Update

RBI's Position on Deferred Consideration in Cross-Border Share Purchase Transactions Liberalised

10 June 2016

RBI's recent amendment permitting deferment of purchase consideration and relaxing escrow requirements in cross border share purchase transactions is a positive step towards promoting the ease of doing business in India and encouraging foreign investment into India.

The Reserve Bank of India (RBI), in a bid to rationalize the existing regime under the Foreign Exchange Management Act, 1999, has recently relaxed the restriction on the payment of deferred consideration in share transfer transactions between an Indian party and a non-resident. This amendment has come into effect from 20 May 2016.

Position Earlier

Prior to the amendment, consideration in a transaction for the purchase of shares between a resident and a non-resident party was required to be paid up-front and deferment of any portion of the total consideration required the prior approval of the RBI. Further, the escrow mechanism for payment of share purchase consideration was permitted under the automatic route for a maximum period of six months, subject to various restrictions.

The Amendment

The amendment provides that in a transaction involving purchase of shares of an Indian company by a non-resident buyer from a resident seller, or vice versa, the consideration may be paid on a deferred basis subject to the following conditions:

- The deferred component of consideration must not exceed 25% of the total consideration.

- Such deferred payment must be made within a maximum period of 18 months from the date of the share transfer agreement.

The amendment provides that such deferred consideration may be structured either through an escrow arrangement or through a seller indemnity (in a case where the entire purchase consideration has been paid up-front).

Any deferred consideration mechanism which does not meet the restrictions as to the amount (i.e. up to 25% of the total
consideration) or duration (i.e. no longer than 18 months) would continue to require the approval of the RBI. It should be noted that the 18 month period commences from the date of the share transfer agreement and not from the date of closing the transaction and therefore effectively, the deferred period for payment of consideration is shorter. In cases where the full consideration is paid up-front and a seller indemnity is obtained, the maximum period of the indemnity would be 18 months from the date of closing the transaction.

Impact of the Amendment

This change in the regulatory position will allow greater flexibility for structuring purchase consideration in share transfer transactions as a mechanism for risk-allocation between the parties. This would also facilitate post-closing purchase price adjustments in M&A transactions, which, in general, are commercially intended to insulate the buyer against any significant changes in the financial condition of the target in the period between execution and closing. Post-closing purchase price adjustments are usually based upon a verification of the net asset value and working capital of the target subsequent to closing, which may result in either a refund of part of the consideration from the seller to the buyer (downward adjustment) or the payment of additional consideration by the buyer to the seller (upward adjustment). Pursuant to this amendment, such price adjustments may be possible in the automatic route subject to the limits on amount and duration for deferred consideration.

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