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EXECUTIVE SUMMARY

Act 239, SLH 2015 (SB0118 SD1 HD2 CD1) required the state Department of Business, Economic Development and Tourism (DBEDT), with the assistance of state Department of Taxation (DOTAX), to study the impact of real estate investment trusts (REITs) in Hawaii. The Hawaii State Legislature appropriated $100,000 for the study. Due to the budget restrictions, $90,000 was approved and released by Governor David Ige in September 2015. DBEDT issued a request for proposal (RFP) on October 14, 2015 and a contract was awarded to a research company on December 8, 2015. The project will begin in early 2016, with an estimated completion date of April 2016.

The study includes four surveys in order to collect data to address the 13 categories of analysis required by Act 239. The surveys are: (1) Survey of Hawaii resident taxpayers; (2) Survey of Hawaii Investment and Financial Companies; (3) Survey of Real Estate Related Companies Located in Hawaii; (4) Survey of Industry Experts and Other Stakeholders.

While the survey results will not be available until April 2016, DBEDT has researched the literature and analyzed the data from private and public sources currently available. With the assistance of DOTAX tabulating data for tax years of 2009 to 2013, we produced this interim report for the 2016 legislature. A final report will be produced and transmitted to the legislature in May 2016.

The findings of our preliminary research, as of December 20, 2015, are the following:

- In Hawaii, 36 REITs were identified operating in the state in 2014
- Only one REIT had its main office in Hawaii
- Total assets for the REITs identified were estimated at $7.8 billion for cost basis (10-k filings) and $11.3 billion for market value basis (NAREIT, 2015)
- 50.8% of the assets were in the retail industry and 24.7% were in hospitality related industries.
- Hawaii dividend income exempted from corporate income tax was estimated to be $256 million in 2014.
- Assuming 95% of the REIT dividends were distributed to shareholders, the corporate income tax forgone was estimated to be $16.3 million in 2014.
- According to the estimate from DOTAX, REIT net income increased 2.6 times between 2012 and 2013, from $79.9 million in 2012 to $208.8 million in 2013.
- The retail sales generated from REIT properties in Hawaii (50.8% of the total REITs) generated an estimated $207 million in State General Excise Tax (GET) in 2014.
ACKNOWLEDGEMENTS

DBEDT would like to thank DOTAX for their assistance with providing aggregate tax data for real estate investment trusts. In addition to providing aggregate tax data, DOTAX also reviewed the report and provided helpful comments and suggestions throughout the process.

DBEDT would like to thank Pedro Villarreal and Dr. David Hunter of the University of Hawaii for their assistance and advice with REIT public financial data.
I. INTRODUCTION

In recent years, many states have re-examined the corporate tax deductions associated with Real Estate Investment Trusts (REITs), especially captive REITs. During Hawaii State Legislature’s 2015 session, a bill was introduced (SB-118), which proposed that the Department of Business, Economic Development and Tourism (DBEDT) conduct a study regarding REITs. The bill passed and became Act 239 (SLH 2015). The new law mandated that DBEDT, with the assistance of the Department of Taxation (DOTAX), study the impact of real estate investment trusts in Hawaii, and the possible effect of repealing the dividends paid deduction for real estate investment trusts.

The purpose of this paper is to answer the research questions regarding REITs, put forth by the legislature and mandated by Act 239 (SLH 2015). This is an interim report that includes a preliminary analysis using existing sources. However, some of the information outlined in the Act does not exist and; therefore, DBEDT issued a request for proposal (RFP) to hire a research firm to collect survey data to address the 13 items listed in Act 239 (SLH 2015). The surveys will be targeted at four groups: Hawaii taxpayers, investment and financial companies, real estate companies, and industry experts and stakeholders. The proposals were reviewed and the contract awarded with an expected project start of early January 2016 and an expected data delivery of April 2016.

This interim report is being issued to provide as much information as possible regarding the 13 items of Act 239 (SLH 2015) before the survey results are available. This report will be followed up with a final report that will include the survey results and address the remaining items of Act 239 (SLH 2015) not addressed in this report.
II. OVERVIEW OF REITS

REITs were established in 1960 by the U.S. Congress to allow individual investors to invest in large-scale, income producing real estate, without having to buy the real estate directly. Generally, REITs own income producing real estate or real estate-related assets. REITs are taxed under sections 857 and 858 of the Internal Revenue code (IRC), which Hawaii has adopted for state tax purposes.

There are three types of REITs. First, Equity REITs own and operate income-producing real estate. Second, Mortgage REITs derive income from real estate loans either directly by owning mortgages or other types of real estate loans, or indirectly through mortgage-backed securities. Third, Hybrid REITs are a combination of Equity REITs and Mortgage REITs.

By law, a REIT must distribute at least 90% of its taxable income in the form of shareholder dividends. The amount distributed to shareholders as dividends then becomes tax deductible for corporate income tax and this is called a Dividend Paid Deduction.

In addition to the mandatory dividend distribution of taxable income, other REIT requirements include: ¹

- Be an entity that would be taxable as a corporation but for its REIT status.
- Be managed by a board of directors.
- Have shares that are fully transferable.
- Have a minimum of 100 shareholders after its first year as a REIT.
- Have no more than 50% of its shares held by five or fewer individuals during the last half of the taxable year.
- Invest in 75% of its total assets in real estate and cash.
- Derive at least 75% of its gross income from real estate-related sources including rents from real property and interest on mortgages financing real property.
- Derive at least 95% of its gross income from such real estate sources as dividends or interest from any source.
- Have no more that 25% of its assets consist of non-qualifying securities or stock in taxable REIT subsidiaries.

Once a REIT pays out a minimum of 90% of its taxable income as dividends, shareholders pay income taxes on those dividends. However, income paid out as dividends by a REIT, generally, is not subject to state corporate income tax and this has implications for state tax revenue.

There is also a different category of REITs, known as “captive REITs.” One unintended consequence of the REIT law was that entities began to spin off their real estate holdings into related-subsidiary REITs and these became known as “captive REITs.” As item 7 from Act 239 specifies, DBEDT was tasked with a “… comprehensive examination of captive real estate investment trusts for companies operating in Hawaii.”

Simply stated, a captive REIT is a REIT created for the sole purpose of receiving rent from a related entity in order to take advantage of the dividend paid deduction. The Multistate Tax Commission defines a captive REIT as:

A real estate investment trust the shares or beneficial interests of which are not regularly traded on an established securities market and more than fifty percent of the voting power or value of the beneficial interests or shares of which are owned or controlled, directly or indirectly, or constructively, by a single entity that is:

1. treated as an association taxable as a corporation under the Internal Revenue Code of 1986, as amended, and
2. not exempt from federal income tax pursuant to the provisions of Section 501(a) of the Internal Revenue Code of 1986, as amended. In order to meet the 100 shareholder requirement, shares are often held by company employees or board members².

While the above definition is rather technical, two key concepts emerged that many states would adopt to separate captive REITs from other REITs: 1) captive REITs are not traded on an established securities market, and, 2) captive REITs are more than 50% owned or controlled by a single entity. As will be seen in the next section, many states relied on these two characteristics to close captive REIT state tax loopholes.

There are two types of captive REITs; rental REITs and Mortgage REITs (Garrett, 2007). The rental captive REIT is most often used by large multi-state retailers, which spin off their real estate holdings into a separate REIT entity (Figure 1). The retailers are then able to reduce their taxable income by the amount of the rent paid to the REIT through the dividend paid deduction (DPD). The REIT then distributes at least 90% of this income to shareholders, a majority of which may be controlled by the original retail entity.

