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To,
Shri G. Padmanabhan,
Executive Director,
Foreign Exchange Department,
Reserve Bank of India,
17th Floor, Central Office Building,
Shahid Bhagat Singh Road,
Mumbai - 400001.

Date: 20th October, 2012.

Dear Sir,

Sub: Liberalised Remittance Scheme (LRS)

RBI has permitted resident individuals to remit abroad upto US\$ 2,00,000 per year for almost any purpose under the Liberalised Remittance Scheme (LRS). This has been appreciated very well by everyone. There are however a few issues under the scheme which have come up. The same are explained below.

1. Purpose of remittance - Setting up companies abroad:

From 2004 to 2010 Indian residents were permitted to open companies abroad under LRS. In the year 2010, RBI managers changed the view. And residents who had already incorporated companies abroad were considered as having violated FEMA.

1.1 The LRS commenced in February 2004 vide AP (Dir) Series circular no. 64 dated 4th February 2004. It permits remittance abroad for current account as well as capital account. This remittance facility under the scheme is "**in addition**" to facilities under other regulations. Thus while under capital account regulations an Indian resident cannot acquire immovable property abroad; under LRS, he is free to acquire immovable property abroad.

1.2 Similarly, under LRS, an Indian resident can open a company abroad and invest in its shares. This was specifically clarified in the

circular and thereafter in several master circulars and FAQs. We have reproduced below some of the clarifications:

“ i) AP (Dir) Circular no. 64 dated 4.2.2004:

3.2 Under this facility, resident individuals will be free to acquire and hold immovable property or **shares or any other asset outside India** without prior approval of the Reserve Bank.

ii) Master Circular dated no. 3 dated 1st July 2004:

Resident individuals are free to acquire and hold immovable property or **shares or any other asset outside India** without prior approval of the Reserve Bank.

iii) Foreign Exchange Facilities for Residents (As on July 1, 2004) - FAQs

34. Can residents avail of this facility for acquiring immovable property and other assets abroad?

Yes. Individuals are free to use this Scheme to acquire and hold immovable property, **shares or any other asset outside India** without prior approval of RBI.

iv) The **subsequent Master circulars** dated 1st July 2005, 1st July 2006, 1st July 2007, 21st February 2008, 1st July 2008, 1st July 2009, and 1st July 2010 also provide for similar language that investment is permitted in shares.

FAQs dated 1st January 2006, February 2007, August 2007, and 2009 – also provide for similar language that investment is permitted in shares.

v) **Master Circulars** dated 1st July 2008, 1st July 2009, 1st July 2010, 1st July 2011 and 1st July 2012 clarify further that investment can be made in shares (**listed or otherwise**). Thus it was clarified that investment could be made in listed **as well as unlisted** (private company's shares).”

Thus there are several pronouncements by RBI that investment in foreign shares is permitted.

1.3 FAQs of 17th September 2010 and subsequent Master Circulars:

In the FAQ dated 17th September 2010, it was for the **first time** stated that LRS could not be used for “setting up a company abroad” [Answer 3(v)].

However subsequent Master circulars dated 1st July 2011 and 1st July 2012 also state that investment can be made in shares (listed or otherwise). There is no restriction on setting up of companies.

We appreciate that FAQs and Master Circulars are not statutory documents. We however do not wish to get into technical arguments. We only wish to point out that not just for a layman, but even for a professional, it becomes difficult to appreciate what is the correct law.

- 1.4 When a liberalisation is made, RBI imposes **several conditions**. Ordinary people do not understand these conditions. There have been cases where people went abroad. Out of their travel allowance they opened bank accounts abroad or gave loans to friends/ relatives. They thought this was permitted as it was within the limit of \$ 2,00,000.

RBI considers this as violation of FEMA procedures. Only reason for such a stand is that there is no "reporting". We submit that a liberalisation should be liberal in its true spirit. If reporting is required, parties may be asked to report within three months after investment.

2. **Amendments to policy - from prospective date:**

We appreciate that the policy can be amended. It is RBI's prerogative to do so. However it can only be from a **prospective date**. RBI has however been taking a view that investments made under LRS in private companies even before 17th September 2010 are violations. People are advised to go for Compounding.

We submit that this is unfair. In a democratic country, the law should state clearly what is permitted and what is not. An interpretation by an individual manager cannot be considered as the law. To consider an investment in a foreign company as a violation - especially when several Master circulars and FAQs have provided that the investment can be made in unlisted companies - is unfair.

