INLAND REVENUE BOARD MALAYSIA

REAL ESTATE INVESTMENT TRUSTS / PROPERTY TRUST FUNDS – AN OVERVIEW

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DIRECTOR GENERAL'S PUBLIC RULING

A Public Ruling as provided for under section 138A of the Income Tax Act 1967 is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board Malaysia. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling.

Director General of Inland Revenue,
Inland Revenue Board Malaysia.

1. Objective

The objective of this Ruling is to explain the real estate investment trusts / property trust funds and Islamic real estate investment trusts in Malaysia.

2. Related Provisions

The provisions of the Income Tax Act 1967 (ITA 1967) related to this Public Ruling are sections 8, 33, 43, 44, 61, 61A, 63C, 63D, 109D, 110, paragraphs *4(a), 4(d),* and Part I and Part X of Schedule 1.

3. Interpretation

The words used in this Ruling have the following meaning:

3.1 "Real estate investment trust" or "property trust fund" means a unit trust scheme that invests or proposes to invest primarily in income generating real estate.

3.2 "Islamic real estate investment trust" is a real estate investment trust that is managed and operated based on Syariah principles.

3.3 "Resident" means resident of Malaysia for the basis year for a year of assessment by virtue of sections 7, 8 or subsection 61(3) of the ITA 1967.

3.4 "Real estate" means land and all things that are a natural part of the land as well as things attached to the land below and above the ground.

3.5 "Individual" means a natural person.

3.6 "Total income", in relation to a person and a year of assessment means total income ascertained in accordance with the ITA 1967.

3.7 "Person" includes a company, a co-operative society, a club, an association, a Hindu Joint Family, a trust, an estate under administration, an individual and a partnership.

3.8 "Institutional investor" means a pension fund, collective investment schemes or such other person approved by the Minister

3.9 "Distribution" refers to the distribution of income by a real estate investment trust or Islamic real estate investment trust to its unit holders.

3.10 "Securities Commission" means the Securities Commission established under the Securities Commission Act 1993.

3.11 "Fund" means a real estate investment trust or Islamic real estate investment trust.

3.12 "Securities laws" means the Securities Industry Act 1983, the Securities Industry (Central Depositories) Act 1991, the Securities Commission Act 1993 and the Futures Industry Act 1993.

4. Real Estate Investment Trusts (REITs)

Generally, REITs can be described as follows:

4.1 Real estate investment trust is an investment trust fund, which acts as a vehicle that pools funds (through the issuance of units) from investors / unit holders comprising individuals, companies, pension funds, associations etc. for investments in real estate. Its major income is rental and it is required to distribute most of its profits to its unit holders.

4.2 The investment is normally in the form of –

(a) buying, managing, selling and leasing real estates

(b) buying units in public listed real property companies, or

(c) investing in debt securities of real property companies.

Among other things, REITs invest in shopping malls, office buildings, apartments, warehouses, health care facilities hotels, theme parks and plantation based assets. Some REITs focus their investment specifically either by location or by property types.

4.3 REITs own a portfolio of large properties particularly commercial real estate. Due to the size and value of such properties, the average private investors would generally not purchase these properties. Therefore, these large investments are broken up into units of smaller value so that the smaller investors can purchase them in the form of units.

4.4 REITs stocks are similar to common stocks in other corporations. Like other corporations, REITs can be publicly or privately held. Public REITs may be listed on public stock exchanges like common stock in other corporations. Listed REITs are a form of publicly traded securities in stock exchanges where market supply and demand determines the unit prices, similar to company share prices. Unit holders get returns through the appreciation of the unit value from price changes and distribution of income (similar to returns from any listed company's stock).

4.5 REITs are required either by regulations or due to tax incentives to distribute most of its income to its unit holders. REITs are tax transparent i.e. the fund is not subject to income tax at REITs level as long as it distributes at least 90% of its total income to its unit holders. REITs qualify as pass-through entities, which are companies that are able to distribute the majority of their income cash flows to unit holders without taxation at the REITs level. As pass-through entities, whose main function is to pass profits to unit holders, most of the REITs business activities are generally restricted to generation of property rental income.

4.6 REITs are not companies but trust bodies. As such, the income distributed by REITs to its unit holders is a distribution of income and not a distribution of dividend.

