REAL ESTATE INVESTMENT CLIMATE IN INDIA

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Foreign Direct Investments in Townships, Housing, and Commercial Construction Industry

- Change in policy of the Government of India in 2005
  - The Government of India has by Press Note 2 of 2005 issued on March 3, 2005 (**the "2005 Press Note"**), stipulated the policy of the Government of India in respect of foreign direct investment (**"FDI"**) in townships, housing, built-up infrastructure and construction-development projects.
- Availability of the automatic route
  - Pursuant to the 2005 Press Note, FDI of up to one hundred percent (100%) is permitted 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, and city and regional level infrastructure).
  - Applicability of the automatic route means that no prior approval of the Government of India or the Reserve Bank of India is required for the investment to be made in these specified activities, subject to meeting certain conditions some of which are outlined in this presentation.

Requirements of the "Automatic Route"

- **Minimum area to be developed.** The minimum area required to be developed depends on the nature of the project:
  - **Development of serviced housing plots:** Minimum land area of 10 hectares.
  - **Construction-development projects:** Minimum built up area of 50,000 square meters.
  - **Combination projects:** Either of the above 2 conditions.
- **Minimum capitalization**
  - The minimum capitalization norm is US$ 10 million for wholly owned subsidiaries, and US$ 5 million for joint ventures with Indian partners. This minimum equity should be brought in within six (6) months of commencement of business.
- **Lock-in period for repatriation**
  - The minimum lock-in period before repatriation of original investment is permitted remains at three (3) years from the completion of minimum capitalization. The investor may be permitted to exit earlier with prior approval of the Government of India.
- **Project completion period**
  - A minimum of fifty percent (50%) of the project must be completed within a period of five (5) years from the date of obtaining all statutory clearances.
- **Additional Requirements**
  - Conformity with all applicable norms and standards and compliance with all applicable rules, bye-laws and regulations.
  - The developer is not permitted to sell undeveloped plots. Undeveloped plots are described as plots where roads, water supply, street lighting, drainage, sewerage, and other conveniences, as applicable under the applicable regulations, have not been made available.

Special Economic Zones (SEZ) Act, 2005

- **A Special Economic Zone ("SEZ") is a specified, delineated and duty-free geographical region that has different economic laws from those of the country in which it is situated.**
  - The Government of India recently enacted the Special Economic Zones Act, 2005 ("**SEZ Act**"), which, along with the SEZ Rules, 2006 ("**SEZ Rules**") that were notified on February 10, 2006, provide for several facilities and benefits available to developers of SEZs and businesses located within SEZs. Each business located within the SEZ is referred to as a separate SEZ Unit ("**SEZ Unit**") and is required to obtain a separate approval as an operating SEZ Unit within the SEZ.
- **Regulatory Framework for setting up an SEZ and SEZ Unit**
  - The federal Ministry of Commerce and Industry lays down the regulations that govern the setting up and administering of the SEZs.
  - The Central Government is involved in notifying SEZs and in overseeing their functioning, while the State Governments play a significant lead role in the development of SEZs in their respective States by stipulating the conditions to be adhered to by an SEZ and granting the necessary approvals.
  - The policy framework for SEZs has been enacted in the SEZ Act and the supporting procedures are laid down in SEZ Rules.
- **An SEZ could be jointly or severally developed by the Central or State Government or a private party, either (a) for manufacturing goods, (b) for rendering services, or (c) as a free trade and warehousing zone.**
  - "*Manufacture*" means to make, produce, fabricate, assemble, process or bring into existence, by hand or by machine, a new product having a distinctive name, character or use and shall include processes such as refrigeration, cutting, polishing, blending, repair, remaking, re-engineering and includes agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture, viticulture and mining.
  - "*Services*" means tradable services which (a) are covered under the General Agreement on Trade in Services, (b) may be prescribed by the Central Government for the purpose of SEZ Act, or (c) earn foreign exchange.
  - "*Free Trade and Warehousing Zone*" means an SEZ wherein mainly trading and warehousing and other activities related thereto are carried on.

