

South Africa: Some hope for REITs

By <u>Denny Da Silva</u> 1 Jun 2020

It is well appreciated that the economy as whole has been hard hit by the lockdown measures introduced to mitigate the spread of Covid-19. Real Estate Investment Trusts (REITs) have not been immune to this and many are facing a significant uphill battle when it comes to maintaining cash flows as a result of the lockdown, the general uncertainty around Covid-19, and tenants either refusing, or simply not being able to pay their rent as it becomes due.



Image source: Getty Images

This has had a knock-on effect for REITs and their investors, particularly because REITs are required to distribute the majority of their income to their shareholders. A REIT essentially provides an investor (whether institutional or an individual) with an indirect means of investing in large-scale, income-producing real estate. In line with this principle, resident investors in REITs should be aware that any dividend or interest received from a REIT, or a controlled company in relation to a REIT, must be treated as gross income and therefore subject to tax in the hands of the investor. The REIT, in turn, gets a corresponding deduction for this amount distributed, so as to reduce its taxable income.

One of the benefits of REIT status is that REITs do not pay capital gains tax on the disposal of immovable property or on the disposal of shares in a property company. Maintaining REIT status is therefore important from inter alia a tax perspective. A company's REIT status for tax purposes is tied to its REIT status on the Johannesburg Stock Exchange (JSE). In other words, only South African listed REITs qualify for the REIT tax regime. Maintaining the JSE listing as a REIT is therefore imperative. In this regard, one of the requirements that needs to be maintained on an annual basis is that, subject to the solvency and liquidity test in the Companies Act, No 70 of 2008, at least 75% of a REITs distributable profits needs to be distributed to investors within four months of their year-end. Failure to do so would put the REIT status in jeopardy and consequently have adverse tax consequences.

The JSE is well aware of the current state of affairs and particularly the precarious position in which REITs find themselves at present. It has therefore issued an <u>invitation to comment</u> for REITs and all stakeholders, so as to decide on the best way forward. Options under consideration by the JSE include deferring the final date by which REITs are required to make their distribution (until it is appropriate and feasible to make this assessment, in the best interest of all stakeholders), or paying a limited distribution or no distribution at all.

Whatever option is chosen by the JSE, it will ultimately be aimed at preserving a company's REIT status. This would then also have an impact from a tax perspective, in that the REIT will continue to enjoy the benefits of the REIT tax regime. However, REITs should also ensure that the full spectrum of requirements in section 25BB of the Income Tax Act, No 58 of 1964 continue to be met, so as not to create any undue mishaps down the line.

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