4.7 Trusts are not separate legal entities. Being a trust, REITs are not legal entities. REITs are a special type of trust created and are constituted when the trust deed is executed by the manager and the trustee. Trustees are the registered legal (holds the legal title) owner of all the assets of REITs including real properties, shares in companies and bank accounts. All the properties and assets of REITs are held by the trustees on behalf of and for the benefit of the beneficiaries of the trust known as unit holders. In other words, unit holders of REITs are the beneficial owners of all the properties of REITs.

5. Real Estate Investment Trusts / Property Trust Funds In Malaysia

Real estate investment trusts (REITs) in Malaysia, launched in 2005 is actually a rebranding of an existing property trust fund (PTF). REITs in Malaysia describes a fund that invests primarily in real estate. The regulatory framework of REITs/PTF in Malaysia are as follows:

5.1 The Securities Commission Act 1993, Guidelines on Real Estate Investment Trusts(Guidelines on REITs) and Guidelines for Islamic Real Estate Investment Trusts (Guidelines for Islamic REITs) issued by the Securities Commission(SC) govern REITs/PTF in Malaysia.

5.2 The SC is a statutory body entrusted with the responsibility of regulating and systematically developing Malaysia's capital markets. It has the direct responsibility of supervising and monitoring the activities of market institutions and regulating all persons licensed under the Capital Markets and Services Act 2007.

5.3 The Guidelines on Property Trust Fund dated 13.11.2002 were replaced and superseded by the SC’s initial Guidelines on REITs dated 3.1.2005. Subsequently, the SC issued revised Guidelines on REITs dated 21.8.2008 which was updated on 13.7.2011.

5.4 The Guidelines on REITs are:

(a) Issued by the SC under section 377 of the Capital Markets and Services Act 2007.

(b) Aimed at providing a regulatory environment that will protect the interests of the investing public and facilitate the orderly development of the REITs industry in Malaysia.

(c) Drawn up to govern the operation of REITs established in Malaysia.

(d) To be complied with by any person intending to establish a REIT in Malaysia and issue, offer or invite any person to subscribe for purchase units of REITs, and

(e) Part of the regulatory framework for REITs in Malaysia and should be read together with the securities laws.

5.5 According to the Guidelines for Islamic REITs, for the establishment of Islamic REITs, a person must observe and comply with both the requirements under the Guidelines for Islamic REITs and the Guidelines on REITs.

6. Islamic REITs In Malaysia

Islamic REITs are described as follows:

6.1 Islamic real estate investment trusts are a form of trust fund providing an investment opportunity for those who wish to invest in real estate through Syariah-compliant capital market instruments.

6.2 Islamic REITs are similar to conventional REITs/PTF as both are collective investment vehicles that pool money from investors and use this pooled capital to buy, manage and sell real estate. The objective is to obtain reasonable returns on investment. Returns are generated from rental income plus any capital appreciation that comes from holding the real estate assets over an investment period. Unit holders will receive their returns in the form of distribution of income and capital gains for the holding period.

6.3 The SC issued Guidelines for Islamic REITs dated 21.11.2005 which complement the Guidelines on REITs. Guidelines for Islamic REITs essentially provide Syariah guidance on the investment and business activities of Islamic REITs.

6.4 The Guidelines for Islamic REITs –

(a) Are as outlined by the Syariah Advisory Council of the SC to facilitate the establishment of Islamic REITs.

(b) Must be adhered to by the market players in the process of establishing Islamic REITs, and

(c) Must be read together with the Guidelines on REITs.

