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Foreword

Owing to its contribution to GDP and employment in our country, the real estate sector has assumed an important place in the Indian economy. The rapid pace of urbanisation and expansion of corporate operations have augmented the need for state-of-the-art residential and commercial projects and diversification into avenues like warehousing, co-working spaces and student housing. The sector is projected to reach a market size of USD 1 trillion by 2030 (compared to USD 120 billion in 2017) and contribute 13% to India's GDP by 2025.[1]

In recent times, the sector has faced many challenges such as lack of funding/liquidity, procedural delays in projects, high tax rates, lack of clear land titles. In order to resolve these problems, the Government of India (GoI) has introduced various fiscal measures and policy reforms such as the Special Window for Funding Stalled Affordable and Middle-Income Housing Project, the Insolvency and Bankruptcy Code (Amendment) Bill, 2019, digitisation of land records, reduction in corporate tax rates. Further, the first real estate investment trust (REIT), which aims to attract private investment and relieve the burden on formal banking institutions, was listed in 2019 and this has set the stage for other real estate developers to consider REIT as a vehicle to raise funds and create more value.

However, despite these structured reforms by GoI to incentivise the sector, the ever-changing tax and regulatory landscape in India makes real estate transactions quite complex.

This report covers the typical transaction structures in the real estate sector and the key tax and regulatory implications that could prove to be dealmakers or deal-breakers. In addition, it focuses on niche factors governing the real estate sector, such as funding options, internal restructuring, affordable housing and REITs. While this report provides insights from a tax and regulatory perspective, a comprehensive analysis of each type of transaction needs to be undertaken.

Hiten Kotak

Leader, Deals

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1 *India Brand Equity Foundation. (December 2018). Indian real estate industry. Retrieved from https://www.ibef.org/industry/real-estate-india.aspx*

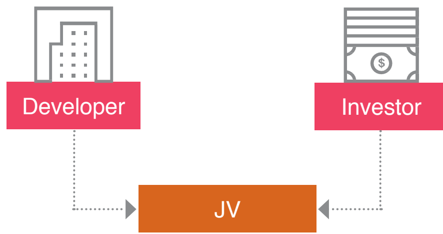
1

Transaction structures

Joint ventures

A joint venture (JV) is a business arrangement wherein two or more parties agree to pool their resources to achieve a common business objective. Under this structure, all the parties retain some control over an entity and have a defined set of activities to be executed. In the real estate sector, a JV is typically formed in one of the following ways:

Pooling of resources



Pooling of resources, as shown above, involves the formation of a JV entity in which the real estate assets are contributed by the developer and funding is provided by an investor(s). The developer and investor(s) enter a JV agreement to capture the rights and obligations of parties to the agreement. There are various tax and regulatory implications to be kept in mind by both the parties while entering such a structure. The key tax and regulatory implications are given below:

A. In the hands of the developer

1. Income tax

1.1. On transfer of assets to the JV:

Property held as capital asset

On transfer of assets to the JV, the developer will be liable to pay capital gains tax, depending on the period of holding of immovable property at the following rates:

Particulars	Tax rates
LTCG (property held for more than 24 months)	20%^
STCG (property held for less than 24 months)	30%^/25%^/22%^ (as applicable)

^Plus applicable surcharge and cess

The benefit of indexation will be available while computing capital gains on transfer of a long-term capital asset with the base year of 2001.

As per section 281 of the Income-tax Act, 1961 (ITA), transfer of land, building, shares or securities (unless held as stock in trade) would be considered as void as against any claim in respect of any tax or any other sum payable by the transferor if such transfer is done during pendency of any proceedings against the transferor or after the completion of the proceedings but before service of notice by a tax recovery officer. However, such transfers would not be considered void if (a) the transfer is made for adequate consideration without notice of pendency of such proceedings or without notice of tax payable by the transferor or (b) with prior permission of the assessing officer.

Property held as stock in trade

If the immovable property is held as stock in trade, transfer of such property will be taxed as 'business income' in the hands of the developer.

Section 50C/43CA of the ITA provides that where an immovable property, held as a capital asset or stock in trade, is transferred at a value less than the stamp duty value (being the ready reckoner rate), then this stamp duty value will be deemed to be the consideration for such a transfer and the developer will be liable to pay tax based on this.

If the JV entity is incorporated as a limited liability partnership (LLP), transfer of land (being a capital asset) by the developer, by way of capital contribution to the LLP, would be subject to capital gains tax in the hands of the developer (depending on period of holding). Under section 45(3) of the ITA, the amount recorded by the LLP in its books of accounts will be deemed to be the full value of the consideration for computation of capital gains in the hands of the developer. However, if the land is held as stock in trade, the provisions of section 45(3) will not apply.

2. Indirect tax

Under the Goods and Services tax (GST) regime, transfer of assets (i.e., land or building) by the developer to the JV entity will not attract any GST, as sale of land and building being an immovable property is outside the purview of the GST in terms of Schedule III of CGST. However, the taxability of any other assets (apart from land and building) will have to be examined from a GST perspective if the same would qualify as supply.

In terms of section 17 of CGST, the value of exempt supply includes sale of land and building (where the entire consideration is received after issuance of completion certificate or first occupation as mandated under Schedule II of CGST). Hence, ITC reversal on account of exempt supply, if any, would be required.

B. In the hands of the investor

1. Income tax

Section 56(2)(x) provides that where a person receives certain property (including shares and securities) for a consideration, which is less than its fair market value (FMV) as prescribed under the Income Tax rules, then the difference between the FMV and consideration paid will be taxed in the hands of the recipient of the property. The amount on which tax is paid will be available as the cost of such property received, for the purpose of calculation of capital gains.

Tax implications on exit by the investor are covered separately (refer to the chapter on ‘Funding Options’).

2. Indirect tax

For levy of GST, there should be an underlying supply of goods or services, or both, for a consideration in the course or furtherance of business. Purchase of equity by investors is outside the purview of GST, since it is a transaction in money.

3. FEMA regulations

3.1 Any flow of funds from non-resident investors to India needs to be in compliance with the applicable FEMA regulations. The Indian real estate market has significant potential to attract large foreign investments.

Therefore, in order to make investments in the Indian construction and development sector more lucrative, the Government has allowed 100% FDI through the automatic route and eased the rules for investment in the construction development (townships, housing, built-up infrastructure) sector. The key conditions for FDI in this sector are given below:

Particulars	Conditions
Allowable FDI in construction/ development of townships, housing, built-up infrastructure	100% (under automatic route)
Minimum area	No minimum area requirement
Minimum FDI	No minimum FDI requirement
Exit under automatic route	• On completion of project or development of trunk infrastructure • After three years, before completion of project, calculated from the date of receipt of each tranche of foreign investment*
Transfer from one non-resident to another non-resident before completion of project	Allowed under the automatic route
Prohibition	Entities engaged in the business of real estate,[2] construction of farmhouses and trading in transferable development rights
FDI in LLP engaged in development of special economic zone (SEZ)	Allowed

**Condition of lock-in not applicable to hotels and tourist resorts, hospitals, SEZs, educational institutions, old age homes and investment by NRIs*

Additionally, 100% FDI under the automatic route is permitted in completed projects for operation and management of townships, malls, shopping complexes and business centres. However, there will be a lock-in period of three years, calculated with reference to each tranche of FDI, and transfer of immovable property or part thereof is not permitted during this period.

3.2 The Government has allowed 100% FDI under the automatic route for the development of industrial parks without applicability of any of the conditions for the construction development (township, housing, built-up infrastructure) sector, as mentioned above, where the following two conditions are satisfied:

- Industrial parks should comprise a minimum of 10 units and no single unit should occupy more than 50% of the allocable area.
- The minimum percentage of the area to be allocated for industrial activity should not be less than 66% of the total allocable area.

C. In the hands of the JV entity

1. Income tax

1.1. Issue of shares to investor(s)

Section 56(2)(viib) of the ITA provides that where a closely held company receives consideration for issue of shares to resident investor(s) in excess of the FMV as prescribed under Income Tax rules, such excess should be taxed as income in the hands of the company.

If the JV entity is incorporated as an LLP, no implications will arise under section 56(2)(viib) of the ITA

1.2. Receipt of immovable property

Where any person (including a company) receives an immovable property, without consideration or for a consideration lower than its stamp duty value i.e. FMV, then the differential amount between the FMV and the consideration paid, if it exceeds 5% of the amount of consideration paid, should be taxed, as 'income from other sources'.

The amount classified as 'income from other sources' on which tax has been paid will be available as cost of the property received, for the purpose of calculation of capital gains.

2. Stamp duty implications

2.1. Transfer of assets (being land or building) should attract a stamp duty cost at the rate prescribed in the respective stamp duty law of the state where assets are located. An indicative stamp duty rate on transfer of assets in certain states is given below:

*2 Real estate business means dealing in land and immovable property with a view to earning profit therefrom and **does not include** development of townships, construction of residential/commercial premises, roads or bridges, educational institutions, recreational facilities, and city- and regional-level infrastructure, and townships. Further, earning of rent/income on lease of the property, not amounting to transfer, will not amount to real estate business.*

Sr. no.	State	Stamp duty rate	Surcharge and registration
1	Maharashtra	5%[3] of the market value of the immovable property	**Registration fee** 1% of the value of the property subject to a maximum cap of INR 30,000
2	Gujarat	3.5% of the consideration or market value of the immovable property, which-ever is higher	**Registration fee** 1% on the consideration or market value of the immovable property, whichever is higher **Surcharge** 1.4% on the consideration or market value of the immovable property, whichever is higher
3	Tamil Nadu	7% of the market value of the property	**Registration fee** 1% of the market value of property
4	Delhi	Woman – 4% of consideration Others – 6% of consideration	**Registration fee** 1% of consideration
5	Karnataka	5% of the market value of the property	**Registration fee** 1% of the market value of the property **Surcharge** 0.5% of the market value of the property

2.2. As per the amendments to the Indian Stamp Act, 1899 (ISA), stamp duty will be payable at the rate of 0.005% of the fair value of shares issued.

3 Additionally, surcharge @ 1% to be payable in case of immovable property located in the city of Mumbai

D. Others

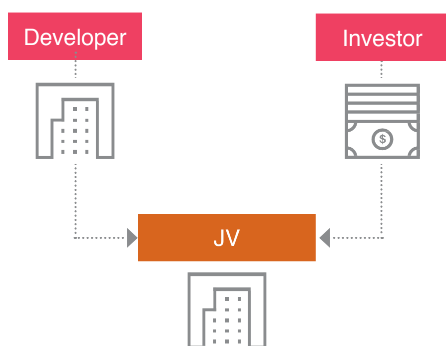
Another important aspect to be considered while entering a JV is the nature of the JV entity, i.e. whether it should be set up as a company or an LLP. Both the company and the LLP structure have pros and cons, and a thorough analysis of this needs to be done before a decision is taken, since it may have an impact on the entire arrangement. As far as the real estate sector is concerned, an LLP provides an effective structure from the tax and regulatory perspective since it provides flexibility for cash repatriation and projects can be easily set up in an LLP and wound up after their completion. Further, an LLP has reduced compliance requirements as compared to a company.

The key characteristics of a company and an LLP are given below:

Particulars	Company	LLP
Relevant legislation	The Companies Act, 2013	The Limited Liability Partnership Act, 2008
Legal entity and perpetual succession	This is a body corporate with a separate legal entity from its members and has perpetual succession.	This is a body corporate with a separate legal entity from its partners and has perpetual succession. An LLP agreement governs the mutual rights and duties of the partners of an LLP and a change in the partners of the LLP will not affect the existence of the rights or liabilities of the entity.
Tax rate	The corporate tax rate is 30%^/25%^/22%^ (as applicable).	For all LLPs, the tax rate will be 30%^
Minimum Alternate Tax (MAT)/Alternate Minimum Tax (AMT)	A company is required to pay MAT on book profits at the rate of 0%/15%^ (as applicable). MAT is payable only in case the tax payable under normal provisions is less than tax payable under MAT provisions. MAT paid can be availed as a credit for 15 years against the income tax payable under normal provisions in excess of MAT payable for respective years.	An LLP is required to pay AMT at the rate of 18.5%^ in case it is claiming a tax holiday. AMT is payable only in case the tax payable under normal provisions is less than tax payable under AMT provisions. AMT paid can be availed as a credit against the income tax payable under normal provisions for 15 years.
Dividend Distribution Tax (DDT)	A company is required to pay DDT at the rate of 20.56% (including surcharge and cess) on profits distributed as dividend to shareholders The said dividend is exempt in the hands of the shareholders. However, if the dividend amount exceeds INR 10 lakh for each shareholder, then 10%^ additional tax is payable by the resident (non-company) shareholder on this dividend.	An LLP is not required to pay DDT on profits distributed to its members. Such distribution of profits will not be taxable in the hands of the members of the LLP.
Others	It is possible to convert a company into an LLP in a tax-neutral manner assuming conditions under the ITA are satisfied. The key conditions are mentioned below: • Total sales, turnover or gross receipts of the company in any of the previous 3 years does not exceed INR 60 lakh. • Total value of assets of the company in any of the previous 3 years does not exceed INR 5 crore. • Shareholders holding at least 50% of company to continue to be the partners of the LLP for a period of five years after the conversion.	It is possible to convert an LLP into a company in a tax neutral manner assuming the conditions under the ITA are satisfied. The key conditions are mentioned below: • Shareholders holding at least 50% of LLP interest to continue to be shareholders of the company for a period of 5 years post conversion. • All the partners before conversion of the LLP become shareholders in the company.

^Plus applicable surcharge and cess

JV in existing special purpose vehicles (SPVs):



Under this structure, the investor(s) are likely to infuse funds into an existing SPV of the developer owning the real estate project. Alternately, the investor(s) may purchase shares from the developer or existing investor(s) by way of secondary sale. Similar to the 'pooling of resources' structure above, the developer and investor will enter a JV agreement to record the rights and obligations of the parties.

There are various tax and regulatory implications to be kept in mind by both the parties while entering such a structure. The key tax and regulatory implications are given below.

A. In the hands of the developer

1. Income tax

1.1. If the real estate project is already set up in a separate SPV and the investor is infusing funds in the existing entity, there should not be any tax implications in the hands of the developer.

Transfer of shares by developers or existing investor(s) to new investors

Transfer of shares by developers or existing investors will attract capital gains tax depending on the period of holding at the following rates (assuming the JV entity is not listed):

Particulars	LTCG* (held for more than 24 months)	STCG** (held for less than 24 months)
Resident	20%^	30%^/ 25%^/ 22%^ (as applicable)
Non resident	10%^#	40%^

**Long-term capital gains*

***Short-term capital gains*

^Plus applicable surcharge and cess
#without benefit of indexation

The indexation benefit should be available in the hands of the resident developer or investor while computing capital gains on transfer of a long-term capital asset.

