

amicus

An e-newsletter from
Lakshmikumaran & Sridharan, India

January 2016 / Issue – 53

Contents

Article

Wishlist 2016 for Real Estate
Sector in India 2

Notifications & Circulars 5

Ratio Decidendi 7

January
2016



Article

Wishlist 2016 for Real Estate Sector in India

By **Kritika Krishnamurthy**

Agricultural land in the rural areas and real estate in cities has always been a stable rock for economies and investors since time immemorial across the world. Warren Buffet in his annual letter to shareholders about investing in real estate in 2014 said “*Whatever the chatter, corn would keep growing in Nebraska and students would flock to NYU.*”¹

For 2016, however, Fitch predicts a negative to stable outlook for real estate sector in India.² To prove Fitch wrong, like Indians often do, the real estate sector in India needs a regulatory tide to ride on, which the year 2016 will hopefully provide. To begin 2016, here are some new-year resolutions India needs to achieve to give a boost to the real estate sector.

Foreign Investment

Foreign investment in “real estate” sector is prohibited but the constituents of this sector underwent changes in the policy from time to time to move certain activities from prohibited to ‘permitted’ while some of it remained subject to legal interpretation. Recently, Press Note No. 12 of 2015 (*Press Note*) issued by Department of Industrial Policy and Promotion, Government of India on 24th November 2015 has clarified some of the

grey areas and removed some long pending doubts. Now, real estate means dealing in land and immovable property with a view to earning profit there from and does not include development of townships, construction of residential/ commercial premises, roads or bridges, educational institutions, recreational facilities, city and regional level infrastructure, townships. Further, a developer is allowed to lease developed property and earn rent/ income on lease of the property and so long as it does not amount to transfer, the activity shall not be considered real estate business.

With new and disruptive business models emerging, doubts continue on whether business facility centres, service apartment facilities, leases on timeshare basis are within or outside the purview of prohibited real estate business in terms of foreign direct investment. To add to the confusion, though notified more than a month and half ago by DIPP, the Press Note is yet to be notified through amendments by Reserve Bank of India (RBI) till which time, it is yet to have the force of law. Considering the increasing efforts to increase foreign investments in India, the definition ought to be favorably interpreted in favour of the innovative business models so long as

¹ *Buffett’s annual letter: What you can learn from my real estate investments*, Fortune, February 24, 2014

² http://b2bimages.iimg.in/files/retail_files/reports/data_file-India-Ratings-FY16-Outlook-for-Real-Estate-Sector-1435559316.pdf

the services do not lead to a transfer of the immovable property involved. Additionally, suitable amendments in foreign exchange regulations will provide the much required breather to the sector.

Real Estate Investment Trusts

Since 2014, India has been working on the regulatory regime of Real Estate Investment Trusts (REITs). In November 2015, foreign investment in real estate investment trusts and infrastructure investment trusts was allowed without government approval.³ The recent 2015 Budget, removed the issue of capital gains tax for sponsors and allowed ‘pass-through’ on rental income. However, capital gains tax will apply on the direct transfer of real estate to these trusts. Moreover, the stamp duty and registration fees implication on any transfer of immovable property to the REIT or the special purpose vehicle continues to attract a huge transaction cost. As of now, the government has not made any move to iron out this crease in the structure.

In 2016, we hope REITs become a more commercially viable and adopted structure in India. REITs, if implemented sustainably in India can provide an exit route to developers from completed commercial assets, aid in development of smart cities in India, attract investors seeking investment in high-quality investment grade properties and facilitate introduction to new set of large moderate (risk

v. return) investors like insurance and pension funds looking for long term investments with steady returns.

Parking Space Conundrum

Developers around India have adopted the trend of selling parking spaces within the common facilities of an apartment to apartment dwellers and third party. In 2016, this trend is a bubble waiting to burst leading to series of litigation in the real estate sector. The Supreme Court of India has held that a parking space is an integral part of the common facilities required to be provided with an apartment and that the parking space shall not be sold separately for valuable consideration. Additionally, the ownership of common areas around an apartment building or within a township vest among the apartment owners jointly in the proportion of their interest in the apartment building.⁴ The judgments were delivered based on interpretation of State legislations but shall have ramifications pan India if the state laws are similarly worded. A word of caution to the real estate developers in India.

