Realty Bites - Indian Regime Governing Real Estate Funds

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Abstract

In this paper, Shagoofa Khan and Siddharth Shah outline the legal, regulatory and tax implications impacting Indian and India centric REFs. They attempt to explain the complex nuances on how structuring of REFs would entail harmonizing the commercial objectives, investors and investment options, with the Indian legal and regulatory regime. The Real Estate Sector is subjected to various levels and kinds of taxes and it pays to get familiar with tax structuring which would require specific attention so as to keep the tax leakage to a minimum.

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Background

The potential is undeniable - with a size close to USD 12 billion and growth rate of around 30 percent every year, the Indian realty sector was bound to witness a sudden upsurge on account of multiple factors including rising domestic demand from the IT, ITES and the manufacturing sector on account of strong corporate growth, increased disposable income in the hands of individuals, unprecedented growth in the domestic consumerism, stable interest rate regime and last but not the least, the opening up of the real estate sector to foreign investment. On account of the attractiveness of the returns and the great potential ahead, it was not surprising to see the advent of dedicated real estate funds **("REFs")** being floated to tap the appetite of domestic and foreign investors alike. The names doing the rounds are Fire Capital, IREO, HDFC, SBI, ICICI Ventures, Kotak, Ascendas, Pantaloon, Anand Rathi and some others. Estimates indicate that REFs expect to raise commitments in excess of USD 1 billion in the coming months. Thus, this special feature analyzes the legal, regulatory and tax implications impacting Indian REFs.

Comparison between alternative forms of investment

Investment Avenues	Rate of Return over the past one year		
	Category Best	Category Average	Category Worst
Equity (diversified)	42.14	-4.11	-20.22
Balanced	9.89	-2.08	-13.39
Debt (medium term)	14.57	10.13	4.5
Debt (short term)	8.78	8.24	7.86
Money Market	9.17	6.50	3.15
Gilt	12.35	11.44	4.18
Real Estate (A Grade Commercial Property)	20.00	13.93	12.00

Excluding Capital Appreciation/Depreciation

Source: RPI Research

Advantage India

Real estate is one of the fastest growing sectors in India. Market analysis pegs returns from realty in India at an average of 14 percent annually, with research estimates indicating that the Indian real estate market is expected to grow from the current USD 14 billion to a USD 102 billion in the next 10 years[1]. Indian real estate has huge potential demand in almost every sector especially commercial, residential, retail, industrial, hospitality, healthcare etc. Commercial office space requirement is led by the burgeoning outsourcing and Information Technology Industry, and led to increase exponentially as the outsourcing boom moves into the manufacturing sector. Estimated demand from IT/ITES sector alone is expected to be 150mn sq.ft. of space across the major cities by 2010, while Tenth Five Year Plan estimated a shortage of 22.4 million dwelling units. Thus over the next 10 to 15 years, 80 to 90 million housing units will have to be constructed with a majority catering to the low income group. The investment required for constructing these and related infrastructure in this period would, thus, be of the order of USD 666 billion to USD 888 billion at roughly USD 33 billion to USD 44 billion per year. Despite these figures, contribution of housing and real estate to India's GDP is a meager 1 percent as against 3-6 percent in developing countries. If the economy grows at the rate of 10 percent, the housing sector has the capacity to grow at 14 percent and generate 3.2 million new jobs over a decade[2]. Apart from the huge demand, India also scores on the construction front. A Mckinsey report reveals that the average profit from construction in India is 18 percent, which is double the profitability for a construction project undertaken in the US. Break up of the gross domestic product by economic activity, real estate and construction figures as posted by the National Accounts Statistics have extracted in the attached **Annexure 1, Annexure 2 and Annexure 3.**

Breakdown of Cost of Construction in India Vs. US (1999)

India

1. Land Cost	18%
2. Profits	5%
3. Labour Cost	28%
4. Material Cost	49%

US

1. Land Cost	9%
2. Profits	37%
3. Labour Cost	30%
4. Material Cost	24%

With this brief discussion on the potential of the housing and real estate sector, we now proceed to discuss the legal, regulatory and tax implications of structuring India centric REFs, including some of the recent developments on the regulatory front impacting the structuring and commercial decisions for REFs.

Exchange Control Implications

Prior to June 1, 2000, foreign investment in Indian securities, including the acquisition, sale and transfer of securities of Indian companies, was regulated by the Foreign Exchange Regulation Act, 1973 **("FERA")** and the notifications issued by the RBI thereunder. Foreign investments into India are now regulated by the provisions of the Foreign Exchange Management Act, 1999 **("FEMA")** and the rules and regulations issued thereunder by the Reserve Bank of India **("RBI")** or Central Government, as the case may be.

By and large, foreign direct investment is now permitted in almost all sectors in India via the "automatic route," save for some exceptional cases such as defence, retail, etc. (commonly referred to as the "negative list"). Under the automatic route, the details of the investments must be filed with the RBI within the prescribed time.

Progressive Liberalization of the FDI Policy[3]

Pre-1991	Was allowed selectively up to 40 percent under FERA
1991	35 high priority industry groups were placed on the automatic route for FDI up to 51 percent
1997	Automatic Route expanded to 111 high priority industry groups up to 100 percent (power)/ 74 percent/ 51 percent/ 50 percent
2000	All sectors placed on the automatic route for FDI except for a small negative list
Post 2000	Many new sectors opened to FDI; viz., insurance (74 percent), construction-development of real estate (100 percent), mass rapid transit systems (100 percent), defence industry (26 percent), tea plantations (100 percent), print media (26 percent). Sectoral caps in many other sectors relaxed; Dividend balancing condition removed.

However, if the investment is not in accordance with the prescribed guidelines or if the activity falls under the negative list, prior approval has to be obtained from the Foreign Investment Promotion Board **("FIPB")**.

As per section 6 of FEMA, "any person may sell or draw foreign exchange to or from an authorized person for a capital account transaction". In other words, capital account transactions are permitted unless specifically prohibited or restricted by the RBI in pursuance of regulations issued under section 6(3) read with section 47 of FEMA. Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 **("TISPRO Regulations")** are the relevant regulations issued by the RBI in this regard.

Sub regulation 4 of the TISPRO Regulations stipulates that an Indian entity shall not issue any security to a person resident outside India or shall not record in its books any transfer of security from or to such person unless permitted under FEMA and the rules/ regulations issued thereunder.

Sub regulation 5 of the TISPRO Regulations lay down the conditions subject to which foreign investors would be permitted to invest into Indian securities. For sake of analysis, the sub regulation 5 has been classified into its sub components in Table 2.

[1]http://www.icicibank.com/pfsuser/icicibank/ibank-nri/nrinewversion/commercial_realestate.htm, visited on November 4, 2005.

[2]Extract taken from address by Shri Sushil Ansal, Chairman Housing and Public Works Committe, FICCI, Seminar on Tax and Regulatory Environment & FDI Regulations governing the Real Estate Sector, May 19, 2005, New Delhi, http://www.ficci.com/ficci/media-room/speeches-presentations/2005/may/may19-tax-ansal.htm, visited on November 4, 2005.

[3]Extracted from Destination India, presentation by Rajeeva Ratna Shah, Secretary, Department of Industrial Policy and Promotion Ministry of Commerce & Industry Government of India, October 14, 2003, and updated for current liberalizations.

Classification of Sub Regulation 5 of TISPRO Regulations

Sub regulation	Deals with	Applicable schedule
5(1)	Investments by foreign individuals (other than citizens of Bangladesh and Pakistan) and foreign entities	Schedule 1
5(2)	Investments by registered Foreign Institutional Investors ("FIIs")	Schedule 2
5(3)(i)	Investments by Non Resident Indians ("NRIs") under Portfolio Investment Scheme in shares and debentures of an Indian Company	Schedule 3
5(3)(ii)	Investments by NRIs other than under Portfolio Investment Scheme in shares and debentures of an Indian Company on non-repatriation basis	Schedule 4
5(4)	Investments by NRIs or registered FIIs in securities other than shares and debentures of an Indian Company	Schedule 5
5(5)	Investments by registered Foreign Venture Capital Investors	Schedule 6
5(6)	Investments by registered FIIs in exchange traded derivative contracts	--
5(7)	Investments by NRIs out of INR funds on non-repatriation basis	–

Each of the schedules to the TISPRO Regulations (as referred to in the adjacent Table 2) lay down specific conditions governing the investment by that particular category of investors. For example, the Foreign Direct Investment ("FDI") Scheme (that stipulates the sectoral caps, viz. the negative list) forms part of Schedule 1 to the TISPRO Regulations.

