The Taxation of Real Estate Investment Trusts (REIT) in South Africa

By

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Declaration

This project is an original piece of work which is made available for photocopying, and for inter-library loan.

Signed

Dated
Acknowledgements

I would like to thank the following people who have assisted me during the writing of this treatise:

• Prof Alex Brettenny for being my supervisor. I am grateful for your assistance and guidance on all technical issues, throughout the course as well as for this treatise.
• Gavin and Margaret Breetzke – for inspiring me to greater heights.
• Benjamin Breetzke – for getting me up in the mornings.
• Carey Breetzke – thank you for your love and support, without which this treatise would have remained a work in progress.
Summary

Real Estate Investment Trusts (REIT’s) provide certain benefits for investors as opposed to them directly investing in property. Many countries worldwide have already established tax systems for REIT’s which give natural persons and companies the benefit of not outlaying substantial capital, and provide certain tax dispensations to them.

The concept of a REIT is new to South Africa. The vehicles that have been used by investors in the past to invest indirectly in property have been Property Unit Trusts (PUTs) and Property Loan Stock Companies (PLS). These different types of entities have had different taxation rules applied to them, as they differed in legal entity, i.e. a trust versus a company. The different types of entity were historically a deterrent to foreign investors who preferred to invest in countries that had the REIT structure and certain tax dispensations.

The National Treasury and the South African Revenue Service (SARS) decided to collaborate in this matter so as to encourage foreign property investment, and launched with effect from 1 April 2013, a new REIT tax dispensation for investors in property portfolios. The REIT created a unified regime in South Africa. All portfolios wanting to call themselves REITs had to qualify under certain requirements, and then they would be eligible for the new section 25BB tax dispensation.
The South African REIT market is relatively new when compared to the Australian REIT market, which is the second largest in the world. The Australian REIT market has been around for approximately forty three years more than the South African REIT market. The Australian REIT regime is analysed in terms of how REITs are taxed in that country.

The final chapter provides a comparison between the South African and Australian REIT regimes. The major differences are identified as to how each country taxes the REITs and the respective shareholders, and from these a few proposals are made which could improve the South African REIT regime in order for it to stand up to worldwide scrutiny.

Key words: Real Estate Investment Trust; flow-through principle; Property Unit Trust; Property Loan Stock Company; property investment; section 25BB; deemed dividend
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CHAPTER 1 INTRODUCTION

1.1 Background to the research

In 1960, the question was posed in the United States of America (USA) of how to include the less fortunate people of American society in property investment. At that time investing in property was something that was only achievable by the affluent – you had to be wealthy in order to invest directly in property. On 14 September 1960, Dwight Eisenhower signed into law the Real Estate Investment Trust (REIT) Act title contained in the Cigar Excise Tax Extension of 1960. A REIT is a corporation, trust or association that acts as an investment agent specialising in real estate and real estate mortgage bonds. After this act, the less affluent could now invest indirectly in property. They could own shares in REITs, and the profits would be distributed to them.

So, REITs have been around for over 50 years. However, the concept of a “REIT” in the Republic of South Africa (RSA) is new. Historically, South Africans have been more familiar with Property Unit Trusts (PUTs) or Property Loan Stock Companies (PLSs). At the time of PUTs and PLSs in RSA, i.e. before 1 April 2013 when the new REIT regime began, most other countries in the world had already established REIT regimes. RSA has made the move to be more in line with these other countries. After the

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2. en.wikipedia.org/wiki/Real_estate_investment_trust#cite_ref-1.
commencement of the REIT regime, the RSA market should be the eighth largest in the world.\textsuperscript{3}

As a result of this change in the real estate investment vehicle in RSA, the National Treasury included in the 2012 Explanatory Memorandum\textsuperscript{4} a proposal to unify a system for taxing real estate investment vehicles. Specifically, a new section 25BB was introduced into the Income Tax Act.\textsuperscript{5}

1.2 Research objectives

The primary objective of this treatise is to provide a critical analysis of the current section 25BB of the Income Tax Act, which governs the REIT regime in South Africa. This primary objective is complimented by a historical overview of PUTs and PLSs before the start of the current REIT regime, which became effective on 1 April 2013. It is also complimented by a comparison between the RSA REIT market and the Australian REIT market. Australia is used because it has the second biggest REIT market in the world\textsuperscript{6} behind that of the USA, and the RSA tax system is more closely aligned to Australia than the USA. This comparative study is undertaken in order to examine the different methods utilised by the different tax legislations in each country (the RSA and Australia), and to determine the adequacy thereof.

\textsuperscript{3} SA Commercial Prop News - South Africa set to be the world's 8th largest REIT market as REIT legislation becomes a reality.
\textsuperscript{4} Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012 (10 December 2012).
\textsuperscript{5} Effective from 1 April 2013.
\textsuperscript{6} Estienne De Klerk. SACSC Breakfast Presentation – 8 April 2014.
In addition, the treatise suggests possible additions to the RSA REIT regime, which could be borrowed from the Australian REIT regime, in order for RSA to stand up to international scrutiny in terms of whether foreign investors will want to invest in our local real estate market, specifically by means of the REIT regime.

1.3 Research method

The REIT structures are analysed with reference to local and foreign precedent, other statutes, books, tax articles and periodicals to obtain relevant information relating to the situation in each of the countries identified above. Articles and publications from the following enterprises will be examined, with a specific focus on the tax treatment of REITs:

1. National Treasury
2. South African Revenue Service (SARS)
3. Australian Tax Office (ATO)
4. PLSA (Property Loan Stock Association) – proposal that both listed and unlisted REITs be accommodated (s25BB currently does not accommodate unlisted companies)
5. Johannesburg Stock Exchange (JSE)
6. Lawyers and tax advisors
1.4 Approach

To meet the research objectives, the approach of the treatise is as follows:

- Chapters 2 and 3 provide a brief overview of the previous situation in RSA regarding PUTs and PLSs (one chapter each), describing the structure of the two different entities, as well as how each entity was taxed.
- Chapter 4 provides a detailed analysis of the changes to the RSA situation that occurred when incorporating section 25BB of the Income Tax Act.\(^7\)
- Chapter 5 provides a detailed analysis of the situation in Australia.
- Chapter 6 concludes the treatise by summing up the differences between the RSA and Australian REIT regimes and providing some possible additions to the RSA REIT regime.

This approach also includes the use of case law from the relevant foreign jurisdictions and attempts to assess the impact of these locally. A comparison of foreign cases to local case law currently in place with respect to PUTs and PLSs is made, as there is not any case law for REITs at the time of the writing of this treatise.

\(^7\) 58 of 1962.
CHAPTER 2 PROPERTY UNIT TRUSTS

2.1 Introduction

The aim of this chapter is to set out what a Property Unit Trust (PUT) is, and to set out some of the history behind the PUT. The chapter also looks at the regulatory landscape behind a PUT. The history will entail how SARS have taxed the PUT in the past, and how the situation has changed with the introduction of the REIT legislation.

2.2 Legal form and regulatory environment of a PUT

PUTs were first introduced into the South African market place in 1969. The legal form of a PUT is a Unit Trust. A PUT is a portfolio of investment grade properties and is managed by an external company (refer to chapter 3 for this difference between a PUT and a Property Loan Stock Company (PLS). These managers that run the affairs of a PUT are regulated by a deed. This document sets out who the beneficial titleholders (unit holders) are. Another name for a PUT is a Collective Investment Scheme in Properties (CISP). The market capitalisation of PUTs has decreased as a percentage to PLS companies over the past 5 to 10 years due to the greater flexibility of the PLS entity.

PUTs have been regulated by the Collective Investment Scheme Control Act\textsuperscript{8} (CISCA) under the auspices of the Registrar of Collective Investment Schemes, which is a Financial Services Board (FSB) function. Before this act was enabled in 2003, PUTs were governed by several acts that date back to 1981. Collective investment schemes must

\textsuperscript{8} No. 45 of 2002.
be registered with the FSB in order to operate legally. All CISPWs are obliged to submit
details of their portfolios to the FSB every three months, including an annual report.
The purpose of this monitoring is to check that CISP managers are not falsifying their
performance and that fund managers are investing according to their deeds.

In correspondence with Estienne de Klerk⁹ and Craig Smith,¹⁰ they mentioned that all
PUTs were required to be listed on the Johannesburg Stock Exchange (JSE) due to the
fact that they are regulated by CISCA, in particular part V of this Act. As a result there,
are various regulatory requirements imposed on PUTs by the JSE.

2.3 Asset Activity Test

A PUT derives most of its income from the rental of immovable property. As a
regulatory matter, the FSB limits PUT investments to the following categories:¹¹

- Specified immovable property assets
- Shares in property companies
- Other assets as determined by the Registrar.

With regard to the other assets mentioned above, the Registrar of Collective
Investment Schemes has stated the following:¹²

1. ‘Definitions. – In this schedule –

   “assets” means –

---

⁹ Executive Director of Growthpoint Properties Limited – discussions held on 22 July 2014.
¹⁰ Part of the Property Franchise Investment Team at STANLIB – discussions held on 23 June 2014.
¹¹ S47(2) of the CISCA (No. 45 of 2002).
a) Participatory interests in a collective investment scheme in property;

b) Linked units (consisting of shares and debentures) in a property loan stock company; or

c) Shares or interest in a company or concern which derives its income solely from property related investments, which assets must be listed on an exchange in the Republic; and

2. **Limits and conditions of inclusion** – (1) A manager may include assets in a portfolio of a collective investment scheme in property, subject to the following limitations and conditions:

   a) The total investment exposure to assets included in a portfolio may not exceed 25 per cent of the market value of all the assets comprised in a portfolio;

   b) All assets issued by a single concern may not exceed 10 per cent of the market value of all the assets comprised in a portfolio; and

   c) A manager must obtain the prior consent of the Trustee for the inclusion of any asset in a portfolio.