7. Key Features Of Conventional REITs/PTF And Islamic REITs In Malaysia

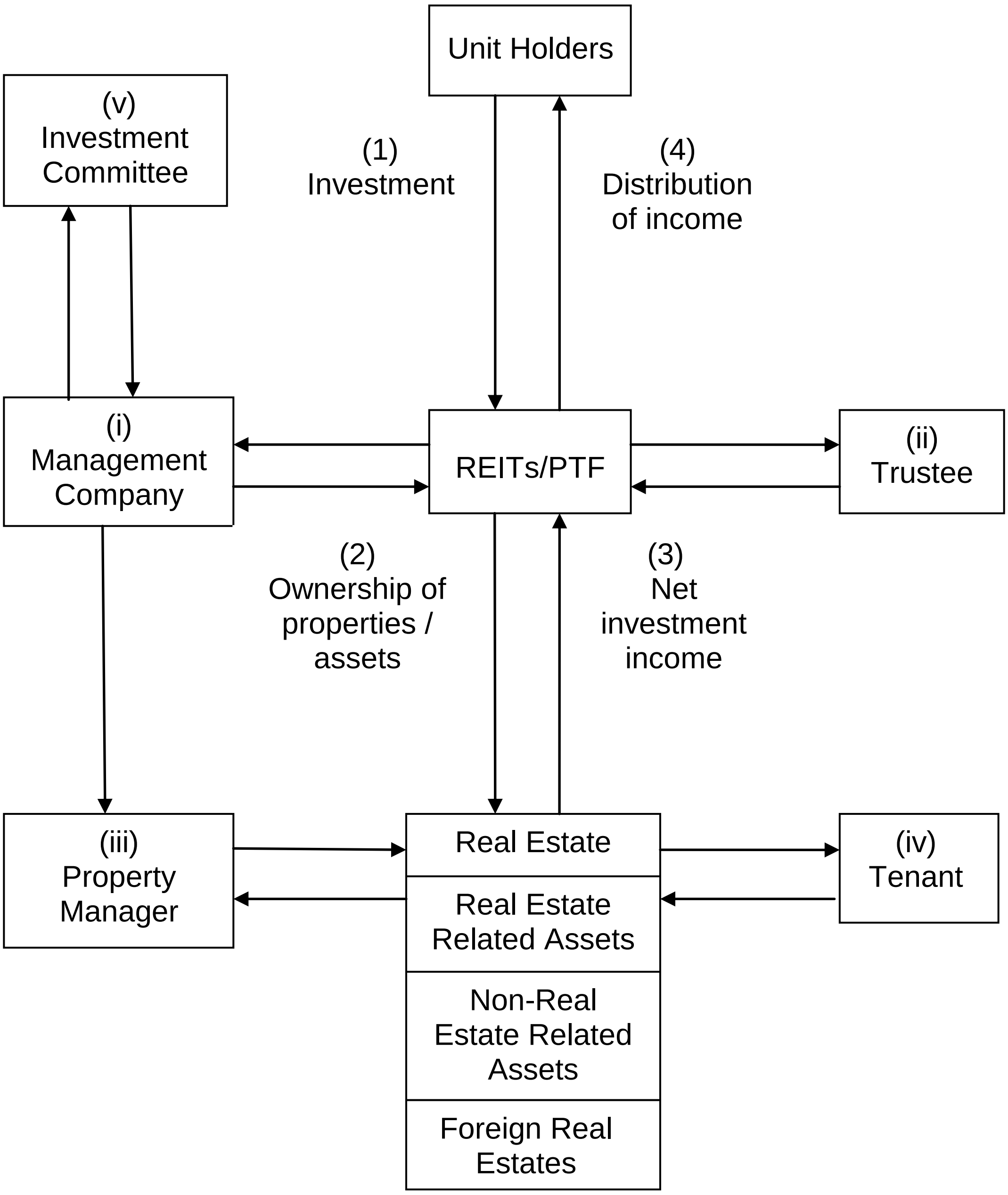
The key features of conventional REITs/PTF and Islamic REITs in Malaysia are as follows:

7.1 A key feature of the REITs/PTF concept is its tax transparency status provided under the Malaysian tax system, whereby the income of REITs/PTF is only taxed at the unit holders level (upon receipt of the distribution of income). The flow through concept enhances the amount of income received by a unit holder. However, to qualify for this tax transparent status, REITs/PTF are required to distribute 90% or more of its total income to unit holders.

7.2 In terms of main structure requirements, conventional REITs/PTF and Islamic REITs share similar characteristics such as valuation, trustees, management companies and property manager. The main difference lies in the regulatory requirement of having a Syariah committee / adviser to perform certain professional functions as specified in the Islamic REITs Guidelines such as to review, to monitor and to approve the Islamic REITs investment. As in any other Islamic finance product, the objective is to ensure permissibility of the investment in the context of Syariah, elimination of *riba* (interest) and *gharar* (ambiguity).

