

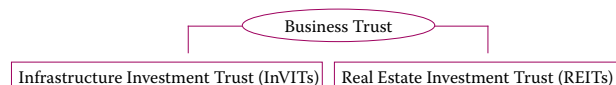
Tax on Income of Unit Holders and Business Trust



The expansion of asset delivery through the public-private partnership (PPP) model has increased the number of assets available for financing. Hence, the SEBI notified the regulations for two new investment vehicles viz. Infrastructure Investment Trust [InVIT] and Real Estate Investment Trust [REIT]. Further, the “Chapter XII-FA” has been inserted by the Finance (No.2) Act, 2014 with respect to “Special Provisions Relating to Business Trusts”. The article discusses briefly the taxability of income of the business trusts and the unit holders as provided in Section 115UA inserted by the Finance (No. 2) Act of 2014. Read on...

1) Business Trust [Section 2(13A) inserted by the Finance (No.2) Act 2014 w.e.f. 1st October 2014]

“Business Trust” means a trust registered as an infrastructure investment trust (InVIT) or a real estate investment trust (REIT), the units of which are required to be listed on a recognised stock exchange, in accordance with the regulations made under the Securities Exchange Board of India Act, 1992 and notified by the Central Government in this behalf.



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a) Infrastructure Investment Trusts (InVITs)

- i. InVITs provide a suitable structure for *financing/refinancing* of infrastructure projects in the country.
- ii. InVITs shall invest in infrastructure projects either directly or through special purpose vehicle (SPV). In case of public private partnership (PPP) projects, such investments shall only be through SPV.
- iii. Special purpose vehicle (SPV) means any *company or LLP*:
 - a. in which the InVIT holds or proposes to hold controlling interest and not less than 51% of the equity share capital or interest;
 - b. which holds not less than 90% of its assets directly in infrastructure projects and does not invest in other special purpose vehicles; and
 - c. which is not engaged in any other activity other than activities pertaining to and incidental to the underlying infrastructure projects.

Taxation

- iv. *Sponsor* means company(s) or LLP(s) or body corporate(s) who set(s) up the InVIT and assigned as such at the time of application made to the Board and in case of PPP projects, shall mean the lead member of the concessionaire SPV.
- v. *Listing shall be mandatory* for both publicly offered and privately placed InVITs.

b) Real Estate Investment Trusts (REITs)

- i. Real estate investment trusts (REITs) allow small investors access to large income producing real estate assets in the same way as mutual funds provide access to stocks.
- ii. REITs have been allowed to invest in the properties directly or through special purpose vehicles.
- iii. The REIT shall not invest in vacant land or agricultural land or mortgages other than mortgage backed securities.
- iv. REIT shall only invest in assets based in India.
- v. "Unit holder" means any person holding units of the REIT.

c) Income-Investment Model of REITs and InVITs

The income – investment model of such REITs and InVITs (referred to as business trusts) has the following distinctive elements:

- i. the trust would raise capital by way of issue of units (to be listed on a recognised stock exchange) and can also raise debts directly both from resident as well as non-resident investors;
- ii. the income bearing assets would be held by the trust by acquiring controlling or other specific interest in an Indian company (SPV) from the sponsor.

2) Taxation Regime Introduced By The Finance (No. 2) Act, 2014 for REITs and InVITs

Entity	Taxation Provisions
Taxation of business trusts (REITs / InVITs)	Sections 2(13A), 10(23FC), 115UA(2), 139(4E) and STT
Taxation of unit holders (other than sponsor holding units acquired by him in exchange for shares of SPV) – Capital gains from transfer of units	Sections 2(42A), 10(38), 111A(1)
Taxation of unit holders – Income distributed by business trust	Sections 10(23FD), 115A, 115UA(1) / (3)
Taxation of sponsor – Capital gains from exchange of SPV shares for units, capital gains on sale of units so acquired	New sub-clause (hc) in Clause (i) of Explanation 1 to Section 2(42A), 2nd Proviso to Section 10(38), new Section 47(xvii), Section 49(2AC) and new 2nd Proviso to Section 111A(1)

