

LEGAL ANALYSIS OF REAL ESTATE INVESTMENT TRUST REGULATION IN INDIA

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As has been the case around the world, the real estate sector has played a pivotal role in the overall growth process of the Indian economy. Since the privatisation of the Indian economy in 1991, the government of India has introduced a variety of investment instruments to capture the interest of millions of potential investors over the last three decades. One such instrument is the Real Estate Investment Trust (REIT). In order to make the market more accessible to investors interested in REIT investments, the Draft Regulations were introduced in 2007. Following numerous modifications, the REIT regulations were finally ratified in 2014 by the Securities and Exchange Board of India. The Indian REIT regulations are aimed at providing an organized market of retail investors in a professionally managed ecosystem. However, since its launch in 2014, the REIT regime in India has failed to attract the expected number of investors. Through this paper, the legal structure of REITs in India is reflected, along with changes experienced up to the 2019 amendment. This study also takes a comparative approach in examining the structural aspects of Indian regulations in comparison to those of other countries, and comes up with some recommendations for the improvement of REIT regulations in India.

Keywords: Real Estate Investment Trust; REIT; Securities and Exchange Board of India; special purpose vehicle.

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Introduction

“Real Estate Investment Trusts¹ are companies that own or finance income-producing real estate across a range of property sectors.”

National Association of Real Estate Investment Trusts

REITs are a subset of innovative structured finance transactions. Due to its customised nature, there are no standard definitions available. Prior to the establishment of REITs in the United States, that is, prior to 1960, the customers could only gain

¹ Hereinafter referred to as REITs.

access to the real estate market by buying real property from the property market.² In India, REIT has been defined as part of a business trust under section 13A of the Income Tax Act which is a form of trust.³ The corporate sector in India is growing at a rapid pace. This unstoppable growth in the corporate sector has introduced a new level of demands in the market. As the corporate sector expands, there is a strong demand for rented buildings, shopping malls, residential buildings, and other social spaces. As a result of this desire for real estate properties, investment in real estate has increased. One of the common features of REITs globally is their slow pace, for example in Singapore the REIT Regulations were launched in 1999 but the first project did not begin until 2002.⁴

Prior to 2014, there was no proper mechanism for investing in real estate, nor was there any systematic approach for doing so in India. Previously, people would rent or buy buildings, and those who invested in them would take loans from banks, financial institutions, and others. As a result, in 2014, the Securities and Exchange Board of India (SEBI) introduced the concept of Real Estate Investment Trust. REITs have the potential to transform the fragmented real estate stratosphere in India. The Indian real estate markets which are characterized by various obligations from acquisitions to disposal, have remained the primary reason why such a regime has not been able to take root in the Indian economy.⁵ However, with the new regulations in place, investors who invest their money in listed units of REITs could benefit from both a stabilized return and an appreciation in the market value of assets in a regulated, transparent environment. Nevertheless, due to a lack of data on REITs since only three have been registered in India to date, and the first being listed on 1 April 2019, it is difficult to assess their market success and compare them to other structured financial entities in conduit form.

1. Real Estate Investment Trust

According to the National Association of Real Estate Investment Trusts, REITs, or real estate investment trusts, are companies that own or finance income-producing

² Su H. Chan et al., *Real Estate Investment Trusts: Structure, Performance, and Investment Opportunities* (2003).

³ Saurav Malpani, *Real Estate Investment Trusts: Are They Heading Towards Reality?*, Vinod Kothari Consultants, 5 August 2014 (Jun. 20, 2021), available at http://www.vinodkothari.com/wp-content/uploads/2014/08/REITs_Are_they_heading_towards_reality.pdf.

⁴ JLL India, *India REITs: Herald a New Era in Real Estate Investments (April 2019)* (Jun. 20, 2021), available at <http://naredco.in/notification/pdfs/updated-india-reits-heralding-a-new-era-in-real-estate-investments.pdf>.

⁵ PricewaterhouseCoopers, *India's New Real Estate and Infrastructure Trusts: The Way Forward* (5th ed., July 2016) (Jun. 20, 2021), available at <https://www.pwc.in/assets/pdfs/research-insights/2019/new-real-estate-and-infrastructure-trusts.pdf>.

real estate across a range of property sectors.⁶ These companies are registered with the Securities Regulator and need to follow eligibility criteria, capital adequacy norms and the listing of their debt or equity securities on a recognised stock exchange. REITs offer a way to include real estate in one's investment portfolio. Additionally, some REITs may offer higher dividend yields than other investments. REITs provide investors with an extremely liquid stake in real estate. They receive special tax considerations and typically offer high dividend yields.⁷ The two most common forms of REITs are Mortgage REITs⁸ and Equity REITs.⁹ However, REITs have limitations such as no guarantee for distribution of assets, tax and regulatory bottlenecks and limitations on the simple basis of economics rationale.¹⁰ Nevertheless, REITs remain an effective way of raising capital and providing investors with an exit strategy.¹¹

1.1. Literature Review

For the review of the literature, the author referred to a reputed law journal and filtered papers titled with Real Estate Investment Trust, finding 18 articles on Hein Online, 13 Articles in JStor and 30 Articles in Science Direct. There have been very few papers that define REITs. In general, all papers have a common reference to REITs as trusts that pool real estate investments.

The New York Institute of Finance (1988) defines REITs as:

A REIT may be a corporation, business trust, or association primarily developed to own or finance real estate. As with most corporations, a board of directors or trustees elected by shareholders sets policy and arranges the day-to-day operation of the REIT by professional managers or advisors. Persons with real estate experience, such as real estate brokers or mortgage bankers, organize many REITs. They may also be organized by commercial banks or insurance companies.¹²

⁶ Helen X.H. Bao et al., *Real Estate Investment Trust Returns: Predictability and Determinants*, 18(1) J. Real Estate Pract. Educ. 107 (2015) (Jun. 20, 2021), also available at <http://www.jstor.org/stable/24863168>.

⁷ James Chen, *Real Estate Investment Trust (REIT)*, Investopedia, 4 November 2017 (Jun. 20, 2021), available at <http://www.investopedia.com/terms/r/reit.asp>.

⁸ Mortgage REITs, on the other hand, invest in mortgages or mortgage securities which are knotted to residential or/and commercial property assets.

⁹ Equity REITs produce income by collecting rent from and selling the various long-term properties owned by them.

¹⁰ Ravi Sinha, *REITs fail confidence test*, The Tribune, 4 April 2015 (Jun. 20, 2021), available at <http://www.tribuneindia.com/news/real-estate/reits-fail-confidence-test/62534.html>.