While executing the transfer of shares, the provisions of Section 50CA need to be considered. The section provides that if a person transfers the shares of a company (other than the quoted shares) at a value lower than the FMV as prescribed under the Income Tax Rules, then such FMV will be deemed to be the consideration for such a transfer, and the developer or existing investors will be liable to pay tax based on the FMV on such a transfer. As per the final rules released, computation of the FMV of the shares of a company will include the stamp duty value of immovable property in a company and the FMV of investments held by a company (calculated as per these rules) and not the book value as recorded in the books of accounts.

If a JV entity is incorporated as an LLP, developers or existing investors may transfer their LLP interest or withdraw a part of the capital to arrive at a pre-determined ratio. While withdrawal of capital in the form of cash may not have any tax implications (depending on facts), transfer of LLP interest should be taxed as capital gains at the following rates:

Particulars	LTCG (held for more than 36 months)	STCG (held for less than 36 months)
Resident	20%^	30%^/ 25%^/ 22%^ (as applicable)
Non resident	20%^	40%^

^Plus applicable surcharge and cess

As discussed in the section on pooling of resources, the provisions of section 281 of the ITA would also be applicable to transfer of shares or securities.

2. Stamp duty implications

2.1. As per the amendments to the Indian Stamp Act, 1899 (ISA), stamp duty will be payable at the rate of 0.015% on the market value of shares (including shares held in dematerialised form) transferred.

B. In the hands of the investor or JV entity

1. Income tax

1.1. Issue of shares or transfer of shares to new investor(s)

Section 56(2)(viib) of the ITA provides that where a closely held company receives consideration for issue of shares to resident investor(s) in excess of the FMV, as prescribed under Income-tax Rules, such excess should be taxed as income in the hands of the company.

If the JV entity is incorporated as an LLP, no implications will arise under section 56(2)(viib) of the ITA.

Section 56(2)(x) provides that where a person receives certain property (including shares and securities) for a consideration, which is less than its FMV as prescribed under the Income-tax Rules, then the difference between the FMV and consideration paid will be taxed in the hands of the recipient of the property. The amount on which tax is paid will be available as the cost of such property received, for the purpose of calculation of capital gains.

Tax implications on exit by the investor are covered separately (refer to the chapter on 'Funding Options').

2. Stamp duty implications

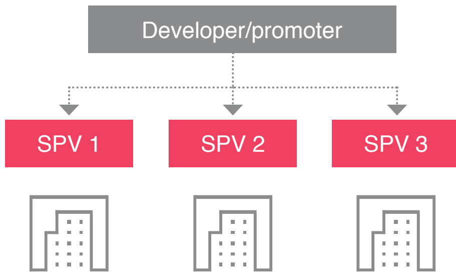
For stamp duty implications on issue of shares refer section on stamp duty under the option of pooling of resources.

3. FEMA regulations

3.1. The implications under the Foreign Exchange Management Act (FEMA) regulations will remain the same as mentioned in the section on pooling of resources.

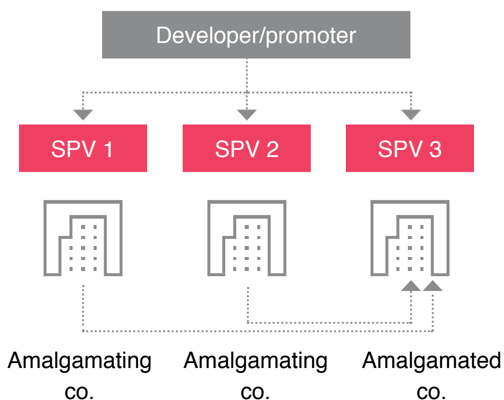
C. Case study

Investment in multiple projects



A developer has multiple projects in India in separate entities and is looking for an investor to invest in all its projects. Typically, investors do not like to invest in separate SPVs and want a single company holding all the projects. The developer may consider the following options to consolidate its projects into a single entity.

Option 1: Merger of all entities

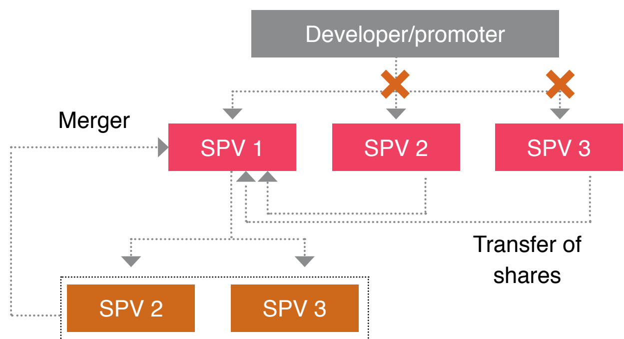


Key points for consideration:

- No adverse tax implications on mergers, assuming conditions mentioned in the ITA are satisfied.
- Stamp duty is payable on merger in states where the registered offices of the amalgamating companies and amalgamated company are situated and also in the states where the immovable properties of the amalgamating companies are situated.
- NCLT and other regulatory authorities need to approve the transaction.

The detailed implications of merger are covered separately (refer to the chapter on 'Internal restructuring')

Option 2: Transfer of shares followed by merger



Key mechanics:

- Developer to transfer shares of SPV 2 and SPV 3 to SPV 1
- SPV 2 and SPV 3 to be merged with SPV 1 through a National Company Tribunal Law (NCLT)-approved scheme of amalgamation

Key points for consideration:

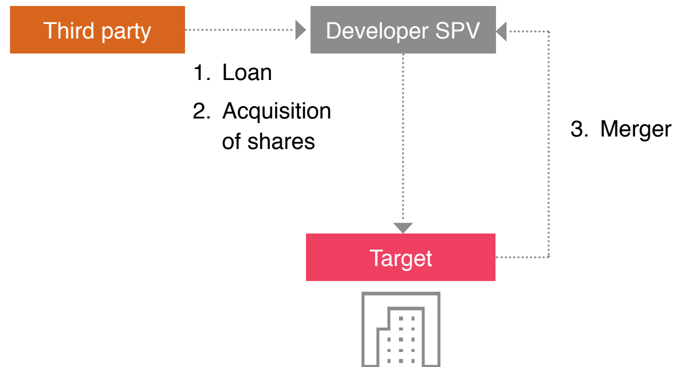
- Transfer of shares will be subject to capital gains in the hands of the developer or promoter (depending on period of holding).
- Transfer of shares should be undertaken at a value not lower than the FMV as per section 56(2)(x)/50CA of the ITA.
- No adverse tax implications on merger assuming conditions mentioned in the ITA are satisfied.
- No stamp duty will be payable on the merger of a wholly owned subsidiary with a holding company where the registered offices of SPVs and immovable properties are located in Maharashtra (stamp duty will be payable in other states).
- Approval is required from the NCLT and other regulatory authorities for the merger.

The detailed implications of merger are covered separately (refer to the chapter on 'Internal restructuring').

Debt financing

A developer is looking for debt financing to purchase an entity (with a real estate project) in India. It would be preferable for the developer to get the loan at the target entity level to make it easier to service the interest on loan and repayment.

Keeping this objective in mind, the following structure may be considered by the developer:



Key mechanics:

- Developer SPV to obtain a loan from a third party
- Developer SPV to use the loan funds to purchase the shares of the Target (having the real estate project)
- Target to be merged with the developer SPV through an NCLT-approved scheme of amalgamation

Key points for consideration:

- Third-party loan will move to the target pursuant to merger.
- There will be no adverse tax implications u/s 56(2)(x) of the ITA in the hands of the developer SPV, assuming the transaction value will be more than the FMV as prescribed under income tax rules.
- There will be no adverse tax implications on the merger assuming the conditions mentioned in the ITA are satisfied.
- Till the time the merger is not completed, there may be a disallowance of interest paid on borrowed funds under section 14A of the ITA.
- Following the merger, the Developer SPV may be able to claim interest expense on a third-party loan as a deduction while computing taxable income (This may vary depending on the facts and circumstances of each case and has been subject matter of litigation in the past).
- Stamp duty-related implications will need to be analysed on the merger.[4] Alternately, a merger of developer SPV with the target may be considered if the stamp duty cost is high.

4 *It should be noted that no stamp duty will be payable on the merger of a wholly owned subsidiary with a holding company where the registered offices of the Target and Developer SPV and immovable properties are located in the state of Maharashtra.*

Development agreement

A development agreement may be defined as an agreement between two or more developers or between a developer and a landowner to construct or develop a real estate project. The agreement, depending on the commercial circumstances, would typically include compensation in the form of revenue sharing or profit sharing. Generally, development-related agreements may be classified under two subheads:

- Joint development agreement (JDA)
- Co-development agreement

A. JDA

Under a JDA, the landowner enters an agreement (registered or unregistered) with a developer to develop a project, along with a power of attorney providing the developer with rights such as right to develop, rights to obtain necessary approvals and create a charge on land etc. In lieu of such development rights, the landowner is compensated in one of the following ways:

- Fixed consideration
- Fixed built-up area
- Percentage of profits

The role of the landowner is typically restricted to providing the developer with development rights and the landowner does not generally participate in construction or development of property. The key tax and regulatory implications relating to this are discussed below.

1. Income tax

The taxation in respect of JDA transactions is to be seen from multiple aspects such as point of taxation of transfer and consideration for such transfer. The tax-related issues differ where an asset is held as a capital asset or as stock in trade. These differences are discussed in detail below.

1.1. Land held as capital asset

a) Point of taxation

Section 2(47) of the ITA inter alia includes any transaction involving permission for possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882. Under a JDA, the landowner parts with possession of the land in lieu of a certain built-up area or cash consideration, or a combination of both.

Section 45(5A) of the ITA states that where an individual or a Hindu Undivided Family (HUF) transfers a capital asset, whether land or a building, to a developer under a JDA, with the consideration to be received as a share in the built-up area (with or without cash payment) then, the gains arising on such transfer will be deemed to arise in the year in which the completion certificate is issued by the authority for the project.

However, if individuals or HUFs transfer their share in the project before its completion, capital gains will arise in the year of the transfer.

This provision has provided relief to all landowners who were deeply aggrieved about this issue. However, this relaxation has only been given for landowners who are individuals or HUFs and not for any other entity. Therefore, it may be implied that where a company or partnership firm or LLP, which is a landowner, enters a JDA, the transfer may be taxable in the year the JDA is signed. In this context, it should be noted that the point of taxation may be shifted to the year of completion where there is a separation of responsibilities between the developer and landowner with respect to the project. This will, however, depend on the facts and circumstances of each case.

b) Value of consideration

The other issue, which arises, is the determination of the total value of consideration in the hands of the landowner for calculation of capital gains, where the landowner receives a share in the built-up area as consideration.

Section 45(5A) of the ITA states that where an individual or an HUF transfers a capital asset, being land or building, to a developer under a JDA and the consideration is to be received as a share in built-up area with or without cash payment, then the total consideration will be deemed to be the stamp duty value of a share in the project at the time of completion, increased by any additional cash received from the developer.

This relaxation has only been provided for landowners who are individuals or HUFs and not for any other entity. However, even though there is no clarity in this matter, it may be implied that the value of consideration for the JDA for other assessees may also be calculated by using the method mentioned above.

With these amendments, the Government has tried to resolve long-pending tax issues relating to JDAs.

c) Applicability of section 50C of the ITA

As per section 50C of the ITA, where a person transfers any capital asset being land and/or building at less than its stamp duty value (i.e. FMV), then such FMV of the property will be deemed to be the consideration paid. There has been litigation as to whether or not the transfer of development rights as part of a JDA would be covered by the provisions of section 50C of the ITA. Based on judicial precedents, there is a risk that such transfer of development rights as part of a JDA may attract the provisions of section 50C of the ITA.

d) Applicability of section 281 of ITA

As discussed in the section 'JV – I. Pooling of resources', the transfer of land or building may be void in case such transfer is done during pendency of any proceedings against the transferor or after the completion of the proceedings but before service of notice by a tax recovery officer. However, there is ambiguity as to whether or not transfer of development rights as part of a JDA would be covered by the provisions of section 281 of the ITA. Based on judicial precedents, there is a risk that such transfer of development rights as part of a JDA may attract the provisions of section 281 of the ITA.

1.2. Land held as stock-in-trade

If the land is held as stock-in-trade by the owner, provisions of capital gains are not attracted. Accordingly, following various judicial pronouncements, subject to facts of each case, it may be possible to take a view that income arising from a JDA is taxable based on the accrual concept as 'business income'. It must be noted that amendments discussed above shall not apply to land held as stock in trade.

As per section 43CA of the ITA, where a person transfers any asset (other than capital asset) being land and/or building at less than its stamp duty value (i.e. FMV), then such FMV of the property will be deemed to be the consideration paid. There is ambiguity as to whether the transfer of development rights as part of a JDA would be covered by provisions of section 43 CA. Unlike section 50C, there have been no judicial precedents on the applicability of section 43CA to this issue. However, the same judicial precedents may also apply in the context of section 43CA and hence there is a risk of applicability of section 43CA to transfer of development rights as part of a JDA.

The provisions of section 281 of the ITA (as discussed above) are not applicable to transfer of any asset held as stock-in-trade.

2. Indirect tax

Following the introduction of GST, the indirect tax landscape has seen rationalisation of erstwhile issues under VAT or service tax in terms of the classification, taxation, valuation, etc, GST law has specifically classified the activity of construction of complex, buildings, civil structures or part thereof and works contracts as supply of services vis-a-vis the traditional dispute whether these are goods or services or both.

The valuation methodology also tries to do away with identification of the proportion of goods and services for the purpose of taxation. The valuation is based on the open market value of the goods or services or both, or the value of similar goods or services or both, or any other reasonable method. It provides that the invoice value will be accepted (as a reasonable method) if the recipient of the goods or services is eligible for input tax credit (ITC).

Typically, in a JDA, there are two underlying transactions—transfer of development rights by the landowner in lieu of construction services and supply of construction services by the developer in lieu of development rights. Taxability of both these transactions has been specified under GST law. This is summarised below:

- Landowner
- Developer

For the landowner, the activity of lease, tenancy, easement and license to occupy land is deemed to be supply of services according to Schedule II (subject to the confirmation on the constitutional validity for levy). Therefore, the activity of transfer of development rights can be categorised as transfer of right or license in land to the developer, which then qualifies as supply of services and subject to GST @ 18%.

For the developer, the construction of a complex, building, civil structure or a part thereof and should attract GST at the rate of 12% or 18% (based on the type of project) on the total value, along with one-third deduction towards the value of land.