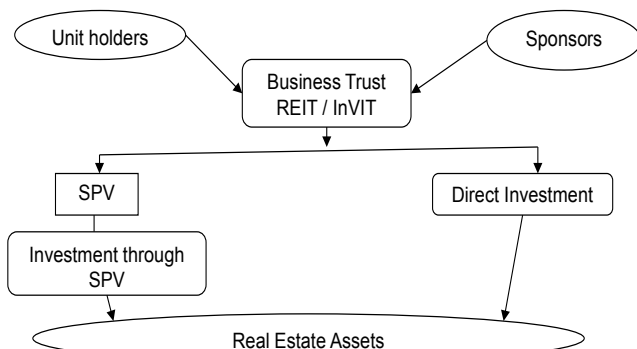
3) Taxation of Business Trusts

i. Tax Exemption To Business Trust In Respect Of Interest Received Or Receivable From SPV [Section 10(23FC) Inserted by The Finance (No.2) Act, 2014]

The Finance (No.2) Act, 2014 inserted Section 10(23FC) w.e.f. 1st April 2015, so as to provide that any income of a business trust by way of interest received or receivable from a special purpose vehicle would *not be included* in the total income of the trust.

• Pass through treatment for interest received by business trust from SPV

The income by way of interest received by the business trust from SPV is accorded pass through treatment i.e. there is no taxation of such interest income in the hands of the trust and no withholding tax at the level of SPV. However, withholding tax at the rate of 5 per cent in case of payment of interest component of income distributed to non-resident unit holders, at the rate of 10 per cent in respect of payment of interest component of distributed



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income to a resident unit holder shall be effected by the trust.

- **No TDS on interest income payable by SPV to business trust**

The Finance (No.2) Act, 2014 has inserted a new Clause (xi) in Section 194A(3) w.e.f. 1st October 2014, so as to exempt from TDS deduction, the income by way of interest referred to in Section 10(23F), i.e., interest income payable by special purpose vehicle (SPV) to a business trust.

ii. Special Provisions Relating To Business Trusts [Section 115UA Inserted By The Finance (No.2) Act, 2014 w.e.f. 1st April 2015]

- 115UA(1):** Notwithstanding anything contained in any other provisions of this Act, any income distributed by a business trust to its unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder as it had been received by, or accrued to, the business trust.
 - **Dividend received by business trust:** The dividend received by the trust shall be subject to dividend distribution tax at the level of SPV and will be exempt in the hands of the trust. Further, the dividend component of the income distributed by the trust to unit holders will also be exempt.
- 115UA(2):** Subject to the provisions of Section 111A and Section 112, the total income of a business trust shall be charged to tax at the maximum marginal rate.
 - **Capital gains on disposal of assets of business trust:** The income by way of capital gains on disposal of assets by the trust shall be taxable in the hands of the trust at the applicable rate. However, if such capital gains are distributed, then the component of distributed income attributable to capital gains would be exempt in the hands of the unit holder. Any other income of the trust shall be taxable at the maximum marginal rate.
- 115UA(3):** If in any previous year, the distributed income or any part thereof,

received by a unit holder from the business trust is of the nature as referred to Section 10(23FC), then, such distributed income or part thereof shall be deemed to be the income of such unit holder and shall be charged to tax as income of the previous year.

iii. Section 139(4E): Mandatory Filing By Business Trust [Inserted By The Finance (No. 2) Act 2014, w.e.f. 1st April 2015 i.e. A.Y. 2015-16]

Every business trust, which is not required to furnish return of income or loss under any other provisions of this Section (i.e. Section 139), shall furnish the return of its income in respect of its income or loss in every previous year and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under Section 139(1).

iv. STT Levy On Transactions In Units Of A Business Trust

Chapter VII of the Finance (No. 2) Act, 2004 deals with levy of securities transaction tax on transaction of equity shares of a company on the stock exchange. This Chapter has been amended by the Finance (No.2) Act, 2014 w.e.f. 1-10-2014 in order to provide levy of securities transaction tax on transactions in units of a business trust on the same lines as are applicable to transactions in equity shares in a company.