² Multistate Tax Commission, 2008
The above example is for a dividend paid by a REIT to shareholders. In some states, it may be possible to gain a second deduction for the dividends received from a REIT by setting up an entity to receive the REIT dividend. The deduction for dividend received is called a dividend received deduction (DRD). While U.S. Revenue Code allows for a 70% deduction of dividends received by corporations, it does not allow this deduction when received from REITs. U.S. revenue code specifically states, “Any dividend received from a real estate investment trust … shall not be treated as a dividend”. However, some states did not have the above or similar clause for their tax codes, and this created an opportunity for a DRD at the state level by establishing a holding company to receive the dividends paid out by the original REIT. This created a double deduction where the dividend paid out by the REIT is deducted on one end and the dividend received by a holding company is deducted on the other end. As will be discussed below, if the dividend received deduction is taken by a holding company out of state, the issue of state tax jurisdiction comes into play.

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3 26 U.S. Code § 243 – d:2, Dividends received by corporations
The second type of captive REIT is the mortgage captive REIT, which is used most often by banks (Garret, 2007). The strategy is to move mortgage interest accrued from the bank itself to a REIT entity and take advantage of the DPD, thus avoiding state corporate income tax.

As noted above, the two characteristics that emerged from the Multistate Tax Commission proposal to define captive REITs were: 1) not traded on an established securities market, and 2) more than 50% owned or controlled by a single entity. In addition to these two points, a third point specific to Hawaii is that REIT rent revenues are subject to Hawaii’s General Excise Tax and this reduces the incentive to establish a captive REIT in Hawaii. Furthermore, Department of Taxation Director Maria E. Zielinski proposed a measure to limit a captive REIT’s ability to benefit from the dividend paid deduction by stipulating “….dividends paid shall not apply to a captive real estate investment trust” (DOTAX Testimony, 2015)\(^4\). The proposed measure used a definition similar to the captive REIT definition of the Multistate Tax Commission definition. We are currently researching captive REITs in Hawaii and will have further analysis for the final report.

In looking towards the future, there could be major changes to the taxation of REITs at the federal level. The Protecting Americans from Tax Hikes Act of 2015 proposes restriction on tax-free spinoffs involving REITs, a reduction in the percentage limitation on assets of taxable REIT subsidiaries, and limitations on designation of dividends by REITs. If passed, this bill would bring major changes to the federal taxation of REITs.

The next section will examine various state policies regarding REITs.

\(^4\) Maria E. Zielinski, Director Department of Taxation. Testimony to the Honorable Jill N. Tokuda Chair and Members of the Senate Committee on Ways and Means. February 18, 2015.
III. EXAMPLES OF STATE REIT TAX POLICIES

At the state level, a majority of states conform to the federal tax code allowing the DPD for REITs\(^5\) and disallowing DRDs for REITs\(^6\). The challenge for many states has been to differentiate between REITs that fulfill the original spirit of the 1960 law, establishing REITs to help small investors, and, “paper REITs,” set up for the sole purpose of avoiding taxes.

Generally, there have been three approaches states have used regarding REIT tax dividends. The first is the disallowance of DPDs for captive REITs, while allowing the DPD for non-captive REITs. The second is combined reporting, mandating that captive REIT income be reported together with the parent entity. The third and most extreme is the disallowance of the DPD for all REITs, both captive and non-captive.

A state that that disallows DPDs for captive REITs is Connecticut, which enacted legislation similar to the Multistate Tax Commission proposal. Connecticut defines a captive REIT as, “…a REIT where more than 50 percent is owned or controlled, directly or constructively, by a single entity and where the REIT is not regularly traded on an established securities market.” (State of Connecticut. 2010). However, Connecticut allows exceptions to the provision when a REIT is a “qualified REIT or a REIT is more than 50 percent owned by a corporation that is, in turn, 10 percent or more constructively owned by:

- A REIT
- An entity exempt from tax under IRC §501(nonprofit entity)
- A listed property trust or other foreign REIT from a country with a tax treaty with the US; or,
- A REIT intended to be regularly traded on an established securities market.”

A good example of a state that requires combined reporting is New York (State of New York, 2014). One of the foundations of the New York tax reform is requiring companies to file based on “economic nexus.” In other words, as long as there is an “economic” connection to the state, physical presence is not required for taxing jurisdiction (Dibello et al., 2010).

As of January 1, 2015, combined reporting is required for corporations and their related entities that meet the following requirements (Grant Thornton LLP, 2014):

\(^5\) 26 U.S. Code § 857(b)(2)
\(^6\) 26 U.S. Code § 243 (d)(3)
- Owns or controls directly or indirectly more than 50% of the capital stock of one or more other corporations or
- More than 50% of the capital stock of which is owned by or controlled directly or indirectly by one or more other corporations or
- More than 50% of the capital stock of which, and the capital stock of one or more other corporations, is owned or controlled, directly or indirectly, the same interests and
- Is engaged in a unitary business with those corporations.

The New York tax reform includes a provision that specifically targets captive REITs by requiring that combined returns include income generated from a "captive REIT" with the parent entity.

New Hampshire imposes an entity-level tax on REITs and does not allow for a REIT DPD, not even for publicly traded REITs.

In addition to legislation, state courts have also addressed captive REITs. One of the primary issues is a state’s jurisdiction to tax dividends received by a holding company from a REIT, especially when the holding company is a different state.

Louisiana challenged the REIT dividend received deduction received by a holding company located in Nevada that originated from an Autozone related entity located within Louisiana (Supreme Court of Louisiana, 2005). Louisiana’s standpoint was that the multi-state business structure effectively transferred income from Louisiana to Nevada, a no corporate tax state. The Louisiana Court upheld Louisiana’s jurisdiction to tax a nonresident shareholder with the decision that, “Louisiana has personal jurisdiction over a nonresident shareholder when Louisiana has provided benefits, opportunities, and protections which helped to create the income.”

On the other hand, the Kentucky courts upheld the right for a retail related REIT to claim a deduction for REIT dividends paid citing that, “AutoZone (referring to the REIT Autozone Development Corporation) properly claimed a deduction for dividends paid to shareholders on its 1995, 1996, and 1997 Kentucky corporate income tax returns was not arbitrary (Common Wealth vs Autozone, 2006-Ca-002175).

