

JAN 22 2008

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
3 chapter 256, Hawaii Revised Statutes, and section 529 of the
4 Internal Revenue Code of 1986, as amended. In November 2007 the
5 program was revamped under a new program manager and re-branded
6 as "HI529 Hawaii's College Savings Program". The program was
7 established and exists to assist and encourage families to set
8 aside funds for future higher education expenses.

9 As of September 30, 2007, there were approximately 3,400
10 accounts in the program, and \$42,600,000 in program assets. The
11 asset size of Hawaii's program is relatively small and the
12 participation rate is low compared to other states' college
13 savings programs. Most states offer some kind of in-state tax
14 deduction or credit for contributions as an incentive for their
15 residents to participate in their college savings programs. To
16 increase Hawaii taxpayers' participation in the program and to
17 increase the program's assets so that the State may be able to

1 obtain a lower program management fee in the future, this bill
2 provides a state income tax deduction for contributions to the
3 program. This income tax deduction will apply to program
4 contributions made in calendar year 2008 and beyond.

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

7 **"§235-7 Other provisions as to gross income, adjusted**
8 **gross income, and taxable income.** (a) There shall be excluded
9 from gross income, adjusted 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 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

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- 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;
- 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

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

3 (13) One hundred per cent of the gain realized by a fee
4 simple owner from the sale of a leased fee interest in
5 units within a condominium project, cooperative
6 project, or planned unit development to the
7 association of apartment owners or the residential
8 cooperative corporation of the leasehold units.

9 For purposes of this paragraph:

10 "Fee simple owner" shall have the same meaning as
11 provided under section 516-1; provided that it shall
12 include legal and equitable owners;

13 "Legal and equitable owner", and "leased fee
14 interest" shall have the same meanings as provided
15 under section 516-1; and

16 "Condominium project" and "cooperative project"
17 shall have the same meanings as provided under
18 section 514C-1.

19 (b) There shall be included in gross income, adjusted
20 gross income, and taxable income: (1) unless excluded by this
21 chapter relating to the uniformed services of the United States,
22 cost-of-living allowances and other payments exempted by

1 section 912 of the Internal Revenue Code, but section 119 of the
2 Internal Revenue Code nevertheless shall apply; (2) unless
3 expressly exempted or excluded as provided by subsection (a)(6),
4 interest on the obligations of a State or a political
5 subdivision thereof.

6 (c) The deductions of or based on dividends paid or
7 received, allowed to a corporation under chapter 1,
8 subchapter B, Part VIII of the Internal Revenue Code, shall not
9 be allowed. In lieu thereof there shall be allowed as a
10 deduction the entire amount of dividends received by any
11 corporation upon the shares of stock of a national banking
12 association, qualifying dividends, as defined in section 243(b)
13 of the Internal Revenue Code, received by members of an
14 affiliated group, or dividends received by a small business
15 investment company operating under the Small Business Investment
16 Act of 1958 (Public Law 85-699) upon shares of stock qualifying
17 under paragraph (3), seventy per cent of the amount received by
18 any corporation as dividends:

19 (1) Upon the shares of stock of another corporation, if at
20 the date of payment of the dividend at least
21 ninety-five per cent of the other corporation's
22 capital stock is owned by one or more corporations

1 doing business in this State and if the other
2 corporation is subjected to an income tax in another
3 jurisdiction (but subjection to federal tax does not
4 constitute subjection to income tax in another
5 jurisdiction);

6 (2) Upon the shares of stock of a bank or insurance
7 company organized and doing business under the laws of
8 the State;

9 (3) Upon the shares of stock of another corporation, if at
10 least fifteen per cent of the latter corporation's
11 business, for the taxable year of the latter
12 corporation preceding the payment of the dividend, has
13 been attributed to this State.

14 However, except for national bank dividends, the deductions
15 under this subsection are not allowed when they would not have
16 been allowed under section 243 of the Internal Revenue Code, as
17 amended by Public Law 85-866, by reason of subsections (b) and
18 (c) of section 246 of the Internal Revenue Code. For the
19 purposes of this subsection fifteen per cent of a corporation's
20 business shall be deemed to have been attributed to this State
21 if fifteen per cent or more of the entire gross income of the
22 corporation as defined in this chapter (which for the purposes

1 of this subsection shall be computed without regard to source in
2 the State and shall include income not taxable by reason of the
3 fact that it is from property not owned in the State or from a
4 trade or business not carried on in the State in whole or in
5 part), under section 235-5 and the other provisions of this
6 chapter, shall have been attributed to the State and subjected
7 to assessment of the taxable income therefrom (including the
8 determination of the resulting net loss, if any).