Title Due Diligence

For ages, India followed the *jagir* and *zamindari* system where proprietary rights in land remained with the king who doled out the right to cultivate and the right to collect revenue on his behalf to *jagirdars* and *zamindars*. With the advent of British rule in

³ Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Eleventh Amendment) Regulations, 2015 dated November 16, 2015

⁴ *Nahalchand Laloochand Pvt. Ltd. v Panchali Co-operative Housing Society Ltd.*, (2010) 9 SCC 536; *DLF Limited v Manmohan Lowe and Ors.*, 2014 (2) SCJ 144

India, the *jagirdars* and *zamindars* usurped title to the land through various legislations passed by the British in a half-hearted attempt to regularize land ownership rights in India. They also developed a complex record of land survey and revenue collection through various registers prescribed under State laws which are unfortunately still existing in India.⁵ If you have ever purchased land in India, you will be lost in the maze of registrations and records you need to update to fortify your title to the land.⁶ Even after all these measures, if the land was reserved for a specific class of persons⁷ or for the service of a God,⁸ your title to land may end up void. Title due diligence is one of the costliest and riskiest exercises taken up by real estate companies in India.

In 2016, India needs at least a step towards a centralized documentation system which records the nature of the land (whether it is reserved for a certain category of individuals or institutions), financial encumbrances and of course, the flow of title of the land. A single window registration system for revenue as well as land records can be created through the offices of the registrar of assurances where it is compulsory to pay registration fees and stamp duty on the title deed for any new transfers.⁹

Some forward looking states like Andhra Pradesh have made attempts to digitize land revenue records and ownership but existing mess of land title for the past centuries is another story fraught with minefields for the new buyer.

Way forward

All in all, the rise and fall of business segments and changes in market trends are all dependent on the psychology of the consumer and the governments. So long as there are Indians looking for stable investment returns either through increasing property value or rentals in a country with high inter-migration rates and a burgeoning young population, the saga of real estate sector in India will continue. But laws, being the accelerator of this growth story, need to keep pace with the changing dynamics and the demands of the market and the stakeholders. Although the present government seems to be trying hard to amend and repeal archaic laws, only time will tell if the country is able to withstand the fast pace of the global economy.

[The author is a Senior Associate, Corporate Practice, Lakshmikumaran & Sridharan, Gurgaon]

⁵ *G. Satyanarayana v Government of Andhra Pradesh*, 2014 (3) ALT 473

⁶ This includes mutation for updating revenue records and application for updating the local 'Pattadar Passbook'

⁷ Various state laws in India prohibit transfer of certain notified land except to protected category of persons as a social welfare measure.

⁸ As recently illustrated in *Sri Jagannath Temple Managing Committee v. Siddha Math & Others*, Civil Appeal No. 7729 of 2009 decided by Supreme Court of India on December 15, 2015

⁹ Section 54, Transfer of Property Act, 1882 read with Section 3, Indian Stamp Act, 1899 and Section 17, Registration Act, 1908

Notifications & Circulars

Start-ups – Government proposes radical changes in laws relating to start-ups in India:

With a view to stimulate the development of startups in India and to provide them with a competitive platform, the government of India has unveiled a three pronged plan which covers Simplification and Handholding; Funding Support Incentives; and having an Industry – Academia Partnership and Incubation. Startups accordingly will be provided with Tax exemptions for 3 years and Tax exemption on capital gains. Some other initiatives proposed include, Compliance regime based on self-certification; Legal support & fast tracking of Patent Examination; Faster exit schemes; Funding support and incentives; and Credit guarantee scheme. Further, ‘Startup’ has also been defined in this regard and eligibility conditions prescribed. [For more details on the available incentives, please refer L&S Corporate Update No. 1 of 2016]

Corporate Social Responsibility (CSR)

clarified: The Ministry of Corporate Affairs has issued clarifications by way of Frequently Asked Questions (FAQ) relating to the Corporate Social Responsibility (CSR) obligations of companies under Companies Act, 2013. Some important aspects clarified by General Circular No. 1 of 2016, dated 12-1-2016 issued for the purpose are: (a) CSR expenditure cannot be claimed as a business expenditure for income tax purposes; (b) Net profit for the purpose of Section 135 of CA 2013 shall be computed as per Section

198 and shall mean ‘profit before tax’; (c) CSR activities must be relatable to activities under Schedule VII of CA 2013 and the entries under Schedule VII should be interpreted liberally; (d) One off events, activities for employees and their families, activities undertaken outside India shall not be considered CSR activities; (e) Holding and subsidiary companies do not have any CSR obligation unless they themselves cross the prescribed thresholds; and (f) Amount spent in excess this year cannot be adjusted against subsequent year’s liability.

Project and Service Exports - Memorandum of Instructions revised:

The Reserve Bank of India through A.P. (DIR Series) Circular No. 39, dated January 14, 2016 has revised the Memorandum of Instructions on Project and Service Exports (PEM) to reflect the following policy decisions of the Government of India: i) the ‘Overseas Construction Council of India’ (OCCI) has been renamed as ‘Project Export Promotion Council’ (PEPC); and ii) civil construction contracts shall now include turnkey engineering contracts, process and engineering consultancy services and Project construction items (excluding steel & Cement) along with civil construction contracts.

