

Concurrent Session: State and Local Taxes

*Thursday, March 31st
11:15am – 12:30pm
Marriott Marquis, Washington DC*

Moderator:

William DeKlerk, Sr. Director-Tax, Essex Property Trust

Panelists:

Darren Chesser, Director-Tax, RLJ Lodging Trust

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Michele Randall, Partner-Tax, EY

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State and Local Tax

March 30-April 1, 2016



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Agenda



- **Optimal State Tax Structures**
- **State Apportionment and Economic Nexus**
- **Combined Return Issues**
- **Indirect Tax Issues**



Optimal state tax structures

- Choice of entity can impact franchise and entity level taxes
 - Planning for minimum taxes and fees
- Franchise Tax Planning
 - QRSs versus LLCs
 - Planning with business trusts
 - Benefits of an LP structure



Minimum and Franchise Taxes

- States with some form of minimum tax due include:
- AZ, CA, CT, DC, ID, KY, MA, MT, NJ, NY, OR, RI, UT, VT
- States that impose some form of franchise tax include:
- AL, AR, CA, CT, DC, GA, ID, IL, KY, LA, MA, MO (repealed), MS, NC, NE, NM, NY, OK, PA, RI, SC, SD, TN, TX, WV (repealed)



Minimum Tax and Fees

- Alabama imposes a business privilege tax (BPT) on LLCs and partnerships of up to \$15,000 for most entities. SMLLCs doing business in Alabama are subject to BPT unless the sole member is qualified or doing business in Alabama. If a SMLLC's sole member is subject to tax, the SMLLC is subject to a \$100 minimum tax.
 - Multiple SMLLCs could result in multiple fees of up to \$15,000. The SMLLC fee can be limited to \$100 by managing the sole members activities in Alabama
- California requires LLCs to file Form 568 and pay an \$800 annual tax and a filing fee of up to \$11,790 based on California gross receipts. California requires limited partnerships to file Form 565 and pay an \$800 filing fee.
- California QRSs are not required to file or pay these fees.
 - LLCs and LPs that are wholly-owned by the REIT could make check-the-box elections to be taxed as corporations (Form 8832) and automatically become QRSs.

Minimum Tax and Fees

- New York
 - Corporate fixed dollar minimum ranges from \$25 to \$200,000 for 2015 tax year and forward based on gross receipts
 - Partnerships are subject to minimum tax of \$25 to \$5000
 - SMLLCs are subject to \$25 minimum tax
- Oregon –
 - Partnerships subject to \$150 minimum tax
 - Corporations are subject to minimum tax that ranges from \$150 to \$100,000 based on gross receipts



Franchise Tax Planning

- QRSs are subject to franchise tax in certain states can be used as blockers
 - Examples include LA, MS, NC and SC
- REIT and QRS business trusts may be exempt from franchise tax in certain states
 - Examples include LA, MO, SC and PA
- Limited partnership structure could be beneficial
 - States may not follow check the box for franchise tax (LA and NC)
 - Limited partner nexus – LA franchise tax
 - *Utelcom, Inc. v. Bridges*, Dkt. No. 535,407 (Division “D”, Ct. App., First Dist., Sept. 12, 2011).
 - *Bridges v. Polychim USA, Inc.*, Court of Appeal of Louisiana, First Circuit, No. 2014 CA 0307, April 24, 2015

QRS Business Trust – Example 1

- REIT is subject to SC income tax but not subject to SC license tax
- QRS business trust is exempt from license tax.



QRS Business Trust – Example 2

- REIT is subject to SC income tax but not subject to SC license tax.
- Operating partnership is flow through entity for both SC income and license tax.





