DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR

RONA M. SUZUKI
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DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
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LATE

To: The Honorable Donovan M. Dela Cruz, Chair;
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair;
and Members of the Senate Committee on Ways and Means

From: Rona M. Suzuki, Director
Department of Taxation

Re: **S.B. 2697, Relating to Taxation of Real Estate Investment Trusts**
Date: Tuesday, February 18, 2020
Time: 10:30 A.M.
Place: Conference Room 211, State Capitol

The Department of Taxation (Department) appreciates the intent of S.B. 2697 and provides the following comments. S.B. 2697 repeals the dividends paid deduction that real estate investment trusts (REITs) are allowed by current law. This will subject REITs' income to the Hawaii corporate income tax in the same manner as other corporations. The measure is effective upon approval and applies to taxable years beginning after December 31, 2020. The bill provides for its automatic repeal on December 31, 2023.

The Department of Business, Economic Development, and Tourism is responsible for economic development, including the role of REITs. The Department is responsible for administering the tax laws in a fair, consistent, and efficient manner.

S.B. 2697 proposes to repeal the dividends paid deduction and is the most administratively efficient way in which to impose income tax on REITs.

The Department notes that it is able to administer the bill with its current effective date.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

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

SUBJECT: INCOME, Disallow dividends paid deductions for REITs

BILL NUMBER: HB 2605; SB 2697

INTRODUCED BY: HB by BROWER, CREAGAN, HOLT, D. KOBAYASHI, C. LEE, LOWEN, MCKELVEY, NAKASHIMA, NISHIMOTO, ONISHI, QUINLAN, SAN BUENAVENTURA, TAKAYAMA, TAKUMI, TODD, Eli, Matayoshi, Morikawa; SB by KEITH-AGARAN, J.KEOHOKALOLE, MORIWAKI, S. Chang, Kanuha, Kidani, Kim, Riviere, Shimabukuro

EXECUTIVE SUMMARY: Disallows dividends paid deduction for real estate investment trusts. Applies to taxable years beginning after 12/31/2020. Sunsets 12/31/2023.

SYNOPSIS: Amends HRS section 235-2.3(b) to provide that section 857(b)(2)(B) (with respect to the dividends paid deduction for real estate investment trusts) shall not be operative for Hawaii income tax purposes.

Amends HRS section 235-71(d) to provide that for tax years beginning after December 31, 2020, no deduction for dividends paid shall be allowed for REITs for Hawaii income tax purposes.

EFFECTIVE DATE: This Act shall take effect upon its approval and shall apply to taxable years beginning after December 31, 2020; provided that this Act shall be repealed on December 31, 2023; provided further that sections 235-2.3(b) and 235-71(d), Hawaii Revised Statutes, shall be reenacted in the form in which they read prior to the effective date of this Act.

STAFF COMMENTS: Currently under federal and state income tax law, a real estate investment trust (REIT) is allowed a dividend paid deduction, unlike most other corporations, resulting in that dividend being taxed once, to the recipient, rather than to the paying corporation. The proposed measure would make that section of the IRC inoperative for Hawaii income tax purposes for tax years beginning after 12/31/19, meaning that REITs would be subject to double taxation like other corporations.

All state income tax systems in the United States, including ours, have a set of rules that are used to figure out which state has the primary right to tax income. For example, most tax systems say that rent from real property is sourced at the location of the property, so if a couple in Florida rents out a property they own on Maui they can expect to pay our GET and our net income tax on that rent. These sourcing rules, which do vary by state but are relatively consistent across state lines, are there to assure consistent and fair treatment between states.

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

Apparently, the evil sought to be addressed by the bill is that (1) REITs are very visible in Hawaii, but do not get taxed because of the deduction allowed for dividends paid, while (2) many REIT owners who receive the dividend income are either (a) outside of Hawaii and don't get taxed either because they are outside of Hawaii, or (b) are exempt organizations that normally are not taxed on their dividend income. Normally we like to have our income tax law conform to the Internal Revenue Code to make it easier for people and companies to comply with it, but our legislature has departed from conformity when there's a good reason to do so (such as if it is costing us too much money). The issue is whether such a good reason exists here.

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

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

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

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

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

> Some real estate investment trust shareholders live in Hawaii, but a substantial majority do not. Further, while real estate investment trusts own more real estate in Hawaii per capita than in any other state, it ranks fortieth in the nation for the number of real estate investment trust shareholders as a percentage of the population. As a result, many real estate investment trusts and their shareholders pay a mere fraction of the Hawaii state income tax compared to what other corporations pay.
>
> The legislature therefore finds that it would be more equitable to decouple from the federal system in this regard so that corporations and other business entities doing business in Hawaii pay a fair tax burden commensurate with the substantial privileges and resources in Hawaii that were used to generate their profits. Real estate investment trusts would continue to receive their generous federal tax exemptions and continue to benefit from Hawaii's low property tax rates.

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

Digested 2/3/2020

Senate Committee on Ways and Means
February 18, 2020 at 10:30 a.m.
State Capitol Conference Room 211

SUPPORTING SB 2697 WITH AN AMENDMENT

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

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

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

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

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

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

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

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

SB-2697
Submitted on: 2/13/2020 3:01:48 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Catherine Susan Graham	Testifying for Faith Action for Community Equity/Housing Now Coalition	Support	Yes

Comments:

Aloha, Chair Dela Cruz and Committee members,

I am testifying in favor of taxing the REITs just like any other corporation that does business in Hawaii. As we all know, REIT properties occupy an enormous amount of our state's land and our land is our most valuable natural resource. The State of Texas does not allow the oil companies to plunder their oil fields without remuneration. Hawaii has been cheated out of up to $60 million dollars annually for a very long time. Investing in Hawaii will not be affected in the long run because REITS will have to pay state tax. There is still plenty money for developers, hotel owners, shopping center owners and other REIT entities to remain profitable after paying a maximum of 6% corporate tax. Since REITS are landowners, Faith Action recommends that the ensuing tax income be funnelled to the development of affordable housing.

Faith Action appreciates that the Legislature passed this bill last year almost unanimously. Because of the fear of another veto by the Governor, we request that this bill be fast-tracked and sent to the Governor by April 16 so that if he does, indeed, veto it, there will be time left for your to overturn his veto this year.

Thank you for your attention to this matter.

WRITTEN TESTIMONY OF

JEFFREY S. CLARK
SVP-TAX & RISK MANAGEMENT
HOST HOTELS & RESORTS, INC.

IN OPPOSITION TO SB 2697

BEFORE THE HAWAII SENATE
COMMITTEE ON WAYS AND MEANS

THE HONORABLE DONOVAN M. DELA CRUZ, CHAIR
THE HONORABLE GILBERT S.C. KEITH-AGARAN, VICE CHAIR

HEARING ON SB 2697
FEBRUARY 18, 2020
10:30 A.M.

Thank you for the opportunity to submit this testimony in opposition to SB 2697 on behalf of Host Hotels & Resorts, Inc. (Host). Host is the largest lodging real estate investment trust (REIT) and one of the largest owners of luxury and upper-upscale hotels. The Company is headquartered in Bethesda, Maryland and is traded on the New York Stock Exchange. Host owns 80 hotels throughout the U.S., Canada and Brazil, including four hotels in Hawaii. Host strongly opposes, and asks you to hold, SB 2697.

In addition, Host would like to emphasize that the federal tax law requirements of a hotel REIT like Host lead to the doubling or tripling of the liability for Hawaii general excise tax (GET) as compared with non-REIT hotel owners.

REITs are subject to federal income tax law requirements that do not apply to other forms of property owners. As relevant here, at least 75% of the annual gross income of a REIT must consist of “rents”. Hotel room charges are not considered to be “rents” for this purpose. As a result, federal income tax law requires hotel REITs to:

- Lease their hotels to a third party or to a taxable subsidiary of the REIT, and
- If leased to a taxable subsidiary of the REIT, the subsidiary must hire an independent third party operator to operate and manage the hotel.

Again, these requirements do not apply to non-REIT hotel owners.

Hawaii imposes GET not only on the room charges and other hotel operating income earned by the hotel from guests, but also on the rent received by the REIT from the taxable subsidiary and on the management fee paid to the operator by the taxable subsidiary. Again, this additional GET is not imposed on a non-REIT hotel owner. As a result, GET is imposed on at least three levels of income of a hotel owned in a REIT structure: the room charges and other operating income received from guests, the rent received by the REIT from the taxable subsidiary, and the management fee paid by the taxable subsidiary to the hotel operator.

For example, Host leases its four hotels in Hawaii, the Fairmont Kea Lani on Maui, the Hyatt Regency Maui Resort & Spa, the Andaz Maui, and the Hyatt Place Waikiki Beach to a taxable subsidiary, and the taxable subsidiary hires independent third party operators (Fairmont and Hyatt) to operate and manage its four hotels. The **additional annual GET liability of approximately $6-$8 million** paid to Hawaii for each of 2017, 2018, and 2019 attributable to the rents received by the REIT from the taxable subsidiary and the management fees paid by the taxable subsidiary to Fairmont and Hyatt would not have been paid if the same entity were both the owner and the operator of the hotels. Because the GET is a gross receipts, rather than a net income, tax, it is a much more reliable source of revenue for the State. It also is a much greater source of revenue to the State than the corporate income tax. The enactment of SB 2697 immediately would risk elimination of this extremely valuable source of GET revenue to the State.

Because of these unique requirements applicable to hotel REITs, the State received more than $16 million of GET in 2018 alone from hotel REITs that own hotels in Hawaii that non-REIT hotel owners do not incur. Yet the proponents of SB 2697 claim that we operate tax-free in Hawaii!

Why own hotels in a REIT structure if it results in more aggregate tax than a non-REIT hotel owner-operator? The simple answer is that the ownership of hotels on the one hand and operating and managing the hotels on the other hand require different knowledge, experience, and expertise and separating the hotel ownership from the hotel operations and management creates more value both for the investors in the REIT and the investors in the hotel operator/manager. As an additional benefit, this separation of ownership and operations/management also creates millions of dollars of tax revenues to, and many jobs, in, this State. This creates a win-win situation, all of which immediately could be jeopardized by the enactment of SB 2697. However, if SB 2697 is enacted, lodging REITs like Host would need to evaluate whether or not to retain their current ownership structure or to change it in order to offset the State corporate income taxes that the legislation would impose.

The estimate of $16 million of incremental GET generated by hotel REITs which could be eliminated if the hotel ownership were changed to a REIT's taxable subsidiary or another non-REIT owner rather than the REIT itself should be compared to the Department of Taxation's 2019 determination that repealing a REIT's dividends paid deduction would raise no more than $10 million per year. Then-Director of DoTax explained on a Hawaii Public Radio interview on April 4, 2019 (beginning at 10:10 in the recording), regarding similar legislation, that even this maximum amount does not contemplate basic planning opportunities that could be employed such as increased leverage or claiming tax credits to which a taxpayer already is entitled and that other non-REITs claim. It makes little sense to jeopardize jobs by scaring off needed investment in Hawaii, especially when the net result (even apart from the macroeconomic losses due to less investment in Hawaii) in terms of both corporate income taxes and GET is a LOSS to Hawaii.

As previously stated, Host Hotels & Resorts, Inc. currently owns four hotels in Hawaii, Hyatt Regency Maui on Kaanapali Beach, Andaz Maui at Wailea Resort, Fairmont Kea Lani, Maui and Hyatt Place Waikiki Beach. A key part of our disciplined approach to capital allocation is to make renewal and replacement capital expenditures that maintain the quality and competitiveness of our hotels. Enactment of SB 2697 would create a strong disincentive for us to employ this approach at our hotels in Hawaii. It would force us to revisit our plans to begin major renovation work at the Fairmont Kea Lani scheduled for 2021, discontinue our ground-up new construction of luxury villas at the Andaz Maui, as well as serve to discourage future investments in our hotels, potentially affecting hundreds of local jobs.

Accordingly, Host respectfully asks the Committee to hold SB 2697.

