

DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
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RONA M. SUZUKI
DIRECTOR OF TAXATION

DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

To: The Honorable Angus L.K. McKelvey, Chair;
The Honorable Lisa Kitagawa, Vice Chair;
and Members of the House Committee on Economic Development & Business

From: Rona M. Suzuki, Director
Department of Taxation

Re: S.B. 2697, S.D. 1, Relating to Taxation of Real Estate Investment Trusts

Date: Friday, March 13, 2020

Time: 9:45 A.M.

Place: Conference Room 309, State Capitol

The Department of Taxation (Department) appreciates the intent of S.B. 2697, S.D. 1, and provides the following comments.

S.B. 2697, S.D. 1, repeals the dividends paid deduction that real estate investment trusts (REITs) are allowed by current law, except REITs for which 100 percent of the property owned is used to provide affordable housing in Hawaii. This will subject affected REITs' income to the Hawaii corporate income tax in the same manner as other corporations. The measure is effective July 1, 2050 and applies to taxable years beginning after December 31, 2020. The bill sunsets on December 31, 2023.

The Department of Business, Economic Development, and Tourism (DBEDT) is responsible for economic development, including the role of REITs. The Department of Taxation is responsible for administering the tax laws in a fair, consistent, and efficient manner. Therefore, the Department defers to DEBDT on the substantive merits of the bill.

S.B. 2697, S.D. 1, proposes to repeal the dividends paid deduction and is the most administratively efficient way in which to impose income tax on REITs. However, the Department notes that **allowance of the dividend paid deduction for REITs dedicated 100 percent to providing affordable housing needs to be better defined to clarify what REITs must do to receive the dividends paid deduction.**

Notwithstanding the Department's concern noted above, it is able to administer the bill provided a functional effective date is inserted.

Thank you for the opportunity to provide comments.



House Committee on Economic Development & Business
March 13, 2020 at 9:45 a.m.
State Capitol Conference Room 309

SUPPORTING SB 2697 SD 1 WITH AN AMENDMENT

The Church of the Crossroads, founded in 1922, is Hawaii's first intentionally multicultural church and is committed to a mission of peace, justice, and environmental preservation.

Real Estate Investment Trusts (REITs) are for-profit corporations that do not pay Hawaii's corporate tax. This is unfair to those corporations that are required to pay the corporate tax, and it deprives the State of tax revenue.

The role of government is to create an infrastructure that supports business activity in general and to maintain a level playing field so that all businesses can compete fairly among each other.

The Hawaii State Legislature has passed legislation that conforms Hawaii tax law with the Internal Revenue Code to ease the administration of State taxes. In a number of cases, however, when the State would have been adversely affected, the Legislature has made exceptions to the Internal Revenue Code.

The State adopted the federal REIT model in its entirety decades ago. By doing so, the State has, perhaps unintentionally, given a competitive advantage to REITs. They are for-profit corporations, but they do not pay a tax on their profits as others do. For the sake of equity and fairness, REITs should be required to pay taxes on their profits.

REITs earn an estimated \$1 billion in profits annually in Hawaii. Applying Hawaii's corporate tax to REITs would result in an estimated \$60 million in tax revenue to the State. Those funds should be applied to reducing the enormous shortage of housing that is affordable to low- and middle-income residents. Some efforts are being made to build affordable housing, but much greater efforts must be made because the shortage is so great and the cost to develop housing is so high. Notably, this bill exempts REITs whose real property is used to provide affordable housing.

The application of REIT tax revenue to affordable housing is consistent with a study entitled, "The Housing Action Plan Final Report to the State Legislature," which was funded by the Legislature and issued in 2017. Among the financing ideas is the dedication of new tax revenue for affordable/workforce housing or infrastructure, with the funds kept separate from the general fund.

This bill should be amended to separate the REIT tax revenue from the general fund and to dedicate it to the creation of affordable housing in Hawaii. We suggest the Rental Housing Revolving Fund. With that amendment, the Church of the Crossroads supports this bill.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Disallow dividends paid deductions for REITs

BILL NUMBER: SB 2697, SD-1

INTRODUCED BY: Senate Committee on Ways & Means

EXECUTIVE SUMMARY: Disallows dividends paid deduction for real estate investment trusts, except for real estate investment trusts that provide affordable housing in the State.

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.

Amends HRS section 235-71(d) to provide that for tax years beginning after December 31, 2020, no deduction for dividends paid shall be allowed for REITs for Hawaii income tax purposes, except where 100% of the trust's real property is used to provide affordable housing in the State.

EFFECTIVE DATE: 7/1/2050.

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 12/31/20, meaning that REITs would be subject to double taxation like 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.

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 (1) REITs are very visible in Hawaii, but do not get taxed because of the deduction allowed for dividends paid, while (2)

many REIT owners who receive the dividend income are either (a) outside of Hawaii and don't get taxed either because they are outside of Hawaii, or (b) 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.

There is an issue that has developed around REITs that own hotels or other operating assets. Under federal rules, REITs cannot receive operating income, but can receive passive income from real estate (such as rent). To operate the hotels, they normally form a taxable REIT subsidiary (TRS), which is taxed as an ordinary corporation, to do that; the TRS then pays rent to the REIT. That rent is of course taxable under Hawaii's GET law, and the hotel REITs have suggested that if this bill passes the hotel REITs will unwind their ownership structure and eliminate the extra level of GET on those rents. In our mind this threat is not credible. The hotel REITs established their holdings before 2018 and presumably found that it was financially beneficial to do so despite the extra level of GET. Since then, the Tax Cuts and Jobs Act drastically reduced the federal corporate income tax rate, from 35% to 21%, and thereby lessened the burden that had been placed on the TRS's. If it was beneficial to adopt a REIT/TRS structure to run a hotel before the Tax Cuts and Jobs Act and the Act slashed the federal corporate rate, it is hard to imagine that unwinding the structure would be financially beneficial.

This bill is similar to SB 301 (2019), which was passed by the Legislature but was vetoed by the Governor amid concerns that enactment of the measure would chill investments in Hawaii and dry up the availability of already-scarce capital to Hawaii projects.

The bill's proponents have an answer to this concern, which is stated in the bill's preamble:

The legislature further finds that real estate investment trusts in Hawaii own real estate assets of approximately \$17,000,000,000, generating an annual income of \$1,000,000,000, which, if taxed at the current corporate rate assessed to all other corporations, would generate Hawaii tax revenues of \$65,000,000 per year. A 2016 analysis conducted by the department of business, economic development, and tourism concluded that the State had foregone about \$36,000,000 in income tax revenues in 2014, and that the amount of real estate investment trust investments has risen substantially since 2014.

Some real estate investment trust shareholders live in Hawaii, but a substantial majority do not. Further, while real estate investment trusts own more real estate in Hawaii per capita than in any other state, it ranks fortieth in the nation for the number of real estate investment trust shareholders as a percentage of the population. As a result, many real estate investment trusts and their shareholders pay a mere fraction of the Hawaii state income tax compared to what other corporations pay.

The legislature therefore finds that it would be more equitable to decouple from the federal system in this regard so that corporations and other business entities doing business in Hawaii pay a fair tax burden, commensurate with the substantial privileges and resources in Hawaii that were used to generate their profits. Real estate investment trusts would continue to receive their generous federal tax exemptions and benefit from Hawaii's low property tax rates.

The Foundation is attempting to present both sides of the argument and is not taking a position for or against this bill's passage.

Digested 3/10/2020



March 10, 2020

SB 2697 S.D.1 RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS.
House Committee on Economic Development and Business
Friday March 31, 2020 at 9:45 a.m. Conference Room 309

Rep. Angus L.K. McKelvey, Chair
Rep. Lisa Kitagawa, Vice Chair

Rep. Stacelynn K.M. Eli	Rep. Sean Quinlan
Rep. Linda Ichiyama	Rep. Kyle T. Yamashita
Rep. Aaron Ling Johanson	Rep. Lauren Matsumoto

Position: Reject

My name is Bret Larson, I am the owner, Kauai Island Brewing Company. We are located on the west side of Kauai in Eleele/Port Allen. We currently provide 35 full and part time jobs in Hawaii. Kauai Island Brewing Company

It has been brought to my attention that the Legislature is again considering a bill that would unfairly add a new corporate tax on real estate investment trusts in Hawaii (SB 2697 SD1). I am a small businessperson in Hawaii and I don't think this would be good for me or for our state's economy. Please do not let such a bill become law.

I followed the news last year and came to the conclusion that this new tax against REITs didn't make sense and would do more harm than good. I was thankful the bill did not become law.

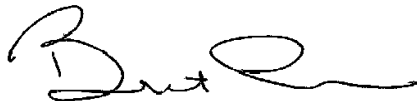
It seems that a small number of politically active supporters are pushing for this tax against REITs, but their view does not represent mine or that of other small local business owners who would suffer because of this radical change in the tax law.

My place of business is in a shopping center owned by a REIT. I have come to understand that REITs, including the owner of this property, are responsible, long-term investors. Just like you and me, they are here in Hawaii for the long-term and have a long-term view of their investments in real estate. Just like I do with my own home. My REIT owner has been good about upkeep and improving the shopping center and, consequently, my business benefits.

I ask that you and the other lawmakers take into consideration the effects this bill would have on my business, as well as its long-term effects on our entire economy. If this bill ends up making it more expensive for REITs to do business in Hawaii, it's likely my business will lose out, as will my employees and the customers I serve.

Please make the right and proper decision and refrain from adding a new tax on REITs – and businesses in Hawaii. The larger negative impacts of passing this new tax far outweigh the benefits.

Mahalo for considering our testimony and **REJECT** SB 2697 SD1

A handwritten signature in black ink, appearing to read "Bret Larson", with a stylized, flowing script.

Bret Larson
Kauai Island Brewing Company, LLC.
808-755-5926
bret@kauaiislandbrewing.com



March 11, 2020

Representative Angus L.K. McKelvey, Chair
Representative Lisa Kitagawa, Vice Chair
Committee of Economic Development & Business

Re: Testimony **Opposing** SB 2697 SD1, Relating to Taxation of Real Estate Investment Trusts

Dear Chair McKelvey, Vice Chair Kitagawa, and Committee Members:

On behalf of Extra Space Storage Inc. ("Extra Space"), thank you for this opportunity to provide our testimony on SB 2697 SD1. Extra Space submits this testimony in **opposition** to this bill.

Extra Space is a publicly traded real estate investment trust ("REIT") that is the second largest owner and operator of self-storage facilities in the United States. Extra Space owns and/or operates 1,647 self-storage properties in 40 states, which comprise approximately 1.2 million units and approximately 125.7 million square feet of rental storage space. Extra Space owns or operates seventeen self-storage facilities in Hawaii.

REITs produce substantial economic benefits to the State of Hawaii in the form of jobs, general excise tax, and real property taxes. In 2019, Extra Space paid the state more than \$1.3 million of general excise tax and almost \$1.5 million of real estate taxes.

The bill seeks to eliminate the dividends paid deduction ("DPD") for all REITs operating in Hawaii. One of the many requirements a REIT must satisfy in order to maintain its REIT status is to distribute annually all of its taxable income to their shareholders. The shareholders then report and pay state and federal tax on those dividends. This allows for a single level of taxation at the shareholder level. In this respect, REITs are most comparable to other "pass-through" entities such as S corporations, LLCs, or partnerships, which are not separately subject to entity level income tax in Hawaii.

Enactment of this bill will result in negative consequences to the real estate industry in Hawaii. The bill will impose double taxation on REIT shareholders. This is inconsistent to the accepted federal and state tax treatment of REITs. No other state (other than New Hampshire) disallows the dividends paid deduction. This tax will put REITs at a disadvantage in relation to other "pass-through" entities that hold real estate.

This tax will essentially be passed on to Hawaii residents and businesses in the form of higher rental rates as REITs must now look for ways to offset this increased tax liability.



This tax will also discourage future investment by REITs in Hawaii as it will now be more costly to operate in Hawaii as compared to other states.

For the foregoing reasons, Extra Space **opposes** SB 2697 SD1 and asks the committee to not move forward on this or any similar bill.

Thank you for your consideration of our testimony.

Sincerely,

A handwritten signature in black ink, appearing to read 'Gwyn McNeal', written over the printed name.

Gwyn McNeal
Executive Vice President, Chief Legal Officer



Park Hotels & Resorts Inc.
Scott Winer, SVP Tax
1775 Tysons Boulevard
7th Floor
Tysons, VA 22102
+1 571 302 5757 Main

WRITTEN TESTIMONY OF

Scott D. Winer
Senior Vice President, Tax
Park Hotels & Resorts Inc.

IN OPPOSITION TO SB 2697, SD 1

BEFORE THE COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS

REP. ANGUS L.K. MCKELVEY, CHAIR

REP. LISA KITAGAWA, VICE CHAIR

HEARING ON SB 2697, SD 1

March 13, 2020

On behalf of Park Hotels & Resorts Inc. (“PARK”), thank you for this opportunity to provide our testimony on SB 2697, SD 1. PARK submits this testimony in **opposition** to SB 2697, SD 1.

SB 2697, SD 1 would, beginning in taxable years after Dec. 31, 2020, disallow real estate investment trusts (“REITs”) from claiming a dividend paid deduction (“DPD”) and thus require REITs to pay corporate income tax to the State of Hawai‘i, for a three year period through December 31, 2023.

The preamble to the legislation states it would be more equitable to decouple from the federal DPD so that business entities doing business in Hawaii pay a fair tax burden commensurate with the substantial privileges and resources used in Hawaii and that REITs will continue to benefit from Hawaii's low property tax rates. As described in more detail below, PARK opposes SB 2697, SD 1 and does not believe it would be equitable to decouple from federal tax law for the following reasons:

- It would not add significant revenue to the State. The Hawaii Department of Taxation (“DoTax”) has stated elimination of the DPD would raise only modest amounts of income taxes while likely resulting in less General Excise Tax (“GET”).
- It would threaten the GET revenue associated with the statutorily required lodging REIT structure.
- Park has been a solid business partner to the state of Hawai‘i – paying significant tax (including GET and property tax, as detailed below).

PARK is a publicly traded lodging REIT (NYSE:PK) that owns 60 premium branded hotels and resorts primarily located in the United States. Included within PARK’s portfolio of hotels are (i) the iconic 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 Hawai‘i. 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. These stringent, complex and costly requirements do Not apply to non-REIT real estate owners and require REITs 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 DPD essentially passing through their taxable income to shareholders.

As state above, one of the REIT requirements is the passive income generation requirement, which separates the federal tax rules for REITs and the rules applicable to non-REIT real estate owners. Federal tax law dictates that a REIT must earn most of its income from “rents”, and income from operating a hotel is not “rents”. Thus, federal law requires that a lodging REIT lease its hotels to a third party or one or more fully taxable subsidiaries. If leased to a taxable subsidiary (which is the structure used by public REITs), the taxable subsidiary is required to hire an independent operator, like Hilton, to manage the hotel. The rents paid by the taxable subsidiary to the REIT hotel owner and the management fees paid to the independent operator are both subject to Hawaii GET.

Thus, hotels operating within the REIT structure are subject to **triple GET taxation, as a result of federal tax law requirements**. In fact, approximately 85% of the additional GET PARK pays is a direct result of federal law requirements governing hotel REIT operations and is not paid by a typical non-REIT hotel owner.

As described below, Park's acquisition and ownership of the two Hawai'i hotels results in approximately **\$11 million in additional GET being paid to the State of Hawaii 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. Thus, unlike non-REIT owners, as a passive real estate company, REITs are long term investors in their real estate. Park, as is widely known, acquired land adjacent to the Hilton Hawaiian Village Waikiki Beach Resort complex with the express intent of investing in an additional hotel tower. The construction of such a new hotel tower will likely cost hundreds of millions of dollars and create significant jobs and additional revenues for the State.

