
A BILL FOR AN ACT

RELATING TO THE CLARIFICATION OF THE DIVIDENDS RECEIVED
DEDUCTION WITH RESPECT TO DIVIDENDS RECEIVED BY REAL ESTATE
INVESTMENT TRUSTS.

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

1 SECTION 1. The purpose of this Act is to clarify
2 provisions of Hawaii's income tax law that deny a deduction for
3 dividends paid by a real estate investment trust. Under the
4 Internal Revenue Code as amended, dividends paid by a real
5 estate investment trust are not deductible under section 857(c).
6 Section 857(c) of the Internal Revenue Code is operative for
7 purposes of chapter 235, Hawaii Revised Statutes. Under the
8 State's income tax law, a "dividend" is a distribution that is
9 treated as a dividend under the Internal Revenue code and
10 section 857(c) provides that for purposes of the federal
11 dividends received deduction, "a dividend received from a real
12 estate investment trust which meets the requirements of this
13 part shall not be considered a dividend."

14 The department of taxation provided guidance concerning the
15 non-deductibility of dividends paid by real estate investment
16 trusts in tax information release No. 98-6 (July 8, 1998).

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1 Subsequently, in In the Matter of the Tax Appeal of HEI and
2 Subsidiaries, T.A. No. 03-0169, the state tax appeal court also
3 concluded that dividends paid by a real estate investment trust
4 are not deductible under chapter 235, Hawaii Revised Statutes.
5 Likewise, in In the Matter of the Tax Appeal of Central Pacific
6 Bank, Inc., T.A. Nos. 00-0075, 03-0155 and 05-0041, the state
7 tax appeal court again ruled that such dividends are not
8 deductible.

9 Notwithstanding the provisions of chapter 235, Hawaii
10 Revised Statutes, the department of taxation's tax information
11 release providing guidance, and these tax appeal court rulings
12 that deny the dividends received deduction for dividends paid by
13 real estate investment trusts under existing law, confusion
14 continues to persist among some taxpayers and tax practitioners.
15 The purpose of this Act is clarify existing provisions of
16 chapter 235, Hawaii Revised Statutes, to provide even greater
17 clarity that a dividend paid by a real estate investment trust
18 is not deductible under section 235-7(c), Hawaii Revised
19 Statutes, which is the codification of the provisions of section
20 243 of the Internal Revenue Code, the federal dividends received
21 deduction.

1 Because this Act is a clarification of existing law, this
2 Act shall take effect on approval and apply to all tax years
3 that are open for audit, examination, and assessment and to any
4 tax appeal, case, or controversy pending on its effective date.

5 SECTION 2. Section 235-7, Hawaii Revised Statutes, is
6 amended by amending subsection (c) to read as follows:

7 "(c) The deductions of or based on dividends paid or
8 received, allowed to a corporation under chapter 1, subchapter
9 B, Part VIII of the Internal Revenue Code, shall not be allowed.
10 In lieu thereof there shall be allowed as a deduction the entire
11 amount of dividends received by any corporation upon the shares
12 of stock of a national banking association, qualifying
13 dividends, as defined in section 243(b) of the Internal Revenue
14 Code, received by members of an affiliated group, or dividends
15 received by a small business investment company operating under
16 the Small Business Investment Act of 1958 (Public Law 85-699)
17 upon shares of stock qualifying under paragraph (3), seventy per
18 cent of the amount received by any corporation as dividends:

19 (1) Upon the shares of stock of another corporation, if at
20 the date of payment of the dividend at least ninety-
21 five per cent of the other corporation's capital stock
22 is owned by one or more corporations doing business in

1 this State and if the other corporation is subjected
2 to an income tax in another jurisdiction (but
3 subjection to federal tax does not constitute
4 subjection to income tax in another jurisdiction);

5 (2) Upon the shares of stock of a bank or insurance
6 company organized and doing business under the laws of
7 the State;

8 (3) Upon the shares of stock of another corporation, if at
9 least fifteen per cent of the latter corporation's
10 business, for the taxable year of the latter
11 corporation preceding the payment of the dividend, has
12 been attributed to this State.