The time of supply for both kinds of transactions, i.e. transfer of development rights by the landowner to the developer against consideration in the form of construction services and by the developer against consideration in the form of development right is governed by notification no. 4/2018 dated 25 January 2018. In terms of the notification, the point in time when GST is payable should arise at the time when the developer transfers the possession or the right in the constructed property to the landowner by entering a deed of conveyance or instrument such as an allotment letter.

As regards the ITC, depending on the nature of outward supply, the landowner may or may not be able to avail the credit on construction services. The developer should be able to avail the above credit. However, reversal of ITC may be required for exempt supplies, if any.

The position above holds good if the arrangement between the landowner and the developer is of the area share. However, if the arrangement is the revenue share or immediate cash payment, then the time of supply may not be deferred as in the case of the area share arrangement as per notification no. 4/2018 dated 25 January 2018 and should be subject to GST at the rate of 18% on the date of signing of the JDA.

Changes with effect from 1 April 2019

In order to give a boost to the real estate industry and to achieve the objective of 'Housing for All', the GST Council has approved multiple changes in the taxation scheme. This will make the industry more formalised and ensure appropriate revenue flows to the Government.

The new scheme is applicable to all projects commencing on or after 1 April 2019 as well as for ongoing projects as on 31 March 2019, and has been linked to the Real Estate (Regulation and Development) Act, 2016. The criteria for classification of new and ongoing projects have been specified in the notifications.

Rate of taxation

The Government, vide notification no. 03/2019-Central Tax (Rate) dated 29 March 2019, has notified a rate of 1.5%/7.5% for affordable housing projects and other housing projects, respectively. The rates given above are subject to a one-third deduction for the value of land. Developers have the option to continue to pay taxes at the old rates or opt for the new rates, but only in the case of ongoing projects.

The rates given above are also only applicable when the output tax liability is paid in cash by way of debiting the electronic cash ledger.

Input tax credit

The rate of tax given above is however subject to the restriction of input tax credit charged on goods and services used in supplying the construction service has not been taken, except to the extent of eligible credit available for opting for the new scheme for ongoing projects.

The landowner is eligible to take credit of tax charged by the developer on supply of construction services in lieu of transfer of development rights or floor space index (FSI) by the landowner.

The eligibility of credit to landowners is subject to further supply of such apartments to their buyers before issuance of completion certificate or first occupation, whichever is earlier, and paying taxes, which is not less than the amount of tax charged by developers.

Rationalisation of procurements

Under the new scheme, developers are liable to procure 80% of the value of input and input services used to supply construction services only from registered suppliers. In cases where there are deficiencies in fulfilment of the 80% criteria, developers will be liable to pay tax on the differential value of procurements under the reverse charge mechanism.

Services by way of grant of development rights, long-term lease of land (against upfront payment in the form of premiums, 'salami', development charges, etc.) or FSI (including additional FSI), electricity, high-speed diesel, motor spirit and natural gas will not form a part of the value of procurements for the purpose of 80% procurement condition as given above.

Developers are liable to pay tax at the rate of 18% on a shortfall in the value of procurements, except in the case of cement and capital goods, wherein tax is liable to be paid at the applicable rate as per the tariff.

Any tax paid under reverse charge on input and input services will be deemed to have been procured from registered persons.

Reporting of procurements

Procurements from registered and unregistered persons will be maintained project-wise and should be reported with the shortfall, along with the tax payment, by 30 June of the following financial year. However, tax on cement received from unregistered persons is to be paid in the month in which the cement is received.

Input tax credit that has not been availed needs to be reported every month by reporting it as ineligible credit in GSTR-3B.

Valuation of supply

The value of construction services provided by developers in lieu of development rights or FSI, will be deemed to be equal to the total amount charged for similar apartments in the project from independent buyers other than landowners nearest to the date of transfer of such development rights or FSI, less the value of land.

Similarly, for landowners, the value of supply of services by way of transfer of development rights or FSI by a person in lieu of residential or commercial apartments will be deemed to be equal to the value of similar apartments charged from independent buyers nearest to the date of transfer of development rights or FSI.

Time of supply

By virtue of notification no. 06/2019-Central Tax (Rate), dated 29 March 2019, liability to pay tax on developer promoter:

- on construction services provided in lieu of development rights or FSI
- on supply of development rights or FSI in lieu of construction services
- monetary consideration or upfront amount paid for supply of development rights or FSI/long term-lease of land.

This will arise on the date of issuance of the completion certificate for a project, where required by the competent authority or on its first occupation, whichever is earlier.

Exemption on transfer of development rights/long-term lease of land

In order to reduce compliance challenges for landowners and ensure appropriate revenue flows to the system, the Government, vide notification no. 04/2019-Central Tax (Rate) dated 29 March 2019, has exempted services supplied by way of:

- transfer of development rights or FSI
- granting of long-term lease of 30 years or more.

on or after 1 April 2019 for construction of apartments, intended for sale to buyers, wholly or partly, except where the entire consideration has been received after issuance of completion certificate, where required, by the competent authority or after its first occupation, whichever is earlier.

This exemption is only available, subject to the condition that output tax is paid on supply of construction services. For any unsold inventory on the date of issuance of a completion certificate or on first occupation of the project, the developer will be liable to pay tax at the rate of 18% on a reverse charge basis on the proportion of value of development rights or FSI/long-term lease premium, as attributable to residential apartments, which remain unbooked in proportion of their carpet area.

The tax payable, based on the above, will not exceed 1% of their value in the case of affordable residential apartments and 5% of the value in the case of residential apartments other than affordable residential apartments remaining unbooked on the date of issuance of completion certificate or on first occupation. This needs to be discharged by the earlier of the two dates.

3. Stamp duty implications

Stamp duty will be payable on entering into a JDA at applicable rates, as mentioned in the stamp duty law of the respective state where the properties are located. An indicative stamp duty rate on JDAs in various states is given below:

State	Entry
Maharashtra	• 5%[5] of the market value of property
Gujarat	• 3.5% of the market value of property
Delhi	• Stamp duty payable at the rate of 4% of the market value of the property in the case of woman or at the rate of 6% of the market value of the property in case of other than woman, under the article of 'Conveyance'
Karnataka	• 2% of the market value of undivided portion/ constructed area to be given to landowner, consideration or money advanced (includes security deposit being refundable)

5 *Additionally, surcharge @ 1% to be payable in case of sale of immovable property located in city of Mumbai.*

4. FEMA regulations

As per FEMA regulations, a non-resident will not be able to become a party to a JDA. However, a non-resident may set up a company in India and such a company may enter a JDA, subject to conditions (refer to the section on JVs).

B. Co-development agreement

Under a co-development agreement, a developer who owns land enters an agreement with another developer to jointly develop a property without creating a separate legal entity. The agreement is likely to distinguish the roles and responsibilities of the developers engaged in developing the project while also stipulating the duties of cash flow, books and accounts, project management, etc. The revenues and/or profits from such an agreement are jointly shared between both the parties, although the manner of compensation will differ from case to case. The various tax and regulatory implications are given below.

1. Income tax

1.1. There is a risk of a co-development agreement being treated as an AOP. The definition of an AOP and their tax implications are discussed below.

1.2. What is an AOP?

There is no definition of AOP under the ITA. Therefore, in order to understand the meaning of an AOP, we need to look at various judicial decisions in the past. According to judicial decisions,[6] an AOP should include the following essential features:

- It must be constituted by two or more persons.
- The constituent members should have come together for a common purpose.
- The association should move by common action and there must be some scheme of common management.
- Cooperation and association among the constituent members must not be perfunctory and/or merely in form. The association must be real and substantial enough for it to be treated as a separate homogenous taxable entity.

Therefore, since the definition of an AOP is fairly subjective, it is important to analyse the facts and the transaction structure of each real estate project to determine whether an AOP has been created.

1.3. Tax implications of an AOP

Where an arrangement is considered as an AOP, the tax implications will be as under:

The tax rates for an AOP differ under the two scenarios, as given below:

a) The shares of the members of the AOP are known.

Particulars	Tax rates
Income of all members does not exceed the basic exemption limit	• Tax at normal slab rates in the hands of the AOP • Share of income from the AOP to be included in the total income of the member only for rate purposes – *member entitled to rebate of tax on the entire share of income*
Income of any member exceeds the basic exemption limit	• Tax at maximum marginal rate (MMR) in the hands of the AOP • Share of income from the AOP exempt in the hands of members
If a member is a non-resident	• Share of foreign member taxed at 40%# and the rest of the income taxed at MMR* in the hands of the AOP • Share of income of the AOP to be exempt in the hands of members

**MMR: 30% plus applicable surcharge and cess*
 # Plus applicable surcharge and cess

b) Shares of the members of the AOP are unknown.

Particulars	Tax rates
If all members are resident	• Tax at MMR* in the hands of the AOP • Share of income of the AOP exempt in the hands of members
If a member is a non-resident	• Total income taxed at 40%# in the hands of the AOP • Share of income of the AOP to be exempt in hands of members

**MMR: 30% plus applicable surcharge and cess*
 # Plus applicable surcharge and cess

Computation of the income of an AOP will be done as per the normal methodology under the ITA. However, certain expenses are not tax deductible under section 40(ba) of the ITA:

- Interest[7] paid by the AOP to its members (reduced by any interest paid by the member to the AOP).
- Salary, bonus, commission, remuneration paid by the AOP to its members.

6 *Commissioner of Income-tax vs Indira Balkrishna (SC) and Linde A.G. vs DDIT (Delhi HC)"*

7 *Certain exemptions for interest provided in section 40(ba) of the ITA*

1.4. MAT

Section 115JB of the ITA was amended vide the Finance Act, 2015 to provide that the share of profit from the AOP is to be excluded for the purpose of calculation of MAT in the hands of its members (being a company).

2. Indirect tax

Taxability under a co-development arrangement may not be similar to JDA, since it is framed for the purpose of pursuing a common objective and to share profits. If it qualifies as an AOP or unregistered joint venture (UJV), then taxability of transfer of assets will have to be examined from a GST perspective based on the arrangement between parties.

Alternatively, if the arrangement involves transfer of TDR by one developer to another for the purpose of construction in an area-sharing arrangement, then the GST implications as stated above in the JDA should apply. However, if the arrangement is on a revenue sharing basis, then the time of supply may not be deferred as in the case of an area sharing arrangement as per notification no. 4/2018 dated 25 January 2018.

Changes w.e.f. 1 April 2019 as captured in the section of Joint Development shall be applicable in this case as well.

3. FEMA regulations

As per FEMA regulations, a non-resident will not be able to become a party to a co- development agreement. However, a non-resident may set up a company in India and such a company may enter a co-development agreement, subject to conditions (refer to the section on JVs).

Project management agreement

A project management agreement is an agreement entered by a project manager with a developer to supervise and manage the development of a real estate project. Under this agreement, a project manager typically does not assume any risks and responsibilities of the real estate project and the compensation is not linked to the performance of the project. The key tax and regulatory implications under this arrangement are given below:

1. Income tax

The amount received as compensation by the project manager will be taxable as 'business income' in his hands. On the other hand, the developer should be able to claim such project management fees as a tax deductible expense in its computation of income.

2. Indirect tax

Under the GST regime, a project management agreement will be liable to GST at the rate of 18% and the benefit of ITC will be available to the developer. However, reversal of ITC on account of exempt supply, if any, needs to be done.

Further, for any project management agreement executed specifically for construction of residential property, the benefit of ITC would be restricted in case the developer has opted for new rates of 1.5%/7.5% (subject to 1/3rd deduction for the value of land), as the case may be.

3. Stamp duty implications

Stamp duty will be payable under the article of 'Agreement' in the state in which the agreement is executed.

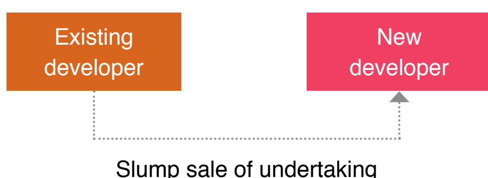
4. FEMA regulations

A foreign entity may directly engage in a project management-related activity with a developer in India as long as the foreign entity is not engaged in construction or development of immovable property.

Business transfer/slump sale

In a scenario, where a developer ('existing developer'), post the commencement of development activities on a piece of land, may be desirous of transferring such 'under construction project' (undertaking) to another developer (new developer). One of the options available to the Existing Developer is to transfer the undertaking on a going concern basis to the new developer entity by way of a slump sale.

In India, a slump sale could either be implemented as a business transfer agreement or through a Scheme of Arrangement under section 230-232 of Companies Act, 2013. A pictorial representation of the transaction is given below.



Slump sale of undertaking

The conditions for a transfer to be taxable as a slump sale under the provisions of the ITA are given below:

- Transfer of one or more undertakings as a result of a sale for a lump sum consideration.
- No values being assigned to individual assets and liabilities of the undertaking in such a sale.
- The 'undertaking' being transferred by way of a slump sale should constitute a business activity and it also includes part of an undertaking or unit or division but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

1. Income tax

1.1.The key tax implications on a slump sale are given below:

<table>
<tr><th>Particulars</th><th>Implications</th></tr>
<tr><td>Capital gains</td><td>Tax impact in the hands of:
Existing developer
As per section 50B of the ITA, capital gains is computed as under:
<table>
<tr><th>Particulars</th><th>Amount</th></tr>
<tr><td>Sale consideration</td><td>xxx</td></tr>
<tr><td>Less: Cost of acquisition of undertaking
(book values of non-depreciable assets + Tax WDV of depreciable assets)</td><td>(xx)</td></tr>
<tr><td>Capital gains</td><td>xxx</td></tr>
</table>
Capital gains is taxable at the following tax rates depending on the period of holding of the undertaking.
<table>
<tr><th>Particulars</th><th>Tax rates</th></tr>
<tr><td>LTCG (undertaking held for more than 36 months)</td><td>20%^</td></tr>
<tr><td>STCG (undertaking held for less than 36 months)</td><td>30%^/25%^/22%^ (as applicable)</td></tr>
</table>
^Plus applicable surcharge and cess
The benefit of indexation while computing capital gains on transfer of long-term undertaking is not available.</td></tr>
<tr><td>Section 56</td><td>Tax-related impact in the hands of a new developer:
Implications under section 56(2)(x) may not be attracted while transferring the undertaking (comprising property held as 'stock in trade') by way of slump sale, since the undertaking is not considered a 'property', defined under Section 56(2)(x) of the ITA.</td></tr>
<tr><td>Section 50C / 43CA</td><td>As per Section 50C/43CA, where a person transfers any property (capital asset or stock in trade), be it land or a building, at less than its stamp duty value (i.e. FMV), then such FMV of the property will be deemed to be the consideration paid. In the case of a slump sale, an undertaking may include land and a building, but a view may be taken that Section 50C/43CA may not apply as the transfer is of an undertaking (not of individual assets) and the taxability of such a slump sale is governed by section 50B of the ITA.</td></tr>
<tr><td>Cost of assets in the hands of the developer entity</td><td>Consideration paid on slump sale will be allocated to individual assets and liabilities based on an independent valuer's report.</td></tr>
<tr><td>Brought forward losses or unabsorbed depreciation of undertaking</td><td>Brought forward losses or unabsorbed depreciation specific to the undertaking will not be transferred to the new developer. These losses may still be available to the existing developer, subject to applicable provisions of the ITA.</td></tr>
</table>

As per section 170 of the ITA, where a person carrying on a business has been succeeded therein by any other person, then the successor shall be assessed in respect of income only after the date of the succession. However, in cases where the predecessor cannot be found, then the assessment of income (including gains arising from transfer of business) of the previous year up to the date of succession and that of income of the year preceding the year in which succession took place can be made in the hands of the successor in the like manner as it would have been made on the predecessor. Further, where any sum payable by the predecessor for such period cannot be recovered from him, then the same can be recovered from the successor. Slump sale being succession of business, the provisions of section 170 should be applicable to the buyer.

