

**Taxation Changes and the Cross-Border Pricing of REITs**

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**Web Appendix**

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## **Appendix I: Canadian Taxation of Corporations, Income**

### **Trusts and their Investors (Individuals)**

Debtholders in Canada receive interest, which is tax-deductible at the corporate level and taxable to the recipient, as it is in most tax regimes. Stockholders' return on investment may comprise dividends, capital gains or both. Dividends are paid out of after-tax corporate income and are taxable in the hands of stockholders. Individual stockholders, in turn, receive a tax credit, which partially offsets the tax paid by the corporation. Capital gains are taxed at a rate that is lower than the rate on income inasmuch as only a fraction (presently one-half) of the actual gain is taxable.

Individual shareholders must include the actual dividend received plus an additional fractional amount (the dividend "gross up") in calculating taxable income. The gross up is intended to adjust the income received to the amount earned by the corporation before the application of the corporate income tax. The tax credit, in turn, is intended to compensate for the tax paid at the corporate level, except that its value has diminished since the introduction of the current taxation model in 1971.

When a trust is inserted between the operating corporation and its owners, the corporation's cash flow will be flowed through to the trust's unit holders and taxed at the personal level. This is operationalized by selling trust units to investors and using the proceeds to acquire the debt and equity of the operating corporation. Often the shares in the corporation are exchanged one-for-one for units in the trust. Non-arm's length debt will be used to generate sufficient interest to eliminate taxable income in the corporation.

All cash flow received by the trust will be flowed through to unit holders and taxed in their hands. Capital gains on the sale of trust units are also taxable to the unit holder. Any amount not flowed through to unit holders is subject to tax at the corporate rate. Distributions in excess of the income generated reduce the cost base of the trust units and are considered to be a tax-free return of capital. However, in doing so, they also reduce the cost of the trust units for capital gains purposes and increase the capital gains taxes on the trust units when they are sold.

## **Appendix II: The REIT Exemption (2006)**

The October 31, 2006 changes to the Income Tax Act were designed to tax individual investors in income trusts and certain publicly-traded limited partnerships as if the income they had received or been allocated were taxable dividends paid by taxable Canadian corporations. The goal was to eliminate the advantage of converting a business operation from the corporate form to an income trust or publicly-traded limited partnership.

Certain REITs were excluded from this change in policy. To qualify for the exemption, a REIT would have to meet four criteria.

1. The REIT must not hold any non-portfolio property other than directly and indirectly held Canadian real property;
2. At least ninety-five percent of the REIT's revenue must be revenue from rent, interest, capital gains and royalties;
3. At least seventy-five percent of the REIT's revenue must be derived from rents from, mortgages on, or dispositions of Canadian real property; and
4. The REIT must hold Canadian real property (directly or indirectly), cash and Canadian government debt comprising at least seventy-five percent of the REIT's equity value

*Source:* Bernstein (2007).

**Table 1: List of Canadian REITs**

<b>Company Name</b>	<b>Net Sales (\$M)</b>	<b>Total Assets (\$M)</b>
ALEXIS NIHON R E INVST TRUST	98.75	663.13
BOARDWALK REAL ESTATE TRUST	282.51	1,809.14
CALLOWAY REAL ESTATE INVT TR	87.95	1,014.62
CANADIAN APT PPTYS REIT	207.90	1,862.46
CANADIAN HTL INCM PPTYS REIT	275.71	569.08
CANADIAN REAL ESTATE INVT TR	224.12	1,468.71
COMINAR REAL ESTATE INVT TR	111.01	705.65
DUNDEE REAL ESTATE INV TRUST	189.57	1,199.79
H&R REAL ESTATE INVT TR	412.82	3,300.91
INNVEST REAL ESTATE INVT TR	279.30	1,021.46
IPC US REAL ESTATE INVT TR	158.44	1,238.71
MORGUARD REAL ESTATE INVT TR	189.58	1,251.47
NORTHERN PROPERTY RE INV TR	50.38	344.33
PRIMARIS RETAIL REIT	106.93	755.22
RIOCAN REIT	581.67	3,952.28
SUMMIT REAL ESTATE INVT TR	260.38	1,931.29
TGS NORTH AMERICAN REIT	61.58	575.47

*Note:* Data reported are for the 2004 fiscal year.