We believe **the DPD should not be disallowed for any period of time or eliminated**. Not only is SB 2697, SD 1 bad public policy, it would not add significant revenue to the State. DoTax has stated elimination of the DPD would raise only modest amounts of income taxes while likely resulting in less GET, both because of less investment by REITs and the likely planning that would reduce lodging REIT duplicate GET payments. The disallowance of the DPD would be inconsistent with federal tax treatment, without a good reason, and the existing rules of virtually all other states with an income-based tax system.

Further, hotels and resorts, including lodging REITs, operating in Hawaii are not subject to low property tax rates. The current Hawaii real property tax rates for hotels and resorts is \$13.90 per thousand of value (1.39%) which is not low compared to other jurisdictions and unlike residential rates is not the lowest rate in the United States.

We believe that our investment and the investments by other REITs in Hawai'i are beneficial to the state and that disallowing the DPD would have the undesirable consequence of discouraging investment by REITs in Hawai'i. In fact, Park is currently in the planning phase related to the possible construction of a hotel tower adjacent to, and to be an addition to, the Hilton Hawaiian Village Waikiki Beach Resort complex. If SB 2697, SD 1 were to become law, it will force us to reconsider whether we will proceed with this and future capital investment projects in the State of Hawai'i.

We believe the proposed legislation will not increase tax revenue for the state as the cost of doing business in Hawai'i will diminish investment returns and result in less investment. Further, disallowance or 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 federal or state income taxes and do not make the same capital investments as REITs. Further, if hotels in Hawai'i are converted to non-REIT ownership, including ownership by taxable subsidiaries of REITs, the additional GET revenue generated solely as a result of the REIT structure will disappear.

We believe the GET, which is a tax on gross receipts rather than a tax on net income, is a more reliable and steadier source of state revenues than corporate income tax and SB 2697, SD 1's enactment would threaten this extremely valuable source of revenues to the State.

PARK's two landmark, oceanfront resorts cater to residents from Hawai'i and the mainland, and international travelers. PARK's Hawai'ian resorts provide significant economic benefit to the State of Hawai'i. 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 Hawai'i in many ways, including:

JOBS: PARK's hotels directly employ more than 2,850 employees. The payroll and associated benefits for these direct employees is in excess of \$203,000,000 annually.

CAPITAL MAINTENANCE: Over the next five years, PARK will likely spend \$200 million at Hilton Hawaiian Village and Waikoloa Village on capital maintenance projects, exclusive of any expansion capital.

CAPITAL DEVELOPMENT / IMPROVEMENTS. Given the long-term nature of our investment, PARK is currently analyzing significant development opportunities that will require meaningful capital investment at both resorts. These capital investments which are at various stages of feasibility / underwriting would be hundreds of millions of dollars.

HAWAII TAXES GENERATED / PAID BY PARK:

- General Excise and Use Tax - Operations. The tax revenues generated from our operations totaled \$27,981,455 in 2019.
- General Excise Tax – Rent / Management Agreement. As described above as a REIT, unlike non-REIT real estate owners, PARK must use a lease structure. As a result, we are required to pay General Excise Tax on the rent paid between our related companies. Effectively a double taxation of the same revenue. This additional GET paid by PARK was \$9,349,896 in 2019 and the additional GET paid by PARK on the management fees paid to our independent operator was \$1,564,830 in 2019.
- Property taxes. Property taxes at PARK's two resorts totaled \$22,403,103 in 2019.

CHARITABLE ENDEAVORS BY PARK and ITS ASSOCIATES in HAWAII:

- PARK associates spend thousands of hours annually volunteering for local events and charities.
- PARK and its associates provide cash and in-kind charitable contributions more than \$600,000 annually.

We believe that Park has been a solid corporate citizen and partner to the state of Hawai'i – paying significant tax, supporting numerous jobs and benefitting the community at-large. PARK's REIT structure and hotel ownership benefits the State of Hawai'i and Kama'aina tremendously in a variety of economic and charitable ways.

If adopted, this controversial legislation would (i) put Hawai'i at a competitive disadvantage for REIT investment, (ii) penalize Hawai'ian citizens, including the Hawaii Employer-Union Health Benefits Trust Fund beneficiaries, that invest in REITs by reducing their investment returns, (iii) discourage REITs from investing in Hawai'i, (iv) require PARK to reassess the level of future capital invested in Hawai'i and our Hawai'ian assets including the potential construction of an additional hotel tower as part of the Hilton Hawaiian Village Waikiki Beach Resort complex, and (v) require Park, as a publicly-traded company, to address our form of ownership and operation in Hawai'i, which could lead to implementing one or more appropriate tax planning techniques or strategies to maintain shareholder value. Further, this legislation would have a chilling effect on the positive economic and charitable impact PARK provides through its REIT ownership and capital investment in Hawai'i.

We thank you again for this opportunity to provide testimony against SB 2697, SD 1 and sincerely hope you consider our **strong opposition** to this proposed legislation.

Respectfully submitted,

Scott Winer
Senior Vice President, Tax



March 11, 2020

Representative Angus L. K. McKelvey, Chair
Representative Lisa Kitagawa, Vice Chair
Members of the House Committee on Economic
Development & Business
Thirtieth Legislature, Regular Session of 2020

RE: **SB 2697, SD1 – RELATING TO TAXATION OF
REAL ESTATE INVESTMENT TRUSTS**
Hearing Date – March 13, 2020 at 9:45 a.m.

Aloha Chair McKelvey and members of the committee,

Thank you for allowing NAIOP Hawaii to submit testimony in **OPPOSITION** to SB 2697, SD1 – Relating to Taxation of Real Estate Investment Trusts. NAIOP Hawaii is the Hawaii chapter of the nation's leading organization for office, industrial, retail, residential and mixed-use real estate. NAIOP Hawaii has over 200 members in the State including local developers, owners, investors, asset managers, lenders and other professionals.

Over the past few years, REIT investment has resulted in several billion dollars of construction activity, creating thousands of local jobs, both construction and permanent, and helping our community maintain a strong economy.

REITs have continued to contribute to our community by investing in affordable housing, retail, healthcare, office buildings and other commercial projects that will serve our community and local families for decades to come.

SB 2697, SD1 would disallow the dividends paid deduction for REITs. Hawaii is already among the most heavily taxed states in the entire country which stifles economic growth, and SB 2697, SD1 would make Hawaii one of only two states to disallow the dividends paid deduction. This change would create additional barriers to do business in our state and would negatively impact the level of interest in future investment in Hawaii and put jobs and revenues at risk.

Representative McKelvey, Chair
Members of the House Committee on
Economic Development & Business
March 11, 2020
Page 2

Simply put, the bill will not provide the tax benefit assumed, but would increase even further the cost of doing business in this state. Accordingly, we respectfully urge you to defer SB 2697, SD1.

Mahalo for your consideration,

Catherine Camp, President
NAIOP Hawaii



March 11, 2020

The Honorable Angus L.K. McKelvey, Chair
The Honorable Lisa Kitagawa, Vice Chair
Committee on Economic Development and Business
State Capitol
415 South Beretania Street
Honolulu, HI 96813

RE: SB 2697/Hearing on March 13, 2020

Dear Chair McKelvey, Vice Chair Lisa Kitagawa and Members of the Committee:

On behalf of Simon Property Group (Simon), thank you for the opportunity to submit this testimony in strong opposition to SB 2697. Simon is a publicly traded real estate investment trust (REIT). We own, develop and manage premier shopping, dining, entertainment and mixed-use destinations, including Waikēle Premium Outlets in Waipahu. As of December 31, 2019, we owned or held an interest in 204 income producing properties in the United States, which consisted of 106 malls, 69 Premium Outlets, a number of other retail properties in 37 states and Puerto Rico. We also own a number of overseas properties.

SB 2697 would eliminate the REIT dividends paid deduction (DPD), contrary to federal law and the laws of virtually every state with a corporate income tax.

Modeled after mutual funds, Congress created REITs in 1960 to provide a way for ordinary Americans to combine their capital in order to invest in professionally-managed, income producing real estate with a single level of taxation. In the past, such investment was generally limited to wealthy investors through partnerships. Unlike other real estate owners, as a REIT, we must meet strict asset, income, and operational tests to ensure that we are a widely-held, real estate-focused company. Unlike other real estate owners, but like mutual funds, we can't retain our earnings. We must distribute at least 90% of our taxable income to shareholders. If we satisfy this distribution requirement as well as the other REIT rules, we are entitled to claim a DPD. We must pay corporate tax on an income we retain.

Like other REITs, we invest for the long-term. We have owned the Waikēle Premium Outlets since 2004. Since we've owned this property, we have invested over \$95 million to improve the



property. This investment has improved the property's value, allowing it to generate about \$1.4 million annually in property taxes and \$1.5 million annually in general excise taxes.

As a publicly traded REIT that invests in multiple states and throughout the world, we must consider the local business climate as a factor in terms of where to invest, and to continue to invest, capital. Enactment of this bill would lead to double taxation of our shareholders and would make Hawaii a less attractive place to invest, not just for Simon, but for other investors who may view its enactment as meant to discourage future investment, thereby jeopardizing jobs and future revenues in the State. Investments in virtually all other states would not be subject to this second level of tax, so SB 2697 would make it more likely that we would invest outside of Hawaii. Please consider the important contributions that REITs have made in Hawaii. We respectfully ask that you hold SB 2697.

Thank you again for the opportunity to submit this testimony.

Sincerely,

Desiree A. Mosiman
Manager
Waikēle Premium Outlets

March 13, 2020

Honorable Angus L.K. McKelvey, Chair
Honorable Lisa Kitagawa, Vice Chair
Committee on Economic Development & Business
State Capitol (conference room 309)
415 South Beretania Street
Honolulu, Hawaii 96813

Re: **Testimony in Opposition to Senate Bill 2697 SD1 relating to real estate investment trusts**

Dear Chair McKelvey, Vice-Chair Kitagawa and Committee Members:

On behalf of Taubman Centers, thank you for the opportunity to provide our testimony in **opposition** to Senate Bill No. 2697 SD1, which is being heard by the Committee on Economic Development & Business on March 13, 2020 at 9:45 am. SB No. 2697 SD1 would disallow the dividend paid deduction for real estate investment trusts ("REITs").

REITs are responsible for a significant amount of economic activity in Hawaii and SB No. 2697 SD1 that increases state income taxation of REITs would be a policy change that 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 it makes Hawaii unattractive for investment by REITs resulting in less economic activity.

Taubman Centers alone invested over \$475 million for the redevelopment of International Market Place. Our shopping center pays annually over \$1.7 million in general excise tax and over \$3.7 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 an estimated 1,000 construction jobs and after opening it created an estimated 1,600 permanent jobs (including employment by tenants). This generated both general excise tax revenues from construction work and individual income tax revenues from both the construction and permanent jobs. Please see page three for the economic benefits in Hawaii created by the REIT industry as a whole.

Taubman Centers in Hawaii

Taubman Centers is a publicly owned REIT engaged in the ownership, operation, management, development and leasing of 26 regional, super-regional and outlet shopping centers in the U.S. and Asia. We completed construction to redevelop International Market Place in Waikiki, Honolulu in August of 2016 for a total cost of over \$475 million. The construction began in 2014 with Queen Emma Land Company and our partner Coastwood Capital Group. The shopping center offers 86 retailers and 8 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 kama'āina alike. We are very excited about the center and are proud to be a part of the community.

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. REITs 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 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 SB No. 2697 SD1 would eliminate and disallow for Hawaii corporate income taxation.

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

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. For local governments the business activity generates property and conveyance taxes.

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

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*
(Prepared for the National Association of Real Estate Investment Trusts® (NAREIT))

² Brewbaker, P.H., Ph.D., CBE. (2015, December). *Economic Impacts of Real Estate Investment Trusts in Hawaii*
(Prepared for the National Association of Real Estate Investment Trusts® (NAREIT))

³ *ibid*

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 SB No. 2697 SD1 resulting in double taxation to REIT profits (once at the REIT level and again at the shareholder level) will affect after tax return on investment of Hawaii residents.

For more information about REITs in Hawaii please visit www.thereitwayhawaii.com.

As previously mentioned, 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 it makes Hawaii unattractive for investment by REITs resulting in less economic activity.

For the foregoing reasons, we respectfully ask the Committee on Economic Development & Business to hold SB 2697 SD1.

Thank you for your consideration of our testimony.

Very truly yours,



Eric C. Smith
Vice President Tax
Taubman Centers, Inc

⁴ *ibid*

March 13, 2020

TO: Committee on Economic Development & Business
Rep. Angus L. K. McKelvey, Chair
Rep. Lisa Kitagawa, Vice Chair

FROM: Fergus & Company, a Limited Liability Company

RE: In Support of SB 2697, Relating to Taxation of Real Estate Investment Trusts
(REITs)

Members of Committee on Economic Development & Business:

We are writing in support of SB 2697 and would like to share some information which is critical for our legislators to make an informed, educated decision on this important issue.

Opponents to this bill have stated that passage of this bill would not raise significant income taxes for the state and have cited prior Department of Taxation (DOTAX) testimony stating this bill would raise only \$2.5M - \$10M annually. We requested DOTAX's back-up assumptions, estimates and calculations behind their tax revenue estimate testimony numbers in June 2019 through the Office of Information Practices (OIP), and were stonewalled for over eight months from viewing any of their data. Finally, earlier this month with legal backing from OIP we received DOTAX's data for their revenue estimate (enclosed). DOTAX estimated that REIT taxable income in Hawaii was \$720M in 2013 and that if this bill passed, REITs would "take advantage of other deductions" to wipe out most of their Hawaii taxable income. DOTAX has since acknowledged to us that their tax revenue estimate is not accurate, especially in regards to the nebulous "other deductions" argument and that they need to revise their estimate. You can see DOTAX's 2020 testimony no longer references their inaccurate estimates.

Using DOTAX's taxable income estimate of \$720M and the Hawaii corporate income tax rate of 6.4%, this bill would raise \$46M of tax revenue for our state ($\$720\text{M} \times 6.4\%$) which badly needs resources to deal with homelessness, affordable housing, pension obligations, and many other issues. Remember, the \$720M taxable income number is based on 2013 data. Over the last few years, REIT owned property in Hawaii has grown by over 38% from \$13 billion in 2013 to \$18 billion in 2019 according to the National Association of REITs (NAREITs), so we expect the current REIT taxable income number to be closer to \$1 billion per year (\$720M with 38% growth). Please view the NAREIT website and click on Hawaii for further detail on the value of REIT owned property in our state: <http://www.reitsacrossamerica.com/>.

Additionally, we conducted an independent study which estimates REIT income in Hawaii based on filing from 34 publicly traded REITs operating in Hawaii in 2018 and have confirmed that income tax raised for Hawaii would be at least \$31M per year based on our partial list. We are happy to share and disclose details and assumptions of this study with anyone interested in learning more.

Opponents to this bill also argue that they contribute to our community through real property tax and general excise tax (GET). The problem with this argument is that you, me and every other taxpayer in Hawaii contributes to the community through real property taxes and GET, AND we also pay income tax (6.4% for corporations, 11% for individuals which may increase to 13%) to support our community. Why should mainland companies be exempt from paying their fair share of Hawaii income tax like everyone else?

Even with the passage of this bill, REITs still enjoy significant tax advantages over other types of businesses. For example, REITs still will be able use their dividend deduction for federal income tax purposes so that the federal income tax burden would be assessed only on their shareholders. This still is a significant advantage over publicly traded corporations which pay income tax at the corporate level and shareholder level.

The issue of double GET is raised by REITs who operating hotels in Hawaii. Keep in mind that Hotel REITs have assembled these unique tax structures and pay additional layers of GET because they still have significant federal income tax advantages over non-REITs competitors. In other words, it still makes sense for them to pay extra general excise tax because they save so much in other taxes compared to their non-REIT real estate competitors.