NAIOP
COMMERCIAL REAL ESTATE
DEVELOPMENT ASSOCIATION
HAWAII CHAPTER

February 14, 2020

Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Members of the Senate Committee on
Ways & Means
Thirtieth Legislature
Regular Session of 2020

RE: **SB 2697 – RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS**
Hearing Date – February 18, 2020 at 10:30 a.m.

Aloha Chair Dela Cruz and members of the committee,

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

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

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

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

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

Mahalo for your consideration,

Catherine Camp, President
NAIOP Hawaii

MAUI
CHAMBER OF COMMERCE
VOICE OF BUSINESS

HEARING BEFORE THE SENATE COMMITTEE ON
WAYS AND MEANS
HAWAII STATE CAPITOL, SENATE CONFERENCE ROOM 211
TUESDAY, FEBRUARY 18, 2020 AT 10:30 A.M.

To The Honorable Donovan M. Dela Cruz, Chair;
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair; and
Members of the Committee on Ways & Means,

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

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

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

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

Sincerely,

Pamela Tumpap

Pamela Tumpap
President

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

95 Mahalani Street, Suite 22A, Wailuku, Hawaii 96793 808-244-0081 info@MauiChamber.com MauiChamber.com

PARK
HOTELS & RESORTS

Park Hotels & Resorts Inc.
Scott Winer, SVP Tax
1775 Tysons Boulevard
7th Floor
Tysons, VA 22102
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WRITTEN TESTIMONY OF

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

IN OPPOSITION TO SB 2697

BEFORE THE COMMITTEE ON WAYS AND MEANS

SENATOR DONOVAN M. DELA CRUZ, CHAIR

SENATOR GILBERT S.C. KEITH-AGARAN, VICE CHAIR

HEARING ON SB 2697

FEBRUARY 18, 2020

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

SB 2697 would, beginning in taxable years after Dec. 31, 2020, disallow real estate investment trusts ("REITs") from claiming a dividend paid deduction ("DPD") and thus require REITs to pay corporate income tax to the State of Hawai'i. The preamble to the legislation states the disallowance would be for a three year taxable period (taxable years beginning after December 31, 2020, which shall repeal on December 31, 2023) but the legislative text does not support the preamble limitation to three years.

Additionally, the preamble to the legislation states it would be more equitable to decouple from the federal DPD so that business entities doing business in Hawaii pay a fair tax burden commensurate with the substantial privileges and resources used in Hawaii and that REITs will continue to benefit from Hawaii's low property tax rates.

As described in more detail below, PARK opposes SB 2697 for the following reasons:

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

PARK is a publicly traded lodging REIT (NYSE:PK) that owns 62 premium branded hotels and resorts primarily located in the United States. Included within PARK's portfolio of hotels are (i) the iconic Hilton Hawaiian Village Waikiki Beach Resort located along Oahu's prestigious Waikiki Beach, and (ii) the Hilton Waikoloa Village located on the Kohala Coast of the Big Island of Hawai'i. PARK strives to be the preeminent lodging REIT, focused on consistently delivering superior, risk adjusted returns for shareholders that invest in the hotel sector. PARK, like most REITs, has a long-term investment focus and is committed to creating sustainable value at its properties.

As you know, Congress enacted the REIT legislation in 1960 to allow individual investors the ability to own and benefit from professionally managed, institutional quality, income-producing real estate. As with all REITs, PARK must meet multiple stringent, complex and costly requirements in order to maintain its status as a REIT, including: organizational requirements, asset holding requirements, passive income generation requirements, and importantly REITs must distribute at least 90% of their taxable income annually. These stringent, complex and costly requirements do Not apply to non-REIT real estate owners and require REITs to continuously access the debt and equity capital markets to obtain capital for maintenance, improvements and growth projects. By meeting these stringent, costly and complex requirements REITs are allowed to claim a DPD essentially passing through their taxable income to shareholders.

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

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

As described below, Park's acquisition and ownership of the two Hawai'i hotels results in approximately **$11 million in additional GET being paid to the State of Hawaii annually**.

Further, as REITs are passive real estate companies, they cannot actively trade in real estate properties without being subject to a 100% tax on the gain. Thus, unlike non-REIT owners, as a passive real estate company, REITs are long term investors in their real estate. Park, as is widely known, acquired land adjacent to the Hilton Hawaiian Village Waikiki Beach Resort complex with the express intent of investing in an additional hotel tower. The construction of such a new hotel tower will likely cost hundreds of millions of dollars and create significant jobs and additional revenues for the State.

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

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

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

We believe the proposed legislation will not increase tax revenue for the state as the cost of doing business in Hawai'i will diminish investment returns and result in less investment. Further, disallowance or elimination of the DPD could result in foundations or pension funds replacing REIT ownership of real property. Foundations and pension funds generally are passive owners that pay no federal or state income taxes and do not make the same capital investments as REITs. Further, if hotels in Hawai'i are converted to non-REIT ownership, including ownership by taxable subsidiaries of REITs, the additional GET revenue generated solely as a result of the REIT structure will disappear.

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

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

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

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

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

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

HAWAII TAXES GENERATED / PAID BY PARK:

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

CHARITABLE ENDEAVORS BY PARK and ITS ASSOCIATES in HAWAII:

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

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

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

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

Respectfully submitted,

Scott Winer
Senior Vice President, Tax

ALA MOANA
HAWAII'S CENTER®

February 14, 2020

Hearing Date: February 18, 2020
Time: 10:30 am
Place: State Capitol, Conference Room 211

Sen. Donovan M. Dela Cruz, Chair
Sen. Gilbert S.C. Keith-Agaran, Vice Chair
State Capitol
Committee on Ways and Means
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to Senate Bill No. 2697

Dear Chairman Dela Cruz, Vice-Chairman Keith-Agaran and Committee Members:

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

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

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Indeed, across its portfolio and in Hawaii, Brookfield Properties' REIT capital and investment are focused on producing stable, long term cash flows over a variety of economic conditions. Brookfield Properties operates three major retail shopping centers in Hawaii – the Prince Kuhio Plaza ("PKP") in Hilo, Whalers Village in Lahaina, and the Ala Moana Center in Honolulu. As the largest indoor shopping center on the island of Hawaii, PKP provides great event space for local Kupuna groups passing on their knowledge of music and dance, artisan craft fairs and the celebration of other local traditions. The latter two are iconic visitor attractions that help sustain Hawaii's important tourism industry. Home to more than 350 stores and restaurants, Ala Moana Center is the primary shopping, dining and leisure destination for Kama`aina and visitors. Our two office buildings, which include the Ala Moana Building (Bank of Hawaii) and Ala Moana Pacific Center (Shokudo Building), primarily are occupied by local tenants who cater to residents. In addition to their important role in tourism, all three centers directly benefit the state and local economy through the Hawaii general excise tax.

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

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

- If Hawaii enacts this legislation, it will be out of step with all other states with respect to the dividends paid deduction for REITs (except for New Hampshire, where we believe REIT investment has been inhibited).
- The deduction for dividends paid by REITs results in a single level of taxation at the shareholder level which is consistent with how limited liability companies, Subchapter S corporations and partnerships that own real estate are taxed. Changing the taxing structure here would put REITs at a disadvantage in relation to these other forms of doing business.
- REITs produce substantial economic benefits to the State of Hawaii in the form of jobs, general excise tax, income tax from persons working or engaging in business at REIT properties, and real property taxes. The three properties annually pay more than $40

million in real property and general excise taxes – metrics that clearly demonstrate that REITs are investing in the economic well-being of the state and its residents.

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

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

Sincerely,

Francis Cofran
Senior General Manager

Jared Chupaila
Chief Executive Officer

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February 14, 2020

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

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

Dear Chair Dela Cruz, Vice Chair Keith-Agaran, and Committee Members:

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

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

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

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

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

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

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

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

Thank you for your consideration of our testimony.

Sincerely,

Gwyn McNeal
Executive Vice President, Chief Legal Officer

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Testimony of
Pacific Resource Partnership

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

SB 2697 Relating to Taxation of Real Estate Investment Trusts

Tuesday, February 18, 2020
10:30 A.M.
Conference Room 211

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

Pacific Resource Partnership (PRP) writes in **opposition** to SB 2697, which disallows dividends paid deduction for real estate investment trusts (REITs).

REITs invest in long-term projects that help communities and economies grow. REIT investments include, but are not limited to, rental housing, medical facilities, shopping centers and commercial buildings, all of which provide important services and functions to the public. Recent REIT-funded projects in Hawaii include the revitalization of the Moanalua Hillside Apartments, which added 491 workforce rental units for Oahu residents, the expansion of Ala Moana Center and the redevelopment of the International Market Place. These projects generated GET revenue and created jobs for Hawaii residents.

Currently on Oahu, Douglas Emmett, a REIT headquartered in California, is converting 1132 Bishop, a 25-story downtown Honolulu office building, into approximately 500 new workforce rental apartments for families in the 80 percent to 120 percent Average Median Income range (80% - 120% AMI). This REIT project is part of the solution to Hawaii's housing crisis.

Locally, Alexander & Baldwin (A&B), with a history of commitment to Hawaii, converted to a REIT in 2017. That conversion allowed A&B to attract additional long-term investors from both inside Hawaii and outside Hawaii, while focusing its investment strategies on Hawaii properties and Hawaii communities.

Given Hawaii's need for significant investments in housing and the services that support and sustain residential communities over the long-term, including transit-oriented communities, Hawaii cannot afford to enact policies that discourage REITs and their investors from doing business in Hawaii.

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

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February 14, 2020

Senator Donovan Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Senate Committee on Ways and Means
State Capitol
415 South Beretania Street
Honolulu, HI 96813

RE: SB 2697 – RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS
Hearing Date – February 18, 2020 at 10:30 a.m.

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

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

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

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

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

Mahalo for your consideration.

HAWAII APPLESEED
CENTER FOR LAW & ECONOMIC JUSTICE

Testimony of the Hawaiʻi Appleseed Center for Law and Economic Justice
In Support of SB 2697 – Relating to Taxation of Real Estate Investment Trusts
Senate Committee on Ways and Means
Tuesday, February 18, 2020, 10:30 AM, in conference room 211

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

Thank you for the opportunity to provide testimony in **SUPPORT of SB 2697**, which would eliminate the corporate tax exemption for REITs. Right now, income produced on Hawaiʻi REIT property is escaping Hawaiʻi income tax. Typically, individuals and corporations in Hawaiʻi that generate income off Hawaiʻi real estate are paying state income tax. REITs should be no exception. Eliminating the exemption would generate an estimated $60 million in tax revenue to fund the infrastructure, projects and programs our that community, and even REITs themselves, depend on.

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

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

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

Mahalo for your consideration of this testimony.

Chamber of Commerce HAWAII
The Voice of Business

Testimony to the Senate Committee on Ways and Means
Tuesday, February 18, 2020 at 10:30 A.M.
Conference Room 211, State Capitol

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

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

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

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

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

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

Finally, like any business, REITs are going to be making their decisions based on where it will be able to generate the best return on investment. By increasing the costs to doing business in Hawaii, and diminishing the return on investment, REITs are going to look to other states to fund future projects.

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

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OPTrust

OPSEU Pension Trust
Fiducie du régime de retraite du SEFPO

February 18, 2020

The Honorable Donovan Dela Cruz, Chair
And Committee Members
Committee on Ways and Means
Hawaii State Senate
415 S. Beretania St., #211
Honolulu, HI 96813

Dear Chair Dela Cruz and Committee Members:

RE: SB2697 Relating to Taxation of Real Estate Investment Trusts

My name is Andrew Alcock, Director, Real Estate Investments, OPTrust, testifying in strong opposition to HB 2605 Relating to Taxation of Real Estate Investment Trusts. OPTrust is one of Canada's largest pension funds with net assets of over $20 billion CAD. The trust administers a defined benefit plan with almost 95,000 members and retirees.

