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TO ALL MEMBERS

TECHNICAL

Direct Taxation

PUBLIC RULING NO. 9/2012 – TAXATION OF REAL ESTATE INVESTMENT TRUSTS / PROPERTY TRUST FUNDS

The Inland Revenue Board (IRB) issued the above Public Ruling (PR) on 26 November 2012. This Ruling replaces the *Guidelines on Real Estate Investment Trusts or Property Trust Funds (REITs/PTF)* dated 29 June 2005 issued by the IRB.

Objective
The objective of this Ruling is to explain the tax treatment accorded to approved REITs/PTF in Malaysia.

Some of the salient points made in the Ruling are highlighted below:

Basis of assessment
The basis period of a REIT/PTF is determined in accordance with provisions of section 21A of the Income Tax Act 1967 (ITA), [except for subsection 21A(5)]. The basis year for a year of assessment (YA) or the financial accounting period ending on a day other than 31 December is the basis period of the REIT/PTF for that year of assessment.

Special tax treatment
Prior to YA 2005, REITs/PTF are taxed in accordance with provisions of the ITA applicable to unit trusts (sections 61(1), 63A and 63B).

With effect from YA 2005, section 63C is applicable. Under this section –
- Rental income received by the REIT/PTF from investments in real property is treated as business income.
- Notwithstanding the above, the amount of deductible expenses is restricted to the gross income from the rental source. Any excess expenditure is not allowed against other sources of income, or to be carried forward for deduction in subsequent years of assessment. No deduction of expenses is allowed if a source does not produce any income. (Refer Example 8 and 9 in the PR.)
- Capital allowance (under Schedule 3 of the ITA) is allowed to be deducted in ascertaining statutory income from rental but the amount is restricted to adjusted income of the rental source for that YA, and any excess capital allowance is not allowed to be carried forward to the following YA. (Refer Example 7 in the PR.)

The following points pertaining to taxation of income of REITs/PTF are to be noted:
- Rental income from all rental properties is treated as a single source of income.
- Section 33(1) of the ITA is applicable in determining allowable expenses. An expense which is deductible under that section is manager's remuneration, but trustee's fee is not regarded as deductible.
- A special deduction from the rental source is allowed under the Income Tax (Deduction for Establishment Expenditure of Real Estate Investment Trust or Property Trust Fund) Rules

2006, in respect of legal, valuation and consultancy fees for establishing REITs/PTF which were incurred prior to approval by the Securities Commission.

- A REIT/PTF deriving rental income from a building that is used (by the tenant) as an industrial building may claim industrial building allowance (IBA) against adjusted income from that rental source.
- From YA 2008, a company which disposes of an industrial building on which it has claimed (or should have claimed) IBA, to a REIT/PTF, is deemed to have disposed of that building for a sum equal to the residual expenditure of the building on the first day of the company's final period, which amount is deemed to be the qualifying expenditure (QE) of the acquirer. As such, the disposer is not subject to any balancing charge or allowance, while the acquirer (REITs/PTF) is eligible to claim IBA on the deemed QE. (Refer Example 3 in the PR.)
- Under transitional provisions, unabsorbed losses and capital allowances ascertained prior to YA 2005 are allowable against income for YA 2005 and subsequent years of assessment. (Refer Example 6 in the PR.)

Exemption of income of REITs/PTF
Prior to YA 2007 – REITs/PTF are tax-exempt on their total income for a YA on an amount equal to the amount distributed to unit holders in the basis period for a YA. The amount not distributed is subject to tax at the prevailing corporate tax rate.

From YA 2007 – REITs/PTF are fully exempt from tax for a YA if they distribute to their unit holders 90% or more of their total income in the basis period for that YA. [Section 61A(1)]
(Refer Examples 11 to 13 of the PR.)

Interest, dividends and other exempt income received by REITs/PTF
A list of the types of interest received by REITs/PTF which are tax-exempt is given in paragraph 9.3 of the PR.

Taxable dividend income forms part of the total income of REITs/PTF. When the total income of the REIT/PTF is distributed to the unit holder, the distribution is subject to tax at the unit holder level.

Exempt income received by REITs/PTF (e.g. capital gains and exempt interest) is not included in computing the total income of REITs/PTF.
(Refer to Examples 14 to 17 for illustrations of the tax treatment on various types of income received by REITs/PTF.)

Distribution of REITs/PTF income to unit holders
Grace period – If the REIT/PTF intends to distribute at least 90% of its total income but falls short of that percentage at the end of the basis period, a grace period of 2 months from the closing of its accounts is given for the REIT/PTF to distribute the balance so as to qualify for tax exemption at the REITs/PTF level.

Withholding tax – Withholding tax must be deducted under section 109D when distribution of income is made to unit holders by REITs/PTF which are exempt under section 61A of the ITA. The rates of withholding tax that are applicable to various classes of unit holders are found in paragraph 11.4 of the PR.

Information to be provided – Details that must be provided on the distribution voucher are listed in paragraph 11.6 of the PR. The REITs/PTF must also provide information relating to unit holders to the IRB. The list of required information is given in paragraph 11.7.

Payment of withholding tax and penalty for failure to pay
The rules relating to payment of withholding tax and administrative procedures for making payment are explained in paragraph 12 of the PR.

Paragraph 13 states that the penalty for failure to pay the amount of withholding tax due under subsection 109D(2) of the ITA is an increase of 10% of the amount which the payer had failed to pay, which amount, together with the amount which the payer had failed to pay, becomes payable immediately to the Director General of Inland Revenue.

A specimen sample of a REITs/PTF distribution voucher is found in Appendix 1.

Members may refer to the full text of PR 9/2012 at the CTIM website or the IRB website.