Despite the incremental liberalization of the Indian economy, the real estate sector continues to feature on the negative list for foreign direct investment. Thus, FDI is permitted only to the extent permitted under Schedule 1 to the TISPRO Regulations. Accordingly, NRIs/Persons of Indian Origin[4] **("PIOs")** are permitted to invest in real estate and housing property, while infrastructure projects, integrated townships and other projects involving large infusion of foreign investments have been opened up for other foreign investors, albeit, subject to various conditions.

Investments by NRIs

As per TISPRO Regulations, NRIs are permitted to invest in the following activities in the real estate sector:

- Development of serviced plots and construction of built up residential premises;
- Investment in real estate covering construction of residential and commercial premises including business centers and offices;
- Development of townships;
- City and regional level urban infrastructure facilities;
- Investment in manufacture of building materials (which is also open to FDI);
- Investment in participatory ventures in the above; and
- Investment in housing finance institutions (which are also open to FDI as non-banking finance companies).

While the above list appears broader than the opportunities open for foreign investors (discussed herein below), the TISPRO Regulation unfortunately are silent as to whether NRIs investing through their offshore companies or through offshore REFs, would still be entitled to investment opportunities specified for NRIs, or whether such offshore companies owned 100 percent by NRIs would be regarded as "foreign investor" and thus be ineligible for the above broader investment opportunities.

In addition to the above, NRIs and PIOs can acquire any immoveable property in India other than agricultural land/plantations/farmhouse, by way of purchase, gift or inheritance. In case of sale of such property, the NRIs/PIOs are permitted to repatriate the sale proceeds, subject to the following conditions[5]:

- In case of residential property, repatriation is allowed only up to a maximum of two properties;
- The amount to be repatriated cannot exceed the amount paid for acquisition of immovable property in foreign exchange;
- In the case of purchase of the property out of rupee funds, repatriation is allowed from the Non Resident Ordinary accounts up to USD 1 million per year, provided the property and/or sale proceeds in the NRO account, have been held for a combined period of not less than 10 years.

Investments By Other Foreign Investors

The first step towards opening of the real estate sector for foreign investors was taken by the Government of India vide issue of Press Note No. 4 (2001 series) which permitted FDI up to 100% for development of integrated townships[6], including housing, commercial premises, hotels, resorts, city and regional level urban infrastructure facilities such as roads and bridges, mass rapid transit systems and manufacture of building materials. Thus, while FDI in integrated townships was opened up in 2001, the real boost for foreign investment came with the issue of Press Note 2 (2005 series) dated March 3, 2005 **("Press Note 2")** which not only dilutes the minimum development area for integrated townships from 100 acres to 25 acres but more importantly opened up the sector for foreign investment in many other forms of construction and development.

Therefore, as per Press Note 2, 100 percent foreign investment is now permitted in townships, housing, built-up infrastructure and construction-development projects (which would include, but not be restricted to, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure), through the automatic route, subject to satisfaction of following conditions:

(a) Minimum area to be developed under each project:

- in case of development of serviced housing plots, a minimum land area of 10 hectares
- in case of construction-development projects, a minimum built-up area of 50,000 square meters
- in case of a combination project, any one of the above two conditions would suffice

(b) Capitalization and lock-in requirements:

- minimum capitalization of USD 10 million for wholly owned subsidiaries and USD 5 million for joint ventures with Indian partners. The funds would have to be brought in within six months of commencement of business of the company.

[4] PIO means an individual, not being a citizen of Pakistan, Bangladesh, Sri Lanka, China, Iran, Nepal or Bhutan, who (i) at any time held Indian Passport or (ii) who or either of whose father or grandfather was a citizen of India by virtue of Constitution of India or the Citizenship Act, 1955.
[5] Investments under the Foreign Exchange Management (Acquisition and Transfer of Immoveable Property in India) Regulations, 2000 issued by the RBI.
[6] Development of land and providing allied infrastructure was considered forming an integrated part of township's development.

- original investment cannot be repatriated before a period of three years from completion of minimum capitalization. However, the investor may be permitted to exit earlier with prior approval of the Government through the FIPB.

(c) At least 50 percent of the project must be developed within a period of five years from the date of obtaining all statutory clearances. The investor would not be permitted to sell undeveloped plots.

For the purpose of Press Note 2, "undeveloped plots" would mean where roads, water supply, street lighting, drainage, sewerage, and other conveniences, as applicable under prescribed regulations, have not been made available. It will be necessary that the investor provides this infrastructure and obtains the completion certificate from the concerned local body/service agency before he would be allowed to dispose off serviced housing plots.

(d) The project shall conform to the norms and standards, including land use requirements and provision of community amenities and common facilities, as laid down in the applicable building control regulations, bye-laws, rules, and other regulations of the State Government/Municipal/Local Body concerned.

(e) The investor shall be responsible for obtaining all necessary approvals, including those of the building/layout plans, developing internal and peripheral areas and other infrastructure facilities, payment of development, external development and other charges and complying with all other requirements as prescribed under applicable rules/bye-laws/regulations of the State Government/ Municipal/Local Body concerned.

(f) The State Government/Municipal/ Local Body concerned, which approves the building/development plans, would monitor compliance of the above conditions by the developer.

Please refer to the actual text of Press Note 2 attached herewith as **Annexure 4**[7].

Despite the further liberalized policy introduced by Press Note 2, several questions remain unanswered in the press note. For example, whether foreign investment is permitted only at the "initial" or "development stage" or whether a foreign investor can participate in a project after an "occupation certificate" is issued. Also, in terms of opportunities, there is huge potential with regard to "redevelopment" of real estate. Press Note 2, unfortunately, does not cover such projects. On account of the growth and economic opportunities of this sector, a clarification on these ambiguities is a must.

Apart from the above, foreign investment is also permitted in the following activities:

- **Roads & Highways, Ports and Harbours**
  100 percent FDI is permitted under the automatic route in projects for construction and maintenance of roads, highways, vehicular bridges, toll roads, vehicular tunnels, ports and harbours.

- **Airports**
  Up to 100 percent FDI permitted. However, investment by foreign investors beyond 74 percent requires prior approval of the FIPB.

- **Mass Rapid Metro Transit System**
  FDI up to 100 percent is permitted on an automatic basis in Mass Rapid Metro Transit System in all metros, including associated real estate development.

- **Special Economic Zones**
  100 percent FDI is permitted under the automatic route. Conditions relating to area, minimum outlay, etc. would be such as may be stipulated under the Special Economic Zones Act 2005 and rules issued thereunder.

- **Industrial Parks, Model Towns and Growth Centres**
  FDI up to 100 percent is permitted in Industrial Parks subject to the approval of Empowered Committee that has been setup by the Government of India, and, inter alia, the following conditions:

  - At least 60 percent area should be for industrial use[8]; and not more than 10 per cent of the area should be utilized for commercial use;
  - At least 50 percent of the total project cost should be spent on infrastructure development;
  - For Industrial Parks which provide built up space for industrial use, the minimum expenditure on infrastructure development including cost of construction of industrial space, shall not be less than 60 percent of the total project cost;
  - For an Industrial Model Town the minimum area should be 1000 acres and it should have a minimum of 50 units. In case of Industrial Parks the minimum number of units is 30.

The actual text of Industrial Park Scheme 2002 is available on the website of Secretariat of Industrial Assistance, at http://siadipp.nic.in/policy/changes/notif.pdf . The respective IT /ITES policies of the states should also be referred to determine the other benefits /conditions impacting setting up of IT Parks.

- **Health care**
  100 percent FDI is allowed in this sector.

- **Hotels & Tourism**
  100 percent FDI is permitted. Hotels include restaurants, beach resorts, and other tourist complexes providing accommodation and/or catering and food facilities to tourists. Tourism related industry include travel agencies, tour operating agencies and tourist transport operating agencies, units providing facilities for cultural, adventure and wild life experience to tourists, surface, air and water transport facilities to tourists, leisure, entertainment, amusement, sports, and health units for tourists and Convention/Seminar units and organizations.

[7] The same is also available on the website of Secretariat of Industrial Assistance, at http://siadipp.nic.in/policy/changes/pn2_2005.pdf.
[8] Industrial use in the context of Industrial parks includes IT enabled services, management and technical consultancy services.