Hawaii courts have also addressed captive REIT related tax issues. There were three cases identified that challenged the disallowance of dividend deductions received from a REIT subsidiary (Department of Taxation Annual Reports 2004-05, 2008-09, 2010-11). Federal tax code states that a dividend received from a REIT shall not be treated as a dividend, thus is not
deductible\textsuperscript{7}. All three of these cases challenged the disallowance of dividends received from a wholly owned REIT subsidiary on the basis that §243 IRC is inoperable in Hawaii. While the court originally upheld the right to tax dividends received from a wholly owned REIT subsidiary, all cases were appealed and settled out of court.\textsuperscript{8}

\textsuperscript{7} 26 U.S. Code §243 Dividends received by corporations
\textsuperscript{8} Tax Appeal of HEI Diversified and Subsidiaries, T.A. No. 03-0169; Tax Appeal of Territorial Mutual Holding Company and Subsidiaries, T.A. Nos. 06-0096 and 07-0079; Tax Appeal of Central Pacific Bank, T.A. Nos. 02-0075, 03-0155, 05-0041, and 07-0098.
IV. DIVIDENDS AND HAWAII TAXPAYERS

As noted above, survey data is being collected to estimate the number of Hawaii taxpayers who invest in REITs that are based in and operate in Hawaii. By definition, REIT shareholders receive dividends that are reported as dividend income on their federal tax returns and the Internal Revenue Service (IRS) Statistics Division compiles statistics by state. While the percentage of taxpayers with REIT dividend income is not available, the percentage of taxpayers with any type of dividend income is available from the IRS; and REIT dividend income would be a subset of this figure. As shown in the table below, 20.4% of Hawaii taxpayers had dividend income in tax year 2013 and the percentage increases with income levels. Hawaii’s percentage was slightly higher than the U.S. figure of 18.8%. While this is total dividend income, taxpayers with REIT dividend income would be within the range of 0 to 20.4% of the total number of Hawaii taxpayers. In order to get a better estimate of this number, DBEDT will conduct a survey of Hawaii taxpayers and this will be presented in the final report.

Table 1. Percentage of Taxpayers with Dividend Income by Income Group, Tax Year 2013

<table>
<thead>
<tr>
<th>Income Group</th>
<th>Hawaii</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% of Taxpayers</td>
<td>% of Taxpayers</td>
</tr>
<tr>
<td></td>
<td>(20.4% reported dividends)</td>
<td>(18.8% reported dividends)</td>
</tr>
<tr>
<td>Under $25,000</td>
<td>7.46%</td>
<td>5.27%</td>
</tr>
<tr>
<td>$25,000-$100,000</td>
<td>25.08%</td>
<td>15.80%</td>
</tr>
<tr>
<td>Over $100,000</td>
<td>67.45%</td>
<td>78.94%</td>
</tr>
</tbody>
</table>

Source: IRS Statistics of Income 2015
V. HAWAII REIT ANALYSIS

- Number of REITs operating in Hawaii. To identify the number of REITs with properties in Hawaii, DBEDT used a two-step process:

1. Identify REITs operating in Hawaii. This was done by researching the SEC’s EDGAR database and the CoStar database (performed by DBEDT) and researching an IRS 2014 business database (performed by DOTAX). A total of 69 potential REITs were identified by the two departments. The ones identified by DBEDT are listed in Appendix B while the ones identified by DOTAX cannot be listed due to the confidential nature of the tax data.

2. For the REITs identified in step one, the data was tabulated from Hawaii Tax Form N-30 (Hawaii Corporate Income Tax) for Tax Years 2009 to 2013 (performed by DOTAX). The methodology may exclude some companies that were REITs before 2014 and it may include some companies that did not operate as REITs in all of the years considered. The 2014 estimates were made by DBEDT based on data from the SEC company filings reported to the U.S. Securities and Exchange Commission (SEC), available in SEC’s EDGAR database, and, additionally, to identify private and non-listed REITs, DBEDT used the private CoStar database – a database of commercial real estate properties. Finally, based on the assembled list of REITs, DOTAX was able to provide aggregated corporate REIT data relevant to Hawaii.

SEC’s EDGAR database is comprised of filings by U.S. companies. The federal securities law requires public companies to file financial information on a quarterly and annual basis. Domestic corporations must submit annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K for a number of specified events and must comply with a variety of other disclosure requirements. DBEDT primarily used corporate 10-K filings for REITs, which provide a comprehensive overview of the company's business and financial condition and include audited financial statements. Corporations are required to file if they list their securities on an exchange or if the number of shareholders is above a certain threshold. However, one down side of the EDGAR database is that it does not include smaller private

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9 US Securities and Exchange Commission
10 US Securities and Exchange Commission
REITs, which are not required to file 10-K forms with the SEC. Generally, private REITs that fall below the following threshold are not required to file:

- 300 shareholders of the class of securities offered; or
- 500 shareholders of the class of securities offered and less than $10 million in total assets for each of its last three fiscal years.

The private CoStar database covers commercial properties in Hawaii and reports if the property is owned by a REIT. The database includes data from a variety of public and private sources, as well as their own staff that track individual properties. This database was used to identify ownership of various properties by REIT status. The Costar database is limited in that it does not provide information such as REIT revenue or the net income for a specific property. However, it complements the EDGAR database by providing information for private REITs, which are not required to file with the SEC.

The data gap for REIT revenue and net income was filled with an aggregated REIT total gross revenue and net income figures from the Hawaii State Department of Taxation. The net income amount represents REIT net income attributed to the state as reported on the state’s N-30 tax form and/or the federal 1120-REIT tax form. At the federal level, all REITs are required to file an 1120-REIT tax form. The SEC’s database has its own limitations because some REITs do not identify their complete real estate holdings in each location or state (although most do). Therefore, there are differences in the REIT number in Hawaii based on SEC filings when compared with the estimated data provided by DOTAX.

Table 2 lists the number of REITs operating in Hawaii. The combined total investment value (which is total asset value) was estimated using the values listed in the REIT 10-K filings as reported in the EDGAR database. It is important to note, that the reported property values from the 10-K forms reflect the cost of purchase plus improvements. These property values do not necessarily reflect current market values and may differ from “market value” estimates. Therefore, we used an estimate provided by the National Association of Real Estate Investment Trusts (NAREIT) which estimates Hawaii REIT property values at $11.3 billion.
Table 2: Estimated Number of REITs and Value of Assets in Hawaii, 2011 – 2014

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of REITs</th>
<th>Total Assets in Hawaii</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>28 (DoTax Estimate)</td>
<td>-</td>
</tr>
<tr>
<td>2010</td>
<td>31 (DoTax Estimate)</td>
<td>-</td>
</tr>
<tr>
<td>2011</td>
<td>29 (DoTax Estimate)</td>
<td>$6,442,423,319&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
<tr>
<td></td>
<td>20 (US SEC)</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>34 (DoTax Estimate)</td>
<td>$7,121,081,773&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
<tr>
<td></td>
<td>24 (US SEC)</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>33 (DoTax Estimate)</td>
<td>$7,327,323,231&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
<tr>
<td></td>
<td>28 (US SEC)</td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>36 (US SEC)</td>
<td>$7,754,495,737&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
<tr>
<td></td>
<td>40 (US SEC + CoStar)&lt;sup&gt;11&lt;/sup&gt;</td>
<td>$11,308,000,000&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

1. DBEDT estimate based on SEC filing, cost based value.
2. NAREIT, market value estimate for REIT owned properties in Hawaii.

**Number of Hawaii-based REITs.** Among all of the REITs operating in Hawaii, there was one REIT identified that is based in Hawaii (whose main office is located in the State of Hawaii). Although other REITs may derive a substantial portion of their revenue from Hawaii, their main offices are located out-of-state. It is important to note that the quantity of REITs operating in Hawaii varies from year to year, as new REITs enter the state and others pull out.

Another caveat is that this number only represents U.S.-based REITs, operating in Hawaii, and does not include foreign-based REITs, such as J-REITs (Japanese REITs), A-REITs (Australian REITs), or S-REITs (Singapore REITs). The sources used for this analysis did not include data on foreign REITs listed on non-U.S. exchanges. However, unless there is a specific tax agreement or a bilateral treaty, foreign REITs are not be eligible for any special tax treatment in the United States.

