

2005 BUDGET: TAX EXEMPT, INCENTIVE AND REITs

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Introduction

The 2005 Budget has announced a tax exempt incentive for the real estate investment trust (REIT)/listed property trusts(LPT). Income distributed by REIT to its unitholders will now be exempted from company tax. For foreign investors, the 28% tax is still applicable and is withheld by the REIT.

Previously income distributions from the REITs are subject to the imputation system. Under the imputation tax system, the tax paid by a company is taken as advance tax paid by the shareholders in respect of the dividends received and the income received by the unitholders will be taxed at their respective tax rates.

For sometime in the property trust circle there has been an issue that the tax exempt status and the tax imputation system yield different after tax income to the REITs/LPTs investors. Tax exempt was the preferred tax treatment. The following example will illustrate whether there are any difference between the two tax treatments and how it impact on individuals, pensioners and tax-exempt bodies.

Example

A RM1 face value REIT/LPT has declared a dividend rate of 10%. What is the after tax income receivable by investors under the tax exempt incentive and the imputation tax system for:

- individuals with personal income tax rate of less than 28%;
- individuals with personal income tax rate of more than 28%;
- pensioners and tax exempt bodies.

Tax exempt system - Current tax scenario with tax exempt incentive for REITs

- individuals with personal income tax rate of less than 28%;

The income distribution to the unitholder will be RM100.00. (Previously the unitholder will receive only RM72.00 with RM28.00 being company tax at 28%.)

	RM
Income distribution say 10% of RM1 face value REIT/LPT	100.00
Tax exempt	<u>0</u>
Income received by unitholder	100.00
Income tax payable by unitholder (Say the income tax rate of the unitholder is 13%)	<u>13.00</u>
After tax income received by unitholder from REIT	87.00

The after tax income received by unitholders from the REIT would depend on each individuals income tax rate. Table 1 shows the after tax income according to tax band of

individuals if the income distribution is declared as income.

Table 1 : After tax income from a RM100 tax exempt income distribution of REIT/LPT

Taxable income (RM)	2003 Tax rate (%)	After tax income from dividend (RM)
Less than 5,000	1	99
Less than 20,000	3	97
Less than 35,000	7	93
Less than 50,000	13	87
Less than 70,000	19	81
Less than 100,000	24	76
Less than 250,000	27	73
More than 250,000	28	72

- individuals with personal income tax rate of more than 28%;

	RM
Income distribution say 10% of RM1 face value REIT/LPT	100.00
Tax exempt	<u>0</u>
Income received by unitholder	100.00
Income tax payable by unitholder (Say the tax rate of the unitholder is 28%)	<u>28.00</u>
After tax income received by unitholder from REIT	72.00

- pensioners and tax exempt bodies.

	RM
Income distribution say 10% of RM1 face value REIT/LPT	100.00
Tax exempt	<u>0</u>
Income received by unitholder	100.00
Income tax payable by unitholder (0% as tax exempt bodies)	<u>0.00</u>
After tax income received by unitholder from REIT	100.00

Imputation tax system - Previous tax scenario with 28% company income tax for REITs

- (a) individuals with personal income tax rate of less than 28%;

	RM
Income distribution 10%	100.00
Company tax at 28%	<u>28.00</u>
Income received by unitholder	72.00
Income tax payable by unitholder on the income distribution (Say the tax rate of the unitholder is 13% - refer Note 1)	<u>13.00</u>
Net income received by unitholder from REIT	59.00
Under the imputation tax system, unitholder is entitled to claim back RM 28.00 - refer Note 2	<u>28.00</u>
After tax income received by unitholder from REIT	87.00

Note

- 1 Say the annual income of an individual is less than RM50,000, after deducting all reliefs, rebates and expenses, the total taxable income will be taxed at a personal income tax rate of 13%. Thus the extra RM100 income distribution from the REIT will be tax at the amount of $(13\% \times RM100) = RM13.00$.
- 2 Under the imputation tax system, individuals with a lower tax rate than the corporate tax rate will be entitled to claim tax credits for the excess tax paid from the dividends.

The after tax income received by unitholders from the REIT would depend on each individuals income tax rate. Table 2 shows the after tax income for individual if the income distribution is declared as income.

