

# Real Estate Investment Trust

An overview

October 2023



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# Introduction

Real Estate Investment Trust (REIT) is an investment pooling vehicle incorporated as a 'trust' to invest in revenue generating real estate assets. The structure allows developers to monetise real estate assets and raise long-term capital from investors while providing regular returns, liquidity, transparency and accountability.

Although REITs as an investment vehicle were introduced in 2014, the first REIT in India was launched in 2019 and as on date there are four listed REITs in India. The pace has been slow but is not materially different from the trend witnessed in other markets such as the US and Singapore. When viewed in the global context, the Indian REIT market, though at a nascent stage, has tremendous potential given the sheer size of REIT-able assets available in India.

A variety of assets such as office, retail, hotels, hospitals, residential, warehouses, etc. can be held under a REIT. As on date, in India we have 3 listed REITs owning office assets and one recently listed REIT owning retail assets, with an aggregate market capitalisation of more than INR 75,000 crores. This is miniscule, when compared globally to ~893 listed REITs across 40 countries with a combined equity market capitalisation of approx. USD 1.9 trillion (as of December 2022). Having said this, within the Asian REIT market, India ranks fifth with significant potential of quality REITable assets across segments, as India marches ahead to becoming a developed economy by 2047.

The Indian real estate sector is poised for a momentous growth and has shown resilience inspite of a global slowdown post pandemic. In tandem, the Indian REIT regulations have also evolved over the last few years aligning it with global norms and making it an attractive proposition for investors and developers. Taking cue from growing investor interest in fractional ownership of real estate assets, SEBI is also considering introducing Micro, Small & Medium REITs, to bring fractional ownership platforms with asset size of INR 25 crores under a REIT structure. Increasingly, the thrust is on ease of business, governance, disclosure, investor protection and simplifying the tax structure.

In this paper, we outline the broad tax and regulatory framework applicable to REITs and aspects which merit attention while migrating to a REIT structure.

# REIT assets

## REITs globally

The various types of REITs available globally on the basis of the type of real estate holdings are as follows:



### Healthcare REITs

These REITs primarily invest in and operate real estate that is healthcare-focused, such as hospitals, nursing facilities, etc.



### Retail REITs

At a minimum, these REITs are required to invest 24% of their assets into commercial retail, including shopping malls and freestanding retail stores.



### Residential REITs

These REITs own and operate manufactured housing along with rental apartment buildings.



### Office REITs

These REITs primarily invest in and operate office space. Therefore, their main source of income is rent received from tenants with long-term leases.



### Mortgage REITs

These REITs constitute approximately 10% of investments into mortgages.

## REIT in India

Real estate or property is defined to mean REITs to hold real estate assets

01

Land and any permanently attached improvements to it, whether leasehold or freehold

02

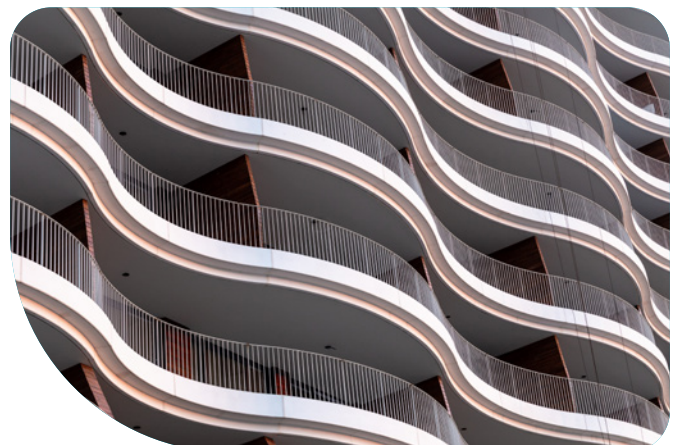
Buildings, sheds, garages, fences, fittings, fixtures, warehouses and car parks

