



STATE OF HAWAII  
**DEPARTMENT OF TAXATION**

P.O. BOX 259  
HONOLULU, HAWAII 96809

December 23, 1993

**TAX INFORMATION RELEASE** No. 93-7

RE: Taxability of Revocable Living Trusts Under the Hawaii General Excise Tax Law, Transient Accommodations Tax Law, and Rental Motor Vehicle and Tour Vehicle Surcharge Tax Law

The use of a Revocable Living Trust (RLT) as an estate planning tool for individuals has become increasingly popular in recent years. The Department has learned that there is some confusion over the proper treatment of a RLT under the General Excise Tax Law when business is conducted by, or business assets are held by, a RLT.

Section 237-3(a), HRS, defines "gross income" subject to tax under the General Excise Tax Law. Gross income includes, but is not limited to:

- (1) The gross receipts of the taxpayer derived from trade, business, commerce, or sales;
- (2) The value proceeding or accruing from the sale of tangible personal property, or service, or both; and
- (3) All receipts, actual or accrued, by reason of the investment of the capital of the business engaged in, including interest, discount, rentals, royalties, fees, or other emoluments.

Under the Income Tax Law, some entities are treated as passthrough entities. Income earned by passthrough entities is attributed to the partners, shareholders, or beneficiaries who then have to report and pay net income tax on the income received. The passthrough entity does not have to pay income tax on that income because the partners, shareholders, or beneficiaries are paying the tax. Most RLT's fall into this category for income tax purposes, so if an individual establishes a RLT the individual will normally report all of the RLT's income and deductions on the individual's own income tax return.

Under the General Excise Tax Law, in contrast, every distinct legal entity is treated as a separate taxpayer. This is set forth in section 237-1, HRS, which defines a "person" subject to the General Excise Tax Law. With respect to RLT's, section 237-1, HRS, defines a person to include ". . . every individual, . . . trustee, . . . trust estate, trust, . . . or other entity." The law therefore specifically says that a trust is distinct from an individual grantor or a trustee, and it does not treat RLT's differently from other kinds of trusts.

Accordingly, any RLT that receives or accrues gross income is required to obtain its own general excise license, keep its own books and records, and file periodic and annual returns in its own name. It is not

proper for an individual grantor of a RLT to report and pay the tax for the RLT if it is the trust, rather than the individual, that is earning the gross income.

Once a RLT receives or accrues gross income, it may distribute that income to its beneficiary or beneficiaries under the terms of its governing instrument. That distribution is not taxable under the General Excise Tax Law.

**Example 1:** G is the grantor of a RLT. The RLT's trust instrument provides that G, while living, may withdraw any or all of the income or principal of the RLT at any time. The RLT holds title to residential property which is rented to tenant T.

The RLT, if it has not already done so, must apply for a general excise license and must report the gross income and pay the tax under its own name and general excise license number; it is not proper for G to report and pay general excise tax on the rental income.

**Example 2:** The facts are the same as in Example 1. G maintains separate trust and personal accounts. Business receipts, including the monthly rent checks from T, are deposited into the trust account, and business expenses, such as the general excise tax for which the RLT is liable, are paid out of the trust account. Personal expenses are paid out of only the personal account. There are no facts indicating that business and personal funds are commingled. After one month G transfers \$5,000 from the trust account to the personal account, reasonably believing that it will not be necessary to retain that money to pay expenses of the business.

The \$5,000 is a distribution from the RLT to G as a beneficiary of the RLT. G is not subject to general excise tax on the \$5,000.

Finally, when a business, or business assets, is transferred from an individual to a RLT, the transfer is treated as a change in ownership. See section 18-237-30(i), Hawaii Administrative Rules. This means:

- (1) The RLT must apply for a general excise tax license, and begin reporting and paying tax on gross income received or accrued after the date of the transfer.
- (2) If the individual transferring the business has no other business activity (actual or planned) for which a general excise tax license is required, the individual should cancel the existing general excise tax license on the appropriate form (Form GEW-TA-RV-1), and the individual's taxable year ends for general excise tax purposes. The individual's annual reconciliation return should be filed on or before the twentieth day of the fourth month following the month in which the transfer took place.

- (3) If the individual transferring the business has other taxable business activity (actual or planned), the individual must notify the Department of the change on the appropriate form (Form GEW-TA-RV-5) .

Under the General Excise Tax Law, RLT's are separate taxpayers from their grantors. Nevertheless, the Department will not assess additional general excise tax, penalties, or interest against any RLT to the extent that it underreported its gross income solely because the grantor of the RLT reported that gross income and paid the proper tax on it. In order to minimize the corrective action required of persons who have been improperly reporting an RLT's income, these persons will be allowed to continue reporting as they have been for their current taxable year, and to treat their business as transferred to the RLT as of the first day of their next taxable year, as illustrated in the following example. This safe harbor shall not apply to any taxable year that begins after June 30, 1994. Furthermore, the Department reserves the right to assess and collect any delinquent general excise license fees from any grantor or RLT that has been conducting business without a proper license.

**Example 3:** G is the grantor of a RLT. The RLT's trust instrument provides that G, while living, may withdraw any or all of the income or principal of the RLT at any time. The RLT holds title to residential property which is rented to tenant T. Neither G nor the RLT engage in, or plan to engage in, any other business or activity taxable under the General Excise Tax Law. G is a calendar year taxpayer. During the calendar year 1993, G has been reporting the RLT's gross income on G's individual general excise tax returns and paying the general excise tax on that gross income. Then:

- (1) G may continue to report the RLT's gross income earned through the month of December, 1993, on the periodic (monthly, quarterly, or semiannual) return due before February 1, 1994, and on the annual reconciliation return due on April 20, 1994.
- (2) G should cancel G's individual general excise tax license, listing the cancellation date as December 31, 1993.
- (3) The RLT must obtain a new general excise tax license and pay the applicable license fee. On the RLT's license application form (Form GEW-TA-RV-3), the business commencement date shall be listed as January 1, 1994.
- (4) No additional general excise tax, penalties, or interest shall be assessed against the RLT for failing to report the gross income that G improperly reported, and paid tax on, prior to January 1, 1994. If, however, G claims a refund of the tax G paid on the RLT's income, the Department may assess the RLT for the proper tax, penalties and interest.

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The Department wishes to emphasize that the principles stated in this Tax Information Release apply to all trusts, not just RLT's. The safe harbor described above and illustrated in Example 2, however, applies only to RLT's.

Section 18-237D-1-03(a), Hawaii Administrative Rules, defines an operator subject to the transient accommodations tax as synonymous with the person who is or should be licensed and required to pay the general excise tax imposed upon gross income derived from furnishing transient accommodations. Section 18-251-1-01, Hawaii Administrative Rules, defines a person subject to the rental motor vehicle and tour vehicle surcharge tax with the same meaning as in section 237-1, HRS. Accordingly, the principles of this Tax Information Release also apply to the transient accommodations tax and the rental motor vehicle and tour vehicle surcharge tax. Any RLT or other trust that is engaged in the business of furnishing transient accommodations, renting motor vehicles, or operating tour vehicles must obtain a proper certificate of registration.

This Tax Information Release does not apply to net income tax. Specifically, the Department is expressing no opinion in this Tax Information Release about when a RLT or other trust that is engaging in business will be treated as an association taxable under the Income Tax Law as a corporation.

  
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Director of Taxation

HRS Sections Explained: HRS §§237-1, 237-3(a)

Rules Sections Explained: §§18-237-30(i), 18-237D-1-03(a),  
18-251-1-01