Benefits of an SEZ and SEZ Unit

- **Benefits to SEZ Developers**
  - 100 per cent of the profits of the Developer arising from the business of developing an SEZ are exempt from income tax. This deduction can be claimed at the option of the assessee for any 10 consecutive years out of 15 years.
  - The Developers of SEZ are not required to pay Minimum Alternate Tax.
  - No dividend distribution tax shall be paid by a Developer engaged in developing, operating and maintaining an SEZ.
- **Benefits to SEZ Units**
  - *Income tax*: profits and gains from business are exempt: 100% for the first 5 years; 50% exemption for the next 5 years; and 50% exemption to the extent that such amounts are re-invested in the SEZ Special Reserve Account.
  - *Losses*: Losses falling under the heads “Profits and Gains from Business or Profession” and “Income from Capital Gains” can be carried forward / set off as long as such loss is related to the business of the SEZ Unit.
  - *Capital Gains* on transfer of assets in case of shifting of an industrial undertaking from an urban area to an SEZ are exempt, provided certain conditions are met.
  - *Interest income* received by a non-resident or a person who is not ordinarily resident in India, on a deposit made in an Offshore Banking Unit situated in an SEZ is exempt from total income.
  - *Exemption from Customs Duty*: SEZ Units may import or procure from the domestic sources, duty free, all their requirements of capital goods, raw materials, consumables, spares, packing materials, office equipment, etc. for implementation of their projects in the SEZ without requiring any license or specific approval, subject to certain conditions.
  - *FDI*: 100% FDI under the automatic route is allowed in the manufacturing sector in SEZ Units, subject to certain exceptions.
  - *Central Sales Tax*: Exemption from Central sales tax on inter-state sale or purchase of goods.
  - *State Taxes*: The State Governments may grant exemption from state taxes, levies and duties to a Developer or an entrepreneur.
  - *Service Tax* : Exemption from Service Tax to the Developer and the SEZ Units to carry on authorized operations in the SEZ.
  - *Labour laws*: All labor laws applicable in India also apply in an SEZ in the same manner.
  - *Stamp duty*: No stamp duty is chargeable on instruments and documents used or entered into for carrying out of the purposes of the SEZ.

The Industrial Park Scheme

- The Industrial Park Scheme, 2002 (the **"Industrial Park Scheme**") notified by the Government of India primarily aims at providing certain tax benefits to undertakings that develop/ develop and operate/ maintain and operate an Industrial Park for the period beginning on April 1, 1997 and ending on March 31, 2006.
- Pursuant to the Industrial Park Scheme, foreign investment up to 100% is permitted on a fully repatriable basis, in companies that are engaged in the business of developing, developing and operating or maintaining and operating an Industrial Park and are approved under the Industrial Park Scheme. The approval of an Industrial Park is granted under the Industrial Park Scheme, either through the automatic route or through the non-automatic route, depending upon the fulfillment of certain eligibility criteria.
- The Industrial Park Scheme and the benefits that may be obtained under it have not been amended by way of the 2005 Press Note.

Key Considerations for Foreign Investors

- Tax Structuring:
  - Avoid Permanent Establishment in India
  - Use of tax efficient jurisdictions like Mauritius, Cyprus or Singapore

- Corporate Structuring:
  - Setting up branch office, project office, subsidiary or management company in India
  - Investor protection: pre-emptive rights, veto rights, tag along and drag along rights, board composition, board and shareholder meetings, put options, and liquidation preferences

- Types of Investment Instruments:
  - Equity
  - Preference Shares
    - Fully / Compulsorily Convertible
    - Partly / Optionally Convertible
    - Non-Convertible
  - Debt
    - Debentures; fully / compulsorily convertible, partly / optionally convertible or non-convertible
    - Other External Commercial Borrowings

- Transaction Costs:
  - Stamp duty applicable in all real estate transactions-as high as up to 15% in some states
  - Startup expenses

- Title:
  - High percentage of land holdings do not have clear titles
  - Land typically held by individuals/families; ownership is unclear and hence land is off market

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