

Real Estate Investment Trust: Bane or Boon to Real Estate Industry?

*Victorino C. Mamalateo**

*Mary Joy B. Mamalateo-Jusay***

I. INTRODUCTION.....	325
II. OBJECTIVES OF REAL ESTATE INVESTMENT TRUST LAW.....	327
III. THE REIT	327
A. <i>Persons Qualified to Enjoy Tax Incentives</i>	
B. <i>Registration and Listing</i>	
C. <i>Nationality Requirement</i>	
D. <i>Dividend Distribution</i>	
E. <i>REIT Requirements</i>	
IV. TAXES AND OTHER RELATED ISSUES.....	335
A. <i>Income Tax</i>	
B. <i>Creditable Withholding Income Tax</i>	
C. <i>Transfer of Real Property</i>	
V. ISSUANCE AND TRANSFER OF INVESTOR SECURITIES	348
VI. VALUE-ADDED TAX.....	350
VII. IMPLEMENTING RULES AND REGULATIONS.....	351
VIII. CONCLUSION.....	353

I. INTRODUCTION

The Real Estate Investment Trust (REIT, pronounced “reet”) dates back to the late 1800s where REITs were allowed to be used by investors as pass-

* '89 LL.M. Concentration in Taxation, Harvard University; '83 M.B.A., University of the East; '70 LL.B., Manuel L. Quezon University. The author is currently the Managing Partner of V.C. Mamalateo & Associates. He was the 2008 Bar Examiner on Taxation and was also Assistant Commissioner for Assessment and Special Operations Services of the Bureau of Internal Revenue and the Managing Partner, Tax Division of Punongbayan & Araullo from 1994–2001. He has authored the following books on Taxation: REVIEWER IN TAXATION (2008), TAX RIGHTS AND REMEDIES (2005), TAXATION OF BUSINESS PROFITS UNDER THE PHILIPPINE TAX CODE AND TAX TREATIES (2005), PHILIPPINE INCOME TAX (2004), and THE VALUE ADDED TAX IN THE PHILIPPINES (2000) with Atty. Victor A. Deoferio, Jr.

** '03 LL.B., San Sebastian College — Recoletos de Manila. The author is currently a Partner of V.C. Mamalateo & Associates. She passed the New York State Bar in 2008 and the Philippine Bar in 2004. She also served as Tax Senior Consultant at the Tax Division of Punongbayan & Araullo.

through entities in order avoid double taxation.¹ Under the United States (U.S.) Internal Revenue Code,² trust incomes were not subject to income tax to the trustee, if they were distributed by the trustee to its beneficiaries who are taxed thereon. In 1960, the U.S. Congress enacted a law allowing the creation of REITs by way of special forms of corporations.³ REITs are not required to pay taxes on net income, as long as it is distributed to shareholders, where it is taxed at the shareholder level.⁴

The importance of REITs in the world economy can be seen through its enormous size and the fact that REITs continue to grow. In 2006, the international market for REITs stood at \$611 billion, and in 2007, it grew to \$764 billion.⁵ Asian REIT markets have also shown strong growth potential with their combined market capitalization of \$49 billion in 2006, ballooning to more than \$80 billion in 2007.⁶ In the last three years, the global value turnover or market activity generated by REITs has grown to its current level of \$1.3 billion, out of which \$65.3 million comes from Asia.⁷ Even amidst the global financial crisis, the number of listed REITs grew and the continued expansion of REITs is best seen in Asia. As of 2008, the number of listed REITs in Asia represents close to one-fifth of the total REIT companies listed worldwide.⁸

The Philippine stock market is considered one of the oldest in Asia, but remains the smallest to date.⁹ Its property sector accounted for 32.4% of total capital raised through the stock market in 2008.¹⁰ There is about \$3 billion worth of investible real property asset in the Philippines that is locked up.¹¹ There is still a huge demand that may be satisfied by REITs in the Philippine property market.¹²

1. Robert D. Campbell & C.F. Sirmans, *Policy Implications of Structural Options in the Development of Real Estate Investment Trust in Europe: Lessons from the American Experience*, 20 J. PROP. INVESTMENT & FIN. 388, 389 (2002).

2. Internal Revenue Code, 26 I.R.C. §§ 651-52 (2000).

3. Campbell & Sirmans, *supra* note 1, at 388.

4. *Id.*

5. SENATE JOURNAL 1432, 14th Cong., 2d Reg. Sess., Senate Sess. No. 44 (Jan. 27, 2009).

6. *Id.*

7. *Id.*

8. *Id.*

9. *Id.*

10. SENATE JOURNAL 1433, 14th Cong., 2d Reg. Sess., Senate Sess. No. 44 (Jan. 27, 2009).

11. *Id.*

12. *Id.*

II. OBJECTIVES OF REAL ESTATE INVESTMENT TRUST LAW

Section 2 of Republic Act (R.A.) No. 9856 or the Real Estate Investment Trust Act of 2009 (REIT Act), provides its objectives, as follows:

- (1) To promote the development of the capital market;
- (2) To democratize wealth by broadening the participation of Filipinos in the ownership of real estate in the Philippines;
- (3) To use the capital market as an instrument to help finance and develop infrastructure projects; and
- (4) To protect the investing public by providing an enabling regulatory framework and environment under which real estate investment trusts, through certain incentives granted herein, may assist in achieving the objectives of this policy.¹³

III. THE REIT

To attain the objectives of the REIT Act, certain tax incentives were granted to REITs and to certain persons investing in REITs. However, to be entitled to said incentives, the requisites provided for in the REIT Act must be satisfied. These requisites include (1) being a qualified investor; (2) complying with the registration and listing requirements; and (3) satisfying the nationality requirements.

A. Persons Qualified to Enjoy Tax Incentives

Under the REIT Act, a REIT or an investor in REIT shares of stock is entitled to tax incentives.

1. Real Estate Investment Trust

A *Real Estate Investment Trust* is a stock corporation established in accordance with the Corporation Code of the Philippines¹⁴ and the rules and regulations promulgated by the Securities and Exchange Commission (SEC) principally for the purpose of owning income-generating real estate assets. A REIT, although designated as a trust, does not have the same technical meaning as “trust” under existing laws and regulations but is used for the sole purpose of

13. An Act Providing the Legal Framework for Real Estate Investment Trust and for Other Purposes [Real Estate Investment Trust Act of 2009], Republic Act No. 9856, § 2 (2009).

14. The Corporation Code of the Philippines [CORPORATION CODE], Batas Pambansa Blg. 68 (1980).

adopting the internationally accepted description of the company in accordance with global best practices.¹⁵

REITs are publicly-listed companies that own and operate income-producing real estate such as condominiums, shopping centers, office spaces, hotels, resorts, and hospitals. REITs may also own and operate infrastructure facilities such as toll ways, airports, and highways.¹⁶ The enactment of the REIT Act does not prohibit the establishment of family corporations.¹⁷ However, an ordinary family-owned corporation cannot avail of the tax benefits and incentives under the said Act. Existing family corporations would not be prejudiced by it.¹⁸

Three key elements are of essential importance in the structure of REITs, namely: (1) their assets and revenues are closely restricted to real estate, plus a limited portfolio of securities;¹⁹ (2) although they are usually public companies, they can avoid paying corporate taxes, so that their owners are not subject to the double taxation normally associated with public corporations;²⁰ and (3) they are required to distribute essentially all of their economic accounting earnings, so that they become taxable at the investor level.²¹

2. Investor in REIT

Investment in the REIT shall be by way of subscription to or purchase of shares of stock of the REIT.²² No shares of stock of the REIT shall be offered for subscription or sale except in accordance with a REIT plan and other requirements and restrictions as may be prescribed by the Commission.²³

The investor in REIT shares of stock may be any person. The term “person” is a generic term used to refer to an income taxpayer who may be an individual, estate or trust, partnership, association, or a corporation.

