Introduction

The Securities and Exchange Board of India (SEBI) has notified the SEBI (Real Estate Investment Trusts) Regulations, 2014 (REIT Regulations) and the SEBI (Infrastructure Investment Trusts) Regulations, 2014 (InVIT Regulations) (collectively the Regulations) on 26 September 2014. The Regulations seek to provide a specialised regulatory framework for the establishment and operation of REITs and InVITs in India.

The Regulations contain certain key differences from the draft regulations incorporating certain concerns raised by industry players during the consultation process. Coupled with clarity on taxation introduced in the last budget announcement, the Regulations provide a comprehensive framework for REITs and InVITs to be developed as viable investment products in India.

Background

Globally, REITs have been key drivers for development of the real estate sector, by providing a platform to retail and institutional investors to invest in real estate properties, offering the benefits of a regulated structure and risk diversification. The prospect of acquiring an interest in completed and yield generating real estate assets with the option to obtain a regular flow of income from REITs, makes them a popular investment option among investors.

Over the last few years, various countries, including many developed countries, like the United Kingdom (UK), Singapore, Australia, Japan, Hong Kong, South Korea and Malaysia have introduced REIT regimes. However, a separate regime for InVITs is a relative novelty on the global stage and keeping in mind the unique landscape prevalent in India with respect to infrastructure projects, SEBI has come out with a specific regime for InVITs.

Below are a few advantages of using the investment trust approach for real estate / infrastructure investments:

- **Liquidity**

  REITs / InVITs are to be structured as listed platforms where units may be bought and sold on a stock exchange. By contrast, buying and selling property or infrastructure assets directly involves higher expenses and requires a great deal of effort. REITs and InVITs will help package less liquid assets into liquid listed securities and would also help developers leverage on completed rent / revenue generating assets by transferring them to a trust structure and helping them redeploy their capital into their core business.

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1 REIT Regulations follow the draft REIT Regulations (Draft REIT Regulations) published in October 2013
2 InVIT Regulations follow the draft InVIT Regulations (Draft InVIT Regulations) published in August 2014
Diversification

Adding REITs / InVITs to a diversified investment portfolio may increase returns and reduce risks to investors since REITs / InVITs may have little correlation with stock market indices. It provides income stability and capital growth for investors.

Depth in Capital Markets

REITs / InVITs will create a healthy secondary market for real estate and infrastructure assets and provide an additional asset class for investors apart from traditional securities.

Stability

REITs are expected to be long term investments in specific properties and hence may act as a stabilising factor in real estate markets.

Development: The onset of the REITs and InVITs regime will see quality standards being set in the terms of acceptable levels of investment grade assets and will enhance the level of professional asset management. There will also be a high level of transparency, corporate governance and financial discipline in maintaining and managing trust assets, thereby ensuring world class infrastructure. Increased capital flow into the sectors through REITs and InVITs may also help in increased development activity.

Transparency: REITs / InVITs are expected to provide operational transparency, since they are registered and regulated by SEBI and are required to adhere to high standards of corporate governance, financial reporting and information disclosure.

REITs and InVITs in India: Structure

The Regulations provide a fairly detailed legal structure for REITs and InVITs to be adopted in India.

Figure 1: REIT / InVIT Structure

A typical REIT / InVIT structure and the parties involved are depicted in the following diagram.

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Salient Features Of The Regulations

The Regulations envisage REITs and InVITs to be set up as ‘trusts’ under the provisions of the Indian Trusts Act, 1882, which would raise funds through an initial public offer in the case of REITs and initial public officer or private placement in the case of InVITs and be listed on the stock exchanges.

