



CONSULTATION ON ESTABLISHING FISCAL INCENTIVES FOR REAL ESTATE TRUSTS (REITs)



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Table of Contents

CHAPTER 1 - INTRODUCTION

03

CHAPTER 2 - CONTEXT ANALYSIS

05

CHAPTER 3 - PROPOSAL

10

CHAPTER 4 - CONCLUSION

16



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This White Paper seeks to widen the process of consultation on how an incentive package for REITs in Malta is best achieved. The primary objectives of this paper are to:

- 1 Explain and give an overview of REITs, while establishing that the bye-laws regulating REITs are already in place in Malta.
- 2 Understand the global and local context of REITs.
- 3 Explain the benefits of introducing fiscal incentives in this space.
- 4 Propose fiscal incentives on three levels of the REITs.

How to Respond

Over the past months, various stakeholders were approached and their views are included in this document. Nonetheless, further feedback may be sent to FinanceMalta via email on: reitsconsultation@financemalta.org

Feedback may be submitted **by not later than 31st January 2024.**

DISCLOSURE UNDER THE FREEDOM OF INFORMATION ACT (CHAPTER 496)

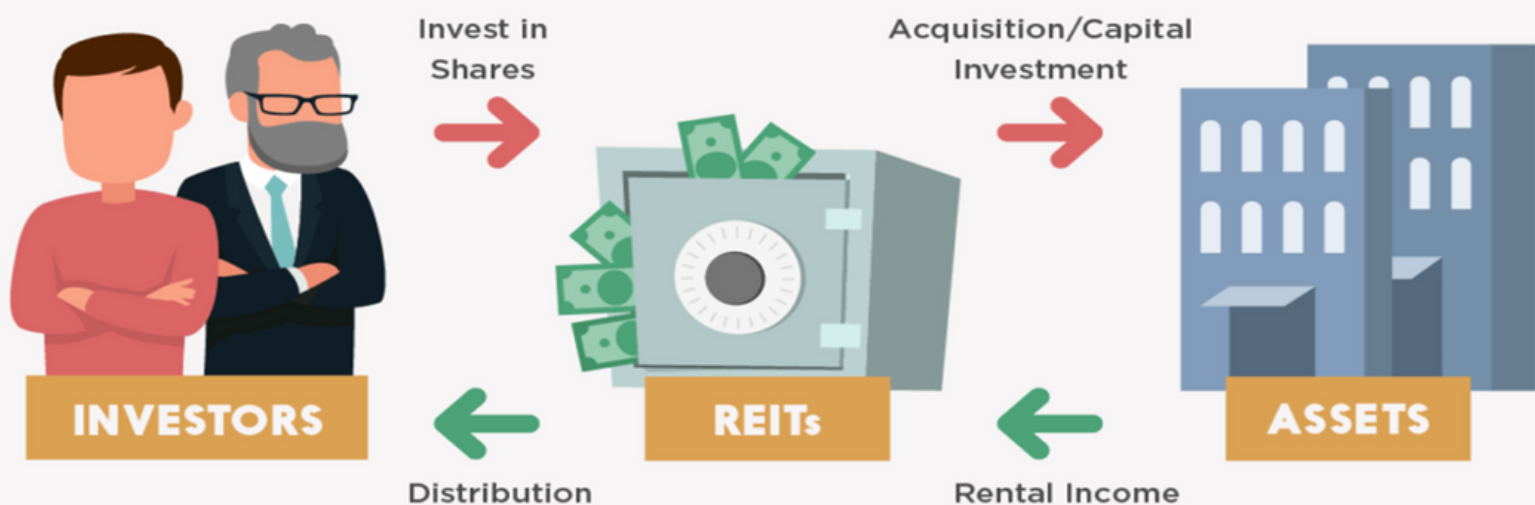
As we are a public authority all documents we hold, including documents related to this public consultation process, may be released following a request to us under the Freedom of Information Act (Chapter. 496), unless such request may be subject of an exemption arising from the same Act.

