

# ***Still More REIT Tax Issues Meeting***

*Wednesday, April 1<sup>st</sup>*

*11:15am – 12:30pm*

*JW Marriot Desert Ridge Resort & Spa  
Phoenix, AZ*

## **Moderator:**

Adam Cohen, Executive Director-Tax, W.P. Carey, Inc.

## **Panelists:**

Lynn Kawaminami, Partner-Tax, Deloitte LLP

Courtney Sargent, Sr. Manager, PwC

Steven Szymanski, SVP-Tax, American Tower Corporation

Roger Laty, VP-Tax, UDR, Inc.



# REIT **Wise** March 31 - April 2 2015



NAREIT's Law, Accounting  
& Finance Conference

JW Marriott Desert Ridge Resort & Spa  
Phoenix, AZ



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April 1, 2015

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# Agenda

- I. Tax Due Diligence Leading Practices
- II. Managing Built-in Gains
- III. Internal Controls in the Tax Function

# Tax Due Diligence Leading Practices

## *Key Items*

- Seat at the Table
  - Tax should be involved up front and in the strategy sessions
  - Meet with key executives to understand strategy (both short and long term)
- Investment Committee
  - Tax should attend and participate in IC meetings and review summaries and presentations before they are submitted to the full IC
- Communicate Early and Often with Deal Teams
  - Understand the pipeline (acquisition and sell side – including whether any assets to be acquired will be sold shortly after)
  - Voice concerns and solutions

# Tax Due Diligence Leading Practices

## *Acquisition Side*

- What are we purchasing?
  - Entities
  - Assets
- Use a checklist (see sample checklist in Appendix)
- Consider how technology can help – so you can focus on the issues
- Three primary work streams – each impacts the others
  - Due diligence
  - Structuring
  - Documents

# Tax Due Diligence Leading Practices

## *Entity Acquisitions – Key Items to Review*

- Leases
- Property services questionnaires
- Organizational chart / entity tax elections
- Tax audits
- Uncertain tax positions (federal, foreign, state, and local)
- Tax attributes / limitations
- Pro forma impact to REIT asset, income and distribution tests
- E&P
- Potential step-up or down in tax basis and allocation of purchase price
- Transaction taxes (transfer taxes, property taxes)
- Funding structure
- Non-income taxes (sales and use taxes, payroll taxes)
- Potential 280G implications
- If target is a JV interest – partnership agreements and ability to be REIT-friendly
- If target is a REIT – REIT tests!!!

# Tax Due Diligence Leading Practices

## *Asset Acquisitions – Key Items to Review*

- Leases
- Property services questionnaires
- Pro forma impact to REIT asset, income and distribution tests
- Potential step-up or down in tax basis and allocation of purchase price
- Transaction taxes (transfer taxes, property taxes)
- Funding structure



# Tax Due Diligence Leading Practices

## *Disposition Side*

- What are we selling?
  - Entities
  - Assets
- Be “diligence-ready” and understand tax implications
- Three primary work streams – each impacts the others
  - Due diligence
  - Structuring
  - Documents

# Managing Built-in Gains

## *C-Corporation Built-in Gains*

- Retain Assets for Built-in Gain Time Frame
  - Maintain a schedule of Built-in Gain by asset
  - Monitor and communicate the changing time frames
- Use C-Corporation NOLs to Offset
- Structure to Defer the Gain – i.e., Section 1031
- Other Non-recognition Structures
  - Joint venture structure
  - Deferred finance lease

# Managing Built-in Gains

## *General Built-in Gains*

- Structure to Defer the Gain
  - Section 1031
  - Installment sale
- Other Non-recognition Structures
  - Joint venture structure
  - Deferred finance lease
- Manage through Taxable Income
  - Structure to “fill the bucket”
  - Tangible property regulations
  - Cost segregation studies
  - Depreciation methods

