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# 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 possible  
6 to the Internal Revenue Code, unless there is good reason to the  
7 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 additionally finds that real estate  
11 investment trusts were established by the federal government to  
12 give 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 out of the state,  
4 results in no Hawaii income tax collected either from the real  
5 estate investment trust or from its shareholders, due to the  
6 fact that shareholders pay any tax on dividends to the state in  
7 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 about  
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 taxes of \$65,000,000  
13 per year. A 2016 analysis conducted by the department of  
14 business, economic development, and tourism concluded that the  
15 State had foregone about \$36,000,000 in income tax in year 2014,  
16 and that the amount of real estate investment trust investments  
17 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 continue to  
13 benefit from Hawaii's low property tax rates.

14 Accordingly, the purpose of this Act is to temporarily  
15 disallow dividends paid deductions for real estate investment  
16 trusts for taxable years beginning after December 31, 2020,  
17 until December 31, 2023.

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

20 "(b) The following Internal Revenue Code subchapters,  
21 parts of subchapters, sections, subsections, and parts of



1 subsections shall not be operative for the purposes of this  
2 chapter, unless otherwise provided:

3 (1) Subchapter A (sections 1 to 59A) (with respect to  
4 determination of tax liability), except  
5 section 1(h)(2) (relating to net capital gain reduced  
6 by the amount taken into account as investment  
7 income), except sections 2(a), 2(b), and 2(c) (with  
8 respect to the definition of "surviving spouse" and  
9 "head of household"), except section 41 (with respect  
10 to the credit for increasing research activities),  
11 except section 42 (with respect to low-income housing  
12 credit), except sections 47 and 48, as amended, as of  
13 December 31, 1984 (with respect to certain depreciable  
14 tangible personal property), and except  
15 section 48(d)(3), as amended, as of February 17, 2009  
16 (with respect to the treatment of United States  
17 Department of Treasury grants made under section 1603  
18 of the American Recovery and Reinvestment Tax Act of  
19 2009). For treatment, see sections 235-110.91,  
20 235-110.7, and 235-110.8;



- 1           (2) Section 78 (with respect to dividends received from  
2           certain foreign corporations by domestic corporations  
3           choosing foreign tax credit);
- 4           (3) Section 86 (with respect to social security and tier 1  
5           railroad retirement benefits);
- 6           (4) Section 91 (with respect to certain foreign branch  
7           losses transferred to specified 10-percent owned  
8           foreign corporations);
- 9           (5) Section 103 (with respect to interest on state and  
10          local bonds). For treatment, see section 235-7(b);
- 11          (6) Section 114 (with respect to extraterritorial income).  
12          For treatment, any transaction as specified in the  
13          transitional rule for 2005 and 2006 as specified in  
14          the American Jobs Creation Act of 2004 section 101(d)  
15          and any transaction that has occurred pursuant to a  
16          binding contract as specified in the American Jobs  
17          Creation Act of 2004 section 101(f) are inoperative;
- 18          (7) Section 120 (with respect to amounts received under  
19          qualified group legal services plans). For treatment,  
20          see section 235-7(a)(9) to (11);



- 1 (8) Section 122 (with respect to certain reduced uniformed  
2 services retirement pay). For treatment, see section  
3 235-7(a)(3);
- 4 (9) Section 135 (with respect to income from United States  
5 savings bonds used to pay higher education tuition and  
6 fees). For treatment, see section 235-7(a)(1);
- 7 (10) Section 139C (with respect to COBRA premium  
8 assistance);
- 9 (11) Subchapter B (sections 141 to 150) (with respect to  
10 tax exemption requirements for state and local bonds);
- 11 (12) Section 151 (with respect to allowance of deductions  
12 for personal exemptions). For treatment, see  
13 section 235-54;
- 14 (13) Section 179B (with respect to expensing of capital  
15 costs incurred in complying with Environmental  
16 Protection Agency sulphur regulations);
- 17 (14) Section 181 (with respect to special rules for certain  
18 film and television productions);
- 19 (15) Section 196 (with respect to deduction for certain  
20 unused investment credits);



- 1 (16) Section 199 (with respect to the U.S. production  
2 activities deduction);
- 3 (17) Section 199A (with respect to qualified business  
4 income);
- 5 (18) Section 222 (with respect to qualified tuition and  
6 related expenses);
- 7 (19) Sections 241 to 247 (with respect to special  
8 deductions for corporations). For treatment, see  
9 section 235-7(c);
- 10 (20) Section 250 (with respect to foreign-derived  
11 intangible income and global intangible low-taxed  
12 income);
- 13 (21) Section 267A (with respect to certain related party  
14 amounts paid or accrued in hybrid transactions or with  
15 hybrid entities);
- 16 (22) Section 280C (with respect to certain expenses for  
17 which credits are allowable). For treatment, see  
18 section 235-110.91;
- 19 (23) Section 291 (with respect to special rules relating to  
20 corporate preference items);
- 21 (24) Section 367 (with respect to foreign corporations);