Franchise Tax Planning

- North Carolina
 - Historically, North Carolina has imposed .15% franchise tax on the highest of the following three bases: (a) issued and outstanding capital stock, surplus, and undivided profits; (b) actual investment in tangible property in North Carolina; or (c) 55% of the appraised valuation of real and tangible personal property in North Carolina.
 - HB 97 replaces the capital stock, surplus, and undivided profits base with a “net worth” base. Generally, the legislation simplifies the capital base by defining it as a taxpayer’s “net worth” is the entity’s “[t]otal assets without regard to the deduction for accumulated depreciation, depletion, or amortization less its total liabilities” computed in accordance with GAAP as of the end of the corporation’s taxable year. A deduction is allowed for accumulated depreciation, depletion, or amortization in accordance with the method used for federal income tax purposes. Note, there are changes to the affiliated debt add back that could broaden the tax base.

Franchise Tax Planning



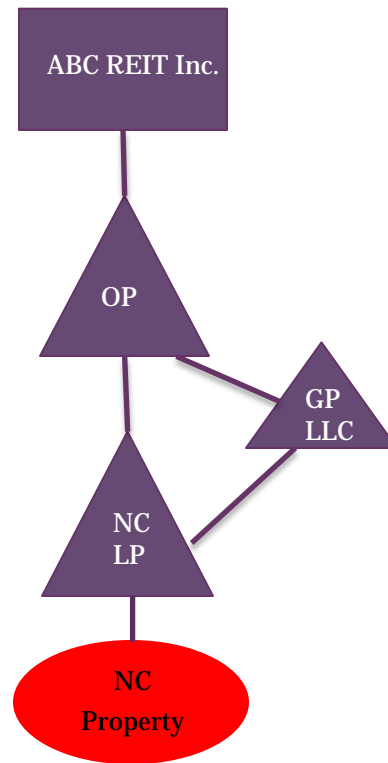
- North Carolina continued
 - HB 97 appears to preserve the special deduction afforded REITs for the aggregate market value of investments in the stock, bonds, debentures, or other securities or evidences of debt of other corporations, partnerships, individuals, municipalities, governmental agencies or governments.
 - HB 97 eliminates the deduction for indebtedness incurred and existing for the purchase or improvement of North Carolina real estate. This change could be significant for REITs that directly/indirectly own SMLLCs holding North Carolina property, as these taxpayers often pay franchise tax based on actual investment in tangible property in North Carolina.



Limited Partnership Example

NC Example

- REIT is subject to tax on higher of its apportioned net worth, investment in tangible property base or appraised value base.
- REIT is allowed a deduction for investment in stock, bonds and partnerships for its apportioned net worth base.
- Holding property in LP limits the flow up from the NC property for its investment in tangible property and appraised value base.