# Managing Built-in Gains

## *General Built-in Gains (continued)*

- Manage through Distributions
  - Elective stock dividends in lieu of cash
  - Retain REIT taxable income
    - Pay tax on the 10%
  - Retain capital gains
    - Pay tax at 35%
    - Pass the gain and credit for tax to shareholders
  - Throw back dividends under section 858
    - Monitor potential 4% excise tax

# Internal Controls in the Tax Function

## ***REIT Status – Key Controls***

- Review Processes / Flowcharts / Memos at beginning of the year
- Communication policy with Property Management and Senior Management
  - They know who you are (senior members of tax team)
  - They know when to call you (executive training)
- REIT Governance Committee
  - Tax Department discusses the test results with Executive Team

## ***Documentation and Procedures***

- Internal audit -- active and engaged throughout the year
- Consider technology solutions to facilitate effective and efficient review
- Advisors review REIT tests quarterly and annually
- Documentation requirements, scope, and level of evidence required
  - Proof of internal review, including review notes and sign-off
  - Memoranda (e.g., tax impact of transactions, REIT diligence procedures and conclusions)

# Internal Controls in the Tax Function

## *REIT Status Controls (continued)*

- Completion of REIT tests and documentation
  - Separate internal preparation and review roles required
    - Challenges
  - Asset tests
    - Reconciliation of US GAAP amounts to asset values used in the asset test
  - Income tests
    - Review new leases (if not standard) and property surveys
    - Quarterly review of revenue accounts
    - Reconciliation of US GAAP amounts to gross income used in income test
  - Distribution test
    - Quarterly review of current and projected REIT taxable income

# Internal Controls in the Tax Function

## *Tax Provision Key Controls*

- Review tax rate reconciliation; compare to previous year and to expectations for the current year
- Review tax account roll-forward schedule and reconcile tax payments, tax accruals, and return to provision adjustments
- Review balance sheet accounts for new accounts or unusual changes for potential new temporary differences

## *Documentation and Procedures*

- Internal Audit – active and engaged throughout the year
- Consider technology solutions to facilitate effective and efficient review
- Documentation requirements, scope, and level of evidence required
  - Proof of internal review, including review notes and sign-off
  - Memoranda (e.g., valuation allowances, purchase accounting, tax impact of transactions, diligence procedures and conclusions)

# Internal Controls in the Tax Function

## ***Other Audit-Related Topics***

- Entity and/or country level forecasts
- Forecast effective tax rate for current year and long term
- Foreign countries – can add significant effort and challenges
  - Outsource versus internal resources
  - Controls and reliance on external resources
  - Monitoring multiple country tax law changes
- Footnote disclosures
  - Procedures and controls for documentation
  - Recent developments



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Note: This sample data request is for illustration only and reflects an entity acquisition of a target REIT with foreign operations. The due diligence request list would typically be tailored for the specific asset class, target structure, and other transaction-specific facts, and follow-on requests to provide further detail would generally be issued as the diligence progresses.

## Tax Data Request

The following is a preliminary list of documents and information needed to perform our tax due diligence procedures. Unless otherwise noted, all information is requested for all open tax years and for the most recent interim period. In addition to the items included on this list, please provide us with any information that you believe would enhance our understanding of the tax position of the company. Please note that we may require additional information as our tax due diligence progresses.

### General

1. Access to tax personnel and/or tax advisors to discuss US federal, state, local and non-US income and non-income tax matters.
2. Current legal organizational structure of the entities being acquired, including all domestic and foreign holdings. Chart should indicate the legal and tax (e.g., check-the-box) form of each entity.
3. Copies of US federal, state, local and non-US income tax returns filed, including but not limited to Forms 1118, 5471, 5472, 8858 and 8865 for all open tax years and access to workpapers prepared in connection with such returns. Additionally, please provide copies of the payroll, excise, sales & use, VAT, and GST tax returns filed for the most recent year.
4. Analysis of all tax attributes (e.g., net operating losses, capital losses, built-in losses, R&D credits, etc.) including expiration dates of such attributes and any applicable limitations on the utilization of such carryovers by legal entity by jurisdiction.
5. List of all significant US federal, state, local and non-US tax elections, including any check-the-box and TRS elections.
6. A schedule reflecting the rollout of amortization and depreciation for current tangible and intangible assets.

