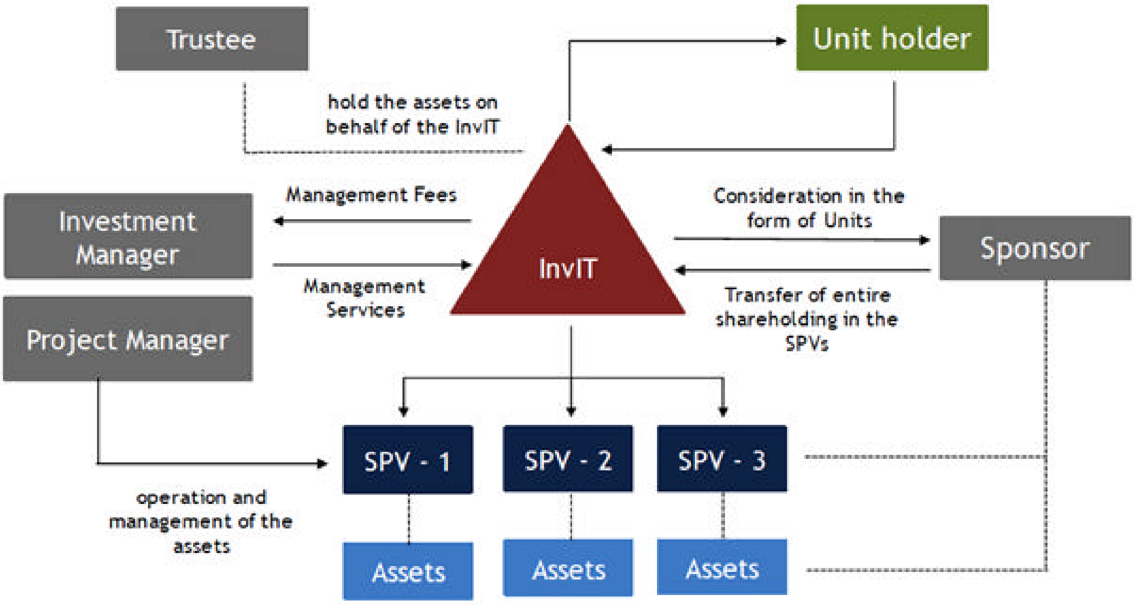
Infrastructure Investment Trust (InvITs) - A Perspective

Sidharth Rath
Group Executive-CRG & TXB
Axis Bank Ltd.

Concept of Infrastructure Investment Trusts (InvIT)

The concept of Infrastructure Investment Trusts, including REITs has been borrowed from the idea of a Business Trust. In India, InvIT was introduced by SEBI in September 2014. InvITs are pooled investment vehicles which are set up as trusts which pool money from investors (both in India and outside India) (who get units in return for their investments) and invest the proceeds in different infrastructure projects.

For a layman, InvIT is a single-scheme mutual fund with mandate to invest only in Infrastructure assets.



Trustee
Unit holder
hold the assets on behalf of the InvIT
Management Fees
Investment Manager
Management Services
InvIT
Consideration in the form of Units
Sponsor
Transfer of entire shareholding in the SPVs
Project Manager
SPV - 1
SPV - 2
SPV - 3
operation and management of the assets
Assets
Assets
Assets

Four pillars of the InvIT framework are:

I. **Sponsor:** The role of the sponsor is to set up the InvIT (as a Trust) and appoint the trustee post execution of an indenture of Trust

The sponsor shall transfer or undertake to transfer its entire ownership of the infrastructure assets to the InvIT after signing a share purchase agreement. The sponsor gets equivalent number of units.

II. **Trustee:** The trustee shall hold the InvITs assets on behalf of the InvIT for the benefit of the unit holders.

III. **Investment manager:** The trustee shall enter into an investment management agreement with the investment manager on behalf of the InvIT. The investment manger's role is to manage the assets and investments of the InvIT. It also looks over the administration and management of the InvIT. The investment manager charges fees for the services provided.

IV. **Project manager:** The Trustee appoints a project manager to undertake the operations and maintenance of the InvIT assets.

The Trustee cannot be an associate of the sponsor or the Investment manager.

InvITs cannot invest in units of other InvITs and it cannot launch any schemes.

The Investment made by the InvIT in infrastructure projects, is subject to a lock in period of three years, and cannot invest in a project whose residual concession period is less than three years.

Need for Infrastructure Investment Trusts in India?