¹¹ Surabhi Arora, *REITs in India! Is this the right time?*, Money Control, 26 August 2014 (Jun. 20, 2021), available at http://www.moneycontrol.com/news/real-estate/reitsindia-is-thisright-time_1163634.html.

¹² Paul Beals & A.J. Singh, *The Evolution and Development of Equity REITs: The Securitization of Equity Structures for Financing the U.S. Lodging Industry*, 10(1) J. Hosp. Fin. Mgmt. 10 (2002) (Jun. 20, 2021), also

Business trusts have existed in the United States since the nineteenth century. Because of the United States Supreme Court's decision to tax these corporations, the United States Congress decided to introduce a special structure for Real Estate Investment Trusts similar to Mutual Funds.¹³ With the emergence of the REIT model in the United States in 1960, many countries later encroached on REITs by adopting the same model. However, Switzerland and Germany already had their own models.¹⁴ The Multistate Tax Commission, USA (2008), defines REITs as, "The term Real Estate Investment Trust shall have the meaning ascribed to such term in Section 856 of the Internal Revenue Code of 1986 as amended."

As per section 856 of the Internal Revenue Code of 1986, a REIT is:

A real estate investment trust, the shares or beneficial interests of which are not regularly traded on an established securities market and more than fifty per cent of the voting power or value of the beneficial interests or shares of which are owned or controlled, directly or indirectly, or constructively, by a single entity that is:

1. treated as an association taxable as a corporation under the Internal Revenue Code of 1986, as amended, and

2. not exempt from federal income tax under the provisions of Section 501(a) of the Internal Revenue Code of 1986, as amended. To meet the 100 shareholder requirement, shares are often held by company employees or board members.¹⁵

In the United Kingdom, REITs were introduced in 2006. The general definition adopted by HM Treasury (2005) in its discussion paper to introduce REITs in the United Kingdom markets is,

Generally, they are closed-ended companies or trusts that hold, manage and maintain real estate for investment purposes, which is leased to tenants.¹⁶

available at https://scholarworks.umass.edu/jhfm/vol10/iss1/3?utm_source=scholarworks.umass.edu%2Fjhfm%2Fvol10%2Fiss1%2F3&utm_medium=PDF&utm_campaign=PDFCoverPages.

¹³ A. Overton Durrett, *The Real Estate Investment Trust: A New Medium for Investors*, 3(1) Wm. & Mary L. Rev. 140 (1961).

¹⁴ Davor Jagodić et al., *REIT Regimes in EU Countries – Institutional Environment versus Attractiveness of Real Estate Investment Vehicles*, research project Croatian Financial Markets and Institutions (2011) (Jun. 20, 2021), available at https://bib.irb.hr/datoteka/547735.konferencija_celje.pdf.

¹⁵ Department of Business, Economic Development & Tourism Research and Economic Analysis Division, Interim Report: Real Estate Investment Trusts in Hawaii: Preliminary Data and Analysis (December 2015) (Jun. 20, 2021), available at https://files.hawaii.gov/dbedt/economic/reports/REIT_Interim_Dec2015.pdf.

¹⁶ HM Treasury, UK Real Estate Investment Trusts: a discussion paper (March 2005) (Jun. 20, 2021), available at http://news.bbc.co.uk/nol/shared/bsp/hi/pdfs/bud05_reits_366.pdf.

KASB Securities Limited (2005) defines REIT as a security that sells like a stock and invests in real estate directly or indirectly.¹⁷ Joshua A. Harris (2012) defines REIT as e-firms that own and manage income-producing commercial real estate for the benefit of their shareholders.¹⁸ Professor Ko Wang (2015) defines REITs as closed-end funds created exclusively for holding real properties, mortgage-related assets or both.¹⁹

A REIT, as per Wang, Sun & Chen in the Chinese market, is a corporation or trust that uses the pooled capital of many investors to invest in or purchase and manage property.²⁰

In Europe, REITs were first introduced officially in the Netherlands taxation regime in 2007, followed by Germany. Their model is almost similar to the United States and is defined as

a company that owns, and in most cases, operates income-producing real estate, such as apartments, office buildings, warehouses and shopping centres.²¹

In India, the concept of REITs began in 1996, when the SEBI (Mutual Funds) Regulations 1996 were amended with chapter VIA to introduce Real Estate Mutual Funds in India.²² Later, it was introduced through a structured finance model, similar to what is available in other countries through the Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014.²³ According to the SEBI Regulations, “a Real Estate Investment Trust shall mean a trust registered as such under these regulations.”

According to FTSE Russell, USA (2021),

¹⁷ KASB Securities Limited, Research Paper on Real Estate Investment Trust (December 2005) (Jun. 20, 2021), available at https://www.secp.gov.pk/wp-content/uploads/2016/05/REITs_ResearchPaper-KASBSecuritiesLimited.pdf.

¹⁸ Joshua A. Harris, *Real Estate Investment Trust Performance, Efficiency and Internationalization*, Electronic Theses and Dissertations, 2004–2019 (2012) (Jun. 20, 2021), available at <https://stars.library.ucf.edu/cgi/viewcontent.cgi?article=3363&context=etd>.

¹⁹ *Id.*

²⁰ Hao Fang et al., *The Impact of Macroeconomic Factors on the Real Estate Investment Trust Index Return on Japan, Singapore and China*, 13(4-1) Invest. Mgmt. Fin. Innov. 242 (2016) (Jun. 20, 2021), also available at https://www.businessperspectives.org/images/pdf/applications/publishing/templates/article/assets/8109/imfi_en_2016_04cont_Fang.pdf.

²¹ Anna Mazurczak, *Development of Real Estate Investment Trust (REIT) Regimes in Europe*, 4(1) J. Int. Stud. 115 (2011) (Jun. 20, 2021), also available at <https://www.jois.eu/files/MazurczakV4N1.pdf>.

²² Chan et al. 2003.

²³ Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014 (Sep. 20, 2021), available at https://www.sebi.gov.in/legal/regulations/aug-2021/securities-and-exchange-board-of-india-real-estate-investment-trusts-regulations-2014-last-amended-on-august-03-2021-_38449.html.

A REIT is a publicly-traded real estate company that owns, and in most cases, operates income-producing real estate such as apartments, shopping centres, offices, hotels and warehouses.²⁴

After analysing all the definitions used by various authors and authorities, it can be concluded that REITs are conduits that hold pooled capital of investors in the form of a trust to purchase and manage real estate properties.