15. Real Estate Investment Trust Act of 2009, § 3 (cc).

16. SENATE JOURNAL 1432, 14th Cong., 2d Reg. Sess., Senate Sess. No. 44 (Jan. 27, 2009).

17. SENATE JOURNAL 1573, 14th Cong., 2d Reg. Sess., Senate Sess. No. 50 (Feb. 10, 2009).

18. *Id.*

19. *Id.* at 1574.

20. *Id.*

21. *Id.*

22. Real Estate Investment Trust Act of 2009, § 4.

23. *Id.*

One of the ways by which the benefits granted under the REIT Act may be enjoyed is by contributing real property in payment for subscriptions of shares of stocks of a corporation.²⁴ Incorporating real property into a REIT has the following benefits: (1) it is a stable investment because it is an investment in real property which is a hard asset; (2) it offers liquidity as REITs generate regular rental income²⁵ since stock dividends declared by REITs are also more valuable than real estate and thus, offer greater liquidity; and (3) succession and estate planning on the part of the owner can avoid the usual problem of having the heirs quarrel over property, by distributing the shares rather than dividing the property among the children.²⁶

B. Registration and Listing

The shares of stock of the REIT must be registered with the SEC and listed in accordance with the rules of the Exchange.²⁷

Investors enjoy the assurance of a fair, transparent and efficient market for buying and selling REIT securities, because the REIT Act requires the listing of REIT stocks in the local stock exchange.²⁸ This makes it easier to buy or sell the REIT shares than it is to directly buy and sell real estate or properties.²⁹

C. Nationality Requirement

A REIT that owns land in the Philippines must comply with foreign ownership limitations imposed under law.³⁰

Article XII of the 1987 Constitution provides:

Section 7. Save in cases of hereditary succession, no private lands shall be transferred or conveyed except to individuals, corporations, or associations qualified to acquire or hold lands of the public domain.³¹

Section 10. The Congress shall, upon recommendation of the economic and planning agency, when the national interest dictates, reserve to citizens

24. SENATE JOURNAL 1576, 14th Cong., 2d Reg. Sess., Senate Sess. No. 50 (Feb. 10, 2009).

25. *Id.* at 1574.

26. *Id.*

27. Real Estate Investment Trust Act of 2009, § 5.

28. SENATE JOURNAL 1573, 14th Cong., 2d Reg. Sess., Senate Sess. No. 50 (Feb. 10, 2009).

29. *Id.* at 1581.

30. Real Estate Investment Trust Act of 2009, § 6.

31. PHIL. CONST. art. XII, § 7.

of the Philippines or to corporations or associations at least sixty per centum of whose capital is owned by such citizens, or such higher percentage as Congress may prescribe, certain areas of investments.³²

D. Dividend Distribution

Section 7 of the REIT Act provides for the required annual dividend distribution of REITs, as follows:

A REIT must distribute annually at least 90% of its distributable income as dividends to its shareholders not later than the last day of the fifth month following the close of the fiscal year of the REIT. Subject to the provisions of this Act, the dividends shall be payable only from out of the unrestricted retained earnings of the REIT as provided for under Section 43 of the Corporation Code of the Philippines. The percentage of dividends received by the public shareholders to the total dividends distributed by the REIT from out of its distributable income must not be less than such percentage shares of the REIT. Any structure, arrangement or provision which would have the effect of diminishing or circumventing in any form this entitlement to dividends shall be void and of no force and effect.

Distributable income excludes proceeds from the sale of the REIT's assets that are re-invested by the REIT within one year from the date of the sale.³³

Section 43, Title IV of the Corporation Code gives the REIT's Board of Directors powers to declare dividends out of the unrestricted retained earnings which shall be payable in cash, in property, or in stock to all stockholders on the basis of the outstanding stock they own.³⁴ The REIT Act even made it mandatory for REITs to pay out a substantial part of their distributable income, a minimum of 90% thereof, by way of dividends to its shareholders to ensure investor protection.³⁵ The remaining 10% of the REIT's income not distributed as dividends may be used for reinvestment purposes.

E. REIT Requirements

After public hearing and unless the SEC provides otherwise, and taking into account public interest, the need to protect investors and develop the country's real estate investment industry to make it globally competitive, the following requirements shall apply:

- (1) *Minimum Public Ownership.* — A REIT must be a public company and to be considered as such, a REIT must: (a)

32. PHIL. CONST. art. XII, § 10.

33. Real Estate Investment Trust Act of 2009, § 7.

34. CORPORATION CODE, § 43.

35. Real Estate Investment Trust Act of 2009, § 7.

maintain its status as a listed company; and (b) upon and after listing, have at least 1,000 public shareholders each owning at least 50 shares of any class of shares who in the aggregate own at least one-third of the outstanding capital stock of the REIT.³⁶

- (2) *Capitalization.* — A REIT must have a minimum paid-up capital of ₱300,000,000.00.³⁷
- (3) *Allowable Investments.* — A REIT may only invest in:
 - (i) Real estate, whether freehold or leasehold, located in the Philippines. A REIT may invest in income-generating real estate located outside of the Philippines: *Provided,* That such investment does not exceed 40% of its deposited property and only upon special authority from the Commission. The Commission in issuing such authority shall consider, among others, satisfactory proof that the valuation of assets is fair and reasonable. An investment in real estate may be by way of direct ownership or a shareholding in an unlisted special purpose vehicle constituted to hold/own real estate;
 - (ii) Real estate-related assets, wherever the issuers, assets, or securities are incorporated, located, issued, or traded;
 - (iii) Managed funds, debt securities and listed shares issued by local or foreign non-property corporations;
 - (iv) Government securities issued on behalf of the Philippine government or governments of other countries and securities issued by multilateral agencies;
 - (v) Cash and cash equivalent items; and
 - (vi) Such other similar investment outlets as the Commission may allow.³⁸
- (4) *Investment in Synthetic Investment Products.* — A REIT may invest not more than 5% of its investible funds in synthetic investment products such as, but not limited to, credit default swaps, credit-linked notes, collateralized debt obligations, total return swaps, credit spread options, and credit default options, and only upon special authority from the appropriate regulatory authority.³⁹

36. *Id.* § 8.1.

37. *Id.* § 8.2.

38. *Id.* § 8.3.

39. *Id.* § 8.4.

