Qs & As

on

New Tax Regime for REITs & InvITs

Everything you need to know about Taxation of REITs & InvITs

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Nilesh Patel

CPA(USA), Former IRS Officer

This Analysis in Form of Questions & Answers on the New Tax Regime for Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) has been made by Nilesh Patel.

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The Opening

The Opening

The legendary Counsel Shri Soli Dastur recently, on 14th July 2014, presented his illuminating analysis of the Direct Taxes proposals of the Finance Bill, 2014 (the recent Budget) at the Lecture Meeting organized by Bombay Chartered Accountants Society (BCAS). The topmost Indian Authority on Direct Taxes, Shri Dastur opened his talk by saying that the New Tax Regime for REITs and InvITs, introduced in the Budget, involves 11 sections and would need a separate lecture by itself for a complete discussion.

Taking cue, we sat down to take a close look at the proposed New Tax Regime for REITs and InvITs. And what did we find? Contrary to the popular understanding, taxation of REITs and InvITs (Business Trusts) is not truly pass-through.

The Opening

Losses incurred by REITs and InvITs cannot pass-through to the Investors. Capital Gains realized by the REITs and InvITs (Business Trust) also cannot pass-through to the Investors - such Gains are instead taxable in the hands of the Business Trust itself. And certain other income received by REITs and InvITs too cannot pass-through to the Investors – such income is taxable in the hands of the Business Trust at maximum marginal rate.

So what income can pass-through to the Investors? Certain specified interest income can pass-though to Investors for taxation in hands of Investors, if the REIT or InvIT actually distributes that income to Investors. But without distribution even that income does not pass-through to the Investors. In fact without distribution by the Business Trust no income or loss can pass-through. And how can the Business Trust distribute income when it itself has incurred loss!

The Opening

Hence the Investors cannot get the benefit of setting-off the losses, if any, incurred by the REITs and InvITs. Besides, REITs and InvITs themselves cannot carry forward the losses for set-off in future because the income is exempt – as the corresponding income is exempt, the losses too are ignored.

Is that true pass-through? The proposed pass-through taxation is totally dependent on distribution of income by the Business Trust to the Investors. The Investors are taxed when they receive the income from the Business Trust. If they do not receive income from the Trust – when the Trust does not distribute its income to the Investors – then the Investors are not taxed on the income received by the Trust.

So where is the pass-through? To be true pass-through, the income – on receipt by the Trust - should automatically flow to the Investors for taxation, regardless of distribution. Likewise losses too should flow to Investors. That is not going to happen under the proposed provisions.

The Opening

Besides that, one more question arises: What if no distribution is made by the Trust? Will then the Trust be taxed? Under the proposed provisions the Trust can avoid paying any tax even when the Trust distributes nothing to the investors - the Trust can keep accumulating income - without distributing income to the Investors, and still be exempt. The exemption therefore is not dependent on distribution.

It seems that the SEBI Regulations on REITs and InvITs - whenever those Regulations become final - will take care of this anomaly. Those Regulations will most likely compel the Trust to distribute its income to Investors. So the Income Tax Act 1961 and the SEBI Regulations will work in tandem.

The Opening

Dear Reader, after taking a close look at the Budget proposals, we present to you this Analysis of the New Tax Regime of REITs and InvITs, in the form of 33 Questions & Answers.

In this Analysis, among other things, we examine what income of REITs and InvITs will be taxed at maximum marginal rate, and why? We also see why exemption is bestowed upon the Trust without regard to distribution by the Trust: *Should there have been a distribution deduction instead of outright exemption?* We also analyse how the proposed provisions of limited pass-through will work in practice - by taking 3 examples.

On going through this analysis you will come to know about Draft SEBI Regulations on REITs, SEBI Consultation Paper on InvITs, Steps in the formation of REITs & InvITs, Investment Structure of REITs and InvITs, Various Transactions that can happen within the framework of REITs and InvITs, and Taxation of those Transactions.

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The Opening

We earnestly hope you find this Analysis useful. We would be grateful for your comments; please convey them at *info@taxwize.in*

REITs

Question 1

What is a Real Estate Investment Trust (REIT)?

Answer 1

A REIT is essentially an investment vehicle. Investors subscribe to Units of a REIT and thus pool together their monetary resources. With the Capital invested by the Investors, a REIT acquires Real Estate Assets.

REITs primarily invest in completed revenue generating Real Estate Assets. Major part of their investments is in completed properties which provide regular income to Investors.

A REIT may invest in completed Real Estate Assets either directly or through a Special Purpose Vehicle (usually a Company).

Question 2

What is the need for Real Estate Investment Trusts (REITs) in India?

Answer 2

Real Estate sector in India has grown at a rapid pace in recent years. And the operations of Corporate sector too have grown. Such growth has increased the demand for commercial buildings – modern offices, malls, conference centers, warehouses, etc.

A suitable investment vehicle is required for a rapidly growing Real Estate sector in India. REIT provides such vehicle for investment.

Question 3

What are the benefits of Real Estate Investment Trusts (REITs) ?

Answer 3

REITs are beneficial to both the Industry as well as the Investors.

Benefits to Industry

- REITs provide a means of exit to the Developer of properties
- By doing so, REITs provide liquidity and enable the Developer to invest in new projects

Answer 3

Benefits to Investors

- REITs provide a less risky avenue of investment to the Investors – investing in under-construction properties is more risky
- REITs provide Investors an avenue to invest in those kinds of properties in which they otherwise would not have been able to take an exposure
- REITs provides regular income to Investors from the rentals received from properties (in which a REITs has invested)

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Question 4

What is the current status of Real Estate Investment Trusts (REITs) in India?

Answer 4

The Securities and Exchange Board of India (SEBI) had proposed Draft Regulations relating to REITs. Those Regulations were placed in public domain for comments. The Final Regulations however are yet to be notified.

Question 5

Which other countries have Real Estate Investment Trusts (REITs)?

Answer 5

Globally the framework for REITs exists in several countries. Important among those are the US, UK, Japan, France, Australia and Singapore.

Question 6

What are the salient features of Real Estate Investment Trusts (REITs)?

Answer 6

REITs generally have the following features:

- REITs are managed by Professional Managers who have skill and experience in property development, redevelopment, acquisitions, leasing and management, etc.
- REITs bring transparency and accountability in the Real Estate Sector
- REITs provide an investment option to long term pools of capital like pension funds and insurance companies – the regular stream of income helps those funds and companies in managing regular outflow to their investors
- Listed REITs provide liquidity – Investors can easily exit

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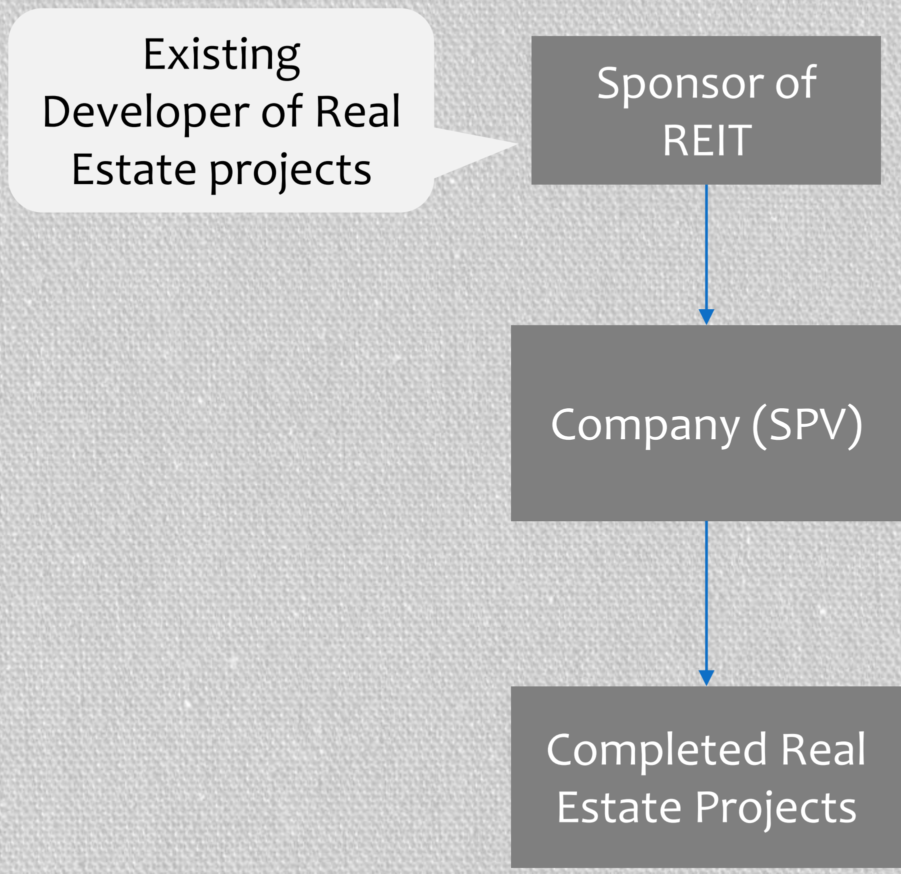
Question 7

What steps are involved in the Formation of a Real Estate Investment Trust (REIT)?

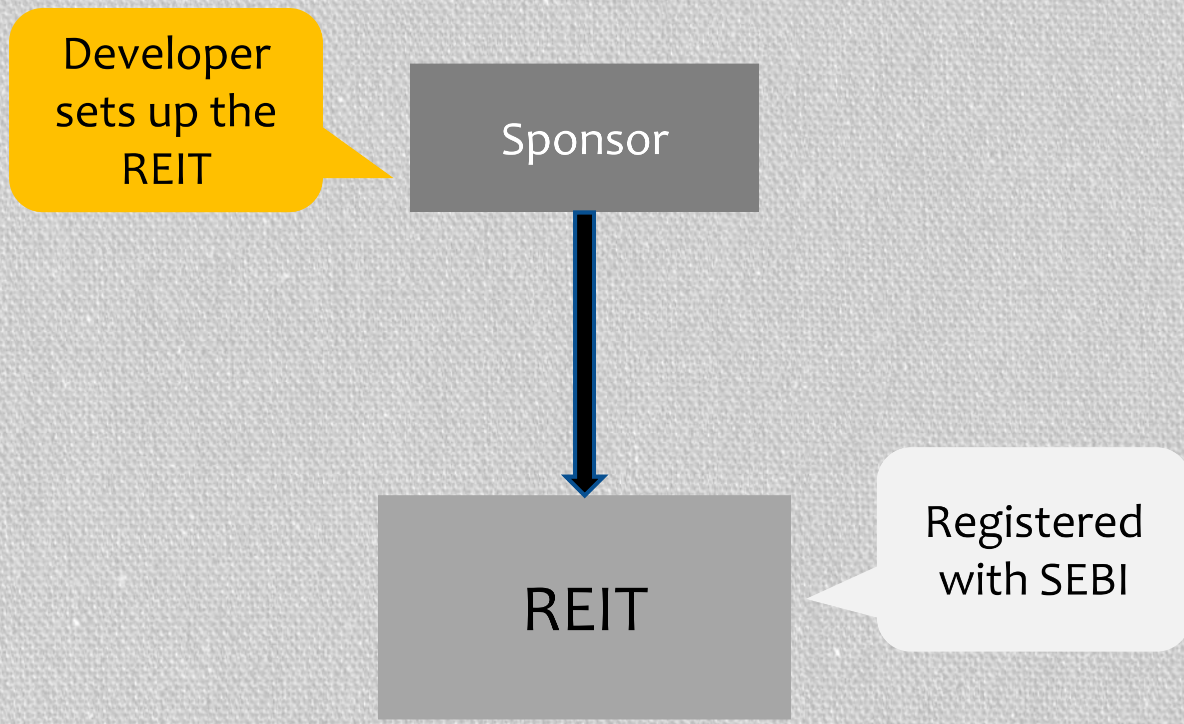
Answer 7

The Steps in formation of REIT are depicted in the next few slides

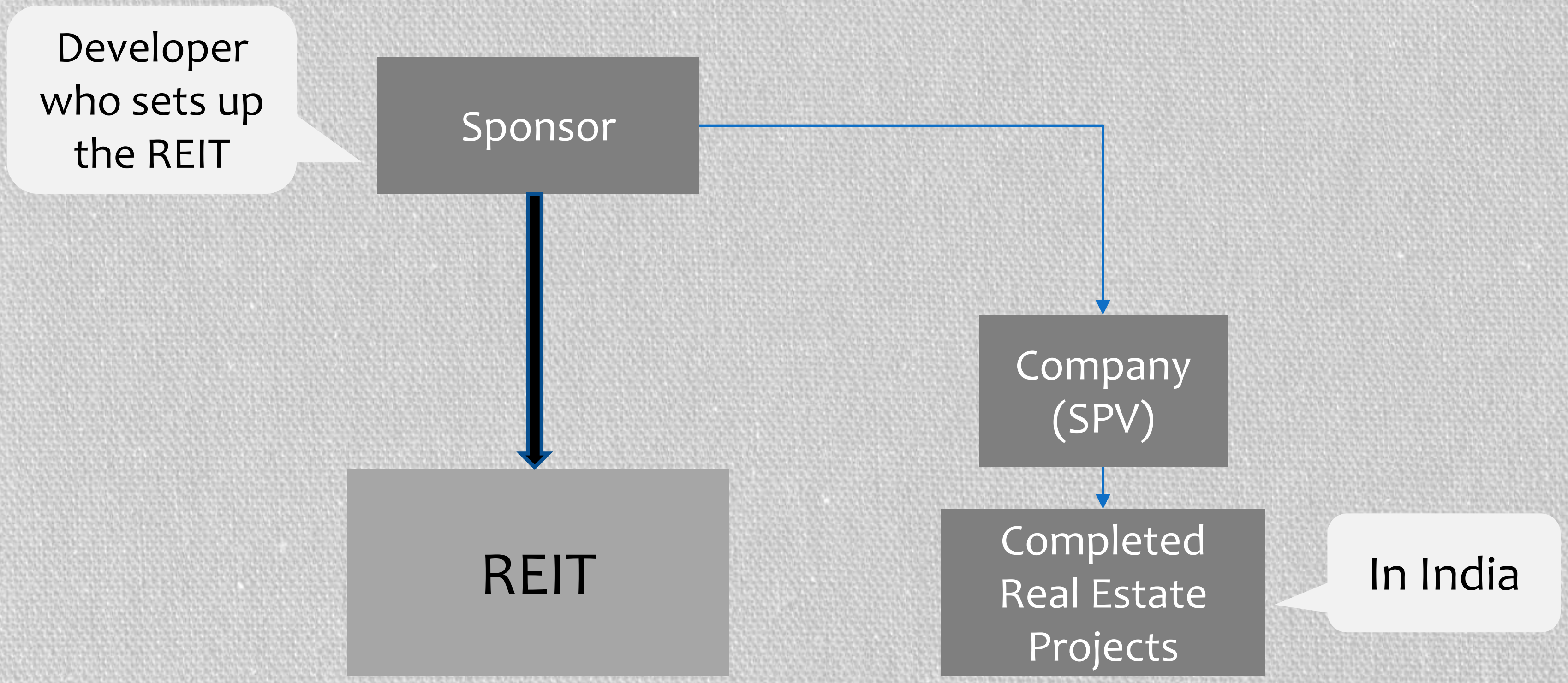
Answer 7


Existing Developer of Real Estate projects
Sponsor of REIT
Company (SPV)
Completed Real Estate Projects

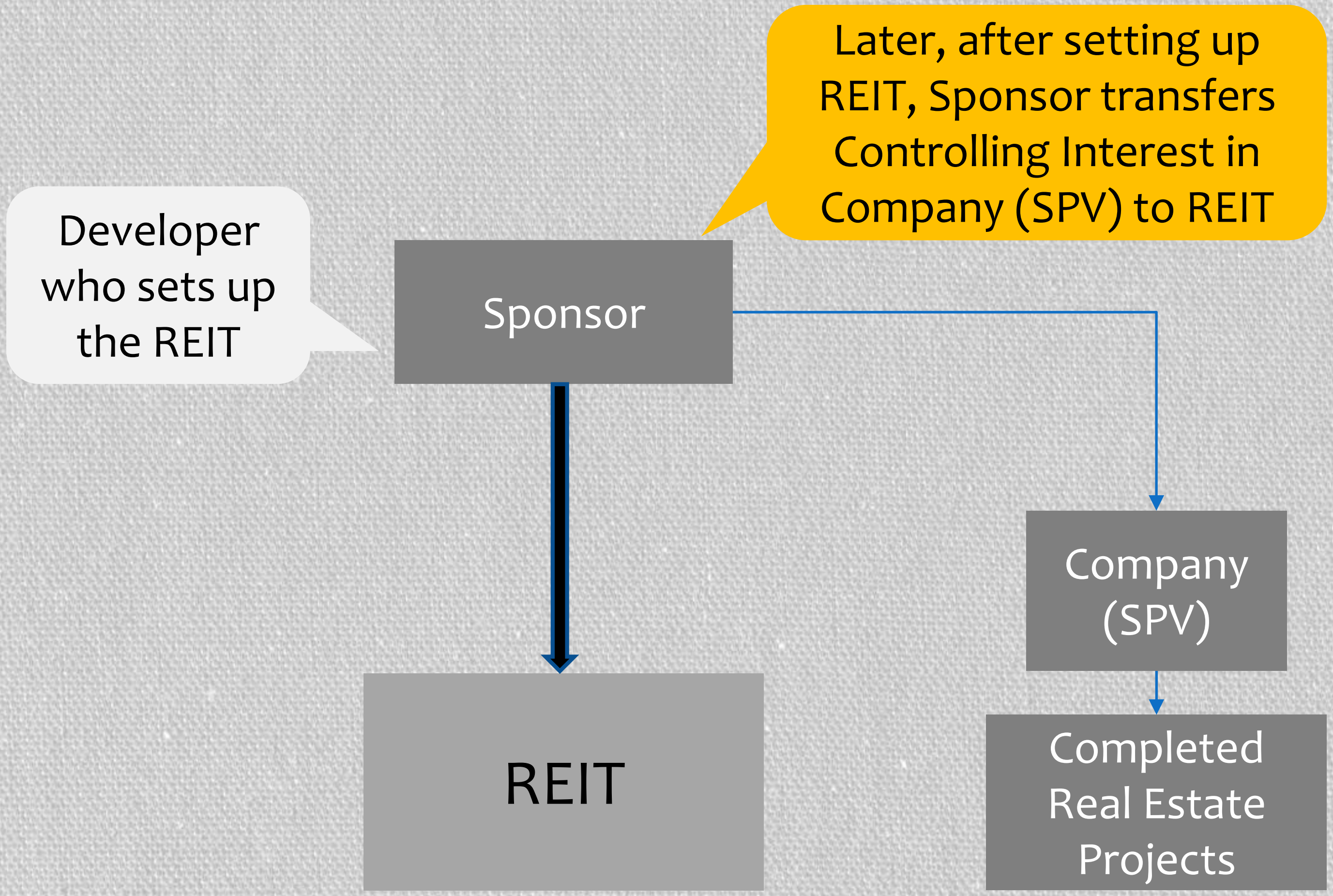
Answer 7


Developer sets up the REIT
Sponsor
REIT
Registered with SEBI

Answer 7


Developer who sets up the REIT
Sponsor
REIT
Company (SPV)
Completed Real Estate Projects
In India

Answer 7



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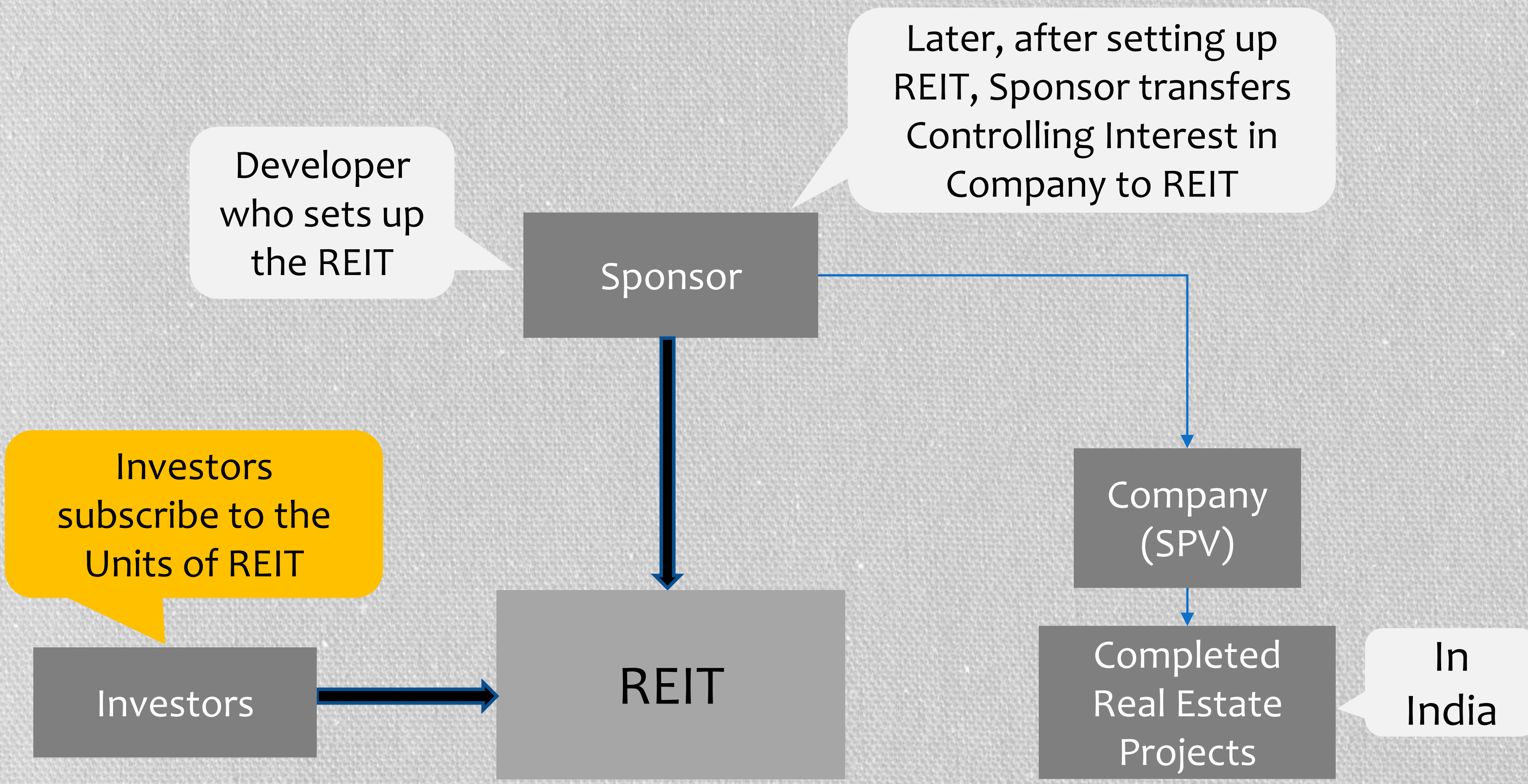
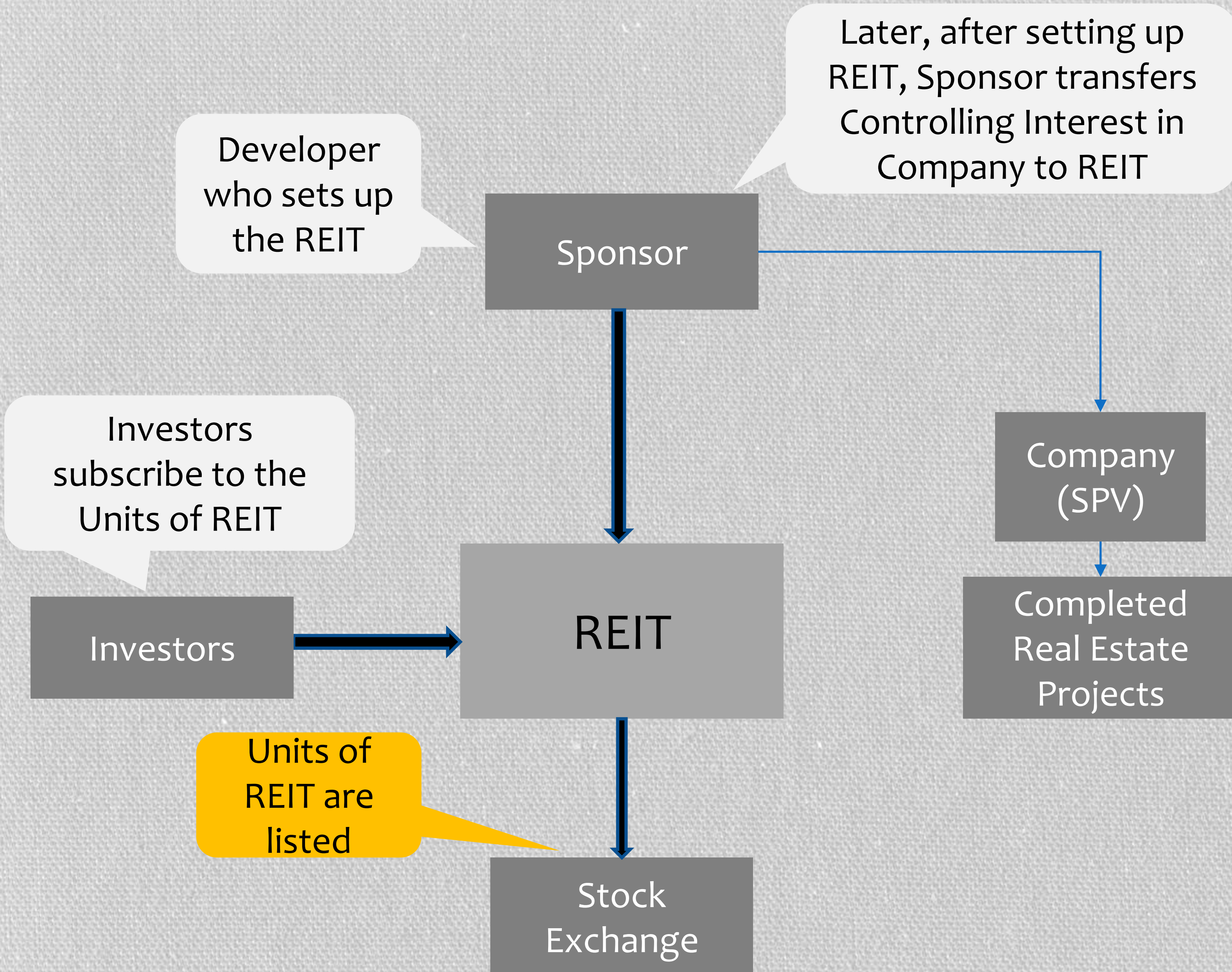
Answer 7

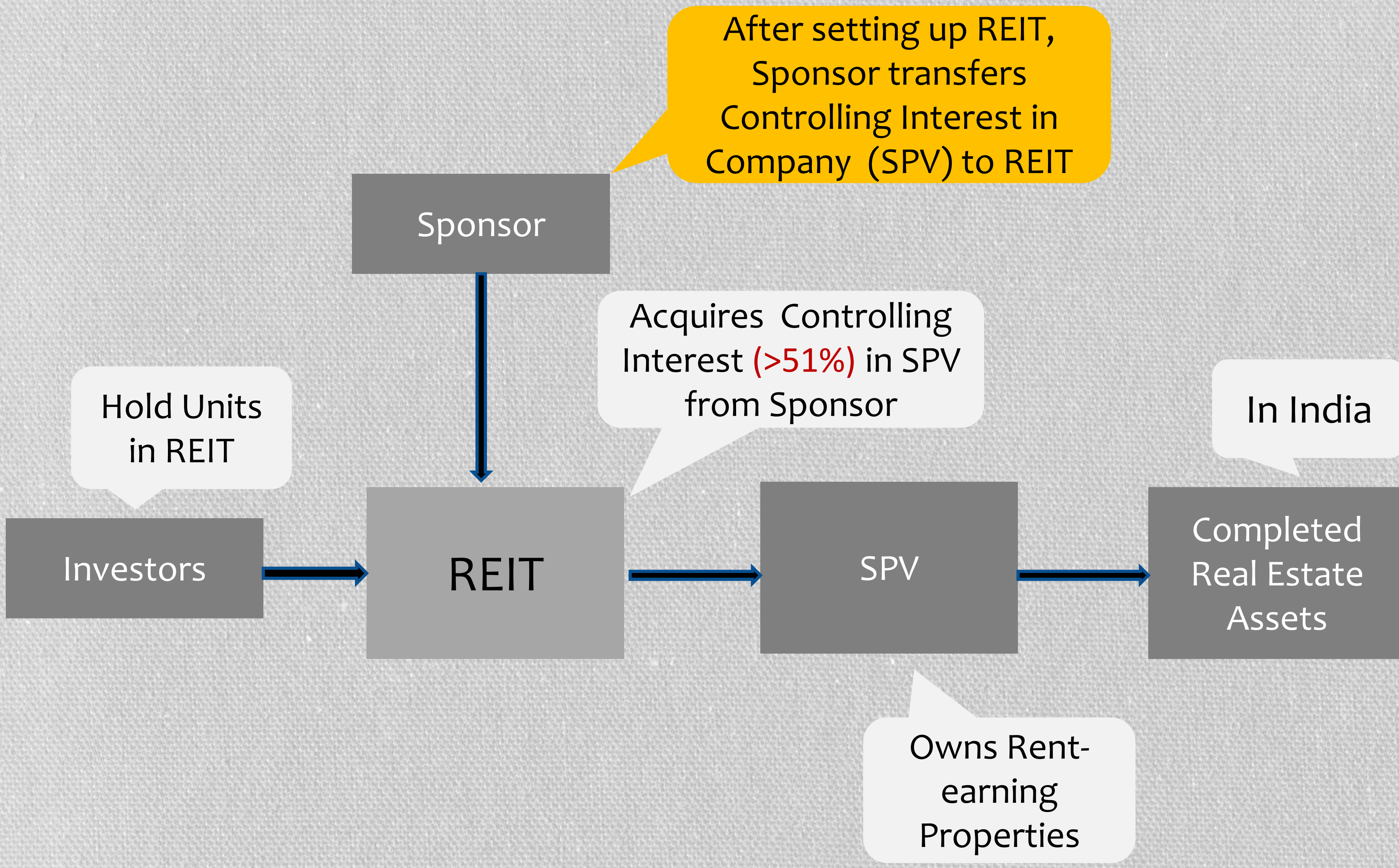


Developer who sets up the REIT
Later, after setting up REIT, Sponsor transfers Controlling Interest in Company to REIT
Sponsor
Investors subscribe to the Units of REIT
Company (SPV)
Investors
REIT
Completed Real Estate Projects
In India

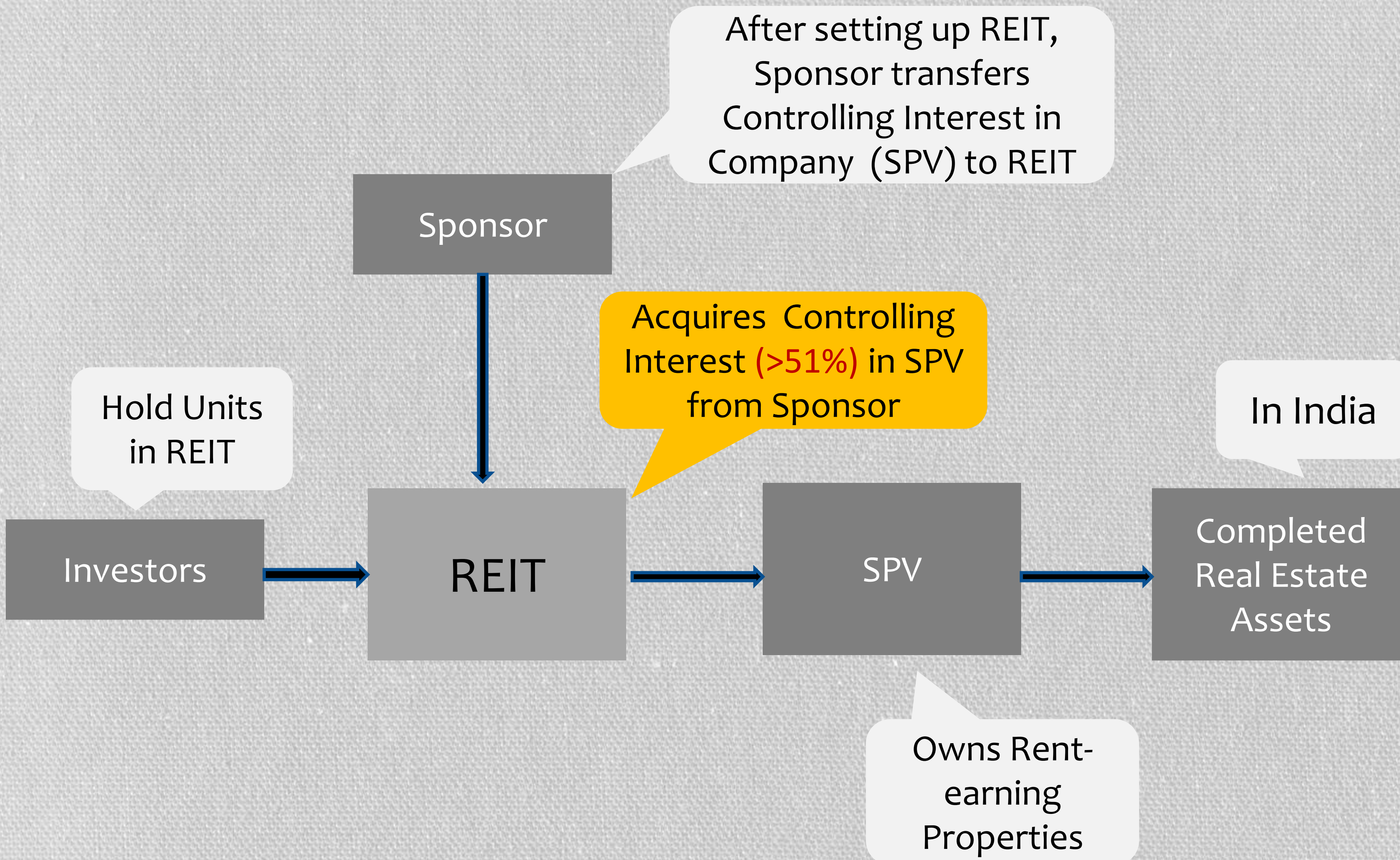
Answer 7


Later, after setting up REIT, Sponsor transfers Controlling Interest in Company to REIT
Developer who sets up the REIT
Sponsor
Investors subscribe to the Units of REIT
Company (SPV)
Completed Real Estate Projects
Investors
REIT
Units of REIT are listed
Stock Exchange

