

DO PASS-THROUGH ENTITIES STRIP INCOME FROM THEIR CORPORATE SUBS? EVIDENCE FROM TAXABLE REIT SUBSIDIARIES*

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INTRODUCTION

THIS PAPER EXAMINES WHETHER REAL ESTATE investment trusts (REITs) reduce the taxable income of their C corporation subsidiaries by overcapitalizing them with debt or overcharging them rent. Taxable REIT subsidiaries (TRSs) were created by the 1999 REIT Modernization Act (RMA) to allow REITs to provide “non-traditional” real estate services, which if produced by the REIT itself generate “bad income” that can threaten the REIT’s pass-through status. TRSs are subject to the regular corporate income tax, and their interest and dividend distributions are “good income” to the parent REIT. To prevent parent REITs from reducing TRS taxable earnings, the RMA placed restrictions on TRS leverage, rental payments, and service charges.

To assess whether interest or rents are being used to reduce TRS taxable income, a comparison group of non-TRS real estate service corporations is drawn from the Statistics of Income (SOI) corporate database for 2001-2004. Leverage, loans from shareholders, and rental expense for TRS and non-TRS corporations are compared, as is the ratio of corporate income tax liabilities to total receipts. Regression results indicate that TRSs do not use more debt or loans from shareholders than non-TRS real estate service corporations; however, they pay significantly higher rents. Nonetheless, TRSs do not appear to pay more in corporate income tax relative to total receipts than non-TRS real estate corporations.

The following section discusses the policy background surrounding the creation of taxable REIT subsidiaries and concerns about their implementation. The third section describes the data and sample used to evaluate TRSs vs. non-TRS real estate service corporations. The fourth section presents the regression results, and the fifth section concludes.

PASS-THROUGH ENTITIES, CORPORATE SUBSIDIARIES, AND INCOME STRIPPING

In the past several decades, pass-through entities such as S corporations, limited liability corporations (LLCs), and partnerships have been promoted as a means of alleviating the distortions introduced by the corporate income tax. Generally, however, pass-through entities do not have access to public equity markets; businesses that wish to issue publicly traded stock must usually form C corporations subject to the corporate income tax.

The tax code does, however, provide for several forms of publicly traded pass throughs, including real estate investment trusts (REITs), regulated investment companies (RICs), and publicly traded partnerships (PTPs). These pass-through entities must generally meet certain restrictions on their income and/or assets in order to maintain their exemption from the corporate income tax. Generally, they must derive the bulk of their income from passive sources such as dividends, interest and rents (in the case of RICs and REITs) or other capital-intensive activities. Allowing these publicly traded entities pass-through status prevents multi-layer taxation of capital income, while giving (small) investors access to diversified investment vehicles. Conversely, the “good income” restrictions prevent erosion of the corporate tax base.

Publicly traded pass throughs owning assets that generate “bad income” can convert that income to “good income” by owning those assets through a subsidiary C corporation which pays corporate income tax on its earnings and distributes to the parent dividends and/or interest. In order to avoid paying corporate income tax on subsidiary earnings, the parent pass-through has an incentive to reduce the subsidiary’s taxable income through overleveraging or engaging in non-arm’s length transactions (transfer pricing). The central question of this study is to what extent REITs engage in these practices with respect to TRSs.

The REIT Modernization Act (RMA), passed as part of the Ticket to Work and Work Incentives Improvement Act of 1999,¹ gave REITs the right to

*The views expressed in this paper are the author’s and do not represent the views of the U.S. Treasury Department.

establish taxable REIT subsidiaries (TRSs). Prior to the RMA, REITs earning more than a *de minimis* amount of income from provision of non-customary services to a property disqualified all income from that property as “good income” under the two REIT income tests. REIT quarterly income tests require at least 95 percent of REIT income to be from passive sources including rent, interest, and dividends, and at least 75 percent of REIT income to be from real estate sources including rent and mortgage interest. Failure to meet these tests results in loss of REIT status (i.e., subjection to the corporate income tax).