7.3 Structure of REITs/PTF

The following diagram illustrates the typical structure of Conventional REITs/PTF in Malaysia:

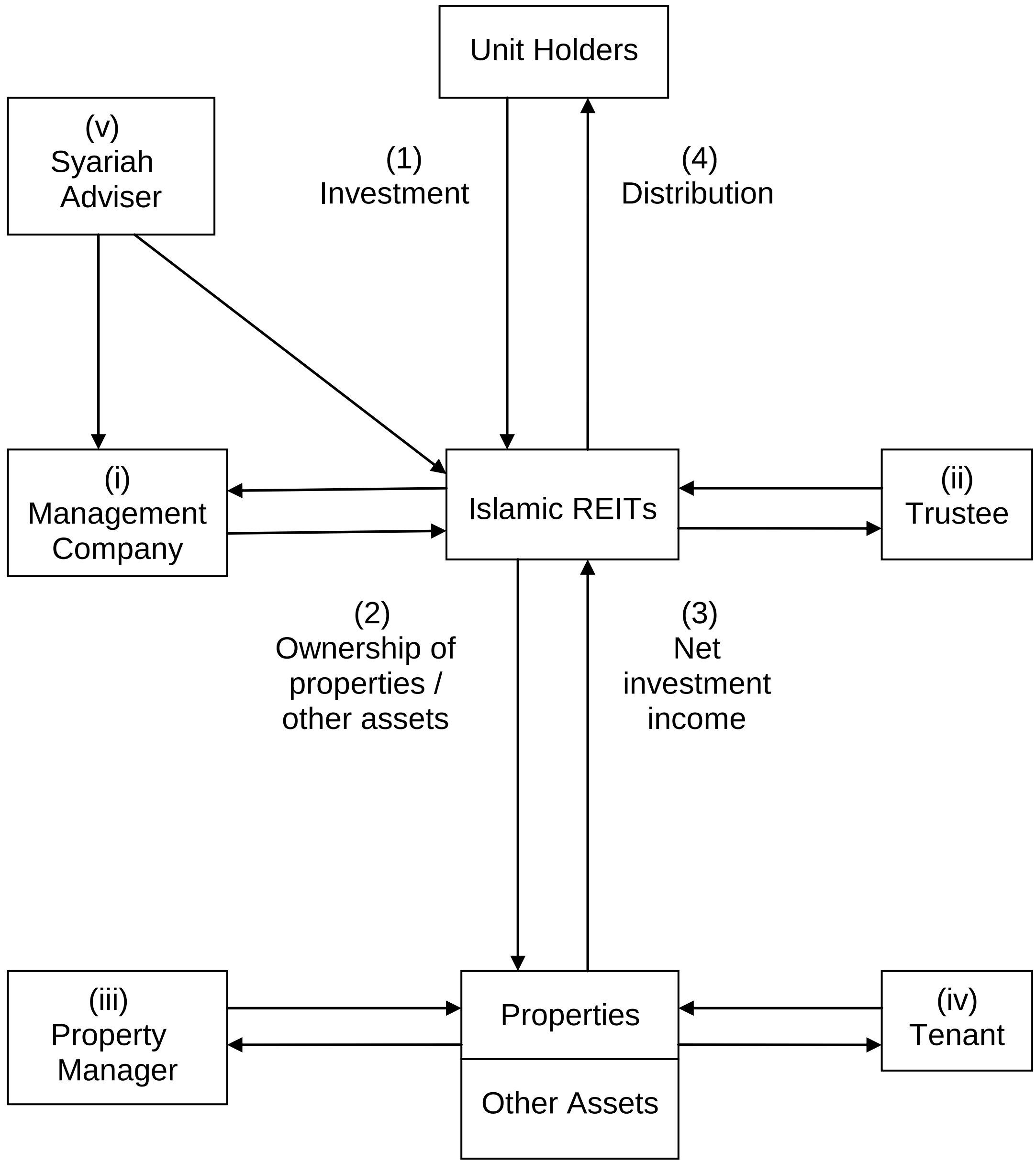


The functions of the stakeholders of conventional REITs/PTF are as follows:

No.	Stakeholder	Functions
(i)	Management Company	Establishes, operates and administers the fund. Management fees are paid in return.
(ii)	Trustee	Acts on behalf of unit holders.
(iii)	Property Manager	Appointed by the management company to manage the real estate and fees are paid in return.
(iv)	Tenant	Rents the property and pays rental.
(v)	Investment Committee	Appointed by the management company to perform oversight functions - management and operation of fund.

