

DAVID Y. IGE
GOVERNOR

DOUGLAS S. CHIN
LIEUTENANT GOVERNOR



LINDA CHU TAKAYAMA
DIRECTOR

DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

**STATE OF HAWAII
DEPARTMENT OF TAXATION**

830 PUNCHBOWL STREET, ROOM 221

HONOLULU, HAWAII 96813

<http://tax.hawaii.gov/>

Phone: (808) 587-1540 / Fax: (808) 587-1560

Email: Tax.Directors.Office@hawaii.gov

To: The Honorable Donovan M. Dela Cruz, Chair
and Members of the Senate Committee on Ways and Means

Date: Tuesday, February 13, 2018

Time: 10:15 A.M.

Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 3067, Relating to Taxation

The Department of Taxation (Department) has serious concerns regarding S.B. 3067 and provides the following comments for your consideration. S.B. 3067 requires that Real Estate Investment Trusts (REITs) file returns reporting their shareholders' pro rata shares of gross income and deductions attributable to this State, provides for composite returns by the REIT, and requires withholding for those shareholders who do not agree to file returns or pay tax on their pro rata share of net income attributable to this State. The measure is effective upon approval and applies to taxable years beginning after December 31, 2018.

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

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

Second, the Department notes that S.B. 3067 may be subject to challenge as it proposes to tax a person whose only connection may be by virtue of owning an interest in a REIT doing business in the State. In *MeadWestvaco Corp. v. Illinois Department of Revenue*, 553 U.S. 16 (2008), the U.S. Supreme Court stated, “[t]he Commerce and Due Process Clauses impose distinct but parallel limitations on a State’s power to tax out-of-state activities, and each subsumes the “broad inquiry” “ ‘whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state.’ ”¹

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

Third, the Department notes that this measure would be placing an administrative burden on REITs that is greater than the burden placed on other similarly situated entities. If the intent of the measure is to create parity between REITs and C-corporations, the Department suggests reconsidering the dividends paid deduction. S.B. 3067 is unlikely to achieve parity because it may be challenged and it is harder to enforce administratively.

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

Finally, the Department notes that the REIT may not be able to fully comply with the requirements of this measure. A REIT will only know the identity of the shareholders directly investing in it. However, many individuals and other investors may hold an interest in a REIT by virtue of owning mutual fund investment shares or other types of investment vehicles. For example, if a mutual fund invests in a REIT, the REIT will know the mutual fund as a shareholder, but will not know the identity of the persons owning a share of the mutual fund. In addition, most individual investors hold their stock interests through a brokerage, and such stock is held in “street name”, meaning in the name of the brokerage and not the investor’s name.

Thank you for the opportunity to provide testimony.

¹ *ASARCO Inc. v. Idaho Tax Comm’n*, 458 U. S. 307, 315 (1982).



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

WRITTEN TESTIMONY OF

SCOTT D. WINER

SENIOR VICE PRESIDENT, TAX

PARK HOTELS & RESORTS INC.

IN OPPOSITION TO S.B. 3067

BEFORE THE HAWAII SENATE

COMMITTEE ON WAYS AND MEANS

SENATOR DONOVAN M. DELA CRUZ, CHAIR

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

HEARING ON S.B. 3067

FEBRUARY 13, 2018

On behalf of Park Hotels & Resorts Inc. ("PARK"), thank you for this opportunity to provide our testimony on S.B. 3067. PARK submits this testimony in opposition to S.B. 3067 as it would be impossible to administer.

PARK is a publicly traded lodging real estate investment trust ("REIT") (NYSE:PK) with approximately 214.8 million shares outstanding (as of December 31, 2017), of which approximately 213.9 million shares are held in street name, and with more than one million shares trading daily it has an immense number of shareholders annually. In fact, on an average trading day, over 1.5 million shares of PARK change ownership. So, PARK's shareholders at the beginning of each day are not the same shareholders at the end of the day. And that turnover happens daily over the course of the year. PARK does not know the identity of its ultimate shareholders on a daily basis.

As a REIT, PARK is already subject to stringent, costly and complex administrative and operating requirements, including paying significant dividends to its shareholders to maintain REIT status. PARK pays its dividends throughout the year and we rely on brokers to provide information to our shareholders related to our dividends (which are reported on IRS Form 1099-DIV). PARK would have no way of knowing from whom we could obtain the required shareholder information on a daily basis or be able to obtain an agreement with respect to Hawaii taxation for every shareholder. As such, S.B. 3067 would impose an impossible compliance burden on PARK (and public REITs in general).

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

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

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

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

JOB: PARK's hotels directly employ more than 2,633 employees. The payroll and associated benefits for these direct employees is in excess of \$186,362,669 million annually.

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

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

TAXES GENERATED BY PARK in HAWAII:

- o Payroll Taxes. Payroll taxes on employee wages totaled \$11,319,811 in 2017.
- o General Excise and Use Tax - Operations. The tax revenues generated from our operations totaled \$25,318,638 in 2017.
- o General Excise Tax – Rent. Because PARK is a REIT and must use a lease structure, we are required to pay General Excise Tax on the rent paid between our related companies. Effectively a double taxation of the same revenue. This additional GET was \$8,033,741 in 2017.
- o Property taxes. Property taxes at PARK’s two resorts totaled \$15,640,124 in 2017.

CHARITABLE ENDEAVORS BY PARK and ITS ASSOCIATES in HAWAII:

- o Park associates spend thousands of hours annually volunteering for local events and charities.
- o Park and its associates provide cash and in-kind charitable contributions in excess of \$500,000.

