© IJCIRAS | ISSN (O) - 2581-5334
October 2019 | Vol. 2 Issue. 5

FOREIGN EXCHANGE SCENARIO AND CURRENCY CONTROL IN INDIA

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Abstract

With the opening of the world economy and increase in international business transactions, Foreign Exchange Frauds and scams have also increased considerably. They are usually performed by fraudulent traders with the objective of gaining profits by trading in the Foreign Exchange Market (FOREX). There can be various instruments by which such activities might be performed. This paper will focus only of the procedure of currency control and foreign exchange regulation in the Indian market. It will highlight the policies and regulations of the central bank "The Reserve Bank of India (RBI)" with respect to various scenarios where foreign exchange management is implemented.

Keyword: Reserve Bank of India (RBI), Foreign Exchange, Rupee, Resident

1. INDIAN FOREIGN EXCHANGE SCENARIO

India's foreign exchange reserve consists of cash, bonds, bank deposits and several other financial assets of currencies other than the Indian Rupee. The total FOREX stood at around $429 billion as on August 2019. It mostly comprises of US dollars as US government and institutional bonds of which around 5% are in the form of gold. The Reserve Bank of India (RBI) and the Foreign Exchange Management Act (FEMA), 1999 regulates the flow of this foreign exchange funds. They serve as a cushion to the government against volatility of the domestic currency rupee. Policies of RBI include steps such as banning the use of foreign currency in India, restricting locals from buying foreign currency, restricting foreign currency exchange only to government approved institutions etc.[6] Presently the daily transactions are around $2 million which is still very low considering the overall size of the Indian market. It is mainly due to the fact that the Rupee is not a widely accepted currently has very low demand in the global market. The most popular currencies used in the Indian market are the US Dollar, the Euro, the British Pound and the Japanese Yen.

Under the below circumstances, a person or groups are considered to be residents:

- A person or company registered in India.
- An office or branch which is owned by someone residing outside India.
- An office or branch which is owned by someone residing in India.

The RBI deals with the following situations:

- ➢ Transfer to funds to a non authorized person.
- ➢ Making payments to a person not residing in India.
- ➢ Receiving payments from outside inside from a non authorized person.
- ➢ All capital account transactions are monitored by the RBI.

The RBI can impose restrictions on transactions under the following conditions:

- ➢ Payment of foreign security is being made to a person residing outside India.
- ➢ Payment of foreign security to a person who is resident in India.
- ➢ Transfer of foreign security by any office or agency in India of a person resident outside the country.

- Borrowing or lending of foreign exchange with any name.
- Exchange of rupee currency between a party resident in India with another party resident outside India.
- Any sort of transaction between a person resident in India with a person resident outside India.
- Exported or Imported Currency notes.
- Non Lease transfer of immovable property outside India for a period of more than 5 years.
- If a person resident outside India acquires immovable property in India for a period of more than 5 years.[5]
- When guarantee or surety is provided for debt or other liability incurred by a person who is resident in India to another person resident outside India.

As per FEMA, any person who has been living in India for more than 182 days in the preceding financial year is considered to be a resident except the following conditions:

- A person who came to the country for business or employment and is staying in the country and intends to do so for an unknown period of time shall be considered as a resident.
- A person who has gone out of the country for job or business or an indefinite period of time shall be treated as a Non-Resident.

As per FEMA, a resident can remit only $250000 per financial year (from 1st April to 32st March) to any current or capital account under the Liberalized Remittance Scheme (LMS) without obtaining permission from the RBI. The LRS helps Indian residents to remit money abroad.

1.1. Currency Import Regulations in India

- Any resident India who was abroad for some time, while returning to India can carry maximum of RBI notes of 25000 rupees. (This rule is not valid for people traveling to India from Nepal and Bhutan).
- For foreign currencies, there is no such restriction for Resident Indians travelling to India from the USA. However if the amount exceeds $5000 (Currency Notes) or $10000 (Foreign Exchange as notes or traveler's cheques), then it will need to pass custom's check. The person has to declare by filling up the CDF (Currency Declaration Form) if the amount exceeds $3000.

