# Opaque taxations may kill REIT appetite: Nishith Desai Associates

Nischal Joshipura of Nishith Desai Associates feels that Real Estate Investment Trust (REITs) may not look attractive on lack of clarity on the taxation front.

In addition, foreign investment in completed assets is prohibited, which may add on to be a hurdle, says Joshipura in an interview with CNBC-TV18. The industry has therefore asked for REIT taxation to be relaxed.

***Below is the verbatim transcript of the interview:***

**Q: I was going through your note where you do say that REIT will be the next progressive step for the real estate sector however the immediate need of the hour is to address issues relating to both tax and foreign investments without which REITs will not go through successfully. So what are the key issues you think that could make REITs unattractive?**

A: The most important issue currently facing the developer community and even the fund management community is for launching REIT is the tax pass-through, which they have been asking for a long time.

Now the problem with the tax proposals which have come out is that the sponsor taxation has not been aligned with the REIT taxation so when the sponsor is transferring the shares of the special purpose vehicle (SPV) which is holding the REIT, there is postponement of the tax for the sponsor but at the same time the sponsor is going to get taxed when he sells the units of the REIT at a later point in time.

This is a big dampener for the sponsors because for normal unit holder when he transfers the units of the REIT on the exchange, there is no tax but the sponsor will have to pay that tax. So that is something which is bothering the sponsors quite a bit.

The second major issue as far as REIT taxation is concerned, is there is no exemption for dividend distribution tax when the SPV plays dividend to the REIT. Now lot of developers have been comparing the REIT model with a listed company model where in case of listed companies there is no compulsion to pay dividend and it is at the boards discussion to decide whether to pay dividend or not.

As compared to that in case of REIT, Sebi has mandated that at least 90 percent of the net distributable cash flows have to be mandatorily distributed to the unit holders. And because it has to be distributed to the unit holders, there is going to be a dividend distribution tax which has to be paid.

Overall, if you look at the REIT taxation, the ultimate unit holder let us say if he is an Indian resident, will be subject to almost 42-43 percent tax which may not be a compelling preposition for any investor to invest in a REIT, he could be better off investing in alternative assets like fixed deposit or directly buying real estate or investing in gold. So that is something which the industry has represented to the finance minister to relax some of these tax proposals to make REIT attractive.

**Q: So what you are saying is it neither benefits the sponsor, the real estate company which wants the REIT, nor does it benefit a retail investor who would want to invest?**

A: That is correct so that is the biggest problem right now. Unless couple of tax proposals is relaxed for the investors and for the sponsors, it is going to be difficult for any sponsor to launch a REIT or an investor to invest in a REIT unless commercially the returns are much higher as compared to some of the other asset classes in which the investors are investing.

If you compare it with some of other developed jurisdictions like Singapore and there are already three Indian REITs which are listed on Singapore. We need to ensure that we are not exporting our capital markets again which we have been doing over the last few years and it is important that this time we get it right because already we have failed two times in launching the REITs and this is the third time. So it is very important that we get our tax proposals right because commercially the sponsors and the investors may still want to diversify into a new asset class but at the same time it is important that they get the returns which they are expecting and the tax is something which is not as much as would stop them from launching the REIT or investing in a REIT.

**Q: What kind of amendments would you like to see in the FII and the QFI regulations in order to make REITs a bit more attractive?**

A: Currently as far as foreign investment is concerned, any type of foreign investment in completed assets in India is not allowed unless that property is in the form of an industrial park, special economic zone, hospitals or hotels.

Now the problem with REIT is that REIT will own a completed property so currently foreign investment in units of REIT is not permitted and hence there is a need to change the exchange control regulations to allow the foreign investor or FIIs or QFIs to invest in the units of a REIT. Also we will need to amend the securities law especially the Securities Contract Regulation Act to provide for units of a REIT in the definition of securities because without that listing of the units of the REIT again would be a challenge. So there are number of laws which will need to be amended to ensure that REIT regime takes off and all laws are in conformity with each other when it comes to creating a conducive regime for REIT.