2. Indirect tax

Transfer of business as slump sale on a going concern basis as a whole or an independent part thereof will not be subject to GST by virtue of exemption as per Notification no. 12/2017–Central Tax dated 28 June 2017. As per the provisions, where there is a change in the constitution of a registered person on account of transfer of the business with the specific provisions for transfer of liabilities, the registered person will be allowed to transfer the input tax credit, which remains unutilised in his or her electronic credit ledger to such transferred business in the manner prescribed. Since a slump sale will be treated as exempt supply, reversal of ITC on common expenses used for business as a whole should be carried out in the manner prescribed in GST law.

3. Regulatory approvals

I. Slump sale through a business transfer agreement

As per section 180 of the Companies Act, 2013, a business transfer agreement may require approval by special resolution from the shareholders of the company, if the undertaking so transferred exceeds 20% of the net worth of the company as per its latest audited financial statements of the preceding financial year or generates 20% of the total income of the company during the previous financial year.

II. Slump sale by Scheme of Arrangement

The Scheme of Arrangement should be filed under section 230–232 of the Companies Act, 2013, and requires the approval of the NCLT. There are certain other regulatory approvals required, which are mentioned below.

- Approvals should also be sought from the Registrar of Companies (RoC), the Regional Director (RD) and intimation given to the Income Tax authorities.
- In the case of listed companies, the approval of the Securities and Exchange Board of India (SEBI) / stock exchanges would also be required.

4. Stamp duty implications

Slump sale by business transfer agreement

Transfer of a business under a slump sale may be considered as 'transfer of movable property' as per judicial pronouncement. However, stamp duty authorities may apply stamp duty on the fair market value of the immovable properties transferred.

Stamp duty entries on conveyance of property in a few states are given below:

State	Movable assets	Immovable assets
Maharashtra	3% of the market value of the property	5%[7] of the market value of the property
Gujarat	The stamp duty will be the higher of: • 2% of the amount of consideration; or • 2% of the market value of the property	The stamp duty will be the higher of: • 3.5% of the amount of consideration; or • 3.5% of the market value of the property
Delhi	6% of the amount of consideration	
Karnataka	5% of the market value of the property	
Tamil Nadu	7% of the market value of the property	

7 Additionally, surcharge @1% to be payable in case of immovable property located in the city of Mumbai.

Slump sale by scheme of arrangement

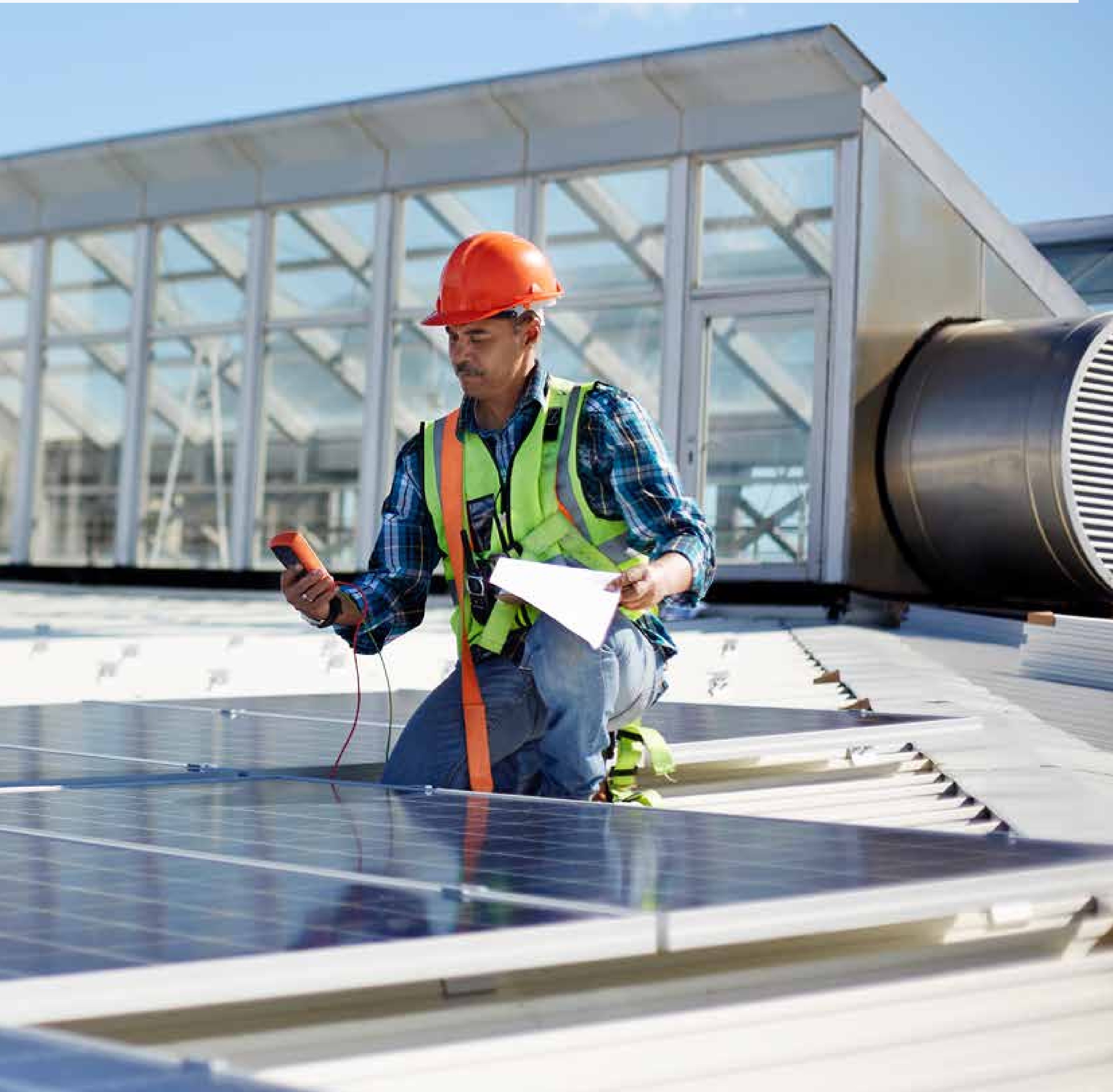
Slump sale of an undertaking through a scheme of arrangement is equivalent to a demerger for the purpose of the Companies Act, 2013.

Stamp duty is payable on the NCLT order approving the scheme in the state where the registered offices of the companies are situated. The majority of state stamp duty laws have specific entries[8] for NCLT orders approving the scheme of arrangement.

In addition to the above, stamp duty should also be payable on any immovable properties that are transferred pursuant to the slump sale.

The stamp duty entries on slump sale under scheme of arrangement in some states remain the same as discussed in the section on 'Internal restructuring – merger of group entities'.

8 Where the specific entry for levying stamp duty on scheme of arrangement is not provided, stamp duty may be paid under the entry of conveyance as per judicial pronouncements.

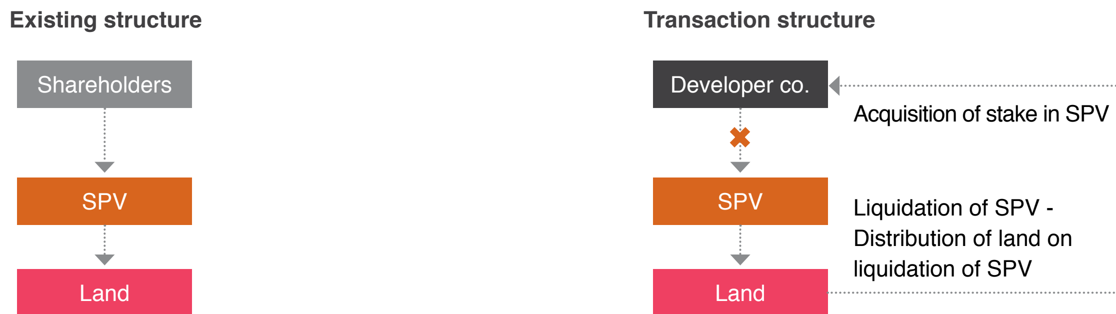


Liquidation

Typically, where a landowner holds land in an SPV, he/she would be desirous of selling the shares of the SPV to the developer instead of the SPV selling the land. Thus, there may be a situation where the developer buys the shares of the SPV, which holds the land parcels.

Post such acquisition, where the land is to be held in the developer company (developer co.), an option of voluntary liquidation may be explored. Under this option, the SPV (assuming it only has land parcels and no other assets) shall be liquidated under the Insolvency and Bankruptcy Code (IBC). On liquidation, the land held by the SPV will be distributed to developer co., it being the only shareholder.
A pictorial representation of the transaction is given below.

The SPV should be solvent at the time of voluntary liquidation.



1. Income tax

1.1. The key tax implications on liquidation are given below:

<table>
<tr><th>Particulars</th><th>Implications</th></tr>
<tr><td>Section 2(22)(c) – deemed dividend</td><td>On liquidation, the SPV will be liable to pay dividend distribution tax at the rate of 20.56% (including surcharge and cess) to the extent the distribution is attributable to accumulated profits before liquidation.</td></tr>
<tr><td>Capital gains</td><td>Tax-related impact in the hands of:

Developer company

As per Section 46 of the ITA, the shareholder will be liable to pay capital gains tax on receipt of assets pursuant to liquidation of a company. The sale consideration will be the market value of the land distributed reduced by the amount considered as dividend, if any.

Capital gains tax is payable, depending on the period of holding of the shares of the SPV (assuming unlisted shares).

<table><tr><th>Particulars</th><th>Tax rates</th></tr><tr><td>LTCG (land held for more than 24 months)</td><td>20%^</td></tr><tr><td>STCG (land held for less than 24 months)</td><td>30%^/25%^/22%^ (as applicable)</td></tr></table>
^Plus applicable surcharge and cess</td></tr>
<tr><td>Cost of land in the hands of the developer company</td><td>Where the developer company has been assessed for income tax under the head ‘capital gains’, the cost of the asset will be its fair market value on the date of distribution considered for the purpose of computing tax liability on liquidation.</td></tr>
</table>

2. Indirect tax

Under the GST regime, no tax is payable on transfer of land. However, reversal of ITC needs to be done on account of exempt supply, if any.

3. Regulatory approvals

Application for voluntary liquidation should be made under section 59 of the Insolvency and Bankruptcy Code, 2016. The majority of the directors are required to provide Declaration of Solvency. The following procedure should be followed:

- Obtaining the approval of the board of directors and shareholders.
- Appointing a liquidator.
- The liquidator making a public announcement for submission of claims against the company and send notices to the concerned authorities, as required.
- Distributing surplus assets after settlement of claims.

4. Stamp duty implications

Distribution of land may entail payment of stamp duty under the entry of conveyance of immovable property.

Stamp duty entries on conveyance of immovable property in certain states have been mentioned earlier (refer to the section on slump sale).

2

Funding options

Background

The Government has been making a multifaceted effort to boost investments from foreign and domestic investors in the real estate sector. The relaxation of foreign exchange regulations, together with other tax and regulatory reforms, has made real estate in India a lucrative investment option among foreign investors. Private equity (PE), which was at a nascent stage, has turned out to be one of the major sources of funding for the fund-deprived sector.

Typically, a PE investor funds a project or company for 4–5 years and seeks an exit after that. In the past, equity/compulsory combustible debentures (CCDs) were the preferred mode of investment for PE investors to benefit from higher returns while also being exposed to higher risks. In addition to this, there has been the emergence of structured debt deals, which permit PE investors to have security (pledge, mortgage, etc.) over their investments and provide an agreed on return, depending on the performance of the company. Investors may also use external commercial borrowings (ECBs) as a mode of investment.

The key characteristics of the funding instruments are given below:

Particulars	Equity	CCD	NCD#	ECB
Government approval	Not required			Required in certain cases
End-use restriction	No end-use restriction		• No end-use restriction for listed non-convertible debenture (NCD) • For unlisted NCD, certain end-use restrictions have been notified	End-use restrictions apply
Permitted lenders	Not applicable	Not applicable	Investor to be registered as FPI	Eligible lenders specified
Voting rights	Voting rights in proportion to stake held	No voting rights till conversion into equity shares	No voting rights	No voting rights
Return	Dividend	Interest	Interest	Interest
Regulatory ceiling on servicing the instrument	No ceiling on the amount of dividend distributed on equity capital, subject to compliance with company law regulations	• No regulatory cap on interest but subject to transfer pricing, if applicable • Deduction of aggregate interest allowed only up to 30% of earnings before interest, tax, depreciation and amortisation (EBITDA), when includes payment to an AE	• No regulatory cap on interest but subject to transfer pricing, if applicable • Deduction of aggregate interest allowed only up to 30% of EBITDA, when includes payment to an AE	• Capped at 'all in cost' defined as per ECB regulations, but subject to transfer pricing, if applicable • Deduction of aggregate interest allowed only up to 30% of EBITDA, when includes payment to an AE
Listing of instrument	Optional	Not possible	Optional	Not possible
Call/Put option	Permitted subject to lock in and exit to non-resident without any assured return as per pricing guidelines		Permitted	Not applicable
Exit option	Sale of shares/buy-back of shares/capital reduction	• Pre-conversion: Sale of CCDs • Post-conversion: Same as equity	Sale/redemption of NCDs	Repayment

 # RBI vide A.P. (DIR Series) Circular no. 24 dated 27 April 2018 read with A.P. (DIR Series) Circular no. 19 dated 15 February 2019 notified that FPI along with related FPI cannot invest in more than 50% of any issue of a corporate bond by an Indian company

With the slight revival of the Indian economy and various incentives implemented by the Government, it is important to analyse the merits and demerits of these instruments while making an investment. However, there are various tax and regulatory implications that need to be kept in mind while this analysis is being conducted.