Answer 7


After setting up REIT, Sponsor transfers Controlling Interest in Company (SPV) to REIT
Sponsor
Acquires Controlling Interest (>51%) in SPV from Sponsor
Hold Units in REIT
In India
Investors
REIT
SPV
Completed Real Estate Assets
Owns Rent-earning Properties

Answer 7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In India
Investors
REIT
SPV
Completed Real Estate Assets
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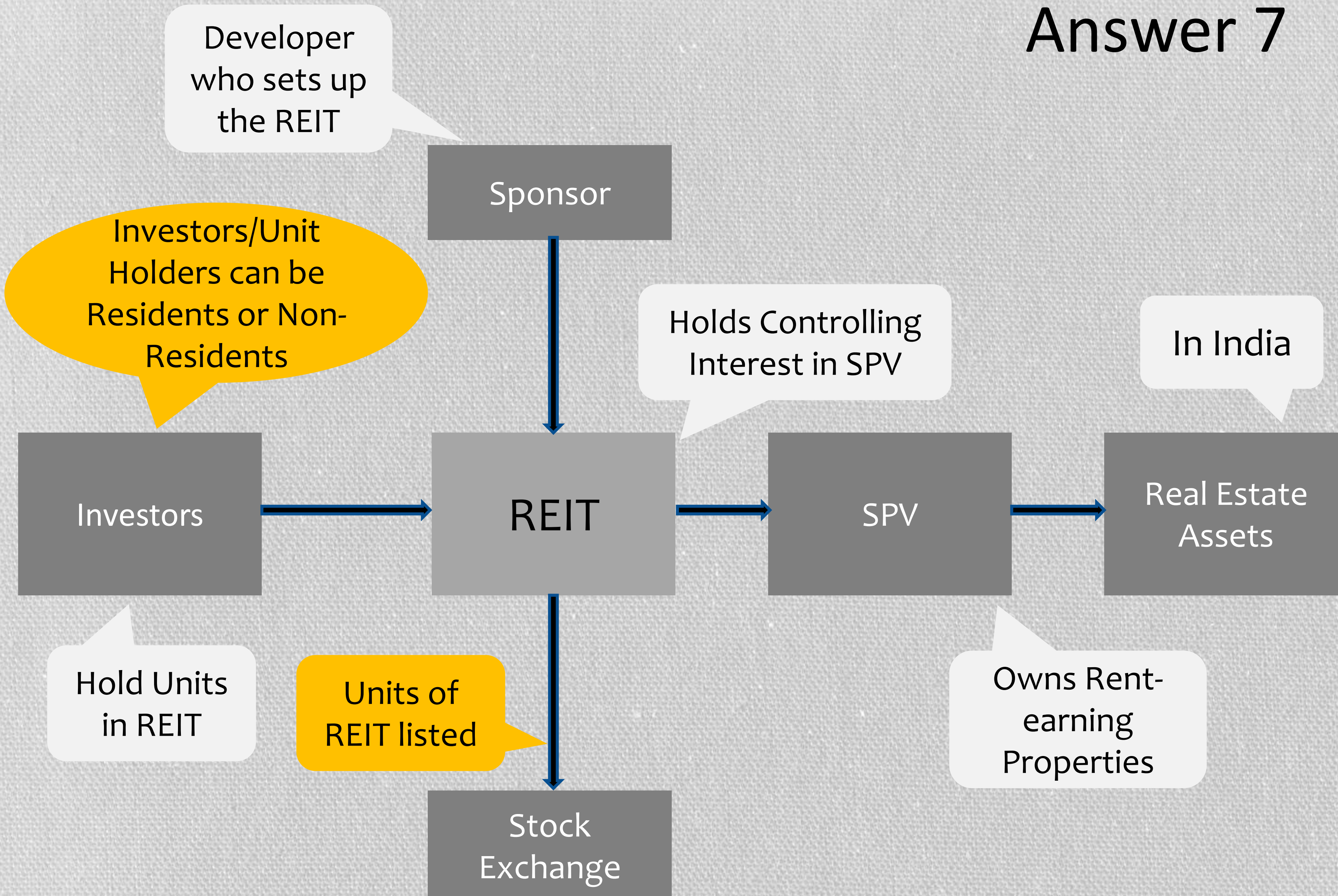
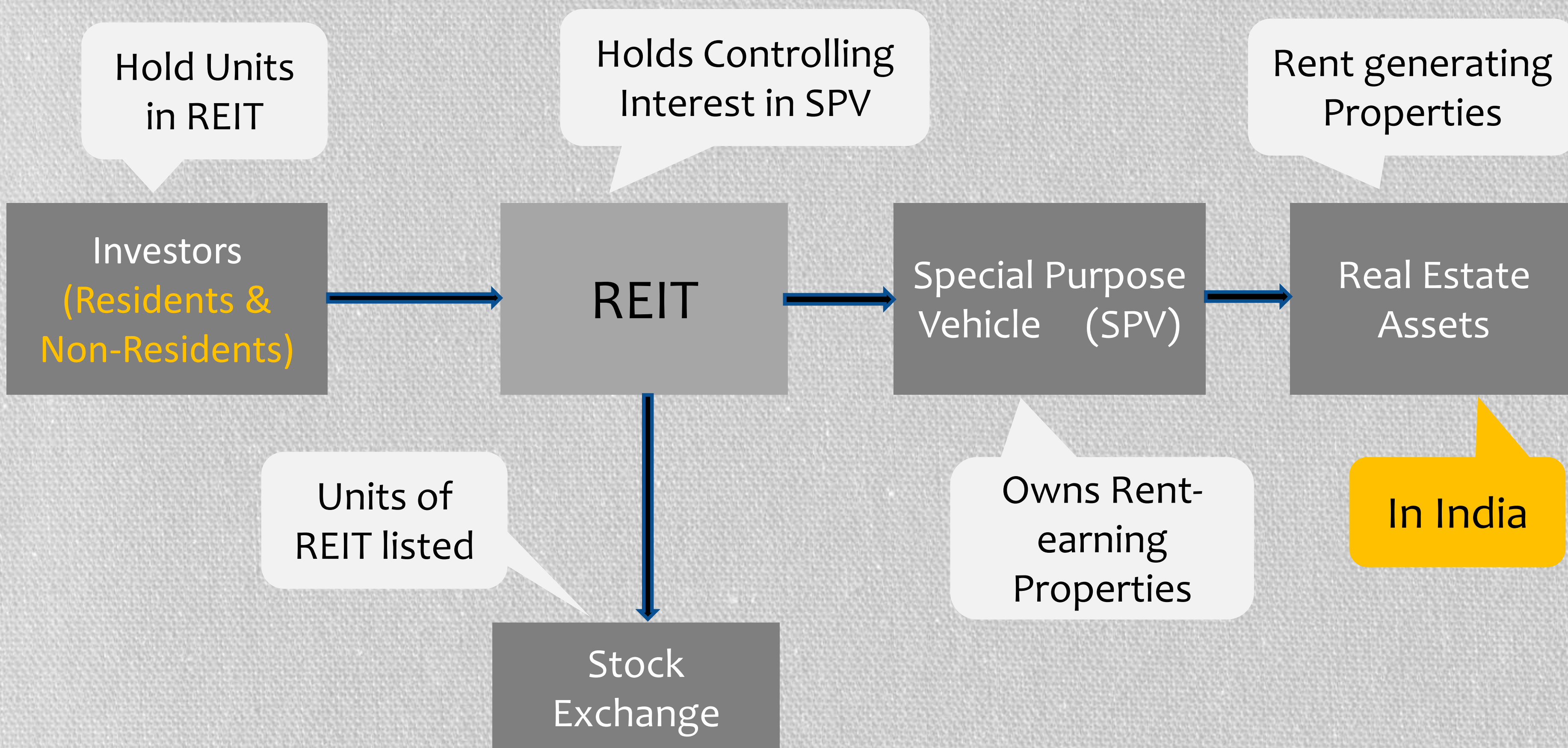


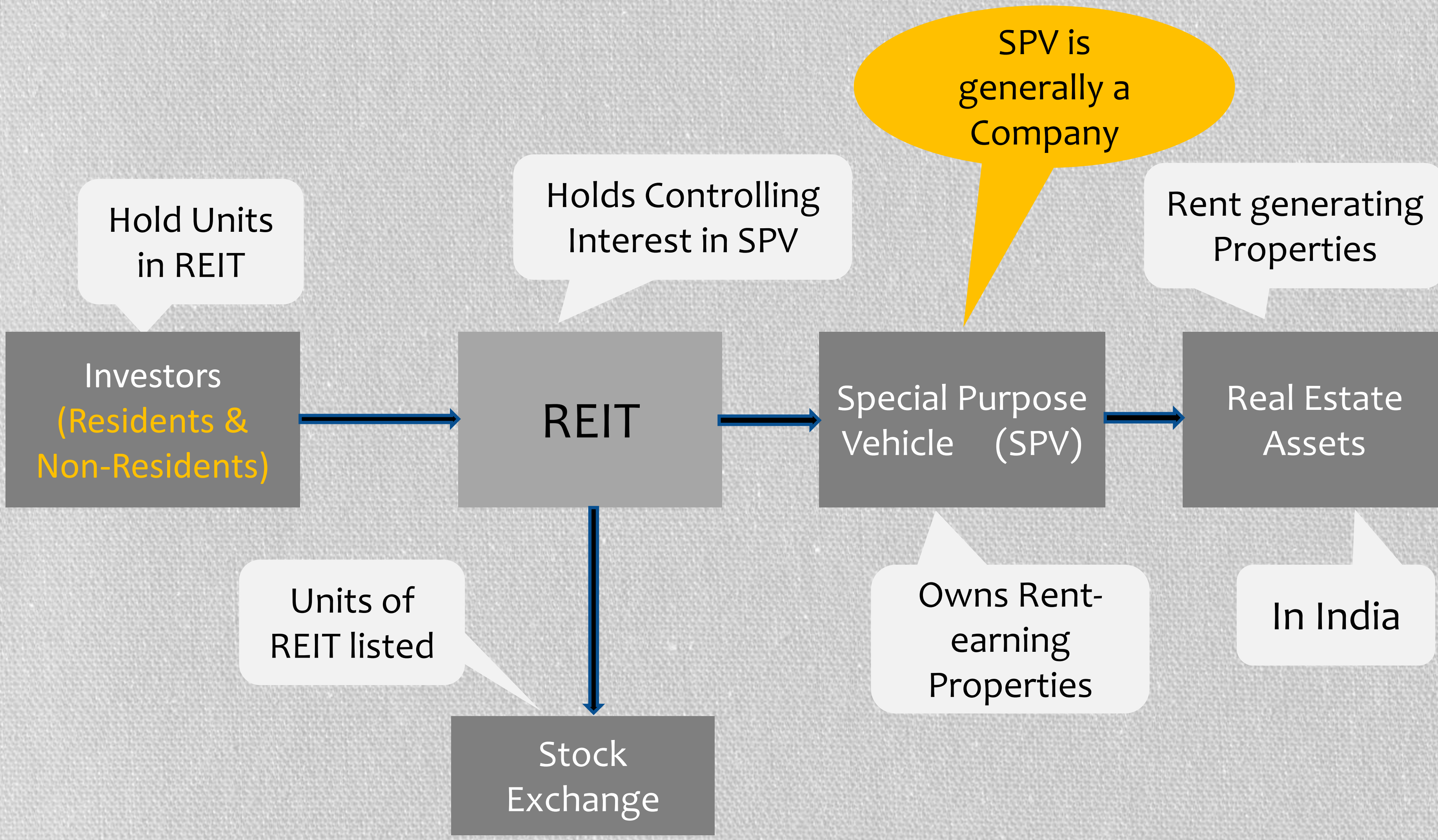
Developer who sets up the REIT
Sponsor
Investors/Unit Holders can be Residents or Non-Residents
Holds Controlling Interest in SPV
In India
Investors
REIT
SPV
Real Estate Assets
Hold Units in REIT
Units of REIT listed
Owns Rent-earning Properties
Stock Exchange

Answer 7

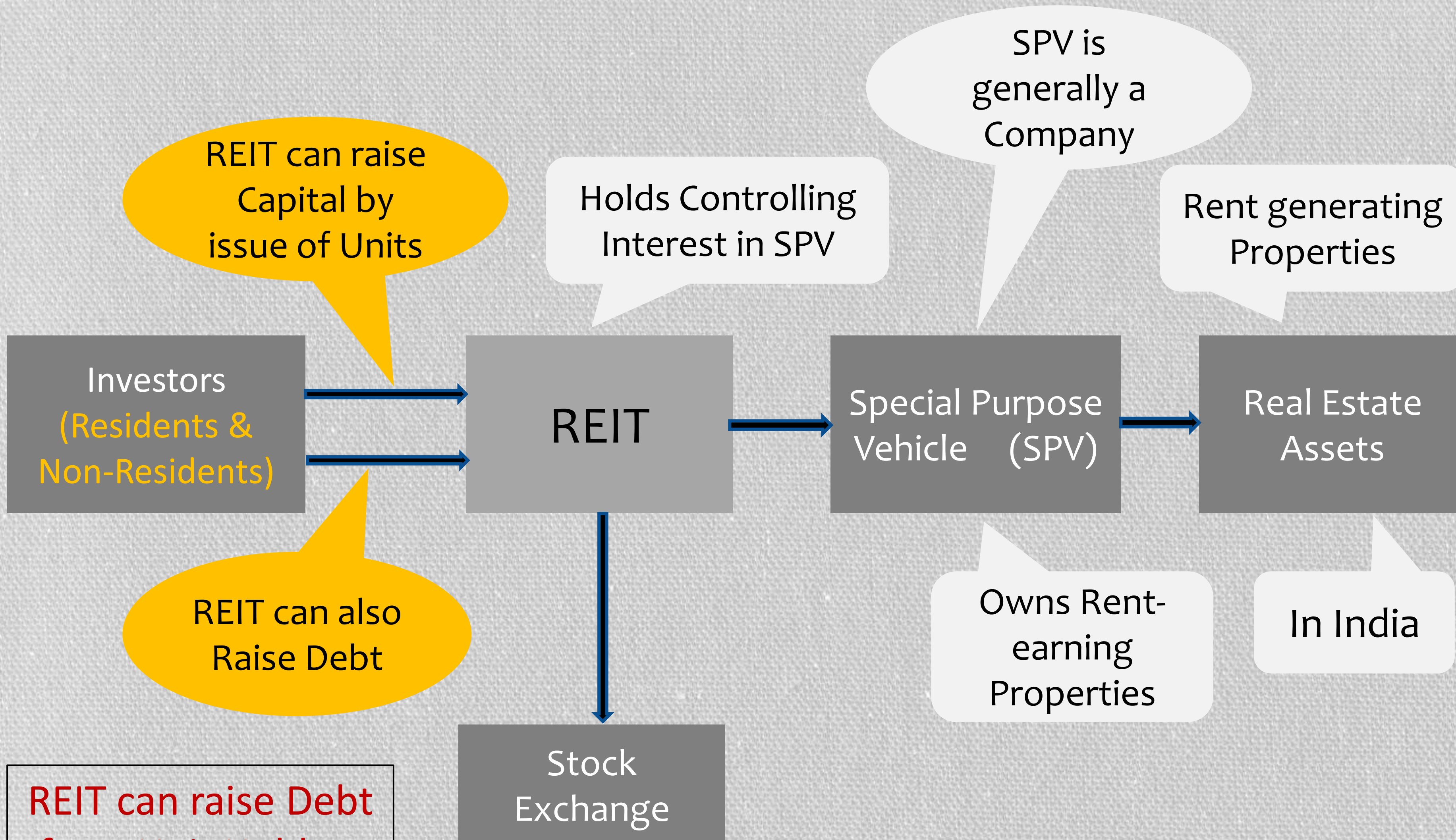


Hold Units in REIT
Holds Controlling Interest in SPV
Rent generating Properties
Investors (Residents & Non-Residents)
REIT
Special Purpose Vehicle (SPV)
Real Estate Assets
Units of REIT listed
Owns Rent-earning Properties
In India
Stock Exchange

Answer 7


Hold Units in REIT
Investors (Residents & Non-Residents)
Holds Controlling Interest in SPV
REIT
SPV is generally a Company
Special Purpose Vehicle (SPV)
Rent generating Properties
Real Estate Assets
Units of REIT listed
Stock Exchange
Owns Rent-earning Properties
In India

Answer 7



REIT can raise Debt from Unit Holders and Other Lenders

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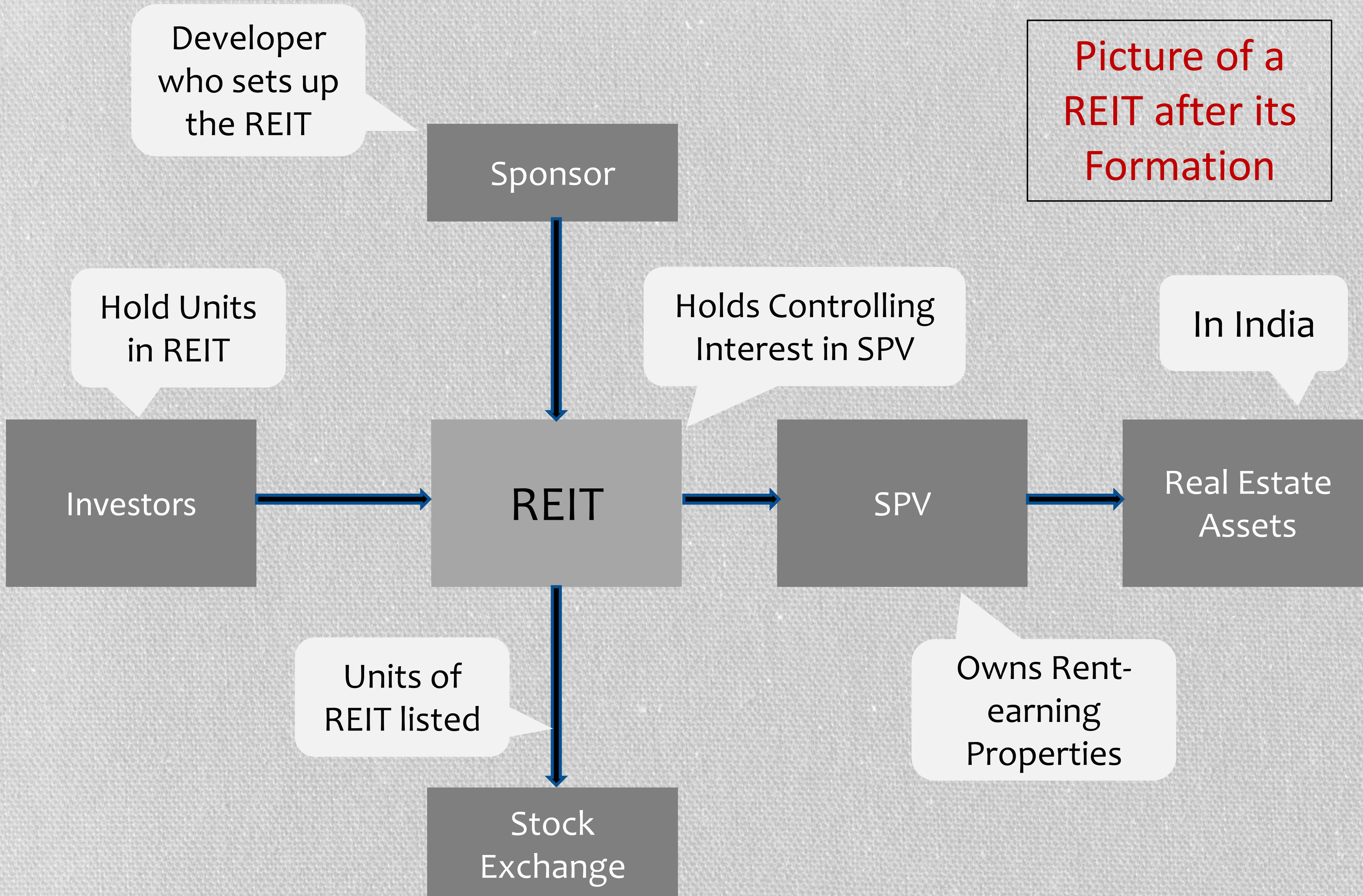
Answer 7

Picture of a REIT after its Formation



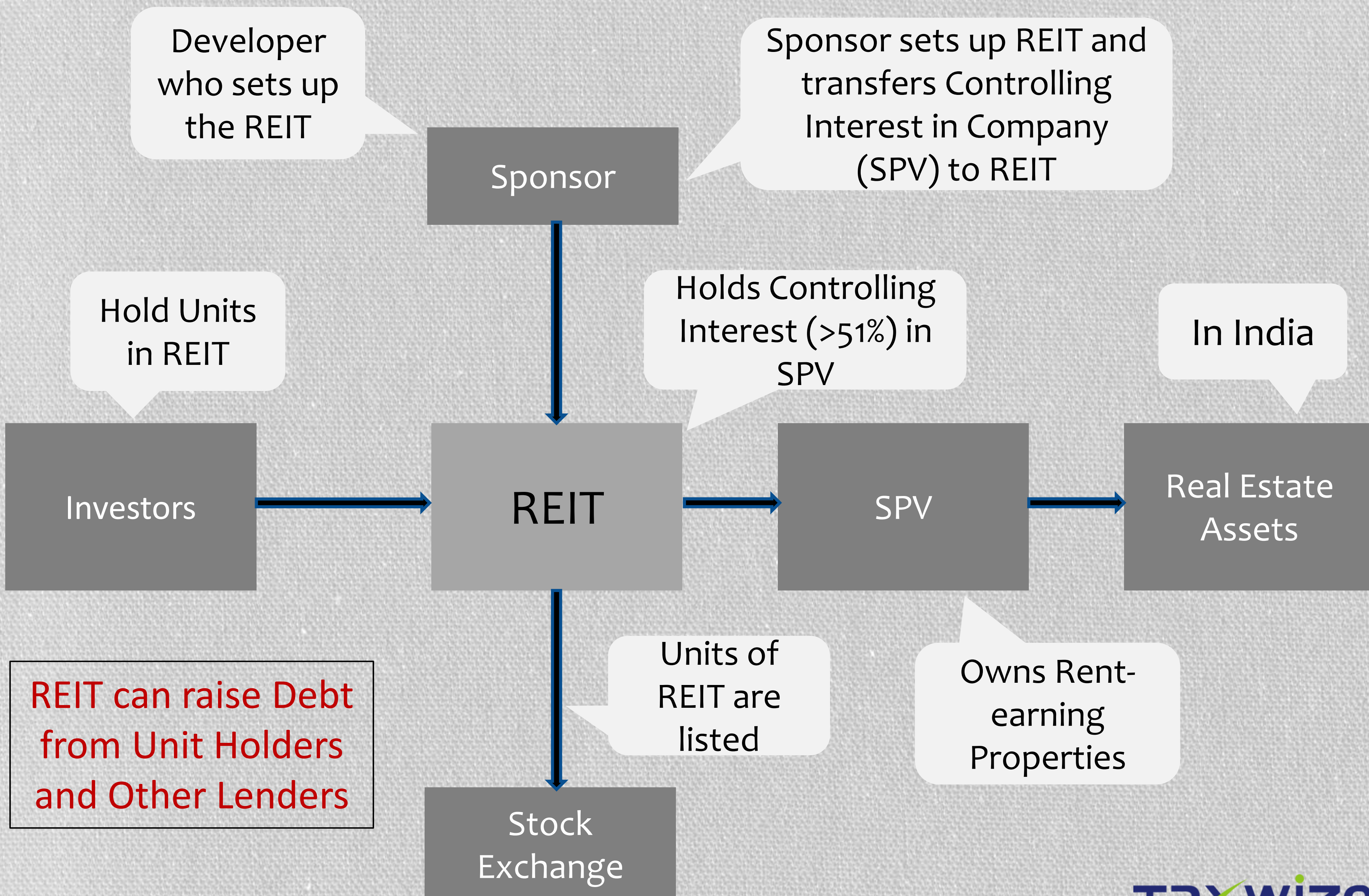
Question 8

What is the typical investment structure of Real Estate Investment Trusts (REITs)?

Answer 8

Typical Investment Structure of REITs is depicted in the next slide

Answer 8



Developer who sets up the REIT
Sponsor
Sponsor sets up REIT and transfers Controlling Interest in Company (SPV) to REIT
Hold Units in REIT
Holds Controlling Interest (>51%) in SPV
In India
Investors
REIT
SPV
Real Estate Assets
Units of REIT are listed
Owns Rent-earning Properties
REIT can raise Debt from Unit Holders and Other Lenders
Stock Exchange

Question 9

What kind of Transactions take place within the framework of a Real Estate Investment Trust (REIT)?

Answer 9

- There are 15 types of Transactions that can take place within the framework of REITs
- In the coming Slides we will look at all those 15 types of Transactions

Answer 9

I. Investors invest in REIT

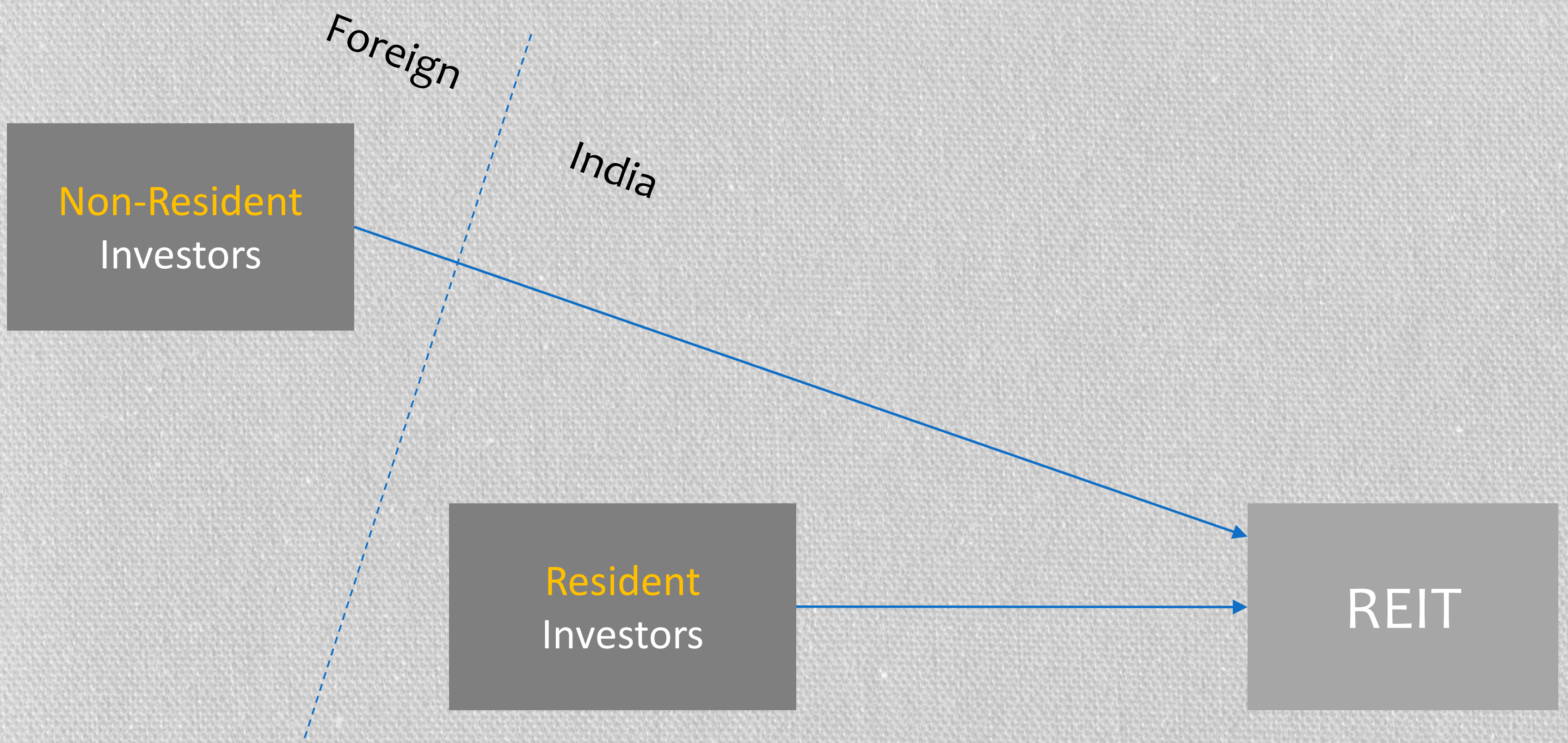
- Investors subscribe to Units of REIT

Investors can be both: Residents and Non-Residents

Answer 9

REITs must be registered with SEBI. A Sponsor (Developer) sets up REIT and registers it with SEBI. After registration, a REIT can raise funds initially through an initial offer. Once Units are listed (on a Stock Exchange), the REIT may later raise funds through follow-on offers.