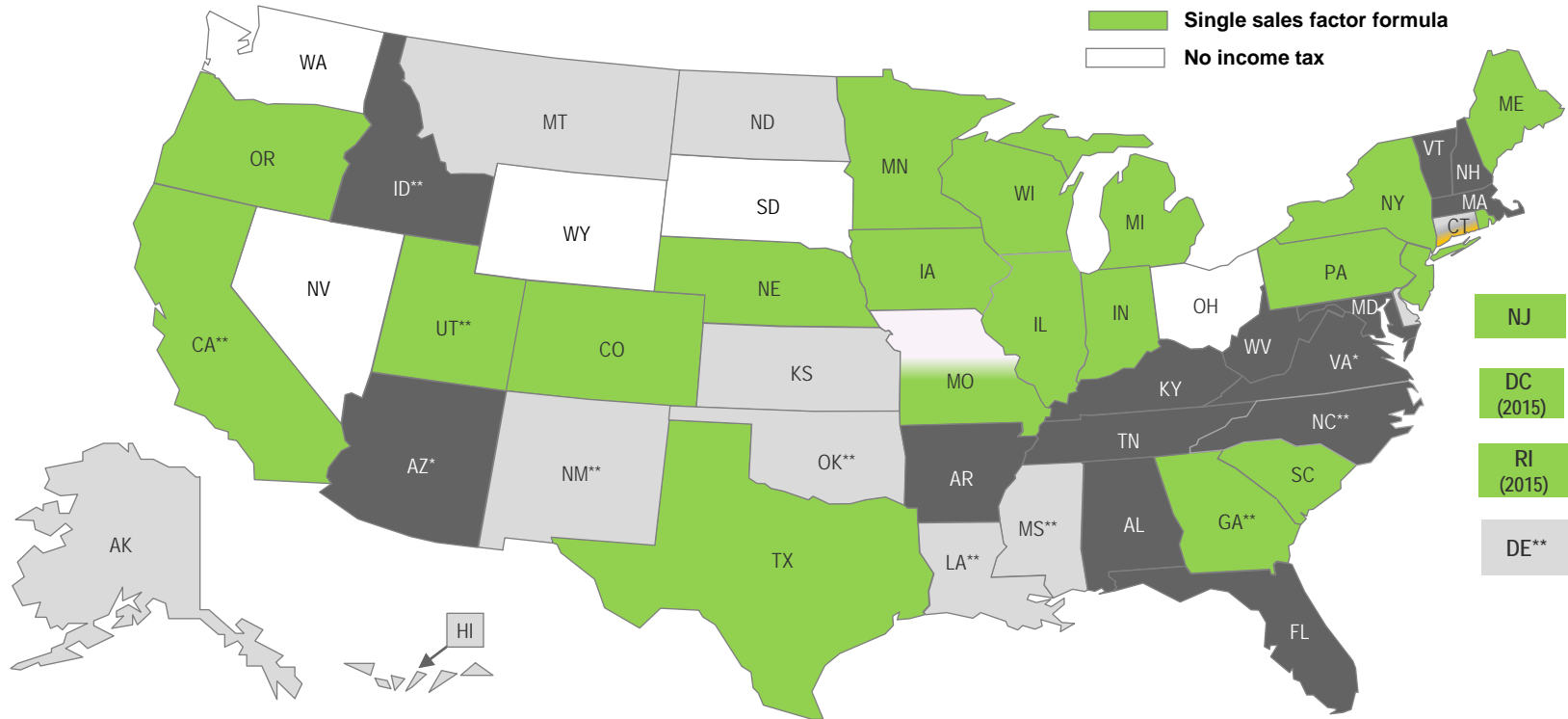
State apportionment

- Apportionment trends
 - Single sales factor
 - Market sourcing
 - What is market sourcing
 - Potential impact
 - ◆ Interest
 - ◆ Dividends
 - ◆ Management fees
- Economic Nexus

Single Sales Factor Adoption (thru Sept 2014)



- 3-factor formula: equal weighting
- 3-factor formula: unequal weighting
- Single sales factor formula
- No income tax







