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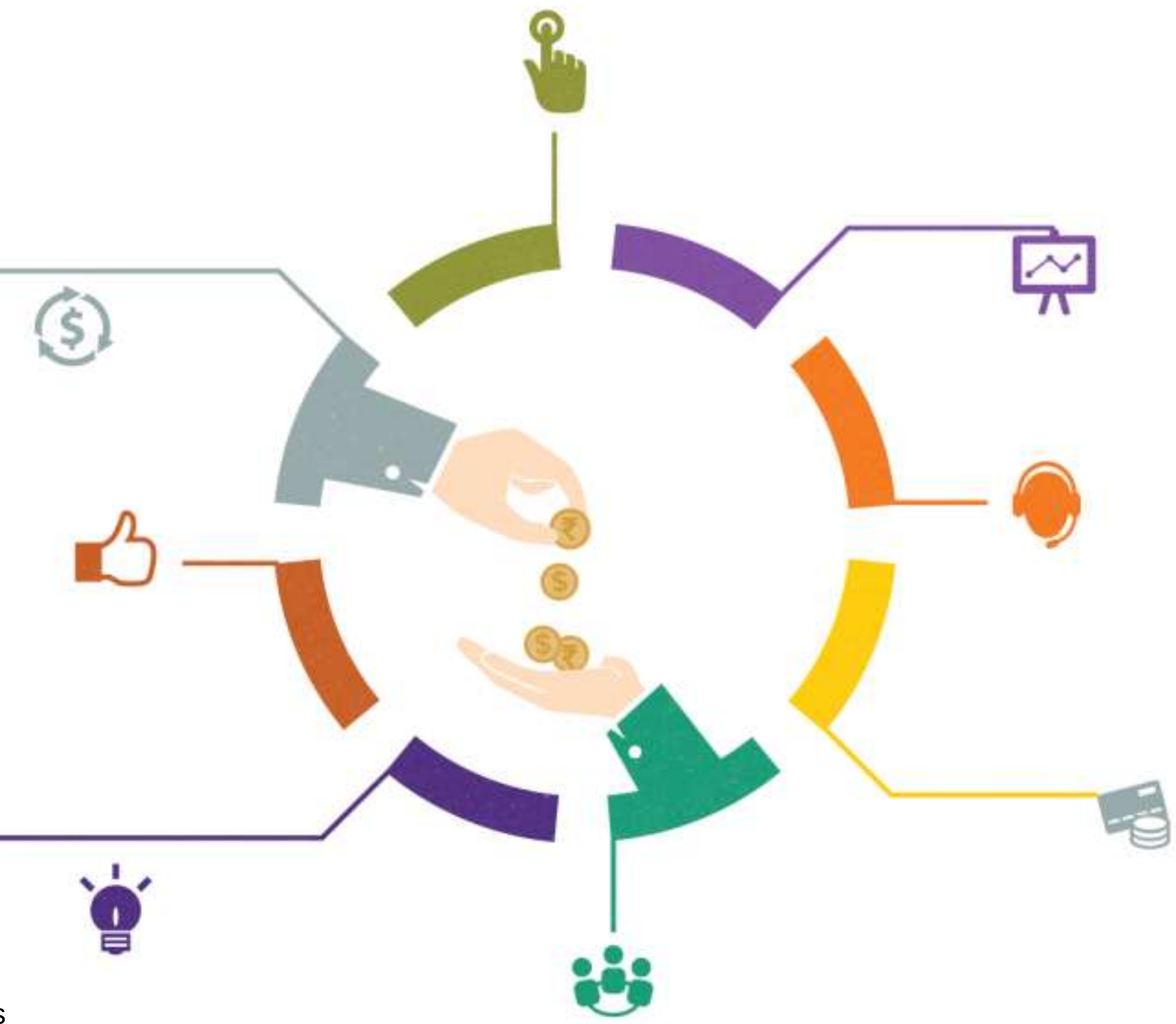
An instinct for growth™

Union Budget 2015-16

Impact on the Real Estate & Infrastructure sector

Contents



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Sector overview

Sector overview

Despite the recent economic slowdown, the Indian real estate sector continues to be a favoured investment avenue for both the domestic and overseas investors. The real estate and infrastructure sector is the second largest employer in India after agriculture. Recognising the importance of infrastructure development in the country and the need to ensure better standard of living for its citizens, the government has undertaken several initiatives. As per industry reports, the total economic value of the real estate sector in the country ranges between US$ 40-45 billion. Further, the sector contributes 5-6% to the country's overall GDP growth.