Eligibility Criteria for Registration of a REIT / InVIT

Any person who wishes to carry on the activities of a REIT or an InVIT would have to obtain appropriate registration from SEBI. The application has to be made in a format to be prescribed by SEBI, along with the prescribed fee.footnote

footnote: At the time of filing the application for registration as a REIT with SEBI, an applicant is required to pay a non-refundable application fee of INR 1 lakh. On the grant of the registration by SEBI, a REIT is further required to pay a non-refundable registration fee of INR 10 lakhs.
The Regulations provide that SEBI may consider any matter which it deems relevant to the activities of a REIT or an InVIT, while deciding on the registration application of an applicant. The Regulations also lay down a list of illustrative factors that SEBI would consider while granting registration to an applicant. These include:

a) **Nature of Entity**

A REIT or an InVIT has to be set-up as a trust with a registered trust deed under the provisions of the Registration Act, 1908.

b) **Net Worth of the Sponsor and the Manager**

The Sponsor of the REIT is expected to have net worth of at least INR 100 crore (in case of multiple Sponsors, each Sponsor needs a minimum net worth of INR 20 crore) and the Sponsor of an InVIT is expected to have a net worth of at least INR 100 crore. The Manager of both a REIT or an InVIT is expected to have a net worth of at least INR 10 crore.

c) **Experience of Parties to the REIT**

The Sponsor, the Manager, and at least 2 key personnel of the Manager are required to have not less than 5 years’ experience in fund management / advisory services / property management in the real estate industry or infrastructure industry. In case of an InVIT, the Manager is further required to have at least one employee with experience in the relevant sub-sector. Sponsors who are developers are further required to have completed at least 2 projects. The experience requirement for the Manager of a REIT can be met by an associate of the Manager.

d) **Qualification of Trustee**

A Trustee to a REIT is required to be registered with SEBI under the SEBI (Debenture Trustees) Regulations, 1993 and is required to not be an associate of the Manager or the Sponsor.

e) ‘**Fit and Proper Test**’:

The applicant and the Parties to the REIT need to be ‘fit and proper’ persons under the SEBI (Intermediaries) Regulations, 2008 and would also need to confirm that they have not been subject to any disciplinary action by SEBI in the past.

**Khaitan Comment**

The Regulations have imposed onerous entry barriers on prospective sponsors by providing for a minimum net worth of INR 100 crore and the requirement of 2 projects having been completed. However, a major change from the Draft REIT Regulations is the provision allowing a REIT to have multiple sponsors. Further, from the perspective of REITs, a relaxation has been provided as the minimum net worth requirement can be met by the sponsors on a collective basis. This should help some of the smaller developers access the REIT market and also enable professional asset managers to manage REITs. Additionally, the provision in respect of experience / track record of associates of the manager in the case of REITs shall also assist in professional asset managers being able to set up new entities to act as managers to REITs.

**Key Parties - Rights and Responsibilities**

SEBI has also prescribed a list of parties to the REIT and an InVIT in the Regulations and has listed down their rights, obligations and responsibilities.

The rights and responsibilities of the Parties to the REIT or an InVIT are as follows:

I. **Trustee**

The Regulations impose a high degree of fiduciary responsibility and duty on a Trustee of a REIT or an InVIT. Some of these duties include:

a) **Appointment and Removal of the Manager**
It is the Trustee who enters into the investment management agreement with the Manager on behalf of a REIT or an InVIT. The Trustee is also required to supervise the process for appointment of a new Manager in the event that the existing Manager is removed by a super-majority vote of the unit holders. Further, in the event of a change in control of the Manager, the Trustee has the obligation of obtaining the consent of the unit holders of a super majority of the unit holders.

b) Supervision of the Manager

The Trustee also has the responsibility of ensuring that the Manager fulfils its obligations under the Regulations and makes timely payment of dividends to the unit holders. Further, the Trustee is also required to obtain a compliance certificate from the Manager on a quarterly basis, wherein the Manager would state/confirm its compliance with its responsibilities under the Regulations.

c) Review Conflicts

The Trustee has the obligation of reviewing all transactions carried out between the Investment Manager and its associates and obtain confirmation that the transactions are on an arm’s length basis.

d) Overall Supervision

The Trustee has the obligation to ensure that the REIT or the InVIT is operating in accordance with the provisions of the trust deed, the offer document and the Regulations. The Trustee also has a duty to inform SEBI, if they observe any action which is detrimental to the interests of the unit holders.

e) Investments by the Trustee

The Trustee is not allowed to invest in the units of the REIT or the InVIT.