Pricing Constraints

FEMA also regulates the price at which a foreign investor invests into an Indian company. Accordingly, shares in an unlisted Indian company[9] may be freely issued to a foreign investor, subject to the following conditions being satisfied:

- The foreign investor subscribes to the Indian company's shares at a price that is not lower than the floor price computed on the basis of the "ex-CCI" formula;
- The consideration for the subscription is brought into India prior to or at the time of the allotment of shares to the foreign investor.

If any of the above conditions is not complied with, then the prior approval of the FIPB and the RBI would be required. However, if the foreign investor is a Foreign Venture Capital Investor registered with the Securities Exchange Board of India ("SEBI"), then the above pricing restrictions would not apply.

Acquisition of Shares through Secondary Purchase

Generally, for any transfer of shares between residents and non-residents resulting from purchase or sale transaction, no prior permission of the FIPB or the RBI is required provided such transfer of shares is done in compliance with the guidelines[10] issued by the RBI and the price for such transfer is in accordance with the RBI pricing guidelines in this regard. As per the pricing guidelines, in respect of an unlisted company, the price is based on the "ex-CCI formula" and in case of listed companies, the pricing should be based on the trading price of the shares on a stock exchange. However, a specific exemption from the above pricing guidelines has been made for SEBI registered Foreign Venture Capital Investors.

Existing Joint Venture or Collaborations

As discussed above, under the Indian exchange control regime, FDI is permitted in various sectors in India without prior regulatory approval. However, as per the erstwhile Press Note 18 (of 1998) this automatic route of making investments into India was not available in the event the foreign investor "has or had any previous joint venture **("JV")** or technology transfer/trademark agreement in the **same or allied field"**. This condition was laid down in the guidelines pertaining to approval of foreign/technical collaborations under the automatic route with previous ventures/tie-up in India issued on December 14, 1998 by the Ministry of Commerce, Government of India (and commonly referred to as Press Note 18). Thus, where the foreign investor did not qualify for the automatic route, he needed to seek the prior approval of the FIPB by filing justification and proof before the FIPB that the new undertaking would not jeopardize the interests of the existing JV or technology/trademark partner.

After several representations and back-and-forth by Government of India on this issue, Press Note 18 was finally scrapped and replaced by the new Press Note 1 (2005 series) dated January 12, 2005.

The said Press Note No. 1 has narrowed down the scope of the policy issue depicted under Press Note 18 to JVs under the "same" field. Thus, as per Press Note 1 prior FIPB approval is required only in cases where the foreign investor has an existing JV or technology transfer or trademark agreement in the **"same"** field. The onus to provide requisite justification as also proof that the new proposal would or would not jeopardise the existing JV or other stakeholders would lie equally on the foreign investor or technology supplier and the Indian partner. Further, Press Note 3 (2005 series) has clarified that "existing" means JV or technology transfer or trademark agreements existing as on the date of Press Note 1, viz. January 12, 2005.

Even if the foreign investment is falling in the "same" field, the Government has carved out following exceptions, for which no prior FIPB approval is required:

- Investments are made by Venture Capital Funds registered with the SEBI;
- The existing JV investment by either party is less than 3 percent;
- The existing JV or collaboration is defunct or sick.

Press Note 1 would impact existing foreign investors wishing to invest in new/multiple real estate investments. Thus, the same needs to be taken into consideration alongwith the clarification issued vide Press Note 3.

Debt Structuring

Leveraging is a critical component in structuring of real estate investments. Foreign debt structuring would especially trigger certain additional compliances under the Indian exchange control regime. Any debt to be taken by an Indian company from foreign sources has to comply with the External Commercial Borrowing Guidelines **("ECB Guidelines")** issued by the RBI[11].

As per the ECB Guidelines, external borrowings are permitted on an automatic basis (i.e. without any prior regulatory approval) provided such borrowings comply with the conditions stipulated therein, inter alia, such as:

- Lender should qualify as a "recognized lender" as contemplated under the ECB Guidelines (e.g. suppliers of equipment, foreign collaborators, foreign equity holders, etc.);
- Minimum maturity period (e.g. in case of ECBs above USD 20 million and up to USD 500 million, the minimum average maturity is stipulated as 5 years);
- Maximum amount of ECB which can be raised in one financial year (viz. USD 500 million for corporates and USD 5 million for non governmental organizations engaged in micro finance activities);
- All-in-cost ceilings (which includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees, which is 200 basis points above 6 month LIBOR in case of ECBs having an average maturity period of 5 year and 350 basis points above 6 month LIBOR in case of ECBs having an average maturity period of more than 5 years);

[9] In case of listed companies, the pricing is based on the trading price of the shares on a stock exchange.
[10] Circular no 16 dated October 4, 2004.
[11] A.P. (DIR Series) Circular No. 5 dated August 1, 2005.

- End-use restrictions, e.g. ECB proceeds cannot be used for working capital, general corporate purpose, acquisition of shares by an Indian company, repayment of existing Rupee loans, for investment in real estate activities, etc.

Here it would be pertinent to note that in case of the end use restriction with regard to "real estate" activities, the ECB Guidelines provide an exception. Accordingly, as per the ECB Guidelines real estate "excludes development of integrated township as defined by Ministry of Commerce and Industry, Department of Industrial Policy and Promotion, SIA (FC Division), Press Note 3 (2002 Series, dated 04.01.2002)". However, Press Note 3 (2002 series) is now superceded by Press Note 2. Further, as per press release[12] issued by Joint Secretary to the Government of India which highlights the liberalized ECB policy of the Government of India refers to Press Note 2 in the end use restrictions discussions, as is evident from the following extract:

> "Utilisation of ECB proceeds is not permitted in real estate. The term 'real estate' excludes development of townships, housing, built-up infrastructure and construction-development projects as defined by Ministry of Commerce and Industry, Department of Industrial Policy and Promotion, SIA (FC Division), Press Note 2 (2005 Series) dated 3rd March 2005." [Emphasis supplied]

Thus, while the press release indicates suppression of Press Note 3 (2002 series) by Press Note 2, the ECB Guidelines still refer to the old language as existed prior to the issue of Press Note 2. While "supercession" would mean that the end use restrictions should not apply to Press Note 2 compliant projects, however, on account of the lack of specific language to this effect in the ECB Guidelines uncertainty may prevail unless RBI amends the ECB Guidelines or issues specific clarification in this regard.

In case of debt being raised by Indian companies from local banks, the RBI has issued some indicative guidelines for banks to put in place a "risk management system" for identification, assessment and containing risks undertaken by banks in terms of their exposure to the real estate sector. The RBI has also prescribed certain additional disclosure norms for banks to report their real estate exposures to the RBI, as follows[13]:

- Direct exposure
  - Residential Mortgages-lendings fully secured by mortgages (self occupied by borrower or rented), individual housing loans up to Rs.15 lakh to be shown separately;
  - Commercial real estate-lendings fully secured by mortgages, including non fund based limits.
- Indirect exposure - fund based and non-fund based exposures on National Housing Bank and housing finance companies.
- Annual reports of the banks should also disclose the gross exposure to real estate sector, including the direct and indirect exposure as above.

Regulatory Implications

Real Estate Investment Trusts **("REITs")**, as commonly understood in the international context, are currently non-existent in India. Over the last few years, there have been several representations by players in the real estate industry and mutual funds to permit setting-up of REITs in India. SEBI, as a nodal agency for regulating the mutual fund and the securities markets in India, constituted a committee to examine and recommend the steps required for introduction of REITs in India. Pursuant to the recommendations of the Satwalekar Committee, Association of Mutual Funds of India ("AMFI") formed a Sub-Committee to formulate a working plan for launching Real Estate Investment Schemes based on the recommendations of the Satwalekar Committee on REFs.

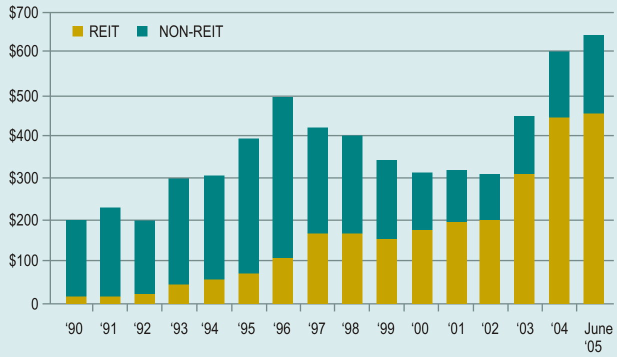
Why REITs?

