



Tax alert: Regulations for Small and Medium Real Estate Investment Trusts (SM REITs) notified

20 March 2024

The Securities and Exchange Board of India ("SEBI"), vide notification dated on 8 March 2024, introduced regulatory framework for facilitation of Small and Medium Real Estate Investment Trusts ("SM REITs") by amending the SEBI (Real Estate Investment Trusts) Regulations, 2014 ("REIT Regulations"), through SEBI (Real Estate Investment Trusts) (Amendment) Regulations, 2024 ("Amended REIT Regulations"), thereby, paving the way to make real estate investment more accessible to wider set of investors and to regulate and foster growth in Fractional Ownership investment.

In a nutshell



SEBI has introduced regulatory framework for SM REITs and has notified Amended REIT Regulations.



SM REIT can be set-up as Trust with an asset size of INR 50 Crores (as against INR 500 Crores in REIT).

Investors can invest in the units of SM REITs with minimum subscription of INR 10,00,000/-
Facilitates migration of existing structures (Fractional Ownership Platforms) into SM REIT.



Mandatory listing of units of the scheme of the SM REITs on designated stock exchanges.

Investments to be made only in completed and revenue generating Properties; investments will not be in under-construction or non-revenue generating real estate assets.



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Background:

- On 12 May 2023 SEBI issued a consultation paper for public comments on Regulatory Framework for Micro, Small & Medium REITs (“MSM REITs”), proposed amendment to REIT Regulations to introduce framework for MSM REITs.
- SEBI, vide its board meeting held on 25 November 2023, had approved regulatory framework for facilitation of SM REITs by way of amendments to REIT Regulations.
- On 8 March 2024 SEBI notified SEBI (Real Estate Investment Trusts) (Amendment) Regulations, 2024, thereby introducing SM REITs.

Key Terms:

Term	Key terms
Real Estate Investment Trust (REIT)	<p>“Real Estate Investment Trust” means</p> <ul style="list-style-type: none">• a person that pools INR 50 crores or more for the purpose of issuing units to at least 200 investors• so as to acquire and manage real estate asset(s) or property(ies), that would entitle such investors to receive the income generated therefrom• without giving them the day-to-day control over the management and operation of such real estate asset(s) or property(ies). <p>Explanation 1. – For the purpose of Amended REIT Regulations, a REIT or Real Estate Investment Trust shall include an SM REIT under Chapter VIB of Amended REIT Regulations.</p> <p>Explanation 2. – For the removal of doubts, it is hereby clarified that for the purpose of Amended REIT Regulations, any company which acquires and manages real estate asset(s) or property(ies) and offers or issues securities to the investors, shall not be construed as a REIT or Real Estate Investment Trust;”</p>
Small and Medium REIT (“SM REIT”)	<p>“Small and Medium SM REIT” means a SM REIT that pools money from investors under one or more schemes whereby:</p> <ul style="list-style-type: none">• Asset size proposed to be acquired is at least INR 50 crores and less than INR 500 crores; and• Minimum number of unitholders of a scheme are not less than 200 (other than Investment Manager, its related parties and associates of the SM REIT)
Investment Manager	<p>“Investment Manager” means a company incorporated in India and which:</p> <ul style="list-style-type: none">• Sets up the SM REIT• Manages assets and investments of SM REIT• Undertakes operational activities of SM REIT
Special Purpose Vehicle (“SPV”)	<p>“Special Purpose Vehicle” means any company which is a wholly owned subsidiary (“WOS”) of the scheme of the SM REIT and the SPV not having any other capital or ownership interest in it.</p>

Key Highlights:

1. SM REIT Structure:

Sl. No.	Parameters	Key provisions of Amended REIT Regulations/criteria
1.	SM REITs	<ul style="list-style-type: none">— To be set up in the form of Trust and the Trust deed to be registered under the provisions of Registration Act, 1908— Trust deed to have its main objective as undertaking activity of SM REIT through one or more schemes in accordance with Amended REIT Regulations.
2.	Trustee	<ul style="list-style-type: none">— Trustee of a Trust should be registered with SEBI under SEBI (Debenture Trustees) Regulations, 1993
3.	Investment Manager/Sponsor	<ul style="list-style-type: none">— A company incorporated in India.— Single entity to operate as Manager and sponsor (i.e., not required to have two separate entities as Manager and Sponsor)— IM to meet net-worth and other eligibility criteria as prescribed.
4.	Special Purpose Vehicle (SPV)	<ul style="list-style-type: none">— SPV will be a company which is WOS of the scheme of the SM REIT— SPV will not have any other capital or ownership interest