03

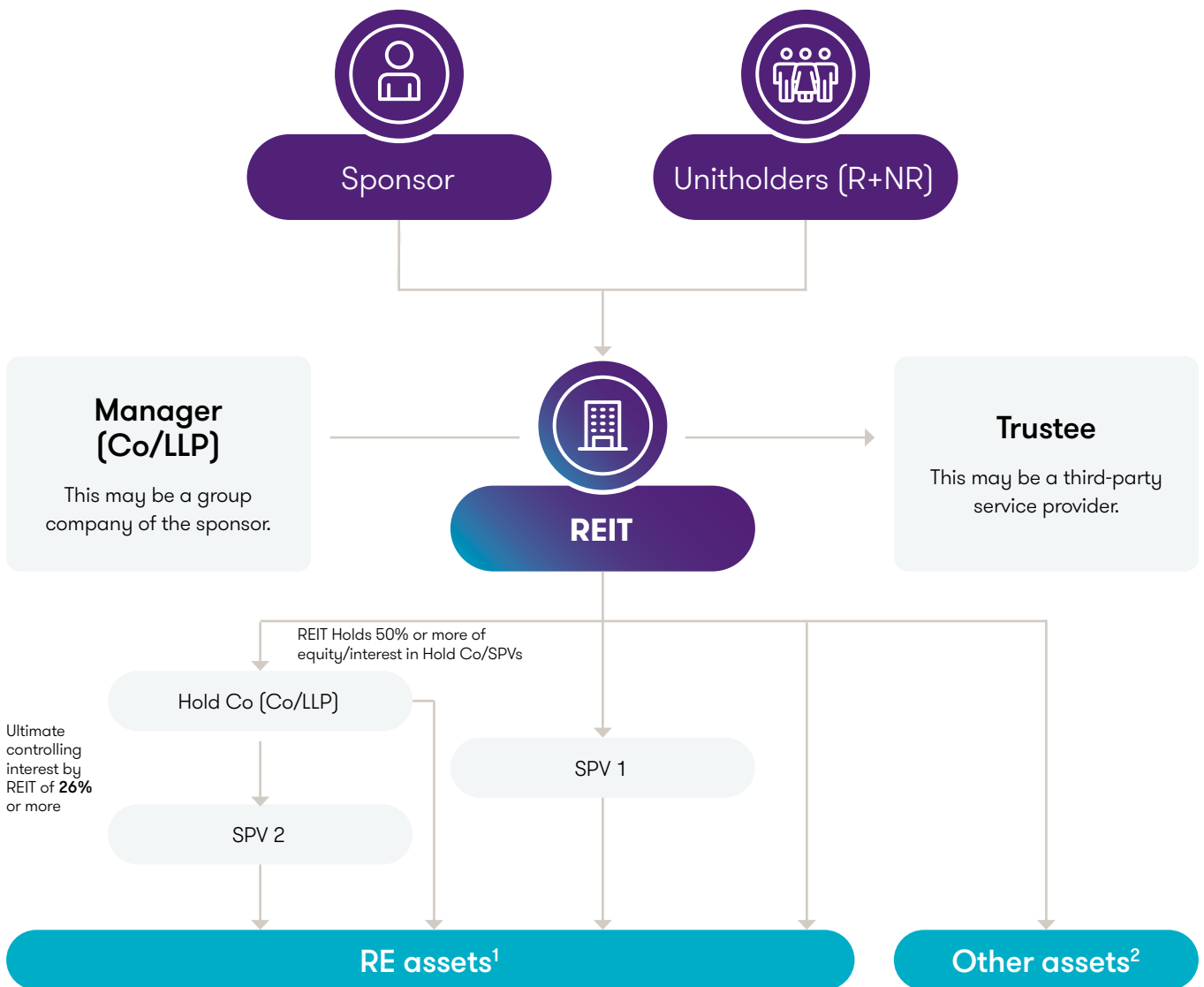
Any other assets incidental to the ownership of the real estate

### However, it does not include

- Mortgage
- Assets covered within the purview of 'infrastructure' under the harmonised list of infrastructure sectors and sub-sectors, excluding:
  - Hotels, hospitals and convention centres, forming part of composite real estate projects, whether rent-generating or income-generating
  - Common infrastructure for composite real estate projects, industrial parks and special economic zones (SEZs)