The success of the REITs regime in offshore jurisdictions is an indication that REITs are not only popular but also inevitable on account of the following important benefits that they offer to small investors:

- **Liquidity:** REITs have helped turn real estate liquid. Through the publicly traded REITs structure (as in the United States of America), investors can buy and sell interests in diversified portfolios of properties-as well as the management associated with them on an instantaneous basis. Illiquidity, the bane of real estate investors, is gone.
- **Security:** Because real estate is a physical asset with a long life during which it has the potential to produce income, investors always have viewed real estate as an investment option with security. Through REIT structures, small investors have the added level of security that was not available earlier. Low levels of debt practiced by several REITs also means greater security for financial system as a whole.
- **Diversification:** Investing in REITs and other publicly traded real estate companies provides diversification benefits because the correlation of REIT returns with the returns of other market sectors is relatively low. The correlation of returns in two different investment categories need not be negative to benefit from diversification. Even low to moderate positive correlation may help to increase long-term risk-adjusted returns.[14]

Growth of Global REIT Markets

Nearly all of the growth in the securitization of real estate assets i.e., listed real estate on the stock market has been through REIT structures. The growth of the global REIT market is demonstarted below $U.S. billion.



Source: UBS, Thomson Financial Datastream

- **Performance:** Since their inception, REITs have provided competitive investment performance. REITs market performance has been roughly comparable to that of Standard & Poor's 500 Index and has exceeded returns on fixed debt instruments or direct investment in real estate. Since REITs (especially in the United States of America) also pay out annually almost all of their taxable income, a significant component of total return reliably comes from dividends[15].

[12] No. 4(19)/2004-ECB dated June 3, 2005.

[13] Ref. RBI/2004-05/ 503, DBS.CO.PP.BC 21 /11.01.005/2004-05, dated June 29, 2005.

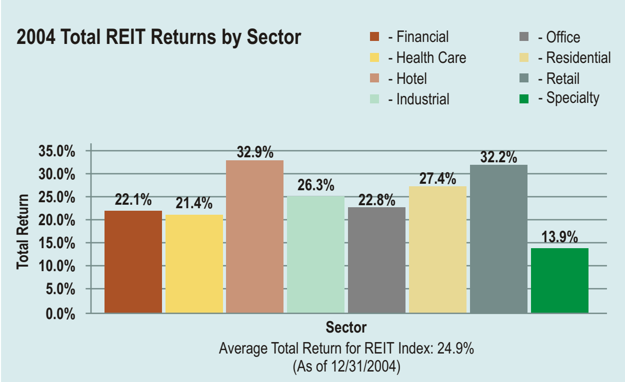
[14] http://www.dollardex.com/sg/index.cfm?current=../contents/reitoverview&contentID=2289, visited on November 4, 2005.

[15] The REIT IPO Source Book: Planning for Real Estate Investment Trust Initial Public Offering, National Association of Real Estate Investment Trusts, 1998 Edn.

AMFI Sub Committee Recommendations

The Sub-committee deliberated on the appropriate structure to be recommended for the introduction of Real Estate Funds in India. It performed an exhaustive study of the features and suitability of the Collective Investment Scheme **("CIS")** versus the Mutual Fund **("MF")** regimes in India for real estate investments. The Sub Committee also analyzed some international experiences, such as in the United States of America **("US")** and in the United Kingdom **("UK")**.

In the US real estate investment is through REITs, which are formed as companies and have an issued share capital. Further, they have the flexibility to raise funds through preference shares and debt, are typically close-ended and listed on the exchanges. REITs in the US were started without tax benefits and did not do well until the US Tax Laws were amended in 1986. The new laws provided them with tax pass through subject to conforming to certain requirements. Accordingly, a US REIT has to satisfy three income tests, two asset tests and one distribution test. In order to qualify as a US REIT, the following conditions must be satisfied: (a) it must be an entity that is taxable as a corporation, in the absence of the election to be treated as a REIT; (b) it must be managed by a Board of directors or trustees; (c) its shares must be fully transferable; (d) it cannot be closely held, in fact it must be widely held and must have a minimum of 100 shareholders; (e) not more than 50 percent of its stock can be held by five or fewer individuals at any time during the last half of each taxable year; (f) it must invest at least 75 percent of its total assets in real estate assets; (g) it must invest at least 75 percent of its gross income from rents from real property, or interest on mortgages on



Average Total Return for REIT Index: 24.9%
(As of 12/31/2004)

real property; (h) it must have no more than 20 percent of its assets consist of stocks in taxable REIT subsidiaries; (i) it must distribute at least 95 percent of its taxable income as deductible dividends to its shareholders. The tax benefits made REITs very popular now in the US and it is understood that there are now more than 300 REITs operating in the US with assets in excess of USD 300 billion[16].

In the UK, real estate investments are done through Pooled Managed Vehicles **("PMVs")**. While these are different from Open-ended Investment Companies **("OICs")**, they can be in the form of trusts. The regulator for these PMVs is the Financial Services Administrator, as is the case for OICs. They, however, have a variable capital and are similar to open-ended funds. PMVs may get tax benefits based on the investor profile. Offshore funds as well as pension fund investors qualify for benefits. However, there are no tax benefits for the regular PMVs. This would be comparable to having no tax benefits for typical OICs. The PMV has the ability to delay redemption if there is excessive pressure to exit the fund[17].

A global comparison of REITs regime is attached herewith as **Annexure 5.**

Based on its analysis of Indian regulations for CIS and MF and the international practices followed in the US and UK, the Sub Committee recommended that Real Estate investments should be structured in the form of Schemes of Mutual Funds. However, considering the illiquidity of the underlying investments, the Sub Committee felt that MF may initially look to launch close ended or interval funds. Nonetheless, in future, the Real Estate Investment Schemes could be structured as open-ended schemes once the comfortable liquidity is achieved in the underlying investments.

The Sub Committee recommended the following as the characteristics of a typical interval fund for Real Estate Investment Schemes ("Scheme") :-

(a) The Scheme would be close ended for a minimum period of 3 years.

(b) The Scheme would open at the end of every quarter for sale of fresh units based on the quarterly Net Asset Valuation ("NAV") calculation and remain open for a minimum period of 15 days. This will enable the fund to grow by soliciting fresh inflows from investors, while giving potential investors a chance to participate in the Scheme after its Initial Offer.

(c) The Scheme would offer redemption/repurchase to the investors at the end of 3 years in a staggered manner. For example, at the end of 3 years, 20 percent of the investment can be redeemed at NAV; at the end of 4 years, 30 percent of the investment can be redeemed at NAV; at the end of the 5th year, balance 30 percent can be redeemed to the investor at NAV.

(d) As the Scheme would be an interval fund, and offers redemption at the end of 3 years, the Scheme may be listed on any Stock Exchange to provide the liquidity to the investors.

(e) The Scheme will calculate the NAV on quarterly basis as per the valuation of the underlying investments.

(f) The Scheme shall operate within the regulations of Mutual Funds as amended from time to time and comply with all the requirements of the SEBI (Mutual Fund) Regulations.

(g) Being part of a MF, the Scheme would be eligible for all tax benefits applicable to MFs in general. This would enhance the attractiveness of the Scheme to investors.

The Sub Committee also made the following recommendations:

- The Schemes be permitted to invest in listed securities, Mortgage-backed securities and debt securities issued by development and construction companies (placed privately), as well as to make direct estate project finance, construction finance, purchase/have an option to purchase buildings under construction with a view to resell the same;
- There should be no levy of stamp duty when the asset is purchased by the SEBI registered Scheme. Alternately, if stamp duty needs to be paid on purchase, a set-off of the amount paid should be allowed against future stamp duty payments, when the property is sold;

[16] Extracted from the speech delivered by Manoj Colin Benjamin, Chairman, Royal Indian Raj International Corporation at REIT World Asia Pacific Conference, October 20, 2003.
[17] Ibid.

- The relevant authorities should provide exemption from annual Property Taxes to Schemes as this would lead to better returns to investors;
- All Land Records be computerized and property transactions be done in a dematerialized manner, as in the case with listed securities;
- While rent controls have been amended in several states, some states still have archaic provisions. Thus, rent control provisions should be streamlined and modified.

The report of the Sub Committee is still pending with SEBI and thus none of the above recommendations have seen the light till date and hence the conventional REITs structure does not exist in India.

Venture Capital Regime

While the demand for a special REITs regime has not been met, in April 2004 SEBI opened a small window for real estate investments under the Venture Capital Fund **("VCF")** and Foreign Venture Capital Investor **("FVCI")** regime.

