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**STATE OF HAWAII
DEPARTMENT OF TAXATION**

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

Date: Thursday, February 8, 2018
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 2702, Relating to Taxation

The Department of Taxation (Department) has concerns regarding H.B. 2702 and provides the following comments for your consideration. H.B. 2702 requires that Real Estate Investment Trusts (REITs) file returns reporting their shareholders' pro rata shares of net income and net income attributable to this State, provides for composite returns by the REIT, and requires withholding for those shareholders who do not agree to file returns or pay tax on their pro rata share of net income attributable to this State. The measure is effective upon approval and applies to taxable years beginning after December 31, 2018.

First, the Department notes the general rule as to the situs of invisible and intangible personal property (notes, bonds, etc.) is that it follows the domicile of the owner, and it is held to be taxable at such domicile. See Frick v. Pennsylvania, 268 U.S. 473 (1925). As noted in Farmer Loan and Trust Co. v. Minnesota, 280 U.S. 204 (1930):

Taxation is an intensely practical matter, and laws in respect of it should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences. We have determined that, in general, intangibles may be properly taxed at the domicile, and we can find no sufficient reason for saying that they are not entitled to enjoy an immunity against taxation at more than one place similar to that accorded to tangibles. The difference between the two things, although obvious enough, seems insufficient to justify the harsh and oppressive discrimination against intangibles contended for on behalf of Minnesota.

Second, the Department notes that H.B. 2702 may be subject to challenge as it proposes to tax a person whose only connection may be by virtue of owning an interest in a REIT doing business in the State. In MeadWestvaco Corp. v. Illinois Department of Revenue, 553 U.S. 16 (2008), the U.S. Supreme Court stated, "[t]he Commerce and Due Process Clauses impose distinct but parallel limitations on a State's power to tax out-of-state activities, and each

subsumes the “broad inquiry” “ ‘whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state.’ ”¹

Some courts have suggested that the state tax jurisdictional standard might require a certain threshold of in-state activity before a tax can be imposed. See Geoffrey Inc. v. South Carolina Tax Commission, 437 S.E.2d 13,18 (S.C. 1993), *cert. denied*, 510 U.S. 992 (1993) (nexus found with respect to an out-of-state corporation engaged in in-state licensing of trademarks to a related party); FIA Card Services, N.A. v. Tax Commissioner, 551 U.S. 1141 (2007) (nexus found with respect to an out-of-state corporation engaged in in-state credit card lending).

Third, the Department notes that this measure would be placing an administrative burden on REITs that is greater than the burden placed on other similarly situated entities. If the intent of the measure is to create parity between REITs and C-corporations, the Department suggests reconsidering the dividends paid deduction. H.B. 2702 is unlikely to achieve parity because it may be challenged and it is harder to enforce administratively.

In addition, the tax imposition on dividends paid to REIT shareholders would be on the gross rather than the net which is generally the rule for net income tax. This measure seems to create a hybrid pass-through, but imposes the net income tax on the gross. Deductions that are otherwise available to a REIT are generally not claimed because of the dividend paid deduction.

Finally, the Department notes that it is unlikely that a REIT will be able to fully comply with the requirements of this measure. A REIT will only know the identity of the shareholders investing in it. However, many individuals and other investors may hold an interest in a REIT by virtue of owning mutual fund investment shares or other types of investment vehicles. For example, if a mutual fund invests in a REIT, the REIT will know the mutual fund as a shareholder, but will not know the identity of the persons owning a share of the mutual fund.

Thank you for the opportunity to provide testimony.

¹ ASARCO Inc. v. Idaho Tax Comm’n, 458 U. S. 307, 315.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Withhold Tax on REIT Dividends

BILL NUMBER: HB 2702

INTRODUCED BY: FUKUMOTO, BELATTI, JOHANSON, KEOHOKALO, C. LEE, LUKE, NISHIMOTO, OHNO, SAIKI, WOODSON, Brower

EXECUTIVE SUMMARY: Requires that real estate investment trusts (REITs) file returns reporting their shareholders' pro rata shares of net income and net income attributable to this State. Provides for composite returns and requires withholding for those shareholders who do not agree to file returns or pay tax on their pro rata share of net income attributable to this State.

SYNOPSIS: Adds a new section to chapter 235, HRS, that establishes a withholding regime for REITs like that already in place for S corporations under section 235-122, HRS.

Requires each REIT shareholder receiving a dividend from the REIT to recognize a pro rata share of income attributable to the State and the pro rata share of income not attributable to the State, to the extent modified under Hawaii income tax law, under rules similar to those in section 235-122(c), HRS.

Requires any REIT to file information returns reporting shareholder level data.

Requires any REIT to obtain an agreement of each shareholder (1) to file a return and make timely payment of all taxes imposed by this State on the shareholder with respect to the income of the real estate investment trust; and (2) to be subject to personal jurisdiction in this State for purposes of the collection of unpaid income tax, together with related interest and penalties. For any shareholder for which no agreement is filed, the REIT shall withhold tax at the highest marginal rate applicable to corporations, if the shareholder is a corporation, or applicable to individuals, if the shareholder is not a corporation.

EFFECTIVE DATE: Taxable years beginning after December 31, 2018.

STAFF COMMENTS: Currently under federal and state income tax law, a 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. This is similar to the one level of tax imposed on owners of S corporations in lieu of taxing the S corporation at the corporate level. Thus, this bill enacts a withholding regime similar to that under the Model S Corporation Income Tax Act (MoSCITA), specifically section 235-122, HRS.

All state income tax systems in the United States, including ours, have a set of rules that are used to figure out which state has the primary right to tax income. For example, most tax systems say that rent from real property is sourced at the location of the property, so if a couple in Florida rents out a property they own on Maui they can expect to pay our GET and our net income tax on

that rent. These sourcing rules, which do vary by state but are relatively consistent across state lines, are there to assure consistent and fair treatment between states.

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

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

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

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

Digested 2/6/2018

COMMUNITY ALLIANCE ON PRISONS

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COMMITTEE ON FINANCE

Rep. Sylvia Luke, Chair

Rep. Ty Cullen, Vice Chair

Thursday, February 8, 2018

2:00 pm

Room 308

SUPPORT - HB 2702 - TAXING REAL ESTATE INVESTMENT TRUSTS (REITS)

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

My name is Kat Brady and I am the Coordinator of Community Alliance on Prisons, a community initiative promoting smart justice policies in Hawai'i for more than two decades. This testimony is respectfully offered on behalf of the approximately 5,500 Hawai'i individuals living behind bars or under the "care and custody" of the Department of Public Safety on any given day. We are always mindful that approximately 1,600 of Hawai'i's imprisoned people are serving their sentences abroad thousands of miles away from their loved ones, their homes and, for the disproportionate number of incarcerated Kanaka Maoli, far, far from their ancestral lands.

HB 2702 requires that real estate investment trusts file returns reporting their shareholders' pro rata shares of net income and net income attributable to this State. It also provides for composite returns and requires withholding for those shareholders who do not agree to file returns or pay tax on their pro rata share of net income attributable to this State and applies to taxable years beginning after 12/31/2018.

Community Alliance on Prisons supports this measure. We urge the committee to pass HB 2702. It is a critical fix to a problem that has long plagued Hawai'i. It keeps tax dollars generated on Hawai'i REIT income where they belong – here, in our state, where the income was made.

A Real Estate Investment Trust or "REIT," is a corporation that owns income-producing real estate, like hotels and shopping malls. REITs have been granted a special tax status which exempts them from paying corporate income tax on the dividends paid to its shareholders. However, as with most forms of income, REIT shareholders pay tax on their income from the REIT.

Over 30 REITs operate in Hawai'i, which collectively own \$13 billion worth of real estate. In 2014, Hawai'i REITs produced \$721 million in dividend income that was exempt from corporate income tax. Without the dividends exemptions for REITs, Hawai'i would have collected an additional \$35 million in revenue that year.

The problem for Hawai'i is that most shareholders of Hawai'i REITs don't live in Hawai'i, so they are paying their income taxes elsewhere. Income generated by Hawai'i property isn't getting taxed here. Instead of going to pay for our roads and schools, tax dollars generated by Hawai'i REITs are paying for roads and schools in New York, or wherever else their shareholders might live.

HB 2702 fixes this problem simply by withholding tax generated by Hawai'i REITs. Instead of paying tax in New York, the tax on Hawai'i REIT income will be paid in Hawai'i, where the income was generated. REIT shareholders will be credited for taxes paid in Hawai'i when they file their income taxes elsewhere, so they will not be double taxed.

Community Alliance on Prisons' concern about REITs stems from the fact that corporate prison companies have converted to REITs to avoid paying taxes. We have learned that CCA/CoreCivic has been circling Hawai'i like buzzards - they appear to have a keen interest in Maui.

