

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

LATE

SUBJECT: INCOME, Withhold Tax on REIT Dividends

BILL NUMBER: SB 3067

INTRODUCED BY: ENGLISH by request, KEITH-AGARAN

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: This Act upon its approval, shall apply to 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. 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.

Following is an article exploring the more technical aspects of the situation. The article is scheduled for publication in *State Tax Notes* in late February 2018, and is reprinted here by permission.

Digested 2/11/2018

Hawaiian SALT

Real Estate Investment Trusts: Exposing a Loophole in Sourcing Rules

Under federal income tax law and that of most states conforming to it, a real estate investment trust (REIT) is allowed a special deduction not generally permitted to corporations, for dividends paid to its shareholders. The resulting reduction of taxable income at the corporate level for federal purposes is similar to that of the more familiar passthrough entities such as partnerships and S corporations. For state purposes, however, the sourcing rules that normally determine which states get to tax the income produce anomalous results.

A REIT is a company that owns, operates, or finances income-producing real estate.¹ REITs own many types of commercial real estate, ranging from office and apartment buildings to warehouses, hospitals, shopping centers, hotels and timberlands.² The law allowing a corporation to elect REIT status was enacted by the U.S. Congress in 1960.³ The law was modeled after that for mutual funds to provide a vehicle for smaller investors to invest in real estate the same way that mutual funds provide a vehicle for investment in stocks and bonds.⁴

A REIT would otherwise be taxable as a C corporation, but because of special provisions set forth in the IRC, a REIT can deduct dividends paid to its shareholders from its corporate taxable income.⁵ Thus, to the extent a REIT distributes its taxable income, no corporate-level taxes are due, and a REIT functions like a pass-through tax entity.⁶ Shareholders pay tax on dividends and any distributed capital gains. Among the many requirements necessary to qualify as a REIT, a company must distribute at least 90% of its taxable income to its shareholders annually.⁷

State income tax systems have a set of rules that are used to determine which state has the primary right to tax income, because more than one jurisdiction often can claim that authority. Justice Stone once wrote:

That rights in tangibles -- land and chattels -- are to be regarded in many respects as localized at the place where the tangible itself is located for purposes of the jurisdiction of a court to make disposition of putative rights in them, for purposes of conflict of laws, and for purposes of taxation, is a doctrine generally accepted both in the common law and other legal systems, before the adoption of the Fourteenth Amendment and since.”⁸

¹ IRC section 856; SEC, “Fast Answers: Real Estate Investment Trusts (REITs)” (Jan. 17, 2012), and National Association of REITs, “Learn About REIT Basics” (undated).

² See National Association of REITs, “Types of REITs” (undated).

³ IRC sections 856, 857 and 858, enacted by Real Estate Investment Trust Act of 1960 (P.L. 86-779) section 10(a).

⁴ Learn About REIT Basics, *supra* note 1.

⁵ *Bagley v. United States*, 114 AFTR 2d 5671 (Bankr. 9th Cir. 2014) and *Bridges v. Autozone Properties, Inc.*, 900 So. 2d 784 (La. 2005).

⁶ *Id.* The dividends paid deduction is provided in IRC section 857(b)(2)(B).

⁷ *Bagley*, *supra* note 5. The 90% distribution requirement is in IRC section 857(a)(1).

⁸ *Curry v. McCannless*, 307 U.S. 357, 363 (1939).

Unsurprisingly, 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 Hawaii general excise tax and Hawaii net income tax on that rent.⁹

For intangibles, a different rule often applies, called the business situs rule. Under that rule, income from intangibles is generally sourced to the location of the intangible holder, such as the residence of a shareholder, except when the intangible income relates to a business in another location, in which case it is sourced to the location of the business.¹⁰

These sourcing rules are relatively consistent across state lines – though with some variation – and ensure consistent and fair treatment between states. Sourcing rules are also necessary to have a valid tax system, because the U.S. Constitution’s Commerce Clause requires fair apportionment of income to the various states connected with it.¹¹

