

# *State and Local Tax Subcommittee Committee Meeting*

*Wednesday, March 30<sup>th</sup>  
4:30pm – 6pm  
Marriott Marquis, Washington DC*

**Moderator:**

Lisa Schmaltz, Director-Tax Accounting & REIT  
Compliance, Welltower, Inc.

**Panelists:**

Sean Kanousis, Principal, PwC  
Scott Smith, Partner, BDO USA, LLP  
Andrew VandenBrul, Partner-State & Local Tax, KPMG  
LLP

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**STATE & LOCAL SUBCOMMITTEE MEETING**  
**(Open to all REITWise® Participants)**  
**Marriott Marquis Washington, DC**  
**Independence E-H**  
**Wednesday March 30th, 2016**  
**4:30 p.m. – 6:00 p.m.**

*Co-Chairs:*

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INVESTMENT  
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*Joseph Gurney, Director-Multistate Tax, Deloitte LLP*  
*Tracy Swearingen, SVP-Taxation, Duke Realty Corporation*

*Panelists:*

*Sean Kanousis, Principal, PwC*  
*Lisa Schmaltz, Director-Tax Accounting & REIT Compliance, Welltower, Inc.*  
*Scott Smith, Senior Director, BDO USA, LLP*  
*Andrew VandenBrul, Managing Director-State & Local Tax, KPMG*

*NAREIT Staff Liaison:*

*Dara F. Bernstein, VP & Senior Tax Counsel*

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- I. Overview of Legislative Developments (State Implications of PATH Act)
- II. Proposed State Tax Legislation: California, Hawaii, PA, and Other States
- III. Other Indirect Tax Issues
- IV. Audit Activity: What are we seeing?

Note: This meeting may qualify for 1.5 hours of continuing professional education credits, depending on the state. For CLE or CPE credit information, please contact Afia Nyarko at 202-739-9433 or [anyarko@nareit.com](mailto:anyarko@nareit.com).



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March 30, 2016



## **Panelists**

Lisa Schmaltz (Welltower), Moderator

Scott Smith (BDO)

Drew VandenBrul (KPMG)

Sean Kanousis (PwC)

## **SALT Subcommittee Co-Chairs**

Tracy Swearingen (Duke Realty)

Joe Gurney (Deloitte)



## AGENDA

- I. Overview of Legislative Developments
- II. Proposed California Tax Legislation:  
Political View and Technical Analysis:  
Repeal of Prop. 13 for Commercial  
Properties?
- III. Other Indirect Tax Issues
- IV. Audit Activity: What are we seeing?



# I. Overview of Legislative Developments



## A. The PATH ACT and State Tax Conformity

### 1. Built in Gains Tax – 5 Years

- a. Where do the states stand?
- b. Rolling (IL, NY); Adoption (CA, FL) and Non-Conformity.
- c. REIT Specific Provisions

### 2. Bonus Depreciation

- a. Where do the states stand?
- b. Rolling (IL, NY); Adoption (CA, FL) and Non-Conformity.
- c. REIT Specific Provisions

### 3. FIRPTA Qualified Foreign Pension Funds

- a. Where do the states stand?
- b. Conformity with IRC 897 in general
- c. IRC 897(1)



## B. State FIRPTA

### 1. Timing

- a. Different than “at-source” withholding
- b. When should we address?
- c. When is it usually addressed?
- d. Best Practices

### 2. Who is a Nonresident?

- a. Different for different jurisdictions
- b. Organization vs. Qualification

### 3. Exemptions

- a. Principal place of business
- b. Continue in business exemption
- c. Examples: California, Georgia, Oregon, Maryland





## Tennessee – Revenue Modernization Act of 2015

- Adopts “Factor presence nexus” for taxable years beginning after December 31, 2015
  - *J.C. Penney National Bank v. Johnson*
  - Revenue Ruling 06-27
  - Tenn. AG Op. No. 15-37
- Market sourcing effective for taxable years beginning on or after July 1, 2016
- Cloud computing sales/use tax (eff. July 1, 2015): deemed delivery of cloud software
- Overhaul of administrative rules to implement the RMA
  - Proposed rules filed February 25, 2016; comments due/hearing on April 26, 2016
  - Market sourcing rules – modeled after MTC, DC, MA
  - New entity classification rules



## Mortgage REITs: Financial Institution classification and special apportionment rules continue to expand

1. Physical Nexus
2. Economic Nexus
3. SINAA
  - a. Solicitation
  - b. Investigation
  - c. Negotiation
  - d. Administration
  - e. Approval
4. Financial Org/Institution Rules
5. Sourcing of income: Whole loans (sale or interest), securitizations, CMBS



## Illinois – H.B. 3086

- Amends definition of “Captive REIT”
  - Effective retroactively to taxable years ending after August 16, 2007
  - Voting power or value of a beneficial interest or shares held in a REIT that are held in a “segregated asset account” of a life insurance company for the benefit of persons or entities that are immune or exempt from federal income tax are not taken into account for purposes of determining if a REIT is a “captive REIT”