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

We thank you again for this opportunity to provide testimony against S.B. 3607 and sincerely hope you consider our strong opposition to this proposed legislation.

Respectfully submitted,



Scott Winer
Senior Vice President, Tax



316 Ilihu Street
Kailua, HI 96734

808-221-5955
MSteiner@SteinerAssoc.com

February 12, 2018

COMMITTEE ON WAYS AND MEANS

Senator Donovan M. Dela Cruz, Chair

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

Senators English, Galuteria, Harimoto, Inouye, Kahele, Kidani, Riviere, Shimabukuro and Wakai

RE: Testimony in Support of SB 3067 – Relating to Taxation

Hearing: Tuesday, February 13, 2018, 10:15 am; Room 211

Location: Hawaii State Capitol, 415 South Beretania Street

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

My name is Michael Steiner and I am the principal of Steiner & Associates, a consulting firm. As the former Executive Director of Citizens for Fair Valuation, I have worked for many years to bring equity to lessees and the State of Hawaii when dealing with Real Estate Investment Trusts (REITs).

I strongly support SB 3067 which will provide equity to the taxpayers of our state. SB 3067 is designed to help support the State of Hawaii and its citizens by requiring REITs to pay their fair share of services used via a state income tax. It is estimated the state would receive between \$40 and \$60 million in funds annually which are desperately needed to support and maintain our security, infrastructure, education, social services and government.

Hawaii now has more REIT-owned property per capita than any other state in the nation which will surely increase under current tax law. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to \$16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

There is no reason why a REIT in Hawaii should be operating tax-free when our state is struggling to meet its commitments. REITs simply do not contribute a fair share to support their existence in Hawaii.

Please protect the health of our Hawaii community and pass SB 3067.

Mahalo nui loa.

Michael Steiner

Michael Steiner, CLM, Principal
Steiner & Associates



February 13, 2018

Hearing Date: February 13, 2018
Time: 10:15 a.m.
Place: State Capitol, Conference Room 211

The J. Kalani English, Chair
The Honorable Gilbert Keith-Agaran, Vice Chair
Committee on Ways and Means
State Capitol
415 S. Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to S.B. 3067, Relating to Taxation

Dear Chairman English, Vice-Chairman Keith-Agaran and Committee Members:

Thank you for the opportunity to provide written testimony on Senate Bill No. 3067. We are Francis Cofran, the Senior General Manager of Ala Moana Center, the largest retail center in the state of Hawaii, and Sandeep Mathrani, the Chief Executive Officer of GGP Inc. ("GGP"). GGP is an S&P 500 publicly traded REIT, and an owner of Ala Moana Center.

Senate Bill No. 3067 proposes an unworkable system. A publicly traded REIT is not limited to 100 shareholders like an S corporation. In fact, GGP has over 957 million shares outstanding with approximately 99.7% held in "street name" by Cede & Co. (an affiliate of The Depository Trust Corporation) on behalf of the ultimate beneficial owners. It is and would be impossible for GGP to provide the name, address and federal identifier required under Senate Bill No. 3067 with respect to all of these shares. There are also possible federal constitutional issues regarding jurisdiction and tax credits in shareholders' residence states that could take years to sort out.

GGP owns 126 retail properties in 40 U.S. states. Our mission is to own and operate best-in-class retail properties that provide an outstanding environment and experience for our communities, retailers, employees, consumers and shareholders. GGP has been a part of the economic fabric of Hawaii for more than 30 years (since 1987) -- managing, owning and reinvesting in its Hawaii real estate assets as part of a long-term commitment that provides economic stability, growth, and jobs through all economic cycles.

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

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

- REITs produce substantial economic benefits to the State of Hawaii in the form of jobs, general excise tax, income tax from persons working or engaging in business at REIT properties, and real property taxes. GGP annually pays more than \$15 million in real property and general excise taxes – metrics that clearly demonstrate that REITs are investing in the economic well-being of the state and its residents.
- During 2012-2016, GGP as part of its longstanding commitment to Hawaii invested almost \$1 billion in capital to construct additional retail square footage and residential condominiums based on the existing Hawaiian tax regime. During the construction period, we estimated economic activity of 11,600 full- and part-time jobs and over \$146 million of state revenue including indirect community benefits. Post-construction, the additional retail will produce an incremental \$33 million of state revenue and 3,000 jobs annually.

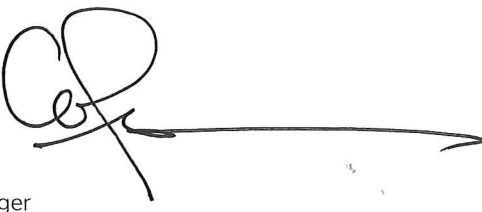

In September 2016, the Department of Business, Economic Development & Tourism ("DBEDT") released its final study on REITs in Hawaii. The report specifically notes that the estimates do not take into account changes in behavior, including the likelihood of reduced future REIT investment, if there are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

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



Please do not allow the perception of a potential short-term revenue increase override the long-term economic benefits and tax revenue that REIT investment brings to the state of Hawaii and its residents under the existing tax regime brings to the state of Hawaii and its residents. For the foregoing reasons, we respectfully oppose Senate Bill No. 3067 and urge you to hold the bill. Thank you for your consideration.

