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LATE

To: The Honorable Donovan M. Dela Cruz
and Members of the Senate Committee on Ways and Means

Date: Tuesday, February 6, 2018
Time: 10:00 A.M.
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 2821, Relating to the Conformity to the Internal Revenue Code

The Department of Taxation (Department) strongly supports S.B. 2821, an Administration measure, and offers the following comments for the Committee's consideration.

S.B. 2821 conforms Hawaii's income and estate and generation-skipping transfer taxes to the Internal Revenue Code (IRC) as of December 31, 2017. Hawaii Revised Statutes (HRS) section 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. 2821 amends HRS section 235-2.3(a), to conform the Hawaii income tax law to the operative IRC sections of subtitle A, chapter 1, as amended as of December 31, 2017. Generally, subtitle A, chapter 1, refers to IRC sections 1-1400U-3. S.B. 2821 also amends HRS section 236E-3, to conform the Hawaii estate and generation-skipping transfer tax law to the operative IRC sections of subtitle B, as amended as of December 31, 2017. Generally, subtitle B refers to IRC sections 2001 through 2801.

In addition, the Department recommends S.B. 2821 be amended to account for two major changes in federal tax law, the new partnership audit rules and the Tax Cuts and Jobs Act, both discussed below.

New Partnership Audit Regime

The "Bipartisan Budget Act of 2015", P.L. 114-74, enacted November 2, 2015, replaced the partnership audit rules enacted in 1982 as part of the Tax Equity and Fiscal Responsibility Act (TEFRA). The new partnership audit rules fully replace the TEFRA rules.

The new partnership audit rules became fully effective for federal tax purposes on

January 1, 2018. The new regime's major policy change is that partnerships must be audited and assessed at the partnership level and are responsible for payment of any additional tax due at the partnership level. The new regime includes an opt-out provision for partnerships with 100 or fewer partners.

The Department recommends conforming to the substance of the new partnership audit rules while maintaining the Department's own timing and administrative provisions. This maintains the current policy of conforming to the substantive provisions of TEFRA, but not conforming to the timing or administrative provisions of TEFRA. The Department's detailed recommendations are included in the draft bill.

Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act, P.L. 115-97, enacted December 22, 2017 (the Act), made major changes to individual and corporate income taxes and to the estate tax. The Department has studied the Act extensively and has included detailed recommendations in the draft bill attached to this testimony.

Due to the immense amount of content contained in the Act, the Department is including an overview of its recommendations and a greatly simplified explanation of selected provisions of the Act.

In general, the Department recommends conforming closely to the Internal Revenue Code (Code) to ease the administration of the income tax as much as possible. However, in this case, the Department is recommending non-conformity in several important areas.

First, the Department recommends maintaining the current allowance of individual itemized deductions, including the mortgage interest deduction and the state and local tax deduction. This will ensure that Hawaii individual taxpayers do not face a Hawaii income tax increase due to the operation of the federal changes.

Second, the Department recommends not conforming to the 20% for income from pass-through entities under new IRC section 199A. The Department believes this provision is inappropriate for Hawaii income tax purposes because Hawaii has made no change to its corporate tax rate. This provision was enacted to maintain the current differential in effective tax rates between C-corporations and pass-through entities. Hawaii has made no change to its corporate tax rates, so there is no change in the relative tax rates to address with such a deduction.

Third, the Department recommends not conforming to bonus depreciation under IRC section 168(k). Since 2003, when this provision was introduced, Hawaii has not conformed to federal bonus depreciation under IRC section 168(k). Under prior law, federal bonus depreciation was equal to 50% of the cost of qualified property. Under the Act, federal bonus depreciation is expanded to 100% of the cost of qualified property. Currently, Hawaii does not conform to IRC section 168(k), therefore, no statutory change is necessary to continue to not conform.

Fourth, the Department recommends continuing conformity to the corporate tax provisions Hawaii currently conforms to. Two noteworthy provisions that were changed are the business interest deduction in IRC section 163(j) and the net operating loss (NOL) deduction in IRC section 172. Currently, Hawaii conforms to these Code sections, so no statutory change is necessary to continue conforming.

The business interest deduction (IRC section 163(j)) is limited to the sum of the business's interest income, 30% of its adjusted taxable income, and any floor financing interest of the business. Any disallowed interest deduction may be carried forward indefinitely. The interest deduction limitations do not apply to taxpayers whose average annual gross receipts for the prior three years do not exceed \$25 million.

The Act limits NOL deductions to 80% of taxable income. The Act also disallows any carryback of NOLs, except for certain farms, and allows indefinite carryforward of NOLs. The NOL limits do not apply to property and casualty insurance companies.

The following are selected provisions of the Act and their effect. The Department's specific recommendations are reflected in the draft bill.

Individual provisions	
Subject	Effect
Mortgage interest deduction	Limits the mortgage interest deduction to interest on loans of \$750,000.
State and Local Tax Deduction	Limits the SALT deduction to \$10,000.
Miscellaneous itemized deductions	Disallows all miscellaneous itemized deductions subject to the 2% AGI floor.
Personal casualty losses deduction	Allows a personal casualty loss deduction only for federally declared disasters.
Congressional living expense deduction	Repeals the \$3,000 deduction for living expenses for members of Congress.
Charitable contributions	Increases the limit on charitable deductions to 60% of AGI.
Right to purchase athletic seats	No deduction for contributions made to reserve the right to purchase athletic tickets.
Limitation on wagering losses deduction	Includes other related expenses in wagering losses for purposes of the deduction.
Medical expense deduction	Reduces the floor on medical expense deductions to 7.5% of AGI.
Alimony payments	Repeals the deduction for alimony paid and repeals the inclusion in income for alimony received.
Moving expense deduction	Disallows moving expense deduction.
529 plan distributions	Allows 529 plan distributions to be used for primary or secondary school tuition.
Discharge of student loan debt	Excludes income from discharge of student loan indebtedness.
ABLE accounts	Allows contributions to ABLE accounts to exceed \$14,000 if the donee is the beneficiary of the account.
Rollovers from qualified tuition programs to ABLE accounts	Allows rollovers from qualified tuition accounts to ABLE accounts.
Employee achievement awards	Includes employee achievement awards in income if they are in cash

	or cash equivalents.
Exclusion of military pay in Sinai	Deems the Sinai Peninsula a combat zone for income tax purposes.
Moving expense reimbursements	Includes moving expense reimbursements in income.

