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A short primer for U.S. companies on commercial office leasing in India - by Edward Goodman

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A U.S. company setting up its business in a foreign country potentially faces many challenges, including significant cultural differences, a lack of familiarity with the legal system and available tax benefits and, in general, learning what is required to do business in India. One challenge that is immediately faced by a U.S. company hoping to do business in India is setting up its operations there, which, initially, is likely to include locating suitable space and negotiation of one or more space leases for its offices. The objective of this article is to demystify this process by summarizing some of the key aspects of the leasing process in India and providing examples of how the leasing process in the U.S. differs from the process in India.

From a U.S. tenant's perspective, the unique issues and considerations involved when negotiating a commercial lease in India include:

- Types of lease documentation;
- Registration and Stamp Duty concerns;
- Bribery and corruption;
- Goods and services tax;
- Lock-in periods;
- Security Deposits and Bank Guaranties; and
- Due Diligence.

Lease Documentation

Depending upon the size and complexity of the particular transaction, the process of leasing office space in the U.S. will often involve the preparation and negotiation of a term sheet or non-binding letter of intent summarizing the key terms of the proposed lease, followed by the preparation and negotiation of the lease itself. Except under special circumstances, or where the lease is of a

significant size, it is not typical in most states in the U.S. for the executed lease, or even a memorandum of that lease, to be recorded in the public records. While most of the concepts reflected in a lease of space in India will be familiar to those involved in leasing space in the U.S., the process in India has some very significant differences in terms of lease documentation and recording (or, in India, registration) that are important to note:

Binding Letter of Intent or Head of Terms

In India, when negotiating the terms of a commercial lease (known there as a lease deed), the parties will typically enter into a binding or non-binding letter of intent or a “Head of Terms” detailing the terms of the proposed lease. In the case of a binding letter of intent, many landlords will ask for a security deposit, or some portion thereof, to bind the parties to the terms of the letter of intent.

If you are representing the tenant, it is important to make sure that the security deposit is refundable if the parties are not able to agree to the terms of the lease deed or if there are due diligence concerns that are not resolved. As opposed to most letters of intent in the U.S., a letter of intent in India is often lengthy and very comprehensive, covering many commercial and legal terms. From a tenant’s perspective it is better to negotiate as many of the terms in the letter of intent (while the landlord is trying to bring the tenant into its building), rather than leaving issues to be negotiated when the security deposit has already been paid and the leverage is with the landlord.

Agreement to Lease

When the space being leased has not yet been constructed and/or it is anticipated that possession thereof will not be delivered to the tenant for a lengthy period of time, the parties may, prior to executing a lease deed, enter into an “Agreement to Lease,” which will contain virtually all of the terms and conditions of the lease deed that will ultimately be signed.

The reason one would want to sign an Agreement to Lease first, and then a lease deed later, is that the lease deed may need to be adjusted at the time the space is delivered to reflect issues that may have arisen during construction of the space or substitution of spaces to reflect the needs of the tenant.

Notwithstanding the foregoing, in many States in India it is not typical to execute an Agreement to Lease, and then a lease deed, for the following reason: As a general proposition, every written agreement in India (including a lease) must be registered in a registrar’s office in the applicable municipality and failure to do so will result in the parties’ inability to enforce the agreement in a legal proceeding. Registration in most cases will require payment of a potentially significant stamp duty, the amount of which differs from State to State. With respect to the registration of an Agreement to Lease, in many States this will require payment of a stamp duty and then another stamp duty in the same amount when the actual lease deed is signed and registered. In a State where this double stamp duty is imposed, it is more common to skip the Agreement to Lease and go right to a lease deed. However, in some States, such as in the State of Karnataka (where the City of Bangalore is located) the stamp duty paid upon the registration of the Agreement to Lease can be set off against

the stamp duty payable upon the registration of the lease deed. For this reason, an Agreement to Lease is not typically used in States where the double stamp duty would apply and in those States the parties will usually proceed directly to a lease deed.

Lease Deed

If an Agreement to Lease has been executed and thereafter the landlord is ready to deliver possession of the leased premises to the tenant (or if no Agreement to Lease is executed for the reason above), the parties will execute a "lease deed," which will be submitted for registration. The registration process is summarized below.

Registration and Stamp Duty

One major difference between the leasing processes in the U.S. and India is the document registration requirement. In addition to payment of the applicable stamp duty, there are certain formalities involving execution and the documentation itself that must be followed, such as: The document must be printed on special paper, the signatories are required to appear in person at the registrar's office and produce valid photo identification (a copy of which is registered as part of the signed document) and the agreement must be submitted for registration within 120 days after the document is signed. There are strict penalties for failure to comply, and failure to register within the statutory period can result in payment of a significant fine and an inability to enforce the agreement in court.

The applicable stamp duty varies from jurisdiction to jurisdiction and, except in cases where the term of the lease deed exceeds 30 years, is based on the average rent payable under the lease deed. Note that the term of the lease can be structured to minimize the stamp duty for a particular lease deed registration. For example, in the State of Telangana (where the city of Hyderabad is located) the stamp duty payable in connection with the registration of a lease deed with a term of less than five years will double if the lease deed has a term of five years or longer. A lease deed with a term of one year or less is not subject to the registration requirement.

