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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Thursday, February 23, 2017
Time: 12:00 P.M.
Place: Conference Room 308, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 1012, H.D.1, Relating to Real Estate Investment Trusts

The Department of Taxation (Department) appreciates the intent of H.B. 1012 H.D. 1 and provides the following comments for your consideration.

The original H.B. 1012 temporarily disallows the deduction for dividends paid by a Real Estate Investment Trust (REIT) for a period of 15 years, except for dividends generated from housing that is affordable to households with incomes at or below 200% of the median family income. The House Committee on Housing amended the measure, allowing a REIT that generates income from trust-owned housing for households with incomes at or below 140 percent of the median family income, as determined by the United States Department of Housing and Urban Development. The original draft allowed the deduction for trust-owned housing for households with income at or below 200 percent of the median family income. H.D. 1 has a defective effective date and is repealed on December 31, 2032.

First, the Department notes that this measure relies upon the study "Real Estate Investment Trusts in Hawaii: Analysis and Survey Results" produced by the Department of Business, Economic Development & Tourism Research and Economic Analysis Division (Report) which was issued in September 2016. Section 1 of this Report concluded the dividends paid deduction resulted "in $36,000,000 in corporate income tax revenue being forgone that the State". However, it is very important to remember that this conclusion is not the equivalent to a revenue gain, if the deduction were disallowed. Meaning that the repeal of the dividends paid deduction is highly unlikely to result in a $36,000,000 gain to the State.

While a REIT must report all of its income on a tax return, it is not mandatory to report all of its allowable deductions. This is because the dividends paid deduction alone will eliminate any tax liability. In other words, to properly estimate a revenue gain, we must also consider the other allowable deductions that can be used to offset tax liability, as well as behavioral responses due to tax planning. The repeal of the dividends paid deduction is only one of many variables that must be considered in determining any potential revenue gain.

Second, the Department notes that it always prefers conformity with the Internal Revenue Code (IRC) where possible, as it provides clear guidance to both the Department and to taxpayers; the Internal Revenue Service has issued substantial guidance in the form of rules and regulations, and there are many court decisions regarding the various sections of the IRC. Conformity greatly minimizes the burden on the Department and taxpayers, thereby assisting compliance with Hawaii's tax law.

Finally, if the Committee wishes to advance this measure, the Department is able to implement this measure with the current effective date.

Thank you for the opportunity to provide comments.

LAND USE RESEARCH
FOUNDATION OF HAWAII
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(808) 521-4717
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February 21, 2017

Representative Sylvia J. Luke, Chair
Representative Ty J.K. Cullen, Vice Chair
House Committee on Finance

Comments and Concerns in Strong Opposition to HB 1012, H.D. 1, Relating to Real Estate Investment Trusts (REITs); Disallows Deduction for Dividends Paid.

Thursday, February 23, 2017, 12:00 p.m., in Conference Room 308

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 1012, H.D. 1. The purpose of this bill is to temporarily disallow the deductions for dividends paid by real estate investment trusts for a period of fifteen years, but with an exception for dividends generated from trust-owned housing that is affordable to households with incomes at or below 140 per cent of the median family income, as determined by the United States Department of Housing and Urban Development. Should HB 1012, H.D. 1 be adopted, for a period of fifteen years, 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.

LURF's Position. LURF acknowledges the intent of this and prior, similar iterations of this measure given what may be perceived to be the potential for tax avoidance and abuse by foreign/mainland corporations and wealthy individuals through real estate ownership arrangements structured through REITs, however, stated justifications for this bill have not been proved or supported by any credible facts or evidence.

The State's Final Report Has Failed to Validate the Alleged Purpose of, and Need for this Proposed Legislation.

Given that an unwarranted change of a universal tax rule in place since 1960 could undoubtedly affect investments made by REITs in Hawaii, significantly reduce the availability of capital in this State, as well as result in other economic repercussions, the Legislature determined in 2015 that it was necessary and prudent to require support for this type of measure prior to considering its passage. Thus, Act 239, Session Laws of Hawaii 2015, was passed which required the State Department of Business, Economic Development & Tourism (DBEDT) and the State Department of Taxation (DOTAX) to study the impact of REITs in Hawaii, and to present material facts and evidence which could show that such proposed legislation is in fact needed, and whether the State's economy will not be negatively affected because of taking the action proposed.

An interim report was released in December 2015 (the "Interim Report"),[1] followed by a final report issued in September 2016 (the "Final Report"),[2] however, even the Final Report appears preliminary at best; is based on assumptions and estimates; relies on inconclusive results of surveys admittedly taken with a small sample size and low response rate; and is fraught with uncertainties, inconsistencies and weighting errors, making it unfeasible and ill-advised to rely upon for presenting any conclusive calculations or impacts.

Inquiries which critically must be, yet have not been proficiently or accurately addressed in the Final Report, include the amount of income the State would in fact receive as a result of the proposed legislation,[3] especially given the likelihood that REIT investment in Hawaii will in turn decline (i.e., whether the proposed measure is fiscally reasonable and sound); and whether it would be possible to replace the billions of dollars in investments currently being made by REITs should they elect to do business elsewhere if this proposed legislation is passed.

Incredibly, the current version of this HB 1012, H.D. 1 nevertheless relies on obscure findings contained in the Final Report, including an unsupported estimate by the DBEDT that in 2014, the deduction resulted in $36,000,000 in corporate income tax revenue being foregone, whereas the Interim Report included an express finding by DBEDT and DOTAX that the corporate income tax forgone was estimated to be $16.3 million (at best) for the same year.[4] No reliable basis or support whatsoever has been

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[1] Department of Business, Economic Development & Tourism Research and Economic Analysis Division. *Real Estate Investment Trusts in Hawaii: Preliminary Data and Analysis - Interim Report*. December 2015.

[2] Department of Business, Economic Development & Tourism Research and Economic Analysis Division. *Real Estate Investment Trusts in Hawaii: Analysis and Survey Results*. September 2016.

[3] LURF understands that even the State DOTAX does not know how much tax income the government might receive as a result of the proposed legislation.

[4] This unsupported new "estimate" is included in HB 1012, H.D. 1 despite the previous express findings of DBEDT and DOTAX that the corporate income tax which the State could potentially forgo was estimated to be $16.3 million (which was the maximum amount within the range estimated) in 2014. *Interim Report*, pp. 3, 20-21, 23.

presented in this bill to explain the approximately $20,000,000 increase in the estimate previously reported by DBEDT. Moreover, the Final Report fails to include credible information regarding the amount of retail sales generated, and other positive economic contributions and impacts made by REITs in Hawaii which would effectively offset the tax revenue, if any, reportedly forgone by the State.

Given the inaccuracy and unreliability of the questionable findings contained in the Interim and Final Reports, as well as the complete failure of said Reports to come to any meaningful and valid conclusions required to be made pursuant to Act 239, it should be brought to this Committee's attention that another study on the economic impacts of REITs in Hawaii dated December 2015, was prepared by economic expert Paul H. Brewbaker, PhD., CBE for the National Association of Real Estate Investment Trusts (the "Brewbaker Study").[5] The Brewbaker Study concludes that the repeal of the dividend paid deduction (DPD) for REITs in Hawaii would likely result in a net revenue loss to the State due to a number and combination of negative consequences which would be experienced by the local economy.

In view of the significant inconsistencies between the Final Report and the Brewbaker Study, LURF believes it would be irresponsible for this Committee to consider, let alone support HB 1012, H.D. 1 which may potentially stifle, if not reverse the current growth of the State's economy, based on its reliance solely upon the untenable findings and conclusions contained in the Final Report, and must respectfully urge this Committee to at the very least, conduct an independent investigation and analysis of all the available facts and information relating to the disallowance of the DPD, and the potential financial and economic consequences thereof, prior to making any decision on this bill.

LURF's Opposition to HB 101, H.D. 1 is also 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 invest in income-producing real estate. Pursuant to current federal and state income tax laws, REITs are allowed a 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%

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[5] Paul H. Brewbaker, Ph.D., CBE. *Economic Impacts of Real Estate Investment Trusts in Hawaii*. December 2015.

of their taxable income to shareholders,[6] 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.

According to the Brewbaker Study, repealing the DPD for REITs would subject Hawaii shareholders to double taxation and may reduce future construction and investment by REITs locally, thereby resulting in revenue loss to the State.[7] Moreover, replacement investor groups may likely be tax-exempt institutions such as pension plans and foundations which would generate even less in taxes from their real estate investments.[8]

2. HB 1012, H.D. 1 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 1012, H.D. 1 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.[9] 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 1012, H.D. 1 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, despite the REITs continuing to be compelled to distribute their taxable income to shareholders as mandated by federal law.

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

[7] *Brewbaker Study* at pp. 1, 32, 38.

[8] *Id.*

[9] New Hampshire is reportedly the only state which imposes corporate income tax on widely-held REITs, however, 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.

3. Hawaii REITs Significantly Contribute to, and 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.

Results from the Final Report indicate that as of September 2016, approximately 42 REITs operating in Hawaii reportedly held assets in the amount of an estimated $7.8 billion at cost basis[10], 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 State General Excise Tax (GET) 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 continue in the future, is undoubtedly attributable in part to REIT investment in Hawaii. Outrigger Enterprises partnered with REIT American Assets Trust to successfully develop the Waikiki Beach Walk. General Growth' Properties' expansion and renovation 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. The capital invested in that project to construct additional retail space and luxury residences will reportedly exceed $1 billion, and the development will have created an estimated 11,600 full- and part-time jobs and over $146 million of state revenue. Taubman Centers, Inc., another REIT, also partnered with CoastWood Capital Group, LLC to revitalize Waikiki through the redevelopment of the International Market Place at a cost of approximately $400 million.

REIT projects have helped to support Hawaii's construction industry immensely[11] by providing thousands of jobs, and continue to significantly contribute to the local economy through development of more affordable housing (more than 2,000 rental housing units for Hawaii's families, such as the Moanalua Hillside expansion of more affordable housing rentals), student housing near the University of Hawaii, health care facilities, offices, shopping centers (Pearlridge Center renovations), and hotels.

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

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[10] *Final Report* at pages 3, 15-16.

[11] In the past five years, REIT-related construction activity alone is estimated to have generated $3 billion in Hawaii GDP.

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.

Proponents of this bill attempt to minimize the negative consequences of disallowing the DPD by claiming that very few Hawaii taxpayers invest in REITs with property in Hawaii, however, LURF understands that in 2014 over 9,000 Hawaii investors had investments in over 70 public, non-listed REITs and received almost $30 million in distributions, and that tens of thousands more directly or indirectly own shares in stock exchange-listed REITs.

Supporters also ignore the fact that tax law changes proposed by HB 1012, H.D. 1 will 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.

If passed, this measure would strongly discourage future investment by REITs in Hawaii, which would ultimately impact jobs, reduce tax revenue and result in significant consequences for the State's future economy.