Corporate and Business	
Subject	Effect
Local lobbying expenses	Repeals the exception that allowed a deduction for local lobbying expenses.
Contributions to capital	Excludes any contribution in aid of construction or any other contribution as a customer of potential customer and any contribution by a governmental entity or civic group.
Rollover of publicly traded securities gain into SSBICs	Disallows rollover of gains on public traded securities to a specialized small business investment corporation.
Temporary 100% expensing for certain business assets	Allows 100% expensing for certain capital assets.
Depreciation limitation for automobiles	Increases the depreciation limitations for passenger automobiles.
Recovery period for farming property	Repeals the requirement for farm property use the 150% declining balance method and allows a 5-year recovery period for farm machinery.
Depreciation periods amended	Adjusts the recovery periods for various categories of property
Business expense deduction	Limits the interest expense deduction to the total of the business's interest income, 30% of its adjusted taxable income, and floor plan financing interest.
Section 179 expensing	Increases the amounts taxpayers are allowed to expense and increases the phase-out threshold.
NOL deduction	Limits the NOL deduction to 80% of taxable income and changes the carryforward and carryback rules.
Like-kind exchanges	Limits like-kind exchanges to real property.
Entertainment expenses	Disallows the deduction for entertainment expenses.
Deduction for FDIC premiums	Limits the amount of FDIC premiums that can be deducted for certain large institutions.
Self-created property not capital asset	Treats self-created property such as a patent or invention as an ordinary asset rather than a capital asset.
Amortization of R&D expenses	Allows certain R&D expenses to be amortized over a 5 year period.
Transfer of value rule	Excludes life-insurance proceeds from a reportable policy sale from income.
Clarification of basis for life insurance	Requires basis in life insurance contracts to be adjusted for mortality, expense, or other reasonable charges incurred.
Sexual harassment settlements	Denies deduction for any settlement related to sexual harassment or sexual abuse that are subject to a nondisclosure agreement.
Alaska native corporations	Excludes certain income received by an Alaska Native Corporation.
Deductibility of fines and penalties	Allows some fines and penalties, such as restitution, to be deducted.
Qualified Opportunity Zones	Provides capital gains tax deferral for qualified opportunity zones.

Pass-through entities	
Pass-through tax treatment	Allows a 20% deduction from income received from a pass-through entity, with limitations.
S corporation conversions	Distributions from a terminated S corporation will be treated from its accumulated adjustment account and from earnings and profits
Electing small business trusts	Makes a nonresident alien a permissible beneficiary of an ESBT
Charitable deductions for ESBTs	Individual rules apply to charitable deductions for ESBTs
Substantial built-in loss	Definition expanded to include a hypothetical disposition of all assets if the transferee would be allocated a net loss of more than \$250,000.
Basis limitation on partnership loss	Applies the basis limitation on the deductibility of partner losses to a partner's distributive share of charitable contributions and foreign taxes.
Limitations on losses for non-corporate taxpayers	Disallows an excess business loss for a taxpayer other than a C corporation.
Look-through gain on sale of partnership interest	Expands gain or loss that is treated as effectively connected with a U.S. trade or business.
Technical termination of partnership	Repeals the technical termination rule for partnerships.
Carried interest	Applies a 3-year holding period for certain long-term capital gain with respect to applicable partnership interests.

Compensation and Benefits	
Subject	Effect
Bicycle commuting reimbursement	Suspends the exclusion for bicycle commuting reimbursements.
Recharacterization of IRA contributions	Recharacterization does not apply to a conversion contribution to a Roth IRA.
Rollover of plan loan assets	Extends the amount of time for contributing a plan loan into an IRA to avoid treatment as a taxable distribution.
Excessive employee remuneration	Repeals the commission and performance based compensation exception to the \$1 million limit on deductibility of compensation.
Qualified equity grants	Tax benefits to employees of start-ups related to stock options.
Length of service awards	Increases the aggregate amount of awards for volunteers to \$6,000.

Tax-exempt Organizations and Estate Tax	
Unrelated business taxable income	Requires inclusion of certain fringe benefits for which a deduction is not allowed in unrelated business taxable income.
Estate and gift tax	Increases the unified credit to \$10 million.
Generation-skipping transfer trust	Increases the exemption to \$10 million.

Thank you for the opportunity to provide comments.

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A BILL FOR AN ACT

RELATING TO CONFORMITY TO THE INTERNAL REVENUE CODE.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The purpose of this Act is to conform Hawaii
2 income and estate and generation-skipping transfer tax laws to
3 the Internal Revenue Code.

4 SECTION 2. Section 235-2.3, Hawaii Revised Statutes, is
5 amended to read as follows:

6 **"235-2.3 Conformance to the federal Internal Revenue Code;**
7 **general application.** (a) For all taxable years beginning after
8 December 31, [~~2016~~] 2017, as used in this chapter, except as
9 provided in section 235-2.35, "Internal Revenue Code" means
10 subtitle A, chapter 1, of the federal Internal Revenue Code of
11 1986, as amended as of December 31, [~~2016~~] 2017, as it applies
12 to the determination of gross income, adjusted gross income,
13 ordinary income and loss, and taxable income, except those
14 provisions of the Internal Revenue Code and federal public laws
15 which, pursuant to this chapter, do not apply or are otherwise
16 limited in application and except for the provisions of Public
17 Law 109-001 which apply to section 170 of the Internal Revenue
18 Code. The provisions of Public Law 109-001 to accelerate the

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1 deduction for charitable cash contributions for the relief of
2 victims of the 2004 Indian Ocean tsunami are applicable for the
3 calendar year that ended December 31, 2004, and the calendar
4 year ending December 31, 2005.

