AN ANALYSIS OF SEBI INFRASTRUCTURE INVESTMENT TRUSTS REGULATIONS, 2014

RUPIN PAWHA, Partner, Juris Legal & Financial Services

PRASHANT PRANJAL, Associate, Juris Legal & Financial Services

ANANYA MOHAN, Intern, Juris Legal & Financial Services

> *"...As an innovation, a modified REITS type structure for infrastructure projects is also being announced as Infrastructure Investment Trusts (InvITs), which would have a similar tax efficient pass through status, for PPP and other infrastructure projects. These structures would reduce the pressure on the banking system while also making available fresh equity. I am confident these two instruments would attract long term finance from foreign and domestic sources including the NRIs..."*[1]
>
> \- *Finance Minister Arun Jaitley, in the Budget for FY 2014-15*

1. INTRODUCTION

The Planning Commission of India has projected an investment of US$ 1 trillion for the infrastructure sector during the 12th Five-Year Plan (2012–17), with 40 per cent of the funds coming from the country's private sector.[2] India's focus on infrastructure since the turn of the millennium has helped make it the second fastest growing economy in the world.[3] The country's constant growth gives investors, domestic and foreign, a tremendous opportunity for investment in its infrastructure sector.

The Securities and Exchange Board of India (the "**SEBI**") on July 17, 2014 came out with draft regulations for Infrastructure Investment Trusts (the "**InvITs**") announced in the finance minister's budget speech on July 10, 2014 to provide easier financing options to developers of

[1] Full text: Finance Minister Arun Jaitley's maiden Budget speech, http://ibnlive.in.com/news/full-text-finance-minister-arun-jaitleys-maiden-budget-speech/485007-3.html

[2] Twelfth Five Year Plan (2012-2017), Economics Sectors, Volume II, http://planningcommission.gov.in/plans/planrel/12thplan/pdf/12fyp_vol2.pdf.

[3] India still second fastest growing economy: Chidambaram, http://www.thehindu.com/business/Economy/india-still-second-fastest-growing-economy-chidambaram/article4959820.ece

public works.[4] Later on September 26, 2014, SEBI released the SEBI (Infrastructure Investment Trusts) Regulations, 2014.[5]

InvITs are a special type of investment vehicle which operate more like mutual funds but invest in infrastructure sector for returns. In this sector the income is usually generated through investments in building roads, bridges, ports, etc., and the returns from such investments are passed on to the investors in the InvITs.

Earlier SEBI had come out with a consultation paper on InvITs on December 20, 2013 (the "**Consultation Paper**") on which it sought comments till January 20, 2014.[6] In the Consultation Paper, SEBI had suggested two mechanisms to set up investment trust facilities. One was to create it as a special category of mutual funds by way of a separate chapter in the SEBI (Mutual Funds) Regulations, 1996. The other option was to create a new set of regulations on the same lines as the regulations proposed for Real Estate Investment Trusts (the "**REITs**").

2. SEBI (INFRASTRUCTURE INVESTMENT TRUSTS) REGULATIONS, 2014

2.1. Overview

As per the SEBI (Infrastructure Investment Trusts) Regulations, 2014 (the "**Regulations**"), InvITs will be able to invest in infrastructure projects only directly or through the Special Purpose Vehicle (the "**SPV**"). For public-private partnership (the "**PPP**") projects, investments can be routed only be through an SPV.

A SPV is a company created for a specific purpose. A PPP is one that usually involves a private entity building public infrastructure that is owned by the government, but from which it earns revenue (through a user charge, toll or a revenue share) over the duration of its agreement with the government. For investors, infrastructure projects are often highly attractive investments since they offer stable return.

It is also mandatory for both publicly listed and privately placed InvITs to get listed on a recognized stock exchange and the listing of the units shall be in accordance with the listing agreement entered into between the InvIT and the designated stock exchanges. As specified under the Regulations, no initial offer shall be made unless the InvIT is registered with the SEBI and the value of the proposed holding of the InvIT in the underlying assets is not less than Rs. 500 crore and the offer size is not less than Rs. 250 crore.

The Regulations bring into the picture entities such as trustees, investment managers and sponsors. Their functions, rights and responsibilities are also mentioned in the Regulations.