Sincerely,



Francis Cofran
Senior General Manager



Sandeep Mathrani
Chief Executive Officer



SanHi

GOVERNMENT STRATEGIES
A LIMITED LIABILITY LAW PARTNERSHIP

DATE: February 12, 2018

TO: Senator Donovan Dela Cruz
Chair, Committee on Ways and Means
Submitted Via Capitol Website

RE: **S.B. 3067 – Relating to Taxation**
Hearing Date: Tuesday, February 13, 2018 at 10:15 a.m.
Conference Room: 211

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

My name is Rick Tsujimura and I am testifying on behalf of the Hawaii members of Nareit. Nareit is the worldwide representative voice for real estate investment trusts—REITs—and publicly traded real estate companies with an interest in U.S. real estate and capital markets. These real estate investment trusts, which have substantial long-term investments in Hawaii, strongly oppose this measure.

Senate Bill 3067 proposes an unworkable system. Unlike an S corporation, a publicly traded REIT is not limited to 100 shareholders who can be easily identified. In fact, many such REITs have millions of shares outstanding, with approximately 99 percent held in “street name” by a central securities depository on behalf of the ultimate owners.

It is and would be impossible for a given REIT to provide the name, address and federal identifying information required under Senate Bill 3067 with respect to all of these shares. And the way in which capital markets operate, with thousands of shareholders entering and leaving the market in a single day or an hour, further compounds an already impossible challenge.

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

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

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

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

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

On a personal level, Hawaii residents have benefitted from REIT investment, which made possible dining at the Cheesecake Factory at Ka Makana Ali'i or taking their family to Wet'n'Wild or going shopping at Pearl Ridge. More eating choices and better Waikiki parking opportunities with the re-development of the International Marketplace, not to mention the financial benefits to the Queens Health System, which is the landowner.

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

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

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

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

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

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

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

Thank you for the opportunity to testify on this measure.



ALEXANDER & BALDWIN
PARTNERS FOR HAWAII

**SB 3067
RELATING TO TAXATION**

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

FEBRUARY 13, 2018

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 3067, “A BILL FOR AN ACT RELATING TO TAXATION.” We respectfully oppose this bill.

While A&B has always been a Hawaii-based company, in 2012, A&B made a strategic decision to migrate its mainland investments back to Hawaii. Since then, A&B has sold most of its mainland properties and has reinvested the proceeds in Hawaii properties, including the acquisition of the Kailua Town commercial center, Pearl Highlands Center (Sam’s Club), Manoa Marketplace, and Waianae Mall. To better support our Hawaii-focused strategy and increase our ability to invest in Hawaii, in an increasingly competitive environment, A&B made the decision to convert to a real estate investment trust (REIT) in 2017. A REIT structure enables A&B to attract new investors to its stock, giving us capital to invest in our Hawaii-focused strategy, and puts us in a better position to compete with large, out-of-state investors, with greater sources of capital, for the acquisition of Hawaii properties, thus keeping them in locally-operated hands. Furthermore, REITs are structured to be long-term holders of real estate, thus complimentary to A&B’s goal of being Partners for Hawaii, with a long-term presence in our communities.

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

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

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

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

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

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

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

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

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

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



February 9, 2018

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 3067, Relating to Real Estate Investment Trusts (REITs) (Establishes requirements and procedures for a REIT to file tax returns and payments.).

Tuesday, February 13, 2018, 10:15 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 a utility company. LURF's mission is to advocate for reasonable, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources, and public health and safety.

SB 3067. The purpose of this bill is to require REITs to file returns reporting their shareholders pro rata shares of net income and net income attributable to this State; to provide for composite returns; and to require withholding for shareholders who do not agree to file returns or pay tax on their pro rata share of net income attributable to this State. Should SB 3067 be adopted, non-resident REIT shareholders will be taxed on dividend income attributable to this State, despite paying income tax in their home state, resulting in a double tax for those shareholders.

LURF's Position. LURF acknowledges the intent of this and prior versions of anti-REIT measures given what may be perceived to be the potential for tax avoidance and abuse by foreign/mainland corporations and wealthy individuals through real estate ownership arrangements structured through REITs, however, reported justifications for this bill have not thus far been proven or supported by any credible facts or evidence.

LURF's Opposition to SB 3067 is Premised on the Following Reasons and Considerations:

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

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

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

Should this measure be passed, non-resident shareholders will be made subject to double taxation on income derived from REIT property in this State, in direct contravention to the intent underlying the federal government's establishment of REITs. Such a consequence may reduce future construction and investment by REITs locally, thereby resulting in revenue loss and damage to the economy of the State. Furthermore, replacement investor groups may likely be tax-exempt institutions such as pension plans and foundations which would generate even less in taxes from their real estate investments.

2. The Bill Raises Constitutionality Issues.

By proposing to assert jurisdiction over, and tax non-residents who otherwise lack any contact with Hawaii other than being purely passive investors in a publicly traded company, SB 3067 raises questions of constitutionality as to whether a sufficient connection exists between those non-resident investors and this State.

3. SB 3067 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 3067 would enact policy change that would create disparity between current Hawaii, federal, and most other states' laws with respect to the taxation of REIT income.

The laws of every other state with an income-based tax system now allow REITs to pass through dividends to shareholders, and currently tax REIT income just once on the shareholder level (not on the entity level), based on the residence of the shareholder that receives the REIT dividends and not on the location of the REIT or its property/projects.

By now proposing to double tax non-resident shareholders of the REITs that do business in Hawaii, SB 3067 would upset the uniformity of state taxation principles as applied between states. Passage of this measure would make Hawaii the only state to double tax non-resident shareholders of widely held REITs as described above.