On 1 January 2013, CCA decided to effectively convert from a standard corporation to a Real Estate Investment Trust (REIT). CCA was given the nod by the Federal government on February 8, 2013 and as a result, its share price exploded upwards. **But what may be lost on shareholders is that CCA operated as a REIT once before in the late 1990s. Its first foray into the REIT world ended in near bankruptcy.**

By converting to a REIT, corporations can avoid paying federal taxes on their earnings as long as at least 90% of those earnings are paid out to shareholders in the form of dividends. This corporate maneuvering to avoid paying federal taxes is yet another one of CCA's questionable business practices. As a New York Times article explained: *"One of the bedrock principles - and the reason for the tax exemption - was that the trusts do not do any business other than owning real estate. But bit by bit, especially in recent years, that has changed as the IRS, in a number of low profile decisions, has broadened the definition of real estate, and allowed companies to split off parts of their business that are unrelated to real estate."*¹ ...

Somewhere along the way, CCA and a host of other companies with fixed assets started taking advantage of the designation by claiming that they effectively manage real estate, and thus fit the criteria for REIT status. But while CCA owns prison real estate, common sense dictates that the company doesn't rent them out - it gets paid to run them.

For example, the Company's 10-K filing in 2011 (and prior) describe its business as: *"We are compensated for operating and managing facilities at an inmate per diem rate based upon actual or minimal guaranteed occupancy levels."*

¹ <http://www.nytimes.com/2013/04/22/business/restyled-as-real-estate-trusts-varied-businesses-avoidtaxes.html?ref=business&r=0>

However, that wording was changed in their 10-K filing in 2012 to: *"We are compensated for providing prison bed capacity and correctional services at an inmate per diem rate based upon actual or minimum guaranteed occupancy levels."*

It seems that this deliberate change in wording was a tortured attempt by Management to reinforce the idea that CCA rents out bed capacity instead of operating and managing facilities, making CCA appear more as a 'land lord' and less as an 'operations and management' service.

Since these tax dollars are coming from real estate it makes sense to use them to fund affordable housing. The revenue generated by HB 2702 is intended to fund the initiatives in HB 2703, which are so critical to helping residents struggling with the highest housing costs in the nation.

Mahalo for the opportunity to testify on this important bill. Please pass HB 2702

"Any system that values profit over human life is a very dangerous one indeed."

Suzy Kassem

Rise Up and Salute the Sun: The Writings of Suzy Kassem



Board of Directors:

House Committee on Finance

Hawai'i Alliance for Progressive Action supports HB2702

Gary L. Hooser

President

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

Andrea N. Brower

Ikaika M. Hussey

Co-Vice Presidents

I am writing on behalf of the Hawaii Alliance for Progressive Action in strong support of HB2702, It is a critical fix to a problem that has long plagued Hawai'i. It keeps tax dollars generated on Hawai'i REIT income where they belong — here, in our state, where the income was made.

Kim Coco Iwamoto

Treasurer

HAPA is a statewide environmental, social and economic justice organization. HAPA engages over 10,000 local residents annually through our work.

Bart E. Dame

Secretary

A Real Estate Investment Trust (REIT) is a corporation that owns income-producing real estate, like hotels and shopping malls. REITs have been granted a special tax status which exempts them from paying corporate income tax on the dividends paid to its shareholders. However, as with most forms of income, REIT shareholders pay tax on their income from the REIT.

Paul Achitoff

Malia K. Chun

Laura Harrelson

Katie McMillan

The problem for Hawai'i is that most shareholders of Hawai'i REITs don't live in Hawai'i, so they are paying their income taxes elsewhere. Income generated by Hawai'i property isn't getting taxed here. Instead of going to pay for our roads and schools, tax dollars generated by Hawai'i REITs are paying for roads and schools in New York, or wherever else their shareholders might live.

Walter Ritte Jr.

Karen Shishido

Leslie Malu Shizue Miki

HB 2702 fixes this problem simply by withholding tax generated by Hawai'i REITs. Instead of paying tax in New York, the tax on Hawai'i REIT income will be paid in Hawai'i, where the income was generated. REIT shareholders will be credited for taxes paid in Hawai'i when they file their income taxes elsewhere, so they will not be double taxed.

Kekaulike Prosper Tomich

Cade Watanabe



Since these tax dollars are coming from real estate it makes sense to use them to fund affordable housing. The revenue generated by HB 2702 is intended to fund the initiatives in HB 2703, which are so critical to helping residents struggling with the highest housing costs in the nation.

Thank you for the chance to testify on this important bill. Please pass HB 2702.
Respectfully,

Anne Frederick, Executive Director
Hawai'i Alliance for Progressive Action (H.A.P.A.)



HAWAII APPLESEED

CENTER FOR LAW & ECONOMIC JUSTICE

Testimony of Hawai'i Appleseed Center for Law and Economic Justice
Supporting HB 2702 – Relating to Taxation
House Committee on Finance

Scheduled for hearing on Thursday, February 8, 2018, 2:00 PM, in Conference Room 308

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

Thank you for the opportunity to testify in **STRONG SUPPORT** of **HB 2702**, which would require that real estate investment trusts file returns reporting their shareholders' pro rata shares of net income and net income attributable to this State, as well as provide for composite returns and require withholding for those shareholders who do not agree to file returns or pay tax on their pro rata share of net income attributable to this State.

Right now, income on Hawai'i REIT property is escaping Hawai'i tax and going elsewhere.

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. However, as with most forms of income, REIT shareholders pay tax on their income from the REIT. REIT shareholders pay both federal and state income tax, which helps to pay for things like roads, schools, and affordable housing.

Over 30 REITs operate in Hawai'i, which collectively own \$13 billion worth of real estate. In 2014, Hawai'i REITs produced \$721 million in dividend income that was exempt from corporate income tax. Without the dividends exemptions for REITs, Hawai'i would have collected an additional \$35m in revenue that year. The amount of Hawai'i property that is invested in REITs has been rapidly increasing, and the amount of revenue lost to the REIT dividend exemption has likely gone up significantly since 2014.

For years, the legislature has considered bills that would eliminate the REIT dividend exemption. However, REITs have argued that eliminating the deduction would be a double tax since shareholders pay income tax. The problem for Hawai'i is that most shareholders of Hawai'i REITs don't live in Hawai'i, so they are paying their income taxes elsewhere. Income generated by Hawai'i property is getting taxed elsewhere. Income made in Hawai'i isn't getting taxed here. Instead of Hawai'i REIT tax dollars going to pay for Hawai'i roads and schools, tax dollars generated by Hawai'i REITs are paying for roads and schools in New York, or wherever else the shareholders might live.

HB 2702 fixes this problem simply by withholding tax generated by Hawai‘i REITs. Instead of paying tax in New York, the tax on Hawai‘i REIT income will be paid in Hawai‘i where the income was generated. This solution eliminates the double-tax concern voiced by REITs regarding eliminating the dividend exemption. And REIT shareholders will be credited for taxes paid in Hawai‘i when they file their income taxes elsewhere—they will not be subject to a double-tax either.

HB 2702 is a critical fix to a problem that has long plagued Hawai‘i. It keeps tax dollars generated on Hawai‘i REIT income where they belong—in Hawai‘i, where the income was made.

These tax dollars can be used to fulfill Hawai‘i’s most pressing need—affordable housing. The revenue generated by HB 2702 is intended to be fund the housing affordability initiatives in HB 2703, which are so critical to helping residents struggling with the highest housing costs in the nation and the lowest wages after accounting for cost of living.

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.

HB-2702

Submitted on: 2/7/2018 12:46:36 PM

Testimony for FIN on 2/8/2018 2:00:00 PM

Submitted By	Organization	Testifier Position	Present at Hearing
Heather Lusk	The CHOW Project	Support	No

Comments:

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

I urge the committee to pass HB 2702. It is a critical fix to a problem that has long plagued Hawai'i. It keeps tax dollars generated on Hawai'i REIT income where they belong — here, in our state, where the income was made.

A Real Estate Investment Trust or “REIT,” is a corporation that owns income-producing real estate, like hotels and shopping malls. REITs have been granted a special tax status which exempts them from paying corporate income tax on the dividends paid to its shareholders. However, as with most forms of income, REIT shareholders pay tax on their income from the REIT.

Over 30 REITs operate in Hawai'i, which collectively own \$13 billion worth of real estate. In 2014, Hawai'i REITs produced \$721 million in dividend income that was exempt from corporate income tax. Without the dividends exemptions for REITs, Hawai'i would have collected an additional \$35 million in revenue that year.

The problem for Hawai'i is that most shareholders of Hawai'i REITs don't live in Hawai'i, so they are paying their income taxes elsewhere. Income generated by Hawai'i property isn't getting taxed here. Instead of going to pay for our roads and schools, tax dollars generated by Hawai'i REITs are paying for roads and schools in New York, or wherever else their shareholders might live.

HB 2702 fixes this problem simply by withholding tax generated by Hawai'i REITs. Instead of paying tax in New York, the tax on Hawai'i REIT income will be paid in

Hawai'i, where the income was generated. REIT shareholders will be credited for taxes paid in Hawai'i when they file their income taxes elsewhere, so they will not be double taxed.

Since these tax dollars are coming from real estate it makes sense to use them to fund affordable housing. The revenue generated by HB 2702 is intended to fund the initiatives in HB 2703, which are so critical to helping residents struggling with the highest housing costs in the nation.

