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News Alert
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Consultation Paper released by SEBI on Infrastructure Investment Trusts

In brief

The Securities and Exchange Board of India ('SEBI') has received suggestions for establishing a framework for Infrastructure Investment Trusts ('InvITs') in the country, based on which, it is exploring a structure that would provide an additional funding avenue for the infrastructure sector in India. SEBI, on 20 December 2013, has released a consultation paper on InvITs.

The introduction of InvITs is aimed at playing a pivotal role in providing wider long-term refinance, freeing up current developer capital/ funds, refinancing existing high-cost debt with long-term low-cost capital, attracting international finance and addressing issues that have commonly caused prorogation of several infrastructure projects.

In this backdrop, SEBI is exploring the following frameworks for introducing InvITs and has also invited public comments on these proposals by 20 January 2014:

a. InvITs under the mutual fund regime; or

b. A separate set of regulations for InvITs.

In this news alert, PwC provides an overview of the suggested frameworks along with their salient features.

InvIT as a Mutual Fund

Considering that the mutual fund regime is established in India, SEBI is exploring permitting InvITs under the mutual fund regime. A framework may be introduced by insertion of a chapter in the SEBI (Mutual Funds) Regulations, 1996 or through a separate set of mutual fund regulations.

The key features of the proposed framework are set out below:

Legal form and registration	• Trust set up under Indian Trust Act, 1882. • Registration required under the InvIT Regulations
Parties to InvIT	• Sponsor – Infrastructure developer/ Special Purpose Vehicle ('SPV') holding a concession agreement – Sponsor to settle the InvIT and transfer the majority shareholding of the SPV to the InvIT – Commitment to be maintained through minimum holding in the InvIT or through a minimum shareholding in the SPV and units in the InvIT • Project Manager – Original concessionaire proposed to be appointed as a Project Manager – Responsible for achieving project milestones as originally envisaged in the concession documents • Advisory Board – Independent advisory board comprising sector experts and other professionals to provide guidance to the InvIT's trustees
Investment conditions and income distribution	• Investment by acquisition of shares of the SPVs in infrastructure projects, mainly Public Private Partnership (PPP) projects. Non-PPP projects may be permitted as well • Mandatory diversification of the portfolio – mix of pre-Commercial Operations Date (COD) projects (at least 50% developed) and post-COD projects (already generating cash flows) • Investment in two or three projects on setting up of the InvIT • Investment only in one sector/ sub-sector permitted • At least 76% of equity shares of the SPV in PPP projects to be held by the InvIT • Non-PPP projects - Transfer of 100% of assets from an SPV to the InvIT subject to investible-grade ratings by RBI-notified rating agencies and discussions with the relevant authorities

	• At least 65% of the net assets to be invested in a scheme in equity shares of companies in line with Equity Oriented Mutual Fund schemes • At least 90% of the net distributable income after tax to be distributed to its investors
Offer of units of InvIT and listing	• Fund raising post registration with SEBI – both from domestic and foreign investors • Foreign investment subject to lock-in of three years, though trading among foreign investors within lock-in period is permitted • Funds raised to be utilised to acquire at least 76% equity shares in SPV and balance can be utilised for refinancing of SPV debt • Listing not mandatory. Preferable from a tax perspective since there is exemption of long- term capital gains tax on sale of units • General procedures for initial/ follow-on offer, filing of offer documents allotment, disclosure in the offer documents and listing of units to be specified in the proposed regulations
Valuation	• Pre-Acquisition – Shares of the SPV – Valued as per Discounted Cash Flow Method – Pre-COD project - Acquisition from a developer at deeper discount rate – Post-COD project - Acquisition from a developer at a discount • Post-Acquisition – Underlying InvIT assets, required to be valued at least once a year; – Six-monthly valuation update of key changes in valuation in the previous six months also required – Net Asset Value to be declared at least once a year
Other requirements	• Detailed disclosure requirements to be specified in the proposed regulations with respect to contractual documents, offer documents etc. • Trust agreement to include the class of beneficiaries, detailed provisions setting forth the purpose of the InvIT and the authority conferred on the Trustees • Concessionaire to carry out the development and operation of the Trust assets and also provide management and collection services with respect to the receivables • For financing through issue of securities, a prospectus needs to be prepared and approved by SEBI. • No gearing limits for an InvIT. However, at least 65% of the funds to be deployed in equity of underlying assets to qualify as an equity-oriented mutual fund

InvIT – Separate framework

SEBI is exploring the option of introducing InvITs under a separate framework i.e. SEBI (Infrastructure Investment Trusts) Regulations ('InvIT Regulations') considering the differing nature of assets, need for special structures and the specific needs of the sector.