INTRODUCTION

Capital Markets is a relatively mature vertical pillar of the financial services sector in Malta. Nevertheless, the Malta Financial Services Advisory Council (MFSAC), in its strategy document launched in March 2023, has identified this sector as being an area which has the potential for further development. During the budget speech for 2024 Government announced that a consultation document would be issued on how an incentive package for REITs in Malta would be best achieved.

In this regard, FinanceMalta, a public-private partnership, has been requested to develop this White Paper. Consultation with stakeholders including the MFSAC Capital Markets Working Group, leading officials from the Ministry for Finance and Employment, representatives from the Opposition, the Commissioner for Revenue and the Malta Developers Association has already taken place. This white paper now serves to open up the consultation to financial services industry leaders and other stakeholders.

WHAT ARE REITS AND HOW DO REITS WORK?



In simple terms, a **Real Estate Investment Trust (REIT)** is a company or trust that owns, operates, or finances income-producing real estate properties. REITs are a way for investors to invest in real estate without directly owning and managing physical properties. They offer a way to invest in a diversified portfolio of real estate assets, such as office buildings, apartment complexes, hotels, shopping centers, and more, without the need for significant capital or direct involvement in property management.



Real Estate Investment Trust

CONTEXT ANALYSIS

REITs – GLOBAL CONTEXT

REITs are a popular way to invest in real estate without physically owning property. This offers the chance for individual investors to invest in real estate without the significant financial commitment for due diligence, maintenance and all the regulation that comes with property ownership. Different countries have different laws and regulations governing REITs, which can impact their attractiveness to investors.

The US is considered to be one of the most attractive countries for REITs due to its well established and highly regulated REIT market, strong investor protection, and favourable tax treatment for REITs.

The attractiveness of European countries for REITs can depend on a variety of factors such as market conditions, regulatory frameworks, tax policies and economic indicators. However, some countries that are generally considered attractive for REIT investment in Europe include Spain, France, Germany and the Netherlands.

In summary, 44 countries have already adopted a REIT regime and, in Europe, this is an industry that has generated \$510 billion and is expected to continue growing at a fast pace in the coming years.



A 2023 survey comparing the major REIT regimes around the world carried out by EPRA, the European Public Real Estate Association, the voice of the publicly traded European real estate sector, is [available here](#). The introduction to the report states that:

“

...The industry has faced significant pressures due to soaring inflation, escalating interest rates, and a volatile geopolitical landscape. Despite these adversities, ***the REIT sector has showcased its resilience and strong operational performance***, successfully navigating through turbulent times in the capital markets. ***REITs continue to grow in popularity and prominence***, attracting the attention of investors, stakeholders, and industry professionals alike. As global markets adapt to changing economic conditions and regulatory frameworks, ***the resilience and adaptability of REITs have shone through***, making them an increasingly attractive option for both seasoned investors and newcomers seeking opportunities in the real estate sector.

”

DEFINITION OF A REIT IN MALTA

The **Bye-Laws** issued by the Malta Stock Exchange were amended in October 2021 to support the introduction of REITs. In these bye-laws, a REIT is defined as being “a publicly traded company which complies with the conditions set out in bye-law 5.02.09, 5.02.10 and 5.02.11 and which has been recognised as eligible as a REIT by the Exchange.”

In summary, the bye laws introduced the following conditions for a listed company to be classified as a REIT:

The Issuer shall provide to the Exchange, a report issued by an Auditor, specifying the Specified Accounting Period, upon which all of the following conditions will be met:

a) The Issuer must have a Property Rental Business which:

A Includes a portfolio of assets of **at least 3 immovable properties in Malta or abroad**; and

B Includes a portfolio of assets of immovable properties in Malta or abroad with **a total value of at least 9 million Euro**; and

C **Does not have 1 immovable property within the portfolio of assets, valued at more than 40% of the total value of the immovable properties** included in the portfolio of assets of the Property Rental Business; and

