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Briefing note September 2012

Why Singapore business trusts are proving popular with Indian sponsors

Reliance Communications' proposed initial public offering ("**IPO**") of Global Telecommunications Infrastructure Trust on the Singapore Stock Exchange (the "**SGX**") and the reported upcoming IPO of Religare Healthcare Trust by Fortis Healthcare mark a renewed interest in Singapore business trusts ("**Business Trusts**").[1]

This relative rise in popularity demonstrates that companies in India are reconsidering Business Trusts as potential capital-raising vehicles. Thus far two Business Trusts with assets in India have listed on the SGX: Ascendas India Trust (listed in 2007) and Indiabulls Properties Investment Trust (listed in 2008). In a typical Business Trust structure, a sponsor company ("Sponsor") transfers its cash-generating assets into the Business Trust, which pays for the assets using proceeds raised from the IPO of its units.

Singapore is the only jurisdiction in Asia that currently has a regulatory framework for Business Trusts under the Business Trusts Act of 2004 (the "**BTA**").[2] Currently, there are nine Business Trusts listed on the SGX. The first Business Trust, Pacific Shipping Trust, listed on the SGX in May 2006 and subsequently delisted on March 8, 2012.[3] In fact, the largest IPO in Singapore's history to date includes the listing of Hutchison Port Holdings Trust on March 18, 2011, which raised approximately S$7 billion.

This client briefing describes the basic characteristics and structures of a Business Trust, highlighting key structural issues faced by Indian Sponsors, and discusses important considerations in structuring a Business Trust in the Singapore context.

What is a Business Trust?

A Business Trust is created through a trust deed that sets forth, among other things, its governance and investment mandate. A Business Trust is managed by a trustee-manager who is the legal owner and manager of the Business Trust's assets. The trustee-manager receives remuneration for its services, which typically comprises a fixed fee and an incentive fee tied to the performance of the Business Trust. Most importantly, a Business Trust, unlike a company, is permitted to make distributions from its cash-flows (instead of profits), provided it remains solvent.

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[1] Source: http://online.wsj.com/article/SB10001424052970203753704577254653434685894.html
[2] Source: A Tale of Two Cities: Business Trust Listings and Capital Markets in Singapore and Hong Kong, Norman P. Ho. Hong Kong approved the business trust form on June 2, 2011 in connection with a proposed spin-off of PCCW's telecommunications business into a business trust, but the applicable legal framework for listed-business trusts is still pending legislation. Malaysia is also in the process of establishing a regulatory framework governing business trusts.
[3] As of July 31, 2012, there were nine standalone Business Trusts, which do not form part of a larger stapled structure, listed on SGX.

Basic Structure of a Business Trust

The structure of a Business Trust depends on the type of assets which it holds, the location of those assets, and tax, legal and commercial considerations. The following steps are typically involved in the IPO of units in a Business Trust:

- **Incorporation of the Trustee-Manager and Constitution of the Business Trust.** A Sponsor incorporates a company in Singapore which will serve as a trustee-manager that constitutes and manages the Business Trust. Typically, a trustee-manager is a wholly-owned (direct or indirect) subsidiary of the Sponsor. Subsequently, the trustee-manager constitutes the Business Trust by executing a trust deed.

- **Acquisition of Assets by Business Trust.** The trustee-manager offers the units in the Business Trust in an IPO and uses the proceeds to acquire the assets from the Sponsor. Typically, the trustee-manager issues the units in the Business Trust to the Sponsor as partial consideration for such acquisition. It is not uncommon for Sponsors to retain a 30%-40% interest in the Business Trust immediately following the IPO.

Indian Tax and Regulatory Regimes and their Effect on Business Trust Structure

There are two categories of Indian Sponsors: one with direct ownership of assets within India and outside India and the other one with indirect ownership of assets within India and outside India. In both cases these assets are to be transferred into a Business Trust. For example, the proposed IPO of units in Global Telecommunications Infrastructure Trust involved offshore subsea cable assets indirectly owned by an Indian Sponsor, whereas the assets in Indiabulls Properties Investment Trust and Ascendas India Trust comprised onshore real estate assets that were directly owned by Indian Sponsors.

Indian Sponsors can divest their indirect ownership of offshore or onshore assets by structuring a Business Trust in the manner described above. However, Indian Sponsors contemplating transferring their directly owned onshore or offshore assets into a Business Trust may require careful pre-offering restructuring in light of the tax and regulatory framework in India, particularly the capital gain taxes on transfers of assets and the regulatory prohibition against "round-tripping".

