

JAN 22 2007

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## A BILL FOR AN ACT

RELATING TO THE STATE OF HAWAII SECTION 529 COLLEGE SAVINGS PROGRAM.

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

1           SECTION 1. In 2002, the State of Hawaii established a  
2 college savings program called "TuitionEDGE" pursuant to chapter  
3 256 Hawaii Revised Statutes and section 529 of the Internal  
4 Revenue Code of 1986, as amended. The program was established  
5 to assist and encourage families to set aside funds for future  
6 higher education expenses.

7           As of November 30, 2006, there were approximately 3,300  
8 accounts in the program, and \$38,100,000 in program assets. The  
9 asset size of Hawaii's program is relatively small and the  
10 participation rate is low compared to other states' college  
11 savings programs. Most states offer some kind of in-state tax  
12 deduction or credit for contributions as an incentive for their  
13 residents to participate in their college savings programs. To  
14 increase Hawaii taxpayers' participation in the program and to  
15 increase the program's assets so that the State may be able to  
16 obtain a lower program management fee, this bill provides a

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1 State income tax deduction for contributions to the program.  
2 This income tax deduction will apply to program contributions  
3 made in calendar year 2007 and beyond.

4 SECTION 2. Section 235-7, Hawaii Revised Statutes, is  
5 amended to read as follows:

6 "§235-7 Other provisions as to gross income, adjusted  
7 gross income, and taxable income.

8 "(a) There shall be excluded from gross income, adjusted  
9 gross income, and taxable income:

- 10 (1) Income not subject to taxation by the State under the  
11 Constitution and laws of the United States;
- 12 (2) Rights, benefits, and other income exempted from  
13 taxation by section 88-91, having to do with the state  
14 retirement system, and the rights, benefits, and other  
15 income, comparable to the rights, benefits, and other  
16 income exempted by section 88-91, under any other  
17 public retirement system;
- 18 (3) Any compensation received in the form of a pension for  
19 past services;
- 20 (4) Compensation paid to a patient affected with Hansen's  
21 disease employed by the State or the United States in

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1 any hospital, settlement, or place for the treatment  
2 of Hansen's disease;

3 (5) Except as otherwise expressly provided, payments made  
4 by the United States or this State, under an act of  
5 Congress or a law of this State, which by express  
6 provision or administrative regulation or  
7 interpretation are exempt from both the normal and  
8 surtaxes of the United States, even though not so  
9 exempted by the Internal Revenue Code itself;

10 (6) Any income expressly exempted or excluded from the  
11 measure of the tax imposed by this chapter by any  
12 other law of the State, it being the intent of this  
13 chapter not to repeal or supersede any such express  
14 exemption or exclusion;

15 (7) Income received by each member of the reserve  
16 components of the Army, Navy, Air Force, Marine Corps,  
17 or Coast Guard of the United States of America, and  
18 the Hawaii national guard as compensation for  
19 performance of duty, equivalent to pay received for  
20 forty-eight drills (equivalent of twelve weekends) and  
21 fifteen days of annual duty, at an:

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- 1 (A) E-1 pay grade after eight years of service;  
2 provided that this subparagraph shall apply to  
3 taxable years beginning after December 31, 2004;
- 4 (B) E-2 pay grade after eight years of service;  
5 provided that this subparagraph shall apply to  
6 taxable years beginning after December 31, 2005;
- 7 (C) E-3 pay grade after eight years of service;  
8 provided that this subparagraph shall apply to  
9 taxable years beginning after December 31, 2006;
- 10 (D) E-4 pay grade after eight years of service;  
11 provided that this subparagraph shall apply to  
12 taxable years beginning after December 31, 2007;  
13 and
- 14 (E) E-5 pay grade after eight years of service;  
15 provided that this subparagraph shall apply to  
16 taxable years beginning after December 31, 2008;
- 17 (8) Income derived from the operation of ships or aircraft  
18 if the income is exempt under the Internal Revenue  
19 Code pursuant to the provisions of an income tax  
20 treaty or agreement entered into by and between the  
21 United States and a foreign country, provided that the  
22 tax laws of the local governments of that country

1 reciprocally exempt from the application of all of  
2 their net income taxes, the income derived from the  
3 operation of ships or aircraft that are documented or  
4 registered under the laws of the United States;

5 (9) The value of legal services provided by a prepaid  
6 legal service plan to a taxpayer, the taxpayer's  
7 spouse, and the taxpayer's dependents;