3. We very humbly submit as under:

- 3.1 Under LRS, individuals should be permitted to incorporate any company abroad; and even to do business abroad. If considered necessary, RBI may require the investors to submit the audited accounts of such companies.

- 3.2 Investment should be permitted in any manner: It should not be necessary to make investment only through the Indian bank account. Even when a person is travelling abroad, he may invest out of funds

available with him. LRS circular may provide that anyone investing / remitting outside India will have to report to RBI within three months.

4. Transactions which are “otherwise not permissible” under FEMA:

4.1 Master circular dated 1st July 2007 for the first time provided that all transactions which are “otherwise not permissible” under FEMA, cannot be undertaken under LRS. (FAQs still do not have such a restriction.) This restriction has been cited to justify that **individuals** are not considered as an “**Indian Party**” under notification no. 120 for investment in foreign companies. Therefore investment in a foreign company by an individual is “otherwise not permissible”. Hence under LRS also, an individual is not permitted to invest abroad.

Our humble submissions:

Consider a situation where an Indian resident wants to acquire an **immovable property** in UK. Under FEMA **Notification no. 7**, he is not allowed to purchase the property. No resident is permitted at all to invest in a foreign immovable property. It is a transaction, which is “otherwise not permissible”. Still under the LRS, an individual can buy the property.

Under section 3, an Indian resident individual cannot deal in foreign exchange. **Under section 8**, if a resident has assets outside India, he has to bring it back to India. LRS circular grants permission to remit and invest abroad for so many transactions which are “otherwise not permissible”.

We cannot appreciate the difference between these two transactions – foreign shares and foreign immovable property. Both are “otherwise not permissible”, but one is considered as “permitted” under LRS and the other is not.

4.2 If a view is taken that - a transaction which is “otherwise not permissible” under FEMA, cannot be undertaken under LRS, **then the whole LRS is redundant**. This is because, LRS is “in addition” to what is permitted under various FEMA regulations. All Master circulars and FAQs state this. Whatever is permitted under LRS is otherwise prohibited under one notification or the other. Whole purpose of LRS is to permit what is “otherwise not permissible”.

5. Investment by individuals:

It seems, RBI considers that investment outside India by “Companies” is safer than investment by “Individuals”. Hence under FEMA Notification No. 120 for overseas investments, individuals are not

permitted to invest abroad. And under LRS, RBI does not want individuals to invest in business.

The current global crisis is largely due to frauds by the US financial institutions. These were large corporates. Even in India, several frauds have happened by the corporates. The fraud is dependent on the intention of person who wants to commit a fraud, and not on the form which he adopts.

Individuals have flourished in several areas in India and globally. Hence not to keep faith in the individuals is inappropriate. We request that individuals should be permitted to invest in companies abroad. They can be asked to get their accounts audited.

6. Compounding:

As we have discussed above, RBI has been insisting on Compounding of transactions where investment has been made in foreign companies under LRS. We submit that Compounding should not be insisted upon in case of investment in foreign company's shares by individuals.

7. Misuse of LRS:

There is an apprehension that the setting up of a foreign company outside India can be misused. We understand that promoters can float companies abroad, borrow funds in that company and then invest in India as FDI. We clearly agree that LRS is not for such purposes.

However misuse by some persons, does not mean that everyone may be barred! In a society, there will be always people who violate laws. That does not mean everyone may be barred. And such round tripping can be resorted to by Companies also. There has been round tripping by large corporate groups. These have been reported in the press.

RBI has periodically clarified which transactions are not permitted. For example when people started undertaking margin trading, RBI has advised that such activities are not permitted. We appreciate that. If necessary, RBI can clarify that LRS & ODI both cannot be used for round tripping etc.

8. Representation:

Considering the above, our representation is as under:

- 8.1 Permit individuals to invest in and to incorporate - foreign companies under LRS. The foreign companies may make further investments or may do business.
- 8.2 Return all Compounding applications which are pending for this purpose.
- 8.3 If at all RBI does not want individuals to invest in foreign companies under LRS, make a clear provision in the LRS circular & then if anyone invests, consider it as a violation.

We humbly request for an appointment where these matters can be discussed & elaborated.

Thanking you,

Yours faithfully,
For Rashmin Sanghvi & Associates
Partner

Rashmin Sanghvi

C.C.: Chief General Manager in-charge.
Chief General Manager - Compounding Cell.
Reserve Bank of India, Mumbai.