State & Local Tax Policy
Bulletin

December 10, 2001

NAREIT's State & Local Tax ("SALT") Subcommittee monitors state and local tax developments affecting the REIT and publicly traded REIT industry in order to keep our members informed and to initiate lobbying and grassroots efforts if necessary. NAREIT wishes to express its thanks to its outgoing State & Local Tax Subcommittee ("SALT") Co-Chairs, Steve Ryan of Deloitte & Touche LLP in Chicago, Illinois, and Rick O'Connor of The Mills Corporation in Rosslyn, Virginia, for their assistance in leading the SALT Subcommittee over the past several years. NAREIT welcomes and congratulates incoming co-chairs, Kathy Miller of Regency Centers Corporation in Jacksonville, Florida, and Jane Steinmetz of PricewaterhouseCoopers LLP in Boston, Massachusetts.

As in the past, one of the most pressing issues involving state taxation is the desire by many states to tax pass-through entities. When Tennessee instituted such a tax in 1999, NAREIT organized a coalition that successfully lobbied for equitable relief for REIT-owned pass-through entities. Similarly, when such a tax was proposed by Alabama in 1999, NAREIT assisted Alabama-based Colonial Properties Trust in advocating a liability cap for this tax (now $15,000, but see below). As discussed below, because so many states are experiencing budget shortfalls, proposals to impose tax on pass-through entities are becoming more commonplace in many states.

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ALABAMA - PROPOSAL TO INCREASE PRIVILEGE TAX:

Alabama's Governor Don Siegelman (D) has called a special session of the legislature that began December 4, 2001, to address his proposals to overhaul the Alabama tax system. His proposals include increasing the business privilege tax's rate and its liability cap from $15,000 to $2 million and withholding on nonresident limited liability entity members. The privilege tax applies to all business entities, including REITs and pass-through entities. NAREIT is monitoring the situation and, if appropriate, may suggest to our members that we begin a legislative initiative opposing the proposals. If your company would be interested in becoming involved in such an initiative, please contact Dara Bernstein at dbernstein@nareit.com. For more information, the Business Council of Alabama's website, http://www.bcatoday.org, contains useful information and links.

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INDIANA - PROPOSAL TO TAX PASS-THROUGH ENTITIES: Legislation is expected to be introduced in Indiana on January 7, 2002, that would impose a franchise tax, in addition to the net income tax, on all pass-through entities (including single member limited liability companies). The franchise tax would apply a rate of .3% to a taxpayer's apportioned net worth (calculated for GAAP purposes). The maximum franchise tax liability would be $100,000. As proposed, the legislation would allow a deduction for a taxpayer's investment in a lower tier entity if the taxpayer owns at least a 20% ownership interest in that entity, provided that each lower-tier entity for which this deduction is claimed pays a minimum tax of $2,500. Thus, if enacted, this tax could add up for some structures with multiple tiers of entities. NAREIT is also monitoring the status of this legislation. Again, if you are interested in more information, please contact Dara Bernstein at dbernstein@nareit.com.

CALIFORNIA - PROP 13 CASE COULD REDUCE YOUR PROPERTY TAX ASSESSMENTS: December 10, 2001, marks the first date that taxpayers may take advantage of an important case involving Proposition 13 to reduce their property tax bills. Absent a change of ownership, California's "Proposition 13" limits how much a property tax assessor can increase the value of California real estate for property tax purposes to 2% per year, thus minimizing increases during times of increasing real estate values. Following several down real estate market years in the late 1990s, the question has arisen as to the appropriate assessment in a year in which the fair market value of the property has risen but only after a decrease in value for the previous year or years. Property tax assessors have argued that they may increase the value to the original Proposition 13 assessed value plus 2% each year since such assessment (effectively ignoring the year or years in which the value decreased), while some taxpayers have argued that property tax assessors only may increase the value by 2% over the previous year's assessment. In <u>County of Orange v. Orange County Assessment Appeals Board #3</u>, posted for members only at www.nareit.com, the Court agreed with the taxpayer who argued that the assessor was limited to a 2% increase over last year's assessment. Many taxpayers have been encouraged to file refund claims to take advantage of this case (which may be overturned on appeal). Because refund claims must be filed no more than four years after the first date in which a tax payment was due, refund claims for the first payment for the 1997 fiscal year are due December 10, 2001.