Advantages of a Business Trust

A Business Trust offers numerous advantages to its Sponsors and investors, primarily: an opportunity for Sponsors to extract value from their assets while maintaining control over their transferred assets and to provide investors an attractive, tax-free return on investment as compared to traditional corporations in Singapore.

- **Extract Value from Assets**. Often times Sponsors in need of capital have cash-flow generating assets "trapped" within their organisational structure. Sponsors may realise value by concurrently transferring these "trapped" assets into a Business Trust and offering the units in the Business Trust to investors. As such, Business Trusts create liquidity from otherwise illiquid assets and are most suited for Sponsors in infrastructure, real estate and shipping businesses, which tend to have cash-generating assets. Reliance Communications recently contemplated listing a Business Trust to raise capital from its subsea cable assets. Although the offering was postponed, it nevertheless demonstrates the versatility of a Business Trust as an alternate capital-raising vehicle for companies with cash-generating assets.

- **Continued Control in the Trust Assets**. Sponsors typically own the trustee-managers and retain controlling unitholdings in the Business Trusts, which affords them sizable influence over the trustee-manager managing the affairs of the Business Trust. Further, to remove the trustee-manager established by a Sponsor requires approval of more than 75% of the unitholders of the Business Trust. However, in all the nine listed- Business Trusts, Sponsors typically retained greater than 25% of the units following the IPO.

- **Attractive, Tax-Free Return on Investment.** The trustee-manager has a right to declare distributions from the cash-flows of the Business Trust. Businesses with depressed net profits from deferred revenues or accounting losses from non-cash expenses, such as depreciation and amortisation, are able to make attractive and stable distributions. Additionally, distributions from a Business Trust are tax-free in Singapore and are not subject to Singapore withholding tax. This tax exemption is applicable to all unitholders regardless of their nationality, identity or tax residence status.

Considerations in Using a Business Trust Structure

While a Business Trust can be an effective capital-raising vehicle, Sponsors should consider the following factors before taking advantage of this structure:

- **Governance of Business Trust**. To address any potential conflict of duties of the trustee-manager to its shareholders and to the unitholders of the Business Trust, the BTA imposes higher corporate governance standards on Business Trusts than on traditional corporations listed on the SGX. The trustee-manager is required, among other things, to have majority directors on its board be independent. Additionally, transactions between the Business Trust and its Sponsor are generally structured at arm's length and directors who have an interest in the transaction usually abstain from voting to approve such a transaction as a matter of good corporate governance.

- **Sponsor Support of Business Trust.** To manage potential conflicts of interest between Sponsor and the Business Trust, the Sponsor typically agrees to a non-compete agreement in favor of the Business Trust and may also grant a right of first refusal to the Business Trust on future purchases or sales of assets. For example, the Sponsor of Indiabulls Properties Investment Trust granted Indiabulls Properties Investment Trust a right to purchase the Sponsor's assets. The Sponsor of Global Telecommunications Infrastructure Trust contemplated granting an option, expiring five years from the listing date, to Global Telecommunications Infrastructure Trust to purchase one of its subsea cable systems that was originally leased to the trust.

- **Listing Criteria of the SGX.** Effective 1 August 2012, an applicant seeking to list on the SGX will need to demonstrate an operating track record and meet the SGX's requirements either in relation to profitability or market capitalisation at the time of IPO. A Business Trust that does not satisfy these requirements will have to show that it will be able to generate operating revenue immediately upon listing, and will have to have a market capitalisation of no less than S$300 million at the time of IPO.

- **Sponsor Liability under the Laws of Singapore.** The trustee-manager and its directors have prospectus liability under the Securities and Futures Act of Singapore (the "**SFA**"). No such liability is imposed on the Sponsor by the SFA, unless the Sponsor is selling its units in the Business Trust as part of the public offering, or has made, and consented to including, any statement in the prospectus which is false or misleading. The Sponsor and its directors and managers, however, remain subject to civil liability arising from any false or misleading statements made by them in the prospectus. Also, the Sponsor is liable to the Business Trust for contractual claims arising from any breach of contract in relation to the transfer of its assets into the Business Trust, and the Sponsor's directors appointed to the board of the trustee-manager remain subject to prospectus liability.