

JAN 20 2023

A BILL FOR AN ACT

RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The legislature finds that the State's income
2 tax treatment of real estate investment trusts should be
3 decoupled from the federal income tax treatment.

4 Pursuant to existing law, it is the legislature's intent to
5 conform the income tax law of the State as closely as possible
6 to the Internal Revenue Code, unless there is good reason to the
7 contrary. The legislature may choose to adopt none of the
8 amendments to the Internal Revenue Code or may provide that
9 certain amendments are limited in their operation.

10 The legislature additionally finds that real estate
11 investment trusts were established by the federal government to
12 give investors, especially small investors, access to income-
13 producing real estate. The federal real estate investment trust
14 provisions allow a dividends paid deduction to the real estate
15 investment trust, thereby allowing the real estate investment
16 trust itself to not pay tax on income distributed to its
17 shareholders, who would then pay tax on that income. Existing



1 state law conforms to these provisions but creates an anomaly
2 because a real estate investment trust that does business in
3 Hawaii but pays dividends to shareholders out of the State
4 results in no Hawaii income tax collections either from the real
5 estate investment trust or from its shareholders, due to the
6 fact that shareholders pay any tax on dividends to the state in
7 which they reside, not where the income was generated.

8 The legislature further finds that real estate investment
9 trusts in Hawaii own real estate assets of about \$17,000,000,000
10 generating an annual income of \$1,000,000,000, which, if taxed
11 at the current corporate rate assessed to all other
12 corporations, would generate Hawaii taxes of \$65,000,000 per
13 year. A 2016 analysis conducted by the department of business,
14 economic development, and tourism concluded that the State had
15 foregone about \$36,000,000 in income tax in 2014 and that the
16 amount of real estate investment trust investments had risen
17 substantially since 2014.

18 Some real estate investment trust shareholders live in
19 Hawaii, but a substantial majority do not. Furthermore, while
20 real estate investment trusts own more real estate in Hawaii per
21 capita than in any other state, it ranks fortieth in the nation



1 for the number of real estate investment trust shareholders as a
2 percentage of the population. As a result, many real estate
3 investment trusts and their shareholders pay a mere fraction of
4 the Hawaii state income tax compared to what other corporations
5 pay.

6 The legislature therefore finds that it would be more
7 equitable to decouple from the federal system in this regard so
8 that corporations and other business entities doing business in
9 Hawaii pay a fair tax burden commensurate with the substantial
10 privileges and resources in Hawaii that were used to generate
11 their profits. Real estate investment trusts would continue to
12 receive their generous federal tax exemptions and continue to
13 benefit from Hawaii's low property tax rates.

14 Accordingly, the purpose of this Act is to:

- 15 (1) Temporarily disallow dividends paid deductions for
16 real estate investment trusts for taxable years
17 beginning after December 31, 2023, and ending before
18 January 1, 2027; and
- 19 (2) Evenly divide and deposit the amounts collected from
20 the disallowance into the dwelling unit revolving fund
21 and rental housing revolving fund.



1 SECTION 2. Section 235-2.3, Hawaii Revised Statutes, is
2 amended by amending subsection (b) to read as follows:

3 "(b) The following Internal Revenue Code subchapters,
4 parts of subchapters, sections, subsections, and parts of
5 subsections shall not be operative for the purposes of this
6 chapter, unless otherwise provided:

7 (1) Subchapter A (sections 1 to 59A) (with respect to
8 determination of tax liability), except section
9 1(h)(2) (relating to net capital gain reduced by the
10 amount taken into account as investment income),
11 except sections 2(a), 2(b), and 2(c) (with respect to
12 the definition of "surviving spouse" and "head of
13 household"), except section 41 (with respect to the
14 credit for increasing research activities), except
15 section 42 (with respect to low-income housing
16 credit), except sections 47 and 48, as amended, as of
17 December 31, 1984 (with respect to certain depreciable
18 tangible personal property), and except section
19 48(d)(3), as amended, as of February 17, 2009 (with
20 respect to the treatment of United States Department
21 of Treasury grants made under section 1603 of the



1 American Recovery and Reinvestment Tax Act of 2009).
2 For treatment, see sections 235-110.91, 235-110.7, and
3 235-110.8;
4 (2) Section 78 (with respect to dividends received from
5 certain foreign corporations by domestic corporations
6 choosing foreign tax credit);
7 (3) Section 86 (with respect to social security and tier 1
8 railroad retirement benefits);
9 (4) Section 91 (with respect to certain foreign branch
10 losses transferred to specified 10-percent owned
11 foreign corporations);
12 (5) Section 103 (with respect to interest on state and
13 local bonds). For treatment, see section 235-7(b);
14 (6) Section 114 (with respect to extraterritorial income).
15 For treatment, any transaction as specified in the
16 transitional rule for 2005 and 2006 as specified in
17 the American Jobs Creation Act of 2004 section 101(d)
18 and any transaction that has occurred pursuant to a
19 binding contract as specified in the American Jobs
20 Creation Act of 2004 section 101(f) are inoperative;