5 Prior law shall continue to be used to determine:

6 (1) The basis of property, if a taxpayer first determined
7 the basis of property in a taxable year to which prior
8 law applies; and

9 (2) Gross income, adjusted gross income, ordinary income
10 and loss, and taxable income for a taxable year to
11 which prior law applies.

12 (b) The following Internal Revenue Code subchapters, parts
13 of subchapters, sections, subsections, and parts of subsections
14 shall not be operative for the purposes of this chapter, unless
15 otherwise provided:

16 (1) Subchapter A (sections 1 to 59A) (with respect to
17 determination of tax liability), except section
18 1(h)(2) (relating to net capital gain reduced by the
19 amount taken into account as investment income),
20 except sections 2(a), 2(b), and 2(c) (with respect to
21 the definition of "surviving spouse" and "head of
22 household"), except section 41 (with respect to the

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- 1 credit for increasing research activities), except
2 section 42 (with respect to low-income housing
3 credit), except sections 47 and 48, as amended, as of
4 December 31, 1984 (with respect to certain depreciable
5 tangible personal property), and except section
6 48(d)(3), as amended, as of February 17, 2009 (with
7 respect to the treatment of United States Department
8 of Treasury grants made under section 1603 of the
9 American Recovery and Reinvestment Tax Act of
10 2009). For treatment, see sections 235-110.91, 235-
11 110.7, and 235-110.8;
- 12 (2) Section 78 (with respect to dividends received from
13 certain foreign corporations by domestic corporations
14 choosing foreign tax credit);
- 15 (3) Section 86 (with respect to social security and tier 1
16 railroad retirement benefits);
- 17 (4) Section 91 (with respect to certain foreign branch
18 losses);
- 19 ~~[-(4)]~~ (5) Section 103 (with respect to interest on state
20 and local bonds). For treatment, see section 235-
21 7(b);

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- 1 ~~[(5)]~~ (6) Section 114 (with respect to extraterritorial
2 income). For treatment, any transaction as specified
3 in the transitional rule for 2005 and 2006 as
4 specified in the American Jobs Creation Act of 2004
5 section 101(d) and any transaction that has occurred
6 pursuant to a binding contract as specified in the
7 American Jobs Creation Act of 2004 section 101(f) are
8 inoperative;
- 9 ~~[(6)]~~ (7) Section 120 (with respect to amounts received
10 under qualified group legal services plans). For
11 treatment, see section 235-7(a) (9) to (11);
- 12 ~~[(7)]~~ (8) Section 122 (with respect to certain reduced
13 uniformed services retirement pay). For treatment,
14 see section 235-7(a) (3);
- 15 ~~[(8)]~~ (9) Section 135 (with respect to income from United
16 States savings bonds used to pay higher education
17 tuition and fees). For treatment, see section 235-
18 7(a) (1);
- 19 ~~[(9)]~~ (10) Section 139C (with respect to COBRA premium
20 assistance);

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- 1 ~~[(+10)]~~ (11) Subchapter B (sections 141 to 150) (with respect
2 to tax exemption requirements for state and local
3 bonds);
- 4 ~~[(+11)]~~ (12) Section 151 (with respect to allowance of
5 deductions for personal exemptions). For treatment,
6 see section 235-54;
- 7 ~~[(+12)]~~ (13) Section 179B (with respect to expensing of
8 capital costs incurred in complying with Environmental
9 Protection Agency sulphur regulations);
- 10 ~~[(+13)]~~ (14) Section 181 (with respect to special rules for
11 certain film and television productions);
- 12 ~~[(+14)]~~ (15) Section 196 (with respect to deduction for
13 certain unused investment credits);
- 14 ~~[(+15)]~~ (16) Section 199 (with respect to the U.S. production
15 activities deduction);
- 16 (17) Section 199A (with respect to the deduction for
17 qualified business income);
- 18 ~~[(+16)]~~ (18) Section 222 (with respect to qualified tuition
19 and related expenses);
- 20 ~~[(+17)]~~ (19) Sections 241 to 247 (with respect to special
21 deductions for corporations). For treatment, see
22 section 235-7(c);

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- 1 (20) Section 250 (with respect to foreign-derived
2 intangible income and global intangible low-taxed
3 income);
- 4 (21) Section 267A (with respect to certain related party
5 amounts paid or accrued in hybrid transactions or with
6 hybrid entities);
- 7 [~~+18~~] (22) Section 280C (with respect to certain expenses
8 for which credits are allowable). For treatment, see
9 section 235-110.91;
- 10 [~~+19~~] (23) Section 291 (with respect to special rules
11 relating to corporate preference items);
- 12 [~~+20~~] (24) Section 367 (with respect to foreign
13 corporations);
- 14 [~~+21~~] (25) Section 501(c)(12), (15), (16) (with respect to
15 exempt organizations); except that section 501(c)(12)
16 shall be operative for companies that provide potable
17 water to residential communities that lack any access
18 to public utility water services;
- 19 [~~+22~~] (26) Section 515 (with respect to taxes of foreign
20 countries and possessions of the United States);

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- 1 ~~[(+23)]~~ (27) Subchapter G (sections 531 to 565) (with respect
2 to corporations used to avoid income tax on
3 shareholders);
- 4 ~~[(+24)]~~ (28) Subchapter H (sections 581 to 597) (with respect
5 to banking institutions), except section 584 (with
6 respect to common trust funds). For treatment, see
7 chapter 241;
- 8 ~~[(+25)]~~ (29) Section 642(a) and (b) (with respect to special
9 rules for credits and deductions applicable to
10 trusts). For treatment, see sections 235-54(b) and
11 235-55;
- 12 ~~[(+26)]~~ (30) Section 646 (with respect to tax treatment of
13 electing Alaska Native settlement trusts);
- 14 ~~[(+27)]~~ (31) Section 668 (with respect to interest charge on
15 accumulation distributions from foreign trusts);
- 16 ~~[(+28)]~~ (32) Subchapter L (sections 801 to 848) (with respect
17 to insurance companies). For treatment, see sections
18 431:7-202 and 431:7-204;
- 19 ~~[(+29)]~~ (33) Section 853 (with respect to foreign tax credit
20 allowed to shareholders). For treatment, see section
21 235-55;