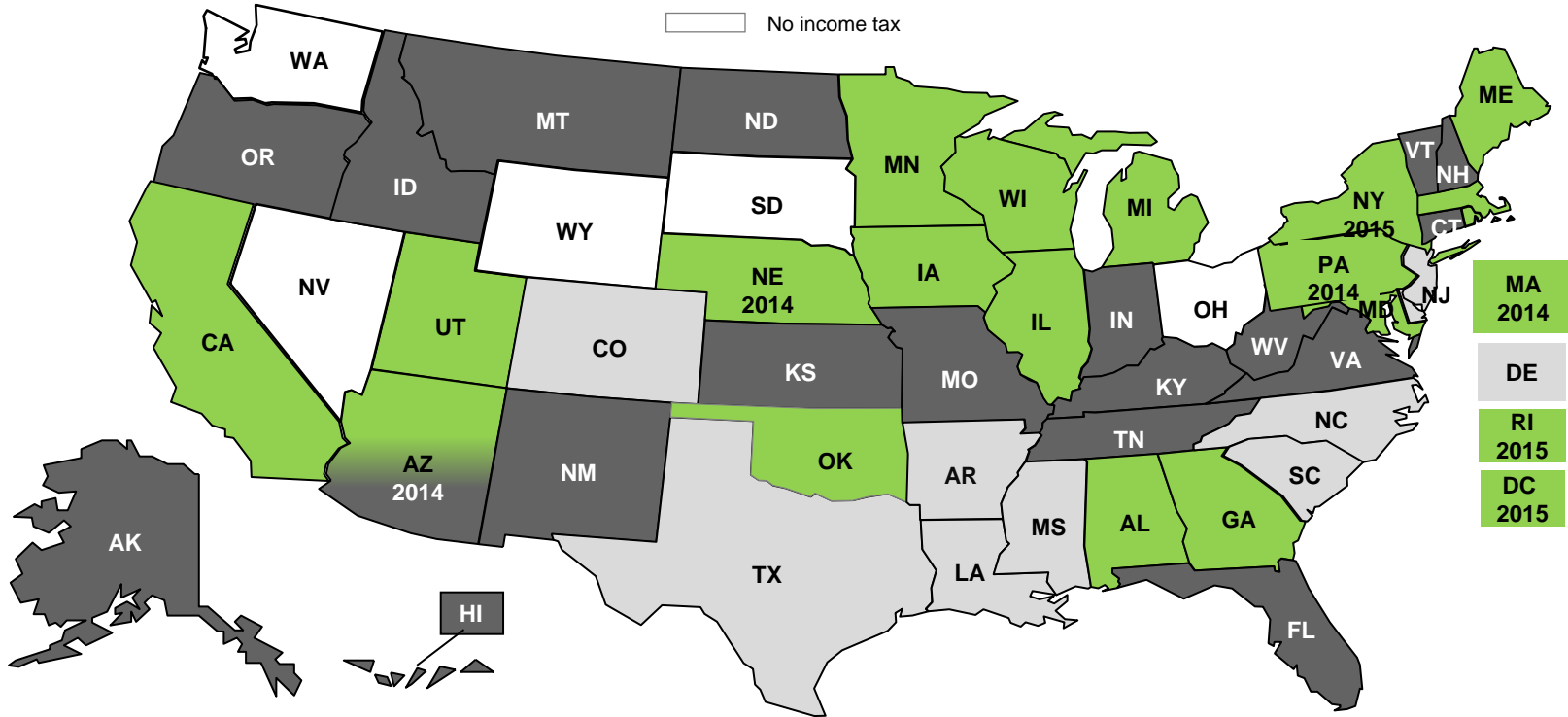
* Single sales factor is either electable or being phased-in

** Different apportionment rules apply to certain industries

Market Sourcing (thru Sept 2014)






-  Source to state where greater portion of income producing activity performed ("all or nothing")
-  Source to state to the extent services performed in state ("to the extent of" or "direct")
-  Source to state where benefit of service received ("benefit" or "market")
-  No income tax

