

INFRASTRUCTURE INVESTMENT TRUSTS

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INTRODUCTION

SEBI had, in December 2013, introduced the concept of Infrastructure Investment Trusts ("**InvIT**") by way of a consultation paper on InvIT. Based on the comments received from the stakeholders on the said consultative paper as well as the tax proposals announced by Mr. Arun Jaitley, Union Finance Minister in the Finance Bill (02) 2014 (*which has since then been enacted as the Finance Act (02) of 2014*). SEBI, at its board meeting held on August 10, 2014, approved certain changes to the draft regulations for Real Estate Investment Trusts ("**REITs**") as well as InvIT namely, the SEBI (Real Estate Investment Trusts) Regulations, 2014 and the SEBI (Infrastructure Investment Trust) Regulation 2014

2014 (the "**InvIT Regulations**") thereby providing a framework for registration and regulation of both the REITs as well as InvITs. The Finance Act (02) of 2014 has provided certain reliefs/ exemptions, including pass through status to InvITs, on the similar lines as have been provided to REITs and which has been dealt more particularly in this note.

Subsequent to the said meeting of SEBI, SEBI has notified the final set of the InvIT Regulations on September 26, 2014.

This Note endeavours to provide an analysis of the concept of InvIT in the light of the InvIT Regulations. Additionally, this Note provides a snapshot of the Income Tax provisions pertaining to InvIT as provided under the Finance Act (02) 2014, Finance Act, 2015 and a foreign exchange perspective on the InvIT Trusts.

CONCEPT AND MEANING

The infrastructure space, specifically the public-private-partnership ("**PPP**") sector comprising roads and highways, ports, power and transmission projects, has been facing severe liquidity crunch due to the limited funding options, high interest cost and subdued investor interest. Witnessing the requirement for infrastructure in a country like India coupled with the huge funding requirements of the infrastructure

developers, the structure of InvIT seems to be a much needed and a welcome introduction.

In terms of the InvIT Regulations, the term "Infrastructure" includes all infrastructure sub-sectors as defined vide notification of Ministry of Finance dated October 7, 2013 where the said Notification comprises the harmonised master list of Infrastructure sub-sectors and shall include any amendments and/or additions that may be made thereof.

The focus area of investment of InvITs lies in financing/ re-financing of the infrastructure projects in the country in the prescribed manner either directly or through the mode of a SPV (in case of PPP projects, only through SPV route).



REGISTRATION AND STRUCTURE OF InvITs

The InvIT Regulations requires that before carrying out any activity, an InvIT shall obtain a registration from SEBI in a manner and by payment of such fees as prescribed under the InvIT Regulations.

In terms of the InvIT Regulations, the InvIT requires to be set up as a Trust and the instrument of trust is in the form of a deed duly registered in India under the provisions of the Registration Act, 1908. The trust deed should have its main objective as undertaking activity of InvIT in accordance with the InvIT Regulations and shall include the responsibilities of the Trustee in terms of the InvIT Regulations. The InvIT shall have a (i) Trustee, (ii) Sponsor(s), (iii) Investment Manager and (iv) Project Manager, all being separate entities. The InvIT Regulations provides for certain eligibility requirements for grant of certificate to InvITs and SEBI, upon satisfaction, shall grant the certificate of registration to an InvIT under the InvIT Regulations.

PARTIES INVOLVED IN THE FUNCTIONING OF InvITs

Trustee

A **Trustee** plays a supervisory role and shall be required to oversee the activities of the investment manager in the interest of the unit holders. The Trustee shall be registered with SEBI under the SEBI (Debenture Trustees) Regulations, 1993.

The InvIT Regulations sets out the various rights and responsibilities of a Trustee which *inter alia* includes:

1. holding the assets of the InvIT for the benefit of the unit holders;
2. to supervise the activities of the investment manager and to ensure that the investment manager is in compliance with his duties, and to procure a compliance certificate from the investment manager; and
3. to supervise the activities of the Project Manager, other than that relating with revenue streams from project and compliance thereof, and to procure a compliance certificate from the project manager.

The trustee shall ensure that the activity of the InvIT is being operated in accordance with the provisions of the trust deed.

Investment Manager

The **Investment Manager** shall make investments decisions with respect to the underlying assets/projects of the InvITs including further investment and divestment. Roles and responsibilities of the Investment Manager shall be specified in the agreement entered into between the Trustee and the Investment Manager.