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- 1 ~~[(30)]~~ (34) Section 853A (with respect to credits from tax
2 credit bonds allowed to shareholders);
- 3 ~~[(31)]~~ (35) Subchapter N (sections 861 to 999) (with respect
4 to tax based on income from sources within or without
5 the United States), except sections 985 to 989 (with
6 respect to foreign currency transactions). For
7 treatment, see sections 235-4, 235-5, and 235-7(b),
8 and 235-55;
- 9 ~~[(32)]~~ (36) Section 1042(g) (with respect to sales of stock
10 in agricultural refiners and processors to eligible
11 farm cooperatives);
- 12 ~~[(33)]~~ (37) Section 1055 (with respect to redeemable ground
13 rents);
- 14 ~~[(34)]~~ (38) Section 1057 (with respect to election to treat
15 transfer to foreign trust, etc., as taxable exchange);
- 16 ~~[(35)]~~ (39) Sections 1291 to 1298 (with respect to treatment
17 of passive foreign investment companies);
- 18 ~~[(36)]~~ (40) Subchapter Q (sections 1311 to 1351) (with
19 respect to readjustment of tax between years and
20 special limitations);
- 21 ~~[(37)]~~ (41) Subchapter R (sections 1352 to 1359) (with
22 respect to election to determine corporate tax on

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1 certain international shipping activities using per
2 ton rate);

3 [~~(38)~~] (42) Subchapter U (sections 1391 to 1397F) (with
4 respect to designation and treatment of empowerment
5 zones, enterprise communities, and rural development
6 investment areas). For treatment, see chapter 209E;

7 [~~(39)~~] (43) Subchapter W (sections 1400 to 1400C) (with
8 respect to District of Columbia enterprise zone);

9 [~~(40)~~] (44) Section 14000 (with respect to education tax
10 benefits);

11 [~~(41)~~] (45) Section 1400P (with respect to housing tax
12 benefits);

13 [~~(42)~~] (46) Section 1400R (with respect to employment
14 relief);

15 [~~(43)~~] (47) Section 1400T (with respect to special rules for
16 mortgage revenue bonds);

17 [~~(44)~~] (48) Section 1400U-1 (with respect to allocation of
18 recovery zone bonds);

19 [~~(45)~~] (49) Section 1400U-2 (with respect to recovery zone
20 economic development bonds); [~~and~~]

21 [~~(46)~~] (50) Section 1400U-3 (with respect to recovery zone
22 facility bonds) [~~;~~]; and

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1 (51) Section 1400Z (with respect to Qualified Opportunity
2 Zones)."

3 SECTION 3. Section 235-2.4, Hawaii Revised Statutes, is
4 amended to read as follows:

5 **"235-2.4 Operation of certain Internal Revenue Code**

6 **provisions; Sections 63 to 530.** (a) Section 63 (with respect to
7 taxable income defined) of the Internal Revenue Code shall be
8 operative for the purposes of this chapter, subject to the
9 following:

10 (1) Section 63(c)(1)(B) (relating to the additional
11 standard deduction), 63(c)(1)(C) (relating to the real
12 property tax deduction), 63(c)(1)(D) (relating to the
13 disaster loss deduction), 63(c)(1)(E) (relating to the
14 motor vehicle sales tax deduction), 63(c)(4) (relating
15 to inflation adjustments), 63(c)(7) (defining the real
16 property tax deduction), 63(c)(8) (defining the
17 disaster loss deduction), 63(c)(9) (defining the motor
18 vehicle sales tax deduction), and 63(f) (relating to
19 additional amounts for the aged or blind) of the
20 Internal Revenue Code shall not be operative for
21 purposes of this chapter;

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1 (2) Section 63(c)(2) (relating to the basic standard
2 deduction) of the Internal Revenue Code shall be
3 operative, except that the standard deduction amounts
4 provided therein shall instead mean:

5 (A) \$4,400 in the case of:

6 (i) A joint return as provided by section
7 235-93; or

8 (ii) A surviving spouse (as defined in section
9 2(a) of the Internal Revenue Code);

10 (B) \$3,212 in the case of a head of household (as
11 defined in section 2(b) of the Internal Revenue
12 Code);

13 (C) \$2,200 in the case of an individual who is not
14 married and who is not a surviving spouse or
15 head of household; or

16 (D) \$2,200 in the case of a married individual
17 filing a separate return;

18 (3) Section 63(c)(5) (limiting the basic standard
19 deduction in the case of certain dependents) of the
20 Internal Revenue Code shall be operative, except that
21 the limitation shall be the greater of \$500 or the
22 individual's earned income; and

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1 (4) The standard deduction amount for nonresidents shall
2 be calculated pursuant to section 235-5.

3 (b) Section 67 (with respect to the two per cent floor on
4 miscellaneous itemized deductions) of the Internal Revenue Code
5 shall be operative for purposes of this chapter except that the
6 suspension in section 67(g) shall not be operative for purposes
7 of this chapter.

8 ~~[(b)]~~ (c) Section 68 (with respect to the overall
9 limitation on itemized deductions) of the Internal Revenue Code
10 shall be operative; provided that the thresholds shall be those
11 that were operative for federal tax year 2009; and provided
12 further that the suspension in section 68(f) shall not be
13 operative for purposes of this chapter.

14 ~~[(c)]~~ (d) Section 72 (with respect to annuities; certain
15 proceeds of endowment and life insurance contracts) of the
16 Internal Revenue Code shall be operative for purposes of this
17 chapter and be interpreted with due regard to section 235-7(a),
18 except that the ten per cent additional tax on early
19 distributions from retirement plans in section 72(t) shall not
20 be operative for purposes of this chapter.

