

# Taxation of InvITs: Navigating the Structured Path to Investor Returns

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*"Taxes are the price we pay for a civilised society,"* said Oliver Wendell Holmes.

Yet in the financial marketplace, taxation is more than a civic duty - it takes the form of a finely woven tapestry of rules, reliefs, and responsibilities. While this tapestry can consequently often be linked to a maze, for investors in Infrastructure Investment Trusts (InvITs), it is more in the form of a highway - structured and predictable, constructed with clarity for those who seek steady income from India's roads, grids and public works.

Understanding these tax provisions is not just a matter of compliance, but a tool to empower you to invest and hold your InvIT units with confidence and optimism.

## 1. The InvIT Structure: Where the Story Begins

An InvIT is a trust that owns infrastructure assets, often through Special Purpose Vehicles (SPVs). These SPVs earn income from their operations (power generation, toll collection, telecom infra, etc), which then flow upward to the InvIT in the form of interest, dividends or loan repayment, and finally into the hands (and accounts) of its unitholders, i.e., investors.

From a tax perspective, primarily three streams of cash flow into the InvIT and will then flow into your hands:

- 1. Interest Income** - Paid by SPVs on the borrowings from the InvIT.
- 2. Dividend Income** - Paid when the SPVs declare dividends.
- 3. Return of Capital / Other Income** - Sometimes called "residual income," this is essentially repayment by the SPVs of the borrowings from the InvIT.

Each stream has its tax flavour, and the law has taken care to spell out exactly how each is treated in your hands and the hands of the InvIT. Notably, the law specifically provides that any income distributed by an InvIT to its unitholders shall be deemed to be of the same nature and in the same proportion in the hands of the unitholder as it had been received by, or accrued to, the InvIT.

## 2. Taxation in the Hands of the Investor

The Income-tax Act, 1961, specifically section 115UA and section 194LBA, govern how InvIT distributions are taxed and how tax is deducted at source (TDS). Let us explore this further by investor category.

## A. Resident Individual Unitholders

- **Interest** – Taxed at your slab rate, but the InvIT must deduct TDS at 10% before paying you.
- **Dividend** – If the SPV has *not* opted for the concessional corporate tax regime under section 115BAA, the dividend is fully exempt in your hands. If it has opted for 115BAA, the dividend is taxable and subject to 10% TDS.
- **Return of Capital** – Not taxable immediately, but it reduces your cost of acquisition. Capital returned in excess of your cost of acquisition gets taxed as Income from Other sources, while you pay capital gains tax only when you sell your units.

*Key conditions:*

If you have not provided your PAN, TDS jumps to 20% under section 206AA.

## B. Resident Non-Individual Unitholders (Mutual Funds, AIFs, Institutions)

- Mutual funds (u/s 10(23D)) and certain AIFs (u/s 10(23FBA)) are exempt from TDS if they furnish proof of their eligibility.
- Some statutory corporations and notified entities may also enjoy an exemption upon providing the requisite documentation.
- Otherwise, TDS rules mirror those for individuals.

## C. Non-Resident Unitholders

- **Interest** – 5% TDS plus surcharge and cess (effective rate varies with income level and investor type).
- **Dividend** – 10% TDS plus surcharge and cess if SPV has opted for s.115BAA; exempt otherwise.
- **Return of Capital** – Same as for residents, no immediate tax.

If PAN is not given, TDS rises to 20% unless relief is available under Rule 37BC (by giving prescribed details without a PAN).

Double Taxation Avoidance Agreements (DTAA) may offer even lower rates, but in most cases, the 5% on interest is already the most beneficial.

## 3. The Return of Capital - The Silent Stream

An exquisite feature of InvITs is the return of capital component in distributions. This is not income in the hands of the InvIT, being repayment of the funds lent to the SPV. Originally, being a debt repayment rather than an income, it was never taxed; however, the Finance Act 2023 amended the position to provide that such an amount would not be taxed in the year of receipt; instead, your cost of acquisition is adjusted downward, subtly increasing the capital gains when you eventually sell.

Further, any such amount distributed to unitholders which cumulatively exceeds their cost of acquisition would be taxed as Income from Other Sources in their hands.

## 4. Capital Gains on Sale of Units

When you sell your InvIT units on the stock exchange:

- **Short-term capital gains (STCG)** - If held  $\leq$  12 months, taxed at 20% (u/s 111A) if sold on an exchange with STT paid.
- **Long-term capital gains (LTCG)** - If held  $>$  12 months, taxed at **12.5% on gains** exceeding ₹1.25 lakh (u/s 112A).

For off-market sales, different rules may apply.

## 5. Snapshot of Tax Implications

Nature of Income	In the Hands of InvIT	In the hands of Unitholders
Interest from SPVs	Exempt	Taxable
Dividend from SPVs (old regime)	Exempt	Exempt
Dividend from SPVs (s.115BAA)	Exempt	Taxable
Return of Capital	Not taxable	Taxed on the amount exceeding CoA
Treasury income	Taxable	Exempt

## 6. The Role of TDS - The Gatekeeper Ensuring Compliance

InvITs are obligated to withhold tax before distributing income. The rates differ based on:

- **Type of income** (interest, dividend)
- **Investor's residential status** (resident, non-resident)
- **Corporate tax choices of SPVs** (115BAA or not)
- **Documentation furnished** (PAN, lower TDS certificates, exemption proofs)

As mentioned earlier, TDS rates for residents would generally be 10%, while those for non-residents would be 5% (plus applicable surcharge & cess).

In many ways, the TDS mechanism acts as a gatekeeper - the fair and transparent system helps the government get its share at the time of income generation itself, acts as a tool for monitoring and ensuring compliance and ensures appropriate credit for the amount to you, the investor, when filing your return.

## 7. The Philosophy of InvIT Taxation

The taxation regime for InvITs in India is designed to preserve their pass-through nature while protecting the exchequer's interests. It strikes a balance: encouraging investment in infrastructure by avoiding multiple layers of tax, providing certainty to investors as well as the InvIT and ensuring collection at source for ease of compliance.

It is like the ancient irrigation systems-allowing water (income) to flow freely from the source (SPVs) to the fields (investors), while channelling a measured share into the community's reservoir (the treasury) - the InvIT playing the role of the farmer to ensure a good crop for all.

## 9. Investor Wisdom - The Final Word

Before you make your InvIT investment, remember:

- Keep your **PAN updated** with your depository.
- Submit exemption declarations if you qualify.
- Explore obtaining lower tax deduction certificates from the Income Tax department to avoid refund situations.
- For non-residents, explore **DTAA benefits** and furnish the required documentation.
- Understand that **return of capital** is not free income-it quietly shapes your future capital gains.

As Kahlil Gibran wrote, *"You give but little when you give of your possessions. It is when you give of yourself that you truly give."*

In the same way, the InvIT gives you more than returns-it offers you a stake in the nation's infrastructure growth story, an opportunity to both contribute to the country's development as well as reap the benefits. With knowledge as your compass, you can navigate the streams of InvIT income-interest, dividends, and return of capital-with absolute confidence in and understanding of each rupee arriving at your doorstep.