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STATE OF HAWAII
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To: The Honorable Angus L.K. McKelvey, Chair
and Members of the House Committee on Consumer Protection and Commerce

The Honorable Karl Rhoads, Chair
and Members of the House Committee on Judiciary

Date: Wednesday, February 04, 2015
Time: 2:30 P.M.
Place: Conference Room 325, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 0082, Relating to Real Estate Investment Trusts

The Department of Taxation (Department) provides the following comments regarding H.B. 82 for your consideration.

H.B. 82 amends the corporation income tax by taxing Real Estate Investment Trusts (REITs) without regard to the federal deduction for dividends paid. The measure would amend Hawaii Revised Statutes (HRS) section 235-7l(d) to provide that the state income tax imposed on REITs is computed prior to the adjustments provided by Internal Revenue Code (IRC) section 857(b)(2), such that REITS would be taxed as any other corporation under Hawaii law. The measure would apply to taxable years beginning after December 31, 2015 and is effective upon approval.

To properly understand the taxation of REITs, it is necessary to understand why they came into existence in the first instance. REITs were first created by Congress in 1960 to give all Americans, and not just the affluent, the ability to invest in income-producing real estate. It is similar to how many Americans invest in stocks and bonds through mutual funds. REITs allow anyone to invest in portfolios of large-scale properties as if they were purchasing shares of stock. REITs can own shopping malls, apartment buildings, student housing complexes, homes, medical facilities, office buildings, hotels, cell towers and timberlands. REITs have been formed in every state and contribute millions of dollars in jobs and investment income to the economy each year.

REITs are generally a pool of properties and mortgages bundled together and offered as a security in the form of unit investment trusts. Each unit in an REIT represents a proportionate fraction of ownership in each of the underlying properties. A REIT and its shareholders are taxed in accordance with IRC sections 856 through 860, provided certain requirements are met. A REIT is generally organized as a corporation, trust or association, and generally results in federal income taxes being imposed on a current basis to its members through the form of dividend distributions.

The Department first notes that disallowing the dividend paid deduction would create a double taxation of income, which could cause taxpayers to lose the incentive to invest in Hawaii based REITs. While it is true that ordinary 'C' corporations also impose a double layer of taxation on income earned by the 'C' corporation, such corporations do not have the limitations that are placed upon REITs, and as such, 'C' corporations have benefits which offset such double taxation that REITs do not.

Under this proposed measure, REITs would still be required to follow the same rules as all other unit investment trusts, which means that REITs must be taxed first at the trust level, then to unit holders. REITs must follow the same method of self assessment as corporations; they have the same valuation and accounting rules as corporations, but instead of passing through profits, they pass cash flow directly to unit holders. In order for REITs to be exempt from taxation at the trust level, they must distribute at least 90% of their income to their unit holders, while 'C' corporations are not so required. 'C' corporations have the ability to retain income and would thus escape double taxation, unlike a REIT, which is required to distribute such income. It should be noted that cash flow distributed as a dividend is not necessarily the same as a dividend from profits. For example, a REIT could have no net profits (and thus would owe no income taxes under this measure) but yet still pay out a dividend. This would occur where a REIT has substantial non-cash deductions such as depreciation and amortization expenses.

REITs often are involved in owning real property that requires substantial cash infusions, which are made possible by the large number of investors putting their cash into a REIT. For example, the renovation of a hotel complex or shopping center is made possible through a REIT which may otherwise not occur because of the large cash outlays that are required. Such projects in Hawaii may be abandoned because of the proposed double taxation under this measure, costing jobs and discouraging investment locally.

The Department also notes that the issue of Hawaii corporations forming “captive” REITs in order to claim both the dividend paid deduction at the REIT level and the dividend received deduction at the parent corporation level, was addressed in Tax Information Release No. 98-6.

While IRC section 243 is inoperative for Hawaii tax purposes (unless otherwise provided) and in lieu of the federal dividend received deduction, Hawaii instead provides a Hawaii corporation with a 100% deduction for dividends received from a national banking association, or dividends received by members of an affiliated group as defined by IRC section 243(b) or a small business investment company or a 70% deduction for dividends received from a corporation that is 95% owned by one or more corporations doing business in Hawaii, a bank or insurance company organized and doing business in Hawaii, or a corporation that can attribute at least 15% of its business to Hawaii, this provision is inapplicable to captive REITs.

Because IRC section 857(c) is currently operative for Hawaii tax purposes and HRS section 235-2.5(a)(2) provides that if a provision in the IRC that is operative in this State refers to an inoperative provision in the IRC that has been codified in chapter 235, HRS, then the reference shall be to the provision in chapter 235, HRS. Therefore, while IRC section 243 is generally inoperative for Hawaii tax purposes, it is codified with modifications under HRS section 235-7(c) and therefore IRC section 857(c) is applicable with reference to section HRS section 235-7(c) instead of IRC section 243. Accordingly, under IRC section 857(c), a dividend paid by a REIT is not considered a "dividend" for purposes of HRS section 235-7(c), and the dividend received deduction is not allowed for Hawaii income tax purposes. Thus, the Hawaii tax treatment of the dividend received deduction as applied to REITs under these circumstances is the same as under federal law.

Thus, the issue of captive REITs and its parent companies avoiding State taxation has already been addressed through the operation of the relevant IRC and HRS sections.

However, if the Legislature believes that some limitation should be applied to prevent "captive" REITs from benefitting from the deduction for dividends paid, the Department recommends that the following language be used, to prevent otherwise legitimate REITS from being unduly penalized, as they would be under the measure as it currently is being proposed:

(e) Section 857 through 858 (with respect to taxation of real estate investment trusts and their beneficiaries) of the Internal Revenue Code shall be operative for purposes of this chapter, subject to the following:

(1) Section 857(b)(2)(B) relating to the deduction for dividends paid shall not apply to a captive real estate investment trust. For purposes of this section, a "captive real estate investment trust" means a real estate investment trust that:

(i) is not regularly traded on an established securities market, and
(ii) 50 percent or more of the voting stock is owned or controlled, directly or indirectly, by a single entity treated as an association taxable as a corporation under the Internal Revenue Code that is not exempt from the federal income tax and is not a real estate investment trust.

(2) The deduction for dividends paid, if any, shall be

limited to such amount of dividends as is attributable to income taxable under this chapter.

(3) In addition to any other penalty provided by law, any real estate investment trust whose tax liability for any taxable year is deemed to be increased pursuant to section 860(c)(1) (relating to interest and additions to tax determined with respect to the amount of the deduction for deficiency dividends allowed) of the Internal Revenue Code shall pay a penalty in an amount equal to the amount of interest for which such trust is liable that is attributable solely to such increase. The penalty payable under this subsection with respect to any determination shall not exceed one-half of the amount of the deduction allowed by section 860(a) of the Internal Revenue Code for such taxable year.

Thank you for the opportunity to provide comments.

NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

WRITTEN TESTIMONY OF

TONY M. EDWARDS
EXECUTIVE VICE PRESIDENT & GENERAL COUNSEL
NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS, INC.
IN OPPOSITION TO H.B. 82

BEFORE THE HAWAII HOUSE OF REPRESENTATIVES
COMMITTEE ON CONSUMER PROTECTION AND COMMERCE

HONORABLE ANGUS L.K. MCKELVEY, CHAIR
HONORABLE JUSTIN H. WOODSON, VICE CHAIR

and

COMMITTEE ON JUDICIARY

HONORABLE KARL RHOADS, CHAIR
HONORABLE JOY A. SAN BUENAVENTURA, VICE CHAIR

HEARING ON H.B. 82

FEBRUARY 4, 2015

♦ ♦ ♦
1875 I Street, NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400 Fax 202-739-9401 www.REIT.com

The National Association of Real Estate Investment Trusts submits this testimony in opposition to H.B. 82. NAREIT is the world-wide representative voice of real estate investment trusts (REITs) and publicly traded real estate companies in the United States.