Equity instruments

Equity shares

1. FEMA regulations

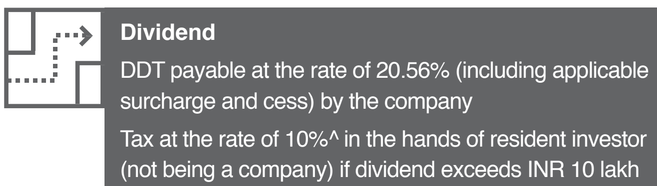
There are no major regulatory hurdles for subscription to equity by domestic investors. The investors and the company should ensure compliance with the Companies Act, 2013 for issue of shares.

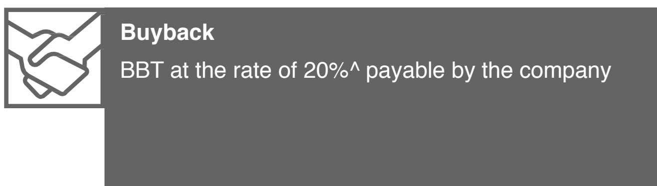
As per FEMA and regulations framed thereunder, FDI is not allowed in the real estate business (Refer to the section on JVs for a definition of this).

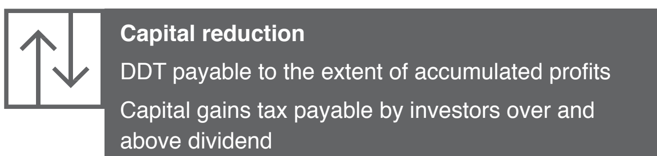
2. Income tax

For the purpose of this section, it is assumed that an investment is made in an unlisted company engaged in the construction and/or development of townships, residential/commercial premises, etc.

A. Repatriation options







2.1. Dividend

Particulars	Implications
In the hands of the company	DDT payable at the rate of 20.56% (including applicable surcharge and cess)
In the hands of investor	**Resident (other than a company)** Taxable at the rate of 10%^ if the dividend amount exceeds INR 10 lakh **Non-resident** No tax implications

^ Plus applicable surcharge and cess

2.2. Buy back

Key company law conditions:

- Maximum buyback in a year: 25% of net worth
- Debt-equity ratio not to exceed 2:1 post buyback
- Buyback subject to further conditions under section 68 of the Companies Act, 2013
- Board of directors' resolution (if up to 10%) and shareholders' resolution (if exceeding 10%) to be passed

Income tax implications

In the hands of the company:

- Buyback tax payable by company at the rate of 20%^ under section 115QA of the ITA.
- No DDT payable by company under section 115-O of the ITA.

^ Plus applicable surcharge and cess

In the hands of the investor (resident or non-resident):

- The consideration received by the shareholders pursuant to the buyback is exempt in their hands.

2.3. Capital reduction

Key company law-related conditions:

- Approval of the NCLT will be required
- Approval required from the shareholders and creditors
- Approval required from RD, ROC
- Capital reduction to be subject to further conditions under section 66 of the Companies Act, 2013

Income tax implications:

Deemed dividend

Any distribution by a company to its shareholders (to the extent of its accumulated profits) on capital reduction should be a deemed dividend and subject to tax as discussed in point 2.1 above.

Capital gains

Any amount distributed on capital reduction, reduced by the amount assessed as a dividend, is chargeable as capital gains in the hands of the shareholders. Although there is no specific provision governing this, the view is adopted from a prominent judicial pronouncement[9] . Therefore, the tax implications will be as under:

Particulars	LTCG (held for more than 24 months)	STCG (held for less than 24 months)
Resident	20%^	30%^/25%^/22%^ (as applicable)
Non-resident	10%^#	40%^

^ Plus applicable surcharge and cess
 # Without benefit of indexation

9 CIT vs G. Narasimhan [1999] 236 ITR 327 (SC)

The indexation benefit will be available to resident investors while computing capital gains on transfer of a long-term capital asset.

B. Exit

A PE investor can exit from a company prominently by way of an initial public offering (IPO) or a secondary sale. The implications in each case are provided below:

<table>
<tr><th>Particulars</th><th>Implications</th></tr>
<tr><td>IPO (offer for sale by a PE investor to the public)</td><td>On an offer for sale, shares offered by promoters or investors will be liable to securities transaction tax. Against this background, the tax rates will be as under:
• LTCG (shares held for more than 24 months) – capital gains will be taxable at the following rates (subject to the treaty's benefit):
<table>
<tr><th>Particulars</th><th>Rates</th></tr>
<tr><td>Resident investor</td><td>10%^#</td></tr>
<tr><td>Non-resident investor</td><td>10%^#</td></tr>
</table></td></tr>
<tr><td></td><td>• STCG (shares held for less than 24 months) – capital gains will be taxable at the following rates (subject to the treaty's benefit):
<table>
<tr><th>Particulars</th><th>On the market</th></tr>
<tr><td>Resident investor</td><td>15%^</td></tr>
<tr><td>Non-resident investor</td><td>15%^</td></tr>
</table></td></tr>
<tr><td>Secondary sale (sale to another PE investor)</td><td>• Capital gains – unlisted company
<table>
<tr><th>Particulars</th><th>LTCG (held for more than 24 months)</th><th>STCG (held for less than 24 months)</th></tr>
<tr><td>Resident</td><td>20%^</td><td>30%^/ 25%^/22% ^ (as applicable)</td></tr>
<tr><td>Non-resident</td><td>10%^#</td><td>40%^</td></tr>
</table>
The indexation benefit will be available to resident investors while computing capital gains on transfer of a long-term capital asset.
In the case of a non-resident shareholder, the buyer is required to withhold appropriate taxes at the time of discharge of the consideration to the shareholder.</td></tr>
</table>

^ *Plus applicable surcharge and cess*
# *Without benefit of indexation*

Compulsorily convertible debentures

CCDs are instruments that are to be converted into equity shares after a definite period of time, as agreed by the issuer and the holders. CCDs carry a rate of interest till the time they are converted into equity shares but cannot be redeemed.

1 FEMA regulations

The regulatory implications for issue of CCDs remain the same as those for issue of equity shares (refer to the section on equity shares).

2 Income tax

The tax implications of CCD instruments are provided below:

<table>
<tr><th>Particulars</th><th>Implications</th></tr>
<tr><td>Secondary sale (sale to another PE investor)</td><td>

- Capital gains – unlisted company

<table>
<tr><th>Particulars</th><th>LTCG (held for more than 36 months)</th><th>STCG (held for less than 36 months)</th></tr>
<tr><td>Resident</td><td>20%^</td><td>30%^/25%^ /22%^ (as applicable)</td></tr>
<tr><td>Non-resident</td><td>10%^#</td><td>40%^</td></tr>
</table>
</td></tr>
<tr><td>Interest</td><td>

- Interest paid on CCDs to investors should be available as a tax-deductible expense to the company, subject to end use and Thin Capitalisation rules (refer section on NCDs).

Resident investor

- Withholding tax (WHT) at the rate of 10% by the company but subject to tax at applicable rates in the hands of the investor

Non-resident investor

- Interest paid on CCDs will be subject to WHT @ 40%^(subject to treaty benefit).
- However, interest paid up to 30 June 2020 to an foreign portfolio investment (FPI) is subject to WHT @ 5% on fulfilment of certain conditions. After 30 June 2020 or on non-fulfilment of conditions, WHT @ 20% (subject to treaty benefit).
</td></tr>
<tr><td>Conversion of CCDs into equity</td><td>

- There are no capital gains implications on conversion of CCDs into equity shares. The period of holding and the cost of acquisition of CCDs shall become the period of holding and cost of acquisition of the equity shares.
</td></tr>
</table>

^ Plus applicable surcharge and cess

 # Without benefit of indexation

When such CCD instruments are converted into equity, the repatriation and exit implications of equity instruments, as explained earlier, should apply.

Debt instruments

Non-convertible debentures

Debt structures are typically funded through listed or unlisted NCDs. Generally, NCDs have a fixed tenure of three to five years and include a coupon that is payable at regular intervals, with or without payment of a premium on redemption, as per commercial negotiations between the parties. The NCDs are generally secured through a pledge, mortgage or charge of assets. The key tax- and regulatory-related implications on listed or unlisted NCDs are provided below:

1. FEMA and SEBI regulations

Non-resident investors need to comply with SEBI (Foreign Portfolio Investment) Regulations, 2019 (FPI Regulations) to invest in debt instruments such as listed NCDs or unlisted NCDs. Accordingly, the non-resident entity must be registered as FPIs in order to subscribe to the listed or unlisted NCDs of an Indian company.

Notably, RBI vide A.P. (DIR Series) Circular no. 24 dated 27 April 2018, read with A.P. (DIR Series) Circular no. 19 dated 15 February 2019, notified that an FPI along with related FPI cannot invest in more than 50% of any corporate bond issued by an Indian company. The RBI has also notified certain end-use restrictions for funds raised as unlisted NCDs, such as investment in the real estate business, capital markets and purchase of land.

Further, FPIs can also invest in the debt instruments under the voluntary retention route (VRR). The key features of VRR are as under:

Particulars	Implications
Investment limit	• The limit is in addition to the general investment limits. • A maximum amount of investment can be INR 75,000 crore to be allocated between government securities, corporate debt instruments and both by the RBI. • Allocation shall be made on tap or through auctions • FPIs along with related FPIs shall not be allotted more than 50% of the amount offered for each allotment by tap or auction, where the demand is more than 100% of the amount offered.
Minimum retention period	• 3 years for each allotment by tap or auction • Commences from date of allotment of limit
Committed Portfolio size (CPS)	• Amount allotted to FPI • Minimum 75% of the CPS needs to be invested in the retention period
Exit	**End of retention period** • Liquidate the portfolio • Shift investment to general investment limit subject to availability of limit • Hold investments till date of maturity **Before the end of retention period** • Sale of investments to other FPIs
Other relaxations	• Exempt for requirements relating to concentration limit or group/single investor wise limits as applicable to corporate bonds

2. Income tax

2.1. Interest

Particulars	Implications
In the hands of the company	Interest paid on listed or unlisted NCDs to investors should be available as a tax deductible expense, subject to end use and Thin Capitalisation rules (as discussed below).
In the hands of the investor	**Resident** WHT at the rate of 10% by the company but subject to tax at applicable rates **Non-resident (subject to treaty benefit)** • WHT at the rate of 5% by the company* • WHT at the rate of 20% by the company in other cases

**Assuming the conditions given under section 194 LD of the ITA are satisfied and interest is paid up to 30 June 2020*

2.2. Exit

As discussed earlier, an investor can exit from a company prominently by redemption of NCDs and secondary sale. The implications in each case is given below:

Particulars	Implications
Redemption of NCDs	**Redemption of NCDs at par** There are no tax implications in the hands of resident or non-resident PE investors and company on redemption.
	Redemption of NCDs at premium: The premium on redemption of NCDs should be categorised as interest or capital gains in the hands of PE investors, depending on the terms of the NCDs and the facts of the case.

<table>
<tr>
<td>Secondary sale (sale to another PE investor)</td>
<td>LTCG# (listed debentures held for more than 12 months or unlisted debentures held for more than 36 months):

Capital gains will be taxable at the following rates (subject to treaty's benefit):

<table>
<tr><th>Particulars</th><th>Listed NCDs</th><th>Unlisted NCDs</th></tr>
<tr><td>Resident investor</td><td>10%^</td><td>20%^</td></tr>
<tr><td>Non-resident investor</td><td>10%^</td><td>10%^</td></tr>
</table>
</td>
</tr>
<tr>
<td></td>
<td>STCG (listed debentures held for less than 12 months /unlisted debentures held for less than 36 months):

Capital gains will be taxable at the following rates (subject to treaty's benefit):

<table>
<tr><th>Particulars</th><th>Listed NCDs</th><th>Unlisted NCDs</th></tr>
<tr><td>Resident investor</td><td>30%^/25%^/ 22%^(as applicable)</td><td>30%^/25%^/ 22%^(as applicable)</td></tr>
<tr><td>Non-resident investor</td><td>40%^</td><td>40%^</td></tr>
</table>
</td>
</tr>
</table>

^ Plus applicable surcharge and cess
 # Without benefit of indexation

2.3. Thin capitalisation rules

Interest paid to investors on CCDs, NCDs or ECBs should be available as a tax-deductible expense to the company. The Finance Act, 2017, has introduced the concept of thin capitalisation, which limits the amount of tax deduction available on interest paid on any borrowings to specified persons.

As per the new provisions, if an Indian company or PE of a foreign company borrows from a non-resident who is an associated enterprise (AE) of such borrower or from a third party with an implicit or explicit guarantee provided by an AE, the interest or payment of a similar nature (of more than INR 10 million) made on such borrowings will be capped at 30% of EBIDTA. The definition of AE is provided in section 92 of the ITA.

Some of the key parameters to classify non-resident persons as AEs are provided below:

- One enterprise holds directly or indirectly not less than 26% of the voting power of the reporting entity.
- The fellow subsidiary, if the parent enterprise holds not less than 26% of the voting power of such fellow subsidiary.
- A loan advanced by an enterprise to the reporting entity constitutes not less than 51% of the book value of assets of the reporting entity.
- More than half the board of directors of the reporting entity or one or more than one executive director is appointed by another enterprise.