According to data released by Department of Industrial Policy and Promotion (DIPP), the construction development sector has attracted foreign direct investment (FDI) to the tune of US$ 24012.87 million between April 2000 and December 2014. It is to be noted that only a fraction of the global real estate funds are invested in India. Further, real estate continues to be the favoured investment asset class among the Indian citizens. The sector has gained investor confidence over a period of time by providing a higher return on their investment, greater than the expected average, from 1991 to 2014, as per recent reports. The size of the Indian real estate market is expected to touch US$ 180 billion by 2020.

The Indian real estate sector witnessed several major regulatory changes during the past year. Announcements pertaining to the creation of Real Estate Investment Trusts (REIT) in India and revision of the FDI norms in the construction development sector are aimed at giving a major boost to the real estate sector in India. The investment community has welcomed the new norms for REITs which enable the listing and trading of REITs on the stock exchange in India, thereby creating new platforms for raising of funds by channelising domestic investments. Further, the issuance of the Press Note 10 of 2014 has eased the regulations for FDI in construction development with the aim of making the sector attractive for overseas investors. The revisions to the FDI regime in the construction development sector is expected to create a ripple effect in the economy by way of infrastructure creation and substantial employment generation.

In terms of its infrastructure, India boasts 200 minor ports and 12 major ports and the second largest road network worldwide with a total length of 4.7 million kilometres. In addition, the country also has the fourth largest rail network in the world with a total length exceeding 64,000 kilometres, the fifth largest electricity generation capacity in the world as well as 454 airports and airstrips. Recognising the pivotal role played by infrastructure for the economy, the government has been taking several initiatives to put an impetus on infrastructure development in the recent years.

Sector overview

Growth drivers

The Indian real estate sector still occupies one of the topmost positions among all the major sectors that have a multiplier effect on the economy. Further, the government of India is confident to enhance the total outlay across the infrastructure sector such as roads, ports, railways and airports during the 12th Five Year Plan (2012-17), mostly via Public Private Partnerships (PPPs).

Key growth drivers for the real estate and infrastructure sector include:

- rapid urbanisation;
- population growth;
- positive demographics;
- rising income levels;
- growth of the services sector;
- increased foreign investments;
- growth of the Indian middle-class;
- increasing demand from Non Resident Indians (NRIs);
- influx of multinational companies;
- growth in organised retail ;
- entry of international retailers in India;
- strong growth in India’s tourism sector.

Challenges

- The sluggish growth of the Indian economy, rising input costs and an overall slowdown in the global economy has resulted in a deceleration in the growth momentum of the real estate and infrastructure sector in recent times
- The recent cash crunch being faced by the real estate players has led to a pilling up of inventory, which has further has worsened their financial position
- Increase in the property prices has further attributed to the widening up of the gap between demand and supply of housing units. Further, financing of affordable housing units is a major policy concern for India
- Procedural delays are another major constraint in the sector
- According to the World Bank’s ‘Doing Business 2015’, India ranked 184th (out of 189 economies) in terms of time required to get construction permits. In India, on an average, 27 procedures are required to get permits, as compared to an average of 14 in South Asia and 12 in the OECD countries
- Delays in project completion