- (5) *Income-Generating Real Estate.* — At least 75% of the deposited property of the REIT must be invested in, or consist of, income-generating real estate.⁴⁰
- (6) *Property Development.* — A REIT must not undertake property development activities whether on its own, in a joint venture with others, or by investing in unlisted property development companies, unless it intends to hold the developed property upon completion. The total contract value of property development activities undertaken and investments in uncompleted property developments should not exceed 10% of the deposited property of the REIT.⁴¹

The REIT is not in the business of buying and selling real property in the expectation that the price of the property would eventually increase. Should a REIT undertake a property development project, it must hold such property upon its completion and turn it into an income-generating property.⁴²

- (7) *Single Entity Limit.* — Not more than 15% of investible funds of the REIT may be invested in any one issuer's securities or any one managed fund, except with respect to government securities where the limit is 25%.⁴³
- (8) *Foreign Assets.* — A REIT may invest in local or foreign assets, subject to the terms of its articles of incorporation. Where an investment in a foreign real estate asset is made, the REIT should ensure that the investment complies with all the applicable laws and requirements in that foreign country such as, but not limited to, foreign ownership restrictions, if any, and requisites of having good and valid title to that real estate.⁴⁴
- (9) *Joint Venture.* — When investing in real estate as a joint owner, the REIT should make such investment by acquiring shares or interests in an unlisted special purpose vehicle constituted to hold/own the real estate and the REIT should have freedom to dispose of such investment. The joint venture agreement, memorandum and articles of association or other constitutive documents of the

40. *Id.* § 8.5.

41. Real Estate Investment Trust Act of 2009, § 8.6.

42. *Id.*

43. *Id.* § 8.7.

44. *Id.* § 8.8.

special purpose vehicle should provide for a minimum percentage of distributable profits of the special purpose vehicle that will be distributed and grant the REIT veto rights over key operational issues of the special purpose vehicle.⁴⁵

- (10) *Aggregate Leverage Limit.* — The total borrowings and deferred payments of a REIT should not exceed 35% of its deposited property: *Provided, however,* That the total borrowings and deferred payments of a REIT that has a publicly disclosed investment grade credit rating by a duly accredited or international recognized rating agency may exceed 35% but not more than 70% of its deposited property.⁴⁶
- (11) *Related Party Transactions.* — Any contract or amendment thereto, between the REIT and related parties, including contracts involving the acquisition or lease of assets and contracts for services, must comply with the following minimum requirements:
- (i) Full, fair, timely and accurate disclosures on the identity of the parties, their relationship with the REIT, and other important details of the transaction have been made to the Exchange and the Commission;
 - (ii) Be on fair and reasonable terms, including the contract price;
 - (iii) Approved by at least a majority of the entire membership of the board of directors, including the unanimous vote of all independent directors of the REIT;
 - (iv) Accompanied by a fairness opinion by an independent appraiser done in accordance with the valuation methodology prescribed by the Commission, in the case of an acquisition or disposition of real estate assets and property or share swaps or similar transactions; and
 - (v) Any other matter that may be materially relevant to a prospective investor in deciding whether or not to invest in the REIT.⁴⁷
- (12) *Valuation.* — A full valuation of a REIT's assets must be conducted by an independent appraisal company, duly accredited by the Commission, at least once a year in

45. *Id.* § 8.9.

46. *Id.* § 8.10.

47. Real Estate Investment Trust Act of 2009, § 8.11.

accordance with the applicable rules of asset valuation and valuation methodology as prescribed by the Commission.⁴⁸

- (13) Fund Manager. — A REIT must appoint a fund manager that is independent from the REIT and its sponsor(s)/promoter(s) and shall be subject to the following minimum requirements:
- (i) It must be a corporation duly organized under the laws of the Republic of the Philippines or a foreign corporation engaged in the business of fund management with proven track record and duly licensed to do business in the Philippines by the appropriate regulatory agency;
 - (ii) It must have a minimum paid-up capital stock or assigned capital of ₱10,000,000.00, unless the Commission provides otherwise;
 - (iii) Its office in the Philippines must have a meaningful role in its business activities and must perform accounting, compliance and investor relations services in the Philippines;
 - (iv) It must comply with the requirements of the relevant law or appropriate regulatory authority on the number of independent directors;
 - (v) It must comply with the corporate governance requirements, including the fit and proper rule, prescribed by this Act and its IRR;
 - (vi) It must adopt measures as may be prescribed by the IRR of this Act to avoid conflicts of interest in the discharge of its duties as fund manager for the REIT; and
 - (vii) It must employ a resident chief executive officer and at least two full-time professional employees who have a track record and experience in financial management as well as experience in the real estate industry.⁴⁹

A “fund manager” is one who is either a bank or trust company under the supervision of the *Bangko Sentral ng Pilipinas* (BSP).⁵⁰ The fund manager must be independent (i.e., one which has no relation with the directors, officers or affiliates of another corporation).⁵¹

- (14) *REIT Property Manager*.— The REIT must appoint a REIT property manager who shall be responsible for

48. *Id.* § 8.12.

49. *Id.* § 8.13.

50. *Id.* § 3 (l).

51. *Id.*

managing the real estate assets such as apartment buildings, office buildings, warehouses, hospital buildings, medical facilities, hotel buildings, resort facilities, manufacturing plants and other physical assets of the REIT. The contract between the REIT and the property manager must comply with the disclosure and other requirements for related party transactions.

The REIT property manager shall be independent from the REIT and its sponsor/promoter and possess the qualifications and be subject to such functions and responsibilities, restrictions and other requirements prescribed by the Commission.⁵²

Fees received by the REIT fund manager and the REIT property manager from the REIT shall not exceed one per cent of the net asset value of the assets under management.⁵³

(15) *Independent Directors.* — At least one-third of the board of directors of a REIT must be independent directors.⁵⁴

Under Section 38, Chapter IX of Republic Act No. 8799 (the Securities Regulation Code), an “independent director” shall mean a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having a relationship with the corporation, which would interfere with the exercise of independent judgment.⁵⁵

In addition thereto, an independent director is one who is not related to or affiliated with the majority or dominant stockholders.⁵⁶

IV. TAXES AND OTHER RELATED ISSUES

Consistent with the objectives of the REIT Act, tax incentives have been granted therein.

A. *Income Tax*

1. REIT

52. *Id.* § 8.14.

53. Real Estate Investment Trust Act of 2009, § 8.18.

54. *Id.* § 8.15.

55. SENATE JOURNAL 1684, 14th Cong., 2d Reg. Sess., Senate Sess. No. 56 (Feb. 24, 2009). *See generally* The Securities Regulation Code [SECURITIES REGULATION CODE], Republic Act No. 8799, § 38 (2000).

56. SECURITIES REGULATION CODE, § 38.

Section 10 of the REIT Act provides that income tax should be paid, as follows:

A REIT shall be subject to income tax under Chapter IV, Title II of the Tax Code of 1997, as amended, on its taxable net income as defined in this Act: *Provided*, That in no case shall a REIT be subject to the minimum corporate income tax, as provided under Section 27 (E) and Section 28 (A) (2) of the same Code: *Provided, further*, That for purposes of computing the taxable net income of a REIT, dividends distributed by a REIT from its distributable income after the close of a taxable year and on or before the last day of the fifth month following the close of the taxable year shall be considered as paid on the last day of such taxable year.