The InvIT Regulations set out certain eligibility requirements for such Investment Manager which includes the following:

- (i) net worth of not less than Rs.10 Crores (Rs.100 million) in case of a body corporate or a company or net tangible assets of a value not more than Rs.10 Crores (Rs.100 million) in case of an limited liability partnership;
 - (ii) minimum 5 years of experience in fund management/advisory services, development in infrastructure sector; and
 - (iii) shall have more than 50 (fifty) percent of its directors in case of a company, or members of the governing board in case of an LLP, as independent directors and shall not be directors or members of the governing board of another InvIT.
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While the roles and responsibilities of an Investment Manager will be governed by the agreement executed between the Trustee and the Investment Manager, the InvIT Regulations sets out certain rights and responsibilities of the Investment Manager. The key rights and responsibilities are set out below:

- (i) make investment decisions with respect to the underlying assets or profits of the InvIT;
- (ii) oversee activities of the project manager with respect to revenue streams; and
- (iii) ensure that the investments are made in accordance with the investment conditions specified in the InvIT Regulations.

Project Manager

The **Project Manager** shall conduct operations and management of a particular InvIT asset with a concessionaire SPV. The obligations of the project manager shall be set out in a project implementation agreement between the Project Manager, the concerned SPV and the Trustee. In case of PPP, such obligations shall be in accordance with the concession agreement or such agreement entered into with the concessioning authority. In addition to the above, the Project Manager shall discharge all the obligations in respect of achieving timely completion of the infrastructure project in terms of the project management agreement.



Sponsor

The **Sponsor** shall be responsible for setting up of the InvIT.

There are certain requirements set out under the InvIT Regulations, which includes:

- (i) an InvIT shall not have more than 3 (three) Sponsors;
 - (ii) each Sponsor shall have a net worth of not less than Rs.100 crores (Rs.1 billion) if it is a body corporate or a company, or net tangible assets of not less than Rs.100 crores (Rs.1 billion) in case it is a limited liability partnership;
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(iii) (Sponsor or its associate (*as defined under the InvIT Regulations*)) shall be required to have a sound track record (*i.e. with a minimum experience of 5 (five) years, and where the Sponsor is a developer at least 2 (two) projects of the Sponsor shall have been completed*) in development of infrastructure or fund management in the Infrastructure sector.

Holding of units by Sponsors. The Sponsor shall, collectively, hold not less than 25% (twenty five percent) of the total units of the InvIT on post issue basis for a period of at least 3 years from the date of listing so that the Sponsor is also exposed to the same amount of risks to which the unit holders are also required to face by virtue of their investments in InvITs. Any holding by Sponsor exceeding 25 (twenty five) percent shall be held for a period of not less than 1 (one) year from the date of listing of such units.

Where the sponsor sells its units, the InvIT Regulations require the exiting sponsor to scout for another person/ entity to act as the Sponsor. The eligibility criteria and roles and responsibilities of the Sponsor shall be in accordance with the InvIT Regulations.

MANNER OF RAISING FUNDS AND INVESTMENT CONDITIONS

An InvIT can invest in both completed/ revenue generating projects as well as under construction projects/ other assets in a manner as provided under the InvIT Regulations. An InvIT can invest in infrastructure projects either directly or through SPV. In case of PPP projects, investment in infrastructure projects has to be mandatorily through SPV's.

An InvIT can raise funds by way of an initial offer and subsequently through follow-on-offer. "Initial offer" has been defined as the first offer of units of an InvIT to the public for subscription and includes an offer for sale of the InvIT units by an existing unit holder to the public. On the other hand, a follow-on-offer shall mean the offer of units of an InvIT to the public for subscription and includes an offer for sale of InvIT units by an existing unit holder to the public.

InvITs can raise funds by way of both publicly offered and privately placed InvITs. The Regulation specifically provides that no unit holder of the InvIT shall enjoy preferential voting or any other rights over another unit holder.

The proposed holding of an InvIT in the underlying assets shall be not less than Rs.500 crores (Rs.5 billion) and the offer size of the InvIT shall not be less than Rs.250 crores (Rs.2.5 billion) at the time of initial offer of units.



INVESTMENT IN COMPLETED AND REVENUE GENERATING ASSETS

An InvIT is permitted to invest in completed and revenue generating Infrastructure assets. Where such investments are proposed for at least 80% (eighty percent) of the value of the assets, the investment shall be subject to the following conditions:

- (a) if the investment has been made through a SPV, only the portion of direct investments in eligible infrastructure projects by such SPV shall be considered; and
- (b) If the project is implemented in stages, the part of the project which can be categorised as completed and revenue generating project shall be considered.