H.B. 82 would eliminate what is known as the dividends paid deduction (or DPD) for all real estate investment trusts in Hawaii. Eliminating the DPD would be contrary to the federal income tax rules applying to widely-held REITs in every income-based tax system like Hawaii except for New Hampshire. It is worth noting that although both Hawaii and New Hampshire have roughly equivalent contributions to the nation economy, REIT investment in Hawaii is about four times that of New Hampshire.

While those who support the legislation state that that investment money can be easily replaced, it is worth noting that as of December 2013, and based on filings with the Securities and Exchange Commission, approximately twenty widely-held REITs have invested about six billion dollars in commercial real estate in Hawaii that results in the employment of many Hawaii residents. The Hawaii real estate owned by REITs generates millions of dollars in property taxes and excise taxes. These taxes are on top of the individual income taxes currently generated by REIT dividends paid to Hawaii residents from income earned wherever the distributing REIT resides or does business. In addition, the sales generated by the tenants that conduct business on the premises owned and operated by REITs generate jobs and taxes as well. Replacing a $6 billion investment is not as easy as it looks.

Background of REITs. Congress created REITs in 1960 specifically to enable small investors to invest in professionally managed, income-producing real estate. REITs are corporations that combine capital of many investors to benefit from a diverse portfolio that may include apartments, hotels, healthcare facilities, shopping centers, senior housing, offices, storage facilities and warehouses. Federal law requires REITs to distribute all their taxable income to their shareholders. The billions of dollars distributed are taxable where the REIT shareholders reside. Hawaii residents invest in REITs that own properties in Hawaii and REITs that own no properties in Hawaii but own properties in other states. The income earned by Hawaii residents in Hawaii is taxed here even if the REIT invested in owns properties elsewhere. The workers who have jobs because of REITs pay income taxes in Hawaii, and the State receives the general excise taxes that these incomes generated through the purchase of goods and services.

Benefits to Hawaii. REITs, such as General Growth Properties, owner of the Ala Moana Shopping Center, and Taubman Centers Inc. the developer of the International Marketplace, have access to public capital markets to raise the large funds needed for such large development projects. The renovation and expansion of Ala Moana enjoys a commitment of over $500 million while the International Marketplace project shows a commitment to invest over $400 million on the part of Taubman. This redevelopment will result in about one thousand construction jobs and 2,500 permanent jobs and all the taxes that activity will produce. These jobs are put in jeopardy by the tax proposed in H.B. 82.

Hawaii investors also benefit from REITs. To date, Hawaii residents have invested approximately $175 million in just 12 SEC-registered, non-listed REITs (one of which went public in 2013). The State is collecting taxes on the millions of dollars distributed by these companies, even though the vast majority of their properties are located outside of Hawaii. Since 1994, Hawaii residents have invested approximately $220 million in 17 SEC-registered REITs, some of which have been sold or undergone initial public offerings.

Except for New Hampshire, every other state that imposes a corporate-level income tax allows the DPD for widely-held REITs. It is hard to imagine Hawaii's position would be improved by partnering with New Hampshire as opposed to being seen as being aligned with the rest of the nation. If Hawaii repeals the DPD, Hawaii would not be viewed as an attractive place for REIT investments. As can be seen from the record, as opposed to the speculation on the part of the supporters of the bill, the REIT investments have resulted in tremendous value and in jobs, all of which produces income for government and residents. Can Hawaii be assured that much of this investment will not be lost if the DPD is repealed? Logic says much of the investment would be lost.

Accordingly, NAREIT urges you not to enact H.B. 82. Thank you again for the opportunity to submit this testimony.

HAWAII GOVERNMENT EMPLOYEES ASSOCIATION
AFSCME Local 152, AFL-CIO

RANDY PERREIRA, Executive Director • Tel: 808.543.0011 • Fax: 808.528.0922

AFSCME
LOCAL 152, AFL-CIO

The Twenty-Eighth Legislature, State of Hawaii
House of Representatives
Committee on Consumer Protection and Commerce
Committee on Judiciary

Testimony by
Hawaii Government Employees Association
February 4, 2015

H.B. 82 – RELATING TO REAL ESTATE
INVESTMENT TRUSTS.

The Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO supports the purpose and intent of H.B. 82, which closes a loophole in our state's income tax law allowing Mainland corporations to take the net income that they earn in Hawaii out state without taxation. This loophole has existed for more than 40 years and needs to be closed. Real estate investment trusts (REITs) are major corporations that own and operate the large shopping centers in Hawaii, many of the Waikiki hotels and the Class A office buildings downtown. These REITs operate profitably and pay no Hawaii corporate income tax. Reportedly, there is more REIT-owned property in Hawaii per capita than any other state.

What is especially disturbing is that their shareholders and senior management pay taxes on the REIT dividends in the states where they reside. As a result, other states are receiving the tax revenue earned locally while our residents pay for the infrastructure, emergency and other government services required to support the commercial properties owned by the REITs. We simply cannot afford to allow this income tax loophole to continue because it causes a loss of millions of tax dollars annually for Hawaii. In addition, the capital gains taxes on the sale of these properties are also not being taxed in Hawaii.

This important legislation will ensure that all real estate investors are treated equally while protecting our local tax base. Thank you for the opportunity to testify in support of H.B. 82.

Respectfully submitted,

Randy Perreira
Executive Director

SUBJECT: INCOME, Real estate investment trusts

BILL NUMBER: SB 118; HB 82 (Identical)

INTRODUCED BY: SB by Kim; HB by Luke

BRIEF SUMMARY: Amends HRS section 2.3(b) to provide that section 857(b)(2)(B) (with respect to the dividends paid deduction for real estate investment trusts) shall not be operative for Hawaii income tax purposes.

Amends HRS section 235-71(d) to provide that for tax years beginning after December 31, 2015, no deduction for dividends paid shall be allowed for real estate investment trusts in the state.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: Currently under federal and state income tax law, a real estate investment trust (REIT) is allowed a dividend paid deduction, unlike most other corporations, resulting in that dividend being taxed once, to the recipient, rather than to the paying corporation. The proposed measure would make that section of the IRC inoperative for Hawaii income tax purposes for tax years beginning after 12/31/15, meaning that REITs would be subject to double taxation similar to other corporations.

All state income tax systems in the United States, including ours, have a set of rules that are used to figure out which state has the primary right to tax income. For example, most tax systems say that rent from real property is sourced at the location of the property, so if a couple in Florida rents out a property they own on Maui they can expect to pay our GET and our net income tax on that rent. These sourcing rules, which do vary by state but are relatively consistent across state lines, are there to assure consistent and fair treatment between states.

Sourcing rules, however, can yield strange results. Here, there is a Hawaii Supreme Court case saying that when real property is sold on the installment basis under an "agreement of sale," where the seller remains on title until the price is paid (although the buyer can live in the house), then the interest on the deferred payments is Hawaii source income and is subject to our net income tax and our GET. There is also a Hawaii Tax Appeal Court case holding that when the seller instead finances the deal by taking a purchase money mortgage on the property, and does not remain on title, then the mortgage interest is sourced to the residence of the seller, who in that case did not live in Hawaii. In the second case the court applied the rule for income from intangibles such as interest, royalties, and dividends, which says that income is sourced to the residence of the recipient unless you can connect it with some active business that the recipient is conducting somewhere else.

Real estate investment trusts (REITs) are source shifters. For income tax purposes, they take in rent income, which is sourced to the location of the property being rented. They don't pay income tax on that income as long as they distribute the money to their shareholders as dividends. The dividend income of their shareholders, on the other hand, is generally sourced to the residence of the shareholders. So the income that the property states expected to tax is instead taxed in the states in which the shareholders live. And, to the extent that REIT shares are held by tax-exempt entities such as labor unions and retirement funds, passive income such as dividends may not be taxed at all. Source shifting is an issue specific to state taxation.

Apparently the evil sought to be addressed by the bill is that REITs are in Hawaii, but do not get taxed because of the deduction allowed for dividends paid, while many REIT owners who receive the dividend income are either outside of Hawaii and don't get taxed either because they are outside of Hawaii, or are exempt organizations that normally are not taxed on their dividend income. Normally we like to have our income tax law conform to the Internal Revenue Code to make it easier for people and companies to comply with it, but our legislature has departed from conformity when there's a good reason to do so (such as if it is costing us too much money). The issue is whether such a good reason exists here.

