# How the tax equation changed for REITs and InvITs from April 1, 2020

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Indian infrastructure investment trusts (InvITs) and real estate investment trusts (REITs) have drawn investments from some of the largest global institutional investors, sovereign wealth funds and pension funds. According to sources, since their introduction in India, InvITs and REITs have together raised more than $3.6 billion of capital.

These vehicles (together referred to as 'business trusts') have significant potential to aid the government in achieving its targets of massive infrastructure development and give a fillip to the commercial realty market in the country.

Unlike other countries, India introduced the framework for these structures a little late. The regime could not pick up until the following steps were taken:

(i)income-tax law was amended by recognising 'business trusts' as tax pass through vehicles (for dividend and interest income from its investments in a special purpose vehicle (SPV));

(ii)investments were incentivised by providing concessional tax rate of 5% on interest up-streamed by the business trusts to non-resident investors; and

(iii) tax exemption was allowed on dividends distributed by the SPVs which were neither subject to a dividend distribution tax (DDT) in the hands of the SPVs (subject to conditions) nor any tax in the hands of the business trust and unitholders.

A tax deferral was also provided to sponsors contributing shares of the SPVs to the business trusts in lieu of units thereof such that any gains on exit will only be realized and taxed when units are sold and not when the shares are transferred to the SPVs.

After the changes introduced in the Finance Act, 2020 (which received Presidential assent on March 27, 2020 and is now in force), the question is – will these structures continue to remain equally attractive?

We analyse here how the tax amendments could potentially impact these structures and the considerations to be kept in mind.

With effect from April 1, 2020, there has been an overhaul of India's dividend tax regime. Until now Indian companies were required to pay DDT and shareholders (except non-corporate residents) were exempt. Going forward, the tax incidence will shift from the company to the shareholders.

In case of business trusts, dividends used to be exempt at each level (albeit subject to some conditions), however, as part of the new dividend taxation regime, the government did not announce any relief specific to the investors in business trusts in its Budget tax proposals, which raised questions regarding attractiveness of these structures.

There were divided views on fairness of this tax change resulting in levy of tax on income which used to be exempt – some did not find it unfair as the government had rationalised the corporate tax rate itself earlier last year. To alleviate the larger concern with respect to taxable dividends, Parliament amended the tax proposals while approving the Finance Bill, whereby the taxability of dividends was made subject to whether or not the SPV has opted for the recently announced concessional corporate tax regime.

If the SPV has opted to be taxed at the concessional corporate tax rate of 22% (against the general rates of 25%/30%), the dividends declared by the SPV will be taxable in the hands of the unitholders and the business trust would be required to withhold tax at the rate of 10% when distributing income representing dividends received from SPVs.

If the SPV has not opted for the concessional corporate tax rate, then dividends would be exempt. The objective seems to be extending one benefit – either exempt dividends or concessional corporate tax rate at the SPV level.

With respect to the effective tax rate on dividends which are taxable, investors should note that while withholding tax is capped at 10%, there is no corresponding amendment to the provision which prescribes special tax rates for dividend income, which for non-residents is 20% (plus applicable surcharge and cess) and for residents, the dividend income will be taxable at ordinary rates (highest slab rate being 30% plus surcharge and cess).

One should also note that the higher rates of surcharge of 25% and 37% (introduced last year for non-corporate taxpayers) would not apply to dividend income.

Further, in the absence of any express carve out from the general withholding tax provision, the SPVs will be required to withhold tax (at the rate of 10%) when distributing dividends to a business trust – even though it is a tax pass through vehicle with respect to such dividend income. Therefore, both business trusts and SPVs would be required to withhold tax at 10% and unless clarified further, this could lead to cashflow issues.

From an overall perspective, going forward, the key structuring considerations would be- tax residence of the investors, whether the SPV should opt for the concessional corporate tax regime, and debt – equity ratio at the SPV level. With respect to the cashflow issue where the SPV withholds tax on dividend distribution, one could approach the government for clarity or follow the procedure of obtaining a nil withholding tax certificate.

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