- 1 (7) Section 120 (with respect to amounts received under
2 qualified group legal services plans). For treatment,
3 see section 235-7(a) (9) to (11);
- 4 (8) Section 122 (with respect to certain reduced uniformed
5 services retirement pay). For treatment, see section
6 235-7(a) (3);
- 7 (9) Section 135 (with respect to income from United States
8 savings bonds used to pay higher education tuition and
9 fees). For treatment, see section 235-7(a) (1);
- 10 (10) Section 139C (with respect to COBRA premium
11 assistance);
- 12 (11) Subchapter B (sections 141 to 150) (with respect to
13 tax exemption requirements for state and local bonds);
- 14 (12) Section 151 (with respect to allowance of deductions
15 for personal exemptions). For treatment, see section
16 235-54;
- 17 (13) Section 179B (with respect to expensing of capital
18 costs incurred in complying with Environmental
19 Protection Agency sulphur regulations);
- 20 (14) Section 181 (with respect to special rules for certain
21 film and television productions);



- 1 (15) Section 196 (with respect to deduction for certain
2 unused investment credits);
- 3 (16) Section 199 (with respect to the U.S. production
4 activities deduction);
- 5 (17) Section 199A (with respect to qualified business
6 income);
- 7 (18) Section 222 (with respect to qualified tuition and
8 related expenses);
- 9 (19) Sections 241 to 247 (with respect to special
10 deductions for corporations). For treatment, see
11 section 235-7(c);
- 12 (20) Section 250 (with respect to foreign-derived
13 intangible income and global intangible low-taxed
14 income);
- 15 (21) Section 267A (with respect to certain related party
16 amounts paid or accrued in hybrid transactions or with
17 hybrid entities);
- 18 (22) Section 280C (with respect to certain expenses for
19 which credits are allowable). For treatment, see
20 section 235-110.91;



- 1 (23) Section 291 (with respect to special rules relating to
2 corporate preference items);
- 3 (24) Section 367 (with respect to foreign corporations);
- 4 (25) Section 501(c)(12), (15), (16) (with respect to exempt
5 organizations); except that section 501(c)(12) shall
6 be operative for companies that provide potable water
7 to residential communities that lack any access to
8 public utility water services;
- 9 (26) Section 515 (with respect to taxes of foreign
10 countries and possessions of the United States);
- 11 (27) Subchapter G (sections 531 to 565) (with respect to
12 corporations used to avoid income tax on
13 shareholders);
- 14 (28) Subchapter H (sections 581 to 597) (with respect to
15 banking institutions), except section 584 (with
16 respect to common trust funds). For treatment, see
17 chapter 241;
- 18 (29) Section 642(a) and (b) (with respect to special rules
19 for credits and deductions applicable to trusts). For
20 treatment, see sections 235-54(b) and 235-55;



- 1 (30) Section 646 (with respect to tax treatment of electing
2 Alaska Native settlement trusts);
- 3 (31) Section 668 (with respect to interest charge on
4 accumulation distributions from foreign trusts);
- 5 (32) Subchapter L (sections 801 to 848) (with respect to
6 insurance companies). For treatment, see sections
7 431:7-202 and 431:7-204;
- 8 (33) Section 853 (with respect to foreign tax credit
9 allowed to shareholders). For treatment, see section
10 235-55;
- 11 (34) Section 853A (with respect to credits from tax credit
12 bonds allowed to shareholders);
- 13 (35) Section 857(b)(2)(B) (with respect to the dividends
14 paid deduction for real estate investment trusts);
- 15 [~~35~~] (36) Subchapter N (sections 861 to 999) (with respect
16 to tax based on income from sources within or without
17 the United States), except sections 985 to 989 (with
18 respect to foreign currency transactions). For
19 treatment, see sections 235-4, 235-5, and 235-7(b),
20 and 235-55;



- 1 [~~36~~] (37) Section 1042(g) (with respect to sales of stock
2 in agricultural refiners and processors to eligible
3 farm cooperatives);
- 4 [~~37~~] (38) Section 1055 (with respect to redeemable ground
5 rents);
- 6 [~~38~~] (39) Section 1057 (with respect to election to treat
7 transfer to foreign trust, etc., as taxable exchange);
- 8 [~~39~~] (40) Sections 1291 to 1298 (with respect to treatment
9 of passive foreign investment companies);
- 10 [~~40~~] (41) Subchapter Q (sections 1311 to 1351) (with
11 respect to readjustment of tax between years and
12 special limitations);
- 13 [~~41~~] (42) Subchapter R (sections 1352 to 1359) (with
14 respect to election to determine corporate tax on
15 certain international shipping activities using per
16 ton rate);
- 17 [~~42~~] (43) Subchapter U (sections 1391 to 1397F) (with
18 respect to designation and treatment of empowerment
19 zones, enterprise communities, and rural development
20 investment areas). For treatment, see chapter 209E;