A REIT shall be subject to the income tax on its taxable net income as defined in Chapter V, Title II of the Tax Code 1997, as amended, instead of its taxable net income as defined in this Act, upon the occurrence of any of the following events subject to such curing period as may be prescribed in the IRR of this Act:

- (i) Failure to maintain its status as a public company as defined in Section 8.1 of this Act;
- (ii) Failure to maintain the listed status of the investor securities on the Exchange and the registration of the investor securities by the Commission; and/or
- (iii) Failure to distribute at least 90% of its distributable income required under Section 7 of this Act.⁵⁷

The term “taxable net income” means the pertinent items of gross income specified in Section 32 of the National Internal Revenue Code of 1997 (Tax Code),⁵⁸ less all allowable deductions enumerated in Section 34⁵⁹ of the said Code,⁶⁰ less the dividends distributed by a REIT out of its distributable income as of the end of the taxable year as: (a) dividends to owners of the common shares; and (b) dividends to owners of the preferred shares pursuant to their rights and limitations specified in the articles of incorporation of the REIT.⁶¹

a. Computation of Income Tax Under the Tax Code

At the outset, it should be emphasized that the tax incentives are granted under the REIT Act only to a domestic corporation. Since the said Act

57. Real Estate Investment Trust Act of 2009, § 10.

58. An Act Amending the National Internal Revenue Code, as Amended, and for Other Purposes [TAX REFORM ACT OF 1997], Republic Act No. 8424, § 32 (1997).

59. *Id.* § 34.

60. *Id.* § 31.

61. Real Estate Investment Trust Act of 2009, § 3 (mm).

defines a REIT as “a stock corporation established in accordance with the Corporation Code of the Philippines,” the enjoyment of the tax incentives under said law shall be limited to domestic corporations.⁶² Thus, a resident foreign corporation, which is a corporation organized under the laws of a foreign country that is doing business in the Philippines, may not qualify as a REIT. Moreover, the term “corporation,” for income tax purposes, includes partnerships, no matter how created or organized.⁶³ Nevertheless, a business partnership registered with the SEC is disqualified from claiming the tax incentives granted under the REIT Act, considering that it is not a stock corporation in accordance with the Corporation Code.⁶⁴

For income tax purposes, the test to determine whether a corporation is a domestic corporation or a foreign corporation depends upon the law under which such corporation is organized. If it is organized under the laws of the Philippines, it is a domestic corporation;⁶⁵ otherwise, it is a foreign corporation.⁶⁶ In other words, the nationality of the owners of the shares of stocks of a domestic corporation is immaterial for purposes of taxation under the Tax Code. However, foreign ownership of shares of stock of a domestic corporation that will own real property cannot exceed 40% of its capital stock pursuant to the provisions of the 1987 Constitution.⁶⁷ The same rule applies with respect to ownership of condominium units in a condominium building as provided for in the Condominium Act.⁶⁸

Under the Tax Code, a domestic corporation is subject to a regular corporate income tax (RCIT) computed at the higher amount between (a) the regular corporate income tax at 30% on its net taxable income (i.e., gross income less allowable deductions) from worldwide sources, except incomes subjected to final withholding taxes, effective 1 January 2009,⁶⁹ and (b) the minimum corporate income tax (MCIT) determined at two per cent of its gross income (i.e., gross sales or revenue less cost of goods sold or service).⁷⁰

Simply stated, there are two computations to be made during the year to determine which type of income tax — regular or minimum — is higher and thus must be paid by such corporation. And if the domestic corporation

62. *Id.* § 3 (cc).

63. *Evangelista, et al. v. Coll. of Int. Rev., et al*, 102 Phil. 141, 147 (1957).

64. *Id.* at 148.

65. TAX REFORM ACT OF 1997, § 22 (C).

66. *Id.* § 22 (D).

67. PHIL. CONST. art. XII, § 2.

68. An Act to Define Condominium, Establish Requirements for its Creation, and Govern its Incidents [Condominium Act], Republic Act No. 4726, § 5 (1966).

69. TAX REFORM ACT OF 1997, § 27 (A).

70. *Id.* § 27 (E) (1).

has retained earnings and distributes dividend during the year, such dividend (whether it is taxable to the recipient thereof or exempt from income tax) is deducted from the retained earnings of the corporation, but is not allowed as a deduction from the gross income of the corporation paying the dividend. The Tax Code enumerates in Section 34 the allowable deductions from gross income and dividend distribution is not listed among these authorized deductions.⁷¹ Dividends declared by the REIT during the year are merely deducted from its Retained Earnings under the equity section of the Balance Sheet. However, such dividends are generally subject to final income tax on the part of the stockholders, who may be individuals or corporations, which the REIT is required to withhold and remit to the Bureau of Internal Revenue (BIR) within the prescribed period.

The income tax due on a domestic corporation shall be computed as follows:

	RCIT	MCIT
Gross Income	100	100
Multiplied by 2% MCIT Rate		x 2%
Less: Deductions	200	
Net Income	80	
Multiplied by Applicable Tax Rate	x 30%	
Regular Corporate Income Tax	24	
Minimum Corporate Income Tax		2
Corporate Income Tax due for the Year	24	

Whichever will result in the higher amount of tax (either RCIT or MCIT) will be paid by a domestic corporation. In the above example, the RCIT of ₱24.00, which is higher than MCIT of ₱2.00, will be paid by the corporation.

b. Computation of Income Tax Under the REIT Act

Under the REIT Act, three income tax incentives are granted to a REIT.

First, a REIT, which must be a domestic stock corporation, is subject to income tax at 30% on its net taxable income. Section 3 (mm) of said law defines “taxable net income” as the pertinent items of gross income less allowable deductions *and dividends distributed out of the REIT’s distributable income as of the end of the taxable year*.⁷²

The Senate’s sample computation of income tax under the REIT Act is as follows: “If the annual income of the corporation was ₱100 million, the allowable deduction is ₱20 million and the net taxable income is ₱80 million

71. *Id.* § 34.

72. Real Estate Investment Trust Act of 2009, § 3 (mm) (emphasis supplied).

but 90% of the net taxable income of ₱72 million is mandatorily distributable; thus, the actual taxable income is only ₱8 million.”⁷³

In formula form, the net taxable income and income tax of a REIT shall be computed as follows:

	Non-REIT	REIT
Gross Income	100	100
Less: Deductions	20	20
Net Income per return	80	80
Less: Corporate Income Tax Due (for non-REIT)	24	
Dividends distributed during the year (90% x RE)		72
Net Taxable Income		8
Multiplied by applicable rate		x 30%
Corporate Income Tax of REIT		2.4
Retained Earnings (RE)	56	5.6

As can be seen from the illustration above, there is a reduced income tax liability on the part of the REIT from ₱24.00 to ₱2.40 through the distribution of dividends to shareholders during the year.

Section 7 of the REIT Act, quoted above, shows that any distribution of dividends, whether the dividends are taxable to the stockholders, such as cash and property dividends, or exempt from income tax because they represent return of capital, such as stock dividends, may be deducted from the gross income of the REIT.⁷⁴ This position is consistent with the principle that where the law does not qualify, it is not for the administrative bodies or the courts to so qualify.⁷⁵ This provision in the REIT Act is a deviation from normal tax and financial accounting rules that allow the accumulation of earned surplus for possible source of expansion of its business or improvement of its facilities and equipment necessary for its operations. Since the REIT Act requires that at least 90% of its distributable income must be declared and paid as dividends within five months of the following year, it is very remote that the provisions of the Tax Code relating to improper accumulation of earnings will apply to REITs.⁷⁶

With respect to REIT properties (real property, shares of stocks, and securities) that may be declared as property dividends, the same may be

73. SENATE JOURNAL 1578, 14th Cong., 2d Reg. Sess., Senate Sess. No. 50 (Feb. 10, 2009).

74. Real Estate Investment Trust Act of 2009, § 7.

75. *Philippine British Assurance Co., Inc. v. Intermediate Appellate Court*, 150 SCRA 521, 527 (1987) (citing *Colgate-Palmolive Phil., Inc. v. Gimenez*, 1 SCRA 267 (1961)).

