

## Suggested amendments to the tax provisions for Real Estate Sector

Sr.	Suggested Amends	Rationale	Changes to the Income Tax Act, 1961
<b>1. Treatment to Business Trusts equivalent to listed entities</b>			
<b>1a</b>	<b>Exemption from Section 2(22)(e)</b>	Business Trusts may invest in a number of Holding companies/ SPVs and it is likely that there may be surplus funds available in one Holding company/ SPV which can be productively lent to another Holding company/ SPV. Considering provisions of Section 2(22)(e), such loans may have adverse tax implications. Provisions of Section 2(22)(e) do not apply to a listed company or its subsidiary. Since units of a Business Trust shall be listed and the Holding company/ SPV is its subsidiary, exemption from Section 2(22)(e) should be available to such Holding companies/ SPVs as they are available to a listed company or its subsidiary.	Insert the following sub-section (c) to Section 2(18) to the definition of “Company in which public are substantially interested”:  <i>“if it is a special purpose vehicle or a holding company referred to under Explanation to section 10(23FC).”</i>
<b>1b</b>	<b>Allow carry forward of losses on exchange of shares of SPV with units of REIT -Exemption from Section 79</b>	SEBI REIT Regulations require the REITs to hold not less than 50% in the SPV. This will lead to a change in shareholding of SPV affecting 49% of its shareholding thereby attracting the provisions of Section 79 resulting in lapse of unabsorbed losses of the SPV. There is a reason to grant exemption for such change in shareholding of SPV since this is part of transfer of asset to a REIT. Moreover, the provisions of Section 79 are not applicable to a listed companies or its subsidiary. The units of a REIT are listed and the SPV is a subsidiary, hence, the exemption should be granted for such change in shareholding so that the losses of SPV do not lapse.	Insert the following sub-section (c) to Section 2(18) to the definition of “Company in which public are substantially interested”:  <i>“if it is a special purpose vehicle or a holding company referred to under Explanation to section 10(23FC).”</i>
<b>2. Permitting 2 level holding structure</b>			
<b>2</b>	<b>Exemption from Dividend Distribution Tax (“DDT”) at the time of distribution of dividend from SPV to holding company</b>	Current structure permits exemption from DDT at the time of distribution of dividend from SPV to business trust. Given that holding company structure has also been permitted, relaxation from DDT should be provided in case of flow of dividend from SPV to holding company in order to give pass through status to a business trust structure for dividends.	Sub-section 7 of section 115-O shall be amended as follows:  <i>“No tax on distributed profits shall be chargeable under this section in respect of any amount declared, distributed or paid by the specified domestic company by way of dividends (whether interim or otherwise) to business trust <b>and/or holding company</b> out of its current income on or after the specified date.”</i>  Further, clause (a) of explanation to sub section 7 of section 115-O shall be amended as follows:  <i>“Specified domestic company” means a domestic company in which a business trust, <b>and/or holding company</b> has become the holder of whole of the nominal value of equity</i>

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		<p><i>share capital of the company (excluding the equity share capital required to be held mandatorily by any other person in accordance with any law for the time being in force or any directions of the Government or any regulatory authority, or equity share capital held by any Government or Government body);”</i></p> <p>Furthermore, clause (c) to explanation to sub section 7 of section 115-O shall be inserted as follows:</p> <p><i>“holding company shall have the meaning as defined in the explanation to clause (23FC) of Section 10”</i></p> <p><i>Also Section 10(23FC) together with the Explanation thereto and Section 47(xvii) together with the Explanation thereto be amended to include a holding company.</i></p>	
<b>3.</b>	<b>Pursuant to the provisions of Finance Act, 2018</b>		
<b>3</b>	<p><b>112A – Long term capital gains on sale of units of a business trust (REIT) proposed to be taxed @ 10% - Grandfathering not being available to REIT units and unlisted shares</b></p> <p>The benefit of grand fathering i.e. Fair Market Value on 31st January, 2018 is not made available to REIT units under the definition of ‘Fair Market Value’. For any new REIT proposal, there is no unit of a business trust on 31st January, 2018 to which the Net Asset Value (Section 55(2)(ac)) can be applied. Further, under Section 49(2AC), the cost of acquisition of a share of a SPV against which units have been allotted in a business trust is the deemed cost of acquisition. There is no quoted value of shares of SPVs available on 31st January 2018.</p> <p>While Indexation benefit has been extended to unquoted shares of companies, this does not bring the cost of acquisition of such unquoted shares at par with the Fair Market Value of similar quoted shares as at 31st January 2018. This shall be the case especially with unquoted shares of companies which have been held for a long time thereby creating a huge difference between the historical cost and its fair market value today.</p> <p>Not extending similar grandfathering benefit to unlisted shares or units of business trust will be a retrograde move and impose a huge tax burden on the shareholders of such companies.</p>	<p>Benefit of Fair Market Value on 31st January, 2018 should be extended to unlisted shares which have been swapped for units of REIT, also based on methodology detailed in Annexure 1 to this note.</p>	