Conclusion. LURF's position is that the findings of the Final Report have failed to credibly present any material facts or circumstances to prove that this proposed legislation is in fact necessary, or that the State's economy will significantly improve because of taking the action proposed. The intent and application of HB 1012, H.D. 1 thus arguably remain unreasonable, unwarranted, and exceedingly anti-business.

Act 239, SLH 2015 was specifically enacted by the State Legislature to validate the alleged purpose of this bill, and the results of the Final Report were considered vital to confirm the need for this type of measure. Therefore, based on the inability of said Report to convincingly and conclusively determine that the State's economy will be negatively impacted as a result of the action proposed, or that this proposed legislation is otherwise warranted, and given that an unjustifiable change of a universal tax rule in place since 1960 could significantly reduce the availability of capital in this State, as well as result in other negative economic repercussions, LURF must **strongly oppose HB 1012, H.D. 1**, and respectfully requests that this bill be held in this Committee.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Disallow REIT Deduction for Dividends Paid

BILL NUMBER: HB 1012, HD-1

INTRODUCED BY: House Committee on Housing

EXECUTIVE SUMMARY: This bill would suspend for 15 years the dividends paid deduction that real estate investment trusts, or REITs, now enjoy. The numerous REITs who now own and manage Hawaii real estate would be taxed like any other corporation doing business in Hawaii.

SYNOPSIS: Amends HRS section 235-2.3(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, except that the deduction shall remain available for dividends generated from trust-owned housing that is affordable to households with incomes at or below 140% of the median family income, as determined by the United States Department of Housing and Urban Development.

Amends HRS section 235-71(d) to provide that for tax years beginning after December 31, 2017, no deduction for dividends paid shall be allowed for REITs for Hawaii income tax purposes.

EFFECTIVE DATE: Upon a date to be determined, applies to taxable years beginning after December 31, 2017. Repealed on December 31, 2032.

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 2/21/2017

Hawai‘i Association of REALTORS®
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1259 A‘ala Street, Suite 300
Honolulu, HI 96817

February 23, 2017

The Honorable Sylvia Luke, Chair
House Committee on Finance
State Capitol, Room 308
Honolulu, Hawaii 96813

RE: H.B. 1012, H.D.1, Relating to Real Estate Investment Trusts

HEARING: Thursday, February 23, 2017, at 12:00 p.m.

Aloha Chair Luke, Vice Chair Cullen, and Members of the Committee.

I am Myoung Oh, Director of Government Affairs, here to testify on behalf of the Hawai‘i Association of REALTORS® (“HAR”), the voice of real estate in Hawai‘i, and its 9,000 members. HAR **opposes** H.B. 1012, H.D.1 which disallows the dividends paid deduction for Real Estate Investment Trusts (REIT) for a period of 15 years.

In 1960, the United States Congress created REITs to allow all individuals the opportunity to invest in large-scale diversified portfolios of income producing real estate. REITs are tied to all aspects of the economy, and has a major impact on our state and encompasses a full range of real estate including affordable housing developments, health care facilities, office buildings, shopping centers and hotels.

These investments in Hawai‘i generate taxes to the State, such as through the workers and jobs it creates (income tax), the General Excise Tax for rental income and property taxes for the counties.

Under this measure, it proposes to remove the income tax deduction for dividends from a REIT, thereby creating a double taxation of income. HAR has concerns that this will become a disincentive to invest in Hawai‘i and negatively impact the economy through these investments in real estate. Some benefits of the REITS include renovation and redevelopment of Waikiki Beachwalk, Waikiki International Marketplace, and Moanalua Hillside Apartments.

This measure will have a negative effect on Hawaii’s investment climate and undermine the State’s credibility as an attractive place to invest in new real estate projects.

Mahalo for the opportunity to testify.

Park Hotels & Resorts Inc.
Scott Winer, SVP Tax
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McLean, VA 22102
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WRITTEN TESTIMONY OF

SCOTT D. WINER

SENIOR VICE PRESIDENT, TAX

PARK HOTELS & RESORTS INC.

IN OPPOSITION TO H.B. 1012

BEFORE THE HAWAII HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCE

HONORABLE SYLVIA LUKE, CHAIR

HONORABLE TY J.K. CULLEN , VICE CHAIR

HEARING ON H.B. 1012

FEBRUARY 23, 2017

On behalf of Park Hotels & Resorts Inc. ("PARK"), thank you for this opportunity to provide our testimony on H.B. 1012 and its companion S.B. 1228. PARK submits this testimony in opposition to H.B. 1012. PARK is a publicly traded lodging real estate investment trust ("REIT") (NYSE:PK) that owns 67 premium branded hotels and resorts globally. Included within PARK's portfolio of hotels are (i) the Hilton Hawaiian Village Waikiki Beach Resort located along Oahu's prestigious Waikiki Beach, and (ii) the Hilton Waikoloa Village located on the Kohala Coast of the Big Island of Hawaii. PARK strives to be the preeminent lodging REIT, focused on consistently delivering superior, risk adjusted returns for shareholders that invest in the hotel sector. PARK, like most REITs, has a long-term investment focus and is committed to creating sustainable value at its properties.

As you know, Congress enacted the REIT legislation in 1960 to allow individual investors the ability to own and benefit from professionally managed, institutional quality, income-producing real estate. As with all REITs, PARK must meet multiple stringent, complex and costly requirements in order to maintain its status as a REIT, including: organizational requirements, asset holding requirements, passive income generation requirements, and importantly REITs must distribute at least 90% of their taxable income annually. Further, as REITs are passive real estate companies, they cannot actively trade in real estate properties without being subject to a 100% tax on the gain. In addition, because of the taxable income distribution requirement, REITs are required to continuously access the debt and equity capital markets to obtain capital for maintenance, improvements and growth projects.

By meeting these stringent, costly and complex requirements REITs are allowed to claim a dividends paid deduction ("DPD") essentially passing through their taxable income to shareholders. The structure does not "unfairly" advantage REITs, as the cost for such allowance is significant. H.B. 1012 and S.B. 1228, propose to "suspend" (for 15 years) the DPD for all REITs operating in Hawaii. We believe the DPD should not be eliminated. The elimination of the DPD 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 eliminating the DPD would have the undesirable consequence of discouraging future investment by REITs. We believe the proposed legislation will not increase tax revenue for the state as the cost of doing business in Hawaii will diminish investment returns and result in less investment. Further, elimination of the DPD could result in foundations or pension funds replacing REIT ownership of real property. Foundations and pension funds generally are passive owners that pay no income taxes and do not make the same investments as REITs.

PARK's two landmark, oceanfront resorts cater to residents from Hawaii and the mainland, and international travelers. PARK's Hawaiian resorts provide significant economic benefit to the State of Hawaii. We have made extensive renovations in excess of ~$228 million at Hilton Hawaiian Village and Hilton Waikoloa Village, over the last 5 years.

PARK's economic footprint benefits the State of Hawaii in many ways, including:

JOBS: PARK's hotels directly employ more than <u>2,731</u> employees. The payroll and associated benefits for these direct employees is in excess of <u>$152,338,584 million</u>.

CAPITAL MAINTENANCE: Over the next five years, PARK will spend almost $200 million at Hilton Hawaiian Village and Waikoloa Village on capital maintenance projects.

CAPITAL IMPROVEMENTS. Given the long-term nature of our investment, PARK is currently analyzing incremental capital investment at both resorts. These investments are sizeable and at various stages of feasibility / underwriting.

TAXES GENERATED BY PARK in HAWAII:

- Payroll Taxes. Payroll taxes on employee wages totaled $10,401,795 in 2016.
- General Excise and Use Tax - Operations. The tax revenues generated from our operations totaled $24,210,890 in 2016.
- General Excise Tax – Rent. Because PARK is a REIT and must use a lease structure, we are required to pay General Excise Tax on the rent paid between our related companies. Effectively a double taxation of the same revenue. We estimate this additional GET to be approximately $8,000,000 during 2017.
- Property taxes. Property taxes at PARK's two resorts was $15,146,337 in 2016.

We believe that PARK's hotels benefit the State of Hawaii and its residents tremendously in a variety of economic ways. We strongly urge that Hawaii not impose double taxation on REITs. If adopted, this controversial legislation would (i) put Hawaii at a competitive disadvantage, (ii) penalize Hawaii citizens who invest in REITs by reducing their returns, (iii) discourage REITs from investing in Hawaii, and (iv) would require PARK to reassess the level of its investment or reinvestment in Hawaii. Further, this legislation would have a chilling effect on the motivation of REITs, like PARK, 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 H.B. 1012 / S.B. 1228 and sincerely hope you consider our strong opposition to this proposed legislation.

Respectfully submitted,

Scott Winer
Senior Vice President, Tax

Testimony of
Christopher Delaunay
Pacific Resource Partnership

HOUSE OF REPRESENTATIVES
THE TWENTY-NINTH LEGISLATURE
REGULAR SESSION OF 2017

COMMITTEE ON FINANCE
Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair

NOTICE OF HEARING

DATE: Thursday, February 23, 2017
TIME: 12:00 pm
PLACE: Conference Room 308

Aloha Chair Luke, Vice Chair Cullen, and Members of the Committee:

We respectfully **oppose** HB 1012, HD1, Relating to Real Estate Investment Trusts (REITs) which temporarily disallows dividends paid deduction for REITs.

Federal law requires REITs to be long-term investors. In Hawaii, REITs have brought stability as well as substantial economic growth to local industries in Hawaii including commercial real estate, construction, retail, healthcare, visitor industry and affordable housing. In 2015, REITs supported more than 11,700 jobs and provided $95 million in tax revenue for the state. Hawaii has been fortunate that REIT investment has brought capital into the State to move projects forward that otherwise have lagged for many years. If this proposed legislation were to pass, it would strongly discourage future investment by REITs in Hawaii. This would ultimately impact jobs, reduce tax revenue and have very significant consequences for future projects.

For the reasons mentioned above, we respectfully request that HB 1012, HD1 be held in Committee. Thank you for the opportunity to share our comments on this important issue with you.

PRP
PACIFIC RESOURCE PARTNERSHIP

PHONE → 808.528.5557 1100 ALAKEA STREET / 4TH FLOOR HONOLULU / HI 96813 TWITTER: @PRPHAWAII WWW.FACEBOOK.COM/PACIFICRESOURCEPARTNERSHIP

(Continued From Page 1)

About PRP
Pacific Resource Partnership (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.

HAWAII REGIONAL COUNCIL OF CARPENTERS

February 22, 2017

Statement of the Hawaii Regional Council of Carpenters – IN OPPOSITION H.B. 1012 H.D.1

Dear Chair Luke and Members of the House Finance Committee:

In 2015, REIT owned projects supported more than 11,700 jobs and $95 million in tax revenue for the state. Hawaii has been fortunate that REIT investment has brought capital into the State to move projects forward that otherwise have lagged for many years.