8 (10) Amounts paid, directly or indirectly, by a prepaid  
9 legal service plan to a taxpayer as payment or  
10 reimbursement for the provision of legal services to  
11 the taxpayer, the taxpayer's spouse, and the  
12 taxpayer's dependents;

13 (11) Contributions by an employer to a prepaid legal service  
14 plan for compensation (through insurance or otherwise)  
15 to the employer's employees for the costs of legal  
16 services incurred by the employer's employees, their  
17 spouses, and their dependents; and

18 (12) Amounts received in the form of a monthly surcharge by  
19 a utility acting on behalf of an affected utility  
20 under section 269-16.3 shall not be gross income,  
21 adjusted gross income, or taxable income for the  
22 acting utility under this chapter. Any amounts

1           retained by the acting utility for collection or other  
2           costs shall not be included in this exemption.

3           (b) There shall be included in gross income, adjusted  
4 gross income, and taxable income: (1) unless excluded by this  
5 chapter relating to the uniformed services of the United States,  
6 cost-of-living allowances and other payments exempted by  
7 section 912 of the Internal Revenue Code, but section 119 of the  
8 Internal Revenue Code nevertheless shall apply; (2) unless  
9 expressly exempted or excluded as provided by subsection (a) (6),  
10 interest on the obligations of a State or a political  
11 subdivision thereof.

12           (c) The deductions of or based on dividends paid or  
13 received, allowed to a corporation under chapter 1,  
14 subchapter B, Part VIII of the Internal Revenue Code, shall not  
15 be allowed. In lieu thereof there shall be allowed as a  
16 deduction the entire amount of dividends received by any  
17 corporation upon the shares of stock of a national banking  
18 association, qualifying dividends, as defined in section 243(b)  
19 of the Internal Revenue Code, received by members of an  
20 affiliated group, or dividends received by a small business  
21 investment company operating under the Small Business Investment  
22 Act of 1958 (Public Law 85-699) upon shares of stock qualifying

1 under paragraph (3), seventy per cent of the amount received by  
2 any corporation as dividends:

3 (1) Upon the shares of stock of another corporation, if at  
4 the date of payment of the dividend at least  
5 ninety-five per cent of the other corporation's  
6 capital stock is owned by one or more corporations  
7 doing business in this State and if the other  
8 corporation is subjected to an income tax in another  
9 jurisdiction (but subjection to federal tax does not  
10 constitute subjection to income tax in another  
11 jurisdiction);

12 (2) Upon the shares of stock of a bank or insurance  
13 company organized and doing business under the laws of  
14 the State;

15 (3) Upon the shares of stock of another corporation, if at  
16 least fifteen per cent of the latter corporation's  
17 business, for the taxable year of the latter  
18 corporation preceding the payment of the dividend, has  
19 been attributed to this State.

20 However, except for national bank dividends, the deductions  
21 under this subsection are not allowed when they would not have  
22 been allowed under section 243 of the Internal Revenue Code, as

1 amended by Public Law 85-866, by reason of subsections (b) and  
2 (c) of section 246 of the Internal Revenue Code. For the  
3 purposes of this subsection fifteen per cent of a corporation's  
4 business shall be deemed to have been attributed to this State  
5 if fifteen per cent or more of the entire gross income of the  
6 corporation as defined in this chapter (which for the purposes  
7 of this subsection shall be computed without regard to source in  
8 the State and shall include income not taxable by reason of the  
9 fact that it is from property not owned in the State or from a  
10 trade or business not carried on in the State in whole or in  
11 part), under section 235-5 and the other provisions of this  
12 chapter, shall have been attributed to the State and subjected  
13 to assessment of the taxable income therefrom (including the  
14 determination of the resulting net loss, if any).