2) The limits determined in subparagraph 2(1) may be exceeded except in so far as the excess is due to appreciation or depreciation of the market value of the underlying assets comprised in the portfolio, or as a result of any corporate action by any of such concern: Provided that a manager may not make any further investments in the asset in question as long as any limit determined in subparagraph 2(1) is exceeded.
3) A manager shall ensure that a portfolio’s investment policy empowers the manager to include assets in a portfolio.’

In terms of a PUT investing in a foreign country, it will only be able to do so if that foreign country has a foreign currency sovereign rating by a rating agency. The rating and rating agency must be determined by the Registrar. Where the country has been rated by more than one agency, the lower of the ratings applies.\textsuperscript{13}

2.4 Gearing and leverage

The FSB model deed has historically limited the gearing of PUTs to no more than 30 per cent (compared to that of PLSs in chapter 3). However, it was suggested by the National Treasury in 2007 that this could be increased up to 60 per cent.

2.5 Requirements to distribute profit

The distribution requirements of a PUT are governed by Section 97 of the Collective Investment Scheme Act, in particular Schedule 2 which is titled “Matters which must be provided for in Deed of Collective Investment Scheme in Property”. The schedule sets out the following:\textsuperscript{14}

‘A deed must provide for the requirements applicable to the administration by a manager of a collective investment scheme in property and must, amongst

\textsuperscript{13} EPRA Reporting. Global REIT survey 2012. South Africa.
\textsuperscript{14} Collective Investment Schemes Control Act No. 45 of 2002
others and as far as applicable, contain provisions regarding the following matters:

a) The investment policy to be followed in respect of each portfolio;

b) The frequency and basis on which the assets of a portfolio are to be valued;

c) The manner in which participatory interests are to be created or cancelled;

d) The manner in which distributions are to be calculated and settled;

e) The limits, terms and conditions under which a manager may for the account of a portfolio borrow money;

f) The charges that may be levied and the method of calculation of those charges;

g) Not less than three months’ written notice must be given to every investor of an increase in any charge and of any change in the method of calculation which could result in an increase or the introduction of any additional charge; and

h) The manner in which a deed may be amended.’

It should be noted that the flow-through characteristics of a trust apply here, as the income distributed by the PUT to the unit holders was not taxed in the Trust. The PUT acted as a vesting trust; hence all the income flowed directly to the unit holders.¹⁵

¹⁵ With the new REIT regime, not all the income has to be distributed now, as was the case with PUTs and vesting trusts.
Any capital gain in the PUT is to be reinvested and cannot be distributed to unit holders, except in the case when the PUT is terminated. These tax aspects are mentioned below.

2.6 Tax implications at a PUT level

Prior to 1 April 2013, a PUT was neither a “person” nor a “company” within the meaning of those terms in section 1 of the Income Tax Act\(^\text{16}\) (ITA)\(^\text{17}\). As mentioned above, the PUT acted like a vesting trust where all income was distributed to the unit holders, to whom dividend distributions accrued by virtue of a deed of trust. PUT distributions were treated as ordinary revenue in the hands of investors. Unlike companies, the net effect was to tax the rental income at only one level.

2.6.1 Before the changes to legislation on 1 April 2013

The situation before the Taxation Laws Amendment Act came into effect was as follows: PUTs could own fixed property directly, or hold shares in fixed property companies.

*Owning property directly*

If a PUT owned fixed property directly, the distribution available to its unit holders would be the property rental less any expenses, or net rental income.

*Owning shares in fixed property*

\(^{16}\) No. 58 of 1962.

\(^{17}\) This definition of ‘person’ was subsequently revised effective 1 April 2013, and will be explored in more detail in chapter 4.
The fixed property companies would earn net rental income and then distribute a dividend to its shareholders, namely the PUTs. The fixed property companies were allowed, in terms of section 11(s), to deduct those dividends from its net rental income. Therefore, the dividends received by the PUT were effectively rental income received from the fixed property company. This rental income was not taxed at the PUT level, but was distributed to the unit holders as rental income.

**Income other than direct rental**

Income of a PUT derived other than by way of dividends from a fixed property company, retained its identity in the hands of the unit holder to whom it had been distributed. For example, if the income consisted of interest and this was distributed to the unit holder, they would be liable for tax on the basis that interest had accrued to them.

The diagram below is an illustration of how the process works:

**Diagram 1**

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18 Diagram and illustration taken from Notes on South African Income Tax 2007 by Huxham and Haupt.
Company Z receives rental of R80 000 and pays a dividend of R50 000. Its tax is calculated as follows:

**Diagram 2**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental received</td>
<td>R80,000</td>
</tr>
<tr>
<td>Dividend paid (section 11(s))</td>
<td>-R50,000</td>
</tr>
<tr>
<td><strong>Taxable income</strong></td>
<td><strong>R30,000</strong></td>
</tr>
<tr>
<td><strong>Tax at 28%</strong></td>
<td><strong>R8,400</strong></td>
</tr>
</tbody>
</table>

The PUT receives a dividend of R50 000 and interest of R10 000. It is not taxed as it is merely a conduit for the unit holders.

Mr X has a taxable income calculated as follows:

---

19 This rate of tax changed to 28 per cent from 29 per cent effective from years ending on 1 April 2008 or thereafter.
**Diagram 3**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend received (not exempt therefore subject to section 10(1)(i)(^{20}))</td>
<td>R50,000</td>
</tr>
<tr>
<td>Interest received</td>
<td>R10,000</td>
</tr>
<tr>
<td>Interest exemption (section 10(1)(i))</td>
<td>R16,500 (^{21})</td>
</tr>
<tr>
<td>Taxable income</td>
<td>R43,500</td>
</tr>
</tbody>
</table>

Section 10(1)(i) is explained in section 2.7.1 below.

**Capital Gains Tax**

The capital gains realised from the sale of assets by a PUT is effectively exempt from tax in the hands of the PUT due to the conduit principle. No capital gains tax (CGT) is triggered for the unit holder when the PUT sells immovable property (paragraph 67A(1) of the Eighth Schedule). The gain attributable to the unit holder of a PUT is determined only upon the disposal of that holder’s participatory interest (paragraph 67A(2) of the Eighth Schedule).

\(^{20}\) Effective from 1 March 2012 this no longer applied as the s10(1)(i) exemption is limited to interest only.

\(^{21}\) Interest exemption for year ending 28 February 2007.
2.6.2 Changes from Secondary Tax on Companies (STC) to Dividends Withholding Tax (DWT)

In 2007, the Minister of Finance announced that STC would be replaced by dividends tax. The dividends tax legislation became effective on 1 April 2012. According to SARS the main objectives behind the change to dividends tax were to:22

- ‘Align South Africa with the international norm where the recipient of the dividend, not the company paying it, is liable for the tax relating to the dividend (with STC South Africa was one of a handful of countries with a corporate level tax on dividends).

- Make South Africa a more attractive international investment destination by eliminating the perception of a higher corporate tax rate (STC is an additional corporate tax) coupled with lower accounting profits (STC has to be accounted for in the Income Statement).’

There is a period of time, from 1 April 2012 up until 31 March 2013 (the date when the new REIT legislation is effective from), where dividends tax legislation affects PUTs. The dividends tax legislation does not change the previous provisions (i.e. section 10(1)(k)(i)(aa)23 and section 11(s)24).

---

22 SARS. A Quick Guide to Dividends Tax, April 2013.
23 This section was still effective at the time of writing this treatise – 30 November 2014.
24 This section was repealed with effect from 1 April 2013.
2.6.3 Roll-over relief

Due to the legal nature of a PUT, i.e. a trust, the reorganisation roll-over provisions of the Act are not available to PUTs.25

2.7 Tax implications at an investment holder level

2.7.1 Before the changes to legislation on 1 April 2013

The dividends that PUTs received were distributed to the unit holder. With effect from the beginning of the 1999 year of assessment, these dividends were historically treated as interest with the effect that, if the unit holder was a natural person, the basic interest and dividend exemption26 could be used in that tax year. There are however, some exceptions to this rule, as Silke mentions:27

‘In the hands of the holder of a participatory interest, dividends distributed (other than those distributed out of profits of a capital nature and those received by or accrued to or in favour of any person who is neither a resident nor carrying on business in the Republic) by a fixed property company, are not exempt from normal tax (s 10(1)(k)(i)(aa)). This means that “revenue-property dividends” distributed to holders of a participatory interest are taxable in their hands, but dividends distributed out of profits of a capital nature (referred to here as “capital-property dividends”) qualify for the general exemption from normal tax. Also qualifying for exemption from normal tax are those “revenue-

---

26 S10(1)(i)(xv).
property dividends” received or accrued to or in favour of a person neither resident nor carrying on business in the Republic.’

See the above diagram for how section 10(1)(k)(i) and section 10(1)(i) are illustrated.

Dividends which a fixed property company claims as a deduction in terms of section 11(s) are not subject to STC (section 64B(5)(b)). Note also that, although the PUT holds shares in the fixed property companies on behalf of the investors, they are not subject to CGT when the trust sells shares. There is only a CGT effect when the investor sells his units. Any interest received by the PUT directly is taxed in the hands of the investors as interest.

Capital Gains Tax

The unit holder of a PUT is not exempt from tax on any capital gains realized on disposal of his participatory interests. He is required to determine a gain or loss in respect of any participatory interest in that portfolio, but only when he disposes of it. Furthermore, he must determine the capital gain or capital loss as the difference between the proceeds from the disposal of the participatory interest and its base cost (paragraph 67A of the Eighth Schedule).

2.7.2 Changes from STC to DWT

The situation since the introduction of dividends tax legislation has not changed much, except for the section 10(1)(i) exemption. The following illustrative example explains:

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28 Diagram and illustration taken from Notes on South African Income Tax 2013 by Huxham and Haupt.
Diagram 4

Company Z received rental of R80 000 and paid a dividend of R50 000. Its tax would have been calculated as follows:

Diagram 5

The PUT received a dividend of R50 000, rental of R7 000 and interest of R10 000. It would not be taxed as it merely acted as a conduit for the unit holders.