# Structure overview



1. Not less than 80% in completed and rent (and/or income) generating projects – (i) only direct investment in real estate properties by the Hold Co/special purpose vehicle (SPV) to be considered; (ii) when the project is implemented in stages, the part which is completed and rent and/or income generating shall be considered  
 2. not more than 20% in other specified assets, including under-construction properties and completed but not rent-generating properties and other specified assets, subject to conditions

# Parties to a REIT



## Sponsor<sup>3</sup>

- Any individual or body corporate
- Responsible for the formation of the REIT and transfer of assets to the REIT
- Each sponsor to hold at least 15% of post-issue unitholding
- **Qualifying criteria**
  - Sponsor(s) should have consolidated network of INR 100 crore (INR 20 crore each sponsor)
  - The sponsor/associate(s) should have a minimum of five years of experience in the development of real estate or fund management in the real estate industry
  - If the sponsor is a developer, should have at least two completed projects
- Minimum lock-in - 15% stake in the REIT locked in for a minimum of three years; balance in excess of 15% for one year following initial public offering (IPO)
- Staggered lock-in introduced for additional units issued after 17 August 2023.



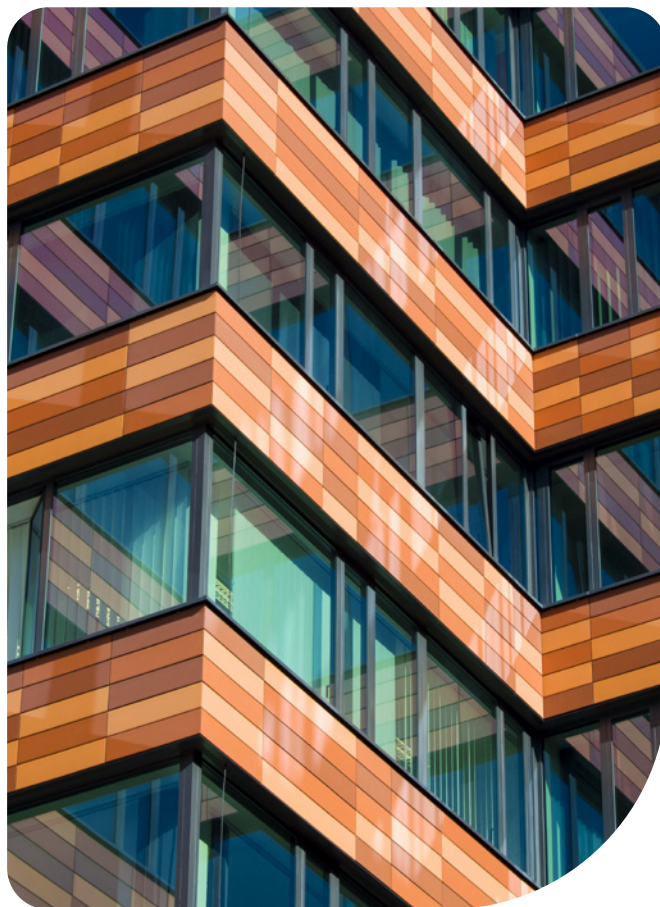
## Trustee

- Registered with the Securities and Exchange Board of India (SEBI) under SEBI (Debenture Trustees) Regulations, 1993
- Should not be related to the sponsor or manager
- Responsible for holding REIT assets for the benefit of unitholders
- Should oversee activities of the manager
- Cannot invest in the units of the REIT for which it is a trustee



## Investment manager

- Can be a company, limited liability partnership (LLP) or body corporate with an office in India
- Responsible for investment-related decisions of the REIT
- Sponsor cannot act as the investment manager except in case of self-sponsored manager
- **Qualifying criteria**
  - Net worth/net tangible assets of at least INR 10 crore
  - Minimum five years of experience in fund management/ advisory services/ property management services or development in the real estate sector ('real estate (RE) experience')
  - At least two key personnel with RE experience of five years each
  - At least 50% of the directors/members of the governing board to be independent and not part of the governing board of another REIT



3. De-classification of the status of a sponsor or change in sponsor or change in control of sponsor is permitted subject to certain conditions

# Key advantages to stakeholders



## Developers

### Liquidity

Alternate way to monetise assets

### Funding

Facilitates fundraising

### Business

- Transformation from an asset-heavy to an asset-light model
- Focus on core competencies