**Distribution of REITs in Hawaii by Industry.** Even though REIT capital is used primarily to acquire real estate, this real estate supports other sectors of the economy. The graph below shows the reported real estate values and the percentages of total value by industry for REIT investments. The largest category is retail, with more than half of the total value of REIT-

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<sup>11</sup> Different number of REITs based on a source, when combined with CoStar database, DBEDT’s total number of REITs in 2014 came up to 40 operating in the state. It is likely, nonetheless, that some of these are branches/subsidiaries of other REITs already counted. Therefore, DBEDT adopted the number identified in the SEC’s database, at the very least there are 36 REITs operating in Hawaii on January 1, 2015.
owned properties in the state (as reported by 10-K filings). The second largest category was hospitality/hotels with about a quarter of REIT property value. Both the retail and hospitality/hotel sectors are significant contributors to Hawaii’s economy.

*Figure 2: Reported Property Value of REITs in Hawaii by Industry, 2014*

![Pie chart showing REIT assets in Hawaii by industry. Retail (50.8%), Hospitality/Hotels (24.7%), Residential/Apartments (6.5%), Commercial/Industrial (8.9%), Other/Student Housing (1.0%), Storage (2.8%), Mortgage (2.1%), Healthcare/Eldercare (2.9%), and Entertainment (0.2%). Total REIT Assets in Hawaii: $7.8 Billion.

Source: Calculations based on company filings to SEC

In addition to retail and hospitality/hotel sectors, based on SEC data, REIT investments reach a broad base of other industries. Sectors with rapidly expanding investments include mortgage REITs, healthcare-focused REITs, hospitality/hotel REITs, and storage REITs. *Mortgage REITs*, even though they still account for a relatively small part of the total portfolio (just above 2%), increased their investments by 936% in Hawaii between 2011 and 2014.

Currently, REITs specializing in *healthcare/eldercare* properties account for about 3% of total REIT investment in the state. However, the amount invested in healthcare/eldercare properties by REITs nearly doubled between 2011 and 2014, increasing by 89%.

REITs investing in the *hospitality/hotel* sector, continue to be drawn to the isles by the excellent revenue potential of Hawaiian properties and have also strongly increased investments in the state’s economy between 2011 and 2014 by over 74%.
REITs investing in *storage* facilities, currently at about 2.6 percent of total REIT investment capital flowing into the state have also registered large increases in investment, growing by 70% between 2011 and 2014.

REIT-owned *residential/apartment* properties increased their holdings in Hawaii by more than 25% between 2011 and 2014, highlighting high demand for rental properties during this time period.

There was slight increase of 3% for REIT-owned *retail* and *entertainment* properties, between 2011 and 2014. As described above, retail is the largest category for REITs invests in state.

On the other hand, the REIT holdings of *industrial and land* decreased by nearly 8%, between 2011 and 2014. *Office* properties owned by REITs, during the same period, decreased by 1% over the period.

- **Analysis of the argument that REITs allow small investors to pool money.** Most REITs that operate in Hawaii are publicly traded and, therefore, provide an opportunity for small investors to invest in large-scale real estate projects. In fact, many small investors may not know they invest in REITs, because they invest indirectly in REITs through mutual funds with REIT holdings. The inter-relationship between REITs and mutual funds is highlighted in the table below (Table 3). The table lists the five largest REITs, operating in Hawaii, by their declared asset values and shows that the top shareholders of each of these REITs are mutual funds.
Table 3: Largest REITs by Assets in Hawaii and Their Shareholders, 2014

<table>
<thead>
<tr>
<th>Rank by Value of Assets in Hawaii</th>
<th>REIT</th>
<th>Assets in Hawaii</th>
<th>Top Shareholders</th>
<th>Shares Held, % of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>General Growth Properties</td>
<td>$2,543,765,600</td>
<td>Vanguard, T. Rowe Price Real Estate, Fidelity® Real Estate Investment Port, Nuveen Real Estate Securities I, SPDR® S&amp;P 500 ETF</td>
<td>7.19, 0.90, 0.84, 0.82, 0.68</td>
</tr>
<tr>
<td>2</td>
<td>Host Hotels and Resorts</td>
<td>$874,000,000</td>
<td>Vanguard, Cohen &amp; Steers Realty Shares, Fidelity® Real Estate Investment Port, SPDR® S&amp;P 500 ETF, DFA Real Estate Securities I</td>
<td>11.70, 1.57, 1.40, 1.05, 0.99</td>
</tr>
<tr>
<td>3</td>
<td>Douglas Emmett, Inc.</td>
<td>$703,519,000</td>
<td>Vanguard, T. Rowe Price Real Estate, Baron Growth Retail, Cohen &amp; Steers Realty Shares, JHancock Disciplined Value Mid Cap</td>
<td>11.88, 3.37, 2.42, 2.13, 1.20</td>
</tr>
<tr>
<td>4</td>
<td>Select Income REIT</td>
<td>$638,470,000</td>
<td>Vanguard, PIMCO EqS® Long/Short Institutional, Forward Select Income A, Prudential Small-Cap Value Z, James Alpha Global Real Estate Invsmts A</td>
<td>9.39, 1.47, 1.13, 0.9, 0.88</td>
</tr>
<tr>
<td>5</td>
<td>American Assets Trust, Inc</td>
<td>$478,668,000</td>
<td>Vanguard, Cohen &amp; Steers, JHancock Disciplined Value Mid Cap, Baron Growth Retail, TIAA-CREF Mid-Cap Value Instl</td>
<td>10.43, 5.07, 2.27, 1.67, 1.14</td>
</tr>
</tbody>
</table>

Source: DBEDT, US SEC, and Morningstar
VI. FISCAL IMPACTS OF REITS IN HAWAII

-Fiscal impact on Hawaii due to Dividend Paid Deduction (DPD) provision for REITs.
In 2013, according to the estimates received from DOTAX, the total amount of taxes the State of Hawaii could have collected from REITs if they had been subjected to a corporate income tax is an estimated $13.2 million (total net REIT income – Hawaii’s share of $208.8 million multiplied by the effective average corporate tax rate of 6.38%). Even though Hawaii’s highest corporate income tax bracket is 6.4%, DBEDT calculated that the effective average tax rate is likely to be 6.38% due to the possibility of dividends at lower income brackets.

This number is lower than some of the estimates cited during the Senate hearings on REITs. One reason for the lower figure in this report is that not all REITs report positive net income (or report negative net income). In tax year 2013, only twenty of the thirty three REITs with property in Hawaii reported positive net income.

As Table 4 notes, the tax impact of REIT DPD on the state—depending on a year— is between -$0.3 million (2009) and -$13.32 million (or up to an estimated -$16.33 million, based on the REITs filings with the SEC in 2014).

DBEDT additionally assumes that none of the dividends distributed by REITs to their shareholders—some of whom may be Hawaii residents—were declared as income in Hawaii, thereby leaving only an estimate of how much the state could capture in corporate income tax.

12 Based on the assumption of average corporate income per REIT of $6,327,273:

<table>
<thead>
<tr>
<th>tax rates:</th>
<th>Income bracket</th>
<th>tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.40%</td>
<td>$25,000</td>
<td>$1,100</td>
</tr>
<tr>
<td>5.40%</td>
<td>$75,000</td>
<td>$4,050</td>
</tr>
<tr>
<td>6.40%</td>
<td>$6,227,273</td>
<td>$398,545</td>
</tr>
</tbody>
</table>

weighted average rate: 6.38%

13 See SB118 Testimony Summary, Appendix C
The reason for this assumption is that there is no reliable way to estimate how many Hawaii investors own shares in REITs with properties in Hawaii.