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## ANNEXURE 1

### Methodology for determining Fair Market Value of unlisted shares

#### 1. Determining the acquisition cost of such unlisted shares based on the movement of the sectoral indices on a recognised stock exchange

Since stock exchanges maintain sectoral indices, values of which are quoted on the exchanges daily, considering the stock prices of companies falling under that sector, the cost of acquisition of unlisted shares which are being offered for sale through IPO can be a value proportionate to its corresponding sectoral index as on the date of listing vs. the index on January 31, 2018. Since the Fair Market Value for determining acquisition cost of listed equities is based on quoted prices, this approach will bring the method of determining cost of acquisition of unlisted shares at par.

To explain: If the Sectoral Index on say the National Stock Exchange was 4,000 on January 31, 2018 and say on the date of listing say March 31, 2019 is 5,000 when the issue price is Rs. 100 per share or unit, the cost of acquisition of such share or unit shall be determined as follows:

$$\text{Cost of acquisition} = 100 \times \frac{4,000}{5,000} = 80$$

Capital gains would therefore be Rs. 20 = Rs. 100 (issue price) – Rs. 80 (derived cost of acquisition)

This can be subject to:

- a. The Company / SPV being in existence as at January 31, 2018
- b. In case of a Business Trust Listing, at least 51% of the assets (in number) of the SPV on Business Trust listing should have been the assets of the SPV, in any form, at January 31, 2018 also.
- c. In case of any other Company, at least 51% of the total asset value on listing should have been the total asset value of the Company at January 31, 2018 also.
- d. Other provisions of the proposed Section 112A can apply to unlisted shares similar to listed shares.

#### 2. Fair Market Value as specified for listed but unquoted shares and securities under Rule 11UA(1)(c)(c) and 11UA(2)(b)

As per the Income Tax Rule 11UA(1)(c)(c), the fair market value of unquoted shares and securities of a listed company shall be estimated to be price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of such valuation. Similarly, as per Income Tax Rule 11UA(2)(b), the fair market value of unquoted equity shares in case of issue of equity shares shall be determined by a merchant banker or an accountant as per Discounted Cashflow (DCF) method. DCF is the prescribed method for valuation of shares even under FEMA also.

Similar fair value determination methodology be prescribed for computing the fair value of unlisted shares as on January 31, 2018.

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### 3. Fair Market Value as specified for unquoted equity shares under amended Rule 11UA(1)(c)(b)

As per Rule 11UA(1)(c)(b) amended vide notification dated July 12, 2017, the fair market value of unquoted equity shares shall be determined after adjusting for the other assets and liabilities as specified in the said amended Rule. The said rule interalia provides for valuation of shares of company holding immovable property considering the value adopted or assessed or assessable by any authority of the Government for payment of stamp duty in respect of the immovable property.

Similar fair value determination methodology be prescribed for computing the fair value of unquoted equity shares as on January 31, 2018.

### 4. Fair Market Value as specified for unlisted equity shares under section 55ac(iii)

As per section 55ac(iii), for unquoted shares as on 31 January 2018 which have been subsequently listed, the fair market value would be basis an amount which bears to the cost of acquisition the same proportion as the Cost Inflation Index for the financial year 2017-18 bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the first day of April, 2001, whichever is later.

Similar fair value determination methodology be prescribed for computing the fair value of unquoted equity shares as on January 31, 2018, which have been swapped for units of REIT

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