The part of such investment not considered for this purpose shall be taken into consideration for the investment in under construction / other assets (*discussed below*).

The Investment shall be further subject to InvIT Regulations, which sets out various conditions to be complied with such as:

- (a) the initial issue of units shall be way of initial offer only;
- (b) subsequent units after initial offer may be by way of follow on offer, preferential allotment, qualifies institutional placement, rights issue, bonus issue, offer for sale or any other mechanism and in the manner as may be specified;
- (c) minimum subscription of from any investor in initial and follow on offer shall be 10 (ten) lakh rupees;
- (d) units proposed to be offered to the public is not less than 25 (twenty five) percent of the total of the outstanding units of InvIT and the units being offered by way of the offer document; and
- (e) the InvIT may invite for subscriptions and allot units to any person, whether resident or foreign, however, such investment to foreign investors shall be subject to guidelines issued by the Reserve Bank of India and the Government.

INVESTMENT IN UNDER CONSTRUCTION/ OTHER ASSETS

The InvIT Regulations permits an InvIT to invest upto 20% (twenty percent) of value of the assets in the following:

- 1) under construction infrastructure projects, whether directly or through SPV as provided under the InvIT Regulations. However, the investments in under construction infrastructure projects shall not be more than 10% (ten percent) of the value of the assets;
- 2) listed or unlisted debt of companies or body corporate in infrastructure sector, except any investment made in debt of the SPV;
- 3) listed shares of companies in India which derive not less than 80 (eighty) percent of their operating income from infrastructure sector;
 - (a) government securities;
 - (b) money market instruments, liquid mutual funds or cash equivalents.

In any event, if the InvIT fails to offer any of its units, whether by way of public issue or private placement, within 3 (three) years from the date of registration, it shall surrender its certificate and cease to operate as an InvIT.

VALUATION OF ASSETS AND DISCLOSURE REQUIREMENTS

The InvIT Regulations prescribe certain requirements for the valuation of the assets and disclosure of the information with the SEBI from time to time.

OTHER CONDITIONS GOVERNING InvIT

The InvIT Regulations prescribes mandatory listing for both publicly offered and privately placed InvITs and to make continuous disclosures in terms of their listing agreement entered between the InvIT and the designated stock exchanges. The units of the InvITs shall be traded, cleared and settled in accordance with the regulations of the stock exchange, as the case maybe.

In terms of the InvIT Regulations, the minimum public holding of InvIT publicly offered after listing shall be 25 (twenty five) percent. The minimum number of unit holders, other than the Sponsor in case of privately placed InvIT shall be 5 (five), each not holding more than 25 (twenty five) percent, and in case of the publicly offered InvIT shall be 20 (twenty) each holding not more than 25 (twenty five) per cent. In addition to the same, the InvIT Regulations also prescribe additional conditions which require to be fulfilled by the InvIT for the purpose of listing the units as well as de-listing of units of InvITs, as the case may be.



The InvIT Regulations also prescribes certain conditions for the trading lot of units on the designated stock exchange as follows:

- (a) Rupees 1 (one) crore for privately placed units;
- (b) Rupees 5 (five) lakhs for publicly traded units; and
- (c) An InvIT shall hold or propose to hold controlling interest and more than 50% (fifty percent) of the equity share capital or interest in the underlying SPV, save and except as may be prohibited by any prevailing laws/ regulatory requirement/ requirement emanating from the concession agreement. In such cases, Sponsor shall enter into an agreement with the InvIT, to ensure that no decision taken by the sponsor, including voting decisions with respect to the SPV, are against the interest of the InvIT/ its unit holders.

There is prohibition on investment in units of other InvITs.

DISTRIBUTION OF INCOME

Subject to the provisions of the Companies Act, 2013, and Limited Liability Partnership Act, 2008, as maybe applicable, in terms of the InvIT Regulations the InvIT shall distribute at least 90% (ninety percent) of the net distributable income (after tax) to the unit holders. Such distributions shall be declared and made at least on half yearly basis. In case of foreign investors, such investment shall be subject to guidelines as may be specified by Reserve Bank of India and the government from time to time.

RELATED PARTY TRANSACTIONS

In terms of the InvIT Regulations, an InvIT shall ensure that all the 'related party transaction' shall be on an arms-length basis in the best interest of unit holders, consistent with the strategy and investment objectives of the InvIT.

