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LATE

TESTIMONY OF
GARY S. SUGANUMA, DIRECTOR OF TAXATION

TESTIMONY ON THE FOLLOWING MEASURE:
S.C.R. No. 158, Requesting the Department of Taxation to Conduct a Study on Disallowing the Dividends Paid Deduction for Real Estate Investment Trusts

BEFORE THE:
Senate Committee on Commerce and Consumer Protection

DATE: Friday, March 22, 2024
TIME: 9:40 a.m.
LOCATION: State Capitol, Room 229

Chair Keohokalole, Vice-Chair Fukunaga, and Members of the Committee:

The Department of Taxation ("Department") offers the following comments on S.C.R. No. 158 for your consideration.

S.C.R. No. 158 requests the Department conduct a study on the advantages and disadvantages of disallowing the dividends paid deduction for real estate investment trusts (REITs), including the following areas of study:

- Estimating changes in various tax revenues collected by the State after disallowing the dividends paid deduction for REITs;

- Considering other states' treatment of the dividends paid deduction for REITs and their impacts; and

- Considering possible exceptions to disallowing the dividends paid deduction for REITs and their impacts.

The Department notes that it can conduct the requested study in the current version of this Resolution. Thank you for the opportunity to provide testimony on this concurrent resolution.

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LATE

March 21, 2024

Senator Jarrett Keohokalole, Chair
Senator Carol Fukunaga, Vice Chair
Senate Committee on Commerce and Consumer Protection

Comments in Support of, and Request for Amendments to SCR 158 Requesting the Department of Taxation (DoTAX) to conduct a study on disallowing the Dividends Paid Deduction [DPD] for Real Estate Investment Trusts [REITs].)

Thursday, March 22, 2024, 9:40 a.m.; State Capitol, Conference Room 229 & Videoconference

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.

SCR 158. The stated purpose of this Resolution is to request that DoTAX conduct a study on disallowing the DPD for REITs in order to estimate the change in revenue collected by the State after such disallowance.

LURF's Position.

LURF believes rather than seeking to decouple from the federal system and disallowing the DPD for REITs based on what is apparently viewed as unjust consequences of the application of the REIT laws to Hawaii, focus should instead be placed upon the numerous benefits brought by REITs to this State which more than compensate for any alleged disadvantages.

Therefore, given 1) the importance of allowing the continuance of the DPD for REITs and its corresponding advantages and benefits to Hawaii's economy; and 2) the continuing attempts by detractors through countless iterations of legislative measures over the past years to eliminate the DPD for REITs based on what is perceived to be the potential for tax avoidance by foreign/mainland corporations and wealthy individuals through real estate ownership arrangements structured through REITs, LURF wholeheartedly supports the performance of **a credible study based upon reliable**

facts and information, expert opinion, and quantifiable evidence to prove that the claimed profits or increase in revenues would in fact be received by the State as a result of the disallowance of the DPD for REITs.

1. **The Final Report on the Impact of REITs in Hawaii Previously Conducted by the State Failed to Validate the Alleged Purpose of and Need for the Disallowance of the DPD for REITs.**

Given that an unwarranted change of a universal tax rule in place since 1960 could potentially 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 investigate 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 DoTAX to study the impact of REITs in Hawaii, and to present material facts and evidence which could show whether such proposed legislation to disallow the DPD for REITs was in fact justified, and whether the State's economy would not be negatively affected as a result of taking the action proposed.

An interim report was released in December 2015 (the "Interim Report"),[1] followed by a final report issued in September 2016 (the "Final Report"),[2] however, even the Final Report is based on assumptions and estimates; relies on inconclusive results of surveys admittedly taken with a small sample size and low response rate; and is fraught with uncertainties, inconsistencies and weighting errors, making it unfeasible and ill-advised to rely upon for presenting any conclusive calculations or impacts.