Determining whether an item of income follows the real estate or intangible sourcing rule is not always easy. The Hawaii Supreme Court held that when real property is sold on an 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 Hawaii taxes.¹² In contrast, the Hawaii Tax Appeal Court held that when the seller instead financed the deal by taking a purchase money mortgage on the property, and does not remain on the title, the mortgage interest follows the business situs rule and is sourced to the residence of the seller, who in the case at hand did not live in Hawaii.¹³

When these rules are applied to REITs, an anomaly results. For income tax purposes, REITs receive rent income, which is sourced to the location of the property being rented, but they don’t pay income tax on that income if 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 rental income earned in the state the REIT property is located would instead be 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 might not be taxed at all.¹⁴ If these general rules are applied, the property state where the income is earned could get no tax revenue. This seems grossly unfair to the property states, which provide police, fire, and other benefits of a civilized society to the property and the REITs’ businesses.¹⁵

Hawaii happens to be the stage on which this anomaly is being examined because the amount of REIT activity in Hawaii has been growing exponentially in recent years: a recent report

⁹ See, e.g., Haw. Admin. R. section 18-235-4-08(a).

¹⁰ *In re McCormac*, 640 P.2d 282 (Haw. 1982), and Haw. Admin. R. section 18-235-4-08(b).

¹¹ *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 287 (1977).

¹² *In re Grayco Land Escrow, Ltd.*, 559 P.2d 264 (Haw. 1977), *cert. denied*, 433 U.S. 910 (1977).

¹³ *In re van Valkenburg*, T.A. No. 1876 (Haw. Tax App. Ct. 1980) (stipulated judgment).

¹⁴ IRC section 512(b)(1) provides that dividends are excluded from “unrelated business taxable income,” on which tax-exempt entities would pay income tax under IRC section 511(a)(1).

¹⁵ As Justice Oliver Wendell Holmes said in 1904, “Taxes are what we pay for civilized society.” This expression appears above the entrance to IRS headquarters in Washington, DC.

estimated net income for REITs in Hawaii at \$79.9 million in 2012, \$208.8 million in 2013, and \$720.6 million in 2014.¹⁶ Hawaii is getting little, if any, income tax on this income from the REITs or most of the REIT shareholders living outside Hawaii, and local property developers, who of course pay income tax as well as other applicable taxes, are upset.

One possible solution¹⁷ to this problem is for states like Hawaii to adopt rules like those for S corporations, which also conduct business but are permitted to elect only one tax, at the shareholder level. The Model S Corporation Income Tax Act (MoSCITA), developed by the American Bar Association,¹⁸ recommended with modifications by the Multistate Tax Commission,¹⁹ and enacted in a few states including Hawaii,²⁰ requires S corporations to determine how much net income is sourced to the reporting state;²¹ report each shareholder's distributive share of that net income,²² and then either obtain and file each shareholder's agreement to file and pay income tax in the reporting state, or withhold and pay tax at the highest applicable rate.²³ This payment would then would be credited to the shareholder if it files a return with the reporting state.²⁴ The reporting state is also required to provide "composite return" procedures, under which a reporting S corporation could elect to pay tax on behalf of its shareholders (and then recoup the payments from the shareholders).²⁵

As a practical matter, states should be able to adapt the reporting requirements so as to use the existing Form 1099-DIV, which provides a convenient box to report state withholding tax. When the shareholders are then taxed in their respective residence states, the residence states typically will give credit against their individual income tax for tax validly imposed by the property states on income that the residence state considers out-of-state income.²⁶ It is arguable that REIT dividends are passthrough business income like income flowing up from S corporations, but, because of the novelty of the idea, it is unclear whether residence jurisdictions would accept this characterization.

¹⁶ Hawaii Department of Business, Economic Development and Tourism, "Real Estate Investment Trusts in Hawaii: Analysis and Survey Results" (Sept. 2016)

¹⁷ Another approach is to disallow the REIT dividend paid deduction outright. Only one state, New Hampshire, does this. N.H. Rev. Stat. section 77-A:1, I.

¹⁸ American Bar Association Subcommittee on State Taxation of S Corps.; and Model S Corp. Income Tax Act and Commentary, 42 *Tax Law*. 1001 (1989).

