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New REIT, InvIT regime spells higher taxation for sovereign funds

Other foreign investors likely to face significantly higher taxation on cashflow distribution too

Sachin P Mampatta | Mumbai February 07, 2023 Last Updated at 16:49 IST

Tax changes in the budget may result in a higher tax outgo for sovereign wealth funds, pension funds and other foreign investors who put money into real estate and infrastructure projects.

Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) are both investment vehicles like mutual funds. The difference is in the underlying asset--while REITs hold property, InvITs hold an infrastructure asset such as a highway. Sebi's regulations require 90 per cent of cashflows in both to be distributed to investors. If they have lent to a company as part of their operations, repayment amounts are subject to similar distribution.

Investors treat the distribution in the same way as the investment vehicle under the existing tax rules. This means that if a REIT received an interest payment, it was also treated as interest income when the REIT distributes the amount to its investor. Many foreign investors had zero tax to pay on loan repayments, since a repayment is not considered income. Treating it as income, as the budget indicated, would mean that their tax rate on this kind would no longer be zero, according to Ajay Rotti, Partner, Dhruva Advisors.

“Foreign investors will now have to pay tax on these receipts and will not even be entitled to the treatment afforded to capital gains,” he said.

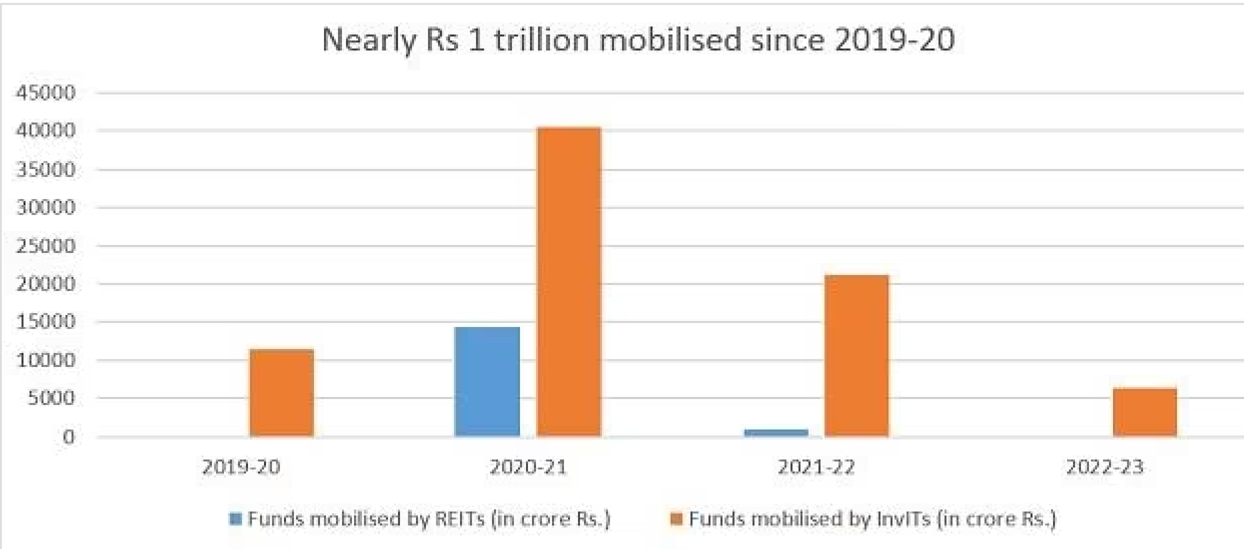
Going forward, investment vehicles will need to change the manner of making such distributions since repayment of debt may attract maximum rate of tax, according to Parul Jain head, international tax and transaction tax Practice at Nishith Desai Associates. The current tax regime affords a concessional tax regime for certain types of dividend income, and for interest income.

"…the proposed regime does not propose to extend the concessional tax rates to distributions made in the form of repayment of debt, resulting in tax rates as high as 40 per cent for foreign investors. While such investors may be able to rely on tax treaties, however there are limited tax treaties which may provide an exemption from tax on such distributions," she said.

"The impact will also be felt by sovereign wealth funds (SWFs)….who would currently be enjoying….exemption from tax on income in nature of dividend, interest or long-term capital gains. The proposed law nullifies the SWF benefit to the extent distributions made to SWFs/ pension funds are in nature of any other distributions including repayment of debt," she added.

Embassy Office Parks REIT said in an exchange notification on Friday that the rule would affect 40 per cent of the amount that it pays to investors. A person familiar with the matter said that the degree of distribution affected can be 10-15 per cent for some vehicles, while it can also account for the majority of distribution for others.

"It is proposed to tax distributed income by business trusts in the hands of a unit holder (other than dividend, interest or rent which is already taxable) on which tax is currently avoided both in the hands of unit holder as well as in the hands of business trust," according to the budget note.



Source: Sebi

Note: Data as of December 2022