2.RELATED ORGANIZATIONS

2.1. Foreign Exchange Dealers Association of India (FEDAI)

It is an association of banks specialized in the Indian foreign exchange market which was created in 1958.[4] It performs the following functions:

- Overlook daily Indian FOREX transactions.
- Supporting and helping member banks in their foreign exchange activities.
- Represents the member banks to RBI.
- Making member banks aware of daily and periodical rates.

FEDAI is a Self Regulatory Organization (SRO). They exist independent of ruling government and are free to formulate their own policies and regulations. It works in association with the RBI and the Fixed Income Money Market and Derivatives Association of India (FIMMDA). In 2018, FEDAI joined hands with Financial Benchmark India, FIMMDA and the Indian Banks Association (IBA) to set benchmarks for Indian Rupee interest and foreign exchange rates.

2.2. Foreign Currency Accounts for Non-Residents in India

2.2.1. Non-Resident External (NRE) Rupee Account

The NRE account helps a Non-Resident Indian living in any country (Except Bangladesh, Pakistan and any other country as specified by the government) to transfer money to India. There is no tax on interest earned from

NRE accounts and also no wealth tax is levied. However such tax reliefs are available only to individuals and not corporates.

2.2.2. Non-Resident Ordinary (NRO) Account

These accounts help in bona-fide rupee transactions for Non-Residents. The account can also be credited by inward transaction in India. The NRO account can be credit only by current income from outside the country such as rent, interest and pension. Balance from an NRO account can be transferred to an NRE account but there is a limit of $1 million. [1] Unlike NRE accounts, tax is charged on interest earned from these accounts.

2.2.3. Foreign Currency Non-Resident (FCNR) Account

This account allows a Non-Resident to deposit foreign currencies in their accounts. Permissible currencies include US Dollars, Canadian Dollars, Australian Dollars, Pound Sterling, Euro and Japanese Yen. These accounts accept term deposits for more than 1 year and maximum of 5 years. Funds in such accounts can be transferred to other NRE accounts for a price. Both the principal amount and interest earned from deposits are exempted from taxes.

2.3. Foreign Currency Accounts for Residents in India

2.3.1. Resident Foreign Currency (RFC) Account

This account is directed to Indian who had been outside the country for atleast more than a year and who needs to deposit foreign currency in an Indian account. The foreign currency can be US Dollar, Euro and Japanese Yen. They can remit currency overseas from such accounts as and when necessary. The currency is convertible and usable in India too. The interest earned from such accounts is taxable on quarterly basis.

2.3.2. Exchange Earner's Foreign Currency (EEFC)

This account is meant for exporters and importers operating in the country. They can use this account to make payments abroad or receive payments from a foreign country. This helps hedge the foreign exchange risks to a considerable extent. The sum kept in such accounts is automatically converted into Indian rupees after a certain period of time unless the account holder shows that he has an equal number of remittances to make.

3.FOREIGN EXCHANGE CONTROL

All foreign transactions are regulated by the Foreign Exchange Management Act (FEMA), 1999. In 1974, the Foreign Exchange Regulatory Act (FERA) was formulated for this purpose. However it was later modified with few amendments and was replaced by FEMA. As per this act, the RBI has sole authority in matter related to foreign exchange and reserves of the country. Authorized dealer is a person who is authorized to act as a dealer for foreign exchange under the FEMA. Foreign Exchange Dealers Association of India (FEDAI) has the right to frame policies related to FOREX business across various banks and also to consult with RBI over issues related to the foreign exchange market. India as a country has immense need for foreign exchange control because any developing economy needs to maintain its reserves of foreign exchange to absorb situations of economic shock. Only countries with very strong balance of payments can relax their foreign exchange control laws. Below are few regulations for different stakeholders:

3.1. General Provisions

No person in India other than someone approved by the RBI can purchase foreign exchange. An Indian company cannot open an account in a foreign country without permission of the RBI. A company based in India cannot make payment to a foreign company out of the money held by it abroad.

