

Real Estate Investment Trusts.... The New Investment Vehicle

The real estate sector has witnessed a rapid economic growth in the recent years and has been at the forefront of the Government's agenda. The growing scale of operations of the corporate sector has increased the demand for commercial buildings and space including modern offices, warehouses, shopping centers, conference centers, etc which propels with it a need to have investment vehicles such as Real Estate Investment Trusts ("REITs").

What are REITs?

REIT is an "Investment Vehicle" which holds & manages large "Commercial Rent-Earning Properties" on behalf of investors and distributes most of its profit as dividends. A REIT stock is similar to any other stock that represents ownership in an operating business & is listed & freely traded on stock exchanges.

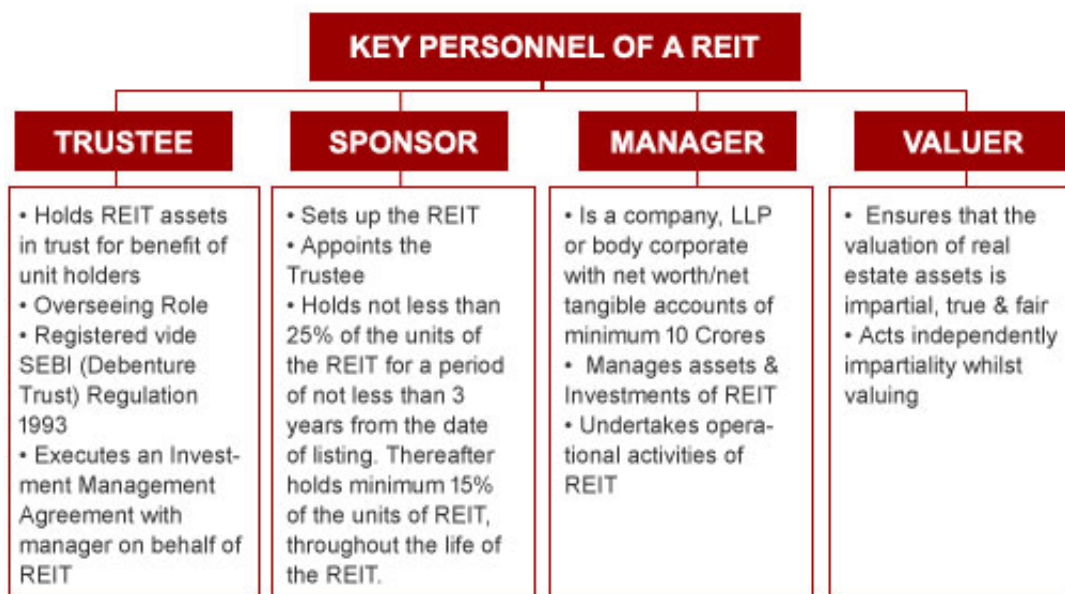
REITs were introduced in the US during the mid-1960s as a means of providing small investors the opportunity to participate in the benefits of ownership of large scale commercial real estate or mortgage lending. As REITs gained popularity, several other countries i.e. Canada, Australia, Hong Kong, Singapore, France followed suit. Over the years REITs have demonstrated the ability to attract and effectively manage investments in the real estate sector globally.

In India, the Securities and Exchange Bank of India ("SEBI") introduced the draft REITs regulations in December, 2007 to encourage and facilitate a healthy growth of REITs in India. However, these regulations could not be finalized for various reasons and hence SEBI reintroduced the Draft REITs Regulations, 2013, which were made public on 10th October 2013 for inviting stakeholders views. These Regulations are pragmatic and take into account most of the concerns of stakeholders and contain many positive features.

LEGAL FRAMEWORK

A brief snippet of the Regulations are detailed below:

1. **Registration and Structure of a REIT** : REITs are required to set up a "Trust" as per the provisions of the Indian Trust Act, 1882 & registered with SEBI. The key personnel of a REIT would involve a Trustee, Sponsor Manager & Valuer. The income bearing assets would be held by the trust or either directly by acquiring control or other specific interest in an Indian Company (SPV) from the sponsor