REITs do pay general excise and property taxes on rents received and property owned – as do the rest of us who are fortunate enough to have rental income or property to our name.

Digested 2/3/15

LAND USE RESEARCH
FOUNDATION OF HAWAII
1100 Alakea Street, Suite 408
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February 2, 2015

Representative Angus L.K. McKelvey, Chair
Representative Justin H. Woodson, Vice Chair
House Committee on Consumer Protection & Commerce

Representative Karl Rhoads, Chair
Representative Joy A. San Buenaventura, Vice Chair
House Committee on Judiciary

Comments and Concerns in Opposition to HB 82, Relating to Real Estate Investment Trusts (REITs); Disallows dividends paid deduction for REITs.

Wednesday, February 4, 2015, 2:30 p.m., in Conference Room 325

The Land Use Research Foundation of Hawaii (LURF) is a private, non-profit research and trade association whose members include major Hawaii landowners, developers and a utility company. LURF's mission is to advocate for reasonable, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources, and public health and safety.

HB 82. The purpose of this bill is to amend Sections 235-2.3 and 2235-71 of the Hawaii Revised Statutes (HRS) to disallow the federal deduction for dividends paid by REITs for purposes of Hawaii income taxation. Should HB 82 be adopted, REITs will be taxed on their net income in Hawaii, while REIT shareholders will continue to be taxed on dividend income received, resulting in a double tax. In short, this measure is intended to subject REITs to the same tax as other corporations.

While LURF understands the intent of this bill given the potential for tax avoidance and abuse by foreign/mainland corporations and wealthy individuals through real estate ownership arrangements structured through REITs, it must nevertheless oppose HB 82 based on the following reasons and considerations:

1. **The "Double-Tax" Resulting from this Proposed Measure is Contrary to the Underlying Intent of REITs.**

REITs are corporations or business trusts which were created by Congress in 1960 to allow small investors, including average, every day citizens, to participate in real estate developments. Pursuant to current federal and state income tax laws, REITs are allowed a dividend paid deduction (DPD), resulting in the dividend being taxed a single time, at the recipient level, and not to the paying entity. Most other corporations are subject to a double layer of taxation – on the income earned by the corporation and on the dividend income received by the recipient.

Proponents of this measure attempting to eliminate the DPD, however, appear to ignore that the deduction at issue comes at a price. REITs are granted the DPD for good reason - they are required under federal tax law to be widely held and to distribute at least 90% of their taxable income to shareholders,[1] and must also comply with other requirements imposed to ensure their focus on real estate. In short, REITs earn the DPD as they must comply with asset, income, compliance and distribution requirements not imposed on other real estate companies.

2. **HB 82 is Contrary to the Tax Treatment of REITs Pursuant to Current Federal Income Tax Rules and Laws of Other States with an Income-Based Tax System.**

HB 82 would enact serious policy change that would create disparity between current Hawaii, federal, and most other states' laws with respect to the taxation of REIT income.

The laws of practically every state with an income-based tax system now allow REITs a deduction for dividends paid to shareholders.[2] Hawaii, as well as other states which impose income taxes currently tax REIT income just once on the shareholder level (not on the entity level), based on the residence of the shareholder that receives the REIT dividends and not on the location of the REIT or its projects.

By now proposing to double tax the REITs that do business in Hawaii as well as their shareholders, HB 82 would upset the uniformity of state taxation principles as applied between states. Other states which have similarly explored the possibility of such a double tax over the past years have rejected the disallowance of the DPD for widely held REITs.

Passage of this measure and the disallowance of the DPD would make Hawaii and New Hampshire the only two states to double tax widely held REITs as described above,

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[1] The State of Hawaii thus benefits from taxes it collects on dividend distributions made to Hawaii residents.

[2] New Hampshire is the only state which imposes corporate income tax on widely-held REITs, and while New Hampshire's Gross State Product is comparable to Hawaii's, REIT investment there amounts to only about twenty-five percent (25%) of that in this State.

despite the REITs continuing to be compelled to distribute their taxable income to shareholders as mandated by federal law.

3. **Hawaii REITs Significantly Benefit the Local Economy.**

Elimination of the DPD would result in a double taxation of income for Hawaii REITs which would certainly mitigate, if not extinguish interest and incentive in investing in Hawaii-based REITs, which currently contribute significantly to Hawaii's economy.

As of December 2013, approximately twenty widely- held REITs reportedly invested about **$6 billion** in commercial real estate in Hawaii, which has resulted in substantial economic activity in local industries including construction, retail, resort, healthcare and personal services, as well as employment for many Hawaii residents, and considerable tax revenues for the state and city governments. Such tax revenues include general excise taxes on rents and retail sale of goods, business income tax on profits made by tenants, income tax from employment of Hawaii residents, and millions of dollars in property taxes.

Proponents of this bill should be mindful that significant economic growth experienced in this State over the past few years, and which is expected to occur in the future, is undoubtedly attributable in part to REIT investment in Hawaii. The Outrigger Enterprise Group partnered with REIT American Assets Trust in order to successfully develop the Waikiki Beach Walk. General Growth's current expansion of the Ala Moana Shopping Center, as well as its partnering with Honolulu-based, local companies (The MacNaughton Group, The Kobayashi Group and BlackSand Capital) to develop the Park Lane residential condominium project is another example. That investment alone will exceed $1 billion and is anticipated to create approximately 3,800 jobs. Taubman Centers, another REIT, is also spending $400 million on the redevelopment of Waikiki's International Marketplace.

Despite claims made by detractors, the multi-billion dollar investments and contributions to Hawaii's economy made by REITs may not be so easily generated through other means or resources. Attracting and obtaining in-state capital for large projects is very difficult. The State should also be concerned with the types of entities willing and able to invest in Hawaii, and should be wary of private investors looking only to make quick gains when the market is booming. Because federal regulations preclude REITs from "flipping" properties, REITs are by law, long-term investors which help to stabilize commercial real estate prices, and which are also likely to become a part of the local community.

4. **The Tax Rule Changes Proposed by this Bill will Unfairly Affect REITs and the Small Investors Which have Already Made Substantial Investments in Hawaii.**

The disallowance of the DPD and resulting increased taxation of REITs will reduce investment returns as well as dividend payments to shareholders, which will no doubt have a significant negative effect on future investment by REITs in Hawaii.

The tax law changes proposed by HB 82 will also unfairly impact those publicly traded REITs which have already made substantial investments in Hawaii and have contributed greatly to the State's economy in reliance on the DPD, which, as discussed above, is considered a fundamental principle of taxation applicable to REITs.

Given that an unwarranted change of such a universal tax rule in place since 1960 may undoubtedly affect investments made by REITs to date in Hawaii and significantly reduce the availability of capital in this State, as well result in other economic repercussions, LURF believes that it would be advisable and prudent for the proponents of this bill to be required to support this measure by facts or studies which would prove that the State's economy will not be negatively affected as a result of the proposed action. Such an investigation or study should include how …

LURF believes it would be irresponsible to agree to support this proposal which may potentially stifle, if not reverse the current growth of the State's economy, without full knowledge of all the facts and information relating to the measure and the potential consequences thereof.

For the reasons stated above, LURF must respectfully **oppose HB 82**, and recommends that this bill be **held in Committee.**

Thank you for the opportunity to provide comments regarding this proposed measure.

Testimony to the House Committee on Consumer Protection and Commerce and Committee on Judiciary
Wednesday, February 4, 2015 at 2:30 p.m.
Conference Room 325, State Capitol

Re: <u>Testimony in Opposition to House Bill No. 82 relating to real estate investment trusts</u>

Dear Chair McKelvey, Vice-Chair Woodson, Chair Rhoads, Vice-Chair San Buenavetura and Committee Members:

On behalf of the Retail Merchants of Hawaii (RMH), thank you for the opportunity to provide testimony in opposition to HB 82, which proposes to eliminate the federal deduction for dividends paid (DPD) by a Real Estate Investment Trust (REIT) for purposes of Hawaii income taxation.