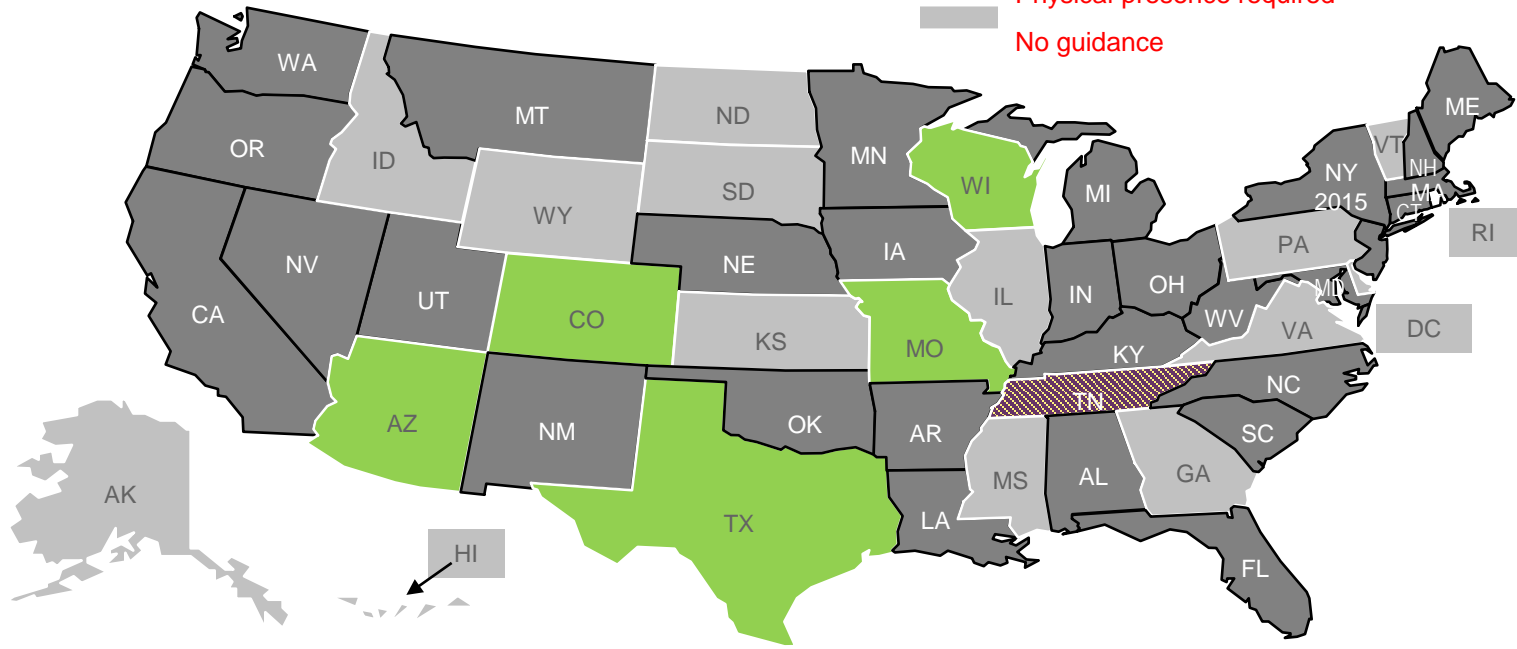


Economic nexus: non-financial



As of Sept. 2015

-  Economic or Geoffrey nexus provisions
-  Physical presence required
-  No guidance





Combined return issues

- General mechanics of computing tax on combined basis
- What is a unitary business and who's included?
- W/E Elections and Inclusions
- REIT and TRS combinations
 - States that apply combined rules broadly
 - States that specifically address REITs and combination
 - States that exclude public or non-captive REITs
 - States that follow federal consolidated return rules in determining group
- NOL computation
- Foreign operations and impact to combined returns