FOREIGN INVESTMENT IN InvIT

Pursuant to a notification of the Reserve Bank of India on November 16, 2015, the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulation, 2000 was amended to permit any person resident outside India (including a Registered Foreign Portfolio Investor or a Non-Resident Indian) to invest in units of Investment Vehicles which shall comprise REITS, InvITs and AIFs governed by their respective regulations issued by the SEBI. Such investments by eligible investors (i) are permitted to be transferred, sold in any manner or redeemed as per the SEBI regulations and RBI / FEMA notifications, from time to time; and (ii) may be pledged to secure credit facilities being extended to such investors.

However, in the event, if the Sponsor or the Investment Manager of an Investment Vehicle is not Indian 'owned and controlled' then any downstream investment by that Investment Vehicle shall be regarded as foreign investment. For any investment determined as foreign investment as per the foregoing, such investment shall have to conform to the sectoral caps and conditions / restrictions, if any, applicable to the company in which the downstream investment is made as per the FDI policy.

APPLICABILITY OF ECB POLICY AND ISSUANCE OF RUPEE DENOMINATED BONDS OVERSEAS

In terms of its circular dated September 29, 2015, the Reserve Bank of India issued a framework for issuance of Rupee denominated bonds overseas within the overarching ECB Policy. The said circular recognises InvITs as an eligible borrower eligible to issue plain vanilla bonds either privately placed or listed on exchanges as per the host country regulations. The minimum maturity period applicable for 5 years and the amounts equivalent to USD 750 million per annum shall be permitted under automatic route and any amounts beyond the said limit shall require the prior approval of the RBI.

PASS THROUGH STATUS UNDER THE TAX REGIME

The Finance Act (02), 2014 has provided a pass through status on the income earned by the InvIT thereby avoiding the case of double taxation. The Finance Act (02) 2014 introduces a new concept of "*Business Trusts*", which signifies a trust registered either as an InvIT or a REIT, the units of which are required to be listed on a recognised stock exchange (in terms of the InvIT Regulations and the SEBI (Real Estate Investment Trust) Regulation 2014 respectively).

The capital gains in the hands of the Sponsor can be deferred when the Sponsor exchanges the shares of the SPV, which holds the assets, with the units of the Business Trust. Despite the capital gains exemption, to sponsors of an InvIT, there was no exemption on Minimum Alternate Tax, a levy which entail an additional tax burden at 18.5% (eighteen decimal point five percent) of the book profits of the Sponsor. The Finance Act, 2015 goes on to address this issue and provides relief to sponsors from MAT in respect to gains arising on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust.

An exemption was provided for the unit holders from long term capital gains in relation to the sale of units on recognised stock exchange subject to the payment of securities transaction tax on sale of such units and the short term capital gains will be taxed @15% (fifteen percent) in addition to applicable surcharge/ cess. Interest income is exempt for REIT, but is taxable in the hands of unit holders.

Since an InvIT is required to mandatorily distribute almost the entire annual income as dividends to unit holders, the SPV would consequently have to suffer the dividend distribution tax (DDT) liability when it distributes income to the InvIT. This shall essentially result in multiple layers of taxation and since the SPV would have to pay the DDT in addition to the applicable corporate income tax on its taxable income, which shall in turn impact the earnings for distribution. Therefore, some clarity with respect to the taxation of dividend distributed by the SPV to the InvIT is expected from the upcoming budget of FY 2016-2017.

OUR VIEW

Although the InvIT Regulations allows InvIT to hold infrastructure assets either directly or through an SPV, the tax benefit for a sponsor to set up an InvIT has been extended only to cases where infrastructure assets are held by the InvIT through an SPV and the Sponsor exchange their shares of an SPV with the unit of the InvIT and not in other mode of transfer.

Although the InvIT Regulations provide for mandatory listing of units of the InvITs, it will have to be seen the actual participation/ level of trading of units as is seen in case of equity shares or whether the listed units of InvITs will just face the same fate as in case of listed debt instrument which are not frequently or easily tradable.

As could be understood from the above, the InvIT Regulations provide for the requirement of control that the InvIT needs to have in a SPV. Therefore, after the successful set up of an InvIT, certain necessary amendments may need to be carried out to the Concession Agreement and other requisite documents with respect to the concerned Infrastructure Projects with a view to provide for the ambit of InvITs so to have such project related documents in sync with the InvIT Regulations.

The introduction of InvIT is a positive move and we believe that this model of investment under InvIT mechanism will have positive impact on the Infrastructure projects in India. However, it will *inter-alia* depend on credibility of sponsor/investment manager and substance and commercial income of underlying assets of InvIT to incite the investors to invest in this new exciting product

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