

## Regulatory Hotline

October 01, 2024

### NEW EXCHANGE CONTROL COMPOUNDING RULES 2024 REPLACES THE 2000 COMPOUNDING RULES – WHAT HAS CHANGED?

- New Compounding Rules aims to expedite and streamline the overall compounding process
- Digital payment options introduced for payment application fee and penalty amounts
- Simplification and rationalization of the provisions to eliminate ambiguity and clarify the process

On September 12, 2024, the Government of India has notified the Foreign Exchange (Compounding Proceedings) Rules 2024 (“**New Rules**”)<sup>1</sup> in supersession of erstwhile Foreign Exchange (Compounding Proceedings) Rules, 2000 (“**Erstwhile Rules**”)<sup>2</sup>.

When a person contravenes any provision of the Foreign Exchange Management Act, 1999 (“**FEMA**”) or any rule, regulation, notification, direction or order issued under this Act, he has the option under Section 15 of FEMA to make an application to compound such contravention, except the contraventions under Section 3(a) of FEMA (i.e., dealing with contravention with suspicion of money laundering, terror financing etc). This would essentially be a voluntary act of the person who wishes to admit such contravention unequivocally and seek redressal for it by paying a monetary penalty as decided by the compounding authority after looking into such application and giving an opportunity of personal hearing.

In order to further simplify the existing framework and procedures for compounding under FEMA, the Government has now introduced New Rules replacing Erstwhile Rules.

#### KEY CHANGES AND IMPLICATIONS

- **Enhanced Monetary Limits:** The monetary limits on the sum involved in contravention, which determines the powers of RBI compounding officers to compound the contraventions (other than the contravention of Section 3(a) of FEMA) are rationally enhanced under New Rules.

As per enhanced limits, an officer not below the rank of Assistant General Manager of the RBI (AGM) is now authorised to compound the contravention involving a sum upto INR 60 lakhs [equivalent to ~USD72000] (earlier, it was upto INR 10 lakhs). The contraventions involving a sum beyond this and upto INR 2.5 crores [equivalent to ~USD300,000] (earlier, it was upto INR 40 lakhs) will be compounded by the Deputy General Manager (DGM). Similarly, the General Manager (GM) can now compound the contraventions involving amount upto INR 5 crores [equivalent to ~USD600,000] (earlier, upto INR 1 crore) and an officer not below the rank of Chief General Manager (CGM) can compound any contravention of any amount above INR 5 crores. This move is intended to reduce the burden on the higher officers, as most of the less serious contraventions will be handled by subordinate officers and it is also likely to expedite the overall compounding process.

The monetary limits determining the powers of compounding officers of the Directorate of Enforcement (ED) to compound the contraventions under Section 3(a) of FEMA however continues to remain unchanged.

- **Compounding Filing Fee & Penalty:** Every application for compounding any contravention should be made to the Foreign Exchange Department of the RBI or the Director of the ED, as applicable. Compounding application filing fee has been revised from the earlier INR 5,000 to INR 10,000 plus GST now. Regarding the mode of payment of application filing fee and compounding penalty amount, Erstwhile Rules required this to be paid only by demand draft (DD). New Rules have now allowed such payment even through National Electronic Fund Transfer (NEFT), or other permissible online modes of payment, in favour of the compounding authority.

Pertinent to note that when the compounding penalty is imposed, the concerned person should pay it strictly within 15 days from the date of issuance of order, failing which, it is deemed that such compounding application was never made. This had posed practical difficulties in certain cases in the past as such payment could only be made by DD which is a time consuming process. Allowing NEFT and other online modes for paying compounding penalty should help overcome any such consequences.

- **Discontinuation of adjudication:** New Rules clarify that in respect of contravention which is already compounded prior to adjudication of such contravention under Section 16 of FEMA, no inquiry or further inquiry can be initiated or continued against the person. There was always a bar on holding or initiating an inquiry for adjudication of contravention which has been successfully compounded however, this revised provision clarifies also to discontinue any existing inquiries by the adjudicating authority.
- **Powers of Compounding Authority:** Apart from the powers to call for further information, records or any other documents conferred upon the compounding authority under Erstwhile Rules, New Rules also empower the authority to require the applicant to take any necessary actions with respect to transactions involved in the contravention. As a process, compounding of contravention is allowed after completing all the administrative actions like obtaining requisite approval of the Government or

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RBI, completion of pending filings, unwinding of transaction etc. The compounding authority is now authorised to require completion of any other actions necessary to compound the contravention without having to return the application and at the same time, complete the process within the prescribed timeline.

