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SCOMET Update: DGFT Issues SOP / Guidelines for Voluntary Self-Disclosure under SCOMET Export Control



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Introduction

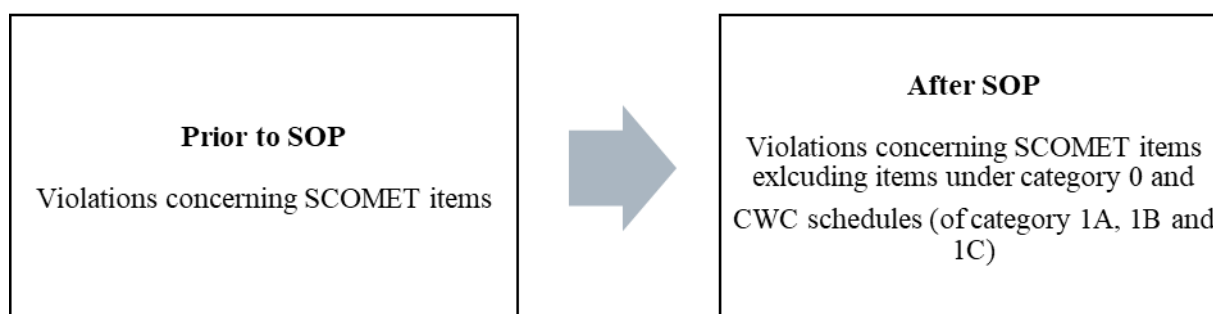
On January 15, 2024, the Indian Directorate General of Foreign Trade (“**DGFT**”) issued the Standard Operating Procedure / Guidelines (“**SOP**”) for Voluntary Self-Disclosure (“**VSD**”) concerning non-compliance / violations relating to the Special Chemicals, Organisms, Materials, Equipment, and Technologies list (“**SCOMET list**”) and SCOMET regulations. The SOP aims to enhance compliance by allowing exporters to disclose violations voluntarily and proactively. Notably, it is a significant step forward, enabling exporters to rectify past non-compliance and to mitigate stricter penalties for lapses in adhering to export control laws.

The present update provides an insight on the evolution of VSD, key highlights of the VSD and the implications for the exporters.

Evolution of VSD

In 2023, the Indian DGFT issued the Foreign Trade Policy 2023 (“**FTP**”) along with the Handbook of Procedures 2023 (“**HBP**”) introducing the VSD mechanism. The HBP stipulates that a VSD should be made to the DGFT immediately upon finding a violation. However, it did not prescribe a detailed procedure, apart from indicating that disclosures could be made via email and that exporters would face strict action under relevant provisions if violations were brought to the DGFT’s attention through means other than a VSD. The DGFT also clarified that a detailed procedure and guidelines would be issued. The present development comes in line with the same.

While the SOP provides a detailed procedure and the format in which the VSD should be made, it narrowed the scope of SCOMET items against which a VSD can be made.



Nevertheless, the VSD framework underscores DGFT’s commitment to fostering a culture of compliance. It encourages exporters to voluntarily disclose any instances of non-compliance with export control regulations, such as the Foreign Trade (Development & Regulation) Act, the Weapons of Mass Destruction Act, and the Customs Act. Therefore, proactive and complete disclosure may result in leniency or mitigation of penalties, as opposed to enforcement actions reserved for violations discovered through inspections or investigations. Critically, the VSD mechanism may help technology companies, as detecting procedurally non-tangible exports bypassing export control scrutiny is challenging. Therefore, making the VSD framework a critical tool for ensuring compliance and rectifying past oversights may be a good starting point.