Under the RMA, REITs were permitted to provide non-customary services through a TRS, a C corporation subject to the corporate income tax whose distributions of dividends and interest to the parent REIT qualify for the 95 percent passive income test. Thus, by virtue of their subjection to the corporate income tax, TRSs can effectively transform “bad income” into “good income.” Whereas prior to the RMA REITs could own no more than 10 percent of the voting stock of any particular entity, they may own 100 percent of the voting stock of a TRS. Also, while securities of any one entity may generally constitute no more than 5 percent of a REIT’s assets, stock in one or more TRSs may constitute up to 20 percent of a REIT’s assets. The RMA also provides for tax-free conversion of preexisting REIT subsidiaries into TRSs.

In order to prevent REITs from reducing TRS taxable income through excess leverage, excess rents, or underpriced service purchases, the RMA imposed the following restrictions: TRSs would be subject to Section of the Internal Revenue Code, which disallows the deduction of interest on related-party debt unless either (1) the corporation’s debt-to-equity ratio is at most 1.5, or (2) the corporation has no “excess interest,” defined as net interest expense (interest paid less interest received) less 50 percent of “adjusted taxable income” (earnings before deduction of interest, depreciation, and taxes) plus any “excess limitation” (carryforward of unused adjusted taxable income from previous periods). Matheson (2008) shows the incidence of these conditions among TRSs.

To prevent REITs from stripping taxable income out of TRSs via excess rental charges, the RMA stipulates that a TRS may rent no more than 10 percent of any property owned by the parent REIT, and must pay rent comparable to that of other tenants. The RMA imposes a 100 percent excise tax on REIT income from transactions with the

TRS in which rent and/or service prices are found upon audit to be non-arm’s length. A safe harbor from this tax exists where (1) the REIT charges comparable rents to tenants not receiving services from the TRS, (2) the TRS charges the same service prices to REIT tenants and unrelated parties, and (3) the TRS charges at least a 50 percent markup over direct costs for services.

This paper examines the issue of whether REITs strip taxable income from TRSs using either excess debt or rents. Since no data on TRS service pricing are available on TRS tax returns, that issue cannot be examined here. To this end, TRS leverage, rental expense, and tax remittances will be compared with those of non-TRS real estate service corporations in the following sections.

DATA

The study data are drawn from the Internal Revenue Service’s Form 8875, *Taxable REIT Subsidiary Election*, and Form 1120, *U.S. Corporate Income Tax Return*, for the years 2001-2004, the first four years of TRS operation. Form 8875 was used to identify the universe of firms electing TRS status during this period. Form 1120 data for those corporations was then extracted from the Statistics of Income (SOI) Corporate Database and Business Master File, and their NAICs codes were identified.

The distribution of these codes is shown in Table 1. A total of 862 TRSs filed Form 1120 during 2001-2004; 80 percent of these firms were in NAICs category 5, “Information, Finance, Real Estate and Professional Services.” Of these 688 firms, 476 or 55.3 percent of all TRSs were in NAICs category 53, “Real Estate and Rental and Leasing.” Within this sector, five NAICs categories each accounted for more than 1 percent of the TRS population, which together constituted 54.1 percent of that population: residential lessors (531110), non-residential lessors (531120), lessors of other real estate properties (531190), real estate property managers (531310), and other activities relating to real estate (531390). These five NAICs codes were used to identify a comparison sample from the Corporate Database.

All corporations with the selected NAICs codes that filed Form 1120 during 2001-2004 and appeared in the Corporate Database were included in the initial sample, excluding S corporations and other pass-through entities. Descriptive statistics of