Investments by VCFs are governed by the SEBI (VCF) Regulations, 1996 **("VCF Regulations")** whereas investments by FVCIs are governed by the SEBI (FVCI) Regulations, 2000 **("FVCI Regulations")**. SEBI amended the VCF and FVCI Regulations by removing "real estate" from the Third Schedule-Negative List to these regulations[18]. Thus, VCFs and FVCIs can invest in venture capital undertakings **("VCUs")** engaged in real estate activities, subject to the investment conditions and restrictions as stipulated in the respective regulations. For details regarding the investment conditions and restrictions as enumerated in the VCF and FVCI Regulations, please refer to the attached **Annexure 6** and **Annexure 7.**

One of the important developments on the VCF front is the recent de-recognition of venture capital sector as a priority sector by RBI. Historically speaking, as per RBI's Master Circular on Lending to Priority Sector[19], investments made by the scheduled commercial banks in venture capital were reckoned under "priority sector lending", provided the VCFs/companies were registered with SEBI under the VCF Regulations. On July 1, 2005[20], this treatment was revoked by RBI and accordingly:

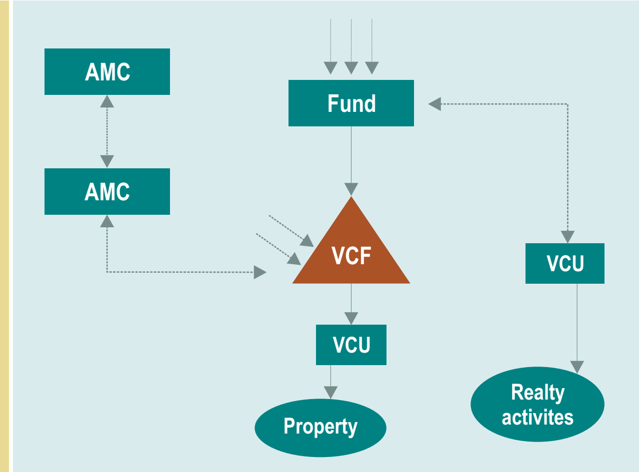
- Fresh investments by banks on or after July 1, 2005 in venture capital shall not be eligible for classification under priority sector lending;
- Investments, which have already been made/to be made by banks up to June 30, 2005, in venture capital shall not be eligible for classification under priority sector lending with effect from April 1, 2006.

This could have an impact on the marketing of REF securities as domestic banks have traditionally been one of the larger investors in VCFs.

On the FVCI front, there has been upsurge on registrations under the FVCI Regulations. This primarily being on account of the benefits that a foreign investor is conferred with if he registers himself as an FVCI under the FVCI Regulations. These are:

- As per the notification issued by the RBI[21], FVCIs benefit from free entry and exit pricing. Under the FEMA and the regulations issued thereunder, the entry and exit pricing of non-resident investors under the FDI route is regulated. For purchase of shares of an unlisted company, the minimum price to be paid by the non-resident investor is linked to the value of the shares determined as per the "ex-CCI" formula. Similarly, for exits involving transfer from a non-resident to a resident, the exit price is capped at the price of the shares on the stock exchange (if the shares are listed) or to "ex-CCI" formula value if the shares are unlisted. A special exemption has been granted to FVCIs whereby they will be exempted from both the entry and exit pricing regulations.
- SEBI has also exempted transfer of shares from FVCIs to the promoters from the public offer provisions under the Takeover Code, if the portfolio company gets listed post investment. This ensures that if the promoters have to buy back the shares from the FVCIs, they will not be burdened with the public offer requirement which otherwise could require them to make an offer to the other shareholders of the company to buy from them up to 20 percent of the paid-up capital of the company.
- FVCIs registered with SEBI have been accorded "Qualified Institutional Buyer" status and would accordingly be eligible for subscribing to securities at the initial public offering of a Venture Capital Undertaking through the book-building route.
- Under the SEBI (Disclosure and Investor Protection) Guidelines, 2000, the entire pre-issue share capital of a company going in for an IPO is locked for a period of one-year from the date of allotment in the public issue. However, an exemption has been granted to domestic VCFs and FVCIs registered with SEBI. This would essentially allow the FVCIs to exit from their investments post-listing.
- Generally the definition of a 'promoter' under the SEBI (Disclosure and Investor Protection) Guidelines, 2000 is very broad and includes any person who has a role to play in the decision of a company going in for an IPO. A private equity investor generally reserves certain veto rights in the company and in most cases is actively involved in the IPO decision by the Company. If the private equity investor is not registered as FVCI, there is a possibility that the private equity investor be treated as a part of the promoter group thereby subjecting it to certain onerous requirements otherwise applicable to promoters. SEBI has clarified that a SEBI registered VCF or an FVCI would not be treated as 'promoter' for the purpose of the above guidelines.

Structuring Implications



[18] Vide Securities and Exchange Board of India (Venture Capital Funds) (Amendment) Regulations, 2004 and Securities and Exchange Board of India (Foreign Venture Capital Investors) (Amendment) Regulations 2004 dated April 5, 2004 and published in the Official Gazette of India dated April 15, 2004.

[19] Dated July 20, 2004.

[20] RBI/2005-06/27, RPCD. No. Plan. BC. 5 / 04.09.01/ 2005-06.

[21] December 2000.

From the structuring perspective, the structures that can be evolved would depend on the kind of investors and real estate projects being targeted. The REF could either be a pure domestic fund set up as a VCF/VCC or a pure offshore fund set up as an FVCI, which would invest into domestic companies (VCUs) engaged in real estate activities. Several variants could then be carved out resulting in parallel or unified structures. The adjacent diagram depicts a typical REF structure.

The structuring exercise also entails deciding upon an appropriate jurisdiction for setting up the FVCI. While India has a sizeable treaty network, not many of the treaties offer (partial complete) exemption from tax on capital gains, as is the case with Mauritius, Cyprus, UAE, Netherlands, Switzerland, etc. In this regard, Singapore is the "new kid on the block" as it offers same benefit on capital gains as the Mauritius treaty and thus becomes a jurisdiction worth exploring for structuring of the offshore pooling vehicle. Accordingly, as per the Protocol to the India-Singapore tax treaty, a Singapore fund can now enjoy the same Indian capital gains tax exemption as is the case with a Mauritius fund claiming under India-Mauritius tax treaty. However, the availability of capital gains tax exemption under the Protocol is subject to the following "limitation of benefits" provisions:

(a) the Singapore resident should not so arrange his affairs with the primary purpose of taking advantage of the benefits of the India-Singapore tax treaty. This would include instances where the resident does not have any bonafide business activities in Singapore; and

(b) the Singapore resident should not be a shell/conduit company.

For the purposes of this provision, a shell/conduit company is any legal entity falling within the definition of a resident with negligible or nil business operations or with no real and continuous business activities being carried out in Singapore. In addition -

- a Singapore resident shall be deemed to be a shell/conduit company if its total annual expenditure on operations in Singapore is less than S$200,000, in the immediately preceding period of 24 months from the date the gains arise,

- a Singapore resident is deemed not to be a shell/conduit company if it is listed on a recognised stock exchange in Singapore or its total annual expenditure on operations in Singapore is equal to or more than S$200,000 in the immediately preceding period of 24 months from the date the gains arise.

Thus, as is evident from the above, the limitation provisions stipulated under the Protocol may pose difficulties in claiming benefits under the India-Singapore tax treaty, there being no such caveats under the India-Mauritius tax treaty or for that matter under the India-Cyprus tax treaty.

In case of REFs, the choice narrows down further as India reserves the right to tax gains on direct or indirect holdings in properties. Added complications arise on account of the desire to use structured products for investments, entailing a regular flow of interest income to investors. In this scenario, Cyprus appears to be a promising jurisdiction, especially since investor confidence is growing on account of its accession to the EU.

