

FIRS issues clarifications on the operations of Real Estate Investment Companies (REICs) in Nigeria

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Background

The Federal Inland Revenue Service (FIRS) recently issued a circular (FIRS Circular 2021/17) to clarify the changes introduced by the Finance Act (FA) 2020 with respect to the taxation of Real Estate Investment Companies (REICs) in Nigeria. This circular updates an earlier circular issued in April 2020 on the same subject, based on the FA 2019. Please refer to our tax alert on the previous circular [here](#) and our FA 2020 [insight series](#) for our analysis of relevant issues in this regard.

Highlights

Dividend and rental income earned by a REIC from companies income tax (CIT), provided that a minimum of 75% of the dividend or rent is distributed within 12 months of the end of the financial year in which the income was earned. We have highlighted the updates in the 2020 circular below:

1. Recap - definitions

- **REIC:** a company duly approved by the Securities and Exchange Commission (SEC) to operate a Real Estate Investment Scheme (REIS) in Nigeria;
- **REIS:** this includes a company, trust or other such corporate structures approved and regulated by the SEC, which is primarily engaged in and invests in income generating real estate assets or real estate related assets and is expected to distribute not less than 75% of its income within 12 months of receipt of the income; and
- **Real Estate:** means income generating property consisting of land or building including a special purpose vehicle (SPV) holding such income generating lands and buildings.

2. Excess Dividends Tax (EDT)

The FIRS circular practically illustrates how EDT is computed in respect of the distribution of dividend and rental income by a REIC. Where a REIC meets the CIT exemption conditions and subsequently distributes dividends to its shareholders, such dividends would be excluded from the total dividends for the purpose of determining EDT.

3. Undistributed Income

The FA 2019 introduced the exemption of dividend and rental income earned by a REIC from companies income tax (CIT), provided that a minimum of 75% of the dividend or rent is distributed within 12 months of the end of the financial year in which the income was earned.



However, the FA 2019 further provided that any undistributed dividend and rental income after 12 months would be subject to CIT in the hands of the REIC, even if it met the minimum distribution requirement. The FA 2020 has now clarified that the full dividend and rental income of a REIC will be exempt from CIT if at least 75% of the income is distributed within 12 months after the year-end in which the income was earned.

4. Tax deductibility of expenses

Although CITA specifically provides for the tax deductibility of dividends or mandatory distributions made by a REIC, the FIRS highlights that such distributions should not be tax deductible, unless the dividend and rental income earned by the REIC are not tax exempt. This is in line with the general tax deduction principles which are also included in CITA.

5. Fees and Other Income

Any other income apart from dividend or rental income under a REIS would not qualify for CIT and WHT exemptions. Therefore, income from other sources such as gains from disposal of assets or management fees would be fully taxable.



Takeaway

One key point identified in our previous [tax alert](#) was the issue of subjecting undistributed income to CIT in the hands of the REIC. This has now been addressed by FA 2020, as a REIC's total dividend and rental income will be CIT exempt, where requisite conditions are met. As previously stated, it is expected that the CIT exemption will also extend to Tertiary Education Tax (TET), similar to other exempt income in CITA.

From an EDT perspective, the circular seemed to suggest that when a REIC meets the conditions for CIT exemption and makes distributions to its shareholders, only the dividend and rental income distributed will be excluded for the purposes of determining the base for EDT. However, it is expected that the undistributed income will also be excluded for EDT purposes, as CITA also provides for the exclusion of all tax exempt income in computing EDT.

The circular states that a REIC is expected to deduct WHT at 10% on dividends distributed to shareholders (unless such shareholder is also a REIC). However, a separate paragraph in the circular highlights that dividend or rental income distributed by a REIC to its shareholders is fully taxable in the hands of the shareholders. These statements appear conflicting, and it is expected that following the deduction of WHT by the REICs where applicable, the shareholder should not be subject to tax on such income.

Considering that the due date for CIT filing is 6 months after a company's year end, and one of the CIT exemption conditions for a REIC is for dividends to be distributed within 12 months from year end, a REIC may have to assume that the exemption conditions are met at the filing date. This may then need to be proven retrospectively to the FIRS during the event of an audit.

From a VAT perspective, the FA 2020 now clearly excludes "interest in land and building" from the definition of goods and services subject to VAT. This is widely considered to include lease/rental of real property. This is a welcome development with expected positive implications for the Real Estate sector.

In order to align with global best practices, additional considerations should be paid to the definition of real estate and real estate related assets. Non-traditional asset classes such as telecom infrastructure and data centers amongst others should be considered to enable REICs to enjoy the full benefits of the tax exemption. The scope of the exemption should be widened to cover other income generating activities such as profits on the disposal of real estate properties to stimulate the growth of the Real Estate industry in Nigeria.



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