
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 may be
6 with the Internal Revenue Code, unless there is good reason to
7 the 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 also finds that real estate investment
11 trusts were established by the federal government to give
12 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 outside the State,
4 results in no Hawaii income tax collected either from the real
5 estate investment trust or from its shareholders. This is due
6 to the fact that shareholders pay any tax on dividends to the
7 state in 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 approximately
10 \$17,000,000,000, generating an annual income of \$1,000,000,000,
11 which, if taxed at the current corporate rate assessed to all
12 other corporations, would generate Hawaii tax revenues of
13 \$65,000,000 per year. A 2016 analysis conducted by the
14 department of business, economic development, and tourism
15 concluded that the State had foregone about \$36,000,000 in
16 income tax revenues in 2014, and that the amount of real estate
17 investment trust investments has risen substantially since 2014.

18 Some real estate investment trust shareholders live in
19 Hawaii, but a substantial majority do not. Further, while real
20 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 benefit from
13 Hawaii's low property tax rates.

14 The legislature also recognizes that Hawaii is experiencing
15 a severe affordable housing crisis with a lack of affordable
16 rental and for sale units. According to the "Affordable Rental
17 Housing Report and Ten-Year Plan," prepared by the department of
18 business, economic development, and tourism (July 2018), housing
19 demand is projected to reach 64,693 units by 2025, with nearly
20 seventy per cent (43,828 units) needed for households earning
21 eighty per cent or less of the area median income. It is



1 therefore in the State's interest to promote the development of
2 affordable housing.

3 Accordingly, the purpose of this Act is to disallow
4 dividends paid deductions for real estate investment trusts for
5 a three-year period, applicable to taxable years beginning after
6 December 31, 2020, except for real estate investment trusts that
7 provide affordable housing in the State.

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

10 "(b) The following Internal Revenue Code subchapters,
11 parts of subchapters, sections, subsections, and parts of
12 subsections shall not be operative for the purposes of this
13 chapter, unless otherwise provided:

14 (1) Subchapter A (sections 1 to 59A) (with respect to
15 determination of tax liability), except
16 section 1(h)(2) (relating to net capital gain reduced
17 by the amount taken into account as investment
18 income), except sections 2(a), 2(b), and 2(c) (with
19 respect to the definition of "surviving spouse" and
20 "head of household"), except section 41 (with respect
21 to the credit for increasing research activities),



1 except section 42 (with respect to low-income housing
2 credit), except sections 47 and 48, as amended, as of
3 December 31, 1984 (with respect to certain depreciable
4 tangible personal property), and except
5 section 48(d)(3), as amended, as of February 17, 2009
6 (with respect to the treatment of United States
7 Department of Treasury grants made under section 1603
8 of the American Recovery and Reinvestment Tax Act of
9 2009). For treatment, see sections 235-110.91,
10 235-110.7, and 235-110.8;

11 (2) Section 78 (with respect to dividends received from
12 certain foreign corporations by domestic corporations
13 choosing foreign tax credit);

14 (3) Section 86 (with respect to social security and tier 1
15 railroad retirement benefits);

16 (4) Section 91 (with respect to certain foreign branch
17 losses transferred to specified 10-percent owned
18 foreign corporations);

19 (5) Section 103 (with respect to interest on state and
20 local bonds). For treatment, see section 235-7(b);



- 1 (6) Section 114 (with respect to extraterritorial income).
2 For treatment, any transaction as specified in the
3 transitional rule for 2005 and 2006 as specified in
4 the American Jobs Creation Act of 2004 section 101(d)
5 and any transaction that has occurred pursuant to a
6 binding contract as specified in the American Jobs
7 Creation Act of 2004 section 101(f) are inoperative;
- 8 (7) Section 120 (with respect to amounts received under
9 qualified group legal services plans). For treatment,
10 see section 235-7(a)(9) to (11);
- 11 (8) Section 122 (with respect to certain reduced uniformed
12 services retirement pay). For treatment, see section
13 235-7(a)(3);
- 14 (9) Section 135 (with respect to income from United States
15 savings bonds used to pay higher education tuition and
16 fees). For treatment, see section 235-7(a)(1);
- 17 (10) Section 139C (with respect to COBRA premium
18 assistance);
- 19 (11) Subchapter B (sections 141 to 150) (with respect to
20 tax exemption requirements for state and local bonds);