21 ~~[(d)]~~ (e) Section 85 (with respect to unemployment
22 compensation) of the Internal Revenue Code shall be operative

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1 for purposes of this chapter, except that section 85(c) shall
2 not be operative for purposes of this chapter.

3 ~~[(e)]~~ (f) Section 108 (with respect to income from
4 discharge of indebtedness) of the Internal Revenue Code shall be
5 operative for purposes of this chapter, except that section
6 108(i) (relating to deferral and ratable inclusion of income
7 arising from business indebtedness discharged by the
8 reacquisition of a debt instrument) shall not be operative for
9 purposes of this chapter.

10 ~~[(f)]~~ (g) Section 121 (with respect to exclusion of gain
11 from sale of principal residence) of the Internal Revenue Code
12 shall be operative for purposes of this chapter, except that for
13 the election under section 121(f), a reference to section 1034
14 treatment means a reference to section 235-2.4(s) in effect for
15 taxable year 1997.

16 ~~[(g)]~~ (h) Section 132 (with respect to certain fringe
17 benefits) of the Internal Revenue Code shall be operative for
18 purposes of this chapter [~~, except that the provision in section~~
19 ~~132(f)(2) that equalizes the dollar amounts for section~~
20 ~~132(f)(2)(A) and (B) shall not be operative]~~ except that:

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1 (1) The suspension in section 132(f)(8) shall not be
2 operative for purposes of this chapter; [and except
3 that]

4 (2) The suspension in section 132(g)(2) shall not be
5 operative for purposes of this chapter; and

6 (3) [section] Section 132(n) shall not apply to United
7 States Department of Defense Homeowners Assistance
8 Program payments authorized by the American Recovery
9 and Reinvestment Act of 2009.

10 ~~[(h)]~~ (i) Section 163 (with respect to interest) of the
11 Internal Revenue Code shall be operative for the purposes of
12 this chapter, except that ~~[provisions in]~~ the following
13 provisions shall not be operative for purposes of this chapter:

14 (1) [section] Section 163(d)(4)(B) (defining net
15 investment income to exclude dividends),

16 (2) [section] Section 163(e)(5)(F) (suspension of
17 applicable high-yield discount obligation (AHYDO)
18 rules) ~~[and],~~

19 (3) [section] Section 163(i)(1) as it applies to debt
20 instruments issued after January 1, 2010, (defining
21 AHYDO), and

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1 (4) Section 163(h)(3)(F) (limiting mortgage interest).

2 [~~shall not be operative for the purposes of this~~
3 ~~chapter.~~]

4 [~~(i)~~] (j) Section 164 (with respect to taxes) of the
5 Internal Revenue Code shall be operative for the purposes of
6 this chapter, except that:

7 (1) Section [~~164(a)(6) and (b)(6)~~] 164(b)(6)(B) (limiting
8 the deduction for state and local taxes) shall not be
9 operative for the purposes of this chapter;

10 (2) The deductions under section 164(a)(3) and (b)(5)
11 shall not be operative for corporate taxpayers and
12 shall be operative only for the following individual
13 taxpayers:

14 (A) A taxpayer filing a single return or a
15 married person filing separately with a
16 federal adjusted gross income of less than
17 \$100,000;

18 (B) A taxpayer filing as a head of household
19 with a federal adjusted gross income of less
20 than \$150,000; and

.B.NO.

1 (4) Section 165 as operative for this chapter shall also
2 apply to losses sustained from the sale of stocks or
3 other interests issued through the exercise of the
4 stock options or warrants granted by a qualified high
5 technology business as defined in section 235-7.3.

6 ~~[(k)]~~ (l) Section 168 (with respect to the accelerated cost
7 recovery system) of the Internal Revenue Code shall be operative
8 for purposes of this chapter, except that sections 168(j)
9 (relating to property on Indian reservations), 168(k) (relating
10 to the special allowance for certain property acquired during
11 the period specified therein), 168(m) (relating to the special
12 allowance for certain reuse and recycling property), and 168(n)
13 (relating to the special allowance for qualified disaster
14 assistance property) of the Internal Revenue Code shall not be
15 operative for purposes of this chapter.

16 ~~[(l)]~~ (m) Section 172 (with respect to net operating loss
17 deductions) of the Internal Revenue Code shall be operative for
18 purposes of this chapter, as further provided in section
19 235-7(d), except that section 172(b)(1)(J) and (j) (both of
20 which relate to qualified disaster losses) of the Internal
21 Revenue Code shall not be operative for purposes of this
22 chapter.

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1 ~~[(m)]~~ (n) Section 179 (with respect to the election to
2 expense certain depreciable business assets) of the Internal
3 Revenue Code shall be operative for purposes of this chapter,
4 except as provided in this subsection:

5 (1) The aggregate cost provided in section 179(b) (1),
6 which may be taken into account under section 179(a)
7 for any taxable year, shall not exceed \$25,000;

8 (2) The amount at which the reduction in limitation
9 provided in section 179(b) (2) begins shall exceed
10 \$200,000 for any taxable year; and

11 (3) The following shall not be operative for purposes of
12 this chapter:

13 (A) Defining section 179 property to include
14 computer software in section 179(d) (1);

15 (B) Inflation adjustments in section 179(b) (5);

16 (C) Irrevocable election in section 179(c) (2);

17 and

18 (D) Special rules for qualified disaster
19 assistance property in section 179(e).

20 ~~[(n)]~~ (o) Section 198A (with respect to the expensing of
21 qualified disaster assistances expenses) of the Internal Revenue
22 Code shall not be operative for purposes of this chapter.

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1 (p) Section 217 (with respect to moving expenses) of the
2 Internal Revenue Code shall be operative for the purposes of
3 this chapter except that the suspension in section 217(k) shall
4 not be operative for purposes of this chapter.

