

SB 971

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SUBJECT: INCOME, Conformity to federal code

BILL NUMBER: SB 971, SD-1; HB 1153, HD-1 (Similar)

INTRODUCED BY: SB by Senate Committee on Ways and Means; HB by House Committee on Finance

BRIEF SUMMARY: Amends HRS section 235-2.3(a) by changing the date references to make the Internal Revenue Code (IRC) applicable for state income tax purposes as it was amended on 12/31/08 for tax years beginning after 12/31/08.

The following sections of the Internal Revenue Code (IRC) shall **not** be operable for Hawaii income tax purposes: sections 63(c)(1)(B) (relating to the additional standard deduction), 63(c)(1)(C) (relating to the real property tax deduction), 63(c)(1)(D) (relating to the disaster loss deduction), 63(c)(4) (relating to inflation adjustments), 63(c)(7) (defining the real property tax deduction), 63(c)(8) (defining the disaster loss deduction), and 63(f) (relating to additional amounts for the aged or blind).

IRC section 165 (with respect to losses) shall **be operative** for Hawaii income tax purposes except that the amount prescribed by section 165(h)(1) (relating to the limitation per casualty) shall be a \$100 limitation per casualty, and sections 165(h)(3)(A) and 165(h)(3)(B) (both of which relate to special rules for losses in federally declared disasters) shall **not** be operative for purposes of this chapter.

IRC section 172 (with respect to net operating loss deductions) shall **be operative** as further provided in section HRS 235-7(d), except that sections 172(b)(1)(J) and 172(j) (both of which relate to qualified disaster losses) of the Internal Revenue Code shall **not** be operative for purposes of this chapter

The increase in IRC Section 179 (with respect to the election to expense certain depreciable business assets) dollar amounts to \$250,000 for tax years beginning after 2008, the increase in section 179 investment limitation to \$800,000 for tax years beginning after 2008, the special rules for qualified disaster assistance property in section 179(e) shall **not** be operative for purposes of this chapter.

IRC section 198A (with respect to the expensing of qualified disaster assistance expenses) shall **not** be operative for purposes of this chapter.

IRC section 451 (which provided general rules for taxable year of inclusion) shall **be operative**, except that the provisions of 451(i)(3) and 451(i)(6) as they relate to a qualified electric utility shall **not** be operative for purposes of this chapter.

IRC section 1221 (with respect to the definition of capital assets) shall **be operative** except that the provisions of section 301 of Public Law 110-343, which provide that gain or loss from the sale or exchange of any applicable preferred stock by any applicable financial institution (such terms being defined by Public Law 110-343) shall be treated as ordinary income or loss, shall **not** be operative. A sale or exchange of any applicable preferred stock by any applicable financial institution (as those terms

are defined by section 301 of Public Law 110-343) shall be treated as a sale of a capital asset and taxed accordingly.

EFFECTIVE DATE: SB - Tax years beginning after December 31, 2008; HB - Upon approval

STAFF COMMENTS: This is the annual conformity measure submitted by the department of taxation TAX-1 (09) in compliance with HRS section 235-2.5 which requires the department to annually submit a measure to maintain state income tax conformity with the federal Internal Revenue Code. The purpose of conformity is to update the state income tax laws with respect to the definition of income with those changes made to the federal Code during the past year and to adopt those changes that are appropriate to Hawaii law.

For those unfamiliar with the operation of the conformity statute, the federal Code is adopted by exception, that is Chapter 1 of subtitle A of the Internal Revenue Code is adopted with the exception of the various Code sections listed in HRS section 235-2.3. Thus, if the Code section is not listed there, it is operative for state income tax purposes. In some cases, Code sections are operative with certain limitations as noted in HRS sections 235-2.4 and 2.45 where provisions like the standard deduction are operative but the state law inserts different amounts for state income tax purposes. Prior to the adoption of the current statute in 1978, changes to the federal Code were adopted by referencing the specific Public Laws of the various sessions of Congress that made those changes. This was a tedious and cumbersome way to adopt the changes to the federal Code as one had to have the specific Public Law in order to understand how a certain tax provision applied for state income tax purposes.

The major federal tax laws from which the provisions are adopted include: (1) Economic Stimulus Act of 2008 (P.L. 110-185); (2) Food, Conservation and Energy Act of 2008 (P.L. 110-234); (3) Heroes Earnings Assistance and Relief Tax Act of 2008 (P.L. 110-245); (4) Housing and Economic Recovery Act of 2008 (P.L. 110-289); (5) Emergency Economic Stabilization Act of 2008 (P.L. 110-343); (6) Fostering Connections to Success and Increasing Adoptions Act of 2008 (P.L. 110-351); and (7) Worker, Retiree, and Employer Recovery Act of 2008 (P.L. 110-458).

Among the sections that are being made inoperative for Hawaii state income tax purposes are those which provide additional tax benefits such the additional deduction for real property taxes for taxpayers who take the federal standard deduction or the bonus depreciation for businesses. Others are geographically specific such as the special rules for gains and losses in a federally declared disaster area such as the flooding in the Midwest last year.

It should be noted that a number of Code amendments last year focused on incentives to help jump start the economy with a variety of tax credits such as those for energy efficiency. Generally Hawaii does not adopt these tax credits for state income tax purposes as these credits are a direct reduction of tax liability. Since federal tax rates are higher than state income tax rates, these credits are usually much more generous than Hawaii can afford.

Digested 3/2/09