1.2. Market Statistics

REITs were first introduced in the United States in 1960, with the incorporation of section 856 of the Internal Revenue Code.²⁵ Since their introduction, REITs in the United States have acquired an overall market capitalization of approximately US\$1.5 trillion.²⁶ Australia was also an early entrant into the REIT framework, where the first REIT was listed in the year 1971. Since then, various amendments have been brought in to provide flexibility to the market. There was a complete change in the framework by introducing the Managed Investment Scheme (MIS) (through which the Australian REITs are governed) into the Corporations Law in 1988. In the United Kingdom, REITs were introduced in the year 2006 as part of the Finance Act of that year. Since then, the market has grown tremendously. Singapore also introduced the REIT in 1999 (whereas the first REIT was listed in the year 2002), commonly identified as S-REIT.

The first and only REIT to be listed in India to date is the Embassy Office Parks REIT in the year 2019, backed by the private equity giant Blackstone. Surprisingly, the first REIT in India was launched approximately five years after the regulations were published in 2014. With the emergence of REITs, the Indian real estate market is moving from traditional finance to the structured finance era. Nevertheless, the cautious response of investors reflects the lack of investor awareness about this new investment vehicle. According to the research report of a brokerage called Anarock, India can raise US\$25 billion through REITs over the next three years.²⁷ However, its slow pace of growth shows that the REIT market has to face many challenges in order to enter the mainstream of investment instruments in the capital market.

²⁴ FTSE Russell, FTSE EPRA Nareit Developed REITs and Non-REITs Indices, 31 March 2022 (Apr. 2, 2021), available at <https://research.ftserussell.com/Analytics/Factsheets/Home/DownloadSingleIssue?issueName=ERGLANDENRG&isManual=false>.

²⁵ Jack E. Roberts, *Real Estate Investment Trust – New Tax-Saving Opportunity for Investors*, 13 Tax Inst. 27 (1961).

²⁶ Market cap of REITs in the U.S. 1975–2020, Statista (Jun. 20, 2021), available at <https://www.statista.com/statistics/916665/market-cap-reits-usa/>.

²⁷ Commercial REITs can raise over \$25 billion in next 3 years: ANAROCK, Newsbarons, 10 October 2019 (Jun. 20, 2021), available at <https://www.newsbarons.com/real-estate/commercial-reits-can-raise-over-25-billion-in-next-3-years-anarock/>.

1.3. Structural Framework of REIT

In India, REIT is structured as a three-party model – the sponsor or sponsor group, the trustee and the manager. The sponsor is the entity that sets up the REIT. A sponsor is needed to transfer the assets to the REIT. A trustee is a person who holds the assets of a trust for the benefit of the unit holders. The manager looks into the investment decisions concerning the assets of the REIT, including additional investment or divestment.²⁸ The manager works in accordance with the Investment Management Agreement, entered into between the trustee and the manager. There are three main structures under which REIT’s may operate:

- The REIT or Trust may hold a Special Purpose Vehicle (SPV) which shall hold the assets.
- The Trust may hold the Holdco which shall have a separate SPV which shall further hold the assets.
- The last model consists of the REIT or Trust directly holding the assets.

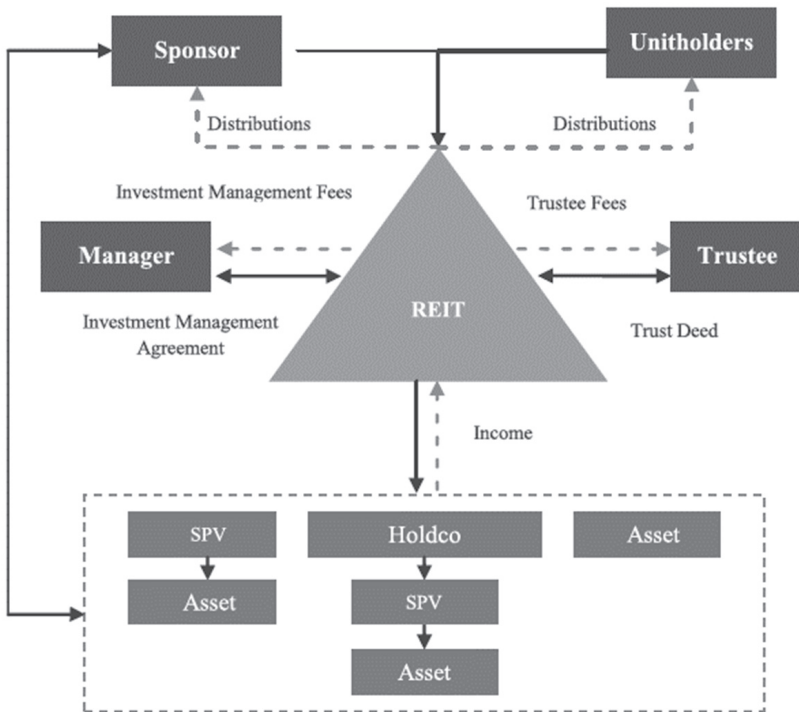


Fig. 1: CAM²⁹

²⁸ REIT Regulation 10(1).

²⁹ Cyril Amarchand Mangaldas, De’constructing InvITs and REITs (October 2020) (Jun. 20, 2021), available at https://www.cyrilshroff.com/wp-content/uploads/2017/01/De_construct_ing-InvITs-and-REITs-.pdf.

2. Regulatory Aspects of REIT India

On 10 October 2013, the Securities and Exchange Board of India (SEBI) released its draft guidelines for REITs, which were open to public opinion, along with the regulation to govern infrastructure investment trusts in India through a separate regulation. The final regulations, however, were issued on 26 September 2014 after considering the opinions. At present, REITs in India are regulated through SEBI (Real Estate Investment Trusts) Regulations,³⁰ 2014.³¹ Currently, foreign market norms for overseas investment have been relaxed.³² However, the REITs market in India has been dormant in India since 2019.³³

2.1. Trustee

The trustee in this structure is responsible under the trust deed for the safe custody of the assets of the REIT and also acts responsibly for the benefit of the unitholders as a whole.

