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REALTY SHOW

REITs likely to get tax-gains coating like mutual funds

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INDIAN investors looking to put money in in the realty segment through investment vehicles could be in line for fiscal incentives. The government is vetting a proposal put forward by market regulator Sebi to provide for a tax waiver on dividend income of Real Estate Investment Trusts (REITs). Sebi has made a case before the government to consider granting tax benefits to REITs on the lines of mutual funds to ensure wider investor participation. REITs are perceived to be lowvolatile investment options, offering a steady income stream in all market conditions, given that they invest largely in income-generating real estate properties.

This is based on the rationale that REITs have to distribute at least 90% of their net income as dividend to its investors, a norm which is practised in several international markets. This being the case, it would be difficult for REITs to take off in India without fiscal incentives , an official associated with the development said.

According to some officials, the government is likely to spell out the tax treatment for REITs in the forthcoming Budget . But what could delay the process is Sebi's failure in firming up the structure of such trusts.

REITs are investment vehicles registered under the Indian Trusts Act and have to be approved by Sebi. They are managed by professional investment management companies and can invest in real estate properties, including apartment buildings and commercial complexes, such as shopping malls. An investor can buy units in a REIT just as he does in a mutual fund and will earn a dividend income on the unit or shares of an REIT.

The income-tax law now provides for a pass-through status for mutual funds and the income earned by the funds is tax-free. But depending upon the nature of the fund, any income distributed by it attracts a dividend distribution tax, the maximum rate of which is capped at 25%. However, unit-holders do not have to pay tax on their dividend income. Sebi has recommended extending a similar tax treatment to REITs. This would mean granting them a pass-through status and exempting all income earned by REITs from tax.

Sebi rule bars REITs from buying vacant land

INVESTORS holding REIT units should also be spared from paying tax on dividends. Income distributed by the REIT would attract dividend distribution tax. Sebi, in its draft guidelines, has suggested that REITs should distribute not less than 90% of their net income after tax as dividends to the unitholders.

"To encourage investments in REITs, the capital gains on transfer of units of REITs should be given the same tax treatment as capital gains on transfer of units of equity-oriented mutual funds. In other words, it means that the unit holder should be exempt from long term capital gains tax," says Jayesh Sanghvi, tax partner, Ernst and Young. Sebi's draft guidelines allow REITs to buy stake in real estate developments. They are, however, barred from buying vacant land. Further, REITs cannot own more than 15% of a single real estate development and 25% of a single developer's portfolio.

Globally, several jurisdictions exempt income that is distributed as dividends from corporate tax and this encourages REITs to distribute up to 100% of their net taxable income as dividend to avoid paying taxes. The dividend income is then taxed in the hands of the unit holder. "Worldover REITs are set up as tax transparent vehicles. In India, currently the only tax transparent vehicle available is a trust. Mutual funds are also set up in the form of trust. Therefore it would be tax effective for investors if REITs were made tax pass-through," said Shefali Goradia, head of international taxes at Nishith Desai Associates. Besides REITs, Sebi wants the government to provide for a waiver of tax deducted at source (TDS) for corporate bonds as well. Sebi has also made out a case for charging STT on the premium of an options and futures contract and not on the entire underlying value of the stock.

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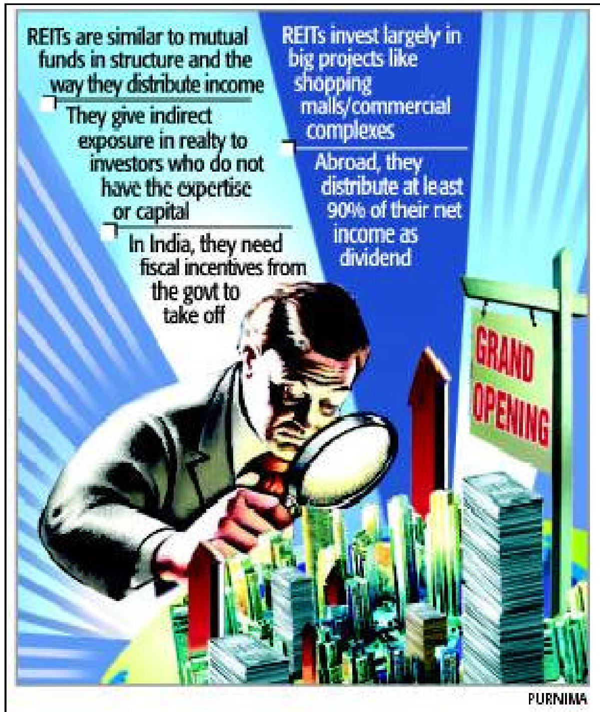
REITs are similar to mutual funds in structure and the way they distribute income
They give indirect exposure in realty to investors who do not have the expertise or capital
In India, they need fiscal incentives from the govt to take off
REITs invest largely in big projects like shopping malls/commercial complexes
Abroad, they distribute at least 90% of their net income as dividend
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