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INDIAN REITs - Recent Policy Developments

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Background

A Real Estate Investment Trust ("**REIT**") is like mutual funds where the money from investors is pooled and then invested in pre-defined sectors with a pre-determined objective. In case of REITs, there involves pooling of money/ funds from investors (where investors get units in the REIT in lieu of their investment in the REIT) where the monies would be used solely for investing in revenue/ rent generating real estate properties and other permissible areas. The returns earned by the REIT would be then distributed to the investors in proportion to the units held by them.

REITs typically make investments in office complexes, information technology parks, large malls, hotels, resorts, hospitals and residential complexes that have apartments on rent or lease.

Globally, the concept of REIT is very well established especially in countries like United States of America, Australia, Singapore etc.. The concept of REIT in India was discussed for quite sometime, however due to uncertainty on tax implications, unclear exchange control laws etc., REIT never quite took off in India. Also, possibly because the market players were apprehensive about the

prospects of REITs. Apprehensive investors, due to such uncertainties, approached jurisdictions where REIT was functioning successfully. For instance, players from India, like IndiaBulls, have already setup property trusts in Singapore.

In India the concept of REIT has only recently received regulatory backing with SEBI enacting the SEBI (Real Estate Investment Trusts) Regulations, 2014 ("**REIT Regulations**"), tax incentives being sanctioned and the opening up of REITs for foreign investments.

As witnessed elsewhere, the introduction of REITs has made the real estate sector more transparent and accountable. REIT stands to benefit both the investor as well as the real estate industry as on one hand, the real estate players can avail easy funding (as opposed to the difficulty in raising funds from banks) and on the other hand, the investors run lesser risks as majority of investment by investors get utilized for income generating projects rather than under-construction projects, which always bear the inherent risk of incompletion or delay in completion.

Raising funds by REIT

In terms of the REIT Regulations, REITs are permitted to raise funds through an initial offer (which is required to be a public issue) and subsequently funds can be raised by way of follow-on offers, preferential allotments, qualified institutional placements, rights issues, bonus issues, offers for sale or any other mechanism, in the manner as may be specified by SEBI.

Investment Conditions for REITS

REITs are permitted to make investment in completed revenue generating properties as well as under construction properties subject to such terms and conditions as are provided under the REIT Regulations. REIT can make investments, either directly or through special purpose vehicles (SPVs) which invest more than 80% of its assets in properties.

If REIT is investing through an SPV, REIT has to hold controlling interest with not less than 50% of the equity share capital or interest in such SPV.

Taxation of REITs in India

Capital Gains earned by REIT are taxable as per applicable provisions of capital gains. Exemption for unitholders for long term capital gains in relation to the sale of units on recognised stock exchange subject to the payment of STT on sale of such units and the short term capital gains will be taxed @15% in addition to applicable surcharge/ cess.

Interest income is exempt for REIT, but is taxable in the hands of unitholders.

REITs are exempt from earnings from renting or leasing or letting out any real estate asset owned directly by REIT. Such income is taxed in the hands of the unitholders. There is no tax on the rent paid to the REITs, however tax is required to be withheld at applicable rates before distribution is made to unitholders.

The Finance Act, 2015 provides relief to Sponsors from MAT in respect of gains arising on transfer of a capital asset, being share of a SPV to a business trust in exchange of units allotted by that trust. However, clarity is required with respect to the taxation of dividend distributed by the SPV to the REIT as well as applicability of MAT on the income of the SPV.

REITs can now have access to funds from abroad

RBI (through its notification dated November 16, 2015), has subject to terms and conditions, permitted foreign investment under the automatic route in certain 'Investment Vehicles'. Investment Vehicles are to mean entities registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose and include REITs, Infrastructure Investment Trusts (InvITs) governed by SEBI (InvITs) Regulations, 2014 and Alternative Investment Funds (AIFs) governed by the SEBI (AIFs) Regulations, 2012.

Further, RBI (Circular dated September 29, 2015) has permitted REITs to issue plain vanilla Rupee denominated bonds either privately placed or listed on exchanges as per the host country regulations.

REITs in Singapore

Singapore has been one of the early adopters of developing the REITs market which has been quite successful and has encouraged developing economies to model their REITs on lines of Singapore Real Estate Investment Trusts ("**S-REITs**"). S-REITs are regulated by MAS-Code of Collective Investment Schemes and Securities and Futures Act, 2001 and the regulatory regime surrounding

REITs established in 1999. S-REITs are restricted to property funds that are structured and regulated as collective investment schemes. Section 286 of the Securities and Futures Act, 2001, requires the collective investment scheme investing primarily in real estate and real estate-related assets to be in form of a trust and listed. Presently, there are more than 25 REITS listed on the Singapore Stock Exchange. The first S-REIT (Capitamall Trust) was launched and listed on the Singapore Stock Exchange in July 2002.

Singapore, as a destination for REITs has developed significantly *inter alia* due to wider scope of investible assets and the fact that it permits investment in real estate assets situated outside Singapore.

Summary

For any new concept to evolve, it requires certain encouragement, relaxations and basically a liberal environment, so that the seed sown blooms into a beautiful flower. The recently granted tax reliefs, REIT Regulations (including provision for listing of units of REITs) and opening of REIT for foreign investments, should only provide an impetus for the development of REITs in India. It may be argued that certain relaxations are further desired on DDT, MAT and on stamp duty implications so as to provide the required fillip for the development of REIT in India, which hopefully will be addressed in the forthcoming budget.

As has been recently reported in the media, a joint report by Real estate consultant Cushman & Wakefield and PHD Chamber of Commerce and Industry, rental income potential of Grade A office space stock in eight major cities in India is estimated at nearly $8 billion by 2019 which can be tapped by REITs.

As far as Singapore is concerned, the market there has already evolved and matured (due to various benefits with respect to tax, stamp duty etc.) to such an extent that it is now a model for other emerging economies. It can be understood that certain reliefs such as the stamp duty concessions no longer

exist in Singapore since it was believed that the REITs market there has been credibly developed.

In India, the ecosystem for REIT has now been made almost as conducive as established REIT systems elsewhere. In light of the new reforms there does not seem to be much of a difference between the REITs environment in India and that one that exists in developed economies such as Singapore. Thus, it can be positively expected that India will become a hub for REITs market and entities will be encouraged to have REITs set up in India, may be even in preference to the developed avenues such as Singapore.

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