4. Compliance with this Measure Would be Unfeasible, if Not Impossible Given the Inability of REITs to Ascertain the Information Required to be Reported by this Bill.

LURF understands that like all public companies, most REIT shares are held in street name by brokers, who are not obligated to report shareholder identifying information to

the REIT. There is thus no feasible way for REITs to ascertain the identities of and other information relating to their non-resident shareholders in order to substantially comply with this measure.

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

LURF believes double taxation of non-resident shareholder income for Hawaii REITs would certainly mitigate, if not extinguish interest and incentive in investing in Hawaii-based REITs, which currently contribute significantly to Hawaii's economy.

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

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

REIT projects have helped to support Hawaii's construction industry immensely³ by providing thousands of jobs, and continue to significantly contribute to the local economy through development of more affordable housing (more than 2,000 rental housing units for Hawaii's families, such as the Moanalua Hillside expansion of more

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

² *Final Report* at pages 3, 15-16.

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

affordable housing rentals), student housing near the University of Hawaii, health care facilities, offices, shopping centers (Pearlridge Center renovations), and hotels.

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

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

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

Supporters also ignore the fact that tax law changes proposed by SB 3067 will unfairly impact those publicly traded REITs which have already made substantial investments in Hawaii and have contributed greatly to the State's economy in reliance on tax principles and tax treatment of its shareholders, which, as discussed above, is considered a fundamental principle of taxation applicable to REITs.

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

Conclusion. LURF's position is that proponents of this measure have failed to credibly present any material facts or circumstances to prove that this proposed legislation is in fact necessary, or that the State's economy will significantly improve because of taking the action proposed. The intent and application of SB 3067 thus arguably remain unreasonable, unwarranted, and exceedingly anti-business.

Moreover, given the potential unconstitutionality of this measure; the practical impossibility of REITs to comply with the reporting requirements of this bill; and that an unjustifiable change of a universal tax rule in place since 1960 could significantly reduce the availability of capital in this State, as well as result in other negative economic repercussions, LURF must **strongly oppose SB 3067**, and respectfully requests that this bill be held in this Committee.

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

Rochelle N. Ito
41-860 Kakaina Street
Waimanalo, Hawaii 96795

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

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

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

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

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

February 12, 2018

Hearing Date: February 13, 2018

Time: 10:15 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* Taxing REIT Shareholders – SB 3067

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

My name is Lily Yan Hughes and I am the Senior Vice President, Chief Legal Officer and Corporate Secretary of Public Storage. We are ***strongly opposed*** to SB 3067. We also oppose the other bills introduced in the Legislature with similar provisions, SB 3101 and HB 2702. We provided a letter of testimony in opposition for the February 8 hearing on HB 2702. SB 3067 would impose Hawaii income taxes on all shareholders of real estate investment trusts (REITs) operating in Hawaii and purports to burden those REITs with oppressive and costly administrative and filing tasks that are simply impossible to perform for publicly traded companies.

Although the bill presumably is an effort to raise added tax revenue, such a law could well have the opposite effect. Even assuming the law would survive legal challenge, such an anti-business tax would strongly incentivize REITs to reduce or avoid future investment in, and possibly redirect investments away from, the state. This could be expected to have adverse long term effects on the Hawaii economy and the state's tax collections.

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

Because we are taxed as a REIT, Public Storage is effectively required to distribute all of its taxable income to our shareholders. The shareholders then report and pay state and federal tax on those dividends. Our shareholders in Hawaii are taxable by the state on the full amount of our dividends (not just the limited portion of those dividends attributable to the 11 properties we have in the state), so the state benefits from the REIT regime. The same basic treatment applies across the U.S. No other state imposes a tax like that proposed in SB 3067.

SB 3067 Deficiencies. The following briefly notes key problems with the bill, we assume many others will weigh in with important concerns.

Publicly Traded REITs Do NOT Know Who Their Shareholders Are and So CANNOT Comply. SB 3067 is patterned on a similar law that applies to Subchapter S corporations. An S

corporation cannot have more than 100 shareholders, so S corporations can identify and provide Hawaii with specific information about their shareholders. By contrast, **publicly traded REITs can have hundreds of thousands of shareholders, with the shareholders changing constantly, and the REITs do NOT know who those shareholders are.**

Public Storage's common stock is traded on the New York Stock Exchange under the symbol PSA. The authors of the bills plainly do not understand that publicly traded companies **CANNOT** specifically identify most of their shareholders, as the bulk of publicly traded stock is held by depositaries in street name. As a result, **the bill simply cannot be applied to publicly traded REITs.** Although Public Storage does not know how many shareholders beneficially hold PSA common stock or who the shareholders are, Public Storage likely has tens of thousands (if not hundreds of thousands) of beneficial shareholders at any time, and the ownership changes constantly as trades take place through the stock exchange. Public Storage has about 175 million outstanding common shares, with reported daily trading volume in 2017 ranging up to 3.8 million shares.