Khaitan Comment

The obligations of a trustee have been inspired from the mutual fund regulations, with the trustee being envisaged as an independent body overseeing the functioning of the REIT or the InVIT as per the Regulations. Unlike the mutual fund regulations, the Trustee cannot be an associate of the Sponsor or the Manager. However, the onus of ensuring that the title of the assets of the REIT or the InVIT is valid has been shifted from the Trustee to the Manager as compared to the Draft REIT Regulations.

II. Manager

The Regulations entrust the Manager with the responsibility of handling the day to day affairs of the REIT or the InVIT and have imposed stringent compliance requirements on the Manager for safeguarding the interests of the unit holders. Some of the important obligations of the Manager include:

a) Separation of Activities

The Manager has to ensure that its activities as the Manager of the REIT or the InVIT are separate from its other activities.

b) Due Diligence on the assets

The Manager has the responsibility to ensure that the assets of the REIT or the InVIT have a legal and marketable title and that the material contracts entered into on behalf of the REIT or the InVIT are legal, valid, binding and enforceable.

c) Investments

The Manager has the primary responsibility of identifying and recommending appropriate investment opportunities for the trust and ensuring that the investments made by the trust are in accordance with the Regulations and the investment strategy of the trust. The Manager also has the responsibility to
manage the real estate assets of the REIT on completion of the investment.

d) **Appointment of key personnel**

The Manager has the responsibility of appointing the Valuer and auditor of the REIT and the InVIT, the registrar and transfer agent, the custodian and any other intermediary required for managing the affairs of the REIT or the InVIT in compliance with the Regulations. While making such appointment, the Manager is required to ensure that it has sufficient key personnel with adequate experience and qualification to undertake management of the REIT or the InVIT.

e) **Listing of the Trust**

In the process of listing of the trust, the Manager is responsible for:

(i) filing the offer documents with SEBI and the stock exchanges;

(ii) obtaining the in-principle approval from the recognised stock exchange(s) where the units are proposed to be listed; and

(iii) dealing with all matters relating to issue and listing of the units of the REIT / InVIT as specified under the Regulations.

f) **Reporting and Compliance**

The Manager has the primary responsibility of ensuring that the trust complies with all the disclosure and reporting obligations towards the SEBI, the stock exchanges, the Trustees and the unit holders, in the manner stipulated under the Regulations. In this regard, the Manager is required to designate an employee / director as the compliance officer of the REIT for monitoring compliance with the Regulations.

g) **Valuation and Audit**

The Manager also has the responsibility to:

(i) ensure that the Net Asset Value of the REIT / InVIT is calculated once every 6 months by the Valuer and declared to the stock exchanges; and

(ii) ensure that the accounts of the REIT / InVIT are audited by the auditor once every 6 months and submitted to the stock exchanges.

h) **Insurance**

The Manager has the responsibility to ensure that the assets of the REIT / InVIT have adequate insurance coverage.

i) **Grievance Redressal**

The Manager has the responsibility to ensure that the grievances of unit holders are addressed in an adequate and timely manner.

### III. Sponsor

The Sponsors are responsible for setting up of a REIT or an InVIT. The Regulations prescribe a minimum commitment by the Sponsors to the REIT by way of a continuing interest, as follows:

a) Hold at least 25% of the total units of the REIT or the InVIT prior to the initial offer on which the following lock-in shall apply:

(i) **Holding beyond 25%**

any holding beyond 25% shall be locked-in for a period of at least 1 year from the date of listing; or

(ii) **Up to 25%**
lock-in of at least 3 years from the date of listing.

b) The minimum Sponsor holding has been provided as 15% of the outstanding units of the REIT at all times and with each Sponsor individually holding a minimum of 5% of outstanding units at all times.