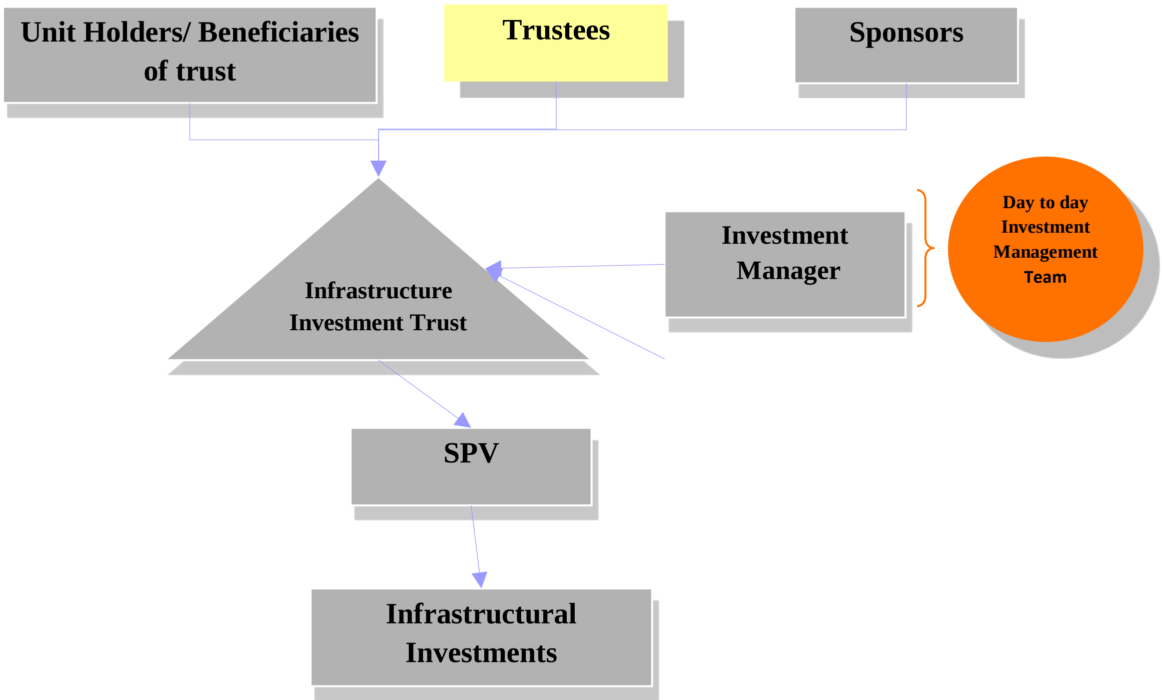
---

[4] Draft SEBI (Infrastructure Investment Trusts) Regulations, 2014, http://www.sebi.gov.in/cms/sebi_data/attachdocs/1405596795567.pdf. See supra note 1 for the full text of the budget speech.

[5] The Press Release can be accessed here: http://www.sebi.gov.in/sebiweb/home/detail/29273/yes/PR-SEBI-Infrastructure-Investment-Trusts-Regulations-2014; The Regulations are available here: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1411722495005.pdf

[6] Consultation paper on Infrastructure Investment Trusts, http://www.sebi.gov.in/cms/sebi_data/attachdocs/1387543144855.pdf.

The trustee shall hold the InvIT's assets in the name of the InvIT for the benefit of the unit holders in accordance with the Trust Deed. The Investment Manager shall make the investment decisions with respect to the underlying assets/ projects of the InvIT including any further investment or divestment of the assets. The sponsor(s) shall set up the InvIT and appoint the Trustee of the InvIT. With regard to the rights of the unit holders, the Regulations state that the unit holder shall have the rights to receive income/distributions as provided for in the Offer Document/Placement Memorandum.



The Regulations further mention that if an investment trust proposes to invest at least 80 per cent of its assets in completed and revenue generating infrastructure assets, it has to raise funds through a public issue of units. These sales will need to have a minimum subscription size and trading lot of at least Rs.5 lakh. Of the remaining 20 per cent, such trusts can invest a maximum of 10 per cent in under-construction infrastructure projects. If such a trust proposes to invest more than 10 per cent of its assets in under-construction public works, it has to mandatorily raise funds through private placement from qualified institutional buyers (typically banks and other financial institutions) and corporate bodies only, according to the draft norms. For such trusts, the minimum investment and trading lot will be of Rs.1 crore and a part of the assets under such trusts will have to be mandatorily invested in at least one completed and revenue generating project and in at least one pre-COD (commercial operation date) project.