Thank you for the chance to testify on this important bill. Please pass HB 2702.
Heather Lusk
Executive Director, Life Foundation/CHOW Project



SanHi

GOVERNMENT STRATEGIES
A LIMITED LIABILITY LAW PARTNERSHIP

DATE: February 7, 2018

TO: Representative Sylvia Luke
Chair, Committee on Finance
Submitted Via Capitol Website

RE: **H.B. 2702 – Relating to Taxation**
Hearing Date: Thursday, February 8, 2018 at 2:00 p.m.
Conference Room: 308

Dear Chair Luke and Members of the Committee on Finance:

My name is Rick Tsujimura and I am testifying on behalf of the Hawaii members of Nareit. 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. These real estate investment trusts, which have substantial long-term investments in Hawaii, strongly oppose this measure.

House Bill 2702 proposes an unworkable system. Unlike an S corporation, a publicly traded REIT is not limited to 100 shareholders who can be easily identified. In fact, many such REITs have millions of shares outstanding, with approximately 99 percent held in “street name” by a central securities depository on behalf of the ultimate owners.

It is and would be impossible for a given REIT to provide the name, address and federal identifying information required under House Bill 2702 with respect to all of these shares. And the way in which capital markets operate, with thousands of shareholders entering and leaving the market in a single day or an hour, further compounds an already impossible challenge.

There are also likely federal constitutional issues, with regard to jurisdiction and tax credits in shareholder residence states that could take years to sort out. In particular, a shareholder in a publicly traded REIT (just like a shareholder in any other publicly traded company) generally has no involvement with the business of the REIT, which may take place in any number of states and/or countries. Imposing state income tax on the passive investor merely because the underlying REIT invests in a particular state raises U.S. constitutional questions whether, among other things, the “purposefulness” of the shareholder’s contact with the State is sufficient to satisfy constitutional requirements. Sorting out potential constitutional challenges could take time and be burdensome on the state.

Just as a small example, a local investment firm, founded in the late 70s originally to manage the pension funds of a small local institution holds millions of dollars in REIT

stocks, none of which own projects in Hawaii, and REIT shares in mutual funds sponsored by Vanguard and Schwab, which may or may not have an interest in Hawaii projects. The chilling effect of this measure would cause such local investors to avoid investment in REITs with Hawaii interests if all of their dividends were withheld pending an investigation into how much of those dividends were in fact derived from Hawaii REIT projects.

This chilling effect will not only impact REITs but also other outside investment.

There are many incorrect assumptions and false claims surrounding REITs premised upon the recent federal tax reform act. The most recent is the assertion that REITs should pay more in taxes because they received big deductions in the recently enacted tax reform legislation. In fact, the new law made no specific changes to the REIT rules. As in the past, all REIT profit, whether in Hawaii or elsewhere, must be distributed to shareholders to be taxed as shareholder dividend income by the IRS and states like Hawaii that have state income taxes. Conflating the corporate tax changes applicable to non-REITs with REIT operations to somehow suggest that REITs benefitted inappropriately is fundamentally false and misleading.

On a personal level, 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 Pearl Ridge. More eating choices and better Waikiki parking opportunities with the re-development of the International Marketplace, not to mention the financial benefits to the Queens Health System, which is the landowner.

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

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

Real estate projects funded by REITs are creating affordable rental housing, including Moanalua Hillside Apartments in Aiea and the new student housing at UH Manoa. REITs also provide office space for small businesses that employ thousands of local residents. Medical facilities made possible by REITs, like Hale Pawa'a, also ensure Hawaii physicians can deliver the highest quality care in state-of-the-art facilities.

While REITs in Hawaii have been good for the local economy, they have also supported a wide variety of non-profit organizations providing much-needed services throughout the state. For example, the REIT that financed Ka Makana Ali'i committed \$1 million dollars to support social services and community programs that

improve the quality of life for local residents. REITs also are an essential component of pension investments of Hawaiian Airlines, the Queen's Health Systems, the Clarence T.C. Ching Foundation and the Hawaii Community Foundation, as well as the investment portfolios managed by Hawaii's two largest banks, First Hawaiian and Bank of Hawaii.

REITs are long-term neighbors in this community. By law they cannot engage in flipping properties. The conflation of REITs with the activities in Kakaako suggests that the nature of REITs is not fully understood. REITs hold their investments for a very long time. Ala Moana has been held by GGP for a very long time. Taubman's interest in the International Marketplace will be for a long time. Douglas Emmett holds office buildings downtown for a long time. These entities are not making a quick profit and leaving town; they are making real investments back into our community and improving our retail, office, hotel, affordable rentals, and medical facilities.

Considering the many problems with the provisions of this measure and the likelihood for real economic harm that could result, if it were to pass, the Hawaii members of Nareit respectfully ask that you hold this bill.

Thank you for the opportunity to testify on this measure.



ALEXANDER & BALDWIN
PARTNERS FOR HAWAII

**HB 2702
RELATING TO TAXATION**

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

FEBRUARY 8, 2018

Chair Luke and Members of the House Committee on Finance:

I am Paul Oshiro, testifying on behalf of Alexander & Baldwin (A&B) on HB 2702, “A BILL FOR AN ACT RELATING TO TAXATION.” We respectfully oppose this bill.

While A&B has always been a Hawaii-based company, in 2012, A&B made a strategic decision to migrate its mainland investments back to Hawaii. Since then, A&B has sold most of its mainland properties and has reinvested the proceeds in Hawaii properties, including the acquisition of the Kailua Town commercial center, Pearl Highlands Center (Sam’s Club), Manoa Marketplace, and Waianae Mall. 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) in 2017. 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-operated hands. Furthermore, REITs are structured to be long-term holders of real estate, thus complimentary to A&B’s goal of being Partners for Hawaii, with a long-term presence in our communities.

In addition, the REIT structure does allow us to continue with our non-REIT businesses such as our diversified agricultural operations in Central Maui, our Grace Pacific operations, and other development activities, by placing these entities in a separate TRS, or taxable REIT subsidiary.

Real estate investment trusts were established by Congress in 1960 to expand access to real estate investments for all investors. REITs generally own, operate, or finance income-producing commercial real estate such as shopping malls, hotels, self-storage facilities, theme parks, and apartment, office, and industrial buildings. Unlike other corporations, REITs must meet several restrictive regulatory requirements which includes a requirement under Federal Law to distribute at least 90% of its taxable income to its shareholders as dividends. At present, all states except for one (New Hampshire) allow REITs to pass through the dividends to its shareholders, without the imposition of a corporate tax, with the tax on these dividends paid by the individual shareholders in their home state of residence.

The purpose of this bill is to impose a Hawaii tax on non-Hawaii resident shareholders for dividends received from REITs with properties in Hawaii. At present, REIT shareholders are required to pay tax in their home state on all dividend income received from REITs, irrespective of where the REIT properties are located. If this bill is passed, Hawaii will become the only state in the nation to impose a tax on non-residents who derive dividend income from property in its state.

A&B has significant concerns with this bill. First, it will be extremely difficult to fully implement. The majority of shares in REITs are presently held in 'street name' by stockbrokers, and the U.S. Securities and Exchange Commission does not require

stockbrokers to disclose the names and addresses of shareholders of stock held in street name. Thus, REITs will not be able to ascertain the identities and addresses of all of the individual non-resident shareholders who hold their stock, in order to comply with the administrative requirements of this bill. In addition, with shares of REIT stock freely traded on stock exchanges with many REITs having thousands of shareholders, recordkeeping on who owned how many shares of REIT stock on specific dates for varying durations of time and allocating Hawaii taxable income to the amount of dividend earned off of Hawaii properties by each individual investor is envisioned to be a significant administrative challenge.

This bill will likely also deter individuals from acquiring and owning shares of REITs with Hawaii holdings because of the administrative burden imposed on the individual shareholder as well. It is our understanding that this bill is premised on the assumption that states in which the non-resident taxpayer resides will grant tax credits to the shareholder for the amount of tax that is paid to the State of Hawaii, thus avoiding double taxation for the shareholder. However, it is not assured that states will indeed provide this tax credit to their resident taxpayers. Should states not provide a corresponding tax credit for Hawaii taxes paid by their resident taxpayers, this will result in a double taxation on dividend income. In addition, individuals who are exempt from income tax such as pension funds, labor unions, and 401ks, as well as residents who reside in states that do not impose an income tax, may face significant challenges trying to recover taxes withheld by Hawaii.

In light of the above, we believe that this bill may discourage both REITs from investing in Hawaii and individual investors/entities from investing in Hawaii REITs. For REITs, these new administrative requirements may compel them to either relocate their

investments elsewhere or to lessen their business activity in Hawaii. When combined with the direct reduction in general excise and income taxes from diminished REIT related construction, fewer jobs, lower earnings, and the reduction in business and individual incomes because of indirect and induced impacts of lower REIT related activity, the State of Hawaii may realize a significant negative impact to its overall economy.