RMH is a not-for-profit trade organization representing nearly 3,000 storefronts statewide, and its membership includes both REITs and non-REITs. The retail industry is the largest single generator of general excise tax revenue and employs 25% of the workforce in the State of Hawaii. We are committed to working with multi-agency partners to foster the growth and welfare of the retail industry.

HB 82 would strongly discourage future investment by REITs in Hawaii, stifling the availability of capital, which would have a negative effect on all of our members. It would make Hawaii an outlier state compared to the rest of the country. New Hampshire is the only state in the nation with an income-based tax system that disallows the DPD, and it has much less capital investment from REITs than Hawaii.

The premise of REITs, or real estate investment trusts, is to be a vehicle designed to allow many small investors to participate in real estate developments much like wealthy developers are able to invest in limited partnerships. Many state and local pension and retirement funds also are REIT investors. Revoking the dividend paid deduction will increase taxation to the REIT and result in double taxation of its income distributed to its shareholders which will reduce investment returns on developments by the REIT and reduce annual dividend payments to shareholders in order to pay the additional state income tax.

Investment by REITs in Hawaii real estate has helped Hawaii improve its economy. In fact, the newly developed International Market Place in Waikiki, Honolulu, Hawaii alone is projected to generate over $10 million annually in general excise tax (from landlord to rents and by tenants from retail sales of merchandise), over $4 million annually in property taxes, and employment of over 1,000 construction jobs and 2,500 permanent jobs (generating individual income tax).

Many widely-held and publicly traded REITs already have made substantial investments in Hawaii projects. To now change the fundamental rule of taxation applicable to REITs would unfairly affect the investments made by REITs in reliance upon the long-standing and virtually universal tax rules allowing the paid dividend deduction.

RMH respectfully requests that the Committees oppose HB 82. Thank you for the opportunity to submit testimony.

[redacted]

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HAWAIIAN DREDGING
CONSTRUCTION COMPANY, INC.

Sent via fax 808-586-6211

February 2, 2015

Honorable Angus L.K. McKelvey, Chair
Honorable Justin H. Woodson, Vice Chair
Committee on Consumer Protection and Commerce
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Honorable Karl Rhoads, Chair
Honarable Joy A. San Buenaventura, Vice Chair
Committee on Judiciary
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

SUBJECT: **OPPOSITION TO H.B. 82, Relating to Real Estate Investment Trusts**

HEARING

DATE: Wednesday, February 4, 2015

TIME: 2:30 p.m.

PLACE: Conference Room 325

Hawaiian Dredging Construction Company **opposes** the passage of H.B. 82, Relating to Real Estate Investment Trusts (REITs), because it will have a chilling effect on future investment by REITs in Hawaii, thereby reducing jobs and negatively affecting Hawaii's economy.

REITs are companies that allow "regular" people to invest in commercial real estate like shopping malls and hotels. Unlike other companies, REITs are required by law to pay out all their income to investors. By changing Hawaii's taxation of REITs, this bill would penalize not only the REITs themselves, but also Hawaii residents who invest in REITs owning real estate in Hawaii.

REITs have been important in helping Hawaii improve its economy. By virtue of the fact that they are required by federal law to be long-term investors, they have brought stability and economic improvement to the Hawaii real estate economy.

February 2, 2015
Page 2

As one of Hawaii's largest contractors, Hawaiian Dredging Construction Company has had the benefit of partnering and working with REITs in developing and improving Hawaii properties, thereby creating jobs, expanding the state's property and sales tax base, and improving the climate for tourism, one of the biggest drivers of Hawaii's economy.

Currently, Hawaiian Dredging Construction Company is working with General Growth Properties, a publicly traded REIT, which, along with locally-based companies, including The MacNaughton Group, The Kobayashi Group and BlackSand Capital, is spending hundreds of millions of dollars in improving the Ala Moana Center and adjacent community. To date, these improvement projects have generated over 1,000 construction jobs, including over 250 for Hawaiian Dredging alone. If REITs like General Growth were not involved in this project, this project would not have been possible. Local capital could not have replicated this investment.

For many years, there has not been a lot of construction activity in downtown or central Honolulu. As a result of General Growth's investment and improvement plans concerning Ala Moana and adjacent area, the whole construction industry is again making progress and building homes for many people in the area, and also revitalizing this major mall to meet the needs of the public for many years to come.

We are concerned that enactment of H.B. 82 could stifle the investment of additional, needed capital by REITs into Hawaii, potentially harming current and future jobs and hurting Hawaii in the long run.

Accordingly, Hawaiian Dredging Construction Company **opposes** H.B. 82.

Thank you for the opportunity to submit this testimony.

William J. Wilson
Chairman
Hawaiian Dredging Construction Company Inc.

GGP

February 3, 2015

Hearing Date: Wednesday, February 4, 2015
Time: 2:30 pm
Place: State Capital, Conference Room 325

Hon. Angus McKelvey, Chair
Committee on Consumer Protection & Commerce

Hon. Karl Rhoads, Chair
Committee on Judiciary

State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill No. 82

Dear Chairman McKelvey, Chairman Rhoads, and Hon. Committee Members of the Committees on Consumer Protection & Commerce and Judiciary:

Thank you for the opportunity to provide written testimony on House Bill No. 82, which would eliminate the federal tax deduction for dividends paid by a real estate investment trust ("REIT") for purposes of Hawaiian income taxation. We are Francis Cofran, the Senior General Manager of Ala Moana Center, the largest retail center in the state of Hawaii, and Sandeep Mathrani, the Chief Executive Officer of General Growth Properties, Inc. ("GGP"), an S&P 500 publicly traded REIT, the owner of Ala Moana Center.

GGP owns 121 shopping malls in 40 states with 124 million square feet of gross leasable space. Our mission is to own and operate best-in-class retail properties that provide an outstanding environment and experience for our communities, retailers, employees, consumers and shareholders. GGP operates three major retail shopping centers in Hawaii – the Prince Kuhio Plaza in Hilo, Whalers Village in Lahaina, and the Ala Moana Center in Honolulu. The latter two are iconic visitor attractions that help to sustain Hawaii's important tourism industry, with the majority of their respective sales made by tourists.

REITs are primarily engaged in owning and operating real estate assets and are generally required to pay out all taxable income in the form of dividends. The REIT's shareholders are subject to income tax on the dividends in their state of residence. This is the uniform and consistent single-tax environment in all states, except New Hampshire where REITs do not have a substantial presence. We believe the New Hampshire tax has inhibited REIT investment.

REITs have a significant real estate investment in Hawaii, which, in turn, produces substantial economic benefits, such as jobs, general excise tax on rents from tenants, general excise tax on sales of goods by tenants, income tax on profits from tenants, real property taxes, and individual income tax from employment of residents of Hawaii.

At Ala Moana Center, GGP has or will be investing almost $1 billion in capital to construct additional retail square footage and luxury residential condominiums based on the existing Hawaiian tax regime. We are making this investment using local partners; Hawaiian Dredging is the general contractor for the retail expansion and The MacNaughton Group, The Kobayashi Group, and Blacksand Capital are our partners in the residential condominiums.

This $1 billion investment is producing substantial benefits to the Hawaiian economy. During the construction period, we estimate economic activity of 11,600 full- and part-time jobs and over $146 million of state revenue including indirect community benefits (known as the "ripple effect"). Post the construction period, the shopping center investment alone will produce an incremental $33 million of state revenue and 3,000 jobs annually.

We are considering future expansion plans at Ala Moana Center that may be as much as an additional $2 billion. However, we would need to reconsider whether this investment could be more profitably deployed elsewhere if House Bill No. 82 was enacted. GGP evaluates investment opportunities throughout the United States, and the state tax implications of those investment opportunities impact our capital allocation decisions. The enactment of House Bill No. 82 or bills of this type ultimately reduce the attractiveness of investing in Hawaii.

Please do not allow a short-term revenue increase to override the long-term economic benefits that REIT investment under the existing tax regime brings to the state of Hawaii and its residents. For the foregoing reasons, we respectfully oppose House Bill No. 82 and urge you to not let it move forward. Thank you for your consideration.

