LATE

March 18, 2014

The Honorable David Ige
Chair, State Senate Ways and Means Committee
Hawaii State Capitol, Room 208
415 South Beretania Street
Honolulu, Hawaii 96813

The Honorable Michelle Kidani
Vice Chair, State Senate Ways and Means Committee
Hawaii State Capitol, Room 228
415 South Beretania Street
Honolulu, Hawaii 96813

HEARING Thursday, March 20, 2014
Time: 9:00 am
Location: Conference Room 211
State Capitol, Honolulu, HI 96813

RE: HB 1726 HD 2 Corporate Income Tax; Real Estate Investment Trusts

Dear Chair Ige, Vice Chair Kidani and Members of the Committee,

On behalf of the Retail Merchants of Hawaii (RMH), thank you for the opportunity to provide testimony in opposition to HB 1726 HD 2, which proposes to eliminate the federal deduction for dividends paid by a Real Estate Investment Trust (REIT) for purposes of Hawaii income taxation.

RMH is a not-for-profit trade organization representing nearly 3,000 storefronts statewide. The retail industry is the largest single generator of general excise tax revenue and employs almost 20% of the workforce in the State of Hawaii. We are committed to working with multi-agency partners to foster the growth and welfare of the retail industry.

HB 1726 HD 2 would strongly discourage future investment by REITs in Hawaii, stifling the availability of capital. The premise of REITs, or real estate investment trusts, is to be a vehicle designed to allow many small investors to participate in real estate developments. Many state and local pension and retirement funds also are REIT investors. Revoking the dividend paid deduction will increase taxation to the REIT and result in double taxation of its income distributed to its shareholders which will reduce investment returns on developments by the REIT and reduce annual dividend payments to shareholders in order to pay the additional state income tax.

The newly developed International Market Place in Waikiki, Honolulu, Hawaii alone is projected to generate over $14 million annually in general excise tax (from landlord to rents and by tenants from retail sales of merchandise), over $4 million annually in property taxes, and employment of over 1,000 construction jobs and 2,500 permanent jobs (generating individual income tax).

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

RMH respectfully request the House Committee of Finance, to defer HB 1726 HD 2 in order to obtain sufficient period to allow REITs to adjust their investments in Hawaii to account for this change.

Sincerely,

Sheri N. Sakamoto

Sheri N. Sakamoto
President

LATE

701 Western Ave., Glendale, CA 91201
818.244.8080 ■ www.publicstorage.com

Hearing Date: Thursday, March 20, 2014
Time: 9:00 AM
Place: Hawaii State Capitol, Conf. Rm. 211

The Honorable David Y. Ige,
Chair, Senate Committee on Ways and Means

The Honorable Michelle N. Kidani
Vice Chair, Senate Committee on Ways and Means

Re: Testimony in Opposition to HB 1726, HD2 – Relating to Taxation

Chair Ige, Vice Chair Kidani, and Members of the Senate Ways and Means Committee:

My name is Steven Glick, Senior Vice President, Chief Legal Officer and Corporate Secretary of Public Storage, testifying in **opposition** to HB 1726, HD2.

Public Storage is a publicly-traded REIT that is the largest owner and operator of self-storage facilities in the United States, with more than 141 million rentable square feet of real estate in 38 states. We have approximately 2,200 facilities and 1.1 million tenants in the United States. We own 11 properties in Hawaii (0.05% of our U.S. facilities) that generated approximately 22 million dollars of gross revenue in 2013, resulting in over a million dollars of general excise tax revenues for the state.

HB 1726, HD2 would eliminate the "dividends paid deduction" (DPD) for Hawaii income tax purposes for all real estate investment trusts (REITs), contrary to federal income tax laws and the laws of virtually every other state that imposes a net income tax on REITs (we understand New Hampshire is the sole exception).

HB 1726, HD2 is flawed both as a matter of tax equity and, long term, revenue generation.

Regarding tax equity, the bill is flawed for the following reasons:

1. The purported problem addressed by the bill is one of an incomplete, anecdotal perception ("wealthy out-of-state investors" profiting from holding valuable Hawaii real estate in REITs that don't pay income taxes in Hawaii). It does not take into account the reality of why Congress created REITs in 1960 (*i.e.*, to enable small investors to own professionally managed, income-producing real estate, using the mutual fund model), or the numerous benefits of REIT investment in Hawaii real estate.