REITs have helped to support Hawaii's booming construction industry through various projects statewide, including the International Marketplace, Ala Moana Center and Moanalua Hillside Apartments, an affordable housing rental project.

REITs represent affordable housing developments, health care facilities, office building, shopping centers and hotels. REITs have also provided more than 2,000 rental housing units for Hawaii's families and, with the housing shortage, these units are important for our community.

Many of our union contractors work regularly with REITs on developing various projects in various industries that all help to benefit our community, provide jobs for our members and boost our economy.

If this proposed legislation were to pass, it could have the unintended consequence of discouraging future investment in Hawaii. This would ultimately impact jobs, reduce tax revenue and have significant consequences.

Thank you for the opportunity to voice our concerns.

STATE HEADQUARTERS & BUSINESS OFFICES

OAHU: 1311 Hougtailing Street, Honolulu, Hawaii 96817-2712 • Ph. (808) 847-5761 Fax (808) 841-0300
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MAUI OFFICE: 330 Hookahi Street, Wailuku, Maui 96793-1449 • Ph. (808) 242-6891 Fax (808) 242-5961
KAUAI OFFICE: Kuhio Medical Ctr. Bldg., 3-3295 Kuhio Hwy., Suite 201, Lihue, Kauai 96766-1040 • Ph. (808) 245-8511 Fax (808) 245-8911

February 7, 2017

Honorable Tom Brower, Chair
Honorable Nadine Nakamura, Vice Chair
Committee on Housing
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to HB 1012, Relating to REIT

Chair Brower, Vice Chair Nakamura, and Committee Members:

The Kobayashi Group, The MacNaughton Group, and BlackSand Capital, are three generations of families in the building industry development, construction, and investors in Hawaii. We are fully engaged and understand the economics of REIT investments and strongly oppose to House Bill 1012.

It is paramount to understand the Congressional legislative intent when the Real Estate Investment Trusts (REIT) was enacted in 1960. This legislation provided an opportunity for small investors to invest in large-scale diversified portfolios of income producing real estate provided that at least 90% of their taxable income is distributed to the investors.

Proponents of HB 1012 have not provided rational justification for the paying of double taxes on the REIT revenues and distribution. There is no "tax loophole" to close. How many public and private companies that you know must distribute a minimum of 90% of their taxable income to their shareholders?

HB 1012 states in part, ". . . repealing the current deduction would promote fairness in the treatment of similar, but differently organized, business entities and would generate additional revenue for state program." If the assumption that REITs were enjoying a tax loophole, don't you think that many Hawaii businesses would have reorganized to become a REIT?

The State DBEDT produced a study, "Real Estate Investment Trusts in Hawaii: Analysis and Survey Results," dated September 2016. Statistically, the data was not quantifiable as the information was not readily available and therefore, assumptions were used.

The report failed to include in their focus the tangible tax benefits generated to the State and Counties. REIT investments have and continue to be a quantifiable financial benefit to the State of Hawaii and County governments in the form of collecting millions of dollars in

State GET, real property assessments, transfer fees from REIT sales, and shareholders income tax on the distribution. REIT investments in Hawaii employ thousands of residents in the construction trade crafts, hospitality industry, retail shops, healthcare, financial institutions, among other jobs. REITs build, renovate, and upkeep their properties at investors expense.

It is incorrect that Hawaii taxpayers subsidize the cost of infrastructure when they must pay impact fees.

The question becomes—can the State of Hawaii financially afford to diminish the presence of REITs in Hawaii? Look around Hawaii and you will be pleasantly surprised that many of the large scale projects such as storage facilities, office buildings, hospitality properties, residential housing, and shopping centers would not have been built without REITs.

We strongly urge you to oppose HB 1012.

Sincerely,

KOBAYASHI GROUP Bert Kobayashi, Senior Advisor	**THE MACNAUGTON GROUP** Duncan MacNaughton, Chairman	**BLACKSAND CAPITAL** Ian MacNaughton, Co-Founder & Managing Partner

BLACKSAND CAPITAL
BJ Kobayashi,
Co-Founder & Managing Partner

WAIKELE

An American Assets Trust Property

February 22, 2017

Honorable Sylvia Luke, Chair
Honorable Ty J.K. Cullen, Vice Chair
Committee on Finance
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Written Testimony to House Bill No. 1012, HD1 (HSCR482) regarding Real Estate Investment Trusts
February 23, 2017 hearing at 12:00 p.m. Room 308

Dear Chair Luke, Vice-Chair Cullen, and Committee Members:

My name is Pamela Wilson, and I am the General Manager of Hawaii Real Estate for American Assets Trust. 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.

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. We are committed to creating sustainable value at our properties. We have helped to nurture local businesses that provide jobs, increase business activity, and contribute to the state's economy (through generation of additional payroll, general excise, property taxes and income taxes earned by residents employed at these properties). We also play a valuable role in support of the local communities.

REITs allow ordinary Americans to invest in real estate. As with all REITs, 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. 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. As a REIT that invests in multiple states, a double taxation would make Hawaii less attractive and encourage the placement of investments in other states that do permit the Dividend Paid Deduction (DPD).

I submit this testimony not only as a shareholder who receives dividends from American Assets Trust but as a life-long resident of Hawaii, a constituent and a kama'aina with enough life experience to remember how dark and foreboding Lewers Street looked before the vibrancy of Waikiki Beach Walk, how the old International Marketplace, though quaint, was floundering, how all this influx of capital has redefined Hawaii as a world class destination.

I ask that you consider the very real financial contributions and community benefits that REITs bring to our State. Please hold Bill 1012. Thank you for the opportunity to submit this testimony.

Sincerely,

Pamela R. Wilson

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

94-849 Lumiania Street Suite 100 Waipahu, Hawaii 96797
Telephone: 808 671-7977 Facsimile: 808 678-8170
Email: pwilson@americanassets.com

Douglas Emmett

Douglas Emmett Management, LLC
808 Wilshire Boulevard, 2nd Floor, Santa Monica, California 90401
Telephone 310.255.7700 Facsimile 310.255.7701

February 21, 2017

Representative Sylvia Luke, Chair
Representative Ty Cullen, Vice Chair
Committee on Finance

RE: HB 1012 HD1 Relating to Real Estate Investment Trusts – In Opposition

Aloha Chair Luke, Vice Chair Cullen and Members of the Committee:

On behalf of Douglas Emmett, Inc. ("*Douglas Emmett*"), thank you for the opportunity to present testimony expressing concerns on House Bill 1012 HD1, which seeks to disallow the deduction for dividends paid by real estate investment trusts.

Douglas Emmett has been investing in Oahu for more than a decade. We currently own over 1,500 apartment units in three multi-family projects: The Villas at Royal Kunia, Waena Apartments, and the Moanalua Hillside Apartments. In addition, Douglas Emmett owns over 1.6 million square feet of office property in downtown Honolulu, including Bishop Square, Bishop Place and Harbor Court.

We are currently building 475 additional units of workforce rental housing at our Moanalua Hillside Apartments. The $120 million budget also includes a refresh for the entire Moanalua Hillside Apartments complex, with upgrades to the exteriors of the existing units, new landscaping and a new recreation center for all tenants.

Background of REITs. Congress created REITs in 1960 in order to enable individuals to invest in commercial real estate. REITs allow individuals to own a small portion of professionally managed, income-producing property, including offices such as Bishop Square, apartments such as the Waena Apartments, hotels, healthcare facilities, shopping centers, senior housing and storage facilities.

Federal law requires REITs to distribute at least 90% of their taxable income to their shareholders. Similar to other typical ways of holding real estate such as limited partnerships or limited liability companies, REIT's are essentially pass through vehicles in that the income earned by REIT shareholders (in the form of their annual dividends) is taxed at the shareholder level on the shareholder's individual tax return. These dividends are then deducted for tax purposes at the REIT level to avoid double taxation on REIT investors.

Although the dividends are deducted at the REIT level to avoid double taxation, REITs - just like any other property owner in Hawai'i - are required to pay all other taxes associated with their real estate holdings, including real property taxes, occupancy, and general excise taxes. By way of example, in 2016, Douglas Emmett paid over $5.1 million in real property taxes and over $3 million in general excise taxes. We expect to pay over $5 million of excise tax on our $120 million Moanalua Hillside Development. When completed, the additional units are projected to generate more than $500,000 of annual general excise tax. Without this development, this additional excise tax on both the construction costs and rental of the new units would not be generated.

REITs Provide Vitally Needed Capital for Hawai'i. As an island state poised for significant population growth over the next several decades, Hawai'i faces unique challenges. Economic growth, job creation and the development of workforce housing are only a few of these issues; addressing these issues will require capital and the primary sources of this investment capital will be from outside of Hawai'i.

In addition to being an important source of capital for Hawai'i, REITs bring real estate development and management expertise across a variety of asset classes. Douglas Emmett, for example, is adding critically needed rental housing. Other REITs are investing significant capital and bringing expertise in retail, hotels, self-storage, water parks, office buildings and medical buildings.

By imposing a double tax on REITs, Hawai'i will be at a competitive disadvantage compared to 48 other states.[1] REITs will compare prospective returns on investment, and over time, will likely shift investment dollars from Hawai'i to other markets. This means Hawai'i will lose a significant source of low-cost capital and development expertise.

We acknowledge that Hawai'i will remain an attractive place to invest, just not for REITs. We believe that tax exempt investors are the most likely source of capital large enough to replace REITs. Tax exempt investors, such as endowments, foundations and pension funds, pay no state income tax. These investors, currently have significant land holdings, CBD office buildings, hotels, and retail properties throughout the islands. Without REIT investment, their proportionate ownership share is likely to grow.

REITs Contribute Significantly to GDP and the Labor/Finance Markets in Hawai'i. Over the past five years, REIT-related construction activity generated an estimated $3 billion in Hawai'i GDP. In 2015 alone, REITs supported more than 11,700 local jobs and labor earnings of nearly $500 million. REITs also work with local banks on numerous financings and refinancings; Douglas Emmett is proud to have the four major Hawai'i banks as lenders.

We believe the elimination of the dividends paid deduction is unlikely to make up for the loss of GDP, jobs and associated income and excise taxes generated by REIT activity. The DBEDT study confirmed that its numbers did not take into consideration "how REITs would change their behavior if the DPD were repealed." According to the State of Hawai'i Department of Taxation:

> ***. . .if Hawai'i eliminates the dividends paid deduction, taxpayers may respond in ways that reduce substantially any latent tax liability, such as by claiming other deductions that are presently not reported on their income tax returns.***

Accordingly, once these deductions are applied, the DBEDT projected revenue figures are likely to significantly decrease and Hawai'i could lose more tax revenue from foregone economic activity in response to eliminating the DPD than would be gained in corporate income taxes.

1. Excludes New Hampshire which is the only state to eliminate the DPD.

House Bill 1012 HD1 Imposes a Double Tax on Hawai'i Residents. House Bill 1012 HD1 will negatively impact investors in REITs that own property in Hawai'i, including Hawai'i residents and Hawai'i pension funds. Should Hawai'i choose to double tax REITs, dividends coming from Hawai'i properties to these Hawai'i domiciled investors will be unfairly penalized.