Thank you for the opportunity to testify.



220 South King Street, Suite 2150
Honolulu, Hawaii 96813
808-599-5800
rmrgroup.com

March 11, 2020

Representative Angus L.K. McKelvey, Chair
Representative Lisa Kitagawa, Vice Chair
Committee on Economic Development & Business
State Capitol
415 South Beretania Street
Honolulu, HI 96813

**RE: SB 2697 SD 1 – RELATING TO TAXATION OF REAL ESTATE
INVESTMENT TRUSTS
Hearing Date – March 13, 2020 at 9:45 a.m.**

Aloha Chair McKelvey, Vice Chair Kitagawa and Members of the Committee,

My name is Jan Yokota and I am the Regional Vice President of the Pacific Region for The RMR Group LLC, which is an alternative asset management company that was founded in 1986 to invest in real estate and manage real estate related businesses. In Hawai'i, The RMR Group manages more than 17,000,000 square feet of property for three real estate investment trusts (REITs): Industrial Logistics Properties Trust; Diversified Healthcare Trust; and Service Properties Trust. The RMR Group *strongly opposes* SB 2697 SD 1.

REITs were established by Congress in 1960 to give everyone, regardless of income level, an opportunity to invest in real estate. By law, a REIT must distribute at least 90% of its taxable income to shareholders as dividends. Many of these shareholders are Hawai'i residents and institutions, such as pension plans of Hawai'i companies and the State of Hawai'i Employees Retirement System, who rely on these dividends for secure income. SB 2697 SD 1 would effectively double tax the REITs and their shareholders.

REITs have access to global capital markets, which provide them with funding to invest in Hawai'i. Over the past few years, investment by REITs in Hawai'i has resulted in several billion dollars of construction activity, creating thousands of local jobs, both construction and permanent, and helping our community to maintain a strong economy. Passage of SB 2697 SD 1 would put future capital investment by REITs in properties in Hawai'i at risk, resulting in a corresponding reduction of general excise taxes and jobs.

REITs have contributed significantly to Hawai'i by adding jobs, increasing revenues for the State and supporting the community through charitable contributions. Any tax revenues that may be generated by SB 2697 SD 1 will be greatly outweighed by the negative consequences to the State's economy, tax revenue and jobs. Accordingly, we respectfully urge you to defer SB 2697 SD 1.

Mahalo for your consideration.

MRC WEST INC

125 Merchant Street Suite 200
Honolulu, HI 96813

March 11, 2020

Representative Angus L. K. McKelvey, Chair
Representative Lisa Kitagawa, Vice Chair
House Members of Committee on Economic Development and Business

Re: Support for SB 2697, Relating to Taxation of Real Estate Investment Trusts
Hearing Scheduled for Friday, March 13, 2020 at 9:45 am in Conference Room 309,
State Capitol

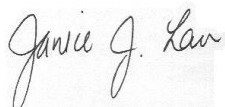
As a business person concerned about Hawaii's economy and long-term community development, I strongly support SB 2697, Relating to Taxation of Real Estate Investment Trusts.

This bill corrects a loophole in our state income tax law that allow 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. 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. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass SB 2697 related to the taxation of REITs. Thank you for the opportunity to testify.

Thank you,



Janice J. Lau
Vice President

SB-2697-SD-1

Submitted on: 3/11/2020 4:21:50 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Galen Fox	Faith Action	Support	No

Comments:

Faith Action supports SB 2697. We are facing the coronavirus pandemic, which will do serious damage to our tourism-based economy. The crisis will cost Hawaii revenue needed to support state priorities, including construction of affordable housing. Why in this atmosphere should we allow some corporations in Hawaii to escape paying the same income tax that every other corporation operating here must pay? The state can, if SB 2697 passes, collect \$83 million a year that otherwise leaves for other states or nations. Let's hold onto the 6.4% of profits that should remain in Hawaii -- it's ours!

Prince Kuhio Plaza

March 13, 2020

Hearing Date: March 13, 2020

Time: 9:45 a.m.

Place: State Capitol, Conference Room 309

Rep. Angus L.K. McKelvey, Chair

Rep. Lisa Kitagawa, Vice Chair

State Capitol

House Committee on Economic Development & Business

415 South Beretania Street

Honolulu, Hawaii 96813

Re: Testimony in Opposition to Senate Bill No. 2697, SD1

Dear Chairman McKelvey, Vice Chair Kitagawa and Committee Members:

Thank you for the opportunity to provide written testimony on Senate Bill No. 2697 SD1. My name is Daniel Kea, General Manager of Prince Kuhio Plaza, on the Island of Hawaii, the largest indoor center on the island and I am Jared Chupaila, Chief Executive Officer of Brookfield Properties' retail group. Simply put, we do not support this Bill that would disallow the dividends paid deduction, subject REIT investment in Hawaii to double taxation, and contradict the taxation of REITs nationwide. As we have previously testified, this legislative path is clearly inappropriate and will ultimately harm Hawaii.

We last testified on behalf GGP; GGP is now known as Brookfield Property REIT and is an affiliate of Brookfield Asset Management. Brookfield Properties' retail group, which encompasses the former GGP portfolio, as well as other retail properties within Brookfield Properties, has an extensive portfolio of mall properties encompassing over 170 locations across 43 U.S. states. Brookfield Properties assures premier quality and optimal outcomes for our tenants, business partners and the communities in which we do business. Brookfield Properties continues GGP's legacy of being a part of the economic fabric of Hawaii for more than 30 years (since 1987) -- managing, owning and reinvesting in its Hawaii real estate assets as part of a long-term commitment that provides economic stability, growth, and jobs through all economic cycles.

Indeed, across its portfolio and in Hawaii, Brookfield Properties' REIT capital and investment are focused on producing stable, long term cash flows over a variety of economic conditions. Brookfield Properties operates three major retail shopping centers in Hawaii – the Prince Kuhio Plaza ("PKP") in Hilo, Whalers Village in Lahaina, and the Ala Moana Center in Honolulu. As the largest indoor shopping center on the island of Hawaii, PKP provides great event space for local Kupuna groups passing on their knowledge of music and dance, artisan craft fairs and the celebration of other local traditions. The latter two are iconic visitor attractions that help sustain Hawaii's important tourism industry. Home to more than 350 stores and restaurants, Ala Moana

PRINCE KUHIO PLAZA

111 E. Puainako Street Hilo, Hawaii 96720

T +1 808 959 3555 F +1 808 959 3655 BrookfieldPropertiesRetail.com

House Committee on Economic Development & Business

Hearing Date: March 13, 2020

Page 2

Center is the primary shopping, dining and leisure destination for Kama`aina and visitors. Our two office buildings, which include the Ala Moana Building (Bank of Hawaii) and Ala Moana Pacific Center (Shokudo Building), primarily are occupied by local tenants who cater to residents. In addition to their important role in tourism, all three centers directly benefit the state and local economy through the Hawaii general excise tax.

Efficient REIT capital allows us to constantly reinvest in and enhance the customer experience as well as evolve to meet the needs of Hawaii. For example, at Ala Moana during 2012-2016, we invested almost \$1 billion to construct additional retail square footage and residential condominiums. We announced in October 2019, that starting in 2021, we plan to build a 550-unit residential tower with a mix of unit sizes with 110 apartments being rented to tenants making no more than 80% of the area median income. This new investment will continue to enhance Ala Moana's standing as a live, work, play destination for all.

In prior year legislative sessions, we have testified in opposition to attempts to eliminate the deduction for dividends paid by REITs. That 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 for 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 the taxing structure here would put REITs at a disadvantage in relation to these other forms of doing business.
- REITs produce substantial economic benefits to the State of Hawaii in the form of jobs, general excise tax, income tax from persons working or engaging in business at REIT properties, and real property taxes. The three properties annually pay more than \$40 million in real property and general excise taxes – metrics that clearly demonstrate that REITs are investing in the economic well-being of the state and its residents.

As we look forward over the next 30 years, future expansion plans could be reconsidered if the attractiveness of investing in Hawaii relative to the rest of the United States is diminished. Proponents of the legislation say that REIT investment would not leave Hawaii but both the Department of Business, Economic Development & Tourism ("DBEDT") and the Department of Taxation have noted that there is no surety that investment will not be reduced and that estimates of revenues will be realized. Deviation from a long held national legislative norm is not good policy.

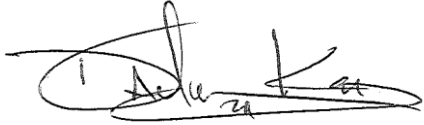
Please do not allow the perception of a revenue increase override the long-term economic benefits that REIT investment, under the existing tax regime, brings to the state of Hawaii and its residents. For the foregoing reasons, we respectfully oppose Senate Bill No. 2697 SD1 and urge you to oppose it as well. Thank you for your consideration.

House Committee on Economic Development & Business

Hearing Date: March 13, 2020

Page 3

Sincerely,

A handwritten signature in black ink, appearing to read "Daniel Kea", with a stylized flourish at the end.

Daniel Kea
General Manager

A handwritten signature in black ink, appearing to read "Jared Chupaila", with a stylized flourish at the end.

Jared Chupaila
Chief Executive Officer



March 11, 2020

Representative Angus L.K. McKelvey, Chair
Representative Lisa Kitagawa, Vice Chair
House Committee on Economic Development & Business

RE: SB 2697 SD1 Relating to Taxation of Real Estate Investment Trusts – In Opposition
Friday, March 13, 2020; 9:45 AM; Conference room 309

Aloha Chair McKelvey, Vice Chair Kitagawa and Members of the Committee:

On behalf of Douglas Emmett, Inc. (“Douglas Emmett”), we appreciate this opportunity to present testimony expressing concerns on SB 2697 SD1, which disallows a dividends-paid deduction (“DPD”) for real estate investment trusts (“REITs”), except for real estate investment trusts that provide affordable housing in the State.

Douglas Emmett has been investing in Oahu for over fifteen years and employs over 275 local residents. Our commercial office portfolio includes Bishop Place, Bishop Square, Harbor Court and the Honolulu Club and our residential portfolio is comprised of over 2,000 workforce rental apartment units. We recently invested over \$120 million to build approximately 500 rental apartments in Moanalua. The development employed hundreds of local construction workers and created desperately needed workforce housing.

Douglas Emmett is currently working to add approximately 500 more rental apartments in downtown Honolulu by converting Bishop Place into workforce housing. We anticipate investing between \$80 million and \$100 million in the Bishop Place project, which will employ a large number of kama’aina union construction workers. The first units should come online in 2020 with rents targeted to serve local families in the 80% to 120% Average Median Income range.

We are concerned that this bill’s targeted double taxation on REIT shareholders will negatively impact REIT investment into Hawaii. The bill incentivizes REITs to invest in states that recognize the intent of Congress for REITs to be a single tax entity. If SB 2697 SD1 is enacted, Hawaii will likely lose one of the best sources of capital to build workforce housing and improve our communities. The bill will also have a negative economic impact on the construction trades, building suppliers, architects, and engineers.

Representative Angus L.K. McKelvey, Chair
Representative Lisa Kitagawa, Vice Chair
House Committee on Economic Development & Business
March 11, 2020
Page 2

We acknowledge that language excepting “real estate investment trusts where one hundred per cent of the trust's real property is used to provide affordable housing in the State” was added to the legislation. However, this language does not mitigate the negative effects of this bill as we are unaware of any REIT for which this exception would apply.

As a stakeholder in Hawaii, Douglas Emmett believes SB 2697 SD1 will eliminate an important source of investment capital that generates substantial local economic activity. Inasmuch as this bill appears to be outside of the best interest of the residents of Hawaii and the objectives of the State to encourage the investment into, and growth of, Hawaii’s economy, we respectfully ask that you hold this bill.

Respectfully,

A handwritten signature in black ink, appearing to read "Kevin Crummy", with a long horizontal stroke extending to the right.

Kevin Crummy
Chief Investment Officer

A handwritten signature in black ink, appearing to read "Michele Aronson", with a long horizontal stroke extending to the right.

Michele Aronson
Senior Vice President



HAWAII APPLESEED

CENTER FOR LAW & ECONOMIC JUSTICE

Testimony of the Hawai‘i Appleseed Center for Law and Economic Justice
In Support of SB 2697, SD1 – Relating to Taxation of Real Estate Investment Trusts
House Committee on Economic Development & Business
Friday, March 13, 2020, 9:45 AM, in conference room 309

Dear Chair McKelvey, Vice Chair Kitagawa, and members of the Committee:

Thank you for the opportunity to provide testimony in **SUPPORT of SB 2697, SD1**, which would disallow the corporate tax exemption for real estate investment trusts (REITs), except for those that provide affordable housing in the State.

Right now, income produced on Hawai‘i REIT property is escaping Hawai‘i income tax. Typically, individuals and corporations in Hawai‘i that generate income off Hawai‘i real estate are paying state income tax. REITs should be no exception. Eliminating the exemption would generate an estimated \$60 million in tax revenue to fund the infrastructure, projects and programs our that community, and even REITs themselves, depend on.

A Real Estate Investment Trust or “REIT,” is a corporation that owns income-producing real estate, like hotels and shopping malls. Like a mutual fund for real estate, people can purchase shares in a REIT to get a portion of the income it generates. REIT’s have been granted a special tax status that exempts them from paying corporate income tax on the dividends paid to its shareholders.

REITs suggest that the exemption is appropriate because REIT shareholders pay income tax. However, while REITs own approximately \$17 billion worth of real estate in Hawai‘i—more than any other state on a per capita basis—we have relatively few residents who are REIT shareholders, ranking 40th in the nation for the number of REIT shareholders as a percentage of the population. That means that a lot of REIT money is going out of our state, and only a little is remaining in. An estimated \$1 billion in profits is created in Hawai‘i on Hawai‘i REIT property, and a significant portion of it is escaping Hawai‘i income tax.

REITs can still operate and thrive in Hawai‘i, even if required to pay their share of taxes needed to build a strong Hawai‘i for everyone. If the Hawai‘i state corporate income tax exemption were eliminated, REITs would still receive generous federal tax exemptions, and they would continue to benefit from Hawai‘i’s extraordinarily low property tax rate. This bill would ensure that REITs start paying their fair share of Hawai‘i income taxes to help support the communities in which they operate.

Mahalo for your consideration of this testimony.

The Hawai‘i Appleseed Center for Law and Economic Justice is committed to a more socially just Hawai‘i, where everyone has genuine opportunities to achieve economic security and fulfill their potential. We change systems that perpetuate inequality and injustice through policy development, advocacy, and coalition building.



Young Progressives Demanding Action
P.O. Box 11105
Honolulu, HI 96828

March 13, 2020
9:45 AM

TO: House Committee on Economic Development & Business
RE: Testimony in Support of SB2697 SD1 With Amendments

Aloha Chair Angus McKelvey, Vice Chair Lisa Kitagawa, Members of the House Committee on Economic Development & Business,

Young Progressives Demanding Action (YPDA) advocates for public policies that reflect the values of young people throughout the State of Hawai‘i. One of those values is that corporations should pay their fair share in taxes so we can in turn invest in our communities. YPDA is in **Support** of **SB2697 SD1**, Relating to Taxation of Real Estate Investments Trusts **With Amendments**. This measure would disallow dividends paid deduction for real estate investment trusts (REITs), except for real estate investment trusts that provide affordable housing in the State. This would come into effect on 7/1/2050. It would apply to taxable years beginning after 12/31/2020, but would sunset in 12/31/2023.

Ala Moana Center is an example of a Real Estate Investment Trusts. One of the most well known REIT-owned properties in Hawai‘i, Ala Moana is currently still busy with business. Ala Moana is also neighbors with houseless individuals who are either sleeping on the beach, or sleeping in front of apartments because of factors like lack of access to healthcare and being unable to afford to survive. The State of Hawai‘i and by extension the legislature must remember its commitment in Article 9, Section 10 of the Hawai‘i State Constitution to the Law of the Splintered Paddle, “Let every elderly person, woman and child lie by the roadside in safety”. Protect and care for the most vulnerable members of our society, especially the houseless. We are currently living in a tale of two cities, two very stark contrasts in our community that cannot be ignored.