This bill will also have a disproportionately negative impact on a Hawaii-focused REIT such as A&B, who intends to have all of its properties situated in Hawaii. If Hawaii becomes the first state in the nation to impose a tax on non-resident REIT shareholders, there is no company in the state that would have a quicker evaporation of investor interest and investments than A&B. This bill will likely hurt those REITs that invest the most in Hawaii, and give a competitive edge to out-of-state entities with only a few holdings in Hawaii and the majority of their investment elsewhere. A&B will be at a significant disadvantage in attracting additional investors to support our continued investment in Hawaii.

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



February 7, 2018

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

Re: Testimony in Opposition to House Bill 2702, relating to Real Estate Investment Trusts/Feb. 8, 2018 Hearing at 2:00 P.M.

Dear Representative Luke and Members of the Committee on Finance,

I am submitting this testimony in opposition to House Bill 2702. This bill attempts to treat public REITs like pass-through entities (partnerships and S corporations) for tax purposes. For several reasons, this proposed law creates some requirements that a public traded company is not going to be able to satisfy.

First, the law requires the REIT to file a return specifically stating (among other things): (1) the name, address, and social security or federal identification number of each person owning stock in the REIT at any time during the taxable year; (2) the number of shares owned by each shareholder during the year; and (3) the income attributable to the State and income not attributable to the State with respect to each shareholder during the taxable year. This approach is not overly burdensome for partnerships and S corporations because the number of partners or shareholders is relatively small (S corporations cannot have more than 35 shareholders). But public companies don't even know who all their shareholders are at all times. Even if they did, imagine the complexity of gathering this information when you have thousands of shareholders freely trading the shares in the REIT on a daily basis. This law not only requires the REIT to determine income attributable to Hawaii, but also allocate this income to each shareholder, many of which might own their shares for less than a full year.

Second, the law would require the REIT to obtain a written agreement from each non-resident shareholder to file a return, make timely payment of all taxes, and be subject to personal jurisdiction in the State. This is simply not feasible when you have thousands of shareholders even if you know who they are. This requirement is further complicated by the fact that many REIT shareholders are mutual funds (who also don't know who their shareholders are at all times) and not for profit entities like foundations and pension funds that are subject to income taxes.

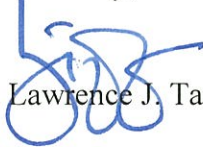
Third, the distribution from the REIT to the non-resident shareholder is still going to be considered a “dividend.” A dividend is sourced to the shareholder’s state of residency. It appears that this legislation would subject non-resident shareholders to Hawaii income tax on their pro rata share of REIT income. It is unclear whether the shareholder would be allowed a credit on the resident income tax return for the tax imposed by Hawaii which would be the case for a partnership or S Corporation.

REITs have been a huge source of investment capital for Hawaii. That capital has created thousands of jobs and a predictable tax base from GET, TAT, and real property taxes. These companies are good corporate citizens.

As I mentioned above, it would not be possible for a publicly traded company to satisfy the requirements of this bill for administrative reasons. Even if you could somehow streamline these requirements, it would still impose a significant burden on the REIT and its shareholders not required by any other state. That would certainly discourage investment in Hawaii and investment in any REIT doing business in Hawaii.

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

Sincerely,



Lawrence J. Taff



WAIKELE

An American Assets Trust Property

February 7, 2018

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

Re: Written Testimony to House Bill No. 2702, Relating to Taxation

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

My name is Pamela Wilson, and I am the General Manager of Hawaii Real Estate for American Assets Trust. American Assets Trust is a New York Stock Exchange-listed Real Estate Investment Trust (REIT) engaged in acquiring, improving, developing and managing premier retail, office and residential properties primarily in Hawaii, Southern California, Northern California, Oregon, and Washington State.

American Assets Trust owns four properties in Hawaii: The Shops at 2150 Kalakaua; Waikēle Center; Waikiki Beach Walk and the Embassy Suites-Waikiki Beach Walk. We are committed to creating sustainable value at our properties. We have helped to nurture local businesses that provide jobs, increase business activity, and contribute to the state's economy (through generation of additional payroll, general excise, property taxes and income taxes earned by residents employed at these properties). We also play a valuable role in support of the local communities.

REITs allow ordinary Americans to invest in real estate. As with all REITs, we must satisfy many strict and expensive requirements in order to maintain our REIT status. One of the requirements is to distribute annually all of our taxable income to shareholders in order for all of our earnings to be taxed at the shareholder level. Another requirement is to own properties for the long-term, rather than to develop and sell properties. Notably, the REIT business model does not depend on "flipping" properties but on providing sustainable returns to our investors from distributions of current earnings and modest capital appreciation of our stock. Thus, we are incentivized to continue making additional investments in Hawaii at these properties.

House Bill 2702 proposes an unworkable system. Unlike an S corporation, a publicly traded REIT is not limited to 100 shareholders who can be easily identified. In fact, many such REITs have millions of shares outstanding, with approximately 99 percent held in "street name" by a central securities depository on behalf of the ultimate owners. It is and would be impossible for a given REIT to provide the name, address and federal identifying information required under House Bill 2702 with respect to all of these shares. And the way in which capital markets operate, with thousands of shareholders entering and leaving the market in a single day or an hour, further compounds an already impossible challenge.

I ask that you consider the very real financial contributions and community benefits that REITs bring to our State. Further I ask that you consider how burdensome this new legislation as proposed would be and how difficult compliance would be. Please hold Bill 2702. Thank you for the opportunity to submit this testimony.

Sincerely,

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



Park Hotels & Resorts Inc.
Scott Winer, SVP Tax
1600 Tysons Boulevard
10th Floor
McLean, VA 22102
+1 703 584 7979 Main

WRITTEN TESTIMONY OF

SCOTT D. WINER

SENIOR VICE PRESIDENT, TAX

PARK HOTELS & RESORTS INC.

IN OPPOSITION TO H.B. 2702

BEFORE THE HAWAII HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCE

HONORABLE SYLVIA LUKE, CHAIR

HONORABLE TY J.K. CULLEN , VICE CHAIR

HEARING ON H.B. 2702

FEBRUARY 8, 2018

On behalf of Park Hotels & Resorts Inc. ("PARK"), thank you for this opportunity to provide our testimony on H.B. 2702. PARK submits this testimony in opposition to H.B. 2702 as it would be impossible to administer.

PARK is a publicly traded lodging real estate investment trust ("REIT") (NYSE:PK) with thousands of shareholders and approximately 214.8 million shares outstanding (as of December 31, 2017), of which approximately 213.9 million shares are held in street name, with millions of shares trading daily. Park does not know the identity of its ultimate shareholders on a daily basis.

As a REIT, Park is already subject to stringent, costly and complex administrative and operating requirements, including paying significant dividends to its shareholders to maintain REIT status. Park pays its dividends throughout the year and we rely on brokers to provide information to our shareholders related to our dividends (which are reported on IRS Form 1099-DIV). Park would have no way of knowing from whom we should withhold Hawaii tax for each dividend distribution. In addition, because income tax is calculated based on federal taxable income for an entire taxable year and apportioned to the state based on sales, property and payroll in Hawaii, Park would have no way of knowing at the time of each distribution the amount of income attributable to Hawaii that would be subject to withholding. As such, H.B. 2702 would impose an impossible compliance and withholding burden on Park and all publicly traded REITs.

Further, we believe the proposed legislation raises constitutionality issues and would likely face judicial challenges, wasting state resources. REITs are passive investment vehicles and investors buy REIT shares to receive passive investment income. Imposing a withholding tax and filing requirement on a passive investor raises constitutional questions about whether there is a sufficient connection between the investor and the state. Furthermore, states in which shareholders are resident are not likely to provide a tax credit for any Hawaii tax withheld. States generally only provide a tax credit for income not "sourced" to the state of residency, and most states consider REIT dividends to be sourced to the shareholder's state of residency taxing REIT dividends, not based upon the state in which the REIT owns and operates property.

We believe that our investment and the investments by other REITs in Hawaii are beneficial to the state and that imposing impossible withholding and reporting burdens on REITs would have the undesirable consequence of discouraging future investment by REITs.

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

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

JOBS: PARK's hotels directly employ more than 2,731 employees. The payroll and associated benefits for these direct employees is in excess of \$186,362,669 million annually.

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

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

TAXES GENERATED BY PARK in HAWAII:

- Payroll Taxes. Payroll taxes on employee wages totaled \$11,319,811 in 2017.

- General Excise and Use Tax - Operations. The tax revenues generated from our operations totaled \$25,318,638 in 2017.
- General Excise Tax – Rent. Because PARK is a REIT and must use a lease structure, we are required to pay General Excise Tax on the rent paid between our related companies. Effectively a double taxation of the same revenue. This additional GET was \$8,033,741 in 2017.
- Property taxes. Property taxes at PARK’s two resorts totaled \$15,640,124 in 2017.

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 in excess of \$500,000.

We believe that PARK’s hotels benefit the State of Hawaii and its residents tremendously in a variety of economic and charitable ways. We strongly urge that Hawaii not impose impossible compliance burdens on REITs. If adopted, this controversial legislation would (i) put Hawaii at a competitive disadvantage for REIT investment, (ii) penalize Hawaii citizens who invest in REITs by reducing their returns, (iii) discourage REITs from investing in Hawaii, and (iv) require PARK to reassess the level of its investment or reinvestment in Hawaii.