¹⁹ Multistate Tax Commission, "The Multistate Tax Commission 'Working Draft' of a Proposed Model Rule for a Partnership Composite Tax Return Applicable to Multijurisdictional Partnerships," reprinted in *State Tax Notes*, Nov. 30, 1992, p. 810.

²⁰ Haw. Rev. Stat. sections 235-121 to -130.

²¹ Determination of the amount of income sourced to the reporting state is normally done under the Uniform Division of Income for Tax Purposes Act, which is in force in most states.

²² MoSCITA section 1007(a); Haw. Rev. Stat. section 235-128(a).

²³ MoSCITA section 1007(c)-(d); Haw. Rev. Stat. section 235-128(c)-(d).

²⁴ MoSCITA section 1007(e); Haw. Rev. Stat. section 235-128(e).

²⁵ MoSCITA section 1007(b); Haw. Rev. Stat. section 235-128(b).

²⁶ The Commerce Clause requires a credit for taxes paid to other states, because otherwise multiple taxation would result, with interstate activity being taxed more than intrastate activity. *Comptroller of Treasury of Maryland v. Wynne*, 135 S. Ct. 1787 (2015); and Jerome R. Hellerstein, Walter Hellerstein, and John A. Swain, *State Taxation*, paras. 20.04[2], 20.10 (3d ed. 2014).

This approach is consistent with federal treatment of distributions to foreign investors. When any corporation distributes a dividend to a foreign person, withholding of federal income tax is normally required.²⁷ Withholding is also required when a partnership distributes its profits derived from U.S. business to a foreign investor.²⁸

The approach is also consistent with federal treatment of REIT dividends under the recently enacted Tax Cuts and Jobs Act. REIT dividends, unlike regular dividends, are eligible for the deduction available to individuals for passthrough business income.²⁹ And even regular dividends are not automatically sourced to the recipient's state of residence; they are subject to the "business situs" rule, where dividends connected with a business are sourced to the location of the business instead.³⁰

Thus, state tax treatment of a REIT dividend distribution as passthrough business income, in a manner consistent with the MoSCITA and the federal rules for the new pass through business deduction, is a possible solution to the current problem for states like Hawaii that receive little or no income tax on substantial amounts of real estate income earned from property in their states by REITs and their shareholders.

²⁷ IRC section 1441.

²⁸ IRC section 1446.

²⁹ IRC section 199A(b)(1)(B).

³⁰ See *supra* note 10 and accompanying text.

February 12, 2018

Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means



RE: **SB 3067 Relating to Taxation – In Opposition**
Tuesday, February 13; 10:15 AM; Conference Room 211

Aloha Chair Dela Cruz, Vice Chair Keith-Agaran and Members of the Committee:

On behalf of Douglas Emmett, Inc. (“*Douglas Emmett*”), thank you for the opportunity to present testimony expressing concerns on SB 3067, which establishes requirements and procedures for a real estate investment trust to file tax returns and payments.

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.

Implementation of SB 3067 is Not Feasible. As a practical matter, SB 3067 cannot be implemented because REITs simply do not know the identities of their shareholders. REIT shares are typically held in “street name.” For example, Douglas Emmett currently has almost 170,000,000 shares outstanding, many of which are held in accounts at brokerage firms such as Vanguard or Charles Schwab. We do not know the names of the individual investors who own these accounts.

In addition, investments in REITs are constantly shifting (e.g., 800,000 shares of Douglas Emmett stock changes hands every day). Given this churn and the fact that we do not know the identity of our shareholders, it would be impossible to ratably allocate income taxes among Douglas Emmett’s investors.

SB 3067 is Contrary to the Congressional Intent of REITs and Penalizes Small Investors. Real estate has traditionally been purchased by large investors in single tax vehicles such as partnerships and LLCs. Because most individuals do not have access to these types of structures, Congress created REITs in 1960 to provide individuals with a single-tax, public investment vehicle, giving them better access to institutional real estate investments. As a result, today individuals can own a small portion of professionally managed, income-producing property, including office buildings such as Bishop Square and apartments such as the Moanalua Hillside Apartments.

Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means
February 12, 2018
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In addition to being impractical to implement, SB 3067 is likely unconstitutional. It imposes an income tax on passive REIT investors who are unlikely to be given any credits for those taxes in their resident states. It also imposes a tax on investors who are investing through individual IRA's, 401(k)'s and other tax-free accounts.

The practical result of SB 3067 is a double tax on individuals seeking to access institutional real estate, undermining Congress' goals when it originally passed REIT legislation. Increased taxes will reduce returns to shareholders and discourage them from investing in REITs that have assets in Hawai'i. This, in turn, will discourage REITs from allocating capital to Hawai'i.

REITs - just like any other property owner in Hawai'i - are already required to pay taxes associated with their real estate holdings, including real property, occupancy, and general excise taxes. By way of example, in 2017, Douglas Emmett paid over \$8.5 million in real property taxes and general excise taxes. We expect to pay over \$5 million of excise tax on our \$120 million Moanalua Hillside Development. When completed, the additional units are projected to generate more than \$500,000 of annual general excise tax. Without this development, this additional tax on both the construction costs and rental of the new units would not be generated.

Douglas Emmett has been working to build additional rental housing units in Moanalua for several years with the goal of building more units in the future. We are aligned with other developers, legislators and Hawai'i residents whose goal is to increase the supply of rental housing. In general, development of rental apartment units is extremely challenging due to Hawaii's high land prices and excessive construction costs. Imposing additional taxes on investors makes developing rental housing in Hawai'i even harder.

Douglas Emmett believes encouraging investment by REITs is good for Hawai'i's economy and ultimately for all its residents. Inasmuch as SB 3067 cannot be practically implemented, discriminates against small investors, and discourages real estate investment in Hawai'i, we respectfully ask that you hold SB 3067.

Sincerely,



Kevin A. Crummy
Chief Investment Officer
Douglas Emmett



Michele L. Aronson
Senior Vice President
Douglas Emmett



HAWAII APPLESEED

CENTER FOR LAW & ECONOMIC JUSTICE

LATE

Testimony of Hawai'i Appleseed Center for Law and Economic Justice
Supporting SB 3067 – Relating to Taxation
Senate Committee on Ways and Means
Scheduled for hearing on Tuesday, February 13, 2018, 10:15a.m., in Conference Room 211

Dear Chair Dela Cruz, Vice Chair Keith Agaran, and members of the Committee:

Thank you for the opportunity to testify in **STRONG SUPPORT** of **SB 3067**, 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.

SB 3067 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 should be credited for taxes paid in Hawai'i when they file their income taxes elsewhere—they should not be subject to a double-tax either.

SB 3067 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 SB 3067 should fund housing affordability initiatives such as those 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.

Hawaii Appleseed Center for Law and Economic Justice

February 13, 2018

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The Twenty-Ninth Legislature
Regular Session of 2018

LATE

THE SENATE
Committee on Ways and Means
Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
State Capitol, Conference Room 211
Tuesday, February 13, 2018; 10:15 a.m.

**STATEMENT OF THE ILWU LOCAL 142 ON S.B. 3067
RELATING TO TAXATION**

The ILWU Local 142 **supports** S.B. 3067, which establishes requirements and procedures for a Real Estate Investment Trust (REIT) to file tax returns and payments. Applies to taxable years beginning after December 31, 2018.

Real Estate Investment Trusts, or REITs, are big business, investing in real estate and mortgage loans and capitalizing on a tax structure that allows them to avoid income taxes. An example of a REIT in Hawaii is General Growth Properties (GGP), which owns Ala Moana Center, the largest shopping center in the State. Alexander & Baldwin, also known as A&B, is a kamaaina company that recently converted to a REIT in order to take advantage of tax breaks—a good move for A&B but not so good for the State of Hawaii, which will now receive far less in taxes from A&B.

S.B. 3067 will require REITs in Hawaii to file tax returns and make payments of income taxes. They will also be required to provide information to the Department of Taxation about shareholders and their stocks, presumably to levy taxes on those shareholders.