Mr X had a taxable income calculated as follows:
Diagram 6

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend received(^{29})</td>
<td>R50,000</td>
</tr>
<tr>
<td>Interest received</td>
<td>R10,000</td>
</tr>
<tr>
<td>Rental received</td>
<td>R7,000</td>
</tr>
<tr>
<td>Interest exemption (if no other interest income received)</td>
<td>-R10,000</td>
</tr>
<tr>
<td>Taxable income</td>
<td>R57,000</td>
</tr>
</tbody>
</table>

The proviso\(^{30}\) to section 10(1)(k)(i) did not apply to dividends paid from capital gains. Dividends withholding tax was payable on these dividends distributed from capital gains. This section and proviso have been adjusted in the Taxation Laws Amendment Act, 2012 (Act No. 22 of 2012), and are now governed by section 25BB\(^{31}\) of the Income Tax Act.

2.8 Conclusion

PUTs have been an effective mode of investment for many entities and, effective 1 April 2013, all PUTs will become part of the new REIT regime, which is examined in chapter four. The JSE has given all PUTs listed on the JSE the option to convert to the new REIT regime. All previously listed PUTs have made the change to the REIT regime.

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\(^{29}\) At the date dividends tax was implemented, s10(1)(i) had been discontinued.

\(^{30}\) Paragraph (aa) of the proviso to s10(1)(k)(i) of the Income Tax Act.

\(^{31}\) Effective from 1 April 2013.
Of the six PUTs that have changed to the REIT regime, five are currently in the process of converting to Corporate REITs. Within two years there could be no Trust REITs on the JSE.\textsuperscript{32}

\textsuperscript{32} Discussion with Estienne de Klerk (Executive Director of Growthpoint Properties Ltd) on 22 July 2014.
CHAPTER 3  PROPERTY LOAN STOCK COMPANY

3.1  Introduction

The previous chapter set out what a PUT was. This chapter sets out what a PLS is, how they are governed, how they have been taxed in the past, and how they are currently taxed.

3.2  Legal form and regulatory environment of a PLS

The difference between a PLS and a PUT is that a PLS is a company regulated by the Companies Act\textsuperscript{33} and is not required to comply with the Collective Investment Schemes Act. A PLS is a legal person for the purposes of South African Law. A PLS company is managed internally by its directors, and not by an external management company. An investor who buys an interest in a PLS company will receive one part equity and one part debenture. The conditions and terms, i.e. interest and repayments of the debentures are governed by a debenture trust deed, and an independent trustee is appointed to look after the debenture holders’ interests.\textsuperscript{34} This debenture portion of the investment will generate interest income for the unit holder at interest rates set out in the debenture trust deed. This interest income is paid out of profits generated from the following income streams of the PLS company:

- Rental
- Sale of assets
- Rendering of property management services

\textsuperscript{33} No 71 of 2008 (Previous to this version of the companies act was No 61 of 1973).
\textsuperscript{34} National Treasury – Discussion paper on Reforming the Listed Property Investment Sector in RSA (Dec 2007).
- **Other immovable property related activities**

Unlike a PUT, it is not a JSE requirement that a PLS be listed. However, if a PLS chooses to be listed then it will have to comply with the JSE requirements. The registration of a PLS company with the Property Loan Stock Association (PLSA) is voluntary.  

### 3.3 Asset activity test

There are no restrictions on the activities of a PLS company other than those set out by the Companies Act and the PLS company’s articles and memorandum of association. A PLS company is allowed to invest in another PLS company, a PUT, property development companies, or any other local or foreign security.  

### 3.4 Gearing and leverage

Any debt financing in a PLS is governed by that company’s memorandum of association and the Companies Act.  

### 3.5 Requirements to distribute profit

Unlike the PUT, there are no legislated requirements for a PLS company to distribute ordinary profits or capital gains. In most cases, a PLS will distribute all its revenue profits through interest on issued debentures, and the balance as dividends. A PLS company that is listed on the JSE will most likely pay out all of its annual income to its

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36 National Treasury – Discussion paper on Reforming the Listed Property Investment Sector in RSA (Dec 2007).
beneficial holders, in comparison to the approximate 80 per cent of other normal listed companies\textsuperscript{38} (other than property companies). If there are any capital gains, these distributions will be governed by the PLS memorandum and articles of association.\textsuperscript{39}

### 3.6 Tax implications at a PLS level

#### 3.6.1 Before the changes to legislation on 1 April 2013

As PLS companies are registered as companies in terms of the Companies Act, they are regarded as companies for income tax purposes. Before the change in legislation effective 1 April 2013 for the new REIT regime, the normal income tax rate for companies was 28 per cent; therefore, PLS companies were subject to tax at this rate.\textsuperscript{40} As mentioned above, the beneficial holder of a share of a PLS company holds a small equity unit as well as a large debenture unit. Interest will be payable on the debenture component. The interest payable by the company will be a tax deductible expense\textsuperscript{41} as it is incurred in the production of income. This excessive level of interest has made this form of interest questionable in terms of tax, and the National Treasury has looked quite closely at this with the new REIT regime.\textsuperscript{42}

\textsuperscript{38} National Treasury – Discussion paper on Reforming the Listed Property Investment Sector in RSA (Dec 2007).
\textsuperscript{40} PLS companies would have been subject to the normal income tax rate as specified by SARS, with 28 per cent being the most recent rate.
\textsuperscript{41} S11(a) of the ITA.
\textsuperscript{42} National Treasury – Discussion paper on Reforming the Listed Property Investment Sector in RSA (Dec 2007).
As mentioned above, PLS companies pay out most, or all, of their profits as interest, and therefore have minimal taxable income. Any taxable income remaining in the PLS will be taxed at a rate of 28 per cent. Interest received by the unit holders is, therefore, taxable in the hands of the investor. The nature of the income earned in a PLS company will depend on whether it owns property directly, or indirectly through a subsidiary company.

**PLS company owning property directly**

If a PLS company owns property directly, it will mainly earn rental income. Taxable income will be calculated after the debenture interest. The company will be able to distribute a dividend on the equity unit portion of the share. However, this will not be a tax deductible expense and there will be STC payable on the distribution. PLS companies are subject to Capital Gains Tax (CGT) on the gain realised on the sale of any fixed property. If any dividend were distributed from capital gains, these would also be subject to STC. If the unit holder realised a gain on the sale of his unit then this would either be classified as a capital gain or ordinary income, depending on the long-term or short-term nature of the investment.

**PLS company owning property indirectly through subsidiary company**

In this situation, a PLS company will effectively own shares in another PLS company, and the subsidiary company will distribute interest to the holding company. The capital and income structure will be duplicated. If any immovable property is disposed of and
a gain realised, then CGT will be payable at the subsidiary level and, as mentioned above, if a unit is disposed of the intention of the investment, whether it is capital or revenue in nature, needs to be ascertained.43

3.6.2 Roll-over relief

The Income Tax Act allows for various roll-over provisions for companies that want to change the structure of their shares. Section 43 of the ITA deals with substitutive share-for-share transactions, and deals specifically with the debenture linked unit of PLS companies who want to change these to equity linked units at a tax-free rate. This is explored in more depth in section 4.4.6.4 below, as one of the sub-sections of section 25BB allows for this roll-over provision.

3.7 Tax implications at an investment holder level

3.7.1 Before the changes to legislation on 1 April 2013

If the unit holder is a corporate entity, it will receive interest income from the debenture unit, and it will receive a dividend from the equity unit. The interest will be taxable in the hands of the corporate entity at the corporate tax rate of 28 per cent, and the dividend income will be exempt from tax, except if the corporate entity is a collective investment scheme and the dividends are paid out of revenue profits, in which case the dividend income will be taxable in the hands of the corporate entity.

43 National Treasury – Discussion paper on Reforming the Listed Property Investment Sector in RSA (Dec 2007).
Any expenditure actually occurred in the production of the taxable income will be allowed as a deduction.

If the corporate entity were to dispose of its unit, the taxation would depend on whether the corporate entity were a dealer (or not) in the units. If the corporate entity were a dealer, it would be taxed at a rate of 28 per cent (revenue nature), but if it were an investor it would be taxed at a CGT rate.\(^4^4\)

If the unit holder were an individual, the tax effects would mostly be similar to that of a corporate unit holder, apart from a number of exceptions. An individual has an interest and dividends exemption in terms of section 10(1)(i) of the Income Tax Act. Additionally, on disposal of the participatory right by an individual unit holder, if the unit holder were a dealer in the units then he would be taxed at his marginal rate (currently between 18 per cent and 40 per cent) on the full proceeds of the sale. If the unit holder were an investor, then the gain on the sale would be taxed at the CGT rate applicable to individuals,\(^4^5\) and taxed at his marginal rate. An individual is also allowed an annual exclusion in respect of any capital gains or losses each year.

\(^4^4\) Prior to 1 March 2012 all corporate entities included 50 per cent of their capital gains in taxable income. Effective 1 March 2012 this has changed to 66.6 per cent.

\(^4^5\) Prior to 1 March 2012 individuals included 25 per cent of their capital gains in their taxable income. Effective 1 March 2012 this changed to 33.3 per cent.
3.7.2 Changes from STC to DWT

Dividends paid on the equity unit will be subject to DWT at a rate of 15 per cent. Previously, the company paying the dividend was liable for the STC at a rate of 10 per cent. Now the liability for the DWT rests with the unit holder. If any dividend were distributed from capital gains, then these dividends would also be subject to DWT.

3.8 Conclusion

The JSE has specified a time frame (two years from the introduction of REIT legislation, i.e. April 2015) in which companies with a debenture structure are allowed to convert their linked unit structure to a share loan structure. This will not impact on the REIT status, but will merely allow PLS companies to reclassify their debentures as equity.46 This does, however, mean that, during this two year time period, the PLS companies who have the intention of converting to a REIT will be able to utilise the new REIT tax dispensations.

