**LHDN.01/35/42/51/84**

# GUIDELINES ON REAL ESTATE INVESTMENT TRUSTS OR PROPERTY TRUST FUNDS (REIT/PTF)

## A. INTRODUCTION

1. In a move to increase the liquidity of the real estate sector and enhance its contribution to the economy, the Government announced in Budget 2005 attractive tax incentives to promote the growth of Real Estate Investment Trusts or Property Trusts (REIT/PTF) in Malaysia. Prior to the announcement, under the tax laws, a property trust fund (essentially an unit trust with income mainly from letting of real property) is taxed as a unit trust but with special deductions in the form of capital allowance deduction and a deduction for specified permitted expenses.

2. Following the announcement, an amendment to the taxation of REIT/PTF was introduced whereby a 'tax flow through' treatment was to be accorded to REIT/PTF. This essentially means that the REIT/PTF will not have to pay any tax but instead the unit holder will be subject to tax on the distributions from the REIT/PTF. With this method of taxation, REIT/PTF is expected to be in a better position to have more income available for distribution to unit holders, producing a relatively high yield investment, making investment in REIT/PTF a more attractive investment option as compared to unit trusts which invest mainly in equities. The amendments to the Income Tax Act 1967 (ITA) on the tax incentives for REIT/PTF are covered in the Finance Act 2004 ( Act 639).

## B. DEFINITION

For the purpose of these Guidelines, the terms PTF and REIT are defined as follows:

(i) ‘Property Trust Fund (PTF)’ has the same meaning assigned thereto under the Guidelines on Property Trust Funds issued by the Securities Commission dated November 2002.

(ii) ‘Real Estate Investment Trust (REIT)’ has the same meaning as a Property Trust Fund (PTF) assigned thereto under the Guidelines on Property Trust Funds issued by the Securities Commission dated November 2002.

## C. EXEMPTION OF INCOME OF REIT/PTF

1. Under the new section 61A ITA, the total income of a REIT/PTF which is equal to an amount of distribution made to unit holders in the basis period for a year of assessment, is exempted from tax at the REIT/PTF level. The balance of total income that is not distributed will be taxed at 28% on the REIT/PTF. It is to be noted that the tax paid by the REIT/PTF, if any, will be available as a tax credit under section 110 ITA when the undistributed income that has been subject to tax at REIT/PTF level is eventually distributed to the unit holders in the subsequent years.

2. The distribution of the total income to unit holders for a year of assessment which is exempted under section 61A ITA must be made not later than two months after the close of the financial year which forms the basis period for a year of assessment of the REIT/PTF.

**Example 1:**

**REIT/PTF Level**

| **Year 1** | RM | **Year 2** | RM |
|---|---|---|---|
| Business (rental) | 10,000 | Business (rental) | 9,000 |
| Interest | 2,000 | Interest | 5,000 |
| Total Income | 12,000 | Total Income | 14,000 |
| Less: Distribution | 10,000 | Less: Distribution | 14,000 |
| Chargeable Income | 2,000 | Chargeable Income | NIL |
| Exempted income | 10,000 | Exempted income | 14,000 |

| | | | |
|---|---|---|---|
| Taxable income | 2,000 | Taxable income | NIL |
| Tax payable 2000 @ 28% | 560.00 | Tax payable | NIL |

| | | | |
|---|---|---|---|
| Distribution by REIT/PTF comprises of: | | Distribution by REIT/PTF comprises of: | |
| Income not subject to tax | 10,000 | Income not subject to tax | 14,000 |
| Income subject to tax | NIL | Income subject to tax (from year 1) | 2,000 |
| Total Distribution | 10,000 | Total Distribution | 16,000 |

**Unit Holder Level**

| **Year 1** | RM | **Year 2** | RM |
|---|---|---|---|
| Distribution from REIT/PTF | | Distribution from REIT/PTF | |
| -not subject to tax @ REIT/PTF | 10,000 | -not subject to tax @ REIT/PTF | 14,000 |
| | | -subject to tax | 2,000 |
| Section 110 set off<br>(no income subject to tax at REIT/PTF level) | NIL | Section 110 set off<br>(arising from income subject to tax at REIT/PTF level) | 560.00 |

3. In a case where dividend income forms part of the total income distributed to unit holders, the tax credit from tax at source is given to the REIT/PTF and the tax computation at REIT/PTF and unit holder level is illustrated in the following example:

