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**LIBERALIZATION OF DEFERRED  
PAYMENTS UNDER FEMA**

If you have questions or would like additional information on the material covered in this Newsletter, please contact the authors:

By: Seema Jhingan, Partner  
([sjhingan@lexcounsel.in](mailto:sjhingan@lexcounsel.in))

Neha Yadav, Senior Associate  
([nyadav@lexcounsel.in](mailto:nyadav@lexcounsel.in))

Saniya Kothari, Associate  
([skothari@lexcounsel.in](mailto:skothari@lexcounsel.in))

**LIBERALIZATION OF DEFERRED PAYMENTS UNDER FEMA**

**1. Introduction**

- 1.1. Deferment of payments in share purchase transactions between non-resident buyers and resident sellers till recently required prior approval of the Reserve Bank of India ("RBI") under Regulation 10 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 ("FEMA Transfer Regulations").
- 1.2. Further, authorized dealer banks in India were allowed to open escrow accounts towards payment of share purchase consideration (subject to various terms and conditions specified by RBI), but the escrow account could only be operational for a limited period of 6 months.<sup>1</sup> In all other cases of opening/maintaining of escrow accounts for FDI related transactions, prior approval from the RBI was necessary.

**2. Liberalization brought in by Regulation 10A**

- 2.1. The above regime on deferred payments has been liberalized by introduction of a new Regulation 10A ("New Regulation") in the FEMA Transfer Regulations, vide Notification No. FEMA.368/2016-RB dated May 20, 2016.<sup>2</sup>
- 2.2. Per the New Regulation, RBI has permitted payment of purchase consideration in cases of transfer of shares by or between a resident buyer and a non-resident seller or vice-versa, on a deferred payment basis, specifically, on the terms given below:

LexCounsel, Law Offices C-10,  
Gulmohar Park New Delhi 110 049,  
INDIA. Tel.:+91.11.4166.2861  
Fax:+91.11.4166.2862

Recommended by:



- The amount of deferred consideration should not exceed 25% of the total consideration payable by the buyer under the relevant transfer transaction;
- The deferred consideration should however be paid by the buyer within a period not exceeding eighteen (18) months from the date of the transfer agreement.

2.3. Escrow Arrangement:

2.3.1. For this purpose, an escrow arrangement may also be made between the buyer and the seller for the deferred consideration (being an amount not exceeding 25% of the total consideration) for a period not exceeding 18 months from the date of the transfer agreement.<sup>3</sup>

2.3.2. Worthwhile to note in this context is the fact that the period of 18 months would begin from the date of the transfer agreement (and not the actual closing of transfer of shares), thereby not taking into account the time lags which are common between execution of share purchase/transfer agreements and the actual closing of the transaction including the time taken for completion of conditions precedent for effecting transfer.

2.3.3. That said, this mechanism would of course be of use in share transfer transactions where parties can agree to fulfill conditions precedent before execution of the share transfer agreements or as conditions subsequent to closing. This mechanism could also be relied on to hold-back part of the consideration (which was so far not possible under international sale transactions) for securing indemnification rights of the purchasers or as a means to achieve mutually agreed post-closing purchase price adjustments.

2.3.4. In a nutshell, the RBI has permitted the following escrow mechanisms under the extant FEMA regime (in the context of share purchase consideration payable for acquisition of shares):

- **6 months Escrow:**

- The entire share purchase consideration can be brought into India and be kept in an escrow account for a limited period of 6 months (from the date of opening of the account).
- In cases, where proposed acquisition/ transfer does not materialize, the authorized dealer bank may allow repatriation/ refund of the entire amount lying to the credit of the Escrow account, without RBI approval.

- **18 months Escrow:**

- Escrow accounts can also be opened for a limited period of 18 months (from the date of transfer agreement) for deferred payments (not exceeding 25% of the total consideration).

- However, the RBI in the New Regulation has not delved into the mechanism for remittance of this Deferred Consideration back to non-resident acquirer (say in case the seller fails to meet the requirements/conditions on which the deferred payment was contingent).

2.4. Indemnity:

- 2.4.1. If the total consideration is paid by the buyer to the seller, the New Regulation allows the seller to furnish an indemnity for an amount not exceeding 25% of the total consideration for a period not exceeding (18) months from the date of the payment of the full consideration.
- 2.4.2. It has been quite common for parties to agree on specific seller indemnity terms in share purchase transactions. However, these indemnity provisions are often uncapped, or if capped are often capped to the entire amount of the purchase consideration.
- 2.4.3. Further, the time period for such indemnification obligations is usually contractually agreed and the limitation period is usually linked to the statutory period of limitation such as three (3) years or a longer period of seven years in case of taxation matters.
- 2.4.4. Typically, indemnification provisions are contractually agreed between the Parties and such indemnification obligations of seller(s) are often included in the share purchase arrangements without any caps or limitations (without the requirement of any RBI approval, with the understanding that remittance of claimed amounts to the non-resident buyer in fulfillment such indemnity obligations, may require RBI approval at a later stage).
- 2.4.5. While the New Regulation intended to provide additional safeguard to the purchaser in case the full consideration has been paid to the seller at the time of transfer of shares/securities, however, the language of the New Provision (which allows furnishing of indemnities for only an amount not exceeding 25% of the total consideration and not exceeding a period of 18 months) seems to suggest, that furnishing of indemnities in excess of the aforesaid thresholds would require prior permission of the RBI. That said, it appears that this may not be the intent of the New Regulation and the parties can continue to include seller indemnity provisions in the share purchase agreements exceeding the prescribed thresholds as above and hopefully a clarification will be issued by the RBI in this regard.

3. Concluding Remarks

Providing a much needed flexibility to buyers and sellers to agree on mutual terms of payments, the New Regulation allows parties to defer acquisition cost if need be, and structure such deferred payments either through an escrow mechanism or in case of fully payment of consideration secure the interest of buyers by way of furnishing of a seller specific indemnity. Keeping the above discussed ambiguities and nuances

of this amendment aside, these relaxations would definitely be helpful in cases where payment of purchase consideration is dependent on contingencies and certain milestone performance based conditions.

#### Endnotes

<sup>1</sup>Introduced vide RBI/2010-11/ 498 A. P. (DIR Series) Circular No. 58 dated May 02, 2011 - Opening of Escrow Accounts for FDI transactions.

<sup>2</sup>*“ 10A. In case of transfer of shares between a resident buyer and a non-resident seller or vice-versa, not more than twenty five per cent of the total consideration can be paid by the buyer on a deferred basis within a period not exceeding eighteen months from the date of the transfer agreement. For this purpose, if so agreed between the buyer and the seller, an escrow arrangement may be made between the buyer and the seller for an amount not more than twenty five per cent of the total consideration for a period not exceeding eighteen months from the date of the transfer agreement or if the total consideration is paid by the buyer to the seller, the seller may furnish an indemnity for an amount not more than twenty five per cent of the total consideration for a period not exceeding eighteen months from the date of the payment of the full consideration*

*Provided the total consideration finally paid for the shares must be compliant with the applicable pricing guidelines.”*

<sup>3</sup>This also seems to be in line with the already existing provision under the Foreign Exchange Management (Deposit) Regulations, 2016; which had provided that in case of transfer of shares between a resident buyer and a non-resident seller or vice-versa, if so agreed between the buyer and the seller, an escrow arrangement may be made between the buyer and the seller for an amount not more than twenty five per cent of the total consideration for a period not exceeding eighteen months from the date of the transfer agreement

#### Feedback

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