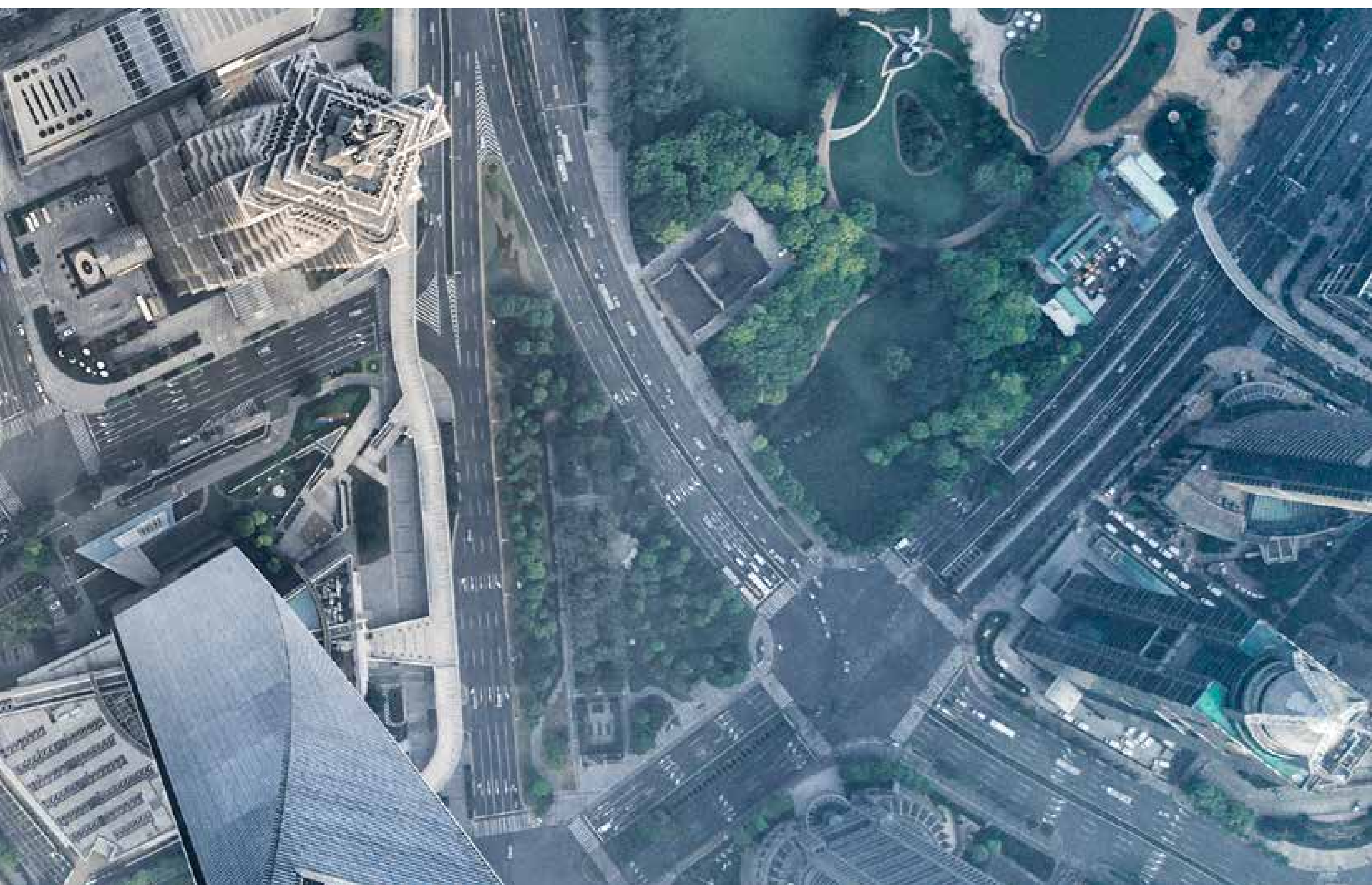
If any interest is disallowed due to a provision mentioned above, this interest can be carried forward for eight assessment years and allowed to the extent of 30% of the EBITDA of the year of claim.

An illustration of the thin capitalisation rule is given below:

Particulars	Scenario A	Scenario B	Scenario C
EBIDTA (A)	100	100	100
Interest paid to AE (B)	40	40	40
Interest paid to third party (C)	20	50	0
Maximum interest deduction allowable, paid to AE (D =A*30%)	30	30	30
Disallowed interest carried forward [(B + C - D) or B whichever is lower]	**30**	**40**	**10**

The carry forward interest may be set off within the next eight assessment years subject to the conditions mentioned above.
An illustration of set-off of interest under Scenario A is given below:

Particulars	Scenario A (Year 2)
EBIDTA (A)	200
Interest paid to AE (B)	30
Interest paid to third party (C)	20
Maximum interest deduction allowable (D = A*30%)	60
Disallowed interest carried forward [(B + C - D) or B whichever is lower]	Nil
Carry forward interest to set off	10
Balance carry forward	20



External commercial borrowings

ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to the parameters mentioned in the FEMA regulations. The key tax and regulatory implications for ECBs are given below:

1. FEMA regulations

A brief overview of FEMA regulations relating to ECBs is given below:

Particulars	Regulations
ECB framework	Framework comprises two options, i.e. foreign currency (FCY)-denominated ECBs and Indian currency (INR)-denominated ECBs.
Commonly used forms of ECB	I. Loans II. Securitised instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares and debentures) III. Buyers' credit IV. Suppliers' credit V. Foreign currency convertible bonds VI. Financial lease VII. Foreign currency exchangeable bonds
Available routes	The first six forms of borrowing mentioned above are allowed under the automatic route or approval route. Foreign currency exchangeable bonds are only allowed under the approval route.
Minimum average maturity period	• 3 years for both FCY-denominated ECBs and INR-denominated ECBs • 5 years, where ECB is raised from foreign equity holder and utilised for working capital purposes, general corporate purposes or repayment of Rupee loans • 7 years, where ECB is raised for repayment of rupee loans availed for capital expenditure • 10 years, where ECB is raised for repayment of rupee loans availed for purposes other than capital expenditure • 10 years, where ECB is raised for working capital or general corporate purposes
Eligible borrowers (related to real estate)	All entities eligible to receive FDI.
All in cost	The benchmark rate plus 450 basis points
End-use restrictions (related to real estate)	ECBs cannot be used for real estate-related activities, investment in capital markets or equity or to purchase land. However, they can be used for development of integrated townships or affordable housing projects.

NCDs that are subscribed to by FPIs are not subject to ECB regulations mentioned above.

2. Income tax

The tax implications on ECBs are provided below:

2.1 Interest

Particulars	Implications
In the hands of the company	Interest paid on ECB (loan/debenture) to investors should be available as a tax deductible expense subject to provisions and thin capitalisation rules (refer section on NCDs).
In the hands of the investor	**Non-resident (subject to treaty benefit)** • WHT at the rate of 5% by the company* • WHT at the rate of 20%/40% by the company in other cases

**Assuming the conditions mentioned under section 194LC of the ITA are satisfied and loan is borrowed before 30 June 2020*

Exit under ECB (loan or debenture) does not generally attract income tax in India, assuming only the principal is repaid.

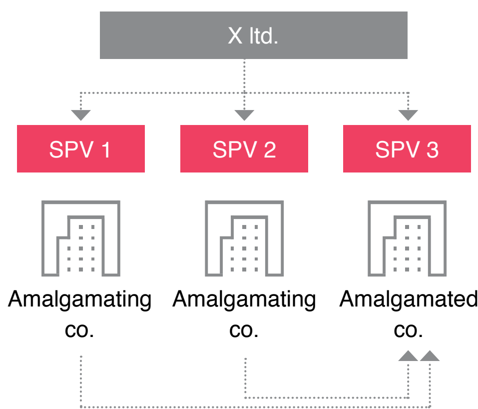
3

Internal restructuring

The corporate structures of real estate developers are highly complex and often consist of various SPVs that hold land parcels. Over a period of time, it becomes increasingly difficult to manage such structures due to administrative and regulatory compliances. Therefore, in order to simplify their corporate structures, real estate developers can consider various options to consolidate the entities. The ensuing paragraphs discuss the various tax and regulatory implications on two consolidation options, (a) merger and (b) demerger.

Merger of group entities

A vanilla merger, wherein two or more entities are combined into one, is one of the simplest ways to consolidate group companies. In India, a merger requires the approval of the NCLT and certain other regulatory authorities such as RD, RoC and Official Liquidator (OL). It is a tax-neutral transaction if certain conditions mentioned in the ITA are complied with. A pictorial representation of the transaction is given below.



The conditions for a merger to be tax neutral are provided below:

- All the properties of amalgamating companies become the property of the amalgamated company.
- All the liabilities of the amalgamating companies become the liabilities of the amalgamated company.
- Shareholders who hold not less than three-fourths of the value of shares in amalgamating companies become shareholders in the amalgamated company (except where shares are held by the amalgamated company or through its nominee or its subsidiaries).

1. Income tax

1.1. The key tax implications on mergers are given below:

Particulars	Implications
Capital gains	Tax impact in the hands of:
	Amalgamating company As per section 47(vi) of the ITA, transfer of capital assets by an amalgamating company is exempt from capital gains.
	Shareholders of amalgamated company As per section 47(vii) of the ITA, exchange of shares of an amalgamating company for the shares of an amalgamated company by shareholders is also exempt.
Particulars	**Implications**
Section 56	Implications under section 56(2)(viib) should be considered and analysed. Exemption is available to an amalgamated company and the shareholders of an amalgamating company under section 56(2)(x) of the ITA.
Cost of assets in the hands of an amalgamated company	Tax written down value (in the case of depreciable assets) and existing cost (in the case of capital assets), in the hands of an amalgamating company.
Brought forward losses or unabsorbed depreciation of amalgamating companies	Brought forward losses will not be available in the hands of an amalgamated company as 'real estate' will not be considered an 'industrial undertaking' under section 72A of the ITA.

2. Indirect tax

No GST is payable in case of merger of group entities, since the same is done under a corporate action or arrangement wherein the shareholders of one company will be allotted the shares of another company. As such there is no supply of goods or services, which is an essential criterion for the levy of GST. As per the provisions, where there is a change in the constitution of a registered person on account of merger with the specific provisions for transfer of liabilities, the said registered person will be allowed to transfer the input tax credit, which remains unutilised in his electronic credit ledger to such merged company in such manner as may be prescribed.

3. Regulatory approvals

A scheme of amalgamation should be filed under section 230–232 of the Companies Act, 2013, and requires the approval of the NCLT. There are certain other regulatory approvals required, which are mentioned below.

- Approvals will also be sought from the ROC, RD, OL and the Income Tax authorities should be intimated.
- In the case of listed companies or NBFCs, the approval of SEBI/stock exchanges and the RBI (as applicable) would also be required.

4. Stamp duty-related implications

A merger is subject to stamp duty in India. Stamp duty is payable on the NCLT order approving the merger in the state where the registered offices of the companies are located. The majority of state stamp duty laws have specific entries[10] for mergers.

In addition to the above, stamp duty is also be payable on any immovable properties that are transferred pursuant to the merger.

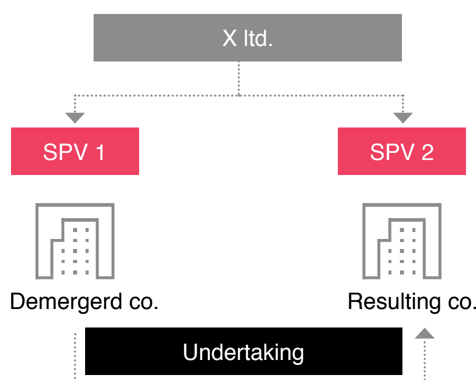
10 Where the specific entry for levying stamp duty on merger is not provided, stamp duty may be paid under the entry of conveyance as per judicial pronouncements.

Details of stamp duty entries on mergers in some states are given below.

State	Entry
Maharashtra	Subject to a maximum of 10% of the market value of shares allotted as consideration, the stamp duty will be the higher of: • 5% of the market value of the immovable property located within the state of Maharashtra of the transferor company • 0.7% of the market value of shares allotted as consideration, subject to a maximum of INR 25 crore. The following points are to be noted: I. Mergers of wholly owned subsidiaries with a holding company may not attract stamp duty as no consideration is paid in Maharashtra.
Gujarat	The stamp duty will be the higher of: • 1% of market value of the immovable property of the transferor company located within the state of Gujarat • 1% of the fair value of shares allotted as consideration, subject to a maximum of INR 25 crore.
Delhi	3% of consideration paid (no specific entry for merger)
Karnataka	The stamp duty will be the higher of: • 3% of the market value of the property • 1% of the consideration issued (including shares cancelled).
Tamil Nadu	The stamp duty will be the higher of: • 2% of the market value of immovable property • 0.6% of the market value of shares issued.

Demerger of undertaking from group entities

A demerger refers to the segregation of the business or divisions of a company. Typically, where there are two or more than two divisions or undertakings, the company segregates one or more divisions by way of a demerger with another company. This helps in the segregation of a businesses in a tax-efficient manner. The demerger process in India requires the approval of the NCLT and certain other regulatory authorities such as the RD and RoC. The following is a pictorial representation of a transaction:



The conditions for a demerger to be tax neutral are given below:

- All the properties relating to the undertaking of a demerged company are transferred to the resulting company.
- All the liabilities relating to the undertaking of a demerged company become the liabilities of the resulting company.
- Assets and liabilities forming a part of the undertaking are transferred at their book value.
  - As per the Finance Act, 2019, the above requirement does not apply to a resulting company, recording the assets and liabilities at values different from the values appearing in the books of the demerged company in compliance with Indian Accounting Standards (Ind AS).
- The transfer of undertaking is on a going concern basis.
- Shareholders who hold not less than three-fourths of the value of the shares in a demerged company become shareholders in the resulting company (except in a situation where the shares are held by the resulting company, or through its nominee or subsidiaries).
- Shares are issued to the shareholders of the demerged company on a proportionate basis.

1. Income tax

1.1. The key tax implications for demergers are given below:

Particulars	Implications
Capital gains	Tax-related impact in the hands of: **Demerged company** As per section 47(vib), transfer of capital assets by a demerged company is exempt from capital gains. **Shareholders of demerged company** As per section 47(vid) of the ITA, transfer or issue of shares by the resulting company to the shareholders is also exempt.
Section 56	Implications under section 56(2)(viib) should be considered and analysed. Exemption is available to the resulting company and the shareholders of the demerged company under section 56(2)(x) of the ITA.
Cost of assets in the hands of the resulting company	The tax written down value (in the case of depreciable assets) and existing cost (in case of capital assets), in the hands of the demerged company.
Brought forward losses or unabsorbed depreciation of the demerged company	To the extent, losses relate to the undertaking directly, such losses should be carried forward by the resulting company. Losses that do not relate to any undertaking should be split in the ratio of assets divided between the demerged company and the resulting company.

2. Indirect tax

In the new taxation regime, no GST shall be payable in case of demerger of undertaking between group entities as the same is done under a corporate action/arrangement wherein the shareholders of one company would be allotted the shares of another company. As such there is no supply of goods or services which is the essential criteria for the levy of GST.

Further, GST law prescribes that the ITC shall be transferred to the resulting company in the ratio of value of assets of the new units as specified in the demerger scheme.

3. Regulatory approvals

Regulatory approvals required for a demerger are similar to approvals needed for a merger, as mentioned above. However, no approval is required from the OL for a demerger.

4. Stamp duty related implications

A demerger is subject to stamp duty in India. Stamp duty is payable on the NCLT order approving the demerger in the state where the registered offices of the companies are located. The majority of state stamp duty laws have specific entries[11] for demergers.

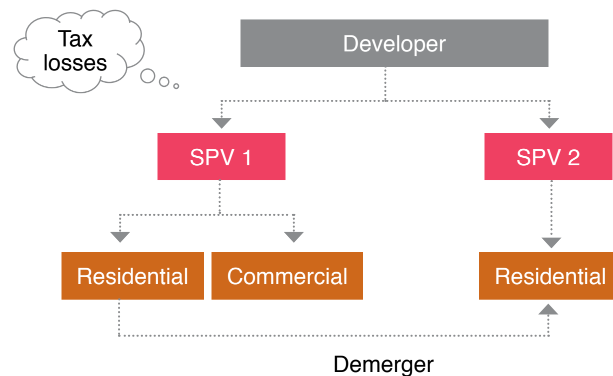
Furthermore, stamp duty should also be payable on any immovable properties that are transferred pursuant to a demerger.