2. REITs are not like regular corporations and should not be treated like regular corporations. Unlike regular corporations, both REITs and mutual funds are subject to a broad array of tests designed to ensure that their income and assets are focused on real estate and securities, respectively, and that their shareholders are currently provided the benefits of those operations (and taxed on the income). As a practical matter, REITs are long-term investors that typically distribute 100% of their taxable income to their shareholders who are taxable on those earnings. For publicly-traded REITs (like Public Storage), there is no reason to think that the shareholders are disproportionately located on the mainland. And, all shareholders (whether located in Hawaii or elsewhere) will be taxable for state purposes on the dividends received (whether or not the dividend income was generated by the REIT in Hawaii or elsewhere).

3. The only real problem raised by the sole public proponent of HB 1726, HD2 (in previous hearings in the House) concerned the potential for Hawaii corporations to use captive REITs to avoid Hawaii tax, but that has already been addressed in Hawaii by the Hawaii State Dept. of Taxation through operation of relevant provisions of the Internal Revenue Code and Hawaii Revised Statutes.

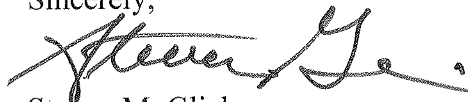
4. The bill would penalize Hawaii residents (small investors as well as large investors) who invest in REITs owning Hawaii real estate. The REITs would be taxed on their Hawaii income, but still required to distribute that income to their shareholders and Hawaii resident shareholders would again be subject to Hawaii tax on the dividends that the REITs are required to distribute.

Regarding revenue generation, HB 1726, HD2 is flawed because it would create an inequitable system of double taxation that would make Hawaii, apparently already capital-poor, less attractive for REITs to invest in. Rendering Hawaii non-competitive over the long term is not a good revenue generation strategy. If this provision is adopted, the added taxes and divergence from the REIT template can be expected to be a significant factor discouraging further investment in Hawaii by Public Storage (and, we suspect, all other REITs), leading REITs to focus their investments in states that conform to the REIT model and permit the DPD.

For all of these reasons, no state that imposes income tax upon REITs other than New Hampshire denies the federal dividends paid deduction proposed by HB 1726, HD2. Indeed, over the past decade, a number of states (*e.g.*, Idaho, Louisiana, New Jersey, North Carolina, and Rhode Island) have examined, and then ***rejected***, the disallowance of a widely-held REIT's DPD. Hawaii should also reject the disallowance of a widely-held REIT's DPD.

We respectfully request that you hold HB 1726, HD2.

Sincerely,



Steven M. Glick
Senior Vice President, Chief Legal Officer
& Corporate Secretary of Public Storage

Taubman

March 18, 2014

Honorable David Ige, Chair
Honorable Michelle Kidani, Vice-Chair
Senate Committee on Ways and Means
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill No. 1726, House Draft 2 relating to Taxation

Dear Chair Ige, Vice-Chair Kidani and Committee Members:

On behalf of Taubman Centers, thank you for the opportunity to provide our testimony in opposition to House Bill No. 1726, House Draft 2, relating to taxation. Taubman is an S&P MidCap 400 publicly-traded and widely owned Real Estate Investment Trust ("REIT") engaged in the ownership, operation, management, development and leasing of 27 regional, super-regional and outlet shopping centers in the U.S. and Asia. Taubman respectfully opposes House Bill No. 1726, House Draft 2, relating to taxation, which is being heard by your Committee on Ways and Means on March 20, 2014 at 9:00 a.m.

The purpose of House Bill No. 1726, House Draft 2, is to eliminate the federal deduction for dividends paid by a REIT for purposes of Hawaii income taxation. REITs, or real estate investment trusts, are a vehicle designed to allow many small investors to participate in real estate developments. Many state and local pension and retirements funds also are REIT investors, and include Employees' Retirement System of the State of Hawaii (ERS) and Hawaii Employer-Union Health Benefits Trust Fund (EUTF).