The current status is that all PLS companies that were listed have converted and have moved to the REIT board of the JSE.47 Mr De Klerk mentioned that you could have a PLS company that was listed and was not a REIT, but then they would not get the benefits of the section 25BB tax dispensation. Two examples are Attacq Limited and

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46 Craig Smith - Part of the Property Franchise Investment Team at STANLIB – discussions held on 23 June 2014.
47 Discussions held with Estienne De Klerk on 22 July 2014 - Executive Director of Growthpoint Properties Ltd.
Freedom Property Fund who have chosen not to be a REIT,\textsuperscript{48} as they prefer not to distribute all their taxable income, instead choosing to reinvest it for further development or investment. These entities will be normal tax paying companies and will not qualify for the new tax dispensation.

\textsuperscript{48}SA Commercial Prop News. Freedom Property Fund heads for the JSE.
CHAPTER 4  NEW SECTION 25BB

4.1  Introduction

This chapter sets out the reasons why a change was needed in the South African real estate investment regime. The requirements to be complied with to form part of the new REIT regime and the new section 25BB are examined.

4.2  The need for change

The change has come about due to the uneven regulation structures of PUTs and PLS companies. Even though both structures are subject to JSE listing requirements, the PUT is only regulated by the FSB. As a result of this, the PUT is a less flexible entity than the PLS company.

PUTs and PLSs have performed reasonably well in recent years in terms of favourable investor yields. However, both structures have failed to offer international investors the uniformity and structure of the REIT structures in other countries. It is for this reason that the Property Loan Stock Association (PLSA) has spearheaded the move to a uniform REIT structure in South Africa that is comparable to other REIT structures in foreign countries so as to entice that foreign investment into South Africa.

Another issue that has led to the change to the REIT structure is the excessive interest expense, as mentioned in chapter 3. According to the Explanatory Memorandum in

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49 Coronation Fund Managers – Profile’s Unit Trusts & Collective Investments.

50 National Treasury – Discussion paper on Reforming the Listed Property Investment Sector in RSA (Dec 2007).
the yield in respect of these debentures should rather be viewed as dividends. The provisions regarding REIT structures will therefore give rise to greater certainty for local and foreign investors, as well as providing simplification regarding the tax implications.

4.3 Section 25BB of the Income Tax Act

This new section of the Income Tax Act will essentially provide certainty regarding the tax dispensation surrounding REITs to local and foreign investors who decide to invest in REITs. The first part of the new section is set out below. It contains some new definitions which will assist with the understanding of the section. The full section can be viewed at Appendix 1.

4.4 Real Estate Investment Trusts

A REIT is defined by the OECD as: 52

‘...a widely held company, trust or contractual or fiduciary arrangement that derives its income primarily from long-term investment in immovable property (real estate), distributes most of that income annually and does not pay income tax on income related to immovable property that is distributed.’

Section 1 of the ITA also defines a REIT as follows: 53

‘“REIT” means a company –

(a) that is a resident; and

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52 OECD: Tax Treaty Issues Related to REITs.
53 SAICA Legislation Handbook 2013/2014, Volume 2;
(b) the shares of which are listed –

(i) on an exchange (as defined in section 1 of the Financial Markets Act and licensed under section 9 of that Act); and

(ii) as shares in a REIT as defined in the JSE Limited Listings Requirements.’

4.4.1 Legal form and regulatory environment

As REITs are being formed from previous PUTs and PLSs, REITs take the form of trusts and companies. REITs are regulated by the JSE and are subject to certain rules. These rules are set out in Section 13 of the JSE listings requirements. Additionally, all company REITs are governed by the Companies Act No. 71 of 2008.

4.4.2 Conditions for an entity to be called a REIT

There are some initial conditions that a company will need to satisfy in order to be called a REIT. These are as follows:  

1. Company to have in excess of R300m in property assets.

2. Company to distribute in excess of 75 per cent of annual income.

3. The company will need to maintain a debt ratio below 60 per cent of the gross value of property assets.

4. The company must earn at least 75 per cent of its revenue from rental income. 

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SACSC Breakfast Presentation by Estienne de Klerk.

Refer below 4.4.4 - Asset activity test for what includes and what does not include rental income.
Once REIT status has been achieved, the above four requirements will have to be met on a continuing basis, and the following two criteria satisfied:

1. A committee within the REIT company is to ensure risk management and annually disclose this; and

2. A REIT company is only to enter into derivative transactions in the ordinary course of business.

The responsibility for these requirements will fall upon the REITs Board of Directors, and confirmation of these requirements will need to be obtained annually by a certificate in compliance. Currently there is no prescribed management model for a REIT, and there is no prescribed property sector investment requirement.

4.4.3 New definition of person

In terms of the Income Tax Act\textsuperscript{56} the definition of person now includes \textit{inter alia} “any portfolio of a collective investment scheme.” A portfolio of a collective investment scheme means\textsuperscript{57} \textit{inter alia} a “portfolio of a collective investment scheme in property”.

A portfolio of a collective investment scheme in property means:\textsuperscript{58}

\begin{quote}
\textit{any portfolio comprised in any collective investment scheme in property contemplated in Part V of the Collective Investment Schemes Control Act}
\end{quote}

\textsuperscript{56} Income Tax Act (No.58 of 1962).
\textsuperscript{57} Definition of “portfolio of a collective investment scheme” from the Income Tax Act (No.58 of 1962).
\textsuperscript{58} Definition of “portfolio of a collective investment scheme in property” from the Income Tax Act (No.58 of 1962).
managed or carried on by any company registered as a manager under section 51 of that Act for the purposes of that Part.’

The previous definition of “person” in the Income Tax Act only included (other than a natural person) an insolvent estate, the estate of a deceased person and any trust.\textsuperscript{59} There was no mention of “any portfolio of a collective investment scheme”. The new definition came into effect with the years of assessment commencing on or after 1 October 2011.

4.4.4 Asset activity test

As mentioned above, a REIT will need to earn the majority of its income as rental income. Rental income will include amounts received from the following:\textsuperscript{60}

1. ‘Use of immovable property including penalty interest
2. Dividends from other REITs
3. Qualifying distributions from a company that is a controlled company
4. Local dividends or foreign dividends from a property company.’

The following items will be excluded from the calculation of rental income to qualify as a REIT:\textsuperscript{61}

1. ‘Asset management fees

\textsuperscript{60} EPRA - Global REIT Survey 2014 – South Africa.
\textsuperscript{61} EPRA - Global REIT Survey 2014 – South Africa.
2. Deal fees

3. Underwriting fees

4. Interest received\(^{62}\)

5. Distributions from non-REIT property companies

6. Distributions from minority stakes in property investment companies.’

There are however, the following limits and conditions that will be applied to the investments of the REIT in order to generate the above rental income items: \(^{63}\)

1. ‘The total investment exposure to assets included in the portfolio may not exceed 25% of the market value of all assets comprised in a portfolio;

2. All assets issued by a single concern may not exceed 10% of the market value of all assets comprised in a portfolio; and

3. A manager must obtain prior consent of the Trustee for the inclusion of any asset in a portfolio.’

The above limits can only be exceeded due to the depreciation or appreciation of the assets in the REITs portfolio.

A REIT may only invest in foreign assets if that country has a foreign currency sovereign rating by a rating agency. \(^{64}\)

\(^{62}\) Compare this to s25BB(6)(b) – this interest received refers to that earned from money market accounts and similar investments.

\(^{63}\) EPRA - Global REIT Survey 2014 – South Africa.

\(^{64}\) EPRA - Global REIT Survey 2014 – South Africa.
### 4.4.5 Unlisted REITs

As mentioned in section 4.4.1, a REIT that is listed on the JSE will qualify for the tax dispensations of section 25BB. Unlisted REITs, however, do not qualify for the section 25BB tax dispensations. In the latest draft response document from the National Treasury and SARS, the following comment and response were noted in a section regarding REIT provisions:

> ‘Comment: Request legislation to extend the REITs tax regime to unlisted property companies.

> Response: Noted. Legislation will be developed next year (2015) in terms of which some unlisted REITS will be considered.’

At the time of submitting this treatise it is unclear how unlisted REITs will be treated. However, based on the National Treasury and SARS response above, the answer regarding unlisted REITs and how they will be able to benefit (or not) from section 25BB will be attended to.

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4.4.6 Tax implications at a REIT level

4.4.6.1 Normal tax implications

The current income tax implications for a REIT are the same as for any company. All companies (excluding those that qualify as Small Business Corporations) are currently subject to normal tax at a rate of 28 per cent. Typically, the items that will be included in the income of the REIT are those items mentioned above that qualify as rental income. Additionally, there could be other items that accrue to the REIT during a year of assessment and these must also be included in the income of the REIT or controlled company.\(^{66}\) The disposal of shares or a linked unit that a REIT holds in another REIT, a controlled company or a property company, must not be included in the income of the REIT.\(^{67}\)

4.4.6.1.1 Deductions allowed

4.4.6.1.1.1 Interest paid

As is the case with other companies, certain deductions will be allowed against the income of a REIT. Amongst other expenses allowed as a deduction is interest paid in respect of a linked unit.\(^{68}\) This interest is deemed to be a dividend\(^ {69}\) that will be exempt from dividends tax in terms of section 64F(2) of the Income Tax Act. Section

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\(^{66}\) Refer to s25BB(3)(a) of the Income Tax Act in Appendix 1.

\(^{67}\) Refer to s25BB(3)(b) of the Income Tax Act in Appendix 1.

\(^{68}\) Refer to s25BB(6)(b) of the Income Tax Act in Appendix 1.

\(^{69}\) Refer to s25BB(6)(c)(i) of the Income Tax Act in Appendix 1.
25BB(6)(c)(ii) of the ITA further mentions that this interest paid must “be deemed not to be an amount of interest” for the purposes of withholding tax on interest.\textsuperscript{70}

Interest that is incurred by a REIT as a result of loans utilised to acquire shares in another REIT or controlled company, is not tax deductible.\textsuperscript{71} Section 24O, however, will allow for the deduction of interest if the interest on the loan is in the production of income, and is within a group of companies. Section 23N is a new section that has become effective from 1 April 2014. Specifically section 23N(5) will limit the deduction of interest for a REIT (amongst other entities). This limit will not apply in the following circumstances:

- Interest incurred by the acquiring company where that interest is incurred in respect of a linked unit in the acquiring company, and that interest accrues to a REIT if:
  - The REIT holds at least 20 per cent of the linked units in the acquiring company;
  - The REIT acquired the linked units before 1 Jan 2013; and
  - At the end of the previous year of assessment, 80 per cent or more of the value of the assets of the acquiring company is directly or indirectly attributable to immovable property.