## Virginia – H.B. 95

- Similar amendment to definition of “Captive REIT” and stock held in segregated accounts of a life insurance company
  - Effective for taxable years beginning on or after January 1, 2016

## Nevada – S.B. 483

- Imposes a new “Commerce Tax”
  - Effective July 1, 2015
  - “Nevada gross revenue” of \$4 million or more
  - Uses market sourcing approach
  - Tax rates vary based on NAICS classification
  - Proposed rules (issued February 17, 2016) address nexus, “taxable entity,” filing requirements, sourcing, and other details



## New York State and City Tax Reform

- Economic Nexus enacted for Corps with \$1M or greater of New York receipts (NYS)
- Bank Tax eliminated (NYS & NYC)
- NYS corp tax rate reduced to 6.5% but MTA Surcharge increased to 28%, thus overall tax rate is 8.32% (Slight tax increase)
- Capital Tax increased to \$5M but will be phased out – 0% by 2021 (NYS)
- Qualified Financial Instruments - 8% rule. In determining New York receipts and net gains from “qualified financial instruments” (generally financial instruments marked to market under IRC § 475 or 1256 (excluding loans secured by real property)), taxpayers may make an annual and irrevocable election to use a fixed percentage method. Under this method, 8% of all net income from qualified financial instruments is included in the apportionment factor numerator. If a taxpayer does not elect the fixed percentage method, receipts and net gains are sourced via a customer based sourcing method (using an individual’s billing address or the commercial domicile of a business).

# New York State and City Tax Reform



- Market Sourcing Rules for Services
- Interest sourced to location of real property
- Net Operating Loss – Creates a New York NOL and no longer conforms to IRC 172
- PNOL – For taxable years prior to 2015, NOLs are converted to PNOLs
- Unitary Combined Reporting – (Applies only to Captive REITs and Captive RICs but could require combined reporting for multiple TRSs)
- Partnership nexus creates corporate partner nexus – does it?

## New York State and City Tax Reform



- The legislation adopts 'effectively connected' income as the starting point for the corporate tax base calculation for non-US corporations (subject to adjustments).
- For foreign corporations, the legislation disallows exclusions, deductions or credits for (1) income from dividends or interest in stock, securities, or indebtedness but only if such income is treated as effectively connected with the conduct of a US trade or business (IRC § 864); (2) any income exempt from federal taxable income under any treaty, but only if such income is treated as effectively connected in absence of such exemption, provided that the treaty does not prohibit the state's taxation of such income; and (3) any income that would be treated as effectively connected if such income were not otherwise excluded from gross income under IRC § 103.

# New York State and City Tax Reform



Under the legislation, a combined report must be filed by any taxpayer:

1. that owns or controls, directly or indirectly, more than 50% of the capital stock of one or more other corporations or
2. more than 50% of the capital stock of which is owned or controlled either directly or indirectly by one or more other corporations or
3. more than 50% of the capital stock of which, and the capital stock of one or more other corporations, is owned or controlled, directly or indirectly, by the same interests *and*
4. that is engaged in a unitary business with those corporations.

Combined returns include:

1. a captive REIT or a captive RIC that is not required to be included in a combined insurance tax report under Article 33.
2. an alien corporation that satisfies the state ownership and unitary thresholds and that is treated as a domestic corporation under IRC Sec. 7701 or has effectively connected income for the taxable year.



## Investment Income

- The legislation redefines investment income to mean income, including capital gains in excess of capital losses, from investment capital (as redefined), to the extent included in computing entire net income, less, in the discretion of the commissioner of finance, any interest deductions allowable in computing entire net income that are directly or indirectly attributable to or investment income. Investment income cannot exceed entire net income.
- The legislation further provides that if investment income, determined without regard to subtracted interest deductions, comprises more than 8% of the taxpayer's entire net income, investment income determined without regard to these deductions cannot exceed 8% of the taxpayer's entire net income. If the amount of interest deductions subtracted exceeds investment income, the excess of such amount over investment income is added back to entire net income.
- In lieu of subtracting from investment income the amount of those interest deductions, a taxpayer may elect to reduce its total investment income by 40%. Investment income does not include any amount treated as dividends under IRC § 78.