It would not be hard to calculate the fiscal impact itself; however, the problem lies with estimating the number of taxpayers with REIT dividends and what portion of those dividends to assign to Hawaii properties. In other words, it is difficult to define the percentage of individual investor REIT portfolios, since they invest in a REIT company and not a specific property. For the estimates in Table 4, therefore, DBEDT assumes $0 additional tax income from REIT shareholders subject to Hawaii income tax. Calculations presented below only reflect fiscal impact based on corporate income tax. According to preliminary research with investment professionals, the percentage of Hawaii REIT investors, as a percentage of total taxpayers, is likely to be in the low single digits.

Table 4: REITs in Hawaii – Estimated Impact on Corporate Income Tax to the State of Hawaii due to Dividend Paid Deduction, 2009 – 2014

<table>
<thead>
<tr>
<th>REIT Total Income, Net Income Before Adjustments, and Hawaii Share for TY's 2009-2014 (C-Corporations only), $ in millions*</th>
<th>Tax Year</th>
<th>Estimated Number of REITS</th>
<th>Total U.S. Income</th>
<th>HI Share of Total Income</th>
<th>HI Share of Net Income**</th>
<th>Estimate of HI Tax impact</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2009</td>
<td>28</td>
<td>$9,139.20</td>
<td>$93.3</td>
<td>$4.70</td>
<td>-$0.30</td>
</tr>
<tr>
<td></td>
<td>2010</td>
<td>31</td>
<td>$9,022.70</td>
<td>$240.4</td>
<td>$57.90</td>
<td>-$3.69</td>
</tr>
<tr>
<td></td>
<td>2011</td>
<td>29</td>
<td>$10,519.90</td>
<td>$333.7</td>
<td>$50.30</td>
<td>-$3.21</td>
</tr>
<tr>
<td></td>
<td>2012</td>
<td>34</td>
<td>$13,913.60</td>
<td>$317.5</td>
<td>$79.90</td>
<td>-$5.10</td>
</tr>
<tr>
<td></td>
<td>2013</td>
<td>33</td>
<td>$19,061.90</td>
<td>$598.2</td>
<td>$208.80</td>
<td>-$13.32</td>
</tr>
<tr>
<td></td>
<td>2014***</td>
<td>36</td>
<td>$28,242.36</td>
<td>$768.03</td>
<td>$256.01</td>
<td>-$16.33</td>
</tr>
</tbody>
</table>

Source: DoTax, SEC

* Net income is income before any adjustments (such as tax credits or deductions for dividends paid). Only positive net incomes are included in the total. The Hawaii share is based on the average of property, payroll and sales shares.

** DBEDT treats net income as taxable income in calculating tax impact.

*** Data for 2014 are estimated based on SEC filings

It is important to note that the figures are estimates. The estimation process consists of two steps:

1. Identify REITs operating in Hawaii. This was done by researching the SEC’s EDGAR database and the CoStar database (performed by DBEDT) and researching an IRS 2014 business database (performed by DOTAX). A total of 69 potential REITs were identified by the two departments. The ones identified by DBEDT are listed in
Appendix B while the ones identified by DOTAX cannot be listed due to the confidential nature of the tax data.

2. For the REITs identified in step one, tabulate data from Hawaii Tax Form N-30 (Hawaii Corporate Income Tax) for Tax Years 2009 to 2013 (performed by DOTAX). The methodology may exclude some companies that were REITs before 2014 and it may include some companies that did not operate as REITs in all of the years considered. The 2014 estimates were made by DBEDT based on data from the SEC.

- **General excise tax (GET) generated by REIT-owned retail properties.** As Table 5 highlights, REIT-owned properties in the retail sector contribute an estimated $207 million to the state’s general fund (the median state GET value per year contributed by the REIT-owned mall/shopping center/outlet is about $5.7 million). The total GET contribution to the State’s general fund was calculated using sales data from each shopping center (reported as sales per square foot) multiplied by the size of the mall and by the state’s tax rate of 4%.

**Table 5: Retail: Estimated Tax Benefit for the State of Hawaii – General Excise Taxes Generated by REIT-owned Malls and Shopping Centers, 2014**

<table>
<thead>
<tr>
<th>Average Sales per Square Foot at REIT-owned Mall/Shopping Center</th>
<th>Average Mall/Shopping Center Size</th>
<th>Estimated Total State GET (at 4.0%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$938</td>
<td>516,343 square feet</td>
<td>$207,430,551</td>
</tr>
</tbody>
</table>

Source: Data taken from company annual reports and/or other formal filings, 2014

Unfortunately, it was not possible to get complete data to estimate full REIT contribution to the state’s tax revenue from other sectors of the economy of the state, where REITs are active (storage facilities, hotels, healthcare facilities, entertainment).
VII. SUMMARY

The findings of our preliminary research, as of December 20, 2015, are the following:

- 36 REITs were identified operating in Hawaii on January 1, 2014
- Only one REIT had its main office in Hawaii
- Total assets for the REITs identified were estimated at $7.8 billion at cost basis (10-k filings) and $11.3 billion at market value (NAREIT, 2015)
- 50.8% of the assets were in the retail industry and 24.7% were in the hospitality-related industries.
- Hawaii dividend income exempted from corporate income tax was estimated to be $256 million in 2014.
- Assuming 95% of the REIT dividends were distributed to shareholders, the corporate income tax forgone was estimated to be $16.3 million in 2014.
- According to the estimate from DoTax, REIT net income increased 2.6 times between 2012 and 2013, from $79.9 million in 2012 to $208.8 million in 2013.
- The retail sales generated from REIT properties in Hawaii (50.8% of the total REITs) generated an estimated $207 million in State General Excise Tax (GET) in 2014.
References


APPENDIX A: ANSWERS TO SB118 SD1 HD1 QUESTIONS

(1) The total number of real estate investment trusts that operate in Hawaii.

Based on combined data from the US Securities and Exchange Commission and private database owned by CoStar Group, 40 REITs were identified that had operations in Hawaii in 2014.

(2) Of that total in paragraph (1), the number that are Hawaii-based.

According to the US Securities and Exchange Commission, there was one REIT, whose main office was located in Honolulu, HI – Pacific Office Properties, Inc.

(3) The number of Hawaii taxpayers who are investors in real estate investment trusts that operate in Hawaii.

Answer – pending survey results.

(4) The number of Hawaii taxpayers who are investors in Hawaii-based real estate investment trusts that operate in Hawaii.

Answer – pending survey results.

(5) A breakdown of Hawaii taxpayers who are investors in Hawaii-based real estate investment trusts that operate in Hawaii, by filing status and income

Answer – pending survey results.

(6) The direct and indirect impacts of real estate investment trusts on the Hawaii economy, especially in real estate development and operation

Answer – pending survey results.

(7) A comprehensive examination of captive real estate investment trusts for companies operating in Hawaii.