Answer 9



REITs can raise capital from Residents as well as from Non-Residents

Answer 9

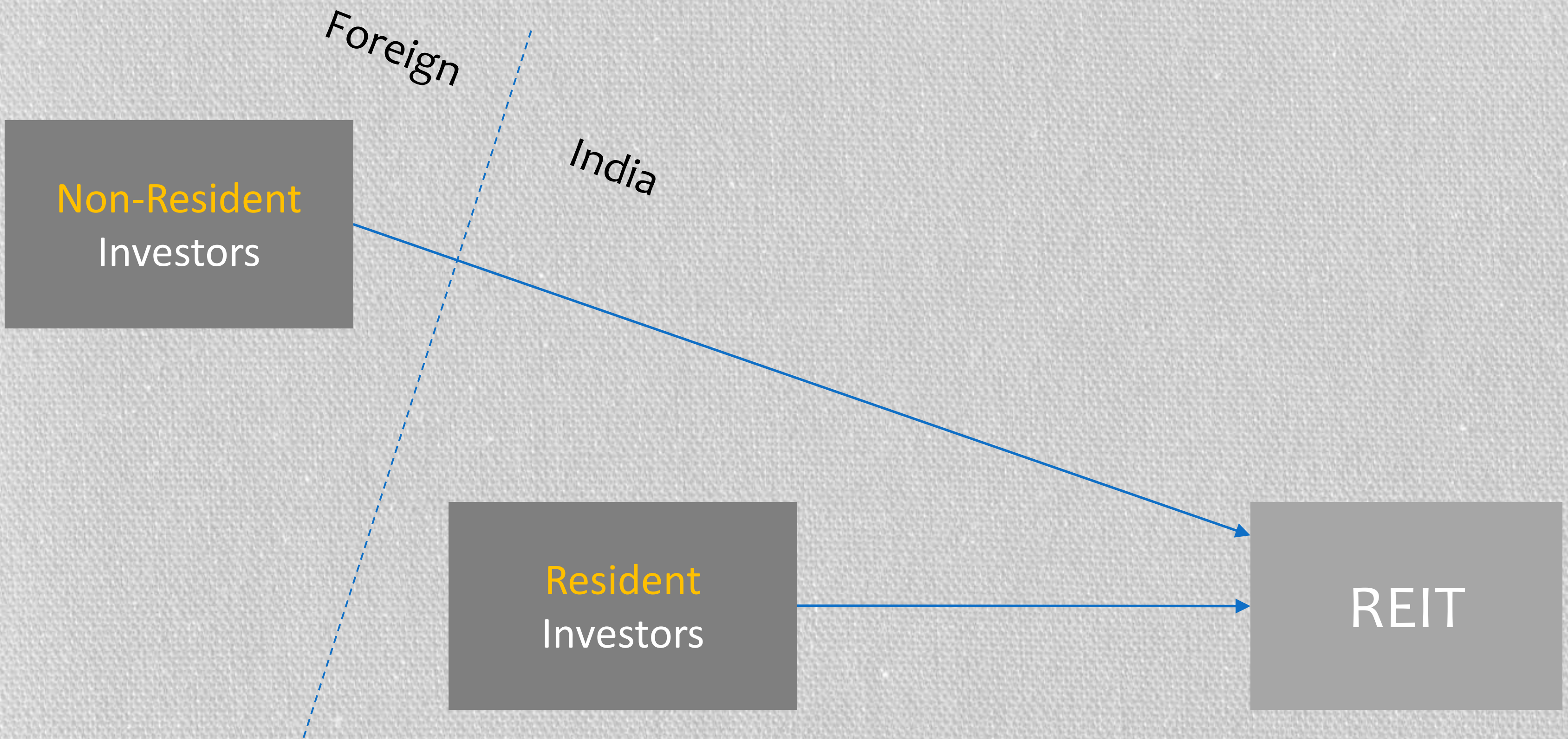
II. Unit Holders (Investors) lend money to the REIT

Unit Holders can be both: Residents and Non-Residents

Answer 9


Investors can lend debt-funds also to the REIT
Investors (Residents & Non-Residents)
REIT

Answer 9



REITs can take **loans** from Resident Unit-Holders as well as from Non-Resident Unit-Holders

Answer 9

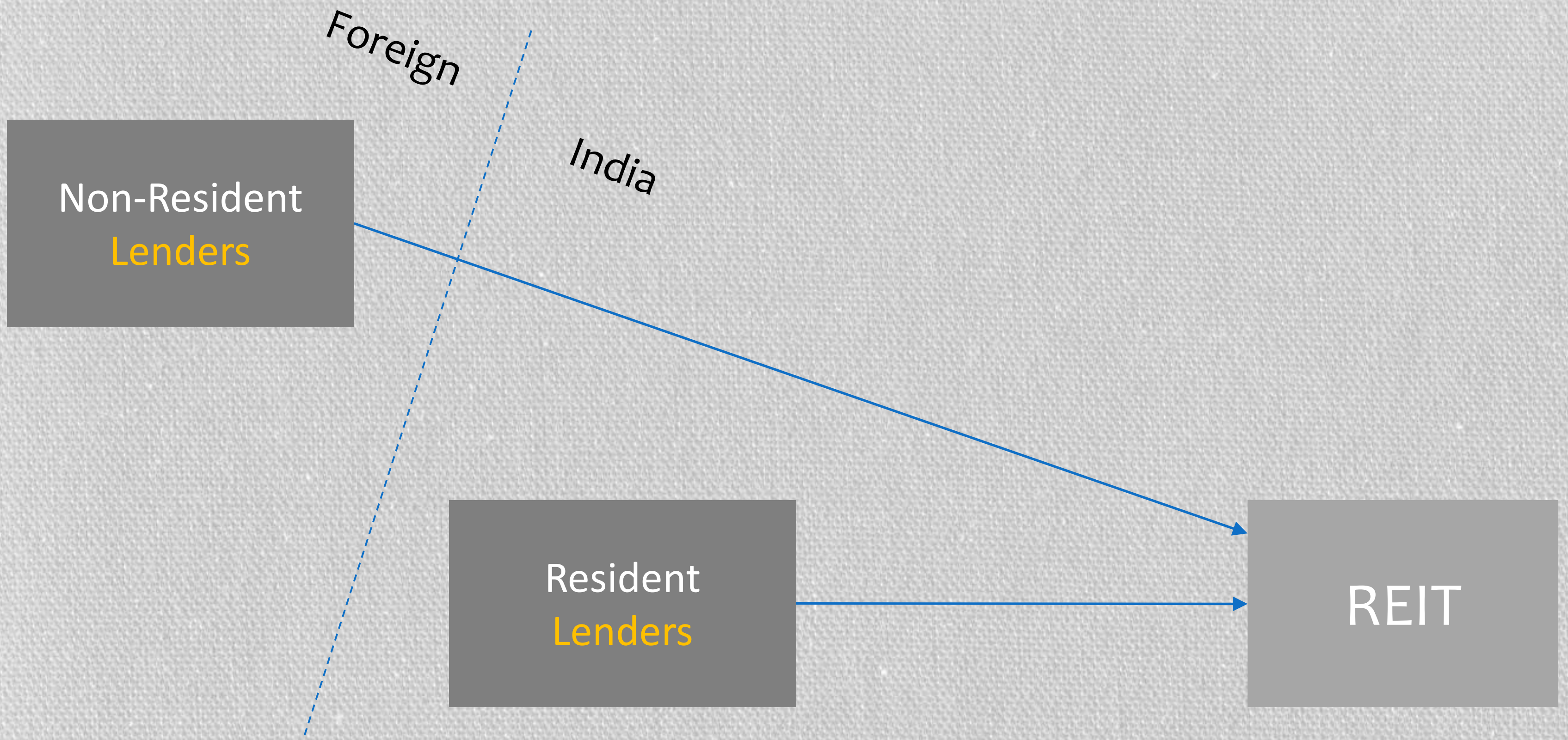
III. Lenders (Non-Unit Holders) lend money to REIT

Lenders can be both: Residents and Non-Residents

Answer 9

REITs can take loans from Resident Lenders. REITs can also take loans from Non-Resident Lenders - by way of ECB (External Commercial Borrowings).

Answer 9

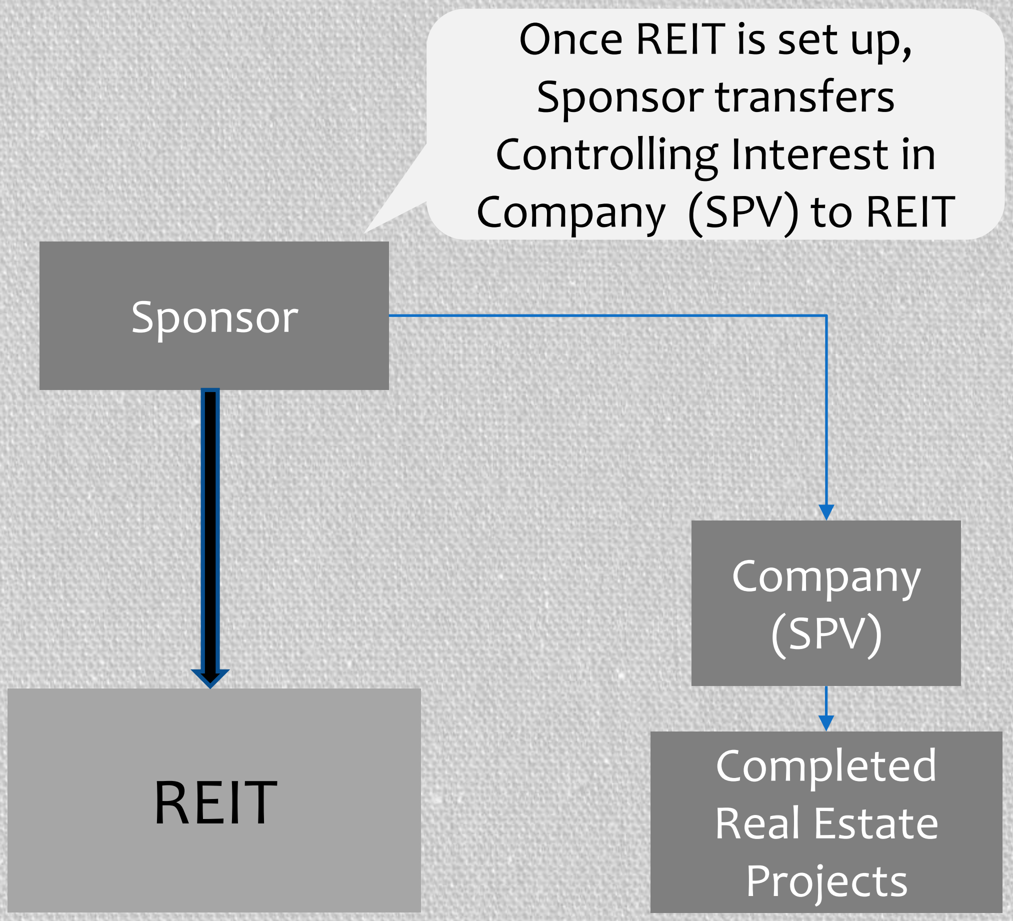


REITs can take **loans** from Resident Lenders as well as from Non-Resident Lenders

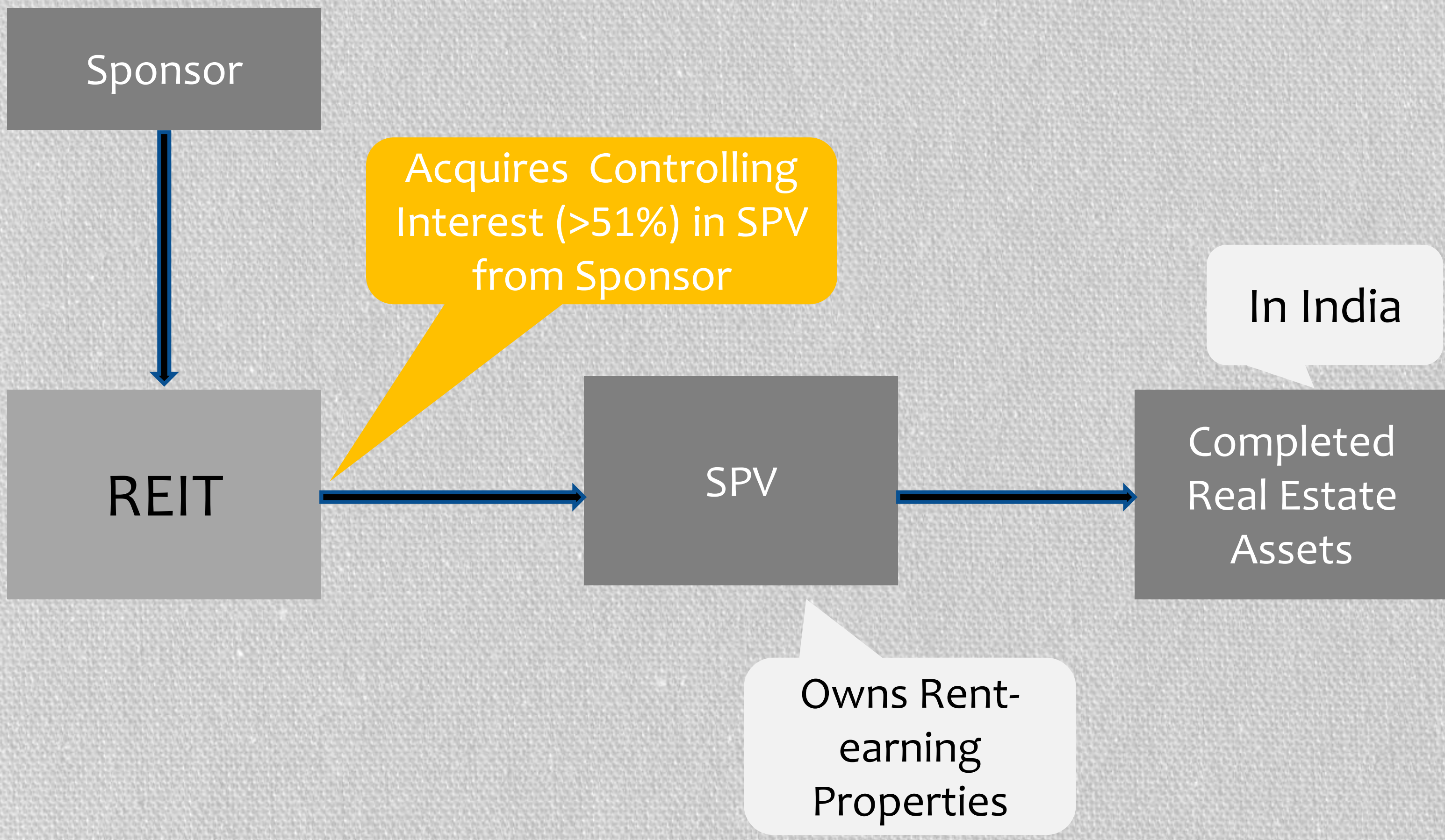
Answer 9

IV. REIT acquires shares of SPV from the Sponsor

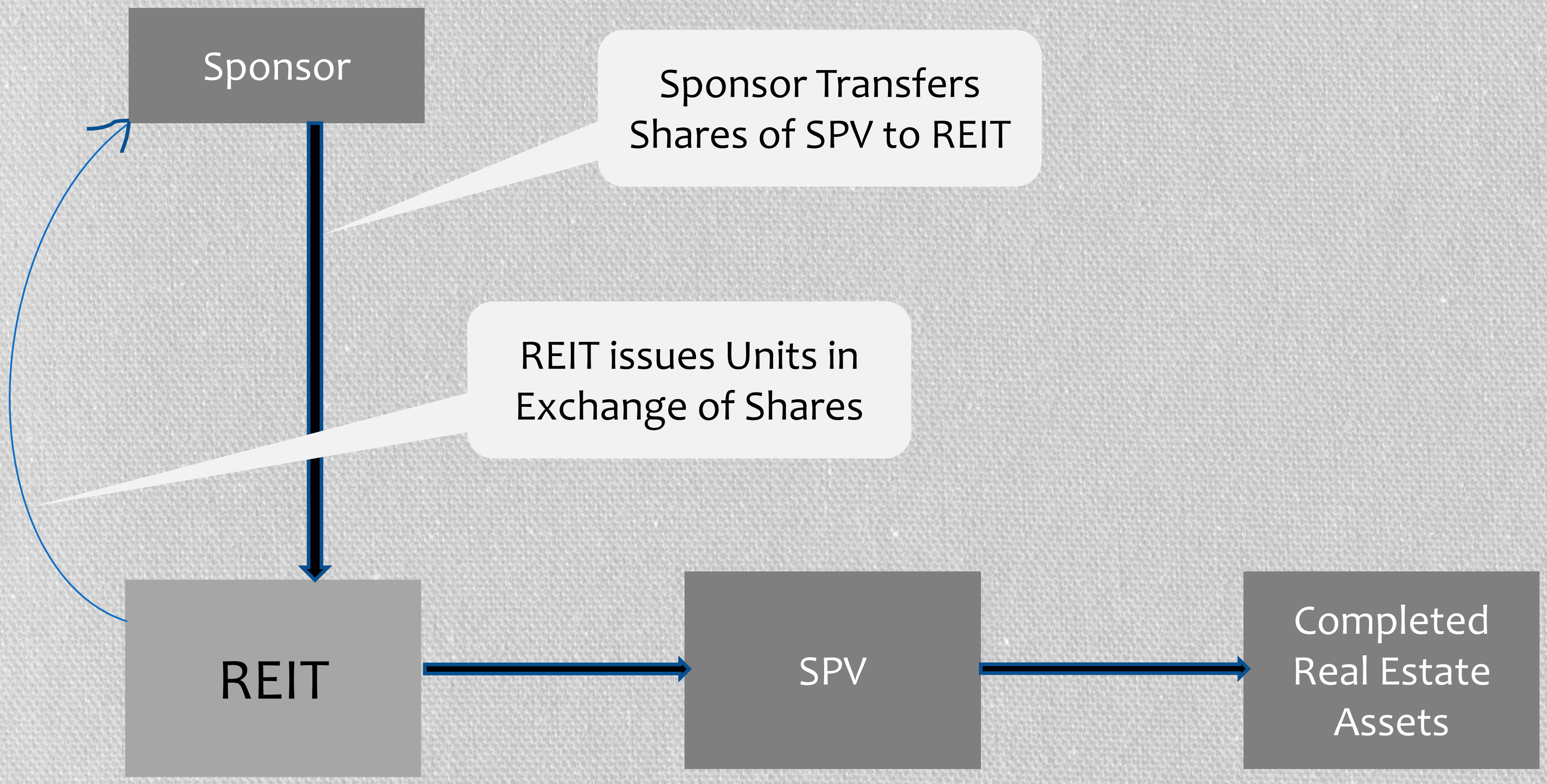
Answer 9


Once REIT is set up, Sponsor transfers Controlling Interest in Company (SPV) to REIT
Sponsor
REIT
Company (SPV)
Completed Real Estate Projects

Answer 9


Sponsor
Acquires Controlling Interest (>51%) in SPV from Sponsor
REIT
SPV
In India
Completed Real Estate Assets
Owns Rent-earning Properties

Answer 9

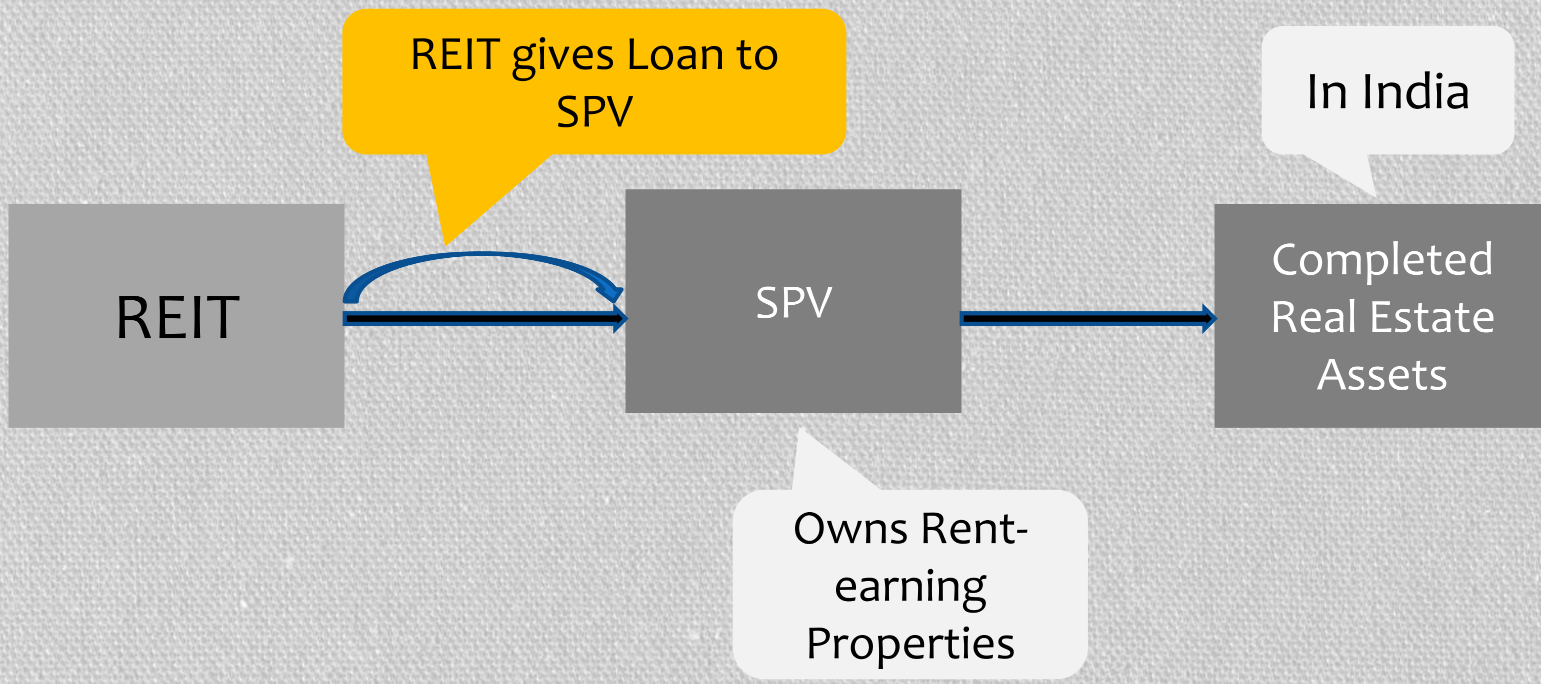


Sponsor
Sponsor Transfers Shares of SPV to REIT
REIT issues Units in Exchange of Shares
REIT
SPV
Completed Real Estate Assets

Answer 9

V. REIT gives loan to SPV

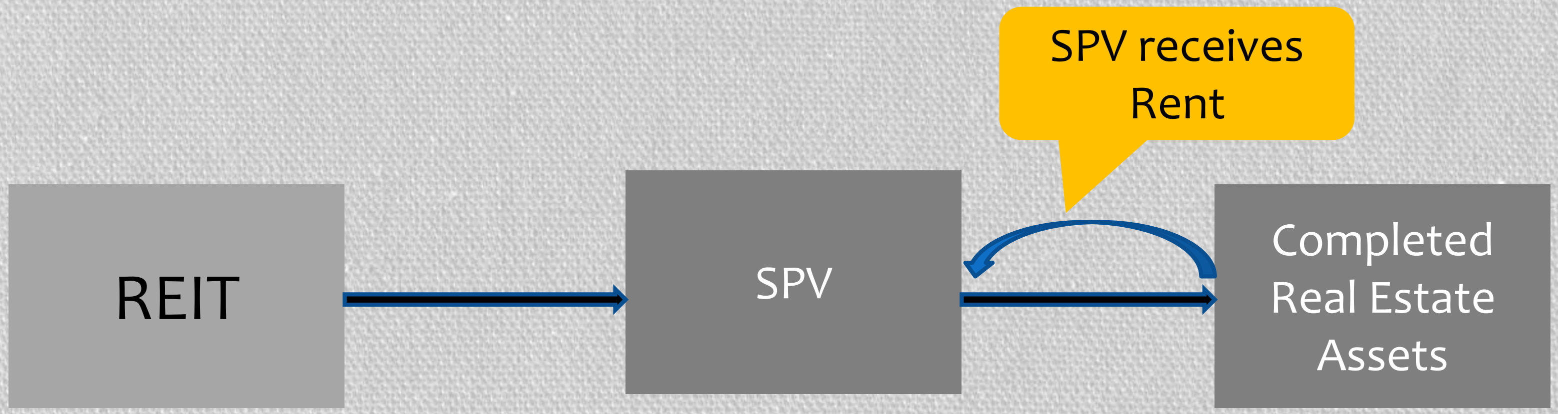
Answer 9


REIT gives Loan to SPV
In India
REIT
SPV
Completed Real Estate Assets
Owns Rent-earning Properties

Answer 9

VI. SPV receives Rent from Properties

Answer 9



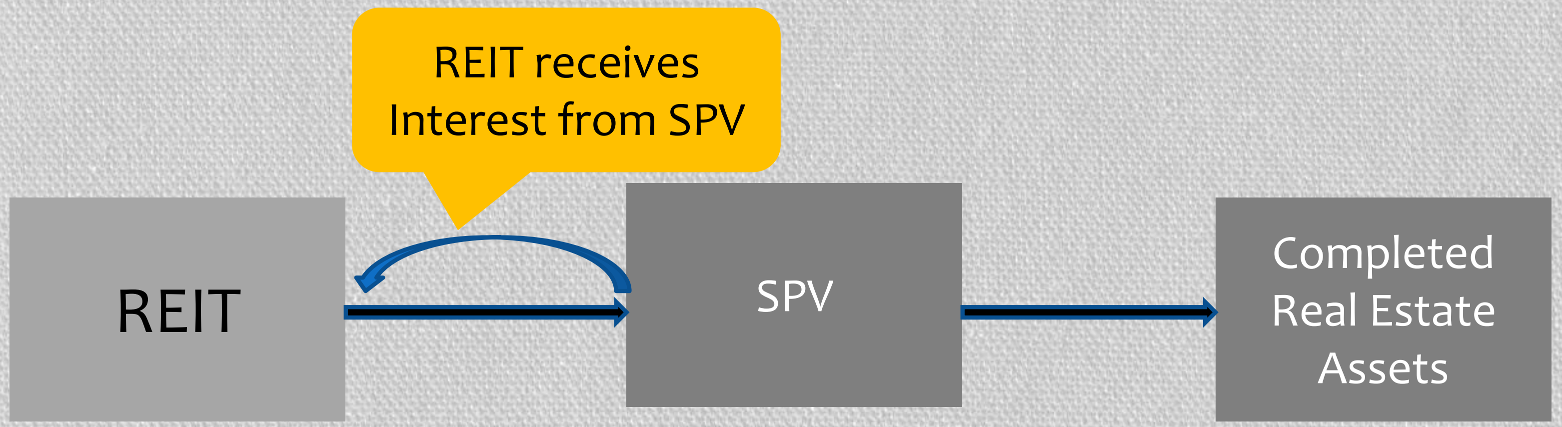
Answer 9

Next come Various Payments Received by REIT from SPV

Answer 9

VII. SPV pays Interest to REIT

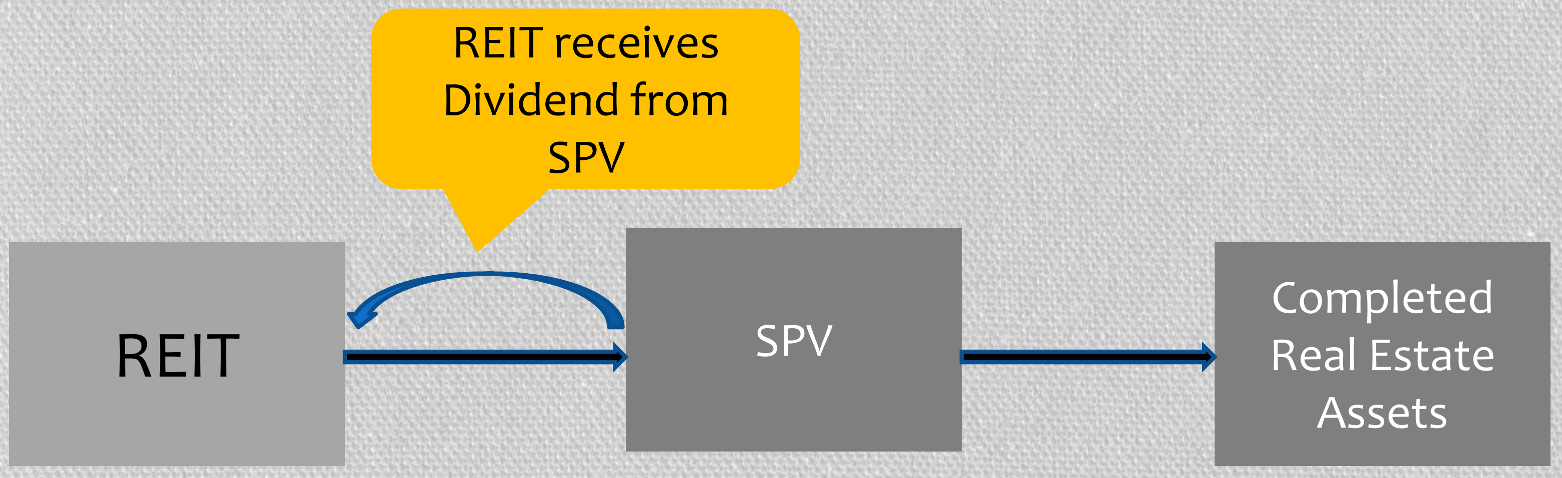
Answer 9


REIT receives Interest from SPV
REIT
SPV
Completed Real Estate Assets

Answer 9

VIII. SPV pays Dividend to REIT

Answer 9

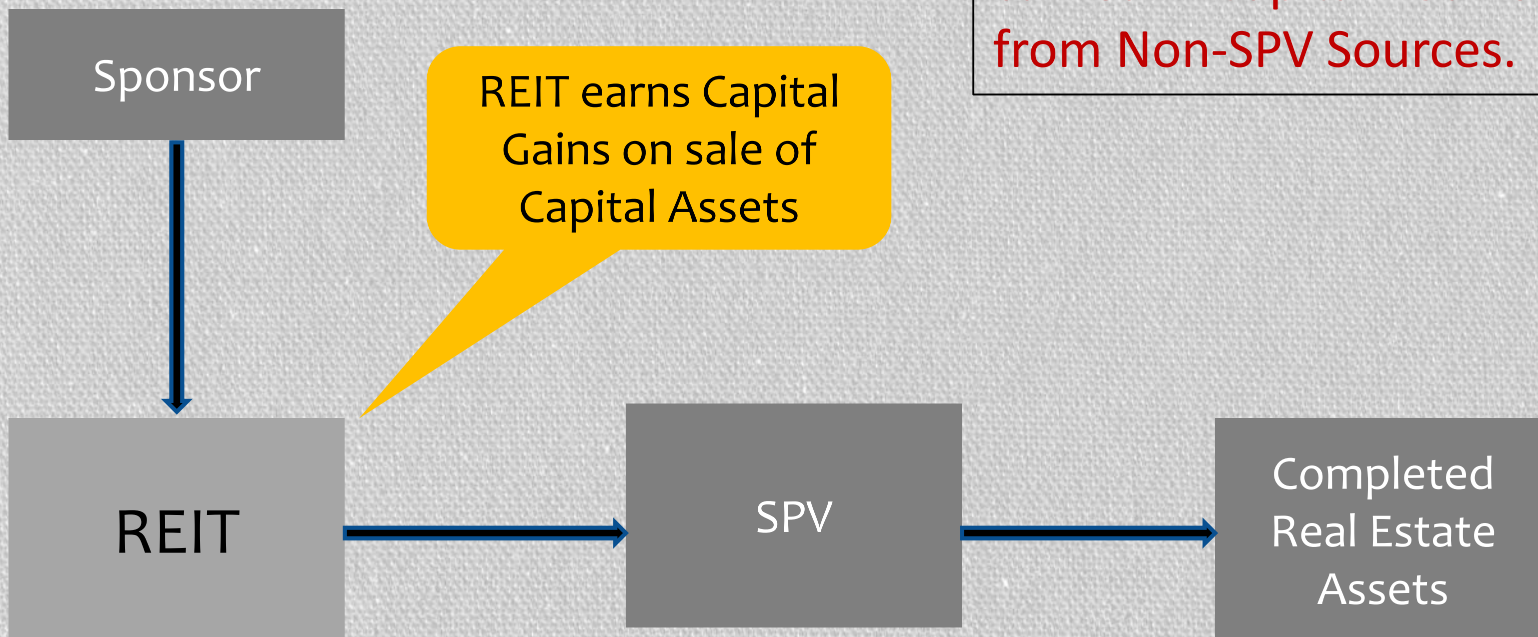

REIT receives Dividend from SPV
REIT
SPV
Completed Real Estate Assets

Answer 9

IX. REIT earns Capital Gains on sale of Capital Assets

Answer 9

REIT can invest in Securities other than Shares of SPV. So REIT can earn Capital Gains from Non-SPV Sources.