Notwithstanding the reality that publicly traded REITs cannot comply with the bill, it would tax all REIT shareholders, and require REITs to (1) provide specific information about all shareholders (names, addresses, TINs) at all times during a year, and (2) obtain and file with the department agreements from nonresident shareholders to file Hawaii returns, pay tax and be subject to personal jurisdiction in Hawaii for the tax (REITs failing to provide the agreements would be required to pay the tax for the shareholders at the highest rate, with a supposed right for the REIT to recover from the shareholders the tax paid "on behalf" of the shareholders). **It is simply impossible for publicly traded REITs to comply with these requirements.**

Exceeds Constitutional Authority. Putting aside the practical impossibility of applying the bill, it is doubtful that any state has the constitutional authority to tax nonresident shareholders of public companies in this fashion, when the shareholders' only connection to the state is the passive ownership of shares through a public stock exchange in a company that may have some Hawaii operations. The dubious legality is compounded by the fact that the bill will impose double taxation or worse on the shareholders.

Double (or More) Taxation; No Workable Credit. The bill is even more problematic given that it effectively seems to require publicly traded REITs to collect the tax for all shareholders (resident or nonresident, including tax exempt and governmental shareholders) because those REITs will not be able to determine which shareholders are resident or nonresident, much less be able to obtain the required agreements from the REIT's anonymous nonresident shareholders. Though the bill purports to credit the shareholders for the taxes the REIT presumably will pay on their behalf, that would be illusory, given that a publicly traded REIT cannot identify the great majority of its shareholders. (How would shareholders claim, or the department or other states' tax administrators allow, credits for taxes anonymously paid on the shareholders' behalf?) Moreover, even if the taxes paid on the shareholders' behalf could be properly matched to particular anonymous shareholders, it is doubtful that the shareholders' states of residence would allow credits because their dividend income typically will be treated as derived from the state of residence.

So, the practical effect of the bill would be to impose double taxation (or worse) on publicly traded REITs' earnings in Hawaii, as shareholders will also be taxable on dividends received and no credits can be expected.

More insidious is that, because SB 3067 purports to impute the taxable income of REITs to their shareholders (without regard to whether the shareholders receive dividends from the REITs¹), shareholders of Hawaii REITs technically would seem to be subject to **triple taxation** under SB 3067:

- (1) the tax anonymously paid by the REIT "on the shareholders' behalf" (for which the shareholders theoretically would be entitled to a credit, but would not benefit from it, as described above);
- (2) the tax due on the REIT's income that is directly attributed to the shareholders by SB 3067 (admittedly, the department will find this quite difficult to trace, given that the REITs won't know who the shareholders are); and
- (3) the tax owed on the actual dividends paid by the REIT.

The prospects for multiple taxation seem even more daunting when one considers that many publicly traded REIT shares are beneficially held by various forms of "pass through" entities, such as partnerships, mutual funds and tax exempt entities. The bill is completely silent as to how those shareholders would or should be affected.

Summary: As outlined above SB 3067 and similar bills:

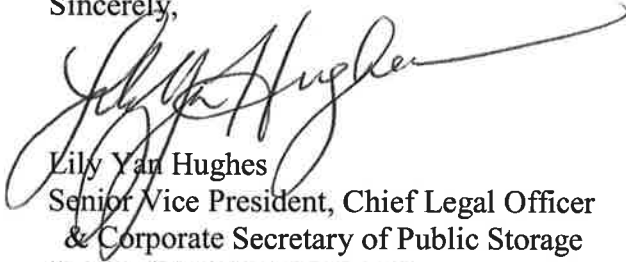
1. would be *very unfair* to REIT shareholders and REITs;
2. cannot be applied to publicly traded REITs, because the REITs do not (and cannot) know who their public shareholders are;
3. exceed the state's authority, given the limited contact of public shareholders with the state, and because the bills would impose double (or worse) taxation on shareholders of publicly traded REITs (credits would NOT be available to shareholders for taxes imposed by the bills);
4. would impose taxes in a way that no other state has pursued; and
5. would push REITs away from Hawaii, likely harming the state by decreasing overall tax collections and economic activity in the state.

Conclusion: SB 3067 Should NOT Move. 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 not pursue unfair, impossible legislation that will dissuade REITs

¹ Contrast this bill with HB 2702, which deals with the treatment of dividends received by shareholders; instead, SB 3067 directly attributes the income of the REIT to its shareholders, without regard to whether any dividends are received.

from investing in the state. We respectfully request that you do *not* move SB 3067 (or any other similar bills) forward.

Sincerely,

A handwritten signature in black ink, appearing to read "Lily Yan Hughes", with a long, sweeping horizontal line extending to the right.

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

lhughes@publicstorage.com
818.244.8080, extension 1537

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

Alexander L. Fergus

125 MERCHANT STREET, SUITE 200
HONOLULU, HAWAII 96813
TELEPHONE (808) 545-1700
FAX (808) 545-1788

February 13, 2018

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

Support for S.B. 3067, Relating to Taxation

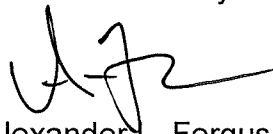
I am a strong supporter of S.B. 3067, Relating to Taxation. I believe this bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of \$40 to \$60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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

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

Very truly yours,

FERGUS & COMPANY
A Limited Liability Company



Alexander L. Fergus
Manager

SB-3067

Submitted on: 2/10/2018 7:41:07 AM

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

Submitted By	Organization	Testifier Position	Present at Hearing
JJ Johnson	Individual	Support	No

Comments:

Support for S.B. 3067, Relating to Taxation

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

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

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

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

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

Saturday, February 10, 2018

Support for S.B. 3067, Relating to Taxation

Gentlemen:

My family has been in Hawaii for four generations. We own small commercial properties here and for many years have paid our share of Hawaii income taxes. We strongly support S.B. 3067, Relating to Taxation.