We thank you again for this opportunity to provide testimony against H.B. 2702 and sincerely hope you consider our strong opposition to this proposed legislation.

Respectfully submitted,



Scott Winer
Senior Vice President, Tax



February 7, 2018

Hearing Date: February 8, 2018
Time: 2:00 p.m.
Place: State Capitol, Conference Room 308

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

Re: Testimony in Opposition to H.B. 2702, Relating to Taxation

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

Thank you for the opportunity to provide written testimony on House Bill No. 2702. We are Francis Cofran, the Senior General Manager of Ala Moana Center, the largest retail center in the state of Hawaii, and Sandeep Mathrani, the Chief Executive Officer of GGP Inc. ("GGP"). GGP is an S&P 500 publicly traded REIT, and an owner of Ala Moana Center.

House Bill No. 2702 proposes an unworkable system. A publicly traded REIT is not limited to 100 shareholders like an S corporation. In fact, GGP has over 957 million shares outstanding with approximately 99.7% held in "street name" by Cede & Co. (an affiliate of The Depository Trust Corporation) on behalf of the ultimate beneficial owners. It is and would be impossible for GGP to provide the name, address and federal identifier required under House Bill No. 2702 with respect to all of these shares. There are also possible federal constitutional issues regarding jurisdiction and tax credits in shareholders' residence states that could take years to sort out.

GGP owns 126 retail properties in 40 U.S. states. Our mission is to own and operate best-in-class retail properties that provide an outstanding environment and experience for our communities, retailers, employees, consumers and shareholders. GGP has been 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.

GGP operates three major retail shopping centers in Hawaii – the Prince Kuhio Plaza in Hilo, Whalers Village in Lahaina, and the Ala Moana Center in Honolulu. The latter two are iconic visitor attractions that help sustain Hawaii's important tourism industry. In addition to their important role in tourism, all three centers directly benefit the state and local economy through the Hawaii general excise tax.

These centers are also key gathering places for our local communities. Efficient REIT capital allows us to constantly reinvest in and enhance the customer experience. For example, we are very supportive and proud of the activities, featuring local performers, that take place at the new Center Stage at Ala Moana Center, our sponsorship of the Fourth of July firework celebration, our enhancements at Whaler's Village, and our ability to introduce to Hawaii residents, retailers and retail concepts which are on the cutting edge and brand new to the State of Hawaii. Efficient REIT capital also allows us to make infrastructure and other improvements that bear fruit in projects like Shirokiya's Japan Village Walk and Foodland Farms at Ala Moana Center.

- If Hawaii enacts this legislation, it will be out of step with all other states which do not impose withholding tax on nonresident shareholders of publicly traded corporations.
- 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. GGP annually pays more than \$15 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.
- During 2012-2016, GGP as part of its long standing commitment to Hawaii invested almost \$1 billion in capital to construct additional retail square footage and residential condominiums based on the existing Hawaiian tax regime. During the construction period, we estimated economic activity of 11,600 full- and part-time jobs and over \$146 million of state revenue including indirect community benefits. Post-construction, the additional retail will produce an incremental \$33 million of state revenue and 3,000 jobs annually.

In September 2016, the Department of Business, Economic Development & Tourism ("DBEDT") released its final study on REITs in Hawaii. The report specifically notes that the estimates do not take into account changes in behavior, including the likelihood of reduced future REIT investment, if there are additional impediments to REIT or shareholder returns. Similarly, the report does not address the revenue loss to the State resulting from future reduced REIT investment. It would be imprudent to enact this legislation risking billions of dollars of new REIT investments and the hundreds of millions of dollars of state revenues and thousands of jobs that would result from those investments.



The DBEDT report did not take into account the taxes incurred by Hawaiian shareholders paid on REIT dividends for REITs without Hawaii property. Paul Brewbaker's study conducted for NAREIT ("Economic Impacts of Real Estate Investment Trusts in Hawaii" (Dec. 2015), available at <http://thereitwayhawaii.com> estimates, using Internal Revenue Service statistical data, that Hawaii received approximately \$8.7 million in tax on all REIT dividends. Hawaii's state protectionism if followed by other jurisdictions could end up harming the investment returns of Hawaiian shareholders and reduce tax revenues received by Hawaii.

Please do not allow the perception of a potential short-term revenue increase override the long-term economic benefits and tax revenue that REIT investment brings to the state of Hawaii and its residents under the existing tax regime brings to the state of Hawaii and its residents. For the foregoing reasons, we respectfully oppose House Bill No. 2702 and urge you to hold the bill. Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read "Francis Cofran", with a long horizontal line extending to the right.

Francis Cofran
Senior General Manager

A handwritten signature in black ink, appearing to read "Sandeep Mathrani", with a period at the end.

Sandeep Mathrani
Chief Executive Officer



February 7, 2018

Hearing Date: February 8, 2018

Time: 2:00 P.M.

Place: Conference Room 308

The Honorable Sylvia Luke, Chair

The Honorable Ty J.K. Cullen, Vice Chair

House of Representatives, Committee on Finance

Re: Testimony *Opposing* Taxing REIT Shareholders – HB 2702

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

My name is Lily Yan Hughes and I am the Senior Vice President, Chief Legal Officer and Corporate Secretary of Public Storage. We are ***strongly opposed*** to HB 2702 (and the bills introduced in the Senate with similar provisions, SB 3067 and SB 3101). The bill would impose Hawaii income taxes on the shareholders of real estate investment trusts (REITs) and purport to burden REITs with administrative and filing tasks that are simply impossible to perform for publicly traded companies.

Although the bill presumably is an effort to raise added tax revenue, such a law could well have the opposite effect. Even assuming the law would survive legal challenge, 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 the Hawaii economy and the state's tax collections.

Public Storage and Hawaii. Public Storage is a real estate investment trust that is the largest owner and operator of self-storage facilities in the United States, with almost 160 million rentable square feet of real estate in 38 states. In the United States we have approximately 2,386 facilities and 1.4 million tenants. We own 11 facilities in Hawaii. In 2017, those properties generated almost \$30 million of gross revenue and we paid the state about \$1.4 million of general excise tax. For the 2017/2018 fiscal year, we expect to pay over \$2 million of real estate taxes in Hawaii.

Public Storage's common stock is traded on the New York Stock Exchange under the symbol PSA. Publicly traded companies ***cannot*** specifically identify most of their shareholders, as the bulk of publicly traded stock is held by depositaries in street name. Although we do not know how many shareholders beneficially hold PSA common stock, it certainly is in the tens, if not hundreds, of thousands, and the ownership changes constantly. Public Storage has about 175 million outstanding common shares, with reported daily trading volume in 2017 ranging up to 3.8 million shares.

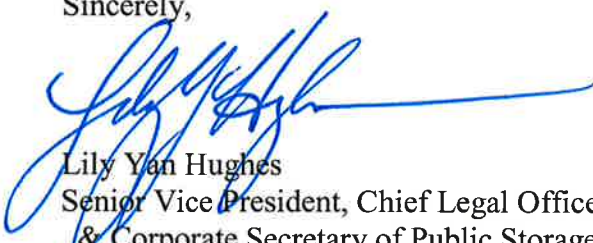
Because we are taxed as a REIT, Public Storage is effectively required to distribute all of its taxable income to our shareholders. The shareholders then report and pay state and federal tax on those dividends. Our shareholders in Hawaii are taxable by the state on the full amount of our dividends (not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

H.B. 2702 is patterned on a similar law that applies to Subchapter S corporations. The drafters of the bill clearly did not consider the differences between S corporations and REITs, particularly publicly traded REITs. An S company cannot have more than 100 shareholders, and the types of shareholders are limited. Publicly traded REITs can have hundreds of thousands of shareholders, with the shareholders changing constantly, and the REITs do not know who those shareholders are. Notwithstanding that reality, the bill would tax all REIT shareholders, and require REITs to (1) provide specific information about all shareholders (names, addresses, TINs) at all times during a year, and (2) obtain and file with the department agreements from nonresident shareholders to file Hawaii returns, pay tax and be subject to personal jurisdiction in Hawaii for the tax (REITs failing to provide the agreements would be required to pay the tax for the shareholders at the highest rate, with a supposed right to recover from the shareholders).

Putting aside the practical impossibility of applying the bill, it is doubtful that the state has the constitutional authority to seek to tax nonresident shareholders of public companies, when the shareholders' only connection to the state is the passive ownership of shares through a public stock exchange, much less using an approach that would effectively impose tax on all shareholders (resident or nonresident, including tax exempt and governmental shareholders) because REITs would be required to collect the shareholders' tax since the REIT would not be able to obtain the required agreements from the REIT's anonymous shareholders. Though the bill purports to permit a credit to the shareholders for the taxes paid, that would be completely illusory, given that a publicly traded REIT cannot identify most of its shareholders; so the practical effect of the proposal would be to impose double taxation on publicly traded REITs' earnings in Hawaii.

We believe Public Storage and other REITs have been, and can continue to be, positive forces in the Hawaii economy. Hawaii should not pursue legislation that will push REITs away. We respectfully request that you do *not* move HB 2702 (or any other similar bills) forward.