\textsuperscript{70} This withholding tax will only be effective from 1 January 2015.
\textsuperscript{71} S23(f) of the Income Tax Act.
\textsuperscript{72} S23N(5)(a) of the Income Tax Act.
4.4.6.1.1.2 Dividends paid – Qualifying distribution

A REIT is allowed to claim the dividends that it distributes to its shareholders as an income tax deduction.\textsuperscript{73} This distribution is referred to as a “qualifying distribution”. This distribution must be at least 75 per cent of its gross income, as mentioned above. This distribution may not exceed the taxable income of the REIT, and the REIT must first take into account any assessed losses brought forward from previous years of assessment, as well as any taxable capital gain.\textsuperscript{74}

In terms of the timing of distributions, a REIT may accrue for a distribution in its 2014 Annual Financial Statements (year of assessment ending 28 February 2014), but only physically pay out the distribution during its 2015 financial year. The calculations of this qualifying distribution will be based on the 2014 figures in the REITs financial statements.\textsuperscript{75}

4.4.6.1.2 Deductions disallowed

Although there are a number of deductions that a REIT is allowed to claim against its income, it is not allowed to claim certain building allowances.\textsuperscript{76} These building allowances are as follows:

- A REIT may not deduct any leasehold improvements\textsuperscript{77}

\textsuperscript{73} Refer to s25BB(2)(a) of the Income Tax Act in Appendix 1.
\textsuperscript{74} Refer to s25BB(2)(b) of the Income Tax Act in Appendix 1.
\textsuperscript{75} Ungerer, M. 19 July 2013. South African REITs – what are the tax implications?
\textsuperscript{76} Refer to s25BB(4) of the Income Tax Act in Appendix 1.
\textsuperscript{77} S11(g) of the Income Tax Act.
• A REIT may not deduct any costs in respect of buildings that are used in the process of manufacture\textsuperscript{78}
• A REIT may not deduct any costs in respect of buildings used by hotel keepers\textsuperscript{79}
• A REIT may not deduct any costs relating to residential buildings\textsuperscript{80}
• A REIT may not deduct any costs in respect of the erection or improvement of buildings in an urban development zone\textsuperscript{81}
• A REIT may not deduct any costs in respect to commercial buildings\textsuperscript{82}
• A REIT may not deduct any costs in respect of certain residential units\textsuperscript{83}

4.4.6.2 Capital gains

A REIT or a controlled company does not pay any capital gains tax on the disposal of any of the immovable property in its portfolio. Additionally, if a REIT disposes of a share in another REIT or controlled company, or a property company, these disposals will also be exempt from capital gains tax in the hands of the REIT.\textsuperscript{84} The REIT may be subject to capital gains tax on the disposal of any other assets.

\textsuperscript{78} S13 of the Income Tax Act.
\textsuperscript{79} S13bis of the Income Tax Act.
\textsuperscript{80} S13ter of the Income Tax Act.
\textsuperscript{81} S13quat of the Income Tax Act.
\textsuperscript{82} S13quin of the Income Tax Act.
\textsuperscript{83} S13sex of the Income Tax Act.
\textsuperscript{84} Refer s25BB(5) of the Income Tax Act in Appendix 1.
4.4.6.3 Withholding tax (WHT)

WHT is only applied to non-residents. WHT on dividends will not apply in respect of dividends paid to a REIT or controlled company from its investments in South Africa, provided the REIT is a South African tax resident company. WHT on interest\(^{85}\) will generally not apply to South African tax residents.\(^{86}\) If a REIT makes a distribution to a non-South African tax resident it will need to withhold 15 per cent of the payment as a tax, but this will be subject to the relevant double tax agreement (DTA).

4.4.6.4 Transition regulations and roll-over relief

Roll-over relief was mentioned previously in section 3.6.2, where a PLS had until the 1 July 2013 to convert to a REIT, and then they have until July 2015 to meet the gearing requirements.

Previous to the new REIT regime, a PLS company would have had a linked unit which consisted of debenture and equity parts. As the interest portion (linked to the debenture unit) is now deemed to be a dividend, it would make sense to convert the debenture unit to an equity unit. This can be done in terms of section 43 of the ITA where this transaction will be tax free. Section 43 deals with substitutive share-for-share transactions.

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\(^{85}\) Effective from only 1 January 2015 at 15 per cent.

\(^{86}\) EPRA - Global REIT Survey 2014 – South Africa.
Section 43 was initially instituted into the ITA in 2012 and deals with the following transactions:

- ‘a swap of equity shares for other equity shares;
- the subdivision and consolidation of non-equity shares for other non-equity shares; and
- a swap of a property-linked unit (such as a dual linked share-debenture in a REIT or a controlled property company) for a share.’

The amended section 43 of the ITA includes a “linked unit” in the definition of “equity share”. It further defines a substitutive share-for-share transaction as:

‘a transaction between a person and a company in terms of which that person disposes of an equity share in the form of a linked unit in that company and acquires an equity share other than a linked unit in that company.’

The amendment in 2013 of section 43 will convert pre-valuation date equity shares to post-valuation date equity shares at an equal amount, i.e. the initial purchase price of the debenture unit is deemed to be the same as the market value of the new equity share. This will allow there to be a nil CGT effect on the transition from the debenture unit to an equity unit. This now clears any previous CGT issues around the transition. The effective date of this new amendment is 4 July 2013.

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88 The term “property linked unit” was first introduced in 2012 when section 43 first became effective. This term has been deleted by the TLAA of 2013.
4.4.6.5 Ceasing to qualify as a REIT

There are also some tax implications if a REIT ceases to qualify as a REIT. If during a year of assessment, a REIT or a controlled company does not qualify as a REIT or controlled company, then the year of assessment for that REIT or controlled company will end on the day that they fail to meet the requirements. The next year of assessment is deemed to commence the following day. Therefore, in the next year of assessment, the REIT dispensation will not be available to that REIT or controlled company.

4.4.7 Tax implications at an investment holder level

4.4.7.1 Domestic unit holder

Distributions from a REIT will either be to a corporate unit holder, or to an individual unit holder. Any distribution made to a domestic unit holder, including interest paid in respect of the debenture portion of linked units, will be deemed to be a taxable dividend. Distributions made to a corporate unit holder will be taxed at 28 per cent. Distributions made to an individual will be taxed at the individual’s marginal tax rate (between 18 per cent and 40 per cent). Capital gains tax for the corporate unit holder will be at 18.6 per cent (28% x 66.6%) on the disposal of a REIT share. Capital gains tax

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90 Refer to s25BB(7) of the Income Tax Act in Appendix 1.
91 Ungerer, M. 19 July 2013. South African REITs – what are the tax implications?
92 Refer to s25BB(6)(a) of the Income Tax Act in Appendix 1.
93 Refer to s10(1)(k)(ii)(aa) of the Income Tax Act.
for an individual will be between 5.9 per cent and 13.3 per cent depending on the individual’s marginal rate of tax (marginal rate x 33.3%) on the disposal of a REIT share.

If a REIT or controlled company cancels the debenture part of a linked unit, there is currently no income tax or capital gains tax effect on this transaction. This particular transaction would be prevalent when the previous PLS company converted to a REIT. The REIT or controlled company is considered to have capitalised the issue price of the debenture to stated capital in terms of IFRS. The expenditure incurred by the shareholder is deemed to be equal to the initial cost of acquiring the linked unit.94 Therefore, the base cost of the shares (for CGT purposes) in the REIT or controlled company held by the shareholder will remain unchanged during the conversion process.95

4.4.7.2 Foreign unit holder

Similarly to that of the domestic unit holder, a REIT will either distribute to a foreign corporate unit holder or a foreign individual unit holder. Distributions made by a REIT to a shareholder who holds a linked unit, including the interest paid on the debenture portion of the linked unit, will be deemed to be a dividend. The capital gains tax rates will be similar to that of the domestic unit holders.

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94 Refer to s25BB(8) of the Income Tax Act in Appendix 1.
95 Ungerer, M. 19 July 2013. South African REITs – what are the tax implications?
Prior to 1 January 2014, there was no DWT on dividends paid by a REIT or a controlled company. After 1 January 2014 however, DWT is to be applied at 15 per cent, subject to any DTA with the relevant country of tax residence of the unit holder. The interest portion is not exempted from the DWT, as the interest is deemed to be a dividend.\textsuperscript{96}

\textsuperscript{96} EPRA - Global REIT Survey 2014 – South Africa.
CHAPTER 5  AUSTRALIAN REIT MARKET

5.1  Introduction

The Australian REIT (A-REIT) market dates back to 1971 when the first REIT was listed on the Australian Stock Exchange (ASX).97 Historically, low interest rates in Australia have made listed properties more appealing due to the yields they offer. This resulted in a surge in the REIT market in 2013, as A-REITs accounted for a third of all money raised via share issues in Australia’s equity capital markets that year.98 Australia is the second biggest REIT market in the world with a market capitalisation of US$87bn99 in 2013, behind that of the United States of America which had a market capitalisation of US$670bn100 in 2013.

5.2  Australian REITs

5.2.1  Legal form

A-REITs are governed by the Income Tax Assessment Acts of 1936 and 1997, the Tax Administration Act of 1953 and the Corporations Act of 2001. That being said, there are no special legal or regulatory requirements needed to be a REIT. However, to benefit from withholding tax changes, the REIT must at least be a Managed Investment Trust (MIT).