7.4 Structure of Islamic REITs/PTF

The following diagram illustrates the typical structure of Islamic REITs in Malaysia:



The functions of the stakeholders of Islamic REITs are as follows:

No.	Stakeholder	Functions
(i)	Management Company	Establishes, operates and administers the fund. Management fees are paid in return.
(ii)	Trustee	Acts on behalf of unit holders.
(iii)	Property Manager	Appointed by the management company to manage the real estate and fees are paid in return.
(iv)	Tenant	Rents the property and pays rental.
(v)	Syariah Adviser	Advises on Syariah related matters.

7.5 Investment activities of REITs/PTF

According to the SC Guidelines on REITs, the fund's property should be relevant and consistent with the investment objective of the fund.

7.5.1 Conventional REITs/PTF are authorised to make the following investments:

(a) Real estate

An investment in real estates can be through direct ownership of real property such as residential or commercial buildings, retail or industrial lots, etc.

(b) Single-purpose companies

An investment in real property can also be through shareholding (whole or majority ownership) in an unlisted company whose principal assets are real property.

(c) Real estate-related assets

An investment in real estate related assets includes units of other REITs, listed securities of property companies and listed securities issued by property companies, listed or unlisted debt securities of property companies and listed or unlisted debt securities issued by property companies and real estate asset-backed securities.

(d) Non-real estate related assets

An investment in non-real estate related assets means investment in listed shares issued by non-property companies, debt securities issued by, or fully guaranteed by the Government of Malaysia and commercial papers or other debt securities issued by companies or institutions with fixed credit ratings by Ram Holdings and Malaysian Rating Corporation Bhd.

(e) Cash, deposits, and money market instruments

The fund's property may consist of the placement of deposits provided that it is with a licensed institution.

(f) Investment in foreign real estates and markets

(i) When making investments in foreign real estates and markets, the management company must ensure that it complies with the relevant rules, guidelines and laws and obtain the necessary approvals / authorisations from relevant authorities (foreign or domestic) prior to the acquisition.

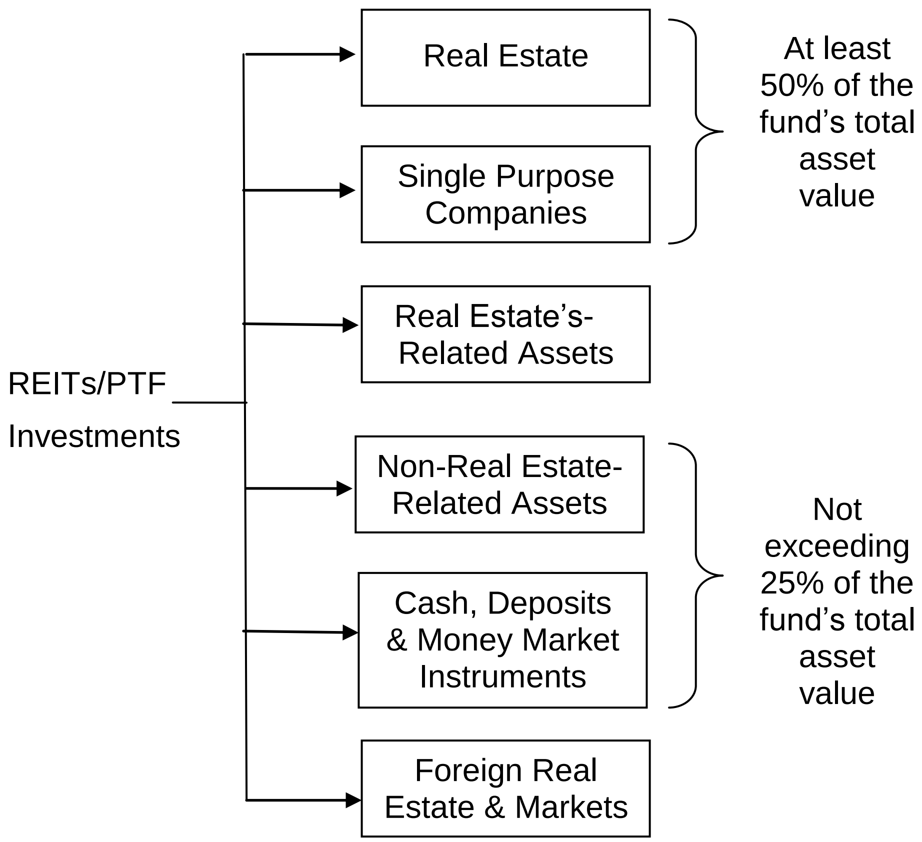
(ii) A fund which acquires or owns real estates located outside Malaysia may participate in forward sales or purchases of any currency or money, including Malaysia Ringgit or any foreign exchange contract of whatsoever nature.