Sincerely,

Francis Cofran
Senior General Manager

Sandeep Mathrani /S/

Sandeep Mathrani
Chief Executive Officer

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THE MACNAUGHTON GROUP

THE HOUSE OF REPRESENTATIVES
THE TWENTY-EIGHTH LEGISLATURE
REGULAR SESSION OF 2015

COMMITTEE ON CONSUMER PROTECTION & COMMERCE
Representative Angus L.K. McKelvey, Chair

COMMITTEE ON JUDICIARY
Representative Karl Rhoads, Chair

Wednesday, February 4, 2015
Conference Room 325, 2:30 PM

HB 82: Relating to Real Estate Investment Trusts

Chair McKelvey, Chair Rhoads and Committee Members, my name is Ian MacNaughton, writing on behalf of The MacNaughton Group and BlackSand Capital, LLC in opposition to HB 82.

HB 82 will disallow the dividends paid deduction for Real Estate Investments Trusts ("REIT" or "REITs") which in turn would double the taxes for the corporation and shareholders. REIT corporations contribute to Hawaii's tax base by paying General Excise Tax (GET) and the dividends paid to shareholders are taxed as income.

We view this bill as damaging one of the few growing and long-term sources of capital that can improve Hawaii's economic picture, by providing outside funding to improve its infrastructure and rapidly ageing commercial asset base. As evidence of this, REIT investment in Hawaii is currently measured at approximately $6 billion dollars and REIT investment per capita in Hawaii is approximately $9,678, the highest of any state in the U.S.

The MacNaughton Group and BlackSand Capital have had the good fortune to partner with REITs in developing and improving a number of Hawaii commercial properties. A good example is the partnership between The MacNaughton Group, BlackSand Capital, Kobayashi Group, and General Growth Properties ("GGP") on the Park Lane Ala Moana residential project at Ala Moana Center ("AMC") in Honolulu. GGP is the current owner of AMC and the company's willingness to partner with local Hawaii-based companies and their ability to provide efficient capital of significant scale given their unique access to the global capital markets was imperative to the projects ability to proceed in a timely manner. We strongly believe that REITs, such as GGP, are critical to the ability to proceed with commercial construction of significant scale in Hawaii and that these projects are very important for the future economic growth of our state.

The MacNaughton Group and BlackSand Capital view the enactment of HB 82 as a serious roadblock to continued REIT investment in State of Hawaii and urge you to oppose this legislation.

Thank you for the opportunity to submit this testimony.

Ian MacNaughton
Managing Partner
The MacNaughton Group

February 4, 2015

State House of Representatives
State of Hawaii
Committee On Consumer Protection & Commerce
Committee On Judiciary

Re: HB 82, Relating To Real Estate Investment Trusts

Chair McKelvey, Chair Rhoads, & Committee Members:

We oppose HB 82 which will disallow dividends paid deduction for Real Estate Investment Trusts (REIT). Eliminating the deduction would mean double taxes for the corporation and shareholders. REIT corporations contribute to Hawaii's tax base by paying General Excise Tax (GET) and the dividends paid to shareholders are taxed as income.

REITs investments in Hawaii are valued at more than $6 billion dollars with primary investments in commercial properties for long term capital appreciation. Most notably is General Growth Properties, owner and operator of Ala Moana Center.

New Hampshire is the only state that disallows dividends paid deduction for REITs. Forbes ranks Hawaii among the bottom 5 states with a poor business climate and describes Hawaii as, "most onerous business tax situations."

Hawaii needs to continue to attract REITs which creates businesses, which in turn create jobs, and yes, contributes to our local economy tax base. The State of Hawaii collects GET from the lease rent and retail sales. The four counties collect higher property tax assessments. Double taxing REITs will enhance tax revenues for the short term, but it will have devastating long term effects as REITs will take their investments to other states with a more favorable tax climate.

Thank you for allowing us to provide our comments.

Bert A. Kobayashi
Chairman & CEO
Kobayashi Development Group

Duncan MacNaughton
Chairman & Founding Partner
The MacNaughton Group

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info@kobayashi-group.com

ENVISION CREATE

Legal Department
701 Western Avenue
Glendale, CA 91201

www.publicstorage.com
818.244.8080

Public Storage

February 2, 2015

Hearing Date: Wednesday, February 4, 2015
Time: 2:30 p.m.
Place: House Conference Room 325

The Honorable Angus L.K. McKelvey, Chair
The Honorable Justin H. Woodson, Vice Chair
House Committee on Consumer Protection & Commerce

The Honorable Karl Rhoads, Chair
The Honorable Joy A. San Buenaventura, Vice Chair
House Committee on Judiciary

Re: Testimony Opposing H.B. No. 82 – Repeal of Dividends Paid Deduction for REITs

Chairs McKelvey and Rhoads, Vice Chairs Woodson and San Buenaventura, and Members of the House Committee on Consumer Protection & Commerce and House Committee on Judiciary:

My name is Lily Yan Hughes, Senior Vice President, Chief Legal Officer and Corporate Secretary of Public Storage, testifying in opposition to HB 82.

Public Storage is a publicly-traded real estate investment trust (REIT) that is the largest owner and operator of self-storage facilities in the United States, with almost 150 million rentable square feet of real estate in 38 states. We have approximately 2,260 facilities and 1.3 million tenants in the United States. We own 11 properties in Hawaii that generated more than $25 million of gross revenue in 2014, resulting in over $1.1 million of general excise tax revenues for the state.

HB 82 would eliminate the "dividends paid deduction" (DPD) for Hawaii income tax purposes for all REITs. The DPD is a central feature of the taxation of REITs, provided because, unlike regular C corporations, REITs are required to distribute their income to their shareholders.

REITs were created by Congress in 1960 working from the mutual fund model, to give small investors the ability to invest in professionally managed real property with pass-through tax treatment of the income (as with the mutual fund model, no double level tax).

Mutual funds similarly permit investments in professionally managed portfolios of securities and mutual funds are also required to distribute their income, which is only taxed once, at the shareholder level. So, REITs and mutual funds are not like regular corporations which can (and typically do) retain their income. Both REITs and mutual funds are subject to a broad array of tests designed to ensure that their income and assets are focused on real estate and securities, respectively, and that their shareholders are currently provided the benefits of those operations (and taxed on the income).

Of course, wealthy investors are also able to structure significant investment in real estate using pass-through entities including partnerships, limited liability companies and subchapter S corporations that may not be liable for any separate Hawaii income taxes. A vocal proponent of the legislation has apparently suggested that he is at some competitive disadvantage because he is taxable on the earnings of his limited liability real estate company. This is hard to understand, as there presumably is only one level of tax on that income, not the double level of tax he is proposing should be required for REITs.

Although little information is available to explain the motivations of supporters of the bill, some articles have offered anecdotes suggesting that shareholders of REITs from the mainland are inappropriately profiting from valuable Hawaii real estate. This is misguided in many ways. First, significant numbers of REIT shareholders reside in Hawaii and there is no reason to think (as some have suggested without any support) that REIT shareholders are disproportionately located on the mainland. Also, the dividends that all REITs pay to shareholders in Hawaii are subject to Hawaii tax (without regard to where the REITs' properties might be located). The bill would particularly penalize Hawaii residents (small investors as well as large investors) who invest in REITs owning Hawaii real estate. The REITs would be taxed on their Hawaii income, but still be required to distribute that income to their shareholders and Hawaii resident shareholders would be subject to double Hawaii tax on the dividends that the REITs are required to distribute.

HB 82 is also flawed from the standpoint of longer term revenue generation for the state. It will plainly cause Hawaii, apparently already capital-poor, to be less attractive for investments by REITs (any rational investor will find an added charge of 6.4% of income daunting). While other investors may step in, why would the state want to push away such a large source of economic development, funding and activity? Making Hawaii less competitive over the long term is not a good revenue generation strategy. If this or similar bills are adopted, the added Hawaiian taxes and divergence from the national REIT template will be a significant factor discouraging further investment in Hawaii by Public Storage (and, we suspect, all other REITs). REITs will rightly focus their investments in states that conform to the REIT model and permit the DPD.