7. Please provide information regarding participation in any listed or reportable transactions, if any.
8. Copies of the ASC 740 calculation and related workpapers for the past 2 years and for the 2 most recent quarters.
9. Details of any positions taken on prior US federal, state, local and non-US tax returns (including, but not limited to, income, payroll, excise, sales, VAT, and GST taxes) for which there is potential exposure. Additionally please provide a summary schedule of any uncertain income and non-income tax reserves (f/k/a: FAS 5, FIN 48) including an explanation of each reserve along with any relevant opinions, correspondence and/or memoranda prepared regarding such tax exposure.
10. Summary of closed, ongoing and pending US federal, state, local and non-US tax audits (including, but not limited to income, payroll, excise, sales, VAT, and GST taxes) for the past five years. For any closed audits, please provide a copy of the revenue agent report issued, including detailed explanations of all audit adjustments. For any closed or ongoing audits, please provide copies of all issued information document requests ("IDR") along with the Company's response to each IDR for the past five years. Also please indicate whether any waivers to extend the statute of limitations have been executed.
11. Copies of tax rulings (or ruling requests), requests for changes in accounting methods or closing agreements entered into by the Company and/or subsidiaries during the past five years (or longer, if there is prospective application).
12. Details regarding the Company's revenue recognition policies for tax purposes with respect to each type of revenue realized.
13. Details of any restructuring history, including corporate merger, acquisition, divestiture, bankruptcy and joint venture occurring within the last five years. For any transaction, please include the date and type of transactions, copies of agreements and tax rulings or legal opinion/memorandum regarding taxability of such transaction and the tax treatment of contingent consideration. Also please include any tax due diligence report or similar document compiled with respect to any such acquisition.
14. Copies of any contract, agreement or arrangement under which the Company and/or any subsidiary has, or at any time in the future may have, an obligation to contribute (whether directly, by indemnity or otherwise) to the payment of a portion of tax (or pay any amount calculated with reference to any portion of a tax) determined on a consolidated, combined or unitary basis.
15. Details related to all related party or inter-company transactions with affiliates, shareholders, and other related parties (e.g., sales, loans, interest, royalties, management fees, deferred inter-company transactions, etc.) including a copy of any agreements entered into with respect to such transactions and a copy of any transfer pricing reports or other documentation supporting the arm's length nature of transactions.

16. Copies of any tax allocation or tax sharing agreements.
17. List of all outstanding debt obligations setting forth key terms (i.e., principal, interest rates, conversion features) and any memoranda, opinion, ruling or similar analysis regarding the nature of such obligation as indebtedness for tax purposes or the deductibility of interest.

## REIT

18. All quarterly asset tests and underlying trial balances since its REIT election.
19. All income tests and underling trial balances since its REIT election.
20. Schedule of distributions and distribution tests since its REIT election.
21. Schedule of any non-REIT year earnings and profits distributed to shareholders.
22. Articles of incorporation.
23. Shareholder list.
24. Schedule of "five or fewer" tests since its REIT election.
25. Copy of demand letters sent since its REIT election.
26. Analysis of any impermissible tenant service income.
27. Schedule of section 1374 built-in gains, if applicable.
28. Hedge identifications.
29. Copies of any "reasonable cause" memorandums or opinions.
30. Copies of all lease agreements.