2. Investment Manager (IM)/Sponsor:

Sl. No.	Parameters	Key provisions of Amended REIT Regulations	
1.	Type of entity	— A company incorporated in India.	
2.	No of entity	— Single entity to operate as Manager and sponsor (i.e., not required to have two separate entities as Manager and Sponsor)	
3.	Net worth of IM	— INR 20 Crores (Out of which INR 10 crores should be in the form of liquid net worth)	
4.	Experience	<ul style="list-style-type: none">— IM should have minimum 2 (two) years of experience in real estate industry or real estate fund management.— Alternatively, IM may employ two KMPs, each of the KMP should have minimum 5 (five) years of experience in real estate industry or real estate fund management.	
5.	Minimum investment of IM in SM REIT (from the date of initial listing)	Time period from initial listing of scheme's units	Minimum investment of IM in SM REIT
		Up to 3 years	REIT has opted not to undertake leverage: 5% of total outstanding units of the cheme

			<p>REIT has opted to undertake leverage:</p> <ul style="list-style-type: none"> 15% of total outstanding units of the scheme (if opted to undertake leverage) <p>Holding of IM in excess of minimum 5% or 15% of total outstanding units shall be held for at least 1 year (from the date of listing of units issued in the initial offer).</p>
		4-5 years	5% of total outstanding units of the scheme
		6-10 years	3% of total outstanding units of the scheme
		11-20 years	2% of total outstanding units of the scheme
		Post 20 years	1% of total outstanding units of the scheme
6.	Activity of IM	<ul style="list-style-type: none"> Only manage assets and investments of the SM REIT and undertake its operational activities. To ensure that trademark, brand name, website etc. of the SM REIT be used exclusively for the activities of SM REIT. 	
7.	Composition of Board of IM	<ul style="list-style-type: none"> At least half of the directors should be independent and should not be director of IM / Manager of other SM REIT or REIT. 	

3. Other key conditions of SM REITs framework:

Sl. No.	Parameters	Key provisions of Amended REIT Regulations
1.	Asset size	— At least INR. 50 crores and less than INR. 500 crores in a scheme
2.	Type of investors	— Indian or Foreign (subject to guidelines specified by Reserve Bank of India [RBI] and the Government of India [GOI])
3.	Minimum no. of investors	— 200 investors (Other than IM, its related parties, and associates)
4.	Minimum subscription price	— INR 10,00,000 per unit
5.	Minimum public unit holding	— At least 25% of the total outstanding units of scheme
6.	Schemes under SM REITs	— Permitted to launch schemes and each Scheme to be identified by a separate name (shall not be

		misleading/portray any guaranteed returns to the investors)
7.	Mode of funding	<p>Scheme of SM REIT:</p> <ul style="list-style-type: none"> — By way of issue of its units May raise funds by issue of its units to Indian or foreign investors (subject to RBI and GOI guidelines) — Opting to utilize leverage: May undertake leverage through borrowings or issuance of debt securities under SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021. <p>SPV of Scheme:</p> <ul style="list-style-type: none"> — To raise fund only from equity investment from the Scheme — May raise funds by way of borrowings from the Scheme. — Scheme of SPV which have opted leverage, the SPV of such scheme may undertake leverage through external borrowings or issuance of debt securities under SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021.
8.	Listing of units	<ul style="list-style-type: none"> — Units of the scheme of the SM REIT shall be mandatorily listed on a recognized stock exchange.
9.	Dematerialization of units	<ul style="list-style-type: none"> — Units of Scheme of the SM REIT to be issued only in dematerialized form.
10.	Investment conditions	<p>Scheme</p> <ul style="list-style-type: none"> — Scheme of SM REIT is not permitted to invest in under-construction or non-revenue generating real estate assets. — Min. 95% of the value of the schemes' assets (for each of its schemes) to be invested in completed and revenue generating properties at all times. — Up to 5% of the value of the schemes' assets may be invested in unencumbered liquid assets. (Cash, units of overnight or liquid mutual fund schemes, fixed deposits, government securities, treasury bills and repo on government securities). <p>SPV</p> <ul style="list-style-type: none"> — To directly and solely own all assets that are acquired or proposed to be acquired by the Scheme — Not be permitted to lend to any entity
11.	Valuation of assets	<p>Valuation frequency:</p> <ul style="list-style-type: none"> — Investment manager to ensure that the valuer to carry out the valuation of the assets of each scheme on an annual basis. — Valuer to undertake physical inspection of each property