The social needs in Hawaii are great and are expected to increase over time. It is shocking that the State allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us.

It's not just a fairness issue, it's also a responsibility issue as those whom are welcomed to do business in Hawaii should honor the community and give back in return.

We were surprised to learn that there is more REIT-owned property in Hawaii per capita than any other state in the nation.

This loophole must be closed so that REITs are taxed the same way as other real estate investors.

We urge the committee to pass S.B. 3067. Thank you for the opportunity to testify.

Very truly yours,

Calvert Chun
HLC Properties Family Limited Partnership
PO Box 61422
Honolulu, HI 96839

McCully Works

40 Kamehameha Ave.

Hilo, Hi. 96720

Support SB 3067

Feb. 13, 2018

Committee on Ways and Means

Chair: Sen. Donovan Delacruz

Vice Chair: Gilbert Keith-Agaran

Aloha,

As a businessman and investor in properties I fully support this bill. It is reasonable that all the properties that were entitled or zoned by the state and the counties should participate in the same tax regime. Currently the Dividend Paid Deduction (DPD) gives a competitive advantage to one particular type of ownership (REITS) and a significant amount of property has been quickly shuffled into this category, to the disadvantage of all the citizens of this state. An obvious consequence of this (estimated) 6.5% advantage is the inflationary driver it creates on pricing; REITS can pay more for a property than "cash" investors since they have the tax advantage.

Small real estate investors can't participate in these sophisticated, large scale, operations. Finally, these ownership regimes dominate in already improved properties rather than acting as developers. While they may initiate improvements or expansions they are primarily passive investors rather than active developers. They reap more than they sow....

All of our citizens suffer since these properties generate fewer taxes to support the state budget. It is fair and reasonable for REIT's to pay taxes on the dividends they return to their investors. It is earned here, it should be paid here.

Mahalo,

Jim McCully
McCully Works
808-933-7000

SB-3067

Submitted on: 2/11/2018 2:05:53 PM

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

Submitted By	Organization	Testifier Position	Present at Hearing
Jake Fergus	Individual	Support	No

Comments:

Senator Donovan M. Dela Cruz, Chair

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

Committee on Ways and Means

Jake Fergus

360 Papa Place, Suite 101

Kahului, HI 96732

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

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

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

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

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

SB-3067

Submitted on: 2/11/2018 8:32:37 PM

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

Submitted By	Organization	Testifier Position	Present at Hearing
Janice Lau	Individual	Support	No

Comments:

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

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of \$40 to \$50 million annually to the state of Hawaii. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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

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

Janice J. Lau

3735C Diamond Head Road

Honolulu, HI 96816

SB-3067

Submitted on: 2/12/2018 5:52:38 AM

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

Submitted By	Organization	Testifier Position	Present at Hearing
Mike	Individual	Support	Yes

Comments:

I believe all income earned in Hawaii should be taxed in Hawaii. State income tax on REITs' Hawaii income are often never paid in any U.S. state, and sometimes in other states but rarely in Hawaii. Hawaii has more REIT property per capita than any other state in the nation, but the income is shipped off tax free.

Why do we let these big corporations take advantage of us? It is unfair to our community.

Please tax REITs on their Hawaii income.

Michael J. Fergus

125 Merchant Street Suite 200

Honolulu, HI 96813

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

Jason Nohea Owens
1904 Naio Street
Honolulu HI, 96817

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

As a life-long Hawaii resident who was born at Kapiolani Hospital and raised in Manoa Valley. I am extremely concerned about Hawaii's economy and long-term community development. I feel that we as the people of Hawaii have an opportunity to make meaningful change for not just ourselves and our children, but for our children's children and many more generations to come. I STRONGLY SUPPORT S.B. 3067, Relating to Taxation and hope that you will too.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This is not right, you have an opportunity to bring this to an end for the good of the people of Hawaii. This results in a loss of \$40 to \$60 million annually to the state. These funds are desperately needed to support the numerous areas that we are not able to fund or fund appropriately that would benefit the day to day lives of the people of the State of Hawaii.

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

Furthermore, companies such as A&B are currently converting to operate as REITs. However, we can't fault them, they are simply taking advantage of the system currently in place. Sadly, they are taking advantage of the system AT THE EXPENSE of the people of Hawaii.

For these reasons, I strongly urge the committee to pass S.B. 3067. I sincerely thank you for taking the time to hear this meaningful and essential bill. Thank you very much for the opportunity to testify.

SB-3067

Submitted on: 2/12/2018 8:05:28 AM

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

Submitted By	Organization	Testifier Position	Present at Hearing
Vivian Shiroma	Individual	Support	No

Comments:

SB-3067

Submitted on: 2/12/2018 8:34:37 AM

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

Submitted By	Organization	Testifier Position	Present at Hearing
Frank Faria	Individual	Support	No

Comments:

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

Tia Teves
125 Merchant Street, Suite 200
Honolulu, HI 93813

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

As a resident concerned about Hawaii's economy and long-term community development, I strongly support S.B. 3067, Relating to Taxation. This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of \$40 to \$60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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

For these reasons, I urge the committee to pass S.B. 3067.

Thank you for the opportunity to testify.