D **Does not include immovable property** that would in accordance with the International Financial Reporting Standards be **described as owner-occupied**.

b) The income arising from the Property Rental Business amounts to at least 75% of the Issuer's total revenue; and/or

c) At least 75% of the aggregate market value of the assets of the Issuer consist of assets that are capable of generating income relating to the Property Rental Business of the Issuer;

d) In order to retain its eligibility as a REIT, the Issuer must at all times ensure that the aggregate of the Specified Debt shall not exceed an amount equal to 50% of the aggregate market value of the assets of the Property Rental Business of the Issuer;

e) the Issuer is obliged to distribute to the shareholders by way of **dividend**, for each accounting period **at least 85% of the distributable profits** allocated to the Property Rental Business arising in each accounting period.

WHY INTRODUCE INCENTIVES?



Diversification: REITs provide a way to diversify one's investment portfolio. By investing in a REIT, one can gain exposure to a diversified pool of real estate assets across different property types (e.g. commercial, industrial) and locations without the need to buy and manage individual properties.



High Dividend Yields: REITs are required to distribute at least 85% of distributable profits to shareholders in the form of dividends. This can lead to attractive and relatively stable dividend yields, making them an attractive option for income-focused investors.



Liquidity: REITs will be publicly traded on the Malta Stock Exchange, which means they are generally more liquid than physical real estate investments. Investors can easily buy and sell REIT shares, providing flexibility and ease of access to their investment.



Professional Management: REITs are managed by real estate professionals with expertise in property acquisition, management, and development. Investors benefit from the expertise of these professionals, who can make strategic decisions to maximize the value of the underlying real estate assets.



Transparency: REITs are required to disclose financial information and performance metrics regularly, offering investors transparency into the operations of the company and the underlying real estate assets.



Accessibility: REITs allow investors with relatively modest amounts of capital to invest in the real estate market.



Potential for Capital Appreciation: While REITs are primarily known for their income generation, they can also offer the potential for capital appreciation if the value of the underlying real estate assets appreciates over time.



Inflation Hedge: Real estate often serves as a hedge against inflation, as property values and rental income can increase over time. REITs can provide investors with a way to benefit from this inflation protection.



Offer a product which is already available in 44 countries (including the US, Spain, France, Germany, the Netherlands...) **In Europe this is an industry that has generated \$510 billion and is expected to continue growing at a fast pace in the coming years.**

Since the introduction of the bye laws in 2019, there were no Issuers who opted for this classification and the main reason is that **there is nothing in these bye laws to compel Issuers to go for this classification in return for them to take on such an onerous dividend distribution policy.**

TAX INCENTIVES OFFERED BY OTHER COUNTRIES

Tax incentives for REITs can vary by country and jurisdiction. However, some common tax incentives that may be available to REITs include:

1) Look through taxation: REITs are typically structured as look-through entities, which means that they do not pay income tax on their earnings, provided they distribute at least a high percentage of their taxable income to shareholders in dividends. Shareholders are then responsible for paying taxes on the dividends that they receive.

2) Tax exemptions or deferrals: Some countries offer tax exemptions or deferrals for REITs, such as exemption from capital gains tax on the sale of real estate.

A possibility in some countries is to hold investments in an individual retirement account and have the possibility for such accounts to be untaxed to encourage pension savings.

3) Tax credits: Some countries offer tax credits when REITs invest in affordable housing or renewable energy.

PROPOSAL

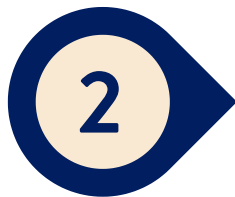
In order for REITs to enjoy success amongst both issuers and investors, it needs to be supported by a clear fiscal framework that remains protective of the integrity of the manner in which the local property market is taxed but that simultaneously reflects the fact that REITs traditionally tend to be tax neutral structures. Naturally, such a fiscal framework would always remain subject to anti-abuse measures so as to avoid misuse of such provisions.