The trustee is bound under the SEBI regulations in the following capacities:

Holder of Assets – The trustee has a fiduciary duty to hold the assets of the trust for the benefit of the unitholders.³⁴

Supervisor – The trustee also serves as supervisor, overseeing the activities of the manager and ensuring that the manager complies with the regulations and the Investment Management Agreement. In addition to supervising the manager, the trustee must ensure that the activities of the REIT are carried out in consonance with the trust deed, REIT regulations and the offer document.³⁵

Protection of Interests of Unit Holders – The trustee has a legal obligation to review and resolve the complaints of the unitholders and seek redress for them.³⁶ They are also required to report any activity to the SEBI if it is detrimental to the interests of the unitholder.³⁷

³⁰ Hereinafter referred to as REIT Regulation.

³¹ Bathiya & Associates LLP, Real Estate Investment Trusts (REIT) in India (October 2018) (Jun. 20, 2021), available at https://www.bathiya.com/wp-content/uploads/2018/10/13.-REIT_Research-Article_Bathiya.pdf.

³² Pooja Thakur, *India Eases Rules to Allow Foreign Investment in REITs*, Bloomberg, 7 May 2015 (Jun. 20, 2021), available at <http://www.bloomberg.com/news/articles/2015-05-07/india-eases-rules-to-allow-foreign-investment-in-reits>.

³³ Divya Malcolm, *India: REITs Regulation from 2014 to Future*, Mondaq, 24 February 2020 (Jun. 20, 2021), available at <https://www.mondaq.com/india/fund-management-reits/897116/reits-regulation-from-2014-to-future>.

³⁴ REIT Regulation 9(1).

³⁵ REIT Regulation 9(16).

³⁶ REIT Regulation 9(6).

³⁷ REIT Regulation 9(18).

2.2. Manager

The main role of a manager is to make all decisions regarding future investment and divestment involving the assets and funds of the REIT.³⁸ The manager also ensures that all current assets of the REIT have proper legal marketable title,³⁹ and that investments are made in accordance with investment conditions and the investment strategy of the REIT.⁴⁰ (The trustee also needs to determine who is responsible if the conditions set under Regulation 18 are not met.) The manager has to undertake the management of REIT assets,⁴¹ which includes lease management, asset maintenance and structural and safety audits. Furthermore, the manager has to appoint various entities (with the approval of the trustee), including a valuer, an auditor, a registrar and transfer agent (RTA), a merchant banker, a custodian and other intermediaries.⁴²

To protect the interests of the trust and unitholders, insurance of the assets is required and the manager must obtain insurance coverage of assets.⁴³

The manager is also responsible for adequately and timely redressing the issues of all unitholders,⁴⁴ as well as disclosing various items of information to the unitholders the board of trustees and the designated stock exchange as stipulated in the regulations.⁴⁵ To fulfil its obligations towards the trustee, the manager has to submit various reports to the trustee, including the quarterly report on the activities of the REIT, valuation reports, decisions to acquire, sell or develop any property, details of any action requiring approval from unitholders and details of any material facts, such as changes in directors, any key legal proceeding and so on.⁴⁶ If the manager fails to provide such information to the trustee as required under Regulation 18 or 9(8), the trustee has to intimate the board and the board may take any action as it deems fit.⁴⁷

The manager has to ensure that the valuation of the REIT is completed by the valuer in accordance with Regulation 21.⁴⁸ In addition, the manager is also responsible for coordinating the REIT operations with the trustee.⁴⁹

³⁸ REIT Regulation 10(1).

³⁹ REIT Regulation 10(2).

⁴⁰ REIT Regulation 10(3).

⁴¹ REIT Regulation 10(4).

⁴² REIT Regulation 10(5).

⁴³ REIT Regulation 10(7).

⁴⁴ REIT Regulation 10(13).

⁴⁵ REIT Regulation 10(14).

⁴⁶ REIT Regulation 10(18).

⁴⁷ REIT Regulation 10(19).

⁴⁸ REIT Regulation 10(21).

⁴⁹ REIT Regulation 10(20).

2.3. Sponsor

The sponsor or sponsor group has to set up the REIT and appoint the trustee.⁵⁰ Because the sponsor is the entity that sets up the REIT, they are generally the original owner of the assets of the trust. As a result, they must transfer or undertake to transfer complete ownership of the real estate assets, shareholding or ownership of the Holdco or SPV prior to the allotment of units of the REIT to applicants.⁵¹ The sponsors are also obligated to hold the minimum interest in the REIT in order to ensure compliance with the regulations.⁵² If the sponsor wishes to exit its position and it falls below the minimum holding requirement, then it may only do so after arranging a new sponsor or selling the units to an existing sponsor. If the same is done, then the approval of the unitholders is a must; otherwise they shall be provided with an exit opportunity.⁵³

3. Taxation Aspects of REIT

Taxation has a significant impact on how investors perceive the instrument and its future. As can be seen, market participation was negligible in the first few years of the framework's launch. Although, amendments have been made to the policy, some issues persist. In this chapter, the author covers taxation of REITs in India, changes made to the policy and additional recommendations to boost investment.

3.1. Sponsor

A REIT can be set up by the sponsor by:

- transfer of shareholding, rights or interest in the holding company or SPV, or
- transferring the real estate asset in favour of the trust, in exchange for units of REIT.

Capital gains are to be deferred when shares of the SPV or Holdco are exchanged for units of the REIT. It is to be paid at the time of disposal of REIT units by the sponsor. While calculating the liability under the heading of capital gains at the time of sale of units, the period of holding will include the time spent holding shares of the SPV, and the cost of acquisition will be the cost of shares in the SPV. An exemption from the Minimum Alternative Tax (MAT) is also provided at the time of such an exchange.⁵⁴

⁵⁰ REIT Regulation 11(1).

⁵¹ REIT Regulation 11(2).

⁵² REIT Regulation 11(3) – Sponsors have to hold a minimum of 25% of the issue after the initial offer for at least three years after the date of listing, and any such holding above the minimum holding shall be held for at least one year after the date of listing. Moreover, the sponsor(s) have to collectively hold at least 15% of the outstanding units at all times and each sponsor has to individually hold at least 5% of the units at all times.

⁵³ REIT Regulation 11(4).

⁵⁴ Previously not provided. Introduced by the Finance Bill of 2018.

These exemptions are not available if the ownership, rights or interest in the real estate asset itself is transferred, as stipulated in the second situation.

The contribution by the sponsor to the trust that is not a shareholding in a SPV or Holdco is also liable to stamp duty (transfer of immovable property) and registration charges. The same is in contrast with Singapore where a transfer of assets in lieu of units of REIT is exempt from stamp duty also.

At the time of the sale of units of a REIT, both capital gains (deferred liability) and securities transaction taxes are required to be paid by the sponsor.