- 1 (25) Section 501(c)(12), (15), (16) (with respect to exempt  
2 organizations); except that section 501(c)(12) shall  
3 be operative for companies that provide potable water  
4 to residential communities that lack any access to  
5 public utility water services;
- 6 (26) Section 515 (with respect to taxes of foreign  
7 countries and possessions of the United States);
- 8 (27) Subchapter G (sections 531 to 565) (with respect to  
9 corporations used to avoid income tax on  
10 shareholders);
- 11 (28) Subchapter H (sections 581 to 597) (with respect to  
12 banking institutions), except section 584 (with  
13 respect to common trust funds). For treatment, see  
14 chapter 241;
- 15 (29) Section 642(a) and (b) (with respect to special rules  
16 for credits and deductions applicable to trusts). For  
17 treatment, see sections 235-54(b) and 235-55;
- 18 (30) Section 646 (with respect to tax treatment of electing  
19 Alaska Native settlement trusts);
- 20 (31) Section 668 (with respect to interest charge on  
21 accumulation distributions from foreign trusts);





- 1       (32) Subchapter L (sections 801 to 848) (with respect to  
2           insurance companies). For treatment, see sections  
3           431:7-202 and 431:7-204;
- 4       (33) Section 853 (with respect to foreign tax credit  
5           allowed to shareholders). For treatment, see  
6           section 235-55;
- 7       (34) Section 853A (with respect to credits from tax credit  
8           bonds allowed to shareholders);
- 9       (35) Section 857(b)(2)(B) (with respect to the dividends  
10       paid deduction for real estate investment trusts);
- 11      ~~[(35)]~~ (36) Subchapter N (sections 861 to 999) (with respect  
12           to tax based on income from sources within or without  
13           the United States), except sections 985 to 989 (with  
14           respect to foreign currency transactions). For  
15           treatment, see sections 235-4, 235-5, and 235-7(b),  
16           and 235-55;
- 17      ~~[(36)]~~ (37) Section 1042(g) (with respect to sales of stock  
18           in agricultural refiners and processors to eligible  
19           farm cooperatives);
- 20      ~~[(37)]~~ (38) Section 1055 (with respect to redeemable ground  
21           rents);



1     ~~[(38)]~~ (39) Section 1057 (with respect to election to treat  
2                   transfer to foreign trust, etc., as taxable exchange);

3     ~~[(39)]~~ (40) Sections 1291 to 1298 (with respect to treatment  
4                   of passive foreign investment companies);

5     ~~[(40)]~~ (41) Subchapter Q (sections 1311 to 1351) (with  
6                   respect to readjustment of tax between years and  
7                   special limitations);

8     ~~[(41)]~~ (42) Subchapter R (sections 1352 to 1359) (with  
9                   respect to election to determine corporate tax on  
10                  certain international shipping activities using per  
11                  ton rate);

12    ~~[(42)]~~ (43) Subchapter U (sections 1391 to 1379F) (with  
13                  respect to designation and treatment of empowerment  
14                  zones, enterprise communities, and rural development  
15                  investment areas). For treatment, see chapter 209E;

16    ~~[(43)]~~ (44) Subchapter W (sections 1400 to 1400C) (with  
17                  respect to District of Columbia enterprise zone);

18    ~~[(44)]~~ (45) Section 14000 (with respect to education tax  
19                  benefits);

20    ~~[(45)]~~ (46) Section 1400P (with respect to housing tax  
21                  benefits);



1        [~~46~~] (47) Section 1400R (with respect to employment  
2                    relief);

3        [~~47~~] (48) Section 1400T (with respect to special rules for  
4                    mortgage revenue bonds);

5        [~~48~~] (49) Section 1400U-1 (with respect to allocation of  
6                    recovery zone bonds);

7        [~~49~~] (50) Section 1400U-2 (with respect to recovery zone  
8                    economic development bonds); and

9        [~~50~~] (51) Section 1400U-3 (with respect to recovery zone  
10                   facility bonds)."

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

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



1 paid shall be allowed), a tax consisting in the sum of the  
2 following: 4.4 per cent if the taxable income is not over  
3 \$25,000, 5.4 per cent if over \$25,000 but not over \$100,000, and  
4 on all over \$100,000, 6.4 per cent. In addition to any other  
5 penalty provided by law any real estate investment trust whose  
6 tax liability for any taxable year is deemed to be increased  
7 pursuant to section 859(b)(2)(A) or 860(c)(1)(A) after December  
8 31, 1978, (relating to interest and additions to tax determined  
9 with respect to the amount of the deduction for deficiency  
10 dividends allowed) of the Internal Revenue Code shall pay a  
11 penalty in an amount equal to the amount of interest for which  
12 such trust is liable that is attributable solely to [~~such~~] the  
13 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, 2112, 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. Applies to taxable years beginning after 12/31/2020. Sunsets 12/31/2023. Takes effect on 7/1/2112. (HD1)

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