Infrastructure is the backbone of any economy and has vertical linkages with other sectors like Iron& steel, cement, freight, etc. As per recent estimate over the next decade, India require over US$ 1.5 trillion investments to fill up infrastructure gap in India. However, during the last five to seven years, especially after the global slowdown, the development of the sector has slowed down. Infrastructure projects inherently require huge capital and have long gestation period. Due to this slowdown in the economy, the sponsors' equity and debt have got stuck, especially in the infrastructure and real estate sectors. This has resulted in a vicious circle where the sponsor's promoters are not being able to churn out their equity portion to undertake fresh projects, and not able to service their debt (which could have been used by banks to lend further). This has also resulted in deterioration of the asset quality of banks which are now reluctant to lend further in this space. Hence, an alternative to bank funding / refinancing is needed. InvITs can become a potential alternative to bank funding and also help the sponsors to free up their equity.

InvITs can bring higher standards of governance into the system as, its ownership will not be concentrated in few hands, and will be professionally managed by the Investment manager and the project manager appointed by the Trustee. In addition to above, InvITs can serve as a suitable vehicle to draw external funding into Indian infrastructure sector.

Current Scenario and Regulatory framework

1. Eligibility Criteria

SEBI has laid down the framework for setting up InvITs in India and has specified eligibility criteria for various parties to the InvITs.

- **Sponsor – Eligibility Criteria**
  a. The number of sponsor for an InvIT cannot exceed **3 (three)**
  b. Net worth of at least **Rs. 100 crores** in case of body corporate or a company or net tangible assets of **Rs. 100 crores** in case of a limited liability partnership
  c. Minimum experience of at least **5 (five) years** and has completed at least two projects
  d. The consolidated number of units held by the sponsor shall not be less than 10%.

- **Investment Manager – Eligibility Criteria**
  a. Net worth of at least **Rs. 10 crores** in case of body corporate or a company or net tangible assets of **Rs. 10 crores** in case of a limited liability partnership
  b. Minimum experience of five years in fund management or advisory services or development in the infrastructure sector
  c. Minimum two employees who have at least **5 (five)** years of experience in fund management or advisory services or development in the infrastructure sector
  d. Minimum one employee having at least **5 (five)** years of experience in the relevant sub-sector in which the InvIT has invested or proposes to invest
  e. Not less than half of the directors/ members should be independent and they should not be directors/ members of another InvIT
  f. An office in India from where operations pertaining to InvIT is proposed to be conducted

- **Trustee – Eligibility Criteria**
  a. Registered with SEBI under Securities and Exchange Board of India (Debenture Trustee) Regulations, 1993
  b. Not an associate of the sponsor or investment manager
  c. Sufficient resources with respect to infrastructure, personnel, etc as specified by SEBI

2. Taxation

The Union Budget 2016-17 brought much awaited clarity on the taxation angle relating to InvITs. Earlier, if the InvIT held assets through a Special Purpose Vehicle (SPV) and the SPV is a company, the company would be liable to pay corporate tax and thereafter when the income is distributed to the InvIT (being a shareholder), it suffers Dividend Distribution Tax which is paid by the SPV and thereafter the income is exempt both in the hands of the InvIT and also its unit holders.

Provided below are the salient features of the proposed changes to the existing tax regime from the Finance Bill, 2016 proposed at the 2016-17 Union Budget:

a. exemption from levy of Dividend Distribution Tax (“DDT”) in respect of distributions made by SPV to the InvIT;
b. such dividend received by the InvIT and its unit holders shall not be taxable in the hands of the InvIT or unit holders;
c. the exemption from levy of DDT world only be in the cases where the InvIT either holds 100% of the share capital of the SPV or holds all of the share capital other than that which is required to be held by any other entity as part of any direction of any Government or specific requirement of any law to this effect or which is held by Government or Government bodies; and
d. the exemption from the levy of DDT would only be in the respect of dividends paid out of current income after the date when the InvIT acquires the specified shareholding in the SPV. The dividends paid out of accumulated and current profits up to this date shall be liable for levy of DDT as and when any dividend out of these profits is distributed by the company either to the InvIT or any other shareholder.

This move was to make the trust structure more tax-efficient and be favorable for the unit holder, in terms of rate of return.

3. Registration

InvITs are required to be established as a Trust under The Indian Trust Act, 1882 and Registration Act, 1908.