3.2. SPV or Holdco

Although the trust has been accorded the status of a pass-through entity, the SPV or Holdco has not been granted any such exemption. The distribution of dividend income by the SPV or Holdco to the trust is liable for Dividend Distribution Tax (DDT) at the rate of 15%. The exemption of capital gains at the time of the transition from the SPV to the REIT is only limited to shares of the SPV. However, if the assets are transferred by the SPV to the REIT, the same is taxable at the time of the transfer itself, as mentioned above.

3.3. Business Trust

Because the REIT is a pass-through entity, dividend income received by the REIT is taxed only at the hands of the SPV or Holdco and is thus exempt at the hands of the REIT. Interest income received by the REIT from the SPV or Holdco is exempt in the hands of the REIT but taxable in the unitholder's hand. Interest income distributed to the unitholders is liable for withholding tax at the rate of 5% in the case of residents and 10% in the case of non-residents. However, capital gains at the time of disposal of assets of the trust are to be taxed in the hands of the trust. As a result, it can be concluded that the pass-through nature is merely hybrid.

3.4. Unitholder

Because a REIT is a pass-through entity, the nature of the income received by the unitholder from the REIT does not lose its character as in the case of companies. The interest income received by the unit holder will be taxed at a concessional rate of 5%. Similarly, rental income received by the trust will be taxed in the category of "Income from House Property."

Because the sale of REIT units is the same as the sale of listed equity shares, the sale of REIT units will be subject to the Securities Transaction Tax (STT). Long Term Capital Gain (LTCG) for the same is exempt, but Short Term Capital Gain (STCG) is taxable at the rate of 15%. If the transaction is not carried out through an exchange, the exemption from LTCG will not be applicable.

4. Recent Changes in REIT Laws in India

Due to the slow growth of REITs in India, it was inevitable for the market regulator to revisit the regulations and minimise the challenges faced by REITs in the Indian market. REIT regulations have been amended numerous times in response to market demands.

4.1. 2017 Amendment

To increase avenues for raising capital, a REIT was permitted to raise funds by issuing debt securities with the caveat that the debt securities so issued should also be listed on any recognised stock exchange.⁵⁵

Thus, the concept of “strategic investor” was introduced.⁵⁶ This was done to boost investor confidence because the units would now be offered to them before the general public. Furthermore, safeguards for public investors were also introduced by establishing a lock-in period and ensuring that the price at which such units are offered to strategic investors is not less than the price offered to the general public (in the case of a difference, that difference in amount needs to be deposited by the investor to the REIT).

The board’s compliance requirement at the time of the application was reduced by excluding close relatives of the applicant from the scope of disclosure of disciplinary action.⁵⁷

The clause requiring REITs to hold at least two projects was removed.

In the case of a related party transaction, the condition of obtaining two reports from different valuers was removed, because merely disclosing the same information was considered to be unnecessary.

The compulsion to follow internationally acceptable accounting standards was also removed. Overall, it can be stated that the 2017 amendment was a sincere effort to reduce the regulation in the sector by removing the overprotection that led to unnecessary complexities in the regulation.

4.2. 2018 Amendment

Controlling interest – Previously, more than 50% ownership or voting rights were required for having a controlling interest, but this has been reduced to not less than 50%. As a result, if an entity holds even 50% of the interest, it will be deemed to have a controlling interest in the same.

Real Estate Asset – the definition has been expanded to include both leasehold and freehold property, regardless of whether it is held by Holdco or a SPV.

⁵⁵ REIT Regulation 20(1).

⁵⁶ REIT Regulation 2 (ztb).

⁵⁷ REIT Regulation 4(2)(l).

Dispute resolution – One of the most important amendments in 2018 is making it mandatory to include a dispute resolution clause in the shareholder agreement or partnership agreement, in the event of a dispute between the REIT and the shareholders or partners of the SPV, where any investment is made by the REIT through the SPV.

Restrictions on nominees – Previously, the manager and trustee were given broad and unfounded power to appoint the majority of the board members of the SPV through which the REIT would invest. The same was to be exercised even when the REIT did not own the majority of interest in the SPV. This has now been amended to limit their ability to appoint their nominees to the board only to the extent of their shareholding.

Investment – Previously, the REIT was not allowed to invest in unlisted companies from the remaining 20% bracket (80% needs to be invested in completed and rent generating properties). The same is now open provided the company derives 75% of its operating income from real estate activities. This step needs to be viewed with caution because it increases the variety of investment options available for the REIT, but there is no compliance with disclosure or corporate governance standards, making an investment in these companies dubious for the investor.

4.3. 2019 Amendment

The minimum subscription amount has been reduced from Rs. 2 lakhs to Rs. 50,000. In addition, the trading lot size has also been reduced from Rs. 1 lakh to Rs. 50,000. These reforms were aimed to hasten the adoption of these products by retail investors.

4.4. 2020 Amendment

As a result of Covid-19, the SEBI has relaxed the filing of documents for fulfilling compliances and administration for REITs and InViTs, as well as lock-in requirements for REITs. Furthermore, the regulator has also broadened the categories of strategic investors for REITs by including insurance companies and mutual funds.⁵⁸

5. Comparative Analysis

Singapore and Australia have been used for comparisons because Singapore has many similarities with India in terms of regulatory financial structure and Australia was one of the early adopters of the REIT framework. Both jurisdictions also form part of the common law legal system, which offers a systematic advantage for the comparison.

5.1. Comparative Structure

As previously stated, the Indian REIT regulations require three parties to form a REIT: the sponsor, the trustee and the manager. The sponsor plays the main role in

⁵⁸ Amendments to SEBI (Real Estate Investment Trusts) Regulations 2014 and SEBI (Infrastructure Investment Trusts) Regulations 2014 (Jun. 20, 2021), available at https://www.sebi.gov.in/sebi_data/meetingfiles/jul-2020/1594015497516_1.pdf.

providing the assets to the trust in exchange for units of the REIT, as well as registering the trust, which further includes appointing the trustee. Thereafter, the trustee plays an active role until the appointment of the manager. Now that all three parties have been established, only the manager and the trustee oversee the functioning of the REIT. Each of them has different rights and responsibilities that set them apart from the others.⁵⁹ The role of the trustee is primarily supervisory, whereas the manager plays a more active role and makes all the investment decisions.⁶⁰ Both the entities have different roles, but as observed in Singapore and Australia, some overlap may become unavoidable, giving rise to conflicts resulting from multiple masters.⁶¹

