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SUBJECT: INCOME, Conformity to federal code

BILL NUMBER: SB 1184; HB 953 (Identical)

INTRODUCED BY: SB by Kim by request; HB by Souki by request

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

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: This is the annual conformity measure submitted by the department of taxation TAX-01 (13) 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) American Taxpayer Relief Act of 2012 (P.L. 112-240) (signed on January 2, 2013); (2) Moving Ahead for Progress in the 21st Century Act of 2012 (P.L. 112-141); and (3) Middle Class Tax Relief and Job Creation Act of 2012 (P.L. 112-96).

It should be noted that a number of Code amendments in the last few years focused on incentives to help jump start 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 version of the bill is a short form proposal with specific amendments to be forthcoming from the department of taxation.

Although the annual conformity bill has adopted the Code as of the last day of the year preceding the session taking such action, it should be pointed out that the American Taxpayer Relief Act of 2012 which helped to avoid the “fiscal cliff” was signed into law on January 2, 2013. While many of the provisions relating to the definition of income were made effective retroactively, it would be prudent to set the effective date for the conformity measure at the date when ATRA 2012 was signed into law which is January 2, 2013 to insure that any and all amendments to sections of the Code which are operative for state purposes are updated.

Digested 1/28/13