Further, subject to approval of the unit holders, a Sponsor may replace itself with another person/entity to be designated as the ‘Sponsor’ of the REIT after the completion of 3 years from the date of listing of the REIT, provided that the re-designated Sponsor holds not less than 15% of the outstanding units of the REIT at all times.

In case of any change in Sponsor or ‘change in control’ of a REIT, prior approval of not less than 60% of all the unit holders by value and by number other than the Sponsor, proposed re-designated Sponsor and their associates, would be required. If this approval is not received, the proposed re-designated Sponsor would have to provide all the unit holders with an option to exit by sale of their units to the proposed re-designated Sponsor.

Khaitan Comment

The REIT and InVIT Regulations do not provide clarity on whether a non-resident can be a Sponsor. Further, while the definitions of ‘Sponsor’ in the REIT Regulations refer to any person, the definition of a sponsor in the InVIT Regulations refers specifically to a company, a LLP or a body corporate. The intention of SEBI in providing for an expanded definition for ‘Sponsor’ in case of REITs is not clear and raises questions as to whether Alternative Investment Funds set up as trusts can act as a sponsor to REITs.

The REIT Regulations prescribe more conditions on the Sponsors as compared to the InVIT Regulations. Under REIT Regulations, the Sponsors are obligated to maintain a combined interest of at least 15% of the REIT at all times or designate a new Sponsor. On the other hand, in the case of an InVIT, a sponsor is free to exit the InVIT completely after three years of listing.

IV. Valuer

The Regulations require the appointment of independent Valuers to the REIT and the InVIT and impose a duty of care on the Valuers to ensure that all valuations are done in a fair and impartial manner. The Valuer has to be a ‘registered valuer’ as per the provisions of Section 247 of the Companies Act, 2013. The Valuers are required to act independently, objectively and impartially, while carrying out the valuation. The Valuer is also expected to perform its duties in an efficient and competent manner while exercising due diligence and an independent professional judgment. It may be noted that section 247 of the Companies Act, 2013 is yet to be enforced and till such time as the Section is enforced, the valuer has to be an independent merchant banker registered with SEBI or an independent chartered accountant with a minimum experience of 10 years in practice.

V. Auditor

The Auditor is expected to conduct the audit to the best of his knowledge and skill and to ensure that the accounts give a true and fair picture of the state of the affairs at the end of the audit period. The Auditor has to draft the audit report in accordance with the applicable auditing and accounting standards. The Regulations also grant the Auditor certain rights in order to fulfill their obligations under the Regulations. The Auditor may be appointed for a maximum period of 5 years, which may be extended subject to unit holders’ approval in the case of auditors who are not individuals.

VI. Project Manager (only in case of InVITs)

The InVIT Regulations require the Manager to appoint a Project Manager who shall be responsible for the operation and management of the assets of the InVIT and in case of investments in under construction assets to ensure that the project is completed on a timely basis.

Investment Conditions

I. REIT
The REIT Regulations require a REIT to invest at least 80% of the REIT assets in completed and rent generating properties\(^4\) and a maximum of 20% of its assets to be invested in other investments.\(^5\) However, a REIT can invest only a maximum of 10% of its assets in developmental properties. REITs can invest through SPVs in which the REIT has a controlling interest of at least 51%. However, the SPV should hold at least 80% of its assets directly in properties and not invest in other SPVs.

Further, the REIT Regulations require a REIT to invest in at least 2 projects with a maximum of 60% of value of assets of a REIT invested in one project. All investments by a REIT are required to be held for a minimum of 3 (three) years.