In its consultation paper titled “Regulation of Business Trusts,” the Monetary Authority of Singapore (MAS) proposed merging the roles of manager and trustee into a single responsible entity known as a “trustee-manager.” The rationale behind such a proposal was twofold: first, to ensure that there is only one entity that is liable; and second, because the trustee, as an independent entity, may not have sufficient business knowledge to supervise or approve the manager’s business decisions because they may involve potential liabilities.⁶² The newly formed single entity may then appoint a manager as an agent to perform managerial functions.⁶³ Australia dealt with the potential problem of split duties in a very similar manner quite early on. In May 1991, the Australian Law Reform Commission (ALRC) was tasked with reviewing the law governing collective investment in Australia. One of the main issues considered was “Whether managers should also have fiduciary duties to investors?” One of the key recommendations in response to the issue was to eliminate the requirement for a trustee and a separate manager which was abolished and replaced by one single entity.⁶⁴ The same recommendation was adopted in the legislation via the Managed Investments Act 1998.⁶⁵ This Vague Citation provides the exact legislative change:

By streamlining the dual functions of a trustee and a manager into a single responsible entity and imposing specific statutory duties on this responsible

⁵⁹ REIT Regulation 9 for trustee, Regulation 10 for manager and Regulation 11 for sponsor and sponsor groups. Regulation 9(3) – The trustee shall oversee activities of the manager in the best interests of the unit holders, ensure that the manager complies with Regulation 10 and shall obtain a compliance certificate from the manager in the form as may be specified on a quarterly basis.

⁶⁰ REIT Regulation 10 – The manager shall make the investment decisions with respect to the underlying assets of the REIT, including any further investment or divestment of the assets.

⁶¹ Kam Fan Sin, *The Legal Nature of the Unit Trust* 204 (1997).

⁶² MAS Consultation Paper, Regulation of Business Trust, Section 3: Structure of Responsible Entity for Business Trust (December 2003), at 12 (Jun. 20, 2021), available at https://www.mas.gov.sg/-/media/MAS/resource/publications/consult_papers/2003/Regulation-of-BT_Consultation-Paper.pdf.

⁶³ *Id.*

⁶⁴ ALRC Report 65.

⁶⁵ Pamela F. Hanrahan, *Managed Investments Law & Practice* (1999), para. 2-420, 2, 301.

entity, the Australian approach has achieved a higher degree of clarity on the duties owed by the responsible entity towards REIT unit-holders.⁶⁶

The argument that the trustee only serves a supervisory role and hence there can be no dispute in determining the liability of the manager or trustee does not hold weight. Until 1988, in Australia until 1988, the trustee was responsible for ensuring that the scheme manager properly discharged its duties. However, the model was discontinued in order to avoid the possibility of a “responsibility gap” between trustees and scheme managers, which could result in defaults in the operation of the trusts.⁶⁷

New Zealand has adopted a special approach by including a specific provision in the Unit Trust Act that the manager of a unit trust is subject to the same liability for its acts and omissions as a trustee.⁶⁸

However, the reason for the removal of the dual-responsible entity structure in Australia’s Collective Investment Scheme can be found in the ALRC report of 1993, which stated that it was not clear which of the parties, namely, manager or trustee, was responsible for which aspect of the scheme,⁶⁹ which sometimes results in neither taking the responsibility for compliance with the law as each can blame the other.

5.2. REITs in BRICS

Initially, the foreign ministers of four states, Brazil, Russia, India and China, established BRIC at a United Nations General Assembly meeting in 2006; South Africa was added to it in 2011. BRICS represents a group of the world’s fastest-growing emerging economies. The BRICS organization was founded to address global challenges and it is garnering attention both regionally and globally.⁷⁰

The structured finance market in Brazil allows two types of conduits: *Fundos de Investimento em Direitos Creditorios* (FIDCs) (asset-backed investment funds) and *Certificados de Recebfevs Imobilidrios* (CRIs) (real estate-backed certificates).⁷¹ These are subject to the regulations of the Securities Exchange Commissions of Brazil. REITs in Brazil have been in existence since 1993. These investment funds for real estate are known as *Fundo de Investimento Imobiliário* (FII).⁷² These are operated as a contractual arrangement between the investor and the fund manager and thus

⁶⁶ Suet Fern Lee & Linda Esther Foo, *Real Estate Investment Trusts in Singapore: Recent Legal and Regulatory Developments and the Case for Corporatisation*, 22(1) *Singap. Acad. L.J.* 36 (2010).

⁶⁷ Jennifer Ball, *Insolvent Unit Trusts in Australia*, 8(5) *International Corporate Rescue* 340 (2011).

⁶⁸ Sec. 3(2)(c) of the Unit Trust Act 1960.

⁶⁹ ALRC Report 65(1).

⁷⁰ Elena Gladun, *The BRICS: A Major Participant in the Multipolar World Order*, 5(1) *BRICS L.J.* 169 (2018).

⁷¹ Georgette C. Phillips, *The Paradox of Commercial Real Estate Debt*, 42(3) *Cornell Int’l L.J.* 335 (2009).

⁷² European Public Real Estate Association, *Global REIT Survey 2016* (2016) (Jun. 20, 2021), available at https://prodapp.epra.com/media/EPRA_REIT_2016_AMERICAS_1481039767927.pdf.

do not have a legal entity structure and capital adequacy requirements. They can also be kept open for an unlimited period.⁷³ The Brazilian Stock Exchange listed approximately 130 publicly traded REITs,⁷⁴ whereas countries like India and China were just considering setting up REITs by 2010,⁷⁵ indicating that Brazil was far ahead of the other BRICS nations in REIT expansion.

Out of all the BRICS nations, China was the only country remaining without REITs after the introduction of the structure in India. The Chinese government has taken initiatives to introduce REITs in 2020 to finance highways and development infrastructure projects regulated under a joint circular of the China Securities Regulatory Commission (CSRC) and the National Development and Reform Commission (NDRC).⁷⁶ This move is expected to increase employment in China and provide the Chinese economy with stimulus while it recovers from the COVID-19 impacts. The Chinese REITs structure is entirely different from that of other REITs operating globally, as there is no specific law to regulate it, only guidelines that allow for a structured conduit with restrictions. However, in Hong Kong, the REIT market has been in existence since 2003, and it is regulated by the Securities and Futures Commission (SFC) under the Real Estate Investment Trust Code 2003.⁷⁷ As per this code, Hong Kong REITs must be established as Hong Kong unit trusts (which is entirely different from the corporate structure available in other BRICS nations).⁷⁸

REITs first appeared in the Russian market in 2001, with a comprehensive legal framework known as ZPIFN (Closed Share Investment Real Estate Fund).⁷⁹ They are allowed to have a trust form or corporate form. These are a very convenient tool for tax planning in Russia.