REITs ultimately mirror other traditional real estate holding structures such as partnerships and limited liability companies. Profits from the real estate are distributed to the ultimate owners – in a REIT's case, its shareholders. Jurisdictions in which REITs invest benefit from REITs access to capital, development activity, and property management expertise as well as from the jobs, revenue and taxes generated by REITs. REITs pay real property and excise taxes, just like other local real estate owners.

As a stakeholder in Hawai'i, Douglas Emmett believes HB 1012 HD1 will eliminate an important source of capital that generates substantial local economic activity. Hawai'i could lose more tax revenue from foregone economic activity in response to DPD elimination than would be gained in corporate income taxes. Inasmuch as House Bill 1012 HD1 appears to be outside of the best interests of the residents of Hawai'i and the objectives of the State to encourage investment and the growth of Hawai'i's economy, we respectfully ask that you defer Bill 1012 HD1.

Sincerely,

Kevin A. Crummy
Chief Investment Officer
Douglas Emmett

Legal Department
701 Western Avenue
Glendale, CA 91201

www.publicstorage.com
818.244.8080

Public Storage

February 22, 2017

Hearing Date: Thursday, February 23, 2017
Time: 12:00 p.m.
Place: Conference Room 308

The Honorable Sylvia Luke, Chair
The Honorable Ty J.K. Cullen, Vice Chair
House of Representatives, Committee on Finance

Re: Testimony ***Opposing*** Repeal of the REIT Dividends Paid Deduction - HB 1012, HD1

Dear Chair Luke, Vice Chair Cullen, and Members of the Committee on Finance:

My name is Lily Yan Hughes and I am the Senior Vice President, Chief Legal Officer and Corporate Secretary of Public Storage. We are ***strongly opposed*** to HB 1012, HD1, and its companion bill, SB 1228. The bills would eliminate the "dividends paid deduction" (DPD) for Hawaii income tax purposes for real estate investment trusts (REITs).[1] The DPD is a central feature of the taxation of REITs; REITs get the deduction because they are effectively required to distribute their income to their shareholders, who are currently taxable on those dividends.

Enactment of HB 1012, HD1 or a similar measure would make REITs separately taxable in Hawaii for a 15 year period, imposing a double tax regime that is completely contrary to the accepted federal and state tax treatment of REITs. Imposing an added 6.4% tax on REITs operating in Hawaii predictably would lead REITs to redirect investments away from the state.

Public Storage and Hawaii. Public Storage is a real estate investment trust that is the largest owner and operator of self-storage facilities in the United States, with almost 154 million rentable square feet of real estate in 38 states. In the United States we have approximately 2,350 facilities and 1.3 million tenants. We own 11 facilities in Hawaii. In 2016, those properties generated more than $28.5 million of gross revenue and we paid the state about $1.3 million of general excise tax. For the 2016/2017 fiscal year, we will pay almost $2 million of real estate taxes in Hawaii.

Because we are taxed as a REIT, Public Storage is effectively required to distribute all of its taxable income to our shareholders. The shareholders then report and pay state and federal tax on those dividends. Our shareholders in Hawaii are taxable by the state on the full amount of our dividends (not just the limited portion of those dividends attributable to the 11 properties we have in the state), so the state benefits from the REIT regime.[2]

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[1] The bills would continue to allow the DPD for dividends related to income arising from providing certain affordable housing.

[2] We are confident that investors in Hawaii directly and indirectly hold significant PSA shares, but we cannot specifically identify our Hawaiian shareholders. Our common stock is publicly-traded on the New York Stock Exchange under the symbol PSA. Publicly traded companies typically cannot specifically identify their shareholders, as most publicly traded stock is held by depositaries in street name.

The preambles to the bills offer little to justify the proposed DPD repeal. The most apparent motivation is a misguided effort to raise added tax revenue. In fact, the bills may well have the opposite effect. Imposing such an anti-business tax will reduce REITs' yields on Hawaii investment and encourage REITs to invest in other states. This can be expected to have adverse long term effects on the Hawaii economy and the state's tax collections. The preambles only other purported justifications are two spurious "fairness" points: (1) a suggestion that because REIT shareholders in other states do not pay Hawaii taxes on the dividends they receive, Hawaii taxpayers somehow are subsidizing the shareholders in other states; there is no subsidy, and of course, Hawaii REIT shareholders do not pay taxes to other states for REIT dividends attributable to properties in other states (and in the case of Public Storage, the great bulk of our dividends are attributable to properties in other states); and (2) asserting that repeal would somehow support fairness in treatment of similar but differently organized businesses; in fact, REITs are treated differently for good reasons, repeal of the DPD would unfairly single out REITs for double taxation, even though REITs, unlike regular corporations, are required to distribute their income and are subject to significant operating restrictions governing their income and assets.

Also, a key fairness issue supports continuing the DPD. If Hawaii breaks from the national REIT template and repeals the DPD, it would subject shareholders in Hawaii to double taxation on income that REITs earn in the state (Public Storage would pay tax to Hawaii on its Hawaii earnings, and our Hawaii shareholders would pay tax to Hawaii again when those earnings are included in their dividends), although shareholders virtually everywhere else would only be subject to a single level of state income tax.

We note too that no state that imposes income tax upon REITs (other than New Hampshire) denies the dividends paid deduction as proposed by HB 1012, HD1 (and SB 1228). Indeed, over the past decade or so, a number of states (*e.g.*, Idaho, Louisiana, New Jersey, North Carolina, and Rhode Island) have examined, and then rejected, legislation that would have disallowed a widely-held REIT's DPD in those states.

As when Hawaii's legislature considered similar proposals in recent years, Hawaii should decline to enact these bills, so that the DPD for widely-held REITs will continue. We respectfully request that you do ***not*** move HB 1012, HD1, or any similar bill forward.

Sincerely,

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

cc: Department of Taxation
Department of Business, Economic Development & Tourism

NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

WRITTEN TESTIMONY OF

STEVEN A. WECHSLER
PRESIDENT & CEO
NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS
IN OPPOSITION TO H.B. 1012, H.D. 1

BEFORE THE HAWAII HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCE
HONORABLE SYLVIA LUKE, CHAIR
HONORABLE TY J.K. CULLEN, VICE CHAIR

HEARING ON H.B. 1012, H.D. 1

FEBRUARY 23, 2017
12:00 P.M.

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

Chair Luke, Vice Chair Cullen, and members of the Committee on Finance,

The National Association of Real Estate Investment Trusts (NAREIT)[1] thanks you for this opportunity to submit testimony in **strong opposition** to H.B. 1012, H.D. 1, which would "temporarily" (for 15 years) eliminate the dividends paid deduction (DPD) for REITs except with respect to certain dividends from affordable housing.

NAREIT opposes H.B. 1012, H.D. 1, because it is contrary to federal income tax rules and the existing laws of virtually every other state with an income-based tax system. Enacting this proposal would double tax REITs and signal Hawaii's discouragement to long-term capital investment. This would potentially result in a reduction of millions of dollars of new REIT investment, a shift in property ownership to tax-exempt owners like pensions and endowments, and loss of revenue and significant jobs generated by REITs to the State. Accordingly, NAREIT respectfully asks this Committee to hold H.B. 1012, H.D. 1.

REITs are a way for people- including Hawaii residents and others – to own professionally-managed, rental real estate. Created by Congress in 1960, REITs are corporations that combine the investment dollars of many investors to own and operate rental properties that may include apartments (like Douglas Emmett's Waena Apartments, which provides workforce housing); theme parks (like CNL Lifestyle Properties' Wet'n'Wild Hawaii); shopping centers (like General Growth Properties' Ala Moana Center and Washington Prime Group's Pearlridge Center); hotels (like American Assets Trust's Embassy Suites at Waikiki Beach Walk), healthcare facilities (like Healthcare Realty Trust's Hale Pawaa medical office building), offices, and storage facilities. There are about 20 Securities and Exchange Commission (SEC)-registered REITs that have invested about $4 billion (as of Dec. 31, 2015) in over 70 Hawaii properties (worth approximately $7.7 billion, based on the equity market capitalization of all equity REITs in the FTSE NAREIT All REITs Index as of Dec. 31, 2015).

Unlike partnerships, LLCs or other C corporations, REITs are legally mandated to distribute all their taxable income to shareholders as dividends so their income is taxed once – at the shareholder level. In exchange for meeting this distribution requirement, federal law grants REITs a DPD. Like every other state with a corporate net income tax but New Hampshire, Hawaii follows federal law and allows a DPD. Thus, the income generated by REITs is reported by, and income taxes on such income are paid by, the shareholders of these companies to their state of residence. In fact, NAREIT's membership includes almost 200 public REITs and hundreds of REIT mutual funds invested in those REITs. Many of these REITs (and the funds that own these REITs) own **no properties** in Hawaii yet distribute millions of dollars in dividends – taxable by Hawaii – to thousands of Hawaii shareholders. Hawaii is able to tax these dividends even though the rental income underlying the dividends is earned in other states.

REITs benefit Hawaii by paying millions of dollars in taxes, creating jobs, and helping local communities. Hawaii economist Dr. Paul Brewbaker conducted a 2015 study on behalf of NAREIT that concluded that "[i]n just the past year REITs were associated with more than 11,700 jobs representing labor earnings of nearly $500 million and $95 million in tax revenue in Hawaii." In fact, REITs –like other commercial property owners - pay millions of dollars in general excise taxes (GET), property taxes and conveyance taxes. By investing hundreds of millions of dollars in property upgrades, their tenants generate even more in GET revenue. For example, Taubman's International Market Place (which opened last summer) is expected to pay in this current year over $1 million in

[1] NAREIT is the worldwide representative voice of real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets.

general excise tax and over $3 million in property taxes. Taubman also paid in total over $1.5 million in local conveyance taxes. The development of the center resulted in employment of over an estimated 1,000 construction jobs, and after opening is expected to create 2,500 permanent jobs (including employment by tenants).

If H.B. 1012, H.D. 1 were enacted, those REITs would be likely to modify their businesses to minimize double taxation and the anticipated Hawaii revenue, risking millions of dollars of capital investment and thousands of jobs. A new tax of 6.4% on net income in one state that does not exist in another state would encourage multi-state REITs to invest where the tax does not exist in order to maximize value to shareholders. The Department of Business, Economic Development and Tourism's (DBEDT) REIT study released in September 2016 specifically notes that its "estimates do not take into account how REITs would change their behavior if the DPD were repealed." For example, REITs may claim deductions or tax credits not currently claimed because currently the DPD fully offsets their income. At the same time, multi-state REITs likely would shift investments among the 48 states where double taxation is absent, and tax-exempt investors like pensions and endowments would fill the vacuum left by their departure and invest in more Hawaii real estate – resulting in no additional tax revenue for Hawaii.