## Investors

### Entry and exit

Easier entry and exit from investment in the RE sector

### Transparency

Improved transparency as regulated under SEBI Regulations

### Returns

- Income stability for investors
- Diversification of investment portfolio
- Mandatory distribution by the REIT at regular intervals



# Regulatory environment

## Investment conditions

Investment limits	Nature of assets
At least 80% of the total value of REIT assets	<p>In completed and rent and/or income-generating real estate properties with a lock-in of three years</p> <ul style="list-style-type: none"><li>• Only the portion of direct investment in real estate properties by the Hold Co/Special purpose vehicle (SPV) will be considered</li><li>• If project implemented in stages, the part which is on rent and/or income-generating will be considered</li></ul>
Balance 20% of the total value in other assets	<p><b>Real estate assets</b></p> <ul style="list-style-type: none"><li>• Under-construction properties<sup>4</sup></li><li>• Under-construction properties which are part of existing income-generating properties owned by the REIT<sup>4</sup></li><li>• Completed but not revenue-generating properties<sup>4</sup></li></ul> <p><b>Other assets</b></p> <ul style="list-style-type: none"><li>• Listed/unlisted debt of companies/body corporates in the real estate sector (excludes investment in the debt of the Hold Co/SPV)</li><li>• Equity shares of listed companies, generating at least 75% of the operating income from real estate activities</li><li>• Unlisted equity shares of companies deriving at least 75% of the operating income from real estate activities<sup>5</sup></li><li>• Others: (i) Mortgage-backed securities; (ii) Government securities; (iii) Unutilised floor space index and transferable development rights with respect to existing investments; (iv) Money market instruments or cash equivalents</li></ul>

<sup>4</sup> Three years lock-in to apply post completion or purchase

<sup>5</sup> Investment through unlisted equity in under-construction properties and in completed but no-rent generating properties to be locked in for three years from completion

### Conditions for investments through SPVs or Hold Co:

- REIT will hold real assets directly or through an SPV or two-level structure through a Hold Co
- If the investment is made through Hold Co, the ultimate holding of the REIT in the underlying SPV will be minimum 26%
- Not less than 51% of the consolidated revenues of the REIT, Hold Co and SPV (other than gains from the disposal of properties) to be from rental, leasing and letting real estate assets or any other income incidental to the leasing of such assets
- Investment through a Hold Co/SPV is subject to below:
  - No other shareholders/ partners in Hold Co/SPV shall exercise any rights that prevents the REIT/Hold Co/SPV from complying with the provisions of REIT regulations – this should be agreed in an agreement with shareholders/ partners before investing in Hold Co/SPV.
  - The manager, in consultation with the trustee, to appoint nominees on the board of Hold Co and/or SPV in proportion to the shareholding/interest of REIT in the Hold Co/SPV.
  - In every meeting of a Hold Co and/or SPV, voting of the REIT should be exercised.

### Investment restrictions:

- Investment in vacant land or agricultural land or mortgages (other than mortgage-backed securities) is not permitted
- Investment in units of other REITs is not permitted
- Unitholder's approval is required for disposal of assets of REIT/Hold Co/SPV or interest in an SPV if it exceeds 10% of the value of the REIT's assets
- REIT to not undertake lending to any person other than the Hold Co/SPV. Investment in debt securities is not to be treated as lending.
- Co-investment is permitted, subject to conditions
- Transactions with related parties to be at arm's length, requires unit holder approval and disclosure