Table 2 : After tax income from a RM100 income distribution of REIT/LPT under the imputation tax system.

Taxable income (RM)	2003 Tax rate (%)	After tax income from dividend (RM)
Less than 5,000	1	99
Less than 20,000	3	97
Less than 35,000	7	93
Less than 50,000	13	87
Less than 70,000	19	81
Less than 100,000	24	76
Less than 250,000	27	73
More than 250,000	28	72

- b) individuals with personal income tax rate of more than 28%;

	RM
Income distribution 10%	100.00
Company tax at 28%	<u>28.00</u>
Income received by unitholder	72.00
Income tax payable by unitholder on the income distribution (Say the tax rate of the unitholder is 28% - refer Note 1)	<u>28.00</u>
Net income received by unitholder from REIT	44.00
Under the imputation tax system, unitholder is entitled to claim back RM 28.00 - refer Note 2	<u>28.00</u>
After tax income received by unitholder from REIT	72.00

- c) pensioners and tax exempt bodies

	RM
Income distribution 10%	100.00
Company tax at 28%	<u>28.00</u>
Income received by unitholder	72.00
Income tax payable by unitholder on the income distribution (0% as tax exempt bodies)	<u>0.00</u>
Net income received by unitholder from REIT	72.00
Under the imputation tax system, unitholder is entitled to claim back RM 28.00 - refer Note 2	<u>28.00</u>
After tax income received by unitholder from REIT	100.00

The above illustration demonstrates that :

- the after tax income under imputation tax system and the tax-exempt benefit is the same for REIT investors;
- pensioners and tax exempt bodies enjoy the highest after tax income.

Comparison of tax benefits among REITs in various countries

The tax exempt incentive declared in the 2005 Budget is in line with the tax transparency benefits enjoyed by REITs in various countries. Table 3 makes comparison between Malaysia with other countries that have REITs. Table 3: Tax benefits of REITs/LPTs in Various Countries (May/June 2004).

Country	Tax Benefits	Minimum Distribution	Minimum Level of Property	Gearing
Malaysia	Yes	Unlimited	75%	<10% of total assets
Australia	Yes	100%	75%	Unlimited
USA	Yes	90%	75%	Unlimited
Europe				
Netherlands	Yes	100%	100%	<60% of total assets
Belgium	Yes	80%	80%	<50% of total assets
France	Yes	85%	80%	Unlimited
U.K.(proposed)	Yes	substantial	75%	Unlimited
Asia				
Japan	Yes	90%	75%	Unlimited
Korea	Yes	90%	70%	Unlimited
Singapore	Yes	100%	70%	<35% of total assets
Hong Kong	Yes	90%	90%	<35% of total assets

Source: Tan, Yen Keng (2004)

Conclusion

In conclusion, there is no difference in the after tax income between tax exempt incentive and the imputation tax system. REITs/LPTs remains an attractive income producing investment/asset for pensioners and entities that enjoy tax exempt status.

The tax imputation system is still applicable for other income yielding property securities such as listed property companies that declare dividends.

References

Boyle, Glenn W. (1996) *Corporate investment and dividend tax imputation*. The Financial Review, 31(1), 209-226

Veerinderjeet, Singh (1994) *Malaysian Taxation: Administrative and Technical aspects*. Longman Malaysia 2edition

APPENDIX

Personal Tax Rates in Malaysia

The rates of tax shown below are applicable to the taxable income of resident individuals:

	Chargeable income RM	Rate %	Tax RM
On the first	2,500	0	0
On the next	2,500	1	25
On the first	5,000		25
On the next	15,000	3	450
On the first	20,000		475
On the next	15,000	7	1,050
On the first	35,000		1,525
On the next	15,000	13	1,950
On the first	50,000		3,475
On the next	20,000	19	3,800
On the first	70,000		7,275
On the next	30,000	24	7,200
On the first	100,000		14,475
On the next	150,000	27	40,500
On the first	250,000		54,975
On the next	250,000	28	

Note: Non-resident individuals are taxed at a flat rate of 28% on all sources of income, except royalties, interest, rental of movable properties and technical or management service fees, which are subject to withholding tax. The withholding tax rates are similar to those imposed on companies.