Table 1
**Taxable REIT Subsidiary NAICS Classifications,
 2001-2004**

<i>Two-Digit Code</i>	<i>Description</i>	<i>Number of Obs.</i>	<i>% Total</i>
10-19	Agriculture, Forestry Fishing and Hunting	1	0.1%
20-29	Mining and Construction	30	3.5%
30-39	Manufacturing	5	0.6%
40-49	Trade	19	2.2%
50-59	Information, Finance, Real Estate and Professional Services	688	80.0%
60-69	Education and Health Care	3	0.3%
70-79	Entertainment, Lodging and Food Services	92	10.7%
80-89	Other Services	14	1.6%
90-99	Not Allocable	12	1.4%
Total		862	100%
<i>Information, Finance, Real Estate and Professional Services</i>		<i>Number of Obs.</i>	<i>% Total</i>
51	Information	14	1.6%
52	Finance and Insurance	95	11.0%
53	Real Estate and Rental and Leasing	476	55.3%
54	Professional, Scientific and Technical Services	29	3.4%
55	Holding Companies	59	6.9%
56	Administrative and Waste Management Services	13	1.5%
Total		684	80%
<i>Real Estate and Rental and Leasing</i>		<i>Number of Obs.</i>	<i>% Total</i>
531110	Residential Lessors	34	4.0%
531120	Non-residential Lessors	95	11.0%
531130	Miniwarehouse and storage lessors	2	0.2%
531190	Lessors of Other Real Estate Properties	22	2.6%
531210	Real Estate Agents and Brokers	5	0.6%
531310	Real Estate Property Managers	67	7.8%
531390	Other Activities Relating to Real Estate	247	28.7%
532100	Automotive Rental and Leasing	1	0.1%
532290	Other Consumer Goods Rental	1	0.1%
532310	General Rental Centers	1	0.1%
532400	Commercial Equipment Rental and Leasing	1	0.1%
Subtotal	Highlighted categories	465	54.1%
Total		476	55.3%

this sample, as well as the sample of TRSs within the selected five categories, are shown in Table 2. Mean values of assets, total income, incorporation year, and sampling weight² for each corporation over the period 2001-2004 were calculated, resulting in 222 observations on TRSs and 7,854 observations on non-TRSs. Table 2 shows that

the average TRS was younger and larger than the average non-TRS, with an average incorporation year of 1997 vs. 1984 for the non-TRS sample, and an average sampling weight of 1.2, vs. 29, for the non-TRS sample. Average asset size for TRSs was more than twice that of non-TRSs, at \$35.4 million vs. \$16 million, and average total income

Table 2
TRSs vs. Other Real Estate Corporations

Mean values per corporation, 2001-2004

Dollar values in \$1000s

	<i>No. Obs.</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>Min</i>	<i>Max</i>
TRSs					
Incorporation year	222	1997	7.8	1929	2004
Assets (\$thous.)	222	35,423	87,170	0	721,655
Income (\$thous.)	222	14,514	40,081	-22,781	363,706
Sampling weight	222	1.2	1.6	1	17
Non-TRSs					
Incorporation year	7,854	1984	16.8	1848	2004
Assets (\$thous.)	7,854	15,970	81,815	0	3,332,404
Income (\$thous.)	7,854	3,416	19,937	-153,722	741,461
Sampling weight	7,854	29	62	1	268

was more than three times that of the non-TRSs, at \$14.5 million vs. \$3.4 million.

To better align the non-TRS sample with the TRS sample, the following restrictions were placed on both data sets: (1) the year of incorporation was restricted to years after 1965 (which eliminated only one TRS observation); (2) total assets were restricted to being greater than zero and less than \$730 million (the maximum TRS value); (3) total income was restricted to between -\$23 million and \$370 million (the TRS income range); (4) the sampling weight had to be at most 17 (the maximum TRS value); and (5) non-TRS corporations were restricted to those that appeared in the Corporate Database in at least two of the four sample years. All observations were also required to have positive gross receipts, the log of which is used in the regressions as a measure of firm size.

Table 3 shows the results of these sample restrictions. Some 122 TRS corporations and 1,558 non-TRS corporations remain. Mean assets and income for the non-TRSs more than double, rendering this sample more comparable with the TRS sample, although mean assets and income for the TRS sample also increase, and remain higher than those of the non-TRS sample.

REGRESSION MODEL AND RESULTS

To determine whether REITs are stripping income from their corporate subsidiaries, it is necessary to examine both the level of debt with

which TRSs are capitalized and the ownership of that debt. Elevated debt levels alone would not necessarily signal income stripping, unless loans from shareholders were also above average (and vice versa). Since REITs may also strip income from TRSs via other transfer-pricing mechanisms, such as charging excessive rents, this study also looks at TRS rental expense relative to other real estate service corporations.