**Table 2: List of U.S. REITs**

<b>Company Name</b>	<b>Net Sales (\$M)</b>	<b>Total Assets (\$M)</b>
ALEXANDRIA R E EQUITIES INC	226.19	2,281.20
AMERICAN HOME MTG INVT CORP	1,180.45	12,885.48
AMERICAN MORTGAGE ACCEPTANCE	30.16	449.46
AMLI RESIDENTIAL PPTYS TR	180.69	1,243.38
AMREIT	33.10	236.97
ARDEN REALTY INC	421.09	2,769.77
BNP RESIDENTIAL PROPERTIES	50.87	367.76
BOSTON PROPERTIES INC	1,416.01	9,052.93
BRE PROPERTIES INC	297.92	2,568.70
CAPITAL AUTOMOTIVE REIT	186.46	2,009.87
CEDAR SHOPPING CENTERS INC	85.79	928.38
COMMONWEALTH REIT	667.97	4,932.42
CORP OFFICE PPTYS TR INC	270.25	1,827.90
CRT PROPERTIES INC	157.38	1,066.23
DUKE REALTY CORP	837.09	6,086.01
EASTGROUP PROPERTIES	120.91	818.31
ENTERTAINMENT PROPERTIES TR	145.04	1,291.20
EQUITY INNS INC	325.97	1,018.79
EQUITY ONE INC	230.93	1,943.39
EQUITY RESIDENTIAL	1,861.14	12,056.08
FIRST POTOMAC REALTY TRUST	75.22	744.14
GABLES RESIDENTIAL TRUST	229.04	1,728.91
GLIMCHER REALTY TRUST	333.27	1,926.59
HANOVER CAPITAL MTG HOLDINGS	38.46	234.44
HEALTH CARE REIT INC	264.05	2,996.29
HERITAGE PPTY INVESTMENT TR	326.45	2,346.08
HERSHA HOSPITALITY TRUST	77.58	470.29
INNKEEPERS USA TRUST	246.26	911.66
INVESTORS REAL ESTATE TRUST	167.38	1,217.54
ISTAR FINANCIAL INC	773.43	8,368.28
KILROY REALTY CORP	235.51	1,646.42
LEXINGTON REALTY TRUST	173.47	2,422.40
LIBERTY PROPERTY TRUST	666.24	4,351.32
MID-AMERICA APT CMNTYS INC	283.16	1,561.49
MISSION WEST PROPERTIES INC	137.26	1,022.29
NATIONWIDE HEALTH PPTYS INC	207.86	1,916.68
NEW PLAN EXCEL REALTY TR	490.05	3,572.76
NEWCASTLE INVESTMENT CORP	345.84	5,819.97
OMEGA HEALTHCARE INVS INC	87.33	779.31

PARKWAY PROPERTIES INC	181.96	1,108.55
RAMCO-GERSHENSON PROPERTIES	135.25	1,015.23
RECKSON ASSOCS REALTY CORP	526.15	3,241.94
REDWOOD TRUST INC	705.94	18,053.07
SENIOR HOUSING PPTYS TRUST	153.93	1,459.31
SHURGARD STORAGE CTRS -CL A	360.80	2,499.99
TANGER FACTORY OUTLET CTRS	183.76	991.32
TAUBMAN CENTERS INC	506.37	2,584.31
TOWN & COUNTRY TRUST	125.56	591.12
TRIZEC PROPERTIES INC	785.43	4,800.08
U S RESTAURANT PROPERTIES	124.47	541.18
UDR INC	632.13	4,139.08
WASHINGTON REIT	186.94	1,153.02
WEINGARTEN REALTY INVST	516.88	3,626.85

*Note:* Data reported are for the 2004 fiscal year.

**Table 3: Descriptive Statistics**

<b>Panel A: Sample Statistics</b>					
<b>Variable</b>	<b>N</b>	<b>Mean</b>	<b>Std Dev</b>	<b>Minimum</b>	<b>Maximum</b>
EW Canadian REITs Portfolio Return	468	0.00104	0.00698	-0.02889	0.03828
VW Canadian REITs Portfolio Return	468	0.00098	0.00876	-0.03479	0.04295
EW US REITs Portfolio Return	468	0.00087	0.00877	-0.03955	0.03123
VW US REITs Portfolio Return	468	0.00096	0.00945	-0.03899	0.03298
<b>Panel B: Pearson Correlation Coefficients</b>					
	caewpret	cavwpret	usewpret	usvwpret	
EW Canadian REITs Portfolio Return (caewpret)	1.00000	0.96136 (<.0001)	0.32707 (<.0001)	0.31002 (<.0001)	
VW Canadian REITs Portfolio Return (cavwpret)		1.00000	0.33714 (<.0001)	0.32445 (<.0001)	
EW US REITs Portfolio Return (usewpret)			1.00000	0.97688 (<.0001)	
VW US REITs Portfolio Return (usvwpret)				1.00000	

*Note:* Prob > |r| under H0: Rho=0 in parentheses.