2. **Raising of funds and listing of securities of REIT** : Initial funds are through an offer and it is mandatory for all REITs to list all its units on the exchanges and continue its units to be listed on the exchange unless delisted under the Regulations. The minimum initial offer size & minimum public float is Rs. 250 crore and 25%. The minimum subscription size for both initial offer and follow-on public offer is INR 2 lakhs.
3. **Investment Conditions and Distribution Policy**: SEBI has imposed several conditions and a few significant ones are enumerated below:
 - i. Minimum 80 % of the value of the REIT assets is required to be invested in completed revenue generating properties;
 - ii. REITs to distribute at least 90% of the net distributable income after tax of the REIT to the investors;
 - iii. REIT shall invest only in assets based in India no investment permitted in vacant land or agricultural land or mortgages other than mortgage backed securities;
 - iv. Aggregate consolidated borrowings and deferred payments of the REIT shall never exceed 50% of the value of the REIT assets. In the event aggregate consolidated borrowings and deferred payments of the REIT exceed 25% of the value of the REIT assets, for any further borrowing the Credit rating shall be obtained from a credit rating agency registered with SEBI and the Approval of unit holders is required to be obtained;
 - v. Not less than seventy five per cent. of value of the REIT assets proportionately on a consolidated basis shall be rent generating;
 - vi. REIT cant invest in units of another REIT;
 - vii. No schemes shall be launched under the REIT;
 - viii. Investment by a REIT shall only be in SPVs or properties or securities or TDR in India;
4. **Valuation of assets** : As REIT thrives on the Real Estate Assets the valuation of REIT becomes of significant importance. The valuation is to be done by the Valuer of all the assets including physical inspection of every property. A full valuation shall be conducted by the valuer once in every year followed by a full valuation report. In addition to the yearly report, a half yearly valuation of the real estate assets shall be conducted by the valuer not less than once every 6 months for incorporating any key changes in the past 6 months.

Tax Incentive under the Budget 2014-15

SEBI came out with the draft regulations in December, 2013 & Tax clarification followed. The budget 2014-15 gave special benefits of tax on the Unit Holder, Trusts and Sponsors which is detailed in the table below and will take effect from 1st October, 2014.

Incidence of Tax:

Sr. No.	TAX IMPACT	UNIT HOLDER	SPONSOR	REIT
1	Dividend	<ul style="list-style-type: none"> • Exempt • Withholding tax at the rate of 10% • Non-Resident holders withholding tax at the rate of 5% 	N/A	Exempt
2	Capital Gains	<ul style="list-style-type: none"> • LTCG : Exempt • STCG: Taxable at the rate of 15% 	Deferred tax liability at the time of disposal of units	N/A
3	Securities Transaction Tax	Applicable	N/A	Applicable

CONCLUSION

The REIT regulations which are largely in line with global REIT regimes take into view the interests of various stakeholders and can help bring the much needed investments for meeting the increasing demand for quality Real Estate in India. Whilst, we await clarification from the Reserve Bank of India on the permissibility of foreign investments in REITs and clarifications from the Revenue authorities on the tax and stamp duty treatment for the REIT regime, to bring certainty in the minds of various stakeholders, the Regulation is no doubt a welcome step as it will provide a fillip to the sentiment in the Indian real estate sector.

Written by :

Ashu Thakur
Proprietor

Urvi Patel
Associate

AT INDIA - LEGAL SNAPSHOTS

Norms eased for FDI in construction :

The Union Cabinet on 29th October, 2014 permitted up to 100% FDI under the automatic route for 'Construction Development Sector'. According to the revised policy no minimum land area requirement for serviced plots is required and the minimum floor area is reduced to 20,000 sq mt from the earlier 50,000 sq mt. It also brought down the minimum capital requirement to USD 5 million from USD 10 million. In case of development of serviced plots, the condition of minimum land of 10 hectares has been completely removed. Also foreign investors are now permitted to exit on project completion or 3 years from the date of final investment subject to the development of trunk infrastructure.

Government relaxes FDI cap in Railways :

The Government vide its circular dated 27th August, 2014 notified 100% FDI for rail infrastructure, through the automatic route. The policy for private investment in rail infrastructure has been amended to allow FDI in the railway transport sector including for construction, operation and maintenance of high-speed train projects, suburban corridor projects through PPP, dedicated freight lines, rolling stock including train sets, locomotives manufacturing and maintenance facilities, railway electrification and signaling systems, freight terminals and passenger terminals, infrastructure in industrial park pertaining to railway line, and mass rapid transport systems.

FDI in defense increased to 49% :

The Ministry of Commerce and the Department of Industrial Policy & Promotion (DIPP) on 26th August, 2014 cleared and increased the FDI limit in defense through the Government route up to 49% from the earlier 26%. FDI above 49% would require the approval of the Cabinet Committee on Security on case to case basis, wherever it is likely to result in access to modern and 'state-of-art' technology in the country. The cap is composite and includes different types of foreign investments i.e. FDI, Foreign Institutional Investors, Foreign Portfolio Investors, Non-Resident Indians, Foreign Venture Capital Investors and Qualified Foreign Investors. The applicant company seeking permission of the government for FDI up to 49% should be an Indian Company owned and controlled by resident Indian citizens and the management of the Applicant Company should be in Indian hands with majority representation on the Board as well as the Chief Executives of the company/partnership firm being resident Indians. Further proposals seeking Government approval for foreign investment beyond 49%, the applicant should be an Indian company/foreign investor.