Key expectations

Industry expectations

- Granting Infrastructure status to the real estate sector, to make it eligible for tax incentives
- Reduction in interest rates for home loans will provide a boost to the sector, while also bridging the gap between demand and supply
- Quick implementation of the Real Estate Regulatory Bill (RERA) enabling the realty market to attract foreign direct investment (FDI)
- Incentives for green real estate, by the way of subsidies to the developers that promote sustainable real estate development
- Provisions need to formulated and modified to stimulate affordable housing, benefitting the middle-class buyers
- Availability of funds at reduced costs: Reducing the interest for builders would reduce the cost of construction and would in-turn, benefit the end-users
- Deduction of interest paid on borrowed capital should be increased to at least Rs 3,00,000 per annum, taking cognisance of the rising interest rates and real estate costs
- Fine-tuning the tax treatment provisions governing the Real Estate Investment Trusts (REITs) taxation to derive the envisaged benefits:
  a) DDT should be done away with on distribution of dividends by SPV to REITs
  b) Capital gains on disposal of REIT units by the sponsor - Disparity between Sponsor and other unit holders to be dealt with to provide a level playing field, as long-term capital gains on the disposal of units by the sponsor is taxable whereas the long-term capital gains are exempt in the hands of other unit holders
  c) Tax deferral should also be provided for swap of rental asset for a unit of REIT
  d) Requirement of holding REIT units for more than 36 months to qualify as long-term capital asset is disincentive for investors vis-à-vis listed equity shares
- Clarity on applicability of tax on Transfer of development rights
- Non-inclusion of value of material provided by service recipient, free of cost to the service provider, for levying service
- Credit should be allowed for Service tax paid on construction service used for providing services pertaining to renting of immovable property
- Removal of MAT on infrastructure companies which are enjoying tax holiday
- Single window clearance for the infrastructure projects which will remove the bottlenecks and help in timely completion of the projects

Key expectations

Industry expectations

- Higher budgetary allocation in key infrastructure sectors like irrigation, roads, power, ports, water supply, etc
- Stimulus to be provided for development of infrastructure in non-metro cities
- Amendment of Section 80-IA regarding the upgrade of existing infrastructure - A suitable amendment may be made in the Act to clarify that the up-gradation/ extension of the existing infrastructure facility would also be eligible for the benefit of Section 80-IA of the Act
- No MAT on infrastructure companies - To attract more investment in the infrastructure sector, MAT on infrastructure companies should be abolished
- Credit should be allowed in construction services for erecting towers and other essential infrastructure
- Reduction in customs duty and CVD should be extended on the import of capital goods required for setting up power plants in India, be it Mega or Non-Mega projects
- Exempt all transmission equipment from the levy of customs duty and CVD when imported for the power projects
- Time limit of six months should be withdrawn for availing Cenvat credit

Source: *Industry report prepared by SIAM and ACMA*

Budget impact – Our view

Real estate

Extending benefits of capital gain exemption to sponsors will push the launch of REITs in India. This incentive will boost the much-needed investments in the Indian real estate sector through the REITs regime. However, increase in the rate of service tax to 14% will make real estate a bit more expensive and can impact the sales. This might impact the overall target of the government to create 6 crore houses under the 'housing for all scheme' by 2022.

Infrastructure

The announcement made by the Finance Minister brings the much-needed relief for the infrastructure sector players by increasing the budget allocations, introducing tax free bonds, and enabling them to move away from obtaining the multiple permission regime to work with the pre-existing regulatory mechanisms.

These announcements will not only help the sector attract investments, but will also help the real estate players in completing projects faster with a much simpler approval mechanism.

Budget announcements - Key policy initiatives

Real estate

- A mission to provide a roof for each family under the ‘housing for all’ by 2022 has been announced. It is targeted to complete 2 crore houses in urban areas and 4 crore houses in rural areas
- VISA on arrival to be extended to 150 countries in stages. This provision is presently available to 43 countries only. Once permitted, it will facilitate travel of expatriate technical experts on a project
- In furtherance to e-governance initiative, it has been proposed that the online central excise and service tax registrations will be done in two working days. It will be allowed to issue digitally signed invoices and maintain electronic records
- In line with the theme of non-adversarial tax regime and streamlining of the dispute resolution process, the scope of Income-tax Settlement Commission has been expanded to include penalty provisions in Customs, Central Excise & Service Tax regime