5 [~~(p)~~] (q) Section 219 (with respect to retirement savings)
6 of the Internal Revenue Code shall be operative for the purpose
7 of this chapter. For the purpose of computing the limitation on
8 the deduction for active participants in certain pension plans
9 for state income tax purposes, adjusted
10 gross income as used in section 219 as operative for this
11 chapter means federal adjusted gross income.

12 [~~(p)~~] (r) Section 220 (with respect to medical savings
13 accounts) of the Internal Revenue Code shall be operative for
14 the purpose of this chapter, but only with respect to medical
15 services accounts that have been approved by the Secretary of
16 the Treasury of the United States.

17 [~~(q)~~] (s) Section 265 (with respect to expenses and
18 interest relating to tax-exempt income) of the Internal Revenue
19 Code shall be operative for purposes of this chapter; except
20 that section 265(b)(3)(G) and (7) shall not be operative and
21 section 265 shall not apply to expenses for royalties and other
22 income derived from any patents, copyrights, and trade secrets

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1 by an individual or a qualified high technology business as
2 defined in section 235-7.3. These expenses shall be deductible.

3 (t) Section 274 (with respect to the disallowance of
4 certain expenses) of the Internal Revenue Code shall be
5 operative for this chapter in the form that it existed as of
6 December 21, 2017.

7 ~~(r)~~ (u) Section 280E (with respect to expenditures in
8 connection with the illegal sale of drugs) of the Internal
9 Revenue Code shall be operative for the purposes of this
10 chapter, except that section 280E shall not be operative with
11 respect to the production and sale of medical cannabis and
12 manufactured cannabis products by dispensaries licensed under
13 chapter 329D and their subcontractors, as defined in section
14 329D-1.

15 ~~(s)~~ (v) Section 382 (with respect to limitation on net
16 operating loss carryforwards and certain built-in losses
17 following ownership change) of the Internal Revenue Code shall
18 be operative for the purposes of this chapter, except that
19 section 382(n) shall not be operative for purposes of this
20 chapter.

21 ~~(t)~~ (w) Section 408A (with respect to Roth Individual
22 Retirement Accounts) of the Internal Revenue Code shall be

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1 operative for the purposes of this chapter, except that section
2 408A(d) (3) (A) (iii) shall not be operative for purposes of this
3 chapter. For the purposes of determining the aggregate amount
4 of contributions to a Roth Individual Retirement Account or
5 qualified rollover contribution to a Roth Individual Retirement
6 Account from an individual retirement plan other than a Roth
7 Individual Retirement Account, adjusted gross income as used in
8 section 408A as operative for this chapter means federal
9 adjusted gross income.

10 [~~u~~](x) In administering the provisions of sections 410
11 to 417 (with respect to special rules relating to pensions,
12 profit sharing, stock bonus plans, etc.), sections 418 to 418E
13 (with respect to special rules for multiemployer plans), and
14 sections 419 and 419A (with respect to treatment of welfare
15 benefit funds) of the Internal Revenue Code, the department of
16 taxation shall adopt rules under chapter 91 relating to the
17 specific requirements under those sections and to other
18 administrative requirements under those sections as may be
19 necessary for the efficient administration of sections 410 to
20 419A.

21 In administering sections 401 to 419A (with respect to
22 deferred compensation) of the Internal Revenue Code, Public Law

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1 93-406, section 1017(i), shall be operative for the purposes of
2 this chapter.

3 In administering section 402 (with respect to the
4 taxability of beneficiary of employees' trust) of the Internal
5 Revenue Code, the tax imposed on lump sum distributions by
6 section 402(e) of the Internal Revenue Code shall be operative
7 for the purposes of this chapter and the tax imposed therein is
8 hereby imposed by this chapter at the rate determined under this
9 chapter.

10 [~~(v)~~](y) In administering section 403 (with respect to
11 taxation of employee annuities) of the Internal Revenue Code,
12 any funds that represent pre-tax employee deferrals or
13 contributions that are distributed from the annuity and used
14 solely to obtain retirement credits under the state employees'
15 retirement system shall not be treated as a rollover for
16 purposes of section 403(b)(8)(A) of the Internal Revenue Code,
17 and those funds shall be subject to income tax under this
18 chapter.

19 [~~(w)~~](z) Section 451 (which provides general rules for
20 taxable year of inclusion) of the Internal Revenue Code shall be
21 operative, except that section 451(i)(3) and (6), as it relates

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1 to a qualified electric utility, shall not be operative for
2 purposes of this chapter.

3 ~~[(*)]~~ (aa) In administering section 457 (with respect to
4 compensation plans of state and local governments and tax-exempt
5 organizations) of the Internal Revenue Code, any funds that
6 represent pre-tax employee deferrals or contributions that are
7 distributed from the deferred compensation plan and used solely
8 to obtain retirement credits under the state employees'
9 retirement system shall not be treated as a rollover for
10 purposes of section 457(e)(16)(A) of the Internal Revenue Code
11 and those funds shall be subject to income tax under this
12 chapter.

13 ~~[(y)]~~ (bb) Section 468B (with respect to special rules for
14 designated settlement funds) of the Internal Revenue Code shall
15 be operative for the purposes of this chapter and the tax
16 imposed therein is hereby imposed by this chapter at a rate
17 equal to the maximum rate in effect for the taxable year imposed
18 on estates and trusts under section 235-51.

19 ~~[(z)]~~ (cc) Section 469 (with respect to passive activities
20 and credits limited) of the Internal Revenue Code shall be
21 operative for the purposes of this chapter. For the purpose of
22 computing the offset for rental real estate activities for state

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1 income tax purposes, adjusted gross income as used in section
2 469 as operative for this chapter means federal adjusted gross
3 income.

4 [~~aa~~](dd) Sections 512 to 514 (with respect to taxation
5 of business income of certain exempt organizations) of the
6 Internal Revenue Code shall be operative for the purposes of
7 this chapter as provided in this subsection.