The other critical component to be borne in mind while performing the structuring exercise is the exposure to Permanent Establishment **("PE")**. PE is that degree of economic penetration which according to the agreement of treaty partners justifies a nation in treating a foreign person for income tax purposes in the same manner as domestic persons are treated[22]. Here it would be pertinent to note the observations of the Andhra Pradesh High Court in the case of CIT V. Visakhaptnam Port Trust[23]:

"In our opinion, the words "permanent establishment" postulate the existence of a **substantial element of an enduring or permanent nature** of a foreign enterprise in another country which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a **virtual projection** of the foreign enterprise of one country into the soil of another country." [Emphasis supplied]

Thus, according to Article 7 read with Article 5 of the tax treaties, the business of a foreign entity is subject to tax in India only to the extent the same is attributable to its PE in India. Thus, while structuring it is important to ensure that no PE exposure is created for the offshore pooling vehicle or the offshore investors as this may lead to loss of capital gains tax exemption under the tax treaty and may trigger Indian tax implications. A PE could be created if the offshore pooling vehicle/investor is regarded to have a fixed place of business in India, or has an office in India, or has a dependent agent in India. Further, it is important to note that in case offshore pooling vehicle/investor coming from a non treaty country, this exposure gets enhanced as the PE-equivalent concept under the ITA, viz. Business Connection **("BC")** has a broader gamut and is defined in less clearer terms as compared to PE under a tax treaty scenario. While structurally, the PE/BC exposures may be structurally addressed, it is equally important that the checks-and-balances built into the structures are adhered to in practical and factual terms as determination of PE/BC is a fact driven exercise and there is no straight jacket formula available to mitigate the risk in its entirety.

A Few Posers?

In the backdrop of the regulatory and tax regime for India centric REFs discussed above, the following emerge as the key considerations in structuring of REFs;

- Need and options for segregation of funds pooled from NRIs, non NRIs and domestic investors-this is critical as it could impact the down line investment opportunities for the REFs;
- Structuring of the foreign investment under the FDI route versus the FVCI route-the ultimate choice of regime being driven by strategic and commercial considerations;
- Structuring of the management structure-domestic versus offshore manager, combination structures, etc. Structuring imperatives for incentivising the employees of offshore/ domestic manager and foreign management team add to the significance of the structuring exercise;
- Structuring of the products to be offered to the clients depending on the risk appetite and preferences of the investors;
- Structuring of exit opportunities, listing options: domestic and abroad.

Tax Implications

(a) General

Taxation of income in India is governed by the provisions of the Income Tax Act, 1961 **("ITA")** as amended by the Finance Acts, from time to time. The ITA lays down elaborate provisions in respect of

[22] John Huston and Lee Williams, Permanent Establishments a planning primer [1993], 1.
[23] 146 ITR 162 (AP).

chargeability to tax, determination of residency, computation of income, et al. Residents are subjected to tax in India on their worldwide income, whereas non-residents are taxed only on Indian source income, i.e. incomes received in India, income that accrues or arises to them in India or is deemed to accrue or arise in India[24]. Section 9 of the ITA stipulates the types of income, which under certain circumstances are deemed to accrue or arise in India, such as interest, royalty, income from any capital asset situated in India, etc. However, in case of a non resident taxpayer being resident of a country with which India has signed a tax treaty, he has the option of being taxed as per the ITA, only to the extent the provisions of the ITA are more beneficial to him[25].

(b) Taxation of VCUs

A VCU being a company incorporated in India is regarded as a tax resident of India and is subject to taxation in India on its worldwide income. Currently, domestic companies are taxed at the rate of 33.66[26] percent on their net profits. Every Indian company distributing dividends to its shareholders is required to pay a Dividend Distribution Tax **("DDT")** of 14.025 percent. The dividends so paid by the Indian company are tax-exempt in the hands of the shareholders, irrespective of their residential status. Please note that the DDT is payable by the Indian company despite the fact that the profits from which the dividends are being distributed may be enjoying tax holiday/exemptions.

Characterization of income

The income of the VCU, depending on the facts and circumstances of the case, may be characterized as "business income" or "income from house property". In the event, the income is characterized and taxed as business income then same is subjected to the full corporate tax of 33.66 percent on net income, i.e. net of all business related expenses and specific tax holidays / exemptions[27] being claimed by the VCU.

In case income of VCU is taxable as income from house property, only two deductions are available, first being the standard deduction at the rate of 30 percent against the annual value and second being deductions for interest payments if the VCU has borrowed funds for purposes of acquisition, construction, repair, renewal or reconstruction of the property. There is no limit on the amount of interest deductible in case of commercial properties and thus if the interest payable exceeds the rental income, the unabsorbed interest can be carried forward for set off in future years.

Interest Income

Any interest that accrues to an FVCI is subject to a withholding tax of 10.45 percent in case of interest on Foreign Currency Convertible Bonds issued by the VCU under the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme 1993 (the "Scheme"), or 20.91 percent on loans made to VCUs in non-Indian currency not under the Scheme (e.g. under the ECB route) and at the rate of 41.82 percent in case of loans made to the VCUs in Indian currency. The withholding tax rates could stand reduced under the tax treaty, if any, between India and home jurisdiction of the FVCI/offshore fund. Interest payments to investors in a VCF would attract interest withholding at varying rates depending on the tax classification of the investor in the VCF.

Capital Gains

Currently, under the ITA, gains are classified as short-term and long-term depending upon the period of holding[28]. Long-term capital gains earned by a VCU upon sale of any property would be taxed at the rate of 22.44 percent and 33.66 percent in case of short-term capital gains. Here too, one would need to pay attention to the characterization of the gains as business income or capital gains which would again depend on the facts and circumstances of each case.

Minimum Alternate Tax

Where the tax payable by the VCU is less than 7.5 percent of its book profits, the tax will be deemed to be 7.5 percent (excluding surcharge and education cess) of such book profits as Minimum Alternate Tax.

Wealth tax

Buildings, residential and commercial premises held by the VCUs will be regarded as assets as defined under Section 2(ea) of the Wealth Tax Act, 1957 and thus be exigible to wealth tax in the hands of the VCUs at the rate of 1 percent on its net wealth in excess of the base exemption of INR 15,00,000. However, commercial and business assets are exempt from wealth tax.

Service Tax

The service tax regime was introduced vide Chapter V to the Finance Act, 1994. Subsequent Finance Acts, (1996 to 2003) have widened the service tax net by way of amendments to Finance Act, 1994. Service tax is levied on specified "taxable services" at the rate of 10[29]percent on the "gross amount" charged by the service provider for the taxable services rendered by him. The Finance Act, 2004 has introduced "construction services" as a taxable service and thus such services provided by the VCU would be subject to service tax in India.

Stamp Duty and other taxes

The real estate activities of the VCU would be subject to stamp duties and other local/municipal taxes, property taxes, which would differ from State to State, city to city and between municipals jurisdictions. Stamp duties may range between 3 to 14 percent.

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[24]Section 4 and 5 of the ITA.
[25]Section 90(2) of the ITA.
[26]Unless specified otherwise, all income tax rates mentioned in this article are inclusive of the currently applicable surcharge at the rate of 10 percent on domestic companies and 2.5 percent in case of foreign companies and the education cess of 2 percent on tax and surcharge.
[27]Under sections 80IA/IB of the ITA.
[28]Gains earned on sale of assets (other than shares) if held for 36 months or less are classified as short term capital gains, whereas gains earned on sale such assets if held for more than 36 months are classified as long term capital gains.
[29]Excluding currently applicable education cess of 2 percent on service tax.

(c) Taxation of VCF/VCC

Taxation of SEBI registered VCF/VCC and its investors are governed according to provisions of section 10(23FB) read with section 115U of the ITA. Accordingly, the VCF/VCC would be regarded as a pass through entity i.e. any income earned by a VCF/VCC would be exempt from tax in its hands under section 10(23FB) of the ITA and taxed only in the hands of the investors when distributions are made by the VCF/VCC as if the investments were made directly by the investors in the VCUs, under section 115U of the ITA. Further, income in the hands of the investors would bear the same character as in the hands of the trustees of the VCF/VCC.

However, there are several procedural anomalies in the taxation regime for VCFs/VCCs. For example, lack of a formal credit mechanism for tax deducted at source by the VCU. This leads to administrative hassles and uncertainty on availability of credit, especially in case of foreign investors.

(d) Taxation of an FVCI

The ITA does not carve out any special concessional tax treatment for FVCIs and thus they are treated on the same footing as a foreign investor. Accordingly, dividends earned by an FVCI/foreign investor would be tax exempt in its hands. Interest income would be taxed at the rates mentioned under the heading "interest" above. Capital gains would be taxed at the rate of 0 percent/10.45 percent/20.91 percent/31.36 percent/41.82 percent depending on the nature of security and period of holding. As stated above, under certain treaties, capital gains are given partial or complete exemption from capital gains tax. On the other hand, if the income from investments are taxed as business income in the hands of the foreign investor/ FVCI, then as stated above, such gains would not be subjected to tax in India in the absence of a PE / BC in India or would be taxed at the rate of 31.36 / 41.82 percent on the gains attributable to the PE/BC in India.