Infrastructure

- The Budget proposals have brought much needed relief to the infrastructure sector, by substantially increasing the budget allocations
- As per the Budget proposals, the investment in the infrastructure sector will increase by Rs 70,000 crore
- **National Investment and Infrastructure Fund (NIIF)** to be established with an annual flow of Rs 20,000 crore
- **Self-Employment and Talent Utilisation (SETU)** to be established as Techno-financial, incubation and facilitation programme to support all aspects of start-up business. Rs 1,000 crore to be set aside as an initial amount
- An expert committee to examine possibility and prepare a draft legislation where multiple prior permissions can be replaced by a pre-existing regulatory mechanism to help India become a favoured investment destination
- Tax-free bonds to be issued to raise funds for rail, road and irrigation sectors
- The PPP model for infrastructure development will be revitalised and the government would bear the major risks therein

Budget announcements - Key policy initiatives

Infrastructure (cont.)

- Further, there are proposals to allocate Rs 150 crore towards infrastructure research & development, with a view to encourage the involvement of academicians, entrepreneurs and researchers to draw national and international experience to foster scientific innovations, and undertake research and development in the infrastructure sector
- The government also proposes to set up five ultra-mega power projects in the country. Further, the government also plans electrification of the remaining 20,000 villages by 2020
- There will be a specific focus on ports in public sector to attract investments and to promote self-employment and talent utilisation
- These announcements not only create a favourable investment platform for the cash-starved sector but also, help players in completing the projects faster with a much simpler approval mechanism

Budget announcements - Direct tax proposals

Real Estate Investment Trusts (REITs) and Infrastructure Investment Trust (InvITs)

- Rental income earned by REITs shall have a pass-through status, being taxable in the hands of the unit holders
- No withholding tax on rental income earned by REITs from directly owned real estate assets - w.e.f. 1 June 2015
- Withholding tax on distribution of rental income (w.e.f. 1 June 2015)
  - Where unit holder is a resident, REIT to withhold tax @ 10%
  - Where unit holder is a non-resident, REIT to withhold tax as per rates in force
- Units received by Sponsors of REITs and InvITs on swap of shares in special purpose vehicles (SPV) shall be entitled to beneficial tax treatment whereby sale or transfer of such units shall be exempted from tax for long-term capital assets and taxed at 15% for short-term capital assets. This treatment will be available, provided the sale of such units has been subjected to Securities Transaction Tax (STT)

Nature of income	REIT and InvIT	Unit holders including sponsor
Interest from SPV	Exempt	Taxable as interest income Withholding tax to be deducted by REIT on distribution (Non-resident – 5%, Others – 10%)
Dividend	Exempt	Exempt
Capital gains on exit by REIT/ InvIT	At the rates applicable to capital gains	Exempt
Capital gains earned by unit holders on sale of REIT/ InvIT units including units held by Sponsors	Not applicable	For unit holders – long-term – exempt – short-term – 15%
Rental income	Exempt	Taxable at the applicable rates

Budget announcements - Direct tax proposals

Tax avoidance

- Acceptance of advance of Rs 20,000 or more in cash for purchase of immovable property shall attract penalty equivalent to the amount of such receipt
- Quoting of PAN has been made mandatory for any purchase or sale of immovable property exceeding a value of Rs 1 lakh
- A new comprehensive Benami Transactions (Prohibition) Bill is proposed to be introduced to cover benami property, especially in the real estate

Minimum Alternate Tax (MAT)

- Currently, as per Section 194C, tax withholding is not required on payments to contractor engaged in plying, hiring or leasing goods carriages, on furnishing of his Permanent Account Number (PAN) to the person making the payment. The exemption is now restricted to contractors owning ten or less goods carriages at any time during the relevant year - w.e.f. 1 June 2015
- Any amount paid to non-resident shall require the payer to provide information in the prescribed format to the revenue authorities, irrespective of whether such payment constitutes income in the hands of the payee or not

Domestic transfer pricing (DTP)

An Indian company is required to comply with transfer pricing provisions, where its specified transactions exceed Rs 5 crore.

This threshold for applicability of domestic transfer pricing provision has been increased from Rs 5 crore to Rs 20 crore.

General Anti Avoidance Rule (GAAR)

Applicability of GAAR has been deferred to 1 April 2017. Further, all investments made till 31 March 2017 have been grandfathered and would be out of the ambit of GAAR provisions.

