# Regulatory Hotline

November 03, 2014

## COMPOUNDING OF CONTRAVENTIONS OF EXCHANGE CONTROL LAWS

- RBI delegates additional compounding authority to its regional offices
- Decentralization intended to bring efficiency to the compounding process and may reduce transaction costs for the applicants
- An urgent need to simplify procedural and filing requirements to ease compounding

The Reserve Bank of India ("**RBI**"), India's central bank has granted additional compounding powers under the Foreign Exchange Management Act, 1999 ("**FEMA**"), to its regional offices across the country. Further, RBI has also re-aligned the jurisdiction of regional offices in respect of certain contraventions. This is part of the recent trend towards delegating compounding powers to regional offices which was, hitherto, concentrated with RBI's central office in Mumbai. This should be a welcome move as it may lead to an efficient and effective resolution of compounding proceedings.

### BACKGROUND

India has an elaborate exchange control regulatory mechanism which typically gets triggered upon any inflow / outflow of foreign exchange. Foreign investors and residents alike often face difficulty in complying with such elaborate regulatory framework and in some cases end up unintentionally / unknowingly breaching some provision(s) of the exchange control laws. FEMA i.e. the parent legislation of the exchange control regulatory framework provides for a mechanism of compounding, a voluntary process to settle admitted contraventions under FEMA.

Section 15 of FEMA permits compounding of contraventions and empowers the Compounding Authority ("**CA**") to compound any contravention in terms of Section 13 of FEMA. Further, Section 46 of FEMA read with Section 15(1) of FEMA empowers the Government of India to make rules, *inter alia*, in respect of certain contraventions of FEMA. Exercising this authority, Government of India has promulgated Foreign Exchange (Compounding Proceedings) Rules, 2000 ("**Compounding Rules**"). The Cell for the Effective Implementation of FEMA (CEFA), established by RBI, administers compounding of certain contraventions under FEMA.

Compounding is a voluntary process initiated by an applicant for an admitted contravention, adjudicated by the CA within the RBI, or the Enforcement Directorate ("**ED**"), as the case may be, in a time-bound manner. FEMA provides for a process of adjudication, under which the applicant may be liable for a penalty of up to three times the sum involved in such contravention where the amount is quantifiable or up to INR 200,000, where the amount is not quantifiable and where the contravention is a continuing one, further penalty which may extend to INR 5,000 for every day after the first day during which the contravention continues. If, however, the applicant choses to opt for a compounding, the CA is authorized to look into the compounding application in terms of the provisions of the Compounding Rules and pass an order asking the applicant to pay the sum compounded.

It is important to note that in case a contravention is discovered by RBI or brought to its notice by the applicant *suo motu*, then depending on the nature of the contravention, RBI has the leeway as to how such a contravention should be dealt with. It can issue an administrative / cautionary advice in case of technical / minor contravention, or decide that the applicant should approach CEFA under the compounding in case of material contravention, to referring the matter to the ED in case sensitive issues are involved / contraventions involved are serious in nature.

While compounding is a time-bound process, the RBI has observed that the number of compounding applications have substantially increased resulting in RBI being unable to process the applications and issue orders within the statutory time line. Hence, the delegation of additional authority to regional offices.

### THE REVISED JURISDICTION

To resolve the above-said problem, RBI has further delegated compounding authority vide its latest circular[1], which follows the recent trend of RBI to delegate compounding authority to its regional offices previously done by way of a circular issued on April 04, 2014[2]. Although, in respect of certain regional offices, RBI has delegated limited authority based on the amount involved in compounding. The additional compounding authority delegated to RBI's regional offices pursuant to the above mentioned circulars is as follows:

| S. No. | FEMA Regulation | Brief Description of Contraventions |
|---|---|---|
| **Delegation of authority vide circular dated October 16, 2014** | | |

## Research Papers

**Taxing Offshore Indirect Transfers in India**
February 28, 2025

**Unlocking Corporate Philanthropy**
February 27, 2025

**Digital Health in India**
February 26, 2025

## Research Articles

**Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?**
February 04, 2025

**INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals**
January 15, 2025

**Key changes to Model Concession Agreements in the Road Sector**
January 03, 2025

## Audio

**CCI's Deal Value Test**
February 22, 2025

**Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice**
December 18, 2024

**Digital Lending - Part 1 - What's New with NBFC P2Ps**
November 19, 2024

## NDA Connect

Connect with us at events, conferences and seminars.

## NDA Hotline

Click here to view Hotline archives.