Conclusion

The Indian real estate industry is evolving from an "unorganized" sector to a more institutionalized and corporatized set up. The participation of foreign investment of specialized players and sophisticated investors in this transition phase will bring in transparency, accountability and emphasis on quality. The statistics doing the rounds these days evidently support the belief that Indian real estate sector promises to be a big draw for foreign investments into the country for times to come. Since real estate investment requires a longer term commitment from investors and the fact that foreign investors are willing to commit billions of dollars in this sector, demonstrates their growing confidence in the Indian economy. Further, the housing and real estate industry has significant linkages with other sectors of the economy and over 250 associated industries. A unit increase in expenditure in this sector has a multiplier effect and the capacity to generate income as high as five times[30].

India has come long way from the high tax rates and opaque administration days. Millennial India is a package deal of a vibrant democracy, a large reservoir of skilled manpower, an economy at the cutting edge of new technology and above all a huge and growing domestic market. Healthy growth rate of approx. 8 percent p.a., implementation of second generation, infrastructural advancements, exchange controls relaxations and government's commitment to move towards more transparency and simplification of the regulatory and tax regime to bring it at par with the best international practices-all add up to make India an attractive investment destination.

India stands to be a formidable player in the global economy - this is reflected in words of the former President of the US, Bill Clinton, "The world cannot afford for India to be a pygmy. You [India] have to be a giant and the right kind of giant"[31]. Time has come for us (the Government and Indians at large) to recognize this fact and the realty sector could very well act as the catalyst leading to a quantum growth of the Indian economy. ■

[30] http://www.ficci.com/ficci/media-room/speeches-presentations/2005/may/may19-tax-ansal.htm, visited on November 4, 2005.
[31] India Today Conclave, India 2003: Global Giant or Pygmy?, February 28 - March 2, 2003, New Delhi.

Annexure 1
Gross Domestic Product by Economic Activity[1]
Statement 10 : Gross Domestic Product By Economic Activity
(at 1993-94 prices)

(Rs. Crore)

1993-94	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04		industry
9	10	11	12	13	14	15		1
241967	**286094**	**286983**	**286666**	**304666**	**283393**	**310611**	**1**	**agriculture, forestry & fishing**
221834	263540	263258	262196	279129	256836	283323	1.1	agriculture
11454	12301	12753	13064	13258	13378	13570	1.2	forestry & logging
8679	10253	10972	11406	12279	13179	13718	1.3	fishing
20092	**26391**	**27269**	**27919**	**28608**	**31185**	**33195**	**2**	**mining & quarrying**
125493	**184578**	**191925**	**206189**	**213681**	**227642**	**243400**	**3**	**manufacturing**
81873	120116	124514	134324	140517	150412	161115	3.1	registered
43620	64462	67411	71865	73164	77230	82285	3.2	unregistered
18984	**26988**	**28401**	**29632**	**30715**	**31659**	**32827**	**4**	**electricity, gas & water supply**
40593	**54389**	**58740**	**62651**	**65161**	**69911**	**74819**	**5**	**construction**
99369	**156874**	**168199**	**174927**	**190436**	**206046**	**224113**	**6**	**trade, hotels & restaurant**
931206	146464	156628	162564	176579	191629	208121	6.1	trade
6163	**10410**	**11571**	**12363**	**13857**	**14417**	**15992**	**6.2**	**hotels & restaurants**
51131	**78883**	**87608**	**98329**	**107395**	**120922**	**141446**	**7**	**transport, storage & communication**
9648	11577	12620	13168	14084	14881	15836	7.1	railways
31429	45574	48586	51854	53880	57158	63544	7.2	transport by other means
634	670	704	726	722	645	696	7.3	storage
9420	21062	25698	32581	38709	48238	61370	7.4	communication
90084	**131892**	**145863**	**150907**	**157746**	**171463**	**183718**	**8**	**financing, insurance, real estate & business services**
41665	70549	79971	78974	81726	91050	97871	8.1	banking and insurance
48419	**61343**	**65892**	**71933**	**76020**	**80413**	**85847**	**8.2**	**real estate, ownership of dwellings & business services**
93632	**136658**	**153379**	**161372**	**169537**	**176141**	**186419**	**9**	**community, social & personal services**
43636	62209	70432	72073	73965	75230	79482	9.1	public administration & defence
49996	74449	82947	89299	95572	100911	106937	9.2	other services
781345	**1082747**	**1148367**	**1198592**	**1267945**	**1318362**	**1430548**	**10**	**gross domestic product at factor cost (1to9)**

[1] http://mospi.nic.in/rept%20_%20pubn/wsnas2005/S10.pdf, visited on November 4, 2005.

Annexure 2
STATEMENT 70 : DOMESTIC PRODUCT FROM REAL ESTATE, OWNERSHIP OF DWELLINGS AND BUSINESS SERVICES[1]

(Rs. Crore)

1993-94	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2003-04**		**Item**
9	10	11	12	13	14	15		1
46117	**53106**	**54636**	**56210**	**57837**	**59510**	**61237**	**1**	**gross rental of dwellings**
20865	23119	23599	24088	24588	25098	25620	1.1	rural
25252	29987	31037	32122	33249	34412	35617	1.2	urban
2609	**3266**	**3410**	**3560**	**3725**	**3898**	**4079**	**2**	**less: cost of repairs & maintenance of dwellings**
1947	2402	2500	2602	2713	2830	2951	2.1	rural
662	864	910	958	1012	1068	1128	2.2	urban
48684	**61625**	**66371**	**72500**	**76681**	**81207**	**86764**	**3**	**gross domestic product**
43507	49840	51226	52650	54112	55613	57158	3.1	dwellings
18917	20717	21099	21486	21874	22269	22669	3.1.1	rural
24590	29123	30127	31164	32238	33344	34489	3.1.2	urban
317	413	437	463	493	525	560	3.2	real estate
3273	9347	12504	16988	19604	22439	26281	3.3	business services
1587	2025	2204	2399	2472	2630	2765	3.4	legal services
265	**282**	**479**	**567**	**661**	**794**	**917**	**4**	**less: F.I.S.I.M.**
48419	**61343**	**65892**	**71933**	**76020**	**80413**	**85847**	**5**	**gross domestic product net of F.I.S.I.M.**
7988	**9851**	**10562**	**11421**	**12266**	**13048**	**13846**	**6**	**less: consumption of fixed capital**
40431	**51492**	**55330**	**60512**	**63754**	**67365**	**72001**	**7**	**net domestic product**

F.I.S.I.M. : Financial intermediation services indirectly measured

[1] http://mospi.nic.in/rept%20_%20pubn/wsnas2005/S10.pdf, visited on November 4, 2005.

Annexure 3
Domestic Product from Construction
STATEMENT 64: DOMESTIC PRODUCT FROM CONSTRUCTION
(at 1993-94 prices)

(Rs. Crore)

1993-94	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2003-04**	**Item**	
9	10	11	12	13	14	15	1	
106458	**144144**	**153730**	**165593**	**171580**	**187352**	**202932**	**1**	**Value of output**
87625	119163	127498	136178	143434	156635	170977	1.1	New Construction
18833	24981	26232	29415	28146	30717	31955	1.2	Repair & Maintenance
40593	**54389**	**58740**	**62651**	**65161**	**69911**	**74819**	**2**	**Gross Domestic Product**
41123	55437	59938	64209	67111	72638	78035	2.1	Gross Domestic Product unadjusted for F.I.S.I.M
530	1048	1198	1558	1950	2727	3216	2.2	**Less:** F.I.S.I.M.
1844	**2942**	**3117**	**3308**	**3338**	**3436**	**3857**	**3**	**Less:** Consump of fixed capital
38479	**51447**	**55623**	**59343**	**61823**	**66475**	**70962**	**4**	**Net Domestic Product**

F.I.S.I.M.: Financial Intermediation Services Indirectly Measured

Annexure 4
Global REIT Comparison[1] [November/December 2005]