**Table 4: Time-Series OLS Regression of Equally-Weighted Canadian REIT Portfolio for the 2005 Event**

<b>Variable</b>	<b>Parameter Estimate</b>	<b>Standard Error</b>	<b>t Value</b>	<b>Pr &gt;  t </b>
Intercept	0.00055	0.00048	1.14	0.2569
EW US REITs Portfolio Return	0.10785	0.05505	1.96	0.0516
Event Dummy	0.01115	0.00457	2.44	0.0156
Adjusted R-Squared				0.0425
Number of Observations				181

**Table 5: Time-Series OLS Regression of Value-Weighted Canadian REIT Portfolio for the 2005 Event**

<b>Variable</b>	<b>Parameter Estimate</b>	<b>Standard Error</b>	<b>t Value</b>	<b>Pr &gt;  t </b>
Intercept	0.00058	0.00065	0.88	0.3780
VW US REITs Portfolio Return	0.13873	0.06941	2.00	0.0472
Event Dummy	0.01251	0.00616	2.03	0.0437
Adjusted R-Squared				0.0341
Number of Observations				181

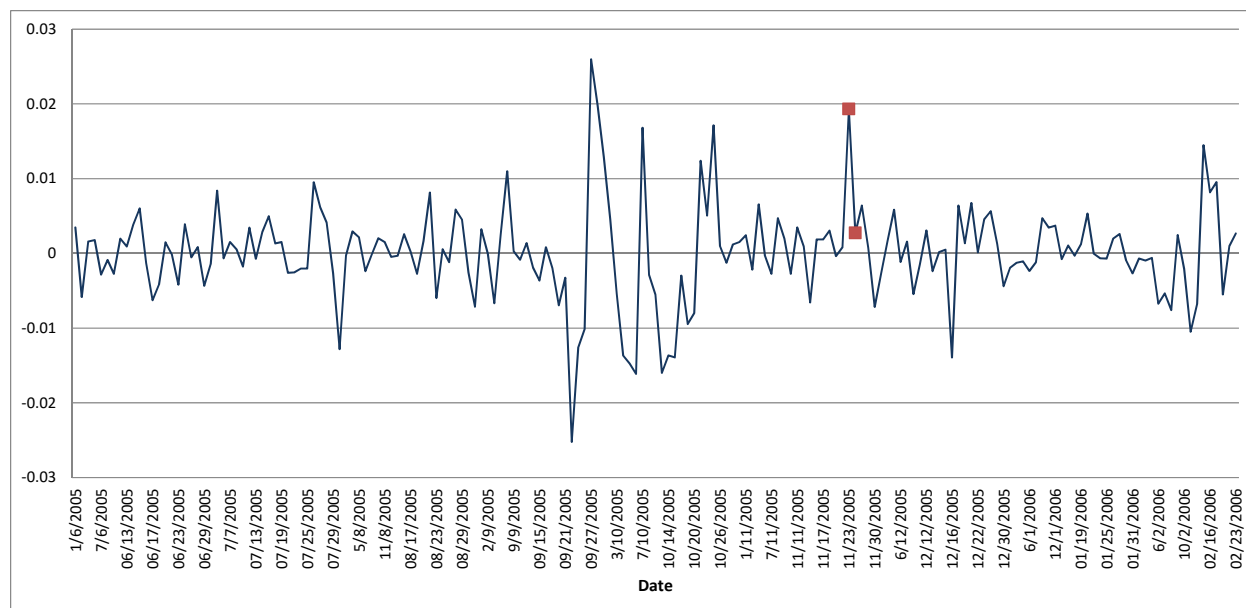


**Table 6: Time-Series OLS Regression of Equally-Weighted Canadian REIT Portfolio for the 2006 Event**

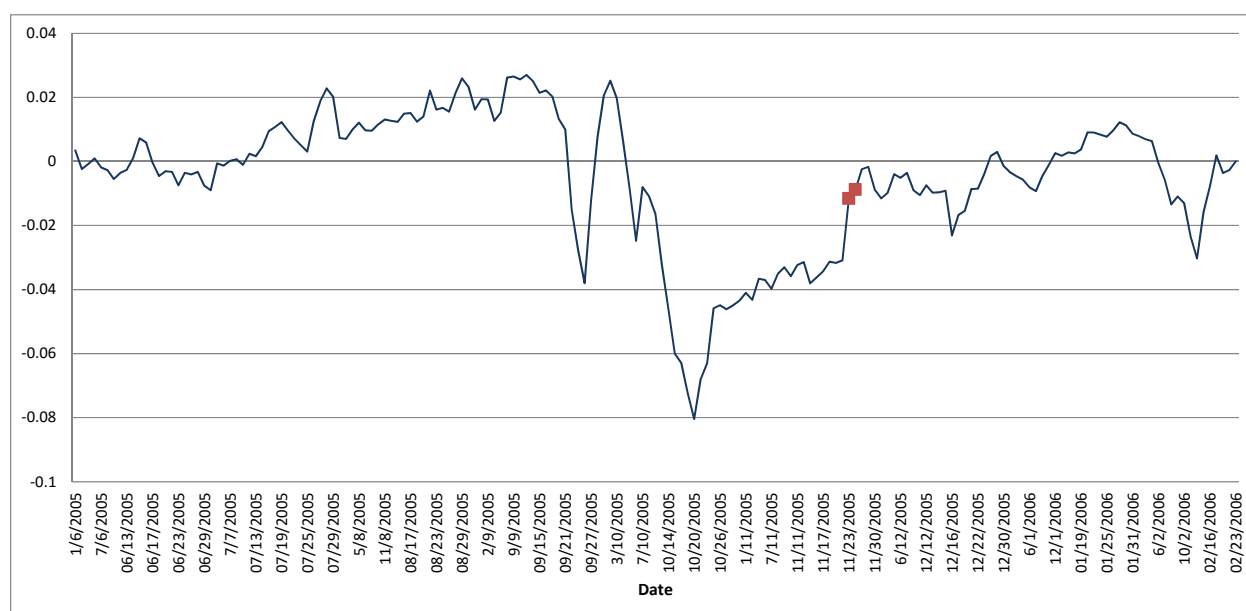
<b>Variable</b>	<b>Parameter Estimate</b>	<b>Standard Error</b>	<b>t Value</b>	<b>Pr &gt;  t </b>
Intercept	0.00136	0.00050	2.72	0.0072
EW US REITs Portfolio Return	0.28747	0.06344	4.53	<.0001
Event Dummy	-0.00903	0.00469	-1.93	0.0556
Adjusted R-Squared				0.1194
Number of Observations				181