OPTrust partnered with DeBartolo Development ("DeBartolo") to develop the Ka Makana Ali'i center in Kapolei. DeBartolo's vision and partnership with the Department of Hawaiian Home Lands ("DHHL") were important factors in OPTrust's decision to invest in Hawaii. One of the deciding factors in OPTrust making its investment in Ka Makana Ali'i, was the sound investment policies of both the State of Hawaii and its partnership with private developers like DeBartolo. OPTrust invests across the globe. Many of those investments are made through REIT structures, which provide a dividend exemption by law. By way of example, there is only one State in the United State of America (New Hampshire) which does not permit the REIT dividend deduction. The ability to invest in Ka Makana Ali'i through a REIT structure was paramount to OPTrust's decision to invest in Hawaii.

REIT's provide a way to finance projects that local investors or the State of Hawaii would not be able to provide. Disallowing the dividends paid deduction for REIT's will result in the double taxation on REIT income and will place Hawaii at a disadvantage compared to other states when it comes to attracting investor capital. Disallowing the deduction would prevent numerous investors from investing in the State of Hawaii, resulting in far fewer development projects and less low-income housing.

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

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We urge you to strongly oppose SB 2697, so that projects such as Ka Makana Ali'i can continue to be built and enhance not only Hawaii's economic growth but continue to provide DHHL with the means to provide more for the native Hawaiian community.

Yours truly,

Andrew Alcock

LAND USE RESEARCH
FOUNDATION OF HAWAII

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February 14, 2020

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

Comments and Concerns in Strong Opposition to SB 2697, Relating to Real Estate Investment Trusts (REITs) (Disallows Dividends Paid Deduction [DPD] for REITs; applies to taxable years beginning after 12.31.2020; sunsets 12.31.23.)

Tuesday, February 18, 2020, 10:30 a.m., in Conference Room 211

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

<u>SB 2697</u>. The purpose of this bill is to amend subsection (b) of Section 235-2.3, Hawaii Revised Statutes to disallow DPDs for REITs. Should SB 2697 be adopted, REITs will be taxed on their net income in Hawaii, while REIT shareholders will continue to be taxed on dividend income received, resulting in a double tax.

<u>LURF's Position</u>. LURF acknowledges the intent of this and prior, similar iterations of this measure given what may be perceived to be the potential for tax avoidance and abuse by foreign/mainland corporations and wealthy individuals through real estate ownership arrangements structured through REITs, however, stated justifications for this bill have not, to date, been proved or supported by any credible facts or evidence. LURF believes the advantages and benefits of continuing the DPD are supported by presently available, credible information and quantifiable evidence, and in fact clearly outweigh any purported profits or increase in state revenue speculated to be received as a result of the proposed disallowance.

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

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

If enacted, SB 2697 would NOT eliminate the burdensome requirements applicable to Hawaii REITs, but would leave them and their shareholders WITHOUT ANY benefits from their investments – even the tax benefits allowed to other non-REIT entities such as tax-exempt pension funds and endowments which earn rental income from real property. Such a result would be clearly inequitable.

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

The State's Final Report on the Impact of REITs in Hawaii Has Failed to Validate the Alleged Purpose of and Need for this Proposed Legislation.

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

An interim report was released in December 2015 (the "Interim Report"),[1] followed by a final report issued in September 2016 (the "Final Report"),[2] however, even the Final Report is based on assumptions and estimates; relies on inconclusive results of surveys admittedly taken with a small sample size and low response rate; and is fraught with

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

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

uncertainties, inconsistencies and weighting errors, making it unfeasible and ill-advised to rely upon for presenting any conclusive calculations or impacts.

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

Given the inadequacy, inaccuracy and unreliability of the tenuous findings contained in the Interim and Final Reports, as well as the complete failure of said Reports to come to any meaningful and valid conclusions required to be made pursuant to Act 239, it should be brought to this Committee's attention that another study on the economic impacts of REITs in Hawaii dated December 2015, was prepared by economic expert Paul H. Brewbaker, PhD., CBE for the National Association of Real Estate Investment Trusts (the "Brewbaker Study").[4] The Brewbaker Study concludes that the repeal of the dividend paid deduction (DPD) for REITs in Hawaii would likely result in a net revenue loss to the State due to a number and combination of negative consequences which would be experienced by the local economy.

In view of the inconsistency between findings contained in the Final Report and the Brewbaker Study, LURF believes it would be irresponsible for this Committee to consider, let alone support SB 2697 which may potentially stifle, if not reverse the current growth of the State's economy, in reliance solely upon the untenable findings of the Final Report and must respectfully urge this Committee to at the very least, conduct an independent investigation and analysis of all the available facts and information relating to the disallowance of the DPD, and the potential financial and economic consequences thereof, prior to making any decision on this bill.

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

> [T]he benefits of continuing with this federally established legislation are clear and quantifiable," and that REITs are an

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

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

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

> important investment vehicle for all types of investments in Hawaii.[6]

The Memorandum goes on to take the position that:

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

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

1. **The "Double-Tax" Resulting from this Proposed Measure is Contrary to the Underlying Intent of REITs.**

REITs are corporations or business trusts which were created by Congress in 1960 to allow small investors, including average, everyday citizens, to invest in income-producing real estate. Pursuant to current federal and state income tax laws, REITs are allowed a DPD resulting in the dividend being taxed a single time, at the recipient level, and not to the paying entity. Most other corporations are subject to a double layer of taxation – on the income earned by the corporation and on the dividend income received by the recipient.

Proponents of this measure attempting to eliminate the DPD, however, appear to ignore that the deduction at issue comes at a price. REITs are granted the DPD for good reason - they are required under federal tax law to be widely held and to distribute at least 90% of their taxable income to shareholders,[8] and must also comply with other requirements imposed to ensure their focus on real estate. In short, REITs earn the DPD as they must comply with asset, income, compliance and distribution requirements not imposed on other real estate companies.

According to the Brewbaker Study, repealing the DPD for REITs would subject Hawaii shareholders to double taxation and may reduce future construction and investment by REITs locally, thereby resulting in revenue loss to the State.[9] Moreover, replacement investor groups may likely be tax-exempt institutions such as pension plans and

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[6] Memorandum at p. 2.

[7] *Id.*

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

[9] Brewbaker Study at pp. 1, 32, 38.

foundations which would generate even less in taxes from their real estate investments.[10]

2. SB 2697 is Contrary to the Tax Treatment of REITs Pursuant to Current Federal Income Tax Rules and Laws of Other States with an Income-Based Tax System.

SB 2697 would enact serious policy change that would create disparity between current Hawaii, federal, and other states' laws with respect to the taxation of REIT income.

The laws of practically every state with an income-based tax system now allow REITs a deduction for dividends paid to shareholders. Hawaii, as well as other states which impose income taxes currently tax REIT income just once on the shareholder level (not on the entity level), based on the residence of the shareholder that receives the REIT dividends and not on the location of the REIT or its projects.

By now proposing to double tax the REITs that do business in Hawaii as well as their shareholders, SB 2697 would upset the uniformity of state taxation principles as applied between states. Other states which have similarly explored the possibility of such a double tax over the past years have rejected the disallowance of the DPD for widely held REITs.

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

Elimination of the DPD would result in a double taxation of income for Hawaii REITs which would certainly mitigate, if not extinguish interest and incentive in investing in Hawaii-based REITs, which currently contribute significantly to Hawaii's economy.

Results from the Final Report indicate that even as of September 2016, approximately 42 REITs operating in Hawaii reportedly held assets in the amount of an estimated $7.8 billion at cost basis[11], 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.

DBEDT's more recent position as taken with regard to virtually identical anti-REIT legislation proposed in this current Legislative Session is proffered in the Memorandum and makes clear the Department's policy that "maintaining stable economic growth for the State is paramount to the future of Hawaii,"[12] as well as its concern that the State's

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[10] *Id.*

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

[12] Memorandum, p. 1.

economy will suffer as a result of the disallowance of the DPD. As stated in the Memorandum:

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

Proponents of this bill should be mindful that significant economic growth experienced in this State over the past years is undoubtedly attributable in part to REIT investment in Hawaii. Outrigger Enterprises partnered with REIT American Assets Trust to successfully develop the Waikiki Beach Walk. General Growth' Properties' expansion and renovation of the Ala Moana Shopping Center, as well as its partnering with Honolulu-based, local companies (The MacNaughton Group, The Kobayashi Group and BlackSand Capital) to develop the Park Lane residential condominium project is another example. The capital invested in that project to construct additional retail space and luxury residences reportedly exceed $1 billion, and the development will have created an estimated 11,600 full- and part-time jobs and over $146 million of state revenue. Taubman Centers, Inc., another REIT, also partnered with CoastWood Capital Group, LLC to revitalize Waikiki through the redevelopment of the International Market Place at a reported cost of over $475 million.

REIT projects have helped to support Hawaii's construction industry immensely[14] by providing thousands of jobs, and continue to significantly contribute to the local economy through development of more affordable housing (more than 2,000 rental housing units for Hawaii's families, such as the Moanalua Hillside expansion of more affordable housing rentals), student housing near the University of Hawaii, health care facilities, offices, shopping centers (Ala Moana Center addition; Pearlridge Center renovations; Ka Makana Ali'i), and hotels.

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

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[13] Memorandum, p. 2.

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

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

Disallowance of the DPD and resulting increased taxation of REITs is expected to reduce investment returns as well as dividend payments to shareholders, which will no doubt have a significant negative effect on future investment by REITs in Hawaii.

Proponents of this bill attempt to minimize the negative consequences of disallowing the DPD by claiming that very few Hawaii taxpayers invest in REITs with property in Hawaii, however, LURF understands that in 2014 over 9,000 Hawaii investors had investments in over 70 public, non-listed REITs and received almost $30 million in distributions, and that tens of thousands more directly or indirectly own shares in stock exchange-listed REITs. Many Hawaii residents are reportedly not even aware that they benefit from REITs either through mutual funds or their pension or retirement accounts.

Supporters of this measure also ignore the fact that tax law changes proposed by SB 2697 will unfairly impact those publicly traded REITs which have already made substantial investments in Hawaii and have contributed greatly to the State's economy in reliance on the DPD, which, as discussed above, is considered a fundamental principle of taxation applicable to REITs.

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

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

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

Hawaiʻi Association of REALTORS®
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1259 Aʻala Street, Suite 300
Honolulu, HI 96817

February 18, 2020

The Honorable Donovan Dela Cruz, Chair
Senate Committee on Ways and Means
State Capitol, Room 211
Honolulu, HI 96813

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

HEARING: Tuesday, February 18, 2020, at 10:30 a.m.

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

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

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

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

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

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

Under this measure, it proposes to remove the income tax deduction for dividends from a REIT, thereby creating a double taxation of income. HAR has concerns that this will become a disincentive to invest in Hawaiʻi, which would negatively impact the economy.

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

Mahalo for the opportunity to testify.

February 14, 2020

Hearing Date: February 18, 2020
Time: 10:30 A.M.
Place: Conference Room 211

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

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

Dear Chair Dela Cruz, Vice Chair Keith-Agaran, and Members of the Committee on Ways and Means:

My name is Tim Scott and I am Public Storage's Tax Counsel. Public Storage ***strongly opposes*** SB 2697, which would repeal the dividends paid deduction for real estate investment trusts ("REITs") operating in Hawaii for 2021, 2022 and 2023. I earlier presented similar testimony to the House Committee on Economic Development & Business in opposition to HB 2605, SB 2697's companion bill.

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

REITs and "Pass Through" Taxation. REITs were designed by Congress to distribute their taxable income to their shareholders, who then report and pay state and federal tax on those dividends. Our shareholders in Hawaii are taxable by the state on the full amount of our dividends, not just the very limited portion of those dividends attributable to the 11 properties we have in the state (compared to our almost 2,500 properties across the nation).[1] This means that Hawaii benefits from the REIT regime because Hawaii shareholders are taxed on all REIT distributed income (not just income earned by the REIT in Hawaii). Nareit analysis has suggested that about 47% of Hawaii households own REIT stock directly or indirectly (compared to 43% nationwide).

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

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

LLCs, partnerships, or S corporations. Hawaii accords those other entities pass-through treatment, even though they are not required to distribute their income to their owners.

