



# Tax and Legal News



February 2022

## REITs - the reduced corporate income tax rate

### Change in corporate tax rate

On 24 February 2021 the Minister of Finance announced that the corporate income tax rate will be lowered to 27% from 28% for companies with years of assessment commencing on or after 1 April 2022. The reduction in rate is however still to be enacted and a change in the planned commencement date may be announced in the 2022 National Budget. The reduction in corporate income tax rate will be done alongside a broadening of the corporate income tax base by limiting interest deductions and assessed losses. The Finance Minister announced that the reason for reducing the rate is to make South Africa's tax system more attractive. Initially one would expect this to be a substantial benefit to all companies and their investors. However, investors in companies such as real estate investment trusts (REITs) may not be in the same after tax position, with regard to the dividends received, as investors in non-REIT companies.

We address the impact of the above changes and how this may impact the individual investor in a REIT.

REITs are investment vehicles which enable investors to receive rental income in a safe, easy and affordable way. REITs are subject to section 25BB of the Income Tax Act (the Act) which, on meeting all specified criteria, provides a REIT an income tax deduction in respect of qualifying distributions declared and paid to investors. The intention with regard to the introduction of the REIT tax legislation, stated in the explanatory memorandum to the Taxation Laws Amendment Act of 2012, was to enable a qualifying REIT to effectively operate as a conduit through which net property income flows to the ultimate investor. In this way the investor is taxed and not the REIT.

Due to tax neutrality there is an argument that the change in the corporate income tax rate may negatively impact certain investors, for example individual investors, in a REIT. Individuals are taxed on a sliding scale in accordance with the level of taxable income earned. Unlike dividends received from non-REIT companies individuals do not receive an exemption on the dividends received from a REIT<sup>[1]</sup>. As such, the full dividend received from a REIT is included in the taxable income of an individual and is taxed at the individual's marginal tax rate. In comparison, dividends received from other (non-REIT) companies by individual investors are exempt from income tax as they have already been taxed at the corporate income tax rate and the dividend will be subject to a 20% dividends tax (which is in fact a tax on the investor).

This creates an issue that individual investors in REITs are not able to receive the benefit of the reduction in

the corporate income tax rate due to the type of company they are invested in. This can be illustrated as follows:

	REIT	Non-REIT (28%)	Non-REIT (27%)
Taxable income before distribution	R100,000	R100,000	R100,000
Less qualifying distribution (assume all taxable income can be distributed)	(R100,000)	R0	R0
Taxable income	R0	R100,000	R100,000
Tax payable by entity	R0	R28,000	R27,000
Dividend tax withheld at 20%	R0	R14,400	R14,600
Distribution to investors <sup>[2]</sup>	R100,000	R57,600	R58,400
Tax on investors taxable income <sup>[3]</sup>	R45,000	R0	R0
Net return for the individual investors	R55,000	R57,600	R58,400

The above illustrative example indicates the impact the reduction in the corporate income tax rate may have on an individual investor in a REIT compared to an individual investor in a non-REIT company. Individual investors in non-REIT companies may receive a higher dividend (after the promulgation) due to the reduction in the corporate income tax rate while individual investors in REITs do not receive this benefit.

### Interest limitation

As noted above the intention of the introduction of the lower rate will be implemented in a revenue neutral manner. In other words, the rate may be lower, but more taxes will be collected in other areas, for instance the limitation of interest deductions.

The amendments to the current interest limitation rules were included in the Taxation Laws Amendment Act No. 20 of 2021 (2021 TLAA). The amendments will, however, only come into operation on the date on which the corporate income tax rate is first reduced the after announcement by the Minister of Finance in the annual National Budget and will apply for years of assessment beginning on or after that date. The amendments will impose further limits on tax deductible interest incurred by taxpayers. Interest deductions that currently are not subject to the interest limitation rule may be subject to them now. REITs, specifically multinational REITs, may equally also be impacted by these proposed changes. If the interest deduction of a REIT is limited, they may need to distribute more cash to remain tax neutral. This may however not be possible resulting in potential adverse tax implications for REITs.

### Utilisation of assessed losses

The budget speech and 2021 TLAA proposed that a limitation will apply, such that a company seeking to set off a balance of assessed loss brought forward from a preceding year against current year taxable income, will only be able to set off the amount of the assessed loss as does not exceed the higher of R1 million and 80% of the amount of taxable income for the year. Taxpayers will therefore be liable to income tax on a minimum of 20% of the company's current years taxable income where that income is in excess of R1 million. The effective date of the amendment mirrors that of the interest limitation amendments. As stated earlier REITs generally distribute all their taxable income in any year of assessment and do not necessarily generate an assessed loss. REITs should therefore not be significantly impacted by the changes to the assessed loss rules. Although it can be argued that certain REIT investors may not benefit from the reduction in the corporate income tax rate, they may on the other hand not be impacted by the changes in the assessed loss rules.

If you require any assistance or advice in this regard please contact us.

[Contact us](#)



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Regards  
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#### Notes

- <sup>1</sup> Section 10(1)(k)(i)(aa) of the Act
- <sup>2</sup> Assuming all are individual investors
- <sup>3</sup> Assuming a marginal tax rate of 45%

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<sup>[3]</sup> Assuming a marginal tax rate of 45%