There will be some who will say this measure will drive REITs out of Hawaii to do business elsewhere and discourage continued investment by current shareholders and new ones. However, real estate in Hawaii is booming, and it is highly unlikely that REITs will abandon the goose that lays the golden egg. Shareholders will likewise continue investing as long as they are able to show a profit, something that is not likely to change any time soon.

What S.B. 3067 will do is require REITs and their shareholders to pay their fair share of taxes. If they are making a profit from real estate ownership through the REIT, it only stands to reason that they should pay taxes on that income.

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

The ILWU urges passage of S.B. 3067. Thank you for the opportunity to offer testimony on this measure.

SB-3067

Submitted on: 2/12/2018 10:47:15 AM

Testimony for WAM on 2/13/2018 10:15:00 AM

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

Comments:

Senator Donovan M. Dela Cruz, Chair

Senator Gilbert S.C. Keith-Agaran, Vice Chair

Committee on Ways and Means

LATE

Michael K. Perkins (Name)

4051 Kaimuki Ave. (Address)

Honolulu, Hawaii (6816 (Address)

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

As a resident concerned about Hawaii's economy and long-term community development, I strongly support S.B. 3067, Relating to Taxation.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of \$40 to \$60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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

For these reasons, I urge the committee to pass S.B. 3067. Thank you for the opportunity to testify.

Sincerely,

Michael Perkins

LATE

SB-3067

Submitted on: 2/12/2018 11:00:00 AM

Testimony for WAM on 2/13/2018 10:15:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Ben Walin	Individual	Support	No

Comments:

Please stop the Reits from stealing from our state.

Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means

LATE

Darryl Wong
1836 Punahou Street
Honolulu, Hawaii 96822

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation of REIT's

As a resident concerned about Hawaii's economy and long-term community development, I strongly support S.B. 3067, Relating to Taxation of REIT's

This bill corrects a major loophole in our State of Hawaii income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our State without paying income tax like the rest of us. This results in a loss of \$40 to \$60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

My understanding is REIT-owned property in Hawaii per capita is higher than any other State in the United States of America. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to \$16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass S.B. 3067. Thank you for the opportunity to testify.

Darryl P Wong

LATE

SB-3067

Submitted on: 2/12/2018 1:31:32 PM

Testimony for WAM on 2/13/2018 10:15:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
steve gold	Individual	Support	No

Comments:

As a resident concerned about Hawaii's economy and community development, I support SB 3067. This bill corrects a loophole in our State income tax that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our State without paying income taxes as the rest of us must.

SB-3067

Submitted on: 2/12/2018 2:55:39 PM

Testimony for WAM on 2/13/2018 10:15:00 AM



Submitted By	Organization	Testifier Position	Present at Hearing
James K. Tam	Individual	Support	No

Comments:

To: Senator Donovan M. Dela Cruz, Chair

Senator Gilbert S.C. Keith-Agaran, Vice Chair

Committee on Ways and Means

From: James K. Tam

841 Bishop Street, Suite 850

Honolulu, HI 96813

Date: February 13, 2018

Re: Support for S.B. 3067, Relating to Taxation

This is to express my concern about Hawaii's economy and long-term community development by strongly supporting S.B. 3067, Relating to Taxation, which would require REITs in Hawaii to pay income tax to produce income that would fund programs for all who live here.

Our current state income tax law allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like

the rest of us. This results in a loss of \$40 to \$60 million annually that is desperately needed to support the ever growing costs of programs for education, social services, and other state commitments. S.B 3067 will stop this.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further escape paying their share. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to \$16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed by passage of S. B. 3067 so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass S.B. 3067. Thank you for the opportunity to testify.

February 12, 2018

Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means



Richard Ing
841 Bishop Street Suite 860
Honolulu, Hawaii 96813

Support for S.B. 3067, Relating to Taxation

As a resident concerned about Hawaii's economy and long-term community development, I strongly support S.B. 3067, Relating to Taxation.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of \$40 to \$60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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

For these reasons, I urge the committee to pass S.B. 3067. Thank you for the opportunity to testify.

