

Letter of Findings Number: 02-20130135
Corporate Income Tax
For the Year Ending December 31, 2011

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ISSUE

I. Corporate Income Tax—Captive REIT.

Authority: IC § 6-3-1-3.5; IC § 6-3-1-34.5; IC § 6-8.1-5-1; I.R.C. § 856; I.R.C. § 857.

Taxpayer protests the addback for dividends paid by a REIT.

STATEMENT OF FACTS

Taxpayer is a real estate investment trust (REIT) operating in Indiana. Taxpayer filed a corporate income tax return with the Indiana Department of Revenue ("Department"). Initially, Taxpayer reported its net income prior to payment of dividends and claimed a deduction for dividends paid by Taxpayer. However, the Department subsequently reversed the deduction and treated that amount as an addback. In other words, Taxpayer reported \$1,000,000 on line 1 of the IT-20 and deducted \$1,000,000 on the IT-20 as dividends paid, arriving at zero adjusted gross income. The deduction was claimed using the numeric code listed for the addback for dividends paid by a "captive REIT." The Department initially accepted the \$1,000,000 line one figure but added back the \$1,000,000 amount claimed as a deduction, resulting in a \$2,000,000 adjusted gross income.

Upon review, the Department adjusted line one of the IT-20 to be zero, which was Taxpayer's federal taxable income. However, the Department did not adjust the addback for dividends paid by a captive REIT. These adjustments resulted in an assessment for Taxpayer. Taxpayer protested the assessment, and this Letter of Findings results.

I. Corporate Income Tax—Captive REIT.

DISCUSSION

Taxpayer protests the imposition of corporate income tax. In particular, Taxpayer protests that it is not a captive REIT and thus should not be required to add back the dividends paid to its owners.

The burden of proving a proposed assessment incorrect rests with the taxpayer, as provided under IC § 6-8.1-5-1(c).

I.R.C. § 856 permits entities meeting certain ownership and operation tests to be classified as REITs for federal tax purposes. Taxpayer meets these tests.

I.R.C. § 857(b)(1) imposes a tax on the "real estate investment trust taxable income" at the rates otherwise provided for C corporations. I.R.C. § 857(b)(2) provides that "real estate investment trust taxable income" is the taxable income of a REIT, with several modifications. One of the modifications under I.R.C. § 857(b)(2)(B) is a deduction for dividends paid.

Indiana law requires certain REITs to add back dividends paid; this provision is currently codified at IC § 6-3-1-3.5(b)(10). This provision requires a REIT to:

Add an amount equal to any deduction for dividends paid (as defined in Section 561 of the Internal Revenue Code) to shareholders of a captive real estate investment trust (as defined in section 34.5 of this chapter).

IC § 6-3-1-34.5 provides that:

(a) Except as provided in subsection (b), "captive real estate investment trust" means a corporation, a trust, or an association:

(1) that is considered a real estate investment trust for the taxable year under Section 856 of the Internal Revenue Code;

(2) that is not regularly traded on an established securities market; and

(3) in which more than fifty percent (50 [percent]) of the:

(A) voting power;

(B) beneficial interests; or

(C) shares;

are owned or controlled, directly or constructively, by a single entity that is subject to Subchapter C of Chapter 1 of the Internal Revenue Code.

(b) The term does not include a corporation, a trust, or an association in which more than fifty percent (50 [percent]) of the entity's voting power, beneficial interests, or shares are owned by a single entity described in subsection (a)(3) that is owned or controlled, directly or constructively, by:

(1) a corporation, a trust, or an association that is considered a real estate investment trust under Section 856 of the Internal Revenue Code;

(2) a person exempt from taxation under Section 501 of the Internal Revenue Code;

(3) a listed property trust or other foreign real estate investment trust that is organized in a country that has a tax treaty with the United States Treasury Department governing the tax treatment of these trusts; or

(4) a real estate investment trust that:

(A) is intended to become regularly traded on an established securities market; and

(B) satisfies the requirements of Section 856(a)(5) and Section 856(a)(6) of the Internal Revenue Code under Section 856(h) of the Internal Revenue Code.

(c) For purposes of this section, the constructive ownership rules of Section 318 of the Internal Revenue Code, as modified by Section 856(d)(5) of the Internal Revenue Code, apply to the determination of the ownership of stock, assets, or net profits of any person.

To be considered a captive REIT, a REIT must meet the tests set forth under IC § 6-3-1-34.5(a)(1), (a)(2), and any one of the criteria set forth under (a)(3). IC § 6-3-1-34.5(b) sets forth various exceptions regarding REITs that may otherwise fall under the definition of a captive REIT under IC § 6-3-1-34.5(a). However, the REIT must meet an exception set forth under IC § 6-3-1-34.5(b) ("the exceptions") separately for each criteria set forth in the flush language in subsection(b). In other words, more than fifty percent of the beneficial interests must meet one or more of the exceptions, more than fifty percent of the voting power must meet one or more of the exceptions, and more than fifty percent of the shares must meet one or more of the exceptions.

Taxpayer meets the criteria under IC § 6-3-1-34.5(a)(1) and (a)(2). The remaining issue is whether Taxpayer meets the tests under IC § 6-3-1-34.5(a)(3) and/or an exception under IC § 6-3-1-34.5(b).

In this particular case, Taxpayer provided an organizational chart representing the owners of the REIT in question. Various pension funds and other entities exempt from taxation under I.R.C. § 501 own more than fifty percent of the beneficial interests in Taxpayer. Taxpayer has provided sufficient factual grounds to conclude that its beneficial interests are owned in such a manner that meets the exception under IC § 6-3-1-34.5(b)(2) to not be considered a captive REIT. With regard to voting control or shares, Taxpayer has not affirmatively established who has voting control over or share ownership in the REIT. Nevertheless, Taxpayer has provided sufficient grounds to conclude that the voting control and share ownership questions should be revisited.

Taxpayer shall provide any information related to who possesses voting control over and share ownership in the REIT no later than thirty (30) days after the issuance of this Letter of Findings, including any information necessary to determine the ownership attribution of any entity. This information shall be reviewed and the assessment adjusted in accordance with such information. If Taxpayer does not provide such information, Taxpayer's protest will be denied.

FINDING

Taxpayer's protest is sustained subject to the provision of additional information. If Taxpayer can timely provide information related to who possesses voting control over and share ownership of Taxpayer, this protest will be sustained subject to Department review. Failure to provide this information will cause the protest to be denied.

Posted: 07/30/2014 by Legislative Services Agency
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