



Lease  
arrangements -  
negotiate or  
re-negotiate

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# Lease arrangements - negotiate or re-negotiate

The current Covid-19 situation will have an impact on existing lease arrangements for office and retail assets, in one or more of the following ways:

- ▶ Partial or complete waiver of lease rent for affected period
- ▶ Deferral of lease rent for the affected period
- ▶ Re-negotiation of lease terms
- ▶ Cancellation of lease agreements

In addition to commercial and revenue impacts, each of these scenarios could impact real estate owners and tenants differently. While tenants are going to be driven by an immediate assessment of need for real estate and short to medium term cash flow requirements, there is a need for real estate owners to examine the following considerations

## Considerations for real estate owners

- ▶ Review existing terms and conditions - whether force majeure clause covers a pandemic or provides the ability to re-negotiate terms or defer/ waive lease rent or provides any other mechanism
- ▶ Impact on property insurance, property taxes and maintenance costs as provided in the lease agreement
- ▶ What documentation is needed to give legally binding effect to any commercial agreement
- ▶ Credit risk assessment of tenants based on credit rating, risk profile, financial strength, impact on tenant business, assets and earning capacity, and potential bankruptcies
- ▶ List down possibilities, which could include:
  - ▶ Complete or partial waiver of dues for affected period
  - ▶ Deferral of dues for affected period - to be recovered over rest of the FY ending March 2021 in equal instalments
  - ▶ Deferral of dues for affected period - to be recovered in the next FY ending March 2022 in equal instalments
  - ▶ Deferral of dues for affected period - to be adjusted in next escalation as per lease agreement
  - ▶ Deferral with interest charge for deferment period
  - ▶ Re-negotiation of lease terms for lesser area
  - ▶ Re-negotiation of lease terms for a downward re-benchmarking of rentals
  - ▶ Termination of lease
- ▶ Define the approach to be followed across types of tenants, micro-markets and locations within a micro-market
- ▶ Impact on debt covenants/ LRD commitments where tenant does not pay rent for affected period
- ▶ Mechanism to forfeit security deposit in part or full

## Accounting, tax, stamp duty considerations

Accounting implications will be governed by principles of accrual which would take into consideration:

- ▶ Legal right to collect
- ▶ Solvency status of tenant, including assessment of impact on tenant's business, assets, earning capacity
- ▶ Overall business climate

Income-tax implications will differ, depending on whether income is offered to tax as "Business income" or "Income from House Property". In case of business income, taxability of income, will be governed by

- ▶ Principles of accrual; and
- ▶ 'Reasonable certainty' test under ICDS

Where income is offered to income tax as "Income from House Property":

- ▶ There is a need to assess whether un-realised rent deduction or vacancy allowance will be available, depending on commercial agreement with tenants and
- ▶ Whether tax will still need to be paid on notional income. If yes, need to explore if overall rents have got re-benchmarked

Where a complete/ partial forfeiture of security deposit is contemplated, one needs to consider the tax implications that could arise, depending on whether it is pursuant to enforcement of contract or a mutually agreed forfeiture

Depending on the nature of waivers/ deferrals or re-negotiation, the corresponding GST impact could be significant. An assessment of the consequences will be critical for each of the options.

From a regulatory and tax perspective, would the re-negotiation need to be documented and registered?

Who would incur the stamp duty and registration costs for such amendment or new document?

## Way forward

- ▶ Determine implications of each alternative to make a judicious determination of preferred 'win-win' solutions with tenants
- ▶ Approaching tax authorities, state government authorities and regulators, to seek specific clarifications or legislative amendments or reliefs in view of the Covid-19 impact

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# Contact

### Gaurav Karnik

Partner and National Leader, Real Estate, EY India

Email- [gaurav.karnik@in.ey.com](mailto:gaurav.karnik@in.ey.com)

Mobile No- +91 9811214668

### Avinash Narvekar

Partner, Tax and Regulatory Services, EY India

Email- [avinash.narvekar@in.ey.com](mailto:avinash.narvekar@in.ey.com)

Mobile No- +91 9820155244

### Maadhav Poddar

Partner, Tax and Regulatory Services, EY India

Email- [maadhav.poddar@in.ey.com](mailto:maadhav.poddar@in.ey.com)

Mobile No- +91 9811571150

### Randhir S. Kochhar

Partner, Transaction Advisory Services, EY India

Email- [randhir.kochhar@in.ey.com](mailto:randhir.kochhar@in.ey.com)

Mobile: +91 9811152600

### Anumeha Jain

Associate Partner, Tax and Regulatory Services, EY India

Email- [Anumeha.Jain@in.ey.com](mailto:Anumeha.Jain@in.ey.com)

Mobile No- +91 9899103459

### Mona Chhabra

Associate Partner, Transaction Advisory Services, EY India

Email- [mona.chhabra@in.ey.com](mailto:mona.chhabra@in.ey.com)

Mobile: +91-98104 03345

### Siddharth Sehgal

Associate Partner, International Tax and Transaction Services, EY India

Email- [siddharth1.sehgal@in.ey.com](mailto:siddharth1.sehgal@in.ey.com)

Mobile: +91 99995 05639

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