**Example 2:**

| **REIT/PTF Level** | RM |
|---|---|
| Business (rental) | 10,000 |
| Dividend (gross) | 20,000 |
| Total Income | 30,000 |
| Less: Distribution | 20,000 |
| Chargeable Income | 10,000 |
| | |
| Tax payable 10,000 @ 28% | 2,800.00 |
| Section 110 set-off | 5,600.00 |
| Tax repayable | 2,800.00 |

| | |
|---|---|
| Distribution by REIT/PTF comprises of: | |
| Income not subject to tax | 20,000 |
| Income subject to tax | NIL |
| Total Distribution | 20,000 |

**Unit Holder Level**

| | |
|---|---|
| Distribution of total income of REIT/PTF | 20,000 |
| Section 110 set off | NIL |
| (no income subject to tax at REIT/PTF level) | |

**Note:** Dividend income forms part of the total income of a REIT/PTF. Tax credits attached to dividends are given as a set-off to the REIT/PTF. When the total income is distributed to the unit holder, the unit holder will be assessed on this income as distribution from the REIT/PTF.

4. There is no change in legislation with respect to the current position on exempt income received by a unit trust as well as undistributed income which has been subject to tax but distributed in the subsequent years to unit holders. Similar to unit trusts, tax treatment of exempt income and undistributed income of a REIT/PTF are as follows:

(i) Exempt income of a REIT/PTF e.g. capital gains and certain interest income will continue to be exempt at the unit holder level. This income is not included in computing the total income of the REIT/PTF.

(ii) Undistributed income of a REIT/PTF for any year of assessment which is subsequently distributed to unit holders will be taxed on the unit holders in the year of assessment that the income is distributed and a set-off given, under section 110 ITA for the tax suffered by the REIT/PTF, in that year of assessment the income is brought to tax ( see Example 1).

## D. SPECIAL TAX TREATMENT OF REIT/PTF

1. With effect from year the of assessment 2005, a special treatment has been accorded to the taxation of rental income from the letting of real property received by REIT/PTF. Under the amendments, rental income from the letting of real property is now treated as business income [paragraph 4(a) ITA] and no longer as rental income [paragraph 4(d) ITA] i.e. the tax treatment accorded prior to amendment to the ITA. Notwithstanding this special treatment, there are limitations imposed i.e. any excess of deductions allowed in arriving at the adjusted income and unabsorbed allowances under Schedule 3 ITA are disregarded for the purposes of the ITA. This means losses from the letting of properties cannot be deducted against income from other sources of income of the REIT/PTF in a basis period. Further, the rental losses and the unabsorbed capital allowances cannot be carried forward to the following year of assessment and used to offset against that year's rental income.

2. With this special treatment being accorded to REIT/PTF, the special deductions presently available to property trusts (essentially unit trusts with income mainly from letting of real property but which do not qualify as a REIT /PTF under Securities Commission guidelines) under sections 63A and 63B ITA will no longer be applicable to a REIT/PTF.

3. In addition, rental income of REIT/PTF is treated as a single source of business income i.e. income from all properties is aggregated as a single source of income.

## E. DEDUCTIBILITY OF EXPENSES

Deductions for expenses under subsection 33(1) ITA will be allowed against the rental income. This will include REIT/PTF manager's remuneration since rental income is now treated as a business source. However, trustee's fee does not fall under subsection 33(1) and is therefore not an allowable deduction.

## F. DISTRIBUTION OF REIT/PTF INCOME

1. **Basis period for the unit holder**

(i) Distribution made out of the income of a REIT/PTF exempted from tax for a basis year for a year of assessment under section 61A would be taxable on the unit holder for that year of assessment. This means the current year's total income of a REIT/PTF that is distributed would follow the basis period of the REIT/PTF. Since in practice, a REIT/PTF may be only able to make payments out to the unit holders after the close of accounts i.e. say for basis period 1.1.2005 to 31.12.2005, payments to unit holders are made on 31.1.2006, distribution from the REIT/PTF would be considered as income of the unit holder for the basis period for the year of assessment 2006. Thus unit holders are required to declare distributions from a REIT/PTF according to date of payment on the distribution voucher.

(ii) The above treatment will also apply to undistributed income with tax credits attached that is distributed by the REIT/PTF to unit holders in the basis period for a year of assessment.

2. **Distribution voucher**

REIT/PTF shall prepare distribution vouchers for the unit holders based on the format shown in the sample attached (Appendix A).