76. Real Estate Investment Trust Act of 2009, § 7.

declared as such based on their book value or fair market value at the time of the dividend declaration. While the law allows the declaration of property dividends, considering the large number of shareholders of REIT, there could be some significant problems in declaring property dividends. In order to prevent confusion as to the proper basis for purposes of complying with the 90% rule that may result in the disqualification of a domestic corporation as a REIT, this issue must be specifically explained or illustrated in the implementing regulations of the SEC and the BIR.

As regards stock dividends that are generally exempt from income tax on the part of the shareholders, there is also benefit on the part of the REIT since it appears that any dividend distribution is deductible from its distributable income during the year.⁷⁷

It must be noted that before a REIT may declare dividends, it is necessary that the REIT has enough unrestricted retained earnings.⁷⁸ Also, the dividends must come from the REIT's distributable income as of the end of the taxable year and that they are distributed during the year they are earned by the REIT, but not later than the fifth month following the close of the year.⁷⁹ Since the shareholders of REIT may include non-resident foreign persons, there could be several of them who may not actually receive the cash or property dividend within the prescribed period in the REIT Act. Constructive receipt of the dividends is thus presumed and the final withholding tax must be deducted and remitted by the REIT within the prescribed period in the Tax Code and its implementing regulations.

Second, the REIT provides that "distributable income excludes proceeds from the sale of the REIT's assets that are re-invested by the REIT within one year from the date of the sale."⁸⁰

The term "distributable income" means net income as adjusted for unrealized gains and losses/expenses and impairment losses and other items in accordance with internationally accepted accounting standards, which "excludes proceeds from the sale of the REIT's assets that are re-invested by the REIT within one year from the date of the sale."⁸¹

Failure of the REIT to distribute at least 90% of its distributable income as dividends to its shareholders within the last day of the fifth month following the close of the taxable year will result in its disqualification from enjoying the tax incentives under the REIT Act.⁸² Accordingly, a REIT

77. *Id.* § 3 (mm).

78. *Id.* § 7.

79. *Id.*

80. *Id.* §§ 3 (j) & 7.

81. *Id.* § 3 (j).

82. *See* Real Estate Investment Trust Act of 2009, § 17.

classified as such for purposes of registration and listing may, however, be treated as a non-REIT or ordinary corporation subject to national internal revenue taxes under the Tax Code, together with the civil penalties attendant to such violations, if at the end of the year or within five months of the following year, it failed to comply with the requirement to distribute 90% of its distributable income as dividends.⁸³ In view thereof, this provision needs to be clarified as it may create possible tax issues in the future.

For example, on 1 June 2011, Corporation A, which is a REIT corporation that adopts the calendar year, sold real property which it acquired on 1 May 2010, as follows:

Selling Price	₱ 500,000,000.00
Less: Cost or Adjusted Basis	₱ 100,000,000.00
Gain from Sale	₱ 400,000,000.00

The entire selling price of ₱500 million was reinvested in January 2012 by the same corporation by buying another real property located in the Philippines.

A liberal interpretation of the distributable income provision of the REIT Act means that the proceeds from sale of REIT assets reinvested within one year from date of sale shall be exempt from income tax and shall, therefore, be excluded in the determination of distributable income. The computation of distributable income shall thus be made as follows:

	(In ₱ million)	
Gross Sales, including unrealized gains		510
Less: Cost of Sales		(100)
Gain from Sale		410
Add: Rental Income		800
Gross Income		1,210
Less: Deductions, including unrealized/impairment losses		(200)
Net Income per book(s)		1,010
Add: Unrealized Losses and Expenses	20	
Impairment Losses	30	50
Less: Unrealized Gains		(10)
Proceeds from sale of REIT assets reinvested		(500)
Distributable Income		550
Less: Dividends distributed during the year		(495)
Net Income per Return		55

This provision, excluding the proceeds from sale of REIT assets reinvested within one year from date of sale, is somewhat similar to the provision in the Tax Code relating to exemption from capital gains tax of the sales proceeds arising from the sale or disposition of principal residence

83. See Real Estate Investment Trust Act of 2009, §§ 17-20.

by an individual, provided that (1) such seller notifies the BIR in writing about his plan to avail of the incentive under the law within 30 days from date of sale, (2) he acquires another principal residence by purchase or construction within 18 months from the date of sale, (3) he utilizes the entire sales proceeds from the sale of the principal residence in acquiring another principal residence, and (4) he deposits in escrow the equivalent amount of the tax with a bank of his choice.⁸⁴

While the law generally exempts from income tax the amount of income, gain, or profit, in this case, the law allows the deduction of proceeds from the sale of REIT assets (consisting of the capital and profit) reinvested within one year from the date of sale from the distributable income of the REIT. Where the law is clear, it needs only to be applied, despite the fact that this may result in lower tax collection for government.

Suppose that, in the illustration above, the REIT incurred net loss during the year. Is a REIT entitled to deduct net operating loss carry-over (NOLCO)⁸⁵ from its gross income for the next three years? We believe that a REIT shall be entitled to the deduction of NOLCO under the same terms and conditions as an ordinary domestic corporation. The tax incentives granted under the REIT Act are additional benefits that may be enjoyed by REITs, but they continue to enjoy the benefits provided for in the Tax Code to all taxpayers.

Third, a REIT is exempt from paying the MCIT.⁸⁶ Thus, whether or not the REIT has positive gross income and net loss during the year, a REIT is exempt from the MCIT, unlike a corporation that is not classified as REIT.⁸⁷

2. Seller of Real Property to REIT

A seller or transferor of real property to REIT is subject to income tax because the REIT Act does not expressly provide for such income tax exemption.⁸⁸ The income tax due will depend (a) on the status of the seller — whether he/she/it is a person engaged in real estate business as a real estate dealer, developer, or lessor, as well as (b) on the nature of the real property sold or transferred.⁸⁹ If the seller or transferor is a person engaged in the real estate business and thus, the real property sold or transferred is an ordinary asset, the gain or loss shall be computed under the global tax

84. See TAX REFORM ACT OF 1997, § 24 (D) (2).

85. See TAX REFORM ACT OF 1997, § 34 (D) (3).

86. Real Estate Investment Trust Act of 2009, § 10.

87. *Id.*

88. *Id.*

89. See TAX REFORM ACT OF 1997, §§ 24 (D) & 27 (D) (5).

system.⁹⁰ In other words, the net taxable income of an individual shall be subject to the graduated income tax rates ranging from five per cent to 32%, while the net taxable income of a domestic corporation shall be subject to the 30% regular corporate income tax, or the gross income shall be subject to the two per cent minimum corporate income tax, whichever is higher.⁹¹

The income from the sale or transfer of real property may, however, be reported under the cash method or the installment or accrual method.⁹² On the one hand, the cash method is used when the entire consideration for the sale or transfer of real property is paid to the seller at the time of sale.⁹³ On the other hand, the installment method may be used when the consideration for the sale or transfer is paid on installments covering more than one taxable year.⁹⁴ There are two types of installment method under the Tax Code.⁹⁵ Where the initial payments, consisting of the down payment and the monthly installment payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made, do not exceed 25% of the selling price, the gross income, which is computed by multiplying the amount received by the gross profit rate, shall be reported in the income tax return for the period.⁹⁶ However, if the initial payments exceed 25% of the selling price, the entire gain or loss from the sale or transfer of the real property shall be reported in the income tax return for the period as if the full consideration was received by the seller or transferor in the period of sale, and the subsequent receipt of the deferred payments in the succeeding years has no income tax consequence.⁹⁷

3. Dividends and Sale of REIT Shares of Stocks by Investor

a. Dividends Paid by REITs

Section 14 of the REIT Act provides the rules governing the dividends to be paid by REITs, as follows:

Cash or property dividends paid by a REIT shall be subject to a final tax of 10%, unless: (a) the dividends are received by a nonresident alien individual

90. See TAX REFORM ACT OF 1997, §§ 24 (A) (2) & 27 (A).

91. *Id.*

92. Commissioner of Internal Revenue v. Isabela Cultural Corporation, 515 SCRA 557, 564 (2007) (citing 2 MERTENS LAW OF FEDERAL INCOME TAXATION 12A-77 (1996)).

