

# Legislators target REIT tax ‘loophole’

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Forget for a moment whether it’s good or bad. Here’s how it works:

A company creates a subsidiary to buy and manage property – say, office buildings or retail stores. It then leases the property from the subsidiary and writes off the rent as a business expense on its state tax return. The subsidiary, in turn, pays little or nothing in taxes.

It’s perfectly legal, most would agree (though some states argued otherwise in court). And for many large corporations, it’s really helped the bottom line. A Wall Street Journal report last February said Wal-Mart Stores Inc. alone had saved “several hundred million dollars” using the approach.

The problem is, what Wal-Mart and others see as a helpful business tool doesn’t go over that well with state tax collectors. And both in courts and in state legislatures, the real estate investment trust corporate income tax shelter is facing impassioned challenges.

Now Rhode Island has joined the REIT battle, with three bills now before the General Assembly, including two co-sponsored by the chairmen of the House and Senate finance committees, that would end the special treatment of REITs here.

Rhode Island’s corporate income tax rate is 9 percent, but REITs, personal holding companies and regulated investment companies pay only 10 cents per \$100, or 1/90th of that. And because dividend payouts are not defined as taxable, REITs’ liabilities can be even smaller.

The proposed legislation, H-6319, H-6333 and S-974 (all use the same language), would delete a special section of the state tax code that deals with those special entities, and instead subject them to the rules for regular corporations. It also would make REIT dividends non-deductible.

This is the first time Rhode Island has taken on REITs, and it has a big incentive to do so: a \$350 million deficit.

Rep. Raymond J. Sullivan Jr., D-Coventry, one of the bills’ sponsors, said that’s part of what motivated him to take action.

“Our finance committees are having to struggle with some very difficult choices,” he said. “A number of social programs are being placed in jeopardy ... The average homeowner is doing everything in their power to pay their property taxes.

And now you have these multi-state companies using these tax shelters to avoid paying their fair share.”

For the corporations involved, “it’s a matter of doing business,” Sullivan said, “but for the rest of us ... it becomes a matter of equity and a matter of fairness.”

A local spokesman for Wal-Mart did not respond to a request for comment for this story. But David R. Carlin III, vice president of government affairs for the Northern Rhode Island Chamber of Commerce and lobbyist for the Rhode Island Chamber of Commerce Coalition, said both groups oppose the legislation and will fight to keep the tax shelters.

“I think that they are definitely a valuable tool for companies that do business in Rhode Island,” Carlin said. “It is not a loophole ... it is in the tax code. It is a tool that is available to businesses, much as the tools that are available to individual taxpayers.”

“We view these tools as important in the overall production of new jobs, new growth, and certainly sustaining jobs and growth,” he added.

Carlin also took issue with the notion that tax benefits for businesses should be targeted as a way to cut the deficit.

“I think the overall picture has to be not how do we increase revenue by adding new taxes or eliminating certain tax tools,” he said. ↯ “It ought to be how do we look at responsibly reducing the cost of state government overall.”

Opponents of the REIT legislation might find some fodder in a report issued last week by the business-backed Rhode Island Public Expenditure Council that cited Ernst & Young figures showing that businesses paid 46 percent of total state and local taxes in Rhode Island in fiscal 2006, compared with 38.7 percent in Massachusetts and 34.3 percent in Connecticut.

The RIPEC report also said businesses paid more than 55 percent of the total increase in state and local tax collections from fiscal 2002 to fiscal 2006, and that corporate income taxes represent 12.5 percent of state and local taxes in Rhode Island, compared with 9.4 percent nationally.

Ellen Frank, an economist at the Poverty Institute at Rhode Island College, which has argued that the state should work to close corporate tax loopholes, said the RIET legislation shouldn’t affect most companies in Rhode Island.

“These are generally employed by large multi-state businesses,” Frank said. “So the result of large multi-state companies not paying their fair share is that small businesses have to make up the slack, as do individual taxpayers in the state. It’s not a level playing field.”

But while the Poverty Institute plans to support the REIT legislation, Frank said a broader solution is actually needed: mandating combined reporting, a system in which companies have to pull together the profits of all their domestic subsidiaries and then allocate a portion of the total to each state. Otherwise, she said, corporations will just find a new loophole.

“Companies are always scouring the tax code for new ways to shelter income,” she said.