# Business Trusts in India

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ahead of the curve

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Infrastructure and real estate are two key sectors that underpin India's sustained economic growth and development. Keeping in mind the support these sector lend the Government of India, including the Securities and Exchange Board of India (**SEBI**) set agendas for their promotion, some of which include:

- attracting international finance into Indian infrastructure and real estate;
- creating a popular investment option for long term pools of capital; and
- providing an option to relieve the stress on the banking sector.

Furthering of these agendas resulted in the introduction of infrastructure investment trusts (**InvITs**) and real estate investment trusts (**REITs** and collectively with InvITs, **Business Trusts**) and the notification of the SEBI (Infrastructure Investment Trusts) Regulations, 2014 (**InvIT Regulations**) and the SEBI (Real Estate Investment Trusts) Regulations, 2014 (**REIT Regulations** and collectively with the InvIT Regulations, the **SEBI Regulations**).

## Why Business Trusts?

Business Trusts are avenues for long-term financing of infrastructure and real estate projects, and today, are considered a preferred investment option as they:

- are structured as trusts that can help de-lever infrastructure project and real estate developers and enable them to undertake new projects to fulfil the infrastructure and real estate needs of India;
- provide an opportunity to participate through stable and liquid instruments and encourage highly governed structures;
- provide investors the opportunity to hold a portfolio of operating assets for a reasonable risk-adjusted yield, with a potential for growth if the portfolio include a percentage of projects that are under-construction; and
- provide smaller and non-institutional investors an opportunity to participate and reap the benefits of growth in these sectors, through a marketable instrument, which is less prone to vicissitudes of speculation and volatility inherent in equity investments.

## Introduction of Business Trusts

REITs were introduced as a concept in the United States of America in 1960. Since then, multiple jurisdictions including Singapore and Hong Kong in Asia, have successfully established and implemented regulatory regimes governing business trusts. Singapore was the first jurisdiction in Asia to have a regulatory framework for business trusts (under the Business Trusts Act of 2004). More recently, Philippines and China have implemented this structure as well.

### REITs

In India, SEBI had issued a draft of the REIT regulations for public comments in December 2007. However, these draft regulations were withdrawn and after a gap of almost five years, in October 2013, SEBI issued a reworked draft of the REIT regulations (**the Draft REIT Regulations**) for public comments. Subsequently, the capital markets regulator undertook a comprehensive consultative process with all relevant industry participants to finalise regulations that would address concerns of the relevant industries. A separate framework had been proposed for REITs by SEBI, in line with the established frameworks in countries such as the United States of America, Australia, Singapore, Japan, France and the United Kingdom.

### InvITs

In 2013, SEBI initiated a consultative process in relation to the structuring of InvITs. One of its initial proposals was to structure them under the existing mutual funds regime while another was to have a separate regulatory framework, like that of REITs. Subsequent to the consultative process, SEBI issued a draft of the InvIT regulations for public comments.

In September 2014, SEBI notified the InvIT Regulations and the REIT Regulations. Parallelly, the Government of India in 2014, introduced the concept of 'Business Trusts' to the Income Tax Act, 1961. These regulations led to two successful initial public offers by InvITs in 2017 and the first initial public offer by a REIT in 2019.

## Recent Regulatory Updates and Changes

In the years since the notification of the SEBI Regulations, on the legal and regulatory front, the government and various regulators (SEBI, the Reserve Bank of India (**RBI**), the Central Board of Direct Taxes, the Pension Fund Regulatory and Development Authority, Insurance Regulatory and Development Authority and others) have implemented several important and positive changes to ensure the success of InvITs and REITs in India, including the following:

### Units as 'Securities'

i. With effect from April 1, 2021 and by way of the Finance Act, 2021, the Government of India amended the Securities Contracts (Regulation) Act, 1956 (**SCRA**) to recognise (a) pooled investment vehicles and (b) the units, debentures, other marketable securities and other instruments issued by Business Trusts as "securities" under Section 2(h) of the SCRA.

ii. Investment in securities of Business Trusts has also been brought under the ambit of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 and the Foreign Exchange Management (Debt Instruments) Regulations, 2019.

## Amendments to SEBI Regulations with respect to structure and governance

Since 2016, SEBI has eased and amended the SEBI Regulations allowing, amongst other things:

i. investment in two-level structures (special purpose vehicle);

ii. removal of the limit of number of sponsors of an InvIT;

iii. rationalisation of the requirements under related party transactions;

iv. creation of certain flexibilities in the eligibility criteria prescribed for the parties to the Business Trusts; and

v. inclusion of provisions in relation to induction of a new sponsor with the approval of the unitholders, change in control of a sponsor, exit option to dissenting unitholders and de-classification of the status of a sponsor, amongst others.