93. *Id.*

94. Bañas v. Court of Appeals, 325 SCRA 259, 277 (2000).

95. TAX REFORM ACT OF 1997, § 49 (B).

96. *Id.*

97. *Id.*

or a nonresident foreign corporation entitled to claim a preferential withholding tax rate of less than 10% pursuant to an applicable tax treaty; or (b) the dividends are received by a domestic corporation or resident foreign corporation, or an overseas Filipino investor in which case, they are exempt from income tax or any withholding tax: *Provided*, That in the case of overseas Filipino investors, they are exempt from the dividends tax for seven years from the effectivity of the tax regulations implementing this Act.⁹⁸

An Overseas Filipino Investor (OFI) is an individual who is a citizen of the Philippines working abroad, including one who has retained or reacquired his Philippine citizenship under Republic Act No. 9225.⁹⁹ The Senate even expanded the definition of an OFI to include any Filipino who can prove that he had been an overseas worker in any capacity.¹⁰⁰

Since Filipino citizens and resident aliens are already subject to the preferential rate of 10% on dividend income received from a domestic corporation,¹⁰¹ we can definitely say that this provision of law contemplates attracting (a) overseas Filipino citizens who are exempt from the dividend tax for seven years from the effectivity of the regulations to implement the law, and (b) persons who are generally subject to final income tax at a rate higher than 10%. These persons include (a) non-resident aliens engaged in trade or business who are subject to 20% final income tax on gross dividends,¹⁰² (b) non-resident aliens not engaged in trade or business in the Philippines who are taxed at 25% on such dividend income,¹⁰³ and (c) non-resident foreign corporations that are subject to dividend tax at a rate not lower than 15%.¹⁰⁴ Domestic corporations and resident foreign corporations are exempt from the dividend tax on dividends received from another domestic corporation under existing provisions of the Tax Code.¹⁰⁵

For purposes of this exemption, is it enough that the status of the investor as non-resident citizen be present at the time of making his investment and for seven years thereafter? There are many possible situations

98. Real Estate Investment Trust Act of 2009, § 14.

99. *Id.* § 3 (w). *See generally* An Act Making the Citizenship of Philippine Citizens Who Acquire Foreign Citizenship Permanent, Amending for the Purpose Commonwealth Act No. 63, as Amended, and for Other Purposes [Citizenship Retention and Re-Acquisition Act of 2003], Republic Act No. 9225 (2003).

100. SENATE JOURNAL 1687, 14th Cong., 2d Reg. Sess., Senate Sess. No. 56 (Feb. 24, 2009).

101. TAX REFORM ACT OF 1997, § 24 (B) (2).

102. *Id.* § 25 (A) (2).

103. *Id.* § 25 (B).

104. *Id.* § 28 (B) (5) (b).

105. *Id.* § 27 (D) (4).

or scenarios that have tax consequences and it is advisable that written definite guidelines therefore be issued by tax authorities.

b. Sale of REIT shares of stock

Any sale, barter, exchange or other disposition of listed investor securities through the Exchange, including block sales or cross sales with prior approval from the Exchange, shall be subject to the stock transaction tax imposed under Section 127 (A) of the Tax Code.¹⁰⁶ Under said law, the one-half of one per cent stock transaction tax shall be computed on the gross selling price or gross value in money of the shares sold, bartered, exchanged or otherwise disposed,¹⁰⁷ and it shall be the duty of the stockbroker who effected the sale to collect the tax and remit the same to the BIR within five working days from the date of collection thereof.¹⁰⁸ However, the gain from the sale of the listed REIT shares of stocks in the local stock exchange is exempt from income tax under the existing law.

If the sale of the listed REIT shares of stock are made over-the-counter (or outside of the local stock exchange), or the REIT shares of stock are sold by the shareholder to the REIT and they become treasury shares, the net capital gain of the seller from such sale shall be subject to the capital gains tax as follows: five per cent on the first ₱100,000.00 net capital gain; and 10%, on any amount of net capital gain in excess of ₱100,000.00.¹⁰⁹ The capital gains tax return shall be filed and the tax shall be paid with the appropriate revenue office within 30 days from the date of sale of the REIT shares of stock.¹¹⁰ Take note, however, that the law requires the seller to file a consolidated capital gains tax return for all transactions involving the REIT shares covered by this paragraph, whereby capital losses may be deducted from capital gains in order to arrive at net capital gain or loss for the year, on or before 15 April of the following year.¹¹¹

B. Creditable Withholding Income Tax

Income payments to a REIT shall be subject to a lower creditable withholding tax of one per cent.¹¹²

106. *Id.* § 127 (A).

107. TAX REFORM ACT OF 1997, § 127 (A).

108. *Id.* § 127 (C).

109. *Id.* § 24 (C).

110. *Id.* § 51 (C).

111. *Id.*

112. Real Estate Investment Trust Act of 2009, § 11.

The present regulations provide for different expanded withholding tax (EWT) rates on different income payments made by or to persons engaged in real estate business. These rates are as follows:

Income Payment	EWT Rate	Basis of EWT
Rental Income	5%	Gross rental income
Management Fees		
If gross amount does not exceed ₱720,000.00	10%	Gross management fees
If gross amount exceeds ₱720,000.00	15%	Gross management fees
Gain from sale of real property:		
If seller is person engaged in real estate		
₱ 500,000.00 or less	1.5%	Gross selling price
Between ₱500,000.00 to ₱2,000,000.00	3%	Gross selling price
Over ₱2,000,000.00	5%	Gross selling price
If seller is not habitually engaged in real estate	6%	Gross selling price
Fees paid to independent contractors	2%	Gross receipts
Commissions paid to real estate brokers	10%	Gross commissions

The withholding tax rate on income payments to REIT, such as rent, management fee, and gain from sale of real property, has been reduced to one per cent under the REIT Act.¹¹³ This move of Congress will certainly improve the cash position and liquidity of REITs, especially in the light of the high rates of creditable withholding taxes being imposed on sales of real property and on rental income.

It should be noted that the said law did not specify the taxable base of the creditable withholding tax. We believe that the absence of such provision in the law means the taxable base remains the same.

Recently, in *Chamber of Real Estate Builders' Associations, Inc. v. Romulo*,¹¹⁴ the Supreme Court ruled that the creditable withholding taxes (CWT) are in the nature of "advance tax payments by a taxpayer in order to extinguish its possible tax obligation."¹¹⁵ They are installments on the annual tax which may be due at the end of the taxable year.¹¹⁶ The CWT does not impose new taxes nor does it increase taxes; it relates entirely to the method

113. *Id.*

114. *Chamber of Real Estate Builders' Associations, Inc. v. Romulo*, 614 SCRA 205 (2010).