Sincerely,



Lily Yan Hughes
Senior Vice President, Chief Legal Officer
& Corporate Secretary of Public Storage

lhughes@publicstorage.com

818.244.8080, extension 1537

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

From: [Amy Perruso](#)
To: [FINTestimony](#)
Subject: HB 2702 -- Relating to Taxation
Date: Tuesday, February 6, 2018 9:15:32 PM

TO: House Committee on Finance
HEARING: Thursday, February 8, 2018, 2:00 PM
PLACE: Conference Room 308
FROM: Amy Perruso
RE: HB 2702 -- Relating to Taxation
ATTENDING HEARING: No

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

I urge the committee to pass HB 2702. It is a critical fix to a problem that has long plagued Hawai'i. It keeps tax dollars generated on Hawai'i REIT income where they belong — here, in our state, where the income was made.

A Real Estate Investment Trust (REIT) is a corporation that owns income-producing real estate, like hotels and shopping malls. REITs have been granted a special tax status which exempts them from paying corporate income tax on the dividends paid to its shareholders. However, as with most forms of income, REIT shareholders pay tax on their income from the REIT.

The problem for Hawai'i is that most shareholders of Hawai'i REITs don't live in Hawai'i, so they are paying their income taxes elsewhere. Income generated by Hawai'i property isn't getting taxed here. Instead of going to pay for our roads and schools, tax dollars generated by Hawai'i REITs are paying for roads and schools in New York, or wherever else their shareholders might live.

HB 2702 fixes this problem simply by withholding tax generated by Hawai'i REITs. Instead of paying tax in New York, the tax on Hawai'i REIT income will be paid in Hawai'i, where the income was generated. REIT shareholders will be credited for taxes paid in Hawai'i when they file their income taxes elsewhere, so they will not be double taxed.

Since these tax dollars are coming from real estate it makes sense to use them to fund affordable housing. The revenue generated by HB 2702 is intended to fund the initiatives in HB 2703, which are so critical to helping residents struggling with the highest housing costs in the nation.

Thank you for the chance to testify on this important bill. Please pass HB 2702.

HOUSE COMMITTEE ON FINANCE

Rep. Sylvia Luke, Chair
Rep. Ty Cullen, Vice Chair

From: Bart Dame
Date: Thursday, February 8, 2018
Time: 2 p.m.
Place: Conference room 308

HB2702, RELATING TO TAXATION

STRONG SUPPORT

My name is Bart Dame and I am testifying as an individual in STRONG SUPPORT of HB2702, which

Requires that real estate investment trusts file returns reporting their shareholders' pro rata shares of net income and net income attributable to this State. Provides for composite returns and requires withholding for those shareholders who do not agree to file returns or pay tax on their pro rata share of net income attributable to this State. Applies to taxable years beginning after 12/31/2018.

REITS are a creative vehicle for mass tax avoidance by profitable enterprises. Unlike a normal corporation, the profits of a REIT are not taxed in Hawaii, despite the considerable profits they make here and even if the income is taxed by shareholders, they reside in other states. For a number of years, there have been proposals seeking to capture some of that income. I believe the approach in this bill may very well solve that problem. And in a just fashion.

Please pass this bill.

Thank you for the opportunity to testify.

From: [Marilyn Mick](#)
To: [FINTestimony](#)
Subject: HB 2702 -- Relating to Taxation
Date: Wednesday, February 7, 2018 10:46:42 AM

TO: House Committee on Finance
HEARING: Thursday, February 8, 2018, 2:00 PM
PLACE: Conference Room 308
FROM: Marilyn Mick
RE: HB 2702 -- Relating to Taxation
ATTENDING HEARING: No

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

I urge the committee to pass HB 2702. It is a critical fix to a problem that has long plagued Hawai'i. It keeps tax dollars generated on Hawai'i REIT income where they belong — here, in our state, where the income was made.

A Real Estate Investment Trust (REIT) is a corporation that owns income-producing real estate, like hotels and shopping malls. REITs have been granted a special tax status which exempts them from paying corporate income tax on the dividends paid to its shareholders. However, as with most forms of income, REIT shareholders pay tax on their income from the REIT.

The problem for Hawai'i is that most shareholders of Hawai'i REITs don't live in Hawai'i, so they are paying their income taxes elsewhere. Income generated by Hawai'i property isn't getting taxed here. Instead of going to pay for our roads and schools, tax dollars generated by Hawai'i REITs are paying for roads and schools in New York, or wherever else their shareholders might live.

HB 2702 fixes this problem simply by withholding tax generated by Hawai'i REITs. Instead of paying tax in New York, the tax on Hawai'i REIT income will be paid in Hawai'i, where the income was generated. REIT shareholders will be credited for taxes paid in Hawai'i when they file their income taxes elsewhere, so they will not be double taxed.

Since these tax dollars are coming from real estate it makes sense to use them to fund affordable housing. The revenue generated by HB 2702 is intended to fund the initiatives in HB 2703, which are so critical to helping residents struggling with the highest housing costs in the nation.

Thank you for the chance to testify on this important bill. Please pass HB 2702.

HB-2702

Submitted on: 2/7/2018 12:00:48 PM

Testimony for FIN on 2/8/2018 2:00:00 PM

Submitted By	Organization	Testifier Position	Present at Hearing
Stephany Cecil		Support	No

Comments:

I support using the corporate income tax funds for housing in Hawaii.

From: [Jonathan Boyne](#)
To: [FINTestimony](#)
Subject: HB 2702 -- Relating to Taxation
Date: Wednesday, February 7, 2018 1:11:25 PM

TO: House Committee on Finance
HEARING: Thursday, February 8, 2018, 2:00 PM
PLACE: Conference Room 308
FROM: Jonathan Boyne
RE: HB 2702 -- Relating to Taxation
ATTENDING HEARING: No

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

I urge the committee to pass HB 2702. It is a critical fix to a problem that has long plagued Hawai'i. It keeps tax dollars generated on Hawai'i REIT income where they belong — here, in our state, where the income was made.

A Real Estate Investment Trust (REIT) is a corporation that owns income-producing real estate, like hotels and shopping malls. REITs have been granted a special tax status which exempts them from paying corporate income tax on the dividends paid to its shareholders. However, as with most forms of income, REIT shareholders pay tax on their income from the REIT.

The problem for Hawai'i is that most shareholders of Hawai'i REITs don't live in Hawai'i, so they are paying their income taxes elsewhere. Income generated by Hawai'i property isn't getting taxed here. Instead of going to pay for our roads and schools, tax dollars generated by Hawai'i REITs are paying for roads and schools in New York, or wherever else their shareholders might live.

HB 2702 fixes this problem simply by withholding tax generated by Hawai'i REITs. Instead of paying tax in New York, the tax on Hawai'i REIT income will be paid in Hawai'i, where the income was generated. REIT shareholders will be credited for taxes paid in Hawai'i when they file their income taxes elsewhere, so they will not be double taxed.

Since these tax dollars are coming from real estate it makes sense to use them to fund affordable housing. The revenue generated by HB 2702 is intended to fund the initiatives in HB 2703, which are so critical to helping residents struggling with the highest housing costs in the nation.

Thank you for the chance to testify on this important bill. Please pass HB 2702.

From: [Kathleen Kikuchi Samonte](#)
To: [FINTestimony](#)
Subject: HB 2702 -- Relating to Taxation
Date: Wednesday, February 7, 2018 1:11:43 PM

TO: House Committee on Finance
HEARING: Thursday, February 8, 2018, 2:00 PM
PLACE: Conference Room 308
FROM: Kathleen Kikuchi Samonte
RE: HB 2702 -- Relating to Taxation
ATTENDING HEARING: No

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

I urge the committee to pass HB 2702. It is a critical fix to a problem that has long plagued Hawai'i. It keeps tax dollars generated on Hawai'i REIT income where they belong — here, in our state, where the income was made.

A Real Estate Investment Trust (REIT) is a corporation that owns income-producing real estate, like hotels and shopping malls. REITs have been granted a special tax status which exempts them from paying corporate income tax on the dividends paid to its shareholders. However, as with most forms of income, REIT shareholders pay tax on their income from the REIT.

The problem for Hawai'i is that most shareholders of Hawai'i REITs don't live in Hawai'i, so they are paying their income taxes elsewhere. Income generated by Hawai'i property isn't getting taxed here. Instead of going to pay for our roads and schools, tax dollars generated by Hawai'i REITs are paying for roads and schools in New York, or wherever else their shareholders might live.

HB 2702 fixes this problem simply by withholding tax generated by Hawai'i REITs. Instead of paying tax in New York, the tax on Hawai'i REIT income will be paid in Hawai'i, where the income was generated. REIT shareholders will be credited for taxes paid in Hawai'i when they file their income taxes elsewhere, so they will not be double taxed.

Since these tax dollars are coming from real estate it makes sense to use them to fund affordable housing. The revenue generated by HB 2702 is intended to fund the initiatives in HB 2703, which are so critical to helping residents struggling with the highest housing costs in the nation.