H.B. 1012, H.D. 1 discourages investment in affordable housing. REITs with office buildings or retail properties in Hawaii currently are encouraged to build workforce housing so their tenants have places to live and shop. Limiting the DPD only to income from affordable housing lowers already low margins, discouraging further investment in affordable housing. Investors would view 15 years as permanent, and would shift capital to states without double taxation. In fact, we understand that at least one large REIT declined to invest in a sizable Hawaii project due to the mere threat of this legislation.

REITs are good for Hawaii: NAREIT urges this Committee to hold H.B. 1012, H.D. 1. Even though H.B. 1012, H.D. 1 purports to suspend the DPD temporarily (for 15 years) and exempt certain "affordable housing," its enactment would be tantamount to repeal. Except for New Hampshire, every other state that imposes a corporate-level income tax allows the DPD for widely-held REITs. Accordingly, NAREIT urges this Committee to hold H.B. 1012, H.D. 1.

To learn more about REITs in Hawaii, see NAREIT's www.theREITwayHawaii.com.

Taubman

February 22, 2017

Honorable Sylvia Luke, Chair
Honorable Ty J.K. Cullen, Vice Chair
Committee on Finance
State Capitol (conference room 308)
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill No. 1012 relating to real estate investment trusts

Dear Chair Luke, Vice-Chair Cullen and Committee Members:

On behalf of Taubman Centers, thank you for the opportunity to provide our testimony in opposition to House Bill No. 1012, which is being heard by the Committee on Finance on February 23, 2017 at 12pm. House Bill 1012 would disallow the dividend paid deduction for real estate investment trusts ("REITs") for a period of 15 years.

Taubman Centers in Hawaii

Taubman Centers is a publicly owned real estate investment trust engaged in the ownership, operation, management, development and leasing of 26 regional and outlet shopping centers in the U.S. and Asia. We recently completed construction to redevelop International Market Place in Waikiki, Honolulu, Hawaii. The construction began in 2014 with Queen Emma Land Company and our partner Coastwood Capital Group. The shopping center, which opened on August 25, 2016, will ultimately offer 90 retailers and 10 restaurants. It is designed to celebrate the rich history of the site and honor Queen Emma's legacy, while adding vitality and appeal to Waikiki for tourists and kamaʻāina alike. We are very excited about the center and are proud to be a part of the community.

As part of our commitment to the local community, during the year 2016 we recognized the following organizations with donations of cash; The Daughters of Hawai'i ($25,000), Hawaiian Music Hall of Fame ($25,000), Bernice Pauahi Bishop Museum ($25,000), The Waikiki Community Center ($30,000), Historic Hawai'i Foundation ($5,000) and Girl Scouts of Hawai'i ($2,500).

REIT Tax Treatment

We are organized, owned and operated in a manner to qualify as a REIT under the Internal Revenue Code for federal income tax purposes. A REIT is a conduit vehicle designed to allow many small investors to participate in real estate development and ownership. They are also owned by institutions comprised of state and local pension funds and 401K individual retirement plans. Some of the requirements to qualify as a REIT include (1) ownership by at least 100 shareholders, (2) a prohibition on being closely held and controlled by limiting ownership by five or fewer persons to no more than a 50% interest in the REIT, (3) meeting certain asset and income tests to ensure we are primarily invested in real estate and operate it for rental purposes as a long term investor, and (4) paying out all of our taxable income as cash dividends to our shareholders which is not required by most other entity forms such as partnerships, LLCs and other c-corporations. Failure to meet these requirements results in losing our REIT tax status or in some circumstances harsh penalties like a prohibited transaction tax for not holding property as a long term investor in a rental real estate business. For meeting these stringent tests, Taubman Centers, like all REITs, is entitled to a deduction for dividends paid to our shareholders to reduce our taxable income. It is this deduction afforded in the federal tax law and permitted by virtually all other states that House Bill No. 1012 would eliminate and disallow for Hawaii corporate income taxation for a period of 15 years.

Because of the forced dividend requirement to distribute all of its taxable income, a REIT's taxable income is effectively taxed at the shareholder level by the state taxing the shareholder's dividend income in their state of residence. 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. For REITs, state income taxation based on the shareholder's residence is the uniform tax treatment in virtually all states that impose an income based tax system. This results in state income taxation by Hawaii on dividends received by Hawaii residents who are shareholders in REITs that may own property and operations outside of the State.[1]

[1] More than 9,300 individual investors in Hawaii receive $30 million in dividend each year
Brewbaker, P.H., Ph.D., CBE. (2015, December). *Economic Impacts of Real Estate Investment Trusts in Hawaii* http://thereitwayhawaii.com/wp-content/uploads/2016/02/REITs-in-Hawaii-final-December-2015.pdf (Prepared for the National Association of Real Estate Investment Trusts® (NAREIT)

REIT Economic Benefits in Hawaii

Approximately 80 REITs have invested 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.[2] Taubman alone invested over $475 million for the redevelopment of International Market Place. In addition, it will continue to require investment to fund significant capital expenditures on a recurring annual basis to maintain the property to our standards and provide the highest quality shopping destination for our shoppers and tenants.

Such business 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.

In year 2015 REITs were associated with more than 11,700 jobs representing labor earnings of nearly $500 million and $95 million in tax revenue in Hawaii. And in the past five years REIT funded construction activity is estimated to have generated $3 billion in Hawaii GDP. [3]

Taubman Centers' International Market Place shopping center is expected to pay in this current year over $1 million in general excise tax and over $3 million in property taxes. To date we have paid in total over $1.5 million in local conveyance taxes. During the development of the center it resulted in employment of over an estimated 1,000 construction jobs and after opening is expected to create 2,500 permanent jobs (including employment by tenants), which generate both general excise tax revenues from construction work and individual income tax revenues from both the construction and permanent jobs.

Hawaii residents own an estimated $2.5 billion in real estate equity through REITs, mutual funds and exchange traded funds that distribute more than $105 million in REIT dividends annually. Approximately 9,300 individual investors in Hawaii receive $30 million each year in REIT distributions.[4] House Bill No. 1012 resulting in double taxation to REIT

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[2] Brewbaker, P.H., Ph.D., CBE. (2015, December). *Economic Impacts of Real Estate Investment Trusts in Hawaii* http://thereitwayhawaii.com/wp-content/uploads/2016/02/REITs-in-Hawaii-final-December-2015.pdf (Prepared for the National Association of Real Estate Investment Trusts® (NAREIT)

[3] ibid

[4] ibid

profits (once at the REIT level and again at the shareholder level) will affect after tax return on investment of Hawaii residents.

To learn more about REITs in Hawaii please visit www.thereitwayhawaii.com.

Such a policy change in state taxation of REITs could discourage future investment by REITs in Hawaii, stifling the availability of capital and putting Hawaii at a competitive disadvantage versus virtually every other state when trying to attract capital for investment. Because investments by REITs generate so much economic activity and create so many local jobs in the State, disallowing the deduction for dividends paid could not only 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.

For the foregoing reasons, we respectfully ask the Committee on Finance to hold House Bill No.1012

Thank you for your consideration of our testimony.

Very truly yours,

Robert S. Taubman
Chairman, President and Chief Executive Officer
Taubman Centers, Inc

200 East Long Lake Road
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48304-2324

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GGP

A RETAIL REAL ESTATE COMPANY

February 22, 2017

Hearing Date: February 23, 2017
Time: 12 pm
Place: State Capital, Conference Room 308

Rep. Sylvia Luke, Chair
Rep. Ty J.K. Cullen, Vice Chair
Committee on Finance
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill No. 1012, HD1

Dear Chairman Luke, Vice-Chairman Cullen, and Committee Members:

Thank you for the opportunity to provide written testimony on House Bill No. 1012, HD1, which would disallow the dividends paid deduction for REITs for 15 years unless the REIT is engaged in providing affordable housing. 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 GGP, Inc. ("GGP"), an S&P 500 publicly traded REIT, an owner of Ala Moana Center.

GGP owns 127 retail properties in 40 states within the U.S. with approximately 121 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 and also directly benefit our local economy through the Hawaii general excise tax. Consequently, the State of Hawaii directly shares the economic benefit of REIT investments in Hawaii to keep and maintain these iconic visitor destinations as attractive as possible.

In addition to their importance to the tourism industry and the Hawaii economy, these centers have become key gathering places for our local communities because as a REIT we have been able to constantly reinvest and enhance the customer experience. For example, we are very supportive and proud of the activities that take place at the new Center Stage at Ala Moana Center, our sponsorship of the Fourth of July firework celebration, our enhancements at Whaler's Village, and our ability to introduce to Hawaii residents, retailers and retail concepts which are on the cutting edge and brand new to the State of Hawaii. Efficient REIT capital allows us to make infrastructure and other improvements which set the stage for projects like Shirokiya's Japan Village Walk and Foodland Farms at Ala Moana Center.

In prior year legislative sessions, we have testified in opposition to attempts to eliminate the deduction for dividends paid by REITs. This testimony has focused on the following points:

- If Hawaii enacts this legislation, it will be out of step with all other states with respect to the dividends paid deduction for REITs except New Hampshire, where we believe REIT investment has been inhibited.
- The deduction for dividends paid by REITs results in a single level of taxation at the shareholder level which is consistent with how limited liability companies, Subchapter S corporations and partnerships that own real estate are taxed; changing this puts REITs at a disadvantage in relation to these other forms of doing business.
- REITs produce a substantial level of economic benefits to the state of Hawaii in the form of jobs, general excise tax ("GET"), income tax from persons working or engaging in business at REIT properties, and real property taxes. During 2016, GGP paid $10.3 million in real property taxes with respect to its three Hawaiian properties and $7.9 million in GET taxes on its rents. It is unfathomable that there is a perception that REITs are not investing in the economic wellbeing of the state and its residents.
- During 2012-2016, GGP has invested almost $1 billion in capital to construct additional retail square footage and residential condominiums based on the existing Hawaiian tax regime. During the construction period, we estimated economic activity of 11,600 full- and part-time jobs and over $146 million of state revenue including indirect community benefits. Post construction, the additional retail will produce an incremental $33 million of state revenue and 3,000 jobs annually.
- Future expansion plans could be reconsidered if the attractiveness of investing in Hawaii relative to the rest of the United States is diminished through the enactment of this bill.

In September 2016, the Department of Business, Economic Development & Tourism ("DBEDT") released its final study on REITs in Hawaii. While the report contains some relevant information, the final report merely reflects a historical look at REIT investment. The report specifically notes that the estimates do not take into account changes in behavior, including the likelihood of reduced future REIT investment, if there is an additional impediment to earning a return caused by the lack of a dividends paid deduction. Similarly, the report does not address the revenue loss to the State resulting from future reduced REIT investment.

