

SB 1316

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SUBJECT: INCOME, Conformity to federal code

BILL NUMBER: SB 1316, Proposed SD-1

INTRODUCED BY: Senate Committee on Ways and Means

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 12/31/10 for tax years beginning after 12/31/10.

Amends HRS section 235-2.4 to provide that: (1) section 68 (with respect to the overall limitation on itemized deductions) of the Internal Revenue Code (IRC) shall be operative, except that sections 68(f) and 68(g) shall not be operative; (2) section 164 of the IRC (with respect to taxes) of the IRC shall be operative except that section 164(b)(5) shall not be operative; (3) section 179 (with respect to the election to expense certain depreciable business assets) of the IRC shall be operative except that the aggregate cost provided in section 179(b)(1) that may be taken into account under subsection 179(a) for any taxable year shall not exceed \$25,000 and the amount at which the reduction in limitation provided in section 179(b)(2) begins shall be \$200,000 for any taxable year.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: This is the annual conformity measure submitted by the department of taxation TAX-01 (11) 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 for 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) The Hiring Incentives to Restore Employment Act (HIRE), (PL 111-147, enacted March 18, 2010); (2) Small Business Jobs Act of 2010 (PL 111-240, enacted September 27, 2010); and (3) Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (PL 111-312, enacted December 17, 2010).

It should be noted that a number of Code amendments in the last few years focused on incentives to help jumpstart the economy with a variety of tax credits. 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 what Hawaii can afford.

This measure makes section 68 (with respect to the overall limitation on itemized deductions) of the IRC operable for state income tax purposes but does not adopt the phase out of the limitation or the December 31, 2009 sunset date. On the federal level, taxpayers with adjusted gross income above a certain amount lost part of their deduction for personal exemptions and itemized deductions. The provision began in the early 1990's and was repealed on December 31, 2009. The itemized deduction reduction called for a reduction of itemized deductions of 3% of the amount that a taxpayer's adjusted gross income (AGI) exceeds the threshold amount. The amount the taxpayer can claim as a deduction is reduced once AGI goes above a certain level for the taxpayer's filing status. The threshold is indexed annually for inflation and for 2009 the levels were: married filing joint/single - \$166,800; and married filing separately - \$83,400. While this provision has expired on the federal level on December 31, 2009, it is unclear which income levels this provision is applicable for Hawaii income tax purposes as the federal levels were indexed for inflation. Thus, it is questionable whether or not Section 68 even exists.

This measure also provides that section 164(b)(5) shall not be operable for Hawaii income tax purposes. The American Jobs Creation Act of 2004 permitted taxpayers to deduct the amount they paid in sales taxes on their federal income tax returns if they itemize deductions, if they kept all of their receipts. As an alternative, the Internal Revenue Service (IRS) has optional sales tax tables based on a taxpayer's income. Amounts paid for a motor vehicle and an aircraft, boat, home or home building materials may be added to the optional tax tables. While this provision was made operable for Hawaii income tax purposes by Act 60, SLH 2005, this measure would now make this provision inoperable for Hawaii state income tax purposes.

The measure also amends the applicability of Section 179 (with respect to the election to expense certain depreciable business assets) of the IRC. While the measure deletes the phrase "shall not be operative for purposes of this chapter," it is questionable whether the following qualification of the portions of Section 179 which were previous **not** operative for Hawaii income tax purposes are now operative: (1) defining section 179 property to include computer software in section 179(d)(1); (2) inflation adjustments 179(b)(5); (3) irrevocable election in section 179(c)(2); and (4) special rules for qualified disaster assistance property in section 179(e). Inasmuch as these paragraphs are preceded with "except," it is not clear whether or not the department is proposing that this draft make the four remaining paragraphs operative.

Digested 2/28/11