- 1 (12) Section 151 (with respect to allowance of deductions
2 for personal exemptions). For treatment, see
3 section 235-54;
- 4 (13) Section 179B (with respect to expensing of capital
5 costs incurred in complying with Environmental
6 Protection Agency sulphur regulations);
- 7 (14) Section 181 (with respect to special rules for certain
8 film and television productions);
- 9 (15) Section 196 (with respect to deduction for certain
10 unused investment credits);
- 11 (16) Section 199 (with respect to the U.S. production
12 activities deduction);
- 13 (17) Section 199A (with respect to qualified business
14 income);
- 15 (18) Section 222 (with respect to qualified tuition and
16 related expenses);
- 17 (19) Sections 241 to 247 (with respect to special
18 deductions for corporations). For treatment, see
19 section 235-7(c);



- 1 (20) Section 250 (with respect to foreign-derived
2 intangible income and global intangible low-taxed
3 income);
- 4 (21) Section 267A (with respect to certain related party
5 amounts paid or accrued in hybrid transactions or with
6 hybrid entities);
- 7 (22) Section 280C (with respect to certain expenses for
8 which credits are allowable). For treatment, see
9 section 235-110.91;
- 10 (23) Section 291 (with respect to special rules relating to
11 corporate preference items);
- 12 (24) Section 367 (with respect to foreign corporations);
- 13 (25) Section 501(c)(12), (15), (16) (with respect to exempt
14 organizations); except that section 501(c)(12) shall
15 be operative for companies that provide potable water
16 to residential communities that lack any access to
17 public utility water services;
- 18 (26) Section 515 (with respect to taxes of foreign
19 countries and possessions of the United States);



- 1 (27) Subchapter G (sections 531 to 565) (with respect to
2 corporations used to avoid income tax on
3 shareholders);
- 4 (28) Subchapter H (sections 581 to 597) (with respect to
5 banking institutions), except section 584 (with
6 respect to common trust funds). For treatment, see
7 chapter 241;
- 8 (29) Section 642(a) and (b) (with respect to special rules
9 for credits and deductions applicable to trusts). For
10 treatment, see sections 235-54(b) and 235-55;
- 11 (30) Section 646 (with respect to tax treatment of electing
12 Alaska Native settlement trusts);
- 13 (31) Section 668 (with respect to interest charge on
14 accumulation distributions from foreign trusts);
- 15 (32) Subchapter L (sections 801 to 848) (with respect to
16 insurance companies). For treatment, see sections
17 431:7-202 and 431:7-204;
- 18 (33) Section 853 (with respect to foreign tax credit
19 allowed to shareholders). For treatment, see
20 section 235-55;



- 1 (34) Section 853A (with respect to credits from tax credit
2 bonds allowed to shareholders);
- 3 (35) Section 857(b)(2)(B) (with respect to the dividends
4 paid deduction for real estate investment trusts);
5 except that section 857(b)(2)(B) shall be available
6 for real estate investment trusts where one hundred
7 per cent of the trust's real property is used to
8 provide affordable housing in the State;
- 9 [~~35~~] (36) Subchapter N (sections 861 to 999) (with respect
10 to tax based on income from sources within or without
11 the United States), except sections 985 to 989 (with
12 respect to foreign currency transactions). For
13 treatment, see sections 235-4, 235-5, and 235-7(b),
14 and 235-55;
- 15 [~~36~~] (37) Section 1042(g) (with respect to sales of stock
16 in agricultural refiners and processors to eligible
17 farm cooperatives);
- 18 [~~37~~] (38) Section 1055 (with respect to redeemable ground
19 rents);
- 20 [~~38~~] (39) Section 1057 (with respect to election to treat
21 transfer to foreign trust, etc., as taxable exchange);