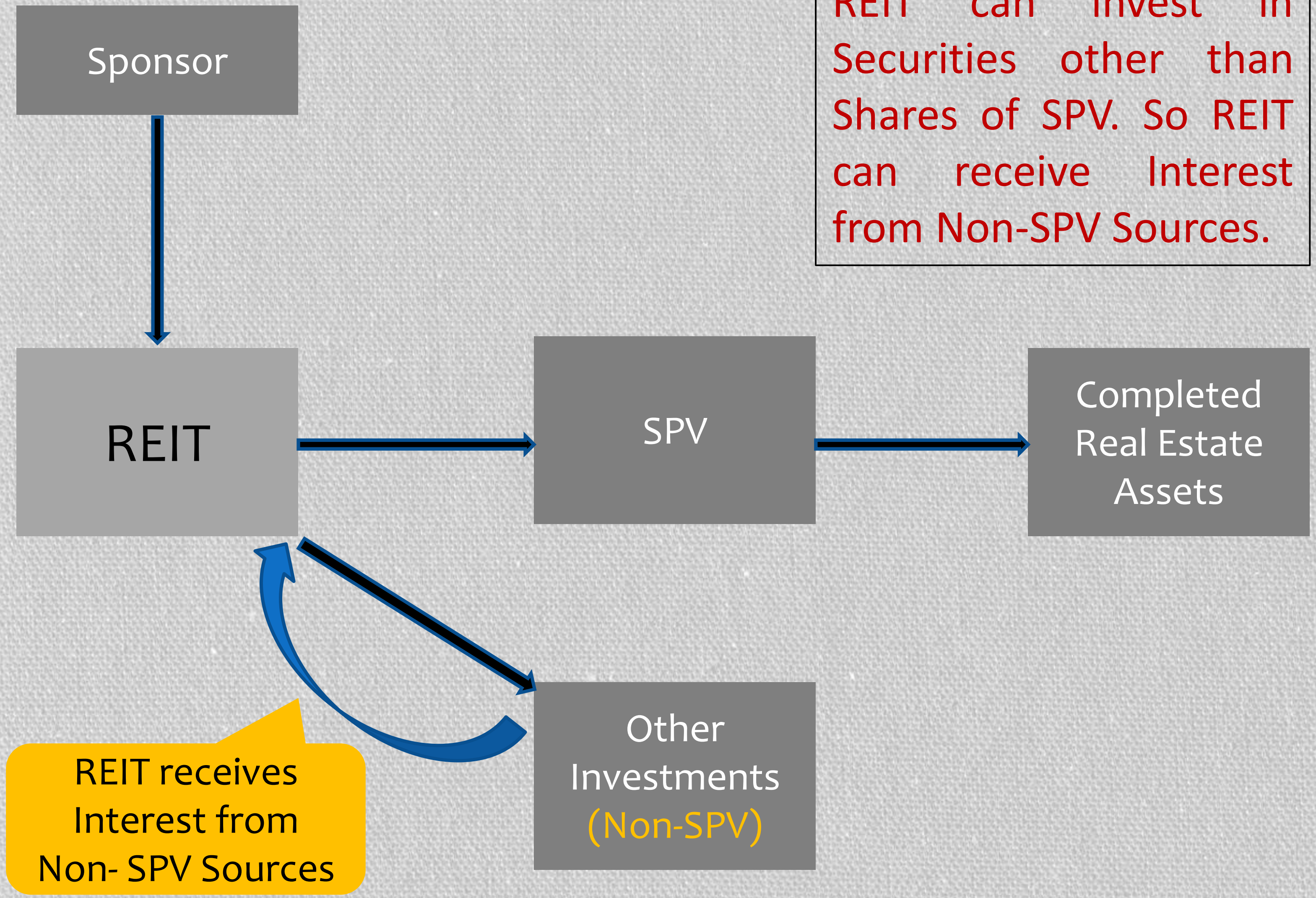


Answer 9

X. REIT receives Interest from Non-SPV Sources

Answer 9

REIT can invest in Securities other than Shares of SPV. So REIT can receive Interest from Non-SPV Sources.



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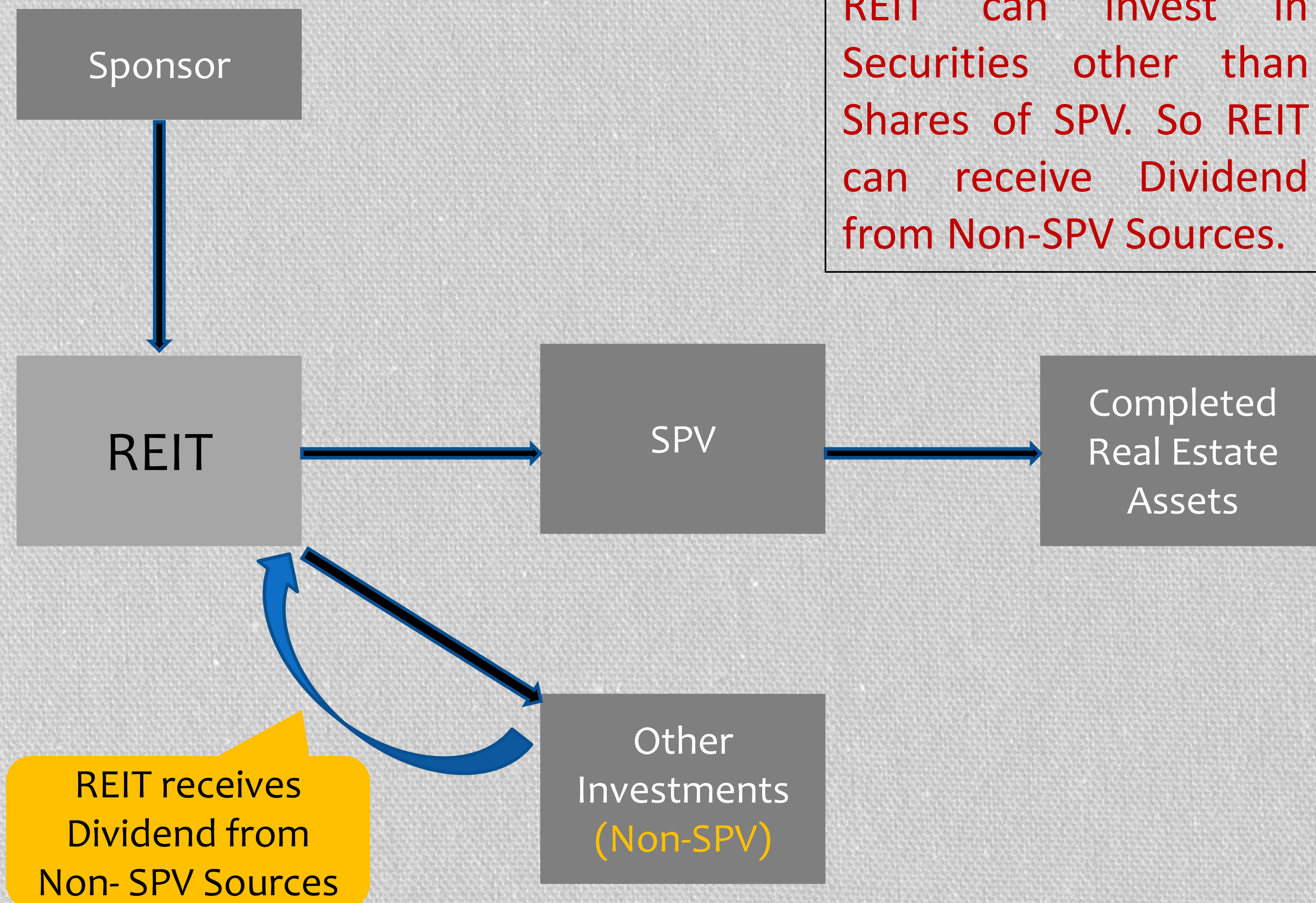
Answer 9

XI. REIT receives Dividend from Non-SPV Sources

Answer 9

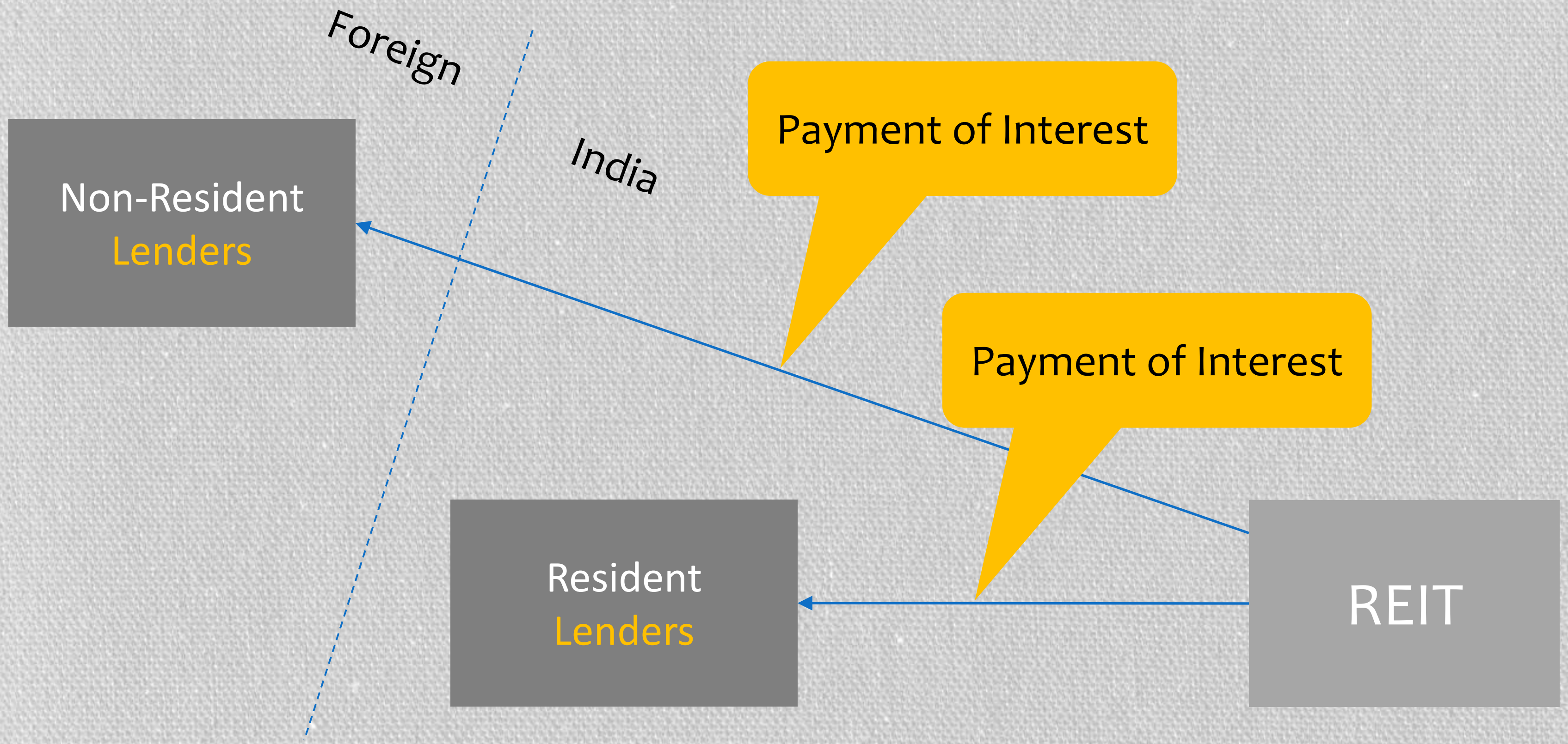
REIT can invest in Securities other than Shares of SPV. So REIT can receive Dividend from Non-SPV Sources.



Answer 9

XII. Payment of Interest by REIT to Third Party Lenders (Non-Unit Holders)

Answer 9



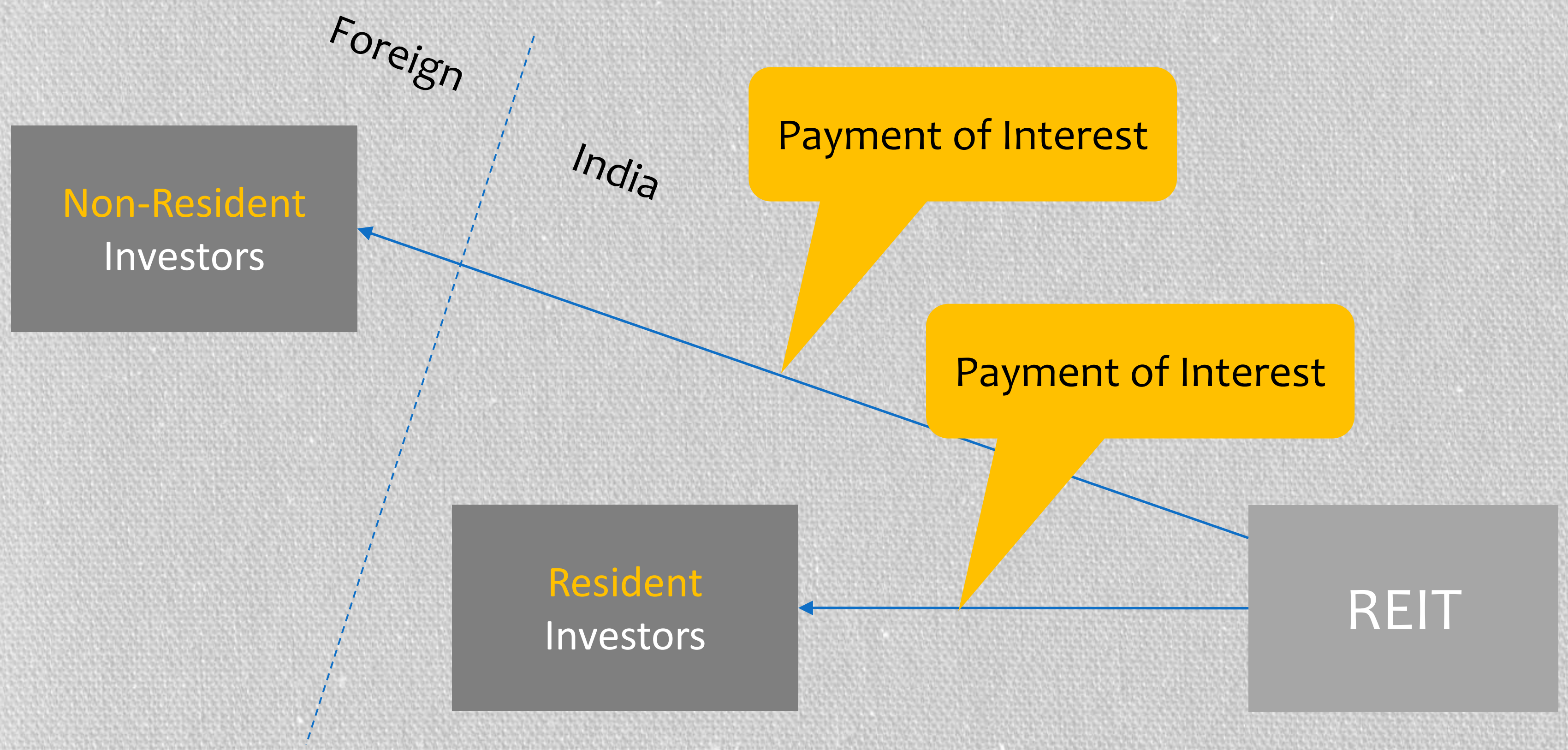
REIT pays Interest to Third Party Lenders (Non-Unit Holders)

Answer 9

XIII. Payment of Interest by REIT to Unit-Holders, on Loans given by them to REIT

This payment (of Interest to Unit-Holders on loans given by them) is different and separate from the Distribution - of the interest component of its income - by REIT to Unit-Holders. This is Payment; the other is Distribution.

Answer 9



REIT pays Interest to Unit-Holders, on loans taken from Unit-Holders

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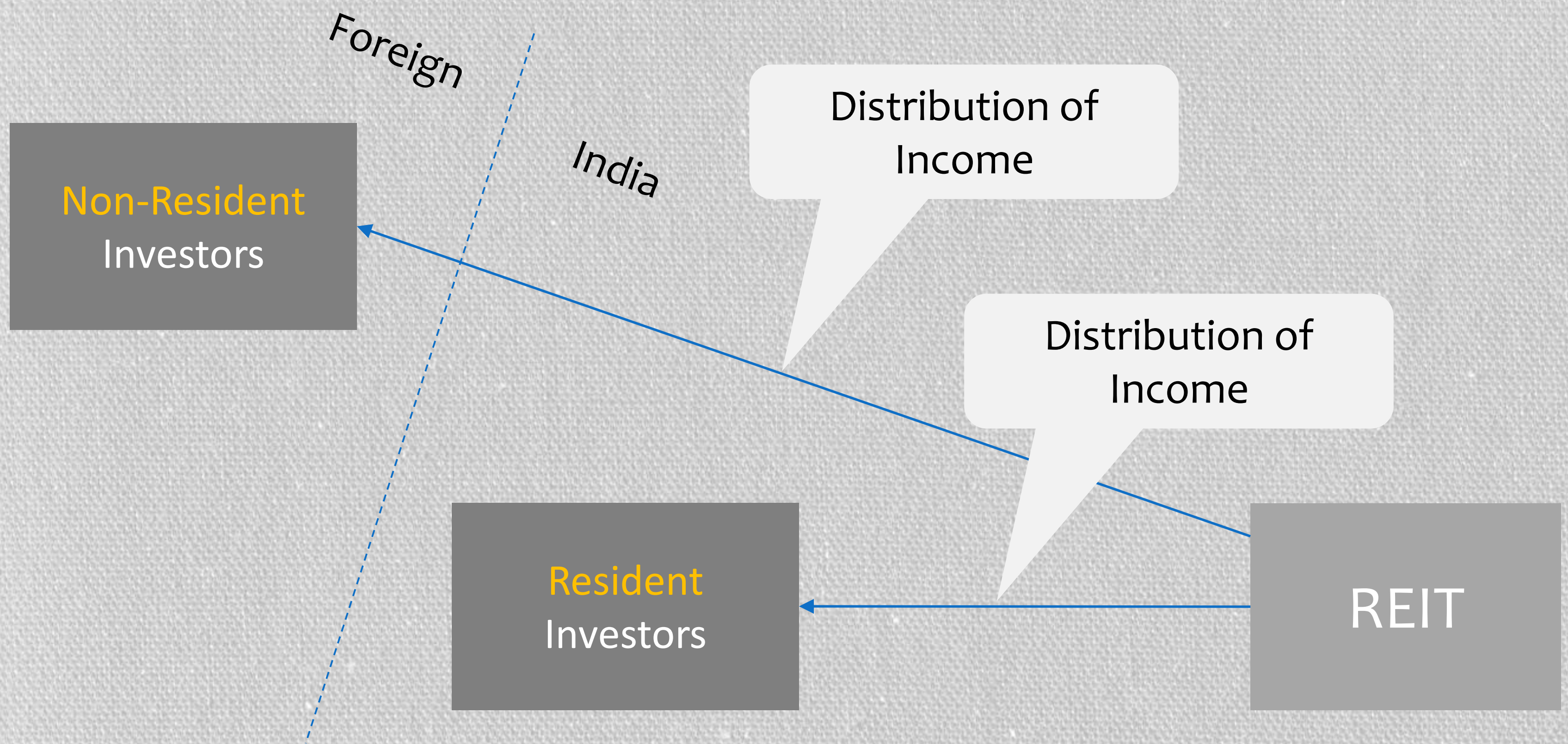
Answer 9

XIV. Distribution of Income by REIT to Unit-Holders

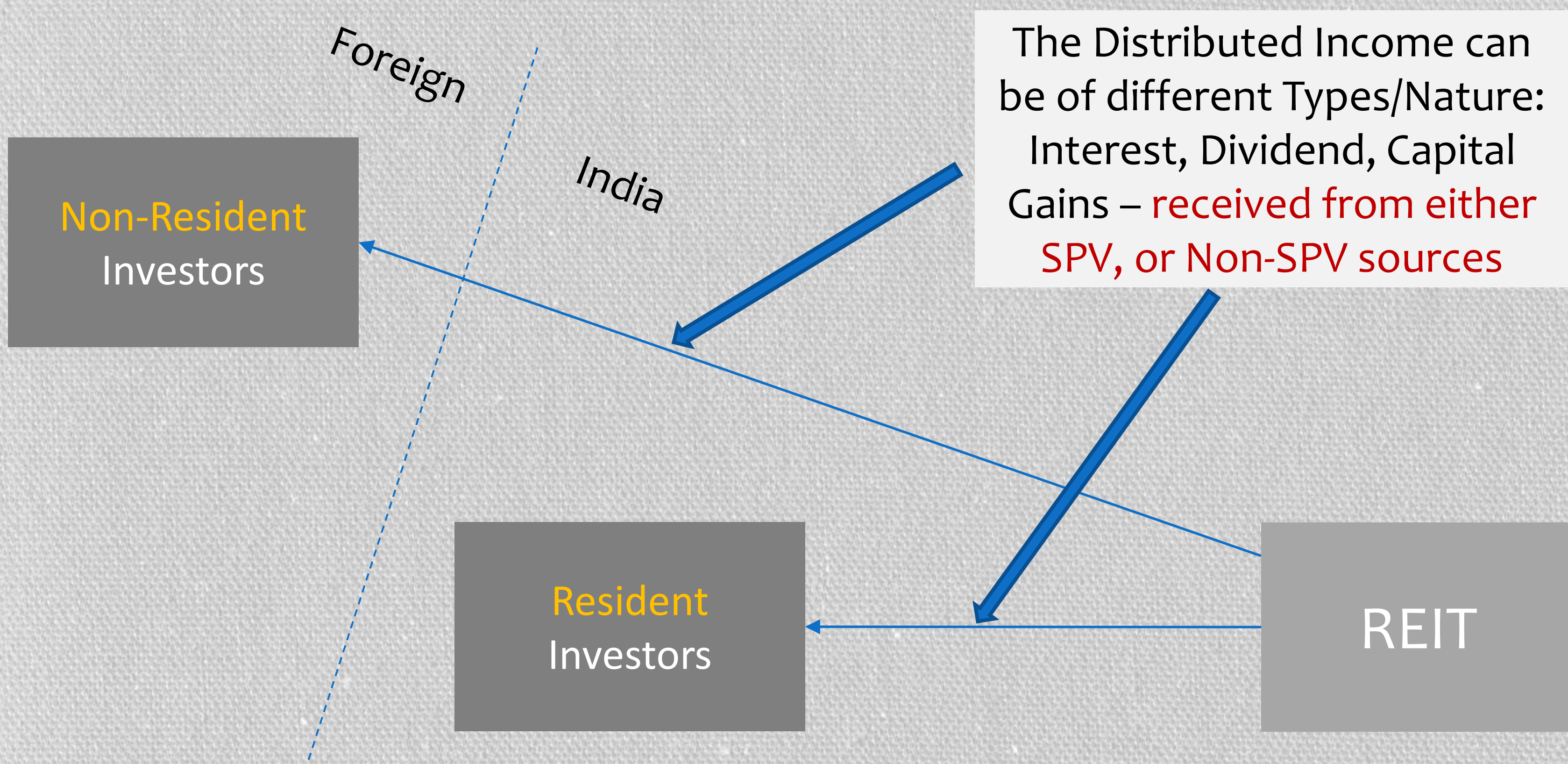
As per the Draft SEBI Regulations (REIT), a REIT has to distribute at least 90% of its net distributable income (after tax) to the Unit Holders.

Answer 9



REIT distributes net distributable income (after-tax) to the Unit-Holders

Answer 9



REIT distributes net distributable income (after-tax) to the Unit-Holders

Answer 9

XV. Sale of Units by the Unit-Holders through Stock Exchange

As per the Draft SEBI Regulations (REIT), a REIT has to list its Units on Stock Exchange. So the Unit Holders can transfer the Units with ease.

Answer 9

- Here we end the presentation of 15 types of Transactions that can take place within the framework of REITs

- Later, we will examine the Tax Aspects of these Transactions

Infrastructure Investment Trusts (InvITs)

Question 10

What is a Infrastructure Investment Trust (InvIT)?

Answer 10

A InvIT, like REIT, is essentially an investment vehicle. Investors subscribe to Units of a InvIT and thus pool together their monetary resources. With the Capital invested by the Investors, a InvIT acquires Infrastructure Assets like roads, seaports, airports, etc.

InvITs invest in both completed and under-completion Infrastructure Projects.

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Question 11

What is the need for Infrastructure Investment Trusts (InvITs) in India?

Answer 11

Undeniably, Infrastructure is the cornerstone of development of any Country. In India, Infrastructure sector needs a significant boost.

So, a suitable investment vehicle is required for investment in Infrastructure sector in India. InvIT provides the vehicle for such investment.

Question 12

What are the benefits of Infrastructure Investment Trusts (InvITs) ?

Answer 12

InvITs are beneficial to both the Developers of Infrastructure Projects and the Investors.

Benefits to Developers

- InvITs provide a suitable structure for financing and re-financing of Infrastructure Projects
- By doing so, InvITs enable the Developer to refinance existing high-cost debt with long-term low-cost capital
- Also, InvITs provide a means to free up the current Developer for re-investment into new projects

Answer 12

InvITs are beneficial to both the Developers of Infrastructure Projects and the Investors.

Benefits to Developers

- InvITs are suitable vehicles to attract international finance into Indian Infrastructure Sector
- InvITs can bring higher standards of governance into infrastructure development and management

Answer 12

Benefits to Investors

- InvITs provide a less risky avenue of investment to the Investors – investing *directly* in Infrastructure Projects is fraught with risks
- InvITs provide Investors an option to invest in those kinds of properties in which they otherwise would not have been able to invest
- InvITs enable Investors to hold a diversified portfolio of Infrastructure Assets

Question 13

What is the current status of Infrastructure Investment Trusts (InvITs) in India?

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Answer 13

In December 2013, the Securities and Exchange Board of India (SEBI) had put forth a Consultative Paper on InvITs, for public comments. The Final Proposals and related Regulations are yet to be notified.

Question 14

What will be the salient features of Infrastructure Investment Trusts (InvITs)?

Answer 14

As per SEBI Consultative Paper InvITs will have the following features:

- InvITs will be registered with SEBI
- Their Units will be listed on a Stock Exchange
- Listed InvITs provide liquidity – Investors can easily exit
- A InvIT will bundle a portfolio of Infrastructure Projects, a mix of completed (already generating cash flows) and under-completion Projects
- InvITs will be managed by Professional Managers having skill and experience in development of Infrastructure Projects

Question 15

How is a InvIT different from a REIT?

Answer 15

The inherent nature of Infrastructure Assets (Roads, Bridges, Ports, Airports, etc.) is different from Real Estate Assets (Malls, Offices, Residential Buildings, Warehouses, etc.)

Answer 15

Specifically, Infrastructure Projects have following unique characteristics :

- At the end of a specified period the assets may be transferred back to the Government
- Only the right to receive cash flows might exist; the right to ownership of the asset might not exist – E.g. the ownership of roads stays with the Government; the Developer has only the right to receive cash flows.
- Various Regulatory Authorities (NHAI, AAI, MMRDA, etc.) are Involved

Answer 15

Considering the differences in the nature of Infrastructure Assets and Real Estate Assets, the Infrastructure Sector requires different types of disclosures and different levels of debt leverage than the Real Estate Sector.

So a separate regulatory framework is required for InvITs, though taxation may be on similar basis as REIT.

REIT is a framework for completed revenue-yielding real estate assets; whereas InvIT is a vehicle for portfolio of completed as well as under-completion Infrastructure Projects.

Question 16

What steps are involved in the Formation of a Infrastructure Investment Trust (InvIT) ?

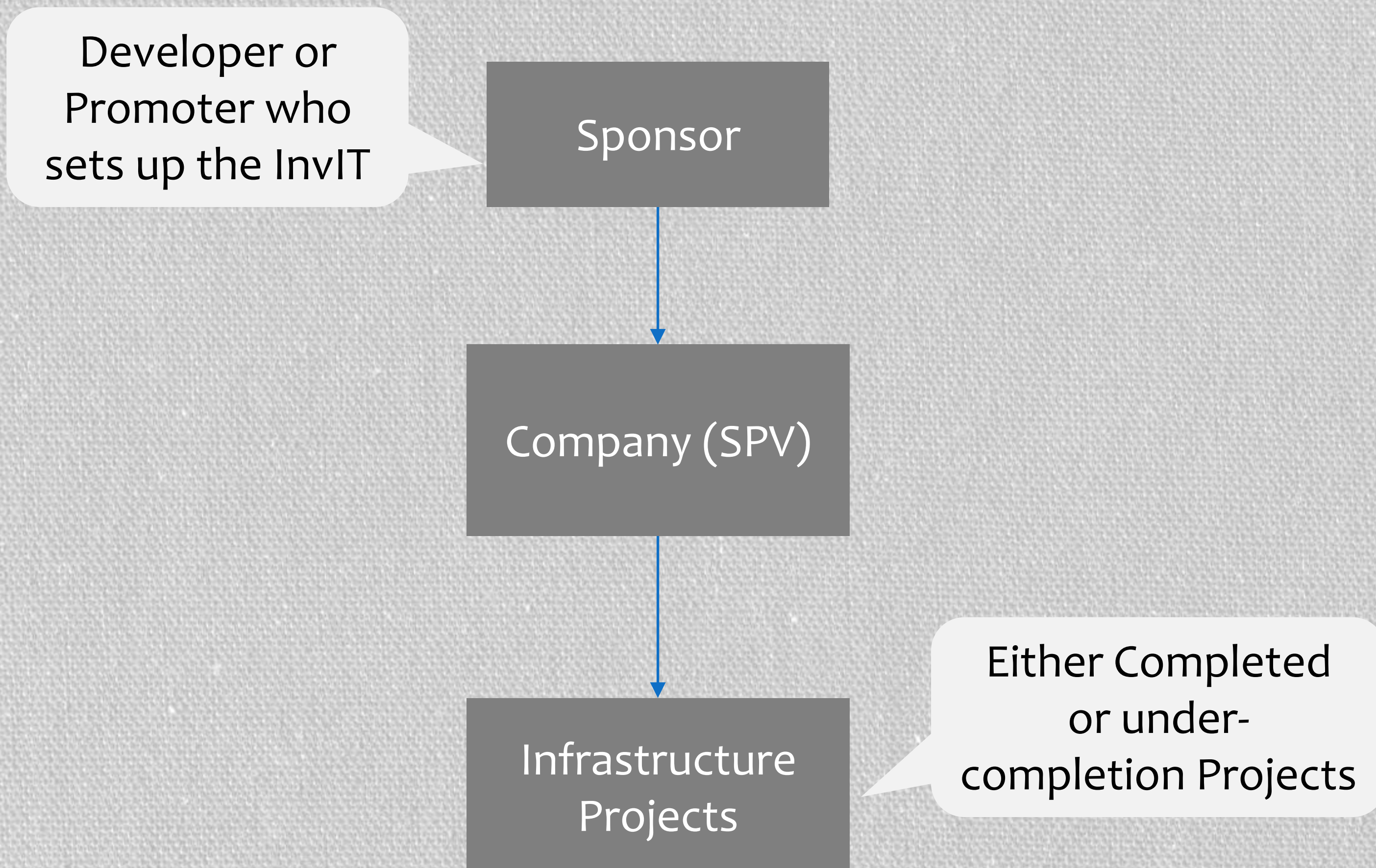
Answer 16

SEBI had placed in public domain a Consultation Paper on InvITs, in December 2013. The Proposal as also the Regulations pertaining to InvITs are yet to be finalized.

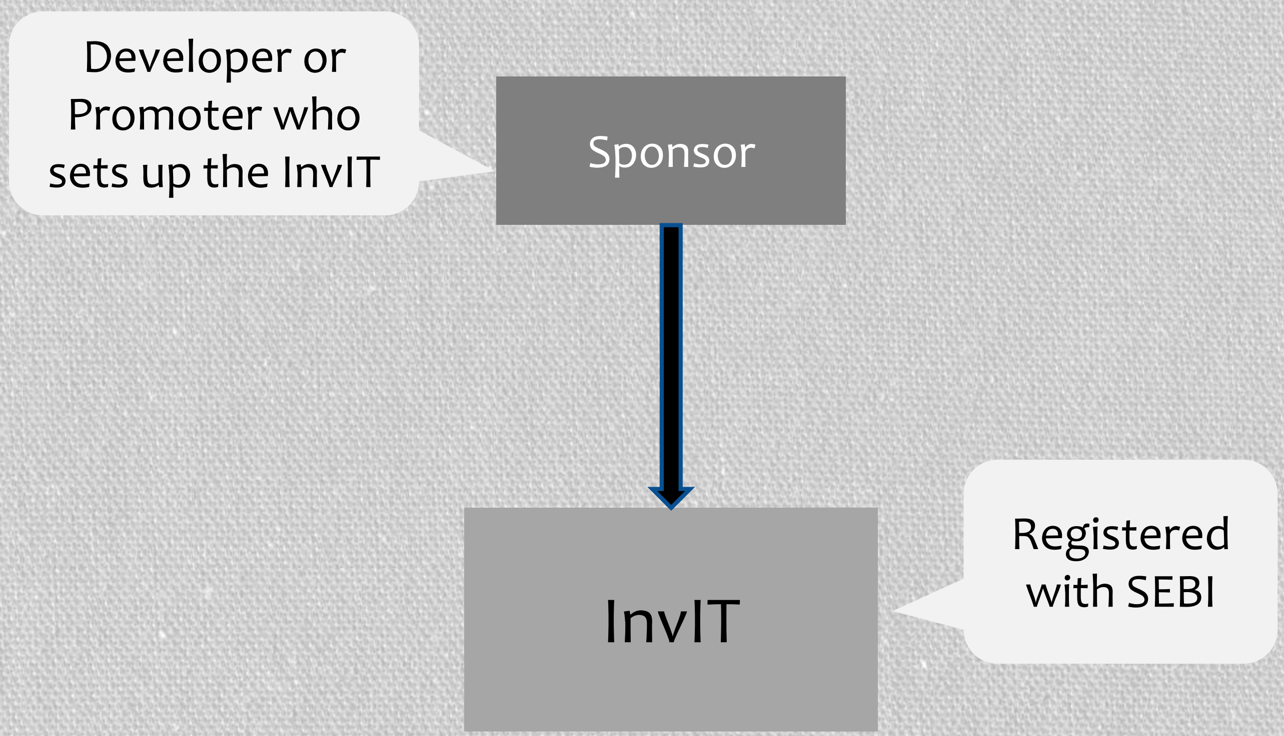
However, the SEBI Consultation Paper and the New Taxation Regime - for both REITs and InvITs – introduced by the Hon. Finance Minister, throw light on the most probable structure of InvITs.

