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Taxation Reforms under Finance Bill, 2016 for REITs and InvITs

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INTRODUCTION

In our earlier Concept Note on Infrastructure Investment Trusts ("**InvITs**") (*updated until February 12, 2016*) and Concept Note on Real Estate Investment Trusts ("**REITs**") (*updated until September 2014*) along with a Short Note on the policy developments with respect to REITs in India vis-a-vis Singapore REITs (*updated until February 20, 2016*), we had, from time to time, covered the regulatory framework (including tax aspects) pertaining to InvITs and REITs.

BACKGROUND

As per the existing taxation regime applicable to these InvITs and REITs (collectively, the "***Business Trusts***"), the following tax incentives *inter-alia* are already provided to Business Trusts:

1. Capital gains in the hands of the Sponsor can be deferred when the Sponsor exchanges the shares of the special purpose vehicles (SPVs), which holds the assets, with the units of the Business Trust. Such gains by Sponsor will only be taxed at the time of any actual sale of units by Sponsor at the later stage.

2. Unit holders were exempt from long term capital gains in relation to the sale of units on recognised stock exchange subject to the payment of securities transaction tax 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 a Business Trust, but is taxable in the hands of unit holders.

3. The Finance Act, 2015 also provided exemption to Sponsors from minimum alternate tax (MAT) in respect to gains arising on transfer of a capital asset, being share of a special purpose vehicle to a Business Trust in exchange of units allotted by that Business Trust.

However, one of the areas which required clarity is regarding applicability of dividend distribution tax (DDT) on the distribution of dividends by SPVs.

BUDGET 2016

The Budget 2016 was presented by the Union Finance Minister on February 29, 2016 wherein the Finance Bill, 2016 ("Finance Bill") was tabled in the Parliament and inter-alia certain changes were proposed in the taxation regime applicable to InvITs and REITs.

The recent Finance Bill *inter-alia*, enumerates the following further much needed exemptions in relation to Business Trusts:

1. The Finance Bill amended the relevant provisions[1] of the Income Tax Act, 1961 (the "***Act***") to provide that no tax shall be chargeable in respect of any dividend declared, distributed or paid by 'specified domestic company' by way of dividends (*whether interim or otherwise*) to the Business Trusts out of its current income on or after the specified date. However, this shall only apply in respect of any dividends declared, distributed or paid by such 'specified domestic company' (*whether interim or otherwise*) out of its accumulated profits and current profits after the specified date. 'Specified domestic companies' have been defined to mean domestic companies in which a Business Trust holds the whole of nominal value of the equity share capital of such company (*cases where some portion of the equity share capital are required to be mandatorily held by any other person*

1. Section 115 – O of the Act was amended to include a new subsection - Sub-section (7) to Section 115 – O of the Act.

in accordance with laws, or direction of the Government have been exempted from this). Specified date is the date of acquisition by the Business Trust of such holding as set out hereinabove.

2. The Finance Bill also amended the relevant provisions[2] of the Act to provide that (a) any income of a Business Trust by way of interest received or receivable from an SPV or the dividend referred to in Section 115 – O (7) shall not be included in the total income of such Business Trust; (b) any distributed income from a Business Trust received by a unit holder which is of the same nature as dividend referred to in Section 115 – O (7) shall not be included in the total income of such unit holder.

A snapshot of the key exemptions provided in this Finance Bill is set out below:

(a) exemption from levy of DDT in respect of distributions made by SPV to the Business Trust;

(b) such dividend received by the business trust and its investor shall not be taxable in the hands of trust or investors;

(c) the exemption from levy of DDT would only be in the cases where the Business Trust either holds 100% of the share capital of the SPV or holds all of the share capital other than that which is required to be held by any other entity as part of any direction of any Government or specific requirement of any law to this effect or which is held by Government or Government bodies; and

(d) the exemption from the levy of DDT would only be in respect of dividends paid out of current income after the date when the Business Trust acquires the shareholding referred in (c) above in the SPV. The dividends paid out of accumulated and current profits upto this date shall be liable for levy of DDT as and when any dividend out of these profits is distributed by the company either to the Business Trust or any other shareholders.

While a 'special purpose vehicle' is defined under relevant SEBI Regulations[3] to inter-alia mean an company or LLP in which the REIT or InvIT holds or proposes to hold controlling interest and not less than fifty percent (50%) of the equity share capital or interest, however, to claim any exemption under the Finance Bill for DDT has been provided only to SPVs in which the Business Trust holds the entire nominal value of equity share capital. This may restrict the exemption granted to only those SPVs where the entire shareholding is held by the Business Trust as opposed to SPVs as per the definition in the aforesaid relevant SEBI Regulations.

2. Clauses 23FC and 23FD of Section 10 of the Act; Section 115UA of the Act.

3. Regulation 2(zy) of the SEBI (InvIT) Regulations, 2014 and Regulation 2(zs) of the SEBI (REIT) Regulations, 2014.

CONCLUSION

The Union Finance Minister while addressing the Parliament while presenting the Budget 2016 noted that the International Monetary Fund has hailed India as a 'bright spot' amidst a slowing global economy and that the World Economic Forum has said that India's growth is 'extraordinarily high'.

In light of the exemptions provided under this Finance Bill it can now be expected that the industry players will be encouraged to set up REITs / INVITs soon and which shall in turn place India as a hub for REITs / InvITs market and the real estate industry and the infrastructure industry will be encouraged to have these Business Trusts set up in India as opposed to approaching other jurisdictions.

We, at Rajani Associates, are currently advising certain entities in setting up of their REITs/InvITs in India. We have extensive expertise in advising companies in real estate and infrastructure sectors. We will be glad to assist the entities in setting up, registration and listing of units of REITs/InvITs.

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