Rupee Denominated Bonds (Masala Bonds)

Introduction:

Raising money through foreign exchange can take place in several ways. The amount raised by way of foreign exchange is broadly categorised under External Commercial Borrowings. One such form of raising money from overseas investors is the Rupee-denominated bonds.

Rupee-denominated bonds are bonds that are denominated in Indian Rupees (INR) and issued to overseas investors primarily for the purpose of increasing the foreign currency inflow. These bonds are called as masala bonds in common parlance to stimulate the culture and cuisine of India internationally. It has been named as such by the International Finance Corporation.

The benefit of issuing Rupee-denominated bonds is that the risk of currency depreciation is borne by the purchaser of bonds and not by the issuer. Then, the reason why the overseas investors purchase such bonds is that they get higher rate of interest compared to the standard interest rate prevailing in their markets.

Why Masala Bonds?

Some of the main benefits of masala bonds are as follows:

- Masala Bonds are an attempt to internationalize the Indian rupee and give strength to Indian financial system and economy
- Borrowers are shielded against the risk of currency fluctuations
- A Liquid rupee-denominated debt markets stimulate financial stability
- It has low-credit risk and high rupee-linked yield for investors.

Eligible Borrowers (Issuer):

a. Any corporate or body corporate
b. Indian banks
c. Real Estate Investment Trusts (REITs)
d. Infrastructure Investment Trusts (INVITs)
e. NBFCs under the regulatory purview of RBI

Current top issuers of masala bonds are HDFC Ltd, NTPC Ltd and Indiabulls Housing Finance. Masala bonds are attractive to bond issuers as it helps them tap foreign investor demand without hedging on foreign currency risk. This has eased the situation where Indian companies had to earlier depend only on External Commercial Borrowings (ECB) that were raised and repaid in foreign currency only.

Eligible Investors (Lender):

The Rupee denominated bonds can only be issued in a country and can only be subscribed by a resident of a country:

a. that is a member of Financial Action Task Force (FATF) or a member of a FATF-Style Regional Body; and
b. whose securities market regulator is a signatory to the International Organization of Securities Commission's (IOSCO's) Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to bilateral Memorandum of Understanding with the Securities and Exchange Board of India (SEBI) for information sharing arrangements; and
c. should not be of a country identified in the public statement of the FATF as:
    i. A jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or
    ii. A jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies

Notes:

- Multilateral and Regional Financial Institutions where India is a member country will also be considered as eligible investors.
- Related party as defined in Ind-AS 24 cannot subscribe such masala bonds.

Utilisation and Negative List:

The proceeds of the borrowing can be used for all purposes except for the following:

i. Real estate activities other than development of integrated township / affordable housing projects;
ii. Investing in capital market and using the proceeds for equity investment domestically;
iii. Activities prohibited as per the Foreign Direct Investment ("FDI") guidelines;
iv. On-lending to other entities for any of the above purposes; and
v. Purchase of Land

Maturity Period:

Borrowings amount (equivalent to INR)	**Minimum maturity period**
Upto USD 50 million	3 years
More than USD 50 million	5 years

Borrowing Limit:

The borrowers are eligible to raise upto USD 750 million equivalent to INR above which the prospective borrowers are required to send their requests to the Reserve Bank through their Authorised Dealer Banks for examination.

Listing on London Stock Exchange:

There are currently 12 masala bonds listed on London Stock Exchange's markets. An increased primary market activity has INR denominated bonds listed in London by International Finance Corporation (IFC), Inter-American Development Bank (IDB) and European Bank for Reconstruction and Development (EBRD).

There is an increasingly wider range of companies looking at London to issue Indian rupee denominated debt securities, and a steadily growing pool of international capital to absorb a higher level of masala bond issuance.

Taxability:

Interest:

As per section 194 LC of Income Tax Act, where any interest in respect of amount borrowed by a specified company or a business trust from a source outside India by way of issue of rupee denominated bond before the 1st day of July, 2020 is payable to a non-resident, the person responsible for making the payment, shall at the time of credit of such income to the account of the payee, deduct the income-tax thereon at the concessional rate of 5%.

Where the non-resident does not have a PAN number, tax shall be deducted at the rate of 20% (Section 206AA). However, Rule 37BC relaxes Section 206AA if the non-resident furnishes the following details or documents:

a) Name, e-mail Id, contact number
b) Address in the country or specified territory outside India of which the deductee is a resident
c) A certificate of his being resident in any country outside India from the Government of that country if the law of that country provides for issuance of such certificate
d) a certificate of his being resident in any country or specified territory outside India from the Government of that country or specified territory if the law of that country or specified territory provides for issuance of such certificate
e) Tax Identification Number of the deductee in the country of his residence and in case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country which he claims to be a resident.

Capital Gains:

As per section 47 (viiaa) of Income Tax Act, where there is a transfer of rupee denominated bonds of an Indian company between two non residents and where such transfer has taken place outside India, then any profits or gains arising from such transfer shall be regarded as exempted transfer and there shall be no capital gain on the same.

Key Milestones:

- **November 2014:** First INR denominated bond listed by International Finance Corporation in London to support infrastructure development in India. The Rs 10 billion 10-year masala bond is the longest-dated paper in the offshore rupee markets.
- **April 2015:** IFC issues a three-and-a-half year, 6.45% bond that raised Rs 16 billion – the largest ever rupee denominated bond issued outside India.
- **August 2015:** IFC issues in London the first INR Green Bond globally. The Rs 3.15billion proceeds were invested in Yes Bank's onshore green bond.
- **July 2016:** HDFC lists world's first offshore masala bond by Indian corporate on London Stock Exchange.
- **May 2019:** Listing of a masala bond from Kerala Infrastructure Investment Fund Board (KIIFB), the only state-government body from India to issue Rs.21.50 billion in rupee-denominated offshore bond.

Conclusion:

Rupee Denominated Bonds can be used by the eligible issuers to raise funds overseas without undergoing the risk of foreign fluctuations as it is borne by the foreign investors. These bonds pose as an attractive option for the foreign investors as the Indian economy is developing at a faster rate. For example, Kerala Infrastructure Investment Fund Board (KIIFB), a statutory body under the State Finance Department recently closed the masala bonds at yield of 9.72 per cent which is quite attractive for a foreign investor where they hardly get 1 – 2 % yield in their domestic country. Higher yield acts as a win - win situation for foreign investor as well as the Indian borrower as borrower gets access to continuous supply of capital and foreign investor gets attractive yield.