97 PWC. Compare and contrast: Worldwide Real Estate Investment Trust (REIT) Regimes.
99 EPRA Reporting – Global REIT survey 2013 – All countries.
An MIT is a unit trust that satisfies certain requirements (see below for requirements). There is a MIT withholding tax regime that is used by A-REITs and other managed funds. The key benefit of the regime is that withholding tax on distributions made by an A-REIT could be as low as 15 per cent.101

The requirements to qualify as an MIT are as follows: 102

i. ‘the trustee of the trust is an Australian resident or the central management and control of the trust is in Australia;

ii. the trust is a “managed investment scheme” operated by a “financial services licensee” whose license covers operating such an investment scheme (as defined in the Corporations Act);

iii. the trust is either widely held or deemed to be widely held by virtue of qualified investors;

iv. a substantial portion of the investment management activities are undertaken in Australia; and

v. no foreign resident individual holds (directly or indirectly) 10 percent or more of the trust.’

The preferred vehicles for holding real estate investments are fixed trusts.103 They can be resident or non-resident fixed trusts. The REIT may adopt one of two structures.104

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101 Simon Clark. Real Estate Investment in Australia. What is a Managed Investment Trust?
103 Refer to section 5.2.2 below for a discussion on Fixed Trusts.
i. A stand-alone unit trust, which holds a passive real estate portfolio; or

ii. It can form part of a listed stapled security where a company share and unit trust unit are stapled so that they cannot be sold separately.

In 1998, the Managed Investment Scheme (MIS) rules were introduced into the Corporations Law. MIS rules govern investment vehicles in Australia, including that of REITs.105

5.2.2 The link between Fixed Trusts and A-REITs

The taxation laws applying to trusts are the subject of some debate and the Australian Taxation Office (ATO) announced that it would attend to a comprehensive review and rewrite of the trust tax law. The process was announced in December 2010, and the ATO released in November 2011 a discussion paper106 where role players in the industry could comment. The proposed effective start date of the new reform was 1 July 2014.

As part of this rewrite, special attention was given to the meaning of a “fixed trust”. This issue was highlighted in the Colonial First State Investments Ltd v Commissioner of Taxation [2011] FCA 16.107 case where the Commissioner of Taxation successfully argued before the Federal Court that the

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105 PWC. Compare and contrast: Worldwide Real Estate Investment Trust (REIT) Regimes.
relevant trust was not a fixed trust. In coming to this decision, the Court applied a test found in the Harmer\textsuperscript{108} case, and reads as follows:\textsuperscript{109}

1. ‘The beneficiary has an interest in the income which is both vested in interest and vested in possession; and

2. The beneficiary has a present legal right to demand and receive payment of the income, whether or not the precise entitlement can be ascertained before the end of the relevant year of income and whether or not the trustee has the funds available for immediate payment.

In Harmer, the Court also noted that this question “must be answered as at the time when the interest was derived... during the tax years”.

The current definition of a fixed trust can be found in a discussion paper put out by the ATO on 30 July 2012:\textsuperscript{110}

- ‘A trust is a fixed trust if entities have fixed entitlements to all of the income and capital of the trust.
- A beneficiary has a fixed entitlement to the income or capital of a trust if they have a vested and indefeasible interest in the income or capital of the trust.
- The terms “vested” and “indefeasible” are not defined in the tax law and take the meaning they have developed through case law.
- A vested interest may be vested in possession, that is, with the beneficiary enjoying a presently existing right to enjoyment, or it may be vested in interest,

\textsuperscript{109}Peter Gell. The decision in Colonial First State Investments Ltd v Commissioner of Taxation [2011] FCA 16.
\textsuperscript{110}ATO. Discussion paper - A more workable approach for fixed trusts.
that is, where the beneficiary instead has a presently existing right to future
enjoyment.

- **An interest is indefeasible where it cannot be terminated, invalidated or
  annulled. If an interest of a beneficiary can be taken away by the exercise of a
  power by the trustee or another person it is defeasible and will not meet the
definition of a “fixed entitlement”.’**

Due to this decision in the Colonial case, the ATO began a consultation process on the
appropriateness of the current definition of a fixed trust, with the release of the
discussion paper, “A more workable approach for fixed trusts.” The discussion paper
outlined the following reform options (refer section 5.2.2.1 and 5.2.2.2 below) of what
the definition of a fixed trust is. A fixed trust will either have to satisfy a clearly defined
rights test, or will have to satisfy the vested and indefeasible requirement.

### 5.2.2.1 Clearly defined rights test

The following extracts are taken from a further ATO discussion paper which briefly
outlines what this requirement is:

> ‘A MIT will satisfy the “clearly defined rights/entitlements” requirement if unit
  holders’ rights to income (including the character of the income) and capital are
  clearly established at all times in the trust’s “constituent documents”. The rights
  should only be able to be changed by an amendment to the trust’s “constituent
documents”.

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111 ATO. Discussion paper - Implementation of a new tax system for managed investment trusts.
In determining whether a MIT is one in which the unit holders have clearly defined rights, it will be necessary to consider the manner or extent to which each unit holder of the MIT can benefit from the trust. If the manner or extent cannot be significantly affected by the exercise, or non-exercise, of a power of a trustee or related entity, then the rights are clearly defined.

A variation on the “no material discretionary elements” approach in Subdivision 126-G could be that a MIT will satisfy the “clearly defined rights” requirement if the following requirements are met:

- it is possible to determine at any point in time (for example, on redemption) the entitlements of beneficiaries to income and capital of the trust and the character of these amounts; and
- having regard to the trust’s constituent documents, it is highly unlikely that the trustee would exercise a power to materially affect the beneficiary’s entitlements to these amounts or their character from period to period.

5.2.2.2 Vested but not defeated

The following extract is taken from another discussion paper from the ATO which sets out what this requirement is:112

‘Another option is to remove the requirement that an interest be “indefeasible” to qualify as a “fixed entitlement” and replace it with a requirement that the interest has not been defeated at the relevant time or over the relevant period

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112 ATO. Discussion paper - A more workable approach for fixed trusts.
that an interest would be a “fixed entitlement” if it is vested and has not been defeated. A vested interest is bound to take effect in possession at some time. It cannot be contingent. This would mean that while interests would need to be certain and identifiable, they would not need to be so certain as to be immune from future defeasance so long as they have not actually been defeated.’

5.2.3 Listing requirements

There are currently no listing requirements for an A-REIT. An A-REIT can be listed or unlisted. If an A-REIT wants to list then it needs to have at least 50 unit holders, each holding a parcel of units with a value of at least AUS$2000. Additionally, in order to be in a position to list, the REIT must qualify as an MIT.

5.2.4 Capital requirements

There are currently no minimum capital requirements for a REIT. If a REIT is listed it must meet the requirements of the Australian Securities Exchange (ASX).

5.2.5 Restrictions on investors

There are currently no investment restrictions on investors in an A-REIT.

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113 PWC. Compare and contrast: Worldwide Real Estate Investment Trust (REIT) Regimes.
115 PWC. Compare and contrast: Worldwide Real Estate Investment Trust (REIT) Regimes.
5.2.6 Gearing and leverage

There are no specific gearing limits for unit trusts under Australian tax law. General thin capitalisation rules may apply to MIT’s which are controlled by non-resident unit holders. These rules may also apply to MIT’s that have control over foreign entities.117

Up until 1 July 2014 the safe harbour test under the general thin capitalisation rules allowed a company to gear up to 75 per cent of its gross assets. Subsequent to 1 July 2014 the new gearing ratio is 60 per cent. Additionally, any interest deductions are reduced where the amount of debt exceeds the permitted gearing ratio as specified above.118

5.2.7 Asset activity test

The primary purpose of public unit trusts that invest in land must be to derive rental income. These entities are referred to as “eligible investment businesses”. Public unit trusts that carry on business to develop land, or buy and sell buildings for capital gain, will not receive flow-through status. These entities will be treated as companies for tax purposes and will be taxed at the corporate tax rate. Eligible investment business includes other passive investment-type activities, such as loans, portfolio share

117 EPRA Reporting – Global REIT survey 2013 – All countries
investment and derivatives.\textsuperscript{119} The following safe-harbour rules have been set up so that the entities do not lose MIT status: \textsuperscript{120}

‘A safe-harbour rule operates to broadly allow a trust to derive up to 25% of its income from investments in land (excluding capital gains from asset realisation) in the form of trading income (i.e. not rent) so long as it is incidental and relevant to the “eligible investment business” being the leasing of land. Further, rent is effectively deemed to derive from trading activities if the rent is intended to transfer all or substantially all of the profits of another person to the lessor. Where a trust does not meet this safe-harbour test, it can assess whether it is investment in land for the purpose, or primarily for the purpose of deriving rent under the existing law. Furthermore, a 2% safe-harbour allowance for non-trading income (at the whole of trust level) reduces the scope for inadvertent minor breaches of the “eligible investment business”. The trustee of a unit trust is taken not to carry on a trading business in a year, if no more than 2% of the gross revenue of the unit trust is income other than from “eligible investment business”.’

\textbf{5.2.7.1 Restrictions on foreign assets}

There are no restrictions on foreign assets for a property trust. A property trust can hold investments indirectly through special purpose vehicles (SPV). The only downside

\textsuperscript{119} PWC. Compare and contrast: Worldwide Real Estate Investment Trust (REIT) Regimes.

\textsuperscript{120} EPRA Reporting – Global REIT survey 2013 – All countries.
to this arrangement is that the benefits of a trust structure may be lost if the SPV is not granted flow-through tax treatment.\textsuperscript{121}

\textbf{5.3 Tax treatment at REIT level}

In order to benefit from the new rules of flow-through principles, an A-REIT must satisfy the relevant MIT requirements as mentioned in section 5.2.1, and the REIT must make an election within the required time limit. The proposed start of the new legislation was 1 July 2014. However, it is unclear at the stage of writing this treatise if this is the effective date, as the ATO has previously shifted this date forward a few times.