The regression model used to explain TRS leverage,

$$\begin{aligned}
 DEBT_i = & \alpha + \sum_j \beta_j NAICS_{ij} + \beta_2 SIZE_i + \beta_3 PROFIT_i \\
 & + \beta_4 TANGIBLE_i + \beta_5 MTR_i \\
 & + \beta_6 TRS_i + \beta_7 NEW_i + \beta_1
 \end{aligned}$$

is adopted from the literature on the determinants of corporate debt.³ *DEBT* is the ratio of long-term debt (the sum of mortgages greater than one year, loans from shareholders, and other liabilities) to total assets, taken from Form 1120, Schedule L.⁴ Because of well-known problems with data reported on Schedule L, an alternative measure of leverage used is the ratio of interest expense to total receipts, the sum of gross receipts plus lines 4-10 of Form 1120 (Grubert, 2008).

NAICS is a set of fixed effects absorbing unobserved variation among firms at the 6-digit NAICS code level. The omitted group is "other activities relating to real estate" (531390). The coefficient on *SIZE*, as proxied by the log of gross receipts,

Table 3
Restricted Sample

Mean values per corporation, 2001-2004

Dollar values in \$1000s

Restricted Sample: $0 < \text{Total Assets} < \$730 \text{ million}; \text{weight} < 17; \text{incorporation year} > 1965;$

$-23 \text{ million} < \text{total income} < \$370 \text{ billion}; \text{Frequency} > 1$ (for non-TRSs)

Gross receipts > 0

	No. Obs.	Mean	Std. Dev.	Min	Max
TRSs					
Incorporation year	122	1996	6.9	1966	2004
Assets (\$thous.)	122	49,218	105,492	0	729,721
Income (\$thous.)	122	23,423	50,674	-1,098	335,544
Sampling weight	122	1.04	0.38	1	5.2
Non-TRSs					
Incorporation year	1,558	1988	9.3	1966	2004
Assets (\$thous.)	1,558	32,356	55,857	8	640,395
Income (\$thous.)	1,558	6,424	16,468	-19,245	308,787
Sampling weight	1,558	2.1	3.3	1	17

Data restricted to firms in SOI Corporate Database

is expected to be positive, since larger firms are better able to obtain credit. The coefficient on *PROFIT*, as proxied by the ratio of net income to total receipts, is indeterminate: on the one hand, firms with strong cash flow will likely be better able to obtain credit; on the other hand, firms that generate net cash flow may opt to self-finance if external fundraising is relatively expensive due to information asymmetries (Myers and Majluf, 1984). The coefficient on *TANGIBLE*, proxied as the ratio of net depreciable and depletable assets plus land to total assets, is expected to be positive, since firms can post tangible assets as collateral for secured loans. The coefficient on *MTR*, the first-dollar marginal tax rate with respect to interest as calculated from the Treasury's corporate income tax model, is expected to be positive, since firms with higher first-dollar (before interest deduction) tax rates have greater incentives to increase debt in order to lower their tax bills.

The variable of particular interest to this study, *TRS*, takes on the value of one for corporations that have filed as TRSs. Another dummy variable, *NEW*, takes on a value of one for TRSs with a date of incorporation 2001 or later: in other words, TRSs that were newly formed after the enabling legislation, in contrast to those that converted from pre-existing firms. If the coefficient on either of these

dummies is positive, (new) TRSs carry a higher level of debt than comparable non-TRS firms.

A second set of regressions examines whether TRSs carry an above-average level of loans from shareholders (LFS). LFS is measured both as the ratio of loans from shareholders to total assets, as reported on Schedule L, and as the ratio of LFS to total debt. Loans from shareholders are analyzed on the same set of regressors as debt levels.⁵ In contrast to the general debt regressions, the coefficient on *SIZE* might be expected to be negative in the LFS regression, as larger firms may find it easier to obtain credit from unrelated parties. The coefficient on *PROFIT* may also be negative, as more profitable firms are likely to have more opportunity for outside or internal financing than less profitable ones. The fact that shareholder loans are sometimes extended by shareholders to firms in distress also suggests a negative relationship between LFS and profitability (Gelter and Roth, 2007).

In the absence of a literature on the determinants of corporate rental expense, the same model is used to gauge the determinants of *RENT*, measured as the ratio of rental expense to either total assets or total receipts. To the extent that rental expense, like interest expense, is deductible from taxable income, the two are substitutes and should respond similarly to firm financial characteristics. *TAN-*

GIBLE, however, is likely to have a negative sign in the rental regression, since firms with more tangible assets will have better access to debt as a means of reducing tax liabilities, and are also more likely to own their own premises. In the rental regressions, a first-dollar *MTR* with respect to rental expense is used instead of a pre-interest deduction *MTR*.

