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Union Budget 2014-15

Impact on the Real Estate sector

July 2014

Content

Overview

The real estate sector has witnessed a challenging time with demands slowing down and over all stagnation in the market. There has been a positive sentiment post general elections. However, it is yet to fully translate in to overall demand.

The positive movement has been sporadic and only in certain quarters. Commercial rental, has grown piggybacking on the international brand's retail boom. On the other hand, the new residential project launches were modest compared to earlier years. In over all, the mood in the sector has been somber, with the woes of sector like rising borrowing cost and reduced margin remaining intact.

The real estate players, for past several years have been seeking policy intervention from the government on both fiscal and non-fiscal side.

On the fiscal side, as per per survey carried out by us at Grant Thornton, an emphatic majority of the sector demanded Section 80-IA tax holiday to be extended to integrated township projects and special residential zones (mass housing/ residential townships). The industry also expects the government to promote eco-friendly projects by providing tax benefits.

The positive announcements in the Budget, would undoubtedly be the clear tax framework being laid out for REIT. The regulatory framework of REIT is such that the fund allocation for new developments is quite restricted in a REIT, however, this is a welcome step.

The enhancement, though a modest one, on deductions available for home buyers would again be greeted by the sector.

On the flipside, the disallowance of expense as a consequence to TDS default in transaction like acquisition of land would have acute impact given the uncertainty on applicability of TDS itself on certain transactions.

In a nutshell, the budget proposals are a mixed bag for the sector. However, some of the tax proposals along with policy initiatives on urban infrastructure and tier II cities would create new demand and avenues for the sector. More importantly the Budget proposal give a positive indication regarding Government's willingness to listen to the concerns of the industry.

We share herein some of the key policy initiatives for this sector in the Budget and the tax proposals!

Key policy initiatives

- A fund allocation to the tune of Rs 7,060 crore has been proposed with a vision to develop 100 smart cities as satellite towns, and for the mordenisation of existing mid-sized cities
- To enhance development of smart cities, FDI conditionality in the sector is proposed to be watered down. This will be the first such relaxation since 2005, when the FDI was first allowed in the sector. Key features of this provision are:
  - built-up area requirement has been reduced from 50,000 square metres to 20,000 square metres
  - minimum capitalisation requirement, in case of wholly-owned subsidiary, proposed to be reduced to US$5 million from US$10 million with a three year post completion lock in
  - projects committing at least 30% of their total cost for low-cost affordable housing will be exempted from minimum built-up area and capitalisation requirements mentioned above
- Proposal to set up a Mission on Low Cost Affordable Housing to get a boost with the allocation of a sum of Rs 4,000 crores by the National Housing Bank (NHB). This has been done to increase the flow of cheaper credit for affordable housing to the urban poor/ EWS/ LIG segment
- Conducive tax regime framed for Infrastructure Investment Trusts and Real Estate Investment Trusts with a view to attract large scale investment in income bearing assets in infrastructure and construction sectors
- Added allocation of funds for skill development will enhance the quality of labour available for this industry

Direct tax proposals

Special provisions related to real estate infrastructure trust (REIT) and infrastructure investment trust (InvTrust)

- Budget has brought in the tax framework for REITs and InvTrusts, even though the regulations are yet to be notified by the SEBI

Salient features of REITs / InvTrusts:

- Units of REIT and InvTrusts to be listed on recognised stock exchanges in India
- Income bearing assets to be held under Indian Special Purpose Vehicles (SPVs), which in turn would be held by REITs/ InvTrusts
- Units of REITs / InvTrusts to be granted same status as listed equity shares i.e. same levy of STT as well capital gains tax benefits (benefits are not available for units received in swap of shares of SPV)
- Swap of shares of SPV for units of REITs / InvTrusts would not be taxed at that instance
- These provisions are proposed to take effect from 1 October 2014
- Budget proposes to provide a clear tax framework for REITs. This will pave the way for the advent of REIT in India. The regulatory framework of REIT is still in a consultative stage. However, in the present form , REIT funds would substantially be available for the acquisition of completed and income bearing assets. The risk profile of the REIT assets can perhaps be increased, and a little more than a mere 10% can be made available for assets other than completed and income bearing assets

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Direct tax proposals

Taxability of REITs / InvTrusts:

Nature of income	REITs / InvTrusts	Unit holders
Interest	Exempt (considered as pass through)	Taxable (on distribution) (Non-resident – 5%, Others – 10%)
Dividend	Exempt	Exempt
Capital gains on exit by REITs/ InvTrusts	At the rates applicable to income under the head capital gains	Exempt (on distribution)
Capital gains on sale of units of REITs/ InvTrusts	NA	Long-term – exempt Short-term – 15% (in case of sponsors long term – 20%, short term – 30%, period of holding and cost of shares of SPV considered)
Other income	Maximum Marginal Rate	Exempt (on distribution)