On that basis, the steps involved in formation of a InvIT are depicted in the next few slides. The Steps are quite similar to the Steps involved in formation of a REIT.

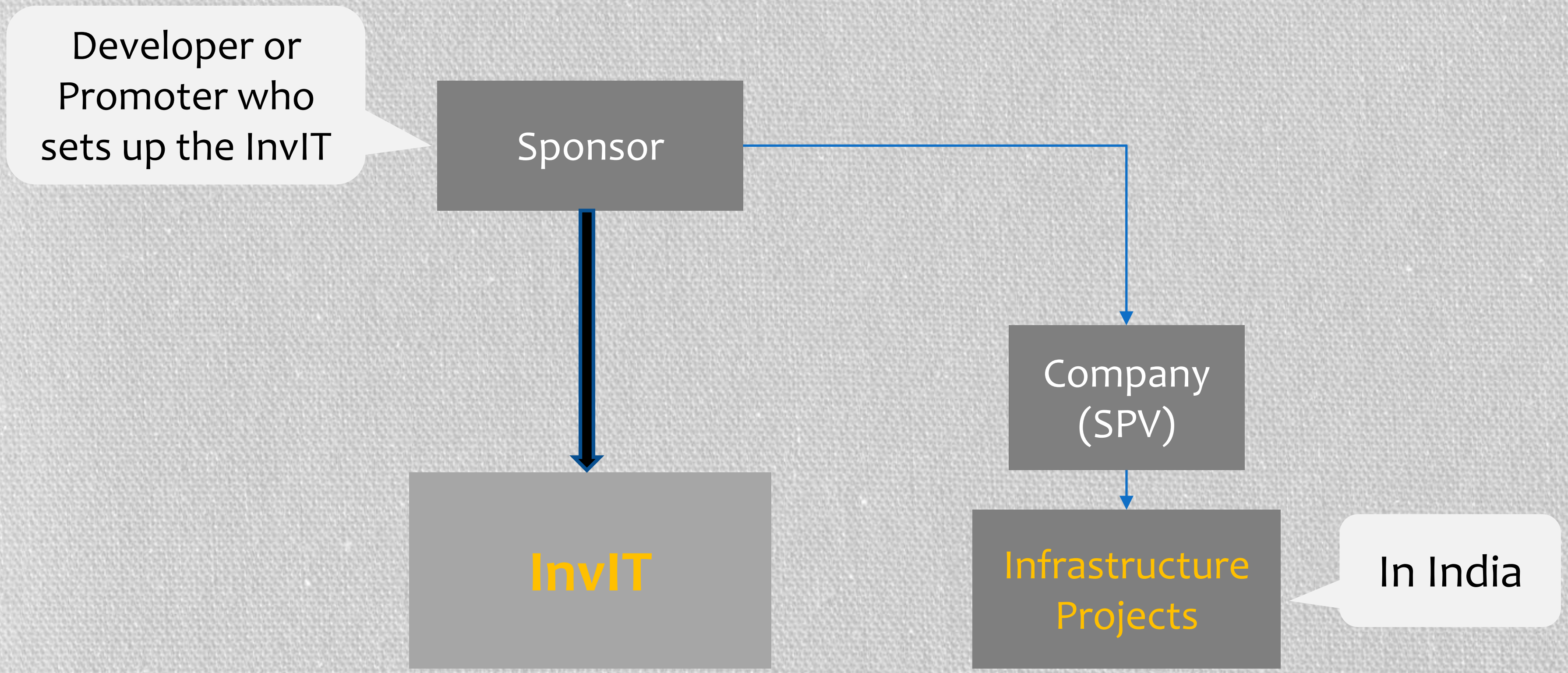
Answer 16


Developer or Promoter who sets up the InvIT
Sponsor
Company (SPV)
Infrastructure Projects
Either Completed or under-completion Projects

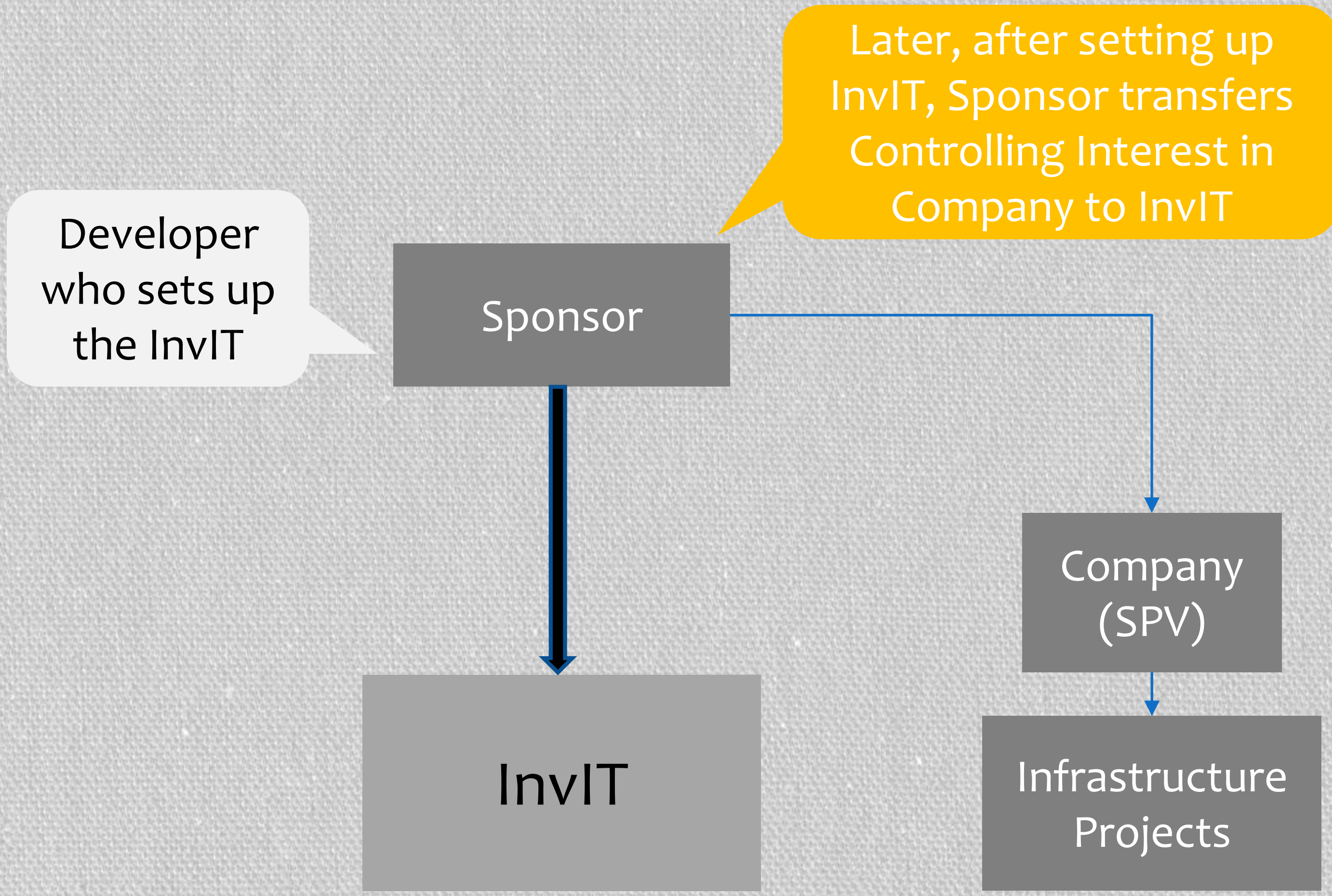
Answer 16


Developer or Promoter who sets up the InvIT
Sponsor
InvIT
Registered with SEBI

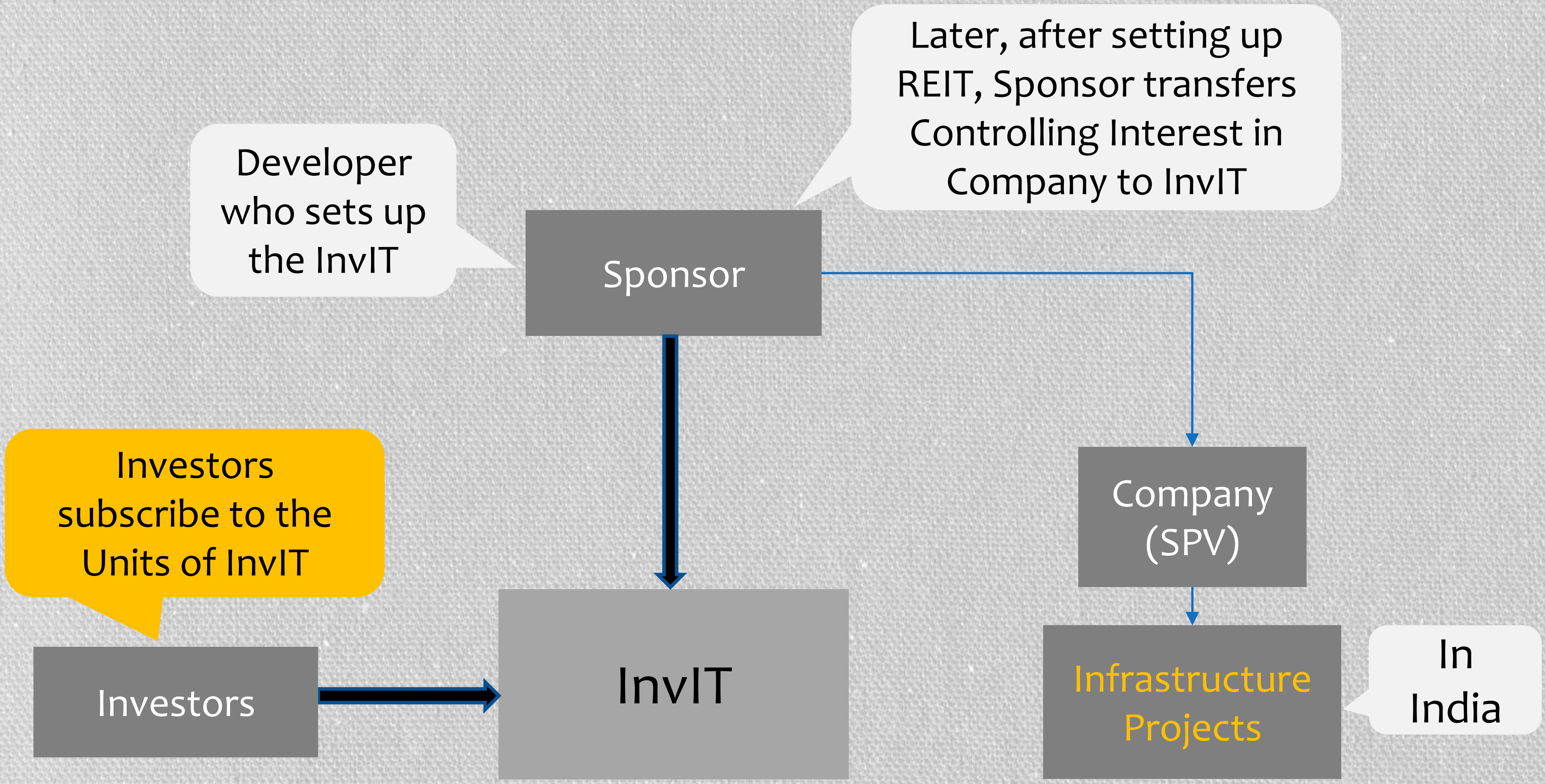
Answer 16


Developer or Promoter who sets up the InvIT
Sponsor
Company (SPV)
InvIT
Infrastructure Projects
In India

Answer 16


Later, after setting up InvIT, Sponsor transfers Controlling Interest in Company to InvIT
Developer who sets up the InvIT
Sponsor
Company (SPV)
InvIT
Infrastructure Projects

Answer 16



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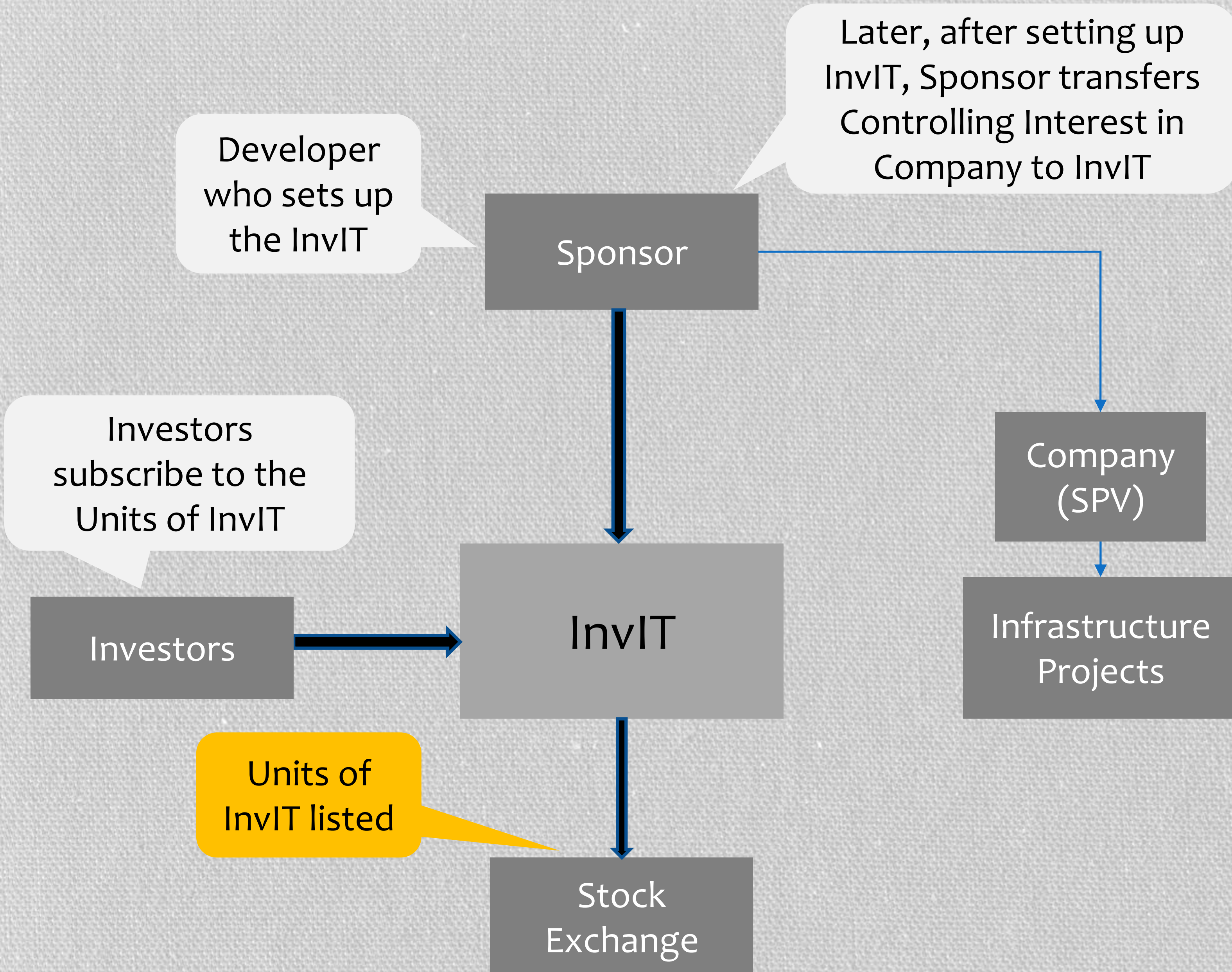
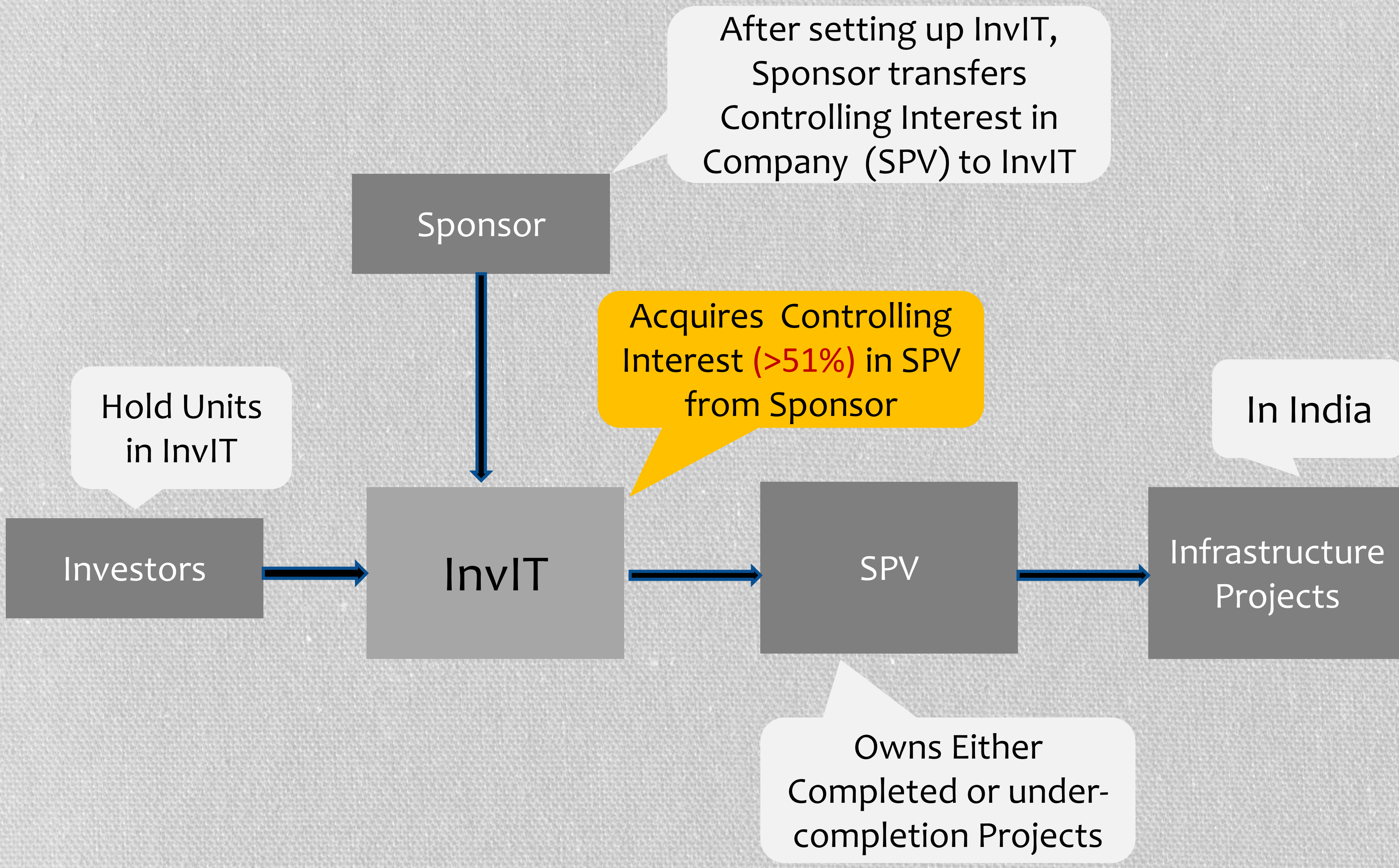
Answer 16

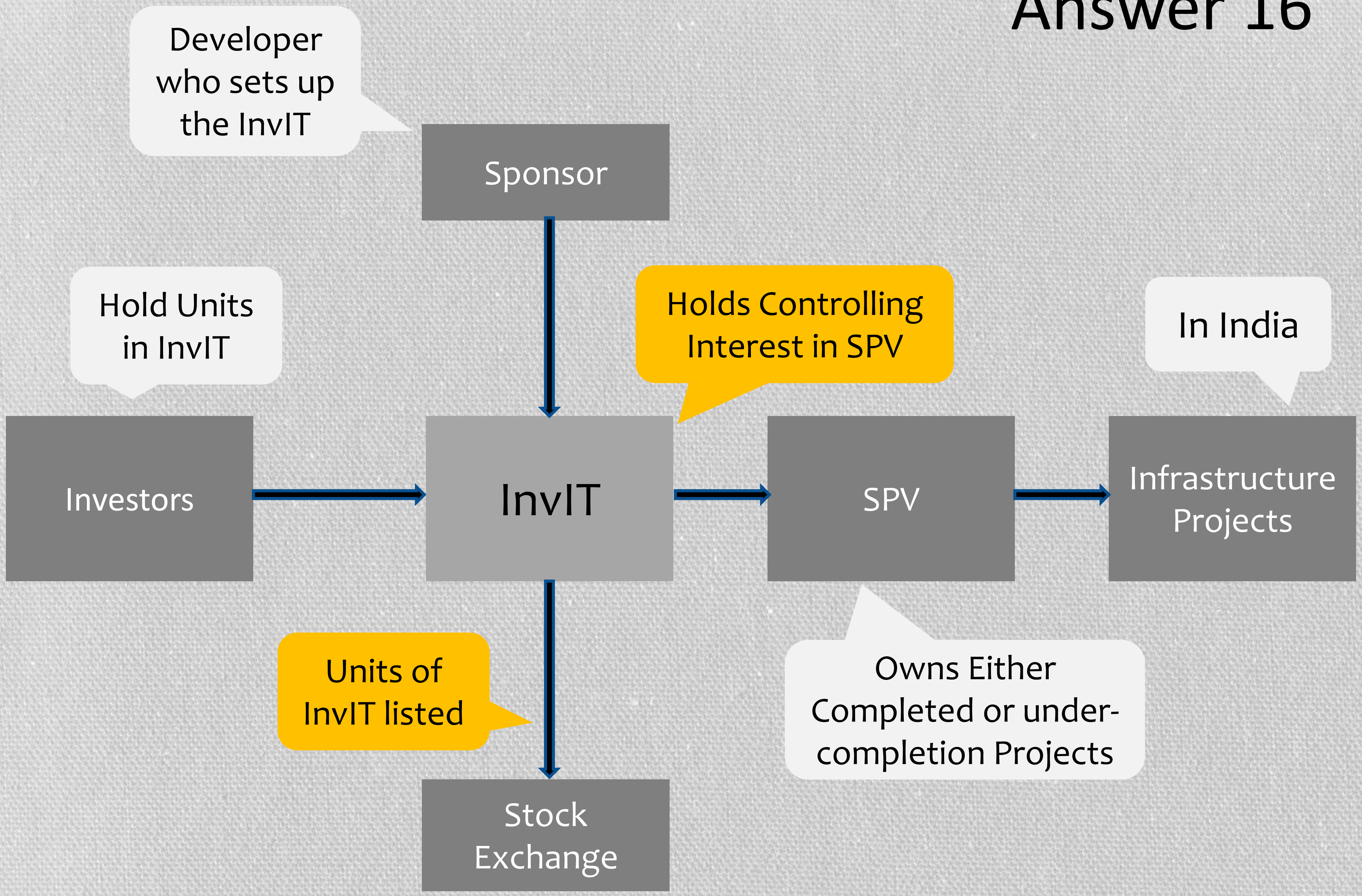


Later, after setting up InvIT, Sponsor transfers Controlling Interest in Company to InvIT
Developer who sets up the InvIT
Sponsor
Company (SPV)
Investors subscribe to the Units of InvIT
Investors
InvIT
Infrastructure Projects
Units of InvIT listed
Stock Exchange

Answer 16


After setting up InvIT, Sponsor transfers Controlling Interest in Company (SPV) to InvIT
Sponsor
Acquires Controlling Interest (>51%) in SPV from Sponsor
Hold Units in InvIT
In India
Investors
InvIT
SPV
Infrastructure Projects
Owns Either Completed or under-completion Projects

Answer 16



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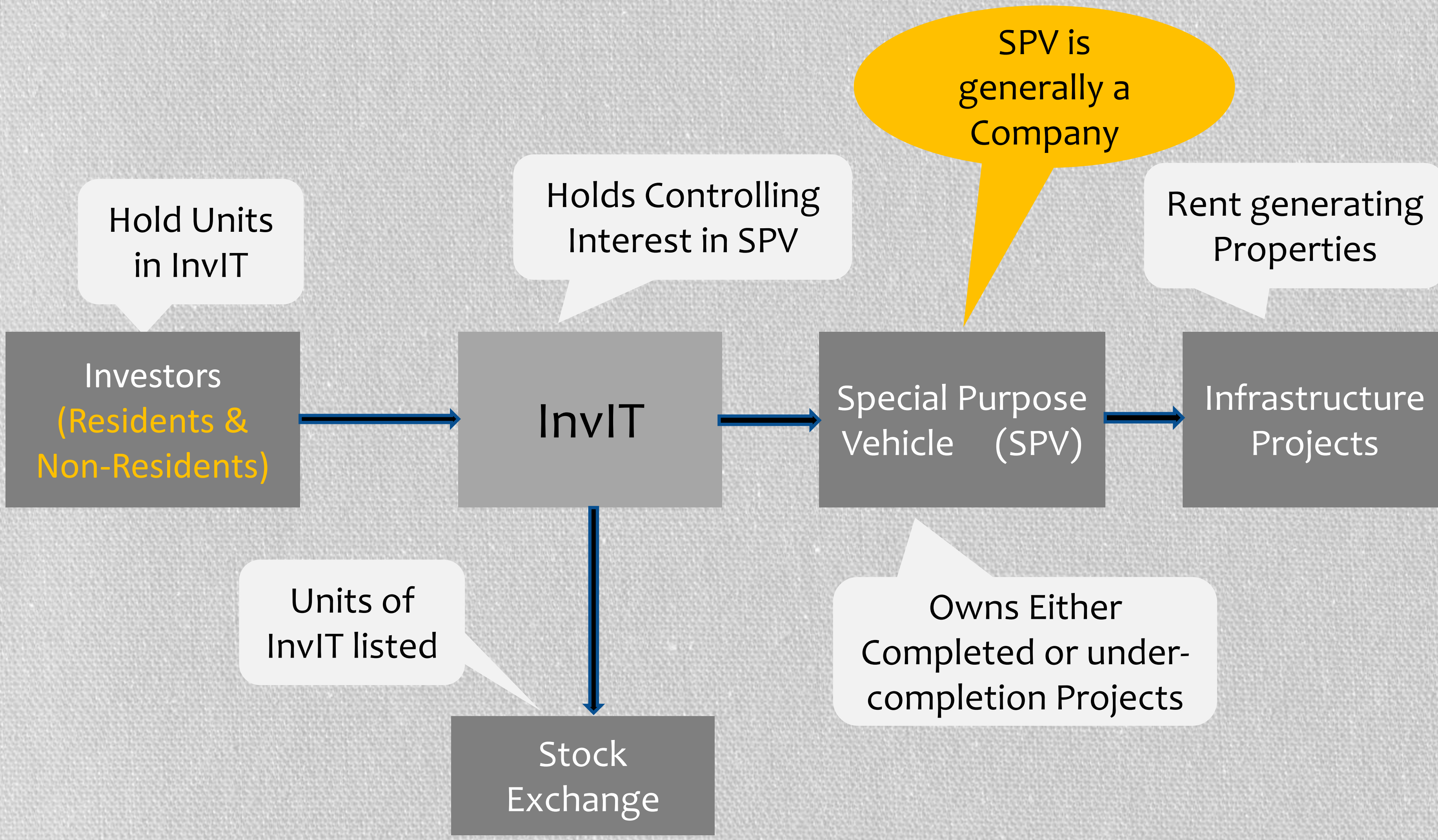
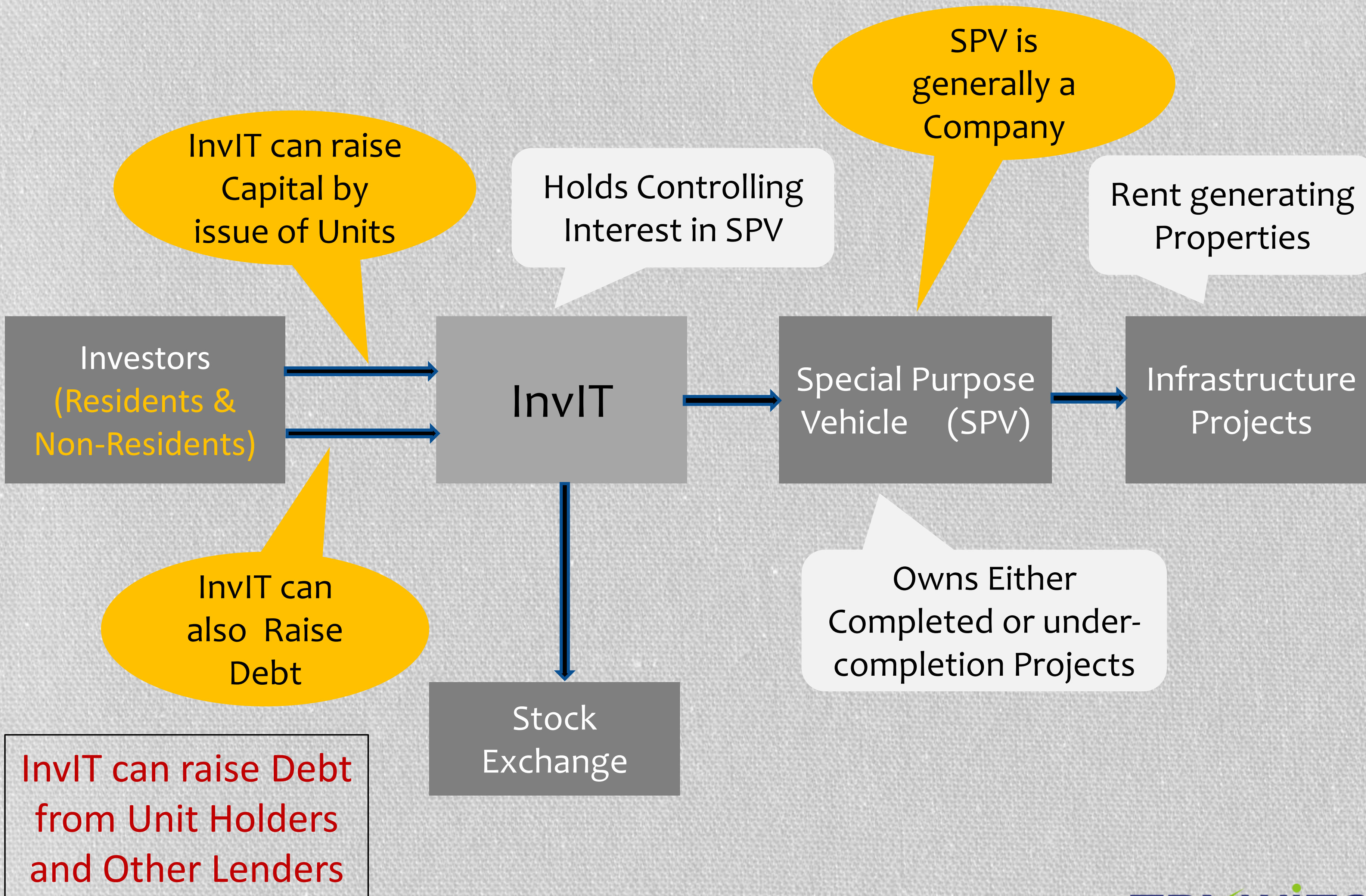
Answer 16


Hold Units in InvIT
Investors (Residents & Non-Residents)
Holds Controlling Interest in SPV
InvIT
SPV is generally a Company
Special Purpose Vehicle (SPV)
Rent generating Properties
Infrastructure Projects
Units of InvIT listed
Stock Exchange
Owns Either Completed or under-completion Projects