Closing the REITs tax loophole and making them pay their fair share of taxes is a much needed reform and a great step in the right direction to begin to address this divide. REITs are a well-off part of our communities. They should be helping to support the communities that they are currently operating in, and be good stewards. With REITs having federal tax exemptions and

benefiting from our low property tax, they are in a great position to pay their fair share in taxes while still being well off. It is a common understanding among residents that it is very hard to live here. With low wages, our workers are taking on several jobs and living paycheck to paycheck. Our peers are also moving out. We need to continue to work together on creating a society that works for all of us.

On the note of having a society that works for all of us, CoreCivic, formerly known as the Corrections Corporation of America is a Real Estate Investment Trust. Showing the bridge that exists between social and economic policies. Our local residents are sent to their Arizona prison, Saguaro Correctional Center. The interest of the private prison industry is to make money off of prisons, which has now expanded its operations to immigration detention facilities. This means that their interest is not in rehabilitation, but keeping more people locked inside and separated from their families while working inmates to the bone without proper compensation. This also means making profit by using the bare amount of resources in necessities like food and healthcare. By holding REITs accountable, it is our hope that we can also end our reliance on private prisons, and begin to have a meaningful discussion on how we can bring our local residents home and have a more restorative criminal justice system.

Please continue to work on the effort to create a Hawai'i that is livable for all generations so that we can all have an opportunity to succeed, afford our basic needs, and have families of our own. Staying here and giving back to the islands. We urge you to **consider an amendment** to remove the sunset date of December 31, 2023 so that Hawai'i taxpayers can benefit from REIT taxation for more than three years.

Young Progressives Demanding Action is in **Support of SB2697 SD1 With Amendments**. We respectfully ask for you to pass it through your committee.

Mahalo for the opportunity to testify,

Jun Shin,
Executive Committee Member
Young Progressives Demanding Action (YPDA)
Cell: 808-255-6663
Email: junshinbusiness729@gmail.com
CC: action@ypdahawaii.org

March 11, 2020

Hearing Date: March 13, 2020

Time: 9:45 A.M.

Place: Conference Room 309

The Honorable Angus L.K. McKelvey, Chair

The Honorable Lisa Kitagawa, Vice Chair

House Committee on Economic Development & Business

Re: Testimony *Opposing* Repeal of the REIT Dividends Paid Deduction – SB 2697 SD1

Dear Chair McKelvey, Vice Chair Kitagawa, and Members of the Committee on Economic Development & Business:

My name is Tim Scott and I am Public Storage's Tax Counsel. Public Storage ***strongly opposes*** SB 2697 SD1, which would repeal the dividends paid deduction for real estate investment trusts ("REITs") operating in Hawaii for 2021, 2022 and 2023. I earlier presented similar testimony to the Senate Committee on Ways & Means when it considered SB 2697, as well as to your Committee when it considered HB 2605, SB 2697's companion bill.

Public Storage and Hawaii. Public Storage is a REIT that is the largest owner and operator of self-storage facilities in the United States, with over 171 million rentable square feet of real estate in 38 states. We have nearly 2,500 facilities and 1.4 million customers in the United States and we own 11 facilities in Hawaii. In 2019, those Hawaii properties generated more than \$31.8 million of gross revenue and we paid the state over \$1.4 million of general excise tax. For the 2019/2020 fiscal year, we will pay real estate taxes in Hawaii of more than \$2.25 million.

REITs and "Pass Through" Taxation. The preamble to the bill ***correctly*** recognizes that REITs were designed by Congress to distribute their taxable income to their shareholders, who then report and pay state and federal tax on those dividends. It then ***wrongly*** asserts that the dividends paid deduction "creates an anomaly" for the state because REITs doing business in Hawaii and paying "dividends to shareholders outside the State, results in no Hawaii income tax collected." The premise that REIT dividends are only paid to "shareholders outside the State" is completely implausible.¹ In fact, Nareit analysis has suggested that about 47% of Hawaii households own REIT stock directly or indirectly (compared to 43% nationwide).

¹ We are confident that investors in Hawaii directly and indirectly hold significant PSA shares, but we cannot specifically identify our shareholders in Hawaii. Our common stock is traded publicly on the New York Stock Exchange under the symbol PSA. Publicly traded companies typically cannot identify their actual beneficial shareholders, as most publicly traded stock is held by depositaries in street name.

Our shareholders in Hawaii are taxable by the state on the full amount of our dividends, not just the very limited portion of those dividends attributable to the 11 properties we have in the state (compared to our almost 2,500 properties across the nation). This means that Hawaii directly benefits from the REIT regime because Hawaii shareholders are taxed on all of the income that REITs are required to distribute (not just income earned by the REIT in Hawaii).

Proponents unfairly compare REITs to separately taxable regular corporations, which are not required to distribute their income. The fact that REITs *must* distribute their income makes “pass-through” taxation (*i.e.*, no entity level tax) perfectly appropriate for REITs, and that treatment is even more suitable for REITs than it is with other pass-through entities such as LLCs, partnerships, or S corporations. Hawaii accords those other entities pass-through treatment with no entity level tax, even though they are not required to distribute their income to their owners.

A New Tax, Causing Double Taxation. The bill would impose new income taxes on REITs operating in Hawaii (but not other pass-through entities). Those taxes would be an added cost of doing business in the state, and REITs would be expected to pass the cost along to Hawaii residents using the REITs’ properties. The bill also will double tax REIT shareholders (the REIT would bear the new income tax and then the shareholders would be taxed again on the dividend income). Owners of other pass-through entities would only bear one level of tax.

Less Net Revenue, Chasing REITs Away. While apparently motivated by an effort to raise added tax revenue, the bill can be expected to have the opposite effect. The preamble offers an unsupported estimate of annual Hawaii REIT income of \$1 billion suggesting it would produce tax revenue of \$65 million a year. Of course, as the Department of Taxation has noted in the past, if Hawaii eliminates the dividends paid deduction, REITs can be expected to offset their tax liabilities through tax planning or with allowable deductions. Others also have projected that a repeal of the dividends paid deduction would jeopardize substantial general excise tax revenues, potentially resulting in a net loss of tax revenue for Hawaii.

Perhaps most importantly, enacting such an anti-business tax would strongly incentivize REITs to reduce or avoid future investment in, and possibly redirect investments away from, the state. This could be expected to have adverse long term effects on Hawaii’s economy and tax collections. An economic study prepared for Nareit by Paul H. Brewbaker, PhD., CBE in December 2015 suggested that by repealing the dividends paid deduction, Hawaii could lose more revenue from foregone economic activity than might be gained in taxes payable by REITs. Another significant consideration for maintaining REIT investment is that the tax laws incentivize REITs to hold investments for the long term. REITs become lasting members of the community; they do not “flip” properties for quick profits.

Breaking with Federal and Other State Treatment. Enactment of SB 2697 SD1 would make REITs separately taxable in Hawaii, imposing a double tax regime that is completely contrary to the accepted federal and state tax treatment of REITs. No state that imposes income tax upon REITs (other than New Hampshire) denies the dividends paid deduction as proposed by SB 2697 SD1. 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 dividends paid deduction in those states.

Strong Recommendation: Do NOT Move this Bill Forward. We believe Public Storage and other REITs have been, and can continue to be, positive forces in the Hawaii economy. For the reasons outlined above, Hawaii should decline to enact this bill, so that the dividends paid deduction for widely-held REITs will continue. We respectfully request that you do ***not*** move forward SB 2697 SD1.

Very truly yours,



A. Timothy Scott

Tax Counsel of Public Storage

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818.244.8080, extension 1286

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

SB-2697-SD-1

Submitted on: 3/11/2020 10:53:12 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Evelyn Aczon Hao	Faith Action for Community Equity	Support	Yes

Comments:



Faith Action for Community Equity is a 24-year-old grassroots, interfaith organization that includes 18 congregations and temples, a union, housing association, health center and two advocacy organizations on Oahu. Faith Action is driven by a deep spiritual commitment to improving the quality of life for our members and all the people of Hawaii. We strive to address issues of social justice at all levels of government.

Testimony in Support of SB2697/SD1

Aloha,

I am Evelyn Hao, President of Faith Action for Community Equity, an organization of multiple faith traditions and community action organizations.

Faith Action, our family, friends, and communities support SB2697/SD1 which removes a loophole in current law that exempts Real Estate Investment Trusts from paying Hawaii taxes. (In stark contrast, non-REIT companies pay their fair share of state taxes.)

Not only do REITs not pay Hawaii taxes, neither do most shareholders of Hawaii REITs. Shareholders pay taxes on their dividends to their home states. Unfortunately 99% of Hawaii REIT shareholders are *not* Hawaii residents. Those taxes do not stay in Hawaii where the profits are made.

Examples of local REIT corporations that pay no Hawaii taxes are Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, Hilton Waikoloa, International Marketplace, and even the kamaaina corporation Alexander and Baldwin.

Last year, local REITS and NAREIT (its national advocate) held a huge mass media campaign spreading fear of last year's REITs legislation, claiming that taxes will discourage future investment in Hawaii.

We disagree.

There are now over 75 REITs in Hawaii which buy Hawaii land and property--and the number is growing. Why? According to NAREIT in its report, "REITs Across America," Hawaii has the 14 highest value per REIT-owned property, and the 12th highest rate of REIT asset value growth from 2014-2017, well ahead of larger states like Colorado, Illinois, and Texas. Furthermore, Hawaii's REIT asset value growth *rate* is over 10 percent higher than the national average.

REITs and non-REIT companies will continue to buy and invest in Hawaii properties regardless of taxes because Hawaii's properties appreciate at a much higher rate of value than most mainland properties. Hawaii is unique and uniquely valuable.

Despite the negative lobbying last year, our legislators heard the people's voices and passed the bill resoundingly. Unfortunately, the Governor vetoed it.

This year, we hope the ultimate outcome will be different and that the bill will become law.

SB 2697/SD1 will ensure that money *made* in Hawaii will *stay* in Hawaii. The estimated \$60 million tax revenue per year can be used for Hawaii's vital needs which includes affordable housing, long term kupuna care, infrastructure, child care/early education, to name a few.

Please pass SB2697/SD1.

Thank you.



SB 2697, SD1, RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS

MARCH 13, 2020 · HOUSE ECONOMIC
DEVELOPMENT AND BUSINESS COMMITTEE ·
CHAIR REP. ANGUS L.K. MCKELVEY

POSITION: Support.

RATIONALE: IMUAlliance supports SB 2697, SD1, relating to taxation of real estate investment trusts, which disallows dividends paid deduction for real estate investment trusts, except for real estate investment trusts that provide affordable housing in the State, applies to taxable years beginning after 12/31/2020, and sunsets 12/31/2023.

Under state taxation law, REITs are currently afforded an exemption from paying corporate income taxes on dividends paid to shareholders. REIT shareholders, however, pay federal and state income taxes on their earnings from the REIT in which they have invested.

Unfortunately, since most shareholders of Hawai'i REITs don't live in the Aloha State, they pay income taxes in other locations (if such income is subject to taxation in the states in which they reside, which it often is not). Thus, income generated from Hawai'i properties is being taxed elsewhere, if at all, sending sorely needed revenue for teacher pay raises, infrastructure, climate change mitigation, human and social services, and affordable housing outside of our shores.

Eliminating REIT dividend deductions will uplift Hawai'i's people. Over 30 REITs operate in Hawai'i, perhaps the most prominent of which is Alexander and Baldwin. REIT properties in the islands include Ala Moana Center, International Marketplace, and the Hilton and Hyatt Hotels.

Notably, CoreCivic, formerly the corruption-plagued private prison firm Corrections Corporation of America, is also a REIT, making this measure not just a matter of economic justice, but also a hallmark of our state's commitment to criminal justice reform.

Collectively, Hawai'i REITs own over \$17 billion worth of real estate and produce \$1.3 billion in dividend income exempt from the corporate income tax, amounting to \$57-\$83 million per year in lost tax revenue—a number that will only increase over time, as real estate values continue to soar.



March 11, 2020

Representative Angus L.K. McKelvey, Chair
Representative Lisa Kitagawa, Vice Chair
House Committee on Economic Development and Business

Comments and Concerns in Strong Opposition to SB 2697, S.D.1, Relating to Real Estate Investment Trusts (REITs) (Disallows Dividends Paid Deduction [DPD] for REITs, except for REITs which utilize one hundred percent of its real property to provide affordable housing in the State; applies to taxable years beginning after 12.31.2020; sunsets 12.31.2023.)

Friday, March 13, 2020, 9:45 a.m., in Conference Room 309

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 utility companies. 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.

SB 2697, S.D.1. The purpose of this bill is to amend subsection (b) of Section 235-2.3, Hawaii Revised Statutes to disallow DPDs for REITs, except for REITs where one hundred per cent of the trust's real property is used to provide affordable housing in the State. Should SB 2697, S.D.1 be adopted, REITs which do not provide affordable housing in the State will be taxed on their net income in Hawaii, while their 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, to date, been proved or supported by any credible facts or evidence. LURF believes the advantages and benefits of continuing the DPD are supported by presently available, credible information and quantifiable evidence, and in fact clearly outweigh any purported profits or increase in state revenue speculated to be received as a result of the proposed disallowance.

In LURF's opinion, the provision in this version of the bill to allow the DPD for REITs that utilize one hundred percent of its real property to provide affordable housing in the State does nothing to address or correct the underlying inequities of, and unsupported factual bases for the overall effort to disallow the DPD for REITs.

While Section 1 of this bill initially states that "it is the legislature's intent to conform the income tax law of the State as closely as may be with the Internal Revenue Code, unless there is good reason to the contrary," the measure thereafter goes on to denounce the intent of the federal REIT law, bemoaning that the application of the law in this State is anomalous because REITs which conduct business in Hawaii may pay dividends to shareholders who reside out of the state, thereby resulting in no Hawaii income tax being collected from either the REIT or those out-of- state shareholders.

These detractors ignore that REIT laws were established specifically to allow REIT income to be taxed at the investor level like partnerships, so long as certain requirements continue to be met. Therefore, in order to remain qualified for such tax status regardless of the state(s) in which they may generate income, REITs must all comply with many strict qualifications and requirements, including being widely-held; investing mainly in real estate; no flipping properties; distributing all of their income (no retention of profits), which offset what are assumed in this case to be unfair benefits.

If enacted, SB 2697, S.D.1 would NOT eliminate the burdensome requirements applicable to Hawaii REITs, but would leave those which do not use one hundred percent of their real property to provide affordable housing in Hawaii - and their shareholders - WITHOUT ANY benefits from their investments – even the tax benefits allowed to other non-REIT entities such as tax-exempt pension funds and endowments which earn rental income from real property. Such a result would be clearly inequitable.

Rather than seeking to decouple from the federal system based on what is apparently viewed as unfair consequences of the application of the REIT laws to Hawaii due to the lesser number of resident REIT shareholders as compared to other states, detractors should focus instead on the numerous benefits brought by REITs to this State which more than make up for the alleged disadvantages.

The State's Final Report on the Impact of REITs in Hawaii 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 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.

Given the inadequacy, inaccuracy and unreliability of the tenuous 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”).⁴ 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 inconsistency between findings contained in the Final Report and the Brewbaker Study, LURF believes it would be irresponsible for this Committee to consider, let alone support SB 2697, S.D.1 which may potentially stifle, if not reverse the current growth of the State’s economy, in reliance solely upon the untenable findings of 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.