Although 40 REITs (as end-2014) operating in Hawaii were identified, DBEDT was unable to identify captive REITs in Hawaii (Costar Database, 2015). Furthermore, rent revenue is subject to Hawaii’s General Excise Tax, even for REITs, and this reduces the incentive to set up a captive REIT structure. Hawaii does not allow the DRD, as explained in testimony by Maria E. Zielinski, Director of Department of Taxation “…a dividend paid by a REIT is not considered a ‘dividend’ for purposes of HRS section 235-7(c), and the dividend received deduction is not allowed for Hawaii income tax purposes (Department of Taxation Testimony, 2015)”. Director Zielinski’s testimony

14 Maria E. Zielinski, Director Department of Taxation. Testimony to the Honorable Jill N. Tokuda Chair and Members of the Senate Committee on Ways and Means. February 18, 2015.
also includes a proposed measure to limit captive REITs ability to benefit from the dividend paid deduction by stipulating that “dividends paid shall not apply to a captive real estate investment trust.” The proposed measure used a definition similar to the captive REIT definition of the Multistate Tax Commission definition. *(For a more complete information, please refer to Section III, Captive REITs in the report – page 6).*

(8) An examination of the argument that real estate investment trusts provide opportunities for small investors to pool funds with others and invest in real estate developments, similar to investments through mutual funds invested in company stocks

Most REITs that operate in Hawaii are publicly-traded and, therefore, provide an opportunity for small investors to invest in large-scale real estate projects. In fact, many small investors may not know they invest in REITs, because they invest indirectly in REITs through mutual funds with REIT holdings. *(For a more complete information, please refer to Section V, Hawaii REIT Analysis, in the report – page 14).*

(9) An examination of the possible transfer pricing if the dividend paid income tax deduction for real estate investment trusts is repealed

There would be a reason for REITs to change their corporate structure in Hawaii because of the new tax and shift their headquarters for the new Hawaii company/subsidiary offshore – potentially leading to real tax losses for the state. Although it will not be easy to dispose assets for majority of REITs – major regional malls, apartment buildings, and hotels are not very liquid assets – the state may induce REITs to change their corporate structure in Hawaii if it imposes a tax.

It is hard for DBEDT to estimate exactly how each company may change their behavior in response to an increase in taxes. In order to more precisely gauge whether transfer pricing is likely if Hawaii repeals the DPD for REITs, the forthcoming surveys will ask REITs and other stakeholders about how their behavior may change if DPD is repealed. *(Also see expanded explanation for question 11, below).*

(10) An examination of the equity and efficiency of the dividends paid income tax deduction for real estate investment trusts

Answer – pending survey results.

(11) The projected tax revenue impact to the State if the dividends paid income tax deduction for real estate investment trusts is repealed
In 2013, the total amount of taxes the State of Hawaii could have collected from REITs if they had been subjected to a corporate income tax is an estimated $13.2 million (total net REIT income – Hawaii share of $208.8 million multiplied by the effective average corporate tax rate of 6.38%). Even though the highest bracket corporate tax rate in Hawaii is 6.4%, allowing for the possibility of dividends at lower income brackets, DBEDT calculated that the effective average tax rate is likely to be 6.38%. Therefore, repealing the dividends paid deduction (DPD) would allow the state to capture this amount, which varies between $0.3 million in 2009 to $13.3 million in 2013. These amounts vary depending on a year, and the reason for variation is that not all REITs report positive income every year. In tax year 2013, only twenty of the thirty three REITs with property in Hawaii reported positive net income.

As Table 4 notes, the tax impact of REIT DPD on the state – depending on a year – is between -$0.3 million (2009) and -$13.32 million (or up to an estimated -$16.33 million, based on the REITs filings with the SEC in 2014).

Table 4: REITs in Hawaii – Estimated Impact on Corporate Income Tax to the State of Hawaii due to Dividend Paid Deduction, 2009 – 2014

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<th>Total US Income</th>
<th>HI Share of Total Income</th>
<th>HI Share of Net Income**</th>
<th>Estimate of HI Tax Impact</th>
</tr>
</thead>
<tbody>
<tr>
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<td>28</td>
<td>$9,139.20</td>
<td>$93.3</td>
<td>$4.70</td>
<td>-$0.30</td>
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<td>-$3.69</td>
</tr>
<tr>
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<td>-$3.21</td>
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<td>$19,061.90</td>
<td>$598.2</td>
<td>$208.80</td>
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<td>$28,242.36</td>
<td>$768.03</td>
<td>$256.01</td>
<td>-$16.33</td>
</tr>
</tbody>
</table>

Source: DOTAX, SEC

* Net income is income before any adjustments (such as tax credits or deductions for dividends paid). Only positive net incomes are included in the total. The Hawaii share is based on the average of property, payroll and sales shares.

** DBEDT treats net income as taxable income in calculating tax impact.

*** Data for 2014 are estimated based on SEC filings
Since many REIT-owned properties in Hawaii are good income generators – the reason many REITs invest in Hawaii – it may not be likely that these companies will decide to sell their properties in the state immediately, even when faced with a substantial additional tax bill. However, increasing taxes will decrease operational income margins and may eventually force the companies to make a decision on whether they should remain in the state, remain in the state as a REIT, reduce their property holdings, or neglect to invest in the needed modernization and renovation of properties.

But just as in the answer to question 9 (above), it is hard for DBEDT to estimate exactly how each company may change their behavior in response to an increase in taxes. In order to more precisely gauge what may change if Hawaii repeals the DPD for REITs, the forthcoming surveys will ask REITs and other stakeholders about how their behavior may change if DPD is repealed.

12. The impact on the real estate development market and capacity if the dividends paid deduction for real estate investment trusts is repealed.

Answer – pending survey results.

13. The impact on the economy of the state if the dividends paid deduction for real estate investment trusts is repealed.

Answer – pending survey results.
## APPENDIX B: PROVISIONAL LIST OF REITS WITH PROPERTY IN HAWAII
(For the year ended December 31, 2014)