Inquiries which critically must be, yet were not proficiently or accurately addressed in the Final Report, include the amount of income the State would in fact **actually receive** as a result of the proposed legislation,[3] and **not an estimate** as proposed by this Resolution - especially given the likelihood that REIT investment in Hawaii will in turn decline (i.e., whether any proposal to elimination the DPD would be fiscally reasonable and sound); and whether it would be possible for the State 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.

LURF understands that the repeal of the DPD for REITs in Hawaii would in fact 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 fact, as far back as five years ago (pre-Covid and Maui wildfires), in an April 26, 2019 *Policy*

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

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

[3] LURF understands that even the DoTAX did not know and was not able to determine how much tax income the government might receive as a result of the proposed legislation.

Memorandum Relating to Taxation of Real Estate Investment Trusts (the "Memorandum"),[4] DBEDT expressly stated that:

> [T]he benefits of continuing with this federally established legislation are clear and quantifiable," and that REITs are an important investment vehicle for all types of investments in Hawaii.[5]

> The Memorandum went 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.[6]

Since 2019, much has transpired, including the Covid 19 pandemic and the Maui wildfires and the economic effects suffered therefrom, so that it has become even more apparent that a repeal of the DPD for REITs may negatively impact this State. Before again attempting to eliminate the DPD for REITs, the proposed study should certainly be conducted in order that the Legislature may investigate and confirm the following significant points:

- Little or no new corporate income tax revenue will be generated by eliminating the DPD for REITs. DoTAX previously stated that $2.5M would be generated in the first year and $10M, at best, per year. DoTAX also stated this number could even be $0, or less, if REITs apply other deductions to lessen tax liability.

- Repealing the DPD would jeopardize GET revenue, which is about 43% of the state's revenue (corporate income tax is about 2-3% of the state's revenue) - Mostly by hotel REITs due to their required tax structure that generates two levels of GET revenue.

- Less capital will be invested in Hawaii, thereby reducing available jobs for Hawaii residents and GET from construction for capital improvements and sales and operations at REIT-owned properties.

- REITs have access to the capital market, enabling REITs to invest significantly in construction projects benefiting their properties and Hawaii's residents.

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[4] 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").

[5] Memorandum at p. 2.

[6] *Id.*

<u>Requested Amendments to SCR 158</u>.

There continues to be a conflict between the positions held between supporters of, and opponents to the DPD for REITs. Those who have continued to attempt to repeal the DPD and who have supported various anti-REIT measures have, however, heretofore failed to present credible and material information, facts or evidence required to prove that the State's economy will significantly improve as a result of disallowing the DPD for REITs. And indisputable information, facts and evidence supporting the benefits of continuing the DPD do appear to exist and in fact clearly seem to outweigh any perceived profits or increased revenue speculated to be received as a result of the proposed disallowance.

LURF therefore supports SCR 158, and this Committee is respectfully urged to effectuate a comprehensive, credible, and impartial study containing analysis of all the available facts and information relating to the DPD for REITs, as well as the potential financial and economic consequences thereof that may impact this State in order to conclusively determine the validity of the DPD for REITs. By authorizing the study, this Committee is further respectfully requested **to amend SCR 158 by including the following amendments which are necessary to ensure accurate, meaningful, and substantiated results**:

1. **Expansion of the scope of the study by inclusion of the following**:

   - Expansion of the knowledge base for the study by including **input from REITS and experts** in corporate tax, and macroeconomics and other relevant fields;
   - The **amount of tax revenue** (as reasonably possible to determine) that the State would in fact receive as a result of disallowing DPD;
   - The **tax impacts** - not limited only to GET from hotels, but including all forms of taxes paid by the other REIT business categories, including affordable, residential, and student housing, as well as retail, industrial, healthcare, and other facilities;
   - The **corporate tax strategies** that could limit the determined amount of state revenue resulting from the disallowance of the DPD;
   - **Macroeconomic study** of Hawaii's overall economy and the impact of REITs;
   - **The economic growth impact** of REITS in Hawaii, including determinations as to whether REITS have **stimulated** Hawaii's economic growth, and whether the disallowance of the DPD would **discourage the State's economic growth;**
   - **Alternatives to replace REITs' investments in Hawaii**, should they elect to do business elsewhere; and
   - **The community service and contributions provided by REITS** to Hawaii's communities, as compared with other corporations in the same industries.

