

IRAS CIRCULAR

INCOME TAX TREATMENT OF APPROVED SUB-TRUST OF A REAL ESTATE INVESTMENT TRUST



INLAND REVENUE
AUTHORITY
OF SINGAPORE

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INTRODUCTION

The Income Tax (Amendment No. 2) Act 2007¹ contains amendments relating to the tax treatment of the trustee of an approved sub-trust of a real estate investment trust (hereinafter referred to as an approved sub-trust). This Circular explains the tax treatment provided by these amendments.

TAX TREATMENT

2 At present, the Comptroller will accord tax transparency treatment² to the trustee of a real estate investment trust ("REIT") if the trustee distributes at least 90% of any taxable income of the REIT to its unitholders in the same year in which such income is derived by the trustee and undertakes that certain administrative procedures are complied with. Before the amendment to Income Tax Act by the Income Tax (Amendment No. 2) Act 2007, tax transparency treatment was confined to the following income –

- a. rental income or income from the management or holding of immovable property but not including gains from the disposal of immovable property;
- b. interest income ancillary to the management or holding of immovable property; and
- c. interest income from deposits with an approved bank or finance company, interest from debt securities and any amount payable from Islamic debt securities (i.e. types of income referred to in section 13(1)(zd), (ze)(i) and (zf)³).

3 With the new Section 43(2A)(a)(iv) introduced by the Income Tax (Amendment No. 2) Act 2007, tax transparency treatment will also be accorded to the distributions of a REIT made out of the distribution it receives from an approved sub-trust, subject to the sub-trust meeting the conditions stated in paragraph 5 below and provided that the sub-trust distribution is made out of the following types of income (hereinafter referred to as qualifying income) in the year the income is derived:

- a. rental income or income from the management or holding of immovable property but not including gains from the disposal of immovable property;
- b. income that is ancillary to the management or holding of immovable property but not including gains from the disposal of immovable property and Singapore franked dividends.

¹ Passed by Parliament on 12 November 2007 and gazetted on 6 December 2007.

² This is made under Section 43(2) of the ITA, where the Comptroller agrees not to charge the trustee with any tax, and to subject the beneficiary to tax on the distribution received.

³ The types of income in paragraphs (b) and (c) which were provided for under section 43(2A)(ii) and (iii) have also been amended by the Income Tax (Amendment No. 2) Act 2007

The distributions made by a REIT to its unitholders out of such qualifying income received from an approved sub-trust will be exempt from tax (if conditions in Section 13(1)(zh) are met), subject to tax at a rate of 10% (if conditions in Section 43(3B) are met) or subject to normal taxation (in all other cases).

4 Tax transparency treatment for the trustee of an approved sub-trust will only be applicable to that part of an approved sub-trust's qualifying income that is distributed to the trustee of an REIT in the same year the income is derived. Consequently, where an approved sub-trust derives:

- a. qualifying income but does not distribute such income to its beneficiaries in the same year in which the income is derived;
- b. qualifying income but distributes such income to a non-REIT beneficiary; or
- c. income other than qualifying income specified in paragraph 3,

the tax transparency treatment will not be applicable and such income will be subject to tax at the level of the trustee of the approved sub-trust. Any distribution made from such after-tax income is capital and will not be subject to any further tax when received by the REIT or other beneficiaries and unitholders of the REIT upon onward distribution by the REIT.

CONDITIONS FOR APPROVED SUB-TRUST STATUS

5 The sub-trust of a REIT will be granted approved sub-trust status if the following conditions are met:

- a. the sub-trust is an unlisted special purpose vehicle that is constituted to hold / own real estate;
- b. the REIT has acquired interest in the sub-trust and is free to dispose of such interest;
- c. the joint venture agreement, memorandum and articles of association and/or other constitutive documents of the sub-trust should provide for, *inter alia*:
 - i. a specified minimum percentage of distributable profits that will be distributed to the beneficiaries, of which the REIT should be entitled to receive its *pro rata* share;
 - ii. veto rights of the REIT over key operational issues, including:
 - (a) amendment of the joint venture agreement, memorandum and articles of association or other constitutive documents;
 - (b) cessation or change of the business;
 - (c) winding up or dissolution;

- (d) changes to the equity capital structure;
- (e) changes to the distribution policy;
- (f) issue of securities;
- (g) incurring of borrowings;
- (h) creation of security over the assets;
- (i) transfer or disposal of the assets;
- (j) approval of asset enhancement and capital expenditure plans for the assets; and
- (k) entry into interested party transactions;

iii. a mode for the resolution of disputes between the property fund and joint venture partners; and

d. the sub-trust has in place a mechanism to properly track and differentiate the distributions to beneficiaries that are REITs vis-à-vis beneficiaries that are non-REITs.

6 Tax transparency treatment will only be accorded to the distributions of a REIT made out of the distribution it receives from an approved sub-trust, if the sub-trust enjoys approved sub-trust status during the period the sub-trust derived its income (out of which the distribution is made) and at the point of distribution to the REIT.