		<p>of the scheme at the time of undertaking a valuation exercise.</p> <p>Requirement of obtaining valuation report in case of:</p> <ul style="list-style-type: none"> — Material development which may have an impact on the valuation of assets; in such case, valuation to be done within two months from the date of event. — Prior to any issue of units to the public and any other issue of units in the scheme and include a summary of the report in the scheme offer document (Valuation report shall not be more than 6 months old at the time of such offer and no material changes have occurred thereafter). — Purchase of a new property or sale of an existing property
12.	Timelines for migration of existing persons, entities, or structures (FOPs)	<ul style="list-style-type: none"> — Application for registration (for migration) – 6 months from notification of Chapter VIB of Amended REIT Regulations (i.e., 6 months from 8 March 2024) or such period as may be granted by the SEBI — Migration of existing persons, entities, or structures (FOPs) to be completed within 6 months from grant of certificate of registration with SEBI as SM REIT.
13.	Use of leverage for funding	<ul style="list-style-type: none"> — Total borrowings and deferred payments net of cash and cash equivalents, at the scheme level, shall not exceed 49% of the value of the scheme assets. — If it exceeds 25% of the value of the scheme assets, then for any further borrowings: <ul style="list-style-type: none"> (i) Credit rating shall be obtained; and (ii) Approval of unit holders shall be obtained
14.	Distribution by the SPVs to Scheme	<ul style="list-style-type: none"> — Min. 95% of Net Distributable Cash Flows (NDCF) to be distributed to the scheme of SM REIT subject provisions of Companies Act 2013 — The amount retained at the SPV level may be utilized as specified by SEBI.
15.	Distribution by Scheme to unit holders	<ul style="list-style-type: none"> — 100% NDCF of the SM REIT Scheme shall be distributed to the unit holders in such schemes.
16.	Related party transactions	<ul style="list-style-type: none"> — SM REITs are not allowed to enter into transactions with related parties including transactions for facility management and management of property — However, the aforesaid restriction shall not apply to payment of fees by SM REIT to investment manager and trustee for carrying on activities of the SM REIT. <p>Note:</p> <p>“Related Party” shall mean related parties under the Companies Act, 2013 or applicable Accounting Standards and the following:</p> <ul style="list-style-type: none"> i. parties to the SM REIT;

		ii. promoters, directors, and partners of the persons in clause (i) above
17.	Annual meeting/rights of unit holders	<ul style="list-style-type: none"> — An annual meeting of unit holders of each scheme shall be held at least once every year within 120 days from the end of financial year and the time between two AGM shall not exceed 15 months. — Unitholders of the scheme have the right to receive distributions as provided in the offer document and to vote in any unitholder’s meeting. — Approval of unitholders (as prescribed) would be required for change in IM and investment strategy.
18.	Tax considerations	<ul style="list-style-type: none"> — The Income-tax Act, 1961 (‘IT Act’) defines “business trust” to mean a Trust registered as a REIT under the Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014, made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) (‘REIT Regulations’). — The IT Act has set out a special regime for taxation of income arising to business Trust and its unitholders under Chapter XII -FA of the IT Act. — The Amended REIT Regulations includes SM REIT under the framework of REIT Regulations and mentions REIT shall include a SM REIT. — Accordingly, the existing taxation framework including as provided in Chapter XII -FA of the IT Act as stipulated for business Trust shall also apply to SM REIT.

Conclusion:

The notification of framework of SM REIT through SEBI (Real Estate Investment Trusts) (Amendment) Regulations, 2024 will increase access to real estate investments, facilitate pooled investment in a wider range of real estate assets as a regulated financial product, thereby facilitating further growth of REITs in India, in turn facilitating greater growth of the real estate sector and all related sectors of the economy and providing liquidity to investors.



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