## Listing of REIT

Particulars	Key regulations
Minimum value of REIT assets	INR 5,000 million
Minimum offer size	INR 2,500 million
Minimum public float (excluding sponsor, manager and associates)	<ul style="list-style-type: none"> <li>• Post-issue capital is less than INR 16,000 million – higher of 25% of post-issue capital or INR 2,500 million</li> <li>• Post-issue capital equal to/more than INR 16,000 million but less than INR 40,000 million – INR 4,000 million</li> <li>• If post-issue capital is equal to or more than INR 40,000 million – 10% of the post-issue capital</li> <li>• Public holding to be increased to at least 25% within a period of three years from the date of listing</li> </ul>
Minimum public subscription	<ul style="list-style-type: none"> <li>• 90% of the issue size</li> </ul>
Minimum investment	<ul style="list-style-type: none"> <li>• INR 10,000 to INR 15,000 per investor</li> </ul>
Maximum subscription	<ul style="list-style-type: none"> <li>• 25% of unit capital (per investor) unless 75% approval in value from other investors has been obtained</li> </ul>
Minimum number of investors	<ul style="list-style-type: none"> <li>• 200 (other than sponsor(s), its related parties and its associates)</li> </ul>
Eligible investors	<ul style="list-style-type: none"> <li>• Resident or foreigner (subject to exchange control guidelines)</li> </ul>
Others	<ul style="list-style-type: none"> <li>• A qualified institutional buyer deemed to be a public subscriber, even if it is a related party of the REIT</li> </ul>
Failure to make listing	<ul style="list-style-type: none"> <li>• If the REIT fails to make its initial offer within three years from registration, it shall surrender its certificate of registration and cease to operate as a REIT.</li> </ul>
Offer for sale	<ul style="list-style-type: none"> <li>• Units may be offered for sale if they have been held for a minimum of one year prior to filing a draft offer with the SEBI. Holding period of securities/interest in an SPV against which units to be issued will be considered for the above</li> </ul>
Leverage	<ul style="list-style-type: none"> <li>• REIT may issue debt securities listed on the recognised stock exchange</li> <li>• Aggregate consolidated borrowings and deferred payment of the REIT, Hold Co and SPV (net of cash and equivalents, not including refundable security deposits to tenants) capped at 49% of the value of REIT assets</li> <li>• The aggregate net consolidated borrowings and deferred payments of the REIT, Hold Co and SPV in excess of 25% of REIT assets are to be subject to the following: <ul style="list-style-type: none"> <li>– Credit rating from a credit rating agency registered with the SEBI</li> <li>– Approval from unitholders (number of votes in favour to be more than the number of votes against)</li> </ul> </li> </ul>
Funds for general purpose	<ul style="list-style-type: none"> <li>• Not more than 10% of the amount raised by the REIT to be used for ‘general purposes’; issue-related expenses not considered as a part of general purposes</li> </ul>
Strategic investors	<ul style="list-style-type: none"> <li>• A strategic investor is defined as an infrastructure finance company registered as a non-banking financial company (NBFC), scheduled commercial bank, multilateral and/or bilateral development financial institution, systemically important NBFC, foreign portfolio investment (FPI), mutual funds and insurance companies.</li> <li>• A strategic investor may jointly/severally invest a minimum of 5% and a maximum of 25% of the total offer size of the REIT.</li> <li>• The draft document should mention the strategic investor.</li> </ul>

# Key tax provisions

## REIT tax regime

Transaction	Tax implications
Interest received from SPVs	Exempt in the hands of the REIT
Income from directly held assets/ other than rental income	Taxable at the maximum marginal rate
Dividends from SPVs	Exempt in the hands of the REIT
Rental income from properties owned by REIT	Exempt in the hands of the REIT
Capital gains on the sale of assets/ shares of SPVs	Taxable at applicable rates depending on the period of holding
Withholding tax obligations	Distribution to unitholders subject to withholding tax <ul style="list-style-type: none"><li>• Interest to a resident at 10% and to a non-resident at 5%<sup>6</sup></li><li>• Dividend to a resident at 10% and to a non-resident at 10%<sup>6</sup> (only if the SPV has opted for the concessional tax regime under Section 115BAA)</li></ul>

6. Increased by applicable surcharge and cess





## Tax regime for unitholders<sup>7</sup>



### Transaction

**Interest income from the SPV distributed by the REIT**

**Dividend income (if SPV has opted for the concessional tax regime under Section 115BAA)**

**Rental income**

**Distribution of any proceeds other than interest, dividend, rent or any other income already taxed at in the hands of REIT**

**Revised cost of units**

**Sale of listed units**



### Tax implications

- Resident investor – at applicable rates (credit for taxes withheld at 10%)
- Non-resident investor (other than FPIs) – 5%<sup>8</sup> (subject to the beneficial provision under the applicable tax treaty)
- FPIs – may be taxed at 20%<sup>8</sup> (subject to beneficial provision under the applicable tax treaty)