Bribery and Corruption

One of the issues encountered when doing business in India, particularly where the assistance of a government official is required, is the need to "grease the wheels" to obtain cooperation. Sometimes the payment made to solicit cooperation is called "speed money." U.S. companies doing business in India need to be aware of a U.S. statute applicable to U.S. companies and, (with some exceptions) their subsidiaries, doing business in foreign jurisdictions called the Foreign Corrupt Practices Act (FCPA). The FCPA generally prohibits the use of bribery to obtain special treatment or favors from governmental officials in other countries. In some cases, the FCPA permits "facilitating" payments to foreign officials to expedite "routine governmental action" but there are many factors that come into play before this defense can be raised and consultation with legal counsel is advisable before engaging in conduct that potentially violates the FCPA.

From a leasing standpoint tenants should make extensive inquiries before conducting business with landlords with a reputation of engaging in such conduct. In addition, it is prudent to include in the lease deed a representation by the landlord that it is not in breach of the FCPA, a covenant to comply with the FCPA during the lease term, and an indemnity of the landlord for claims made against the tenant because of a breach of the FCPA by the landlord.

Goods and Services Taxes

Since 2017, a single value-added tax, called a “Goods and Service Tax” (GST), is imposed in India upon the manufacture, sale, and consumption of goods and services at the national level. The GST applies to rents payable under a lease of commercial property and most leases require the tenant to pay the GST to the landlord, which then pays the GST to the government. The GST applicable to commercial rents is assessed at the rate of 18%, although it may be available as a credit against other taxes payable by the tenant.

Lock-in period

One of the unique concepts applicable to commercial leases in India is the “lock-in period.” Where a lock-in period applies, the tenant has the right, after the expiration of a number of years of the lease term, called the lock-in period, to terminate the lease deed upon several months’ prior notice to the landlord and without penalty.

For example, if the lease term is ten years but the lock-in period is three years, the lease deed is terminable by the tenant anytime during the last seven years of the term of the lease. If there is a renewal option the right to terminate will usually continue during the renewal period. In the U.S. a lease termination right is often difficult for a tenant to obtain absent unusual circumstances and will be heavily negotiated. For tenants entering into a new venture in India this right can be very valuable.

Security Deposits and Bank Guaranties

As opposed to the handling of security deposits in most commercial leases in the U.S., security deposits in India are typically commingled with other funds of the landlord and may even be used to fund the construction of the building or the premises, as the case may be. This practice presents the obvious risk that the security deposit will not be available when it is required to be returned by the landlord.

To address this risk, tenants entering into a leased deed or an Agreement to Lease pursuant to which a security deposit has been provided, but where the space has not yet been constructed and will not be completed for some time, will ask for assurances that the security deposit will be refunded if the landlord defaults and fails to deliver possession of the premises in accordance with the landlord’s obligations. One tool used by tenants is to require that the landlord provide a bank guaranty, similar to a letter of credit in the U.S., to the tenant, which may be drawn upon to obtain a refund of the security deposit if the tenant is so entitled. This is often resisted by landlords but is

important to insist upon.

Another remedy often provided in commercial leases in India to a tenant whose security deposit is being wrongfully withheld, is to permit the tenant to retain possession of the premises after the expiration date of the lease until the security deposit is returned. While in most cases this will be of small comfort to a tenant that has already moved to another location, the inability to lease the space to another tenant is a strong motivator for the landlord to return the deposit promptly. Providing that the deposit will bear a default rate of interest until returned is another incentive for the landlord to comply with its lease obligations.

Due Diligence

One major distinction between the leasing process in India and the U.S. is the importance in India of conducting due diligence prior to entering into a lease, including, but not limited to, in connection with:

- The chain of ownership of the property in which the U.S. company is leasing space;
- Restrictions on the use of the property;
- Any encumbrances on the property;
- Potential litigation affecting the property;
- Potential claims involving ownership of the property by religious organizations or those claiming ancestral rights; and
- The procurement of all necessary occupancy permits.

For example, if the chain of ownership is not clearly evidenced in the records one may find that the same property has been fraudulently transferred by one owner to two or more different parties or that development options have been granted to other parties which, in each case, could affect the rights of the tenant under the lease. As opposed to dealing with landlords in the United States (particularly owners in the business of leasing space to sophisticated tenants) which, in most cases, can be assumed to have taken the necessary steps regarding confirmation of ownership, permitted use, etc., it is important to make sure that all of these steps have been addressed before entering into a lease in India. When representing clients leasing space in India we work with local counsel to ensure that all appropriate due diligence, including review of title, zoning and use limitations, litigation searches and encumbrances, etc., is conducted.

For many U.S. companies, the process of leasing space in India can be daunting. Hopefully, the foregoing introduction to leasing space in India will make the process appear to be less opaque and permit those exploring the possibility of leasing space in India to be more cognizant of the potential risks and how to address them.

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