Any fiscal framework adopted should be such that it also remains **accessible to foreign Issuers**. The requirement for the REIT to **comply with the Listing Rules** also ensures that **only reputable issuers** are attracted to the Exchange.

In this regard, it is being proposed that Tax Incentives are introduced on three levels:



Level 1 - Setting up of REIT



Level 2 - Tax at the level of the REIT



Level 3 - Tax at the level of the Investor

IT IS ALSO PROPOSED THAT PREFERENTIAL TREATMENT IS GIVEN TO THE FOUNDATION FOR AFFORDABLE HOUSING

SETTING UP OF REIT

For those companies owning immovable property in Malta and that are considering the possibility of setting up a REIT, a corporate clean-up exercise may first be required so as to carve out the Property Rental Business (as defined in the MSE's Bye Laws) that will be held by the REIT and segregate it from all other property.

Although in principle, the transfer of the Property Rental Business by the property owning company to the REIT should be a taxable transaction, in situations where the REIT and the property holding company qualify as a "group" for the purposes of the Maltese Income Tax Act ("ITA"), then such transfer should qualify for the intra-group relief provisions that are contained in ITA.

Additionally, the transfer of shares in the REIT to the general public in consequence of the listing of the shares of the REIT on the Malta Stock Exchange should be exempt from Maltese income tax on capital gains under the listing exemption.

That being said, to the extent that an intra-group-exemption would have been relied on as part of any corporate restructuring that may have taken place before the listing of the REIT, the transfer of shares to the general public as part of the listing of the REIT may trigger fiscal de-grouping considerations.

(Indeed, although some non-taxation provisions are contemplated in the law in situations involving listed entities these are rather restricted and may in practice not suffice for this purpose.)

In the context of a REIT, it is submitted that imposing a tax on such a de-grouping can result in a material deterrent which would most probably make such a REIT structure unfeasible at the outset.

Thus, it is being proposed that rules are introduced that would specifically disapply the de-grouping provisions in all instances where the listing of the REIT on the MSE may have been preceded by any corporate restructuring (including restructurings which would have been required due to the corporate clean up exercise mentioned above).



As regards those situations where the original property holding companies and the REIT do not form part of the same group of companies for capital gains purposes, we suggest that one should introduce provisions (with any anti-avoidance rules that may be appropriate) to exempt from tax the original transfer of such properties into the REIT, i.e. in effect to set up the REIT. This carve out should also apply in the case that the property/ies are directly held by an individual.

It is also being proposed that any duty on documents due on transfer of property into a REIT is waived.

TAX AT THE LEVEL OF THE REIT

Having attractive and tax neutral measures in place is critical to the promotion of the REIT to property owners and investors alike. A number of REITs' fiscal frameworks are indeed targeted at removing taxation both at the level of the REIT and at the level of the investor, although the manner in which this is achieved by jurisdictions naturally vary.

From a local perspective, the REIT may be said to share a number of characteristics with a collective investment scheme (CIS), in terms of the collective investment of capital, risk-spreading and the pooling of contributions and profits.

In light of the similar characteristics shared by CISs and REITs, it is being proposed that one considers introducing specific tax rules regulating the taxation of the REIT that would be modelled on the existing Maltese fiscal framework applicable to CISs - but at the same time not requiring a CIS licence since otherwise this would represent a disproportionate regulatory burden and partly negate the scope of having a different regime for REITs.

Below are some high-level principles on the basis of which such tax rules for REITs may be modelled:

(i) Any income or capital gains derived by the REIT from any immovable property situated in Malta should be subject to Maltese tax.

In the case of REITs given the increased costs as a result of the necessary regulatory oversight, it is suggested that the 15% tax rate already applicable under Maltese tax law for rental income would be revised down to the existing 10% tax rate for CISs (investment income for prescribed funds), which 10% tax rate would apply on the gross rents. This could also be somewhat more practical in that one would not need to determine which expenses are tax deductible or not.