For all of these reasons, no state that imposes income tax upon REITs (other than New Hampshire) denies the dividends paid deduction as proposed by HB 82. Indeed, over the past decade, a number of states (*e.g.*, Idaho, Louisiana, New Jersey, North Carolina, and Rhode Island) have examined, and then rejected, the disallowance of a widely-held REIT's DPD. As it did when similar proposals were raised last year, Hawaii should again reject the disallowance of a widely-held REIT's DPD.

We respectfully request that you do **not** move HB 82 forward.

Sincerely,

Lily Yan Hughes
Senior Vice President, Chief Legal Officer
& Corporate Secretary of Public Storage
lhughes@publicstorage.com
818.244.8080 ext. 1537

Taubman

February 2, 2015

Honorable Angus L.K. McKelvey, Chair
Honorable Justin H. Woodson, Vice Chair
Committee on Consumer Protection & Commerce
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Honorable Karl Rhoads, Chair
Honorable Joy A. San Buenaventura, Vice Chair
Committee on Judiciary
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill No. 82 relating to real estate investment trusts

Dear Chair McKelvey, Vice-Chair Woodson, Chair Rhoads, Vice-Chair San Buenavetura and Committee Members:

On behalf of Taubman Centers, thank you for the opportunity to provide our testimony in opposition to House Bill No. 82, relating to real estate investment trusts. Taubman is an S&P MidCap 400 publicly-traded and widely owned Real Estate Investment Trust ("REIT") engaged in the ownership, operation, management, development and leasing of 21 regional, super-regional and outlet shopping centers in the U.S. and Asia. Taubman respectfully opposes House Bill No. 82, relating to taxation of real estate investments, which is being heard by the Committee on Consumer Protection & Commerce and Committee on Judiciary on February 4, 2015 at 2:30 p.m.

The purpose of House Bill No. 82 is to eliminate the federal deduction for dividends paid by a REIT for purposes of Hawaii corporate income taxation. REITs are a conduit vehicle designed to allow many small investors to participate in real estate development and ownership. Many state and local pension and retirements funds also invest in REITs.

The elimination of the dividend paid deduction would effect a radical change in taxation of REITs. By law, REITs are required to distribute 90% of their income to shareholders and in practice normally distribute at least 100% of their taxable income. Because of this forced dividend requirement, the REIT's taxable income is effectively taxed at the shareholder level by the state taxing jurisdictions in which the shareholders reside. This allows for a single level of taxation at the shareholder level and no double taxation (i.e., it prevents taxation at both the entity level and again at the shareholder level) and is consistent with the treatment of investors in mutual funds that are treated as regulated investment companies for tax purposes. It is also consistent with the tax treatment of income and gains earned by partnerships that are commonly used by privately held real estate investors and for which Hawaii follows federal law and treats as pass-through entity (partner level reporting of income and no taxation at the entity level).

In practice, the state income taxation of a REIT's operations is based on the residence of its shareholders, rather than the location of the REIT or its projects. Thus, Hawaii already receives state income tax on dividends received by Hawaii residents who are shareholders in REITs that may own property and operations outside of the State. For publicly-traded and widely held REITs, this is the uniform tax treatment in virtually all states that impose an income based tax system.[1]

Approximately 20 publicly-traded REITs have invested over $6 billion in commercial real estate in Hawaii and are responsible for significant economic activity in the construction industry, resort industry, restaurant and retail industry, office and industrial leasing and others. Taubman alone has committed an investment of over $400 million for the redevelopment and revitalization of International Market Place in Waikiki, Honolulu, Hawaii. A REITs ability to access and raise capital with equity offerings in the public markets to make these type of real estate investments in Hawaii and other states make it a unique investment vehicle and a major advantage over privately held real estate with a limited amount of investors.

Such economic activity generates substantial economic benefit for Hawaii, including providing jobs, as well as significant tax revenues for the State government. The tax revenues include substantial general excise taxes on rents from tenants, on the sale of goods and services at retail by the tenants, and on construction activities, transient accommodations taxes on revenues from hotel operations, business income tax from profits from tenants and contractors, increased real property taxes, and individual income tax from employment of residents of Hawaii in the construction, retail, restaurant and resort industries.

Taubman's shopping center development is currently under construction and is projected to generate over $10 million annually in general excise tax (from landlord rents and by tenants from retail sales of merchandise), over $4 million annually in property taxes, and employment of over 1,000 construction jobs and 2,500 permanent jobs, generating both general excise tax revenues from construction work, as well as individual income tax revenues from both construction and permanent jobs.

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[1] We have no objection to limiting the dividend paid deduction for captive or privately owned REITs. They are different than widely owned REITs since captive REITs are primarily used as a tax strategy to lower their affiliate's effective income tax rate from non-real estate business activities.

Such a policy change in state taxation of REITs is likely to discourage future investment by REITs in Hawaii, stifling the availability of capital.[2] Revoking the dividend paid deduction will eliminate the conduit nature of a REIT altogether and impose an entity level income tax on the REIT which will result in double taxation of its income distributed to its shareholders. This will reduce investment returns on developments by the REIT and potentially reduce annual dividend payments to shareholders (individual investors and state and local pension and retirements funds) in order to pay the additional state income tax (impacting shareholder returns on their investment).

Thus, this measure would put Hawaii at a competitive disadvantage versus virtually every other state when trying to attract capital for investment in the State. Because investments by REITs generate so much economic activity and create so many local jobs in the State, disallowing the deduction for dividends paid not only would hurt workers in Hawaii, over the long run, it ultimately may result in less tax revenue for the State as its makes Hawaii unattractive for investment by REITs resulting in less economic activity.

Finally, we note that many publicly-owned REITs already have made substantial investments in Hawaii projects. To now change a fundamental rule of taxation applicable to REITs would unfairly affect the investments made by REITs in reliance upon the long-standing state of Hawaii income tax rules allowing the dividend paid deduction permitted in nearly every other U.S. state. If the Legislature decides to make this fundamental change, we respectfully urge that it be delayed for a sufficient period to allow REITs to adjust their investments in Hawaii to account for this change.

For the foregoing reasons, we respectfully but strongly oppose House Bill No. 82.

Thank you for your consideration of our testimony.

Very truly yours,

Robert S. Taubman
Chairman, President and Chief Executive Officer

200 East Long Lake Road
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[2] As of December 31, 2014, there were approximately 200 publicly-traded REITs in the United States, with a market capitalization of around $800 billion.

Written testimony of:

ASHLEY H. PEEPER,
VP OF TAX

and

JOSEPH T. JOHNSON,
CHIEF FINANCIAL OFFICER

CNL LIFESTYLE PROPERTIES, INC.

BEFORE THE HAWAII LEGISLATURE
REGARDING HB 82 / SB 118
RELATING TO REAL ESTATE INVESTMENT TRUSTS

February 3, 2015

On behalf of our shareholders, we thank you for this opportunity to voice our strong concern and opposition to HB 82 and its companion SB 118. We represent CNL Lifestyle Properties, Inc. ("CLP"), a real estate investment trust, or "REIT", which owns Wet 'N' Wild Hawaii located in Kapolei, Hawaii. CLP is an unlisted publicly owned REIT that invests in lifestyle related properties such as ski resorts, gated attractions, waterparks, marinas, and healthcare facilities. CLP, like most REITs, has a long-term investment focus and is committed to creating sustainable value at its properties. CLP leases many of its properties under long-term leases to operators who are highly qualified in each of their respective industries. For example, we have leased Wet 'N' Wild Hawaii to an affiliate of Premier Parks, LLC which owns and operates several amusement and water parks throughout the United States. Because CLP has a long-term investment objective, we lease our properties on a long-term basis, as we have done here in Hawaii, typically for 20 years with multiple renewal extensions.