Key Highlights of the SOP

- **Scope of Self-Disclosure and Kinds of Violations:** Exporters can report past violations involving unauthorized exports or other breaches of the SCOMET guidelines. Violations may include:
 - Exporting SCOMET items without the requisite authorization or license.
 - Exporting to UN sanctioned individuals/ entities without knowledge
 - Exporting items (not under the SCOMET list) and used/diverted for or manufacture of weapons of mass destructions or their delivery systems.
 - Using the export authorization to an entity by a new entity formed after the name change, merger, or de-merger without prior approval / amendment from licensing authority.
 - Failing to obtain permission in India for facilitating or undertaking verification or access to records/documents directly or indirectly by the foreign organization.
 - Failing to maintain records as mandated by export control regulations.
 - Non-compliance with reporting obligations as mandated by export control regulations.
 - Providing unauthorized access to technical data/technical assistance
 - Any other violation not listed above.
- **Key Considerations for Imposing Penalties in the Case of Voluntary Disclosures:** The VSD recognizes that despite voluntary self-disclosure the concerned may face penalties. However, the VSD empowers the IMWG to consider voluntary disclosure with supporting documents, as required, as a mitigating factor in determining the penalties. In addition, the VSD prescribes that the IMWG may *inter alia* consider:
 - Whether the violation was intentional or inadvertent, systematic or not;
 - the reasons for violation;
 - whether an internal compliance has been instituted or improved; the degree of familiarity with export control laws; past violations;
 - And/or knowledge of senior management about the violation.
- **Procedure:** The process for voluntary self-disclosure broadly involves the following steps:
 - The Indian exporter should file Appendix 10M informing the DGFT of the violation immediately after such a violation is discovered and confirmed internally.
 - If the concerned authority confirms that such violation exists, and show cause issued by the DGFT, the Indian exporter has to provide full disclosure and necessary documents within 30 days or extended deadline as provided.
- **Assessment by IMWG:**
 - After receiving all the information as indicated above, the DGFT should place the case before the Inter-Ministerial Working Group (“IMWG”), which will evaluate disclosures on a case-by-case basis in accordance with the relevant laws and regulations.
 - Once such evaluation is complete, the IMWG should provide its recommendation to the DGFT.
 - Such recommendations include:
 - To inform the exporter that no further action is warranted

- to issue a show cause notice
 - to issue an adjudication order
- Recommendations by the IMWG will guide DGFT's actions, ensuring decisions align with the Export and Import Policy and applicable laws. Once the DGFT determines the appropriate action based on the above recommendation, it should apprise the IMWG of the action taken.

Implications for Exporters

First, while the scope of violations reported under the VSD scheme is expansive and covers a majority of violations, it also provides an option for coming forward with any other violations not covered by the list of specified violations. However, it is important for an exporter to consider that the disclosure of any violation of the SCOMET regulations under the VSD may potentially be covered under the sanction's regulations of Western countries, which may attract greater liabilities or consequences than initially intended. While it is suggested to follow the applicable regulations of the jurisdictions in which business is being conducted, it is crucial to consider all possible consequences before making declarations under the VSD. Therefore, seeking appropriate legal advice is recommended.

Second, while the factual information sought by the Indian regulator aims to understand the reasons behind the violations (as disclosed) before determining the course of actions including penalties, the manner in which this information will be assessed remains uncertain. It is also unclear the level of leniency the Indian regulator is expected to apply when granting immunity if VSD is made. Therefore, one must keep a close watch of the number of applications filed under the VSD, precedents, and the types of violations reported, which will in turn allow exporters to come forward and report such violations.

The Income Tax Department published schemes similar to the VSD i.e., the Income Declaration Scheme of 2016. This scheme provided an opportunity for individuals who had not fully paid their taxes in the past to come forward, declare undisclosed income, and pay tax, surcharge, and penalties totaling 45% of the declared undisclosed income. The scheme proposed that declarations made under it would be exempt from wealth tax in respect of the assets specified in the declaration. It also proposed that no scrutiny or inquiry under the Income Tax Act or Wealth Tax Act would be undertaken in respect of such declarations, and immunity from prosecution under these Acts would be granted. The Indian government also proposed immunity from the Benami Transactions (Prohibition) Act, 1988, for such declarations, subject to certain conditions. The scheme also stipulated that if a declaration was made with misrepresentation or suppression of facts, it would be treated as void. Some of these schemes have seen limited success due to the contentious pre-condition regarding misrepresentation or suppression of facts, which depends on subjective factors and the discretion exercised by the regulator. It remains to be seen how the Indian regulators would implement the VSD mechanism.

Lastly, the VSD scheme does not provide clarity on the past period that exporters should consider when making a VSD declaration. That being said, the benefits of the SOP far outweigh the ambiguity regarding the past period. Also, when no specific period of limitation is provided, a reasonable period of limitation must be construed. In most cases, this reasonable period is considered to be five years. However, the facts would be important to assess whether the period for which the exporter is claiming leniency, and the available records, are sufficient for the IMWG to consider the request.

Having said that, exporters should continue to:

- Conduct thorough internal audits to remain compliant with applicable regulations and/or identify any violations.

- Strengthen compliance protocols to ensure adherence to regulations.
- At the same time, they must leverage the VSD mechanism to report lapses promptly and transparently

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at elptrade@elp-in.com or write to our authors:

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