Budget announcements - Direct tax proposals

Income Tax Rates - Individuals:

- Basic rate of tax, slabs and education cess have remained unchanged for all individuals
- Surcharge has been increased from 10% to 12% for individuals having taxable income exceeding Rs 1 crore

Income Tax Rates - Firm/ Local authorities:

- Basic rate of tax and education cess have remained unchanged
- Surcharge has been increased from 10% to 12%, where the taxable income exceeds Rs 1 crore

Income Tax Rates - Companies:

- Basic rate of tax and education cess have remained unchanged
- Surcharge for domestic companies have been increased by 2% as follows:
  - Surcharge @ 7% (if the taxable income > Rs 1 crore but < Rs 10 crore)
  - Surcharge @ 12% (if the taxable income > Rs 10 crore)
- Surcharge for foreign companies have remained unchanged
- The Finance Minister proposes to phase out exemptions and reduce the corresponding rate for corporate tax from 30% to 25% over next four years

Wealth Tax

- Wealth tax to be abolished

Proposal to reduce corporate tax, along with phasing out of exemptions, is a welcome step towards improving the ease of doing business. However, no roadmap in this regard has been laid out.

Budget announcements - Indirect tax proposals

Budget amendments

Service tax
(Effective from 1 April 2015, unless specified otherwise)

Service tax exemption has been withdrawn for construction, erection, commissioning or installation of original works with regards to an airport or port

Service tax exemption applicable to government, a local authority or a government authority by way of construction, erection, commissioning or installation, completion, fitting out repair, maintenance, renovation, or alteration has been withdrawn with regards to the following:

- a civil structure or any other original work meant predominantly for use other than for commerce, industry, or any other business or profession
- a structure meant pre-dominantly for use as (i) an educational institution, (ii) a clinic, or (iii) arts and cultural heritage institution
- a residential complex predominantly meant of self-use or the use of their employees or other person as specified
- Penalty provisions have been rationalised in favour of the taxpayer
- Prosecution provisions of Section 132 of the Customs Act, 1962, which relates to giving false declarations, false documents, etc, has been listed as an offence in Part B of the Money Laundering Act

GST

- GST 2016 implementation timeline has been reiterated
- There has been no discussion on rates or roadmap

Budget announcements - Indirect tax proposals

Budget amendments

Service tax
(Effective from a date to be notified after enactment of the Finance Bill, 2015)

- Service tax rate increased from 12.36% (inclusive of all cess) to 14% (subsuming all cess)
- An additional 2% tax proposed to be charged on taxable service value in the form of Swachh Bharat cess (SBC)

(Effective from 1 April 2015, unless specified otherwise)

- The rate of abatement available in relation to GTA services, and transport of goods by vessel of passengers by air is detailed in the table below:

Particulars	Pre-budget	Post-budget
Transport of goods by road	75%	70%
Transport of goods in a vessel	60%	70%
Transport of passenger by air - Economy class - Other than economy class	 60% 60%	 60% 40%

Budget announcements - Indirect tax proposals

Budget amendments

CENVAT Credit Rules, 2004
(Effective from 1 March 2015; unless otherwise specified)

- The period of availing CENVAT credit on inputs and input services extended from six months to one year from date of invoice / challan or other specified documents
- CENVAT credit of service tax paid under domestic reverse charge now allowed to claimant, without linking it to the payment of services to the input service provider (effective from 1 April 2015)
- Effective from 1 April 2015, CENVAT credit wrongly taken (i.e. availed) or utilised by manufacturer or output service provider to attract recovery proceedings under Central Excise Act and Service Tax Law respectively with similar penalties
- CENVAT credit on inputs and capital goods allowed to manufacturer or output service provider, as the case may be, even in case of direct receipt of such goods in the premises of the job worker on the direction of principal manufacturer/ output service provider
- CENVAT credit allowed to principal manufacturer on inputs, whether as such or after partial processing, sent from premises of one job worker to another job worker
- The time limit for return of capital goods from premises of a job worker to principal manufacturer/ output service provider increased from six months to two years

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