



NATIONAL ASSOCIATION OF  
REAL ESTATE INVESTMENT TRUSTS®

WRITTEN TESTIMONY OF

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THE NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS, INC.

BEFORE THE MAINE LEGISLATURE'S  
JOINT STANDING COMMITTEE ON TAXATION

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HEARING ON L.D. 2074

FEBRUARY 5, 2008



Senator Perry, Representative Piotti and members of the Committee, the National Association of Real Estate Investment Trusts, Inc. (NAREIT), thanks you for this opportunity to submit written testimony in opposition to L.D. 2074, legislation that would impose an additional capital gains tax on all real estate investment trusts (REITs) contrary to federal tax rules and the existing laws of virtually every other state with an income-based tax system. NAREIT is the worldwide representative voice for U.S. REITs and U.S. publicly traded real estate companies. Members include traded and non-traded REITs and other businesses that own, operate, and finance income-producing real estate, as well as those firms and individuals who advise, study, and service those businesses.

In Maine, over twenty widely-held REITs have invested hundreds of million of dollars in commercial real estate, employ many Maine residents and invest in subsidiary entities that pay millions of dollars in Maine taxes. The Maine real estate owned by REITs generates millions of dollars in property taxes. These taxes are on top of the individual income taxes currently generated by REIT dividends paid to Maine residents, as well as the sales and other taxes generated by the tenants that conduct business on the premises owned and operated by REITs. Maine teachers, state, county, and municipal employees, legislators, and judges also benefit from REITs through the nearly \$100 million investment of the Maine State Retirement System's investment in a REIT index fund. Furthermore, several institutional money managers based in Maine manage over \$20 million of investment in REITs, including a number of REITs that own no Maine properties.

**Background: REITs Are Not “Tax Shelters,” But Were Designed to Benefit the “Small Investor.”** By way of background, Congress created REITs in 1960 to enable investors from all walks of life to own professionally managed, income-producing real estate through companies modeled after mutual funds. REITs are corporations or business trusts that combine the capital of many investors to benefit from a diversified portfolio of income-producing real estate, such as apartments, hotels, shopping centers, ski resorts, golf courses, offices, timberlands and warehouses. REITs are required to distribute at least 90% of their taxable income to their shareholders. In exchange for distributing taxable income and any net capital gains (and for satisfying a number of other requirements to ensure that REITs remain real estate-focused), federal law grants REITs (and mutual funds) a dividends paid deduction (DPD). In 2006, publicly traded REITs distributed more than \$15 billion to their shareholders.

**REITs Benefit Investors and the Economy.** Congress' vision has been realized: As of December 31, 2007, 152 publicly traded REITs had a total market capitalization of over \$312 billion. Investors, large and small, have benefited from owning REITs: the 35-year compound annual return for the period ending December 31, 2007 of the S&P 500 stock index was 10.97%, while that of equity REITs was 13.16%. The economy benefits from REITs as well – because REITs cannot pass through losses to investors (unlike partnerships), their focus must be on creating value for shareholders. Furthermore, unlike other real estate owners that use high levels of debt, average debt levels for public REITs are around 50%, leading to less volatility in the real estate market and fewer bankruptcies and workouts. Over 20 countries have some form of REIT legislation in place that allows for a single level of taxation.

**Most States Tax REIT Income Only Once at the Shareholder Level.** Nearly every state with an income-based tax system, including Maine currently, allows both the DPD for REITs and does not impose a separate capital gains tax on REITs. As a result of the DPD, most, if not all, of a REIT's income is taxed at one level – the shareholder level. Maine thus benefits by taxing Maine residents



investing in REITs that have no Maine operations. For example, since 2000, hundreds of Maine investors have invested over \$20 million in two SEC-registered but non-traded REITs that do no business in Maine. These REITs distributed more than \$8 million to Maine investors during this time period, thereby increasing Maine's potential tax revenues significantly. We oppose L.D. 2074 for the following reasons:

- L.D. 2074 would discourage investment in Maine. Imposing a new tax on REIT capital gains would make Maine virtually the only state with an income-based tax system to impose a double level state income tax on REIT capital gains. Although L.D. 2074 would allow Maine REIT shareholders some type of credit for this tax paid by REITs, non-Maine REIT shareholders resident in states with income taxes would face an additional level of income tax on their dividends from REITs with Maine properties, potentially causing them to shun such investments. Most REITs investing in Maine have the overwhelming majority of their investments in states other than Maine, and many of them could choose to sell their Maine properties or, at the least, not expand their Maine operations, because investments in other states could produce better after-tax returns.
- L.D. 2074 would enact a drastic policy change that would put Maine at odds with all other states regarding the taxation of REIT income at the shareholder level only based on the state of shareholder residence. Virtually every state with an income-based tax system, including Maine currently, allows REITs a deduction for dividends paid. Further, no other state with an income-based tax system imposes a separate capital gains tax on REITs that essentially disregards the DPD. Additionally, Maine currently taxes all REIT dividend income received by Maine resident shareholders, regardless of where the REIT's real estate is located. All other states that impose income taxes also tax the REIT income based on the location of the resident that receives the REIT dividends and not based on the location of the real estate. L.D. 2074 would shatter this comity of state taxation principles by unilaterally double taxing REITs (and their shareholders) that do business in Maine. In the past decade, a number of states such as Idaho, Louisiana, New Jersey, and North Carolina, and Rhode Island have examined, and then rejected, the disallowance of a widely held REIT's DPD.
- It wrongly assumes that REITs operate just like other real estate companies without recognizing the asset, income, compliance and 90% distribution requirements placed on REITs that other companies need not satisfy.
- As a practical matter, listed REITs could not comply with L.D. 2074. While L.D. 2074 proposes to allow Maine resident shareholders in certain REITs that pay Maine taxes some type of credit from tax for taxes paid by these REITs, most listed REITs cannot ascertain the residency of their shareholders and could not inform their shareholders easily and practically of the amount of Maine tax paid. Thus, this feature of the legislation likely would be of little help to Maine REIT shareholders.

Accordingly, NAREIT urges you not to enact L.D. 2074. Thank you again for the opportunity to submit this testimony.

