Foreign Exchange Management Act 1999 (FEMA)

In an increasingly interconnected global economy, the management and regulation of foreign exchange transactions hold a pivotal role in shaping a nation's economic landscape. The Foreign Exchange Management Act (FEMA) of 1999 is a landmark legislation in the Indian context that seeks to address the complexities and challenges of foreign exchange transactions within the country.

This pivotal law, which replaced the earlier Foreign Exchange Regulation Act (FERA), embodies the evolution of India's approach to foreign exchange management, moving from a restrictive and controlled regime towards a more liberalized and open framework. In the following article, we will elaborately discuss FEMA.

Foreign Exchange Management Act 1999 (FEMA)

The Foreign Exchange Management Act (FEMA) came into effect on the 1st of June, 2000, replacing the Foreign Exchange Regulation Act (FERA). The intentions of the Foreign Exchange Management Act are to perhaps revise and unite laws that relate to transactions of foreign exchange and encourage orderly maintenance and development of the foreign exchange markets in India. FEMA is not as restrictive as some of the FERA regulations and is in line with India's economic liberalisation policies.

Objectives of FEMA

The Foreign Exchange Management Act act aims to provide systematic support for the exchange of foreign currency. FEMA aims to consolidate and revise the previous Foreign Exchange Regulation Act (FERA) to enhance foreign trade activities and simultaneously foster a healthy foreign exchange market within the country. It imposes regulations but such that facilitate trade and exchange management. Its objectives are

- **Facilitating External Trade and Payments:** FEMA's first objective is to simplify and facilitate international trade activities and transactions.
- **Promoting Orderly Development of the Foreign Exchange Market:** FEMA's second goal is to ensure the systematic growth, stability, and regulation of India's foreign exchange market.

What is the Need of FEMA?

The Foreign Exchange Management Act (FEMA) was introduced to replace the Foreign Exchange Regulation Act (FERA) due to several compelling reasons stemming from the changing economic landscape and the need for a more liberal approach towards foreign exchange management. FERA, while initially enacted with the intention of regulating transactions involving foreign exchange and controlling the import and export of currency, here is a list of several drawbacks that became apparent over time which led to the need for FEMA.

- **Stringent Regulations and Control:** FERA imposed strict and often drastic regulations on foreign exchange transactions. It controlled the movement of foreign currency and made every transaction subject to stringent scrutiny and approval. This level of control hindered the ease of doing business and discouraged foreign investment.
- **Presumption of Guilt:** One of the significant drawbacks of FERA was the presumption of guilt until proven innocent. This reversal of the burden of proof placed individuals and businesses in a difficult position, forcing them to prove their innocence even for minor violations. This contradicted the established principle of "innocent until proven guilty" in legal systems.

- **Inflexibility:** FERA's approach was characterised by a lack of flexibility. It followed a "prohibited unless permitted" philosophy, which meant that any foreign exchange transaction or activity not explicitly allowed was considered illegal. This rigid approach hindered economic growth and discouraged foreign investors.
- **Negative Impact on Economic Liberalisation:** As India embarked on economic liberalisation and opened its doors to foreign investment and global economic integration, FERA's stringent measures were increasingly seen as a hindrance. The rules and regulations impeded the flow of capital and created barriers for foreign investors.
- **Need for Liberalisation:** The need for a more liberal and conducive environment for foreign exchange management became apparent as India aimed to attract foreign investment, encourage exports, and boost economic growth. FERA's restrictive provisions were counterproductive to these goals.

Why was FEMA implemented?

In response to all the issues mentioned in the earlier section, the Indian government drafted the Foreign Exchange Management Bill (FEMA) to replace FERA. FEMA was designed to reflect the evolving needs of the Indian economy, embracing a more open and flexible approach towards foreign exchange management. FEMA aimed to remove the harsh and rigid measures of FERA and replace them with a set of regulations that facilitated foreign investment, trade, and economic growth.

Key Provisions of the Foreign Exchange Management Act (FEMA)

Below is a summary of the key provisions of the Foreign Exchange Management Act (FEMA) 1999, focusing on its essential provisions and regulations.

Dealing and Transfer of Foreign Exchange (Sections 3 and 4)

- Section 3: Prohibits dealing in or transferring foreign exchange or foreign security to unauthorized individuals.
- Section 4: Restricts Indian nationals from acquiring, holding, owning, possessing, or transferring foreign exchange, foreign security, or immovable property located outside India, unless specified by the Act.

Current and Capital Account Transactions (Sections 5)

- Section 5: Allows individuals to sell or draw foreign exchange for current account transactions, with the government's authority to impose reasonable restrictions if necessary.
- Section 5: Permits individuals to sell or draw foreign exchange for capital account transactions. RBI, in consultation with the government, specifies permissible transactions and foreign exchange limits.
- Section 5: RBI can regulate various activities, including foreign security transfer, borrowing/lending in foreign exchange, rupee transactions, deposits, currency-related matters, and property transactions.

Ownership of Foreign Currency and Property (Section 6)

- Section 6: Indian residents can hold, transfer, or invest in foreign currency, foreign security, or immovable property outside India if acquired while being a non-resident or inherited from a non-resident.
- Section 6: Non-residents can hold, transfer, or invest in Indian currency, security, or property if acquired while being a resident in India.

Establishment of Foreign Entities in India (Section 6)

- Section 6: RBI has the authority to regulate the establishment of branches, offices, or businesses by non-residents in India, relating to specific activities.

Exporter Declarations and Realization of Proceeds (Section 7)

- Section 7: Requires exporters of goods and services to provide true and accurate declarations to RBI, ensuring the realization and repatriation of full export proceeds.

Realization and Repatriation of Foreign Exchange (Section 8)

- Section 8: Mandates residents to take reasonable steps to repatriate foreign exchange due or accrued within RBI-specified time limits and methods.

Exemptions from Realisation and Repatriation (Section 9)

- Section 9: Grants certain exemptions from the requirement to realise and repatriate foreign exchange in specific cases.

Conclusion

India's transition from FERA to FEMA reflects a purposeful shift from stringent controls to a more flexible and growth-oriented approach in foreign exchange management. This transition signifies the nation's commitment to fostering international trade, encouraging foreign investment, and maintaining a dynamic foreign exchange market, aligning with its aspirations for sustained economic progress.