Sincerely,

Richard Ing

SB-3067

Submitted on: 2/12/2018 3:48:09 PM

Testimony for WAM on 2/13/2018 10:15:00 AM

LATE

Submitted By	Organization	Testifier Position	Present at Hearing
Candace Takahashi	Individual	Support	No

Comments:

To:
Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means

From:
Larry Gilbert
1200 Queen Emma St Apt 1808
Honolulu HI 96813



Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

As a resident concerned about Hawaii's economy and long-term community development, I strongly support S.B. 3067, Relating to Taxation.

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Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means

LATE

Julian Zamade (Name)
738 Ume St. (Address)
Honolulu, Hawaii 96819 (Address)

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

As a resident concerned about Hawaii's economy and long-term community development, I strongly support S.B. 3067, Relating to Taxation.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of \$40 to \$60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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For these reasons, I urge the committee to pass S.B. 3067. Thank you for the opportunity to testify.

From: [Nicole Woo](#)
To: [WAM Testimony](#)
Cc: [Roger Epstein](#)
Subject: SB 3067 – Relating to Taxation
Date: Monday, February 12, 2018 2:25:41 PM



This is the written testimony of Roger H. Epstein, Esq. (cc:ed on this message).

Hearing on SB 3067 – Relating to Taxation
Before the Senate Committee on Ways and Means
On Tuesday, February 13, 2018 at 10:15 a.m.
In Conference Room 211

Dear Chair Dela Cruz, Vice Chair Keith-Agaran, and members of the Committee:

Thank you for the opportunity to provide COMMENTS on SB 3067, which would establish requirements and procedures for a real estate investment trust to file tax returns and payments.

My name is Roger Epstein, and I have over 50 years of experience in tax law. I was the chair of the Tax Department of Cades Schutte and have extensive experience in all areas of tax law handled by the Tax Department. Prior to joining Cades Schutte in 1972, I was a Tax Law Specialist with the National Office of the Internal Revenue Service in Washington, D.C. and prior to that, I was an Internal Revenue Agent in Washington D.C.

Background: Real Estate Investment Trusts and Hawaii Tax

Federal tax law permits REITs to pass the tax on their income to their shareholders when distributed as dividends. U.S. 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.

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

A simple and fair solution is proposed. Hawaii can follow the established rules for non-residents of other “pass through” entities, such as is done at the Federal level with respect to foreign REIT shareholders. **REITs** can remain free of Hawaii income tax. They **will merely withhold and pay over a minimum Hawaii tax on behalf of all their shareholders.** The rate of this tax should be fixed somewhere between the Hawaii corporate capital gain rate of 4% and the ordinary income rate of 6.4%-say 5%. The shareholders should receive a credit against their home State tax, for the Hawaii tax withheld, so no REIT shareholders will have to pay two State income taxes. Tax-exempt shareholders, like pension plans, should be permitted to file a claim for refund.

Summary

- REITs and their shareholders are the only business people in Hawaii who pay no **Hawaii income tax** on their substantial income (\$720M in 2014).
- Proposal continues no Tax to REITs on their Hawaii income.
- Collection by REIT of tax owed by out of state shareholders on their REIT income received.
- Adopts a minimum tax on REIT dividends (5%) and require REIT withholding.
- We should confirm that REIT shareholders will receive a home state credit for Hawaii taxes , to insure no double tax.

Mahalo for your time and consideration of this testimony.

LATE

SB-3067

Submitted on: 2/12/2018 10:22:15 PM

Testimony for WAM on 2/13/2018 10:15:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Matthew Friedman	Individual	Support	No

Comments:

Senator Donovan M Dela Cruz, Chair

Senator Gilbert S.C. Keith-Agaran, Vice Chair

Committee on Ways and Means

Matthew Friedman

347 Opihikao Place

Honolulu, HI 96825

Monday, February 12, 2018

Support for S.B. No. 3067, Relating to Taxation

As an economist concerned about Hawaii's long-term economic stability, I strongly support S.B. No. 3067

For years, the out-of-state owners of Ala Moana Center, Public Storage, Bishop Square, as well as many other retail centers, office buildings, hotels and industrial parks, have paid virtually no state tax on their real-estate operations in Hawaii. These mainland firms manage to avoid paying state taxes by holding their assets in a real estate investment trust (REIT).