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

In fact, in a more recent April 26, 2019 *Policy Memorandum Relating to Taxation of Real Estate Investment Trusts* (the “Memorandum”),⁵ the DBEDT expressly states that:

[T]he benefits of continuing with this federally established legislation are clear and quantifiable,” and that REITs are an important investment vehicle for all types of investments in Hawaii.⁶

The Memorandum goes on to take the position that:

[I]f the state income tax is imposed on a REIT there may be negative impacts to the state’s economic health and the business climate, such as a reduction of general excise, property and state income taxes; decline of jobs; potential loss of future investments; and increased perception of Hawaii as a fiscally challenging state to do business.⁷

Given the inability of the Final Report and the Memorandum to conclusively support the validity of this measure, and based on the following reasons and considerations, LURF must oppose SB 2697, S.D.1.

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, everyday 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% of their taxable income to shareholders,⁸ and must also comply with other requirements imposed to ensure their focus on real estate. In short, REITs earn the DPD as they must

⁵ Department of Business, Economic Development & Tourism. *Policy Memorandum Relating to Taxation of Real Estate Investment Trusts*, from Mike McCartney, Director, to The Honorable Donovan Dela Cruz, Chair, Senate Ways and Means; and The Honorable Sylvia Luke, Chair, House Finance. April 26, 2019 (herein the “Memorandum”).

⁶ Memorandum at p. 2.

⁷ *Id.*

⁸ The State of Hawaii thus benefits from taxes it collects on dividend distributions made to Hawaii residents.

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.⁹ 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.¹⁰

2. SB 2697, S.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.

SB 2697, S.D.1 would enact serious policy change that would create disparity between current Hawaii, federal, and 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. 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 REITs that do business in Hawaii as well as their shareholders, SB 2697, S.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.

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 even as of September 2016, approximately 42 REITs operating in Hawaii reportedly held assets in the amount of an estimated \$7.8 billion at cost basis¹¹, 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

⁹ Brewbaker Study at pp. 1, 32, 38.

¹⁰ *Id.*

¹¹ Final Report at pages 3, 15-16.

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.

DBEDT's more recent position as taken with regard to virtually identical anti-REIT legislation proposed in this current Legislative Session is proffered in the Memorandum and makes clear the Department's policy that "maintaining stable economic growth for the State is paramount to the future of Hawaii,"¹² as well as its concern that the State's economy will suffer as a result of the disallowance of the DPD. As stated in the Memorandum:

Given the current economic conditions, the unintended consequences of imposing a corporate tax on REITs are not worth the potential benefits. Hawaii needs to be a place that is able to attract investment capital in order to create quality jobs and a sustainable economy.¹³

Proponents of this bill should be mindful that significant economic growth experienced in this State over the past years 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 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 reported cost of over \$475 million.

REIT projects have helped to support Hawaii's construction industry immensely¹⁴ 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 (Ala Moana Center addition; Pearlridge Center renovations; Ka Makana Ali'i), and hotels. To now require REITs to dedicate one hundred percent of their real property to provide affordable housing in the State in order to qualify for the DPD is unreasonable, especially given their current efforts and contributions to the development of affordable housing in Hawaii, and their support of the local construction industry.

¹² Memorandum, p. 1.

¹³ Memorandum, p. 2.

¹⁴ In the past five years, REIT-related construction activity alone is estimated to have generated \$3 billion in Hawaii GDP.

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

4. The Disallowance of the DPD Proposed by this Bill will Unfairly Affect REITs and the Small Investors Which Have Already Made Substantial Investments in Hawaii.

Disallowance of the DPD and resulting increased taxation of REITs is expected to 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. Many Hawaii residents are reportedly not even aware that they benefit from REITs either through mutual funds or their pension or retirement accounts.

Supporters of this measure also ignore the fact that tax law changes proposed by SB 2697, S.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 believes proponents of this bill and other anti-REIT measures have continued to fail to present any credible and material facts or circumstances required to prove that this proposed legislation is in fact necessary, or that the State's economy will significantly improve as a result of taking the action proposed. Available and undisputable information, facts and evidence supporting the benefits of continuing the DPD in fact clearly outweigh any perceived profits or increased revenue speculated to be received as a result of the proposed disallowance. The intent and application of SB 2697, S.D.1 therefore remain unreasonable, unwarranted, and exceedingly anti-business.

Given that an unjustifiable change of a universal tax rule in place since 1960 could significantly reduce the availability of capital in Hawaii, as well as result in other negative economic repercussions for this State, LURF must **strongly oppose SB 2697, S.D.1**, and respectfully requests that this bill be held in this Committee.

Testimony of
Pacific Resource Partnership

House Committee on Economic Development & Business
The Honorable Angus L.K. McKelvey, Chair
The Honorable Lisa Kitagawa, Vice Chair

SB 2697 SD1 Relating to Taxation of Real Estate Investment Trusts

Friday, March 13, 2020
9:45 A.M.
Conference Room 309

Aloha Chair McKelvey, Vice Chair Kitagawa, and Members of the Committee:

Pacific Resource Partnership (PRP) writes in **opposition** to SB 2697 SD1, which disallows dividends paid deduction for real estate investment trusts (REITs) except for REITs that provide affordable housing in the State.

REITs invest in long-term projects that enable communities and economies to grow. They provide a means to invest in Hawaii's infrastructure. REIT investments include, but are not limited to, rental housing, medical facilities, shopping centers and commercial buildings, all of which provide important services and functions to the public. Some REIT-owned projects serve the districts you represent and serve as important economic drivers for those areas, such as Napili Plaza, Whaler's Village, Hyatt Regency—Maui Resort and Spa in Lahaina; Kaneohe Bay Shopping Center in Kaneohe; Opule Street Industrial Space, Kapolei Medical Park, and Ka Makana Alii in Kapolei; and Pearlridge Center in Aiea.

The coronavirus outbreak has created uncertainty in the State's economy. The State Council on Revenues now anticipates FY2021 tax revenues will undershoot previous targets ~\$300 million due to the coronavirus pandemic. A recent report from the University of Hawaii estimates that visitor spending could drop 10% and the service industry could lose 6,000 jobs. In the midst of such economic uncertainty, Hawaii cannot afford to enact policies that discourage REITs and their investors from doing business in Hawaii, especially since we know that REIT-owned projects play a vital role in serving our local communities.

Given the above, PRP respectfully requests that this Committee defer SB 2697 SD1. Thank you for the opportunity to submit written testimony.





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Corey Rosenlee
President

Osa Tui, Jr.
Vice President

Logan Okita
Secretary-Treasurer

Wilbert Holck
Executive Director

TESTIMONY BEFORE THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS

RE: SB 2697, SD1 - RELATING TO TAXATION OF REAL ESTATE
INVESTMENT TRUSTS

FRIDAY, MARCH 13, 2020

COREY ROSENLEE, PRESIDENT
HAWAII STATE TEACHERS ASSOCIATION

Chair McKelvey and Members of the Committee:

The Hawaii State Teachers Association **strongly supports SB 2697, SD1, with a suggested amendment to use these part of these funds to help provide a dedicated revenue stream to fund salary adjustments for veteran public school teachers, including public charter school teachers, and pay differentials for teachers in special education, Hawaiian language immersion, and hard-to-staff positions.** This bill once passed, disallows dividends paid deduction for real estate investment trusts.

Hawaii has some of the most highly coveted real estate in the nation not only due to its gorgeous scenery, appeal as a tourist destination, and status as an urban hub in the middle of the Pacific, but also because it has the lowest property tax rate in the nation. These factors have led to an explosion in real estate development throughout the islands, including real estate owned by real estate investment trusts or REITs. In fact, REITs own approximately \$17 billion worth of real estate in Hawai'i—more than any other state on a per capita basis. Meanwhile, Hawaii real estate values continue to skyrocket, making it harder and harder for Hawaii residents to afford living at home. Without a disincentive to investors and speculators, Hawaii will continue to experience an exponential increase in real estate property values and those barely making it in Hawaii will be even closer to homelessness.

Unlike corporate investors, investors in real estate investment trusts are exempt from paying corporate income tax on dividends. Thus, dividends from REITS are taxed only once at the shareholder level, and these taxes are paid in the form of income tax to the investor's home state. The implication of this is that while the state

plays host to REITs, it receives virtually no taxes from REITs. Because Hawaii ranks 40th in the nation for the number of REIT shareholders as a percentage of the population, income taxes paid on dividends by shareholders are, for the most part, going out of state.

Decoupling Hawaii's income tax treatment of REITs from federal income tax treatment would generate \$65 million in annual revenue which would take money made off of real estate investments in Hawaii and inject it back into the people of Hawaii. **In fact, we suggest an amendment that would direct some of this funding revenue that could be used to end Hawaii's teacher shortage crisis by providing a dedicated revenue stream to fund salary adjustments for veteran teachers and pay differentials for teachers in special education, Hawaiian language immersion, and hard-to-staff positions salary adjustments.**

To provide a dedicated revenue stream to help end the teacher shortage crisis and to provide a disincentive to the real estate investment and speculation driving up property values in our state we ask you to **support this bill.**



Eric W. Gill, Financial Secretary-Treasurer

Gemma G. Weinstein, President

Godfrey Maeshiro, Senior Vice-President

Wednesday March 11, 2020

Hawaii State Legislature
House Committee on Economic Development & Business
Hawaii State Capitol
415 South Beretania St.

Re: SB 2697, SD1 relating to Real Estate Investment Trusts

Aloha Chair McKelvey, Vice-Chair Kitagawa and members of the House Committee on Economic Development & Business:

UNITE HERE Local 5 is a local labor organization representing nearly 12,000 hotel, health care and food service workers employed throughout our State would like to offer comments in support of SB 2697, SD 1.

We believe that SB 2697 would correct an existing loophole in our State's income tax law that currently allows mainland corporations operating profitably as real estate investment trusts or "REITs" to take the net income they earn here out of State, tax free. REITs already get a generous federal tax break and benefit from Hawaii's low property tax rates. Our State can no longer afford to provide this kind of a tax break to real estate speculators and investors. While we recognize the need for balancing out the interests of private enterprise and business, this Bill is about first and foremost protecting the State's financial interests.

The very fact that REIT's and their lobbying arm NAREIT can spend so much money on advertising, lobbying activities, etc. demonstrates their ability to thrive. The fact of the matter is that REIT's can afford paying taxes here in Hawaii, while our local people keep being priced out of our own island home.

We ask for your Committee's support in adopting SB 2697, SD1.

Thank you.



MAUI
CHAMBER OF COMMERCE
VOICE OF BUSINESS

**HEARING BEFORE THE HOUSE COMMITTEE ON
ECONOMIC DEVELOPMENT & BUSINESS
HAWAII STATE CAPITOL, HOUSE CONFERENCE ROOM 309
FRIDAY, MARCH 13, 2020 AT 9:45 A.M.**

To The Honorable Angus L.K. McKelvey, Chair;
The Honorable Lisa Kitagawa, Vice Chair; and
Members of the Committee on Economic Development & Business,

**TESTIMONY IN OPPOSITION TO SB2697 RELATING TO
TAXATION OF REAL ESTATE INVESTMENT TRUSTS**

Aloha, my name is Pamela Tumpap and I am the President of the Maui Chamber of Commerce, with approximately 650 members. I am writing share our opposition to SB2697.

The Maui Chamber of Commerce opposes SB2697 to disallow dividends paid deduction for real estate investment trusts (REITs). REITs are important to our state's economy as they provide outside capital. They are also important for our economic development as they frequently develop shopping centers and commercial buildings that benefit businesses and workforce rental housing that is desperately needed by residents. Passing this bill will hurt Hawaii's REITs and make investors less likely to invest in our state.

Therefore, we oppose this bill and ask that it be deferred. We appreciate the opportunity to testify on this matter.

Sincerely,

Pamela Tumpap
President

To advance and promote a healthy economic environment for business, advocating for a responsive government and quality education, while preserving Maui's unique community characteristics.



**Testimony to the House Committee on Economic Development and Business
Friday, March 13, 2020 at 9:45 A.M.
Conference Room 309, State Capitol**

**RE: SB 2697 SD1, RELATING TO TAXATION OF REAL ESTATE INVESTMENT
TRUSTS**

Chair McKelvey, Vice Chair Kitagawa, and Members of the Committee:

The Chamber of Commerce Hawaii ("The Chamber") **does not support** SB 2697 SD1, which disallows dividends paid deduction for real estate investment trusts, except for real estate investment trusts that provide affordable housing in the State, and applies to taxable years beginning after December 31, 2020. This bill would also sunset after December 31, 2023.

The Chamber is Hawaii's leading statewide business advocacy organization, representing about 2,000+ businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

Hawaii businesses already pay many taxes, and this bill represents yet another tax increase on our business community. REITs invest in many important local projects that would not be able to secure funding otherwise. For example, before American Assets Trust became a partner in the Waikiki Beach Walk, the property owner was not able to secure funding locally.

Additionally, REITs are also long-term property owners. They do not flip properties, which keeps our commercial real estate prices down and adds stability to the market. An increase in taxes on these companies, who owns the commercial space, would likely be passed down to the hundreds of businesses that hold leases in their buildings. As a result, these businesses would have to pass the increased cost of operating onto their customers. In other words, this measure could have a ripple effect that affects not just REITs, but also their tenants and consumers.

Finally, like any business, REITs are going to be making their decisions based on where it will be able to generate the best return on investment. By increasing the costs to doing business in Hawaii, like any business, REITs are going to be making their decisions based on where it will be able to generate the best return on investment. By increasing the costs to doing



Chamber *of* Commerce HAWAII
The Voice of Business

business in Hawaii, and diminishing the return on investment, REITs are going to look to other states to fund future projects.

In consideration of these concerns, we respectfully urge you to defer SB 2697 SD1.
Thank you for the opportunity to testify.

**WRITTEN TESTIMONY OF
GLADYS QUINTO MARRONE
EXECUTIVE DIRECTOR
NAREIT HAWAII
IN OPPOSITION TO SB 2697 SD 1
BEFORE THE HAWAII HOUSE
COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS**

**THE HONORABLE ANGUS L.K. McKELVEY, CHAIR
THE HONORABLE LISA KITAGAWA, VICE-CHAIR**

**HEARING ON SB 2697 SD 1
MARCH 13, 2020
9:45 A.M.**

Dear Chair McKelvey, Vice Chair Kitagawa and Members of the House Committee on Economic Development & Business:

Thank you for the opportunity to submit this testimony on behalf of Nareit Hawaii and its REIT members active in and that have substantial long-term investments in Hawaii. Nareit is the worldwide representative voice for real estate investment trusts—REITs—and publicly traded real estate companies with an interest in U.S. real estate and capital markets.

Earlier this year, Nareit was pleased to open its new Nareit Hawaii office. Nareit Hawaii's responsibilities include representing REITs locally, coordinating outreach to investors and the investment community in Hawaii, and working with government agencies as well as community and charitable organizations to address social issues of importance.

For the reasons discussed in more detail below, we strongly oppose, and ask you to hold, SB 2697 SD 1, legislation that would temporarily eliminate the REIT "dividends paid deduction" (DPD) "except for REITs when 100% of the [REIT's] real property is used to provide affordable housing in the State".

- **SB 2697 SD 1's enactment and elimination of the DPD would likely produce less overall revenue than current law due to: 1) little to no additional corporate income tax revenues; 2) lower GET revenue based on hotel REITs' addressing their form of operation in Hawaii including their current inter-company lease structure, 3) lower GET revenue based on decreased economic activity because of the loss of REIT investment; and 4) the expected negative impacts from COVID-19 to the economy and business revenues in Hawaii.**
- **The bill is not a revenue producing bill. According to [the Department of Taxation's statistics](#), on average, close to 70% of all Hawaii corporations pay no corporate income tax. If enacted, REITs would be expected to adjust their tax planning and begin claiming state tax deductions and credits not currently used – similar to what other non-REIT corporations already do.¹]**
- **Loss of general excise tax (GET) would likely more than offset any increase:** Federal law applicable to hotel REITs requires them to use a lease structure that results in an additional level of GET **not applicable to non-REITs**. As described below, jeopardizing this additional GET could more than offset any revenue gains.