The key features of the proposed framework are set out below:

Legal form and registration	• Trust set up under Indian Trust Act, 1882 • Registration required under the InvIT Regulations
Parties to InvIT	• Sponsor – Lead member of the consortium (primary promoter) which had bid for the project. In case of multiple projects, respective promoters to be co-sponsors – At least 24% of the number of units of the InvIT to be held by the sponsor at all times. For multiple sponsors, limit to apply to combined holding of sponsors – Net worth and experience criteria to be laid down in the proposed InvIT Regulations • Manager – Two sets of managers to be appointed by the InvIT : (i) Manager of the InvIT (Manager); (ii) Project managers at each SPV level (Project Manager) – Roles and responsibilities of the Manager and Project Manager to be governed by the investment management agreement with the trustee and concession agreement respectively – Experience, minimum net worth, manpower with sufficient relevant experience of the Manager to be laid down in the InvIT Regulations – Manager to appoint an advisory board comprising independent experts, representatives from regulatory authorities, major stakeholders and investors. Board to play an advisory role in managing the activities of the InvIT • Trustee – Trustee to be independent of the sponsor and the manager. Minimum number of independent directors required to achieve independent nature – Role of the trustee is to hold the InvIT assets on behalf of investors in accordance with the trust deed and to oversee the activities of the InvIT

	• Others – Other parties such as an independent engineer etc. may be required under the concession agreement.
Categories for raising funds	• Category I InvIT – Can invest in developmental assets and fully developed assets – Institutional investors (domestic or foreign) – Subscription amount of each investor – at least INR 5 crore – Funds to be raised by way of private placement • Category II InvIT – Can invest only in fully developed assets – Any investor (domestic or foreign) – Subscription amount of each investor – at least INR 10 lakh – Funds to be raised by way of an IPO/FPO/rights issue/bonus issues/preferential allotment etc.
Investment conditions and income distribution	• Category I InvIT – Category I InvIT to invest in pre-COD/post-COD projects with investment in a minimum of at least two projects • Category II InvIT – Category II InvIT to invest in one year post-COD revenue generating projects with investment in a minimum of at least four projects • Other conditions – Investment permissible only in infrastructure projects (based in India) belonging to one sector/sub-sector – Un-invested funds may be invested in liquid instruments, cash equivalents, government securities, etc. – Invest in the projects directly or through SPV – In case of investment though SPV route, the InvIT to have control over the SPV and should hold not less that 51% of the shares in the SPV – At least 90%of the net distributable income after tax to be distributed to its investors
Public offer	• Minimum market capitalisation - INR 1,000 crore • Minimum float – 25% for Category II InvIT • Minimum offer size – INR 250 crore

Leveraging	• Category I InvITs - No restrictions on borrowings/deferred payments (consolidated) of the InvIT • Category II InvITs - Borrowings and deferred payments to be =<50% of value of assets. Borrowings and deferred payments >25% of the value of assets subject to: – Credit rating – Approval of majority of investors
Others	• Full valuation (in a prescribed format) to be undertaken at least once a year by a valuer with relevant experience; six-monthly update of key changes in valuation for Category II InvITs • Rights to remove manager, auditor, valuer, etc. provided to investors; Annual meeting of investors mandatory for Category II InvITs for matters such as presentation of latest annual accounts, valuation reports, performance of the InvIT, approval of auditors and their fees, appointment of valuer, etc. • Related party transactions to be at arm's length and necessary disclosures are required • Disclosure requirements for listing to be prescribed under proposed InvIT regulations

Taxation

InvIT as a mutual fund	The Indian Income-tax Act provides for the taxation mechanism for a mutual fund registered under SEBI. In the event the InvIT regulations are introduced under the SEBI mutual fund regime, the taxability of the InvIT and its unit holders should be covered under the ambit of the taxation regime currently in place for mutual funds. Broad incidence of tax on the InvIT/ mutual fund and the unit holders under the regime are summarised as follows: **InvIT** • Income of the InvIT should be exempt from tax • There is no distribution tax payable by the InvIT since it would qualify as an equity oriented fund **Unit holders** • Income received from an InvIT is exempt from tax in the hands of the unit holders • Long-term capital gains arising on the sale of the units of an equity-oriented fund listed on a recognised stock exchange (subject to securities

	transaction tax) should not be taxable in the hands of the unit holders • Short-term capital gains arising on the sale of the units of an equity-oriented fund listed on recognised stock exchange (subject to securities transaction tax) should be chargeable to tax at the rate of 15% (*plus* applicable surcharge and education cess)
InvIT under a separate framework	Under this scenario, the current tax laws may have to be amended to provide for similar tax treatment of InvITs / unit holders as provided for if InvITs were to be introduced as mutual funds. In the absence of such specific amendments, the taxation of InvITs may have to be governed by the principles of trust taxation. In such a case, the final incidence of tax may be upon the InvIT/ unit holders depending upon the nature of the trust

Conclusion.

The release of the consultation paper on InvIT is an indicative step by the market regulator to augment fund flow into the Indian infrastructure space and eliminate impediments to the development of this sector. The actual impetus can however be gauged only when the final regulations are rolled out, after taking into account the public comments received, if any.

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