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To: The Honorable Jill N. Tokuda, Chair
and Members of the Senate Committee on Ways and Means

Date: February 4, 2016

Time: 9:00 A.M.

Place: Conference Room 211, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 2921, Relating to Conformity to the Internal Revenue Code.

The Department of Taxation (Department) strongly supports S.B.2921, an Administration measure. S.B. 2921 conforms Hawaii's income and estate and generation-skipping transfer taxes to the Internal Revenue Code (Code) as of December 31, 2015.

Sections 235-2.5(c) and 236E-4, Hawaii Revised Statutes (HRS), require the Department to submit legislation to each regular session of the legislature to adopt the Code as it exists on the December 31 preceding the regular session.

S.B. 2921 amends section 235-2.3(a), HRS, to conform the Hawaii income tax law to the operative Code sections of subtitle A, chapter 1, as amended as of December 31, 2015. Generally, subtitle A, chapter 1, refers to Code sections 1 through 1400T.

S.B. 2921 also amends section 236E-3, HRS, to conform the Hawaii estate and generation-skipping transfer tax law to the operative Code sections of subtitle B, as amended as of December 31, 2015. Generally, subtitle B refers to Code sections 2001 through 2801.

S.B. 2921 also makes a technical amendment to section 235E-3, HRS, to refer to decedents dying after December 31, 2015. This amendment is to ensure the Code as of December 31, 2015 applies to decedents dying after that date, not to those who have died during previous periods.

The United States Congress enacted the following tax measures during 2015, which the Department analyzed to determine if amendments to conformity were necessary:

1. "Slain Officer Family Support Act of 2015," P.L. 114-7, enacted April 1, 2015;

2. "Medicare Access and CHIP Reauthorization Act of 2015," P.L. 114-10, enacted April 16, 2015;
3. "Don't Tax Our Fallen Public Safety Heroes Act," P.L. 114-14, enacted May 22, 2015;
4. "Defending Public Safety Employees' Retirement Act," P.L. 114-26, enacted June 29, 2015;
5. "Trade Preferences Extension Act of 2015," P.L. 114-24, enacted June 29, 2015;
6. "Surface Transportation and Veterans Health Care Choice Improvement Act of 2015," P.L. 114-41, enacted July 31, 2015;
7. "Airport and Airway Extension Act of 2015," P.L. 114-55, enacted September 30, 2015;
8. "Bipartisan Budget Act of 2015," P.L. 114-74, enacted November 2, 2015;
9. "Fixing America's Surface Transportation Act," P.L. 114-94, enacted December 4, 2015;
10. "Continuing Appropriations Act, 2016," P.L. 114-113, enacted December 18, 2015.
11. "Protecting Americans from Tax Hikes Act of 2015," P.L. 114-113, enacted December 18, 2015.

The Department analyzed each of the foregoing Acts and identified no necessary changes to Hawaii's income tax law. However, the Department wishes to point out two areas where changes may be needed. The first is to our conformity to Code section 1374 regarding the shortened five-year recognition period for S corporation built in gains. The Department has never conformed to the five-year built in gains recognition period, instead using the ten-year period.

The Protecting Americans from Tax Hikes Act of 2015 amended Code section 1374 to permanently codify the five-year period. As amended, the five-year period would apply for Hawaii tax purposes. In general, the Department recommends conforming as closely as possible to the Code. However, if the legislature intends to maintain prior policy to not conform in this area, subsection (h) of section 235-2.45, HRS, can be amended to read as follows:

"(h) Subchapter S (sections 1361 to 1379) (with respect to tax treatment of S corporations and their shareholders) of Chapter 1 of the Internal Revenue

Code shall be operative for the purposes of this chapter as provided in part VII; [~~except that section 1374(d)(7)(B), (C), and (D) shall not be operative for purposes of this chapter.~~] except that for purposes of section 1374(d)(7)(A), a 10-year recognition period shall apply."

The Department also points out the change to Code section 132(f)(2). That section was amended to increase the exclusion amount for employer provided carpooling and mass transit benefits. The monthly exclusion was increased from \$100 to \$175. This matches the monthly exclusion amount for employer provided parking. The Code has long contained a special rule creating parity between the mass transit exclusion and the parking benefit exclusion; Hawaii has never conformed to the increased mass transit exclusion.

As amended, the increased exclusion will apply for Hawaii tax purposes. As stated above, the Department recommends conforming as closely as possible to the Code. Therefore, the Department recommends conforming to the increased amount of the exclusion.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

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SUBJECT: INCOME, ESTATE, Conformity to Internal Revenue Code

BILL NUMBER: SB 2921; HB 2392 (Identical)

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

EXECUTIVE SUMMARY: Conforms the Hawaii income tax and estate and generation-skipping transfer taxes to federal changes adopted through December 31, 2015.

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 12/31/15 for tax years beginning after 12/31/15. Amends HRS section 236E-3 by changing the date references to make the IRC applicable for state estate and generation-skipping tax purposes as it was amended on 12/31/15 for tax years beginning after 12/31/15.

EFFECTIVE DATE: The income tax provisions are effective to taxable years beginning after December 31, 2015; the estate and generation-skipping tax provisions apply to decedents dying or taxable transfers occurring after December 31, 2015.

STAFF COMMENTS: This is the annual conformity measure submitted by the department of taxation TAX-01 (16) 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, and in compliance with HRS section 236E-4 which requires the department to annually submit a measure to maintain state estate and generation-skipping tax conformity with the federal Internal Revenue Code.

The purpose of conformity is to update the state tax laws with those changes made to the federal Code during the past year and to adopt those changes that are appropriate for Hawaii law.

Digested 1/27/2016