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

Less Net Revenue, Chasing REITs Away. While apparently motivated by an effort to raise added tax revenue, the bill can be expected to have the opposite effect. Although proponents of similar bills have offered unsupported estimates of very large increased annual tax collections, Hawaii's Department of Taxation reported that a similar prior bill only would produce collections of about $2.2 million in its first year, with perhaps $10 million per year afterwards. The Department also noted that REITs might offset their tax liabilities through tax planning or with allowable deductions. Others have projected that a repeal of the dividends paid deduction would jeopardize substantial general excise tax revenues, potentially resulting in a net loss of tax revenue for Hawaii.

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

Breaking with Federal and Other State Treatment. Enactment of SB 2697 would make REITs separately taxable in Hawaii, imposing a double tax regime that is completely contrary to the accepted federal and state tax treatment of REITs. No state that imposes income tax upon REITs (other than New Hampshire) denies the dividends paid deduction as proposed by SB 2697. Indeed, over the past decade or so, a number of states (*e.g.*, Idaho, Louisiana, New Jersey, North Carolina, and Rhode Island) have examined, and then rejected, legislation that would have disallowed a widely-held REIT's dividends paid deduction in those states.

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

Very truly yours,

A. Timothy Scott

A. Timothy Scott
Tax Counsel of Public Storage
tscott@publicstorage.com
818.244.8080, extension 1286

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

SB-2697
Submitted on: 2/16/2020 6:05:44 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

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

Comments:

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Testimony in Support of SB2697

Aloha, Chair Dela Cruz and members of the Senate Ways and Means Committee

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

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

REITs shareholders do pay income taxes in the states where they live. However, unfortunately for Hawaii, 99% of shareholders of Hawaii REITs are *not* Hawaii residents, so those taxes do not stay in Hawaii.

Examples of local REITs that pay no Hawaii taxes are Ala Moana Shopping Center, Pearlride Shopping Center, Hilton Hawaiian Village, Hilton Waikoloa, International Marketplace, and even the kamaaina corporation Alexander and Baldwin. There are now over 55 REITs in Hawaii which buy Hawaii land and property--and the number is growing. Why? According to NAREIT itself, in its report “REITs Across America,” Hawaii has the highest REIT asset value per capita than any other state. It also happens to have the 14th highest value per REIT-owned property, and the 12th highest rate of REIT asset value growth from 2014-2017, well ahead of larger states like Colorado, Illinois, and Texas. Hawaii’s REIT *asset value growth rate* is over 10 percent higher than the national average.

REITs and non-REIT companies will continue to buy and invest in Hawaii properties regardless of taxes because Hawaii’s properties are unique and uniquely valuable!

Last year, the REITS lobby, including NAREIT (the national REIT advocate), spent a huge budget spreading fear of last year's REITs legislation. Despite that noise, our legislators heard the people's voices and passed the bill resoundingly. But, unfortunately, the Governor vetoed it.

This year, we hope the ultimate outcome will be different.

SB 2697 will ensure that money *made* in Hawaii will *stay* in Hawaii. The estimated $60 million tax revenue per year can be used for affordable housing, long term kupuna care, infrastructure, child care/early education, and other vital needs.

Please pass SB2697.

Thank you.

SENATE COMMITTEE ON WAYS AND MEANS

February 18, 2020 10:30 AM Room 211

In SUPPORT of SB2697: Relating to Taxation of Real Estate Trusts

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Aloha Chair Dela Cruz, Vice Chair Keith-Agaram, and members of the committee,

On behalf of our 20,000 members and supporters, the Sierra Club of Hawaiʻi supports passage of SB2697- which seeks to establish a fairer tax system in the state of Hawaiʻi by disallowing dividends paid deduction for real estate investment trusts.

Since 1968, the Sierra Club of Hawaiʻi has worked to help people explore, enjoy, and protect the unique natural environment of the Hawaiian Islands. We believe that the health of our environment will benefit from a fairer tax system, such as the taxation of Real Estate Investment Trusts. REITs are corporations that own income-producing real estate, like retail and hospitality-related establishments. Examples of REIT property include Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, the International Marketplace, and many others. There are 42 REITs operating in Hawaiʻi, with only 1 REIT having its main office in Hawaiʻi- meaning that almost all of these properties are owned by mainland-based corporations and shareholders.[1]

As the law is currently written, all dividends paid out to REIT shareholders (at least 90% of REIT income) can be deducted from REIT income taxes. As a result, the state of Hawaiʻi is missing out on potential tax revenues of $65 million annually from these corporations- funds that could be used to protect our natural resources, build much needed affordable housing, fund our schools and social services, and repair public infrastructure in the face of climate change.

The Sierra Club recognizes that there is a nexus between the environment and economic justice issues. This bill will require REITs and their shareholders to pay their fair share of taxes, creating a more equitable system to the benefit of all of Hawaiʻi. Our tax system reinforces our income inequality; forcing more and more families to live paycheck-to-paycheck and make short-term decisions about their lives that usually impose a greater burden on the natural environment. We support tax fairness because we know that with a more balanced tax system, Hawaiʻi's residents, our communities, and our environment as a whole will prosper.

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[1] http://files.hawaii.gov/dbedt/economic/data_reports/REIT_Final_9.19.16.pdf

Lastly, we recommend an amendment to remove the sunset date of December 31,2023 or at least extend the sunset date much further into the future so that Hawaiʻi taxpayers can benefit from REIT taxation for more than three years.

Thank you very much for this opportunity to provide testimony in **support of SB2697.**

Mahalo,

Jodi Malinoski, Policy Advocate

Taubman

February 17, 2020

Honorable Donovan M. Dela Cruz, Chair
Honorable Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means
State Capitol (conference room 211)
415 South Beretania Street
Honolulu, Hawaii 96813

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

Dear Chair Dela Cruz, Vice-Chair Keith-Agaran and Committee Members:

On behalf of Taubman Centers, thank you for the opportunity to provide our testimony in **opposition** to Senate Bill No. 2697, which is being heard by the Committee on Ways and Means on February 18, 2020 at 10:30 am. SB 2697 would disallow the dividend paid deduction for real estate investment trusts ("REITs").

REITs are responsible for a significant amount of economic activity in Hawaii and SB 2697 that increases state income taxation of REITs would be a policy change that could discourage future investment by REITs in Hawaii, stifling the availability of capital and putting Hawaii at a competitive disadvantage versus virtually every other state when trying to attract capital for investment. Because investments by REITs generate so much economic activity and create so many local jobs in the State, disallowing the deduction for dividends paid could not only hurt workers in Hawaii, over the long run, it ultimately may result in less tax revenue for the State as its makes Hawaii unattractive for investment by REITs resulting in less economic activity.

Taubman Centers alone invested over $475 million for the redevelopment of International Market Place. Our shopping center pays annually over $1.7 million in general excise tax and over $3.7 million in property taxes. To date we have paid in total over $1.5 million in local conveyance taxes. During the development of the center it resulted in employment of an estimated 1,000 construction jobs and after opening it created an estimated 1,600 permanent jobs (including employment by tenants). This generated both general excise tax revenues from construction work and individual income tax revenues from both the construction and permanent jobs. Please see page three for the economic benefits in Hawaii created by the REIT industry as a whole.

Taubman Centers in Hawaii

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

REIT Tax Treatment

We are organized, owned and operated in a manner to qualify as a REIT under the Internal Revenue Code for federal income tax purposes. A REIT is a conduit vehicle designed to allow many <u>small investors</u> to participate in real estate development and ownership. REITs are also owned by institutions comprised of <u>state and local pension funds and 401K individual retirement plans</u>. Some of the requirements to qualify as a REIT include (1) ownership by at least 100 shareholders, (2) a prohibition on being closely held and controlled by limiting ownership by five or fewer persons to no more than a 50% interest in the REIT, (3) meeting certain asset and income tests to ensure we are primarily invested in real estate and operate it for rental purposes as a long term investor, and (4) paying out <u>all</u> of our taxable income as cash dividends to our shareholders which is not required by most other entity forms such as partnerships, LLCs and other corporations. Failure to meet these requirements results in losing our REIT tax status or in some circumstances harsh penalties like a prohibited transaction tax for not holding property as a long term investor in a rental real estate business. For meeting these stringent tests, Taubman Centers, like all REITs, is entitled to a deduction for dividends paid to our shareholders to reduce our taxable income. It is this deduction afforded in the federal tax law and permitted by <u>virtually all other states</u> that SB No. 2697 would eliminate and disallow for Hawaii corporate income taxation.

Because of the forced dividend requirement to distribute <u>all</u> of its taxable income, a REIT's taxable income is effectively taxed at the shareholder level by the state taxing the shareholder's dividend income in their state of residence. This allows for a single level of taxation at the shareholder level and no double taxation (i.e., it prevents taxation at both the entity level and again at the shareholder level) and is consistent with the treatment of investors in mutual funds that are treated as regulated investment companies for tax purposes. For REITs, state income taxation based on the shareholder's residence is the uniform tax treatment in virtually all states that impose an income based tax system. This results in state income taxation by Hawaii on dividends received by Hawaii residents who are shareholders in REITs that may own property and operations outside of the State.[1]

REIT Economic Benefits in Hawaii

Approximately 80 REITs have invested in commercial real estate in Hawaii and are responsible for significant economic activity in the construction industry, resort industry, restaurant and retail industry, office and industrial leasing and others.[2] Taubman alone invested over $475 million for the redevelopment of International Market Place. In addition, it will continue to require investment to fund significant capital expenditures on a recurring annual basis to maintain the property to our standards and provide the highest quality shopping destination for our shoppers and tenants.

Such business activity generates substantial economic benefit for Hawaii, including providing jobs, as well as significant tax revenues for the State government. The tax revenues include substantial general excise taxes on rents from tenants, on the sale of goods and services at retail by the tenants, and on construction activities. For local governments the business activity generates property and conveyance taxes.

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

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[1] More than 9,300 individual investors in Hawaii receive $30 million in dividend each year
Brewbaker, P.H., Ph.D., CBE. (2015, December). *Economic Impacts of Real Estate Investment Trusts in Hawaii* (Prepared for the National Association of Real Estate Investment Trusts® (NAREIT)

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

Hawaii residents own an estimated $2.5 billion in real estate equity through REITs, mutual funds and exchange traded funds that distribute more than $105 million in REIT dividends annually. Approximately 9,300 individual investors in Hawaii receive $30 million each year in REIT distributions.[4] SB 2697 resulting in double taxation to REIT profits (once at the REIT level and again at the shareholder level) will affect after tax return on investment of Hawaii residents.

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

As previously mentioned, such a policy change in state taxation of REITs could discourage future investment by REITs in Hawaii, stifling the availability of capital and putting Hawaii at a competitive disadvantage versus virtually every other state when trying to attract capital for investment. Because investments by REITs generate so much economic activity and create so many local jobs in the State, disallowing the deduction for dividends paid could not only hurt workers in Hawaii, over the long run, it ultimately may result in less tax revenue for the State as its makes Hawaii unattractive for investment by REITs resulting in less economic activity.

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

Thank you for your consideration of our testimony.

Very truly yours,

Heaphy

Chris B. Heaphy
Secretary
Taubman Centers, Inc

[4] ibid

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WRITTEN TESTIMONY OF
GLADYS QUINTO MARRONE
EXECUTIVE DIRECTOR
NAREIT HAWAII
IN OPPOSITION TO SB 2697
BEFORE THE HAWAII SENATE
COMMITTEE ON WAYS & MEANS

THE HONORABLE DONOVAN M. DELA CRUZ, CHAIR
THE HONORABLE GILBERT S.C. KEITH-AGARAN, VICE CHAIR
HEARING ON SB 2697
FEB. 18, 2020
10:30 A.M.

1003 Bishop Street, Suite 2700
Honolulu, HI 96813
808-237-2474

nareithawaii.com

Dear Chair Dela Cruz, Vice Chair Keith-Agaran, and Members of the Senate Committee on Ways and Means:

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

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

For the reasons discussed in more detail below, we strongly oppose, and ask you to hold, SB 2697, legislation that would eliminate the REIT "dividends paid deduction" (DPD) temporarily.