Thank you for the chance to testify on this important bill. Please pass HB 2702.

From: Marion McHenry
To: FINTestimony
Subject: HB 2702 -- Relating to Taxation
Date: Wednesday, February 7, 2018 2:12:16 PM

TO: House Committee on Finance
HEARING: Thursday, February 8, 2018, 2:00 PM
PLACE: Conference Room 308
FROM: Marion McHenry
RE: HB 2702 -- Relating to Taxation
ATTENDING HEARING: No

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

I urge the committee to pass HB 2702. It is a critical fix to a problem that has long plagued Hawai'i. It keeps tax dollars generated on Hawai'i REIT income where they belong — here, in our state, where the income was made.

A Real Estate Investment Trust (REIT) is a corporation that owns income-producing real estate, like hotels and shopping malls. REITs have been granted a special tax status which exempts them from paying corporate income tax on the dividends paid to its shareholders. However, as with most forms of income, REIT shareholders pay tax on their income from the REIT.

The problem for Hawai'i is that most shareholders of Hawai'i REITs don't live in Hawai'i, so they are paying their income taxes elsewhere. Income generated by Hawai'i property isn't getting taxed here. Instead of going to pay for our roads and schools, tax dollars generated by Hawai'i REITs are paying for roads and schools in New York, or wherever else their shareholders might live.

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Since these tax dollars are coming from real estate it makes sense to use them to fund affordable housing. The revenue generated by HB 2702 is intended to fund the initiatives in HB 2703, which are so critical to helping residents struggling with the highest housing costs in the nation.

Thank you for the chance to testify on this important bill. Please pass HB 2702.

LATE

HB-2702

Submitted on: 2/7/2018 2:02:32 PM

Testimony for FIN on 2/8/2018 2:00:00 PM

Submitted By	Organization	Testifier Position	Present at Hearing
Greg and Pat Farstrup		Support	No

Comments:

Trickle down doesn't work!

This bill is another way to fight against income inequality and work FOR Hawaii's middle and lower income families and homeless people.

Please pass it.



LATE

February 7, 2018

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

Comments and Concerns in Strong Opposition to HB 2702, Relating to Real Estate Investment Trusts (REITs); Reporting Shareholders' Pro Rata Shares of Net Income and Net Income Attributable to this State.

Thursday, February 8, 2018, 2:00 p.m., in Conference Room 308

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

HB 2702. The purpose of this bill is to require REITs to file returns reporting their shareholders pro rata shares of net income and net income attributable to this State. Should HB 2702 be adopted, non-resident REIT shareholders will be taxed on dividend income attributable to this State, despite paying income tax in their home state, resulting in a double tax for these shareholders.

LURF's Position. LURF acknowledges the intent of this and prior versions of anti-REITs measures 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 thus far been proven or supported by any credible facts or evidence.

LURF's Opposition to HB 2702 is Premised on the Following Reasons and Considerations:

1. The Double Tax on Non-Residents Resulting from this Proposed Measure is Contrary to the Underlying Intent of REITs.

REITs are corporations or business trusts which were created by Congress in 1960 to

allow small investors, including average, every day citizens, to invest in income-producing real estate. Pursuant to federal tax law, REITs are required to be widely held and to distribute at least 90% of their taxable income to shareholders and must also comply with other requirements imposed to ensure their focus on real estate. In short, REITs must comply with asset, income, compliance and distribution requirements not imposed on other real estate companies. In exchange for such compliance, REIT dividends are allowed to be passed through to its shareholders, taxes on which are paid in the individual shareholders' home states regardless of where the REIT property is located or where REIT income is derived.

Should this measure be passed, non-resident shareholders will be made subject to double taxation on income derived from REIT property in this State, in direct contravention to the intent underlying the federal government's establishment of REITs. Such a consequence may reduce future construction and investment by REITs locally, thereby resulting in revenue loss and damage to the economy of the State. Furthermore, 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.

2. HB 2702 is Contrary to the Tax Treatment of REITs Pursuant to Current Federal Income Tax Rules and Laws of Other States with an Income-Based Tax System.

HB 2702 would enact policy change that would create disparity between current Hawaii, federal, and most other states' laws with respect to the taxation of REIT income.

The laws of every other state with an income-based tax system now allow REITs to pass through dividends to shareholders, and 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 property/projects.

By now proposing to double tax non-resident shareholders of the REITs that do business in Hawaii, HB 2702 would upset the uniformity of state taxation principles as applied between states. Passage of this measure would make Hawaii the only state to double tax non-resident shareholders of widely held REITs as described above.

3. Compliance with this Measure Would Not be Possible Given the Inability of REITs to Ascertain the Information Required to be Reported by this Bill.

LURF understands that like all public companies, most REIT shares are held in street name by brokers, who are not obligated to report shareholder identifying information to the REIT. There is thus no way for REITs to ascertain the identities of and other information relating to their non-resident shareholders in order to substantially comply with this measure.

4. Hawaii REITs Significantly Contribute to and Benefit the Local Economy.

LURF believes double taxation of non-resident shareholder income for Hawaii REITs 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 2016 State Department of Business, Economic Development & Tourism Research and Economic Analysis Division's Final Report on REITs¹ (the "Final Report") indicate that as of September 2016, approximately 42 REITs operating in Hawaii reportedly held assets in the amount of an estimated \$7.8 billion at cost basis², which has resulted in substantial economic activity in local industries including construction, retail, resort, healthcare and personal services, as well as employment for many Hawaii residents, and considerable tax revenues for the state and city governments. Such tax revenues include State General Excise Tax (GET) on rents and retail sale of goods, business income tax on profits made by tenants, income tax from employment of Hawaii residents, and millions of dollars in property taxes.

Proponents of this bill should be mindful that significant economic growth experienced in this State over the past few years, and which is expected to continue in the future, is undoubtedly attributable in part to REIT investment in Hawaii. Outrigger Enterprises partnered with REIT American Assets Trust to successfully develop the Waikiki Beach Walk. General Growth' Properties' expansion and renovation of the Ala Moana Shopping Center, as well as its partnering with Honolulu-based, local companies (The MacNaughton Group, The Kobayashi Group and BlackSand Capital) to develop the Park Lane residential condominium project is another example. The capital invested in that project to construct additional retail space and luxury residences will reportedly exceed \$1 billion, and the development will have created an estimated 11,600 full- and part-time jobs and over \$146 million of state revenue. Taubman Centers, Inc., another REIT, also partnered with CoastWood Capital Group, LLC to revitalize Waikiki through the redevelopment of the International Market Place at a cost of approximately \$400 million.

REIT projects have helped to support Hawaii's construction industry immensely³ by providing thousands of jobs, and continue to significantly contribute to the local economy through development of more affordable housing (more than 2,000 rental housing units for Hawaii's families, such as the Moanalua Hillside expansion of more affordable housing rentals), student housing near the University of Hawaii, health care facilities, offices, shopping centers (Pearlridge Center renovations), and hotels.

¹ Department of Business, Economic Development & Tourism Research and Economic Analysis Division. *Real Estate Investment Trusts in Hawaii: Analysis and Survey Results*. September 2016.

² *Final Report* at pages 3, 15-16.

³ Since 2011, REIT-related construction activity alone is estimated to have generated billions in Hawaii GDP.

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

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

The Hawaii tax on non-resident REIT shareholders is expected to have a significant negative effect on future investment by REITs in Hawaii. Proponents of this bill attempt to minimize negative consequences by claiming that very few Hawaii taxpayers invest in REITs with property in Hawaii, however, LURF understands that in 2014 over 9,000 Hawaii investors had investments in over 70 public, non-listed REITs and received almost \$30 million in distributions, and that tens of thousands more directly or indirectly own shares in stock exchange-listed REITs.

Supporters also ignore the fact that tax law changes proposed by HB 2702 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 tax principles and tax treatment of its shareholders, which, as discussed above, is considered a fundamental principle of taxation applicable to REITs.

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

Conclusion. LURF's position is that proponents of this measure have failed to credibly present any material facts or circumstances to prove that this proposed legislation is in fact necessary, or that the State's economy will significantly improve because of taking the action proposed. The intent and application of HB 2702 thus arguably remain unreasonable, unwarranted, and exceedingly anti-business.

Moreover, given the practical impossibility of REITs to comply with the reporting requirements of this bill, and that an unjustifiable change of a universal tax rule in place since 1960 could significantly reduce the availability of capital in this State, as well as result in other negative economic repercussions, LURF must **strongly oppose HB 2702**, and respectfully requests that this bill be held in this Committee.



HAWAII REGIONAL COUNCIL OF CARPENTERS

LATE

February 7, 2018

Statement of the Hawaii Regional Council of Carpenters – IN OPPOSITION H.B. 2702

Dear Chair Luke and Members of the House Finance Committee:

Thank you for allowing us to share our concerns of how this bill could have negative consequences for investment in Hawaii's economy.

REITs have funded affordable housing developments, healthcare facilities, office buildings, shopping centers and hotels. They provide assets to the community, job opportunities, tax revenue, and essential improvements that government can't shoulder alone.