15 (d) (1) For taxable years ending before January 1, 1967, the  
16 net operating loss deductions allowed as carrybacks  
17 and carryovers by the Internal Revenue Code shall not  
18 be allowed. In lieu thereof the net operating loss  
19 deduction shall consist of the excess of the  
20 deductions allowed by this chapter over the gross  
21 income, computed with the modifications specified in  
22 paragraphs (1) to (4) of section 172(d) of the



1 Internal Revenue Code, and with the further  
2 modification stated in paragraph (3) hereof; and shall  
3 be allowed as a deduction in computing the taxable  
4 income of the taxpayer for the succeeding taxable  
5 year;

6 (2) (A) With respect to net operating loss deductions  
7 resulting from net operating losses for taxable  
8 years ending after December 31, 1966, the net  
9 operating loss deduction provisions of the  
10 Internal Revenue Code shall apply; provided that  
11 there shall be no net operating loss deduction  
12 carried back to any taxable year ending prior to  
13 January 1, 1967;

14 (B) In the case of a taxable year beginning in 1966  
15 and ending in 1967, the entire amount of all net  
16 operating loss deductions carried back to the  
17 taxable year shall be limited to that portion of  
18 taxable income for such taxable year which the  
19 number of days in 1967 bears to the total days in  
20 the taxable year ending in 1967; and

21 (C) The computation of any net operating loss  
22 deduction for a taxable year covered by this

1 subsection shall require the further  
2 modifications stated in paragraphs (3), (4), and  
3 (5) of this subsection;

4 (3) In computing the net operating loss deduction allowed  
5 by this subsection, there shall be included in gross  
6 income the amount of interest which is excluded from  
7 gross income by subsection (a), decreased by the  
8 amount of interest paid or accrued which is disallowed  
9 as a deduction by subsection (e). In determining the  
10 amount of the net operating loss deduction under this  
11 subsection of any corporation, there shall be  
12 disregarded the net operating loss of such corporation  
13 for any taxable year for which the corporation is an  
14 electing small business corporation;

15 (4) No net operating loss carryback or carryover shall be  
16 allowed by this chapter if not allowed under section  
17 172 of the Internal Revenue Code;

18 (5) The election to relinquish the entire carryback period  
19 with respect to a net operating loss allowed under  
20 section 172(b)(3)(C) of the Internal Revenue Code  
21 shall be operative for the purposes of this chapter;  
22 provided that no taxpayer shall make such an election

1 as to a net operating loss of a business where such  
2 net operating loss occurred in the taxpayer's business  
3 prior to the taxpayer entering business in this State;  
4 and

5 (6) The five-year carryback period for net operating  
6 losses for any taxable year ending during 2001 and  
7 2002 in section 172(b)(1)(H) of the Internal Revenue  
8 Code shall not be operative for purposes of this  
9 chapter.

10 (e) There shall be disallowed as a deduction the amount of  
11 interest paid or accrued within the taxable year on indebtedness  
12 incurred or continued, (1) to purchase or carry bonds the  
13 interest upon which is excluded from gross income by subsection  
14 (a); or (2) to purchase or carry property owned without the  
15 State, or to carry on trade or business without the State, if  
16 the taxpayer is a person taxable only upon income from sources  
17 in the State.

18 (f) Losses of property as the result of tidal wave,  
19 hurricane, earthquake, or volcanic eruption, or as a result of  
20 flood waters overflowing the banks or walls of a river or  
21 stream, or from any other natural disaster, to the extent of the  
22 amount deductible, under this chapter, not compensated for by

1 insurance or otherwise, may be deducted in the taxable year in  
2 which sustained, or at the option of the taxpayer may be  
3 deducted in equal installments over a period of five years, the  
4 first such year to be the calendar year or fiscal year of the  
5 taxpayer in which such loss occurred.

6 (g) In computing taxable income there shall be allowed as  
7 a deduction:

- 8 (1) Political contributions by any taxpayer not in excess  
9 of \$250 in any year; provided that such contributions  
10 are made to a central or county committee of a  
11 political party whose candidates shall have qualified  
12 by law to be voted for at the immediately previous  
13 general election; or
- 14 (2) Political contributions by any individual taxpayer in  
15 an aggregate amount not to exceed \$1,000 in any year;  
16 provided that such contributions are made to  
17 candidates as defined in section 11-191, who have  
18 agreed to abide by the campaign expenditure limits as  
19 set forth in section 11-209; and provided further that  
20 not more than \$250 of an individual's total  
21 contribution to any single candidate shall be  
22 deductible for purposes of this section.

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1        (h) The following annual deductions from gross income  
2 shall be allowed for contributions to the Hawaii college savings  
3 program provided under chapter 256:

4        (1) Up to \$10,000 for individual taxpayers;

5        (2) Up to \$10,000 for married couples filing separate  
6 returns; provided that each spouse may claim a  
7 deduction up to \$10,000; and

8        (3) Up to \$20,000 for married couples filing joint  
9 returns, individuals filing as the head of households,  
10 or individuals filing as surviving spouses.