2.2. Tax Incentives

Neither the Consultation Paper released by SEBI nor the Regulations talk about the tax incentives to be provided to the InvITs. In the Finance Minister's budget speech, the government proposed tax incentives for InvITs to help attract long term funds from foreign and domestic investors, including NRIs. It was announced by the government that InvITs will have pass through for the purpose of taxation.[7]

Noting the importance of certainty in the taxation aspects of REITs and InvITs, the government through the Finance (No.2) Bill, 2014 has proposed "to amend the Income Tax Act (the "**IT Act**") to put in place a specific taxation regime for providing the way the income in the hands of such trusts is to be taxed and the taxability of the income distributed by such business trusts in the hands of the unit holders of such trusts".[8]

Such regime has the following main features:–

i. The listed units of a business trust, when traded on a recognised stock exchange, would attract same levy of securities transaction tax (the "**STT**"), and would be given the same tax benefits in respect of taxability of capital gains as equity shares of a company i.e., long term capital gains, would be exempt and short term capital gains would be taxable at the rate of 15%.
ii. In case of capital gains arising to the sponsor at the time of exchange of shares in SPVs with units of the business trust, the taxation of gains shall be deferred and taxed at the time of disposal of units by the sponsor. However, the preferential capital gains regime (consequential to levy of STT) available in respect of units of business trust will not be available to the sponsor in respect of these units at the time of disposal. Further, for the purpose of computing capital gain, the cost of these units shall be considered as cost of the shares to the sponsor. The holding period of shares shall also be included in the holding period of such units.
iii. The income by way of interest received by the business trust from SPV is accorded pass through treatment i.e., there is no taxation of such interest income in the hands of the trust and no withholding tax at the level of SPV. However, withholding tax at the rate of 5 per cent in case of payment of interest component of income distributed to non-resident unit holders, at the rate of 10 per cent in respect of payment of interest component of distributed income to a resident unit holder shall be effected by the trust.
iv. The dividend received by the trust shall be subject to dividend distribution tax at the level of SPV but will be exempt in the hands of the trust, and the dividend component of the income distributed by the trust to unit holders will also be exempt.
v. The income by way of capital gains on disposal of assets by the trust shall be taxable in the hands of the trust at the applicable rate. However, if such capital gains are distributed, then the component of distributed income attributable to capital gains would be exempt in the hands of the unit holder. Any other income of the trust shall be taxable at the maximum marginal rate.
vi. The business trust is required to furnish its return of income.

This amendment came into effect from October 1, 2014.

---

[7] Union Budget: Tax Incentives for REITs, InvITs Proposed, http://www.outlookindia.com/news/article/Union-Budget-Tax-Incentives-for-REITs-InvITs-Proposed/849092.
[8] FINANCE (No. 2) BILL, 2014, PROVISIONS RELATING TO DIRECT TAXES, http://www.thehindubusinessline.com/multimedia/archive/01993/Budget_Memorandum_1993278a.pdf.

3. COMPARATIVE ANALYSIS

3.1. India *vis-a-vis* International Perspective

InvITs are a special type of investment vehicle which operate more like mutual funds but invest in infrastructure sector for returns. Similar structures are in place in international markets, such as the business trust model in Singapore and the master limited partnership in the USA. These have provided a boost to infrastructure sector/ specific sub-sectors in the relevant countries.

3.1.1. Singapore's Business Trust Model

A Business Trust is a trust that runs and operates a business enterprise. Registered business trusts must have a trustee-manager whose role is to safeguard the interests of beneficiaries (referred to as 'unit holders' under the Business Trusts Act) and to manage the business of the trust. The framework to regulate business trusts activities and the responsibilities of a trustee-manager can be found under the Business Trusts Act[9] and the Business Trusts Regulations[10].

This model has proven to be very effective in Singapore as over the past decade, Singapore has become a leading hub for infrastructure project finance.[11]

In the Singaporean model, the investors do not have any operational control or shareholders' rights, but they benefit from a steady dividend stream. The trustee-manager is also professionally managed, and reports to the board which comprises primarily independent directors. In this way, the fiduciary responsibility to beneficiaries is placed squarely on a single trustee-manager. This model supports strong governance and efficient management processes - qualities that appeal to potential investors, as their interests are paramount.

What is interesting about these trust structures is that the infrastructure assets are controlled and operated by the trustee manager and not the trust that holds or owns them. Irrespective of the trust ownership structure, the independent trustee manager structure therefore ensures that the operations of the assets are aligned with the aim of maximising value for unit holders. Several Singaporean infrastructure developers and owners have also opted for the business trust structure.