The DBEDT report finds that the average amount of corporate income tax forgone between 2009-2014 was $9.6 million. It would be imprudent to enact this legislation in hopes of generating such a small amount of tax revenues, while risking billions of dollars of new REIT investments and the hundreds of millions of dollars of state revenues and thousands of jobs that would result from those investments. There has been significant focus that the DBEDT report reflects that for 2014, the amount of corporate income tax estimated to be foregone was $36 million. We believe this was a one-time event and should not be viewed as the normal

A RETAIL REAL ESTATE COMPANY

continuing revenue stream. That is even more obvious when it is eliminated, the average foregone tax revenue drops to $4.3 million and if you double the 2013 foregone tax as a proxy for 2014, the average is $5.3 million. In both instances, a much lesser foregone income stream.

The DBEDT report found that in-state residents in 2014 only paid approximately $1 million of tax that would offset the amount of corporate tax foregone. However, the study neglected to take into account the taxes incurred by Hawaiian shareholders paid on REIT dividends for REITs without Hawaii property. Paul Brewbaker's study conducted for NAREIT (See Paul Brewbaker, "Economic Impacts of Real Estate Investment Trusts in Hawaii" (Dec. 2015), available at http://thereitwayhawaii.com) estimates, using Internal Revenue Service statistical data, that Hawaii receives approximately $8.7 million in tax on all REIT dividends. Hawaii's state protectionism if followed by other jurisdictions could end up harming the investment returns of Hawaiian shareholders and reduce tax revenues received by Hawaii.

Please do not allow the perception of a revenue increase 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. 1012 and urge you to not let it move forward. Thank you for your consideration.

Sincerely,

Francis Cofran
Senior General Manager

Sandeep Mathrani
Chief Executive Officer

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Disallow REIT Deduction for Dividends Paid

BILL NUMBER: HB 1012, HD-1

INTRODUCED BY: House Committee on Housing

EXECUTIVE SUMMARY: This bill would suspend for 15 years the dividends paid deduction that real estate investment trusts, or REITs, now enjoy. The numerous REITs who now own and manage Hawaii real estate would be taxed like any other corporation doing business in Hawaii.

SYNOPSIS: Amends HRS section 235-2.3(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, except that the deduction shall remain available for dividends generated from trust-owned housing that is affordable to households with incomes at or below 140% of the median family income, as determined by the United States Department of Housing and Urban Development.

Amends HRS section 235-71(d) to provide that for tax years beginning after December 31, 2017, no deduction for dividends paid shall be allowed for REITs for Hawaii income tax purposes.

EFFECTIVE DATE: Upon a date to be determined, applies to taxable years beginning after December 31, 2017. Repealed on December 31, 2032.

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 2/21/2017

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kimcoco@kimcoco.com

KIM COCO IWAMOTO, ESQ.

COMMITTEE ON FINANCE
Hearing on Thursday, February 23, 2017
12:00 P.M. in Conference Room 308

Testimony in **STRONG SUPPORT for HB1012 HD1**

Dear Chair Sylvia Luke, Vice Chair Ty J.K. Cullen, and Committee Members,

As a Hawaii resident that has invested in real property and REITs, I am in STRONG SUPPORT of HB1012 HD1.

Some of the opposition testimony warned your committee that the REIT investors, wealthy individuals and corporations, would utilize alternative state tax-deductions and we would not see a gain in our tax revenue. When they testify in person, please inquire into which alternative tax deductions their investors would use, then take note and close those loop holes next year. You can be assured, the wealthy and the corporations never leave a tax deduction on the table; they use what they can and carry the rest forward for use in future years.

When you look at some of the opposition's charts and tables, you can see how high-ranking Hawaii is for REIT developments. Hawaii is also high-ranking for rise in real estate prices, rise in apartment rental prices, rise in homelessness. Coincidence or collateral damage? Land and labor in Hawaii are extremely limited resources. Most of the REIT developments cited in the opposition testimony created insurmountable competition for land and labor. Truly affordable housing projects cannot afford to compete against the inflated land or labor costs. It is clearly more profitable for REIT investors to develop air-conditioned storage units on land in the urban core that used to be, or should have been, affordable apartments for Hawaii's working families.

Is Hawaii's own tax scheme making it more profitable for corporations to build storage, than to build affordable housing? We need to stop saying we need more affordable housing and we want to fix our homelessness crisis, if we are just going to turn around and give more subsidies to the kind of developments that contribute to, or perpetuate, these conditions.

Hawaii's REIT tax deductions underscore the regressiveness of our tax system to benefit the wealthy at the expense of the lowest income households. We need to mitigate this economic injustice by capturing the REIT taxes and increase the low-income renters and food tax credits.

For these reasons, I urge your committee to pass HB 1012 as amended by HD 1. Thank you for your time and consideration

Kim Coco Iwamoto

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February 21, 2017

HOUSE OF REPRESENTATIVES
THE TWENTY-NINTH LEGISLATURE
REGULAR SESSION OF 2017

COMMITTEE ON FINANCE
Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair
Members of the Committee

RE: **Testimony in Support of HB 1012 – Relating to Real Estate Investment Trusts**
Hearing: Thursday, February 23, 2017, 12:00 pm; Room 308
Location: Hawaii State Capitol, 415 South Beretania Street

Aloha Chair Luke, Vice Chair Cullen and members of the Committee,

My name is Michael Steiner and I am the principal of Steiner & Associates, a consulting firm. As the former Executive Director of Citizens for Fair Valuation, I have worked for many years to bring equity to lessees and the State of Hawaii when dealing with Real Estate Investment Trusts (REITs).

While I have previously submitted testimony in strong support for HB 1012 to the Committee on Housing, I would like to add that on February 11, 2017, **the Star Advertiser reported on Governor Ige's announcement to trim more than $21 million from his proposed budget for the Department of Education**. That is $21 million dollars that will ***not*** be available to help the students of Hawaii. However, that shortfall and more is recoverable by taxing the REITs on their Hawaii based earning through a state income tax.
http://www.staradvertiser.com/2017/02/11/hawaii-news/revised-budget-trims-21-million-from-schools/

HB 1012 is designed to help support the State of Hawaii and its citizens by requiring REITs to pay their fair share of services used via a state income tax. It is estimated the state would receive between $30 and $60 million annually in funds which are desperately needed to support and maintain our security, infrastructure, education, social services and government.

It is time to take a stand and require REITs to contribute to the general well-being of Hawaii.

Please protect the health of our Hawaii community and pass HB 1012.

Mahalo nui loa.

Michael Steiner

Michael Steiner, CLM, Principal
Steiner & Associates

Alexander L. Fergus

125 MERCHANT STREET, SUITE 200
HONOLULU, HAWAII 96813
TELEPHONE (808) 545-1700
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February 22, 2017

HOUSE OF REPRESENTATIVES
THE TWENTY-NINTH LEGISLATURE
REGULAR SESSION OF 2017

COMMITTEE ON FINANCE
Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair
Members of the Committee

Re: Support for H.B. No. 1012, Relating to Real Estate Investment Trusts (REITs)

Aloha Chair Luke, Vice Chair Cullen and members of the Committee:

As a business person and community member concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Very truly yours,

Alexander L. Fergus

February 22, 2017

State Capitol
Representative Sylvia Luke
Chair, Committee on Finance
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill 1012, H.D. 1, relating to Real Estate Investment Trusts/Feb. 23, 2017 Hearing at 12:00 P.M.

Dear Representative Luke and Members of the Committee on Finance,

We are submitting this testimony in strong opposition to House Bill 1012. We are respectively, the Managing Partner and Founder and Managing Partner of The Shidler Group, which is based in Honolulu and invests in the formation and capitalization of real estate-related companies and new investment initiatives, including the acquisition and ownership of individual properties and portfolios. The Shidler Group has created real estate investment trusts (REITs) that have invested in Hawaii and in the Mainland including Pacific Office Properties which is headquartered in Honolulu.

This bill is very similar to bills introduced last year to eliminate the dividends paid deduction for public REITs. The proponents of taxing REITs focus on two things. First, there is a tax "loophole" that allows REITs to avoid paying corporate income tax to the State of Hawaii that needed to be closed – there is an injustice that needs to be fixed. Second, in addition to the fairness argument, the proponents believe that the legislators, in these tough economic times, should be doing everything possible to increase tax revenue.

First, we don't believe that the way REITs are taxed should be considered a so-called "loop hole." You have to consider Congress' motive for enacting this legislation back in 1960. Historically, commercial real estate in the United States has been owned by partnerships, or tax exempt institutions such as pension funds and foundations. Partnerships pay no income tax; income is only taxed at the partner level. However, a corporation is required to pay income tax at the corporate level and then the shareholders also pay tax on the dividends they receive. Therefore, corporations were at a distinct disadvantage to these other ownership structures when competing for the same assets. By providing a tax deduction for dividends paid to shareholders (unlike regular corporations), taxable income is eliminated as long as the REIT is paying dividends equal to or greater than its taxable income. This allows a REIT to operate for tax purposes like a partnership. This also allows capital to be raised in regulated public markets for real estate investment and provides a way for small investors to invest in commercial real estate projects.

Second, the proposed legislation in unlikely to generate anywhere near the estimates from the study commissioned by DBEDT. Most states, including Hawaii, require corporations with operations in many states to use a 3-factor formula based on property owned in the state, payroll in the state, and sales in the state to determine how much of their worldwide taxable income will be apportioned to the state. You cannot estimate the tax revenue by multiplying the gain on the sale of an asset located in Hawaii by the corporate tax rate.

Third, the DBEDT study completely underestimates the enormous amount of additional GET revenue that has resulted from REIT investment in Hawaii. The study estimates that REITs generate $200 million per year in revenue. However, this does not include the GET paid on the construction of the Ala Moana Shopping Center and International Marketplace projects plus the additional GET on rental revenue – this alone would dwarf the potential additional corporate income tax revenue that would be raised from taxing REITs.

Fourth, additional tax revenue, if any, will only be generated if this proposed legislation does not change the behavior of REITs operating in Hawaii. The underlying assumption is that REITs will just absorb this additional cost. We believe the more likely outcome is that they will divest themselves from their Hawaii assets over time, restructure to claim additional deductions or credits not currently claimed, and/or not make future investments in Hawaii. If that is correct, the commercial properties will likely go back to being owned by partnerships and tax-exempt entities that pay no income tax to Hawaii. We will have lost the benefits that resulted from REIT investment in return for nothing.

States and municipalities across the country have offered corporations long-term tax breaks to attract investment and the jobs and tax revenues that result from that investment. Hawaii has not had to do that. REITs have invested in Hawaii and we have benefited from that investment. But, we now have proposed legislation would eliminate the dividends paid deduction for a 15-year period, with an exception for income derived from affordable housing (we also believe it will be extremely difficult and costly to calculate the taxable income that would qualify for the exemption). Changing the rules after someone has already made a significant investment is simply bad public policy. How confident would you be in investing in Hawaii after we change the rules after the fact and join New Hampshire to be the only two states in the country taxing REITs?

