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To: The Honorable Donovan M. Dela Cruz, Chair  
and Members of the Senate Committee on Ways and Means

Date: Wednesday, February 6, 2019  
Time: 10:00 A.M.  
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director  
Department of Taxation

Re: S.B. 1130, Relating to Taxation

The Department of Taxation (Department) supports the intent of S.B. 1130 and offers the following comments for the Committee's consideration.

S.B. 1130 amends HRS section 235-2.4(ee) to provide that IRC section 512(a)(7) is not operative for Hawaii income tax purposes. The Tax Cuts and Jobs Act of 2017 (TCJA) disallowed certain fringe benefit deductions for ordinary businesses. As a corollary, the TCJA added IRC section 512(a)(7) to increase the unrelated business taxable income (UBTI) of a tax-exempt organization for the same amounts that are disallowed as deductions to ordinary businesses.

Through Act 27, SLH 2018, Hawaii did not conform to the disallowance of deductions for ordinary businesses in an effort to maintain the status quo for taxpayers under Hawaii income tax. However, due to an oversight, Hawaii did conform to the increase in UBTI under IRC section 512(a)(7). Therefore, the treatment of ordinary businesses and tax-exempt organizations is inconsistent. The Department therefore supports the intent of this bill to rectify the inconsistent treatment.

However, the Department notes that S.B. 1267, the Department's annual conformity bill, contains language to fix this inconsistency. The Department generally prefers that any changes to conformity with the Internal Revenue Code be restricted to a single bill. The Department also notes that the language in the two bills is not identical. The Department prefers the language contained in S.B. 1267. Therefore, the Department requests the Committee use S.B. 1267 to make this important correction.

Thank you for the opportunity to provide comments.



UNIVERSITY of HAWAI'I  
FOUNDATION

**TESTIMONY OF THE UNIVERSITY OF HAWAI'I FOUNDATION  
ON SENATE BILL NO. 1130, RELATING TO TAXATION.**

**Hearing Date:** February 6, 2019  
**Committee:** Senate Committee on Ways & Means  
**Time:** 10:00 a.m.  
**Location:** Room 211, State Capitol  
**Testifier** Hugh R. Jones, In-House Counsel (956-6378)

The University of Hawai'i Foundation ("UHF"), a private, nonprofit corporation, supports the passage of this bill that would "decouple" Hawaii from a newly created provisions of the Internal Revenue Code that imposed income tax on fringe benefits like employee parking provided by nonprofit organizations. UHF presently provides parking benefits to approximately 65 employee and this income tax prevents UHF from devoting more of its revenues in support of University advancement and University programs.

*For Our University, Our Hawai'i, Our Future*

2444 Dole Street, Bachman Hall 105, Honolulu, HI 96822 • P: (808) 956-8849 F: (808) 956-5115 • [www.uhfoundation.org](http://www.uhfoundation.org)

Among the many changes and provisions in the Tax Cuts and Jobs Act (TCJA) passed in December 2017, one that has resulted in confusion and extensive discussion is the taxability of certain qualified transportation fringe benefits provided to employees, including parking benefits.

The TCJA introduced a provision under which nonprofit organizations that provide certain fringe benefits to employees must now include the value of those benefits in unrelated business income tax and report it on Form 990-T. If a nonprofit pays or reimburses employees for transit passes, using a commuter highway vehicle, or qualified parking expenses, the nonprofit must now include the amount expended for these qualified transportation fringe benefits in unrelated business income.

This provision of TCJA has been widely criticized and is further subject to bi-partisan efforts to repeal it in Congress. For now, though, it remains on the books. By electing not to conform to this flawed federal law, Hawaii would avoid replicating a problematic federal law and would provide relief for the many Hawaii nonprofits that provide their employees with benefits such as bus passes or parking.

We ask for your support of this bill to “decouple” state law from IRS law, to prevent nonprofits that provide employee parking benefits from devoting more of their revenues in support of their tax exempt, charitable and public benefit purposes.

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**Testimony to the Senate Committee on Ways and Means  
Senator Donovan Dela Cruz, Chair  
Senator Gilbert Ketih-Agaran, Vice Chair  
Wednesday, February 6, 2019, 10:00 a.m.  
Conference Room 211  
SB 1130 – Relating to Taxation**

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Dear Chair Dela Cruz, Vice-Chair Keith-Agaran and members of the WAM Committee:

On behalf of the Hawai`i Alliance of Nonprofit Organizations, I would like express **support of SB 1130, Relating to Taxation.**

Hawai`i Alliance of Nonprofit Organizations (HANO) is a statewide, sector-wide professional association of nonprofits. Our mission is to unite and strengthen the nonprofit sector as a collective force to improve the quality of life in Hawai`i. Our member organizations provide essential services to every community in the state.