3.2. Investments made in India by Foreign Companies

As per the Industrial Policy Resolution of India, foreign enterprises are given non-discriminatory treatment and are at par with domestic enterprises. Foreign Direct Investments (FDIs) can be done in India in two ways. One is the automatic procedure which does not require the approval of the government. The other is through "Foreign Investment Facilitation Portal" under the Department of Industrial Policy and Promotion, Ministry

of Commerce and Industry, Government of India.[2] There are 11 approved sectors apart from which in all other sectors, prior government approval is required before investing in the country. Foreign Institutional Investors (FIIs) can invest in upto 24% of the issued and paid up capital of a company. Non Resident Indians (NRIs) can invest through either government or automatic routes except for individuals from Pakistan and Bangladesh who has to follow the government route.

3.3. Foreign Companies opening branches in India

The government of India recently announced that foreign defense, telecom and information broad casting companies will not need RBI's permission to open branch offices in India provided they have approval from the appropriate Ministry. This change has been done in the FEMA policies to bring about ease of doing business in the country by foreign investors. For companies trying to open branches who belong to any other sector, permission of the RBI is necessary else remittance facilities will not be provided to that branch.

3.4. Indian companies investing outside India

Prior approval of the RBI is necessary for a company for investing outside the Indian Territory.[2] Investments can be in the form of Joint Ventures with a foreign company. In the long term this would help increase India's foreign exchange reserves.

3.5. Indian companies opening branches outside India

In this case too, approval of RBI is necessary for the Indian company as opening of a foreign branch would mean remittances from India to abroad for which permission of RBI is required. If permission is not taken, then remittance facilities will not be available for that company for that foreign branch.

3.6. Indian Companies employing foreign personnel

For this scenario, prior approval of the bank is necessary so that the foreign employees can make remittances to their home country.

3.7. Special restrictions on foreign companies doing business in India

- Restrictions on a person staying in India to give loans to a non banking company controlled by non residents.
- A company controlled by non residents or which is incorporated outside India cannot act as an agent in India regarding commercial or trading transactions without approval by the RBI or the central government.

3.8. Issuance of shares and securities by companies

Non residents are restricted from holding of securities or transferring of securities. Entering of any address outside India is restricted for this purpose. However in case of bearer securities where the ownership is not known, control cannot be implemented on the securities.

3.9. Foreign companies controlled by residents

There are many companies functioning abroad who majority stakes are owned by resident Indians. Many times, these companies retain balances instead of remitting them to India. They also hide dividends and hence the valid share of profits does not reach India. Keeping these practices in mind, laws and regulations have been framed to safeguard the interests of the country.[3] Such policies include providing details of the company such as assets and dividends.

3.10. Export business of companies

An exporter from India has to provide a declaration to the customs department that the full export value has been paid or shall be paid within a prescribed time period. RBI can however extend this period if required. Also while exporting to countries outside countries with bilateral relations, payment has to be made in any convertible currency. The exporter should also not be involved in any activities that might affect the realization of export proceeds. These are some measures to ensure that the entire export value is received by the country. Also all foreign exchanges are to be received by a bank

approved by the RBI and not the trading company directly.

4.CONCLUSION

We can see that the foreign exchange regulations are framed in a manner so as to protect the domestic interests of the country and such policies will remain in action until the country has enough foreign exchange reserves to bear any kind of global currency shock. RBI is quite prompt in taking decisions and there is usually no problem to any stakeholders due to delay or red tapism. Modernization is taking place at rapid pace owing to advent of new financial technologies. Trading and business firms are moving towards electronic platforms since the Indian Rupee is the 20th most actively traded currency globally with an average of around $53 billion transactions per day.[6] Proper and systematic regulations can help increase transparency and bring about a level playing field. However it also bring along increased IT costs.

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