Asia Pacific Guide to Lending and Taking Security - India

When lending to borrowers

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# 1. Are there any restrictions in relation to the type of borrower who may borrow foreign currency or in relation to the term of foreign currency and/or the amount of foreign currency borrowed by local entities?

Yes. The ECB Guidelines (see "Background") prescribe the categories of entities to which an ECB can be made available and also limit the amounts that the entities may borrow without the RBI's approval.

**Entities to which ECBs may be made available**

A foreign currency-denominated ECB may be made available to all entities eligible to receive foreign direct investment in India, port trusts, units in a special economic zone, the Small Industries Development Bank of India and the Export Import Bank of India.

An ECB denominated in Indian rupees may be made available to all entities eligible to borrow foreign currency ECBs as well as to registered entities engaged in microfinance activities, entities that are registered not-for-profit companies, registered societies/trusts/cooperatives and nongovernmental organizations.

**Term of ECBs**

Generally, an ECB must have a minimum average maturity of three years. However, depending on the end use of an ECB, the ECB Guidelines prescribe the following minimum average maturities:

ECB raised by manufacturing companies up to USD 50 million or its equivalent per financial year: 1 year.

ECB raised from a foreign equity holder for working capital purposes, general corporate purposes or for repayment of Indian rupee loans: 5 years.

ECB raised for working capital purposes or general corporate purposes or on-lending by nonbanking financial companies (NBFCs) for working capital purposes or general corporate purposes: 10 years.

ECB raised for repayment of Indian rupee loans availed domestically for capital expenditure or on-lending by NBFCs for the same purpose: 7 years.

ECB raised for repayment of Indian rupee loans availed of domestically for purposes other than capital expenditure or on-lending by NBFCs for the same purpose: 10 years.

**Limits on the amount of ECBs**

Eligible borrowers are permitted to borrow up to USD 750 million or the equivalent by way of ECBs each financial year. Any borrowings exceeding the above amounts require the RBI's prior approval.

# 2. Are there any restrictions on the rate of interest or default interest that may be charged?

The ECB Guidelines prescribe an all-in-cost ceiling of 500 basis points above the benchmark rates for foreign currency ECBs. For ECBs in Indian rupees, the ECB Guidelines prescribe an all-in-cost ceiling of 450 basis points above the benchmark rates. The benchmark rate in the case of foreign currency ECBs refers to any widely accepted interbank rate or alternative reference rate of six-month tenor applicable to the currency of borrowing, e.g., EURIBOR for euros. The benchmark rate in the case of Indian rupee-denominated ECBs is the prevailing yield of the government of India securities of the corresponding maturity. The "all-in cost" includes rate of interest, other fees, expenses, charges, guarantee fees and export credit agency charges, whether paid in foreign currency or Indian rupees, but will not include commitment fees and withholding tax payable in Indian rupees.

Default interest must not exceed 2% above the rate of interest agreed under the facility agreement. Any payment of default interest over and above that rate may require the RBI's prior approval.

# 3. Are there any restrictions on particular lenders or classes of lender entering into credit transactions with borrowers?

ECBs can only be extended by a lender that is a resident of any one of the following:

A country that is a member of the Financial Action Task Force (FATF) or a member of an FATF-style regional body; and should not be a country identified in the FATFs public statement as a jurisdiction that has strategic anti-money laundering or combating the financing of terrorism deficiencies to which countermeasures apply, or a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the FATF to address the deficiencies.

A country whose securities market regulator is a signatory to the Multilateral Memorandum of Understanding of the International Organization of Securities Commission's (IOSCO) Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to a bilateral memorandum of understanding with the SEBI for information-sharing arrangements.

Further, the following are also recognized lenders under the ECB Guidelines:

Multilateral and regional financial institutions of which India is a member.

Individuals provided they are foreign equity holders.

Individuals provided they are subscribing to bonds or debentures listed offshore.

Foreign branches or subsidiaries of Indian banks (only for foreign currency-denominated ECBs).

# 4. Are there any exchange controls that will apply to payments to be made in foreign currencies or to foreign lenders?

Yes, see "Background." Further, the ECB Guidelines contain restrictions in relation to the following:

The amount of ECBs that can be raised (see the answer to question 1 of this section).

The amount of interest and fees that can be paid on ECBs (see the answer to question 2 of this section).

The assets that can be provided as security for an ECB (see "Regulatory approvals" in the answer to question 10 of the "If taking security" section).

The prepayment of ECBs (any proposed prepayment that does not comply with the stipulated minimum average maturity, as mentioned in the answer to question 1 of this section, requires the RBI's prior approval).

Indemnity payments by an Indian borrower to a person resident outside India (these require the RBI's prior approval).

# 5. Is there any requirement to deduct or withhold tax from any amounts to be paid or repaid to a lender (whether domestic or foreign)? If so, at what rate must tax be deducted and from what kinds of payment?