- Resident investor – at applicable rates (credit for taxes withheld at 10%) – benefit of Section 80M extended to domestic unitholder being a company, provided such dividend is distributed within the prescribed timeline
- Non-resident investor (including FPIs) – 20%<sup>8</sup> (subject to beneficial provision under the applicable tax treaty)

Taxable at applicable rates

Distributions in excess of issue price to be taxable as income from other sources at applicable rates

Cost of acquisition of unit of a business trust to be reduced by all distributions received by the unitholders, other than interest, dividend, rent and income taxed in the hands of REIT

- Long-term capital gains beyond INR 0.1 million taxable at 10%<sup>8</sup>
- Short-term capital gains taxable at a concessional rate of 15%<sup>8</sup>
- For non-residents, provisions and rates under applicable tax treaties to be considered

7. Income of unitholders is exempt in certain situations: Capital gains from transfer by a non-resident of REIT units listed on a recognised stock exchange in an international financial services centre (IFSC) in India if the consideration for such transfer is paid in a foreign currency

Dividend income, if such dividend is from an SPV which has not opted for the concessional tax regime under Section 115BAA

8. Increased by applicable surcharge and cess

# Tax implications

## Sponsor

Transaction	Tax implications
Swapping of shares of SPVs with units of REIT	<ul style="list-style-type: none"><li>• Transaction not regarded as 'transfer' and no tax implication on the exchange/swap of shares for units</li><li>• Deferral of minimum alternate tax (MAT) implications</li></ul>
Swapping of assets with units of REITs	<ul style="list-style-type: none"><li>• No specific exemption under the tax law</li><li>• Taxable under normal provisions and under MAT</li></ul>
Sale of units listed on the stock exchange	<ul style="list-style-type: none"><li>• Long-term capital gains beyond INR 0.1 million taxable at 10%<sup>9</sup></li><li>• Short-term capital gains taxable at a concessional rate of 15%<sup>9</sup></li><li>• For non-residents, provisions and rates under applicable tax treaties if eligible to access tax treaty</li></ul>

## SPV

Transaction	Tax implications
Dividend distributed to the REIT	Dividend income exempt in the hands of the REIT
Interest paid to the REIT	<ul style="list-style-type: none"><li>• Deduction available to the SPV</li><li>• Exempt in the hands of the REIT</li></ul>
Capital gains on the sale of assets	Taxable at applicable rates depending on the period of holding
Income from a real estate asset	Taxable as business income
Withholding tax obligations	<ul style="list-style-type: none"><li>• No withholding required for dividend</li><li>• No withholding required for interest on loan paid by an SPV to the REIT</li></ul>

<sup>9</sup> Increased by applicable surcharge and cess

# Migration of assets to REITs: Key considerations

01

## Disinvestment of non-core assets

Given that REITs are permitted to hold only RE assets, all non-RE assets will have to be disinvested/hived off

02

## Eligibility of sponsor and investment manager

Pertinent to identify key parties to the REIT to ensure the criteria for requisite experience in the RE sector are satisfied

03

## Restriction on multi-layer holding

The sponsor group may have to restructure its holding structure if there are more than two layers in the existing structure for holding RE assets

04

## Capital structure and leverage

REIT regulations stipulate a cap on aggregate debt levels; accordingly, pertinent to streamline external borrowings and analyse the mode of transfer and capital structure

05

## End use of funds raised

The funds raised by the REIT may be utilised to repay existing external debt or sponsor debt assigned to the REIT SPVs; substituting third-party debt with REIT debt needs to factor in transfer pricing implications



# Acknowledgements

## Authors

### Shabala Shinde

Partner, Tax  
Grant Thornton Bharat  
shabala.shinde@in.gt.com

## Contributors

Pradeep Mistry  
Janhvi Shah

## Editorial review

Runa Dasgupta  
Sonali Lingwal

## Design

Vikas Kushwaha

## For media enquiries, write to

[media@in.gt.com](mailto:media@in.gt.com)



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