7 Any application for approved sub-trust status shall be made by the trustee of the sub-trust (or an authorized signatory of the trustee of the sub-trust where the trustee is a company) to the Corporate Tax – Large Corporations branch of IRAS, and should be accompanied by a duly completed declaration and undertaking form (see Annex 1), confirming that all the conditions enumerated in paragraph 5 above are met, as well as undertaking to inform the Comptroller of any change to any of these conditions. Where there is such a change in conditions, the approved sub-trust status (if granted) will cease to take effect from the date of the change.

TIMING ISSUES

8 In any case where the accounting year end of the sub-trust is different from that of a REIT or unitholder of the REIT and where tax transparency treatment is applicable, any distribution derived by the trustee or by the unitholders of an REIT, as the case may be, will be assessed to tax in the hands of such trustee or unitholders for the year of assessment relating to the basis period in which the qualifying income is derived by the approved sub-trust. Annex 2 provides an example to illustrate this.

9 The above changes effected by the Income Tax (Amendment No. 2) Act 2007 will take effect from the Year of Assessment 2008.

ENQUIRIES

10 For general enquiries or clarifications on this Circular, please call 63513322.

Inland Revenue Authority of Singapore

**Attn: The Comptroller of Income Tax
Inland Revenue Authority of Singapore**

**DECLARATION AND UNDERTAKING FOR THE PURPOSE OF APPLYING
FOR APPROVED SUB-TRUST STATUS***

I, _____ of _____ (“the
Name of authorised signatory *Name of applicant sub-trust*
applicant sub-trust”), hereby declare that:

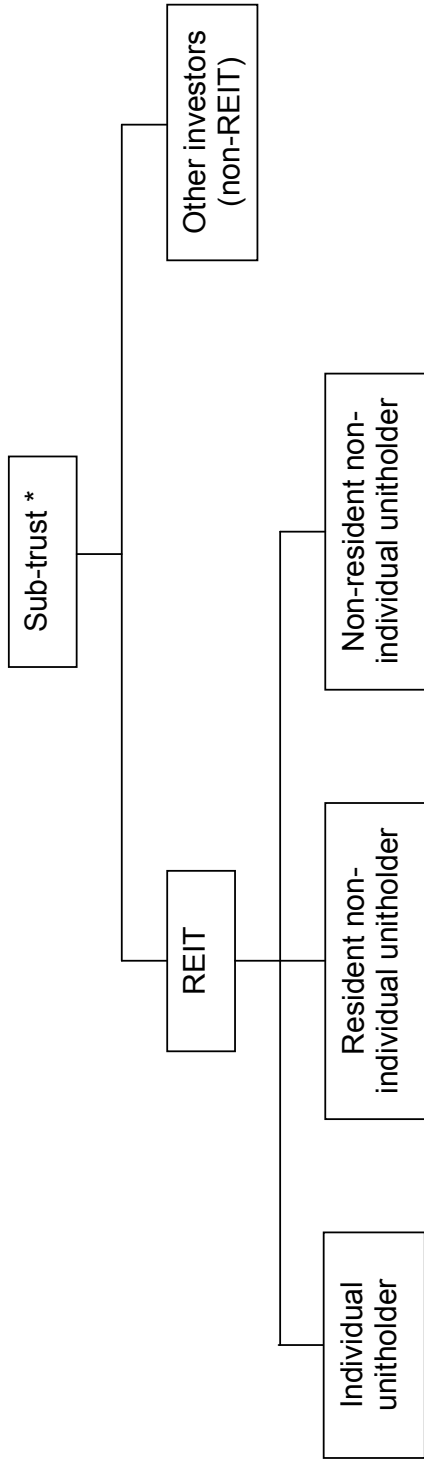
- a. the applicant sub-trust is an unlisted special purpose vehicle that is constituted to hold / own real estate;
- b. the Real Estate Investment Trust, _____
Name of REIT
 (“the REIT”), in respect of which the applicant sub-trust is applying for approved sub-trust status, has acquired interest in the applicant sub-trust and is free to dispose of such interest;
- c. the joint venture agreement, memorandum and articles of association and/or other constitutive documents of the applicant sub-trust provides for, *inter alia*:
 - i. a specified minimum percentage of distributable profits that will be distributed to the beneficiaries, of which the REIT should be entitled to receive its *pro rata* share;
 - ii. veto rights of the REIT over key operational issues, including all of the following:
 - (a) amendment of the joint venture agreement, memorandum and articles of association or other constitutive documents;
 - (b) cessation or change of the business;
 - (c) winding up or dissolution;
 - (d) changes to the equity capital structure;
 - (e) changes to the distribution policy;
 - (f) issue of securities;
 - (g) incurring of borrowings;
 - (h) creation of security over the assets;
 - (i) transfer or disposal of the assets;
 - (j) approval of asset enhancement and capital expenditure plans for the assets; and
 - (k) entry into interested party transactions;
 - iii. a mode for the resolution of disputes between the REIT and other joint venture partners (or “beneficiaries of the REIT”); and

* Section 43(2A)(a)(iv).