The elimination of the dividend paid deduction would effect a radical change in taxation of REITs. By law, REITs are required to distribute 90% of their income to shareholders. In practice, REITs normally distribute at least 100% of their taxable income. Because of the dividend paid deduction, the distributions effectively are taxed at the shareholder level by the state taxing jurisdictions in which the shareholders reside. This allows for a single level of taxation at the shareholder level and no double taxation (i.e., it prevents taxation at both the entity level and again at the shareholder level) and is consistent with the treatment of investors in mutual funds that are treated as regulated investment companies for tax purposes. Therefore, in practice, state income taxation of REITs is based on the residence of its shareholders, rather than the location of the REIT or its projects. Thus, Hawaii will receive income tax on distributions received by Hawaii residents who are shareholders in REITs that may be located outside of the State and which may have properties outside of the State. For publicly-traded and widely held REITs, this is the uniform tax treatment in virtually all states that impose an income based tax system.[1]

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[1] We have no objection to limiting the dividend paid deduction for captive or privately owned REITs. They are different than widely owned REITs since captive REITs are primarily used as a tax strategy to

Taubman

Approximately 20 publicly-traded REITs have invested over $6 billion in commercial real estate in Hawaii and are responsible for significant economic activity in the construction industry, resort industry, restaurant and retail industry, office and industrial leasing and others. Such economic activity generates substantial economic benefit for Hawaii, including providing jobs, as well as substantial tax revenues for the State government. The tax revenues include substantial general excise taxes on rents from tenants, on the sale of goods and services at retail by the tenants, and on construction activities, transient accommodations taxes on revenues from hotel operations, business income tax from profits from tenants and contractors, increased real and property taxes, and individual income tax from employment of residents of Hawaii in the construction, retail, restaurant and resort industries.

Taubman alone has committed an investment of $400 million for the redevelopment and revitalization of INTERNATIONAL MARKET PLACE in Waikiki, Honolulu, Hawaii. This project currently under construction is projected to generate over $14 million annually in general excise tax (from landlord rents and by tenants from retail sales of merchandise), over $4 million annually in property taxes, and employment of over 1,000 construction jobs and 2,500 permanent jobs, generating both general excise tax revenues from construction work, as well as individual income tax revenues from both construction and permanent jobs.

Such a policy change in taxation of REITs is likely to strongly discourage future investment by REITs such as Taubman in Hawaii, stifling the availability of capital.[2] Revoking the dividend paid deduction will increase taxation to the REIT and result in double taxation of its income distributed to its shareholders which will reduce investment returns on developments by the REIT and potentially reduce annual dividend payments to shareholders (individual investors and state and local pension and retirements funds like ERS and EUTF) in order to pay the additional state income tax (impacting shareholder returns on their investment). Thus, this measure would put Hawaii at a competitive disadvantage versus virtually every other state when trying to attract capital for investment in the State. Because investments by REITs generate so much economic activity and create so many local jobs in the State, disallowing the deduction for dividends paid not only would hurt workers in Hawaii, over the long run, it ultimately may result in less tax revenue for the State as its makes Hawaii unattractive for investment by REITs resulting in less economic activity.

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

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lower their affiliates effective income tax rate from non-real estate business activities. As suggested in NAREIT's testimony, there is Multistate Tax Commission model legislation for that purpose.

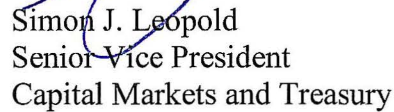
[2] As of February, 2014, there were approximately 204 publicly-traded REITs in the United States, with a market capitalization of around $700 billion.

Taubman

For the foregoing reasons, we respectfully but strongly oppose House Bill No. 1726, House Draft 2.

Thank you for your consideration of our testimony.

Very truly yours,



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March 19, 2014

Senator David Y. Ige, Chair
Senator Michelle N. Kidani, Vice-Chair
Senate Committee on Ways and Means
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill No.1726, H.D. 2

Dear Chair Ige, Vice-Chair Kidani and Committee Members:

Thank you for the opportunity to provide written testimony on House Bill No. 1726, H.D. 2, which would eliminate the federal tax deduction for dividends paid by a real estate investment trust ("REIT") for purposes of Hawaiian income taxation. We are Francis Cofran, the Senior General Manager of Ala Moana Center, the largest retail center in the state of Hawaii, and Sandeep Mathrani, the Chief Executive Officer of General Growth Properties, Inc. ("GGP"), an S&P 500 publicly traded REIT, the owner of Ala Moana Center.