115. *Id.* at 634.

116. *Id.* at 640 (citing *Chavez v. Ongpin*, 186 SCRA 331, 337 (1990)).

and time of payment.¹¹⁷ Also, the use of the gross selling price (GSP)/fair market value (FMV) as basis to determine the withholding taxes is evidently for purposes of practicality and convenience.¹¹⁸ Obviously, the withholding agent/buyer who is obligated to withhold the tax neither knows nor is he privy to how much the taxpayer/seller will have as net income at the end of the taxable year. Instead, said withholding agent's knowledge and privity are limited only to the particular transaction in which he is a party. In such a case, his basis can only be the GSP or FMV as these are the only factors reasonably known or knowable by him in connection with the performance of his duties as a withholding agent.¹¹⁹

C. Transfer of Real Property

i. Documentary Stamp Tax

The sale or transfer of real property to REITs, including the sale or transfer of any and all security interest thereto, shall be subject to 50% of the applicable documentary stamp tax imposed under Title VII of the Tax Code.¹²⁰

Under Section 196 of the Tax Code, on all conveyances, deeds, instruments, or writings, whereby any land or other realty sold shall be granted, assigned, transferred or otherwise conveyed to the purchaser, a documentary stamp tax is imposed based on the consideration contracted to be paid for such realty, or on its fair market value determined in accordance with Section 6 (E) of the Tax Code, whichever is higher:

- (a) When the consideration, or value received or contracted to be paid for such realty, after making proper allowance of any encumbrance, does not exceed ₱1,000.00, ₱15.00;
- (b) For each additional ₱1,000.00, or fractional part thereof in excess of ₱1,000.00 of such consideration or value, ₱15.00.¹²¹

While Section 173 of the Tax Code provides that the documentary stamp tax shall be levied and paid for by the person making, signing, issuing, accepting, or transferring the taxable document, and provides further that whenever one party to the taxable document enjoys exemption from the tax, the other party thereto who is not exempt shall be the one directly liable for the tax,¹²² the 50% discount from the payment of documentary stamp tax

117. *Id.*

118. *Id.* at 635.

119. *Id.* at 635-36.

120. Real Estate Investment Trust Act of 2009, § 12.

121. TAX REFORM ACT OF 1997, § 196.

122. *Id.* § 173.

granted under the REIT Act should be available not only to the buyer-REIT but also to the seller thereof, pursuant to the express provisions of the REIT Act.¹²³

2. Registration and Annotation Fees

All applicable registration and annotation fees related or incidental to the transfer of assets or the security interest thereto, shall consist of 50% of the applicable registration and annotation fees.¹²⁴

The incentives granted can be availed of by an unlisted REIT, provided it is listed with an Exchange not later than two years from the date the incentives were initially availed of.¹²⁵

The 50% of the applicable DST shall nevertheless be due and demandable, together with other applicable charges thereon from the date such taxes should have been paid, upon the happening of any of the following events, subject to the curing period as may be prescribed:

- (i) Failure to list with an Exchange within the period prescribed in this section;
- (ii) Failure to maintain its status as a public company as defined in Section 8.1 of this Act;
- (iii) Failure to maintain the listed status of the investor securities on the Exchange and the registration of the investor securities by the Commission; and/or
- (iv) Failure to distribute at least 90% of its distributable income required under Section 7 of this Act.¹²⁶

It must be noted that while REITs may be extended exemption from registration and annotation fees, it shall be subject to real property taxes like any ordinary real estate owner under the Local Government Code.¹²⁷

V. ISSUANCE AND TRANSFER OF INVESTOR SECURITIES

For the issuance and transfer of investor securities, the following rules shall apply:

- (i) The original issuance of investor securities shall be subject to DST under Title VII of the Tax Code of 1997, as amended;

123. *See* Real Estate Investment Trust Act of 2009, § 12.

124. *Id.*

125. *Id.*

126. *Id.*

127. *See generally* An Act Providing for a Local Government Code of 1991 [LOCAL GOVERNMENT CODE OF 1991], Republic Act No. 7610, bk. II (1991).

- (ii) Any sale, barter, exchange or other disposition of listed investor securities through the Exchange, including block sales or cross sales with prior approval from the Exchange, shall be subject to the stock transaction tax imposed under Section 127 (a) of the Tax Code of 1997, as amended;
- (iii) Any sale, barter or exchange or other disposition of listed investor securities through the Exchange, including block sales or cross sales with prior approval from the Exchange, shall be exempt from the DST prescribed under Title VII of the Tax Code of 1997, as amended;
- (iv) Any initial public offering and secondary offering of investor securities shall be exempt from the tax imposed under Section 127 (b) of the Tax Code of 1997, as amended.¹²⁸

The original issuance of the REIT shares of stocks shall be subject to documentary stamp tax provided for in Section 174 of the Tax Code. Under said section, the stamp tax on every original issue of stocks of stock by any corporation shall be ₱1.50 on each Two hundred pesos, or fractional part thereof, of the par value of such shares of stock.¹²⁹ However, under the REIT Act, subsequent sale or transfer of REIT shares shall be exempt from documentary stamp tax.¹³⁰

The sale or other disposition of REIT shares of stocks by a person who is not a dealer in securities through a local stock exchange shall be subject to the stock transaction tax computed at one-half of one per cent of the gross selling price, and such transaction is exempt from income tax.¹³¹ However, if the seller of the REIT shares is a dealer in securities,¹³² the gain, if any, shall be treated as ordinary income subject to the regular corporate income tax or minimum corporate income tax, as the case may be, and shall also be subject to value-added tax.

The REIT's initial public offering (IPO), i.e., when it offers its shares to the public through the local stock exchange, shall be exempt from the IPO tax imposed under Section 127 (B) of the Tax Code.¹³³ The IPO tax is seen as a big deterrent to private corporations to raise funds from the public through offering their shares through the local stock exchange. The seller of

128. *Id.*

129. TAX REFORM ACT OF 1997, § 174.

130. Real Estate Investment Trust Act of 2009, § 13.

131. TAX REFORM ACT OF 1997, § 127 (A).

132. *Id.* § 22 (U).

133. Real Estate Investment Trust Act of 2009, § 13 (iv).

REIT shares in a secondary offering shall also be exempt from said IPO tax.¹³⁴

VI. VALUE-ADDED TAX

A REIT shall be subject to value-added tax (VAT) under Title IV of the Tax Code on gross sales from any disposal of real property, and on gross receipts from the rental of such real property.¹³⁵ A REIT shall not be considered “a dealer in securities and shall not be subject to VAT on its sale, exchange or transfer of securities forming part of its real estate-related assets.”¹³⁶

Based on the above provisions of law, there are three general categories of REIT transactions, two of which are subject to VAT, while the third transaction is exempt from it.