4. Who can invest in units of an InvIT

a. Strategic Investors, who invest not less than 5% of the total offer size, including:
   i. An infrastructure finance company registered with the RBI as a NBFC
   ii. Scheduled Commercial bank
   iii. International Multilateral financial institution
   iv. Systemically important NBFC registered with RBI
   v. Foreign Portfolio Investors

b. QIBs
   i. A mutual Fund, Venture capital fund, and foreign venture capital investor registered with SEBI
   ii. A FII and sub-account, registered with SEBI
   iii. A PFI as defined in section 4A of the Companies Act, 1956
   iv. Scheduled Commercial Bank
   v. Multilateral and Bilateral Development financial Institution
   vi. State Industrial Development Corporation
   vii. Insurance funds setup and managed by army, navy, or air force of the Union of India
   viii. Insurance Companies registered with IRDA
   ix. A Provident fund with minimum corpus of Rs 20 Cr
   x. A pension fund with minimum corpus of Rs 25 Cr
   xi. National Investment fund set up by the Govt of India

c. Anchor investors

d. Any other investors making a minimum investment of Rs 10 lakh

5. Issue and Allotment of Units

a. Public Offer

In the event the InvIT has a minimum of 80% of its assets in completed and revenue generating infrastructure projects:

- Initial offer shall be in the form of a public issue
- Minimum subscription from any investor in the initial and follow on offer shall be ? 10,00,000
- Units proposed to be offered to the public is not less than 25% of the total of the outstanding units of the InvIT

b. Private Placement

In the event the InvIT has a minimum of 10% of its assets in under-construction projects:

- The funds will be raised by way of private placement.
- Units shall be offered to only qualified institutional buyers and body corporates.
- Minimum investment of Rs. 1 crore.
- Privately placed units shall be offered to not less than 5 investors and shall not exceed 1000 investors.

An InvIT can raise funds by way of both publicly offered and privately placed InvITs by issue of units. However, the interest or the equity share capital held by the InvIT in the assets shall not fall below 50%. In case of public issue, minimum subscription amount is Rs 10 lakh, both in IPO and FPO. The units offered to the public are not less than 25% of the total outstanding units. Also, the units allocated shall not be more than 75% to QIBs and not more than 60% of the portion available for allocation to QIBs shall be allocated to anchor investors (including strategic investors).

In case of private placement, the units shall be issued only to QIBs and Body corporates, with a minimum investment amount of Rs 1 Cr. Also, privately placed units shall be offered to not less than 5 investors and shall not exceed 1000 investors.

6. Distribution by SPVs to the InvIT

- Subject to the provisions of the Companies Act, 2013, and the LLP Act, 2008, as may be applicable , the SPVs shall distribute not less than 90% of its net distributable cash flows to the InvITs
- Accordingly, the InvITs shall distribute 90% of the net distributable cash flows of the InvIT to the unit holders
- Distributions shall be made twice in a financial year, in case of publicly issued InvITs and once every year in case of privately placed InvITs.
- Disposition proceeds arising out of the sale of assets of the InvIT / SPV or sale of equity shares or interest in the SPV are not required to be distributed to the InvIT or to the unit holders if the proceeds are being used to reinvest into another infrastructure asset.

Developing InvITs Market in India – What does it take?

SEBI’s approval to GMR and IRB group to set up their InvIT is a big leap towards the development of InvIT market in India. However there are certain issues which needs to be addressed by the Government and Regulators to make InvIT market vibrant

1. **Taxation:** The clarity on the taxation angle was the most important step for the development for the development of InvITs in India. Taking it further, the foreign investors should be exempted from withholding tax to draw more participation. Retail investor should also be given tax exemption, the success in infrastructure bonds in the past being the good.
2. **Change in Ownership of Assets:** InvIT regulation require sponsor to transfer or undertake to transfer its entire ownership of the infrastructure assets to the InvIT. However, in certain cases, the concessionaire authority (e.g. NHAI) may not permit the change in control / ownership and have lock in period for the same. For better administration, transfer of 100% ownership to InvIT should be allowed on case to case basis
3. **Tax benefit on account of change in ownership:** Certain SPVs might have brought forward tax losses. In case of transfer of ownership to InvIT, the SPV may lose the tax benefit due to change in control ownership (InvIT has to hold minimum 51% in the SPV). Allowing SPV to continue with the tax benefits will help the InvIT to be attractive for the investors.
4. **Stamp duties:** Exemption may be given for the stamp duty payable during the transfer of asset to the InvIT.
5. **Single window:** For all regulatory approvals related to the SPV and InvIT there should be one single window.
6. **Number of Sponsors:** Currently, the sponsor(s) together shall hold not less than 10% of the total units of the InvIT after initial offer of units, on a post-issue basis for a period of not less than 3 years from the date of the listing of such units. The regulator’s plan to allow five sponsors is a positive step given that it allow the latter to free up a higher capital for fresh investment and also diversify the holding structure
7. **Capital Gain Tax Treatment:** It should be at par with the Equity Investments
8. **Investment by Insurance Companies:** Insurance Regulatory and Development Authority should allow investment in InvIT by Insurance Companies under Infrastructure Sector.