(iii) Investments in real estate related assets and non-real estate related assets are limited to foreign markets where the regulatory authority is a member of International Organization of Securities Commissions.

7.5.2 The SC Guidelines on REITs also state that at least 50% of a fund's total asset value must be invested in real estate or single-purpose companies at all times.

7.5.3 As for the fund's investment in non-real estate related assets, cash, deposits and money market instruments, the SC Guidelines on REITs states that these investments must not exceed 25% of a fund's total asset value.

7.5.4 The following diagram summarises the investment activities of REITs/PTF as specified in the SC Guidelines on REITs:



7.6 Investment activities of Islamic REITs

Islamic REITs are authorised to make the following investments in accordance with SC Guidelines for Islamic REITs.

(a) Acquiring real estate with existing tenants

(i) The appointed Syariah committee / adviser must carry out Syariah-compliant assessments to assess any property that Islamic REITs intend to acquire. In general, Islamic REITs are collective investment schemes in real estate in which the tenants operate permissible activities according to Syariah principles.

(ii) However, for the acquisition of any property involving tenants' activities that are non-permissible, the fund manager for Islamic REITs must perform additional compliance assessments. The total rental from non-permissible activities must be compared to the total turnover of the Islamic REITs to obtain the percentage of rental from these activities. If the percentage of the rentals from the non-permissible activities exceeds the permitted benchmark of 20%, then the Syariah committee/Syariah adviser shall advise the Islamic REITs fund manager not to invest in the real estate.

(iii) If the tenant operates both permissible and non-permissible activities, the fund manager shall calculate the proportion of rental from non-permissible activities by reference to the total area occupied in respect of all activities. As for activities which do not require the usage of space, e.g. service based activities, the calculation will be based on the *ijtihad* (reasoning from the source of Syariah by qualified Syariah scholars) of the Syariah committee/Syariah adviser.

(b) Investment, deposit and financing for Islamic REITs

(i) Islamic REITs must ensure that all forms of investment, deposit and financing instruments comply with Syariah principles.

(ii) Islamic REITs are restricted in the properties in which they can invest. Investments can include industrial buildings, storage facilities and residential developments but hotels are generally unacceptable as they often have bars. Hospitals, on the other hand, are acceptable as investments for Islamic REITs.

(iii) In some cases, a Syariah committee/Syariah adviser may determine that where income derived from *haram* (illegitimate) sources is a negligible part of a larger investment, cleansing of that *haram* portion is possible by making a payment of a financial penalty or a charitable contribution.

(iv) The financial structure of Islamic investments does not permit straight lending and borrowing under Islamic law. Generally, the investment structure is in the form of a series of lease mechanisms with third-party financing. Islamic REITs redefine conventional mortgage financing into a lease structure, so that lease payments are payable against the assets rather than interest *(riba)* payments.

(v) In Islamic-compliant REITs, *ijarah* (lease financing) which is an Islamic alternative of conventional leasing is practiced. If REITs/PTF want to purchase a property, the REITs/PTF (customer) approaches the bank with a request for *ijarah* financing. The bank purchases the property from the vendor and receives the title of ownership. Then the bank leases the property to the REITs/PTF after execution of the lease agreement. The REITs/PTF pay the purchase price upfront through periodic payments as per the lease agreement. At the end of the lease period, the REITs/PTF can purchase the property from the bank under a separate agreement. Economically, the REITs/PTF are the owner and for tax purposes, the REITs/PTF own the property. As *ijarah* is structured like a lease and treated as a lease for Islamic purposes, the REITs can be Syariah-compliant.