CALIFORNIA - HOTEL PROPERTIES MAY BE ENTITLED TO LOWER PROPERTY TAX ASSESSMENTS POST-SEPTEMBER 11th: NAREIT understands that the State Board of Equalization has extended the deadline to December 24th for applying for "Section 170" relief following the disasters on September 11th. Typically, Section 170 relief can be granted only for physical damage to property following a disaster, rather than for a decrease in value due to other disaster-related reasons (such as a reduction in occupancy following the September 11th events). Nevertheless, we understand that the State is considering granting relief to property owners, such as hotel owners that have experienced a loss in value directly attributable to the September 11th events.

OHIO MUNICIPALITIES CONTINUE TO TARGET THE DIVIDENDS PAID DEDUCTION: NAREIT is aware of certain situations in which Ohio municipalities, which impose a net income tax on earnings and profits, have challenged a REIT's entitlement to the dividends paid deduction. Notably, in <u>City of Columbus v. New Plan Realty Trust</u>, http://204.210.241.251/docushare/dscgi/ds.py/Get/File-403/99-1350.doc, the Court of Appeals reversed the City of Columbus' determination that New Plan was not entitled to a dividends paid deduction and held that it was entitled to a DPD because that was how the taxpayer calculated "net profits" under the "accounting system used . . . for federal income tax purposes" as required by Columbus' statute. 2000 WL 122503 (Aug. 29, 2000). On the other hand, the statutes of some of the municipalities, such as that in the City of Gallipolis, contain a specific prohibition against deductions for "distribution[s] of profits to shareholders of a corporation." While such a provision appears to be intended against disguising the typically non-deductible distribution of profits to shareholders as a deductible salary payment, it is more difficult for REITs to demonstrate that a DPD is allowed in this context.

MICHIGAN - AMICUS BRIEF TO BE FILED IN PROPERTY TAX CASE: With the assistance of NAREIT's Property Tax Task Force, chaired by Norm Quinn of the Equity Property Tax Group and Martin Lutsky of The Rouse Company, and the help of Mark Parish of Taubman Centers, Inc., the Michigan Supreme Court has agreed to allow the filing of an amicus brief in the WPW Acquisition Company v. City of Troy case. That case concerned whether the Michigan legislature could limit the benefit of a cap on assessments by making changes in the underlying statute that resulted in increases in assessed values.

TEXAS - EXPECT 2003 LEGISLATIVE SESSION TO INCLUDE PROPOSED TAX ON LIMITED PARTNERSHIPS: Unlike every other state that permits a DPD, Texas did not conform to the 1999 REIT Modernization Act ("RMA"). Accordingly, corporate REITs that invest in Texas property directly may not be entitled to a DPD if they have formed taxable REIT subsidiaries and therefore do not meet the REIT asset tests in effect prior to the RMA's effective date. (Business trust REITs are exempt from the tax.) The potentially devastating impact of such nonconformity may be minimized by investing in Texas through a wholly-owned or almost wholly-owned limited partnership because such partnerships currently are not subject to tax in Texas. As in the past, Texas is considering imposing a tax on limited partnerships during its next legislative session in 2003. NAREIT will continue to monitor and keep our members advised of legislative developments in Texas.

MARK YOUR CALENDARS

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NAREIT's 2002 Law & Accounting Conference is May 8-10, 2002, at The Broadmoor Hotel and Resort in Colorado Springs, Colorado.
We are now starting to plan the program for the conference.
If you would like to suggest any topics, please e-mail Dara Bernstein, dbernstein@nareit.com, by close of business December 17, 2001.