Stamp duty entries on a demerger are similar to the entries on a merger, as mentioned above.

5. Case study

A developer has a commercial and a residential real estate project in an existing SPV. The residential projects of the SPV have substantial tax losses. The developer is looking for an investor who will invest in its residential projects.

Keeping in mind this objective, the following structure can be considered by the developer.



Key mechanics:

- SPV to demerge its 'residential business' into SPV2 through an NCLT-approved scheme of arrangement

Key points for consideration:

- There are no adverse tax implications for the demerger, assuming that the conditions mentioned in the ITA are satisfied.
- Stamp duty is payable on the demerger.
- The residential project's tax-related losses are to be transferred to SPV2 on the demerger (as per section 72A of the ITA). The benefits of this can be availed by SPV2, but this needs to be commercially discussed with the investor while finalising the valuation of SPV2.
- Approvals are required from the NCLT and other regulatory authorities.

11 Where the specific entry for levying stamp duty on demerger is not provided, stamp duty may be paid under the entry of conveyance as per judicial pronouncements.

4

Affordable housing

Affordable housing refers to the development of household units to address the housing needs of low and middle income households. The Government has devised various policy initiatives and tax exemptions in this regard, which are in line with its vision of 'Housing for All by 2022'. In a major relief to the housing sector, the then Finance Minister, Shri Arun Jaitley accorded 'infrastructure' status to affordable housing, giving a much-needed thrust to the sector. This section discusses the benefits of the Government's policy and tax incentives.

Conferring 'infrastructure' status on the affordable housing segment will make borrowing for projects easier, since it will permit increased tenure of loans, reduced interest rates and improved terms. This will help in reducing developers' costs of borrowing, which in turn, will help in bringing down the cost of housing. This new status will open up many funding options by allowing insurance companies, pension funds and other sovereign funds to invest in the sector. Moreover, ECBs will also be available. The 'infrastructure' status accorded to the sector will simplify the approval process for affordable projects, provide clear guidelines and increase transparency in the affordable housing segment.

1. Income tax

In a bid to give impetus to affordable housing, section 80-IBA was introduced in the Finance Act, 2016, which grants profit-linked tax exemption. The section provides 100% tax exemption on profits earned on an affordable housing project, subject to certain conditions. The regulations or conditions governing the exemption have been relaxed through Finance Act, 2019 and applicable for projects approved on or after 1 September 2019.

The key regulations for claiming tax exemption under section 80-IBA of the ITA are as under:

Sr. no.	Particulars	Conditions
1	Project approval by a competent authority	On or after 1 September 2019
2	Project completion	Within five years from the date of approval
3	Size of a plot of land	• Not less than 1,000 sq. m in cities such as Delhi, National Capital Region (limited to Delhi, Noida, Greater Noida, Ghaziabad, Gurugram, Faridabad), Mumbai (whole of Mumbai Metropolitan Region), Chennai, Hyderabad and Kolkata • Not less than 2,000 sq. m in any other place
4	Carpet area of a residential unit	• Does not exceed 60 sq. m in cities such as Delhi, Delhi National Capital Region (limited to Delhi, Noida, Greater Noida, Ghaziabad, Gurugram, Faridabad), Mumbai (whole of Mumbai Metropolitan Region), Chennai, Hyderabad and Kolkata • Does not exceed 90 sq. m in any other place
5	Stamp duty value of residential unit	• Does not exceed INR 45 lakh
6	Utilisation of the floor area ratio	• Not less than 90% in cities such as Delhi, Delhi National Capital Region (limited to Delhi, Noida, Greater Noida, Ghaziabad, Gurugram, Faridabad) Mumbai (whole of Mumbai Metropolitan Region), Chennai, Hyderabad and Kolkata Not less than 80% for any other place

While a tax incentive has been provided by means of a tax holiday, a company may have to pay MAT at the rate of 15%^.

Even an LLP which undertakes an affordable housing project, it will also be liable to pay AMT at the rate of 18.5%^ assuming it claims deduction u/s 80-IBA.

^ plus applicable surcharge and cess

2. Indirect tax

Supply of under-construction flats under affordable housing segment attracts an effective GST rate of 8% (12% less 1/3rd deduction for the value of land). However, sale of a building (on receipt of the entire consideration following issue of the completion certificate or first occupation certificate, as mandated under Schedule II of the Act), should be exempt under GST. However, reversal of ITC due to exempt supply, if any, will be required.

Changes with effect from 1 April 2019

Supply of under-construction flats in the affordable housing segment attracts an effective GST rate of 1% (1.5% less 1/3rd deduction for the value of land). However, sale of a building (on receipt of the entire consideration following issue of the completion certificate or first occupation certificate, as mandated under Schedule II of the Act) should be exempt under GST. However, reversal of ITC due to exempt supply, if any, will be required.

Under the new scheme of taxation, an affordable residential apartment will mean a residential apartment with carpet area not exceeding 60 sqm. in metropolitan cities and 90 sqm. in cities or towns other than metropolitan cities for which the gross amount charged is not more than INR 45 lakh.

The gross amount will be considered the amount charged for supply of construction services, that charged for transfer of land or lease and any other amount charged to the buyer including preferential location charges, development charges, parking charges, common facility charges, etc.

5

Real Estate Investment Trust (REIT)

An REIT is an investment platform for small investors and a breather for entities engaged in the sector. Against this backdrop, SEBI had introduced REIT as a platform for trading.

1. What is an REIT?

In common parlance, an REIT is a SEBI-registered investment vehicle that owns and operates real estate assets and allows institutional and retail investors to earn stable and low-risk income generated through ownership of commercial or retail real estate.

2. What's in it for developers or sponsors?

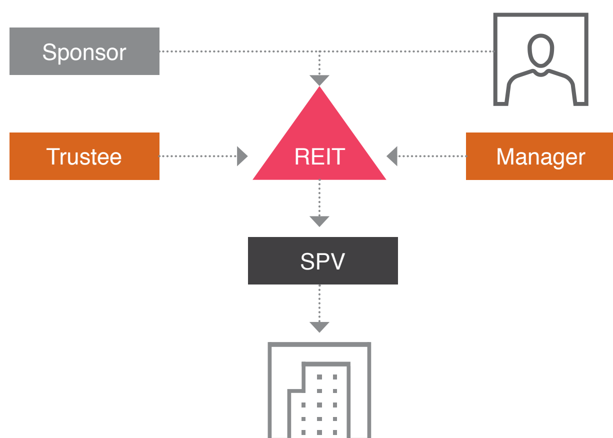
A sponsor or developer is required to swap his or her properties, assets or holdings in SPVs holding the assets to a REIT in consideration of its units. These units should be offered to the public and generate liquidity for sponsors or developers. The REIT model provides an opportunity to monetise existing assets and reduce debt.

3. What's in it for investors?

Globally, REITs have been key drivers for development in real estate as they provide an investment platform for retail and institutional investors.

Since the platform is regulated, it reduces the inherent risks and provides investors opportunities to invest in stable return-generating instruments with low risk to capital. A REIT, being a listed platform, provides an easy entry and exit option to new as well as existing investors.

4. Typical REIT structure:



A brief description of the parties involved in a REIT structure is given below:

- **Sponsor:** A sponsor is akin to a promoter in an IPO. Typically, a sponsor is a developer who owns real estate and is the one who sets up a REIT.
- **Trustee:** A trustee is an independent person who manages a REIT on behalf of a unitholder, in accordance with SEBI's regulations.
- **Manager:** A manager is an entity who manages the assets and investments of a REIT and undertakes operational activities.

5. Regulatory implications

REITs are governed by SEBI regulations. This is elaborated in the table below:

Particulars	Regulations
Key investment conditions	**Asset-related conditions** • At least 80% of the value of an REIT is to be in completed and rent-generating real estate, with a lock-in period of three years from the purchase date. • A maximum of 20% of the total value of REITs can be from: - Under construction properties with a lock-in period of three years after completion - Listed or unlisted debt of real estate companies - Mortgage-backed securities - Equity of listed and unlisted companies in India, generating at least 75% of their operating income from real estate activities - Government securities - Unutilised FSI and TDR with respect to existing investments - Cash or money market instruments **Additional conditions:** • Direct holding of real estate assets in India or through a hold company or an SPV • Investment not permitted in vacant land, mortgages or agricultural land (with certain exceptions) • Investment in another REIT or lending not permitted (other than into the Hold Co. /SPV) • Unitholders' approval required for disposal of a REIT's/Hold Co.'s assets or interest in an SPV if it exceeds 10% of the value of the assets in a financial year

Distribution policy	• A minimum of 90% of the net distributable cash flow of a REIT/Hold Co. • With respect to cash flows received from SPVs by Hold Co., 100% of such cash flow shall be required to be distributed • Distribution to be undertaken at least once every six months • At least 90% of sale proceeds to be distributed unless reinvestment is proposed within a period of 1 year
Public offer	• Minimum value of REIT assets: INR 500 crore • Minimum public float: 25% • Minimum offer size: INR 250 crore • Minimum subscription amount: INR 50,000 per applicant • Trading lot: 100 units • Minimum number of subscribers: 200
Sponsors' holdings	• Minimum post-IPO holding of at least 25% - Three-year lock-in period of 25% for a post-IPO holding - One-year lock-in period for the balance for a post-IPO holding • Sponsors' (on consolidated basis) should hold at least 15% perpetually • Each sponsor is individually required to hold at least 5% • Divestment of 15% of sponsor's continued holding subject to the following: - Completion of a three-year lock-in period from the listing date - Another sponsor acquiring the minimum holding with the prior approval of unitholders

6. Income tax

With the advent of REITs in Indian stock markets, the Government has recently introduced various income tax measures to ensure that REIT regulations are at par with world standards and there are effective REIT listings in India. A brief overview of the tax incidence in the hands of various parties involved is as follows:

1. In the hands of a sponsor or developer (on setting up of a REIT)

Income stream	Resident/Non-resident
Swap of shares of companies (holding assets) to a REIT	Capital gains to be exempt; MAT not applicable on the gains arising on account of the swap
Swap of assets to a REIT	Taxable

2. In the hands of a REIT

Income stream	From an SPV	Direct ownership
Rent	Taxable at SPV	Pass-through for REITs (tax incidence on unitholders)
Dividend	Pass-through: Possible to take a view that section 115BBDA of the ITA may not apply if SPV is classified as a specified domestic company	NA
Interest	Pass-through	NA
Capital gains	Taxable	Taxable

3. In the hands of unitholders (including sponsors)

Income stream	Resident	Non-resident
Rent from REITs	Taxable at applicable rates	Taxable at applicable rates (subject to benefit of treaty)
Dividend	Exempt: Possible to take a view that section 115BBDA of the ITA may not apply	Exempt
Interest	Taxable at applicable rates (WHT at the rate of 10%)	WHT at the rate of 5% (final tax under domestic law)
Capital gains on the sale of units on the floor of stock exchange (subject to securities transaction tax)	LTCG[12] : Taxable at the rate of 10%^ (without indexation) STCG: Taxable at the rate of 15%^ MAT[13] applicable for companies	LTCG: Taxable at the rate of 10%^(without indexation) (subject to treaty benefit) STCG: Taxable at the rate of 15%^ (subject to tax treaty benefit)

^Plus applicable surcharge and cess

7. FEMA

Investment by non-resident unit holders in an REIT is governed by Rule 6(c) read with Schedule VIII of the Foreign Exchange Management (Non-dent Instruments) Rules, 2019. These rules primarily provide that:

- Foreign investments in an REIT are allowed under the automatic route and downstream investment by an REIT will not be subject to restrictions under FEMA such as pricing guidelines and sectoral caps if the sponsor and the manager of the REIT are Indian-owned and controlled.

8. Conclusion

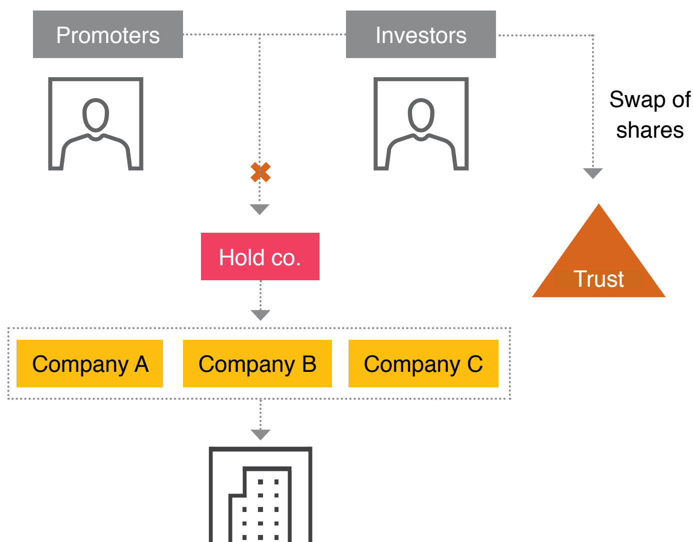
REITs could be a game changer for the Real Estate and Infrastructure sector. They could redefine funding strategies and provide a lucrative platform for retail and institutional investors to reap benefits. With the Government giving REITs a much-needed boost in the regulatory and tax field, the market for these investment vehicles is expected to grow at a rapid pace in the future, helping to accelerate growth in the Indian economy.

12 Units held for more than 36 months will be considered as long term.

13 MAT will be chargeable at the rate of 0%/15% (plus applicable surcharge and cess).

9. Case study

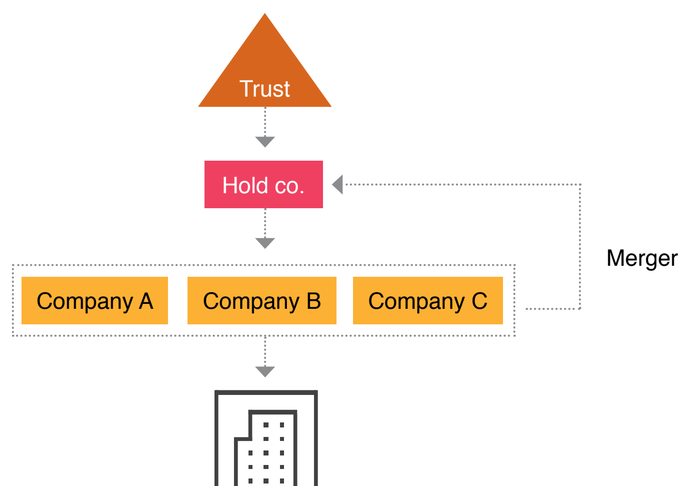
A real estate developer with a multi-tier structure wants to list a REIT in India. In order to do so, the promoters and investors will swap their shares in the holding company for units in the REIT. Given below is a pictorial representation of this:



While such a swap is permitted under SEBI's guidelines, there are some tax implications that may need to be kept in mind:

- No DDT exemption is available for a dividend declared by company A, B or C to hold co.
- If the loan is routed through hold co., the REIT may be entitled to take the benefit of an interest pass-through. It must be kept in mind that there will be WHT implications on the interest paid by company A, B or C to hold co.

