

JAN 19 2024

A BILL FOR AN ACT

RELATING TO TAXATION.

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 in order to more
4 equitably tax all corporations doing business in Hawaii and to
5 generate revenues by use of the State's resources.

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

12 The legislature also finds that real estate investment
13 trusts were established by the federal government to give
14 investors, especially small investors, access to income-
15 producing real estate. The federal real estate investment trust
16 provisions allow a dividends paid deduction to the real estate
17 investment trust, thereby allowing the real estate investment



1 trust itself to not pay tax on income distributed to its
2 shareholders, who would then pay tax on that income.

3 Existing state law conforms to these provisions but creates
4 an anomaly because a real estate investment trust that does
5 business in Hawaii and pays dividends to shareholders outside
6 the State, results in no Hawaii income tax collected either from
7 the real estate investment trust or from its shareholders. This
8 is because shareholders pay any tax on dividends to the state in
9 which they reside, not where the income was generated.

10 The legislature further finds that real estate investment
11 trusts in Hawaii own real estate assets of approximately
12 \$18,000,000,000, generating an annual income of \$1,000,000,000,
13 which, if taxed at the current corporate rate assessed to all
14 other corporations, would generate Hawaii tax revenues of
15 \$65,000,000 per year. A 2016 analysis conducted by the
16 department of business, economic development, and tourism
17 concluded that the State had foregone about \$36,000,000 in
18 income tax revenues in 2014, and that the amount of real estate
19 investment trust investments has risen substantially since 2014.
20 Regardless of the amount of tax revenues foregone, the State
21 should be collecting taxes as it does for other real estate



1 corporations to ensure fairness to all such businesses using the
2 State's resources to reap benefits for its shareholders.

3 While some real estate investment trusts that do business
4 in Hawaii reside in the State, a substantial majority do not,
5 and thus their dividends flow to the state in which they reside
6 rather than to the benefit of Hawaii. Further, while real
7 estate investment trusts own more real estate in Hawaii per
8 capita than in any other state, Hawaii ranks fortieth in the
9 nation for the number of real estate investment trust
10 shareholders as a percentage of the population. As a result,
11 many real estate investment trusts and their shareholders pay a
12 mere fraction of the Hawaii state income tax compared to what
13 other corporations pay. During a time when Hawaii faces major
14 budget shortfalls for this year and several years to come, it is
15 imperative that all corporations pay the corporate income tax
16 due to the State and its citizens for the infrastructure and
17 other resources that the State provides them.

18 The legislature therefore finds that it would be more
19 equitable to decouple from the federal income tax system in
20 regards to the dividends paid deductions for real estate
21 investment trusts so that these corporations and other business



1 entities doing business in Hawaii pay a fair tax burden,
2 commensurate with the substantial privileges and resources in
3 Hawaii that were used to generate their profits. Real estate
4 investment trusts would continue to receive their generous
5 federal tax exemptions and benefit from Hawaii's low property
6 tax rates.

7 The legislature also recognizes that Hawaii is experiencing
8 a severe affordable housing crisis with a lack of affordable
9 rental and for sale units. According to the "Affordable Rental
10 Housing Report and Ten-Year Plan," prepared by the department of
11 business, economic development, and tourism (July 2018), housing
12 demand is projected to reach 64,693 units by 2025, with nearly
13 seventy per cent (43,828 units) needed for households earning
14 eighty per cent or less of the area median income. It is
15 therefore in the State's interest to promote the development of
16 affordable housing.

17 Accordingly, the purpose of this Act is to disallow
18 dividends paid deductions for real estate investment trusts for
19 a three-year period, applicable to the taxable years beginning
20 after December 31, 2024, except for real estate investment
21 trusts that provide affordable housing in the State.



1 SECTION 2. Section 235-2.3, Hawaii Revised Statutes, is
2 amended 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
19 section 48(d)(3), as amended, as of February 17, 2009
20 (with respect to the treatment of United States
21 Department of Treasury grants made under section 1603



1 of the American Recovery and Reinvestment Tax Act of
2 2009). For treatment, see sections 235-110.91,
3 235-110.7, and 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 except that section 857(b)(2)(B) shall be available
16 for real estate investment trusts where one hundred
17 per cent of the trust's real property is used to
18 provide affordable housing in the State;
- 19 [+35+] (36) Subchapter N (sections 861 to 999) (with respect
20 to tax based on income from sources within or without
21 the United States), except sections 985 to 989 (with



1 respect to foreign currency transactions). For
2 treatment, see sections 235-4, 235-5, and 235-7(b),
3 and 235-55;

4 ~~[(36)]~~ (37) Section 1042(g) (with respect to sales of stock
5 in agricultural refiners and processors to eligible
6 farm cooperatives);

7 ~~[(37)]~~ (38) Section 1055 (with respect to redeemable ground
8 rents);

