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SEBI's New Initiative – SEBI proposes to liberalize Fund Managers' Regulations & boost REITs

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Gaurav N. Pingle

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SEBI's New Initiative - SEBI proposes to liberalize Fund Managers' Regulations & boost REITs

SEBI Board, in its meeting held on June 17, 2016, took some crucial and important decisions which includes amendments to the SEBI (Portfolio Managers) Regulations, 1993 pursuant to introduction of Section 9A in the Income Tax Act, 1961 and amendments to the SEBI (Real Estate Investment Trusts) Regulations, 2014. After the board meeting, SEBI floated consultation paper to amend Portfolio Managers, Regulations. The article is a compilation and analysis of the SEBI decisions and consultation paper floated after the Board Meeting along with its impact on the securities market and market participants.

Proposed amendment to SEBI (Portfolio Managers) Regulations, 1993 pursuant to introduction of Section 9A in Income Tax Act

Summary of Decision: In the Union Budget 2015-16, the Finance Minister made an announcement to insert Section 9A in the Income Tax Act (also known as 'Safe Harbour Norms'). Section 9A states that fund management activity carried out through an Eligible Fund Manager located in India acting on behalf of an overseas fund (Eligible Investment Fund, 'fund') shall not constitute business connection in India subject to the satisfaction of certain prescribed conditions. The conditions include:

(*i*) Fund is not a person resident in India,

(*ii*) Fund is a resident of a country or a specified territory with which an agreement has been entered into by Central Government,

(*iii*) Aggregate participation or investment in the fund (directly or indirectly) by persons resident in India does not exceed 5% of the corpus of the fund,

(*iv*) Fund and its activities are subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident,

(*v*) Fund has a minimum of 25 members who are, directly or indirectly, not connected persons,

(*vi*) Any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding ten per cent,

(*vii*) Aggregate participation interest, directly or indirectly, of 10 or less members along with their connected persons in the fund, shall be less than 50%,

(*viii*) Fund shall not invest more than 20% of its corpus in any entity;

(*ix*) Fund shall not make any investment in its associate entity,

(*x*) Monthly average of the corpus of fund shall not be less than Rs. 100 crore,

(*xi*) Fund shall not carry on or control and manage, directly or indirectly, any business in India or from India,

(*xii*) Fund is neither engaged in any activity which constitutes a business connection in India nor has any person acting on its behalf whose activities constitute a business connection in India other than the activities undertaken by the eligible fund manager on its behalf;

(*xiii*) Remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken by him on its behalf is not less than the arm's length price of the said activity.

With an objective of laying down an enabling framework for Eligible Fund Managers, SEBI Board approved the proposal to amend SEBI (Portfolio Managers) Regulations after floating a Consultative Paper. The amendments to the Regulations are proposed for: (i) Insertion of a separate Chapter relating to 'Eligible Fund Managers' which will apply to Eligible Fund Managers exclusively pertaining to their activities as portfolio managers to Eligible Investment Funds, (ii) Procedure for an existing SEBI-registered Portfolio Manager to function as an Eligible Fund Manager, (iii) Procedure for registration of an existing foreign based fund manager desirous of relocating to India or a fresh applicant to function as an Eligible Fund Manager, (iv) Obligations and Responsibilities of Eligible Fund Managers, (v) Non-applicability of certain provision of Portfolio Managers Regulations on Eligible Fund Managers.

Impact of the decisions: The provisions relating to 'Safe Harbour' as prescribed under Section 9A of the Income Tax Act provides for several stringent requirements due to which the fund managers would prefer to continue to be based outside and may not to be able to operate from India. Therefore, till the provisions relating to 'Safe Harbour' in the Income Tax Act are not liberalized, the offshore fund managers would not have any incentive to shift their base to India. If there are no such incentivizing provisions in the Income Tax Act, it may result in the futile exercise of SEBI Board in approving the proposal to liberalize the SEBI (Portfolio Managers) Regulations.

On June 21, 2016, SEBI floated consultation paper for public comments to amend SEBI (Portfolio Managers) Regulations with an objective to seek comments from the public for the purpose of laying down an enabling framework for the registration of Eligible Fund Managers to manage Eligible Investment Funds pursuant to corresponding provisions in the Income Tax Act, 1961. Vide the Consultation Paper, it is proposed that the Eligible Fund Managers will be exempted from certain provisions of SEBI (Portfolio Managers) Regulations. The proposed exemptions include compliance from the requirements of a contract between the portfolio manager and its clients and contents of contract, requirement of providing Disclosure Document by portfolio manager to the client at least 2 days prior to entering into agreement, requirement of minimum investment that a portfolio manager can accept, etc. The decision of amending SEBI (Portfolio Managers) Regulations and introducing Section 9A in Income Tax Act has got adequate significance as the Government has already announced taxation incentives for the offshore fund managers who are willing to relocate to India.

Proposed amendment to SEBI (Real Estate Investment Trusts) Regulations, 2014

The SEBI notified Real Estate Investment Trusts ('REITs') Regulations on September 26, 2014. With an objective to smoothen the registration process and liberalize the process of launching of the offer, SEBI Board has approved to float a Consultation Paper proposing certain changes and providing some clarification in the REIT Regulations. SEBI proposes to: (i) Remove restriction on the SPV to invest in other SPVs holding the assets, (ii) Change in the number of sponsors, (iii) Rationalize the compliance with respect to Related Party Transactions (RPTs) requirements, (iv) Aligning minimum public holding requirement with SCRR, (v) Allowing REITs to invest up to 20%, in under construction assets, (vi) Responsibilities of trustee and its associates.

Impact of the decisions: The proposal of amending and liberalizing SEBI (Real Estate Investment Trusts) Regulations, 2014 is to bring in active participation of the real estate companies and making REITs more attractive for the investors and increasing their participation. The investment in REITs would also help investors in diversifying their investment portfolio. As per the extant regulations, REITs are allowed to invest up to 10%, in under construction assets and it is proposed to increase to 20%. However, there are two sides to the same coin. Though, it may be permitted to invest a higher amount in under-construction assets which may improve the returns for REITs, however the risk involved in such investment product may substantially increase.

According to industry estimates, REITs can generate investment to the tune of $20 billion. Industry watchers point that for REITs to be attractive, the returns from REITs must be higher than FD rates. Currently, its yields are not as attractive. Several real estate players such as Unitech, DLF, Embassy, Prestige, Supertech and Blackstone are among those who had evinced interest in REIT listings.

Conclusion: SEBI Board's decision to amend and liberalize Portfolio Managers, Regulations and Real Estate Investment Trusts, Regulations are with an objective of encouraging companies to issue unique instruments in the securities market and also provide the investors an option for diversifying their portfolio and investing their funds in different instruments. The effectiveness of the proposed amendment to SEBI

(Portfolio Managers) Regulations will be dependent on the more liberalized provisions of Section 9A in the Income Tax Act, 1961. The proposed amendments to the SEBI (Real Estate Investment Trusts) Regulations were most anticipated and most awaited. However, amendment in both the Regulations will take time to take effect, as the same will be introduced after issuing consultative paper and elaborate public participation.