9 (d)(1) For taxable years ending before January 1, 1967, the
10 net operating loss deductions allowed as carrybacks
11 and carryovers by the Internal Revenue Code shall not
12 be allowed. In lieu thereof the net operating loss
13 deduction shall consist of the excess of the
14 deductions allowed by this chapter over the gross
15 income, computed with the modifications specified in
16 paragraphs (1) to (4) of section 172(d) of the
17 Internal Revenue Code, and with the further
18 modification stated in paragraph (3) hereof; and shall
19 be allowed as a deduction in computing the taxable
20 income of the taxpayer for the succeeding taxable
21 year;

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

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

16 (C) The computation of any net operating loss
17 deduction for a taxable year covered by this
18 subsection shall require the further
19 modifications stated in paragraphs (3), (4), and
20 (5) of this subsection;

21 (3) In computing the net operating loss deduction allowed
22 by this subsection, there shall be included in gross

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

10 (4) No net operating loss carryback or carryover shall be
11 allowed by this chapter if not allowed under section
12 172 of the Internal Revenue Code;

13 (5) The election to relinquish the entire carryback period
14 with respect to a net operating loss allowed under
15 section 172(b)(3)(C) of the Internal Revenue Code
16 shall be operative for the purposes of this chapter;
17 provided that no taxpayer shall make such an election
18 as to a net operating loss of a business where such
19 net operating loss occurred in the taxpayer's business
20 prior to the taxpayer entering business in this State;
21 and

1 (6) The five-year carryback period for net operating
2 losses for any taxable year ending during 2001 and
3 2002 in section 172(b)(1)(H) of the Internal Revenue
4 Code shall not be operative for purposes of this
5 chapter.

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

14 (f) Losses of property as the result of tidal wave,
15 hurricane, earthquake, or volcanic eruption, or as a result of
16 flood waters overflowing the banks or walls of a river or
17 stream, or from any other natural disaster, to the extent of the
18 amount deductible, under this chapter, not compensated for by
19 insurance or otherwise, may be deducted in the taxable year in
20 which sustained, or at the option of the taxpayer may be
21 deducted in equal installments over a period of five years, the

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1 first such year to be the calendar year or fiscal year of the
2 taxpayer in which such loss occurred.

3 (g) In computing taxable income there shall be allowed as
4 a deduction:

5 (1) Political contributions by any taxpayer not in excess
6 of \$250 in any year; provided that such contributions
7 are made to a central or county committee of a
8 political party whose candidates shall have qualified
9 by law to be voted for at the immediately previous
10 general election; or

11 (2) Political contributions by any individual taxpayer in
12 an aggregate amount not to exceed \$1,000 in any year;
13 provided that such contributions are made to
14 candidates as defined in section 11-191, who have
15 agreed to abide by the campaign expenditure limits as
16 set forth in section 11-209; and provided further that
17 not more than \$250 of an individual's total
18 contribution to any single candidate shall be
19 deductible for purposes of this section.

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

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- 1 (1) Up to \$10,000 for individual taxpayers;
- 2 (2) Up to \$10,000 for married couples filing separate
- 3 returns; provided that each spouse may claim a
- 4 deduction up to \$10,000; and
- 5 (3) Up to \$20,000 for married couples filing joint
- 6 returns, individuals filing as the head of households,
- 7 or individuals filing as surviving spouses.

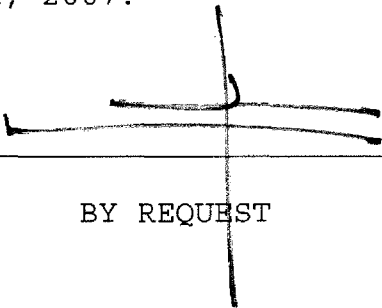
8 If the amount of the deduction exceeds the taxpayer's taxable
9 income for the taxable year the contribution is made, the excess
10 deduction may be used as a deduction against the taxpayer's
11 taxable income in subsequent tax years until the excess
12 deduction is exhausted."

13 SECTION 3. New statutory material is underscored.

14 SECTION 4. This Act, upon its approval, shall apply to
15 taxable years beginning after December 31, 2007.

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INTRODUCED BY:


BY REQUEST

Report Title:

529 College Savings Program.

Description:

To provide taxpayers a state tax deduction for contributions to Hawaii's college savings program.

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 2008 and beyond.

MEANS: Amend section 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. In November 2007 the program was revamped under a new program manager and re-branded as "HI529 Hawaii's College Savings Program". The program was established and exists 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 in the State of Hawaii's 529 program, is \$305,000. As of September 30, 2007, there were approximately 3,400 accounts in the program, and \$42,600,000 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 in the future, 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, and provide an important incentive to save for future qualified higher education expenses. This will encourage further participation in the program, and may allow the State to secure a lower program management fee in the future 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 estimated that the amount of lost tax revenues would be approximately \$2,805,000 per year ($\$10,000 \times 3,400$ accounts = \$34,000,000; $\$34,000,000 \times 8.25\%$ Maximum Tax Rate = \$2,805,000 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, 2007.