In view of the above, the following structure may be considered by a developer or promoter:



Key mechanics:

- Company A, B or C is to be merged with Hold co. through an NCLT-approved scheme of amalgamation (post listing or prior to listing),

Key points for consideration:

- There will be no adverse tax-related implications on the merger, assuming conditions mentioned in the ITA are satisfied.
- Stamp duty is payable on the merger.
- Approval is required from the NCLT and other regulatory authorities.
- After the merger, DDT exemption on the dividend from company A, B or C to the REIT is available, assuming the REIT holds the entire equity share capital of company A, B or C.
- After the merger, interest income received by the REIT from company A, B or C should be eligible for interest pass-through, without any withholding at SPV level.

6

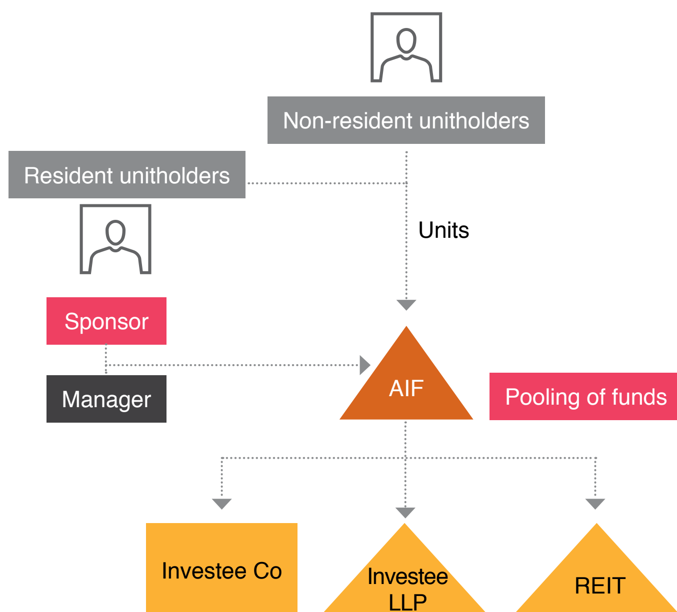
Alternate Investment Fund (AIF)

AIFs raise funds from institutional investors and high net worth individuals to invest in alternative investments and include venture capital funds, private equity funds, social venture funds, etc.

1. What is an AIF?

An AIF is a privately pooled investment vehicle, set up as a company, LLP or trust, regulated by SEBI's regulations. It can collect funds from both Indian and foreign investors and is not subject to any other SEBI regulations relating to its fund management activities.

2. Typical AIF structure



A brief description of the parties involved in an AIF structure is given below:

- **Sponsor**: A sponsor is the person who sets up the AIF, and includes a promoter in the case of a company and a designated partner in the case of LLP.
- **Manager:** A manager is an entity who manages the investments of an AIF.
- **Trustee:** In the case of an AIF set up as a trust, a trustee manages the AIF on behalf of the unitholders, in accordance with SEBI's regulations, and may also appoint a manager.

3. Categories of AIFs

AIF regulations specify three categories of AIFs. Typically, from a transaction standpoint, Category I and II are relevant. We have therefore evaluated only Category I and II AIFs. A brief description of Category I and II AIF is given below:

Parameters	Category I	Category II
Categorisation as per SEBI regulations	Funds with strategies to invest in start-ups or early stage ventures, SMEs or other sectors, which the Government or regulators think socially or economically desirable Includes venture capital funds, SME funds, social venture funds, infrastructure funds	Funds that cannot be categorised as either Category I AIFs or Category III AIFs Includes private equity funds or debt funds with no specific incentives or concessions given by the Government
Open- or close-ended fund	Close-ended fund	Close-ended fund
Tenure	Minimum three years; extension of term possible up to two years subject to conditions	Minimum three years; extension of term possible up to two years subject to conditions
Investment in one investee company	Not more than 25% of investible funds	Not more than 25% of investible funds
Investment in other AIFs	Investment in Category I AIF permissible	Investment in Category I and II AIF permissible

4. Regulatory implications

AIFs are governed by SEBI (Alternative Investment Funds) Regulations, 2012. SEBI's regulations governing AIFs are provided below

Particulars	Regulations
Key investment conditions	• The minimum corpus of an AIF should be INR 200 million. • Unitholders can hold units of a minimum value of INR 10 million. This limit has been reduced to INR 2.5 million for employees, managers or directors of AIFs. • The total number of unitholders is restricted to 1,000. In the case of companies, the restrictions of the Companies Act, 2013 will apply. • AIFs should not solicit or collect funds except by way of private placement. • Investments by Category I or II AIFs in shares of listed companies on institutional trading platform will be deemed to be investment in unlisted securities.
Sponsor or manager holdings	Contribution per AIF by manager or sponsor in the form of an investment in AIF (not by waiver of management fees) as under: • Category I or II AIFs: Continuing interest of at least 2.5% of the corpus or INR 50 million, whichever is lower
Listing	• Units of close-ended AIFs may be listed on a stock exchange, only after final closure of the fund or scheme, subject to minimum tradeable lots of INR 10 million.

5. Income tax

SEBI registered Category I AIFs and Category II AIFs have been accorded a tax pass through status under the ITA.

A brief overview of a tax incidence in the hands of various parties (assuming AIF as Trust):

1. In the hands of an AIF

Income stream	Category I/II AIF
Business income	Taxable in hands of AIF
Other than business income	Pass through for AIF (tax incidence on unitholders)
Withholding On payments made to AIF:	
In nature of business income	Applicable
In nature of other than business income	Not applicable

2. In the hands of unitholders (including sponsors) of Category I and II AIFs

Income stream	Resident	Non-resident
Income distributed by AIF		
1. Business income	Exempt	Exempt
2. Other than business income	WHT at the rate of 10% by AIF	WHT at rates in force (subject to treaty benefit) by AIF
Interest	Taxable at applicable rates	Taxable at rates in force (subject to treaty benefit)
Dividend	Exempt, subject to applicability of 115BBDA	Exempt
Capital gains	Taxable at applicable rates depending on the nature of the gain MAT may be payable if applicable	Taxable at rates in force (subject to benefits of treaty), depending on the nature of gain
Capital gains on sale of units of the AIF	LTCG: Taxable at the rate of 20%^ STCG: Taxable at applicable rates	Taxable at rates specified below(subject to treaty benefit) LTCG: Taxable at the rate of 20%^(with indexation) STCG: Taxable at applicable rates

^Plus applicable surcharge and cess

The Finance Act, 2019, has extended the exemption from applicability of provisions of section 56(2)(viib) of the ITA (as described earlier), to include Category II AIFs.

6. FEMA

Investment by non-resident unit holders in a REIT is governed by Rule 6(c) read with Schedule VIII of the Foreign Exchange Management (Non-dent Instruments) Rules, 2019. These rules primarily provide that:

- Foreign investments in an AIF are allowed under the automatic route and downstream investment by an AIF will not be subject to restrictions under FEMA, such as pricing guidelines and sectoral caps only if the sponsor and the manager of the AIF are Indian owned and controlled.

7. Conclusion

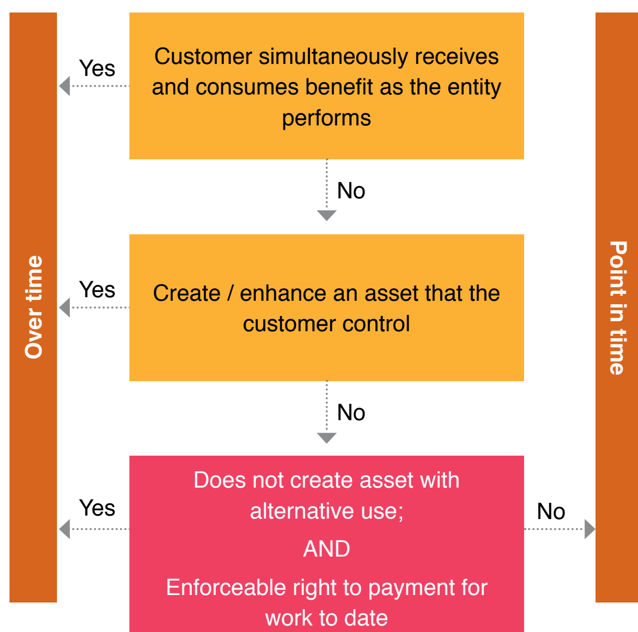
The regulatory framework for AIFs has evolved over a period of time. With the Government focusing on providing a flexible regime for foreign investors to invest in India, the amendments in the AIF regulatory regime provides an impetus to Indian fund managers to set up domestic funds and invest in identified Indian investment opportunities.

7

Revenue Recognition

IND AS 115 – Revenue from Contracts with Customers

1. Ind AS 115 on Revenue from Contracts with Customers was notified by the Ministry of Corporate Affairs on 28 March 2018, effective from accounting periods beginning on or after 1 April 2018. Ind AS 115 replaces existing revenue recognition guidance prescribed by Ind AS 11, 'Construction contracts', Ind AS 18, 'Revenue' and Guidance Note on Accounting for Real Estate Transactions issued by ICAI for entities to whom Ind AS is applicable.
2. The core principle of Ind AS 115 is that an entity will recognise revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The core principle is described in a five-step model framework:
   - Step 1: Identify the contract with the customer
   - Step 2: Identify the separate performance obligations in the contract
   - Step 3: Determine the transaction price



   - Step 4: Allocate the transaction price to separate performance obligations
   - Step 5: Recognise revenue when (or as) each performance obligation is satisfied
3. Ind AS 115 states that a performance obligation is satisfied over time when at least one of the following criteria is met:
4. The last criterion was developed to assist entities in their assessment of control in situations where applying the first two criteria for recognising revenue over time is challenging.
5. Based on above, the real estate developer shall be able to recognise revenue over time i.e. on percentage of completion method if any of the aforementioned criteria are satisfied, else the revenue shall be recognised at a point in time i.e. project completion method. Timing of revenue recognition is crucial and may have a bearing on the computation of taxes.
6. The right to payment for performance to date is met if an entity is entitled to payment for performance completed to date, at all times during the contract term, even if the customer terminates the contract for reasons other than the entity's non-performance. In assessing whether a right to payment is enforceable, management should consider relevant laws or regulations in addition to the contract terms. An entity's enforceable right to payment for performance completed to date will generally be evidenced by the contractual terms agreed to by the parties. However, legislation or legal precedent in the relevant jurisdiction might supplement or override the contractual terms. An entity asserting that it has an enforceable right to payment despite the lack of a contractual right should have sufficient legal evidence to support this conclusion. The fact that the entity would have a basis for making a claim against the counterparty in a court of law is not sufficient to support that there is an enforceable right to payment.
7. Few factors to determine whether there is an 'enforceable right to payment for work to date' are given below and this assessment may require significant judgement:
   - Whether the customer has a right to terminate the contract at any time or not.
   - If a customer acts to terminate the contract without having right to terminate the contract at that time (including when a customer fails to perform its obligations as promised), whether the contract (or other laws) might entitle the entity to continue to transfer to the customer the goods or services promised in the contract and require the customer to pay the consideration promised in exchange for those goods or services.
   - Whether entity has a customary business practice of not enforcing right to payment clauses in its contracts? Would such a business practice render the right unenforceable in a particular legal environment.
   - Whether the payments at least compensate the entity for performance to date. Whether the payments by customer are non-refundable in the event of a contract cancellation (for reasons other than non-performance).
   - Whether milestone payments are based on developer's performance? A specified payment schedule may not necessarily indicate that the entity has a right to payment for performance.

Income Computation and Disclosure Standards (ICDS)

8. ICDS were notified by CBDT on 29 September 2016 and were made applicable for computing income from FY 2016-17 onwards.
9. ICDS on construction contract prescribe contractors to follow the percentage of completion method (POCM) for computing income from such contracts.
10. The CBDT had released draft ICDS on real estate transactions for public comments, which prescribes the real estate developers to follow percentage of completion method for computing income from real estate projects. However, it has not been notified.

Against such a backdrop, it is necessary to assess the impact on the taxes of an entity which follows two distinct approaches of recording income under accounting provisions and tax provisions.

Glossary

Abbreviation	Full form
AMT	Alternate Minimum Tax
AOP	Association of Persons
AE	Associated Enterprise
CCD	Compulsorily Convertible Debenture
CGST	Central Goods and Services Tax Act, 2017
CPS	Committed Portfolio Size
DDT	Dividend Distribution tax
DIPP	Department of Industrial Policy and Promotion
EBIDTA	Earnings before Interest, Tax, Depreciation and Amortisation
ECB	External Commercial Borrowing
FDI	Foreign Direct Investment
FEMA	Foreign Exchange Management Act, 1999
FMV	Fair Market Value
FPI	Foreign Portfolio Investor
FSI	Floor Space Index
GST	Goods and Services Tax
HUF	Hindu Undivided Family
INR	Indian Rupee
IPO	Initial Public Offering
ITA	Income-tax Act, 1961
ITC	Input Tax Credit
JDA	Joint Development Agreement
JV	Joint Venture
LLP	Limited Liability Partnership
LTCG	Long-term Capital Gains
MAT	Minimum Alternate Tax
MMR	Maximum Marginal Rate
NAV	Net Asset Value

Abbreviation	Full form
NBFC	Non-banking Finance Company
NCD	Non-convertible Debentures
NCLT	National Company Law Tribunal
OL	Official Liquidator
PE	Private Equity
RBI	Reserve Bank of India
RD	Regional Director
REIT	Real Estate investment Trust
ROC	Registrar of Companies
SEBI	Securities Exchange Board of India
SEZ	Special Economic Zone
SPV	Special Purpose Vehicle
STCG	Short-term Capital Gains
TDR	Transferrable Development Rights
VAT	Value-added Tax
WHT	Withholding Tax

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Please note:

- We have not assessed the effect of the provision of GAAR on the case studies described in the foregoing paragraphs, either as a whole or with regard to each step in the overall process.
- Stamp duty is a state-specific topic and is subject to frequent changes. Therefore, the stamp duty implications mentioned in this report are based on desktop research and should be verified with the local consultant.
- We have not commented in detail on the transitional aspects of open contracts pursuant to the amendment in GST rates in March 2019.

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