**Khaitan Comment**

The provision to allow a REIT to invest up to 20% of the value of the REIT assets in assets that are not completed and rent generating properties provides greater flexibility to the Manager of a REIT. While the 10% limit provided other investments for in the Draft REIT Regulations included all forms of other investments including investments in developmental properties, the REIT Regulations by providing a separate category of 10% for developmental properties has offered greater flexibility to the manager to obtain greater exposure to developmental properties. At the same time, the limit of 10% investment in developmental properties ensures that the REIT is not exposed to undue risk. While, SEBI’s intention in requiring a REIT to mandatorily have a minimum of 2 assets appears to have been driven by the objective of risk diversification, it goes against the globally accepted principle of a REIT being a vehicle that could hold a single pre-identified revenue generating real estate asset. Further, the Draft REIT Regulations had provided the REIT with a flexibility to invest in more than one asset if it so desired and from that perspective, the REIT Regulations appear to be reducing the flexibility that prevailed under the Draft REIT Regulations.

A very important change that has been brought about in the REIT Regulations as compared to the Draft Regulations relate to the ability of a REIT to lease its area to related parties. The REIT Regulations provide that a REIT can lease its entire rental area to related parties subject to adequate disclosures and obtaining a fairness opinion from a valuer. This is in contrast to the Draft Regulations that provided that a REIT could lease a maximum of 20% of its area to related parties. This change enables entities that own and utilise real estate assets to package the asset into a REIT and then enter into a lease back arrangement with the REIT for the use of the asset. This has the potential to become a major focus of interest for a lot of banks and corporates possessing considerable real estate assets.

### II. InVIT

SEBI envisages two kinds of InVITs in the InVIT regulations namely, (i) InVITs which shall invest more than 10% of its assets in under-construction projects ("Category I InVITs") and (ii) InVITs which shall invest not less than 80% of its assets in completed and revenue generating projects\(^6\) ("Category II InVITs"). InVITs shall invest in a minimum of two infrastructure projects.

Minimum investment from an investor in a Category I InVIT shall be INR 1 crore and in a Category II InVIT shall be INR 10 lakh.

InVITs shall invest in projects being executed on a PPP basis only through SPVs. Investment by InVITs in SPVs are subject to certain additional conditions from a corporate governance perspective.

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\(^4\) Rent generating property’ means property, of which, not less than 75% of the area has been rented / leased out.

\(^5\) Developmental properties which shall be held by the REIT for not less than three years after completion and shall be leased out; Listed or unlisted debt of companies; mortgage backed securities; Equity shares of companies listed on a recognized stock exchange in India which derive not less than 75% of their revenues from Real Estate activity; Government securities; and money market instruments or Cash equivalents.

\(^6\) ‘Completed and revenue generating project’ means an Infrastructure Project, which prior to the date of its acquisition by, or transfer to, the Infrastructure Investment Trust, satisfies the following conditions:

(i) the Infrastructure Project has achieved the commercial operation date as defined under the relevant project agreement including concession agreement, power purchase agreement or any other agreement of a similar nature entered into in relation to the operation of a project or any agreement entered into with the lenders;

(ii) the Infrastructure Project has received all the requisite approvals and certifications for commencing operations; and

(iii) the Infrastructure Project has been generating revenue from operations for a period of not less than one year;
Khaitan Comment

The InVIT Regulations retain the approach prevalent in the Draft InVIT Regulations of segregating InVITs into two categories and restricting investment in InVITs to institutional investors. This approach recognises the risks prevalent in investing in under-construction infrastructure assets in India.

Public Offer and Listing of Units

All offer of units (initial and or follow on offer) of the REIT (the Offer) shall be made by filing of the offer document with SEBI and the Designated Stock Exchange (the Offer Document).

Units of Category I InVITs are to be offered on a private placement basis only to Qualified Institutional Buyers and Body Corporates and shall be listed on a recognized stock exchange within 30 days of issuance. Units of Category II InVITs are to be issued by way of offer to the public.

If a REIT or an InVIT fails to make an offer or its units as prescribed by the Regulations within three years from the date of registration with SEBI, it shall surrender its certificate of registration to SEBI and cease to operate as a REIT or an InVIT. SEBI may, if it deems fit, extend the period by another one year.

