Chapter 19 - Foreign Exchange Management Act (FEMA)

Introduction

Foreign Exchange Management Act or in short (FEMA) is an act that provides guidelines for the free flow of foreign exchange in India. It has brought a new management regime of foreign exchange consistent with the emerging frame work of the World Trade Organisation (WTO). Foreign Exchange Management Act was earlier known as FERA (Foreign Exchange Regulation Act), which has been found to be unsuccessful with the proliberalisation policies of the Government of India.

FEMA is applicable in all over India and even branches, offices and agencies located outside India, if it belongs to a person who is a resident of India.

Some Highlights of FEMA

- It prohibits foreign exchange dealing undertaken other than an authorised person;
- It also makes it clear that if any person residing in India, received any Forex payment (without there being a corresponding inward remittance from abroad) the concerned person shall be deemed to have received they payment from a nonauthorised person.
- There are 7 types of current account transactions, which are totally prohibited, and therefore no transaction can be undertaken relating to them. These include transaction relating to lotteries, football pools, banned magazines and a few others.
- FEMA and the related rules give full freedom to Resident of India (ROI) to hold or own or transfer any foreign security or immovable property situated outside India.
- Similar freedom is also given to a resident who inherits such security or immovable property from an ROI.
- An ROI is permitted to hold shares, securities and properties acquired by him while he was a Resident or inherited such properties from a Resident.
- The exchange drawn can also be used for purpose other than for which it is drawn provided drawl of exchange is otherwise permitted for such purpose.
- Certain prescribed limits have been substantially enhanced. For instance, residence now going abroad for business purpose or for participating in conferences seminars will not need the RBI's permission to avail foreign exchange up to US$. 25,000 per trip irrespective of the period of stay, basic travel quota has been increased from the existing US$ 3,000 to US$ 5,000 per calendar year.

Buyers's /Supplier's Credit

Trade Credit have been subjected to dynamic regulation over a period of last two years. Now, Reserve Bank of India (RBI) vide circular number A.P. (DIR Series) Circular No. 24, Dated November 1, 2004, has given general permission to ADs for issuance of Guarantee/ Letter of Undertaking (LoU) / Letter of Comfort (LoC) subject to certain terms and conditions . In view of the above, we are issuing consolidated guidelines and process flow for availing trade credit .

1. Definition of Trade Credit : Credit extended for imports of goods directly by the overseas supplier, bank and financial institution for original maturity of less than three years from the

date of shipment is referred to as trade credit for imports.
Depending on the source of finance, such trade credit will include supplier's credit or buyers credit , Supplier 's credit relates to credit for imports into India extended by the overseas supplier , while Buyers credit refers to loans for payment of imports in to India arranged by the importer from a bank or financial institution outside India for maturity of less than three years.

It may be noted that buyers credit and suppliers credit for three years and above come under the category of External Commercial Borrowing (ECB), which are governed by ECB guidelines. Trade credit can be availed for import of goods only therefore interest and other charges will not be a part of trade credit at any point of time.

2. Amount and tenor : For import of all items permissible under the Foreign Trade Policy (except gold), Authorized Dealers (ADs) have been permitted to approved trade credits up to 20 millions per import transaction with a maturity period (from the date of shipment) up to one year.

Additionally, for import of capital goods, ADs have been permitted to approved trade credits up to USD 20 millions transactions with a maturity period of more than one year and less than three years. No roll over/ extension will be permitted by the AD beyond the permissible period.

3. All in cost ceiling : The all in cost ceiling are as under: Maturity period up to one year 6 months LIBOR +50 basis points.

Maturity period more than one year but less than three years 6 months LIBOR* + 125 basis point
* for the respective currency of credit or applicable benchmark like EURIBOR., SIBOR, TIBOR, etc.

4. Issue of guarantee, letter of undertaking or letter of comfort in favour of overseas lender : RBI has given general permission to ADs for issuance of guarantee / Letter of Undertaking (LOU) / Letter of Comfort (LOC) in favour of overseas supplier, bank and financial instruction, up to USD 20 millions per transaction for a period up to one year for import of all non capital goods permissible under Foreign Trade Policy (except gold) and up to three years for import of capital goods.

In case the request for trade credit does not comply with any of the RBI stipulations, the importer needs to have approval from the central office of RBI.

FEMA regulations have an immense impact in international trade transactions and different modes of payments.RBI release regular notifications and circulars, outlining its clarifications and modifications related to various sections of FEMA.