

Transfer of SEZs: permitting foreigners to invest in real estate?

By Manisha Paranjape
 (pictured) **and Dhaval Vussonji**



The Policy for Special Economic Zones (SEZ) in India has not been as hugely successful as was contemplated in 2005, when the policy was enacted in the form of the Special Economic Zones Act, 2005 (the Act) with rules made thereunder. A number of applications have been made for transfer of SEZs by original promoters.

Requests made to the Board of Approval (BOA), constituted under the Act, to permit transfer of promoter's shares in the entity setting up the SEZ (the SEZ Developer) were initially rejected on the grounds of an objection raised by the Department of Revenue that these transactions would amount to sale of land in an SEZ which is not permissible under Rule 11(9) of the SEZ Rules, 2006. However, the Department of Legal Affairs later issued a clarification that change in equity structure of the SEZ Developer and a consequent change in management would not amount to a sale of land as the land would continue to vest in the SEZ Developer. Pursuant to this clarification, the BOA has, since September, 2011, been approving transfer of shares of SEZ Developers on a case by case basis subject to certain conditions.

The permission given by the BOA, particularly to the promoters of an SEZ Developer developing an Information Technology SEZ, to transfer their shares to a foreign investor has caused some to argue that such a decision is tantamount to allowing foreign investment (FDI) in the prohibited real estate sector. In support of this line of thought, it has been suggested that while Press Note 2 of 2005 issued by the Directorate of Industrial Policy and Promotion (DIPP) permits FDI up to 100 percent under the automatic route in construction-development projects, the decision of the BOA in fact permits foreign investors to buy developed real estate.

Having stated the aforesaid, the BOA generally grants approval for transfer of SEZs only on a case to case basis and the

permission casts continued responsibilities and obligations upon the SEZ Developer post transfer of shares. Though a portion of the SEZ referred to above, is today operational, Phase II of the said SEZ is still in the nascent stage of construction. It therefore appears that the altered SEZ Developer entity will continue to have the responsibility of completing the setting up of the SEZ and transfer of completed buildings seems only incidental. In any event, the current FDI Policy permits FDI in construction-development (with relaxed conditions for SEZs) and there appears to be no bar on such FDI even if parts of the project have already been completed. Shares of companies holding such partially completed projects are also transferable in terms of the FDI Policy.

In the above circumstances, the decision of the BOA does not

... the decision of the BOA does not seem to be an indirect attempt to permit FDI in constructed real estate ...

seem to be an indirect attempt to permit FDI in constructed real estate. Changed circumstances, especially related to taxation, are making development of SEZs commercially unviable causing many promoters to look at exiting their SEZ ventures. Prior to the decision of the BOA allowing stake sale in SEZs, the only option left to such promoters was to have the SEZ de-notified, which meant the demise of the SEZ altogether. Permission for transfer of shares seems to be the only option to ensure that

SEZs which are already approved and notified, are completed and become operational.

In the modern world of specialisation of the real estate industry in India, in assets such as SEZs, real estate trusts being formed for holding of leased assets and specialised companies being involved in management of SEZs, the amendments to the SEZ Policy are a welcome move for real estate developers and will provide an impetus to the development of SEZs in India.

Kanga & Co.

Readymoney Mansion
 43, Veer Nariman Road
 Mumbai 400 001, India

Tel: (91) 22 6623 0000
 (91) 22 2204 2288

Email: manisha@kangacompany.com
dhaval.vussonji@kangacompany.com
www.kangacompany.com