- 1 ~~[(39)]~~ (40) Sections 1291 to 1298 (with respect to treatment
2 of passive foreign investment companies);
- 3 ~~[(40)]~~ (41) Subchapter Q (sections 1311 to 1351) (with
4 respect to readjustment of tax between years and
5 special limitations);
- 6 ~~[(41)]~~ (42) Subchapter R (sections 1352 to 1359) (with
7 respect to election to determine corporate tax on
8 certain international shipping activities using per
9 ton rate);
- 10 ~~[(42)]~~ (43) Subchapter U (sections 1391 to 1379F) (with
11 respect to designation and treatment of empowerment
12 zones, enterprise communities, and rural development
13 investment areas). For treatment, see chapter 209E;
- 14 ~~[(43)]~~ (44) Subchapter W (sections 1400 to 1400C) (with
15 respect to District of Columbia enterprise zone);
- 16 ~~[(44)]~~ (45) Section 14000 (with respect to education tax
17 benefits);
- 18 ~~[(45)]~~ (46) Section 1400P (with respect to housing tax
19 benefits);
- 20 ~~[(46)]~~ (47) Section 1400R (with respect to employment
21 relief);



- 1 ~~[(47)]~~ (48) Section 1400T (with respect to special rules for
2 mortgage revenue bonds);
- 3 ~~[(48)]~~ (49) Section 1400U-1 (with respect to allocation of
4 recovery zone bonds);
- 5 ~~[(49)]~~ (50) Section 1400U-2 (with respect to recovery zone
6 economic development bonds); and
- 7 ~~[(50)]~~ (51) Section 1400U-3 (with respect to recovery zone
8 facility bonds~~[-]~~)."

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

11 "(d) In the case of a real estate investment trust there
12 is imposed on the taxable income, computed as provided in
13 sections 857 and 858 of the Internal Revenue Code but with the
14 changes and adjustments made by this chapter (without prejudice
15 to the generality of the foregoing, for taxable years beginning
16 before January 1, 2021, the deduction for dividends paid is
17 limited to ~~[such]~~ the amount of dividends as is attributable to
18 income taxable under this chapter~~[-]~~ and, for taxable years
19 beginning after December 31, 2020, no deductions for dividends
20 paid shall be allowed, except for real estate investment trusts
21 where one hundred per cent of the trust's real property is used



1 to provide affordable housing in the State), a tax consisting in
2 the sum of the following: 4.4 per cent if the taxable income is
3 not over \$25,000, 5.4 per cent if over \$25,000 but not over
4 \$100,000, and on all over \$100,000, 6.4 per cent. In addition
5 to any other penalty provided by law any real estate investment
6 trust whose tax liability for any taxable year is deemed to be
7 increased pursuant to section 859(b)(2)(A) or 860(c)(1)(A) after
8 December 31, 1978, (relating to interest and additions to tax
9 determined with respect to the amount of the deduction for
10 deficiency dividends allowed) of the Internal Revenue Code shall
11 pay a penalty in an amount equal to the amount of interest for
12 which such trust is liable that is attributable solely to [~~such~~]
13 the increase. The penalty payable under this subsection with
14 respect to any determination shall not exceed one-half of the
15 amount of the deduction allowed by section 859(a), or 860(a)
16 after December 31, 1978, of the Internal Revenue Code for [~~such~~]
17 the taxable year."

18 SECTION 4. Statutory material to be repealed is bracketed
19 and stricken. New statutory material is underscored.

20 SECTION 5. This Act shall take effect on July 1, 2050, and
21 shall apply to taxable years beginning after December 31, 2020;



1 provided that this Act shall be repealed on December 31, 2023,
2 and sections 235-2.3(b) and 235-71(d), Hawaii Revised Statutes,
3 shall be reenacted in the form in which they read on the day
4 prior to the effective date of this Act.



Report Title:

Taxation; Real Estate Investment Trusts; Dividends Paid
Deduction

Description:

Disallows dividends paid deduction for real estate investment trusts, except for real estate investment trusts that provide affordable housing in the State. Effective 7/1/2050. Applies to taxable years beginning after 12/31/2020. Sunsets 12/31/2023. (SD1)

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