Naturally, the REIT would always have the normal option to elect to be taxed on its rental income under Article 4(1) of the ITA.

The transfer by the REIT of any immovable property situated in Malta or any real rights thereon would be subject to Maltese tax in terms of withholding tax provisions under Article 5A of the ITA, or to the extent that the REIT qualifies for an election to opt out and the option is exercised by the REIT, then the provisions under Article 5 of the ITA would apply.

(ii) All other income and capital gains of the REIT that is not generated from immovable property situated in Malta would be wholly exempt from Maltese income tax, subject to (iii) below;

(iii) With respect to those REITs that have the majority (at least 85%) of their Property Rental Business situated in Malta, then any “investment income” as defined by the ITA and derived by such REIT would be subject to Maltese income tax, thereby ensuring that any tax framework introduced to govern the REIT does not offer any additional advantages over that currently in place for CISs.

From a tax accounting perspective, the general tax accounting framework should apply to the REIT. Consequently, all income derived by the REIT that would be exempt in terms of the above-mentioned provisions would be allocated to the Untaxed Account of the REIT. All other income would be allocated to the Final Taxed Account or the Immovable Property Account, as the case may be.

TAX AT THE LEVEL OF THE INVESTOR

The general principles of Maltese tax should apply once the REIT makes any distribution of taxed or untaxed profits to its investors.

To the extent of any profits that would have been subject to tax in Malta and therefore allocated to the Immovable Property Account or Final Taxed Account, as the case may be, any distribution of such profits should not be subject to any further tax at the level of the investor, irrespective of whether the investor is Maltese resident or not.

However, to the extent that the REIT makes any distribution of untaxed profits from its Untaxed Account, there would be the obligation of the REIT to withhold 15% when making such a distribution to Maltese resident investors other than a company. Any such distribution of untaxed profits to non-Maltese resident investors would in terms of normal rules not trigger any withholding tax obligations.

PREFERENTIAL TREATMENT TO THE FOUNDATION FOR AFFORDABLE HOUSING

The Foundation for Affordable Housing is a social purpose foundation set up in 2022 by the Government of Malta and the Archdiocese of Malta, with the principal aim of developing affordable housing programmes. While the Government is one of the founders, it does not own a majority shareholding, and the Foundation acts autonomously from the central administration, including the Ministry for Social and Affordable Accommodation and the Housing Authority. The Foundation is by nature a non-profit organization. The organization was set up with the sole purpose of developing residential property and financial instruments which should create adequate affordable housing solutions for people whose income renders them ineligible for social accommodation yet is still insufficient to allow them to buy or lease property unaided.

In this consultation paper, it is being further proposed that should the Foundation for Affordable Housing be interested to launch a REIT with the sole purpose of furthering its objective, in its case the tax on gross rental income is waived altogether.

ATTRACTIVENESS OF REITS

In order to further promote the attractiveness of REITs, it is important that clear tax rules are introduced so as primarily to **reduce tax uncertainty** but also to ensure that such **REITs are taxed in a similar manner to collective investment schemes**.

Such tax rules for Maltese REITs will also address the point that from a country competitiveness perspective, **Malta would have specific fiscal rules for REITs** which is indeed the situation which one finds in a number of foreign jurisdictions.

Summary:



Reduce tax uncertainty



REITs are taxed in a similar manner to collective investment schemes



Malta would have specific fiscal rules for REITs

CONCLUSION

This White Paper calls for a consultation of the proposed REIT system. The recommended proposals are expected to pave the way for developing an effective REIT regime in Malta in 2024. Such proposals need to have wide support from the key stakeholders.

Like any investment, REITs also come with risks, including interest rate sensitivity, economic conditions, and the specific performance of the underlying real estate assets so investors would need to seek advice before investing in them.

However, the authorities are committed to continue working closely with stakeholders to ensure wider investment opportunities with minimal negative impacts.