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

Nicholas W. Teves, Jr.
1010 Paapu Street
Honolulu, HI 96819

Monday, February 12, 2018

Support for S.B. 3067, Relating to Taxation

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

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

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

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

13 February, 2018

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

Stephen A. Kane
60 N Beretania Street
Apt 3804
Honolulu HI 96817

Support for S.B. 3067, Relating to Taxation

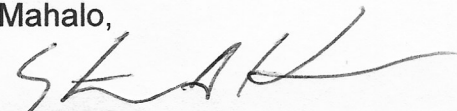
As a long-time resident of Hawaii, I am concerned about Hawaii's community development and economic outlook, I strongly support S.B. 3067, Relating to Taxation.

S.B. 3067 corrects a significant loophole in current Hawaii state income tax law allowing corporations to operate profitably as Real Estate Investment Trusts (REIT's) in Hawaii without paying income tax on profits like all other Hawaii residents and businesses working and supporting our communities. With more than 80 properties and an estimated value of more than \$16,000,000,000.00 mainland and international corporations acting as REIT's present a significant loss in Hawaii tax revenue that, if collected, could support much needed community development here in Hawaii. The loss in tax revenue estimated at more than \$60M annually could, and should, be available to support local education, social services and community priorities here in Hawaii.

Hawaii currently has more REIT owned property per capita than any other state in the nation and REIT's are only expanding in Hawaii. This expansion, without paying the same taxes as local real estate investors, has created an unbalanced advantage in development opportunities for REIT's operating in Hawaii. Without an even playing field local real estate investors and developers continue to be at a significant disadvantage while supporting the people of Hawaii and contributing to our economy. This loophole must be closed so that Hawaii companies can compete on the same level as mainland and international REIT's. The State of Hawaii must be able to recognize the much-needed tax revenue lost through this loophole that will support our communities and the future of Hawaii.

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

Mahalo,



Stephen A. Kane

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

Mrs. Julianne Hughes
1189 Waimanu St. #1203
Honolulu HI 96814

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

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

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

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

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

SB-3067

Submitted on: 2/12/2018 9:49:28 AM

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

Submitted By	Organization	Testifier Position	Present at Hearing
Francis U Imada	Individual	Support	No

Comments:

As a Certified Public Accountant and resident of Hawaii I strongly support S.B. 3067, Relating to Taxation.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. Local companies such and Alexander & Baldwin (with non-resident shareholders) are also considering a REIT for their real estate investments. This results in a loss of \$40 to \$60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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

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

Francis U. Imada

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

LATE

SUBJECT: INCOME, Withhold Tax on REIT Dividends

BILL NUMBER: SB 3067

INTRODUCED BY: ENGLISH by request, KEITH-AGARAN

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

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

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

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

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

EFFECTIVE DATE: This Act upon its approval, shall apply to taxable years beginning after December 31, 2018.

STAFF COMMENTS: Currently under federal and state income tax law, a REIT is allowed a dividend paid deduction, unlike most other corporations, resulting in that dividend being taxed once, to the recipient, rather than to the paying corporation. This is similar to the one level of tax imposed on owners of S corporations in lieu of taxing the S corporation at the corporate level. Thus, this bill enacts a withholding regime similar to that under the Model S Corporation Income Tax Act (MoSCITA), specifically section 235-122, HRS.

All state income tax systems in the United States, including ours, have a set of rules that are used to figure out which state has the primary right to tax income. For example, most tax systems say

that rent from real property is sourced at the location of the property, so if a couple in Florida rents out a property they own on Maui they can expect to pay our GET and our net income tax on that rent. These sourcing rules, which do vary by state but are relatively consistent across state lines, are there to assure consistent and fair treatment between states.

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

Real estate investment trusts (REITs) are source shifters. For income tax purposes, they take in rent income, which is sourced to the location of the property being rented. They don’t pay income tax on that income as long as they distribute the money to their shareholders as dividends. The dividend income of their shareholders, on the other hand, is generally sourced to the residence of the shareholders. So, the income that the property states expected to tax is instead taxed in the states in which the shareholders live. Source shifting is an issue specific to state taxation.

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

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

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

Digested 2/11/2018

Hawaiian SALT

Real Estate Investment Trusts: Exposing a Loophole in Sourcing Rules

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

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

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

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

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

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

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

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

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

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

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

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

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

Unsurprisingly, most tax systems say that rent from real property is sourced at the location of the property. So if a couple in Florida rents out a property they own on Maui they can expect to pay Hawaii general excise tax and Hawaii net income tax on that rent.⁹

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

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

Determining whether an item of income follows the real estate or intangible sourcing rule is not always easy. The Hawaii Supreme Court held that when real property is sold on an installment basis under an agreement of sale, where the seller remains on title until the price is paid (although the buyer can live in the house), then the interest on the deferred payments is Hawaii source income and is subject to Hawaii taxes.¹² In contrast, the Hawaii Tax Appeal Court held that when the seller instead financed the deal by taking a purchase money mortgage on the property, and does not remain on the title, the mortgage interest follows the business situs rule and is sourced to the residence of the seller, who in the case at hand did not live in Hawaii.¹³

When these rules are applied to REITs, an anomaly results. For income tax purposes, REITs receive rent income, which is sourced to the location of the property being rented, but they don’t pay income tax on that income if they distribute the money to their shareholders as dividends. The dividend income of their shareholders, on the other hand, is generally sourced to the residence of the shareholders. So the rental income earned in the state the REIT property is located would instead be taxed in the states in which the shareholders live. And to the extent that REIT shares are held by tax-exempt entities such as labor unions and retirement funds, passive income such as dividends might not be taxed at all.¹⁴ If these general rules are applied, the property state where the income is earned could get no tax revenue. This seems grossly unfair to the property states, which provide police, fire, and other benefits of a civilized society to the property and the REITs’ businesses.¹⁵

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

²⁷ IRC section 1441.

