



**Fiscal Estimate Narratives**  
**DOR 3/5/2008**

LRB Number <b>07-3712/4</b>	Introduction Number <b>SB-527</b>	Estimate Type <b>Original</b>
<b>Description</b> Income and franchise taxes imposed on real estate investment trusts and regulated investment companies		

**Assumptions Used in Arriving at Fiscal Estimate**

A real estate investment trust (REIT) is a real estate company whose primary business is managing groups of income-producing properties; similarly a mortgage REIT is a company that invests in mortgages. To qualify as a REIT for federal tax purposes, the entity must pay out in dividends at least 90% of its taxable profit. By having REIT status, the company receives a dividends paid deduction that effectively allows it to be treated as a pass-through entity and avoid corporate federal income tax.

Under current law, Wisconsin has adopted federal provisions that generally allow a REIT to deduct dividends paid from the entity's taxable income.

Multi-state entities may be using the pass-through treatment of REITs to shift income in an attempt to avoid taxation in states that use unitary reporting. The tax avoidance may occur as follows: Taxpayer A has nexus in Wisconsin. All its properties are owned by REIT B. Company A reduces its tax liability to the extent that its income is reduced by the rent expenses paid to REIT B. REIT B is 99% owned by Company C (often located outside the state). REIT B pays dividends to Company C; REIT B takes a dividends paid deduction, thereby eliminating its tax liability. Because Company C owns at least 70% of the stock of REIT B, it is allowed a dividends received deduction (under s. 71.26(3)(j)). Moreover, if Company C is located in a state with no Wisconsin nexus, it is not subject to Wisconsin tax.

A captive REIT is a REIT that is more than 50% owned or controlled, directly or indirectly by a single corporation that is not a REIT or is otherwise exempt from state tax. The bill disregards certain transactions for amounts paid to a captive REITs.

Based on data for tax year 2003 returns for firms that claimed large deductions for both rent expense and dividends received from affiliates, the estimated revenue increase of the proposal is between \$6 and \$12 million from disregarding the transaction for amounts paid to a nonqualified, captive REIT. Data do not allow a determination of which firms were engaging in tax planning through the use of captive REITs. The fiscal effect would be higher if more Wisconsin rent expenses are paid to REITs than is assumed in the estimate or if other types of expenses paid to captive REITs would be disregarded under the bill. The fiscal effect will also be higher to the extent that transactions between entities and captive mortgage REITs would be disregarded; however, data are not available to estimate the revenue increase related to mortgage REITs.

**Long-Range Fiscal Implications**

## Fiscal Estimate Worksheet - 2007 Session

Detailed Estimate of Annual Fiscal Effect

Original     
  Updated     
  Corrected     
  Supplemental

<b>LRB Number</b> 07-3712/4		<b>Introduction Number</b> SB-527	
<b>Description</b> Income and franchise taxes imposed on real estate investment trusts and regulated investment companies			
<b>I. One-time Costs or Revenue Impacts for State and/or Local Government (do not include in annualized fiscal effect):</b>			
<b>II. Annualized Costs:</b>		<b>Annualized Fiscal Impact on funds from:</b>	
		Increased Costs	Decreased Costs
<b>A. State Costs by Category</b>			
State Operations - Salaries and Fringes	\$	\$	
(FTE Position Changes)			
State Operations - Other Costs			
Local Assistance			
Aids to Individuals or Organizations			
<b>TOTAL State Costs by Category</b>	<b>\$</b>	<b>\$</b>	
<b>B. State Costs by Source of Funds</b>			
GPR			
FED			
PRO/PRS			
SEG/SEG-S			
<b>III. State Revenues - Complete this only when proposal will increase or decrease state revenues (e.g., tax increase, decrease in license fee, ets.)</b>			
	Increased Rev	Decreased Rev	
GPR Taxes	\$	\$	
GPR Earned			
FED			
PRO/PRS			
SEG/SEG-S			
<b>TOTAL State Revenues</b>	<b>\$</b>	<b>\$</b>	
<b>NET ANNUALIZED FISCAL IMPACT</b>			
	State	Local	
NET CHANGE IN COSTS	\$	\$	
NET CHANGE IN REVENUE	\$See text	\$	
<b>Agency/Prepared By</b>		<b>Authorized Signature</b>	<b>Date</b>
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