2. **Necessary retention of qualified experts.** The DoTAX and/or other State departments and agencies involved in the study must be authorized to hire credible

and dependable experts in corporate tax, macroeconomics, and other relevant subject matter areas to ensure accuracy and credibility of the study's results.

3. **Necessary adequate funding.** This Resolution must also include provisions for necessary and sufficient funding to retain the experts required to perform and complete the comprehensive study covering all areas of expertise including, but not limited to corporate tax, Hawaii taxes, and macroeconomics.

Conclusion. As this Committee is well aware, the State is presently still recovering from the economic devastation caused by the COVID-19 pandemic, as well as the Maui wildfires. Given the currently dire fiscal, health and social environments, it is only reasonable and prudent for this Legislature to conduct the proposed comprehensive study prior to giving future consideration to any proposed change of a universal tax rule in place since 1960, which could significantly reduce the availability of capital in Hawaii, as well as result in other significant, negative economic repercussions for this State. For these reasons, LURF must **support SCR 158, and respectfully requests passage of this Resolution with the amendments set forth above.**

Thank you for the opportunity to provide comments regarding this important matter.

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LATE

March 22, 2024

The Honorable Jarrett Keohokalole, Chair
Senate Committee on Commerce and Consumer Protection
State Capitol, Conference Room 229 & Videoconference

RE: Senate Concurrent Resolution 158, REQUESTING THE DEPARTMENT OF TAXATION TO CONDUCT A STUDY ON DISALLOWING THE DIVIDENDS PAID DEDUCTION FOR REAL ESTATE INVESTMENT TRUSTS.

HEARING: Friday, March 22, 2024, at 9:40 a.m.

Aloha Chair Keohokalole, Vice Chair Fukunaga, and Members of the Committee:

My name is Lyndsey Garcia, Director of Advocacy, testifying on behalf of the Hawaiʻi Association of REALTORS® ("HAR"), the voice of real estate in Hawaii and its over 11,000 members. HAR provides **comments** on Senate Concurrent Resolution 158, requesting the Department of Taxation to conduct a study on disallowing the dividends paid deduction for real estate investment trusts.

In 1960, the United States Congress created Real Estate Investment Trusts ("REIT") 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: Moanalua Hillside Apartments and Waena Apartments
- Student Housing: Hale Mahana Student Housing
- Healthcare Facilities: Hilo Medical Center, Kapiolani Medical Center, and Pali Momi Medical Center
- Retail: Prince Kuhio Plaza, Pearlridge Center, 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. There have been proposals to remove the income tax deduction for dividends from a REIT, thereby creating a double taxation of income. HAR has concerns that these proposals will become a disincentive to invest in Hawaii, which would negatively impact the economy.

Additionally, such proposals impact those that invest in REITs, such as retirees who use this as part of their retirement income. Approximately 44% of Hawaii households own and benefit from REITs through their retirement savings and other investments, so any additional taxes on REITs in Hawaii would hurt those households.

Mahalo for the opportunity to testify on this measure.

Nareit Hawaii Real estate working for you®

LATE

WRITTEN TESTIMONY OF
GLADYS QUINTO MARRONE
EXECUTIVE DIRECTOR
NAREIT HAWAII

COMMENTS ON SCR 158
BEFORE THE HAWAII SENATE COMMITTEE ON
COMMERCE AND CONSUMER PROTECTION

SENATOR JARRETT KEOHOKALOLE, CHAIR
SENATOR CAROL FUKUNAGA, VICE-CHAIR

HEARING ON SCR 158
FRIDAY, MARCH 22, 2024
9:40AM, Room 229
Hawaii State Capitol

Dear Chair Keohokalole, Vice-Chair Fukunaga, and members of the Committee on Commerce and Consumer Protection:

Thank you for the opportunity to submit this testimony on behalf of Nareit Hawaii and our REIT members active in Hawaii. Nareit Hawaii is the local office of Nareit, a 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.