Modeled after mutual funds, Congress created REITs in 1960 to allow even the smallest investor to own and benefit from professionally managed, institutional quality, income-producing real estate. CLP currently has approximately 93,000 shareholders which are comprised of mostly individual or family owners, with few or no institutional investors. As with all REITs, CLP must meet many strict and costly requirements in order to maintain its status as a REIT. For example, REITs must distribute at least 90% of their taxable income annually, shares must be transferrable, they cannot be "closely held", they cannot "flip" properties without being subject to a 100% tax on the gain, and they cannot provide more than a small amount of tenant-specific services (like maid service in apartments) without jeopardizing REIT status. For this reason, REITs are not "unfairly" advantaged; they face additional burdens for which they receive the benefit of the dividends paid deduction.

The proposed new tax on REITs would be inconsistent with federal tax rules and the existing rules of virtually all other states with an income based tax system. Additionally, we believe that our investment and the investments by other REITs in Hawaii are beneficial to the state and that such a tax would have the undesirable consequence of discouraging additional investments in the future. We strongly believe the proposed legislation's lack of conformity with the federal tax rules and the tax rules of most other states will diminish competitiveness of Hawaii to attract and to retain capital investments. If Hawaii repeals the dividends paid deduction, Hawaii would no longer be viewed as an attractive place for REIT investments by the market place.

CLP acquired Wet 'N' Wild Hawaii (formerly known as Hawaiian Waters) for $15 million in May 2009. Since that time, we have worked to identify capital improvements and maintenance projects to enhance the park experience and to make the water park even more successful. To that end, we have since invested several million additional dollars in the park to make enhancements and improvements which helps to draw both local residents and vacationers to the park.

CLP believes that its ownership of Wet 'N' Wild Hawaii and its motivation to continue to invest in the waterpark benefits the State of Hawaii in many ways, including:

- **JOBS.** Wet 'N' Wild Hawaii employs more than 350 employees with payroll and benefits in excess of $1.7 million.

- **CAPITAL IMPROVEMENTS**. Given the long-term nature of our investment and the structure of our leases, we are motivated (provided we are not subsequently discouraged by state tax law) to make sizeable investments to achieve orderly, sustainable growth at our properties. Waterpark infrastructure is expensive to both acquire and maintain which is a key reason there are so few waterparks in existence. Our principal investment objective is to preserve, protect, and enhance the long-term value of our assets. CLP is positioned to make, and has made, sizeable investments after it purchases waterparks because our REIT business model does not depend on a "quick flip" sale of the resort or high "private equity" level returns to our investors. This is why we have invested more than $3 million to install new rides, including a family friendly raft ride and a state of the art racing slide. We also have plans to make an additional investment of $750,000 to install a new waterslide in during 2015.

- **CAPITAL MAINTENANCE.** The existing infrastructure of a waterpark is extensive and costly to maintain on an annual basis. Once a property has fallen behind on maintenance, repair, and replacement schedules, a waterpark can begin a downward spiral of its annual business volume. Our REIT business model and structure of our tenant leases ensure we do not neglect this critical obligation. In fact, since it acquired the property in May 2009, CLP has invested more than $1.7 million for repair and maintenance items, including –

    - Refurbishment of pools and slides,
    - New pumps and equipment for rides,
    - New filtration systems for the pools,
    - New restaurant equipment, and
    - Parking lot refurbishment.

- **STABILITY.** CLP's focus is to create stability for both its shareholders, the State of Hawaii, as well as for the communities and families that depend on the economic contribution provided by Wet 'N' Wild Hawaii. To this end, CLP's stated target leverage ratio is not to exceed 50%. Market demands placed on public REITs have compelled REIT managers to use debt conservatively, which means properties do not have to be managed solely to generate the cash flow required to service high levels of debt. Our low leverage ratio gives us greater control over our assets, complementing and enhancing our investment view. A lower debt versus equity ratio cushions CLP (and other REITs) from the negative effects of fluctuations in the real estate market that have traditionally occurred over time.

- **TAXES GENERATED BY WET 'N' WILD HAWAII.** CLP's ownership of this prominent Hawaii property produces substantial tax revenue for Hawaii – revenue that will grow if continued investment motivation is not diminished by this ill-advised proposed legislation:

    - **Payroll Taxes.** Payroll taxes on employee wages totaled $197,208 in 2014.

    - **General Excise and Use Tax – Property Operations.** The tax revenues in this category totaled $497,060 in 2014.

    - **General Excise and Use Tax – Rent.** Because CLP is a REIT and must use a lease structure, we are required to pay General Excise Tax on the rent received for both real and personal property. This tax was approximately $127,000 for 2013 and $117,000 for 2014.

    - **Gas Taxes.** State taxes paid on gasoline purchases by guests traveling to and from the park.

- **Property Taxes.** CLP paid approximately $285,000 in property tax for 2014.

- **Transfer Taxes.** CLP paid a transfer tax of $62,000 when it acquired the waterpark.

- **Taxes on Seller's Gain in Connection with Properties Sold to REITs.**

- **Dividend Taxes Paid by REIT Investors.** REIT investors currently pay tax on their dividend income in their state of residence. The current system allows the State of Hawaii to collect taxes annually from REIT shareholders in Hawaii through personal state income taxes no matter where the REIT does business. <u>By adopting HB 82 / SB 118 and imposing a tax at the corporate REIT level, Hawaii would reduce the amount of cash ultimately available to be paid to Hawaii investors, thus putting them at an economic disadvantage</u>.

In addition, we believe that Wet 'N' Wild Hawaii further benefits the State of Hawaii and the island of Hawaii by creating an attractive amenity that helps draw visitors from the U.S. mainland, Japan and other locations.

In conclusion, we strongly urge that Hawaii not impose double taxation on REITs as the enactment of HB 82 and SB 118 would prescribe. If adopted, this unwise legislation would (i) put Hawaii at a competitive disadvantage compared to virtually all other states, (ii) penalize Hawaii citizens who invest in REITs by reducing their returns, and (iii) discourage REITs from investing in Hawaii properties. Further, this legislation would have a chilling effect on the motivation of REITs, like CLP, which currently own property in Hawaii, to improve these assets and grow their positive economic impact through additional capital investment.

We thank you again for this opportunity to provide testimony against HB 82 / SB 118 and sincerely hope you consider our strong opposition to this proposed legislation.

From: mailinglist@capitol.hawaii.gov
Sent: Monday, February 02, 2015 9:23 AM
To: CPCtestimony
Cc: ack@ack-inc.com
Subject: *Submitted testimony for HB82 on Feb 4, 2015 14:30PM*

HB82
Submitted on: 2/2/2015
Testimony for CPC/JUD on Feb 4, 2015 14:30PM in Conference Room 325

Submitted By	Organization	Testifier Position	Present at Hearing
albert c. kobayashi inc	Individual	Oppose	No

Comments:

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

Do not reply to this email. This inbox is not monitored. For assistance please email webmaster@capitol.hawaii.gov

Michael J. Fergus

125 MERCHANT STREET, SUITE 200
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TELEPHONE (808) 545-1700
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February 4, 2015, 2:30 p.m., Conference Room 325

TO: Committee on Consumer Protection & Commerce
Rep. Angus L. K. McKelvey
Rep. Justin H. Woodson

Committee on Judiciary
Rep. Karl Rhoads
Rep. Joy A. San Buenaventura

FROM: Michael J. Fergus

RE: In Support of HB 82, Relating to Real Estate Investment Trusts

Members of the Committee on Consumer Protection & Commerce and Committee on Judiciary:

I strongly support HB 82 which will eliminate the tax deductibility of dividends for Real Estate Investment Trusts (REITs). A loophole in our state income tax law that came from the '60's allows mainland corporations to take the net income that they earn in Hawaii out of state, tax free. These corporations, which own and operate the major shopping centers in Hawaii, most of the Class A office buildings downtown, major industrial tracts like Mapunapuna, and many of the hotels in Waikiki and on the neighbor islands, are called Real Estate Investment Trusts (REITs). They pay no Hawaii corporate income tax.

There are about 25 major corporations operating profitably as REITs in Hawaii and they are all headquartered on the mainland. Further, their senior management and 99.5% of their shareholders live on the mainland and they pay taxes on their REIT dividends in the states where they reside. So other states are receiving the tax revenue earned in Hawaii even while our residents and local businesses foot the bill for the infrastructure, emergency and social services required to support the commercial properties owned by these REITs.