- (1) The sale of real property by a REIT is subject to value added tax based on gross selling price, provided that the transaction does not fall under any of the exempt transactions under Section 109 (P) of the Tax Code. Said section provides that the sale of real properties not primarily held for sale to customers or held for lease in the ordinary course of trade or business, or real property utilized for low-cost and socialized housing as defined by Republic Act No. 7279, otherwise known as the Urban Development and Housing Act of 1992,¹³⁷ and other related laws, residential lot valued at ₱1,500,000.00 and below, house and lot, and other residential dwellings valued at ₱2,500,000.00 and below, shall be exempt from VAT.¹³⁸

The REIT Act intends the original transfer of real estate to REITs to be exempt from VAT. Subsequent sale of that real property by the REIT is subject to VAT.¹³⁹

134. SENATE JOURNAL 1686, 14th Cong., 2d Reg. Sess., Senate Sess. No. 56 (Feb. 24, 2009).

135. Real Estate Investment Trust Act of 2009, § 15.

136. *Id.*

137. *See generally* An Act to Provide for a Comprehensive and Continuing Urban Development and Housing Program, Establish the Mechanism for its Implementation, and for Other Purposes [Urban Development and Housing Act of 1992], Republic Act No. 7279 (1992)

138. TAX REFORM ACT OF 1997, § 109 (P).

139. SENATE JOURNAL 1686, 14th Cong., 2d Reg. Sess., Senate Sess. No. 56 (Feb. 24, 2009).

- (2) The receipt of rental income arising from lease of real property by a REIT, management fees and other fees for rendition of services is subject to value added tax based on gross receipts, provided that such lease contract is not covered by Section 109 (Q) of the Tax Code. Said section provides that the lease of a residential unit with a monthly rental not exceeding ₱10,000.00 shall be exempt from VAT.¹⁴⁰
- (3) The REITs are required to invest at least 75% of its property on income-generating real estate.¹⁴¹ The remaining 25% of its property may be invested by REITs in real estate-related assets, such as shares of stocks of regular real estate companies. Here the REIT invests on share of stock rather than investing on real estate itself. Since there is a prohibition on REITs acting as broker, it cannot engage in the act of buying and selling its assets. The fund manager of the REITs is the one responsible for managing and investing its assets, and buying and selling on its behalf.¹⁴²

The REIT Act also makes the original transfer of real estate-related shares of stocks to REITs exempt from VAT. However, the subsequent sale thereof is subject to VAT.¹⁴³ It appears that this clarification is not consistent with existing VAT law. The sale or transfer of securities forming part of its real estate-related assets should be exempt from VAT because the REIT Act expressly treats a REIT as a non-dealer in securities. Hence, regardless of the amount and the number of its sales transactions involving such securities, such transactions are exempt from VAT and must be covered by non-VAT receipts.¹⁴⁴

VII. IMPLEMENTING RULES AND REGULATIONS

Section 22 of the REIT Act provides that:

Within 90 days from the effectivity of this Act, the Commission, in coordination with the *Bangko Sentral ng Pilipinas* (BSP) and the Department of Finance (DOF) and in consultation with other stakeholders such as the Philippine Stock Exchange and the real estate industry, shall promulgate the implementing rules and regulations of the provisions of this Act: *Provided*, That the Commission, the BSP and the DOF may continue to issue

140. TAX REFORM ACT OF 1997, § 109 (Q).

141. Real Estate Investment Trust Act of 2009, § 8.5.

142. *Id.* § 3 (f).

143. *Id.*

144. *Id.* § 15.

separate regulations that will apply exclusively to the institutions under their respective jurisdiction, consistent with the implementing rules and regulations: *Provided, further*, That the Commissioner of the Bureau of Internal Revenue shall issue the IRR regarding all tax provisions of this Act (Tax Regulations), subject to the review of the Secretary of Finance, in accordance with Section 4 of the Tax Code, as amended, after full and complete consultation with all sectors concerned.¹⁴⁵

There are four agencies that would supervise REITs, namely:

- (1) SEC. — The SEC shall be responsible for the general supervision of and compliance by the REITs with all the requirements under the REIT Act, such as the mandatory distribution by way of dividends of at least 90% of the REIT's annual distributable income to its stockholders. The SEC has already released its approved IRR on 13 May 2010;¹⁴⁶
- (2) BSP. — The BSP has supervision over the operations of banks and exercises such regulatory powers as provided in the New Central Bank Act and other pertinent laws over the operations of banks, finance companies and non-bank financial institutions performing quasi-banking functions. Given that a fund manager could either be a bank or trust company under the supervision of the BSP, its involvement in the formulation of the IRR is required;¹⁴⁷
- (3) DOF/BIR. — The involvement of the DOF/BIR in drafting the IRR is also required because of the tax incentives extended to REITs subject to compliance with certain requirements under the REIT Act. The SEC's approved IRR already includes inputs from the BIR on the tax aspects of the REIT Act;¹⁴⁸ and
- (4) Philippine Stock Exchange (PSE). — The PSE would also be involved in the formulation of its own rules due to the mandatory requirement by the REIT Act that REITs be listed in the stock exchange. The PSE released its proposed listing rules for REITs on 18 May 2010.¹⁴⁹

145. *Id.* § 22.

146. Implementing Rules and Regulations of the Real Estate Investment Trust Act of 2009 (2010).

147. Real Estate Investment Trust Act of 2009, § 22.

148. *Id.*

149. Philippine Stock Exchange, Inc., Proposed Listing Rules for Real Estate Investment Trusts (REITS), Memorandum No. 2010-0236 (May 18, 2010).

VIII. CONCLUSION

On the one hand, traditionally conservative on its views, tax administration believes that the REIT Act will be a bane to revenue collection as it will impact adversely on the tax collection efforts of the government. Indeed, the DOF recommended presidential veto of the bill.

On the other hand, the private sector headed by the PSE and the Chamber of Real Estate Builders Association strongly believes that the passage of the law is a boon to the economy and can even help contribute to the government coffers. The REIT Act promotes transparency for tax reporting purposes and new business opportunities that will be created should translate to a broader tax base for government. A study conducted by the University of Asia and the Pacific concluded that the government will not only recover every peso of tax incentive but may also gain between ₱0.15 to ₱0.35 more over a 15-year period.¹⁵⁰

At any rate, the REIT Act lapsed into law on 17 December 2009 after Pres. Gloria Macapagal-Arroyo did not veto it within 30 days from receipt of the enrolled bill by the Office of the President from Congress.¹⁵¹

In view of certain tax incentives granted under the law (a) to the REIT itself, particularly allowing proceeds from sale of REIT assets reinvested within one year from date of sale and dividends distributed during the year as allowable deductions from gross income, and (b) to certain non-resident investors, including non-resident citizens who are exempt from income tax for seven years on dividends received from REITs, the REIT Act may be seen as a boon to the real estate industry and will definitely contribute to the long-term growth and development of the capital market. However, the basic policy stated in the law to democratize wealth by broadening the participation of Filipinos in the ownership of real estate in the Philippines appears to be attainable only to a limited extent. The reason for this opinion is that resident citizens, who are supposed to be the big target market of this new law, are already enjoying the 10% final tax on dividend income received from domestic corporations under the Tax Code. There is no additional incentive for them under the REIT Act with respect to receipt of taxable dividends. Thus, what is being encouraged here is merely the portfolio investment in REITs from non-resident persons who are subject to income tax at rates higher than 10% of gross dividends. What remains as a strong incentive to invest in REIT shares for resident citizens is the mandatory requirement to declare 90% of the distributable income of REITs during the year.

150. 2d Annual REIT Asia Pacific Philippine Summit 2010, *available at* <http://reits2010.tpgi.org/> (last accessed Aug. 31, 2010).

151. REIT bill lapses into law, *available at* <http://www.abs-cbnnews.com/business/12/21/09/reit-bill-lapses-law> (last accessed Aug. 31, 2010).