ANNEX 2

ILLUSTRATION OF THE YEAR OF ASSESSMENT FOR WHICH DISTRIBUTIONS FROM AN APPROVED SUB-TRUST WILL BE ASSESSED TO TAX WHEN THE APPROVED SUB-TRUST, REIT AND UNITHOLDER OF REIT HAVE DIFFERENT ACCOUNTING YEAR ENDS

1 A typical holding structure between a REIT and its sub-trust is as follows:



* Assume that approved sub-trust status was accorded on 1 January 2008

2 The accounting year ends of the various participants are as follows:

| | | | | | |
|----------------------------|-----------|----------|-----------------------|------------------------------------|--|
| <i>Participant</i> | Sub-trust | REIT | Individual unitholder | Resident non-individual unitholder | Non-resident non-individual unitholder |
| <i>Accounting year end</i> | 30 June | 31 March | Not applicable | 30 September | 30 September |

3 The sub-trust makes the following distributions A to D:

| | <i>Distribution date</i> | <i>Distributions made out of qualifying income derived from:</i> |
|---|--------------------------|--|
| A | 15.3.08 | 1.11.07 to 29.2.08 |
| B | 15.7.08 | 1.3.08 to 30.6.08 |
| C | 15.12.08 | 1.7.08 to 31.10.08 |
| D | 15.3.09 | 1.11.08 to 28.2.09 |

4 Assume that the trustee of the REIT immediately on-distributes the distribution from sub-trust to REIT's own unitholders, and that all the conditions for granting tax transparency to REIT are complied with.

5 The applicable tax treatment with respect to the REIT and its unitholders are as follows:

| | <i>Qualifying income derived from</i> | <i>YA of Sub-trust</i> | <i>Payable to</i> | <i>Tax rate</i> | <i>Remark</i> |
|---|---------------------------------------|------------------------|--|--------------------------------|---|
| A | 1.11.07 – 31.12.07 | 2009 | Trustee of REIT | Trustee's rate | Approved sub-trust status was only accorded on 1.1.08. |
| | | | Individual unitholder | Exempt ** | If the unitholder derives the distribution through a partnership in Singapore or from the carrying out of a trade, business or profession, and the basis period for the partnership, trade, business or profession ends in December, the distribution will be assessed in YA 2009 (i.e. follow the basis period of approved sub-trust). |
| | 1.1.08 – 29.2.08 | 2009 | Resident non-individual unitholder | Corporate tax rate for YA 2009 | |
| | | | Non-resident non-individual unitholder | 10% | |

| | | | | | |
|---|----------------------|------|--|--------------------------------|---|
| B | 1.3.08 – 30.6.08 | 2009 | Individual unitholder | Exempt ** | If the unitholder derives the distribution through a partnership in Singapore or from the carrying out of a trade, business or profession, and the basis period for the partnership, trade, business or profession ends in December, the distribution will be assessed in YA 2009 (i.e. follow the basis period of approved sub-trust). |
| | | | Resident non-individual unitholder | Corporate tax rate for YA 2009 | |
| C | 1.7.08 – 31.10.08 | 2010 | Non-resident non-individual unitholder | 10% | If the unitholder derives the distribution through a partnership in Singapore or from the carrying out of a trade, business or profession, and the basis period for the partnership, trade, business or profession ends in December, the distribution will be assessed in YA 2010 (i.e. follow the basis period of approved sub-trust), instead of YA 2009. |
| | | | Individual unitholder | Exempt ** | |
| | | | Resident non-individual unitholder | Corporate tax rate for YA 2010 | Even though part of the distribution was paid out of qualifying income of sub-trust derived before 30.09.08, the full amount of distribution will be assessed to tax in YA 2010 (i.e. follow the basis period of approved sub-trust), instead of YA 2009. |
| | | | Non-resident non-individual unitholder | 10% | |

| | | | | | |
|---|----------------------|------|--|--------------------------------|---|
| D | 1.11.08 – 28.2.09 | 2010 | Individual unitholder | Exempt ** | If the unitholder derives the distribution through a partnership in Singapore or from the carrying out of a trade, business or profession, and the basis period for the partnership, trade, business or profession ends in December, the full amount of distribution will be assessed in YA 2010 (i.e. follow the basis period of approved sub-trust), instead of YA 2009. This is notwithstanding the fact that part of the distribution was paid out of qualifying income of sub-trust derived before 31.12.08. |
| | | | Resident non-individual unitholder | Corporate tax rate for YA 2010 | |
| | | | Non-resident non-individual unitholder | 10% | |

** unless the unitholder derives the distribution through a partnership in Singapore or from the carrying on of a trade, business or profession