Article

Infrastructure Debt Funds to accelerate the growth of Infrastructure Sector

CA. Nidhi Jain
nidhijain@vinodkothari.com
CS. Vinita Nair
vinita@vinodkothari.com
March 4, 2013

Check at:
http://india-financing.com/staff-publications.html
for more write ups.

Article

The Finance Bill, 2013 ("**Bill**") has several amendments with respect to investment in infrastructure sector. Going with the past trend and stressing upon the importance of the infrastructure development, the Finance Minister, Mr. P. Chidambaram while presenting the Budget for 2013-14, has focused on the need for infrastructure development. To quote him:

"While every sector can absorb new investment, it is the infrastructure sector that needs large volumes of investment. The 12th Plan projects an investment of USD 1 trillion or INR 55,00,000 crores in infrastructure. The Plan envisages that the private sector will share 47 percent of the investment. Besides, we need new and innovative instruments to mobilise funds for this order of investment."

> ***"While every sector can absorb new investment, it is the infrastructure sector that needs large volumes of investment"***

Though the figure of USD 1 trillion was based on the 9% growth target when the 12^{th} Plan was announced, and today, for the current year, the growth estimated is 5.5%. So, the investment target has to be changed. The Planning Commission itself is of opinion that India will not be able to achieve USD 1 trillion target for investment in the infrastructure sector during the 12th Plan (2012-17) in view of lower economic growth prospects.

Still, there is a vast gap and to meet the targets, there is a strong need to infuse investment in the infra sector.

With such a high investment target, there is a need to attract huge investment in infrastructure sector and in harmony with the want of promoting investment in the infrastructure sector, the Fin Min has taken steps to encourage new and innovative instruments like Infrastructure Debt Funds ("**IDFs**") for infra funding.

❖ Need for IDFs:

- Infrastructure projects have a long gestation period for which they require sustainable and low cost long-term financing. The lenders, which are mostly banks as Insurance and Pension Fund, do not have the risk appetite for such kind of investment. Further, the fact that the pay-back period for infra projects are too long, banks suffers asset-liability mismatch because of long term infra funding.

- So, there is a dearth of long term funds for infra sectors, because of which their cost of projects increases significantly.

- The government had set up the India Infrastructure Finance Company Ltd. (IIFCL) with the objective of providing long-term debt for infrastructure projects. However, its lending was restricted to about 30% of the project debt, thus the balance 70% were left to be raised mainly from the commercial banks.

❖ Budget 2011-12 laid down the foundation of IDFs:

- In the budget for the year 2011-12, the setting up of IDFs was announced to facilitate the flow of long-term debt into infrastructure projects.

- Further, in order to attract foreign funds for financing of infrastructure, the Fin Min announced creation of special vehicles in the form of notified IDFs. The interest payments on the borrowings of these funds were subject to a reduced withholding tax rate of 5% instead of rate of 20%.

- The Income of the IDF made exempt from tax u/s 10 (47) of the Income Tax Act ("**IT Act**").

- These initiatives were aimed mainly to lure the investors to invest in infrastructure projects.

❖ Existing IDFs in India:

- Presently, there are four IDFs registered with SEBI viz. ICICI Prudential Infrastructure Debt Fund, Birla Sunlife Infrastructure Debt Fund, IDBI Infrastructure Debt Fund & IDFC Infrastructure Debt Fund. Further, IL&FS Infrastructure Debt Fund & India Infra Debt (the first Infrastructure Debt Fund under the NBFC Structure) was launched in February 2013.

❖ What's in store for IDFs in the Budget 2013-14?

- India Infrastructure Finance Corporation Ltd (IIFCL), in partnership with the Asian Development Bank ("**ADB**"), will offer credit enhancement to infrastructure companies that wish to access the bond market to tap long term funds. This credit enhancement will help Infra companies to enhance their rating to AA level and thus making it an eligible instrument for investment by institutions like Insurance Companies and Pension Funds.

- During last financial year, ten infrastructure or infrastructure finance companies, including IIFCL, National Highways Authority of India (NHAI), Housing and Urban Development Corp (Hudco), Power Finance Corp (PFC) and IRFC, were allowed to issue tax free bonds. They raised approx INR 30,000 crores in 2011-12 and are expected to raise about INR 25,000 crores in 2012-13. **In this budget, the Fin Min has decided to allow some**

institutions to issue tax free bonds in 2013-14 upto a total sum of INR 50,000 crores.

- Tax-free infrastructure bonds were proposed by the government to channelize retail and institutional savings into the infra sector of the country through long-term bonds. To make these bonds attractive and widen the investor base, government has allowed full tax exemptions to interest income from these bonds.

❖ Tax amendments for IDFs in the Budget 2013-14:

- The Finance Bill seeks to amend section 115R of the IT Act, with effect from 1st June, 2013 relating to tax on distributed income to unit holders. A proviso has been inserted after clause (iii) of sub-section (2) of Section 115R to the effect that any income distributed by a mutual fund under an infrastructure debt scheme to a non-resident (other than a company) or a foreign company shall be liable for payment of additional income-tax at the rate of five per cent on the income distributed.

> - ***IIFCL set up.***
> - ***Exemption of tax from IDF.***
> - ***Low withholding tax of 5% for foreign investors on interest on infra bonds.***

- Further, the expression 'infrastructure debt fund scheme' has been defined by inserting an explanation under Section 115R of the Income tax Act, to the following effect:-

  "*ii*) 'infrastructure debt fund scheme' shall have the same meaning as assigned to it in clause (*1*) of regulation 49L of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 made under the Securities and Exchange Board of India Act, 1992."

- The Bill further amends section 194LC of the IT Act with effect from 1st June, 2013. As per section 194LC, a withholding tax of only 5% is required to be deducted by the Specified Indian Company while paying interest on Infrastructure Bonds or for paying interest on ECBs. One of the requirement under this section is that the borrowing should be in foreign currency.

Sub-section (2) of the said section is amended to provide that where a non-resident or a foreign company has deposited any sum of money in foreign currency in a designated account and such sum (as converted in rupees), is utilized to subscribe to any long term infrastructure bonds issued by the specified company in India, then, such borrowing for the purposes of section

Article

194LC shall be deemed to have been made by the specified company in foreign currency.

Further, the expression 'designated account' has been defined by inserting an Explanation as clause (a) to the sub-section (2) of section 194LC, to the following effect:-

> "(a) "designated account" means an account of a person in a bank which has been opened solely for the purpose of deposit of money in foreign currency and utilisation of such money for payment to the specified company for subscription in the long-term infrastructure bonds issued by it;."

❖ Concluding remarks

The income of an IDF is exempted u/s 10 (47) of the IT Act. There is a lower withholding tax of 5% on income by way of interest received from IDFs by foreign investors u/s 194LB of the IT Act. Also, the same withholding tax of 5% is applicable on interest income from Infra Bonds issued by Indian Companies to foreign investors. Further, if the credit enhancement is provided by institutions like IIFCL in collaboration with ADB, we do not see a reason why the infra bond market will not accelerate. The better rating of Infra companies through credit enhancement will also ensure participation of Insurance funds and Pension funds in providing cost-effective infra funding. The balance sheet of banks loaded with long term infra loans will be off-loaded with the help of take-out finance.

This article was also adopted and published in Moneylife. To view the same in Monetlife click here: http://www.moneylife.in/article/infrastructure-debt-funds-to-accelerate-the-growth-of-infrastructure-sector/31448.html