

Real estate investment trusts in Hong Kong

Real estate investment trusts in Hong Kong First created in the United States in the early 1960s, real estate investment trusts (REITs) are investment funds that engage in income-generating real estate properties. They combine attributes of real estate and stock-based investment, making the benefits of commercial real estate investment accessible to a large quantity of investors. In an increasing number of jurisdictions, REITs offer the opportunity for meaningful dividends, portfolio diversification, liquidity, transparency and performance. In Hong Kong, they have been available for some 15 years. Currently there are ten REITs with a total market capitalisation of some USD 30.3bn (May 2017), investing in various types of real estate, including office buildings, shopping malls and hotels. Of these trusts, six detain real estate chiefly in Hong Kong, whereas the remaining four hold real estate in Mainland China. Pursuant to the 2003 Code on Real Estate investment trusts ("Code"), REITs need to be authorised by Hong Kong's Securities and Futures Commission (SFC). They must be structured in the form of a trust. REITs can hold real estate either directly – or indirectly, *i.e.*, by means of special purpose vehicles. The REIT must be listed on the Hong Kong Stock Exchange Limited (SEHK) within a time period agreed upon by the SFC. It is subject to the SEHK listing rules. The Hong Kong regulations do not contain any specific capital requirements (e.g. minimum capital or market capitalisation) nor any restrictions with regard to investors, such as in terms of nationality or minimum number. The REIT must predominantly invest in real estate, which may be located in Hong Kong or overseas. At least three quarters of the assets need to be income-generating properties. When the REIT invests in hotels, recreation parks and serviced apartments, such investments must be carried out through special purpose vehicles. What is more, the REIT may not invest in vacant land or engage in or participate in property development activities (except for refurbishment, retrofitting, renovations and certain property development activities). In principle, the REIT must hold its interest in each property for a period of at least two years, unless the investors have agreed to an earlier disposal. In cases where the REIT specifies a particular type of real estate, it must invest at least 70% of its non-cash assets in such type of real estate. According to existing SFC regulations, the dividend payout ratio of a REIT has to be at least 90%. In addition, investors should note that the amount available for distribution will also be adjusted for losses/gains from real estate revaluation or disposal.

Tax treatment at REIT level *Profits* According to the Inland Revenue Ordinance of Hong Kong, an authorised REIT is exempt from Hong Kong profits tax. By contrast, rental income from real estate a REIT holds in Hong Kong directly is subject to Hong Kong property tax. In cases where the REIT holds real estate in Hong Kong through special purpose vehicles, such vehicles are subject to profits tax of 16.5% with regards to the profits obtained from real estate (level of the fiscal year of 2016/17). At the same time, such special purpose vehicles are generally exempt from property tax. Income generated from real estate located outside Hong Kong as well as capital gains are in general not subject to property tax and profits tax. In general, dividends paid by a special purpose vehicle to another special purpose vehicle are exempt from profits tax.

Stamp duty Transfers of real estate in Hong Kong are subject to Hong Kong stamp duty at a flat rate of 15%. When shares in a Hong Kong company are transferred, the Hong Kong stamp duty at the rate of 0.2% applies to the higher of the transfer consideration or the value of the shares. Hong Kong stamp duty also applies to a lease of real state in Hong Kong. Depending on the term of the lease, it ranges from 0.25% to 1% of the average yearly rent. Moreover, unless specifically exempted, any residential property acquired by an individual or a company and resold or transferred within a specified period of time after acquisition is subject to a Special Stamp Duty (SDD). Depending on the length of that period, the SDD ranges from 10% to 20% of the stated consideration or of the market value, whichever is higher. There is no withholding tax on interest, dividends or distributions from a REIT in Hong Kong.

Tax treatment at the investor level *Income and capital gains* As regards the taxation of current income, distributions received from a REIT are not subject to any Hong Kong tax. As far as the taxation of capital gains are concerned, gains on disposal of units in a REIT are exempt from Hong Kong profits tax, provided that such gains represent capital gains. By contrast, an investor doing a business in Hong Kong that consists in the acquisition and the disposal of units in a REIT is subject to Hong Kong profits tax with regard to any gains obtained from the disposal of the units in Hong Kong.

Stamp duty Hong Kong stamp duty is due with respect to the transfer of REIT units of 0.2% of the transfer consideration payable in equal parts by the transferor and the transferee.