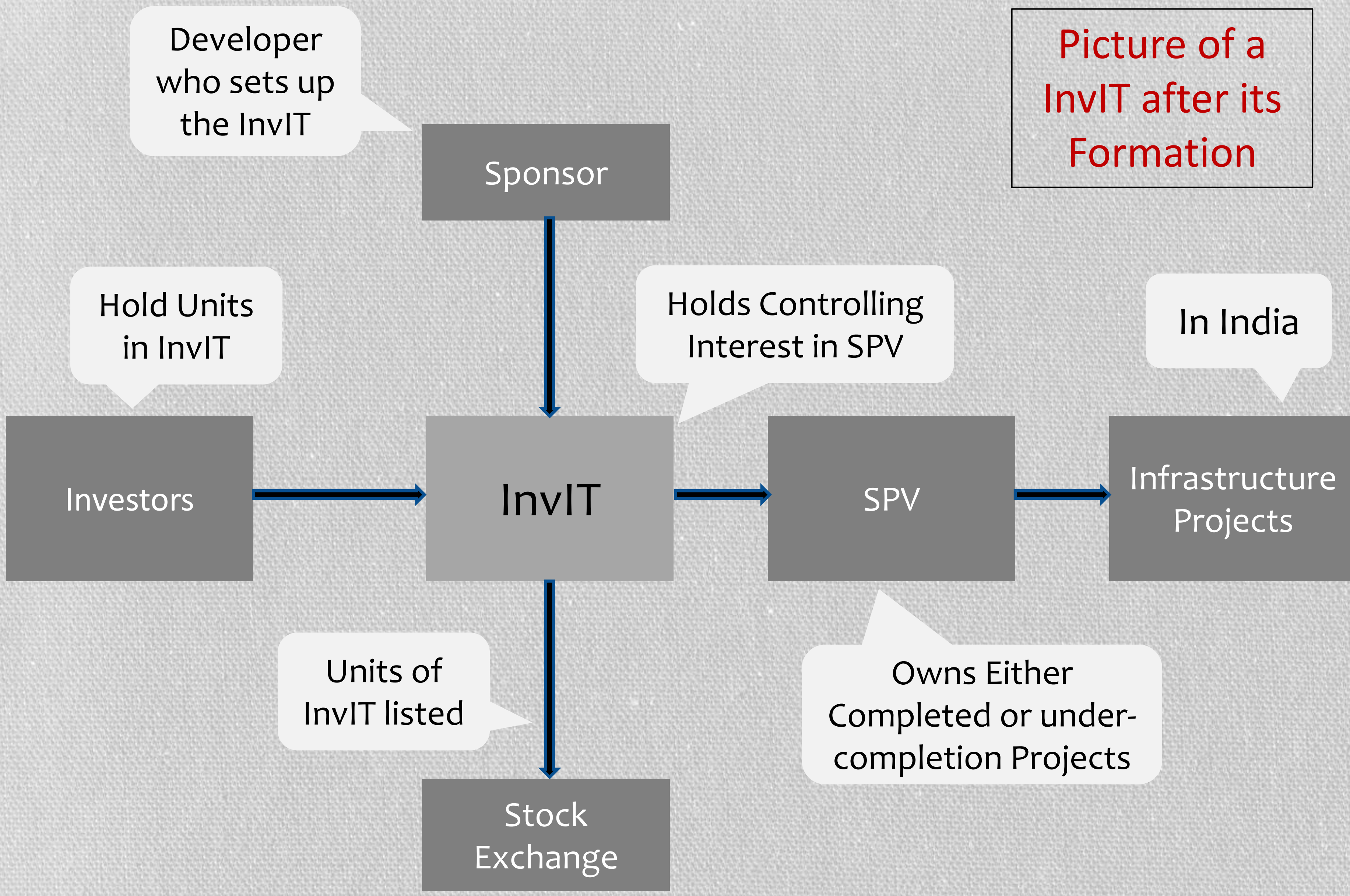
Answer 16



InvIT can raise Capital by issue of Units
Holds Controlling Interest in SPV
SPV is generally a Company
Rent generating Properties
Investors (Residents & Non-Residents)
InvIT
Special Purpose Vehicle (SPV)
Infrastructure Projects
InvIT can also Raise Debt
Stock Exchange
Owns Either Completed or under-completion Projects
InvIT can raise Debt from Unit Holders and Other Lenders

Answer 16

Picture of a InvIT after its Formation



Question 17

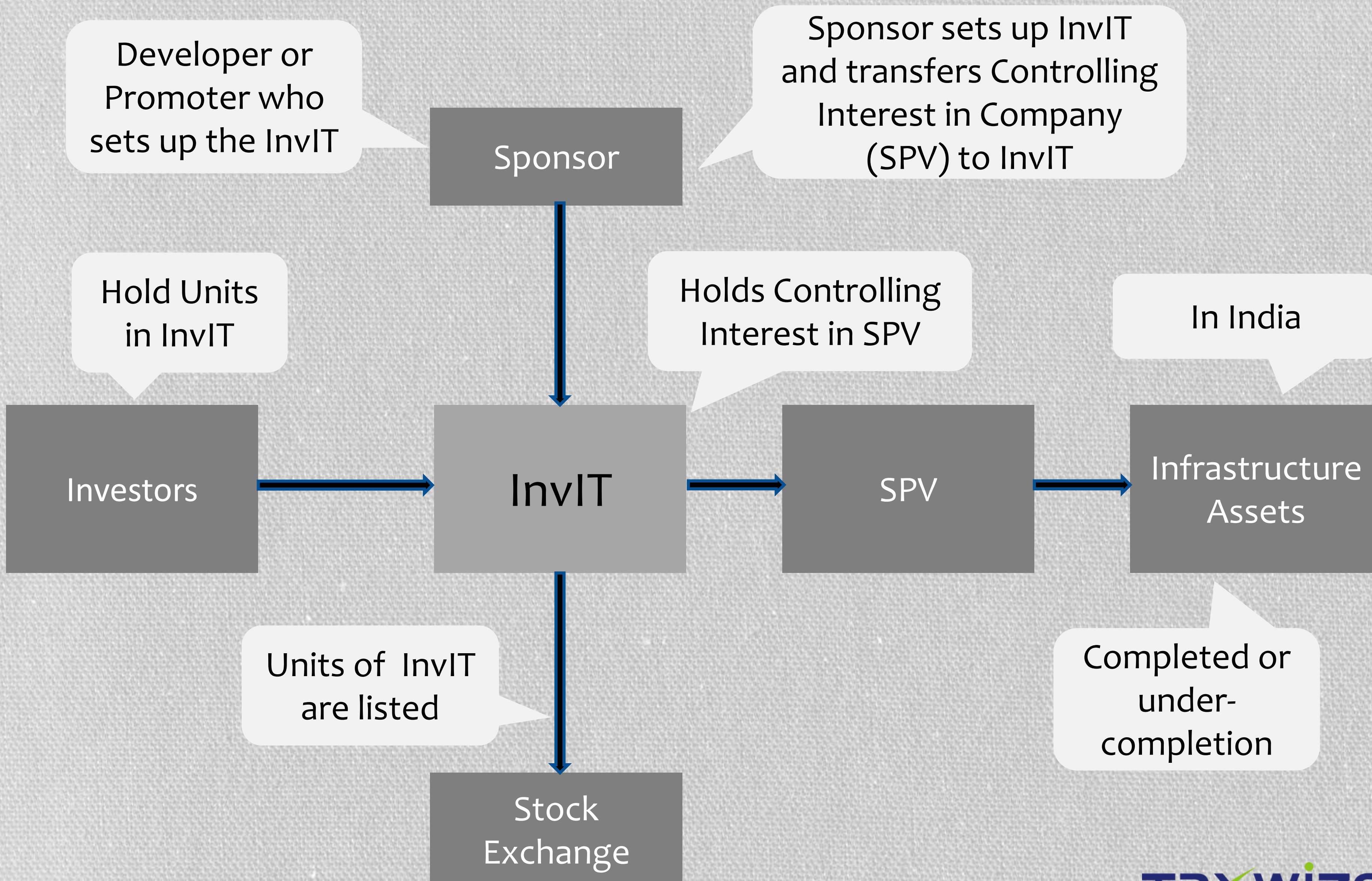
What is the typical investment structure of Infrastructure Investment Trusts (InvITs) ?

Answer 17

SEBI had placed in public domain a Consultation Paper on InvITs, in December 2013. The Proposal as also the Regulations pertaining to InvITs are yet to be finalized.

Based on the SEBI Consultation Paper on InvITs, and the New Taxation Regime for REITs & InvITs, announced in the recent Budget, one may say that the Investment Structure of a InvIT is quite similar to that of a REIT.

Answer 17



Developer or Promoter who sets up the InvIT
Sponsor
Sponsor sets up InvIT and transfers Controlling Interest in Company (SPV) to InvIT
Hold Units in InvIT
Holds Controlling Interest in SPV
In India
Investors
InvIT
SPV
Infrastructure Assets
Units of InvIT are listed
Completed or under-completion
Stock Exchange

Question 18

What kind of Transactions are involved in the context of a Infrastructure Investment Trust (InvIT)?

Answer 18

Transactions involved in the context of a InvIT are similar to the transactions that are involved in the context of a REIT. They are not here depicted again to avoid repetition, especially because the tax aspects of transactions in the context of REITs and InvITs are similar. In fact, for taxation, both REITs and InvITs are clubbed together as “Business Trust”.

We will now move on to the tax aspects – the taxation of transactions in the context of both REITs and InvITs will get covered there.

Taxation of REITs & InvITs

Question 19

What New Tax Regime is proposed in the Budget for Taxation of REITs and InvITs?

Answer 19

First we will take a general look at the new provisions, proposed by the Finance Bill 2014 to lay down a separate Taxation Regime for REITs and InvITs.

Then we will analyse each of those provisions one-by-one.

Answer 19

It is proposed in the Budget that the following new provisions may be inserted in the Income Tax Act, 1961 to lay down a separate Taxation Regime for REITs and InvITs -

- **Sec. 2(13A)**: Definition of Business Trust – Business Trust means a REIT and a InvIT registered with SEBI, the Units of which are required to be listed on a recognized Stock Exchange
  - For taxation, the REITs and InvITs are treated in a similar manner. Both are clubbed together within the definition of 'Business Trust'. All relevant provisions therefore apply equally to both REITs and InvITs.

Answer 19

- **Sec. 2(42A)** - *Explanation 1, Clause (i)(hc):* For computing Capital Gain on future transfer of Units (of the Business Trust), by the Sponsor, the holding period of shares of SPV (which were exchanged for Units) will be included in the holding period of the transferred Units
  - To be classified as Long Term Capital Asset the holding period of Units must be more than 36 months
  - In the case of Sponsor who acquires Units in exchange of his shares in the SPV, the holding period of those shares *plus* the holding period of Units should be more than 36 months, for the Capital Gain to be taxed as Long Term Capital Gain
  - In cases of other Unit Holders the holding period of Units should be more than 36 months, for the Capital Gain to be treated as Long Term Capital Gain

Answer 19

- **Sec. 10(23FC):** Exemption of interest income of Business Trust – any income received or receivable by a Business Trust by way of interest from a Special Purpose Vehicle (SPV) is exempt from tax
  - Please note that *only that interest income is exempt which is received by the Business Trust from a SPV.*
  - Interest received by the Business Trust from any other sources (Non-SPV sources) is taxable – at maximum marginal rate. [Where is the Pass-Through?]
  - Further, Capital Gains realised by the Business Trust also is taxable in the hands of the Business Trust – at regular tax rate. [Where is the Pass-Through?]
  - Any loss incurred by the Business Trust, for whatever reasons – cannot flow to the investors. [Where is the Pass-Through?]

Answer 19

- **Sec. 10(23FC):** *Explanation*
  - SPV is defined to mean an Indian Company in which the Business Trust holds controlling interest and specific percentage of shareholding prescribed by Relevant (REIT or InvIT) SEBI Regulations

    (Shareholding of 51% or more is required by the Draft SEBI Regulations on REITs)

Answer 19

- **Sec. 10(23FD):** Exemption of Distributed Income (other than Distributed Interest Income) received or receivable by a Unit Holder from the Business Trust

  - As gathered from the SEBI proposals, a Business Trust is expected to distribute its surplus to the Unit Holders
  - Distributed Interest Income is *taxable* in hands of the Unit Holder
  - All other components of the Distributed Income - other than interest - are *exempt* in the hands of Unit Holder

Answer 19

- **Sec. 10 (38):** Long Term Capital Gain on sale of Units of a Business Trust is exempt from tax, if the sale of Units is chargeable to Securities Transaction Tax (STT)
  - But in case of a Sponsor, the Capital Gain (Long Term or Short Term) on future transfer of Units – Units acquired in exchange of shares of SPV - will be taxable *[II Proviso to Sec. 10 (38)]*

Answer 19

- **Sec. 47(vii):** Transfer of shares of SPV (by Sponsor, Transferor) to a Business Trust in exchange of Units of that Business Trust, will not be regarded as a Transfer for purposes of Capital Gains – so, no Capital Gain will arise at the time of such exchange

    - However the Capital Gain arising in future on transfer of the Units will be taxable in hands of the Sponsor

Answer 19

- **Sec. 49 (2AC):** To compute Capital Gain on future transfer of Units by the Sponsor, the Cost of Acquisition of the Units of Business Trust, received by the Sponsor in exchange of shares of SPV, will be equal to the Cost of Acquisition of those shares

  - In case of a Sponsor, the Capital Gain (Long Term or Short Term) on future transfer of Units – Units acquired in exchange of shares of SPV - will be taxable *[II Proviso to Sec. 10 (38)]*

  - To compute Capital Gain on future transfer of Units, the Cost of Acquisition of a Unit will be deemed to be equal to 'the Cost of Acquisition that was incurred by the Sponsor on acquisition of the shares of SPV'

Answer 19

Sec. 47 (vii) *read with* **Second Proviso to Sec. 10 (38)** *read with* **Sec. 49 (2AC)** show that the Capital Gain arising to the Sponsor on transfer of shares of SPV to the Business Trust – in exchange for Units - is deferred to the point of time when the Sponsor transfers the Units of the Business Trust in future.

Answer 19

- **Sec. 111A (1):** Short-Term Capital Gains on transfer of Units of Business Trust, by Unit Holders (other than Sponsor) shall be taxed at concessional rate of 15%
  - But Short-Term Capital Gains realized by a Sponsor, on transfer of Units - received by the Sponsor in exchange of shares of SPV - will be taxed at regular rate *[II Proviso to Sec. 111A (1)]*

Answer 19

- **Sec. 115A (1)(a)(iiaa)(BA):** Interest paid by the Business Trust on foreign currency loan will be taxed at 5% in hands of Non-Resident Unit Holders

  - The Unit Holders (Residents as well as Non-Residents) can advance loans to REITs and InvITs, besides subscribing to the Units
  - The provision mentioned above lays down the tax rate of interest paid to Non-Resident Unit Holders
  - Please note, however, that the payment of Interest to Unit Holders on loans advanced by them to the Business Trust is different and separate from distribution of interest income to them – the former is payment of interest; the later is distribution of interest component (but taxation of both is similar)

Answer 19

- **Sec. 115A (1)(a)(iiac)(BA):** Distributed Interest Income – received by the Business Trust from SPV – will be taxed at 5% in hands of Non-Resident Unit Holders
  - The surplus distributed by the Business Trust to the Unit Holders will comprise of various types or components of income: interest received from SPV, interest received from Non-SPV sources, dividend received from SPV, dividend received from Non- SPV sources and Sales Consideration of Capital Assets sold by the Business Trust
  - The component of interest received from SPV – distributed to Unit Holders - is taxable in hands of the Unit Holders. All other components of distributed income are exempt in the hands of Unit Holders.
  - The above provision lays down that component of interest from SPV will be taxed at 5% in hands of Non-Resident Unit Holders

Answer 19

- New Chapter XII-FA - Special Provisions Relating to Business Trusts
  - Sec. 115UA

Answer 19

- **Sec. 115UA**:

  (1) Distributed income in hands of the Unit Holders will be of the same nature and in the same proportion as the income in the hands of the Business Trust.

  - What is the need for this provision? We try to find the answer in the following discussion.

Answer 19

- The surplus distributed by the Business Trust to the Unit Holders will come from a basket of mixed receipts; the surplus will comprise of various types, or components, of income received by the Business Trust:
  - *interest received from SPV*
  - *interest received from Non-SPV sources*
  - *dividend received from SPV*
  - *dividend received from Non- SPV sources; and*
  - *Sales Consideration of Capital Assets sold by the Business Trust*

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Answer 19

- There is a difference in the taxation of 'interest received from SPV' and taxation of all other types or components of income
- The 'interest received from SPV' is *exempt in the hands of the Business Trust* but is *taxed in the hands of Unit Holders* – this is the pass-through taxation mentioned by the Hon. Finance Minister in his Budget Speech

Answer 19

- The other types, or components, of income (interest from Non-SPV sources and Capital Gains on sale of Capital Assets) are *taxable in the hands of the Business Trust* and are *exempt in the hands of the Unit Holders* – so it is a limited pass-through taxation

- Because different components of income are taxed in different manner, it is necessary to segregate the various components of distributed income so that 'interest received from SPV' is clearly identified for taxation in hands of Unit Holders

Answer 19

- **Sec. 115UA:**

  (2) Total Income of the Business Trust other than Capital Gain will be taxed in the hands of the Business Trust at the *maximum marginal rate*. And Capital Gain will be taxed as per Sec. 111A and 112.

  - Only the Interest received from SPV is exempt in the hands of the Business Trust (Dividend of course is exempt under the regular provisions)
  - Interest received from Non-SPV sources is taxable at maximum marginal rate
  - And Capital Gains realized by the Business Trust is taxable at prescribed rate for taxation of Capital Gains in regular cases

Answer 19

- **Sec. 115UA:**

  (3) Any Distributed *Interest* Income – of the same nature (interest received from SPV) as referred to in Sec. 10 (23FC) - received by a Unit Holder from the Business Trust shall be deemed to be income of the Unit Holder and shall be charged to tax.

  - This is the charging provision for pass-through taxation of interest income received by the Business Trust from SPV
  - Such interest is exempt in the hands of the Business Trust and is instead taxable in the hands of Unit Holders – but only on distribution

Answer 19

- **Sec. 115UA**:

  (4) The Person responsible for making payment of 'Income distributed by the Business Trust to the Unit Holders' must provide a statement to the Unit Holders and to the Prescribed Authority, in the prescribed form within the prescribed time limit. (Rules relating to the Statement are yet to be notified)

  - The statement will most likely contain information about the proportion of various components of distributed income – as explained before in the context of sub-section (1) of Sec. 115 UA

Answer 19

- **Sec. 139 (4E):** A Business Trust who is not required to file Return of Income or Loss under any other provisions of Sec. 139 will have to file such Return under this provision
  - Even if a Business Trust has no taxable income it still has to file Return of Income
  - It is apparent that this is a kind of reporting requirement
  - From the Return, various components of income received by the Trust and distributed by the Trust to Unit Holders, and the proportion of those distributed components can be found and verified by the Tax Authorities

Answer 19

- **Sec. 194A (3)(xi):** Interest Income payable by SPV to the Business Trust shall be exempt from TDS
    - Because the interest income received by the Business Trust from SPV is not taxable in the hands of the Business Trust, there is no point in deducting TDS at the level of SPV

Answer 19

- **Sec. 194LBA**: TDS on Interest Income (received by the Business Trust from SPV) distributed by the Business Trust to Unit Holders will be – For Resident Unit Holders:10%; For Non-Resident Unit Holders: 5%

  - In the hands of Resident Unit Holders the Distributed Interest Income (received by the Business Trust from SPV) will be taxable under Sec. 56 at regular rates

  - Such Interest Income will be exempt in hands of the Business Trust under Sec. 10 (23FC) – it will be exempt even if no distribution is made by the Business Trust

Answer 19

- **Sec. 194LC**: Amendment in the existing provision to provide for TDS at 5% on payment of Interest by Business Trust on external commercial borrowings

    - REITs and InvITs can borrow funds from Unit Holders (Residents or Non Residents)

    - REITs and InvITs can also borrow funds from Third Party (Non Unit Holders) Lenders (Resident or Non Resident)

Analysis of how the provisions under the New Tax Regime for REITs and InvITs will work in practice

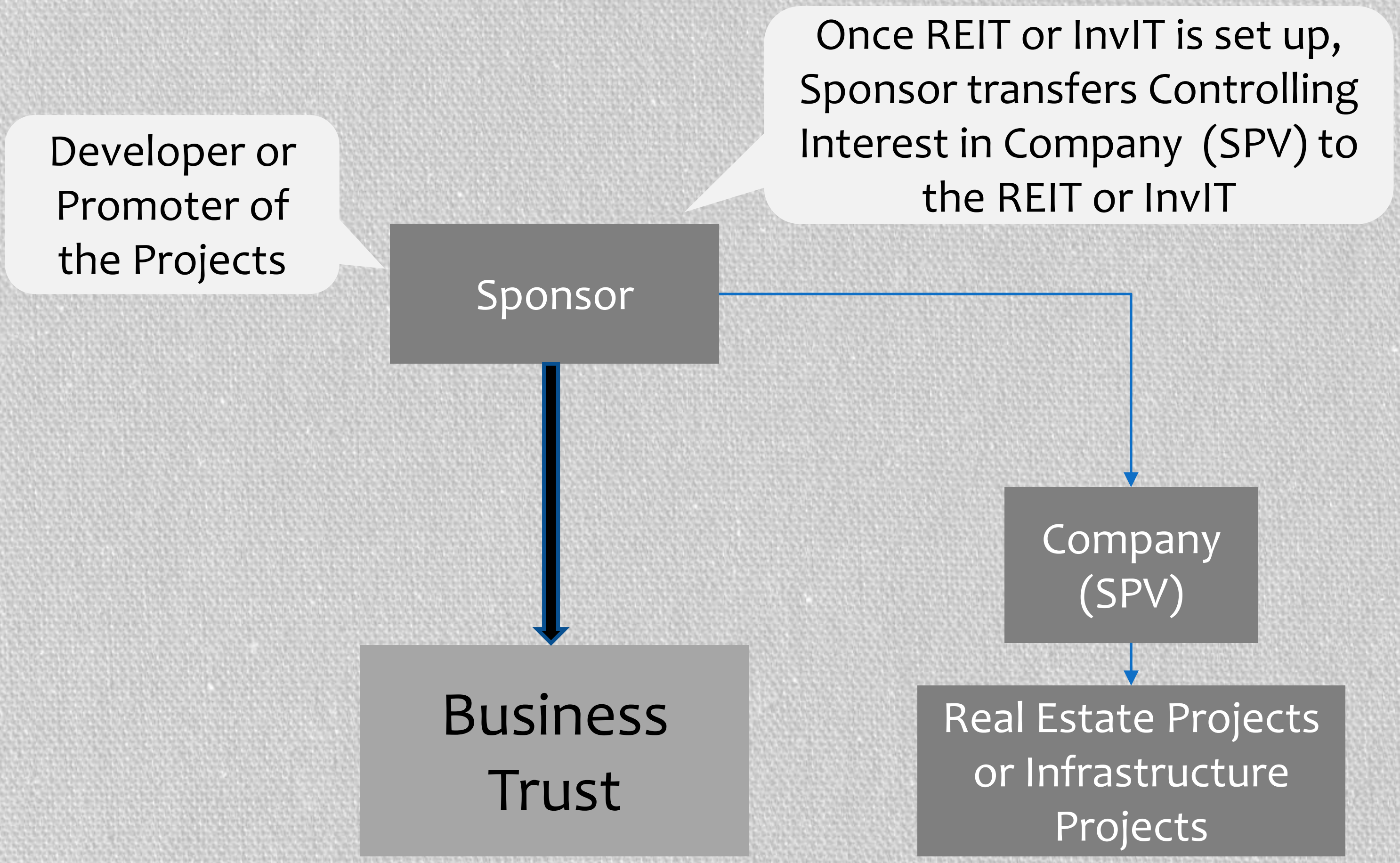
Question 20

What will be the tax implications of transaction between Business Trust (REIT or InvIT) and the Sponsor?

Answer 20

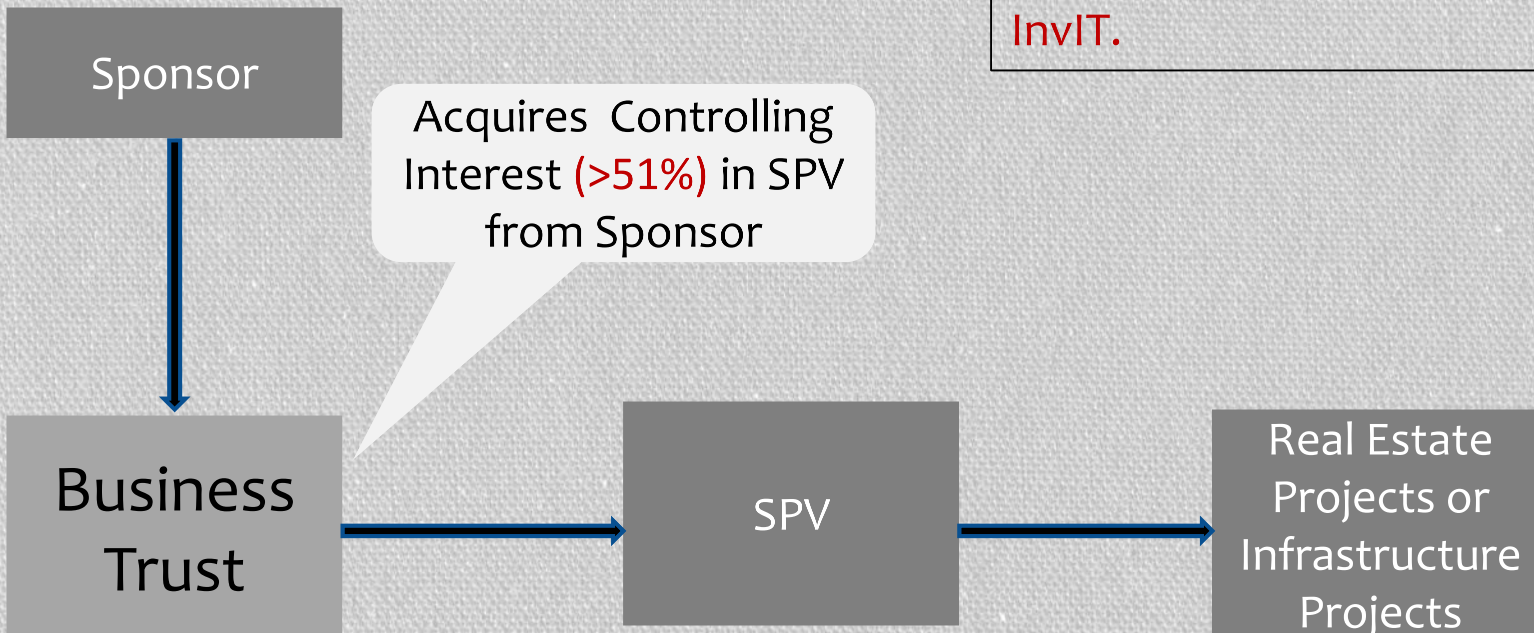
Let us first look at the Transactions that arise when a Business Trust (REIT or InvIT) acquires shares of SPV from the Sponsor

Answer 20


Developer or Promoter of the Projects
Once REIT or InvIT is set up, Sponsor transfers Controlling Interest in Company (SPV) to the REIT or InvIT
Sponsor
Company (SPV)
Business Trust
Real Estate Projects or Infrastructure Projects

Answer 20

Here, after setting up the REIT or InvIT, the Sponsor transfers Controlling Interest in Company (SPV) to the REIT or InvIT.



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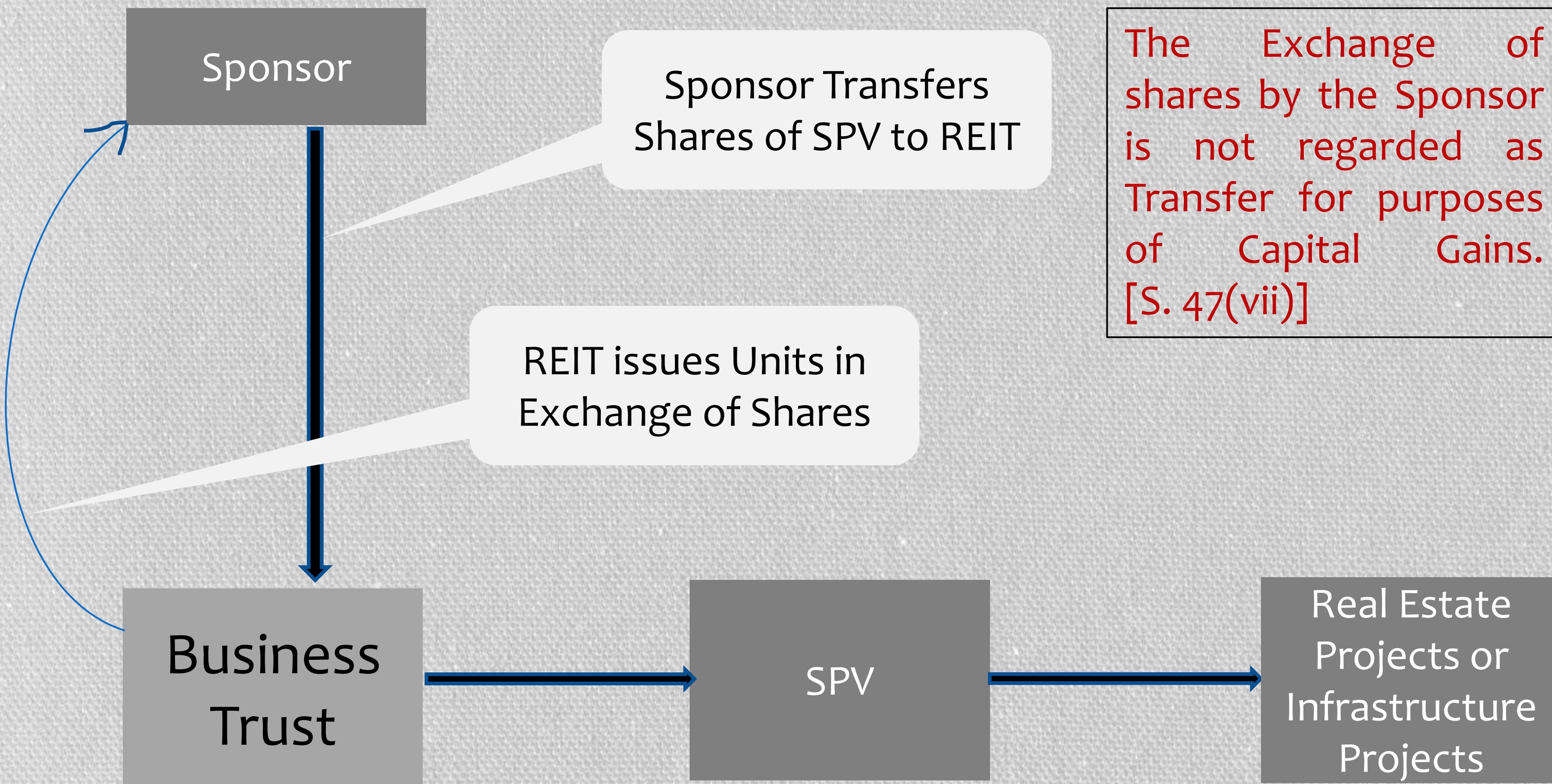
Answer 20


Sponsor
Sponsor Transfers Shares of SPV to REIT
REIT issues Units in Exchange of Shares
Business Trust
SPV
Real Estate Projects or Infrastructure Projects
The Exchange of shares by the Sponsor is not regarded as Transfer for purposes of Capital Gains. [S. 47(vii)]

Answer 20

Tax implications when a Business Trust (REIT or InvIT) acquires shares of SPV from the Sponsor in exchange of Units

- The acquisition of shares of SPV by the Business Trust is not regarded as Transfer by the Sponsor, for purposes of Capital Gains [Sec. 47(vii)].
- So, no Capital Gain arises to the Sponsor at the time of transfer of shares to Business Trust (BT) in exchange of Units of BT.
- If , however, any other form of consideration – other than Units – is paid by the BT to the Sponsor, for shares of SPV, then Capital Gains would arise.

Question 21

What will be the Tax implications when a Sponsor transfers the Units of the Business Trust (REIT or InvIT) in future?

Answer 21

Tax implications when Sponsor transfers the Units of the Business Trust (REIT or InvIT) in future

- The Draft SEBI Regulations on REITs and Consultation Paper on InvITs lay down some lock-in period for the transfer of Units by the Sponsor.
- When the Sponsor transfers the Units in future, he will have to pay Capital Gain Tax, regardless of the fact that the Units are listed and bear STT, and regardless also of the fact that other Unit Holders are exempted, or taxable at concessional rate of 15% on STCG *[II Proviso to Sec. 10(38); II Proviso to Sec. 111A (1)]*

Answer 21

Tax implications when Sponsor transfers the Units of the Business Trust (REIT or InvIT) in future

- The Cost of Acquisition of Units, for computing Capital Gains on future transfer, shall be taken as equal to the Cost of Acquisition of the shares of SPV *[Sec. 49 (2AC)]*
- For computing Capital Gains on future transfer of Units the holding period of shares of SPV will be included in the holding period of the Units *[Sec. 2(42A) - Explanation 1, Clause (i)(hc)]*
- For computing Capital Gains on future transfer of Units, holding period of 36 months is for LTCG
- There will be no exemption of LTCG and no concessional Tax Rate on STCG

Question 22

What will be the tax impact on Special Purpose Vehicle (SPV), which is a Company owning and operating Real Estate or Infrastructure Projects?