The offer of units may be made through the Manager by filing an Offer Document with SEBI and the Designated Stock Exchange in the case of REITs and Category II InVITs and with SEBI in the case of Category I InVITs.

Disclosure in the Offer Document

The offer document of a REIT or an InVIT shall contain material, true, correct and adequate disclosures to enable the investors to make an informed decision. The offer document shall also contain / disclose all information as specified under Schedule III to the Draft Regulations and other disclosures as may be specified by SEBI. The offer document shall not contain any misleading or any untrue statements or any mis-statements nor shall it provide for any guaranteed returns to the investors. The offer document shall contain, amongst other disclosures, the following disclosures:

- Name of the REIT / InVIT, registration particulars, address and contact details;
- Details of the Sponsor, the Manager, the Trustee and the Valuer and the Project Manager in the case of an InVIT;
- Brief background of the REIT / InVIT and the structure and the description of the REIT;
- Terms of the issue including number of units, price, issue opening date and issue closing date;
- Market Overview;
- Description of assets under the REIT / InVIT;
- Business details and strategy;
- Borrowing policy;
- Related party transactions;
- Valuation;
- Financials;
- Rights of unit holders;
- Title disclosures, litigations and regulatory actions;
- Risk Factors;
• Legal, Regulatory and tax overview; and
• Other general information.

**Filing of Offer Document**

In the case of REITs and Category II InVITs, the draft offer document is required to be filed with SEBI at least 21 days prior to the opening of the offer along with a due diligence certificate. In case no modifications are suggested by the SEBI in the draft offer document within 21 days from the date of filing, the REIT or the Category II InVIT may issue the offer document to the public. It is required to be hosted on the websites of the stock exchanges, where the units are proposed to be listed for public comments, for a period of not less than 10 days. Prior to the issue, the final offer document shall be filed with the stock exchanges and SEBI.

The aforementioned initial offer or follow-on offer will have to be undertaken within 6 months from the last date for issuance of observations by SEBI, if any or if no observations have been issued by SEBI, within 6 months from the date of filing of the offer document / follow-on offer document with the stock exchange. A REIT or the Category II INVIT fails to undertake its initial offer within 18 months of its registration with SEBI is required to surrender its certificate of registration to SEBI and cease operations as a REIT or a Category II INVIT.

**Issue Structure**

1. Minimum asset size should be not less than INR 5 billion;
2. The offer size is not less than INR 2.5 billion;
3. The offer can be to a resident and or non-resident; in case of offer to a non-resident, it shall be subject to guidelines as may be specified by the Reserve Bank of India and the government from time to time;
4. Size / face value of one unit of the REIT shall be INR 100,000 and of a Category I InVIT shall be INR 10 million and of a Category II InVIT shall be INR 500,000;
5. Minimum application for subscription shall be at least INR 200,000 in the case of a REIT, INR 1 million in case of a Category II InVIT and INR 10 million in case of a Category I InVIT;
6. The initial offer and the follow-on offer shall be kept open for subscription for 30 days;
7. If the REIT or the InVIT fails to collect subscriptions amounting to at least 75% of the issue size, or the number of subscribers under the issue are less than 20, the money collected from all applicants shall be refunded within 15 days from the closure of the offer;
8. The REIT or the InVIT shall have the liberty to retain oversubscription to the extent of 25% of the issue size;
9. Allotment on oversubscription shall be on a proportionate basis;
10. Refund of money, if any, to the applicants shall be made within 15 days from the closure of the offer;
11. Issue of all units shall be in dematerialised form; and
12. If the REIT or the InVIT fails to allot or list the units within 15 days from the closure of the issue, then it shall pay interest to the unit holders at the rate of 15% per annum, till the date of allotment or listing of the units.