The Indian model is somewhat similar to the Singaporean model. The Regulations will benefit by including the provisions relating to the liabilities and obligations of investments managers to the unit holders, possibly along the same lines as contained in the Singaporean Model.

3.1.2. Master Limited Partnership in the USA

---

[9] Business Trusts Act, http://statutes.agc.gov.sg/aol/search/display/printView.w3p;ident=470f458f-6283-4fa9-881f-84b156d00232;page=0;query=Id%3A%2233b62990-fe61-4bc5-871b-61c2f2941d15%22%20Status%3Ainforce;rec=0#pr1-he-.

[10] Business Trusts Regulations, http://statutes.agc.gov.sg/aol/search/display/view.w3p;ident=8d10b5aa-20dc-400f-b2bd-345ecdfce6ee;page=0;query=CompId%3A702516f6-9021-4560-8fa0-94e82c08296d;rec=0;resUrl=http%3A%2F%2Fstatutes.agc.gov.sg%2Faol%2Fbrowse%2FrelatedSLResults.w3p%3Bletter%3DB%3BpNum%3D1%3Bparent%3Dac191a7f-6c43-4d4c-ba3f-543ef0aafdce%3Btype%3DactsAll#pr21-he-.

[11] Financing via Business Trusts, KPMG, http://www.kpmg.com/sg/en/pressroom/pages/mc20130920.aspx.

Master Limited Partnerships Parity Act was introduced in the US Senate last year and has been referred to the finance committee.[12]

A Master Limited Partnership ("**MLP**") is a business structure that is taxed as a partnership, but whose ownership interests are traded on a market like corporate stock. Whereas profit from publicly traded corporations is taxed at both the corporate level and the shareholder level, income from MLPs is taxed only at the shareholder level because it is treated as a partnership for tax purposes.

An MLP consists of limited partners (investors) and general partners (managers). The limited partners – who can number in the thousands – provide capital and receive quarterly required distributions generally equivalent to shareholder dividends in a corporation. They play no role in the operation of the MLP, while the general partners manage the MLP's daily operations. General partners can take the form of another company or a group of individuals, typically holding a 2 percent ownership stake.

Some of the aspects of Master Limited Partnership are on the same line of the Regulations. The MLP Parity Act is still pending and it is not very clear as to what provisions are going to be finally incorporated and how the Act will be accepted by the market.

3.2. Comparison with REITs

It has been already stated in this article that InvITs are formed on the same lines as REITs. There two trusts serve the same purpose in two different sectors. REITs regulations were released few days ago and since then have been well received and expected to bring revolutionary changes in the real estate sector. Running on the lines of REITs that work on pooled investments, InvITs will help project developers free up their balance sheets from ongoing projects and raise cheaper and longer duration funds for new projects.

4. Conclusion, Criticisms and Suggestions

A strong infrastructure sector is vital to the development of a country's economy. The market regulator SEBI recently notified the Regulations along with the REITs regulations.[13]

At present, what happens is that even if a developer has the technical capability to execute more projects, he does not have the financial capacity as he has already taken up bank loans to implement his ongoing projects. The InvITs would help developers unlock their capital and take up more projects. A lot of companies have already shown interest in the plan. These structures would reduce the pressure on the banking system while also making available fresh equity.

InvITs will provide a suitable structure for infrastructure financing and a boost to infrastructure projects. This is a brilliant effort taken by the market regulator and taking into consideration the current situation it will not be entirely wrong to say that this is the need of the hour and

[12] Master Limited Partnerships Parity Act, https://beta.congress.gov/bill/113th-congress/senate-bill/795.

[13] Govt to launch realty investment trusts by August, http://indianexpress.com/article/business/business-others/govt-to-launch-realty-investment-trusts-by-august/.

should be implemented as soon as possible. However, provisions with regard to the remedies in case of concealment of information; appeals and jurisdiction of courts in case of dispute; general penalties; composition of offence; liabilities of unit holders; and liabilities of manager to unit holder needs to be added to make the regulation more comprehensive. Also clarity in the regulations with respect to their similarity with mutual funds and collective investment schemes is required.

Additionally it should be borne in mind that the problems faced by infrastructure development and financing includes the non-availability of debt financing, the lack of depth of the corporate bond markets, the fact that the bankruptcy regime in India is still behind the curve, and so on. These are apart from the other concerns in the infrastructure sector that pertain to project-related issues such as land acquisition, permits and consents, environmental issues, resettlement and rehabilitation, etc. The present step by SEBI addresses only one problem faced by the infrastructure sector being equity financing and its consequences need to be considered in the larger picture.