REITs in South Africa were first introduced in 2013.⁸⁰ These are corporate entities or trusts, similar to the REIT structure in the other BRICS nations that pool investors'

⁷³ European Public Real Estate Association, *supra* note 72.

⁷⁴ Adriana Bruscatto Bortoluzzo et al., *Diversification and Property Control Impact on the Performance of Brazilian Real Estate Investment Trusts (REITs)*, 8(1) *Revista Evidenciação Contábil & Finanças* 5 (2020) (Jun. 20, 2021), also available at <https://www.balas.org/resources/Documents/2018%20Conference%20Files/2018%20Conference%20Proceedings/Diversification%20and%20property%20control%20impact%20on%20the%20performance%20of%20Brazilian%20Real%20Estate%20Investment%20Trusts.pdf>.

⁷⁵ CFA Institute, *Asia-Pacific REITs: Building Trust through Better REIT Governance* (2011) (Jun. 20, 2021), available at <https://www.cfainstitute.org/-/media/documents/article/position-paper/asia-pacific-reits.ashx>.

⁷⁶ S&P Global, *China's Infrastructure REIT Market: From Slow Start to Big Bang?* (October 2022) (Jun. 20, 2021), available at https://www.spglobal.com/_assets/documents/ratings/research/100046937.pdf.

⁷⁷ World Services Group, *Hong Kong: Hong Kong REITs Update* (February 2006) (Jun. 20, 2021), available at <https://worldservicesgroup.com/publications.asp?action=article&artid=1211>.

⁷⁸ *Id.*

⁷⁹ Andrei Protasov, "The Future of Investment in Commercial Real Estate – Alternative Financing," ILM, 26 June 2019 (Jun. 20, 2021), available at <https://www.ilm.ru/en/expert-opinion-interview/andrei-protasov-future-investment-commercial-real-estate-alternative>.

⁸⁰ Mpilo Ntuli & Omokolade Akinsomi, *An Overview of the Initial Performance of the South African REIT Market*, 25(2) *J. Real Estate Lit.* 365 (2017) (Jun. 20, 2021), also available at <https://www.jstor.org/stable/26391920>.

funds to invest in the real estate sector and are listed on the Johannesburg Securities Exchange (JSE).⁸¹

Overall, REITs in the BRICS nations have huge growth potential. According to Frédéric Juillet (2012), investing in the BRICS regions provides a higher return on investment than investing in the United States markets.⁸²

5.3. REITs vs. InvITs

Both REITs and InvITs (Infrastructure Investment Trusts) were introduced in India by the SEBI in 2014 and are regulated through the SEBI (Infrastructure Investment Trusts) Regulations 2014. The structure of both instruments is nearly identical, namely, pooling of investment, listing and investment in assets. InvITs are a type of pool that invests in operational infrastructure such as highways and power plants and is managed by a trustee and manager in the same way REITs are. Income from Indian corporate entities controlled by InvITs or REITs is exempt from taxes.⁸³ In terms of features and functionality, InvITs are similar to mutual funds or real estate investment trusts (REITs).⁸⁴ India's first InvIT, IRB InvIT Fund (sponsored by IRB Infrastructure Developers Ltd; a publicly held company), was launched on 25 April 2017 and called for bids (similar to how a company offers its equity shares for sale in an initial public offering) between 3 May and 5 May 2017.⁸⁵ Like REITs, InvITs lack the backing of tangible assets, which is an important factor for investors, and investors give priority REITs over InvITs. Both are permitted to invest in mutual funds up to a certain amount. Compared with REITs, InvITs are more thinly traded.⁸⁶ Nevertheless, the market for REITs and InvITs is relatively nascent in India. The InvITs market in India expanded much earlier than the REITs market.⁸⁷

⁸¹ iGrow Wealth Investments, Investing in SA Real Estate Investment Trusts for Good Returns (Jun. 20, 2021), available at <https://igrow.co.za/investing-in-sa-real-estate-investment-trusts-for-good-returns/>.

⁸² Frédéric Juillet, *Analysis of the Real Estate Investment Trust (REIT) Industry*, MBA Student Scholarship (February 2012) (Jun. 20, 2021), available at https://scholarsarchive.jwu.edu/cgi/viewcontent.cgi?article=1005&context=mba_student.

⁸³ Mukesh Butani & Seema Kejriwal, *India's Budget – Implications for the international business community*, MNE Tax, 3 February 2021 (Jun. 20, 2021), available at <https://mnetax.com/indias-budget-implications-for-the-international-business-community-42368>.

⁸⁴ Definition of "Infrastructure Investment Trusts," *The Economic Times* (Jun. 20, 2021), available at <https://economictimes.indiatimes.com/definition/infrastructure-investment-trusts>.

⁸⁵ Kayezad E. Adajania, *InvITs in your mutual fund. Good or bad?*, LiveMint, 1 May 2017 (Jun. 20, 2021), available at <http://www.livemint.com/Money/MBYzpoth1PltwCNCxVn9SP/InvITs-in-your-mutual-fund-Good-or-bad.html>.

⁸⁶ Sunil Sanghai, *Better late than never! Investors finally lap up Indian REITs & InvITs*, *The Economic Times*, 10 August 2020 (Jun. 20, 2021), available at <https://m.economictimes.com/markets/stocks/news/better-late-than-never-investors-finally-lap-up-indian-reits-invits/articleshow/77350999.cms>.

⁸⁷ PricewaterhouseCoopers, *supra* note 5.

5.4. Comparative Legal Issues

Over the last decade, REITs and InvITs have developed into a mature market, providing easy access to high-quality assets and enabling a stable return on investments. To illustrate this, as of 2012, there were over 500 REITs across 22 countries.⁸⁸ The Indian drafters of the regulations have considered this and provided distinct roles and responsibilities for both of them that are mutually exclusive. The intention of the legislators is quite evident as the trustee has been provided with the role of holding the property for the benefit of unitholders, overseeing the activities of the manager (ensuring that the manager complies with reporting and disclosure requirements, reviewing the status of complaints of unitholders and their redress by the manager and ensuring that the distributions are made by the manager on time), whereas the manager has to ensure that the working of the trust is smooth concerning the maintenance of the properties, such as ensuring that the properties have a proper legal and marketable title and that investment decisions are made in compliance with the regulations. More safeguards have also been introduced in this respect, which include the trustee's obtaining a compliance certificate from the manager on a quarterly basis.⁸⁹

But the main question to be addressed here is whether it is better to have separate roles and responsibilities for managers and trustees or to combine the roles of manager and trustee into a single entity.