## Video

**Vaibhav Parikh, Partner, Nishith Desai Associate on Tech, M&A, and Ease of Doing Business**
March 19, 2025

| | | |
|---|---|---|
| 1. | Regulation 10A(b)(i) read with paragraph 10 of Schedule I to TISPRO Regulations[3] | Delay in submission of form FC-TRS on transfer of shares from resident to non-resident |
| 2. | Regulation 10A(B)(2) read with paragraph 10 of Schedule I to TISPRO Regulations | Delay in submission of form FC-TRS on transfer of shares from non-resident to resident |
| 3. | Paragraph 4 of TISPRO Regulations | Taking on record transfer of shares by investee company, in the absence of certified form FC-TRS. |

**Delegation of authority vide circular dated April 04, 2014**

| | | |
|---|---|---|
| 1. | Paragraph 9(1)(A) of Schedule I to TISPRO Regulations | Delay in reporting inward remittance received for issuance of shares |
| 2. | Paragraph 9(1)(B) of Schedule I to TISPRO Regulations | Delay in filing form FC(GPR) after issue of shares |
| 3. | Paragraph 8 of Schedule I to TISPRO Regulations | Delay in issue of shares/refund of share application money beyond 180 days, mode of receipt of funds, etc. |
| 4. | Paragraph 5 of Schedule I to TISPRO Regulations | Violation of pricing guidelines for issue of shares |
| 5. | Regulation 2(ii) read with regulation 5(1) to TISPRO Regulations | Issue of ineligible instruments such as non-convertible debentures, partly-paid shares, shares with optionality clause, etc. |
| 6. | Paragraph 2 or 3 of Schedule I to TISPRO Regulations | Issue of shares without approval of RBI or FIPB respectively, wherever required |

## OUR SUGGESTIONS

While it is a welcome step that RBI has delegated further compounding authority to its regional offices, there are certain features of the compounding scheme wherein improvements may be made. Some of our suggestions are as follows:

- ***Applications through an electronic medium***: One of the suggested ways to further improvise the compounding mechanism would be to allow administrating the compounding applications through an electronic medium until the personal hearing stage. This would lead to significant reduction in transaction costs for the applicants and the RBI.
- ***Appeal against CA's order***: Also, currently there is no provision for appeal against the order of the CA. As a result, the applicant has to either pay the sum compounded by the CA or refuse to pay it, in which case, the matter is then referred to the Adjudicating Authority (*i.e.* the ED) by the RBI. In this regard, RBI should consider providing an appellate mechanism wherein applicants could have redressal against the order of the CA. This should help in bringing enhanced objectivity to the compounding process. In order to avoid frivolous appeals, the RBI may consider imposing a certain percentage of the compounded amount as applicant's filing fees. This would help the applicants get a second hearing and at the same time, discourage applicants from filing frivolous appeals.

Hopefully appropriate actions will be taken in this direction.

## CONCLUSION

The decentralization of compounding authority by RBI should be a welcome trend as long as it leads to efficient and effective administration of the compounding mechanism. This should now make the process of making applications fairly easy and less cumbersome for the applicants. Further, delegation of compounding authority to regional offices should make the compounding process more accessible and logistically convenient for applicants who are spread out across India and may not be necessarily be based in Mumbai. This would also lead to a lower transaction cost for the applicants.

The delegation of authority would equally help the RBI as well, as prior to this change; the CA at the central office had to request relevant documents relating to the contravention matter from the respective regional offices. This was not only cost ineffective but, time consuming. Hence, decentralization of compounding authority would make the whole compounding process relatively smooth for both the stakeholders i.e. the applicants and the RBI.

FEMA was introduced to simplify the exchange control regulatory regime. However, over a course of time, numerous procedural and filing requirements have been introduced by way of executive rule making. Because of complicated procedural and filing requirements, many breaches which occur are merely technical in nature, and most of them do not involve a malafide intent or deliberate default. Maybe it's time for RBI to rethink the need of complicated procedural and filing requirements. Simplifying such requirements and doing away with the non-critical ones will go a long way towards clearing the regulatory maze and the ease of doing business in India.

– Rahul Rishi, Aditya Shukla & Kishore Joshi
You can direct your queries or comments to the authors

---

[1] RBI/2014-15/266, A.P.(DIR Series) Circular No. 36 dated October 16, 2014 *available at*: http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/36APDIR102014.pdf

[2] RBI/2013-14/553, A.P. (DIR Series) Circular No.117 dated April 04, 2014 *available at*: http://rbidocs.rbi.org.in/rdocs/notification/PDFs/553APD04042014.pdf

[3] Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000

---




**SIAC 2025 Rules: Key changes & Implications**
February 18, 2025

**How Cross Border M&A Will Shape the AI Age**
February 13, 2025