13 However, except for national bank dividends, the deductions
14 under this subsection are not allowed when they would not have
15 been allowed under section 243 of the Internal Revenue Code, as
16 amended by Public Law 85-866, by reason of subsections (b) and
17 (c) of section 246 of the Internal Revenue Code. For the
18 purposes of this subsection fifteen per cent of a corporation's
19 business shall be deemed to have been attributed to this State
20 if fifteen per cent or more of the entire gross income of the
21 corporation as defined in this chapter (which for the purposes
22 of this subsection shall be computed without regard to source in

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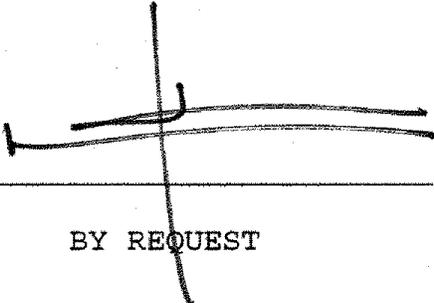
1 the State and shall include income not taxable by reason of the
2 fact that it is from property not owned in the State or from a
3 trade or business not carried on in the State in whole or in
4 part), under section 235-5 and the other provisions of this
5 chapter, shall have been attributed to the State and subjected
6 to assessment of the taxable income therefrom (including the
7 determination of the resulting net loss, if any).

8 Notwithstanding the foregoing, any dividend received from a
9 real estate investment trust which, for the taxable year of the
10 trust in which the dividend is paid, qualifies under part II of
11 subchapter M (section 856 and following) of the Internal Revenue
12 Code, shall not be treated as a dividend for purposes of this
13 subsection."

14 SECTION 3. New statutory material is underscored.

15 SECTION 4. This Act shall take effect upon approval, and
16 shall apply to any tax year that is open for audit, examination,
17 or assessment and to any tax appeal, case, or controversy
18 pending on its effective date.

19
20 INTRODUCED BY: _____

A handwritten signature is written over a horizontal line. Below the signature, the words "BY REQUEST" are printed. A vertical line is drawn through the signature and the text "BY REQUEST".

SB 1503

JUSTIFICATION SHEET

DEPARTMENT: Taxation

TITLE: A BILL FOR AN ACT RELATING TO THE CLARIFICATION OF THE DIVIDENDS RECEIVED DEDUCTION WITH RESPECT TO DIVIDENDS RECEIVED BY REAL ESTATE INVESTMENT TRUSTS.

PURPOSE: To clarify the application of the deduction for dividends received by a corporation from a Real Estate Investment Trust ("REIT").

MEANS: Amend section 235-7(c), Hawaii Revised Statutes (HRS).

JUSTIFICATION: The purpose of this bill is to clarify that, in conformance with federal tax law, the State's deduction for dividends received by a corporation, as provided under section 235-7(c), HRS, is not available if such dividends are received from a REIT. This bill also reaffirms that section 235-7(c), HRS, is a codification of section 243 of the Internal Revenue Code of 1986, as amended, which is the federal provision for the dividends received deduction.

Because REITs are allowed to deduct the amount of dividends it pays to another corporation, both Hawaii and federal law disallow the dividends received deduction when a corporation receives distributions (i.e., dividends) from a REIT. Allowing the dividends received deduction in this instance would permit 70 percent of REIT dividends to entirely escape corporate income taxation.

Impact on the public: Prevents taxpayers from arguing that the dividends received deduction is available when such dividends are received from REITs. Instills confidence in the tax system by promoting equity and fairness.

Impact on the department and other agencies: This measure assists the department in administering the tax laws.

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GENERAL FUND: None.

OTHER FUNDS: None.

PPBS PROGRAM
DESIGNATION: TAX 100.

OTHER AFFECTED
AGENCIES: None.

EFFECTIVE DATE: Upon approval and shall apply to any tax year that is open for audit, examination, or assessment and to any tax appeal, case, or controversy pending on its effective date.