SB 1130 decouples Hawaii income tax law from the IRS new section 512(a)(7) of the Tax Cuts and Jobs Act, which took effect on January 1, 2018. Section 512(a)(7) imposes a flawed and confusing 21% unrelated business *income* tax (UBIT) on transportation *expenses* of charitable organizations, churches and philanthropic organizations, on fringe benefits like parking passes and bus passes for employees.

The federal law has been widely criticized and is further subject to bi-partisan efforts to repeal it. For now, though, it remains on the books.

By electing not to conform to this flawed federal law, Hawaii would avoid replicating a problematic federal law and would provide relief for the many Hawaii nonprofits that provide their employees with benefits such as bus passes.

We ask for your support of this bill to “decouple” state law from IRS law, to prevent further unnecessary costs from detracting from critical mission delivery by Hawaii nonprofits. Please pass SB 1130 out of your committee.

Mahalo for the opportunity to provide testimony.

Lisa Maruyama  
President and CEO

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: INCOME, Decouple from IRC 512(a)(7)

BILL NUMBER: SB 1130

INTRODUCED BY: DELA CRUZ

EXECUTIVE SUMMARY: Specifies that Internal Revenue Code section 512(a)(7), with respect to increases in unrelated business taxable income by disallowed fringes, is not operative in Hawaii income tax law.

SYNOPSIS: Amends HRS section 235-2.4(ee) by specifying that IRC section 512(a)(7) is not operative in Hawaii.

EFFECTIVE DATE: Upon approval.

STAFF COMMENTS:

### *Tax exemption for certain organizations*

Section 501(a) exempts certain organizations from Federal income tax. Such organizations include: (1) tax-exempt organizations described in section 501(c) (including among others section 501(c)(3) charitable organizations and section 501(c)(4) social welfare organizations); (2) religious and apostolic organizations described in section 501(d); and (3) trusts forming part of a pension, profit-sharing, or stock bonus plan of an employer described in section 401(a).

### *Unrelated business income tax, in general*

The unrelated business income tax (UBIT) generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions. An organization that is subject to UBIT and that has \$1,000 or more of gross unrelated business taxable income must report that income on Form 990-T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore, an organization may engage in a substantial amount of unrelated business activity without jeopardizing its exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities. Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

An organization determines its unrelated business taxable income by subtracting from its gross unrelated business income deductions directly connected with the unrelated trade or business. Under regulations, in determining unrelated business taxable income, an organization that operates multiple unrelated trades or businesses aggregates income from all such activities and subtracts from the aggregate gross income the aggregate of deductions. As a result, an

organization may use a loss from one unrelated trade or business to offset gain from another, thereby reducing total unrelated business taxable income.

#### *Organizations subject to tax on unrelated business income*

Most exempt organizations are subject to the tax on unrelated business income. Specifically, organizations subject to the unrelated business income tax generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable trusts); (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a); and (3) certain State colleges and universities.

#### *Exclusions from Unrelated Business Taxable Income*

Certain types of income are specifically exempt from unrelated business taxable income, such as dividends, interest, royalties, and certain rents, unless derived from debt-financed property or from certain 50-percent controlled subsidiaries. Other exemptions from UBIT are provided for activities in which substantially all the work is performed by volunteers, for income from the sale of donated goods, and for certain activities carried on for the convenience of members, students, patients, officers, or employees of a charitable organization. In addition, special UBIT provisions exempt from tax activities of trade shows and State fairs, income from bingo games, and income from the distribution of low-cost items incidental to the solicitation of charitable contributions. Organizations liable for tax on unrelated business taxable income may be liable for alternative minimum tax determined after taking into account adjustments and tax preference items.

#### *Operation of Section 512(a)(7)*

Under the TCJA, unrelated business taxable income includes any expenses paid or incurred by a tax exempt organization for qualified transportation fringe benefits (as defined in section 132(f)), a parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)), or any on-premises athletic facility (as defined in section 132(j)(4)(B)), provided such amounts are not deductible under section 274. That is, the TCJA disallowed deductibility of transportation fringe benefits for nonexempt organizations; for exempt organizations providing such benefits, the organizations are required to include in their UBTI the value of the benefits and to pay tax as if that value were income.

#### *Present and Proposed State Treatment*

Presently, Hawaii conforms to the above fringe benefit provisions of the TCJA. The bill proposes that Hawaii decouple.

The Foundation notes that the above provisions will require tax-exempt organizations that do not conduct unrelated business to file a Form 990-T. The Department of Taxation requires organizations filing a 990-T to file a comparable State form, Form N-70NP, and then typically expects such organizations to register for and report General Excise Tax. GET, however, would not apply to organizations with deemed income under this federal provision. To prevent possible confusion, the Foundation has no problem with the proposed decoupling.