(c) Insurance

Islamic REITs must use the Takaful schemes to insure their real estate. If the Takaful schemes are unable to provide the insurance coverage, then it is permissible for Islamic REITs to use the conventional insurance schemes.

(d) Forward sales or purchases of currency for risk management

Listed Islamic REITs with foreign real estates in its portfolio may be permitted to participate in currency purchase. Islamic REITs are permitted to participate in forward sales or purchases of currency and are encouraged to deal with Islamic financial institutions. Then it will be bound by the concept of *wa'd* (a unilateral promise where only one party is obligated to fulfil his promise / responsibility). The party that is bound is the party that initiates the promise. However, if Islamic REITs deal with conventional financial institutions, they are permitted to participate in the conventional forward sales or purchases of currency.

7.7 The non-permissible activities of conventional REITs based on SC Guidelines on REIT are as follows:

(a) Extension of loans or any other credit facility.

(b) Property development (excluding refurbishment, retrofitting, renovations or extensions carried out on existing real estates within a fund's investment portfolio), and

(c) Acquire vacant land.

7.8 The rental activities classified as non-permissible based on SC Guidelines for Islamic REITs are as follows:

(a) Financial services based on *riba* (interest) e.g. operations of commercial banks and other financial institutions engaged in *riba* based activities. *Riba* is considered usury (act or practice of loaning money at an exorbitant rate of interest) under Islamic law. Interest is considered unearned income and unjust.

(b) Gambling / gaming.

(c) Manufacture or sale of non-halal products or related products.

(d) Conventional insurance.

(e) Entertainment activities that are non-permissible according to Syariah e.g. casinos or leasing to bars, hotels, nightclubs etc.

(f) Manufacture or sale of tobacco-based products or related products.

(g) Stock broking or share trading in Syariah non-compliant securities, and

(h) Hotels and resorts.

Apart from the activities listed above, the Syariah committee/Syariah adviser can apply *ijtihad* for other activities that may be deemed non-permissible to be included as a criteria in assessing the rental income for Islamic REITs.

Note: Islamic REITs would have to comply with both the requirements under the Guidelines On Conventional And Guidelines For Islamic REITs [as mentioned in paragraphs 5.5 and 6.4(iii) of this Ruling] in respect of the non-permissible activities as explained in paragraphs 7.7 and 7.8 above.

7.9 Income of REITs

(a) In both conventional REITs/PTF and Islamic REITs, returns to unit holders will be from the income generated through the use of the real estates and any capital gain. In Islamic REITs, the source of this income, i.e. the use of the real estates has to be Syariah compliant.

(b) REITs derive income such as –

(i) Rental income from tenants.

(ii) Gains from sale of investments.

(iii) Interest income ancillary to the holding or management of property.

(iv) Interest income from deposits in financial institutions and debt securities.

(v) Dividend (taxable and tax exempt), and

(vi) other income such as rental income from car park, hall, gymnasium, food stalls, storeroom, maintenance, advertising, promotion, functions, overdue interest from tenants, penalties and service charge for miscellaneous services.

7.10 Fees and Expenses of REITs

According to the SC Guidelines on REITs, the fund can be charged with the following fees and expenses:

(a) A management company and trustee may only be remunerated by way of an annual fee charged to the fund if it is permitted by the deed of REITs and clearly disclosed in the prospectus.

(b) Only expenses directly related and necessary in operating and administering a fund may be paid out of the fund. Among these expenses are –

(i) Maintenance of real estates belonging to the fund.

(ii) Taxes and other duties charged on the fund by Government and other authorities.

(iii) Fees and other expenses properly incurred by the auditor appointed for the fund.

(iv) Fees for the valuation of any investment of the fund by independent valuers for the benefit of the fund.

(v) Costs incurred for the modification of the deed of the fund than those for the benefit of the management company or trustee.

(vi) Cost incurred for any meeting of the unit holders other than those convened for the benefit of the management company or trustee, and

(vii) Listing expenses for listing on the stock exchange.

Note: Although the above expenses can be charged to the fund, the deductibility of these expenses for tax purposes are still subject to sections 33 and 39 of the ITA 1967.

(c) the fund should not be charged with expenses such as general overheads and costs for services expected to be provided by a management company.

(d) reimbursement to the trustee for any expenses appropriately incurred in the performance of duties and responsibilities as a trustee.