	U.S.	Australia	Netherlands	Canada	Belgium	Singapore	Japan	France	Hong Kong	Malaysia	Korea	Taiwan
Management Internal or External	Either	Either	Internal	Internal	Either	External	External	Either	Either	External	Either	Either
Investment Restrictions												
Real Estate Investments	75%+	50%+ of revenue from rent*	100%	80%+	100%	70%+	75%+	Flexible	100%	50-75%	70%+	75%+
Overseas Investment	OK	OK	OK	OK	Prohibited	OK	OK	OK	OK	OK but approvals required	OK	OK but approvals required
Development	OK	OK	Minimal	OK	Minimal	20% of total assets	OK (but 50%+of assets must be income) producing)	Prohibited	Prohibited	OK (limit to 30% of equity)	OK	Prohibited
Gearing Limit	None	None	60% property assets	None	50% of total assets	35% total asset***	None	None	45% of total assets	35%	Limit to 200% of equity	35%
Payout	90%+ of taxable income (post deprec.)	100% of taxable income (post deprec.)	100% of fiscal earnings	85% of distributable cash (pre-deprec.)	80% of taxable income and net debt paydown	100% of taxable income (no deprec.)	90%+ of taxable income (post deprec.)	85% of taxable income from rentals, 50% of capital gains	90% + of net income after tax (no deprec.)	No restrictions (but undistributed earnings is taxed at 28%)	90%+ of equity less capital and reserve	100% of distributable income (post expense and reserve)
Closed Ended**	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Closed ended mostly, opened end need gov.'s approval
Listed/Unlisted**	Both	Both	Both	Listed	Listed	Listed	Listed	Listed	Listed	Both	Both	Both
Tax Transparency	Yes	Yes	Yes^	Yes	Yes^	Yes	Yes	Yes^	No**	Yes	Yes	Yes+

Notes:
* This is a condition of entry into the LPT index, not a regulatory requirement.
^ Taxed at source on overseas income and non-exempt activities such as development (France only).
** Not needed as there is no tax on dividends in HK.
^^ Currently, Germany is the only country with tax transparent option that is unlisted and open ended that is available to both tax paying and tax exempt investors.
*** With ›35% with an A rating.
^^^ Capital gains from the tax - exempt portion can be distributed in-line with tax treatment of rent.
\+ No tax on capital gain, but 6% on dividend gain.

Source: UBS

[1] http://www.nareit.com/portfoliomag/05special/p28_side1.shtml, visited on November 18, 2005

Annexure 5
Investment Conditions and Restrictions under the VCF Regulations[1]

Minimum investment in a venture capital fund

11. (1) A venture capital fund may raise monies from any investor whether Indian, foreign or non-resident Indians by way of issue of units.
(2) No venture capital fund set up as a company or any scheme of a venture capital fund set up as a trust shall accept any investment from any investor which is less than five lakh rupees:
Provided that nothing contained in sub-regulation (2) shall apply to investors who are, -
(a) employees or the principal officer or directors of the venture capital fund, or directors of the trustee company or trustees where the venture capital fund has been established as a trust; or
(b) the employees of the fund manager or asset management company.
(3) Each scheme launched or fund set up by a venture capital fund shall have firm commitment from the investors for contribution of an amount of at least Rupees five crores before the start of operations by the venture capital fund.

Investment conditions and restrictions

12. All investment made or to be made by a venture capital fund shall be subject to the following conditions, namely: -
(a) venture capital fund shall disclose the investment strategy at the time of application for registration;
(b) venture capital fund shall not invest more than 25% corpus of the fund in one venture capital undertaking;
(c) shall not invest in the associated companies; and
(d) venture capital fund shall make investment as enumerated below:
(i) at least 66.67% of the investible funds shall be invested in unlisted equity shares or equity linked instruments of venture capital undertaking
(ii) Not more than 33.33% of the investible funds may be invested by way of
(a) subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed
(b) debt or debt instrument of a venture capital undertaking in which the venture capital fund has already made an investment by way of equity
(c) Preferential allotment of equity shares of a listed company subject to lock in period of one year
(d) the equity shares or equity linked instruments of a financially weak company or a sick industrial company whose shares are listed
Explanation-1 For the purpose of these regulations, "a financially weak company" means a company, which has at the end of the previous financial year accumulated losses, which has resulted in erosion of more than 50% but less than 100% of its networth as at the beginning of the previous financial year
(e) Special Purpose Vehicles which are created by a venture capital fund for the purpose of facilitating or promoting investment in accordance with these Regulations
Explanation-The investment conditions and restrictions stipulated in clause (d) of regulation 12 shall be achieved by the venture capital fund by the end of its life cycle.
(e) Venture capital fund shall disclose the duration of life cycle of the fund.

Prohibition on listing

13. No venture capital fund shall be entitled to get its units listed on any recognised stock exchange till the expiry of three years from the date of the issuance of units by the venture capital fund.

[1] As enumerated in Chapter III of the SEBI (VCF) Regulations, 1996.

Annexure 6
Investment Conditions and Restrictions under the FVCI Regulations[1]

Investment Criteria for a Foreign Venture Capital Investor

11. All investments to be made by a foreign venture capital investors shall be subject to the following conditions: -
(a) it shall disclose to the Board its investment strategy.
(b) it can invest its total funds committed in one venture capital fund.
(c) it shall make investments as enumerated below:
(i) atleast 66.67% of the investible funds shall be invested in unlisted equity shares or equity linked instruments of Venture Capital Undertaking.
(ii) not more than 33.33% of the investible funds may be invested by way of:
(a) subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed
(b) debt or debt instrument of a venture capital undertaking in which the foreign venture capital investor has already made an investment by way of equity.
(c) preferential allotment of equity shares of a listed company subject to lock in period of one year.
(d) the equity shares or equity linked instruments of a financially weak company or a sick industrial company whose shares are listed.

Explanation 1:- For the purpose of these regulations, a "financially weak company " means a company, which has at the end of the previous financial year accumulated losses, which has resulted in erosion or more than 50% but less than 100% of its net worth as at the beginning of the previous financial year."

(e) Special Purpose Vehicles which are created for the purpose of facilitating or promoting investment in accordance with these Regulations.

Explanation - the investment conditions and restrictions stipulated in clause (c) of regulation 11 shall be achieved by the Foreign Venture Capital Investor by the end of its life cycle".

(d) It shall disclose the duration of life cycle of the fund.

Annexure 7
Government of India, Ministry of Commerce & Industry, Department of Industrial Policy & Promotion SIA (FC Division)

Press Note 2 (2005)

Subject: Foreign Direct Investment (FDI) in townships, housing, built-up infrastructure and construction-development projects

With a view to catalysing investment in townships, housing, built-up infrastructure and construction-development projects as an instrument to generate economic activity, create new employment opportunities and add to the available housing stock and built-up infrastructure, the Government has decided to allow FDI up to 100% under the automatic route in townships, housing, built-up infrastructure and construction-development projects (which would include, but not be restricted to, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure), subject to the following guidelines:

a. Minimum area to be developed under each project would be as under:
i. In case of development of serviced housing plots, a minimum land area of 10 hectares

ii. In case of construction-development projects, a minimum built-up area of 50,000 sq.mts

iii. In case of a combination project, any one of the above two conditions would suffice

b. The investment would further be subject to the following conditions:
i. Minimum capitalization of US $10 million for wholly owned subsidiaries and US $5 million for joint ventures with Indian partners. The funds would have to be brought in within six months of commencement of business of the Company.

ii. Original investment cannot be repatriated before a period of three years from completion of minimum capitalization. However, the investor may be permitted to exit earlier with prior approval of the Government through the FIPB.

c. At least 50% of the project must be developed within a period of five years from the date of obtaining all statutory clearances. The investor would not be permitted to sell undeveloped plots. For the purpose of these guidelines, "undeveloped plots" will mean where roads, water supply, street lighting, drainage, sewerage, and other conveniences, as applicable under prescribed regulations, have not been made available. It will be necessary that the investor provides this infrastructure and obtains the completion certificate from the concerned local body/service agency before he would be allowed to dispose of serviced housing plots.

d. The project shall conform to the norms and standards, including land use requirements and provision of community amenities and common facilities, as laid down in the applicable building control regulations, bye-laws, rules, and other regulations of the State Government/Municipal/Local Body concerned.

e. The investor shall be responsible for obtaining all necessary approvals, including those of the building/layout plans, developing internal and peripheral areas and other infrastructure facilities, payment of development, external development and other charges and complying with all other requirements as prescribed under applicable rules/bye-laws/regulations of the State Government! Municipal/Local Body concerned.

f. The State Government/Municipal/Local Body concerned, which approves the building/ development plans, would monitor compliance of the above conditions by the developer."

2. Para (iv) of Press Note 4 (2001 Series), issued by the Government on 21.5.2001, and Press Note 3 (2002 Series), issued on 4.1.2002, stand superceded.

[1] As enumerated in Chapter III of the SEBI (FVCI) Regulations, 2000.