Are tax exemptions available to REITs in Nigeria untapped?

...the very features of the REIT enable or activate pockets of tax exemptions...

A Real Estate Investment Trust (REIT) is defined as a Collective Investment Scheme (CIS) that enables investors to pool their resources to form, own and manage portfolios of real estate properties. It offers the benefits of real estate ownership without the attendant expenses or difficulties of being a landlord.

Sec. 154 of the Investment and Securities (IAS), 2007 empowers the Securities and Exchange Commission (SEC) to approve, register and regulate collective investment schemes in Nigeria, including those that are administered as REITs. The Securities and Exchange Commission Rules and Regulations, 2011, contain both rules of general and specific applications governing the operation of collective investment schemes in Nigeria.

As an investment scheme, REITs/REICs can either be publicly traded on the stock exchange or owned by private investors. The typical features of a contemporary REIT are as follows:

- The SPV may be a corporation or an Investment Trust
- It is managed by a Board of Directors or Trustees
- The SPV has secondary market window for liquidity or debt sourcing, and this implies that the SPV can be funded through foreign loans
- The SPV has a minimum of 100 shareholders
- Not more than 50% of shares are held by 5 or fewer individuals
- It invests at least 75% of the total assets in real estate assets (typically investment properties from which rental income is earned) and in Government Securities
- It derives at least 75% of gross incomes from rents and mortgages and even so, 90-95% of this gross income must come from rents, interest and capital gains on other securities
- It pays dividends on at least 90-95% of taxable income
- REITs securities are Asset Backed Securities (ABS). That is, its income streams are derived from and backed by a specific pool of underlying assets (real estate assets and other securities).

The SPVs are liable to Companies Income Tax (CIT) at the rate of 30%.

However the very features of the REIT enable or activate pockets of tax exemptions which should attract investors and fund managers who are interested in investing in tax efficient schemes.

The first of such tax exemption is the tax waiver issued through the Debt Management Office in 2010 by President Jonathan in 2010. He approved a waiver of taxes on all categories of bonds, Federal, sub-national, corporate and supra-national bonds, Mortgage-backed Securities, and Asset-backed securities (which is the case with REIT's securities), etc. The range of taxes covered by the approval, are those prescribed under the Personal Income Tax Act, Value Added Tax and the Capital Gains Tax Act.

This implies that the dividends of publicly traded REIT securities are exempt from withholding taxes (WHT) in the hands of the investors. Value Added Tax (VAT) and Capital Gains Tax (CGT) on sales of these units or securities are also not applicable. This exemption does not preclude the SPVs from paying CIT at 30% of their taxable income.

However, incomes derived from investments in government securities and corporate bonds are deducted before arriving at the taxable incomes for CIT purposes in line with the 'CIT exemption of profits order, 2011'

Secondly, regarding the investment properties of the REITs, capital allowance is claimable as they are 'in use' for the generation of the business profits. This enables further relief on the computed taxable profits for CIT purposes for a period of ten (10) years on each of the investment property. Upon sale of these assets, however, balancing charge is expected to be computed to compensate for this capital allowance claimed on the asset earlier in its useful life. Even then, sales of investment assets do not occur until after tens of years of the asset's existence.

Where under the requirements of the International Financial Reporting Standards (IFRS), these assets are stated at fair values, these fair values act as boost to the profit or loss accounts and the net assets of the SPVs without necessarily attracting immediate cash tax payments. Only the future CGT payable on such fair values is calculated and recognised as deferred tax. Upon eventual sale of these investment properties, roll over relief is available (to suspend the CGT payable) where the proceeds of sale are employed in acquiring another asset of the same class.

Furthermore, any foreign loans obtained to fund the REIT's investments can be structured to gain full advantage of the tax exemptions on foreign loans. There are graduated scales of percentage tax exemptions on interest payments on foreign loans where they satisfy certain grace and repayment periods requirements. 100% tax exemption is allowed where the grace period of the loan is not less than 2 years and the total repayment period for the loans (including the grace period) is above 7 years.

Today, REITs are highly successful and beneficial in about twenty countries world over, in respect of providing less risky investment options in real estate to both small and big investors, regular and dependable income to the unit holders and attraction of massive Foreign Direct Investment (FDI) in the real estate sector of these countries. Perhaps an awareness of these pockets of tax exemption available for the REITs in Nigeria could provide the required boost to this sector.