Expansion of combined reporting***








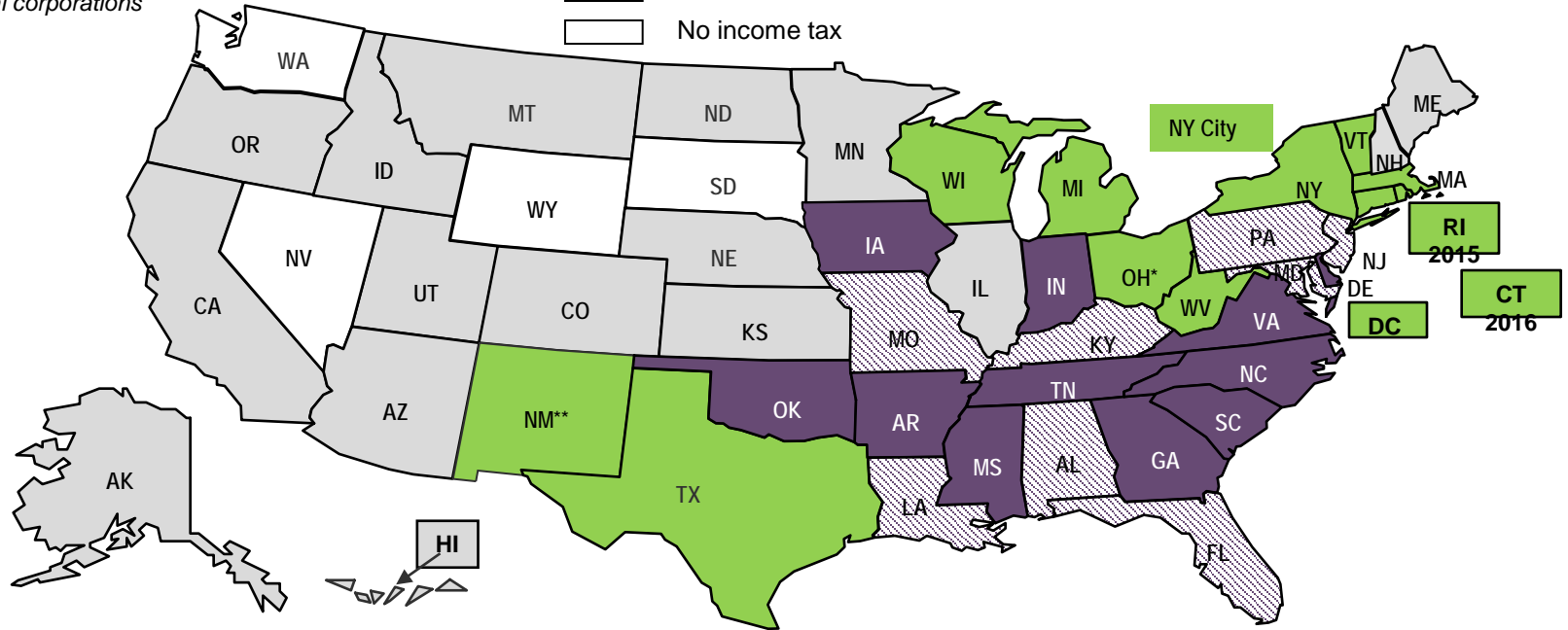
As of 08 December 2015

* For purposes of the CAT

** Limited to big box retailers

***General corporations

-  Combined reporting/consolidated return required prior to 2004
-  Combined reporting/consolidated return adopted for 2004 or later
-  Combined reporting legislation proposed in 2015
-  Separate return state
-  No income tax





Other income tax reporting issues

- **Non-conformity Issues**
 - Tax Add backs
 - Depreciation
 - Related Party Interest Expense Add backs
 - NOLs
 - Recent Developments
 - New federal partnership procedures
 - Path Act
 - US Treaties



Indirect Taxes

- Sales and use taxes
 - Taxable income streams
 - Real property rental
 - Management fees
 - Real estate repair and maintenance
 - Construction
 - Intercompany transactions
 - Rental of tangible personal property
 - States may not exempt internal rent on real property lease (Hawaii)
 - Audit Issues



Indirect Taxes

- Sales & Use tax due on services, potentially taxable on:
- Janitorial services – AR, CT, DC, FL, HI, IA, MD, MN, NE, NJ, NM, NY, OH, PA, SD, TX & WV
- Repair services – AR, CT, DC, FL, HI, IA, KS, LA, MS, NE, NJ, NM, NY, OH, PA, SD, TN, TX, UT, WA, WI & WY

Indirect Taxes



- **Locals may impose tax on real estate rental receipts**
 - **California**
 - Los Angeles/Oakland
 - San Francisco has phased in new tax
 - Other city local taxes
 - **Delaware**
 - **Kentucky**
 - **Michigan**
 - **Ohio**
 - **Philadelphia/Other Pennsylvania Cities**
 - **Virginia**
 - **West Virginia**
 - **Washington**



Indirect tax issues

- **Transfer Taxes**

- The taxability of real estate transactions is dependent on both the type of the transaction and the jurisdiction in which the property is located as states have taken different approaches.
- Two types of real estate transfer tax transactions
 - Direct Asset Transfer
 - Controlling Interest Transfer
- For example, both Texas and Arizona have opted to not impose any tax on the transfer of real property whether it is done directly or indirectly.
- Alternatively, 17 states have elected to impose a tax on the indirect transfer of a controlling interest in real property.



Indirect tax issues

- **Transfer Tax Compliance**
 - **Non-recorded transactions**
 - Generally, filed with State Department of Revenue but can be required at the local level
 - Forms may not be available
 - County recorders may not understand non-recorded transactions
 - **Buyer/seller tax responsibility**
 - **Timing of returns**
 - Due dates can range from date of close to 45 days after close
 - **Audits and other issues**
 - Local non-conformity
 - Review of fair market value
 - California case law - *Ardmore*