¹ Note that Former Director of the Hawaii Department of Taxation, Linda Chu Takayama, in this Feb. 4, 2019 [interview](#) with Hawaii Public Radio ("Raising Taxes on REITs"), beginning at 10:10, stated that a similar bill would raise at best \$10 million per year. We understand that this estimate is in the process of being updated.

- **SB 2697 SD 1's enactment would risk job loss at a time when "COVID-19 will impose significant economic impacts in Hawaii,"² and the construction industry is reportedly weakening.** Hawaii can ill afford the loss of investment during this crisis. Tourism, which is the mainstay of Hawaii's economy, is under assault as visitors decide to avoid travelling and spending money in our state. Yet, Hawaii needs the jobs REITs provide in the hotel industry, construction industry, affordable rentals, and retailing. Now is not the time to set up roadblocks for businesses of any kind.
- **SB 2697 SD 1's new language "except that section 857(b)(2)(B) shall be available for real estate investment trusts where one hundred per cent of the trust's real property is used to provide affordable housing in the State" is ambiguous and difficult to implement without more definition.**

The remainder of this testimony provides additional detail and information.

REITs in Hawaii

REITs are companies that provide a way for anyone, including Hawaii residents, to own professionally managed, income-producing real estate for the long term—just like the way mutual funds let small investors buy stock in a corporation. Many local people own REITs, either as individual investors or through mutual funds and employer or union pension plans.

Many Hawaii residents may not even realize that they benefit from REITs either through mutual funds or their pension or retirement accounts. [Nareit analysis of data](#) from 2016 Federal Reserve Board Survey of Consumer Finances (SCF), the Employment Benefit Research Institute data on 401(k) equity allocations (EBRI), Census population and household counts, and Morningstar Direct data, indicates that about 47% of Hawaii households own REIT stock directly and/or through mutual funds or certain retirement accounts. There are more than 200 publicly traded REITs, and only about 30 REITs with Hawaii properties. As a result, a significant portion of REIT ownership most likely relates to REITs with properties outside of Hawaii.

REITs are long-term property holders that own, renovate, and manage affordable housing projects, commercial buildings, medical facilities, shopping centers, cell phone towers, and hotels throughout Hawaii. Examples of REIT-owned properties in Hawaii include:

² UHERO, "Interim Forecast Update: COVID-19 Will Impose Significant Economic Impacts in Hawaii" (March 11, 2020), available at this [link](#).

- the state-of-the-art Hale Pawa'a Medical Building in Downtown Honolulu (Healthcare Realty Trust);
- nearly 500 soon-to-be available [affordable housing rentals](#) at Bishop Place in Honolulu for tenants earning between 80% and 120% of area median income and workforce rentals at Moanalua Hillside apartments (Douglas Emmett Inc.)
- Pearlridge Center in Aiea, which just last year completed a \$33 million renovation (Washington Prime Group);
- Ka Makana Ali'i in Kapolei, whose revenues assist DHHL in building homes for Native Hawaiians;
- A number of hotels, including Hilton Hawaiian Village (Park Hotels & Resorts, Inc.); Fairmont Kea Lani on Maui (Host Hotels & Resorts, Inc.); and Wailea Beach Marriott Resort & Spa (Sunstone Hotel Investors, Inc.), all of which, as described below, are required to use a lease structure that generates at least \$16 million in general excise taxes to the state over what non-REITs would owe.

In addition, Brookfield Property REIT recently announced that starting in 2021, it plans to build a 550-unit residential tower with a mix of unit sizes with 110 apartments being rented to tenants earning 80% or less of the area median income.

In addition to building affordable workforce rental units, there are REITs with a social impact mission that help to keep affordable units affordable in a variety of situations including, after their housing assistance contracts expire, by providing needed equity and debt financing. This too adds to the inventory of affordable housing units in a community.

In fact, we are aware of a few social impact REITs that have been interested in investing in affordable housing in Hawaii. They have bid on properties in the past and remain interested in investing in affordable housing in Hawaii as part of their mission.

Thus, REITs can help contribute to community needs in many ways— very specific priority needs like housing and education, beyond providing jobs and increasing economic activity in Hawaii.

REITs also have increased student housing opportunities at the University of Hawaii. EdR developed the Hale Mahana apartments at the University of Hawaii at Manoa. American Campus Communities also redeveloped Frear Hall for the University of Hawaii a number of years ago.

However, retaining the DPD in Hawaii is critical to attracting this new REIT activity to our state. With every other state with a corporate income tax but one honoring the DPD, Hawaii would not be competitive for these REIT investments, should the DPD be repealed. Other states would be a much more attractive investment locales for these REITs which own investments throughout the U.S. At a time when Hawaii has many basic needs for its working residents, Hawaii needs to encourage REITs to

continue to provide jobs for Hawaii's residents, and to continue to support broader community needs both through their business activities, other forms of tax revenue that they pay to the state and counties, and their charitable activities.

SB 2697 SD 1's Enactment Would Produce Less State Tax Revenue than Current Law

According to the Department of Taxation's statistics on business income taxes, on average, close to 70% of all Hawaii corporations pay no corporate income tax in a given year. If enacted, REITs would be expected to adjust their tax planning and begin claiming state tax deductions and credits not currently used. Both UHERO and the Council on Revenues are predicting an economic downturn, particularly due to COVID-19. Accordingly, corporate income tax revenues, which are particularly volatile, are likely to decrease significantly, as they did in 2009-10 following the financial crisis.

Because of unique requirements applicable to lodging REITs, essentially resulting in an additional level of GET, the state received more than \$16 million in annual GET in 2018 alone just from hotel REITs in Hawaii that non-REIT hotel owners wouldn't owe.

- Federal law requires that lodging REITs—**unlike non-REIT hotel owners**—to lease their hotels either to an unrelated company or to a fully taxable REIT subsidiary at market rent that must hire an unrelated hotel operator (like Marriott or Hilton).
- Park Hotels & Resorts, Inc.'s' [testimony](#) (on page 28 of the posted testimony) with respect to a similar bill, [SB 2409](#), said this extra GET was over \$9 million more than a non-REIT would pay in GET—and that is just one hotel REIT. When aggregated with other REIT hotel owners in Hawaii, this additional GET is estimated to have **exceeded \$16 million in 2018**.
- And as a tax on gross receipts rather than a tax on net income, the GET is a very stable source of almost half of state revenues and compared with the corporate income tax (around 1-3%) (For example, see data from Council on State Revenues for [FY 2019 To FY 2025](#)). **SB 2697 SD 1's enactment would seriously endanger this extremely valuable source of GET revenues to the state.** Not only that, enactment also would put at risk the revenues and jobs created by non-hotel REITs that invest in the state.
- Given the risk of losing up to \$16 million in GET annually, and the risk of lost jobs, it would not be prudent to enact SB 2697 SD 1.

SB 2697 SD 1 Enactment Would Risk Job Losses for Hawaii Residents

SB 2697 SD 1 risks significant job loss at a time when the construction industry is reportedly weakening. Enactment of SB 2697 SD 1 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 (who invest significantly in real estate), and loss of revenue and the stability of hundreds of the jobs generated by REITs to the state. These existing and potential jobs belong to real people. Is it fair to risk significant job loss by enacting this proposal, particularly in light of the March 11, 2020 UHERO report that COVID-19 will result in “job losses of nearly six thousand workers by the third quarter of this year, and a very restrained pace of hiring for the next several years” and [DBEDT's report](#) to the Hawaii Senate Ways & Means Committee and House Finance Committee on Jan. 7, 2020 that the construction industry is weakening?

Enacting this proposal would signal Hawaii's discouragement of long-term capital investment in the state. REITs provide sorely needed investment capital to Hawaii. If this measure is passed it is very likely that potential REIT and non-REIT investors, fearing unexpected law changes post-investment, would choose to deploy their capital elsewhere, and Hawaii would be on the outside looking in.

Hawaii's significant economic growth over the past several years is, and we hope into the future, will be, in large part a direct result of REIT investment. The popular new addition to Ala Moana Center was made possible by REIT funding. That project alone was estimated to have brought in more than \$146 million in state revenue in 2016. Since completion, the additional retail sales produced some estimated \$33 million in GET revenue for the state, along with 3,000 new jobs.

Hawaii residents have benefitted from REIT investment, which made possible dining at the Cheesecake Factory at Ka Makana Ali'i or taking their family to Wet'n'Wild, or going shopping at Pearlridge, more eating choices and better Waikiki parking opportunities with the redevelopment of the International Market Place, not to mention the financial benefits to the Queens Health System, which is the landowner.

These jobs and tax revenue would not be here without REIT funding. REIT investment continued during the recession we recently experienced. While regular investors shied away from redevelopment, REITs continued to build and improve their properties, providing a boost to the state's local economy through needed construction jobs and later retail jobs for the completed projects.

Contrary to its goals of fairness, SB 2697 SD 1's enactment would impose obligations and liabilities on REITs that are not imposed on non-REIT corporations or partnerships

Contrary to the goals of “fairness,” enactment of SB 2697 SD 1 would be anything but fair by imposing additional obligations and liabilities on REITs not imposed on non-REIT corporations or partnerships.

Specifically, REITs are just corporations or business trusts that file a tax return with the IRS electing REIT status. If they comply with the many requirements imposed on REITs, among them, being widely-held (no family-owned, closely-held businesses); investing mostly in real estate; not “flipping” properties (or paying a 100% tax on gains if they do) and distributing all of their income, they can deduct their distributions from their taxable income. As a result, their income is taxed at the investor level—like that of partnerships. If they don’t meet these requirements, they are taxed at the entity level like non-REIT corporations, and then again at the shareholder level when their income is distributed. Non-REIT corporations and partnerships aren’t subject to the burdens and obligations imposed on REITs; most importantly, unlike REITs, they can retain their profits.

If enacted, SB 2697 SD 1 wouldn’t eliminate the requirements applicable to REITs—they would still need to be widely held, invest mostly in real estate; distribute all of their income, and not flip properties, but these requirements would not apply to non-REIT corporations or partnerships. Despite being subject to these requirements, REITs would be unable to claim the DPD in Hawaii with respect to distributed income. Thus, although non-REIT corporations and partnerships in Hawaii could retain 100% of their income; REITs in Hawaii would be required to distribute at least 90% of their income, and both would be unable to claim a DPD.

SB 2697 SD 1 would not change the tax exemption of other entities that earn rental income from real property such as tax-exempt pension funds and endowments, who invest in rental real estate through partnerships, sometimes along with REITs, and pay no income tax on their earnings from those properties.

Finally, because REITs generally have no income tax liability, they generally do not claim tax credits, and they cannot pass through credits or losses to investors. Non-REIT corporations and partnerships can and do claim tax credits, and partnerships can pass through credits and losses to investors.

SB 2697 SD 1’s “Affordable Housing” Language is Ambiguous and Would be Difficult to Implement

The bill would permit the DPD “for real estate investment trusts where one hundred per cent of the trust’s real property is used to provide affordable housing in the State.”

Does “real property” refer to only real property in Hawaii? If a business owns part of an affordable housing project in Hawaii, but also owns real property in 48 other states, will that business be precluded from the exemption? Moreover since REIT ownership is in its “stock” not in its real property, if a business owns an affordable project in Hawaii but has other investments in other types of property in

other parts of Hawaii or in other states, does that preclude the use of the exemption? Unless the term “real property” is adequately defined the exemption may be without effect.

If a business owns a mixed use facility with commercial and affordable housing does that preclude use of the exemption? If a project generates income for use of a non-profit hospital is that less of a public service than affordable housing? Is healthcare less important than housing?

What is “affordable housing”? Long debated in Hawaii, the classifications are varied and numerous and should be defined. Is the legislature deferring this definition to the Department of Taxation? In such case, the legislature should provide clear guidelines as to the group or groups being targeted.

SB 2697 SD 1 Would Violate Core State Comity Principles

SB 2697 SD 1 would be contrary to federal income tax rules and the existing laws of virtually every other state with an income-based corporate tax system. Virtually every state with an income-based tax system, including Hawaii currently, allows REITs a deduction for dividends paid. (New Hampshire is the only state with income-based corporate tax that does not permit a DPD. New Hampshire has much less REIT investment than Hawaii despite having a similarly sized economy). Additionally, Hawaii currently taxes all REIT dividend income received by Hawaii resident shareholders, regardless of where the REIT's real estate is located or the REIT does business.

Please Hold SB 2697 SD 1

For the reasons described above, Nareit Hawaii requests the Committee to hold SB 2697 SD 1.

SB-2697-SD-1

Submitted on: 3/12/2020 9:33:02 AM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Catherine Susan Graham	FACE/Housing Now Coalition	Support	Yes

Comments:

Aloha Chair McKelvey and Committee Members,

As you know, Faith Action for Community Equity strongly supports the taxing of REITs as corporations here in the state of Hawaii. We are in agreement with the SD1 of waiving the tax for REITs that provide affordable housing.

This is both an economical issue (more taxes for State programs, projects, etc) and an ethical and moral issue. Hawaii's beauty and land are its natural resources. Now REITs are benefitting from these resources without paying their fair share and the state and her residents are suffering.

Please pass this bill as quickly as possible so we can get it to the Governor by April 16. If he chooses to veto it again, the Legislature will have the opportunity to overturn his veto.



ALEXANDER & BALDWIN
PARTNERS FOR HAWAII

**SB 2697 SD1
RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS**

**PAUL T. OSHIRO
DIRECTOR – GOVERNMENT AFFAIRS
ALEXANDER & BALDWIN, INC.**

MARCH 13, 2020

Chair McKelvey and Members of the House Committee on Economic Development
& Business:

I am Paul Oshiro, testifying on behalf of Alexander & Baldwin (A&B) on SB 2697 SD1, “A BILL FOR AN ACT RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS.” We respectfully oppose this bill.

While A&B has always been a Hawaii-based company, in 2012, A&B made a strategic decision to be 100% Hawaii-based and to migrate its mainland investments back to Hawaii. Since then, A&B has sold all of its mainland properties and has reinvested the proceeds in Hawaii—acquiring properties including the Kailua Town commercial center, Manoa Marketplace, Waianae Mall, Laulani Village (Ewa Beach), Puunene Shopping Center (Maui), and Hokulei Village (Kauai). In 2017, to better support our Hawaii-focused strategy and increase our ability to invest in Hawaii in an increasingly competitive environment, A&B made the decision to convert to a real estate investment trust (REIT). A REIT structure enables A&B to attract new investors to its stock, giving us capital to invest in our Hawaii-focused strategy, and puts us in a better position to compete with large, out-of-state investors, with greater sources of capital, for the acquisition of Hawaii properties,

thus keeping them in locally-owned hands, with a management team that lives here and is committed to Hawaii. Furthermore, REITs are structured to be long-term holders of real estate, thus complementary to A&B's goal of being Partners for Hawaii, with a long-term commitment to our communities.

Real estate investment trusts were established by Congress in 1960 to enable all types of investors to invest in real estate. REITs generally own, operate, and finance income-producing commercial real estate such as shopping malls, hotels, self-storage facilities, theme parks, and apartment, office, and industrial buildings. Other REITs provide financing for income-producing real estate by purchasing or originating mortgages and mortgage-backed securities, which provides liquidity for the real estate market.

In Hawaii, REIT investments help communities grow through the development of workforce rental housing, medical facilities, shopping centers, and commercial buildings that enhance our quality of life. REITs own high-quality office, retail, and industrial space, which provide a favorable environment for numerous locally owned businesses to operate and grow. These REIT owned facilities also provide numerous employment opportunities and jobs for Hawaii's residents.

