

Department of Legislative Services
Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 968

(Senators King and Elfreth)

Budget and Taxation

Ways and Means

Income Tax - Captive Real Estate Investment Trusts - Alterations

This bill modifies the definition of a “captive real estate investment trust (REIT)” for purposes of the Maryland income tax addition modification for the amount of the federal dividends paid deduction claimed by a captive REIT. Specifically, the bill excludes from the definition of a captive REIT a corporation, trust, or association that otherwise meets the ownership requirements for status as a captive REIT and is more than 50% owned or controlled by (1) an entity organized as a trust in which a listed Australian property trust owns or controls, directly or indirectly, 75% or more of the voting power or value of the beneficial interests or shares of the trust or (2) a qualified foreign entity, as defined by the bill. **The bill takes effect July 1, 2023, and applies to tax year 2023 and beyond.**

Fiscal Summary

State Effect: General fund revenues, Higher Education Investment Fund (HEIF) revenues, and Transportation Trust Fund (TTF) revenues and expenditures may decrease by an indeterminate amount beginning in FY 2024, as discussed below.

Local Effect: Local highway user revenues may decrease by an indeterminate amount beginning in FY 2024, as discussed below.

Small Business Effect: Minimal.

Analysis

Bill Summary: “Qualified foreign entity” means a corporation, trust, association, or partnership that is organized under the laws of a foreign government and:

- at least 75% of the total asset value of the entity at the close of the entity's taxable year is represented by real estate assets, as defined in § 856 of the Internal Revenue Code (IRC), cash and cash equivalents, and U.S. government securities;
- is not subject to tax on amounts distributed to the entity's beneficial owners or is exempt from entity-level taxation;
- on an annual basis, distributes at least 85% of the taxable income of the entity, as computed in the jurisdiction in which the entity is organized, to the holders of the shares or certificates of the beneficial interests of the entity;
- of which not more than 10% of the voting power or value of the beneficial interests or shares of the entity is owned or controlled directly, indirectly, or constructively by a single entity or individual, or the beneficial interests or shares of the entity are regularly traded on an established securities market; and
- the entity is organized in a foreign country that has a tax treaty with the U.S. government.

Current Law: A corporation, trust, or association that operates as a vehicle for investment in real estate and meets various specified requirements may qualify for treatment as a REIT for federal income tax purposes. To qualify for REIT status, a corporation, trust, or association must, among other requirements, derive at least 95% of its gross income from specified passive income sources and at least 75% of its income from specified real estate sources.

In general, for purposes of computing federal taxable income, a REIT that distributes at least 90% of its income to shareholders and otherwise meets all applicable requirements may deduct the amount of dividends paid during the taxable year. Thus, such dividends are subject to income tax only at the shareholder level.

Maryland's income tax generally conforms to the federal tax treatment of REITs, except in the case of "captive REITs," which are more than 50% owned or controlled by a single entity. Chapters 583 and 584 of 2007 disallowed the dividends paid deduction for captive REITs for purposes of Maryland corporate income tax. Thus, a REIT that meets the definition of a captive REIT must add back to income the amount of its federal dividends paid deduction for purposes of Maryland's corporate income tax.

The Acts defined a captive REIT as a corporation, trust, or association:

- that is considered a REIT for the taxable year under § 856 of the IRC;
- that is not regularly traded on an established securities market; and
- where more than 50% of the voting power or value of the beneficial interests or shares, at any time during the last half of the taxable year, is owned or controlled,

directly or indirectly, by a single entity that is subject to the provisions of Subchapter C of Chapter 1 of the IRC.

The Acts expressly excluded from the definition of a captive REIT:

- a corporation, trust, or association that meets the ownership requirements for status as a captive REIT and is more than 50% owned or controlled by (1) a REIT other than a captive REIT; (2) a person exempt from taxation under § 501 of the IRC; or (3) a listed Australian property trust; or
- subject to regulations, a REIT that is intended to become regularly traded on an established securities market, as specified.

State/Local Fiscal Effect: The bill's changes, which narrow the definition of a captive REIT for Maryland income tax purposes, are based on provisions of the Multistate Tax Commission's Proposed Model Statute for Taxation of Captive Real Estate Investment Trusts as amended by the Multistate Tax Commission's Executive Committee on January 3, 2008. Under the bill, fewer REITs may be considered captive REITs subject to the Maryland addition modification for the amount of the federal dividends paid deduction claimed by a captive REIT.

Thus, beginning in fiscal 2024, general fund, HEIF, and TTF revenues decrease to the extent the bill exempts additional REITs from the addition modification for captive REITs and reduces the corporate income tax liability of affected entities. A portion of TTF revenues from the corporate income tax are used to provide transportation capital grants to local governments (local highway user revenues); thus, local highway user revenues and corresponding TTF expenditures may also decrease beginning in fiscal 2024.

A preliminary analysis by the Comptroller's Office indicates that most REITs subject to the existing addition modification would not be impacted by the bill's changes. However, the Comptroller's Office advises that a thorough examination of the individual corporate structures of potentially affected entities is required in order to fully analyze the bill's potential impact on corporate income tax revenues. Thus, a precise estimate of the bill's effect on State and local finances cannot be determined at this time.

Additional Information

Prior Introductions: Similar legislation has not been introduced within the last three years.

Designated Cross File: None.

Information Source(s): Comptroller's Office; Multistate Tax Commission; Department of Legislative Services

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