Hawaii is in an enviable position. We are already attracting the capital investment. That investment is creating predictable tax revenues and jobs. In 2015, corporate income tax represented one-half of one percent of the total tax revenue for the state. It is uncertain whether this legislation will actually increase corporate tax revenue, but supporters of this legislation are willing to risk all the benefits we have derived from REIT investment in the hope of generating a negligible amount of additional tax revenue. It is analogous to risking $10 to get an extra $1 - that is a very poor risk/reward trade off.

On the surface, the sentiment of this legislation sounds simple and fair - “REITs should pay taxes like everyone else.” But, it’s not that simple. How fair is it to eliminate the opportunity for small investors to invest in commercial real estate? Most commercial property owners do not pay income tax and they aren’t bringing operational expertise and the job creation that REITs do either. Why should we give them a competitive advantage against REITs? Calculating and tracking the additional revenue generated from this legislation will be far from simple.

Hawaii stands to lose much more than we could possibly gain by passing this legislation. We urge you to not support this legislation.

Sincerely,

Lawrence J. Taff

Jay H. Shidler

Tia K. Teves

February 22, 2017

HOUSE OF REPRESENTATIVES
THE TWENTY-NINTH LEGISLATURE
REGULAR SESSION OF 2017

COMMITTEE ON FINANCE
Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair
Members of the Committee

Re: Support for H.B. No. 1012, Relating to Real Estate Investment Trusts (REITs)

Aloha Chair Luke, Vice Chair Cullen and members of the Committee:

As a business person and community member concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair

Matthew Friedman, PhD
Contact: 303.898.9111

Wednesday, February 22, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

I am a research economist who has spent the past year investigating the dividends paid deduction (DPD), a special tax deduction granted only to business entities known as Real Estate Investment Trusts (REITs), as one possible factor depressing Hawaii's corporate income tax revenues. This deduction allows certain corporations engaged in real estate activities to deduct business profits distributed to shareholders from their net income, leaving the firm liable for little or no income tax. REITs are very active in Hawaii, in fact the state ranks top in the nation in terms of per capita REIT investment. With significant real property holdings and headquartered almost exclusively outside the state, these firms earn excess profits at the expense of the local business community and they are the probable culprits in a scheme that is robbing Hawaii's tax system and eroding its tax base.

My research, which will be presented to the public later this month, highlights the role the DPD plays in Hawaii's trend of diminishing corporate income tax receipts. Hawaii has a top corporate income tax bracket of 6.4 percent, close to the national average of 7.2 percent. And while that rate Hawai'i charges corporations on their earnings ranks ahead of more than a quarter of states, it still leaves Hawai'i dead last in the portion of tax revenue derived from corporate income. The question is clear: where is the leak?

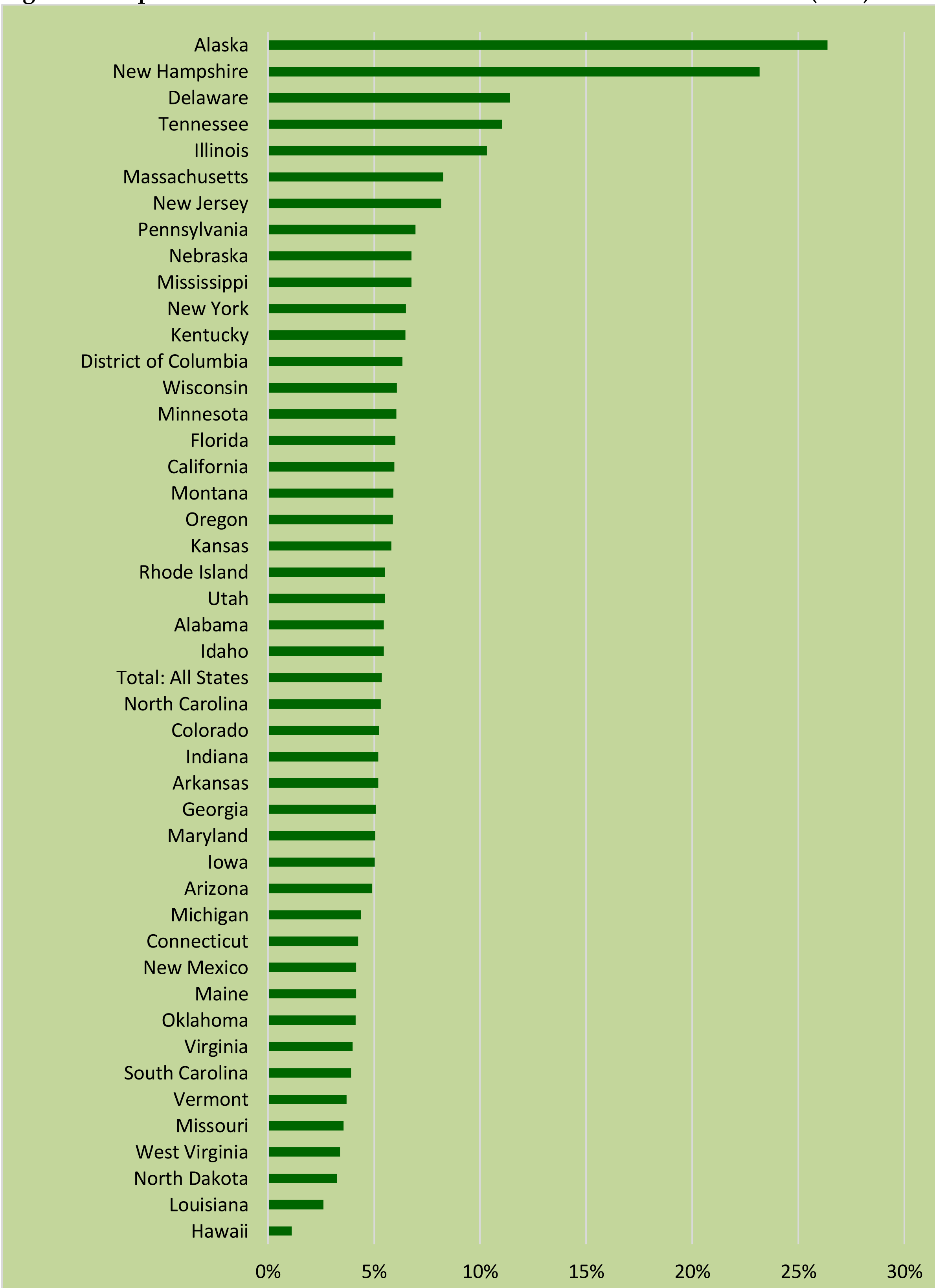
Careful analysis of state tax records, securities filings and property data shows that the dividends paid deduction is unfairly shrinking certain firms' corporate tax liability by tens of millions of dollars annually for no clear purpose or benefit.

This bill is an opportunity to reform an inefficient law that favors wealthy mainland interests over local businesses. Closing the DPD loophole and taxing REITs the same as other local firms is fair, equitable, and prudent. It will, without question, have a strictly positive impact on state corporate income tax receipts while simultaneously bolstering the competitiveness of local real estate firms competing against larger mainland interests. Eliminating the DPD loophole will restore fairness to the tax system and increase revenues, allowing the state to better invest in programs and infrastructure that will benefit the entire state – not just the wealthy foreigners currently benefiting from the special tax advantage that would be temporarily eliminated were this bill to become law.

Over the lifetime of this legislation, the total tax revenue recovered for the state is likely to exceed $1 billion.

The DPD is a special tax advantage that motivates firms to alter their organizational structure so as to enjoy their corporate profits tax free. This is the definition of a giveaway and it needs to end. It is bad for Hawai'i businesses and it is bad for Hawai'i taxpayers. I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Figure 2: Corporate Net Income Tax as a Portion of Total State Tax Revenues (2015)



Source: U.S. Census Bureau, [2015 Annual Survey of State Government Tax Collections]

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LATE

COMMITTEE ON FINANCE
Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair
Members of the Committee

Thursday, February 22, 2017

RE: Testimony in Support of HB 1012 – Relating to Real Estate Investment Trust
Hearing: Thursday, February 23, 2017, 12:00 p.m.; Room 308
Location: Hawaii State Capitol, 415 South Beretania Street

Imagine a developer or large investor coming to Hawaii and offering to buy hotels, shopping centers, office buildings, industrial parks and residential projects. He explains he is coming to Hawaii due to our strong market and stability. He sees the potential to make a reasonable operating profit and even more on the appreciation or increase in value over time. He only asks the State of Hawaii for one thing. All he wants is to pay No State Income Taxes as long as he owns the properties.

Of course, we would say that is not a reasonable concession and would only raise the taxes on the local residents. We would tell the buyer to take their money and buy somewhere else.

Unfortunately we are not doing that. We are allowing many mainland and local companies to avoid paying millions in state taxes due to our willingness to accept the federal tax laws as a basis for our state taxes. We need to demand our legislative plug the tax loophole that was given to the "Real Estate Investment Trust" (REIT)S by the federal government. Hawaii's adopted the federal tax code as the basis of our state tax code. Therefore, a REIT pays no federal taxes + state taxes as long as it pays out 95% of its net income yearly out to its stockholders.

The federal government doesn't care since the stockholders receiving the dividends paid to them by the REITS claim it as income on the federal tax returns and pay the federal income taxes on the REIT dividend to the federal government. The state gets nothing unless some of the stockholders live in Hawaii. Unfortunately the majority of the REITS are mainland or foreign owned. The state doesn't receive as much as it gave away. REITS earn the money in Hawaii, pay no state of Hawaii taxes, but the stockholders pay the state taxes on the mainland depending on where the stockholders live.

Hawaii as did most states, adopt the federal tax code and by doing so automatically waive the state taxes on REITS. Being a small state and since we have such a strong real estate market we have more REIT owned property than most states based on our size.

We need to ask our legislature to plug the REIT loophole and keep that state tax revenue in Hawaii. We need to reduce the tax burden to the local taxpayer. This is the lost tax revenue that can pay for schools, housing, healthcare, etc.

Our legislators need to put Hawaii residents first and stop giving the REITS a tax free status in Hawaii.

Let's keep the tax revenue in Hawaii instead of having it paid to a mainland state. Let's reduce our resident tax responsibility instead of giving our tax revenue to a mainland state. Let's follow the state of New Hampshire which has already plugged the REIT loophole and now charge them all state taxes.

The REITS will say they do all kinds of wonderful things, but they do what all local owners and tax paying owners would. The only difference is REITS pay no state income taxes. Of course, they will fight to keep that benefit. We the tax payers of Hawaii need to fight and see that the pay taxes like everyone else.

Rep. Sylvia Luke, Chair
Rep. Ty J.K. Cullen, Vice Chair
Committee on Finance

LATE

Vivian Shiroma
302 Anonia Street, Honolulu, HI 96821
(808) 373-1028

Thursday, February 23, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

Thank you for the opportunity to speak in favor of H.B. No. 1012, Relating to Real Estate Investment Trusts.