To gauge how much tax TRSs are paying relative to non-TRS real estate service corporations, a final set of regressions is presented in which the ratio of taxes paid to total receipts (*TAX*) is regressed on the TRS dummies, firm size and financial characteristics, and the ratios of leverage and rental expense to total receipts.

The sample in Table 3 was further truncated to eliminate implausible values of both the left-hand and right-hand side variables. The ratio of long-term debt to assets (or interest expense to total receipts) was restricted to at most two. The rent to asset (or total receipts) ratio and tangibility were restricted to at most one. The profitability ratio was restricted to a maximum value of plus or minus two. Marginal tax rates were limited to values between zero and 0.5. This reduced the regression sample from 1680 to 1597 observations.

Descriptive statistics of the regression variables are presented in Table 4. TRSs constitute 6.5 percent of the observations, and new TRSs 1.4 percent.

Table 4
Descriptive Statistics of Regression Data

2001-2004 Firm Averages				
Variable	Mean	Std. Dev.	Min	Max
Total Assets	34,342	62,101	0.02	729,721
Total Receipts*	8,206	24,410	0	539,223
Long-Term Debt/Assets	0.53	0.4	0	1.96
Interest Paid/Total Receipts	0.22	0.25	0	1.96
Rent Paid/Assets	0.01	0.04	0	0.53
Rent Paid/Total Receipts	0.02	0.07	0	0.9
Shareholder Loans/Debt	0.07	0.19	0	1
Taxes/Total Receipts	0.03	0.07	0	1.14
Size*	7.81	1.56	-3.5	13.2
Profitability*	0.08	0.18	-1.53	1.75
Tangibility*	0.52	0.36	0	1
MTR - first dollar wrt interest	0.22	0.15	0	0.39
MTR - first dollar wrt rent	0.12	0.15	0	0.41
TRS Dummy	0.07	0.25	0	1
New TRS Dummy	0.01	0.12	0	1
Naics 531110	0.16	0.36	0	1
Naics 531120	0.36	0.48	0	1
Naics 531190	0.15	0.36	0	1
Naics 531310	0.13	0.34	0	1
Naics 531390	0.20	0.40	0	1

Number of observations: 1597

*Total Receipts: Gross receipts + nonoperating income

*Size: Log total receipts

*Profitability: (Net income+interest paid+rents paid+net depreciation)/total assets

*Tangibility: (Land+net depreciable assets+net depletable assets)/total assets

The mean ratio of long-term debt to assets was 53 percent, and loans from shareholders constituted 7 percent of total debt, or about 3 percent of total assets. Rental expense accounted for an average of one percent of assets, or 2 percent of total receipts. The mean ratio of tax remittances to total receipts is 3 percent.

Table 5 presents the regressions of the two leverage measures, long-term debt to assets (columns 1-3) and interest paid to total receipts (columns 4-6). As can be seen, the TRS variables are almost uniformly insignificant. In the only significant case, the univariate regression in Column 4, the coefficient on the *TRS* dummy is negative, indicating that without controlling for other firm characteristics TRSs pay less in interest relative to total receipts than comparable non-TRS corporations. TRSs do not appear to use any more debt that other real estate corporations. Leverage was positively related to tangibility and the MTR (in the interest ratio regression), as predicted, but unrelated to profitability; the relationship between firm size and leverage depended on the leverage measure used.

Table 6 presents the regression of the ratio of loans from shareholders to total debt (columns 1-3) and total assets (columns 4-6). Again, the TRS variables are insignificant. Together with the results in Table 5, this result suggests that parent REITs

are not using income from TRSs. As predicted, loans for shareholders are negatively related to corporate size. They are also negatively related to the marginal tax rate, which may reflect the theory that loans from shareholders are commonly used by distressed firms; however, the LFS ratios are unrelated to profitability (even when the MTR variable is omitted).

