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NAREIT's Law, Accounting & Finance Conference

March 22 – 24, 2017

SALT Subcommittee Meeting



Panelists

◆ NAREIT SALT Subcommittee Co-Chairs:

Joseph Gurney, Director, Deloitte LLP

Tracy Swearingen, SVP-Taxation, Duke Realty Corporation

Panelists:

Drew Adams, VP & Director-Tax, Public Storage

Sam Melehani, Tax Partner, PwC

Michele Randall, Tax Partner-Real Estate SALT Leader, EY

Scott Smith, National Technical Practice Leader-State & Local Tax, BDO USA LLP

Federal Tax Reform and Its Impact on State and Local Taxation

Impact of Federal Tax Reform on State and Local Taxes

- ◆ Background on Federal Tax Reform
 - ◆ President Trump's Reform Plan
 - ◆ Corporate and Pass-through Rate – 15%
 - ◆ Eliminate AMT
 - ◆ Repatriation Incentives
 - ◆ Changes to deductions involving business expenses and interest paid

Impact of Federal Tax Reform on State and Local Taxes

- ◆ Background on Federal Tax Reform
 - ◆ House of Representatives
 - ◆ Corporate Rate – 20%
 - ◆ Allows for businesses to expense 100% of costs (as apposed to depreciate)
 - ◆ Eliminates net interest expense for businesses

State Tax Issues Associated with Federal Tax Reform

- ◆ Conformity to the Internal Revenue Code
 - ◆ The vast majority of states fundamentally conform to the Internal Revenue Code (“IRC”) either on a rolling basis or as the IRC existed at a certain date
 - ◆ Dramatic change to the IRC can fundamentally separate state tax codes from the IRC

State Tax Issues Associated with Federal Tax Reform

- ◆ Lowering the federal rate increases the relativity of the state tax rates
 - ◆ Under the House and President Trump's proposed plans, the corporate rate would be somewhere between 15-20%
 - ◆ The highest rate for states varies from 3% to 12%

2017 State and Local Tax Updates

Recent State and Local Tax Updates

- ◆ The Alabama Tax Tribunal held that a financial institution taxpayer (a bank filing as a C Corp) was entitled to deductions for dividends received from a REIT, because the REIT is also considered a corporation under Alabama law.
 - ◆ *Ameris Bank v. Dep't of Revenue*; No. BIT. 16-255
- ◆ In Connecticut, REITs must file as part of a combined group (if the group is unitary).
 - ◆ *Regarding the Calculation of the Corporation Business Tax on a Combined Unitary Basis, OCG-3*

Recent State and Local Tax Updates

- ◆ NYC Tax Appeals Tribunal ruled that, for the purposes of the REIT transfer real estate transfer tax rate, the taxpayers' use of EMV to determine the transfer of controlling interest under the 40% test was supported by administrative code.
 - ◆ [Matter of VCP One Park REIT LLC](#); TAT(H)14-26(RP)
- ◆ In a letter ruling, Tennessee Department of Revenue held that a REIT's distribution of a assets to a limited partner constituted a nontaxable return on capital and therefore was not subject to Tennessee Hall income tax.
 - ◆ [TN Dept. of Rev. Ltr. Rul. # 16-11](#)

Recent State and Local Tax Updates

- ◆ As in 2014, 2015, and 2016, legislation, [H.B. 1012](#) and [S.B. 1228](#), has been proposed in Hawaii to eliminate the dividends paid deduction (DPD) “temporarily” (for 15 years).
- ◆ Both would provide a limited exception for dividends attributable to affordable housing.
- ◆ The Hawaii house is expected to vote on H.B. 1012 on March 7th.
- ◆ S.B. 1228 was not heard in the Senate.

Partnership Audit Rules and REITs

Federal Partnership Audit Rules

- ◆ Bipartisan Budget Act of 2015
- ◆ It provides for one set of partnership-level audit rules that will apply to all partnerships, subject to an opt-out election available to some partnerships with 100 or fewer partners.
- ◆ Assess and collect tax at the partnership level, rather than for the partners
- ◆ NAREIT suggested regulatory [comments](#) (deficiency dividends)

State Implications

- ◆ Potential conflict – Nonresident Partner Withholding Obligations
 - ◆ A majority of states require partnerships to withhold taxes for some nonresident partners and directly remit those taxes to the state.
- ◆ Potential conflict – Composite Returns
 - ◆ A composite return is a return where a partnership files for its electing nonresident partners and computes and reports the income and tax attributable to the electing nonresident partners on a single return.
 - ◆ Deficiency dividends?

States' Reactions

- ◆ States have introduced legislation setting forth their own partnership audit rules in conjunction with IRC
 - ◆ [Arizona SB 1288](#) – Passed in 2016 Legislative Session
 - ◆ [Minnesota HF 1227](#) – Introduced to House
 - ◆ [Montana HB 47](#) – Currently in legislative committee

General State Conformity Issues

Federal-Conformity Adjustments and Issues for REITs

- ◆ Non-Conformity
 - ◆ Captive REITs

- ◆ Adjustments
 - ◆ State and local income tax deduction
 - ◆ Depreciation
 - ◆ Intercompany/Related Party Add-backs (separate from the IRC § 1502 adjustments)

Allocation of Built-In Gains Among States

- ◆ Built-In Gains – Generally
 - ◆ When a C Corp converts to a REIT or when a C Corp transfers assets to a REIT in certain instances, the transaction is treated as if the assets were sold, resulting in taxable gain.
 - ◆ 5-Year recognition window
 - ◆ The gain is taxed at the highest corporate rate of 35%.
- ◆ New IRC § 337 Regulation
 - ◆ 10-year recognition window for REITs adjusted to 5-year

State Treatment of Built-In Gains

- ◆ General Conformity to built-in gains rules
 - ◆ Most states conform via IRC general conformity statutes
 - ◆ IRC generally only used to determine state starting point
- ◆ Recognized built-in gains subject to apportionment
 - ◆ See Iowa Code § 52.1(5), which states that S Corporations that are subject to the built-in gains tax under IRC § 1374 “are subject to Iowa corporation income tax on this income to the extent received from business carried on in this state or from sources in this state.”
 - ◆ Potentially analogous to either DIT or installment sale income

State Real Estate Tax Issues for 2017

Forthcoming Developments

- ◆ California Supreme Court will hear *926 North Ardmore Avenue LLC v. County of Los Angeles* on April 5, 2017 to determine the applicability of California's documentary transfer tax is incurred by transferring a controlling interest in a legal entity holding real property interests

Forthcoming Developments

- ◆ New York State FY18 Budget Revenue Proposals
 - ◆ Part AA – change treatment of nonresident partner’s sale of partnership interest in certain Rev. Rul. 99-6 transactions.
 - ◆ Part JJ – expands scope of real estate transfer tax to transfer of certain pass-through entities and non-publicly-traded corporations with an interest in New York real property.
- ◆ Philadelphia Bill 160810, effective 7/1/2017, will impose the realty transfer tax when 75% or more of a real estate company is transferred in any 6 year period.