A REIT, unlike other corporate entities, generally pays no tax at the corporate level, thanks to a "dividends paid deduction." Instead, Hawaii law requires that at least 90 percent of a REIT's taxable income be distributed directly to shareholders, who will then pay income tax on those dividends. The flaw in this design, however, is that because REITs are taxed only at the shareholder level, shareholders who reside outside of Hawaii typically pay zero tax in Hawaii. Instead, they pay income taxes to their state of residence. This means a REIT shareholder can make a fortune collecting rent in Waikiki, but when that fortune is taxed, it might pay for pension benefits in Illinois or a new highway in New York.

Fortunately some of our state legislators have recognized this loophole and S.B. No. 3067 to plug it. Passage of this bill would broaden and stabilize Hawaii's tax base without burdening Hawaii residents or businesses with any additional tax obligations.

Conservative estimates project that closing this loophole would recover nearly tens of millions of dollars in tax revenue annually. While significant, the actual figure is likely to be greater, especially considering the potential capital gains on future sales of REIT-owned property.

Obviously, the big-money mainland firms who profit from this tax loophole will be staunchly opposed to closing it. Illinois-based General Growth Properties (GGP), Michigan-based Taubman and the rest of the REIT community have and will continue to lobby lawmakers to defeat SB 3067. They argue it threatens the positive economic benefits that their current investments provide the local economy and jeopardizes future investment. Don't believe them.

First of all, to suggest that the economic benefits created by Ala Moana Center would vanish should its owner, GGP, be taxed like every other business entity in the state borders on absurd. GGP may decide to owner, GGP, be taxed like every other business entity in the state borders on absurd. GGP may decide to go back to the mainland, but it doesn't get to take Ala Moana Center with it; the mall would stay and so would the property and general excise tax revenues that come with it. Should GGP (or any other REIT) decide paying taxes on its Hawaii income is prohibitive, there would be a line of tax-paying non-REIT investors stretching as far as the eye can see waiting to buy those properties, thereby increasing the economic benefits to the state on any existing or future projects.

Second, recognize that Hawaii has no substitute in the real-estate world. Hawaii will remain a lucrative destination for investment dollars, given the excess profits that can be generated because of our islands' unique culture and position geographically. Whatever outside investment may be discouraged by this bill can be countered with targeted tax breaks for new investments - there is no reason to offer a blanket subsidy for mainland ownership of existing properties.

The current system of tax giveaways to out-of-state investors puts local firms at a competitive disadvantage. This is neither conducive to growth nor prudent from the standpoint of supporting the local community. Leaving this loophole open would only incentivize more firms to pack a bag full of dollars in Hawaii and fly off with it to fund some other state's infrastructure. Supporting SB 3067 will help ensure that all businesses in Hawaii are doing their fair share to maintain our paradise.

Thank you for the opportunity to testify.

Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means



Ryan Matsumoto
3438 Niolopua Dr.
Honolulu, Hawaii 96817

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

I am a resident, born and raised in Hawaii concerned about Hawaii's economy and long-term community development, I strongly support S.B. 3067, Relating to Taxation.

This bill will begin the process of closing the egregious loophole in our state income tax law that allows mainland corporations that operate profitably as REITs in Hawaii to take the net income out of our state without paying income tax like they should. The loss of an estimated \$40-\$60M in annual tax revenue will have a huge impact in a state where there are constant shortfalls to support the costs of education, social services, and the many other critical government initiatives that are imperative to the survival of our island community.

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

For these reasons, I urge the committee to pass S.B. 3067. Thank you for the opportunity to testify.

To: Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means



From: Chad Love
1164 Bishop Street, Suite 1105
Honolulu, Hawaii 96813

Tuesday, February 13, 2018

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As a resident concerned about Hawaii's economy and long-term community development, I strongly support S.B. 3067, Relating to Taxation.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of \$40 to \$60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means



Jack Belli (Name)

94-1120 Manino Place (Address)

Waipahu 96797 (Address)

Tuesday, February 13, 2018

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