<table>
<thead>
<tr>
<th>Category</th>
<th>Combined: SEC+ Costar databases</th>
<th>Ticker</th>
<th>Exchange traded on</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Multiple lines</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 storage/land/industrial</td>
<td>SELECT INCOME REIT</td>
<td>SIR</td>
<td>NYSE</td>
</tr>
<tr>
<td>2 storage/land/industrial</td>
<td>EQUITY COMMONWEALTH</td>
<td>EQC</td>
<td>NYSE</td>
</tr>
<tr>
<td>3 hotel/residential/retail</td>
<td>ISTAR FINANCIAL INC.</td>
<td>STAR</td>
<td>NYSE</td>
</tr>
<tr>
<td>4 office/residential</td>
<td>DOUGLAS EMMETT, INC.</td>
<td>DEI</td>
<td>NYSE</td>
</tr>
<tr>
<td><strong>Specialty</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Entertainment - water park</td>
<td>CNL LIFESTYLE PROPERTIES, Inc.</td>
<td>NNN</td>
<td>NYSE</td>
</tr>
<tr>
<td>6 Storage</td>
<td>CORPORATE PROPERTY ASSOCIATES 17 – GLOBAL INC.</td>
<td>non-traded</td>
<td></td>
</tr>
<tr>
<td>7 Storage</td>
<td>CORPORATE PROPERTY ASSOCIATES 18 – GLOBAL INC.</td>
<td>non-traded</td>
<td></td>
</tr>
<tr>
<td>8 Storage</td>
<td>PUBLIC STORAGE</td>
<td>PSA</td>
<td>NYSE</td>
</tr>
<tr>
<td>9 Storage</td>
<td>EXTRA SPACE STORAGE, INC.</td>
<td>EXR</td>
<td>NYSE</td>
</tr>
<tr>
<td>10 Storage</td>
<td>W.P. CAREY, INC.</td>
<td>WPC</td>
<td>NYSE</td>
</tr>
<tr>
<td>11 Golf Course</td>
<td>NEWCASTLE INVESTMENT CORP.</td>
<td>NCT</td>
<td>NYSE</td>
</tr>
<tr>
<td><strong>Office</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>PACIFIC OFFICE PROPERTIES TRUST, INC.</td>
<td>PCFO</td>
<td>OTCQB Marketplace</td>
</tr>
<tr>
<td>13 ANGELO, GORDON &amp; CO.</td>
<td></td>
<td>private</td>
<td></td>
</tr>
<tr>
<td>14 NORTHSTAR ASSET MANAGEMENT GROUP INC.</td>
<td></td>
<td>NSAM</td>
<td>NYSE</td>
</tr>
<tr>
<td><strong>Health Care Facilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 SENIOR HOUSING PROPERTIES TRUST</td>
<td></td>
<td>SNH</td>
<td>NYSE</td>
</tr>
<tr>
<td>16 HEALTHCARE REALTY TRUST INCORPORATED</td>
<td></td>
<td>HR</td>
<td>NYSE</td>
</tr>
<tr>
<td>17 HEALTHCARE TRUST OF AMERICA, INC</td>
<td></td>
<td>HTA</td>
<td>NYSE</td>
</tr>
<tr>
<td><strong>Hotel</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18 XENIA HOTELS &amp; RESORTS</td>
<td></td>
<td>XHR</td>
<td>NYSE</td>
</tr>
<tr>
<td>19 BEHRINGER HARVARD OPPORTUNITY REIT II, INC.</td>
<td></td>
<td>non-traded</td>
<td></td>
</tr>
<tr>
<td>20 HOST HOTELS &amp; RESORTS, L.P.</td>
<td></td>
<td>HST</td>
<td>NYSE</td>
</tr>
<tr>
<td>21 SUNSTONE HOTEL PARTNERSHIP, LLC</td>
<td></td>
<td>SHO</td>
<td>NYSE</td>
</tr>
<tr>
<td>22 HOSPITALITY PROPERTIES TRUST</td>
<td></td>
<td>HPT</td>
<td>NYSE</td>
</tr>
<tr>
<td>23 RLJ LODGING TRUST</td>
<td></td>
<td>RLJ</td>
<td>NYSE</td>
</tr>
<tr>
<td>24 STARWOOD PROPERTY TRUST, INC.</td>
<td></td>
<td>STWD</td>
<td>NYSE</td>
</tr>
<tr>
<td></td>
<td>Retail</td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>------------------------------------------------------------------------</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>25</td>
<td>GENERAL GROWTH PROPERTIES</td>
<td>GGP</td>
<td>NYSE</td>
</tr>
<tr>
<td>26</td>
<td>HOWARD HUGHES CORP.</td>
<td>HHC</td>
<td>NYSE</td>
</tr>
<tr>
<td>27</td>
<td>TAUBMAN CENTERS, INC.</td>
<td>TCO</td>
<td>NYSE</td>
</tr>
<tr>
<td>28</td>
<td>SIMON PROPERTY GROUP</td>
<td>SPG</td>
<td>NYSE</td>
</tr>
<tr>
<td>29</td>
<td>LEXINGTON REALTY TRUST</td>
<td>LXP</td>
<td>NYSE</td>
</tr>
<tr>
<td>30</td>
<td>AMERICAN ASSETS TRUST, INC.</td>
<td>AAT</td>
<td>NYSE</td>
</tr>
<tr>
<td>31</td>
<td>AMERICAN REALTY CAPITAL PROPERTIES, INC. (VEREIT - AS OF JULY 2015)</td>
<td>ARCP</td>
<td>NYSE</td>
</tr>
<tr>
<td>32</td>
<td>WP GLIMCHER, INC. (A PART OF WASHINGTON PRIME GROUP - 2014)</td>
<td>WPG</td>
<td>NYSE</td>
</tr>
<tr>
<td>33</td>
<td>GETTY REALTY CORP.</td>
<td>GTY</td>
<td>NYSE</td>
</tr>
<tr>
<td>34</td>
<td>TORCHLIGHT INVESTORS/DOF IV REIT HOLDINGS LLC</td>
<td>private</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Mortgage</th>
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<tbody>
<tr>
<td>35</td>
<td>WINTHROP REALTY TRUST</td>
<td>FUR</td>
<td>NYSE</td>
<td></td>
</tr>
<tr>
<td>36</td>
<td>OWENS REALTY MORTAGE, INC</td>
<td>ORM</td>
<td>NYSE</td>
<td></td>
</tr>
<tr>
<td>37</td>
<td>NORTHSTAR REALTY FINANCE CORP.</td>
<td>NRF</td>
<td>NYSE</td>
<td></td>
</tr>
<tr>
<td>38</td>
<td>APOLO COMMERCIAL REAL ESTATE FINANCE, INC.</td>
<td>ARI</td>
<td>NYSE</td>
<td></td>
</tr>
<tr>
<td>39</td>
<td>BLACKSTONE MORTGAGE TRUST</td>
<td>BXMT</td>
<td>NYSE</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>OTHER</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>40</td>
<td>University Dormitory</td>
<td>AMERICAN CAMPUS COMMUNITIES</td>
<td>ACC</td>
<td>NYSE</td>
</tr>
</tbody>
</table>

Sources: US SEC; Costar
APPENDIX C: SUMMARY OF TESTIMONIES– SB118

In support of the bill, focused on the following issues:

- Tax equity
- REITs should be held accountable to the high cost of living in HI
- The bill will improve tax fairness and corporate responsibility
- The bill will raise revenue
- The bill will help prevent tax leakage
- The bill will not have an adverse impact on the state
- HI will remain an attractive place for investment if the bill passes
- HI does not need archaic tax provision benefiting mainland companies
- The bill will serve to protect our tax base
- The authorities should be cautious in passing the bill, but it should not have a very negative impact
- The current provision is redundant
- The bill will not affect investment in HI
- HI will remain attractive as destination for investment if the bill passes
- The bill will open opportunities for other investors
- If REIT investors pull out, the assets will remain in HI
- There is no easy substitute for HI, unique location/will remain attractive
- The current system is a disadvantage to local investment companies
- HI will remain attractive to REITs
- NH still has more REITs than US average, even without the tax break
- Double taxation is not an issue

Against the bill:

Testimonies against the bill raised the following issues:

