NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

WRITTEN TESTIMONY OF

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REGARDING S.B. 118, S.D. 1

BEFORE THE HAWAII HOUSE OF REPRESENTATIVES
COMMITTEE ON CONSUMER PROTECTION AND COMMERCE

HONORABLE ANGUS L.K. MCKELVEY, CHAIR
HONORABLE JUSTIN H. WOODSON, VICE CHAIR

and

COMMITTEE ON JUDICIARY

HONORABLE KARL RHOADS, CHAIR
HONORABLE JOY A. SAN BUENAVENTURA, VICE CHAIR

HEARING ON S.B. 118, S.D. 1

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The National Association of Real Estate Investment Trusts submits this testimony regarding S.B. 118, S.D.1. NAREIT is the world-wide representative voice of real estate investment trusts (REITs) and publicly traded real estate companies in the United States.

S.B. 118, as originally proposed, would have eliminated what is known as the dividends paid deduction (or DPD) for all REITs operating in Hawaii. S.B. 118, S.D. 1 now provides for a study regarding the impact of REITs operating in Hawaii. NAREIT believes that such a study will demonstrate why the DPD should not be eliminated.

Eliminating the DPD would be contrary to the federal income tax rules applying to widely-held REITs in every state with an income-based tax system like Hawaii except for New Hampshire. It is worth noting that although both Hawaii and New Hampshire have roughly equivalent contributions to the nation economy, REIT investment in Hawaii is about four times that of New Hampshire.

While those who support the legislation as originally proposed state that that investment money can be easily replaced, it is worth noting that as of December 2013, based on filings with the Securities and Exchange Commission, approximately twenty widely-held REITs invested about six billion dollars in commercial real estate in Hawaii that results in the employment of many Hawaii residents. The Hawaii real estate owned by REITs generates millions of dollars in property taxes and excise taxes. These taxes are on top of the individual income taxes currently generated by REIT dividends paid to Hawaii residents from income earned wherever the distributing REIT resides or does business. In addition, the sales generated by the tenants that conduct business on the premises owned and operated by REITs generate jobs and taxes as well. Replacing a $6 billion investment is not as easy as it looks and since tax-exempt organizations such as pension plans and endowments are major investors in large scale commercial real estate, these players would be the most likely to fill any vacuum created by REITs investing in other states. NAREIT hopes that S.B. 118, S.D.1, as amended to provide for a study to analyze the impact of REITs in Hawaii, will bring needed factual clarity to the benefits Hawaii obtains by maintaining conformity to virtually all other states regarding a REIT's dividends paid deduction.

Background of REITs. Congress created REITs in 1960 specifically to enable small investors to invest in professionally managed, income-producing real estate. REITs are corporations that combine capital of many investors to benefit from a diverse portfolio that may include apartments, hotels, healthcare facilities, shopping centers, senior housing, offices, storage facilities and warehouses. Federal law requires REITs to distribute all their taxable income to their shareholders. The billions of dollars distributed are taxable where the REIT shareholders reside. Hawaii residents invest in REITs that own properties in Hawaii and REITs that own no properties in Hawaii but own properties in other states. The dividend income earned by Hawaii residents in Hawaii is taxed here even if the REIT invested in owns properties elsewhere. The workers who have jobs because of REITs pay income taxes in Hawaii, and the State receives the general excise taxes that this income generates through the purchase of goods and services.

Just Like Other Taxpayers Are Not Taxed On Mandatory Expenses Like Property Taxes, REITs Should Not Be Taxed on the Taxable Income They Cannot Retain. Hawaii allows taxpayers to deduct certain expenses like property taxes when calculating their taxable income. This is because taxpayers should not be taxed on the cash used to pay these expenses. Unlike other businesses, REITs are required to distribute all their income so this income is taxed at the shareholder level. As a result, REITs should not be taxed on money that they cannot keep.

For example, like other businesses, REITs have to pay property taxes. Thus, if both a REIT and non-REIT businesses have $100 of rental income and $10 of property taxes, they both get a $10 deduction. Then, they are both left with $90 ($100-$10). Unlike the other business, the REIT has to distribute the remaining $90. Thus, it has no cash left. Here, it has distributed $90, and is left with $0 in cash; thus, it pays no tax for federal income tax purposes and for state tax purposes in states with corporate income taxes (other than New Hampshire).

Benefits to Hawaii. REITs, such as General Growth Properties, owner of the Ala Moana Shopping Center, and Taubman Centers Inc., the developer of the International Marketplace, have access to public capital markets to raise the large funds needed for such large development projects. The renovation and expansion of Ala Moana enjoys a commitment of over $500 million while the International Marketplace project shows a commitment to invest over $400 million on the part of Taubman. This redevelopment will result in about one thousand construction jobs and 2,500 permanent jobs and all the taxes that activity will produce. These jobs would have been put in jeopardy by the tax proposed as a result of S.B. 118.

Hawaii investors also benefit from REITs. Between January 2010 and 2015, almost 11,000 Hawaii investors invested over $380 million in around 70 SEC-registered, non-listed REITs, some of which have been sold or undergone initial public offerings. These companies have distributed approximately $100 million to these Hawaii investors. In addition to investing in public, non-listed REITs, Hawaii investors invest in publicly traded REITs through mutual funds, particularly mutual funds dedicated to publicly traded REIT stock. In fact, thousands of Hawaii shareholders have invested about $60 million in several dedicated REIT mutual funds sponsored by a single mutual fund company. In 2014 their accounts received income and capital gain distributions totaling $8.5 million. The State is collecting taxes on the millions of dollars distributed to Hawaii investors by these companies and funds that invest in REITs, even though almost all of the properties held by these REITs are located outside of Hawaii.

Except for New Hampshire, every other state that imposes a corporate-level income tax allows the DPD for widely-held REITs. It is hard to imagine Hawaii's position would be improved by partnering with New Hampshire as opposed to being seen as being aligned with the rest of the nation. If Hawaii repeals the DPD, Hawaii would not be viewed as an attractive place for REIT investments. As can be seen from the record, as opposed to the speculation on the part of the supporters of S.B. 118 as originally proposed, the REIT investments have resulted in tremendous value and in jobs, all of which produces income for government and residents. Can Hawaii be assured that much of this investment will not be lost if the DPD is repealed? Logic says much of the investment would be lost, and NAREIT believes that the economic impact study proposed by S.B. 118, S.D. 1 will confirm this.

Accordingly, NAREIT does not oppose a study to analyze the impact of REITs in Hawaii as provided for in S.B. 118, S.D. 1. Thank you again for the opportunity to submit this testimony.