- **SB 2697's enactment would likely produce less overall revenue than current law.**

- **Department of Taxation's (DoTax) public testimony regarding similar legislation estimates at best an incremental increase in revenue from enactment of similar legislation:** Enactment would raise, at best, approximately $2.5 million the first year and $10 million annually thereafter according to DoTax's public testimony.[1]

- **DoTax says actual revenue could be lower–even zero:** A DoTax representative cautioned in public testimony and a radio interview that actual revenue raised could be lower.[2]

- **Loss of general excise tax (GET) would likely more than offset any increase:** Federal law applicable to hotel REITs requires them to use a lease structure that results in an additional level of GET **not applicable to non-REITs.** As described below, jeopardizing this additional GET could more than offset any revenue gains.

[1] Note comments around 3:40:23 to 3:40:38 /4:01:24 of the Feb. 12, 2019 video of the House Consumer Protection & Commerce hearing on a 2019 bill that also would have eliminated the REIT DPD, HB 475, HD 1, available at this link.

[2] Note comments around 3:41:02 to 3:41:41 / 4:01:24 of the Feb. 12, 2019 video of the House Consumer Protection & Commerce hearing on HB 475 HD 1 available at this link and comments of Former Director of the Hawaii Department of Taxation, Linda Chu Takayama in this Feb. 4, 2019 interview with Hawaii Public Radio ("Raising Taxes on REITs"), beginning at 10:10.

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nareithawaii.com

- **What about the larger amounts asserted by proponents?** DoTax testimony suggests proponents are relying on “incorrect” numbers in an earlier DBEDT study.[3]

- **SB 2697’s enactment would risk job loss at a time when the construction industry is reportedly weakening.** It would not be prudent to risk this job loss given the unlikelihood of any overall revenue gain.

The remainder of this testimony provides additional detail and information.

REITs in Hawaii

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

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

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

- the state-of-the-art Hale Pawa'a Medical Building in Downtown Honolulu (Healthcare Realty Trust);
- nearly 500 soon-to-be available affordable housing rentals at Bishop Place in Honolulu for tenants earning between 80% and 120% of area median income and workforce rentals at Moanalua Hillside apartments (Douglas Emmett Inc.)
- Pearlridge Center in Aiea, which just last year completed a $33 million renovation (Washington Prime Group);

[3] Note comments around 3:40:40 to 3:40:56 /4:01:24 of the Feb. 12, 2019 video of the House Consumer Protection & Commerce Committee hearing on HB 475 HD 1, available at this link.

- Ka Makana Ali'i in Kapolei, whose revenues assist DHHL in building homes for Native Hawaiians;
- A number of hotels, including Hilton Hawaiian Village (Park Hotels & Resorts, Inc.); Fairmont Kea Lani on Maui (Host Hotels & Resorts, Inc.); and Wailea Beach Marriott Resort & Spa (Sunstone Hotel Investors, Inc.), all of which, as described below, are required to use a lease structure that generates at least $16 million in general excise taxes to the state over what non-REITs would owe.

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

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

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

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

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

However, retaining the DPD in Hawaii is critical to attracting this new REIT activity to our state. With every other state with a corporate income tax but one honoring the DPD, Hawaii would not be competitive for these REIT investments, should the DPD be repealed. Other states would be a much more attractive investment locales for these REITs which own investments throughout the U.S. At a time when Hawaii has many basic needs for its working residents, Hawaii needs to encourage REITs to continue to provide jobs for Hawaii's residents, and to continue to support broader community needs both through their business activities, other forms of tax revenue that they pay to the state and counties, and their charitable activities.

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

According to the Department of Taxation, enactment would only raise an incremental amount of revenue; however, enactment could result in a potential $6 million loss when factoring in potential lost general excise tax (GET) revenue

In an April 4, 2019 Hawaii Public Radio interview regarding similar legislation, former Department of Taxation Director Linda Chu Takayama stated the following when speaking merely of the corporate income tax impact of enactment of similar legislation (beginning at 10:10 in "Raising Taxes on REITs"): "[Our economist's analysis] is that it might bring in $2 million the first year, something less than $10 million in the out years, and even that's a little bit fuzzy because that doesn't represent all of the deductions that these companies could be taking; once you factor that in, the number goes way down." See also footnotes 1-3 above and accompanying text for more detail.

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

- Federal law requires that lodging REITs–**unlike non-REIT hotel owners**–to lease their hotels either to an unrelated company or to a fully taxable REIT subsidiary at market rent that must hire an unrelated hotel operator (like Marriott or Hilton).

- Park Hotels & Resorts, Inc.'s' testimony (on page 28 of the posted testimony) with respect to a similar bill, SB 2409, said this extra GET was over $9 million more than a non-REIT would pay in GET–and that is just one hotel REIT. When aggregated with other REIT hotel owners in Hawaii, this additional GET is estimated to have **exceeded $16 million in 2018**.

- And as a tax on gross receipts rather than a tax on net income, the GET is a very stable source of almost half of state revenues and compared with the corporate income tax (around 1-3%) (For example, see data from Council on State Revenues for FY 2019 To FY 2025). **SB 2697's enactment would seriously endanger this extremely valuable source of GET revenues to the state.** Not only that, enactment also would put at risk the revenues and jobs created by non-hotel REITs that invest in the state.

- Given the risk of losing up to $16 million in GET annually, and the risk of lost jobs, it would not be prudent to enact SB 2697.

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SB 2697 Enactment Would Risk Job Losses for Hawaii Residents

SB 2697 risks significant job loss, at a time when the construction industry is reportedly weakening. Enactment of SB 2697 would potentially result in a reduction of millions of dollars of new REIT investment, a shift in property ownership to tax-exempt owners like pensions and endowments (who invest significantly in real estate), and loss of revenue and the stability of hundreds of the jobs generated by REITs to the state. These existing and potential jobs belong to real people. Is it fair to risk significant job loss by enacting this proposal, particularly in light of DBEDT's report to the Hawaii Senate Ways & Means Committee and House Finance Committee on Jan. 7, 2020 that the construction industry is weakening?

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

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

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

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

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

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

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

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

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

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

SB 2697 Would Violate Core State Comity Principles

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

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Please Hold SB 2697

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

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WAIKELE
PREMIUM OUTLETS®
A SIMON CENTER

February 14, 2020

The Honorable Donovan M. Dela Cruz, Chair
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means
State Capitol
415 South Beretania Street
Honolulu, HI 96813

RE: SB 2697/Hearing on February 18, 2020

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

On behalf of Simon Property Group (Simon), thank you for the opportunity to submit this testimony in strong opposition to SB 2697. Simon is a publicly traded real estate investment trust (REIT). We own, develop and manage premier shopping, dining, entertainment and mixed-use destinations, including Waikele Premium Outlets in Waipahu. As of September 30, 2019, we owned or held an interest in 204 income producing properties in the United States, which consisted of 106 malls, 69 Premium Outlets, a number of other retail properties in 37 states and Puerto Rico. We also own a number of overseas properties.

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

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

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

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

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

Thank you again for the opportunity to submit this testimony.

Sincerely,

Desiree Mosiman

Desiree A. Mosiman
Manager
Waikele Premium Outlets

Desiree Mosiman

94-790 Lumiaina Street, Suite #100, Waipahu, HI 96797 | 808.676.1497 | Fax 808.676.9700 | www.premiumoutlets.com

ALEXANDER & BALDWIN
PARTNERS FOR HAWAI'I

SB 2697
RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS

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

FEBRUARY 18, 2020

Chair Dela Cruz and Members of the Senate Committee on Ways & Means:

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

While A&B has always been a Hawaii-based company, in 2012, A&B made a strategic decision to be 100% Hawaii-based and to migrate its mainland investments back to Hawaii. Since then, A&B has sold all of its mainland properties and has reinvested the proceeds in Hawaii—acquiring properties including the Kailua Town commercial center, Manoa Marketplace, Waianae Mall, Laulani Village (Ewa Beach), Puunene Shopping Center (Maui), and Hokulei Village (Kauai). In 2017, to better support our Hawaii-focused strategy and increase our ability to invest in Hawaii in an increasingly competitive environment, A&B made the decision to convert to a real estate investment trust (REIT). A REIT structure enables A&B to attract new investors to its stock, giving us capital to invest in our Hawaii-focused strategy, and puts us in a better position to compete with large, out-of-state investors, with greater sources of capital, for the acquisition of Hawaii properties, thus keeping them in locally-owned hands, with a management team that lives here and is committed to Hawaii. Furthermore, REITs are structured to be long-term holders of real estate, thus complementary to A&B's goal of being Partners for Hawaii, with a long-term commitment to our communities.

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

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

BILL WILL RESULT IN DOUBLE TAXATION OF SHAREHOLDER DIVIDENDS

The purpose of this bill is to disallow the dividend paid deduction for real estate investment trusts. At present, all states except for one (New Hampshire) allow REITs to pass through its federally mandated shareholder dividend distribution without the imposition of a corporate tax, as individual shareholders are responsible to pay the tax on these dividends. The disallowance of the dividend paid deduction will result in the double taxation of Hawaii REIT shareholder dividends. This will essentially result in Hawaii REITs continuing to distribute, as mandated by Federal Law, at least 90% of their taxable income to shareholders. However, unlike the other states, the REIT will also pay Hawaii corporate income tax prior to making the dividend distribution to its shareholders, thus reducing the amount of dividends shareholders will receive. In addition, shareholders of Hawaii REIT properties will also continue to be responsible to pay income tax on the distributed dividends—a second tax on the same profits.

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

NEGATIVE IMPACT ON HAWAII'S ECONOMY

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

Today, only New Hampshire disallows the REIT dividend paid deduction. If this bill is enacted into law, REITs and their investors may prefer to invest in states other than Hawaii. Hawaii, along with REITs with properties in Hawaii, will be at a competitive disadvantage in attracting additional investors and capital to support continued investment, economic development, and growth in our state. When combined with the direct reduction in general excise and income taxes from diminished REIT related construction, fewer jobs, and the reduction in business and individual income taxes because of the direct and indirect impacts of lower REIT related activity, this bill poses a significant risk to the health of the state's overall economy.

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

Douglas Emmett

February 14, 2020

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

RE: SB 2697 Relating to Taxation of Real Estate Investment Trusts – In Opposition
Tuesday, February 18, 2020; 10:30 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"), we appreciate this opportunity to present testimony expressing concerns on SB 2697, which disallows a dividends-paid deduction ("DPD") for real estate investment trusts ("REITs").

Douglas Emmett has been investing in Oahu for over fifteen years. We currently own over 2,000 workforce rental apartment units and recently invested over $120 million to build approximately 500 rental apartments in Moanalua. The development employed hundreds of local construction workers and created desperately needed workforce housing.

Douglas Emmett is currently working to add approximately 500 more rental apartments in downtown Honolulu by converting one of our office properties into workforce housing. We anticipate investing between $80 million and $100 million in the Bishop Place project, which will employ a large number of kama'aina union construction workers. The first units should come online in 2020 with rents targeted to serve local families in the 80% to 120% Average Median Income range. Douglas Emmett also owns two other office properties in downtown Honolulu, and we employ over 275 local residents.

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

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

Respectfully,

Kevin Crummy
Chief Investment Officer

Michele Aronson
Senior Vice President

HAWAII STATE TEACHERS ASSOCIATION
Teaching Today for Hawaii's Tomorrow

1200 Ala Kapuna Street ♦ Honolulu, Hawaii 96819
Tel: (808) 833-2711 ♦ Fax: (808) 839-7106 ♦ Web: www.hsta.org

Corey Rosenlee
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Wilbert Holck
Executive Director

LATE

TESTIMONY BEFORE THE SENATE COMMITTEE ON
WAYS AND MEANS

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

TUESDAY, FEBRUARY 18, 2020

COREY ROSENLEE, PRESIDENT
HAWAII STATE TEACHERS ASSOCIATION

Chair Dela Cruz and Members of the Committee:

The Hawaii State Teachers Association **strongly supports SB 2697, with suggested amendment at the end of this testimony**. This bill once passed, disallows dividends paid deduction for real estate investment trusts.