Answer 22

Tax impact on SPV

- SPV will usually be a Company
- It is a Company that owns and operates Real Estate Projects and Infrastructure Projects
- SPV will earn income in the form of Rent, Toll Collection, User Fees, etc.
- The Total Income of SPV will be taxable at normal rate, like any other Company
- Deduction under Sec. 80-IA might be available to the SPV if the conditions of that Section are fulfilled

Answer 22

Tax impact on SPV

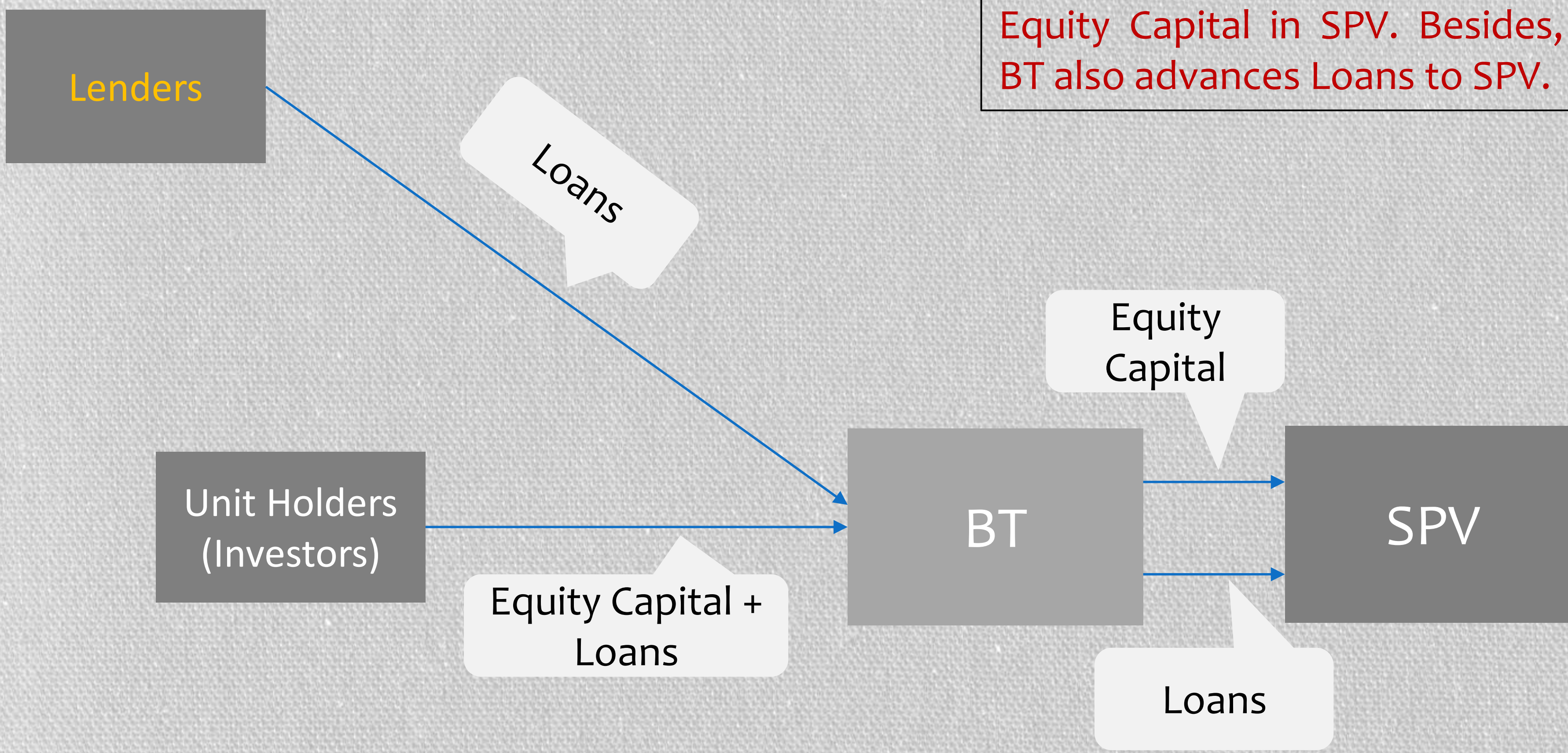
- SPV will have to pay Dividend Distribution Tax (DDT) when Dividend is distributed by it to the Business Trust and to other shareholders

Question 23

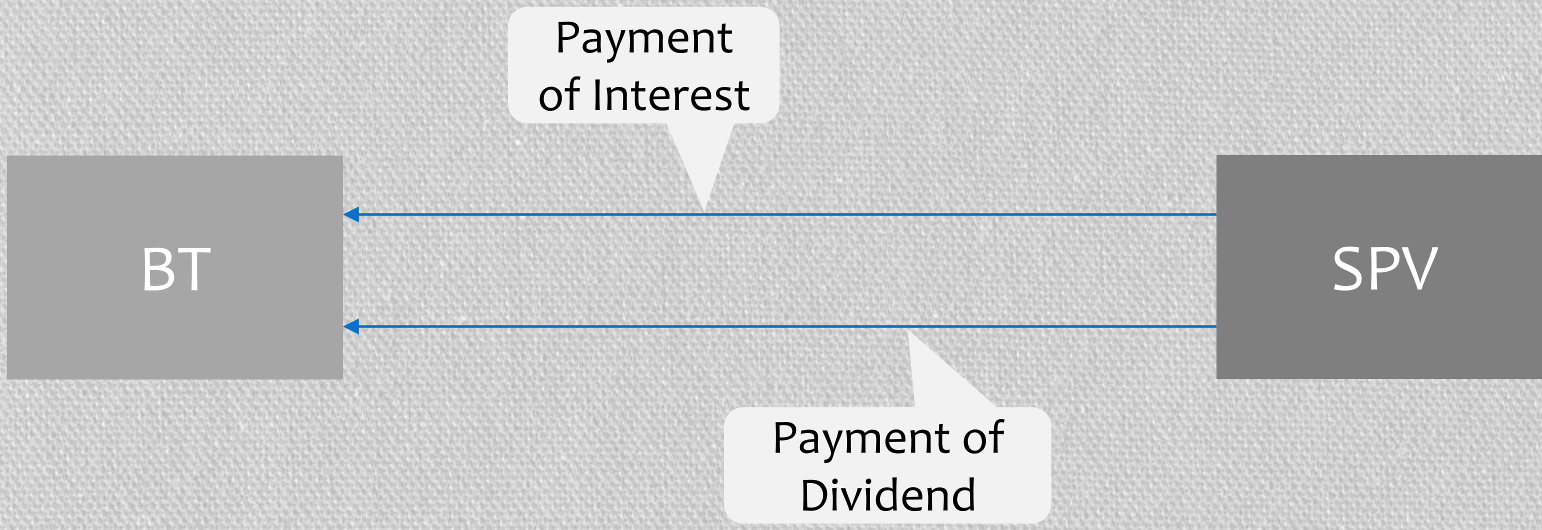
What are the tax implications of transactions between a Business Trust and a SPV?

Answer 23

Business Trust (BT) invests Equity Capital in SPV. Besides, BT also advances Loans to SPV.

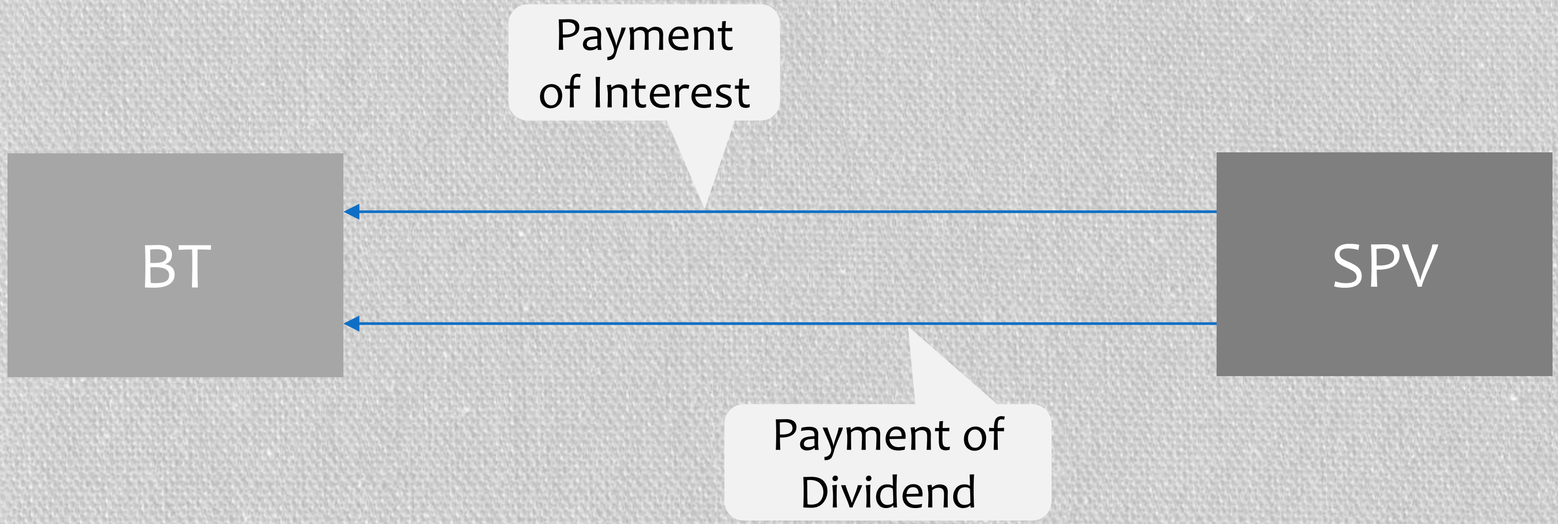


Answer 23



SPV pays Interest and Dividend to the Business Trust

Answer 23



- Interest paid by SPV to BT is deductible as expenditure in hands of SPV
- Interest received by BT is exempt from tax in hands of BT
- No TDS is to be made by SPV on payment of Interest
- On dividend paid, SPV has to pay DDT
- Dividend is exempt from tax in hands of BT

Answer 23

- Interest received by BT *from SPV* is exempt from Tax [Sec. 10(23FC)]

  - Interest received by BT from SPV is exempt even if BT does not distribute that Interest Income to the Unit Holders

  - So, a BT can keep accumulating the Interest and then invest it, without paying any tax on it

  - And if the Interest is not distributed to the Unit Holders, even they do not pay any tax on that interest

(However, under Draft SEBI Regulations the BT is required to distribute 90% of surplus to the Unit Holders)

Question 24

What kind of income of Business Trust will be taxed at normal rate?

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Answer 24

- Capital Gains realized by BT will be taxed at the normal rate (applicable to Capital Gains in regular cases) in the hands of BT

  - Capital Gains will not be taxed in hands of Unit Holders on pass-through basis

  - Capital Gain component of distributed income will be exempt in hands of Unit Holders

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Question 25

What kind of income of Business Trust will be taxed at the Maximum Marginal Rate? Why?

Answer 25

- Interest received by BT from any other Source – other than SPV - is taxable at maximum marginal rate

  - Under Draft SEBI Regulations, one can infer that REITs can invest in Non-SPV assets as long as they have a controlling interest (not less than 51% shareholding) in the SPV

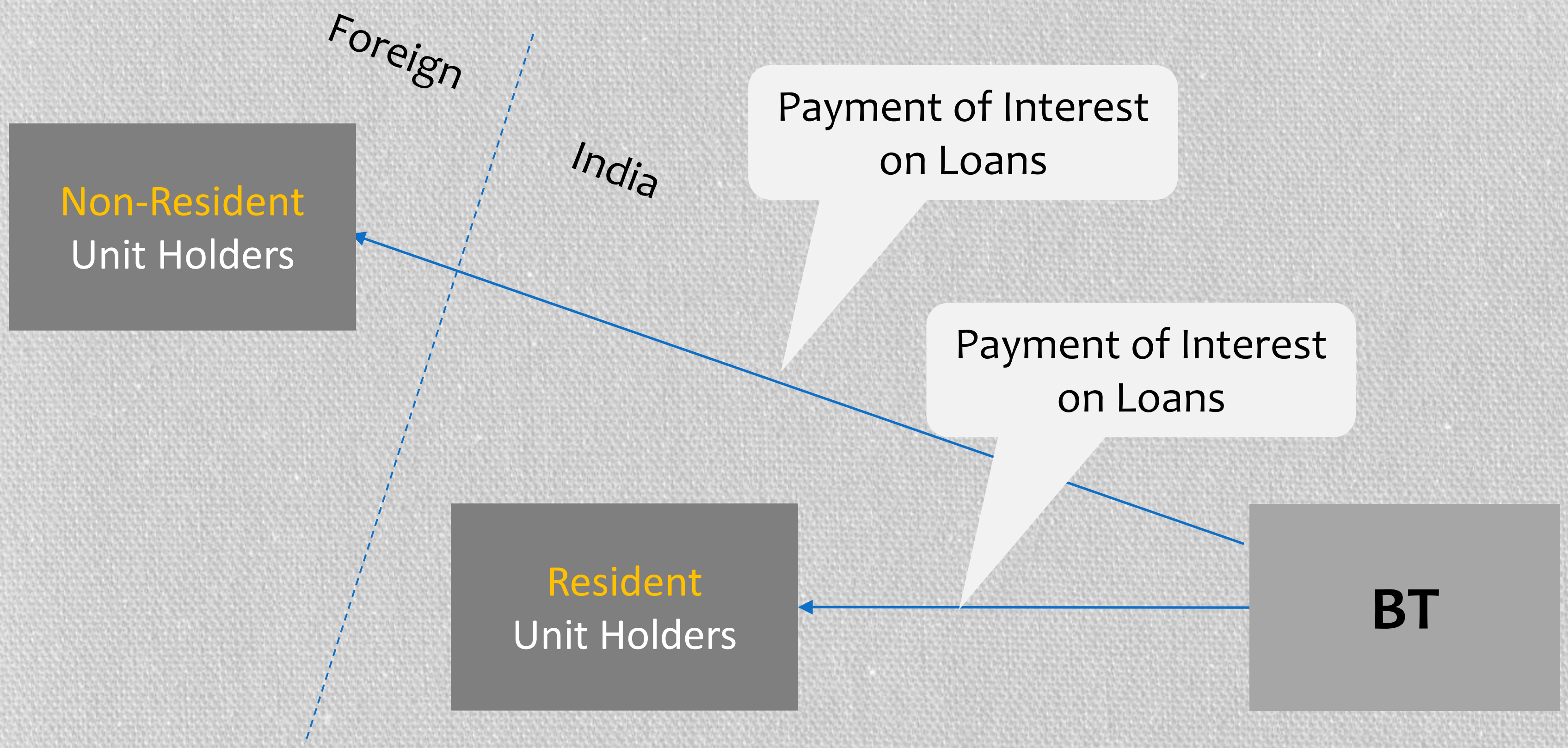
  - The provision to tax interest from Non-SPV source at maximum marginal rate is obviously proposed to discourage REITs and InvITs from investing in Non-SPV assets and securities

Tax implications of transactions between a Business Trust and its Unit Holders

Question 26

What are the tax implications of interest paid by Business Trust to the Unit Holders, on loans advanced by them?

Answer 26



Business Trust pays Interest on loans advanced by the Unit Holders – this payment is different from Distribution of Interest by BT. Still, the taxation of both types of Interest (directly paid on loan, or distributed) is the same. Exception is when Non-SPV interest is distributed by BT – such interest is taxable in hands of BT and exempt in hands of Unit Holders.

Answer 26

Relevant Provisions on Taxation of payment of *Interest on Loan* made by BT to Unit Holders

- Interest received by a Unit Holder - on loans to BT - is taxable. The Rate of Tax depends on the residential status of the Unit Holder.
  - Interest received by Resident Unit Holder is taxable at normal tax rate. But it is subject to TDS at 10% *[Sec. 194A]*
  - Interest received by Non-Resident Unit Holder is taxable at 5% *[Sec. 115A (1)(a)(iiaa)(BA)]*.
  - And it is subject to TDS also at 5% [Sec. 194LC]

Question 27

What are the tax implications of distribution of interest income (received from SPV) by the Business Trust to the Unit Holders?

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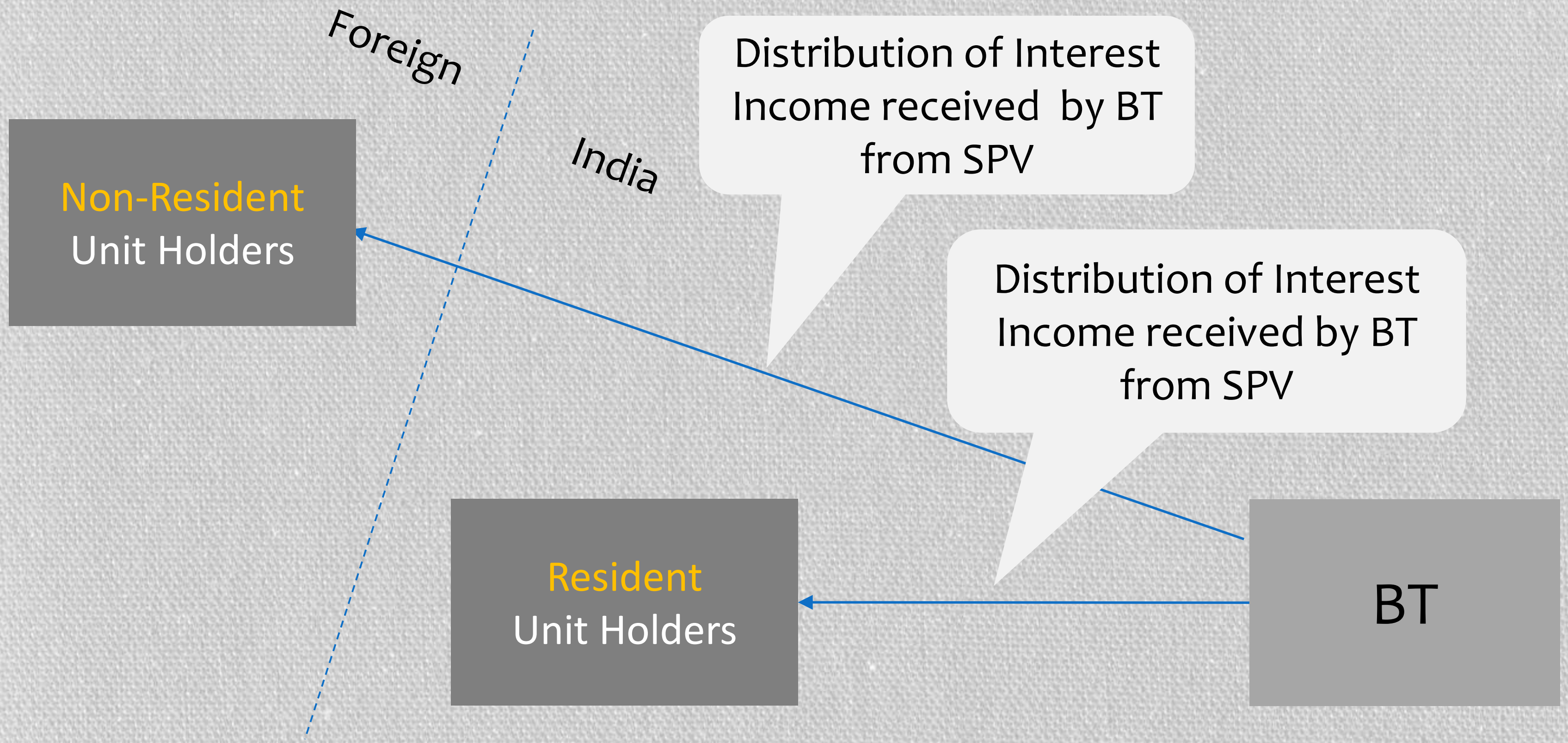
Answer 27



Business Trust distributes Interest component of income (received from SPV) to the Unit Holders – this Distribution of Interest Income is different from Interest paid by BT on loan from Unit Holders. But, the taxation of both types of Interest (directly paid on loan, or distributed) is the same. Exception is when Non-SPV interest is distributed by BT – such interest is taxable in hands of BT and exempt in hands of Unit Holders.

Answer 27

Relevant Provisions on Taxation of Distribution of *Interest Component of Income (SPV source)* made by BT to Unit Holders

- Interest Component (SPV source) of Distribution received by a Unit Holder from BT is taxable. The Rate of Tax depends on the residential status of the Unit Holder.
  - Distributed Interest Income received by Resident Unit Holder is taxable at normal tax rate. But it is subject to TDS at 10% *[Sec. 194LBA]*
  - Interest received by Non-Resident Unit Holder is taxable at 5% *[Sec. 115A (1)(a)(iiac)(BA)]*
  - And it is subject to TDS also at 5% *[Sec. 194LBA]*

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Question 28

What are the tax implications of distribution of other components (non-interest) of income (received from SPV), by the Business Trust to the Unit Holders?

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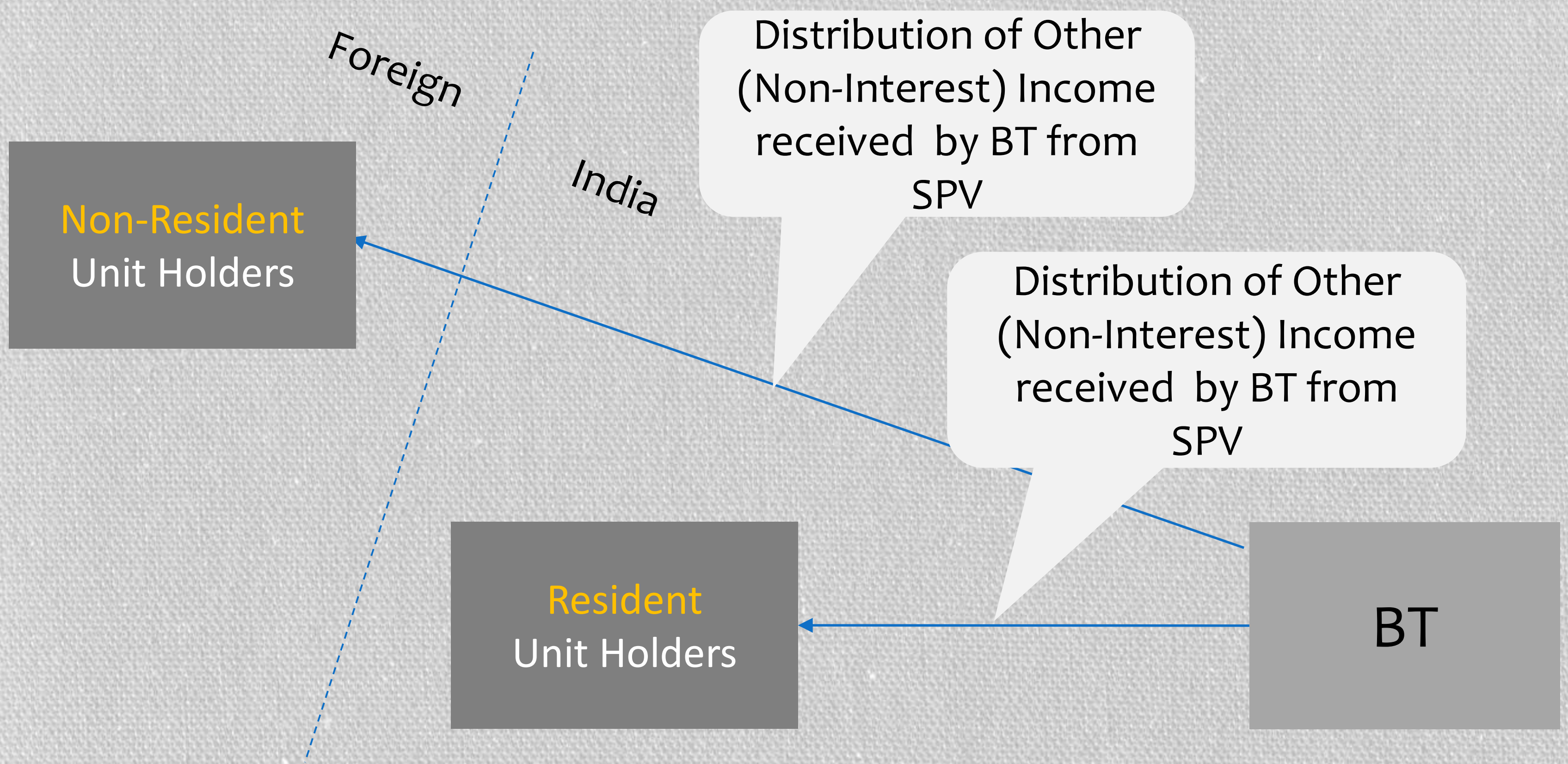
Answer 28



Business Trust distributes Non-Interest component of income (received from SPV) to the Unit Holders. Such component would ordinarily consist of Dividend income.

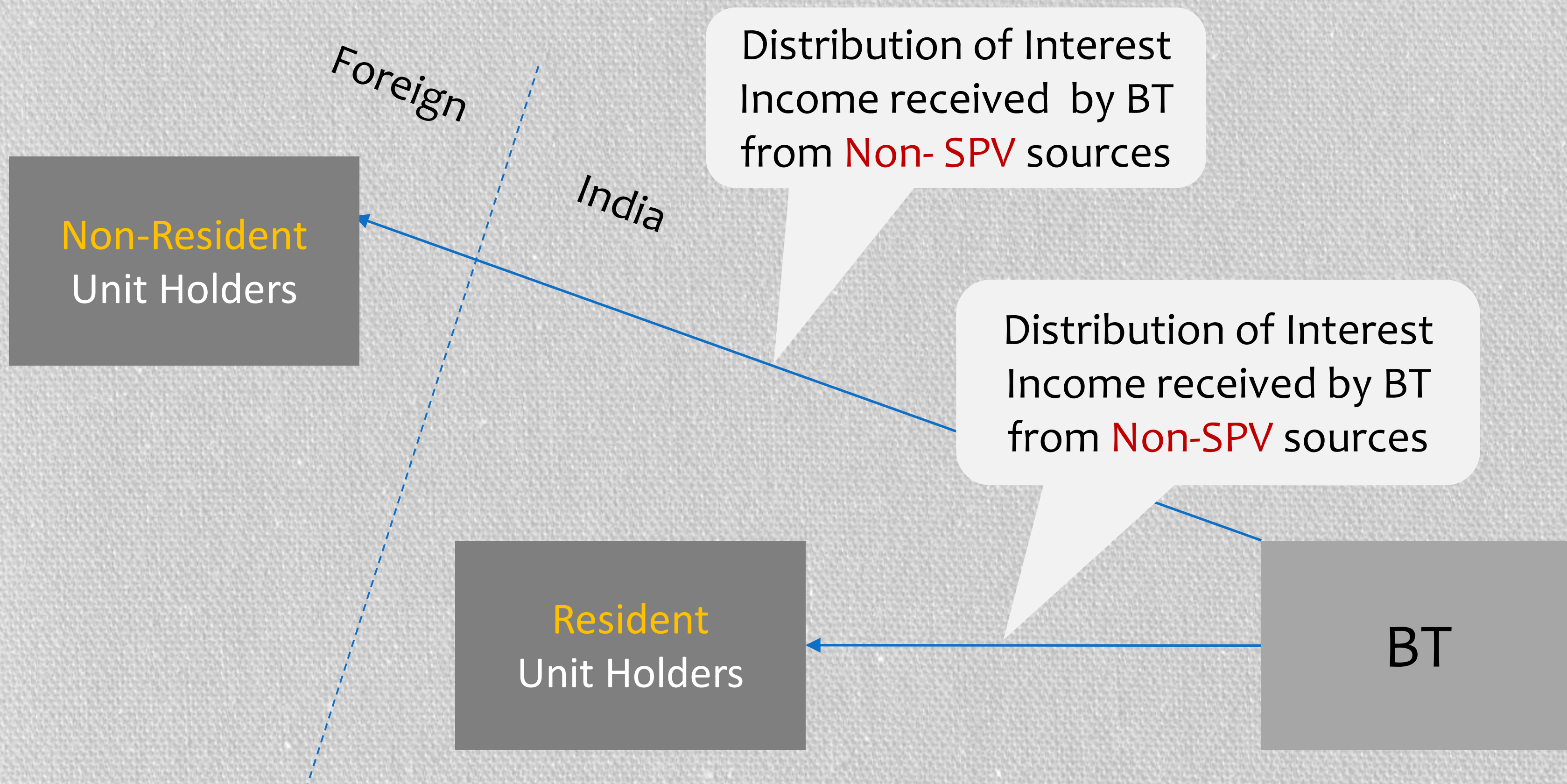
Answer 28

Distributed income (other than distributed interest income – SPV source) received or receivable by a Unit Holder from the Business Trust is exempt, not taxable *[Sec. 10(23FD)],* whether it is Dividend or any Other Income.

Question 29

What are the tax implications of distribution of interest income (received from Non- SPV sources), by the Business Trust to the Unit Holders?

Answer 29



Business Trust distributes Interest component of income (received from Non-SPV sources) to the Unit Holders – this Distribution of Interest Income is different from distribution of Interest income received by BT from SPV.

Answer 29

- Any Distributed income - *other than distributed interest income out of interest received by the Business Trust from SPV* - received or receivable by a Unit Holder from the Business Trust is exempt, not taxable *[Sec. 10(23FD)].*

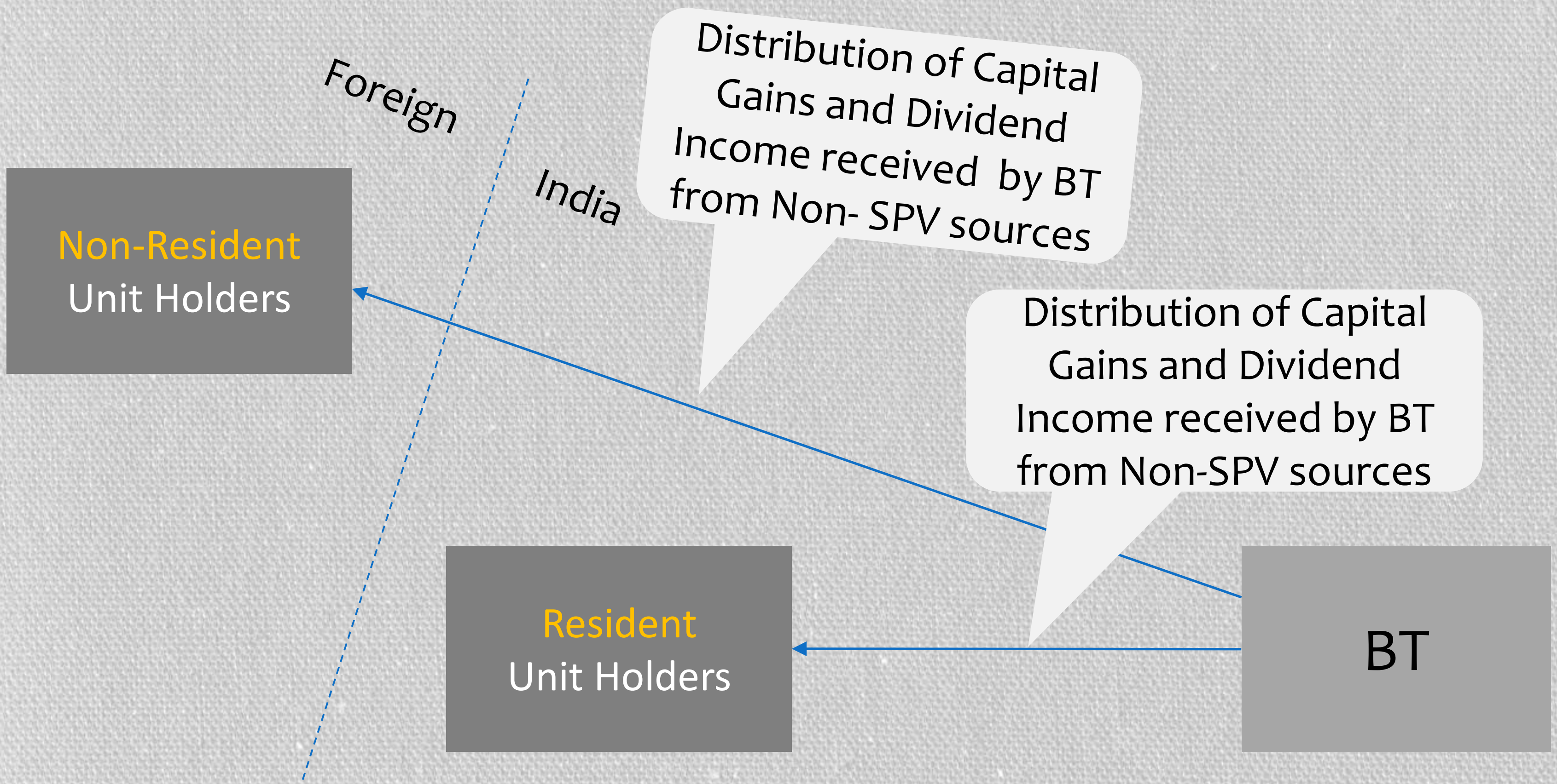
- The Interest received by the Business Trust from Non-SPV sources is taxable in the hands of the Business Trust (at maximum marginal rate); in the hands of the Business Trust, only the Interest received from SPV is exempt.