8 "Unrelated business taxable income" means the same as in
9 the Internal Revenue Code, except that in the computation
10 thereof sections 235-3 to 235-5, and 235-7 (except subsection
11 (c)), shall apply, and in the determination of the net operating
12 loss deduction there shall not be taken into account any amount
13 of income or deduction that is excluded in computing the
14 unrelated business taxable income. Unrelated business taxable
15 income shall not include any income from a legal service plan.

16 For a person described in section 401 or 501 of the
17 Internal Revenue Code, as modified by section 235-2.3, the tax
18 imposed by section 235-51 or 235-71 shall be imposed upon the
19 person's unrelated business taxable income.

20 [~~bb~~](ee) Section 521 (with respect to cooperatives) and
21 subchapter T (sections 1381 to 1388, with respect to
22 cooperatives and their patrons) of the Internal Revenue Code

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1 shall be operative for the purposes of this chapter as to any
2 cooperative fully meeting the requirements of section 421-23,
3 except that Internal Revenue Code section 521 cooperatives need
4 not be organized in Hawaii.

5 [~~ee~~](ff) Sections 527 (with respect to political
6 organizations) and 528 (with respect to certain homeowners
7 associations) of the Internal Revenue Code shall be operative
8 for the purposes of this chapter and the taxes imposed in each
9 section are hereby imposed by this chapter at the rates
10 determined under section 235-71.

11 [~~dd~~](gg) Section 529 (with respect to qualified tuition
12 programs) shall be operative for the purposes of this chapter,
13 except that sections 529(c)(6) and 529(e)(3)(A)(iii) shall not
14 be operative.

15 [~~ee~~](hh) Section 529A (with respect to qualified ABLE
16 programs) shall be operative for the purposes of this chapter,
17 except that section 529A(c)(3) (with respect to additional tax
18 for distributions not used for disability expenses) shall not be
19 operative.

20 [~~ff~~](ii) Section 530 (with respect to Coverdell
21 education savings accounts) of the Internal Revenue Code shall
22 be operative for the purposes of this chapter. For the purpose

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1 of determining the maximum amount that a contributor could make
2 to an education individual retirement account for state income
3 tax purposes, modified adjusted gross income as used in section
4 530 as operative for this chapter means federal modified
5 adjusted gross income as defined in section 530.

6 SECTION 4. Section 235-2.45, Hawaii Revised Statutes, is
7 amended to read as follows:

8 **"235-2.45 Operation of certain Internal Revenue Code**
9 **provisions; sections 641 to 7518.** (a) Section 641 (with respect
10 to imposition of tax) of the Internal Revenue Code shall be
11 operative for the purposes of this chapter subject to the
12 following:

13 (1) The deduction for exemptions shall be allowed as
14 provided in section 235-54(b);

15 (2) The deduction for contributions and gifts in
16 determining taxable income shall be limited to the amount
17 allowed in the case of an individual, unless the contributions
18 and gifts are to be used exclusively in the state; and

19 (3) The tax imposed by section 1(e) of the Internal Revenue
20 Code as applied by section 641 of the Internal Revenue Code is
21 hereby imposed by this chapter at the rate and amount as
22 determined under section 235- 51 on estates and trusts.

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1 (b) Section 667 (with respect to treatment of amounts
2 deemed distributed by trusts in preceding years) of the Internal
3 Revenue Code shall be operative for the purposes of this chapter
4 and the tax imposed therein is hereby imposed by this chapter at
5 the rate determined under this chapter; except that the
6 reference to tax-exempt interest to which section 103 of the
7 Internal Revenue Code applies in section 667(a) of the Internal
8 Revenue Code shall instead be a reference to tax-exempt interest
9 to which section 235-7(b) applies.

10 (c) Section 685 (with respect to treatment of qualified
11 funeral trusts) of the Internal Revenue Code shall be operative
12 for purposes of this chapter, except that the tax imposed under
13 this chapter shall be computed at the tax rates provided under
14 section 235-51, and no deduction for the exemption amount
15 provided in section 235-54(b) shall be allowed. The cost-of-
16 living adjustment determined under section 1(f)(3) of the
17 Internal Revenue Code shall be operative for the purpose of
18 applying section 685(c)(3) under this chapter.

19 (d) Section 704 of the Internal Revenue Code (with respect
20 to a partner's distributive share) shall be operative for
21 purposes of this chapter; except that section 704(b)(2) shall
22 not apply to:

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1 (1) Allocations of the high technology business investment
2 tax credit allowed by section 235-110.9 for investments made
3 before May 1, 2009;

4 (2) Allocations of net operating loss pursuant to section
5 235-111.5;

6 (3) Allocations of the attractions and educational
7 facilities tax credit allowed by section 235-110.46; or

8 (4) Allocations of low-income housing tax credits among
9 partners under section 235-110.8.

10 (e) Section 1202 (with respect to partial exclusion for
11 gain from certain small business stock) of the Internal Revenue
12 Code shall be operative for purposes of this chapter, except
13 that section 1202(a)(3) and (4) shall not be operative for
14 purposes of this chapter.

15 (f) Section 1212 (with respect to capital loss carrybacks
16 and carryforwards) of the Internal Revenue Code shall be
17 operative for the purposes of this chapter; except that for the
18 purposes of this chapter the capital loss carryback provisions
19 of section 1212 shall not be operative and the capital loss
20 carryforward allowed by section 1212(a) shall be limited to five
21 years; except for a qualified high technology business as

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1 defined in section 235-7.3, which shall be limited to fifteen
2 years.

3 (g) Section 1221 (with respect to the definition of capital
4 assets) is operative; provided that the provisions of section
5 301 of Public Law 110-343, which provide that gain or loss from
6 the sale or exchange of any applicable preferred stock by any
7 applicable financial institution (such terms being defined by
8 Public Law 110-343) shall be treated as ordinary income or loss,
9 shall not be operative. A sale or exchange of any applicable
10 preferred stock by any applicable financial institution (as
11 those terms are defined by section 301 of Public Law 110-343)
12 shall be treated as a sale of a capital asset and taxed
13 accordingly.