## Amendments to SEBI Regulations with respect to unit capital

Subsequently, SEBI also notified various amendments to the SEBI Regulations and issued a multitude of circulars to incentivise the establishment of Business Trusts in India and make their units available for retail participation, including:

i. InvITs being permitted to raise initial capital by way of a private placement of either listed or unlisted units;

ii. listed Business Trusts being permitted to raise further equity capital through a preferential issue of units, institutional placement of units and rights issues (including fast track rights issues);

iii. unlisted InvITs being permitted to undertake a rights issue;

iv. reduction in the lots of units for bidding and trading by InvITs and REITs for the purposes of public offers of units by Business Trusts and reduction in the minimum subscription limits;

v. reduction in the minimum holding of the sponsors;

vi. minimum number of unitholders in an unlisted InvIT (other than the sponsor, its relates parties and associates) being increased to five, such that the collective holding is at least 25% of the total units of the InvIT at all times; and

vii. introduction of guidelines for conversion of private listed InvITs to public InvITs and private unlisted InvITs to private listed InvITs.

Some of these routes have already been tested in the market, with a listed InvIT concluding a PIPE deal and a rights issue, and a listed REIT concluding a qualified institutions placement of units. In the last financial year, the country witnessed the establishment and listing (by way of a public offer) of the first InvIT set up by a central public sector enterprise. Three InvITs listed their units through the private placement route, including the NHAI InvIT set up by the National Highways Authority of India and one REIT listed its units on the stock exchanges. The market also witnessed the first rights issue by a listed InvIT and the first block trade by a sponsor of a listed REIT.

## Borrowing and Issuing of Debt Securities

i. As on date, leverage limit of InvITs can be up to 70% of their assets while that of REITs can be up to 49% of their assets, subject to compliance with certain conditions.

ii. In 2019, RBI permitted banks to lend to InvITs only.

iii. Listed Business Trusts have been permitted to issue listed debt securities. To incentivise this, investment by foreign portfolio investors, mutual funds and insurance companies in debt securities issued by Business Trusts has also been permitted. The first public issue of debt securities by a listed InvIT was concluded in 2021.

## Taxation

i. Certain taxation related benefits were granted to Business Trusts and/ or investors of Business Trusts, including exemptions related to dividend distribution tax, in the Union Budget of 2016.

ii. Under current Indian tax laws, units of a Business Trust held for more than 36 months are considered long-term capital assets while units held for less than or up to 36 months are regarded as short-term capital assets. Any gain arising in case of sale of units through a recognised stock exchange in India is subject to short-term or long-term capital gains tax at concessional rates.

iii. In accordance with the Finance Act, 2020, dividend or distributions distributed by a Business Trust shall be exempt in the hands of the unitholders, provided the special purpose vehicle (**SPV**) distributing such dividends has not exercised the option to pay corporate tax under the corporate tax regime available in terms of, and subject to compliance with, Section 115BAA of the Income Tax Act, 1961. The corresponding withholding tax provisions were also amended to this effect.

iv. Further, dividend income received by a Business Trust from an SPV, in which the Business Trust holds controlling interest or such interest as prescribed under the SEBI Regulations is exempt.

v. The Finance Act, 2021 also exempted the payment of tax deducted at source on dividends paid to InvITs, REITs and units and other instruments issued by InvITs and REITs.

## Way Forward

We expect more interesting developments in the coming years. Other than the standard fare, India may have Business Trusts holding a more eclectic portfolio of assets including warehouses, infrastructure for educational institutions, hotels and hospitals. One can also expect some migration of InvITs listed through the private placement route towards a public investor base, enabling participation by non-institutional and retail investors. Further development of these products will likely increase investor participation and therefore, trading, buttressed by consistent distributions by listed InvITs and REITs. InvITs may also increase M&A activity in some of the infrastructure sectors (such as, roads and highways and renewable energy) due to their progressive emergence as infrastructure investment platforms (as much as infrastructure financing options) and as the listed InvITs aim to increase their AUMs and yield through value accretive third-party acquisitions. With the challenges being faced by some of the existing infrastructure developers and increased focus in divesting non-core businesses, the infrastructure sector will be dependent on InvITs to address some of these concerns. We have already seen Business Trusts bidding for (i) infrastructure assets or real estate assets directly from the government and (ii) assets undergoing corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016.

We also expect legal and regulatory changes, jurisprudential developments and establishment of norms or precedents in the context of Business Trusts including in terms of employee benefits, corporate governance requirements and insider trading prevention requirements. Moreover, with increasing clarity on the regulatory framework, a variety of transactions may be undertaken by Business Trusts, including buy-backs, open offers and de-listing.

Given the opportunities, the immediate future appears very exciting for the stakeholders of Business Trusts. This is expected to be a safe avenue for investment by different classes of investors in India and see more investment resulting in quality, long-term portfolios with high standards of corporate governance and healthy and regular returns. This will hopefully reduce the large amounts of debt on corporate India’s balance sheets.

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