BILL WILL RESULT IN DOUBLE TAXATION OF SHAREHOLDER DIVIDENDS

The purpose of this bill is to disallow the dividend paid deduction for real estate investment trusts. At present, all states except for one (New Hampshire) allow REITs to pass through its federally mandated shareholder dividend distribution without the imposition of a corporate tax, as individual shareholders are responsible to pay the tax on these dividends. The disallowance of the dividend paid deduction will result in the double taxation of Hawaii REIT shareholder dividends. This will essentially result in Hawaii REITs

continuing to distribute, as mandated by Federal Law, at least 90% of their taxable income to shareholders. However, unlike the other states, the REIT will also pay Hawaii corporate income tax prior to making the dividend distribution to its shareholders, thus reducing the amount of dividends shareholders will receive. In addition, shareholders of Hawaii REIT properties will also continue to be responsible to pay income tax on the distributed dividends—a second tax on the same profits.

If REITs and their investors are double taxed in Hawaii, it is likely that investors may shift their investments to other states where a better return on their investments can be realized. This will result in REITs spending and investing less money in Hawaii to operate, maintain, and enhance their properties. Hawaii's economy will inevitably be negatively impacted should the dividend paid deduction be disallowed.

NEGATIVE IMPACT ON HAWAII'S ECONOMY

REITs provide a much-needed source of outside capital for Hawaii. Very few individual investors and a fairly small number of corporate players in Hawaii have capital market access equivalent to what is enabled by REITs. REITs bring this externally raised capital to invest in, develop, and enhance properties here in Hawaii. In addition, REITs continually invest during both good and bad economic times, thus softening the impact of recessions and local economic downturns.

Today, only New Hampshire disallows the REIT dividend paid deduction. If this bill is enacted into law, REITs and their investors may prefer to invest in states other than Hawaii. Hawaii, along with REITs with properties in Hawaii, will be at a competitive disadvantage in attracting additional investors and capital to support continued investment, economic development, and growth in our state. When combined with the direct reduction

in general excise and income taxes from diminished REIT related construction, fewer jobs, and the reduction in business and individual income taxes because of the direct and indirect impacts of lower REIT related activity, this bill poses a significant risk to the health of the state's overall economy.

Based on the aforementioned, we respectfully request that this bill be held in Committee. Thank you for the opportunity to testify.

SB-2697-SD-1

Submitted on: 3/10/2020 9:55:03 AM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
lynne matusow	Individual	Oppose	No

Comments:

Why don't you stop playing sunset games? If there is a sunset, there should be a sunrise, which doesn't exist. Just kill the bill now instead of giving it three years of life. I am a REIT shareholder who lives in the state of Hawaii and I resent your monkeying around with my income. The bill says some REIT shareholders live in Hawaii but a substantial majority do not. What are the numbers?

Just kill the bill now so we can go on with our lives.

lynne matusow

SB-2697-SD-1

Submitted on: 3/10/2020 12:36:47 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Ellen Godbey Carson	Individual	Support	No

Comments:

I am writing in SUPPORT of SB2697, with a request for an amendment. Real Estate Investment Trusts (REITs) should pay taxes in Hawaii for their profits earned off Hawaii properties. The loophole in our laws that has failed to tax REITS in the past has led to a large erosion in our tax base, since REITs own major commercial properties in Hawaii that are escaping our corporate tax laws, while all other corporations pay corporate tax. That loophole should be closed. **This bill should be amended to dedicate a major portion, up to 100% of its tax revenues, to the creation of affordable housing in Hawaii.** With that amendment, I would be in full support of this bill.

SB-2697-SD-1

Submitted on: 3/10/2020 3:38:17 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Robin Hart	Individual	Support	No

Comments:

I SUPPORT SB2697

REITs earn an estimated \$1 billion in profits annually in Hawaii. Applying Hawaii's corporate tax to REITs would result in an estimated \$60 million in tax revenue to the State. Those funds should be applied to reducing the enormous shortage of housing that is affordable to low- and middle-income residents. Some efforts are being made to build affordable housing, but much greater efforts must be made because the shortage is so great and the cost to develop housing is so high. Notably, this bill exempts REITs whose real property is used to provide affordable housing.

The application of REIT tax revenue to affordable housing is consistent with a study entitled, "The Housing Action Plan Final Report to the State Legislature," which was funded by the Legislature and issued in 2017. Among the financing ideas is the dedication of new tax revenue for affordable/workforce housing or infrastructure, with the funds kept separate from the general fund.

Testimony of
Paul H. Brewbaker, Ph.D., CBE
Kailua, Hawaii
March 13, 2020

Opposing SB 2697, SD1 (SSCR3095)
RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS

Hawaii State Legislature House of Representative
Committee on Economic Development & Business

Drop S.B. 2697, a testament to the persistence of bad economic ideas. S.B. 2697 seeks to eliminate a dividends-paid deduction authorized by the U.S. Congress 60 years ago in creating Real Estate Investment Trusts (REITs). This tax protocol, to which 49 states adhere, democratizes ownership of commercial real estate through mutual fund-like, pass-through, S-corporate structures. REITs dismantled the monopoly power of wealthy developers and families with concentrations of real estate holdings and associated political power in the mid-20th century. Hawaii's S.B. 2697 seeks to revive monopoly power of small numbers of wealthy local developers or landowners for the political benefit of its sponsors and its misguided nonprofits' benefactors. S.B. 2697 will erode the contestability of commercial real estate markets in Hawaii, which is enhanced by the presence of REIT investors. S.B. 2697 is bad policy favoring a couple Hawaii developers who support this bill publicly on behalf of others who won't show up.

My economic analysis of REIT investments' economic impacts on Hawaii as a consultant to the National Association of REITs (NAREIT) about five years ago, in collaboration with its chief economist at the time, Brad Case, documented magnitudes and scope of REIT investments in Hawaii which probably wouldn't have happened were they not structured as pass-throughs, their net incomes *only* taxed once. The report quantified REITs' economic impacts in terms of the usual measures: gross product, employment and associated earnings, and tax revenue. It was a reminder, as learned in undergraduate economics courses, that taxing capital twice is dumb.

The NAREIT report observed that a tax rate of zero (in 49 states) established a level playing field, but a positive tax rate (in one of them, Hawaii) would be a disincentive to investment *in that one state*. REIT-associated economic activity already generates significant tax revenues in Hawaii. Five years ago I estimated that REIT-based investment activity in Hawaii was associated with \$95 million in state tax revenue, and with \$184 million over five years of REIT-led economic recovery in Hawaii, 2010-2014. In 2014 alone REIT-based activities yielded state taxes exceeding that year's Hawaii corporate net income tax revenue of \$66 million. Simply put, the assertion that REITs do not generate Hawaii tax revenue is false.

The report documented more than 9,000 individual Hawaii investors and dozens of Hawaii advisers and institutions which received more than \$105 million REIT dividends annually, generating \$9 million in state taxes. At that time, comprising only a *partial* enumeration from public data, these investors included the Hawaii Employer-Union Benefits

Trust Fund (EUTF), University of Hawaii 403(b) Plan, the Hawaiian Airlines Pension Master Trust, Hawaii Pacific Health Savings Plan, Kamehameha Schools, Queen's Health Systems (Pension Plan, Land Company Endowment Fund, and Retirement Plus Plan), Hawaii Community Foundation, Office of Hawaiian Affairs, and City & County of Honolulu 457 Deferred Compensation Plan. Thousands more investors *in Hawaii* were unidentifiable because of the structure of their investment vehicles.

Every state except one conforms to federal income tax rules allowing widely-held and/or publicly traded REITs (and mutual funds) to deduct their dividends paid to shareholders. Hawaii might not collect income taxes from REIT shareholders outside the state, but Hawaii *does* collect income taxes from residents who own REIT shares on income from *properties* located outside the state. This is true even if, *as in the majority of cases*, a REIT does no business in and owns no properties in Hawaii.

At best, revenue estimates from double-taxing REITs in Hawaii are ambiguous, ranging from the possible (\$9 million), to the unrepresentative (\$36 million (DBEDT 2014)) to the ridiculous (\$65 million; this bill). The report that the legislature commissioned DBEDT to write, contemporaneously and non-collusively with respect to my report, used an unrepresentative, single tax-year experience to calibrate ongoing annual revenue consequences of withdrawing the dividends-paid deduction on REIT investments in Hawaii. Every subsequent estimate I have seen uses this intellectually dishonest methodology. The estimate in this bill is a fiction.

Such estimates are based on the assumption that investments are inert, that they do not change regardless of variations in the user cost of capital. Yet changes in the effective tax rate are one of the most significant factors in the user cost of capital.¹ DBEDT assumed that when the user cost of capital is changed because of an increase in the effective tax rate investors *continue to behave as if the user cost of capital did not change*. DBEDT calibrated to an unrepresentative tax year an estimate of effects of a change in one parameter—the effective tax rate—and applied it under the hypothesis that behavior is unaffected by changes in the tax rate. S.B. 2697 is premised on this bogus logic.²

You can't have it both ways. Either REITs invest in Hawaii *because* their behavior *is* responsive to economic variables, or REITs invest in Hawaii because their behavior *is not* responsive to economic variables. It can't be both. If REITs invest in Hawaii because they *are* responsive, then a tax increase which induces them to *disinvest* will not generate the same tax revenue as when REITS do *not* respond to economic variables. If REITs responded to economic

¹ Typically, the other main factors are the risk-free rate of interest, the depreciation rate, and a risk premium.

² SB 2697 reads, in its SECTION 1, "A 2016 analysis conducted by the Department of Business, Economic Development and Tourism concluded that the State had foregone about \$36 million in income tax in year 2014, and that the amount of real estate investment trust investments has risen substantially since 2014." It asserts that "The legislature further finds that real estate investment trusts in Hawaii. . . , if taxed, at the current corporate rate assessed to all other corporations, would generate Hawaii taxes of \$65 million per year." Testimony by the Hawaii State Teachers Association, citing *property tax* differentials as a causal factor in REIT investments in Hawaii, concluded likewise that changing corporate net income tax rates *would not be* a causal factor in REIT investments. Which is it? Taxes *are* causal, or are *not* causal?

variables by investing in Hawaii, then double-taxing REITs will lower investment and will reduce tax revenue. This legislation finds that REITs responded to economic variables by investing in Hawaii, but that double-taxing REITs will *not* change investment and will increase tax revenue. Wait, what? They can't respond *and not respond*.

The only good estimate I've seen of REIT double taxation, derived from a dynamic computable general equilibrium model calibrated to Hawaii's economy, yielded virtually nothing in additional State tax revenue: short-term gains from double taxation were essentially negated by long-term losses from foregone investment.³

Higher effective taxes could lead REIT capital to abandon Hawaii and swarm to the 48 states where the user cost of capital has not changed, or lead to ownership changes which thwart S.B. 2697's revenue aspirations.⁴ If REIT-based capital is immobile, then nothing will change *because* capital is immobile by assumption. But capital doesn't just sit there. Capital is mobile. S.B. 2697 assumes the *opposite* of what's true. It is a tax policy change that will make people in Hawaii worse off by reducing investment or—at best—induce changes in the market for corporate control which will leave tax revenues unchanged.

For-profit C corporation entities which retain earnings *rather* than distributing their net income in taxable dividends already have the ability to acquire or build such properties as REITs' investments. C-corps' optimizing decisions, retaining corporate net income rather than declaring and distributing it as taxable individual income, also are influenced by the tax regime. It is not "unfair" for C-corps to pay taxes when S-corps do not, as some religious groups assert. C-corps simply could distribute their retained earnings as dividends, or form a REIT. If they choose not to when that choice is available, they must already consider themselves better off. They could have chosen differently but didn't. There is nothing unfair about that.

SECTION 1 of S.B. 2697 reveals a logical flaw contradicting the interstate commerce principle. It reads, in part, "Existing state law conforms to [federal] provisions, but creates an anomaly because a real estate investment trust that does business in Hawaii, but pays dividends to shareholders out of the state, results in no Hawaii income tax collected either from the real estate investment trust or from its shareholders, due to the fact that shareholders pay any tax on dividends to the state in which they reside, not where the income was generated." This is true in 49 states. You can't tax their residents; they can't tax yours. It's not an anomaly if it's true everywhere.⁵

³ Using a dynamic computable general equilibrium model, we consultants experimentally simulated tax consequences. The present value of long-term tax revenues foregone from lower investment (plus disinvestment) negated the present value of short-term revenue gains from the higher effective tax rate implied by withdrawal of the dividends-paid deduction. REIT investors have 48 states into which capital will be redeployed from Hawaii, inducing capital outflow, requiring dynamic economic modeling for tax policy analysis.

⁴ The most likely next class of investors to whom REITs would sell would be non-taxable entities such as pension funds, certain insurance companies, and university endowments.

⁵ The only anomaly is the (one) state which is the exception rather than the rule. Why be that state?

SB-2697-SD-1

Submitted on: 3/11/2020 12:35:32 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Nanea Lo	Individual	Support	No

Comments:

Hello,

I am a member of Faith Action for Community Equity and I strongly support this bill. Please pass SB 2697 and close the loophole that exempts REITs from paying state corporate income tax. REITs already get a generous federal tax break and benefit from Hawaii's low property tax. They can operate and thrive in Hawai'i while paying state income tax, as every other Hawai'i corporation does. REITs operating in Hawaii need to do their part in supporting our community by paying their fair share of state taxes.

Mahalo for this opportunity to provide testimony in support of SB 2697.

me ke aloha 'Ä• ina,

SB-2697-SD-1

Submitted on: 3/11/2020 1:25:50 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Marian Heidel	Individual	Support	No

Comments:

Aloha, I am a member of Faith Action for Community Equity and I strongly support this bill. Please pass SB 2697 and close the loophole that exempts REITs from paying state corporate income tax. REITs already get a generous federal tax break and benefit from Hawaii's low property tax. They can operate and thrive in Hawai'i while paying state income tax, as every other Hawai'i corporation does. REITs operating in Hawaii need to do their part in supporting our community by paying their fair share of state taxes.

Mahalo for this opportunity to provide testimony in support of SB 2697.

Marian Heidel

Kailua, HI 96734

SB-2697-SD-1

Submitted on: 3/11/2020 2:51:27 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Michael deYcaza	Individual	Support	No

Comments:

SB-2697-SD-1

Submitted on: 3/11/2020 5:46:44 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Steven Costa	Individual	Support	No

Comments:

SB-2697-SD-1

Submitted on: 3/11/2020 5:47:36 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Carla Allison	Individual	Support	No

Comments:

Aloha, I am a member of Faith Action for Community Equity and I strongly support this bill. Please pass SB 2697 and close the loophole that exempts REITs from paying state corporate income tax. REITs already get a generous federal tax break and benefit from Hawaii's low property tax. They can operate and thrive in Hawai'i while paying state income tax, as every other Hawai'i corporation does. REITs operating in Hawaii need to do their part in supporting our community by paying their fair share of state taxes. Mahalo for this opportunity to provide testimony in support of SB 2697.

SB-2697-SD-1

Submitted on: 3/11/2020 6:06:57 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Ashleigh Loa	Individual	Support	No

Comments:

Aloha, I am a member of Faith Action for Community Equity and I strongly support this bill. Please pass SB 2697 and close the loophole that exempts REITs from paying state corporate income tax. REITs already get a generous federal tax break and benefit from Hawaii's low property tax. They can operate and thrive in Hawai'i while paying state income tax, as every other Hawai'i corporation does. REITs operating in Hawaii need to do their part in supporting our community by paying their fair share of state taxes. Mahalo for this opportunity to provide testimony in support of SB 2697.

SB-2697-SD-1

Submitted on: 3/11/2020 7:16:45 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Mark K.Wilson III	Individual	Support	No

Comments:

Dear members of the House Committee on Economic Development & Business,

As a concerned voter and a member of Faith Action for Community Equity, I strongly urge you to support SB2697. I was delighted when our legislature passed a similar bill last year and terribly disappointed when the Governor vetoed it. Simple justice would require REITs operating in our state, like every other Hawaii corporation, to pay state corporate income tax. Last year our legislators recognized this, and I hope you will do so again. Despite any pressure to give REITs an unfair advantage, please don't give up on doing the right thing. Maybe you will inspire the Governor to do the right thing as well!