\textbf{5.3.1 Normal tax}

\textbf{5.3.1.1 Distribution requirements}

Full distribution of income and capital will normally occur. If there is any undistributed income or capital, it is taxed at a rate of 46.5 per cent.\textsuperscript{122} If the MIT has any tax losses, these must be carried forward to be set off against any future taxable income of the MIT. These may not be distributed to the unit holders. MIT’s must distribute the taxable income to its unit holders within three months of its year end.\textsuperscript{123}

\textsuperscript{121} EPRA Reporting – Global REIT survey 2013 – All countries.
\textsuperscript{122} PWC. Compare and contrast: Worldwide Real Estate Investment Trust (REIT) Regimes.
\textsuperscript{123} KPMG. Taxation of Real Estate Investment Trusts. An overview of the REIT regimes in Europe, Asia and the Americas. December 2013.
5.3.1.2 Withholding tax on distributions

Distributions to domestic shareholders within Australia are not affected by withholding tax. If an A-REIT distributes to a foreign resident, it will have to withhold tax at a rate of 30 per cent, or a reduced amount of 15 per cent if they invest through certain countries.\(^{124}\) There is a 10 per cent withholding tax on interest distributions, which may be reduced by a double tax treaty. For all other types of income, the rate of withholding tax will depend on whether the trust is an MIT.

For a non-MIT, tax is deducted depending on the type of unit holder. Tax is withheld at 30 per cent for companies, individuals at their marginal rate starting on 29 per cent, and non-resident trustee beneficiaries at 45 per cent. The unit holder will then be required to submit an Australian tax return in respect of these distributions, and can then claim certain deductions in arriving at that income from the trust. The tax withheld by the trustee can be claimed as a tax credit, and the unit holder might then be in a refund situation.\(^{125}\)

In the situation of an MIT, with foreign investors residing in a country that has an effective exchange of information on tax matters with Australia, the trustee will need to withhold tax at a rate of 15 per cent up to the 2009/2010 income year, and from the 2010/2011 income year and thereafter at a rate of 7.5 per cent. For foreign investors

\(^{124}\) PWC. Compare and contrast: Worldwide Real Estate Investment Trust (REIT) Regimes.

\(^{125}\) EPRA Reporting – Global REIT survey 2013 – All countries.
that fall outside of countries that have an effective exchange of information on tax matters with Australia, the trustee must withhold tax at a rate of 30 per cent.\textsuperscript{126}

5.3.2 Capital gains tax

The net capital gains tax of an MIT is included in the taxable income of the trust. There is a 50 per cent capital gains tax discount available to MIT’s, and there is a 33 per cent capital gains tax discount which applies to superannuation funds.\textsuperscript{127}

5.4 Tax treatment at investor level

5.4.1 Normal tax

Resident unit holders will be liable for the full amount of taxable income on the distribution from an A-REIT in the year in which they are entitled to that income. This applies irrespective of when the actual payment is physically paid to the unit holder. Distributions from an A-REIT will retain their nature; therefore, the tax treatment of the different items may differ. Income from a domestic source as well as a foreign source could be included in a distribution. The resident unit holder will be allowed a foreign tax credit for any foreign taxes paid by the A-REIT.\textsuperscript{128}

\textsuperscript{126} KPMG. Taxation of Real Estate Investment Trusts. An overview of the REIT regimes in Europe, Asia and the Americas. December 2013.
\textsuperscript{127} KPMG. Taxation of Real Estate Investment Trusts. An overview of the REIT regimes in Europe, Asia and the Americas. December 2013.
\textsuperscript{128} PWC. Compare and contrast: Worldwide Real Estate Investment Trust (REIT) Regimes.
Corporate unit holders are subject to tax at a rate of 30 per cent on the taxable portion of distributions. This applies for both domestic and foreign income. Individuals will be taxed on a progressive basis up to the maximum amount of 46.5 per cent on distributions received from an A-REIT. This applies to both foreign and domestic income. However, the individual will be entitled to foreign tax credits for the withholding tax applied in the foreign country.  

5.4.2 Capital gains tax

Distributions of a capital nature from an A-REIT may also include a tax deferred component, a capital gains tax component and a foreign tax credit component. Tax deferred amounts (which is similar to deferred tax in South Africa) are attributed to timing differences between accounting and tax allowances.

If an A-REIT holds a capital asset for more than twelve months, and then disposes of that asset, the A-REIT will claim a 50 per cent CGT discount, and only distribute this 50 per cent to its unit holders. The unit holders will include this 50 per cent capital gain component in their net capital gain calculation. If a unit holder disposes of an A-REIT unit there will be CGT implications.  A corporate unit holder will be taxed at a rate of

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130 PWC. Compare and contrast: Worldwide Real Estate Investment Trust (REIT) Regimes.
30 per cent on the disposal of its units. An individual will be taxed at a progressive rate up to a maximum of 46.5 per cent.\textsuperscript{131}

\subsection*{5.4.3 Non-resident investors}

If an A-REIT distributes income attributable from an Australian source to a non-resident of Australia, that income will be subject to withholding tax, as mentioned in 5.3.1.2 above. If the A-REIT distributes foreign sourced income to a non-resident, this will be tax free, and then the tax in the non-resident’s hands will be determined by any treaty agreements.

Non-residents are exempt from capital gains tax in relation to “non-taxable Australian assets”. The 50 per cent capital gains tax discount does not apply to taxable capital gains for non-residents.\textsuperscript{132} The disposal of any A-REIT units held by non-residents will have CGT implications for the non-resident if that non-resident owns 10 per cent or more of the A-REIT units.\textsuperscript{133} Refer above for the various rates of tax on both normal income (5.3.1.2) and capital gains (5.3.2).

\begin{flushleft}
\textsuperscript{131} KPMG. Taxation of Real Estate Investment Trusts. An overview of the REIT regimes in Europe, Asia and the Americas. December 2013.
\textsuperscript{132} Effective for any capital gains after 8 May 2012.
\textsuperscript{133} PWC. Compare and contrast: Worldwide Real Estate Investment Trust (REIT) Regimes.
\end{flushleft}
5.5 OECD view on REITs

The Organisation for Economic Co-operation and Development (OECD) currently has 34 member countries,\textsuperscript{134} and also works with emerging market countries of which South Africa is one. The OECD Model Tax Convention on Income and on Capital “provides a means to settle on a uniform basis the most common problems that arise in the field of international juridical double taxation”.\textsuperscript{135}

The OECD first put out a discussion document on treaty issues relating to REITs in October 2007.\textsuperscript{136} The relevant Articles mentioned by the OECD Model Tax Convention on Income and on Capital for REIT income are:

Article 6 – Income from immovable property

Article 7 – Business profits

Article 10 – Dividends

Article 11 - Interest

Article 13 – Capital gains

The Double Tax Agreement (DTA) would always need to be considered when there is flow of income and capital between foreign countries. The most relevant Article in a DTA for a distribution from a REIT would be Article 10 on Dividends. Article 10 would, however, need to be read in conjunction with the other Articles mentioned above, as each no Article can be read in isolation from the others.

\textsuperscript{134} List of OECD Member countries - Ratification of the Convention on the OECD.
\textsuperscript{135} OECD Model Tax Convention on Income and on Capital.
\textsuperscript{136} OECD. Tax Treaty Issues Related To REITs.
An issue that has been raised by the OECD in its commentary paper\textsuperscript{137} is the distinction between a large and a small investor in a REIT. A small investor has no control over the investments made by the REIT. The OECD has suggested that these small investors have not made investments in the immovable property, but have actually invested in a company (the REIT) and hence any distribution should be treated as a portfolio dividend. The large investor, on the other hand, has a more particular interest in the property that the REIT invests in, and the REIT can be seen as a substitute for the direct investment in the property itself. Due to this, the OECD sees that it would be appropriate to restrict the taxing of the large investor at source. The commentary, therefore, mentions the following:

‘States that wish to achieve that result may agree bilaterally to replace paragraph 2 of the Article by the following:

*However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State (other than a beneficial owner of dividends paid by a company which is a REIT in which such person holds, directly or indirectly, capital that represents at least 10 per cent of the value of all the capital in that company), the tax so charged shall not exceed:

a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25

\textsuperscript{137} OECD. Commentary on Article 10: Concerning the taxation of dividend.
per cent of the capital of the company paying the dividends (other than a paying company that is a REIT);

b) 15 per cent of the gross amount of the dividends in all other cases.’

This particular section in the DTA between Australia and South Africa was updated on 23 December 2008 (date of enforcement is 12 November 2008) and reads as follows:138

‘However, those dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident for the purposes of its tax, and according to the law of that State, but the tax so charged shall not exceed:

(a) 5 per cent of the gross amount of the dividends if the beneficial owner of those dividends is a company which holds directly at least 10 per cent of the voting power in the company paying the dividends;

(b) 15 per cent of the gross amount of the dividends in all other cases.’

A second issue raised by the OECD is the issue around a REIT not qualifying as a resident of a contracting state. The OECD gives an example of how paragraphs 1 and 2 of Article 10 of the DTA should be amended139 in this instance:

138 SARS. Protocol amending the agreement between the Government of the Republic of South Africa and the Government of Australia for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.
139 OECD. Commentary on Article 10: Concerning the taxation of dividends.
1. ‘Dividends paid by a company which is a resident, or a REIT organised under the laws, of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in, and according to the laws of, the Contracting State of which the company paying the dividends is a resident or, in the case of a REIT, under the laws of which it has been organised, but if the beneficial owner of the dividends is a resident of the other Contracting State (other than a beneficial owner of dividends paid by a company which is a REIT in which such person holds, directly or indirectly, capital that represents at least 10 per cent of the value of all the capital in that company), the tax so charged shall not exceed:

   a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends (other than a paying company that is a REIT);

   b) 15 per cent of the gross amount of the dividends in all other cases.’

A third issue raised by the OECD is where the REIT is structured as a trust and therefore does not qualify as a company. The OECD sets out an additional example of what could be added to paragraph 2 of Article 10:

‘For the purposes of this Convention, where a REIT organised under the laws of a Contracting State makes a distribution of income to a resident of the other
Contracting State who is the beneficial owner of that distribution, the
distribution of that income shall be treated as a dividend paid by a company
resident of the first mentioned state.’
CHAPTER 6 CONCLUSION

This treatise has taken the reader through the history of the REIT regime and its origins. The PUT (chapter 2) and PLS (chapter 3) regimes have been analysed up to the current REIT regime that was effective 1 April 2013. The situation of how REITs are currently taxed have been analysed in chapter 4, and a then a final study of how REITs are currently taxed in Australia has been performed in chapter 5.

