Business Standard

Realtors await tax clarity before launching REITs

Property developers, who have large commercial property portfolios, await clarification on dividend distribution tax (DDT)

Raghavendra Kamath | Mumbai November 25, 2015 Last Updated at 12:11 IST

Property developers, who have large commercial property portfolios, are keenly awaiting the government's clarification on tax issues such as dividend distribution tax (DDT) before floating real estate investment trusts (REITs).

REITs are similar to mutual funds, and can be listed and traded on stock exchanges. These have to distribute a majority of their income as dividend.

In April this year, the union government said minimum alternate tax (MAT) would not be applicable on notional book gains, arising from exchange of shares in SPV (special purpose vehicles) with unit of trusts

in infrastructure and real estate (Reits/InvITs), thus fulfilling a long pending demand of developers.

In this year's budget, the government announced capital gains tax exemption at the hands of the sponsor and other fiscal incentives to investors.

Despite the relaxation, developers and consultants feel DDT at the special purpose vehicle level is still a major hurdle for launching REITs especially when a REIT is required to distribute 90% of its lease rental income to the unit holders.

"The government has taken extremely welcome steps to facilitate REITs by resolving most issues pertaining to MAT and capital gains. However, resolution of residual issues like DDT in line with global norms on REITs will further facilitate the process," said Ashok Tyagi, group chief financial officer at DLF, the country's largest property developer.

However, Tyagi clarified that DLF promoters are selling 40% stake in the company's rental arm DLF Cyber City Developers Ltd (DCCDL) and any plans of a REIT will be discussed subsequent to closure of the transaction.

"Government should exempt DDT at SPV level. Otherwise, there is too much tax leakage will happen," said a senior executive at K Raheja Corp which looked into floating REITs in the past.

Both DLF and Raheja have raised funds through floating commercial mortgage backed securities whereby they have mortgaged their commercial properties to raise funds in the interim.

According to realty consultancy Jones Lang LaSalle, 80-100 million sq ft of office space in the country worth at least Rs 60,000 crore may qualify to be included under REITs. These assets could together generate rentals of Rs 6,000 crore annually.

Jitu Virwani, chairman and managing director of Bengaluru based Embassy said the company is waiting for the laws on REIT in the coming months.

Earlier, a joint venture between private equity firm Blackstone and Embassy group decided to shelve plans to list a $2-billion Reit in India due to tax issues.

However, Ruchir Sinha, co-head, private equity and M&A at Nishith Desai Associates said policy changes that were pending to allow foreign investments in REITs have just been announced, which is important since the current tax regime REITS is more optimized for foreign investors than domestic investors.

"However, on the legal side, issues like DDT, complete pass through and sponsor eligibility criteria need to be sorted; but more importantly it is the larger faith in the Indian cap rate compression story that needs to develop since issues like tax and currency risks supersede the yield, which is comparable in other markets as well," Sinha said.

According to Somy Thomas, managing director, valuation and advisory services at Cushman & Wakefield, said that apartment DDT relaxation, stamp duty had to be relaxed by the state governments while transferring the asset.