Taxability of advance for transfer of a capital asset

- Budget proposes to insert a new clause under Section 56(2) of the Income Tax Act (the Act) for the taxability of any sum of money received as advance or otherwise in the course of negotiations for transfer of a capital asset
- It is proposed to tax this income as 'Income from Other Sources', if such sum has been forfeited by the intended seller and negotiations do not result in transfer of such capital asset
- A consequential amendment is proposed in the definition of the term 'Income'
- The existing provisions of Section 51 of the Act provides that any such advance retained or forfeited is to be reduced from the cost of acquisition/ WDV/ FMV of such asset. In order to avoid double taxation, the relevant section proposes that the same shall not be deducted from the cost of acquisition/ WDV/ FMV of such asset
- The proposed amendment will take effect from FY 2014-15

Direct tax proposals

Enhanced compensation on compulsory acquisition

- Budget proposes that compensation received pursuant to an interim order of a court, tribunal or other authority be deemed as income chargeable under the head "capital gains" in the year in which the final order is adjudicated by a court, tribunal or other authority
- This provision will take effect from FY 2014-15

TDS default on acquisition of immovable property will result in disallowance

- TDS was introduced on transfer of immovable property with effect from 1 June 2013. Default in this respect though attracted interest and penalty provision but did not result in disallowance of interest itself
- However, the Budget proposes to enlarge the consequential provision of disallowance and now 30% of the expense on which there is a TDS default would be disallowed. The sector would have to be careful to comply with the TDS requirements, while acquiring land and immovable property

Direct tax proposals

Tax withholding on interest income earned by non-resident

- Tax withholding at the rate of 5% on interest payment to non residents in respect of foreign currency borrowings is proposed to be extended to business trusts, as well
- Such concessional treatment is proposed to be applicable for monies borrowed before 1 July 2017 (as against the present time limit of 1 July 2015) or under a loan agreement entered before 1 July 2017
- Under existing provisions, apart from foreign currency loan, this reduced withholding tax rate of 5% applies only to interest on long-term infrastructure bonds. This benefit is now proposed for all long-term bonds (i.e. whether infrastructure bonds or not)
- This provision will be effective from 1 October 2014

Unlisted shares to remain short-term capital asset for 36 month

- Long term capital assets enjoy a beneficial rate of tax. Until now, unlisted shares were considered to be long-term once held for a period of 12 months
- Budget proposes to amend the definition of short-term capital asset and now shares of a unlisted domestic company would remain a short-term capital asset for 36 months
- This will have immense impact on the sector where reorganisations are common and what is even more in vogue is to transfer property by transferring the shares of a unlisted company which houses such property
- This provision will be effective from FY 2014-15

Direct tax proposals

Enhanced deduction for interest on housing loan

- Deduction for interest paid on capital borrowed for acquisition/construction of a self occupied house proposed to be increased from Rs 1.5 lakh to Rs 2 lakh under Section 24 of the Act

Increase in deduction limit for investments under Section 80C from Rs 1 lakh to Rs 1.5 lakh

- Deduction for principal amount repaid on capital borrowed for acquisition/ construction of house proposed property is available under Section 80C of the Act
- The above two proposals are proposed to apply from FY 2014-15 and likely to improve housing demand

Investment in residential house property

- As per the existing provisions, deduction from capital gains on transfer of certain assets is available, in case investment is made in **a residential house.** There has been uncertainty whether deduction will be available only in respect of one or more than one residential house properties. The Budget puts an end to this ambiguity by proposing the benefit of exemption from capital gains only if the capital gain arising on transfer of specified long-term capital asset is invested in **one residential house situated in India**
- This provision will take effect from FY 2014-15

Indirect tax proposals

Service tax on service portion of works contract

- Value of taxable service for maintenance or repair of immovable property increased from 60% to 70% of the contract value under works contract valuation provision
- This change will come into effect from 1 October 2014
- This amendment has resulted in only 2 types of works contract under valuation provision, thus reducing the disputes on classification between the two categories

CENVAT Credit on inputs and input services

- From 1 September 2014, a service (including a real estate developer) provider shall not be eligible to avail CENVAT credit in relation to inputs or input services after 6 months from the date when such claim is eligible (i.e. any of the dates in documents specified under Rule 9(1) such as invoice, supplementary invoice, bill of entry, challan evidencing payment of tax, etc)

General update

- No amendments have been proposed regarding general tax rate structure of Indirect taxes levied in India
- Tax rates (Customs and Excise) have been changed for certain specific goods in certain specified sectors/ industries
- No concrete announcement on GST implementation timeline and roadmap
- Government hopes to find a solution during this fiscal and approve the legislative scheme in discussion with States after giving due consideration to their apprehensions

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