1 [~~(43)~~] (44) Subchapter W (sections 1400 to 1400C) (with
2 respect to District of Columbia enterprise zone);
3 [~~(44)~~] (45) Section 14000 (with respect to education tax
4 benefits);
5 [~~(45)~~] (46) Section 1400P (with respect to housing tax
6 benefits);
7 [~~(46)~~] (47) Section 1400R (with respect to employment
8 relief);
9 [~~(47)~~] (48) Section 1400T (with respect to special rules for
10 mortgage revenue bonds);
11 [~~(48)~~] (49) Section 1400U-1 (with respect to allocation of
12 recovery zone bonds);
13 [~~(49)~~] (50) Section 1400U-2 (with respect to recovery zone
14 economic development bonds); and
15 [~~(50)~~] (51) Section 1400U-3 (with respect to recovery zone
16 facility bonds)."

17 SECTION 3. Section 235-71, Hawaii Revised Statutes, is
18 amended by amending subsection (d) to read as follows:

19 "(d) In the case of a real estate investment trust there
20 is imposed on the taxable income, computed as provided in
21 sections 857 and 858 of the Internal Revenue Code but with the



1 changes and adjustments made by this chapter (without prejudice
2 to the generality of the foregoing, for taxable years beginning
3 before January 1, 2024, the deduction for dividends paid is
4 limited to [~~such~~] the amount of dividends as is attributable to
5 income taxable under this chapter[~~],~~] and, for taxable years
6 beginning after December 31, 2023, no deductions for dividends
7 paid shall be allowed), a tax consisting in the sum of the
8 following: 4.4 per cent if the taxable income is not over
9 \$25,000, 5.4 per cent if over \$25,000 but not over \$100,000, and
10 on all over \$100,000, 6.4 per cent. In addition to any other
11 penalty provided by law any real estate investment trust whose
12 tax liability for any taxable year is deemed to be increased
13 pursuant to section 859(b)(2)(A) or 860(c)(1)(A) after
14 December 31, 1978, (relating to interest and additions to tax
15 determined with respect to the amount of the deduction for
16 deficiency dividends allowed) of the Internal Revenue Code shall
17 pay a penalty in an amount equal to the amount of interest for
18 which the trust is liable that is attributable solely to the
19 increase. The penalty payable under this subsection with
20 respect to any determination shall not exceed one-half of the
21 amount of the deduction allowed by section 859(a), or 860(a)



1 after December 31, 1978, of the Internal Revenue Code for the
2 taxable year.

3 Notwithstanding the foregoing, beginning January 1, 2022,
4 the department shall require a real estate investment trust
5 subject to this chapter to:

6 (1) Notify the department, in the manner prescribed by the
7 department, of its operation as a real estate
8 investment trust in the State no later than fifteen
9 days from the first day of operation in the State;
10 provided that, for real estate investment trusts
11 operating in the State as of July 1, 2021, the
12 department shall be notified no later than January 15,
13 2022;

14 (2) Properly designate on its tax return that it is a real
15 estate investment trust, as required by the
16 department;

17 (3) Complete its tax return in the specific manner
18 required by the department, including following line-
19 by-line instructions; and

20 (4) Submit a copy of the real estate investment trust's
21 federal tax return covering the same period with each



1 state tax return that the real estate investment trust
2 files with the department under this chapter.

3 Any real estate investment trust that fails to comply with these
4 requirements shall be assessed a penalty of \$50 per day.

5 Notwithstanding any law to the contrary, amounts collected
6 as taxes on dividends paid under this subsection shall be paid
7 into the state treasury as state realizations to be kept and
8 accounted for as provided by law; provided that fifty per cent
9 shall be deposited to the credit of the dwelling unit revolving
10 fund established pursuant to section 201H-191 and fifty per cent
11 shall be deposited to the credit of the rental housing revolving
12 fund established pursuant to section 201H-202."

13 SECTION 4. Statutory material to be repealed is bracketed
14 and stricken. New statutory material is underscored.

15 SECTION 5. This Act, upon its approval, shall apply to
16 taxable years beginning after December 31, 2023; provided that
17 this Act shall be repealed on December 31, 2026, and sections
18 235-2.3(b) and 235-71(d), Hawaii Revised Statutes, shall be
19 reenacted in the form in which they read on the day prior to the
20 effective date of this Act.

21



S.B. NO. 359

INTRODUCED BY:

A handwritten signature in black ink, appearing to be 'B. S. L.', written over a horizontal line.



S.B. NO. 359

Report Title:

Taxation; Real Estate Investment Trusts; Dividends Paid
Deduction; Dwelling Unit; Rental Housing

Description:

Disallows dividends paid deduction for real estate investment trusts. Specifies that amounts collected from the disallowance be evenly divided and deposited into the dwelling unit revolving fund and rental housing revolving fund. Applies to taxable years beginning after 12/31/2023. Sunsets 12/31/2026.

The summary description of legislation appearing on this page is for informational purposes only and is not legislation or evidence of legislative intent.