9 ~~[(38)]~~ (39) Section 1057 (with respect to election to treat
10 transfer to foreign trust, etc., as taxable exchange);

11 ~~[(39)]~~ (40) Sections 1291 to 1298 (with respect to treatment
12 of passive foreign investment companies);

13 ~~[(40)]~~ (41) Subchapter Q (sections 1311 to 1351) (with
14 respect to readjustment of tax between years and
15 special limitations), except for section 1341 (with
16 respect to computation of tax where taxpayer restores
17 substantial amount held under claim of right);

18 ~~[(41)]~~ (42) Subchapter R (sections 1352 to 1359) (with
19 respect to election to determine corporate tax on
20 certain international shipping activities using per
21 ton rate);



1 [~~42~~] (43) Subchapter U (sections 1391 to 1397F) (with
2 respect to designation and treatment of empowerment
3 zones, enterprise communities, and rural development
4 investment areas). For treatment, see chapter 209E;
5 [~~43~~] (44) Subchapter W (sections 1400 to 1400C) (with
6 respect to District of Columbia enterprise zone);
7 [~~44~~] (45) Section 14000 (with respect to education tax
8 benefits);
9 [~~45~~] (46) Section 1400P (with respect to housing tax
10 benefits);
11 [~~46~~] (47) Section 1400R (with respect to employment
12 relief);
13 [~~47~~] (48) Section 1400T (with respect to special rules for
14 mortgage revenue bonds);
15 [~~48~~] (49) Section 1400U-1 (with respect to allocation of
16 recovery zone bonds);
17 [~~49~~] (50) Section 1400U-2 (with respect to recovery zone
18 economic development bonds); and
19 [~~50~~] (51) Section 1400U-3 (with respect to recovery zone
20 facility bonds)."



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

3 "(d) In the case of a real estate investment trust there
4 is imposed on the taxable income, computed as provided in
5 sections 857 and 858 of the Internal Revenue Code but with the
6 changes and adjustments made by this chapter (without prejudice
7 to the generality of the foregoing, for the taxable years
8 beginning before January 1, 2025, the deduction for dividends
9 paid is limited to [~~such~~] the amount of dividends as is
10 attributable to income taxable under this chapter[~~],~~ and, for
11 taxable years beginning after December 31, 2024, no deductions
12 for dividends paid shall be allowed, except for real estate
13 investment trusts where one hundred per cent of the trust's real
14 property is used to provide affordable housing in the State), a
15 tax consisting in the sum of the following: 4.4 per cent if the
16 taxable income is not over \$25,000, 5.4 per cent if over \$25,000
17 but not over \$100,000, and on all over \$100,000, 6.4 per cent.
18 In addition to any other penalty provided by law any real estate
19 investment trust whose tax liability for any taxable year is
20 deemed to be increased pursuant to section 859(b)(2)(A) or
21 860(c)(1)(A) after December 31, 1978, (relating to interest and



1 additions to tax determined with respect to the amount of the
2 deduction for deficiency dividends allowed) of the Internal
3 Revenue Code shall pay a penalty in an amount equal to the
4 amount of interest for which the trust is liable that is
5 attributable solely to the increase. The penalty payable under
6 this subsection with respect to any determination shall not
7 exceed one-half of the amount of the deduction allowed by
8 section 859(a), or 860(a) after December 31, 1978, of the
9 Internal Revenue Code for the taxable year.

10 Notwithstanding the foregoing, beginning January 1, 2022,
11 the department shall require a real estate investment trust
12 subject to this chapter to:

13 (1) Notify the department, in the manner prescribed by the
14 department, of its operation as a real estate
15 investment trust in the State no later than fifteen
16 days from the first day of operation in the State;
17 provided that, for real estate investment trusts
18 operating in the State as of July 1, 2021, the
19 department shall be notified no later than January 15,
20 2022;



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

4 (3) Complete its tax return in the specific manner
5 required by the department, including following line-
6 by-line instructions; and

7 (4) Submit a copy of the real estate investment trust's
8 federal tax return covering the same period with each
9 state tax return that the real estate investment trust
10 files with the department under this chapter.

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

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, 2024; provided that
17 this Act shall be repealed on December 31, 2027, and sections
18 235-2.3(b) and 235-71(d), Hawaii Revised Statutes, shall be



1 reenacted in the form in which they read on the day prior to the
2 effective date of this Act.

3

INTRODUCED BY:



A handwritten signature in black ink, appearing to read "J. Minner", is written over a horizontal line.



S.B. NO. 2528

Report Title:

Taxation; Real Estate Investment Trusts; Dividends Paid
Deduction; Affordable Housing

Description:

Disallows dividends paid deduction for real estate investment trusts, except for real estate investment trusts that provide affordable housing in the State. Applies to taxable years beginning after 12/31/2024. Sunsets 12/31/2027.

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