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

Unlike corporate investors, investors in real estate investment trusts are exempt from paying corporate income tax on dividends. Thus, dividends from REITS are taxed only once at the shareholder level, and these taxes are paid in the form of income tax to the investor's home state. The implication of this is that while the state plays host to REITs, it receives virtually no taxes from REITs. Because Hawaii ranks 40th in the nation for the number of REIT shareholders as a percentage of the population, income taxes paid on dividends by shareholders are, for the most part, going out of state.

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

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

LATE

February 17, 2020

Re: SB 2697

Senator Donovan Dela Cruz
Ways and Means Committee
The Senate
State of Hawaiʻi

Dear Senator Dela Cruz and Members of the Committee,

I am a retired United Church of Christ clergyperson who has lived in Hawaiʻi for over 40 years. I am writing in support of SB 2697 relating to the taxation of REITs.

I have a primary argument to make in support of the bill: Profits generated from Real Estate Investment Trusts on property held in Hawaiʻi should be taxed by the State of Hawaiʻi and the taxes generated should be directed to the State of Hawaiʻi.

Please vote affirmatively for S. B. 2697. The bottom line is that fairness dictates that profits from investment property in Hawaiʻi should by taxed by the State of Hawaiʻi to benefit the people of Hawaiʻi.

Yours truly,

The Rev. D. Neal MacPherson

LATE

SB-2697
Submitted on: 2/17/2020 5:50:07 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Clare M Hanusz	Testifying for Aloha Immigration / Clare Hanusz, Esq.	Support	Yes

Comments:

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

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

LATE

SB-2697
Submitted on: 2/17/2020 5:17:14 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Jon T Davidann	Testifying for FACE	Support	No

Comments:

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

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

HAWAII OPERATING ENGINEERS
INDUSTRY STABILIZATION FUND

Affiliated AFL-CIO
OPEIU - 3 - AFL-CIO (3)

Uniting our strengths and working together
for a better tomorrow.

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Senate Committee on Ways and Means
Honorable Donovan M. Dela Cruz, Chair
Honorable Gilbert S.C. Keith-Agaran, Vice Chair
Honorable Members of the Senate Committee on Ways and Means

February 17, 2020

RE: **OPPOSITION OF S.B. 2697 RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS.**

The Operating Engineers Industry Stabilization Fund is deeply concerned about what will happen if Hawaii breaks from the federal tax code and repeals the deduction real estate investment trusts receive on the dividends paid to their shareholders. These REIT shareholders include thousands of Hawaii residents who would see their pensions and future incomes diminished by this legislation.

The union organization we represent, Operating Engineers Local 3 (OE3) is also highly invested in REITs and REIT related projects in the state of Hawaiʻi. This type of legislation will have an adverse effect on our current and future investments in Hawaii, our pension returns, and our members. Therefore, we **strongly oppose S.B. 2697.**

Officials from the Hawaii State Department of Taxation (DoTax) have stated publicly that these types of REIT taxation bill would produce an estimated $2.2 million in additional income tax revenue the first year and less than $10 million per year after that. However, DoTax noted this estimate does not represent all the deductions REIT-owned companies could take if this bill becomes law, the result of which would be a substantial decline in the tax revenue generated and therefore underfund the proposed "Returning Resident Down Payment Program."

Hawaiʻi will puts at risk $16 million or more of hotel REIT General Excise Tax (GET) revenue this type of bill becomes law.

- Federal law requires all REITs, including hotel REITs, to have 75% of their annual revenues come from rent and/or other real estate-related sources.
- In order for a REIT that owns a hotel to qualify as a REIT, the REIT has to earn rent. It can do so by creating a taxable subsidiary (which is subject to federal and Hawaii corporate income tax), which pays lease rent (at market rates) for the property to the REIT.
- Those taxable subsidiaries, in turn, are prohibited from operating hotels and must hire hotel operators to manage day to day operations.

- GET revenue is captured from each of these layers of ownership/management. Available data show this additional GET revenue is about $16 million for Hawaiʻi each year that non-REIT hotels do not pay.
- If this bill passed, hotel REITs will reassess their form of operation in Hawai'i, potentially putting at risk this $16 million in GET, the potential loss of which could equate to an estimated net loss of $6 million for Hawaiʻi when taking into account DoTax's $10 million revenue estimate.

REITs create affordable workforce rental housing in Hawaiʻi.

- Douglas Emmett is the largest developer of affordable workforce rental apartments in Hawai'i.
- Douglas Emmett recently built 491 new units at its Moanalua Hillside Apartment Community in Aiea.
- Douglas Emmett just announced it will be converting office space at 1132 Bishop Street into 500 affordable workforce rental units for those making 80-120% of the median area income.

44% of Hawaiʻi households own REIT stock through their retirement savings and other investment funds.

- Many Hawaiʻi residents rely on REIT stock, both in Hawaiʻi and other markets, for their pensions.
- Bank of Hawaii and First Hawaiian Bank hold millions of dollars worth of shares of REITs on behalf of their clients.
- Hawaiʻi pension plans, like those of Queen's Health System and Hawaiian Airlines, Inc. have allocated millions of dollars of their portfolios to REITs.

For all these reasons, we are deeply concerned about this bill and its impact on our industry, even as we see slower growth of our economy. Scaring people away from funding projects in Hawaiʻi is the last thing we need now as an industry and a state. I urge you to hold this bill for the sake of Hawaii's working families.

Sincerely,

Pane Meatoga III

Pane Meatoga III
Community Liaison
Hawaii Operating Engineers Industry Stabilization Fund

LATE

SB-2697
Submitted on: 2/17/2020 2:36:42 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Steven Costa	Testifying for FACE	Support	Yes

Comments:

Please support passage of REITS Bill

LATE

SB-2697
Submitted on: 2/17/2020 2:34:11 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Lawrence S Franco	Testifying for Stand Up Maui	Support	No

Comments:

I see this legislation as equal treatment on the income earned by all corporations. While struggling with our housing crisis, we continue to look for sources of income to meet our people's need for an affordable home. This could be one of those sources.

LATE

SB-2697
Submitted on: 2/17/2020 12:22:36 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Jake Fergus	Testifying for Fergus & Company	Support	Yes

Comments:

See attached

Hawaiʻi
Construction
Alliance

LATE

P.O. Box 179441
Honolulu, HI 96817
(808) 220-8892

February 18, 2020

The Honorable Donovan Dela Cruz, Chair
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair
and members
Senate Committee on Ways and Means
415 South Beretania Street
Honolulu, Hawaiʻi 96813

RE: OPPOSTION for SB2697 , RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS

Dear Chair Dela Cruz, Vice Chair Agaran, and members:

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

We are deeply concerned about what would happen if Hawaii becomes only the second state to break from the federal tax code and repeal the deduction real estate investment trusts receive on the dividends paid to their shareholders. These REIT shareholders include thousands of Hawaii residents who would see their pensions and future incomes diminished by this legislation.

Many of the members of this committee may not know that some of our member unions are seeing a drastic reduction in work hours. In some unions, the reduction is as much as 25 percent. The benches are filling up with unemployed workers. We are also seeing members falling off our membership lists. That means these men and women, fathers and mothers, who belong to our unions are no longer collecting unemployment. Their unemployment benefits have run out, and they no longer can afford to pay membership dues.

This measure proposes to increase the tax burden on REITs, which already pay many millions in property tax and millions more in GE tax. This additional taxation will make it difficult for REITs to continue investing in new projects and make improvements to their existing properties.

I would like to tell you something about REIT investment. REITs invest in Hawaii when the economy is soft or in recession. And because they invest continuously, even during recessions, projects like the expansion of Ala Moana Center and the redevelopment of the International Market Place, as well as numerous other projects, it was possible for thousands of workers to remain employed during a slow period for Hawaii's construction industry.

This bill basically targets the construction industry and all the jobs REITs provide to our members. It's also important for you to know that most of our members are a paycheck away from homelessness, so anything that would restrict the ability of REITs to finance projects or any barriers to more economic investment would deal a heavy blow to many working people and their families.

Last session when another bill was introduced to raise taxes on REITs by taking away the deductions on funds distributed to shareholders, I was told by that some investments in projects and expansions to existing REIT properties, were put on hold pending the Legislature's decision on that bill. And right now, there are projects that have been put on hold because investors are seeing signs of a contraction in the economy.

For all these reasons, we are deeply concerned about this bill and its impact on our industry, even as we see storm clouds forming over our economy. Scaring people away from funding projects in Hawaii is the last thing we need now as an industry and a state. I urge you to hold this bill for the sake of Hawaii's working families.

Therefore, we strongly ask for your committee's favorable action on SB2697.

Mahalo,

Nathaniel Kinney
Executive Director
Hawaiʻi Construction Alliance
execdir@hawaiiconstructionalliance.org

SB-2697
Submitted on: 2/13/2020 3:11:04 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

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

Comments:

This is unfair to the many taxpayers who use this dividend income for everyday expenses. REITs are one of the safest investments, with a dividend component as well as a growth component. You are doing a diservice to many seniors and others who need this income to live on, and not have to divert away some for taxes. To add insult to inury, you are sunsetting the provision after three years, which means you really do not support it.

Please kill this bill.

lynne matusow

SB-2697
Submitted on: 2/13/2020 3:11:37 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

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

Comments:

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

TO: **SENATE COMMITTEE ON WAYS AND MEANS**
Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair

FROM: Eldon L. Wegner, Ph.D.
Professor Emeritus in Sociology, UH-Manoa

SUBJECT: SB2697 Relating to Taxation of Real Estate Investment Trusts

HEARING: Tuesday February 18, 2020, 10:30 am
Conference Room 211, Hawaii State Capitol

POSITION: Support with a suggested amendments. Currently, REITS allow individuals to avoid paying Hawaii state taxes on the profits from business transactions in the state of Hawaii. This bill would end this unfair practice by closing that loophole. However, we suggest an amendment that the additional revenue be channeled into affordable housing and programs to end homelessness.

RATIONALE:

I am offering my testimony as an individual. I am a Professor Emeritus in Sociology, UH-Manoa. I belong to Faith Action and Church of the Crossroads. This bill is a priority for both of these organizations in the current legislative session.

Real Estate Investment Trusts (REITs) are corporations that use a loophole to avoid the Hawaii corporate tax. **We should not give away potential state revenue to wealthy individuals and then make the claim that the state can't afford to solve our pressing housing problems.**

We need solutions to our affordable housing crisis now!

REITs own income-producing property in Hawaii, including Ala Moana Center, the Hilton Hawaiian Village Resort, as well as office buildings and many other shopping centers and hotels. Together, they own property with an estimated total value of $18 billion that earns an estimated $1 billion in profits annually. If Hawaii's corporate tax were applied to REITs, an estimated $60 million in tax revenue would be generated.

Meanwhile, Hawaii faces an enormous shortage of housing that is affordable to low- and middle-income individuals and families. New housing is being built, but most of it is priced for the high-income strata. Some efforts are being made to build affordable housing for low- and middle-income levels, but much greater efforts must be made because the need is so great and the cost of housing is so high.

Various ideas to fund affordable housing are contained in an action plan for workforce/affordable housing that was funded by the Legislature and issued in 2017. Those ideas include dedicating new tax revenue for affordable/workforce housing or infrastructure, with the funds kept separate from the general fund. (Housing Action Plan Final Report to the State Legislature, 2017, p. xii)

The revenue generated by repealing the tax exemption for REITS could easily be dedicated to funding affordable housing and programs for the houseless. The bill should be amended to separate the new tax revenue from the general fund and direct it to the creation of affordable housing in Hawaii.

Thanks you for the opportunity for me to submit testimony.

Sincerely,
Eldon L. Wegner, Ph.D.

Testimony on SB 2697

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

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

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

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

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

I support passage of SB 2697.