Table 7 presents the results of the regressions of rental expense to total assets (columns 1-3) and total receipts (columns 4-6). TRSs clearly spend a higher amount on rent relative to their assets than non-TRS real estate service corporations: Whereas the average corporation in the sample spends 1 percent of assets on rent, TRSs spend an additional 3 percent of assets on rent. This result, which is robust to all specifications of the rent-to-assets equation, is consistent with parent REITs' charging their subsidiaries excessive rent and/or with overconsumption of office space by TRSs. Relative to total receipts, however, the coefficient on the TRS dummy is significant only in the univariate regression, where TRS status increases rental expense by two percent of receipts. Controlling for other corporate financial characteristics in this specification renders TRS status insignificant. Rental expense was positively related to firm size and profitability (in the rent-to-assets regression), and negatively

Table 5
Leverage

Sample	Long-term Debt/Assets			Interest Paid/Total Receipts		
	1	2*	3*	4	5*	6*
TRS	-0.05 1.12	0.04 1.13	0.05 1.11	-0.06 2.41	0.00 0.16	-0.01 0.29
New TRS			-0.02 0.23			0.02 0.32
Size		0.02 3.61	0.02 3.59		-0.02 4.82	-0.02 4.79
Profitability		-0.07 1.33	-0.07 1.32		-0.04 1.22	-0.04 1.22
Tangibility		0.28 9.35	0.28 9.35		0.08 3.97	0.08 3.97
MTR		0.09 1.31	0.09 1.31		0.21 4.89	0.21 4.87
Intercept	0.54 52.25	0.12 2.16	0.12 2.17	0.23 35.79	0.27 8.02	0.27 7.99
Dep. Mean	0.54	0.54	0.54	0.22	0.22	0.22
No. Obs.	1597	1597	1597	1597	1597	1597
Adj. R-squared	0.00	0.11	0.10	0.00	0.07	0.07

Table 6
Loans from Shareholders

<i>Sample</i>	<i>LFS/Debt</i>			<i>LFS/Assets</i>		
	<i>1</i>	<i>2*</i>	<i>3*</i>	<i>4</i>	<i>5*</i>	<i>6*</i>
TRS	-0.02 <i>0.87</i>	-0.01 <i>0.70</i>	0.00 <i>0.14</i>	0.01 <i>0.36</i>	0.01 <i>0.61</i>	0.02 <i>1.13</i>
New TRS			-0.05 <i>1.06</i>			-0.05 <i>1.28</i>
Size		-0.02 <i>5.29</i>	-0.02 <i>5.34</i>		-0.01 <i>3.53</i>	-0.01 <i>3.6</i>
Profitability		0.03 <i>1.05</i>	0.03 <i>1.05</i>		0.04 <i>1.75</i>	0.04 <i>1.76</i>
Tangibility		0.01 <i>0.89</i>	0.01 <i>0.89</i>		0.03 <i>2.2</i>	0.03 <i>2.2</i>
MTR - interest		-0.09 <i>2.63</i>	-0.09 <i>2.59</i>		-0.1 <i>3.26</i>	-0.1 <i>3.21</i>
Intercept	0.07 <i>14.24</i>	0.20 <i>7.41</i>	0.20 <i>7.48</i>	0.05 <i>12.18</i>	0.12 <i>5.09</i>	0.12 <i>5.16</i>
Dep. Mean		0.07			0.05	
No. Obs.		1597			1597	
Adj. R-squared	0.00	0.02	0.02	0	0.02	0.02

Coefficients in bold are significant at at least the 5 percent level.

*NAICs fixed effects not shown.

Table 7
Rents Paid

	<i>Rent/Total Assets</i>			<i>Rent/Total Receipts</i>		
	<i>1</i>	<i>2*</i>	<i>3*</i>	<i>4</i>	<i>5*</i>	<i>6*</i>
TRS	0.03 <i>8.43</i>	0.03 <i>7.33</i>	0.03 <i>6.71</i>	0.02 <i>2.61</i>	0.01 <i>1.58</i>	0.01 <i>0.86</i>
New TRS			-0.004 <i>0.42</i>			0.02 <i>1.19</i>
Size		0.003 <i>5.06</i>	0.003 <i>5.02</i>		0.004 <i>3.56</i>	0.004 <i>3.62</i>
Profitability		0.05 <i>10.12</i>	0.05 <i>10.12</i>		<i>0.02</i> <i>1.69</i>	<i>0.02</i> <i>1.69</i>
Tangibility		-0.01 <i>2.16</i>	-0.01 <i>2.16</i>		-0.01 <i>2.56</i>	-0.01 <i>2.57</i>
MTR - rent		0.007 <i>1.15</i>	0.01 <i>1.17</i>		0.00 <i>0.25</i>	0.00 <i>0.19</i>
Intercept	0.01 <i>7.73</i>	-0.02 <i>2.9</i>	-0.01 <i>2.87</i>	0.02 <i>11.94</i>	0.00 <i>0.35</i>	0.00 <i>0.42</i>
Dep. Mean		0.01			0.02	
No. Obs.		1597			1597	
Adj. R-squared	0.04	0.16	0.16	0.00	0.03	0.03

