures align with constitutional principles, preserving the delicate equilibrium between national security imperatives and fundamental rights.

– Rahul Rishi & Dr. Milind Antani

You can direct your queries or comments to the authors.

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<sup>1</sup>MANSA–Centre for Development and Social Action v. Managing Director, Development Credit Bank & Others, writ petition no.6111/2014

<sup>2</sup>Section 11 of the Foreign Contribution (Regulation) Act, 2010, available at: <https://www.india code.nic.in/bitstream/123456789/2098/1/a2010-42.pdf>

<sup>3</sup>Section 12 of the Foreign Contribution (Regulation) Act, 2010, available at: <https://www.in diacode.nic.in/bitstream/123456789/2098/1/a2010-42.pdf>

<sup>4</sup>Section 46 of the Foreign Contribution (Regulation) Act, 2010, Power of Central Government to give directions.—The Central Government may give such directions as it may deem necessary to any other authority or any person or class of persons regarding the carrying into execution of the provisions of this Act.

<sup>5</sup>Regulation 35A of Banking Regulation Act, 1949, Power of the Reserve Bank to give directions.--(1) Where the Reserve Bank is satisfied that-- (a) in the <sup>2</sup>[public interest]; or (aa) in the interest of banking policy; or (b) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company; or (c) to secure the proper management of any banking company generally, it is necessary to issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions.(2) The Reserve Bank may, on representation made to it or on its own motion, modify or cancel any direction issued under sub-section (1), and in so modifying or cancelling any direction may impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect.

<sup>6</sup>Section 9 of the Foreign Contribution (Regulation) Act, 2010, available at: <https://www.indiacode.nic.in/bitstream/123456789/2098/1/a2010-42.pdf>

<sup>7</sup>For details see: <https://www.indiacode.nic.in/bitstream/123456789/2098/1/a2010-42.pdf>

<sup>8</sup>Swadeshi Cotton Mills vs. Union of India (13.01.1981 - SC) : MANU/SC/0048/1981 - Highlighted that governmental actions without proper notice or hearing were deemed contrary to law.

<sup>9</sup>Keshav Mills Co. Ltd. vs. Commissioner of Income Tax, Bombay North (08.02.1965 – SC : MANU/SC/0102/1965 - The maxim "audi alteram partem" inherent in the principle of natural justice emphasizes the significance of a fair hearing, ensuring that both parties have the opportunity to present their case.

<sup>10</sup>Article 21 of the Constitution of India - Protection of life and personal liberty.—No person shall be deprived of his life or personal liberty except according to procedure established by law

<sup>11</sup>Maneka Gandhi vs. Union of India (UOI) and Ors., (25.01.1978 - SC) : MANU/SC/0133/1978

<sup>12</sup>Madhyamam Broadcasting Limited v. UOI, Civil Appeal No. 8129 of 2022, available at: [https://main.sci.gov.in/supreme-court/2022/6825/6825\\_2022\\_1\\_1501\\_43332\\_Judgement\\_05-Apr-2023.pdf](https://main.sci.gov.in/supreme-court/2022/6825/6825_2022_1_1501_43332_Judgement_05-Apr-2023.pdf)

<sup>13</sup>Ibid.

<sup>14</sup>Article 19(1)(g) of the Constitution of India - Protection of certain rights regarding freedom of speech, etc.— (1) All citizens shall have the right to practise any profession, or to carry on any occupation, trade or business.

For details see: <https://cdnbb.s3.amazonaws.com/s380537a945c7aaa788ccfcdf1b99b5d8f/uploads/2023/05/2023050195.pdf>

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