SB-2697
Submitted on: 2/14/2020 10:01:49 AM
Testimony for WAM on 2/18/2020 10:30:00 AM

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

Comments:

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

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

Chair Donovan Dela Cruz
Vice Chair Gilbert Keith-Agaran
Senate Committee on Ways & Means

Tuesday, February 18, 2020
10:30 AM

TESTIMONY IN SUPPORT OF SB2697 RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS

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

My name is Jun Shin. I am 20 years old, a member of Generation Z. I am a Sophomore at the University of Hawaiʻi at Mānoa, and a member of the Faith Action for Community Equity (FACE). I am testifying in **support** of **SB2697** relating to taxation of real estate investment trusts**.**

This has become an issue that is very close to my heart. I live in the Ala Moana area currently, so I'm personally neighbors with the Ala Moana Center, one of the well known REIT-owned properties in Hawaiʻi that is constantly busy. However, I am also neighbors with houseless individuals, and have also seen their struggles up close while coming home from school. I want to be able to do something to help our fellow human beings who have just as much worth as everyone else and who are struggling. To me, this is a tale of two cities, two very stark contrasts in my community that needs fixing and it cannot be ignored.

Closing the REITs tax loophole and making them pay their fair share of taxes is a much needed reform and a great step in the right direction to begin to address this divide. REITs are a well-off part of our communities. They should be helping to support the communities that they are currently operating in, and be a good neighbor. With REITs having federal tax exemptions and benefiting from our low property tax, they are in a great position to pay their fair share in taxes while still being well off. It is a common understanding among residents that it is very hard to live here. With low wages, our workers are taking on several jobs and living paycheck to paycheck, close to seeking the streets for refuge while our young people are moving out. We need to continue to work together on creating a society that works for all of us.

By doing their part, REITs can still operate and thrive in Hawaiʻi while being a responsible community member. By paying their share of the taxes, they are helping to build a strong Hawaiʻi for everyone, revenue that would be able to go to critical needs. Please continue to help in making a Hawaiʻi that is livable for my generation and generations to come so that we can all have an opportunity to succeed, afford our basic needs, and have families of our own, staying here and giving back to the islands. For future generations, I ask you to please **support** and **pass SB2697** out of your committee and eliminate the corporate income tax exemption on dividends paid out by REITs.

Thank you for the opportunity to testify,

Jun Shin
1561 Kanunu St.
Honolulu, HI 96814
Cell: 808-255-6663
Email: junshinbusiness729@gmail.com

SB-2697
Submitted on: 2/14/2020 11:00:00 AM
Testimony for WAM on 2/18/2020 10:30:00 AM

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

Comments:

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

SB-2697
Submitted on: 2/15/2020 8:07:29 AM
Testimony for WAM on 2/18/2020 10:30:00 AM

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

Comments:

Hello,

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

It is important for me that Hawaiʻi should have equitable and affordable housing for its communities that it serves and not big corperations.

Please suppor this bill.

me ke aloha ʻÄ• ina,

Nanea Lo

SB-2697
Submitted on: 2/15/2020 9:27:51 AM
Testimony for WAM on 2/18/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Keith Neal	Individual	Support	No

Comments:

I strongly support SB2697. Real estate investment trusts (REIT) are business cooperations and must pay Hawaii state corporate taxes like any other business in the state. REIT’s enjoy public infrastructure and services, yet do not pay their share of the burden for which they enjoy. The Department of Business, Economic Development, and Tourism has concluded that the State has foregone tens of millions in income tax annually. This is wrong.

Passing SB2697 creates greater tax equity for Hawaii by requiring REIT’s to pay their fair share. The additional public income to the state would go to benefit our local communities and aging infrastructure.

Furthermore, the legislation should not sunset so soon. To create a more predictable, stable business and public planning environment the legislation needs to be enforce for decades, if not permanently.

Sincerely,

Keith Neal

Waimea, HI

96743

SB-2697
Submitted on: 2/15/2020 9:46:07 AM
Testimony for WAM on 2/18/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Wendy Arbeit	Individual	Support	No

Comments:

I strongly support this bill.

Taxing REITs is long overdue. They attract the kind of investments that don't benefit our residents. The housing built by offshore investors is overpriced for the average working person living in Hawaii, architecturally replicating the suburban sprawl and strip malls blighting the landscape of the mainland. The malls they purchase charge rents that discourage local businesses. (Look at Ala Moana SC).

SB-2697
Submitted on: 2/15/2020 12:48:08 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

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

Comments:

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

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

Thank you!!

Marian Heidel, Kailua, HI 96734

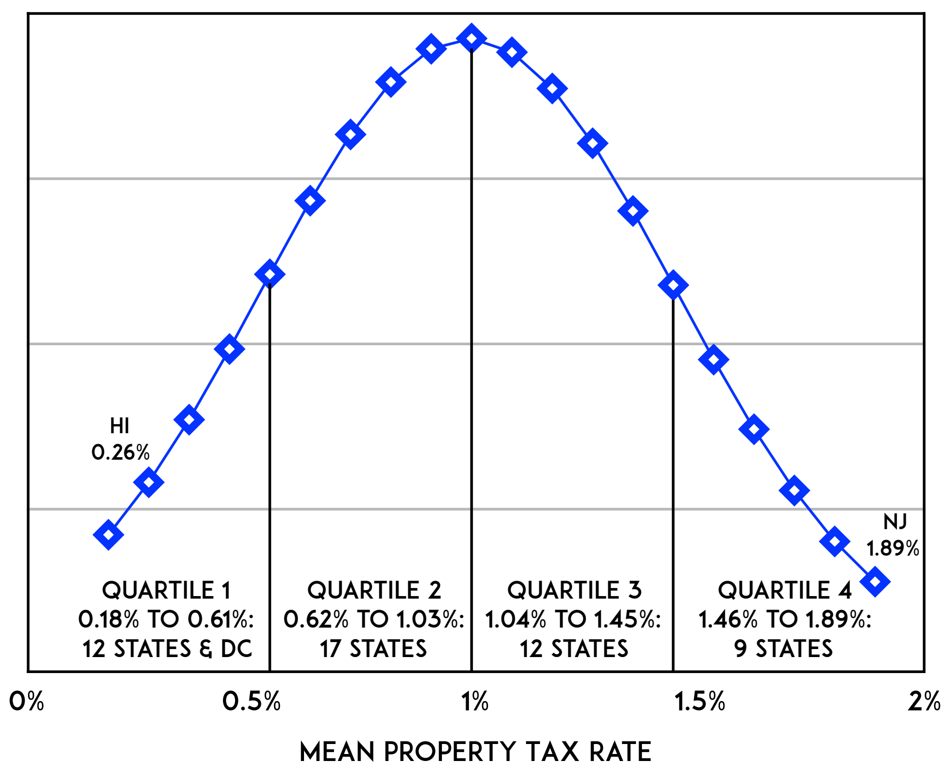
Testimony of Dylan P. Armstrong, Individual
Before the Senate Committee *on Ways & Means*

In support of Senate Bill 2697
Relating to Taxation

Aloha Chair Dela Cruz, Vice Chair Keith-Agaran, and Members of Ways and Means:

I write **<u>in support</u>** of the proposed measure, Senate Bill 2697. As we deal with a changing Hawai'i economy, and challenges not limited to an aging population, depopulation, deferred maintenance for our infrastructure, et cetera—we must think systematically about revenues. The estimated value of lands held by Real Estate Investment Trusts (REITs) is $17 billion. Our Governor's Operating Budget request for Fiscal Year 2021 was $15.7 billion. Those REIT assets generate approximately $1 billion annually, paying some of lowest property taxes of a major state.

This normal distribution table below, made by myself from the tax data available on www.tax-rates.org shows that our mean tax rate is anomalous among U.S. states and D.C.. Our state rank of 50th,with a mean property tax rate of 0.26%, places us only before Louisiana (0.18%) as having the lowest mean taxes.



It is true that our mean property taxes are low as a percentage of home value due to exceptionally high demand for housing. I do not advocate raising taxes on struggling local people. However, our current tax system exacerbates our tax liabilities across the state. We can fill this gap with revenues from REITs.

Testimony of Dylan P. Armstrong, Individual
Before the Senate Committee *on Ways & Means*

In support of Senate Bill 2697
Relating to Taxation

The tax rates proposed in SB2697 are essentially reasonable, and not so burdensome that they would be expected to eliminate real estate investment. Let our tax policies be data-driven, not anomalous. Looking at the big picture, we ought to shift the tax burden away from senior citizens, the disabled, and the working class. Our reliance on the General Excise Tax (GET) and Income Taxes does the opposite. Our tax system punishes work, even as our working struggle to maintain multiple jobs to get by. This system also punishes consumption. Yet the working class consumes a higher percentage of household income in the form of goods and services, like groceries and utilities. The richest residents consume the relative least as a percentage of household income.

I do not suggest that we punish the middle and upper-middle class residents with increases in taxation to cover existing gaps in state funding. Our middle class is part of our working class. Instead, reasonably elevating investment property taxation for REITs is where to look. Taxing REITs at a higher rate shifts the tax burden significantly to non-residents. Non-resident investors use our land and infrastructure, too, while simultaneously getting an unfair deal with comparatively lower General Excise Tax and Income Tax burden.

In fairness to struggling local taxpayers, please pass SB2697. Thank you for your consideration.

Sincerely yours,

Dylan P. Armstrong

Dylan P. Armstrong, Individual

Some References, Accessed 14 February 2020

The FB 2019-21 Executive Biennium Budget. State of Hawai‘i. December 17, 2018. https://budget.hawaii.gov/wp-content/uploads/2018/12/FB-19-21-BIB-FINAL-12.13.18.pdf

Property Taxes by State. Tax-Rates.org. http://www.tax-rates.org/taxtables/property-tax-by-state

SB-2697
Submitted on: 2/16/2020 9:09:37 AM
Testimony for WAM on 2/18/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Katherine MacPherson	Individual	Support	No

Comments:

Senate Committee on Ways and Means

February 18, 2020 at 10:30 a.m.

State Capitol Conference Room 211

SUPPORTING SB 2697 WITH AN AMENDMENT

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

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

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

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

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

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

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

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

2020 TESTIMONY OF ROGER EPSTEIN RE: SB 2697

My name is Roger Epstein and I have been an international business lawyer in Hawaii for over 45 years.

I am in favor of SB 2697. DOTAX has revised its estimates and the Governor should now see Hawaii is losing about $60 Million of annual income tax revenue owed by REITs.

Real Estate Investment Trusts ("REITs") are the only entities that do not pay Hawaii income tax on their Hawaii real estate income. Those against this bill argue that we need REIT investment in Hawaii. However, I have had many, many investors from China, Japan, Vietnam, Canada and other countries seeking to invest in Hawaii real estate, who were unable to find available investments. Yet REITs have found $18Billion of Hawaii investments, perhaps because they can bid higher for properties, since the don't pay income taxes.

Of course Hawaii wants investment from outsiders. But do we want it so badly that we are willing to entirely eliminate income taxes. Hawaii real estate investment is very desirable. There will be many other investors who will pay the same property taxes and GET as REITs, and will also pay Hawaii income taxes.

Only desperate third world countries give complete income tax holidays to real estate investors. Hawaii is the opposite of that. We are a highly desirable real estate investment destination. Let's not sell ourselves short and give away $60 million a year in taxes. Hawaii could well use those funds and REITS have already had tax breaks from 2013-2019 of an estimated $300 million.

I submit that that's enough. Time for REITs to pay like everyone else.*

*I strongly believe that the proper way to tax REITS is by withholding on REIT dividends, as the Feds do. Since that bill apparently can't pass in

Hawaii, this is the only alternative for Hawaii to get the income tax revenue it deserves.

SB-2697
Submitted on: 2/16/2020 3:08:52 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
William Bekemeier	Testifying for Faith Action for Community Equity	Support	No

Comments:

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

SB-2697
Submitted on: 2/16/2020 5:53:48 PM
Testimony for WAM on 2/18/2020 10:30:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Deanna Espinas	Testifying for Faith Action for Community Equity	Support	Yes

Comments:

HEARING BEFORE THE SENATE COMMITTEE ON WAYS AND MEANS

HAWAII STATE CAPITOL, SENATE CONFERENCE ROOM 211 TUESDAY, FEBRUARY 18, 2020 AT 10:30 A.M.