SEBI notifies the revised Employee Stock Option Plan Regulations :

SEBI notified the SEBI (Share Based Employee Benefits) Regulations, 2014 on the 28th of October

2014. These Regulations have been implemented for regulating all schemes introduced by companies for the benefit of their employees, involving dealing in shares (directly or indirectly) which are listed on a recognized stock exchange in India. The New Regulations cover the following new additional employee benefit schemes (i) Stock Appreciation Rights Scheme (ii) General Employee Benefits Scheme (iii) Retirement Benefit Scheme. The earlier SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 (ESOP Guidelines) is repealed with certain exceptions.

SEBI tightens the Insider Trading norms

The Securities and Exchange Board of India has in its meeting held on 19th November, 2014 reconditioned the 'Prohibition of Insider Trading' regulations with more stringent measures and aligning its norms with international practices. These New Rules, based on Justice Sodhi Committee report, would replace the SEBI (Prohibition of Insider Trading) Regulations 1992. The definition of 'insider' has been made wider by including persons connected on the basis of being in any contractual, fiduciary or employment relationship that allows such person access to unpublished price sensitive information (UPSI). The directors, employees and all other persons in the deeming category covered under 1992 regulations would continue to be covered. The term 'Insider' will also include a person who is in possession or has access to UPSI. Further immediate relatives will be presumed to be connected persons, with a right to rebut the presumption

Amendments in SEBI (Foreign Venture Capital Investors) Regulations, 2000

The FVCI Regulations did not allow investments in NBFCs and Hire Purchase Companies except in Equipment Leasing. On 19th November, 2014 the Board approved amendments in FVCI Regulations to allow FVCIs to invest in NBFC-CIC (Core Investment Companies), as defined by RBI.

Tighter Norms for NBFCs to lend against shares

The RBI has vide its circular dated 21st August, 2014 (RBI/2014-15/186 DNBS (PD). CC.No.408/03.10.001/2014-15) prescribed tighter norms for non-banking financial companies (NBFCs) to lend against shares, mainly for the purpose of tackling volatility in the capital market due to offloading of shares by NBFCs. Under the new rules, financial companies will have to maintain a loan-to-value (LTV) ratio of 50% in loans given against shares. Presently finance companies can accept only group I securities as collateral for loans of value more than Rs 5 lakh. NBFCs with asset size of Rs 100 crore and above will have to report on-line to stock exchanges, information about shares pledged in their favor, by borrowers for availing loans.

Revision of Monetary Limits for filing of Appeals before the Income Tax Appellate Tribunal, High Courts and Supreme Court

The Central Board of Direct Taxes, the primary regulatory body for Tax matters has revised monetary limits & conditions for filling departmental appeals (in Income Tax matters) before Appellate Tribunal, High Court and Supreme Court the revised Limits are detailed as under :

Sr. No.	Appeals in Income-Tax matters	Monetary Limit (in INR)
1	Before Appellate Tribunal	4,00,000/-
2	U/s 260 A before High Court	10,00,000/-
3	Before Supreme Court	25,00,000/-

It is clarified that an appeal should not be filed merely because the tax effect in a case exceeds the monetary limit prescribed and that filing of appeal in such cases is to be decided on merits of the case. The proposal for filing Special Leave Petition under Article 136 of the Constitution before the Supreme Court should in all cases shall be sent to the Directorate of Income-Tax (Legal & Research), New Delhi & the decision to file Special Leave Petition shall be in consultation with the Ministry of Law & Justice.

Residents and Non-Residents can now carry upto Rupees 25k abroad

The Reserve Bank of India has with a view to facilitating travel requirements of residents traveling abroad as well as non-residents visiting India, permitted any person resident in India to take outside India (other than to Nepal and Bhutan) Indian currency notes up to an amount not exceeding Rs 25,000/- (Rupees Twenty-Five Thousand only) as against Rs. 10,000/- (Rupees Ten Thousand only). Further resident Indians who had gone out of India on a temporary visit, may bring into India at the time of their return from any place outside India (other than from Nepal and Bhutan), Indian currency notes up to an amount not exceeding Rs.25,000/-(Rupees Twenty-Five Thousand only).

ATA INDIA - Advocates & Solicitors

Ashu Thakur & Associates
Advocates & Solicitors,
506 Gundecha Chambers, 5th floor,
Nagindas Master Road, Mumbai - 400 023.
Phone Nos. : +(91)(22) 2261 7120, +(91)(22) 2261 7214.
Mobile : +91 9820549603.
Email: ashu@ataindia.co.in

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