14 (h) Subchapter S (sections 1361 to 1379) (with respect to
15 tax treatment of S corporations and their shareholders) of
16 Chapter 1 of the Internal Revenue Code shall be operative for
17 the purposes of this chapter as provided in part VII[~~; except~~
18 ~~that section 1374(d) (7) (B), (C), and (D) shall not be operative~~
19 ~~for purposes of this chapter~~].

20 (i) Section 1400N (with respect to tax benefits for Gulf
21 Opportunity Zone) of the Internal Revenue Code shall be
22 operative for the purposes of this chapter, except that sections

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1 1400N(a) (with respect to tax-exempt bond financing); 1400N(b)
2 (with respect to advance refundings of certain tax-exempt
3 bonds); 1400N(c) (with respect to the low income housing
4 credit); 1400N(d) (with respect to special allowance for certain
5 property acquired on or after August 28, 2005); 1400N(e) (with
6 respect to increase in expensing under section 179); 1400N(h)
7 (with respect to increase in rehabilitation credit); 1400N(l)
8 (with respect to credit to holders of Gulf tax credit bonds);
9 1400N(m) (with respect to application of new markets tax credit
10 to investments in community development entities serving Gulf
11 Opportunity Zone); 1400N(n) (with respect to treatment of
12 representations regarding income eligibility for purposes of
13 qualified residential rental project requirements) shall not be
14 operative for purposes of this chapter.

15 (j) Section 1400S (with respect to additional tax relief
16 provisions) of the Internal Revenue Code shall be operative for
17 the purposes of this chapter, except that section 1400S(d) (with
18 respect to the special rule for determining earned income) shall
19 not be operative for the purposes of this chapter.

20 (k) Section 6015 (with respect to relief from joint and
21 several liability on joint return) of the Internal Revenue Code
22 is operative for purposes of this chapter.

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1 (1) Sections 6103(i)(3)(C) and 6103(i)(7) (with respect to
2 disclosures of information to the United States Justice
3 Department or appropriate federal or state law enforcement
4 agency for purposes of investigating terrorist incidents,
5 threats, or activities, and for analyzing intelligence
6 concerning investigating terrorist incidents, threats, or
7 activities) of the Internal Revenue Code shall be operative for
8 the purposes of this chapter.

9 (m) Sections 6221, 6222, [~~and 6231~~] 6223, 6225, and 6226
10 (with respect to [~~tax treatment of partnership items~~]
11 partnership audits) of subchapter C of chapter 63 of the
12 Internal Revenue Code shall be operative for the purposes of
13 this chapter; provided that if a taxpayer makes the election
14 under section 6221(b) for federal income tax purposes, that
15 taxpayer must make the same election for Hawaii income tax
16 purposes.

17 (n) [~~Subchapter D (sections 6240 to 6255) (with respect to~~
18 ~~simplified audit procedures for electing large partnerships)]
19 Section 6241 of the Internal Revenue Code shall be operative for
20 the purposes of this chapter[~~, with due regard to Chapter 232~~
21 ~~relating to tax appeals~~] ; except that subsections (1), (3), and
22 (5) shall not be operative for purposes of this chapter.~~

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1 (o) Section 6501(e) (with respect to limitation on
2 assessment and collection where there is a substantial omission
3 of items) of the Internal Revenue Code shall be operative for
4 purposes of this chapter.

5 (p) Section 6511(h) (with respect to running of periods of
6 limitation suspended while taxpayer is unable to manage
7 financial affairs due to disability) of the Internal Revenue
8 Code shall be operative for purposes of this chapter, with due
9 regard to section 235-111 relating to the limitation period for
10 assessment, levy, collection, or credit.

11 (q) Section 7518 (with respect to capital construction fund
12 for commercial fishers) of the Internal Revenue Code shall be
13 operative for the purposes of this chapter. Qualified
14 withdrawals for the acquisition, construction, or reconstruction
15 of any qualified asset that is attributable to deposits made
16 before the effective date of this section shall not reduce the
17 basis of the asset when withdrawn. Qualified withdrawals shall
18 be treated on a first-in-first-out basis.

19 SECTION 5. Section 236E-3, Hawaii Revised Statutes, is
20 amended to read as follows:

21 "**§236E-3 Conformance to the Internal Revenue Code; general**
22 **application.** For all decedents dying after December 31, [~~2016,~~]

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1 2017, as used in this chapter, "Internal Revenue Code" means
2 subtitle B of the federal Internal Revenue Code of 1986, as
3 amended as of December 31, [~~2016,~~] 2017, as it applies to the
4 determination of gross estate, adjusted gross estate, federal
5 taxable estate, and generation-skipping transfers, except those
6 provisions of the Internal Revenue Code and federal public laws
7 that, pursuant to this chapter, do not apply or are otherwise
8 limited in application."

9 SECTION 6. Statutory material to be repealed is bracketed
10 and stricken. New statutory material is underscored.

11 SECTION 7. This Act shall take effect upon its approval;
12 provided that:

13 (1) Section 2 shall apply to taxable years beginning after
14 December 31, 2017; and

15 (2) Section 3 shall apply to decedents dying or taxable
16 transfers occurring after December 31, 2017.

17

INTRODUCED BY: _____

BY REQUEST

_____.B. NO._____

Report Title:

Conformity to the Internal Revenue Code for 2017; Income Tax;
Estate and Generation-skipping Transfer Tax

Description:

Conforms Hawaii income and estate and generation-skipping
transfer tax laws to the Internal Revenue Code of 1986, as
amended as of December 31, 2017.

The summary description of legislation appearing on this page is for informational purposes only and is not legislation or evidence of legislative intent.

LATE

SB-2821

Submitted on: 2/5/2018 10:42:30 AM

Testimony for WAM on 2/6/2018 10:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Lucia You		Oppose	No

Comments: