A BILL FOR AN ACT

RELATING TO TAXATION OF REAL ESTATE INVESTMENT TRUSTS.

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

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

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

The legislature finds that real estate investment trusts were established by the federal government to give investors, especially small investors, access to income-producing real estate. The federal real estate investment trust provisions allow a dividends paid deduction to the real estate investment trust, thereby allowing the real estate investment trust itself to not pay tax on income distributed to its shareholders, who would then pay tax on that income. Existing state law conforms
to these provisions, but creates an anomaly because a real
estate investment trust that does business in Hawaii, but pays
dividends to shareholders out of the state, results in no Hawaii
income tax collected either from the real estate investment
trust or from its shareholders, due to the fact that
shareholders pay any tax on dividends to the state in which they
reside, not where the income was generated.

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

Some real estate investment trust shareholders live in
Hawaii, but a substantial majority do not. Further, while real
estate investment trusts own more real estate in Hawaii per
capita than in any other state, it ranks fortieth in the nation
for the number of real estate investment trust shareholders as a percentage of the population. As a result, many real estate investment trusts and their shareholders pay a mere fraction of the Hawaii state income tax compared to what other corporations pay.

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

Accordingly, the purpose of this Act is to disallow dividends paid deductions for real estate investment trusts for taxable years beginning after December 31, 2020, which shall repeal on December 31, 2023.

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

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

(1) Subchapter A (sections 1 to 59A) (with respect to
determination of tax liability), except
section 1(h)(2) (relating to net capital gain reduced
by the amount taken into account as investment
income), except sections 2(a), 2(b), and 2(c) (with
respect to the definition of "surviving spouse" and
"head of household"), except section 41 (with respect
to the credit for increasing research activities),
except section 42 (with respect to low-income housing
credit), except sections 47 and 48, as amended, as of
December 31, 1984 (with respect to certain depreciable
tangible personal property), and except
section 48(d)(3), as amended, as of February 17, 2009
(with respect to the treatment of United States
Department of Treasury grants made under section 1603
of the American Recovery and Reinvestment Tax Act of
2009). For treatment, see sections 235-110.91,
235-110.7, and 235-110.8;
(2) Section 78 (with respect to dividends received from certain foreign corporations by domestic corporations choosing foreign tax credit);

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

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

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

(6) Section 114 (with respect to extraterritorial income). For treatment, any transaction as specified in the transitional rule for 2005 and 2006 as specified in the American Jobs Creation Act of 2004 section 101(d) and any transaction that has occurred pursuant to a binding contract as specified in the American Jobs Creation Act of 2004 section 101(f) are inoperative;

(7) Section 120 (with respect to amounts received under qualified group legal services plans). For treatment, see section 235-7(a)(9) to (11);
(8) Section 122 (with respect to certain reduced uniformed
services retirement pay). For treatment, see section
235-7(a)(3);
(9) Section 135 (with respect to income from United States
savings bonds used to pay higher education tuition and
fees). For treatment, see section 235-7(a)(1);
(10) Section 139C (with respect to COBRA premium
assistance);
(11) Subchapter B (sections 141 to 150) (with respect to
tax exemption requirements for state and local bonds);
(12) Section 151 (with respect to allowance of deductions
for personal exemptions). For treatment, see
section 235-54;
(13) Section 179B (with respect to expensing of capital
costs incurred in complying with Environmental
Protection Agency sulphur regulations);
(14) Section 181 (with respect to special rules for certain
film and television productions);
(15) Section 196 (with respect to deduction for certain
unused investment credits);
(16) Section 199 (with respect to the U.S. production activities deduction);
(17) Section 199A (with respect to qualified business income);
(18) Section 222 (with respect to qualified tuition and related expenses);
(19) Sections 241 to 247 (with respect to special deductions for corporations). For treatment, see section 235-7(c);
(20) Section 250 (with respect to foreign-derived intangible income and global intangible low-taxed income);
(21) Section 267A (with respect to certain related party amounts paid or accrued in hybrid transactions or with hybrid entities);
(22) Section 280C (with respect to certain expenses for which credits are allowable). For treatment, see section 235-110.91;
(23) Section 291 (with respect to special rules relating to corporate preference items);
(24) Section 367 (with respect to foreign corporations);
(25) Section 501(c)(12), (15), (16) (with respect to exempt organizations); except that section 501(c)(12) shall be operative for companies that provide potable water to residential communities that lack any access to public utility water services;

(26) Section 515 (with respect to taxes of foreign countries and possessions of the United States);

(27) Subchapter G (sections 531 to 565) (with respect to corporations used to avoid income tax on shareholders);

(28) Subchapter H (sections 581 to 597) (with respect to banking institutions), except section 584 (with respect to common trust funds). For treatment, see chapter 241;

(29) Section 642(a) and (b) (with respect to special rules for credits and deductions applicable to trusts). For treatment, see sections 235-54(b) and 235-55;

(30) Section 646 (with respect to tax treatment of electing Alaska Native settlement trusts);

(31) Section 668 (with respect to interest charge on accumulation distributions from foreign trusts);
1. (32) Subchapter L (sections 801 to 848) (with respect to insurance companies). For treatment, see sections 431:7-202 and 431:7-204;

2. (33) Section 853 (with respect to foreign tax credit allowed to shareholders). For treatment, see section 235-55;

3. (34) Section 853A (with respect to credits from tax credit bonds allowed to shareholders);

4. (35) Section 857(b)(2)(B) (with respect to the dividends paid deduction for real estate investment trusts);

5. [(35)] (36) Subchapter N (sections 861 to 999) (with respect to tax based on income from sources within or without the United States), except sections 985 to 989 (with respect to foreign currency transactions). For treatment, see sections 235-4, 235-5, and 235-7(b), and 235-55;

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

7. [(37)] (38) Section 1055 (with respect to redeemable ground rents);
Section 1057 (with respect to election to treat transfer to foreign trust, etc., as taxable exchange);

Sections 1291 to 1298 (with respect to treatment of passive foreign investment companies);

Subchapter Q (sections 1311 to 1351) (with respect to readjustment of tax between years and special limitations);

Subchapter R (sections 1352 to 1359) (with respect to election to determine corporate tax on certain international shipping activities using per ton rate);

Subchapter U (sections 1391 to 1379F) (with respect to designation and treatment of empowerment zones, enterprise communities, and rural development investment areas). For treatment, see chapter 209E;

Subchapter W (sections 1400 to 1400C) (with respect to District of Columbia enterprise zone);

Section 1400O (with respect to education tax benefits);

Section 1400P (with respect to housing tax benefits);
Section 1400R (with respect to employment relief);
Section 1400T (with respect to special rules for mortgage revenue bonds);
Section 1400U-1 (with respect to allocation of recovery zone bonds);
Section 1400U-2 (with respect to recovery zone economic development bonds); and
Section 1400U-3 (with respect to recovery zone facility bonds).

SECTION 3. Section 235-71, Hawaii Revised Statutes, is amended by amending subsection (d) to read as follows:
"(d) In the case of a real estate investment trust there is imposed on the taxable income, computed as provided in sections 857 and 858 of the Internal Revenue Code but with the changes and adjustments made by this chapter (without prejudice to the generality of the foregoing, for taxable years beginning before January 1, 2021, the deduction for dividends paid is limited to [such] the amount of dividends as is attributable to income taxable under this chapter[.][,] and, for taxable years beginning after December 31, 2020, no deductions for dividends
paid shall be allowed), a tax consisting in the sum of the
following: 4.4 per cent if the taxable income is not over
$25,000, 5.4 per cent if over $25,000 but not over $100,000, and
on all over $100,000, 6.4 per cent. In addition to any other
penalty provided by law any real estate investment trust whose
tax liability for any taxable year is deemed to be increased
pursuant to section 859(b)(2)(A) or 860(c)(1)(A) after December
31, 1978, (relating to interest and additions to tax determined
with respect to the amount of the deduction for deficiency
dividends allowed) of the Internal Revenue Code shall pay a
penalty in an amount equal to the amount of interest for which
such trust is liable that is attributable solely to [such] the
increase. The penalty payable under this subsection with
respect to any determination shall not exceed one-half of the
amount of the deduction allowed by section 859(a), or 860(a)
after December 31, 1978, of the Internal Revenue Code for [such]
the taxable year."

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

SECTION 5. This Act shall take effect upon its approval
and shall apply to taxable years beginning after December 31,
2020; provided that this Act shall be repealed on December 31, 2023; provided further that sections 235-2.3(b) and 235-71(d), Hawaii Revised Statutes, shall be reenacted in the form in which they read prior to the effective date of this Act.

INTRODUCED BY: ____________________
Report Title:
Taxation; Real Estate Investment Trusts; Dividends Paid Deduction

Description:

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