8. **Rental Income Of REITs/PTF** - **Special Tax Treatment**

With effect from the year of assessment 2005, rental income received by the REITs/PTF from its investments in real properties would be treated as a single source of business income. Notwithstanding this special tax treatment, the ascertainment of the adjusted income of REITs/PTF in the basis period for a year of assessment in relation to rent from the letting of real property is subject to certain restrictions. This is discussed further in Public Ruling titled *Taxation of Real Estate Investment Trust/Property Trust Fund*.

9. Exemption Of REITs/PTF Income

REITs/PTF receive exempt income and this income continues to be an exempt income when distributed to the unit holders. REITs/PTF that comply with section 61A of the ITA 1967 are tax-exempt. Details are as follows –

(a) With the introduction of section 61A which takes effect from the year of assessment 2005, a tax flow through treatment was accorded to REITs/PTF. Under this treatment, REITs/PTF were tax-exempt on its total income for a year of assessment, equivalent to the amount of income distributed to the unit holder in the basis period for the year of assessment. The amount of income not distributed in that year of assessment is subject to tax at the prevailing corporate tax rate at the REITs/PTF level.

(b) With effect from the year of assessment 2007, with the amendment to subsection 61A(1), REITs/PTF are fully exempt from tax for a year of assessment if they distribute to their unit holders 90% or more of their total income in the basis period for that year of assessment. Where the distribution is less than 90% the whole chargeable income will be subject to income tax at the prevailing corporate tax rate.

10. Rental Income Of A Unit Trust (Other Than REITs/PTF)

To ensure that REITs/PTFs enjoy the special tax treatment where rental income from the letting of property is treated as a business source, a new provision under section 63D was introduced to exclude rental income received by a unit trust other than REITs/PTF as a business source. Other property trusts that do not qualify as REITs/PTF under SC's REITs Guidelines will continue to have their rental income treated as a source under paragraph 4*(d)* of the ITA 1967 and special deductions will be available to these unit trusts under sections 63A and 63B of the ITA 1967.

11. Filing Of Income Tax Return Form

REITs/PTF are required to file an Income Tax Return Form (ITRF) i.e. Form TR within seven months from the date following the close of the accounting period.

Example 1

Highand REIT commenced operations on 1.11.2007 and made up its accounts to 30.6.2008 and subsequently to 30 June every year.

The accounting periods are as follows:

Year Of Assessment	Accounting Period
2008	1.11.2007 to 30.06.2008
2009	1.07.2008 to 30.06.2009
2010	1.07.2009 to 30.06.2010

The basis periods and filing due dates of ITRF are as follows:

Year of Assessment	Basis Period	Due Date
2007	1.11.2007 to 31.12.2007	31.1.2009
2008	1.01.2008 to 31.12.2008	31.1.2010
2009	1.07.2008 to 30.06.2009	31.1.2010
2010	1.07.2009 to 30.06.2010	31.1.2011

12. Other Tax Considerations

The other taxes to be considered are –

12.1 Stamp Duty

All instruments of transfer of real property to REITs/PTF approved by the SC are exempted from stamp duty with effect from 13.9.2003 [Stamp Duty (Exemption)(No.4) Order 2004 [P.U.(A) 21/2004]. All instruments of deed of assignment executed between REITs/PTF approved by the SC and the disposer relating to the purchase of real property are exempted from stamp duty [Stamp Duty (Exemption)(No.27) Order 2005 P.U.(A) 484/2005].

12.2 Real Property Gains Tax

While the disposal of properties by REITs/PTF are not subject to income tax, real property gains tax (RPGT) is applicable on the disposal of properties in Malaysia or interests therein. A chargeable gain on disposal of chargeable assets (real property) by unit trusts to any person is subject to RPGT. Similarly, RPGT is imposed on the chargeable gain on disposal of chargeable assets by any person to unit trusts other than REITs/PTF approved by the SC.

For REITs/PTF, with effect from 13.9.2003, a chargeable gain on disposal of chargeable assets (real property) by any person to REITs/PTF approved by the SC is exempted from RPGT [Real Property Gains Tax (Exemption)(No.4) Order 2003 P.U.(A) 451/2003].

Director General of Inland Revenue,
Inland Revenue Board Malaysia.