The National Treasury and SARS have, however, made strides to bring the REIT regime in South Africa in line with its foreign counterparts in an effort to promote foreign investment in local property. It has been mentioned in the response document\textsuperscript{140} that SARS and the National Treasury still have a few updates to consider on the new REIT regime, and it is submitted that we should see some more changes to REIT legislation in due course.

6.1 Differences between the RSA and Australian REIT regimes

In chapter 1 of this treatise, one of the objectives was to analyse and compare the REIT regimes between RSA and Australia. The differences that arise between the Australian and RSA REIT markets are as follows:

6.1.1 Major differences

- Australian REITs can be listed or unlisted. RSA REITs must be listed.
- There are no linked units in Australian REITs. In RSA REITs there are still linked units, from the previous Property Loan Stock Company regime.
- There are no capital requirements for an Australian REIT. RSA REITs have a capital requirement of at least R300 million in property assets.
- Australian REITs are subject to CGT. RSA REITs are not subject to CGT.

6.1.2 Minor differences

- Australian REITs are called MIT’s and fixed trusts. RSA REITs are referred to as REITs.
  - For an Australian REIT to list it must only qualify as an MIT, and have 50 unit holders with capital of AUS$100,000.
- Australian REITs have Trustees that govern them. RSA REITs have Board Members.
- There are no restrictions on foreign asset investments for Australian REITs. There must be a foreign currency sovereign rating by a rating agency for an RSA REIT to invest in that particular foreign country.
- There is no minimum distribution rule for the income of Australian REITs. The qualifying distribution in RSA REITs must be at least 75 per cent of the gross income.
• Any undistributed income in an Australian REIT is taxed at 46.5 per cent. The equivalent tax rate in RSA is 28 per cent.
  
  • In Australia this rate of 46.5 per cent is the maximum marginal rate of a natural person, whereas the 28 per cent is the corporate tax rate in RSA.

• There is a 10 per cent withholding tax on interest for Australian REITs. Currently, in RSA there is no withholding tax on interest, but effective from 1 January 2015, there will be a withholding tax of 15 per cent.

• At an investor level in Australia, corporate unit holders are taxed at 30 per cent and individual unit holders are taxed at a maximum rate of 46.5 per cent. RSA corporate unit holders are taxed at 28 per cent, and individual unit holders are taxed at a maximum rate of 40 per cent.

6.2 Proposed legislative amendments

As previously mentioned, the Australian REIT market has been around for approximately forty three years longer than that of RSA, so it is submitted that it is quite an established market. As the RSA REIT market is relatively new when compared to the Australian market, it is submitted that there are a few outstanding issues which SARS and the National Treasury could propose.
Based on the major differences above, it is submitted that the South African REIT regime could borrow the following ideas to further align itself as a world class REIT regime:

- One of the biggest issues currently in the South African REIT regime is the issue of unlisted REITs, as mentioned in section 4.4.5, which should be addressed in 2015. Currently, as mentioned in section 3.8, any unlisted REIT does not benefit from the section 25BB tax dispensations. In Australia, both listed and unlisted REITs benefit from the REIT tax dispensations as per section 5.2.3. Next year, 2015, should reveal whether or not South Africa borrows this idea from Australia.

- A further issue where we could use an idea from the Australian REIT regime is that of the lack of linked units when acquiring an interest in a REIT. The unit holders of the previous PLS type entities would still hold a linked unit in the newly converted REIT entity as mentioned in section 4.4.6.4. Even though any distribution from the debenture unit is deemed to be a dividend, it would make sense to implement an effective date for these debenture units to be converted to an equity unit. This could have further benefits for foreign investors. It would be a simpler system, and any double taxation agreement with that foreign jurisdiction would then only be in terms of Article 10 that deals with dividends. There would be no potential issue with interest distributions. Article 10 of any DTA is discussed in section 5.5 above.
These amendments would provide certainty to the different types of local entities who invest in RSA REITs. It is submitted that they might go a long way to making the property investment market in RSA more attractive for foreign investors, and ultimately the RSA REIT market would take a step closer to standing up to international scrutiny.
APPENDIX 1

25BB. Taxation of REITs

(1) For the purpose of this section—

“controlled company” means a company that is a subsidiary, as defined in IFRS, of a REIT;

“property company” means a company –

(a) in which 20 per cent or more of the equity shares or linked units are held by a REIT or a controlled company (whether alone or together with any other company forming part of the same group of companies as that REIT or that controlled company); and

(b) of which at the end of the previous year of assessment 80 per cent or more of the value of the assets, reflected in the annual financial statements prepared in accordance with the Companies Act for the previous year of assessment, is directly or indirectly attributable to immovable property;

“qualifying distribution” in respect of a year of assessment of a company that is a REIT or a controlled company as at the end of a year of assessment, means any dividend (other than a dividend contemplated in paragraph (b) of the definition of “dividend”) paid or payable, or interest incurred in respect of a debenture forming part of a linked unit in that company if the amount thereof is

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141 SAICA Legislation Handbook 2013/2014, Volume 2; All sections of the Income Tax Act in this version are effective on or before 1 March 2014; As it stood on 30 November 2014 when treatise was submitted.
determined with reference to the financial results of that company as reflected in the financial statements prepared for that year of assessment, if-

(a) at least 75 per cent of the gross income received by or accrued to a REIT or a controlled company until the date of the declaration of that dividend consists of rental income where a REIT or a controlled company is incorporated, formed or established during that year of assessment; or

(b) in any other case, more than 75 per cent of the gross income received by or accrued to a REIT or a controlled company in the preceding year of assessment consists of rental income:

Provided that any amount that must be included in the income of the REIT or controlled company in terms of section 9D(2) must not be included in the gross income of the REIT or controlled company in respect of that year of assessment for the purposes of this definition;

“rental income” means any amount received or accrued-

(a) in respect of the use of immovable property, including a penalty or interest in respect of late payment of any such amount;

(b) as a dividend (other than a dividend contemplated in paragraph (b) of the definition of 'dividend') from a company that is a REIT at the time of the distribution of that dividend;

(c) as a qualifying distribution from a company that is a controlled company at the time of that distribution; or
(d) as a dividend or foreign dividend from a company that is a property company at the time of that distribution.

(2)(a) There must be deducted from the gross income for a year of assessment of-

(i) a REIT; or

(ii) a controlled company that is a resident,

the amount of any qualifying distribution made by that REIT or that controlled company in respect of that year of assessment if that company is a REIT or a controlled company on the last day of that year of assessment.

(b) The aggregate amount of the deductions contemplated in paragraph (a) may not exceed the taxable income for that year of assessment of that REIT or that controlled company, before taking into account--

(i) any deduction in terms of this subsection;

(ii) any assessed loss brought forward in terms of section 20; and

(iii) the amount of taxable capital gain included in taxable income in terms of section 26A.

(3)(a) Any amount received by or accrued to a company that is a REIT or a controlled company on the last day of a year of assessment in respect of a financial instrument must be included in the income of that company.
(b) Paragraph (a) does not apply to the disposal of a share or a linked unit in a company that is a REIT, a controlled company or a property company on the date of that disposal.

(4) A company that is a REIT or a controlled company on the last day of a year of assessment may not deduct by way of an allowance any amount in respect of immovable property in terms of section 11(g), 13, 13bis, 13ter, 13quat, 13quin or 13sex.

(5) In determining the aggregate capital gain or capital loss of a company that is a REIT or a controlled company on the last day of a year of assessment for purposes of the Eighth Schedule, any capital gain or capital loss determined in respect of the disposal of--

(a) immovable property;

(b) a share or a linked unit in a company that is a REIT at the time of that disposal; or

(c) a share or a linked unit in a company that is a property company at the time of that disposal,

must be disregarded.

(6)(a) Any amount of interest received by or accrued to a person during a year of assessment in respect of a debenture forming part of a linked unit held by
that person in a company must be deemed to be a dividend received by or accrued to that person during that year of assessment. 142

(b) Any amount of interest received by or accrued to a company that is a REIT or a controlled company during a year of assessment in respect of a debenture forming part of a linked unit held by that company in a property company must be deemed to be a dividend received by or accrued to that company during that year of assessment if that company is a REIT or a controlled company at the time of that receipt or accrual.

(c) Any amount of interest paid in respect of a linked unit in a REIT or a controlled company must be deemed-

i) to be a dividend paid by that REIT or that controlled company for the purposes of the dividends tax contemplated in Part VIII of this Chapter; and

ii) not to be an amount of interest paid by that REIT or that controlled property company for the purposes of the withholding tax on interest contemplated in Part IVB of this Chapter.

(7) If during any year of assessment a company that is a REIT ceases to be a REIT and that company does not qualify as a controlled company or a company

142 The author is aware that the Draft Explanatory Memorandum on the Taxation Laws Amendment Bill of 2014 issued on 17 July 2014 to include whether a linked unit is held by a resident or non-resident. In the case of a non-resident, the controlled foreign company rules in section 9D can apply in which case the REIT will be taxed on a percentage of the income of the CFC.
that is a controlled company ceases to be controlled company and that company does not qualify as a REIT--

(a) that year of assessment of that REIT or controlled company is deemed to end on the day that the company ceases to be either a REIT or a controlled company; and

(b) the following year of assessment of that company is deemed to commence on the day immediately after that company ceased to be either a REIT or a controlled company.

(8) If a REIT or a controlled company cancels the debenture part of a linked unit and capitalises the issue price of the debenture to stated capital for the purposes of financial reporting in accordance with IFRS--

(a) the cancellation of the debenture must be disregarded in determining the taxable income of the holder of the debenture and of the REIT or controlled company;

(b) expenditure incurred by the shareholder of the REIT or controlled company in respect of the shares is deemed to be equal to the amount of the expenditure incurred in respect of the acquisition of that linked unit; and
(c) the issue price of the cancelled debenture must be added to the contributed tax capital of the class of shares that forms part of the linked unit.


Profile Media [Handbook]

De Klerk, E. 8 April 2014. SACSC Breakfast Presentation. 


