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**NATIONAL ASSOCIATION OF  
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May 26, 2011

Ms. Loretta King  
Multistate Tax Commission  
444 N. Capitol Street, N.W., Suite 425  
Washington, D.C. 20001-1538  
[lking@mtc.gov](mailto:lking@mtc.gov)

Re: Comments on Multistate Tax Commission's Proposed Model Statute  
Regarding Partnership or Pass-Through Entity Income That is Not Subject to  
Income Tax: Suggested Statutory Language

Dear Ms. King:

The National Association of Real Estate Investment Trusts (NAREIT)<sup>®</sup> thanks you for the opportunity to submit additional comments on the Multistate Tax Commission's (MTC) draft Proposed Model Statute Regarding Partnership or Pass-Through Entity Income That is Not Subject to Income Tax, which is posted on [www.mtc.gov](http://www.mtc.gov) (2011 Proposed Draft). These comments suggest revised statutory language, consistent with our May 12, 2011 comments in which we recommended that the 2011 Proposed Draft be modified so that it achieves its goal of preventing inequitable treatment among taxpayers without modifying the existing state tax treatment of widely-held REITs.

NAREIT is the worldwide representative voice for REITs and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate, and finance income-producing real estate, as well as those firms and individuals who advise, study, and service those businesses.

**EXECUTIVE SUMMARY**

Because we are not experts in the state taxation of insurance companies, these comments assume that the Proposed Draft will address the taxation of insurance-company owned pass-through entities generally in the manner set forth in the Proposed Draft. However, we remain concerned about the imposition of an entity-level tax on partnerships and disregarded entities, particularly because these structures for decades have been the preferred structure of investing in real estate.



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As we have previously mentioned with respect to the 2011 Proposed Draft, while NAREIT understands the MTC's objective in avoiding inequitable treatment among taxpayers, it appears that the Proposed Draft overreaches by inadvertently imposing tax on certain non-public REITs implicitly recognized as legitimate and non-abusive by the MTC in connection with its model captive REIT statute as well as potentially certain REIT-owned partnerships –structures used by the vast majority of real estate owners in the U.S. Accordingly, we recommend that the 2011 Proposed Draft be modified so that its effect is limited to its original objective-- addressing the perceived inequity with respect to insurance company ownership of pass-through entities. Specifically, we recommend the following changes to the Proposed Draft. First, the Proposed Draft should limit its current language regarding any entity not subject to income tax to those investment structures with respect to which the MTC already has indicated a concern – pass-through entities more than 50% owned by insurance companies. If this is not done, at the very least, the Proposed Draft should clarify that a REIT is considered “subject to income tax.” Second, the Proposed Draft should not treat a REIT as a pass-through entity because a REIT is not a pass-through entity; unlike a partnership or disregarded entity which may retain or distribute income, it is required to distribute at least 90% of its taxable income as a dividend (meaning it needs sufficient earnings and profits to support such a distribution), and, unlike a partnership or limited liability company, it may not pass through credits or losses to its investors. To the extent that there is concern about insurance company ownership of REITs, this concern should be addressed through an amendment to the MTC's captive REIT statute.

### PROPOSAL: REVISED STATUTORY LANGUAGE

NAREIT suggests the following marked changes to the Proposed Draft (marked in red below):

(a) When 50 per cent or more of the capital interests or profits interest in an entity for which deductions would be allowed under section 162 of the Internal Revenue Code, 26 U.S.C. 162 and that would otherwise be treated as a partnership or disregarded entity for purposes of [insert applicable state tax or taxes] is owned, directly or indirectly through a pass-through entity,<sup>1</sup> by [an insurance company, with a citation to the state tax statute applicable to such entity type], the net income [or alternative tax base] that passes through to such [insurance company] shall be taxed to the partnership or disregarded entity as if the partnership or disregarded entity were a corporation subject to tax under chapter [insert state statute].

Deleted: identify each entity type that is not subject to income tax

Deleted: and that state wants to cover under this provision, such as “

Deleted: ”

Deleted: each

Deleted: name each entity type identified above, e.g. “

Deleted: .”]

<sup>1</sup> Ownership through a taxable entity should not be relevant because the stated concern relates to the income of a lower-tier entity escaping taxation because it is earned by an entity not subject to income tax. To the extent that the MTC disagrees, and, for example, wishes to consider ownership through a REIT or mutual fund, Proposed Draft should only consider such ownership to the extent that the relevant shareholder owns more than 5% of a listed REIT or mutual fund.

<sup>2</sup> Although NAREIT believes that this ambiguous language regarding any entity not subject to income tax should be deleted from the Proposed Draft, to the extent the MTC disagrees, the language first should be clarified to state specifically that a REIT as defined under section 856 of the Internal Revenue Code of 1986, as amended, is “subject to income tax.”



(b) To the extent applicable, income that is taxable to the partnership or disregarded entity pursuant to this section, and any related tax attributes and activities shall be included and taken into account in a combined report filed under [*insert state statute*].

~~(c) [if necessary] For purposes of [the MTC's draft model captive REIT statute], an insurance company shall be treated as an association taxable as a corporation under the Internal Revenue Code of 1986, as amended.~~

**Deleted:** As used herein, the term "partnership or disregarded entity" shall include a real estate investment trust (REIT) within the meaning of Section 856 of the Internal Revenue Code of 1986, as amended.

\*\*\*\*\*

Thank you again for the opportunity to submit these comments. Please contact me at (202) 739-9446, or my colleague Tony Edwards, at (202) 739-9408, if you would like to discuss these comments in more detail.

Sincerely,



Dara F. Bernstein  
Senior Tax Counsel

Cc: Sheldon H. Laskin, Esq. ([slaskin@mtc.gov](mailto:slaskin@mtc.gov))