**Khaitan Comment**

From the perspective of investors eligible to invest in REIT and InVITs, SEBI has made necessary amendments to the SEBI (Alternative Investment Funds) Regulations, 2014 to enable alternative investment funds to invest in REITs and InVITs. However, while foreign
portfolio investors have been included in the definition of ‘strategic investors’ in the InVIT Regulations, no amendment has been made to the SEBI (Foreign Portfolio Investors) Regulations, 2014 to permit foreign portfolio investors to invest in REITs and InVITs. Relevant amendments in this regard have also not been issued by the Reserve Bank of India.

Listing

Listing of the REIT and a Category II InVIT on a recognised stock exchange after the initial offer is mandatory and shall be no later than expiry of 12 days from the date of closure of the offer. In this regard, the REIT shall enter into a listing agreement with a recognised stock exchange.

The minimum public float for the REIT and Category II units shall be 25% at all times, failing which, action may be taken by SEBI and/or the stock exchange, including delisting of units. For the purpose of this requirement, ‘public’ shall not include any ‘related party’ to the REIT or any person as may be specified by SEBI. The Regulations clarify that a REIT and an InVIT can be listed pursuant to a binding agreement between the Sponsors and the Trustee to transfer the assets to the REIT or the InVIT post the listing of the REIT or the InVIT.

Delisting

The Trustee is required to apply for delisting of units of the REIT and the InVIT to SEBI and the stock exchanges, if (a) the public float falls below 25%, (b) the number of unit holders of the REIT (other than related parties) falls below 200 in the case of a REIT and a Category II InVIT and below five in the case of a Category I InVIT; or (c) if the Sponsor, the Manager or the unit holders have so requested. Keeping in mind the interests of the unit holders, SEBI and the stock exchanges may approve or reject the application for delisting. On delisting, the REIT or the InVIT as the case may be shall be required to surrender its certificate of registration to SEBI and shall not be permitted to undertake the activity of a REIT or an InVIT. However, the trusts and the Parties to the trusts shall continue to be liable for all their acts of omissions and commissions notwithstanding such surrender.

Rights of the Unit holder

In addition to receiving income / distributions as provided for in the offer document, the unit holders are provided with the right to vote on certain issues that affect the governance and operations of the REIT. In case of matters relating to governance of the REIT or the InVIT, the number of votes cast in favour of the proposal should be one and a half times the number of votes cast against, while in case of operational matters, the number of votes cast in favour of the proposal should be three times the number of votes cast against.

Dividend policy

REITs and InVITs are required to distribute at least 90% of the net distributable income, as dividend to the unit holders.

KCO Comment: The Regulations do not define ‘net distributable income’ and this could lead to ambiguities on certain issues such as whether reserves can be created etc. and therefore, a clarification by SEBI same would help in bringing about clarity.

Borrowings and deferred payments

REITs and InVITs are allowed to have aggregate consolidated borrowings and deferred payments not exceeding 49% of the assets of the REIT. In the event the aggregate consolidated borrowings and deferred payments exceed 25% of the value of the trust assets, credit rating and approval of unit holders shall be required for any further borrowing.

Taxation of the REIT

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7 Matters relating to governance of the REIT include matters such as the appointment and removal of the Manager and Trustee, the approval of related party transactions etc.
8 Matters relating to the operation of the REIT include matters such as the approval of the Auditor and the Valuer.
The amendments to the Income Tax Act, 1961 (IT Act) introduced by the newly formed National Democratic Alliance (NDA) government has provided clarity on the taxation of REITs and InvITs with respect to their investments in SPVs.

REITs and InvITs have been envisaged in the nature of ‘business trusts’ raising money from investors through issue of units to be invested in income bearing assets held by the trust through a controlling interest in a SPV to be brought in by the sponsor through transfer of SPV shares into the REIT.

a) Transfer of the SPV from the Sponsor to the trust

Capital gains arising at the time of transfer of the SPV to the trust is to be deferred to the time of disposal of the units by the Sponsor. While the preferential capital gains treatment on transfer of units will not be available (pursuant to point (c) below), for the purpose of computing capital gains, the cost and holding period of the shares of the SPV will be taken into account.