It's time to close the REIT income tax loophole. Currently, around $14 billion of Hawaii property is owned by REITs. These companies are earning an estimated $700 million to $1 billion every year in Hawaii, but they pay zero income tax. That is a loss of between $30 to $60 million annually in taxes for Hawaii. Then there's the capital gains tax on the sale of these properties, which is also not being taxed in Hawaii. If a REIT sells one of its trophy shopping centers in Hawaii for a $100 million gain, the taxes on the gain are paid to the mainland states where its shareholders live. Hawaii gets nothing. If a local corporation sold a property for a $100 million gain, the State of Hawaii would collect $4 million in capital gains tax. REITs may pay general excise tax, conveyance tax and real property taxes in

Hawaii, but in the case of the retail, office and industrial properties, 100 percent of those taxes are passed on to the REITs' overburdened local tenants; so, again, these REITs effectively pay no taxes in Hawaii. Why should we give out-of-state investors a tax break that we don't give to our own local citizen-investors who are paying state income taxes ranging from 6 percent to 11 percent?

There is more REIT-owned property in Hawaii per capita than any other state in the nation, and by a wide margin. The REITs argue that if we tax them and make them pay their fair share of taxes, they will no longer invest here. That is simply not true. The state of New Hampshire has taxed REITs for years and still has more REIT-owned property per capita than the median U.S. state. All we are asking is that they pay 6.4% of the income earned in Hawaii to the state to support our community like the rest of us do.

There is no reason why any investor in Hawaii should be operating tax-free when our state is struggling to pay for our children's education, services for our elderly, and to deliver promised benefits to its retirees. REITs don't pay sufficient taxes to support Hawaii's infrastructure and don't support our local charities in a meaningful way, then they ship our money out of state, tax free. There are plenty of local, mainland, and foreign tax-paying investors here, such as Alexander & Baldwin, Castle & Cooke, Watumull Properties, private equity funds, hedge funds, and mainland institutional investors. We should level the playing field and tax REITs the same way as other real estate investors. We need to protect our tax base for the benefit of our community.

Thank you.

LATE

Testimony of Brooke Wilson
Pacific Resource Partnership

Committee on Consumer Protection & Commerce
Representative Angus L.K. McKelvey, Chair
Representative Justin H. Woodson, Vice Chair

Committee on Judiciary
Representative Karl Rhoads, Chair
Representative Joy A. San Buenaventura, Vice Chair

HB 82 – Relating to Real Estate Investment Trusts
Wednesday, February 04, 2015
2:30 P.M.
State Capitol – Room 325

Aloha Chairs McKelvey and Rhoads, Vice Chairs Woodson and San Buenaventura and members of the Committees:

PRP is a not-for-profit organization that represents the Hawaii Regional Council of Carpenters, the largest construction union in the state, and more than 240 of Hawaii's top contractors. Through this unique partnership, PRP has become an influential voice for responsible construction and an advocate for creating a stronger, more sustainable Hawaii in a way that promotes a vibrant economy, creates jobs and enhances the quality of life for all residents.

We **oppose** HB 82, Relating to Real Estate Investment Trusts (REITs) which disallows dividends paid deduction for REITs.

Hawaii has challenges generating in-state capital to refresh aging commercial properties and hotels. However, in the last 5 years, our state has been fortunate to attract approximately $6 billion in REITs investment to our shores. As a result, projects such as the expansion and renovation of Ala Moana Center, the redevelopment of the iconic International Marketplace, and the Outrigger Hotels Waikiki Beachwalk project have spurred thousands of jobs in retail, healthcare, tourism and construction.

Unfavorable tax laws will only encourage REITs investments to look away from Hawaii and invest in other areas of the country. It is important to note that Hawaii's tax policy is in line with 49 other states. By keeping tax laws the way they are, Hawaii will remain competitive for attracting billions of dollars to fund needed improvements in our community.

(Continued From Page 1)

For the reasons mentioned above, we respectfully request that HB 82 be held in Committees. Thank you for the opportunity to share our comments on this important issue with you.

LATE TESTIMONY

WAIKELE

An American Assets Trust Property

February 3, 2015

Honorable Angus L.K. McKelvey, Chair
Honorable Justin H. Woodson, Vice Chair
Committee on Consumer Protection and Commerce
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Honorable Karl Rhoads, Chair
Honorable Joy A. San Buenaventura, Vice Chair
Committee on Judiciary
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill No. 82 relating to Real Estate Investment Trusts
February 4, 2014 hearing at 2:30 p.m.

Dear Chair McKelvey, Vice-Chair Woodson, Chair Rhoads, Vice-Chair San Buenaventura and Committee Members:

My name is Pamela Wilson, and I am the General Manager of Hawaii Real Estate for American Assets Trust. I am a life-long resident of our Islands. I have worked for American Assets Trust for the past nine years and have witnessed the positive impact that they have had on our communities. American Assets Trust is a New York Stock Exchange-listed Real Estate Investment Trust (REIT) engaged in acquiring, improving, developing and managing premier retail, office and residential properties primarily in Hawaii, Southern California, Northern California, Oregon, and Washington State.

On behalf of American Assets Trust, thank you for the opportunity to provide our testimony in respectful opposition to House Bill No. 82, relating to taxation of real estate investment trusts.

REITs allow ordinary Americans to invest in real estate. As with all REITs, and unlike other non-REIT property owners, we must satisfy many strict and expensive requirements in order to maintain our REIT status. One of the requirements is to distribute annually all of our taxable income to shareholders in order for all of our earnings to be taxed at the shareholder level. Another requirement is to own properties for the long-term, rather than to develop and sell properties. By taxing REITs at the entity level, this bill would penalize not only the REITs themselves, but also Hawaii residents and pension funds who invest in REITs owning Hawaii real estate.

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Email: pwilson@americanassets.com

Like most REITs, American Assets Trust is a long-term property investor. We are committed to creating sustainable value at our properties. American Assets Trust owns four properties in Hawaii: The Shops at 2150 Kalakaua; Waikele Center; Waikiki Beach Walk and the Embassy Suites-Waikiki Beach Walk. In particular, approximately ten years ago, American Assets Trust made a significant investment to acquire the Waikiki Beach Walk with our partner Outrigger Enterprises, at that time. Our understanding is that capital from local investors was not available to make this investment during that period. As a publicly traded company, American Assets Trust has access to the public capital markets, which provides an efficient source of capital to invest in and improve properties like Waikiki Beach Walk. Since then American Assets Trust has provided additional capital for improvements to maintain this property as a world class destination.

Since making these investments, the entire area has improved tremendously. From creating local businesses that produce many jobs, increased business activity, and additional improvement to the state's economy (including through generation of additional payroll, general excise, and income taxes earned by residents employed at these properties). Not to mention the growth in tourism over the last decade which in large part is a result of the long term patient capital allocation by REITs to create high quality, world class retail and resort destinations that tourists enjoy and are drawn back to time and time again.

Notably, the REIT business model does not depend on "flipping" properties but on providing sustainable returns to our investors from distributions of current earnings and modest capital appreciation of our stock. Thus, we are incentivized (assuming state law regarding REITs does not change) to continue making additional investments in Hawaii at these properties.

Furthermore, unlike other non-REIT property investors, publicly traded REITs like American Assets Trust are compelled by market forces to borrow money at a conservative level. As a result, we do not have to manage our properties in a manner just to generate the cash flow required to service higher levels of debt. This conservative debt level provides a cushion for American Assets Trust when there are fluctuations in the real estate market and provides stability for the community and families that depend on the economic contributions provided by the continued vitality of Waikiki Beach Walk and our other Hawaii properties.

Enactment of H.B. 82 would impose a double tax on our income. As a REIT that invests in multiple states, enactment also would make Hawaii less attractive to us and encourage us to place our investments in other states that do permit the Dividend Paid Deduction (DPD).

For these reasons, American Assets Trust **opposes** H.B. 82.

Thank you for the opportunity to submit this testimony.

Pamela R Wilson

Pamela R. Wilson
General Manager, Hawaii Real Estate
American Assets Trust

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