The Law Reform Commission of Australia raised and responded to the same question. In its report No. 65 (para. 12), a dilemma was faced: whether to revise the roles of both the parties more precisely under the same regime or to focus on a single party model and question whether the mandated third party is necessary.

Traditionally, the trustee took full responsibility for undertaking the activities of the trust and was responsible for the beneficiaries. But in commercial or business trusts, the liability is shared between the manager and the trustee. It is the role of the trustee to oversee the activities of the manager in the interest of the unitholders,⁹⁰ but from a legal viewpoint the trustee should not be involved in determining the commercial viability of each of the manager's investment decisions.⁹¹ As a result, the entire concept of dual responsibility was considered problematic by the Australian Law Reform Commission.

Hence, there can be three known approaches for solving the problems arising out of the dual responsible entity structure of a REIT:

⁸⁸ PricewaterhouseCoopers, *India's New Real Estate and Infrastructure Trusts: The Way Forward* (Jun. 20, 2021), available at <https://www.pwc.com/sg/en/publications/assets/aprea-in-realestate-infra-trusts.pdf>.

⁸⁹ REIT Regulation 9(3).

⁹⁰ REIT Regulation 10.

⁹¹ Australian Law Commission report – Permanent Trustee Company Limited Submission. Also, Singapore in 2003 provided the same rationale, see Bao et al. 2015.

- Defining the distinct roles and responsibilities of the managers and trustee will ensure that liability in the event of a breach can be attributed to any or both of the parties. This will ensure that the problem of two masters blaming each other for any default does not exist. This model has been adopted in India.

- Another model is to abolish the dual-responsible entity structure in favour of a single entity that will be responsible to the unitholders in case of any breach. This entity will be the sole entity that will owe a fiduciary duty to the investors. The model was adopted by Australia and Singapore in 1998⁹² and 2004⁹³ respectively. The trustee may also appoint a manager to undertake the activities of the REIT, but the manager will be solely liable to the unitholders.

- A third option is to make the manager also owe a fiduciary duty to the unitholders, as currently the manager is only a contractual party to the REIT. This same model was adopted by New Zealand, but it was rejected by the ALRC because “when a person is under fiduciary duties of his own, it should not be necessary for another fiduciary to watch that those fiduciary duties are performed.”⁹⁴ As a result, this model itself advocates for a single entity.

When comparing the REIT markets, it is evident that the Brazilian and South African REIT markets are far more developed as compared to those of other BRICS nations. India and China are just getting started and Russia prefers the structure of mutual funds. In all REIT structures, the entity must distribute at a major profit (at least 90% in Brazil, India and China and 75% in South Africa and Russia) of their income to their investors and the instrument is closed-ended.

Conclusion and Suggestions

The regulations have been drafted in such a manner that the roles and responsibilities of the trustee and manager are separated, thus making them mutually exclusive. Nonetheless, in light of the challenges already faced in other jurisdictions, they can continue to implement reforms and look for the single entity model that will further promote investor (unitholder) protection, which is the primary goal of the SEBI.

Currently, if the transfer of units is done in exchange for shares of the SPV then the transaction is tax neutral. The same exemption can be considered for the transfer of ownership of properties directly from the sponsor because it saves SPV level distribution if the same exemption is provided directly.

Although, the initial exchange of shares for a unit of REIT is not a commercial transaction in and of itself, the sponsor is liable for VAT, hence the government may

⁹² Managed Investment Act 1988.

⁹³ Business Trust Act 2004.

⁹⁴ Law Council of Australia Submission (1992).

consider exempting the transaction from the purview of VAT. Adding to transition cost, stamp duty and registration charges are mandatory. Similarly, transfer of assets at the initial stage shall also be considered for exemption from stamp duty payable when assets are transferred to a REIT or SPV owned by a REIT. A similar exemption has been granted in Singapore.

Because SPVs are typically established in corporate form, any distribution made by an SPV will be liable for distribution tax. As a result, the government should consider providing an exemption to the SPV if it distributes profits to the REIT in the form of a dividend.

For capital gains, mere deference is provided at the time of transition from an SPV to a trust. As a result, at the time of selling units, the sponsor will be liable for a large amount of tax, whereas the unitholder will be exempt.⁹⁵

The units of REIT are not classified as securities under the Securities Contract Regulations Act 1956 (SCRA). Moreover, under the Income Tax Act, for a transaction to be considered long-term for capital gains tax purposes, the time limit is three years; otherwise, the transaction is taxed as short-term capital gains. However, there is an exemption for listed equity shares: the consideration period is reduced from thirty-six months to twelve months. The same treatment is proposed for units of investment trust to bring them on par with equity investments.

The current pass-through provision is illusory. The pass-through benefit for the REIT is restricted to only interest income and rental income, which are taxed at the hands of investors, whereas the income arising from capital gains and other income is taxable at the REIT or trust level. The SPV is also required to pay full corporate taxes and dividend distribution tax (DDT).

One of the main reasons for the high market capitalisation of the REITs in the United States is their accessibility to various institutional investors. In India, the Insurance Regulatory and Development Authority of India (IRDAI) should consider relaxing the investment regulatory guidelines for insurance companies in order to increase their investor base, and pension funds should consider making REIT an eligible instrument to invest in.

To date, there has only been one issue in the REIT segment in India. The policy has undergone significant changes in terms of relaxing various structural and taxation aspects and reforms are currently underway to make the vehicle more lucrative for investors, which will also unlock value for different stakeholders by providing liquidity to the so-called illiquid sector. By comparing the regulations with those of Singapore and Australia, various changes, with an emphasis on the dual structure model, can be incorporated to avoid any future challenges faced on the same subject matter.

⁹⁵ Sriram Govind & Ruchir Sinha, *REITs: Tax Issues and Beyond*, Mondaq, 3 November 2014 (Jun. 20, 2021), available at http://www.mondaq.com/article.asp?article_id=351206&type=mondaq&r=2&t=5.

By analysing the consistent efforts of regulators and the government regarding incorporating changes in the policy, one can predict the Pandora's Box waiting to be opened in the sector in the near future.

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