International Financial Services Centre - Permissible activities and relaxations for banking units notified:

RBI has relaxed norms in relation to permissible activities of International Banking Units (IBUs) set up within an International Financial Services

Centre (IFSC). The permissible activities and relaxations are as follows: (a) IBUs can open foreign currency current accounts of units operating in IFSCs and of non-resident institutional investors to facilitate their investment transactions. All transactions through these accounts must be undertaken via bank transfers; (b) IBUs can raise short-term liabilities from banks and it has been decided that RBI will not prescribe any limit for raising such short-term liabilities from banks. However, the IBUs must maintain LCR as applicable to Indian banks on a standalone basis and strictly follow the liquidity risk management guidelines issued by RBI to banks.

Further, NSFR will also be applicable to the IBUs as and when it is applied to Indian banks; (c) Exposure ceiling for IBUs shall be 5 percent of the parent bank's Tier-I capital in case of a single borrower and 10 percent of parent bank's Tier-1 capital in the case of a borrower group. It may be noted that RBI Notification RBI/2015-16/282DBR.IBD.BC.8536/23.13.004/2015-16, dated 7-1-2016 issued for the purpose also notes that presently IBUs cannot raise liabilities from retail customers including high net worth individuals (HNIs) and cheque facility is not available for holders of current accounts in the IBUs.

Credit facilities to overseas step-down subsidiaries of Indian corporate relaxed: RBI has by Notification No. DBR.IBD.BC.No.68/23.37.001/2015-16,

dated December 31, 2015 issued following relaxations in respect of credit facilities to overseas step-down subsidiaries of Indian corporate: (i) Banks may now extend funded and/or non-funded credit facilities to the step-down subsidiaries of Indian companies including to those beyond the first level, to finance the projects undertaken abroad; (ii) The immediate overseas subsidiary of the Indian company must be directly controlled by the Indian parent company through any of the modes of control recognized under the Indian Accounting Standards. In addition, the Indian parent company must directly hold a minimum 51% of its shareholding; (iii) All the step-down subsidiaries, including the intermediate ones, must be wholly owned subsidiary of the immediate parent company or its entire shares shall be jointly held by the immediate parent company and the Indian parent company and / or its wholly owned subsidiary. The immediate parent should, wholly or jointly with Indian parent company and / or its wholly owned subsidiary, have control over the step-down subsidiary; and (iv) Banks shall make additional provision of 2% (in addition to country risk provision that is applicable to all overseas exposures) against standard assets representing all exposures to the step-down subsidiaries, to cover the additional risk arising from complexity in the structure, location of different intermediary entities in different jurisdictions exposing the Indian company, and hence the bank, to greater political and regulatory risk.

Relaxation of additional filing fees for Tamil Nadu and Puducherry: The MCA through General Circular No. 16 of 2015 dated December 30, 2015 has decided to relax the additional fees payable by the Companies

located in the State of Tamil Nadu and Union Territory of Puducherry, on e-forms AOC-4, AOC (CFS) AOC-4XBRL and e-Form MGT-7, up to January 30, 2016, wherever additional fee is applicable.

Ratio Decidendi

Company courts not to interfere with proceedings by secured creditor under SARFAESI Act: The Supreme Court of India, with respect to the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 (“SARFAESI Act”), has held that powers under the Companies Act cannot be wielded by the Company courts to interfere with proceedings by a secured creditor to realize its secured interests in terms of the provisions of the SARFAESI Act.

The present case arose out of a Division Bench judgment of Punjab and Haryana High Court which upheld the judgment of the Company Court and approved of certain fetters placed upon the appellant while allowing it to exercise its powers as a secured creditor under the SARFAESI Act and proceed with the sale of the secured assets. A division Bench of the Delhi High Court had differed with the views taken by the Punjab and Haryana High Court. According to the Delhi High Court, the company judge or the official liquidator cannot have any say in the sale of secured assets by the secured creditors under the SARFAESI Act.

The Supreme Court in this regard noted that

Section 13 of SARFAESI Act grants a right to enforce the security interest “*without the intervention of the court or tribunal*”. Various provisions of the SARFAESI Act, which contained *non obstante* clauses indicating that it operated as a complete code, a position that was accepted by previous judicial decisions, were also analyzed by the Court. It was noted that several protections were already present in the legislative scheme as a result of which neither the company court nor the liquidator can exercise greater interference in such sale process. [*Pegasus Asset Reconstruction P. Ltd. v. Haryana Concast Ltd.* - Civil Appeal No. 3646 of 2011, decided on 29-12-2015]

Huge penalties being levied by SEBI, correct: The Supreme Court, while deciding upon the imposition of penalty under 15J of the Securities And Exchange Board of India Act, 1992 (“SEBI Act”) has held that there was a clear intention of the legislature to impose high penalties for certain offences, and that the court finds no reason to water them down.