- Would lead to loss of new business in HI
- Make HI less competitive as a destination for investment $
- Hurting HI investors in REITs by subjecting them to an extra tax
- Eliminating the DPD would be contrary to the federal income tax rules
- Between January 2010 and 2015, almost 11,000 Hawaii investors have 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."
- Repealing DPD will lead to a disparity on laws treating REITs - federal, other states
- Will lead to a loss of the current benefit to the economy
- Will have an unfair effect on small investors in REITs
- A careful study is warranted
- Believe NH tax changes have inhibited REIT investment; little presence in NH due to unfavorable tax policies
  Currently, REITs have a significant benefit to HI economy
- If the bill becomes effective, future plans of additional $2 billion investment into Ala Moana will be reconsidered
- Short-term gain may inflict long-term damage on HI economy
- If there are more non-Hawaiian REIT investors than Hawaiian REIT investors, that must mean that we have benefited by receiving a disproportionate share of the money raised by REITs and invested in real estate.
- The bill would discourage future REIT investment in Hawaii
- The bill would prevent many Hawaiians from participating in the real estate markets
- It is bad public policy to change the tax laws applicable to certain investments, after the investment has been made
- not true that mainland shareholders of HI REITs are profiting on business in HI because:
  * 1. many REIT shareholders are HI residents
  * 2. DPD to HI residents is subject to HI income tax - the bill would unfairly penalize HI REIT investors
  * 3. Longer-term capital revenue generation logic flaw - additional 6.4% tax would limit new investment from any rational investor
- "A REIT’s ability to access and raise capital with equity offerings in the public markets to make these type of real estate investments in Hawaii and other states make it a unique investment vehicle and a major advantage over privately held real estate with a limited amount of investors."
- We have no objection to limiting the dividend paid deduction for captive or privately owned REITs. They are different than widely owned REITs since captive REITs are primarily used as a tax strategy to lower their affiliate’s effective income tax rate from non-real estate business activities.
- A policy change in state taxation will discourage future investment; stifling availability of capital; and putting HI at a competitive disadvantage lower tax revenue for HI in the long term
- If leg. passes, request to give time for REITs to adjust their investments to account for the change
- The bill is damaging to the HI economy
- REITs are business creators and jobs creators, resulting in greater tax revenue to the state
- Hawaii has challenges generating in-state capital to refresh aging commercial properties and hotels
- The bill is a wrong way to raise revenue
- The bill would limit outside funding for projects
- The bill will have devastating long-term effect on REITs, as they will leave the state
- The bill will result in the capital being diverted away from HI
- The bill will lead to a more inefficient use of resources once REIT are not investing
- The bill will send wrong signaling
- Other sources of revenue grew in HI except Hawaii corporate income tax revenues

In addition to testimonies in support or against the bill, testimonies that aimed at not taking any side, but to tried to remain neutral were made by Ms. Maria Zielinski, Director of the Department of Taxation, and, by the Tax Foundation of Hawaii. Below are the major issues raised by them:

- "disallowing the dividend paid deduction would create a double taxation of income, which could cause taxpayers to lose the incentive to invest in Hawaii based REITs"
- "cash flow distributed as a dividend is not necessarily the same as a dividend from profits (REIT could have no net profits (and thus would owe no income taxes under this measure) but yet still pay out a dividend. This would occur where a REIT has substantial non cash deductions such as depreciation and amortization expenses.)"
- REITs often are involved in owning real property that requires substantial cash infusions, which are made possible by the large number of investors putting their cash into a REIT may be affected because of the proposed double taxation under this measure, possibly impacting jobs and discouraging investment locally
- "merely subjecting a REIT to the corporate income tax will not guarantee any significant amount of revenue being raised due to transfer pricing. Given the ease of large corporations to move profits to lower tax jurisdictions, it is not clear to the Department that any substantial revenue gain will result from this measure."
- under IRC section 857(c), a dividend paid by a REIT is not considered a “dividend” for purposes of HRS section 235-7(c), and the dividend received deduction is not allowed for Hawaii income tax purposes. Thus, the Hawaii tax treatment of the dividend received deduction as applied to REITs under these circumstances is the same as under federal law
- Adherence to the federal Internal Revenue Code
Summary of Testimonies on SB118, SD1

All testimonies on the proposal to study the effects of repealing the dividends paid deduction for REITs are in support of the bill. Below is the summary of the major issues highlighted in the testimonies:

- "NAREIT believes that such a study will demonstrate why the DPD should not be eliminated."
- want to know if study can determine whether it is possible to replace investment lost due to tax imposition
- whether the measure is fiscally reasonable
- support the bill with the understanding that interested parties be allowed to provide input to the study to DBEDT and DOTAX
- we believe such a study will indicate why the dividend paid deduction for a REIT should be permitted and therefore why there should be no change in the existing law
- In favor of the study, but it will be problematic to find the necessary and accurate data

In addition, two testimonies by DOTAX Director Ms. Maria Zielinski and by DBEDT Director Mr. Luis Salaveria raised the following issues:

- DBEDT appreciates the overall intent of this bill, but is concerned that the Department would not have adequate funding resources to carry out the intent of this bill.

- DOTAX does not currently track which corporations file an income tax return as a REIT. For Hawaii tax purposes, a REIT files a standard corporation income tax return, just as any other 'C' corporation would file. The Department has not required a REIT to identify itself as such.
Summary of Testimonies on SB118, SD1, HD1

The bill requires DBEDT to study the impact of real estate investment trusts (REIT), and requires a REIT to make an affirmative election to be taxed as a REIT and provide certain data to DBEDT for producing reports to the legislature.

Most of the testimonies focused on the merits of the study and did not object to the study by DBEDT, except for two testimonies that were against the measure. Below are the major issues raised in testimonies:

- As a practical matter, publicly listed REITs are not required to and will not be able to identify “the total number of Hawaii taxpayers who are direct investors in that REIT and the amounts paid to those investors” and will therefore automatically be prohibited from the DPD. Non-traded REITs may be able to compile this information but it will not be without significant additional time and effort.
- Significant concerns about the bill, since much of the information will be impossible to obtain
- There are still a number of ambiguities in the bill language, such as the following:
  o The number of investor changes over time - what time point to report?
  o Large number of shares are held in brokerages – it is impossible to know the number of investors
  o Is there any specific time period the report would need to cover?
  o What is the timing envisioned between making the election in taxes and information to be provided to DBEDT?
  o How is “HI investor” defined?
  o How is “direct investor” defined?
  o Unsure about the details of HI taxpayer status
- There are other reasons to invest in HI real estate aside from DPD
- Many REITs will remain in HI, even with DPD eliminated

There were a couple of testimonies in opposition to the bill. They raised the following issues to justify their opposition to the bill studying the effects of repealing DPD for REITs in Hawaii:

- NAREIT opposes the legislation as currently drafted because stock exchange-traded REITs would be unable to comply with its requirements.
- "Because REITs whose securities are traded on established securities markets (e.g., the New York Stock Exchange or NASDAQ) will not be able to identify ""the total number of Hawaii taxpayers who are direct investors in that REIT and the amount of dividends paid to those investors,"" as a practical matter, the legislation would invalidate the DPD for these companies."
- It is not possible to know whether the securities listed on these forms are owned directly by such money managers or on behalf of their underlying clients.
- A carefully crafted study to analyze the impact of REITs in Hawaii would bring needed factual clarity to the benefits Hawaii obtains by maintaining conformity to virtually all other states regarding a REIT’s DPD. However, as drafted, S.B. 118, S.D.1, H.D. 1 would not do so. As an alternative, NAREIT suggests that DBEDT be authorized to...
obtain the requisite information through statistical sampling and reasonable estimation methods."
- "For all practical purposes, SB. 118, S.D. 1, H. D. 1 would eliminate the DPD for REITs in Hawaii, even if a study is undertaken and recommends against eliminating the DPD. Accordingly, NAREIT respectfully opposes the study to analyze the impact of REITs in Hawaii as provided for in S.B. 118, S.D. 1, H.D. 1."

In addition, the testimonies of Ms. Maria Zielinski, Director of the Department of Taxation, and by Mr. Luis Salaveria, Director of DBEDT, focused on the following issues:

- Insufficient timing
- There is no data for 13 requirements
- There are problems with identifying REIT investors (including mutual funds issues)
- Significant cost involved
- There is missing information, necessary to make appropriate policy recommendation
- Issues with tax filing deadlines
- Issues with mutual funds – inability to get estimate on the proportion and numbers of HI investors.