²⁸ IRC section 1446.

²⁹ IRC section 199A(b)(1)(B).

³⁰ See *supra* note 10 and accompanying text.

February 12, 2018

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



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

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

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

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

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

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

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

Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair
Committee on Ways and Means
February 12, 2018
Page 2

In addition to being impractical to implement, SB 3067 is likely unconstitutional. It imposes an income tax on passive REIT investors who are unlikely to be given any credits for those taxes in their resident states. It also imposes a tax on investors who are investing through individual IRA's, 401(k)'s and other tax-free accounts.

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

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

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

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

Sincerely,



Kevin A. Crummy
Chief Investment Officer
Douglas Emmett



Michele L. Aronson
Senior Vice President
Douglas Emmett



HAWAII APPLESEED

CENTER FOR LAW & ECONOMIC JUSTICE

LATE

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

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

Thank you for the opportunity to testify in **STRONG SUPPORT** of **SB 3067**, which would require that real estate investment trusts file returns reporting their shareholders' pro rata shares of net income and net income attributable to this State, as well as provide for composite returns and require withholding for those shareholders who do not agree to file returns or pay tax on their pro rata share of net income attributable to this State.

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

A Real Estate Investment Trust or "REIT," is a corporation that owns income-producing real estate, like hotels and shopping malls. Like a mutual fund for real estate, people can purchase shares in a REIT to get a portion of the income it generates.

REIT's have been granted a special tax status that exempts them from paying corporate income tax on the dividends paid to its shareholders. However, as with most forms of income, REIT shareholders pay tax on their income from the REIT. REIT shareholders pay both federal and state income tax, which helps to pay for things like roads, schools, and affordable housing.

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

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

SB 3067 fixes this problem simply by withholding tax generated by Hawai'i REITs. Instead of paying tax in New York, the tax on Hawai'i REIT income will be paid in Hawai'i where the income was generated. This solution eliminates the double-tax concern voiced by REITs regarding eliminating the dividend exemption. And REIT shareholders should be credited for taxes paid in Hawai'i when they file their income taxes elsewhere—they should not be subject to a double-tax either.

SB 3067 is a critical fix to a problem that has long plagued Hawai'i. It keeps tax dollars generated on Hawai'i REIT income where they belong—in Hawai'i, where the income was made.

These tax dollars can be used to fulfill Hawai'i's most pressing need—affordable housing. The revenue generated by SB 3067 should fund housing affordability initiatives such as those in HB 2703, which are so critical to helping residents struggling with the highest housing costs in the nation and the lowest wages after accounting for cost of living.

Mahalo for your consideration of this testimony.

The Hawai'i Appleseed Center for Law and Economic Justice is committed to a more socially just Hawai'i, where everyone has genuine opportunities to achieve economic security and fulfill their potential. We change systems that perpetuate inequality and injustice through policy development, advocacy, and coalition building.

Hawaii Appleseed Center for Law and Economic Justice

February 13, 2018

Page 3 of 3

The Twenty-Ninth Legislature
Regular Session of 2018

LATE

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

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

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

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

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

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

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

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

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

SB-3067

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

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

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

Comments:

Senator Donovan M. Dela Cruz, Chair

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

Committee on Ways and Means

LATE

Michael K. Perkins (Name)

4051 Kaimuki Ave. (Address)

Honolulu, Hawaii (6816 (Address))

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

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

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

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

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

Sincerely,

Michael Perkins

LATE

SB-3067

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

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

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

Comments:

Please stop the Reits from stealing from our state.

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

LATE

Darryl Wong
1836 Punahou Street
Honolulu, Hawaii 96822

Tuesday, February 13, 2018

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

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

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

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

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

Darryl P Wong

LATE

SB-3067

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

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

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

Comments:

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

SB-3067

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

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



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

Comments:

To: Senator Donovan M. Dela Cruz, Chair

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

Committee on Ways and Means

From: James K. Tam

841 Bishop Street, Suite 850

Honolulu, HI 96813

Date: February 13, 2018

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

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

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

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

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

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

February 12, 2018

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



Richard Ing
841 Bishop Street Suite 860
Honolulu, Hawaii 96813

Support for S.B. 3067, Relating to Taxation

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

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

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

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

Sincerely,

Richard Ing

SB-3067

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

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

LATE

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

Comments:

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

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



Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

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

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

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

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

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

LATE

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

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

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

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

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

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

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



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

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

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

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

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

Background: Real Estate Investment Trusts and Hawaii Tax

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

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

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

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

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

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

Summary

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

Mahalo for your time and consideration of this testimony.

LATE

SB-3067

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

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

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

Comments:

Senator Donovan M Dela Cruz, Chair

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

Committee on Ways and Means

Matthew Friedman

347 Opihikao Place

Honolulu, HI 96825

Monday, February 12, 2018

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

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

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

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

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

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

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

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

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

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

Thank you for the opportunity to testify.

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



Ryan Matsumoto
3438 Niolopua Dr.
Honolulu, Hawaii 96817

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

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

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

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

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

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



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

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

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

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

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

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

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



_____Jack Belli_____ (Name)
_____94-1120 Manino Place_____ (Address)
_____Waipahu 96797_____ (Address)

Tuesday, February 13, 2018

Support for S.B. 3067, Relating to Taxation

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

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

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

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