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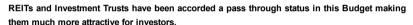
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Guest Column > Real Estate Investment Trusts accorded pass through status; albeit with limitations

## Real Estate Investment Trusts accorded pass through status; albeit with limitations

REITs and Investment Trusts have been accorded a pass through status in this Budget making them much more attractive for investors.

Amit Maheswari Sep 2, 2014



A Real Estate Investment Trust (REIT) is an entity that owns, and invariably in a lot of cases, operates income-producing real estate. Real Estate Investment trusts (REITs) are very popular in several countries including USA, Australia, Singapore, Japan, France, UK, etc. Globally, REITs own various kinds of commercial real estate like office space, studio apartments, warehouses, hospitals, shopping centers, hotels, etc. Some REITs also engage in financing of real estate.

Real estate investments, unlike financial instruments do not allow small ticket purchases. REITs are akin to mutual funds in the way they are structured and hence allow large number of small investors to invest into real estate and thereby generate better returns. The investors get enhanced liquidity coupled with higher returns. The developer also gets much needed liquidity as it opens a new source of capital.



SEBI has issued final regulations applicable to REITs on 10th August, 2014. As per the regulations, Indian REITs would be allowed to only invest in commercial property. Given the minimum size of Rs. 500 crore and that of initial offer of Rs. 250 crore, only serious players would get in. Only 20% of the assets can go into under-construction shares/debt estate assets. of real companies and mortgage backed securities thereby reducing the risk associated with investing in REITs. Minimum size of retail participation is Rs. 2 lakh and Rs. 10 lakh

for REITs and Infrastructure Investment Trusts ("InvITs") respectively. Another important changes bought in the final guidelines is allowing FIIs participation in REITs.

Before the Finance (No. 2) Bill, 2014, there was no clarity on the tax treatment of REITs. REITs/InvITs have been accorded a pass through status in this Budget making them much more attractive for investors.

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The investors instead of the REITs would be subject to tax in respect of interest income received from a Special Purpose Vehicle (SPV) by the REITs. TDS would be 10% in case of distribution of income to residents and 5% (final tax rate) in the case of non- resident unit holder. In the case of dividends distributed by the SPV, it would not be taxable in the hands of REITs as well as the shareholders since DDT would be paid by the SPV. Capital gains earned by REITs upon sale of shares in SPV or sale of real estate assets would be taxed at regular rates for capital gains and there would be no further tax in the hands of the unit holders after distribution of the same. Capital gains arising to the unit holders of REITs would be accorded the same treatment as that of listed securities since Securities Transaction Tax would be applicable to sale and purchase of units of REITs. Any other income like lease rentals, property management fee, etc. would be taxed at 30% in the hands of REITs and again this income distributed to unit holders would be exempt in the hands of unit holders. Transfer of shares of the SPV by the sponsor to a REIT in exchange of units of REITs would be exempt from tax. However when the sponsor sells the units of the REITs it would not get the preferential capital gains regime applicable when STT is paid. When a sponsor would sell real estate assets directly to a REIT then there is no concession whatsoever and this may act as a dampener in

exempt from tax. However when the sponsor sells the units of the REITs it would not get the preferential capital gains regime applicable when STT is paid. When a sponsor would sell real estate assets directly to a REIT then there is no concession whatsoever and this may act as a dampener in certain cases. Also, in case of assets held in an SPV structured as a Limited Liability Partnership("LLP"), then transferring of partnership interest in LLP to the REIT in exchange of units of REITs may be taxable. As of now there is lack of clarity on whether REITs can invest in LLPs, which has emerged as a preferred option for holding real estate.

The favorable tax regime for REITs in this Budget and the subsequent SEBI regulations are a very positive step in making regular income bearing and appreciating real estate accessible to retail investors. Developers can benefit from increased liquidity from easier access to capital. REITs would be a preferred form of asset backed investment with visible revenue streams and offering adequate protection to investors. They would also introduce much needed transparency in the sector. With an uptick in sentiment towards commercial real estate, REITs have the potential to be become an important vehicle for getting exposure to real estate.

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