**Table 7: Time-Series OLS Regression of Value-Weighted Canadian REIT Portfolio for the 2006 Event**

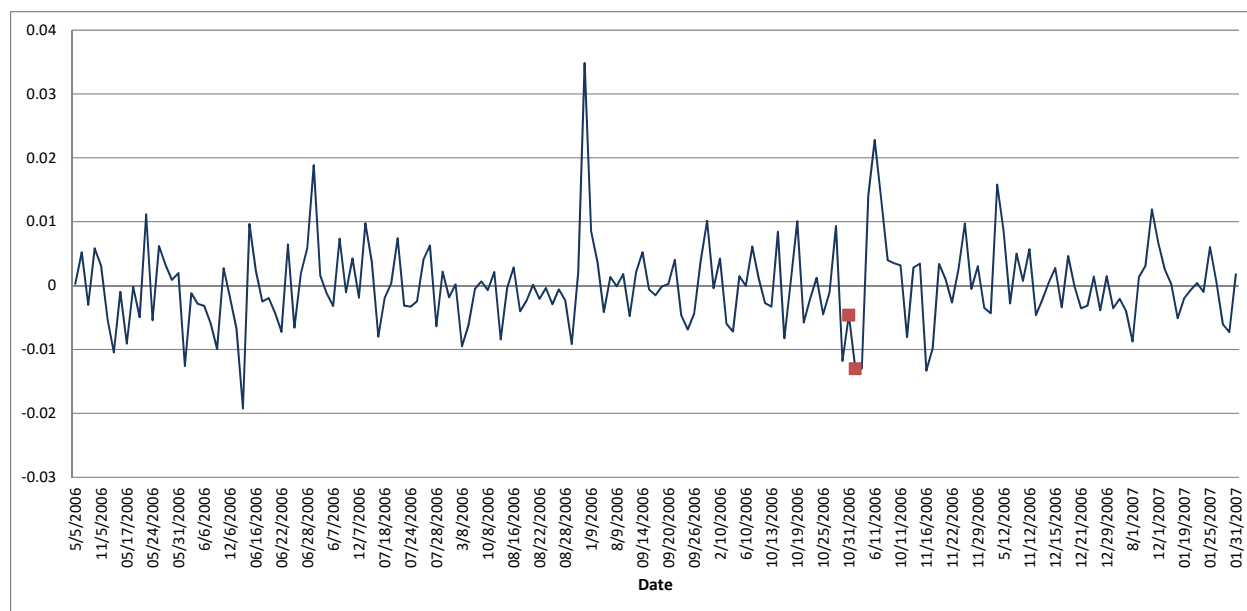
<b>Variable</b>	<b>Parameter Estimate</b>	<b>Standard Error</b>	<b>t Value</b>	<b>Pr &gt;  t </b>
Intercept	0.00119	0.00061	1.93	0.0547
EW US REITs Portfolio Return	0.30413	0.07123	4.27	<.0001
Event Dummy	-0.00792	0.00576	-1.37	0.1712
Adjusted R-Squared				0.0977
Number of Observations				181



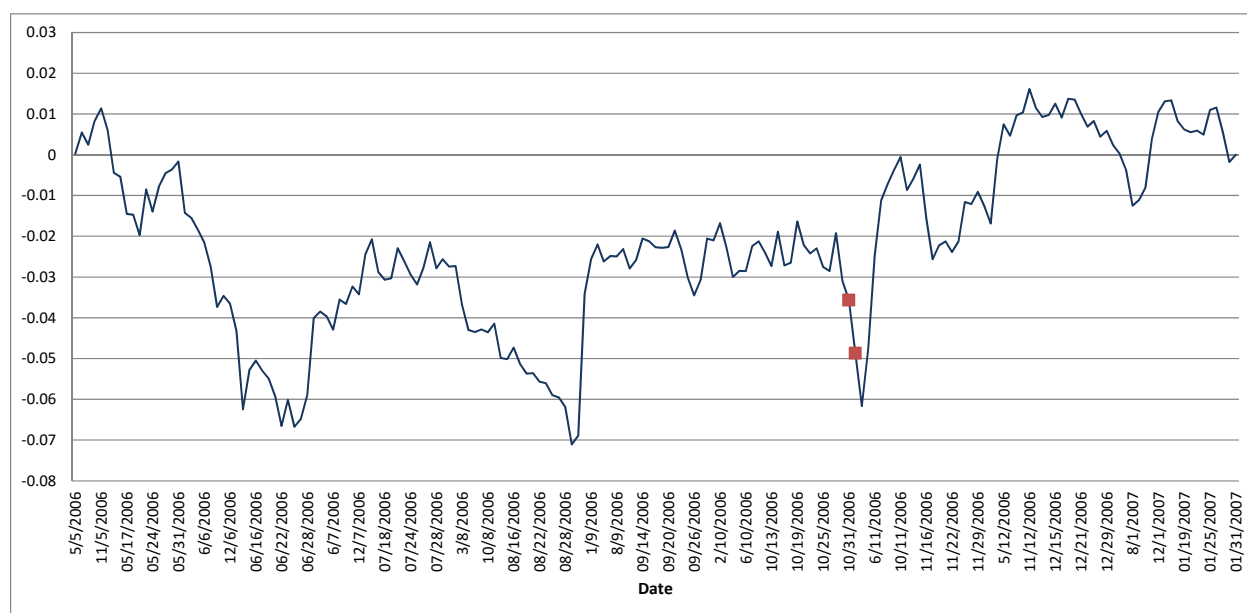
**Figure 1: Mean Abnormal Returns around the 2005 Event**



**Figure 2: Cumulative Abnormal Returns around the 2005 Event**



**Figure 3: Mean Abnormal Returns around the 2006 Event**



**Figure 4: Cumulative Abnormal Returns around the 2006 Event**