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Will the budget remove tax hurdles for REITs?

Clear bottlenecks in REITs, says developers

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Last year, the government made certain tax concessions for transferring shares from an SPV (special purpose vehicle) to REITs. Photo: Mint

Mumbai: Realty firms expect the upcoming budget would bring in few of the much-needed tax reforms and benefits that would help spruce up the real estate market that is reeling under piling debt and mounting pressure to clear unsold inventories.

The long-awaited listing of Real Estate Investment Trusts (REITs), an investment vehicle that many believe would bring stability and attract funds to the sector, is yet to take off. Many developers are hoping that the finance minister would consider removing few of its bottlenecks, specially scrapping the high dividend distribution tax (DDT), in order to make it more lucrative for investors.

Through REITs, developers can raise funds to finance projects. It works similar to mutual funds where individuals and institutions pool in money to invest in leased office or retail assets. They are often traded on stock exchanges. Last year, market regulator Securities and Exchange Board of India (Sebi) had cleared norms on listing of REITs. Unit holders of REIT earn return on investment through value appreciation or rental income generated from the commercial assets.

Last year, the government made certain tax concessions for transferring shares from an SPV (special purpose vehicle) to REITs. However, around 20% tax is still levied on the rental income received by REITs and hence significantly bringing down its value of return when it finally reaches the investors.

"We are still okay whatever the finance ministry decides to do with DDT as we are certain that everything about REIT cannot be completely tax neutral. However, I think Sebi in its deliberations with the foreign institutional investors has recommended to do away with the particular tax. So it's up to the finance ministry and we got to see what they decide to do with it," Rajeev Talvar, chief executive officer (CEO), DLF Ltd, told Mint over the phone.

DLF, the country's largest real estate firm by market capitalisation, has been gearing up to launch India's first REIT to raise an estimated ₹6,000 crore over the next two years. Other big property developers have also expressed interest in floating REITs.

A joint venture between global private equity fund Blackstone Group Lp and partner Embassy Property Developments Pvt. Ltd have delayed their plans to list a $2 billion Reit in India due to tax issues.

Kalpesh Maroo, partner, BMR & Associates LLP, a tax advisory firm, said one of the biggest hurdles to REITs listing is the high dividend tax which is making it unattractive to investors.

"Profits of the company when they get distributed back to the REIT and from the REIT back to investors they have to come by way of dividend distribution tax. By definition of REIT, 90% of the surplus cash have to be distributed. However, the surplus money that goes back to the trust needs to go through a dividend tax. 20% is a large number for it. It is one of the biggest reasons why REIT has not taken off," said Maroo.

According to Ashutosh Limaye, research head of JLL India, rental yield that a property developer earns out of grade A commercial property stands at around 8-9%. However, after DDT, the return one gets from REIT is about 6-6.5% which anybody can earn easily by keeping fixed deposits in a bank, he added.

"Removal of DDT will result in a rush of investment in REITs and this could prove to be decisive for the sector. Additionally, REITs offer the benefits of diversification, safety and easy exit. Simplifying the tax system will provide a major lift to the

industry," said Surendra Hiranandani, chairman and managing director, House of Hiranandani.