

## Introduction of the Tax Efficient Nigerian REIT.

A Real Estate Investment Trust (REIT) can be broadly defined as an investment vehicle created for the purpose of buying, developing, managing and selling real estate assets and related interests.

In jurisdictions outside Nigeria where the REIT has taken hold, the REIT is run as a tax efficient vehicle that has helped to promote healthy economic growth through individual investment in real estate. Generally, investors in these jurisdictions view the REIT as a preferred investment vehicle as a result of some of the perceived advantages of the REIT which include the existence of a high dividend payout and the enjoyment of the expertise of professional managers of the REIT. Furthermore, the REIT creates an opportunity for investors (who would otherwise not have had the chance) to directly invest in real estate property without having to own the property.

The above in mind, one can say that the Nigerian REIT is long overdue.

### **Brief Historical Background**

In the United States of America, the first 'formal' REIT came into being in 1960 by an Act of Congress. The idea was to create an avenue for individual investors to directly partake in the ownership and financing of real estate projects. The REITs was run as a pool of real estate or real estate related assets with the investor having a tradable interest in the same.

Under this US model (which is presently being followed by a number of other jurisdictions)<sup>1</sup>, a number of tax advantages<sup>2</sup> presently apply to the REIT. These advantages are precedent upon certain conditions which include the following:

The REIT must:

- Have a minimum of 100 shareholders
- Have fully transferable shares

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<sup>1</sup> Japan, Hong Kong, and Singapore, Canada and soon to be implemented in the UK

<sup>2</sup> i.e. being treated as a pass-through entity



- distribute at least 90% of its income to its investors,
- derive the majority of its income from long-term holding in real estates,
- have at least 75% of its investments as real estate assets and
- have broad subscription base (to this end, no 5 individuals combined are allowed to own 50% of the REIT).

Some variations to the above described model have been introduced in some other REIT jurisdictions. In June 2005 for example, the Hong Kong REIT was amended to allow the REIT to invest in overseas real estate and to increase its maximum borrowing ratio from 35% to 45% of the total gross asset value. Also, the requirement that the management company must 100% of the real estate was relaxed to be a majority control requirement. These variations basically go to show how the REIT is being made to suit the individual peculiarities and developments of the different REIT jurisdictions.

### **The Nigerian REIT**

The question may then be asked, why is the Nigerian REIT yet to take off?

The statutory provisions that relate to the setting up of a REIT in Nigeria are at best described as inadequate. The Investment and Securities Act and the pursuant SEC Rules barely scratch the surface in providing detailed regulation for the REIT<sup>3</sup>

As a result of this inadequacy, there is yet to exist a Nigerian REIT in the true, internationally accepted, sense.

The inadequacy in regulation and statutory provisions in relation to the Nigerian REIT is especially glaring from a tax perspective. A look at the REIT in other jurisdictions show the REIT is treated as a tax efficient investment vehicle set up for the purpose of investing in real estate. To this end, the REITs in these other jurisdictions are allowed certain tax incentives to maintain their REIT status. Unfortunately, this is not the case in Nigeria as at the present time, the REIT is not treated differently from any other business entity tax wise.

### **Tax Considerations**

In considering tax incentives which the Nigerian REIT may adopt to attract investment, a leaf should be borrowed from other jurisdictions that have had the chance to implement these incentives successfully. A few examples of these incentives are described below:

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<sup>3</sup> The regulation states as follows; “The provisions relating to the regulation of Investment Trust shall for the time being apply. These provisions referred to are basically those that apply to unit trust schemes in Nigeria.

#### Rent and Rent Generating Assets:

Under the Nigerian REIT, rent and rent-generating assets should qualify for tax exemption. To qualify for this tax exemption these assets should consist of at least 70% of the Income asset of the REIT.

#### Capital Gains Tax

In Nigeria, profits from unit trust schemes are not subject to capital gains tax as long as such profits are reinvested.<sup>4</sup> It can be inferred that this provision would still apply to the REIT for the time being as the regulations applying to investment trusts generally apply to the REIT. It is suggested that the Nigerian REIT should take a step further in this regard and give an extended period (e.g. 18- 24 months) for cash reinvestment from property sales before the amount in question becomes liable capital gains tax. This would in effect grant the REIT additional time to reinvest the cash without having to distribute profits immediately which in essence provides more time for capital appreciation and thus prevent the depletion of the REIT fund.

#### Governor's Consent and Stamp Duties

Under the Land Use Act<sup>5</sup> the Governor's consent is crucial and must be obtained for a fee before a valid legal transfer of real property is effected. This must occur before completion of transfer of the property. Furthermore, a deed of assignment must be stamped ad valorem within thirty days of its first execution of the deed. This of course is at an additional cost to the transferee REIT and increases compliance costs which would ultimately be passed on to the individual investors. It is therefore suggested that the stamp duty be fixed at a reasonable flat rate to serve as a tax incentive to the Nigerian REIT.

#### **Moving Forward**

The Nigerian REIT as it stands now is not a tax efficient investment vehicle. This is due to a number of reasons one of them being the fact that Nigeria's tax regime (as opposed to other jurisdictions) discussed above imposes a relatively heavy tax burden on the real estate investment vehicle. This burden includes property tax, stamp duties, consent fees in addition to the tax liability of the individual investors' income (and in some cases, capital gains tax). Furthermore, statutory provisions defining and regulating REITs still remain quite elementary and need a general overhaul to keep up with the pace of global REITs.

The present writer is aware of on-going reforms occurring in relation to the provision of tighter and more detailed regulations. One can only hope that the outcome of these reforms would be worth the long wait.

Worthy of note at this point however that although it is wise for the Nigerian REIT to learn from the models of other jurisdictions, it is also very important to consider Nigeria's peculiar economic capabilities. For example, to follow the US and UK example of distributing at least 90% of the company's profits to investors may prove fatal to any

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<sup>4</sup> S. Capital gains Tax Act

<sup>5</sup> S.22 of the Land Use Act

company operating at this time in the country as it leaves very little room for reinvestment which is crucial to build up the REIT.

In conclusion, the present writer believes that Nigerian REIT, when up and running would prove an excellent investment vehicle that would be advantageous to both the private investor and the real estate sector of the Nigerian economy at large.

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