b) Income of the trust

i. Interest Income

Interest income from the SPV holding asset shall be accorded a pass-through tax treatment whereby no tax will be levied on such income in the hands of the trust and withholding being applied on distribution of such interest by the SPV. However, distribution of such interest income to the unit holders will attract withholding tax at the rate of 5% in case of non-residents and 10% in case of resident unit holders;

ii. Dividend income

Dividend income received by the trust from the SPV shall be exempt from any tax, however the SPV may have to pay dividend distribution tax on any distribution as applicable;

iii. Capital Gains

To be taxed at the trust level at the applicable rate, however any distributions to the investors shall be exempt from further taxation; and

iv. Other Income

Any other income of the trust will be taxable at the maximum marginal rate of 30%.

c) Income of Unitholders

i. Interest Income

Interest income net of withholding distributed by the trust to the unit holder will be subject to tax at the regular rate;

ii. Dividend income

No further tax on the dividend income in the hands of the Unit holders;

iii. Capital Gains

Any income distributed by the trust which relates to capital gains on sale of SPV shares shall not be subject to any further tax in the hands of the Unit holder. However, any sale of the trust units by a Unit holder on the stock exchanges would attract the same levy of securities transaction tax and will be given the same tax treatment as sale of equity shares, i.e. long term capital gains shall be exempt and short term will be taxed at 15%. This is expected to provide tax efficient liquidity for the holders of trust units and parity with their listed equity investments; and

iv. Other Income

No further tax.

The tax proposals clearly envisage that any tax paid by the trust shall be for and
on behalf of the unit holders and hence to that extent the unit holders should be able to avail any eligible deductions or set-offs against their other relevant income. This should be welcome by the industry as this would provide a real ‘pass-through’ of income and tax to unit holders.

However, one issue that would require more clarity would be that since the Regulations envisages REIT and InVITs to either hold the assets directly or through SPVs, whereas the tax amendments above appear to only deal with cases where the assets are held through SPVs. It is unclear if REITs / InVITs owning direct assets would be entitled to claim the benefits under the above provisions.

Direct Investment in Assets

No special provisions have been introduced in the IT Act with respect to the tax treatment of REITs and InVITs investing directly in assets. In such a case, it is possible that the trusts may be considered as business trusts and their income would be subject to tax at the maximum marginal rate of 30%. In such a situation, it may be possible for the trust to deduct various expenses incurred by the trust such as management fees etc. from its total income.

It is also possible that the rental income earned by the trust would be considered as ‘income from house property’ and subject to tax under the applicable provisions of the IT Act. In such a situation, there may be no pass through available for the investors.

However, the stamp duty implications involved in direct investments by REITs and InVITs in holding assets directly may ensure that very few REITs and InVITs are structured in such a manner.

Open Issues from a Tax Perspective

The recent amendments to the IT Act have not provided any clarity on whether REITs and InVITs and the SPVs would be subject to minimum alternate tax. Further, the IT Act currently does not provide for any tax exemption to Sponsors on long term capital gains obtained by the sale of units of the REIT or the InVIT on the stock exchange. This is in contrast to the position in the case of equities where the promoter is exempt from payment of long term capital gains tax on the sale of shares on the stock exchange. These are some of the issues on which the government can provide more clarity to ensure the attractiveness of REITs and InVITs as investment products to both Sponsors and investors.

Road Ahead

The introduction of the REIT and the InVIT Regulations by SEBI represents a positive attempt by SEBI and the government to provide liquidity to the real estate and infrastructure sectors and strengthen the Indian capital markets. The Regulations represent an effort to imbibe global best practices while at the same time, ensuring that the same is made suitable for the Indian economic context. However, there are issues still remaining on the tax efficiency of these products as a full pass through status (which is the norm in other jurisdictions) has not been provided to REITs and InVITs. It remains to be seen if Sponsors and investors would keep aside the tax concerns and fulfil regulatory and governmental expectations regarding the success of these products.

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