GGP owns 120 shopping malls in 40 states with 124 million square feet of gross leasable space. Our mission is to own and operate best-in-class retail properties that provide an outstanding environment and experience for our communities, retailers, employees, consumers and shareholders. In addition to Ala Moana Center, GGP also owns and operates Whalers Village in Lahaina and Prince Kuhio Plaza in Hilo.

REITs are entities primarily engaged in the business of owning and operating real estate assets. Pursuant to the Internal Revenue Code ("Code"), REITs are required to satisfy certain asset and income tests (generally required to own real estate and have a substantial portion of income from real estate). The Code also requires REITs to distribute at least 90% of their taxable income as dividends. The Code treats these distributions as a deduction from taxable income. As a result, these dividends are taxed at the shareholder level in the jurisdictions in which the shareholder resides. This is the uniform tax treatment in all states, except New Hampshire where REITs do not have a substantial presence. Such tax treatment provides a consistent single-tax environment for REITs and their shareholders, a substantial portion of which are mutual funds and pension plans which ultimately are owned by individuals. If REITs are subjected to any increase in income tax burden, it will reduce distributions and subject shareholder returns to double taxation.

The elimination of the dividends paid deduction would be a fundamental change to the philosophy surrounding the taxation of REITs. REITs have a significant real estate investment in Hawaii which produces substantial economic benefits, such as jobs, general excise tax on rents from tenants, general excise tax on sales of goods by tenants, income tax on profits from tenants, real property taxes and individual income tax from employment of residents of Hawaii.

In 2013, Ala Moana Center directly provided more than 3,000 direct full- and part-time jobs. Using state tax multipliers from the official Hawaii input-output model, the state received roughly $106 million in combined tax revenues, primarily general excise tax and real property taxes. Including indirect community benefit (known as the "ripple effect"), the figure would increase to approximately $182 million in total state revenues.

As you may be aware, GGP is currently engaged in a development project in which we are investing approximately $660 million that will add approximately 650,000 square feet to Ala Moana, essentially the equivalent square footage of a new mall. The economic impact to the state of Hawaii of this development is significant. Our economic impact study indicates that over 1,300 full time equivalent construction jobs will be created for the three year construction period. Including both employment at Ala Moana and indirectly in the community, more than 3,800 full time equivalent jobs will be created once the project is finished. Our study estimates that there will be incremental governmental revenues, both state and county, of approximately $50 million during the three years. Finally, after completion, our study indicates new annual county and state revenues of over $31 million with most of this figure accruing to the state.

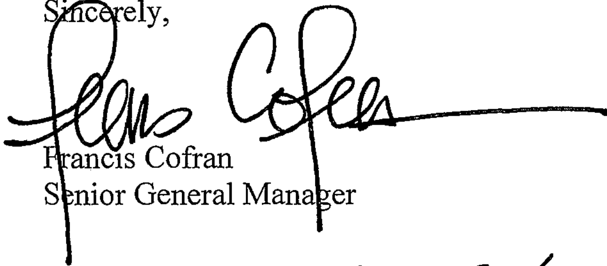
Upon completion, Ala Moana Center will produce $210 million of annual net operating income and will produce $213 million of annual revenue to the government of Hawaii. Over the next ten years, we estimate over $2 billion of government revenue from the existing center, the new development described above but excluding the condominium project described below. Upon completion of the current development project, we estimate Ala Moana Center will be the economic engine for more than 6,800 jobs, directly and indirectly.

We have also entered into a joint venture to build residential condominiums at Ala Moana with an investment of approximately $600 million. While we do not have an economic impact study related to this part of the development, we believe the economic impact will be significant and would generate additional revenues to the state of Hawaii.

The enactment of this bill will have a significant impact on our investment returns and ultimately increase the costs on our tenants, making it less attractive for them and for us to invest in Hawaii. Please do not allow a short-term revenue increase to override the long-term economic benefits that REIT investment, free of a Hawaiian income tax, brings to the state of Hawaii and its residents. The state tax implications are important to our capital allocation and investment decisions. We and many other publicly-owned REITs have made substantial investments in Hawaii on the basis of a stable and known income tax framework. Additional tax burdens reduce investment returns and make investments less attractive.