## Pennsylvania – Capital Stock/Foreign Franchise Tax Phase-Out

- Fully phased-out for tax years beginning after December 31, 2015
- REITs often structured property-holding entities as disregarded partnerships rather than SMLLCs to minimize this tax
- Consider structuring alternatives following phase-out

## Missouri – Franchise Tax Phase-Out

- Fully phased-out for tax years 2016 and thereafter

## Pennsylvania – Local Gross Receipts Tax Litigation

- *Fish v. Township of Lower Merion*
- PA Supreme Court overturned Commonwealth Court decision on 12/21/15
- Gross receipts from rentals allowed to be subject to local business privilege tax under the Local Tax Enabling Act



## Massachusetts – Voluntary Disclosure Program for the Settlement of Uncertain Tax Issues

- Eligibility: “uncertain tax liability” of \$100,000 or more
- Anonymous contact with DOR permitted; DOR will notify within 30 days if eligible; taxpayer then has 45 days to accept by filing application and disclosing identity
- April 1, 2016 – May 31, 2016

## California – Chief Counsel Ruling 2015-02

- Services provided to a business customer that uses the service to provide a service to its customers
- Treated as a “non-marketing service” and sourced to business customer’s location
- “Look-through rule” not applied

## District of Columbia – Act 21-307

- Latest in a series of “emergency legislation” that temporarily repeals the “blacklist” of foreign jurisdictions treated as tax havens for combined reporting purposes (this emergency legislation expires May 17, 2016)



## Federal Partnership Audit Rules – Overview

- Federal partnership audit rules effective for tax years beginning after December 31, 2017 [Bipartisan Budget Act of 2015]
- Procedural rules for partnership audits and adjustments
- Repeals Tax Equity and Fiscal Responsibility Act (TEFRA)
- Applies to all partnerships, although some partnerships with fewer than 100 partners may be able to opt out
- According to IRS, fewer than half a percent of partnership returns are audited
- Under new rules, partnership will pay the tax, interest and penalties on underpayments with tax calculated by multiplying the net of adjustments times the highest statutory or individual rate
- As an alternative to paying tax, partnerships can issue adjusted K-1's to the partners who then must report the adjustment in the year made
- No amended partnership returns will be filed
- Statute of limitations will be determined based on when the partnership return was filed and considers extensions between the partnership and Treasury
- Partnerships are represented by a “partnership representative” — does not need to be a partner



## Federal Partnership Audit Rules – State Considerations

- Generally, state conformity is either rolling or as of a certain date
- Conformity is normally limited to substantive rules and does not extend to administrative provisions
- As a result, state conformity to the new federal partnership audit rules will vary widely
- At its meeting in Salt Lake City on March 2, 2016, the Multistate Tax Commission (MTC) addressed the new federal partnership audit rules as an emerging issue
- Federal adjustments can be small on a per partner basis, especially after allocation or apportionment
- May have a more immediate impact in states with mandatory withholding and composite returns
- If states do not address conformity, there is a question of whether partners will receive sufficient information to prepare an amended return at the state level
- States may not be able to audit partnerships, unless they are “taxpayers”
- Significant questions of the statutes of limitations – partnership’s vs. partners’



## Pennsylvania – Intercompany Expense Addback

- Act 52 of 2013, 72 P.S. § 7401(3)1.(t) provides an addback for certain intercompany intangible (and related interest) expenses
- PA DOR Issued Information Notice Corporation Taxes 2016-1 on February 19, 2016, providing the DOR’s positions on:
  - Applicable intangible assets
  - Direct or indirect attribution on expenses and costs
  - Embedded intangibles
  - Interest expenses are presumed “directly related” to an intangible expense if engaged in any intangible transaction with an affiliate
  - Exceptions – principal purpose, arm’s-length, foreign treaty and conduit
  - Add-back credit – “subject to tax” credit



## Other Developments

- Crowdfunding
- California Proposed Dividend sourcing
- Hawaii: Two Proposals to eliminate DPD
- Louisiana: *Bridges v. Polychim USA, Inc.* No. 2014 CA 0307 (La. Ct. App. 4/24/15)



## California Proposition 13

- Constitutional Amendment
- Prop 13 reform
- Full vs Partial attribution method



## Other Indirect Tax Issues

### A. New York Transfer Tax Litigation

(1) *In re GKK 2 Herald LLC*, New York City Tax Appeals Tribunal, No. TAT(H) 13-25(RP)

(2) *In the Matter of the Petition of Jonis Realty/E. 29<sup>th</sup> Street, LLC*, New York City Tax Appeals Tribunal, No. TAT(H) 09-9R(RP)

### B. Property Tax changes in Ownership in Florida and Michigan

(1) *Florida – Form DR-430*

(2) *Michigan – Form L-4260*

### C. Sales and Use Tax Issues





## Pennsylvania & Philadelphia Realty Transfer Tax Issues

- Taxes imposed on “acquired real estate companies”
  - Transfer of 90% or more of the capital and profits interests in a real estate company within 3 years
  - Interest in a lower-tier real estate company are considered real estate – prevents indirect transfer of a real estate company without taxation
- Combination of transfers of less than 90% direct ownership in a real estate company, along with indirect transfers of the remaining owner(s) may minimize the tax
  - Philadelphia Law Department recently stated that such indirect transfers may be viewed in conjunction with the direct transfers, resulting in imposition of the tax
  - Pennsylvania DOR position appears to differ
- Tax rates are significant
  - Philadelphia – 3% of computed value
  - Pennsylvania – 1% of computed value, plus county tax outside of Philadelphia (generally an additional 1%)



IV. Audit Activity: What are we seeing?