In the present case, the SEBI had levied a penalty of Rs. 1 Crore for non-submission of information sought by it to investigate certain alleged manipulation, in the shares of the

respondent company. The Order was contested in the Securities Appellate Tribunal (“SAT”) which noted that although the violation was clearly established, the respondent company was in a bad financial position and such large penalty was impossible to be recovered and hence the Order of penalty had effectively no meaning. The SAT further had held that even though “*impecuniosity*” of the party was not specifically listed as a factor under Section 15J of the SEBI Act providing for certain factors to be considered for levy of penalty, it has nevertheless to be considered.

The Supreme Court however set aside the

order of SAT stating that Section 15J listed certain exhaustive factors for consideration of penalty and no other factor, including “*impecuniosity*”, can be considered. Further the wordings of Section 15(A)(a) was also definite and prescribed penalty of Rs. 1 lakh per day (albeit with an upper limit of Rs. 1 crore) which the Court has held to be absolute. The Supreme Court also held that the amended penalty provision left no discretion with the assessing officer and thereby, even the scope of Section 15J was drastically reduced for this purpose. [*Chairman SEBI v. Roofit Industries Ltd - Civil Appeal Nos. 1364-1365 of 2005, decided on 26-11-2015*]

NEW DELHI

5 Link Road,
Jangpura Extension,
Opp. Jangpura Metro Station,
New Delhi 110014

B-6/10, Safdarjung Enclave
New Delhi - 110 029
Phone : +91-11-4129 9811
E-mail : lsdel@lakshmisri.com

MUMBAI

2nd floor, B&C Wing,
Cnergy IT Park,
Appa Saheb Marathe Marg,
(Near Century Bazar)Prabhadevi,
Mumbai - 400025.
Phone : +91-22-24392500
E-mail : lsbom@lakshmisri.com

CHENNAI

2, Wallace Garden,
2nd Street
Chennai - 600 006
Phone : +91-44-2833 4700
E-mail : lsmds@lakshmisri.com

BENGALURU

4th floor, World Trade Center
Brigade Gateway Campus
26/1, Dr. Rajkumar Road,
Malleswaram West, Bangalore-560 055.
Ph: +91(80) 49331800
Fax: +91(80) 49331899
E-mail : lsblr@lakshmisri.com

HYDERABAD

'Hastigiri', 5-9-163, Chapel Road
Opp. Methodist Church, Nampally
Hyderabad - 500 001
Phone : +91-40-2323 4924
E-mail : lshyd@lakshmisri.com

AHMEDABAD

B-334, SAKAR-VII,
Nehru Bridge Corner, Ashram Road,
Ahmedabad - 380 009
Phone : +91-79-4001 4500
E-mail : lsahd@lakshmisri.com

PUNE

607-609, Nucleus, 1 Church Road,
Camp, Pune - 411 001. Maharashtra
Phone : +91-20-6680 1900
E-mail : lpune@lakshmisri.com

KOLKATA

2nd Floor, Kanak Building
41, Chowringhee Road, Kolkatta-700071
Phone : +91-33-4005 5570
E-mail : lskolkata@lakshmisri.com

CHANDIGARH

1st Floor, SCO No. 59, Sector 26,
Chandigarh - 160026
Phone : +91-172-4921700
E-mail : lschd@lakshmisri.com

GURGAON

OS2 & OS3, 5th floor,
Corporate Office Tower,
AMBIENCE Island, Sector 25-A,
Gurgaon- 122001
Phone: +91- 0124 - 477 1300
Email: lsgurgaon@lakshmisri.com

EUROPE

Lakshmikumaran & Sridharan SARL
35-37, Avenue Giuseppe Motta, 1202 Geneva
Phone : +41-22-919-04-30
Fax: +41-22-919-04-31
E-mail : lsgeneva@lakshmisri.com

Disclaimer: *Corporate Amicus* is meant for informational purpose only and does not purport to be advice or opinion, legal or otherwise, whatsoever. The information provided is not intended to create an attorney-client relationship and not for advertising or soliciting. Lakshmikumaran&Sridharan does not intend to advertise its services or solicit work through this newsletter. Lakshmikumaran&Sridharan or its associates are not responsible for any error or omission in this newsletter or for any action taken based on its contents. The views expressed in the article(s) in this newsletter are personal views of the author(s). Unsolicited mails or information sent to Lakshmikumaran&Sridharan will not be treated as confidential and do not create attorney-client relationship with Lakshmikumaran&Sridharan. This issue covers news and developments till 16th January, 2016. To unsubscribe e-mail Knowledge Management Team at newslettercorp@lakshmisri.com

www.lakshmisri.com

www.addb.lakshmisri.com

www.lakshmisri.cn

www.lakshmisri.ch