- **Taxation of capital gains arising to the unit holder (other than the Sponsor):** The listed units of a business trust, when traded on a recognised stock exchange, would attract same levy of securities transaction tax (STT) and would be given the same tax benefits in respect of taxability of capital gains as equity shares of a company i.e. long term capital gains, would be exempt under Section 10(38) and short term capital gains would be taxable at the rate of 15 percent under Section 111A.

The income by way of capital gains on disposal of assets by the trust shall be taxable in the hands of the trust at the applicable rate. However, if such capital gains are distributed, then the component of distributed income attributable to capital gains would be exempt in the hands of the unit holder.

v. Tax and TDS of 5% On Distributed Interest Income Received By Non-Resident From Business Trust

- a) As per Section 10(23FC) as inserted by the Finance (No.2) Act 2014 w.e.f. 1-4-2015, *any income* of a business trust by way of *interest received* or receivable from a special purpose vehicle would not *be included* in the total income of the trust.

If interest income, as *specified* under Section 10(23FC), being *received from SPV*, is distributed by business trust to *unit-holder*, then the tax deduction under Section 194LBA is applicable at the rate of 5 percent in case of non-resident and at the rate of 10 percent in case of resident.

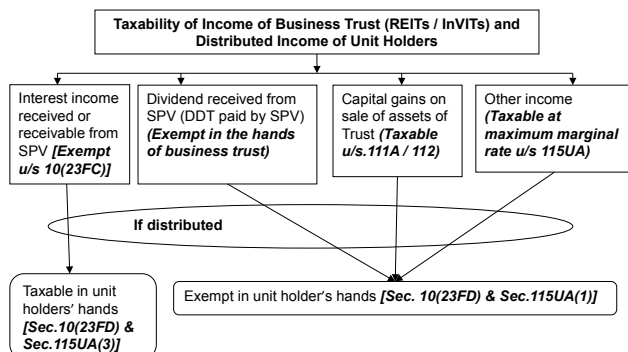
- b) Section 115A as amended by the Finance (No.2) Act 2014 provides that if an *Indian company [or business trust] borrows money in foreign currency from a source outside India either under a loan agreement or by way of issue of long-term infrastructure bonds*, as approved by the Central Government, then the interest payment to a non-resident person would be subject to a concessional rate of tax at the rate of 5 percent.

Consequently, *Section 194LC as amended by the Finance (No.2) Act 2014* provides that in case of *external commercial borrowings* by the business trust, tax will be *deducted at the rate of 5 percent on interest payments to non-resident lenders*.

4) Taxation Of Income In The Hands Of Unit Holders

- a) **Tax Exemption To Distributed Income Received By A Unit Holder From The Business Trust [Section 10(23FD) inserted by the Finance (No.2) Act 2014 w.e.f. 1-4-2015]**

Any distributed income, referred to in *Section 115UA [Para (3)(ii) supra]*, received by a *unit holder* from the business trust, *not being of the nature* as referred to in Section 10(23FC) [Para (3)(v), *supra*], shall not be included in the total income of such unit holder.



Example:

An REIT earns ₹10 Crore income: ₹4 Crore from rentals from real estates, ₹2 Crore as interest from SPV, ₹3 Crore as dividend from SPV and ₹1 Crore as capital gains. REIT distributes ₹4 Crore to its unit holders. A unit holder Mr. X receives ₹50,000.

Tax treatment of ₹50,000/- in Mr. X's case is as follows:

S. No.	Amount attributable to REIT's	₹
1	Rental income	20,000
	(4 / 10) crore x 50,000	
	Exempt u/s 10(23FD) read with Section 115UA(1)	
2	Interest income from SPV	10,000
	(2 / 10) crore x 50,000	
	Taxable by reason of Section 10(23FC) read with Section 115UA(1) and Section 115UA(3) under the head "Income From Other Sources"	
3	Dividend income	15,000
	(3 / 10) crore x 50,000	
	Exempt u/s 10(23FD) read with Section 115UA(1)	
4	Capital gains income	5,000
	(1 / 10) crore x 50,000	
	Exempt u/s 10(23FD) read with Section 115UA(1)	

b) Taxation Of Capital Gains Arising From Transfer Of Units Of Business Trust

- i. **"Short-Term Capital Asset"** means a capital asset held by an assessee for *not more than 36 months* immediately preceding the date of its transfer.