- Here is the General Rule: whatever is taxed in hands of Business Trust is exempt in hands of Unit Holders, and whatever is exempt in the hands of Business Trust is taxed in the hands of Unit Holders.

Question 30

What are the tax implications of distribution of other non-interest income like Capital Gains and Dividend (received from Non- SPV sources), by the Business Trust to the Unit Holders?

Answer 30



Business Trust distributes Non-Interest component of income i.e. Capital Gains and Dividend (received from Non- SPV sources) to the Unit Holders.

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Answer 30

- Any Distributed income - *other than distributed interest income out of interest received by the Business Trust from SPV* - received or receivable by a Unit Holder from the Business Trust is exempt, not taxable [Sec. 10(23FD)].
- The Capital Gains received by the Business Trust from Non-SPV sources is taxable in the hands of the Business Trust; in the hands of the Business Trust, only the Interest received from SPV is exempt.
- This is the General Rule: whatever is taxed in hands of BT is exempt in hands of Unit Holders, and whatever is exempt in the hands of BT is taxed in the hands of Unit Holders.
- Dividend, of course, is exempt in hands of both the Business Trust and the Unit Holders

Tax implications of transactions between a Business Trust and its Lenders (Non Unit Holders)

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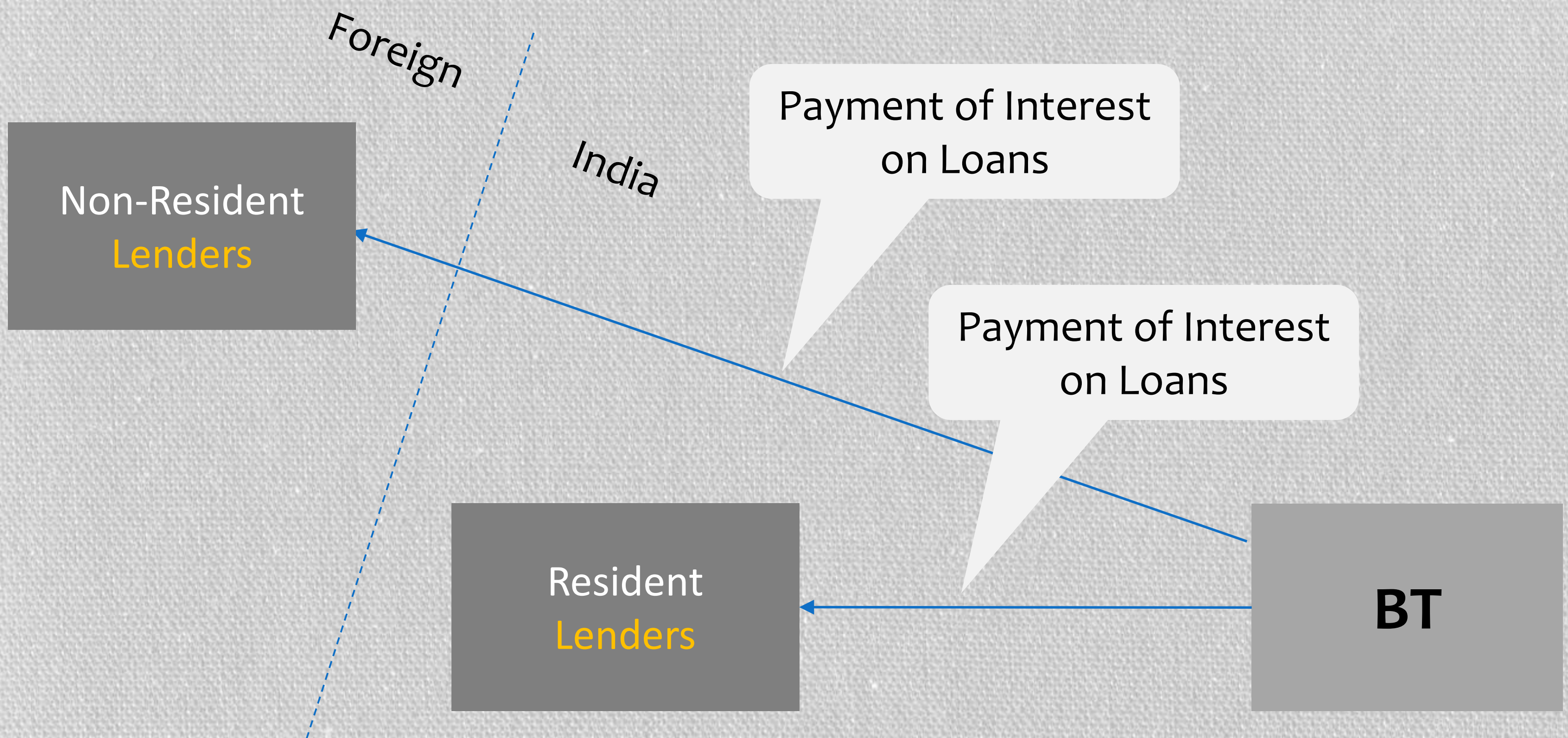
Question 31

What are the tax implications of interest paid by Business Trust to the Lenders who are not Unit Holders?

Answer 31



Business Trust pays Interest on loans advanced by Lenders, including External Commercial Borrowings. Though this interest payment is different from the Interest paid by BT to its Units Holders, still the taxation of both types of Interest (paid on loans from Non Unit Holders and on loans from Unit Holders) is the same.

Answer 31

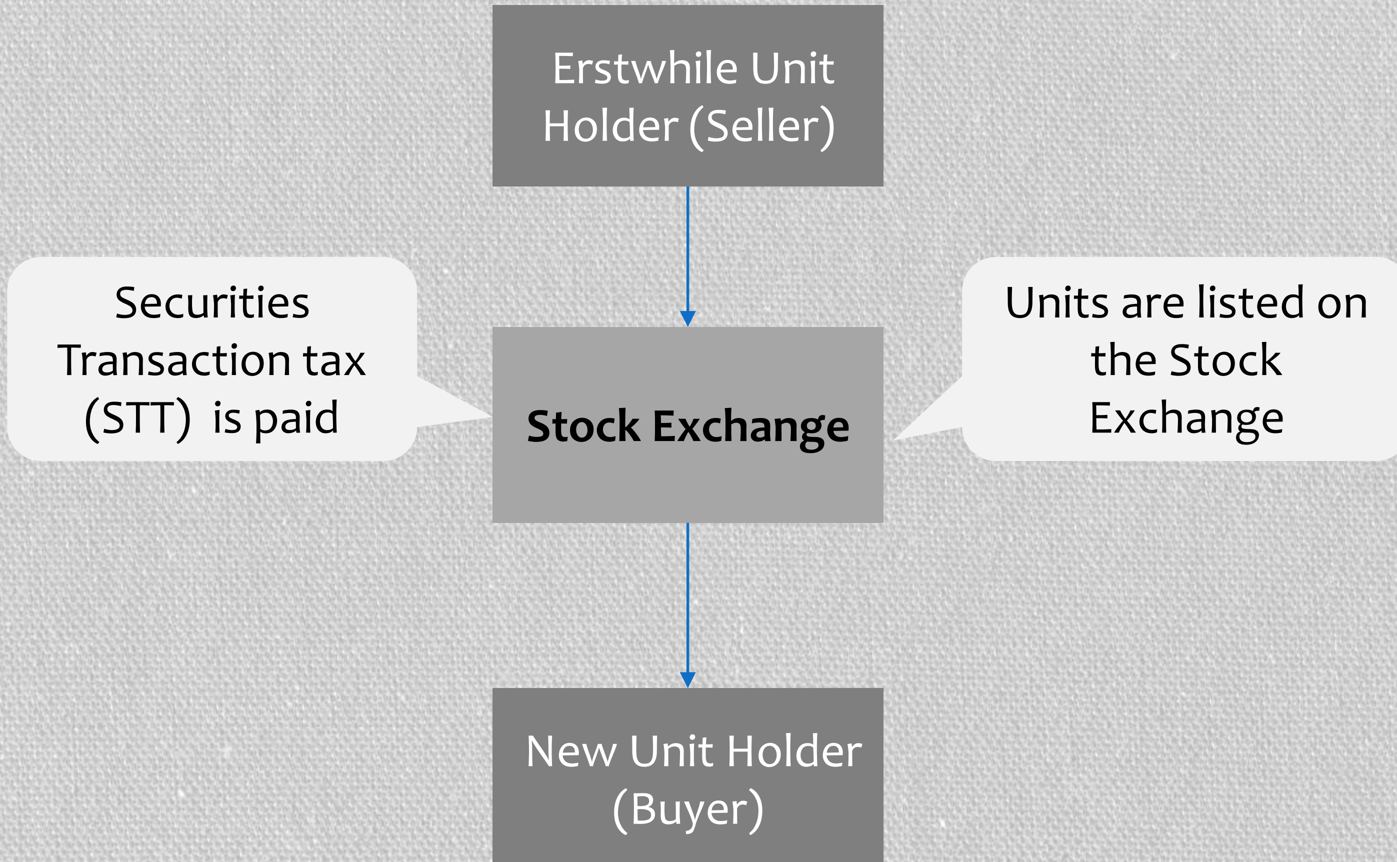
Relevant Provisions on Taxation of payment of *Interest on Loan* made by BT to Lenders (Non Unit Holders)

- Interest received by a Lender, on loans to BT, is taxable. The Rate of Tax depends on the residential status of the Lender.
  - Interest received by Resident Lender is taxable at normal tax rate. But it is subject to TDS at 10% *[Sec. 194A]*
  - Interest received by Non-Resident Lender is taxable at 5% *[Sec. 115A (1)(a)(iiaa)(BA)]*
  - And it is subject to TDS also at 5% *[Sec. 194LC]*

Question 32

What are the tax implications of sale of Units by the Unit Holders?

Answer 32



- Long Term Capital Gain is Exempt from tax *[Sec. 10(38)]*
- Short Term Capital Gain is taxable at 15% *[Sec. 111A (1)]*

Answer 32

- Rules for Sponsor - who sells Units acquired in exchange for shares of SPV - are different: No relief is granted on Capital Gain arising to the Sponsor on sale of those Units.

- Long Term Capital Gain and Short Term Capital Gain arising on sale of those Units are taxable at regular rates in the hands of the Sponsor.

Answer 32

Period of Holding for Long Term Capital Gain

- Long Term Capital Gain: If Unit is held for more than 36 months *[Sec. 2(42A)]*
- Short Term Capital Gain: If Unit is held for 36 months or less *[Sec. 2(42A)]*

In case of a Sponsor the holding period of shares of SPV will add on to the holding period of Units

[**Sec. 2(42A)** - *Explanation 1, Clause (i)(hc)]*

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Question 33

How will the provisions of Sec. 115 UA (New Chapter XII-FA) work in practice?

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Answer 33

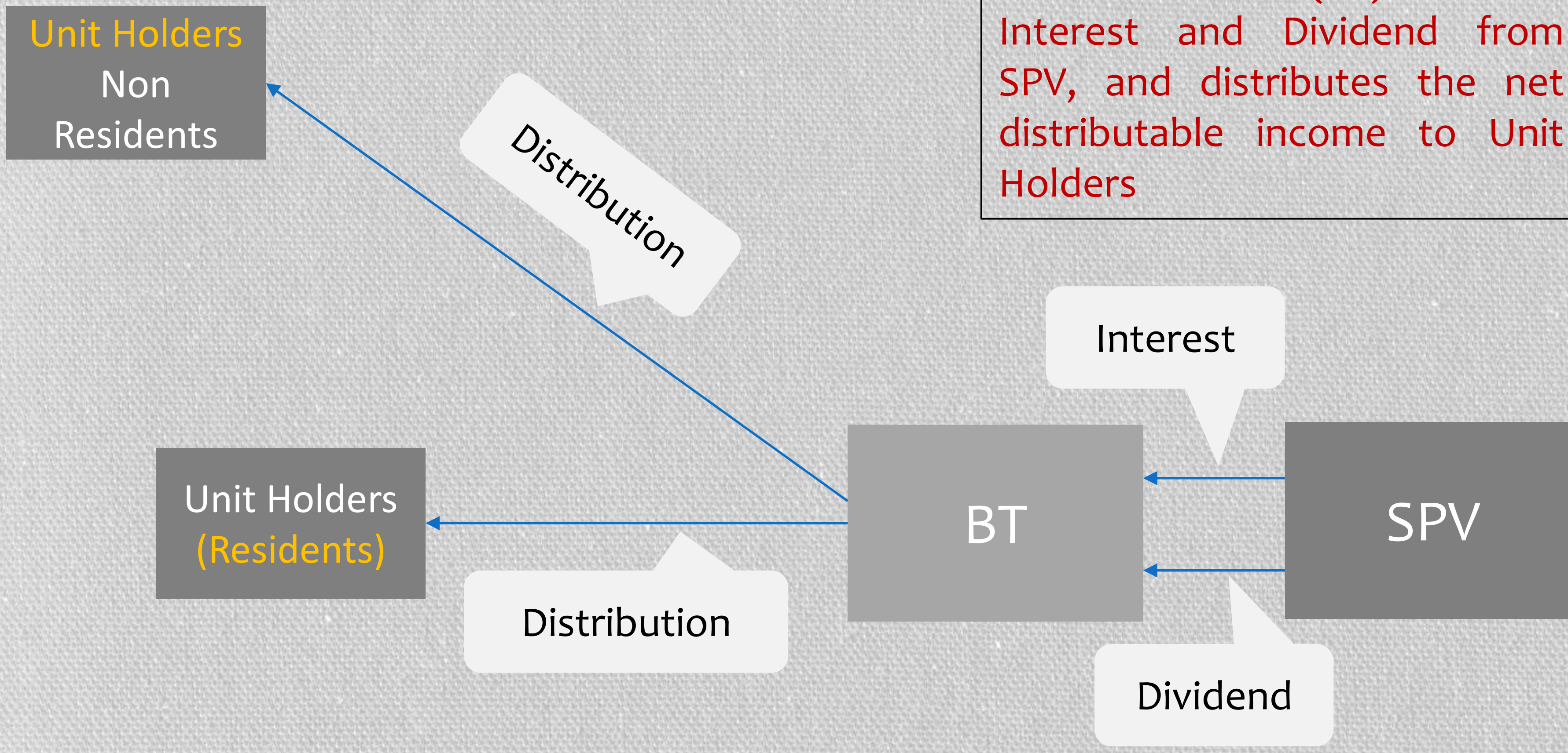
In the following few Slides we demonstrate - with the help of 3 Examples - how the provisions of Sec. 115 UA (New Chapter XII-FA) will work in practice.

Answer 33

Example 1

Example 1

Business Trust (BT) receives Interest and Dividend from SPV, and distributes the net distributable income to Unit Holders



Example 1

FACTS

- Business Trust (BT) receives interest of Rs. 4000 (without TDS) and Dividend of Rs. 1000 (after DDT) from the SPV Company.
- So BT receives total receipts of Rs. 5000 from SPV.
- Out of that, BT distributes 90% i.e. Rs. 4500 to the Unit Holders.
- Total number of Units held by the Unit Holders is 1000: Residents hold 700 Units and Non Residents hold 300 Units.

Q: How will the interest and dividend be apportioned in the hands of Unit Holders? (Interest is Taxable)

Example 1

	Total	Interest	Dividend
Income Received by BT from SPV	5000		
Nature of Income Received by BT from SPV		4000	1000
Income Distributed by BT to Unit Holders (UH) [1]	4500 (90% of 5000)		
Ratio of Income Components in hands of UH [2]		4000/5000	1000/5000
Nature of Income Received in hands of UH [Sec. 115UA (1)] [1] X [2]		3600 (Taxable in hands of UH)	900 (Exempt in hands of UH)
No. of Units	1000		
Per Unit Components of Distributed Income		3.60 (Taxable in hands of UH)	0.90 (Exempt in hands of UH

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Example 1

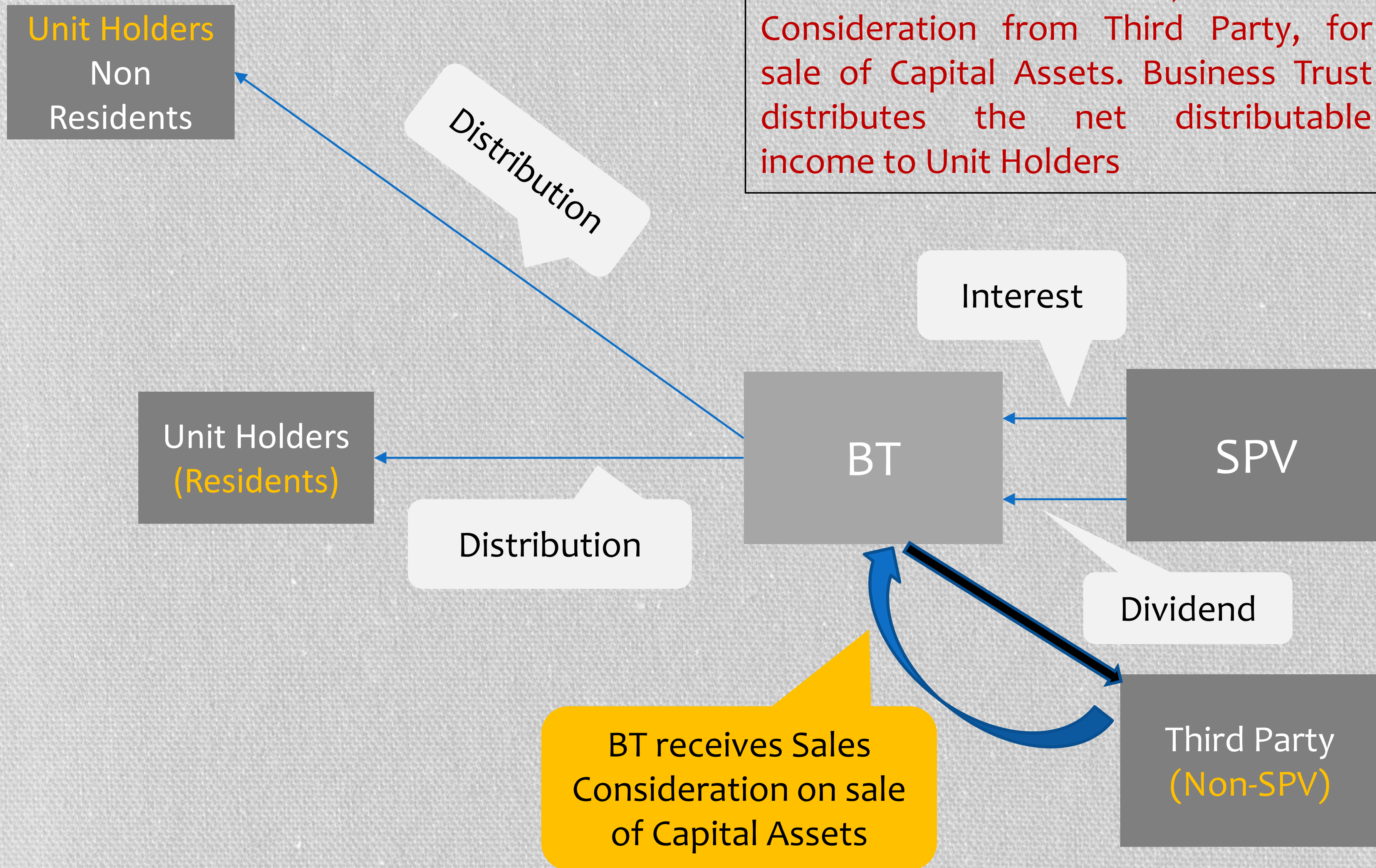
Unit Holders	No. of Units Held	Taxable Interest received from BT	Total Taxable Interest Income	Tax Rate
Residents	700	3.60 per unit	2500	Regular Tax Rate
Non Residents	300	3.60 per unit	1080	5%

Answer 33

Example 2

Example 2

Business Trust (BT) receives Interest and Dividend from SPV; and Sales Consideration from Third Party, for sale of Capital Assets. Business Trust distributes the net distributable income to Unit Holders



Example 2

FACTS

- BT receives interest of Rs. 4000 (without TDS) and Dividend of Rs. 1000 (after DDT) from the SPV Company.
- So BT receives total receipts of Rs. 5000 from SPV.
- BT also receives Sales Consideration of Rs. 30,000 from a Third party on sale of Capital Assets.
- So BT receives total receipts of Rs. 35,000: Rs. 5000 from SPV + Rs, 30,000 from Non-SPV Source

Example 2

FACTS

- Out of the Total Receipts of Rs. 35,000, BT distributes 90% i.e. Rs. 31,500 to the Unit Holders.
- Total number of Units held by the Unit Holders is 1000: Residents hold 700 Units and Non Residents hold 300 Units.

Q: How will the interest, dividend and capital consideration be apportioned in the hands of Unit Holders? (Interest is Taxable)

Example 2

	Total	Interest	Dividend	Capital Consideration
Income Received by BT from SPV	5000			
Nature of Income Received by BT from SPV		4000	1000	
Income (Consideration) Received by BT from Non-SPV Source	30,000	-	-	30,000
Income Distributed by BT to Unit Holders (UH)	31,500 (90% of 35000)			

Capital Gains will be taxable in hands of BT at regular tax rate i.e. the rate normally applicable to Capital Gains

Example 2

	Total	Interest	Dividend	Capital Consideration
Income Distributed by BT to Unit Holders (UH) [1]	31,500 (90% of 35000)			
Ratio of Income Components in hands of UH [2]		4000/35000	1000/35000	30000/35000
Nature of Income Received in hands of UH [Sec. 115UA (1)] [1] X [2]		3600 (Taxable in hands of UH)	900 (Exempt in hands of UH)	27,000 (Exempt in hands of UH)
No. of Units	1000			
Per Unit Components of Distributed Income		3.60 (Taxable in hands of UH)	0.90 (Exempt in hands of UH)	27 (Exempt in hands of UH)

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Example 2

Unit Holders	No. of Units Held	Taxable Interest received from BT	Total Taxable Interest Income	Tax Rate
Residents	700	3.60 per unit	2520	Regular Tax Rate
Non Residents	300	3.60 per unit	1080	5%

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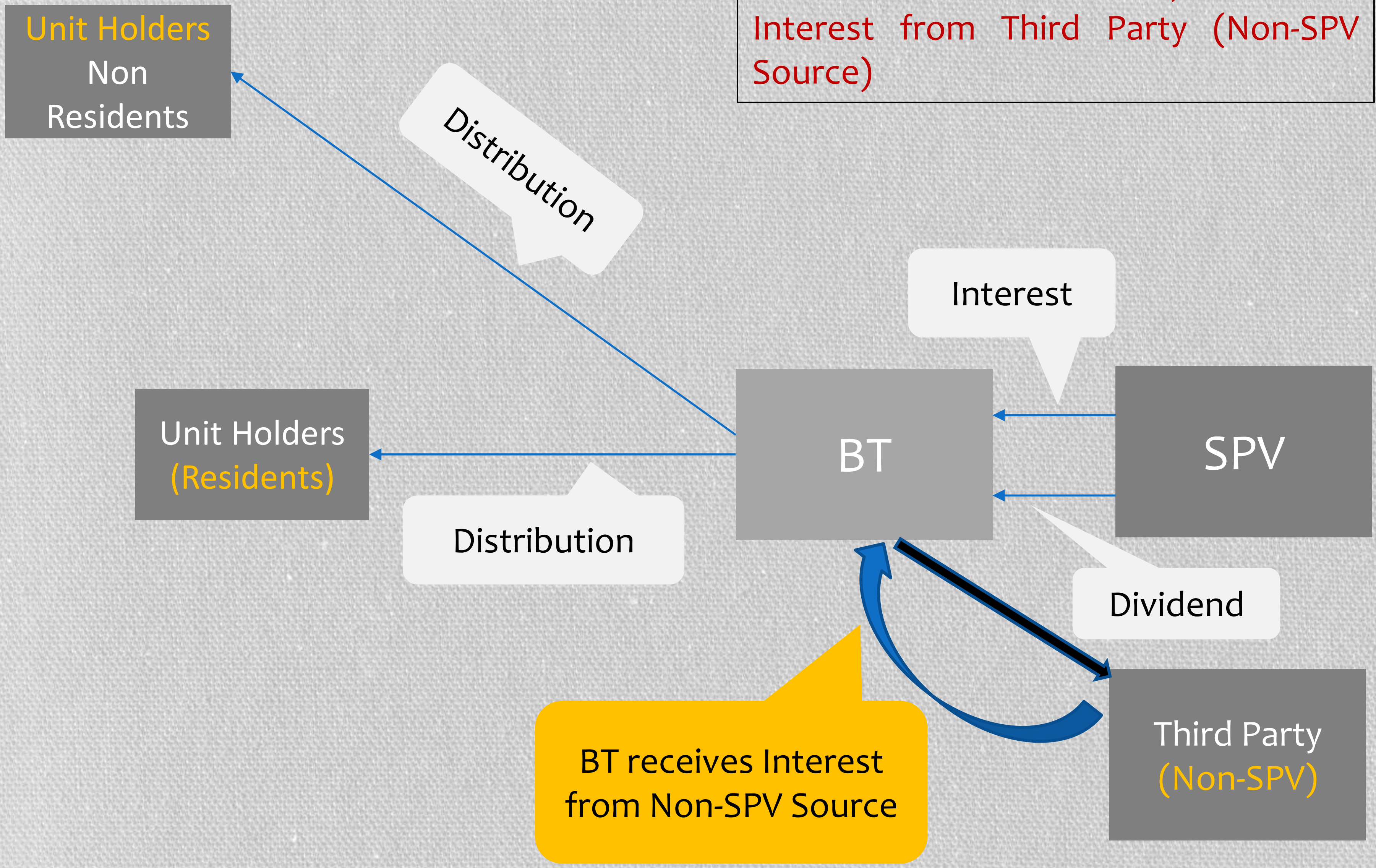
Answer 33

Example 3

Example 3

Business Trust (BT) receives Interest and Dividend from SPV; and also Interest from Third Party (Non-SPV Source)



Example 3

FACTS

- BT receives interest of Rs. 6000 (without TDS) and Dividend of Rs. 2000 (after DDT) from the SPV Company.
- So BT receives total receipts of Rs. 8000 from SPV.
- BT also receives interest of Rs. 1000 from Non-SPV Sources
- So BT receives total receipts of Rs. 9,000: Rs. 8000 from SPV + Rs, 1000 from Non-SPV Sources

Example 3

FACTS

- Out of the Total Receipts of Rs. 9000, BT distributes 90% i.e. Rs. 8,100 to the Unit Holders. (Under Draft SEBI Regulations BT is supposed to distribute 90% of surplus).
- Total number of Units held by the Unit Holders is 2000: Residents hold 1200 Units and Non Residents hold 800 Units.

Q: How will the interest and dividend from SPV and interest from Non-SPV sources be apportioned in the hands of Unit Holders? (Interest from SPV is Taxable)

Example 3

	Total	SPV Interest	SPV Dividend	Non-SPV Interest
Income Received by BT from SPV	8000			
Nature of Income Received by BT from SPV		6000	2000	
Income (Interest) Received by BT from Non-SPV Source	1000	-	-	1000
Income Distributed by BT to Unit Holders (UH)	8100 (90% of 9000)			

Non-SPV Interest will be taxable in hands of BT at maximum marginal rate

Example 3

	Total	SPV Interest	SPV Dividend	Non-SPV Interest
Income Distributed by BT to Unit Holders (UH) [1]	8100 (90% of 9000)			
Ratio of Income Components in hands of UH [2]		6000/9000	2000/9000	1000/9000
Nature of Income Received in hands of UH [Sec. 115UA (1)] [1] X [2]		5400 (Taxable in hands of UH)	1800 (Exempt in hands of UH)	900 (Exempt in hands of UH)
No. of Units	2000			
Per Unit Components of Distributed Income		2.70 (Taxable in hands of UH)	0.90 (Exempt in hands of UH)	0.45 (Exempt in hands of UH)

Example 3

Unit Holders	No. of Units Held	Taxable Interest received from BT	Total Taxable Interest Income	Tax Rate
Residents	1200	2.70 per unit	3240	Regular Tax Rate
Non Residents	800	2.70 per unit	2160	5%

Summary

Summary

Nature of Income	Business Trust (REIT or InvIT)	Unit Holders	Transferor	SPV Company
Capital Gains on transfer of shares of the SPV, by the Sponsor, in exchange for the units of Business Trust	Not Applicable	Not Applicable	No Capital Gains will arise at the time of exchange of shares. Capital Gains will be taxable later when the units of the Business Trust, received in exchange of the shares, are sold by the Sponsor.	Not Applicable

Summary

Nature of Income	Business Trust (REIT or InvIT)	Unit Holders	SPV Company
Interest income received by Business Trust From SPV, on money lent to SPV	Interest received from SPV will be exempt from tax in the hands of Business Trust. So the SPV will not be required to deduct tax at source.	The interest will be taxed in the hands of Unit Holders only when the interest is actually distributed by the Business Trust to the Unit Holders.	Deduction of interest, as expenditure, will be available to the SPV as per the normal provisions of the I.T. Act 1961

Summary

Nature of Income	Business Trust (REIT or InvIT)	Unit Holders	SPV Company
Interest income received by Business Trust from SPV, on money lent to SPV. Such interest income is taxable in hands of Unit Holders when it is distributed by the Business Trust to them.	Interest received from SPV will be exempt from tax in the hands of Business Trust. So the SPV will not be required to deduct tax at source.	The interest component of the income distributed by the Business Trust will be taxable in the hands of Unit Holders at the following rates: • 5% (plus applicable surcharge and education cess) in case of Non-resident Unit Holders; • At normal income-tax rates in case of Resident Unit Holders.	Deduction of interest paid to Business Trust will be available to the SPV, as per the normal provisions of the I.T. Act 1961

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Summary

Nature of Income	Business Trust (REIT or InvIT)	Unit Holders	SPV Company
Dividend income received from the SPV on the shares held by the Business Trust	Dividend received will be exempt from tax	Dividend component of the income distributed by the Business Trust will be exempt from tax in hands of Unit Holders	DDT will be payable by the SPV
Capital Gains on disposal of assets by the Business Trust	Capital Gains will be taxable at the rates normally applicable to 'Capital Gains'	The Capital Gain component of the income distributed by the Business Trust will be exempt from tax in hands of Unit Holders	Not Applicable
Other Income (E.g. Interest from Non-SPV Sources) received by the Business Trust	Other Income will be taxed at the maximum marginal rate	Any distributed income (other than interest income from SPV) received by Unit Holders from the Business Trust will be exempt from tax	Not Applicable

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Summary

Nature of Income	Business Trust (REIT or InvIT)	Unit Holders	SPV Company
Capital Gains on sale of Units of the Business Trust	Not Applicable	Capital Gains arising on sale of Units of Business Trust, listed on a recognized stock exchange and subject to STT, will be treated as under: • Long Term Capital Gains will be exempt from tax; • Short Term Capital Gains will be taxable at the rate of 15% (plus applicable surcharge and education cess)	Not Applicable

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Summary

Notes:

- For computing Capital Gains in hands of the Sponsor (Transferor), on sale of Units received in exchange of Shares of the SPV, the Cost of the Shares, which were exchanged for Units, will be considered as the Cost of those sold Units. Also, the period of holding of the exchanged Shares will be included to determine the period of holding of the Units.

- The Business Trust will be required to furnish Return of Income, even if it is otherwise not required to do so.

- The Business Trust will also be required to file other necessary forms and comply with other reporting requirements, as may be prescribed later.

- Interest payable by the Business Trust on External Commercial Borrowings availed from Non-resident lenders will be taxable at the concessional rate of 5% subject to fulfilment of the prescribed conditions.

- The proposed amendments relating to withholding taxes or TDS will be effective from 1st October 2014

The Ceremony of Closing

The Closing

Dear Reader, You have now arrived at the end of this E-Book. We at Taxwize hope your journey through this E-Book was fruitful, a journey worth undertaking.

As you might have observed REITs and InvITs (Business Trusts) are not going to be taxed on true pass-through basis. Especially the losses incurred by REITs and InvITs cannot be claimed by Investors by invoking the pass-through principle. So the Investors will not get benefit of setting off losses incurred by the Trust.

The Trust too cannot carry forward those losses for set-off in future because the corresponding income is exempt in hands of the Trust.

The Closing

This inbuilt restriction is unfair. The provisions need to be modified to allow true fiscal pass-through of loss, without regard to distribution; when the Trust incurs loss, the loss should automatically flow through to the Investors.

Other than that the New Tax Regime for REITs and InvITs is an encouraging step to give boost to Real Estate and Infrastructure Sectors. Let us hope it takes India forward in the coming years.

We now end with a humble request: Please mail your comments to us at this email ID: info@taxwize.in

Your comments are invaluable to us - we will eagerly await them.

Thank you.

Contact

Website: www.taxwize.in

For any queries related to this Analysis you may Contact Nilesh Patel – *CPA (USA), IRS (Former)* at the Email ID: Nilesh@taxwize.in

Thank You