## Operating Partnership

31. Schedule of section 704(c) built-in gains.
32. Copies of any tax protection agreements.

### State and Local

- 33. A list, such as a tax calendar, of all state and local tax returns (i.e., income, franchise, sales) filed by each entity.
- 34. Schedule detailing state apportionment factors (including property, payroll and sales numerators and denominators by state) of each entity.
- 35. Copies of any correspondence from state, local or foreign taxing authorities questioning the activities of each entity in any jurisdiction and copies of responses by the entity or its representatives, if any.
- 36. Details on sales, use and other non income tax policies and procedures.

### Compensation and Payroll

- 37. All documentation (including "change in control" agreements, executive employment agreements and qualified plan documents) detailing change of control payment or benefit that results in non-deductible "excess parachute payments" and excise taxes pursuant to section 280G.
- 38. Details on the Company's use of independent contractors including policies for determining and monitoring contractor status, number of Forms 1099 issued and amounts reported.

### International – US Multinational

- 39. Schedule of all foreign jurisdictions in which the Company or its subsidiaries: (a) files a tax return, (b) has employees, (c) owns assets or (d) has employees or agents that reside or make regular visits to and/or perform service or inspection type functions.
- 40. Schedule of EBITDA and cash taxes by country.
- 41. Summary schedule of earnings and profits (E&P) and tax pools by country.
- 42. Schedule of intercompany debt and related notes.
- 43. Copies of tax planning schedules, slides or memoranda.
- 44. Schedule of distributable reserves deficits or other trapped cash by country.
- 45. Details as to the Company's compliance with VAT and customs tax/reporting.

- 46. Copies of the most recent Form 1042 and the Form W8BEN utilized to reduce withholding taxes for the 5 largest payments.
- 47. Details regarding any agreements (e.g., APAs, etc.) entered into with tax authorities.
- 48. Schedule of all qualified business units ("QBUs") and section 987/988 pools.

### **International – US subsidiary of foreign parent**

- 49. Analysis of whether the target is a US Real Property Holding Company within the meaning of Section 897.
- 50. Earnings stripping calculations for all relevant years.
- 51. Details regarding any inbound financing arrangements.
- 52. Copies of the most recent Form 1042 and the Form W8BEN utilized to reduce withholding taxes for the 5 largest payments.

### **Customs and Global Trade**

- 53. Please provide a list of countries to which the Company (or a related entity) imports goods. Information should include, but not be limited to, description of goods imported, whether the exporter and importer are related parties, as well as the total customs value and duty paid in the last year for each country.
- 54. Please provide a list of countries out of which the Company (or a related entity) exports goods. Information should include, but not be limited to, description of goods exported, what countries the goods are exported to, as well as total value of exports in the last year for each country.
- 55. Details of licenses required to import or export goods (if any).
- 56. Details with respect to any past or pending Customs or Export Authority audits, penalties or disputes (ongoing or resolved). Information should include, but not be limited to, correspondence with a Customs or Export Authority, issues raised, proposed resolutions and, if closed, the outcome.
- 57. Details of any Duty Deferral, Bonded Facilities or Free Trade Agreements utilized by the company.

### **Value Added Tax (VAT) and Goods and Services Tax (GST)**

58. Please provide a list of countries in which the Company (or its subsidiaries) is registered for VAT/GST purposes as well as details on the periodical VAT/GST position (payment vs. refund) in those countries.
59. Please provide a list of countries where the Company is acting as “importer of record” and include details on the delivery terms/incoterms that are generally being used.
60. Please provide information as to whether the Company (i) accrued for VAT/GST, (ii) maintains VAT/GST receivables on the balance sheet, and/or (iii) is currently sitting on any VAT/GST refund that is not being reimbursed by the Tax Authorities.
61. Details on VAT/GST policies and procedures.

**This list contains general information only and is provided as a sample in connection with the REITWise 2015 presentation “Still More REIT Tax Issues.” The respective speakers and their firms are not, by means of providing this sample list, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This sample list is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. The respective speakers and their firms shall not be responsible for any loss sustained by any person who relies on this sample list.**