- **1st Proviso (As Amended By The Finance (No.2) Act, 2014)**

However, in the following cases, an asset, held for *not more than 12 months*, is treated as short-term capital asset –

- a security (other than a unit) listed in a recognised stock exchange in India;
- a unit of the UTI;
- a unit of an equity oriented fund [i.e. same meaning as assigned to it in the Explanation to Section 10(38)];
- Zero coupon bonds (whether quoted or not).

Hence, *units of business trust* will be *short term* capital assets if held for *not more than 36 months* immediately preceding the date of its transfer. Units of a business trust become *long-term* capital assets if held for *more than 36 months*.

- ii. The Finance (No.2) Act 2014 w.e.f. 1-10-2014, inserts Clause (hc) in Explanation 1 to Section 2(42A), as follows:

“(hc) In the case of a capital asset, being a unit of a **business trust, allotted pursuant to transfer of share or shares as referred to in Clause (xvii) of Section 47**, there shall be included the period for which the share or shares were held by the assessee;”

- o The period of holding of *units of business trust*, being acquired as specified under Section 47(xvii), will be counted from the date of holding of share(s) in SPV.
- Finance (No.2) Act 2014 w.e.f. 1-4-2015 inserted Section 47(xvii) to provide that any transfer of a capital asset, being *share of a special purpose vehicle*, to a business trust in exchange of units allotted by that trust to the transferor shall *not be regarded as transfer* for the purposes of Section 45.
- Section 49(2AC) - Cost of acquisition of *unit of a business trust* [inserted by the Finance (No.2) Act 2014 w.e.f. 1-4-2015] provides that where the capital asset, being a unit of a business trust, became the *property of the assessee in consideration of a transfer* as referred under Section

47(xvii), the *cost of acquisition* of the asset shall be deemed to be the cost of acquisition to him of the *share referred to* in the said clause.

5) Comments

- i. **Capital gains arising to sponsor at the time of exchange of shares in SPVs for units of the business trusts – taxation deferred till sale of units**

In case of capital gains arising to the sponsor at the time of exchange of shares in SPVs with units of the business trust, the *taxation* of gains shall be *deferred* and *taxed* at the time of *disposal of units* by the sponsor. However, the *preferential capital gains regime (consequential to levy of STT) available in respect of units of business trust will not be available to the sponsor in respect of these units at the time of disposal*. Further, for the purpose of computing capital gain, the cost of these units shall be considered as *cost of the shares to the sponsor*. The *holding period* of shares shall also be *included* in the holding period of such units.

- ii. **Tax exemption to long term capital gains arising from transfer of any units of a business trust**

Section 10(38) has been amended by the Finance (No.2) Act 2014 w.e.f. 1-4-2015. Tax exemption in Section 10(38) has been *extended to long-term capital gains* arising on *transfer of a unit* of a business trust as it is *applicable to units of an equity oriented fund*. However, the exemption will not apply to any income arising from transfer of any units of a business trust which were acquired *in consideration of a transfer as referred under Section 47(xvii) of the Act*.

- iii. **Concessional 15% tax on short term capital gains on transfer of units of a business trust**

Section 111A(1) provides for the levy of tax at *concessional rate of 15 percent* on short term capital gain in certain cases. The provisions of Section 111A(1) have been amended by the Finance (No.2) Act 2014 w.e.f. 1-4-2015, to extend the concessional rate of tax to short term capital gains from transfer of units of a business trust. However, the provisions of Section 111A shall not apply in respect of any income arising from transfer of units of a business trust which were acquired by the assessee in consideration of a transfer as referred under Section 47(xvii) of the Act. ■

The Finance (No.2) Act 2014 w.e.f. 1-4-2015 inserted Section 47(xvii) to provide that any transfer of a capital asset, being share of a special purpose vehicle, to a business trust in exchange of units allotted by that trust to the transferor shall not be regarded as transfer for the purposes of Section 45.