REITs provide jobs and create tax revenue opportunities. In 2015 the contribution of REITs through REIT owned projects supported more than 11,700 jobs and \$95 million in tax revenue for the state. Ala Moana Center was made possible by REIT funding and brought in more than \$146 million in state revenue in 2016. Since completion, the additional retail sales produced some \$33 million in GET revenue for the state, along with 3,000 new jobs.

Policies which add additional requirements on Hawaii's REITs risk driving that investment somewhere else, an action which could reduce employment and tax revenue, which we know is not the intention of this body. We believe that there is greater value in keeping Hawaii competitive for attracting REIT investment.

Thank you for the opportunity to voice our concerns.

STATE HEADQUARTERS & BUSINESS OFFICES

OAHU: 1311 Houghtailing Street, Honolulu, Hawaii 96817-2712 • Ph. (808) 847-5761 Fax (808) 841-0300

HILO OFFICE: 525 Kilauea Avenue, Room 205, Hilo, Hawaii 96720-3050 • Ph. (808) 935-8575 Fax (808) 935-8576

KONA OFFICE: 75-126 Lunapule Road, Kailua-Kona, Hawaii 96740-2106 • Ph. (808) 329-7355 Fax (808) 326-9376

MAUI OFFICE: 330 Hookahi Street, Wailuku, Maui 96793-1449 • Ph. (808) 242-6891 Fax (808) 242-5961

KAUAI OFFICE: Kuhio Medical Ctr. Bldg., 3-3295 Kuhio Hwy., Suite 201, Lihue, Kauai 96766-1040 • Ph. (808) 245-8511 Fax (808) 245-8911

LATE

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

RE: HB 2702 Relating to Taxation – In Opposition
Thursday, February 8; 2:00 PM; Agenda #1; Conference Room 308

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

On behalf of Douglas Emmett, Inc. (“*Douglas Emmett*”), thank you for the opportunity to present testimony expressing concerns on House Bill 2702.

Douglas Emmett has been investing in Oahu for more than a decade. We currently own 1,700 workforce apartment units in three multi-family projects. In addition, Douglas Emmett owns over 1.6 million square feet of office property in downtown Honolulu. We are currently spending \$120 million to develop 475 new workforce rental apartments. The project is already having a positive, local economic impact by employing over 800 people and hundreds of local vendors.

HB 2702 Would Result in Double Taxation on REIT Shareholders and Penalize Small Investors. As a REIT, Douglas Emmett has only been able to make these investments because our shareholders are not penalized for investing in the State of Hawai’i. Real estate has traditionally been purchased by large investors in single tax vehicles such as partnerships and LLCs. Without a similar single-tax, public company vehicle, Congress realized that individuals would not have access to institutional real estate investments since entities paying double tax cannot competitively operate such investments. As a result, Congress created REITs, allowing individuals to own a small portion of professionally managed, income-producing property, including office buildings such as Bishop Square or apartments such as the Moanalua Hillside Apartments. However, if REIT shareholders are penalized with a double tax, small investors will lose their principal means of investing in institutional real estate and Hawai’i will lose a significant source of capital for its real estate markets.

Implementation of HB 2702 is Not Feasible. As a practical matter, HB 2702 cannot be implemented because REITs simply do not know the identity or tax status of their shareholders. Investments in REITs are constantly shifting (e.g., 800,000 shares of Douglas Emmett stock changes hands every day), REITs are typically held in unidentified “street name,” and the undisclosed beneficiaries are often individuals’ IRA’s, 401(k)’s and other tax-free accounts.

Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair
Committee on Finance
February 7, 2018
Page 2

Douglas Emmett believes encouraging investment by REITs is good for Hawai'i's economy and ultimately for all its residents. Inasmuch as House Bill 2702 eliminates opportunities for small investors, cannot be practically implemented and discourages real estate investment in Hawai'i, we respectfully ask that you defer HB 2702.

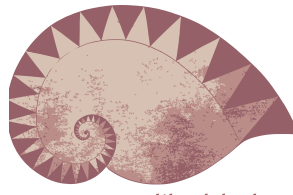
Sincerely,



Kevin A. Crummy
Chief Investment Officer
Douglas Emmett



Michele L. Aronson
Senior Vice President
Douglas Emmett



Pono Hawai'i Initiative

LATE

Josh Frost - President • Kau'i Pratt-Aquino - Secretary • Patrick Shea - Treasurer
Kristin Hamada • Nelson Ho • Summer Starr

Thursday, February 8, 2018

Relating to House Bill 2702
Testifying in Support

Aloha, Chair Luke, Vice-Chair Cullen, and Members of the House Committee on Finance,

The Pono Hawai'i Initiative (PHI) **supports HB2702 Relating to Taxation**, which requires that real estate investment trusts (REITs) file returns reporting their shareholders' pro rata shares of net income and net income attributable to this State. It also provides for composite returns and requires withholding for those shareholders who do not agree to file returns or pay tax on their pro rata share of net income attributable to this State.

This bill provides a critical fix to a problem that has long plagued Hawai'i. It keeps tax dollars generated on Hawai'i REIT income where they belong — here, in our state, where the income was made.

REITs have been granted a special tax status which exempts them from paying corporate income tax on the dividends paid to its shareholders. However, as with most forms of income, REIT shareholders pay tax on their income from the REIT.

Over 30 REITs operate in Hawai'i, which collectively own \$13 billion worth of real estate. In 2014, Hawai'i REITs produced \$721 million in dividend income that was exempt from corporate income tax. Without the dividends exemptions for REITs, Hawai'i would have collected an additional \$35 million in revenue that year.

The problem is most shareholders of Hawai'i REITs don't live in Hawai'i, so they are paying their income taxes elsewhere. Income generated by Hawai'i property isn't getting taxed here. Instead of going to pay for our roads and schools, tax dollars generated by Hawai'i REITs are paying for roads and schools and services wherever their shareholders might live.

This bill addresses the problem by simply withholding tax generated by Hawai'i REITs. Instead of paying tax in elsewhere, the tax on Hawai'i REIT income will be paid in Hawai'i, where the income was generated. And REIT shareholders will be credited for taxes paid in Hawai'i when they file their income taxes elsewhere, so they will not be double taxed.

Since these tax dollars are coming from real estate it makes sense to use them to fund affordable housing. The revenue generated by HB2702 should be earmarked to the Rental Assistance Revolving Fund to address housing affordability. This allocation is critical to helping residents struggling with the highest housing costs in the nation.

For all these reasons, we urge to you move the bill forward.

Mahalo for the opportunity,

Gary Hooser

Executive Director

Pono Hawai'i Initiative, an organization member of the Common Good Coalition

Real Estate Investment Trusts Hawaii Tax: 2018 Legislative Proposal Resolves Tax
Conundrum in a Proper and Fair Manner

Federal tax law permits REITs to pass the tax on their income to their shareholders when distributed as dividends. US REIT shareholders pay regular Federal tax on their REIT dividends, when filing their annual tax returns. For foreign shareholders, the REIT withholds Federal income tax from their dividends as paid, and transmits that to the IRS as tax paid by the foreigners.

Hawaii also permits REITs to push the tax on their Hawaii income to their shareholders. But Hawaii does not have a withholding rule for its out of state shareholders that would be similar to the Federal rule for foreigners.

Accordingly, Hawaii is currently collecting no income tax from REITs and no income tax from non-Hawaii resident REIT shareholders, who make up the vast majority of Hawaii REIT shareholders. (Many may be paying tax in their home state, but not to Hawaii.)

Past legislative attempts to impose Hawaii tax on the REIT itself have not been successful, as this would result in double tax on their income, inconsistently with the Federal rules. Since REITs now bring substantial capital and jobs to Hawaii, Hawaii has not wanted to be the one State that imposes a double tax on REIT income. On the other hand, by 2014 (the last year of recorded info), annual REIT income earned in Hawaii had already risen to \$720M, and Hawaii has never gotten even a single income tax on most of this income in any year.

A simple and fair solution is proposed. Hawaii can follow the established rules for non-residents of other "pass through" entities, such as S Corporations, and the Federal rule for REIT taxation on foreign shareholders.

By mirroring the existing Hawaii law for S Corps, REITs can remain free of Hawaii income tax. They will merely withhold and pay over the Hawaii tax on behalf of any non-Hawaii shareholders who doesn't formally declare their obligation to pay taxes to Hawaii. (The US Commerce clause insures that shareholders living in a State that also has an income tax will receive a credit against their home State tax, for the Hawaii tax withheld. No Hawaii REIT shareholders will have to pay two State income taxes.) Alternatively, because REITs have so many intermediary shareholders (mutual funds, (mutual funds, etc.) we could simply adopt a minimum rate for REIT dividends of 4-6.4%.

Summary

- I. REITs and their shareholders are the only business people in Hawaii who pay no Hawaii income tax on their substantial income (\$720M in 2014).
- II. Proposal continues no Tax to REITs on their Hawaii income.
- III. Collection by REIT of tax owed by out of state shareholders on their REIT income received.
 - A. Adopts existing S Corp statutory withholding.
 - B. REIT shareholders home state credit for Hawaii taxes paid insures no double tax.