11 If the amount of the deduction exceeds the taxpayer's taxable  
12 income for the taxable year the contribution is made, the excess  
13 deduction may be used as a deduction against the taxpayer's  
14 taxable income in subsequent tax years until the excess  
15 deduction is exhausted."

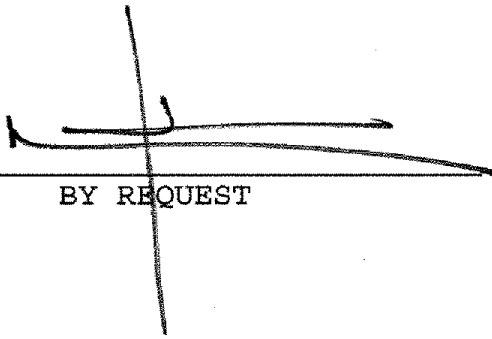
16        SECTION 3. Statutory material to be repealed is bracketed  
17 and stricken. New statutory material is underscored.

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1 SECTION 4. This Act, upon its approval, shall apply to  
2 taxable years beginning after December 31, 2006.

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INTRODUCED BY: \_\_\_\_\_



BY REQUEST

JUSTIFICATION SHEET

DEPARTMENT: Budget and Finance

TITLE: A BILL FOR AN ACT RELATING TO THE STATE OF HAWAII SECTION 529 COLLEGE SAVINGS PROGRAM.

PURPOSE: To provide Hawaii taxpayers with an annual maximum deduction of \$10,000 per individual or \$20,000 for a married couple filing jointly against their taxable income. The deduction will be a matching amount subject to the aforementioned maximum amounts for contributions made to Hawaii's section 529 college savings program in calendar year 2007 and beyond.

MEANS: Amend sections 235-7, Hawaii Revised Statutes ("HRS").

JUSTIFICATION: In 2002, the State of Hawaii established a college savings program called "TuitionEDGE" pursuant to chapter 256, HRS, and section 529 of the Internal Revenue Code of 1986, as amended. The program was established to assist and encourage families to set aside funds for future higher education expenses.

In general, an account owner establishes an account for a designated beneficiary, contributes after-tax dollars into the account, and invests the contributions in various investment options offered under the program. These investment options are provided by a program manager that charges account owners a program management fee. The earnings on the contributions grow tax-deferred, and distributions to pay for a beneficiary's qualified higher education expenses are not subject to federal or State income tax (this tax-free treatment was made permanent by the Pension Protection Act of 2006). Currently, the maximum amount that account owners can contribute to an account is \$305,000. As of November 30, 2006, there were approximately 3,300 accounts in the

program, and \$38.1 million in program assets.

The asset size of our program is relatively small and our participation rate is low compared to other states' college savings programs. Most states offer some kind of in-state tax deduction or credit for contributions as an incentive for their residents to participate in their college savings programs. To increase our residents' participation in the program and to increase the program's assets so that the State may be able to obtain a lower program management fee, this bill proposes to amend section 235-7, HRS, by providing a state income tax deduction for program contributions. The proposed state income tax deduction will be a maximum of \$10,000 per year for individual taxpayers and \$20,000 per year for married couples filing jointly or heads of households.

Impact on the public: This proposal will make Hawaii's program much more attractive to Hawaii taxpayers to save for future qualified higher education expenses, will encourage further participation in the program, and may allow the State to charge a lower program management fee as the program assets grow.

Impact on the department and other agencies: An increase in the size of Hawaii's program will provide the Department of Budget and Finance with more leverage to negotiate lower program management fees with program managers and investment product providers. Although a State income tax deduction will result in a loss of tax revenues to the State, it is anticipated that the amount of lost tax revenues will be minimal and the benefits to Hawaii taxpayers will outweigh the loss of tax revenue. Assuming the maximum deduction of \$10,000 per account, it



is anticipated that the amount of lost tax revenues would be approximately \$2,722,500 per year (\$10,000 X 3,300 accounts = \$33,000,000; \$33,000,000 X 8.25% Maximum Tax Rate = \$2,722,500 potential tax revenue loss)

GENERAL FUNDS: None.

OTHER FUNDS: None.

PPBS PROGRAM DESIGNATION: BUF-115

OTHER AFFECTED AGENCIES: Department of Taxation

EFFECTIVE DATE: Upon approval, for taxable years beginning after December 31, 2006.