Table 8
Tax Remittances

<i>Controls:</i>	<i>Taxes Paid/Total Receipts</i>				
	<i>1</i>	<i>2*</i>	<i>3*</i>	<i>4*</i>	<i>5*</i>
TRS	0.00 <i>0.06</i>	0.00 <i>0.35</i>	0.00 <i>0.32</i>	0.00 <i>0.47</i>	0.00 <i>0.34</i>
New TRS			0.02 <i>1.39</i>		0.02 <i>1.67</i>
Size		0.00 <i>0.15</i>	0.00 <i>0.07</i>	0.00 <i>0.49</i>	0.00 <i>0.40</i>
Profitability		0.08 <i>8.33</i>	0.08 <i>8.31</i>	0.08 <i>8.76</i>	0.08 <i>8.74</i>
Tangibility		-0.03 <i>5.17</i>	-0.03 <i>5.18</i>	-0.02 <i>4.67</i>	-0.02 <i>4.68</i>
Interest/Receipts				-0.05 <i>7.77</i>	-0.05 <i>7.80</i>
Rent/Receipts				-0.11 <i>4.89</i>	-0.11 <i>4.94</i>
Intercept	0.03 <i>18.11</i>	0.03 <i>3.55</i>	0.03 <i>3.46</i>	0.05 <i>5.07</i>	0.05 <i>4.97</i>
Dep. Mean			0.03		
No. Obs.			1597		
Adj. R-squared	0.00	0.07	0.07	0.11	0.13

Coefficients in bold are significant at at least the 5 percent level.

*NAICs fixed effects not shown.

related to tangibility. No relationship was found with the pre-rental expense marginal tax rate.

Finally, Table 8 presents the regressions of the ratio of firm tax remittances to total receipts. As can be seen, there is no indication that TRSs pay more or less taxes than non-TRS firms. As would be expected, tax remittances are positively related to profitability and negatively related to tangibility (since tangible assets tend to generate deductions). Also predictably, the coefficient on both interest and rent to receipts ratios are negatively related to tax expense, and the coefficient on rental expense is steeper: A 1 percentage point increase in the ratio of rents paid to total receipts reduces the tax ratio by 0.11 percentage points, vs. a 0.05 percentage point decrease for a one point increase in the interest ratio.

CONCLUSIONS

This study finds no evidence that TRSs use more debt than non-TRS real estate service corporations; nor are they any more likely to use loans from shareholders. TRSs do, however, have significantly more rental expense relative to their assets than

non-TRS firms. This does not, however, appear to lower their tax remittances significantly: TRSs in general pay no less taxes relative to total receipts than comparable non-TRS real estate service corporations. These results suggest parent REITs are not using leverage to strip income from their corporate subsidiaries. However, they do suggest that REITs may be overcharging their corporate subsidiaries for rent, and they leave open the question of other forms of parent-sub transfer pricing.

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Notes

¹ U.S. Public Law 106-170, Part II, Subpart A.

² The SOI Corporate Database is a stratified random sample of corporations filing Form 1120. Sampling probability is directly related to corporation size, as

measured by assets or income; sampling weight is the inverse of sampling probability. For a precise description of the methodology, see U.S. Department of the Treasury (2005, p 9).

³ See, for example, John Graham (1999).

⁴ The ratio of total debt to assets, which is 92 percent correlated with the ratio of long-term debt to assets, was also analyzed; results were broadly similar. Long-term debt accounted for 81 percent of total debt.

⁵ An additional dummy variable, which took on a value of one for TRSs that qualify for deduction of related-party interest under Section 163(j), was included in the LFS regressions. It was never significant and was therefore omitted from the results.

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