Nareit Hawaii appreciates the intent behind SCR 158 and offers the following **comments:**

After reflecting over the last ten years, we would support a comprehensive study by the Hawaii State Department of Taxation (DoTax) on the impact of a repeal of the Dividends Paid Deduction (DPD) for REITs, if it evaluated the impact on investment, jobs, and output and the subsequent changes to total, individual, and General Excise (GET) taxes collected. Furthermore, the study should analyze the consequent and subsequent changes in the way REITs would do business in Hawaii, including the change in the way hotel REITs operate, which could significantly and substantially affect the amount of GET paid by said hotel REITs, and the extent that REIT investment would be directed to all other states that conform to the Congressional REIT rules.

Our caution in the Legislature's requesting a study, as outlined in SCR 158, is that a study that only considers a portion, but not all, of these issues may lead to an erroneous conclusion impacting policy decisions, which could cause severe damage to Hawaii's economy and economic growth.

Nareit Hawaii offers the following **recommendations to expand the study**, which should:

- Be conducted by tax revenue experts and economists.
- Take into account macroeconomics--changes in behavior (reduced investment, investing elsewhere, delay or withdrawal of construction projects, etc.) by REITs if the DPD is disallowed.
  - The Hawaii State Department of Business, Economic Development and Taxation (DBEDT) study conducted in 2017 explicitly recognized the limitations of not accounting for likely behavior: "It is important to note there are some limitations to the estimates...with regards to corporate income tax behavior. Specifically, the estimates do not take into account how REITs would change their behavior if the DPD were repealed. In other words, how would REITs change their tax strategy under the new scenario of REITs being subject to state corporate income tax?" (chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://files.hawaii.gov/dbedt/economic/data_reports/REIT_Final_9.19.16.pdf, page 20)
  - According to the State of Hawaii Department of Taxation, in the DBEDT study: "The Department of Taxation believes that if Hawaii eliminates the dividends paid deduction, taxpayers may respond in ways that reduce substantially any latent tax liability, such as by claiming other deductions that are presently not reported on their income tax returns." (Ibid.)
  - An EY study conducted in 2017 considered the macroeconomic effects of a DPD repeal in Hawaii. The study estimated that repealing Hawaii's DPD would result in fewer jobs and lower wages in Hawaii relative to what would otherwise have occurred. The study found that Hawaii Gross State Product would be reduced by, on average, $11 million (2017-2021), $29 million (2022-2026), and $46 million each year after. These macroeconomic effects reduced average revenue gains to a fraction of what would be expected in a static analysis. (Macronomic impact of the proposed repeal of the dividends paid deduction in Hawaii, EY, March 2017)

- Compare loss of GET from hotel REITs to any potential increase in corporate income tax revenue.
- Reflect REIT investment in Hawaii across ten asset classes (www.reitsacrossamerica.com/hi), including affordable residential, student housing, telecommunications infrastructure, and healthcare facilities, to capture the complete picture of REIT investment in Hawaii.

- Show any potential tax revenue gains netted against losses incurred during COVID years, or otherwise.
- Examine overall capital expenditure by REITs during COVID years, compared to other capital expenditure by non-REITs, and impact to GET and construction jobs.
- Examine expected REIT projects and impact on GET and corporate income tax and the loss of revenue, construction and other jobs if REITs withdraw from those projects.
- Include a comparison of investment between REIT long-term ownership versus non-REIT entities that acquire and sell properties as a business model.

If this study is authorized, it should be adequately designed, funded, and implemented.

We appreciate the opportunity to provide comments on SCR 158.