Mahalo,

Mark Wilson

SB-2697-SD-1

Submitted on: 3/11/2020 7:30:39 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Kathy Jaycox	Individual	Support	No

Comments:

Aloha and thank you for this opportunity to submit testimony in support of SB2697, SD1.

As a member of Faith Action for Community Equity, I strongly support this bill, which will close a loophole that exempts REITs from paying corporate income tax. My understanding is that REIT shareholders pay income tax on the profits they earn -- but 99% of Hawaii's REIT shareholders live outside of Hawaii. So we are allowing REITs to benefit from our low property taxes and to utilize our resources without contributing their fair share to the cost of doing business here. This is just one of many reasons why the cost of living here is continuing to drive our own people out of state.

Thank you for this opportunity to provide testimony.

Kathy Jaycox

SB-2697-SD-1

Submitted on: 3/11/2020 11:43:30 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Robert H Stiver	Individual	Comments	No

Comments:

I have advocated state taxation of REITs for two years. As a member of Faith Action for Community Equity strongly supporting this bill, I ask that you see reality and seize the moment to gain additional tax revenue for good purpose. Please pass SB 2697 and close the loophole that exempts REITs from paying state corporate income tax. REITs already get a generous federal tax break and benefit from Hawaii's low property tax. They can operate and thrive in Hawai'i while paying state income tax, as every other Hawai'i corporation does. REITs operating in Hawaii need to do their part in supporting our community by paying their fair share of state taxes. Mahalo for this opportunity to provide testimony in support of SB 2697.

SB-2697-SD-1

Submitted on: 3/12/2020 9:45:09 AM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Valerie Wayne	Individual	Support	No

Comments:

The role of government is to create an infrastructure that supports business activity in general and to maintain a level playing field so that all businesses can compete fairly among each other.

The Hawaii State Legislature has passed legislation that conforms Hawaii tax law with the Internal Revenue Code to ease the administration of State taxes. In a number of cases, however, when the State would have been adversely affected, the Legislature has made exceptions to the Internal Revenue Code.

The State adopted the federal REIT model in its entirety decades ago. By doing so, the State has, perhaps unintentionally, given a competitive advantage to REITs. They are for-profit corporations, but they do not pay a tax on their profits as others do. For the sake of equity and fairness, REITs should be required to pay taxes on their profits.

The application of REIT tax revenue to affordable housing is consistent with a study entitled, "The Housing Action Plan Final Report to the State Legislature," which was funded by the Legislature and issued in 2017. Among the financing ideas is the dedication of new tax revenue for affordable/workforce housing or infrastructure, with the funds kept separate from the general fund.

This bill should be amended to separate the REIT tax revenue from the general fund and to dedicate it to the creation of affordable housing in Hawaii. We suggest the Rental Housing Revolving Fund. With that amendment, the Church of the Crossroads supports this bill.

Valerie Wayne



OPTrust

OPSEU Pension Trust

Fiducie du régime de
retraite du SEFPO

March 13, 2020

The Honorable Angus McKelvey, Chair
And Committee Members
Committee on Economic Development & Business
House of Representatives
415 S. Beretania St., #309
Honolulu, HI 96813

LATE

Dear Chair McKelvey and Committee Members:

RE: SB2697 SD1 Relating to Taxation of Real Estate Investment Trusts

My name is Andrew Alcock, Director, Real Estate Investments, OPTrust, testifying in strong opposition to SB2697 SD1 Relating to Taxation of Real Estate Investment Trusts. OPTrust is one of Canada's largest pension funds with net assets of over \$21 billion CAD. The trust administers a defined benefit plan with over 96,000 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. One of the deciding factors in OPTrust making its investment in Ka Makana Ali'i, was 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. By way of example, there is only one State in the United State of America (New Hampshire) which does not permit the REIT dividend deduction. 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. Disallowing the dividends paid deduction for REIT's will result in the double taxation on REIT income and will place Hawaii at a disadvantage compared to other states when it comes to attracting investor capital. Disallowing the deduction would prevent numerous investors from investing in the State of Hawaii, resulting in far fewer development projects and less low-income housing.

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(Toronto calling area)

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{00425428.1}

www.optrust.com

Should this bill pass, OPTrust would be forced to direct its investment capital elsewhere. Unfortunately, we also understand and recognize that any changes in the law will have a very undesirable effect on DHHL and impact any income that they receive to further their efforts to build housing and provide programs for their beneficiaries.

Further, as we are all experiencing, the coronavirus is impacting economies all over the world. As the coronavirus continues to grow, we can all expect to be affected by businesses shutting down to address health concerns. You already know that the State will lose over 6,000 jobs and the Council on Revenues has predicted little or no tax growth, meaning State revenues have taken a sharp downward turn.

The dividends that are paid out by REITs provide income to everyday people such union workers, retirees, and teachers. Passage of this bill will impact the amount of revenue that everyday people receive. With the world's economy in limbo, passing this bill will create more economic uncertainty to the numerous individuals who receive dividends through their pension funds and other investments.

We urge you to strongly oppose SB 2697 SD1, so that projects such as Ka Makana Ali'i can continue to be built and enhance not only Hawaii's economic growth but continue to provide DHHL with the means to provide more for the native Hawaiian community, Hawaii's community at large, and for the everyday people who receive income from their savings.

Yours truly,

A handwritten signature in dark ink, appearing to read 'Al Alcock', followed by a horizontal line extending to the right.

Andrew Alcock



HAWAII LABORERS-EMPLOYERS COOPERATION AND EDUCATION TRUST
650 Iwilei Road, Suite 285 • Honolulu, HI 96817 • Phone: 808-845-3238 • Fax: 808-845-8300 • URL: hilecet.org

LATE

March 12, 2020

**HAWAII STATE HOUSE OF REPRESENTATIVES
COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS**

**Honorable Angus McKelvey, Chair
Honorable Lisa Kitagawa, Vice Chair**

**DATE: Friday, March 13, 2020
TIME: 9:45 A.M.
PLACE: Conference Room 309
State Capitol
415 S. Beretania Street
Honolulu, HI 96813**

RE: OPPOSED TO SB2697 SD1 - RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS

Aloha Chair McKelvey, Vice Chair Kitagawa, and members of the Committee on Economic Development & Business:

The Hawaii Laborers-Employers Cooperation and Education Trust (LECET) is a labor-management partnership between the 5000+ members of the Hawaii Laborers' International Union of North America Local 368 and its 250+ unionized contractors. The Laborers' International Union of North America is the largest construction union in the United States.

Hawaii LECET OPPOSES SB2697 SD1, which disallows a dividends-paid deduction for real estate investment trusts ("REITS") and imposes a state corporate income tax on REITS. This bill would negatively impact those that invest in real estate through REITS and subject them to a double taxation. Passage of SB2697 SD1 will also have the unintended consequence of curtailing development of affordable housing projects. Had a bill such as SB2697 SD1 been enacted, projects such as Moanalua Hillside workforce housing and Kapolei Lofts rental housing, as well as large-scale development projects like Kamakana Ali'i shopping center, may not have been built. Hawaii LECET asks for your consideration and opposition to SB2697 SD1.

Mahalo,

**Hawaii Laborers-Employers Cooperation
and Education Trust Fund**



LIUNA!

LATE

HAWAII LABORERS UNION (LIUNA) LOCAL 368
1617 Palama Street
Honolulu, Hawaii 96817

PETER A. GANABAN
*Business Manager/
Secretary-Treasurer*

ALFONSO OLIVER
President

JOBY NORTH II
Vice President

TONI FIGUEROA
Recording Secretary

JAMES DRUMGOLD JR.
Executive Board

ORLANDO PAESTE
Executive Board

JOSEPH YAW
Executive Board

MARTIN ARANAYDO
Auditor

RUSSELL NAPIHA'A
Auditor

MARK TRAVALINO
Auditor

ALFRED HUFANA JR.
Sergeant-At-Arms

House Committee on Economic Development and Business
Hawaii State Capitol, 309
Friday, March 13, 2020
9:45 a.m.

RE: OPPOSE: Senate Bill 2697

Aloha Chair McKelvey, Vice-chair Kitagawa and Members of the Committee:

The Hawaii Laborers' Union; Local 368 stands **opposed** to SB2697.

The Laborer's Union is comprised of over 5000 working and retired men and women across the State of Hawaii.

We oppose SB2697 because of its potential to harm Hawaii's construction industry and, ultimately, the state's economy, if enacted into law. It is our position there is no valid rationale that makes economic sense for this bill to become law and upend how Real Estate Investment Trusts (REITs) operate in Hawaii.

REITs have proven to be valuable contributors to the health of Hawaii's construction industry and its thousands of skilled contractors and laborers statewide. REITs have established a proven track record in Hawaii of making major capital investments in large-scale projects that benefit the community over the long term.

REITs do not flip properties to make a quick buck. In contrast, REITs can be counted on to make long-term commitments to ensure quality and craftsmanship in the projects and facilities they own, build or manage in Hawaii. This includes places that are valued by residents and local businesses, and are key to our quality of life, such as Ala Moana Center, Pearlridge, Ka Makana Alii, Manoa Marketplace, the new Hale Pawa medical facility and several affordable housing projects.

REITs also have a history of investing in Hawaii during economic downturns, a fact that has kept many construction workers employed when other projects were drying up or put on hold around the state. There are indicators that Hawaii could be heading toward another economic downturn. If that is the case, the state can continue to count on REITs investing in Hawaii projects – as long as REITs are not motivated to take their business elsewhere due to bad policy decisions.

LIUNA Local 368
1617 Palama Street
Honolulu, HI 96817
Phone: (808) 841-5877
Fax: (808) 847-7829
www.local368.org

Feel the Power

While this was true at the opening of the 2020 Legislative Session, it holds even more true at mid-session now that we are experiencing the severe economic impacts of COVID-19 and the negative effects it can have on not just our local, but global economy.

Reports now say that we are in a global recession. We should not forget, that a key economic indicator as to whether we are on the path to recovery is the health of our construction industry. When it comes to economic recessions, construction almost ALWAYS leads the way in recovery. Therefore, we feel that promoting a Bill that could serve to negatively impact the industry would be unwise during a crisis that negatively impacts our local economy.

Therefore, on behalf of the over 5000 hardworking and retired members of The Hawaii Laborers' Union; Local 368 we respectfully request that SB2697 be held.

Thank you for the opportunity to testify on this matter.

March 13, 2020

The Honorable Angus L.K. McKelvey, Chair
House Committee on Economic Development and Business
State Capitol, Room 309
Honolulu, HI 96813

LATE

RE: S.B 2697, SD1, Relating to Taxation of Real Estate Investment Trusts

HEARING: Friday, March 13, 2020, at 9:45 a.m.

Aloha Chair McKelvey, Vice Chair Kitagawa and Members of the Committee,

I am Ken Hiraki, Director of Government Affairs, testifying on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its over 10,000 members. HAR **strongly opposes Senate Bill 2697, SD1**, which disallows the dividend paid deduction on Real Estate Investment Trusts (REIT.)

In 1960, the United States Congress created REITs to allow all individuals, and not just the wealthy, the opportunity to invest in large-scale diversified portfolios of income producing real estate.

REITs are tied to all aspects of the economy, and have a major economic impact on our state that encompasses a full range of real estate, including:

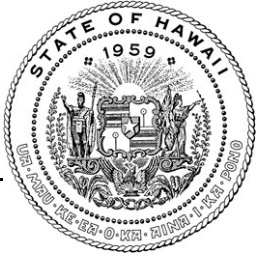
- Affordable Housing: Waena Apartments and The Lofts at Kapolei
- Student Housing: Hale Mahana Student Housing
- Healthcare Facilities: Hilo Medical Center, Kapiolani and Pali Momi Medical Center
- Retail: Prince Kuhio Plaza, Whaler's Village and Ka Makana Ali'i

REITs bring in investment to help build thriving communities where residents can live, work and play. REITs not only provide a boost to our economy through construction of these projects, but create real job opportunities.

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, which would negatively impact the economy.

Additionally, this would also impact those that invest in REIT, such as retirees who use this as part of their retirement income.

Mahalo for the opportunity to testify.



DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

DAVID Y. IGE
GOVERNOR
MIKE MCCARTNEY
DIRECTOR

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Web site: dbedt.hawaii.gov

Telephone: (808) 586-2355
Fax: (808) 586-2377

Statement of
MIKE MCCARTNEY
Director

LATE

Department of Business, Economic Development, and Tourism
before the

HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS

Friday, March 13, 2020
9:45 AM
State Capitol, Conference Room 309

In consideration of
SB 2697, SD1
RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS.

Chair McKelvey, Vice Chair Kitagawa, and Members of the Committee.

The Department of Business, Economic Development and Tourism (DBEDT) offers comments on SB2697, SD1, which would disallow dividends paid deduction for real estate investment trusts, except for real estate investment trusts that provide affordable housing in the State.

The department is concerned that the change in real estate investment trust policy may discourage business investments in Hawaii. Our position remains as it was last session, that disallowing dividends paid deductions can negatively impact investment in all areas of Hawaii's economy. The unintended consequences of imposing a corporate tax can negatively affect Hawaii's ability to attract investment capital, which creates jobs and ensures a sustainable economy.

This policy position from DBEDT is from an economic development position, and does not take into consideration the tax, fiscal and revenue policy, as it relates to the State of Hawaii.

We defer to the Departments of Taxation and Budget and Finance on fiscal and taxation aspects. We stand ready to do further analysis and review to inform decision making to ensure Hawaii's economic health.

Thank you for the opportunity to comment.

LATE

SB-2697-SD-1

Submitted on: 3/12/2020 7:28:07 PM

Testimony for EDB on 3/13/2020 9:45:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Soo San Schake	Individual	Support	No

Comments:

Aloha,

Please pass this bill to bring much needed tax dollars back into our local economy and help to keep Hawaii's profits in our state to benefit our local communities.



March 13, 2020

The Honorable Angus McKelvey, Chair
The Honorable Lisa Kitagawa, Vice Chair
and members
House Committee on Economic Development and Business
415 South Beretania Street
Honolulu, Hawai'i 96813

**RE: OPPOSITION for SB2697 SD1, RELATING TO TAXATION OF REAL ESTATE
INVESTMENT TRUSTS**

Dear Chair McKelvey, Vice Chair Kitagawa, and members:

The Hawai'i Construction Alliance is comprised of the Hawai'i Regional Council of Carpenters; the Laborers' International Union of North America, Local 368; the Operative Plasterers' and Cement Masons' Union, Local 630; International Union of Bricklayers & Allied Craftworkers, Local 1; and the Operating Engineers, Local Union No. 3. Together, the member unions of the Hawai'i Construction Alliance represent 15,000 working men and women in the basic crafts of Hawai'i's construction industry.

We are deeply opposed to this bill.

Last session we warned about the negative effects that the taxation of REITs would have on Hawaii's economy and warned policy makers about an impending slowdown of construction.

At present we are confronted with a global pandemic that is still in its infancy, and the economy has lost trillions of dollars of wealth in the last two weeks.

Tourism has ground to a halt, and we have no idea if an economic recovery is months, or even years, away.

Proposing a change to tax policy that will push away investment in Hawaii at this time is beyond the scope of reason.

Therefore, we strongly ask for your committee's deferral on SB2697 SD1.

Mahalo,

A handwritten signature in dark ink, appearing to read "Nathaniel Kinney". The signature is fluid and cursive, with the first name being more legible than the last.

Nathaniel Kinney
Executive Director
Hawai'i Construction Alliance
execdir@hawaiiconstructionalliance.org