For the foregoing reasons, we respectfully oppose House Bill No. 1726, H.D. 2. Thank you for your consideration.

Sincerely,



Francis Cofran
Senior General Manager

Sandeep Mathrani
Chief Executive Officer

THE SENATE
THE TWENTY-SEVENTH LEGISLATURE
REGULAR SESSION OF 2014

COMMITTEE ON WAYS & MEANS
Senator Ige, Chair

3/20/2014
Rm. 211, 9:00 AM

HB 1726, HD 2
Relating to Taxation

Chair Ige and Members of this Committee, my name is Max Sword, here on behalf of Outrigger Hotels & Resorts in opposition to HB 1726.

We view this legislation as damaging one of the few growing sources of capital that can improve Hawaii's economic picture, by providing outside funding to improve its infrastructures, especially in its tourist areas. Also, due to the way that Federal law allows Real Estate Investment Trusts (REITS) to operate, REIT investment money tends to be long-term investments, not short term. REIT's also allows small investors, whether they are individuals or companies to participate in these types of investments.

Outrigger Hotels has had the good fortune to partner and work with REITs in developing and improving a number of Hawaii properties. A good example is the partnership between Outrigger and American Assets Trust, Inc (a REIT). With out this partnership, we would NOT have been able to develop what everyone has called one of the best developments to happen in Waikiki, Waikiki Beach Walk on Lewers Street.

Another good example of what funds from a REIT can do, can be seen currently happening at the International Market Place. The site is being developed by Taubman Center, a publicly traded REIT and when the planned improvements are complete, we anticipate that the desirability of the hotels in the area will be significantly improved.

Outrigger views the enactment of H.B. 1726, H.D. 2 as a serious roadblock to continued REIT investment in State of Hawaii and urges you to oppose this legislation.

Thank you again for the opportunity to submit this testimony.

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Michael J. Fergus

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FAX (808) 545-1788

March 20, 2014, 9:00 a.m., Conference Room 211

TO: Senate Committee on Ways and Means
Rep. David Ige, Chair

FROM: Michael J. Fergus

RE: In Support of HB 1726, Relating to Real Estate Investment Trusts

Members of the Ways and Means Committee:

I strongly support HB 1726 which will eliminate the tax deductibility of dividends for Real Estate Investment Trusts (REITs). Only REITs have been allowed to deduct dividends paid in determining their taxable income and the result is that they pay no state income tax. It was the intention of the REIT law that the tax will be paid at the shareholder level but 99+ percent of the shareholders live on the mainland so Hawaii never gets its share of the income tax generated by these companies. REITs pay general excise tax, conveyance tax and real property taxes in Hawaii, but in the case of the retail, office and industrial properties, 100% of those taxes are passed on to the REITs' overburdened tenants; so the REITs effectively pay no tax in Hawaii. Why should we give out-of-state investors a tax break that we don't give to our own tax-paying citizen investors?

REITs own a great amount of property in Hawaii. All the land in Mapunapuna and large amounts of land at Sand Island and Campbell Industrial Park are owned by REITs. Ala Moana and Pearlridge Centers, and all of the Public Storage facilities are owned by REITs. The majority of downtown class A office space is owned by REITs, as well as a great number of hotels in Waikiki and on the neighbor islands. Even Wal Mart and some of the other big retailers have set up REITs that own their store buildings.

NAREIT says that $6 billion has been invested in REITs in Hawaii. If they achieve a 10 percent return on investment, that is $600 million in income that is not being taxed in Hawaii, or perhaps half of that after deducting interest and depreciation expense. $300 million times six percent equals $18 million in potential tax revenues, before considering the tax on capital gains from the sale of assets such as Ala Moana Center.

There is no reason why any investor in Hawaii should be operating tax-free. REITs don't pay any taxes to support Hawaii's infrastructure and our local charities, then they ship our money out of state. There are plenty of local, mainland and foreign tax paying investors here, such as Alexander & Baldwin, BlackSand Capital, hedge funds, and mainland institutional investors. This bill would make REITs equal to other real estate investors.

It is clear that the REIT dividend deduction is eroding our tax base significantly. Please support the passage of this bill.

Thank you.