To The Honorable Donovan M. Dela Cruz, Chair;

The Honorable Gilbert S.C. Keith-Agaran, Vice Chair; and Members of the Committee on Ways & Means,

TESTIMONY IN SUPPORT OF SB2697 RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS

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

Kim Watts
Ewa Beach

LATE

Testimony Before the Senate Ways and Means Committee
Supporting SB 2697, Relating to REITs
Galen Fox of Faith Action, February 18, 2020

I support taxing REITs because, in part:

1. REITs steal money that belongs in Hawaii:

Paraphrased from the Tax Foundation: 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.

REITs are source shifters. REITs don't pay income tax on that income as long as they distribute the money as dividends to their shareholders. The dividend income of their shareholders 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.

2. REITs paying Hawaii's corporate tax will maintain their subsidiaries that result in paying the GET twice:

Paraphrased from the Tax Foundation: Because REITs cannot receive operating income, yet can receive rent from real estate, they form REIT subsidiaries paying rent to REITs that is subject to Hawaii's GET law. REITs say that if SB 2697 passes, the REIT subsidiaries will disappear, eliminating the extra GET the state collects on rents.

REITs established their subsidiaries because it it benefitted them despite paying GET twice. The 2018 Trump tax law drastically reduced the corporate income tax rate from 35% to 21%, sharply educing the federal tax burden on REIT subsidiaries. If it was beneficial to create a REIT subsidiary before federal tax reform, maintaining the subsidiaries now continues to make sense.

3. Why forego at least $36 million in revenue?

Paraphrased from the Tax Foundation: According to SB 2697's preamble, real estate investment trusts in Hawaii own real estate assets of about $17 billion, generating an annual income of $1 billion, which, if taxed, at the current corporate rate assessed to all other corporations, would generate Hawaii taxes of $65 million per year. A 2016 analysis conducted by the department of business, economic development, and tourism concluded that the State had foregone about $36 million in income tax in year 2014, and that the amount of real estate investment trust investments has risen substantially since 2014.

Mahalo.

LATE

Date: February 16, 2020

To: Representative Donovan M. Dela Cruz, Chair
Representative Gilbert S.C. Keith-Agaran, Vice Chair
Members of the Ways and Means Committee

Re: Strong Support for SB2697, Relating to Taxation of Real Estate Investment Trusts

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Aloha,

My name is Jarresa Kiyoko Harris, a Master's in Social Work student at the University of Hawaii at Manoa. I am testifying in **strong support of SB2697**, which would disallow dividends paid deduction for real estate investment trusts (REITs)

REITs have a total property value of $18.21 billion and only paid $190 million in property taxes (Nareit, 2019). These properties have been excluded in paying the corporate tax, which could have provided much more revenue for Hawaii. Other businesses are paying this corporate tax in order to operate in Hawaii, yet REITs have been able to escape these taxes.

For example, Ala Moana Center is one of the many REITs here in Hawaii (Nareit, 2019). They are continuously expanding with new businesses operating. As one of the main shopping centers on the island, Ala Moana Center has thousands of consumers who invest their time and money there. They are one of the REITs who slip by the corporate tax, but if they do pay this tax, they could still smoothly operate their businesses and help generate revenue for the state.

With the extra revenue that could be provided by REITs, I suggest that the money can go towards funding affordable housing programs that can help many in being able to still live in our beautiful state. There are individuals and families who work hard every day to be able to survive on the land that they have been born and raised in. I have witnessed many people struggle with finding a secure place to live due to the rise in our economy.

REITs can afford to pay the corporate tax while still being able to operate smoothly. The revenue generated could assist the state in various ways, such as addressing the need for affordable housing. Please do not let the state lose money that could be gained through these taxes. Mahalo for supporting SB2697.

Sincerely,
Jarresa Kiyoko Harris

LATE

Testimony of
Paul H. Brewbaker, Ph.D., CBE
Kailua, Hawaii
February 18, 2020

Opposing S.B. 2697
RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS

Hawaii State Legislature
Senate Committee on Ways and Means

Drop S.B. 2697. Legislators' obsession with bills of this sort evidence the persistence of bad economic ideas and the quest for political power. S.B. 2697 yet again seeks to eliminate a dividends-paid deduction authorized by the U.S. Congress 60 years ago in creating Real Estate Investment Trusts (REITs). This is a tax protocol to which 49 States have adhered in order to democratize ownership of commercial real estate through mutual fund-like, pass-through, S-corporate structures designed to dismantle the monopoly power of wealthy developers and families with concentrations of real estate holdings and associated political power. Because *it does nothing else*, least of all augment tax revenues, S.B. 2697 can only be an attempt to revive monopoly power of small numbers of wealthy developers or landowners for the personal political benefit of its sponsors and their benefactors. S.B. 2697 will erode the contestability of commercial real estate in Hawaii which is enhanced by the presence in the islands of REIT investments. Welcome to the Age of Trump: more power to Hawaii developers who support this bill publicly, and others who won't show up (but are willing to free-ride).

As a disclaimer, although this bill strategically avoids mentioning it, I wrote the first economic analysis of REIT investments' economic impacts on Hawaii as a consultant to the National Association of REITs (NAREIT) about five years ago, in collaboration with its chief economist at the time, Brad Case. The NAREIT report documented magnitudes and scope of REIT investments in Hawaii which probably wouldn't have happened were they not structured as pass-throughs, their net incomes *only* taxed once, in terms of the usual measures: gross product, employment and associated earnings, and tax revenue. Yes, tax revenue. A report which you had commissioned DBEDT to write, contemporaneously and non-collusively with respect to my report, was mysteriously delayed from publication for more than one year. (I showed them mine months before I saw theirs.) Nevertheless, upon DBEDT's publication, which this bill notes explicitly, and because of their report's finding that bills like this would be accretive to tax revenue—which they will not—the *Honolulu Star-Advertiser* reported on DBEDT's report and not mine. Perhaps it was confirmation bias (it undermines predetermined beliefs and is ignored).

My report suggested that just as a zero tax rate (in 49 states) was *not* a disincentive to investment, but that a positive tax rate (in one of them, Hawaii) would be a disincentive to REIT *investment* activity which already generates significant tax revenues in Hawaii. At best, results of imposing such a tax are ambiguous if non-zero.[1] The DBEDT report used an unrepresentative, single tax-year experience to calibrate ongoing annual revenue consequences of withdrawing the dividends-paid deduction on REIT net income by assuming that investments are inert, that they do not change, regardless of variations in the user cost of capital for which changes in the effective corporate tax rate are one of the most significant.[2] Then, when the user cost of capital is changed because of an increase in the effective tax rate (removing the dividends-paid deduction), DBEDT assumed that investors *continue to behave as it the user cost of capital did not change*. DBEDT calibrated to an unrepresentative tax year an estimate of effects of a change in one parameter—the effective corporate tax rate—and applied it under the hypothesis that behavior is unaffected by changes in the tax rate. We all know this is bogus. We knew it at the time. We still know it. You know it. DBEDT knew it. Their economists knew it, and agreed with me. Department of Taxation officials know it and have told you so repeatedly. I personally have told you, or legislators at the time, in at least one public hearing and more times than that in writing, that DBEDT's results were bogus. Developers who support this bill (both of them) even exaggerate DBEDT's bogus results, each year a version of this bill surfaces. This bill *literally* cites DBEDT's bogus result based on the unrepresentative tax year experience.[3] Bogacity begets bogacity.

You can't have it both ways. Either REITs invest in Hawaii *because* their behavior *is* responsive to economic variables, or they are inert. It can't be both. If REITs invest in Hawaii because they *are* responsive to economic variables, then a tax increase which induces them to *disinvest* will not generate the same tax revenue as when REITS do *not* respond to economic variables, paying a tax they need not pay in 48 other states. My report argued that REITs responded to economic variables by investing in Hawaii and that double-taxing them risks lower investment and no tax revenue. DBEDT argued that REITs responded to economic variables by investing in Hawaii and that double-taxing them generates taxes because REITs do not respond to economic variables. Wait, what? They can't respond *and not respond*.

Higher taxes could lead REIT capital to abandon Hawaii and swarm to the 48 states where the user cost of capital has not changed. Increasing the effective tax rate on REITS could either decapitalize Hawaii or lead to ownership changes which result in the same thing: no

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[1] In an unpublished dynamic computable general equilibrium model on which we experimentally simulated longer-run tax consequences, tax revenues foregone from lower investment (and disinvestment) negated revenue gains from the higher effective tax rate implied by withdrawal of the REIT dividends-paid deduction. REIT investors have 48 states into which capital can be redeployed costlessly for superior returns if S.B. 2796 is adopted in Hawaii. Even if capital reallocation is not instantaneous, capital moves in finite time, requiring dynamic economic analysis. This second report was never published for reasons I never fully understood, but respected. I only report its now because the simulation results were carefully calibrated to international experience (there being no U.S. state experiences upon which to draw) and broadly validated predictions of economic theory which overturn DBEDT's result.

[2] The other main factors are the risk-free rate of interest, the depreciation rate, and a risk premium.

[3] SB 2697 reads, in its SECTION 1, "A 2016 analysis conducted by the department of business, economic development, and tourism concluded that the State had foregone about $36 million in income tax in year 2014 [*sic*], and that the amount of real estate investment trust investments has risen substantially since 2014."

meaningful change in tax revenues.[4] If REIT-based capital is *im*mobile, as DBEDT assumed in its bogus tax revenue estimates, then you can raise the effective tax rate by withdrawing the dividends paid deduction, detonate nuclear devices under large shopping malls, impair REIT development of affordable (the adjective) rental housing, *and nothing will change* because capital is immobile by assumption. *Of course* tax revenues increase: *you assumed capital just sits there* when you raise its tax rate. But capital doesn't just sit there. Capital is mobile. S.B. 2697 assumes the *opposite* of what's true—facts not in evidence, as TV lawyers like to object—and predicts a bogus tax revenue result from a tax policy change that will make people in Hawaii worse off by reducing private investment.

I'm pretty sure most of you know this already. I don't even work with NAREIT now but I would get the same result in my report were it to be updated through the remainder of the 2010s. REITs were responsible for a significant, perhaps even a dominant portion of private construction in Hawaii during the 2010s—physical capital formation, the creation of productive capacity. Nothing prevented other investors or developers from doing the same things: many did. Changes in the market for corporate control should be expected. A higher effective corporate tax rate will reduce investment, and will induce changes in ownership favoring non-taxable entities. Remember, for-profit C corporation-type entities which retain earnings *rather* than distributing their net income in taxable dividends already have the ability to acquire or build such properties as REITs' investments. C-corps' optimizing decisions, retaining corporate net income rather than declaring it as taxable individual income, also are influenced by the tax environment. If it is "unfair" for C-corps to pay taxes when S-corps do not, then C-corps could simply distribute their retained earnings as dividends or form a REIT. If they choose not to when that choice is available, they must already consider themselves better off because they could have chosen differently but didn't. There is nothing unfair about that.

Finally, I feel obliged to point out that the thinly-veiled "keep the money in state" xenophobic mentality underlying this bill is both logically contorted and fails to understand the spirit of the commerce clause which is one of the principle advantages of our economic union within the United States, a major reason for Hawaii's high living standard as a U.S. state. Capital flows across state boundaries—like flows of goods, services, labor, information, and technology—largely unrestricted by border inspections or by tariffs like the ones which impede free trade between countries. States impose differential taxes at their own risk. States initiate differential subsidies to "beggar-their-neighbors." Life is complicated; imperfections abound. Essentially, we have free trade within the U.S. That's why we rock. That's how we roll. SECTION 1. of S.B. 2697 reveals a logical flaw contradicting this commerce principle. It reads, in part, "Existing state law conforms to [federal] provisions, but creates an anomaly because a real estate investment trust that does business in Hawaii, but pays dividends to shareholders out of the state, results in no Hawaii income tax collected either from the real estate investment trust or from its shareholders, due to the fact that shareholders pay any tax on dividends to the state in which they reside, not where the income was generated." Dude: *this is true in every state*. Boo-hoo, you can't tax residents in other states. *Neither can they*. It's not an anomaly if it's true everywhere. Get it? Keeping the money in state is not a thing. Move on.

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[4] My report conjectured that the most likely next class of investors to whom REITs would sell would be non-taxable entities such as pension funds, certain insurance companies, and university endowments.