I am not a real estate investor. I am just one of the many hard-working, middle-income residents of Hawaii who has always paid out a large share of my earnings for various taxes. Believe me, there are no loopholes to reduce my tax bill and every year I pay my fair share.

My daughter is a second-year teacher at Kaiser High School. She loves her job and has already managed to help several kids graduate who might not have succeeded without her push. Although we know public schools are chronically underfunded, we were still shocked when she opened her classroom door on her first day to find a graveyard of broken furniture, and not even enough damaged desks, much less space, to accommodate the large number of students she'd been assigned. She feels teachers are underpaid, but she willingly pays out of pocket for additional copies of books they need for her literature units, pens and pencils for the students, and granola bars for the kids who don't eat lunch.

The State needs more money for public education, services for our growing elderly population, help for the homeless, and endless other projects. Why is it that middle class taxpayers always seem to be asked to bear the financial burden? The costs of raising and educating our children, maintaining a home, and caring for our parents have tapped us out. We have no way to save for retirement and are worried we may never pay off the large mortgages we carry into our 60's and 70's. These challenging economic times call for creative measures.

H.B. 1012 is a great idea and merits continued action. It could be a new source of millions of dollars of income annually to the state, for as long as these companies continue to do business in Hawaii. And it would make revenues generated in Hawaii stay in Hawaii instead of going to other states.

On behalf of all the tax-burdened, working class people here, please pass H.B. 1012. Let's ask everyone to contribute their fair share to support this special community.

February 23, 2017

OPTrust

OPSEU Pension Trust

Fiducie du régime de retraite du SEFPO

The Honorable Sylvia Luke, Chair and Committee Members
Committee on Finance
Hawaii State Capitol, Rm. 308
Honolulu, HI 96813

LATE

Dear Chair Luke and Committee Members:

RE: HB 1012 HD1 Relating to Real Estate Investment Trusts

My name is Andy Alcock, Director, Real Estate Investments, OPTrust, testifying in opposition to HB 1012 HD1 Relating to Real Estate Investment Trusts ("REIT's"). OPTrust is one of Canada's largest pension funds, with net assets of over $19 billion CAD. The trust administers a defined benefit plan with almost 87,000 members and retirees.

OPTrust partnered with DeBartolo Development ("DeBartolo") to develop the Ka Makana Ali'i center in Kapolei. DeBartolo's vision and partnership with the Department of Hawaiian Home Lands ("DHHL") were important factors in OPTrust's decision to invest in Hawaii. OPTrust's investments are made through a very long vetting process, but more importantly, the investment in Ka Makana Ali'i was made because of the sound investment policies of both the State of Hawaii and its partnership with private developers like DeBartolo. OPTrust invests across the globe. Many of those investments are made through REIT structures, which provide a dividend exemption by law. The ability to invest in Ka Makana Ali'i through a REIT structure was paramount to OPTrust's decision to invest in Hawaii.

REIT's provide a way to finance projects that local investors or the State of Hawaii would not be able to provide. Eliminating the distribution deduction for REIT's will not provide the income to the State that HB1012 HD1 envisions. Rather, it would be a detriment to the development of many projects such as low-income housing or future commercial developments, because it effectively would prevent investors from making investments in the State of Hawaii. Should HB 1012 HD1 be passed, it would no longer be efficient for OPTrust to make investments in the State of Hawaii, including Phase 2 of the Ka Makana Ali'i project. As result, OPTrust would be forced to invest elsewhere. Unfortunately, we also understand and recognize that any changes in the law will have a very undesirable effect on DHHL's budget.

We urge you to strongly oppose HB1012 HD1 Relating to REIT's, so that projects such as Ka Makana Ali'I can continue to be built and add to Hawaii's economic growth.

Thank you for this opportunity to testify.

Yours truly,

Andrew Alcock
OPTrust

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LATE

DEBARTOLO
DEVELOPMENT

February 23, 2017

The Honorable Sylvia Luke, Chair and Committee Members
Committee on Finance
Hawaii State Capitol, Rm. 308
Honolulu, HI 96813

Dear Chair Luke and Committee Members:

RE HB 1012 HD1 Relating to Real Estate Investment Trusts

My name is Rich Hartline, VP Development of DeBartolo Hawaii testifying in opposition to HB 1012 HD1 Relating to Real Estate Investment Trusts.

DeBartolo Hawaii was able to develop the Ka Makana Ali'i in Kapolei because of our partnership with a REIT organization. Financing a large project such as Ka Makana Ali'i is very difficult, and it took many years of working through many financing markets, before financing was structured and the project built. Ka Makana Ali'i is a long term project that will cost over $700 million to develop and construct. DeBartolo and its partners are looking at ways to complete Phase 2 of the project. Should the law affecting REIT's change, Phase 2 financing will get very difficult, thereby resulting in either a delay in the project or the project stops.

The Ka Makana Ali'i Center is built on land that is on a very long term lease with the Department of Hawaiian Home Lands. The rent generated by the center is used to provide services for native Hawaiians and more importantly, to provide income to DHHL's general budget. Our ability to work with a REIT, as a financing tool, was very important in the ability for the center be built and remains important for the financing of Phase 2. At the time, financing tools for a project of the size of Ka Makana Ali'i were not readily available. The project was built because a REIT was able to see the vision of the second city and the need to help enhance DHHL. Passage of HB 1012 HD1 will have a very serious impact on the ability to finance Phase 2 of the project and operate Phase 1 which in turn will have a definite impact upon DHHL's budget going forward.

REIT's provide a way to finance projects that local investors or the State are not be able to provide. Taxing REIT's will not provide the income to the state that HB 1012 HD1 envisions. Rather, it is a detriment to the development of many projects such as low-income housing or future commercial developments with state agencies such as DHHL that is necessary, because it effectively stops investment made to the state by outside investors.

We urge you to strongly oppose HB 1012 HD1 Relating to Real Estate Investment Trusts, so that projects such as Ka Makana Ali'i can continue to be built and add to Hawaii's economic growth.

Thank you for this opportunity to testify.

LATE

The Twenty-Ninth Legislature
Regular Session of 2017

HOUSE OF REPRESENTATIVES
Committee on Finance
Rep. Sylvia Luke, Chair
Rep. Ty J.K. Cullen, Vice Chair
State Capitol, Conference Room 308
Thursday, February 23, 2017; 12:00 p.m.

STATEMENT OF THE ILWU LOCAL 142 ON H.B. 1012, HD1
RELATING TO REAL ESTATE INVESTMENT TRUSTS

The ILWU Local 142 **supports** H.B. 1012, HD1, which temporarily disallows the deduction for dividends paid by Real Investment Trusts (REITs) for a period of 15 years, but with an exception for dividends generated from trust-owned housing that is affordable to households with incomes at or below 140% of the median family income.

The State is losing out on millions of dollars in taxes because of because of the tax deduction for dividends paid by Real Estate Investment Trusts. REITs are able to avoid paying state taxes as long as they distribute 90% of their taxable income to shareholders, who then pay taxes only in their home states. Most of the REITs with real estate holdings in Hawaii have shareholders/investors who do not live in Hawaii. Since REITs themselves currently enjoy a deduction for dividends paid, and most shareholders are not Hawaii taxpayers, the State receives virtually NO taxes from real estate activity of REITs in Hawaii.

The State can certainly use another revenue source. Requiring REITs to pay income taxes would be one means of generating revenues to support the services and programs needed to address a myriad of issues facing our residents—including public education, early childhood education, homelessness and affordable rental housing, access to quality health care, and support for the elderly and disabled as well as their caregivers.

Those who oppose repealing the deduction argue that REIT investment will dry up. We think this is most unlikely. Real estate in Hawaii is highly profitable. Investors would be foolish to pull out of Hawaii simply because of taxes they must pay. Paying taxes should be considered a cost of doing business. Everyone should pay their fair share of taxes to benefit the entire community. In fact, if this bill is not passed, more corporations with real estate holdings may seek to convert into Real Estate Investment Trusts in order to avoid paying taxes. If that happens, the State could potentially lose even more tax revenue.

S.B. 1012, SD1 calls for the law to be repealed in 15 years. Although we believe repeal is not necessary, removing the deduction for a temporary period is one way to test the true impact of the lost deduction. Will it drive REITs from Hawaii? Or will REITs continue to do business in Hawaii and will the added revenue allow the State to do more for its residents?

The ILWU urges passage of S.B. 1012, SD1. Thank you for the opportunity to offer testimony on this measure.

The Twenty-Ninth Legislature
Regular Session of 2017

LATE

HOUSE OF REPRESENTATIVES
Committee on Finance
Rep. Sylvia Luke, Chair
Rep. Ty J.K. Cullen, Vice Chair
State Capitol, Conference Room 308
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H.B. 1012, HD1 calls for the law to be repealed in 15 years. Although we believe repeal is not necessary, removing the deduction for a temporary period is one way to test the true impact of the lost deduction. Will it drive REITs from Hawaii? Or will REITs continue to do business in Hawaii and will the added revenue allow the State to do more for its residents?

The ILWU urges passage of H.B. 1012, HD1. Thank you for the opportunity to offer testimony on this measure.

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GCA of Hawaii

GENERAL CONTRACTORS ASSOCIATION OF HAWAII

Quality People. Quality Projects.

Uploaded via Capitol Website

LATE

February 23, 2017

TO: HONORABLE SYLVIA LUKE, CHAIR, HONORABLE TY CULLEN, VICE CHAIR, COMMITTEE ON FINANCE

SUBJECT: **OPPOSITION TO H.B. 1012, HD1, RELATING TO REAL ESTATE INVESTMENT TRUSTS**. Temporarily disallows the deduction for dividends paid by real estate investment trusts for a period of 15 years, but with an exception for dividends generated from trust-owned housing that is affordable to households with incomes at or below 140% of the median family income.

HEARING

DATE: February 23, 2017
TIME: 12:00 p.m.
PLACE: Capitol Room 309

Dear Chair Luke, Vice Chair Cullen and Members of the Committee,

The General Contractors Association of Hawaii (GCA) is an organization comprised of over five hundred general contractors, subcontractors, and construction related firms. The GCA was established in 1932 and is the largest construction association in the State of Hawaii. The GCA's mission is to represent its members in all matters related to the construction industry, while improving the quality of construction and protecting the public interest.

GCA is in opposition to H.B. 1012, HD1, Relating to Real Estate Investment Trusts (REITs), which proposes to eliminate the dividends paid deduction (DPD) would result in the double taxation of REITs in Hawaii and would have a negative impact on our state's economy. REITs are required by federal law to be long-term investors. In Hawaii, REITs have brought stability as well as substantial economic growth to local industries in Hawaii including commercial real estate, construction, retail, healthcare, visitor industry and affordable housing. REITs in Hawaii develop and improve infrastructure across the islands, increasing tax revenue, building homes for residents and supporting tourism, one of the largest drivers of Hawaii's economy.

For these reasons we oppose this bill and request its deferral. Thank you for the opportunity to present our views on this matter.