Withholding tax is payable on payments of interest in relation to ECBs by Indian borrowers to foreign lenders. Currently, the rate is 5% where the loan agreement in relation to the ECB is entered into before 1 July 2023 subject to the satisfaction of certain conditions notified by the government of India. For interest payments by an Indian company on money borrowed or debt incurred in foreign currency on or after 1 July 2023, the rate is 20% plus surcharge and cess, while in other cases, a 40% rate plus surcharge and cess would apply. This is subject to the availability of tax treaty benefits and compliance with the requisite conditions for availing such benefits.

# 6. Are there any “thin capitalization” or other rules that may limit the extent to which interest payments may be deducted for tax purposes?

The thin capitalization provisions impose limitations on the deduction of excess interest incurred by way of interest or payments of a similar nature by an Indian company or a permanent establishment of a foreign company ("**PE**") to its nonresident associated enterprise in respect of debt borrowed. Excess interest is an interest amount exceeding 30% of the earnings before interest, taxes, depreciation and amortization (EBITDA) of the Indian company or PE.

These rules are only applicable where the interest, or payments of a similar nature, amount exceeds Indian rupees 10 million. Further, the interest expense that is disallowed against income will be allowed to be carried forward and allowed as a deduction against profits and gains of any business or profession carried on for up to eight assessment years, subject to the limits mentioned.

The thin capitalization rules are also applicable in instances of interest payments to third-party lenders that provide a loan on the basis of an associated enterprise, either providing an explicit or implicit guarantee to such third-party lender or depositing a corresponding amount with such lender.

Thin capitalization provisions are not applicable to Indian companies and PEs engaged in the banking or insurance business or notified NBFCs. These provisions are also not applicable with respect to interest paid in respect of a debt issued by a lender that is a PE of a nonresident that is engaged in the business of banking (for example, where the lender is the branch of a foreign bank in India).

# 7. Are there any registration, notarization, translation or reporting requirements in relation to the loan documents?

A facility agreement is not required to be registered or notarized with any authority. However, the details of the ECB are required to be reported to the RBI through the authorized dealer category-I bank in the form prescribed under the ECB Guidelines. The said report has to be made in English.

No specific translation requirements apply if the documents are in English.

See the answer to question 11 of the "If taking security" section for the requirements in relation to security documents.

# 8. Are there any stamp, documentary, registration, notarization or other taxes, duties or fees chargeable in relation to the loan documents? If yes, what are the amounts and when are they payable?

There are no taxes, duties, fees or other charges payable to any governmental authority or the RBI for using foreign currency loans.

However, stamp duty must be paid on credit agreements, guarantee deeds and security documents. The stamp duty payable on the documents varies from state to state. Usually, it is the obligation of the borrower, guarantor or security provider (as the case may be) to pay the stamp duty.

Stamp duty is paid prior to, or at the time of, execution of a document in India. Payment of stamp duty is often a determinative factor in choosing the location for the execution of documents. However, if a document is stamped in one Indian state but the original or a copy of it is brought into another Indian state that levies a higher stamp duty, differential stamp duty may be payable in the other state, depending on the nature of the document and the stamp duty laws in that state.

If a document is executed outside India, under Indian law, no stamp duty is payable on or before its execution. However, if the document or a copy of it is received in India, stamp duty may be payable on it, depending on the Indian state where the document is received and the nature of the document.

See the answer to question 11 of the "If taking security" section for the requirements in relation to fees payable in relation to security documents.

# 9. Does the law recognize the subordination of the debt that a debtor owes to one creditor to that which the debtor owes to another creditor? If yes, how is this usually effected?

Yes. Contractual subordination, by which lenders agree among themselves how the payment of debts will be prioritized, is the usual way of achieving this. It is usually documented in a subordination deed or an intercreditor agreement.

# 10. Are there any classes of unsecured and unsubordinated creditor whose claims against a debtor would rank equally with or above those of the debtor’s other unsecured and unsubordinated creditors (e.g., the claims of employees and tax authorities or the claims of creditors under particular kinds of instrument)? If yes, what classes of creditors are preferred?

See the answer to question 1 of the “If things go wrong” section.

# 11. Are there any consumer protection or similar laws that apply if credit is made available to individuals or other classes of debtor? If yes, what laws are applicable?

Individuals are not eligible to borrow ECBs and, therefore, consumer protection laws are not relevant to loans made under the ECB Guidelines.

# 12. Are there any prohibitions or limitations on the extent to which a company can give financial assistance for the purchase of: (a) its own shares or those of any affiliated company; or (b) assets owned by it or any affiliated company?

Under the Companies Act, 2013, a public company is not permitted to provide, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made by any person of, or for any shares in, the company or its holding company. However, this rule does not apply to private companies.

Further, under the ECB Guidelines, ECBs cannot be used for acquisition of shares other than acquisition of shares in an overseas entity in accordance with the guidelines issued by the RBI.

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