

# Tax shelters under scrutiny

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PROVIDENCE — The state will lose more than \$10 million this year because of loopholes that allow multistate corporations such as Wal-Mart to use tax shelters to avoid paying tens of thousands of dollars in state taxes.

While the shelters are difficult to detect, state Tax Administrator David M. Sullivan estimates that between 10 and 20 companies operating in Rhode Island — primarily large banks and major retailers — use loopholes to reduce their tax liability.

“There could be more,” Sullivan said. “They are totally legal under the way our laws are written now.”

One of the loopholes allows a company to save on state taxes by essentially paying rent to itself (an out-of-state company it owns). Another allows a corporation to save by paying an out-of-state subsidiary to use its own corporate logo and other “intangible assets.”

Facing a projected budget shortfall of at least \$90 million next year, Rhode Island lawmakers are following the lead of states around the nation moving to close the loopholes. A handful of such bills have been introduced this session, one backed by the chairman of the Senate Finance Committee, Stephen Alves, D-West Warwick.

“It’s a matter of tax fairness. Even corporations should be paying their fair share,” said Alves, whose bill targeting “captive real estate investment trusts” was endorsed by his committee yesterday. “I’m not one of those to say let’s go after the big corporations. But these are loopholes that they don’t enjoy in other states. Why should they get them here in Rhode Island?”

The governors of six states, including Massachusetts, have recommended this year that their states close “tax avoidance” loopholes, according to a report issued last month by the Washington-based nonpartisan Center on Budget and Policy Priorities. Overall, 20 states have adopted such policies.

Sullivan would not disclose which corporations operating in Rhode Island use loopholes. The state can access such information only by auditing private tax records.

But records filed with the secretary of state’s office show several large corporations with a presence in Rhode Island also have subsidiaries in Delaware. Tax shelters are largely based in Delaware, which doesn’t tax many forms of corporate income.

Sullivan estimates that Rhode Island could recover \$8.3 million in corporate taxes next year by blocking the use of “passive investment companies,” also known as “Delaware holding companies.” The scheme has existed for roughly two decades, Sullivan said.

The passive investment company loophole works like this:

Rhode Island law allows corporations to sell or transfer intangible assets, such as company logos, patents, and other intellectual property, to passive investment companies in other states.

After a corporation that does business in Rhode Island establishes such a company in Delaware, the Rhode Island parent pays the holding company for use of the intangible assets. The payment is considered a business expense and deducted from the parent company’s corporate income-tax liability in Rhode Island.

A popular example that landed in the South Carolina Supreme Court (often the only way that use of such loopholes are exposed) involved Toys “R” Us and a Delaware-based subsidiary named Geoffrey Inc., after the toy company’s giraffe mascot.

Ellen Frank, senior economist for Rhode Island College’s Poverty Institute, has been studying the loopholes as state leaders struggle to balance the fiscal 2008 budget without cutting social programs.

“These techniques tend to be used by large multistate companies, which puts smaller local companies at a decided disadvantage, competing with these big-box stores that have managed to evade taxes,” she said. “The small businesses and individual taxpayers have to pick up the lost revenue.”

She noted that some corporations have shifted from relying on passive investment companies to something known as “captive real estate investment trusts,” or REITs. The REITs work much the same way as the investment companies, but deal with real-estate holdings instead of intangible assets.

Sullivan said that use of REITs could cost the state more than \$1 million this year.

For example, a company transfers ownership of its Rhode Island property to a REIT in Delaware. The Rhode Island stores then pay rent to the Delaware subsidiary, and the corporation can deduct the rent payments from its Rhode Island corporate-tax liability.

Records filed with the secretary of state’s office reveal that several companies with locations in Rhode Island have REITs.

The Wal-Mart Real Estate Business Trust, based in Delaware, handles the rental of retail store locations in Rhode Island, according to secretary of state filings. There is a separate Sam’s Real Estate Business Trust, which oversees the rental of retail store locations for Sam’s Club (also owned by Wal-Mart).

Similarly, the Textron Realty Corp. is a Delaware-based subsidiary of Providence-based Textron Inc. Its purpose is the “ownership and rental of real property,” according to its most recent filing with the secretary of state.

Company representatives from Wal-Mart and Textron declined to comment when contacted yesterday.

Gary Sasse, executive director of the business-backed Rhode Island Public Expenditure Council, acknowledged that the loopholes give multistate corporations an advantage over local companies.

“There’s no question that there are loopholes in Rhode Island’s corporate-tax structure which need to be addressed,” he said. “The government shouldn’t be giving an advantage to one company over another.”

But Sasse said that Rhode Island businesses pay 46 percent of total state and local taxes — slightly above the national average — and warned that there may be negative economic consequence should the state’s corporate tax code be dramatically altered.

The governor’s office had a similar warning, characterizing the move to close loopholes as a new tax on business.

“Governor Carcieri is not in favor of raising taxes on corporations,” spokesman Jeff Neal said. “Providing a disincentive for business to expand and relocate in Rhode Island — that doesn’t help create jobs. The governor is always willing to consider tax-policy reform, but raising individual taxes, largely for the purpose of increasing spending, or closing a deficit, will have negative consequences for the Rhode Island economy.”

Frank doubted the likelihood that companies would leave Rhode Island if the loopholes were closed.

“Anything that potentially increases the tax liability of businesses could be perceived as anti-business,” she said. “On the other hand, it’s also true that not all companies use these loopholes. Those that do in many cases are large retailers that won’t leave the state because they need a presence here.”

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