3. **Information on resident unit holders**

In respect of resident unit holders, when distributions are made, the REIT/PTF shall furnish to Lembaga Hasil Dalam Negeri (LHDN) the following information -

- name of unit holder
- identity card number/company registration number
- taxable income
    - exempt at REIT/PTF level
    - undistributed income from previous years
- tax suffered at REIT/PTF level on undistributed income.

This information can be forwarded in a diskette to:

Lembaga Hasil Dalam Negeri Malaysia
Cawangan Pungutan
Unit Cukai Pegangan
Tingkat 13, Blok 8A
Kompleks Pejabat Kerajaan
Jalan Duta, Kuala Lumpur
Karung Berkunci 11061
50990 Kuala Lumpur

## G. TAX TREATMENT OF UNIT HOLDERS

At the unit holder level there is a need to differentiate between resident unit holder and non-resident unit holder. The tax treatment is as follows:

1. **Resident unit holders**

   In the case of resident unit holders, income distributed by a REIT/PTF (that is exempted at REIT level under section 61A ITA) will be subject to tax i.e. for companies at the rate of 28% or for an individual at scale rates.

2. **Non-resident unit holders**

   In respect of non-resident unit holders, income distributed by the REIT/PTF will be taxed at a rate of 28% and the tax will be collected through a withholding tax mechanism. The income distributed that is subject to withholding tax is only income that is exempt from tax at REIT/PTF level under section 61A ITA.

## H. PROCEDURES REGARDING PAYMENT OF WITHHOLDING TAX FOR NON-RESIDENT UNIT HOLDERS

1. Withholding tax shall be deducted by the REIT/PTF upon distributing its income to non resident unit holders. For the purpose of facilitating deduction of withholding tax, REIT/PTF may use the information available in the Central Depository System (CDS) account to determine the residence status of the unit holder i.e based on nationality of the unit holder. In cases where unit holders are able to confirm their tax residence directly to the REIT/PTF, the

REIT/PTF may also rely on the unit holders confirmation for purposes of deducting withholding tax.

2. REIT/PTF shall pay withholding taxes on a global basis in respect of all its non-resident unit holders and not separately for each non-resident unit holder. The tax deducted shall be remitted to LHDN within one month after distributing such income by completing the prescribed form CP 37E (Appendix B). The form together with the payment must be submitted to the Collections Branch at the following locations:

| | |
|---|---|
| Peninsular Malaysia | Lembaga Hasil Dalam Negeri Malaysia<br>Cawangan Pungutan<br>Tingkat 15, Blok 8A<br>Kompleks Pejabat Kerajaan<br>Jalan Duta, Karung Berkunci 11061<br>**50990 Kuala Lumpur** |
| Sabah & WP Labuan | Lembaga Hasil Dalam Negeri Malaysia<br>Unit Pungutan, Tingkat Bawah<br>Wisma Bandaraya<br>Jalan Masjid Lama<br>**88600 Kota Kinabalu** |
| Sarawak | Lembaga Hasil Dalam Negeri Malaysia<br>Unit Pungutan<br>Aras 3, 6, 7, 8 & 15<br>Wisma Ting Pek Khiing<br>No.1, Jalan Padungan<br>**93100 Kuching** |

3. Since the payment is on a global basis, there is no need for the registration of separate income tax files for each non-resident unit holder. However details of the payments must be made available upon request by LHDN.

4. In a case where the REIT/PTF fails to deduct the withholding tax due, the REIT/PTF shall be liable to an increase in tax equal to 10% of the amount of distribution made to the non-resident. Both the tax and the increase in tax becomes a debt due from the REIT/PTF to the Government.

5. Generally withholding tax of 28% is a final tax. However, if a non-resident unit holder has income from sources other than REIT/PTF for which he is required to file tax returns, income from REIT/PTF may be included in the return, in which case the income will be subject to tax at the non-resident tax rate of 28% and a set-off under section 110 ITA will be given for the tax deducted at source in computing his tax payable for a year of assessment.

## I. EXEMPTION OF REAL PROPERTY GAINS TAX AND STAMP DUTY

The following exemptions are available in respect of any disposal of real property to REIT/PTF:

(i) **Real Property Gains Tax ( Exemption) (No. 4) Order 2003:**

Chargeable gains on the disposal of a chargeable asset to REIT/PTF is exempted from real property gains tax with effect from 13.9.2003.

(ii) **Stamp Duty (Exemption) (No. 4) Order 2004:**

All instruments of transfer of real property to a REIT/PTF are exempted from stamp duty with effect from 13.9.2003.

**JABATAN TEKNIKAL**
**LEMBAGA HASIL DALAM NEGERI**
**MALAYSIA.**
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