- **Non-Compoundable Cases:** A dedicated new rule 9 is introduced in New Rules, as against proviso to Rule 8(2) of Erstwhile Rules, to specifically list out the cases which cannot be compounded. These cases include matters where the amount is not quantifiable, attracting special provisions relating to assets held outside India in contravention of FEMA or Section 3(a) of FEMA or where the adjudicating authority has already passed an order imposing penalty.
- **Revision in Compounding Application Format:** New Rules have revised the application format making it more structured and clearer. New format requires specific disclosures under each head and aims to provide compounding authority with the clear understanding of facts and nature of contravention. The ED investigation related undertaking has also been revised in line with New Rules and as per this, the applicant should also undertake to immediately inform the compounding officer where the order is passed by the adjudicating authority on or before the issuance of the compounding order.

Also, to avoid any inconvenience in implementing these new requirements, it is clarified that New Rules would apply only for new applications and not for compounding matters pending on the date of their commencement.

## OUR VIEWS

These newly introduced changes certainly simplify the existing FEMA compounding process. Providing multiple options to make payments is in line with the current trends. Raising monetary thresholds for handling compounding matters and discontinuation of pending adjudication actions for compounded cases would help improve overall efficiency of the compounding officers and ensure speedy redressal of cases. Revision of reporting formats and providing necessary clarifications like how to treat current pending applications etc. is also a welcome move.

Having said that, there are few other areas or issues, as briefly stated below, which needs to be addressed by the regulator so as to further simplify and rationalise the compounding process:

- While computing the 3 years' cooling off period for compounding the contravention second time, the scope of '*similar contravention*' should be clarified as there are different views around this. In some cases, a person is not allowed to compound a contravention under one provision of FEMA if he has already compounded contravention under some other provision of FEMA during past 3 years;
- FEMA allows *only admitted contravention* to be compounded. However, it may at times creates hesitation and makes it difficult for the business institutions which always have high regards towards Indian laws, however, on account of certain misjudgments/uncertainties have inadvertently, ended up going against the letter or spirit of law. Hence, where the contravention occurred inadvertently, purely due to ambiguity in the law and where the person has acted diligently throughout the transaction and voluntarily approached to compound such contravention in order to buy peace, compounding may be allowed without requiring such person to *admit the contravention*;
- New Rules maintain the same 180 days as the maximum period, like Erstwhile Rules, within which the compounding application should be disposed of by the compounding authority. This timeline may, however, be revisited and reduced, since almost all the FDI, ECB and overseas investment reporting related contraventions are completely dealt with by levying the LSF at present;
- Currently, any FDI and ECB filings related contraventions occurred prior to the introduction of LSF are subject to compounding process and to address this, the amnesty scheme which was recently introduced for regularising overseas investment filings under LSF route, should be extended to FDI and ECB filings as well. By enhancing the scope of LSF, the compounding authorities can focus and address serious contraventions more effectively and in an expedited manner;
- While the compounding authority is authorised to afford an opportunity of personal hearing to the applicant, based on the averments made during such hearing and conduct of party, the authorities should be given discretionary powers to reconsider and reduce the penalty amount computed based on the guidance note on computation matrix and the other indicative factors stated in the RBI Master Directions on FEMA Compounding<sup>3</sup>; and
- As per current trends and to achieve greater efficiency, the regulators should also consider moving the whole compounding process from physical to online mode, including allowing online filing of the application.

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<sup>1</sup><https://static.pib.gov.in/WriteReadData/specificdocs/documents/2024/sep/doc2024912392301.pdf>

<sup>2</sup>[https://upload.indiacode.nic.in/showfile?actid=AC\\_CEN\\_2\\_45\\_00004\\_199942\\_1517807323986&type=rule&filename=FEM%20\(%20Compounding%20Proceedings%20\)%20Rules%202000.pdf](https://upload.indiacode.nic.in/showfile?actid=AC_CEN_2_45_00004_199942_1517807323986&type=rule&filename=FEM%20(%20Compounding%20Proceedings%20)%20Rules%202000.pdf)

<sup>3</sup>[https://www.rbi.org.in/Scripts/BS\\_ViewMasDirections.aspx?id=10190](https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10190)

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