

ACT 39

S.B. NO. 81

A Bill for an Act Relating to Taxation.

*Be It Enacted by the Legislature of the State of Hawaii:*

SECTION 1. The legislature finds that there are certain income and excise tax exemptions for which there are few or no taxpayers who qualify. The purpose of this Act is to repeal those little-used exemptions.

SECTION 2. Section 235-2.3, Hawaii Revised Statutes, is amended by amending subsection (b) to read as follows:

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

- (1) Subchapter A (sections 1 to 58) (with respect to determination of tax liability).
- (2) Section 78 (with respect to dividends received from certain foreign corporations by domestic corporations choosing foreign tax credit).
- (3) Section 86 (with respect to social security and tier 1 railroad retirement benefits).
- (4) Section 103 (with respect to interest on certain governmental obligations). For treatment, see section 235-7(b).
- (5) Section 103A (with respect to mortgage subsidy bonds).
- (6) Section 120 (with respect to amounts received under qualified group legal services plans). For treatment, see sections 235-2.4,

- [235-7(a)(10) to (12),] 235-7(a)(9) to (11), and 235-9(a)(2) and (5).
- (7) Section 122 (with respect to certain reduced uniformed services retirement pay). For treatment, see section 235-7(a)(3).
  - (8) Section 151 (with respect to allowance of deductions for personal exemptions). For treatment, see section 235-54.
  - (9) Section 169 (with respect to amortization of pollution control facilities). For treatment, see section 235-11.
  - (10) Section 196 (with respect to deduction for certain unused investment credits).
  - (11) Section 221 (with respect to deduction for two-earner married couples).
  - (12) Subchapter B, part VIII (sections 241 to 250) (with respect to special deductions for corporations), except sections 248 (with respect to organizational expenditures) and 249 (with respect to limitation on deduction of bond premium on repurchase). For treatment, see section 235-7(c).
  - (13) Section 269A (with respect to personal service corporations formed or availed of to avoid or evade income tax).
  - (14) Section 280C (with respect to certain expenses for which credits are allowable).
  - (15) Section 280D (with respect to portion of chapter 45 taxes for which credit or refund is allowable under section 6429).
  - (16) Section 291 (with respect to special rules relating to corporate preference items).
  - (17) Section 367 (with respect to foreign corporations).
  - (18) Subchapter F (sections 501 to 528) (with respect to exempt organizations), except as provided in section 235-2.4. For treatment, see section 235-9.
  - (19) Subchapter G (sections 531 to 565) (with respect to corporations used to avoid income tax on shareholders).
  - (20) Subchapter H (sections 581 to 597) (with respect to banking institutions). For treatment, see chapter 241.
  - (21) Section 642(a), (b), and (d) (with respect to special rules for credits and deductions).
  - (22) Section 668 (with respect to interest charge on accumulation distributions from foreign trusts).
  - (23) Subchapter L (sections 801 to 845) (with respect to insurance companies). For treatment, see sections 431-318 and 431-320.
  - (24) Section 853 (with respect to foreign tax credit allowed to shareholders). For treatment, see section 235-55.
  - (25) Subchapter N (sections 861 to 999) (with respect to tax based on income from sources within or without the United States), except part IV (sections 991 to 997) (with respect to domestic international sales corporations). For treatment, see sections 235-4, 235-5, and 235-7(b).
  - (26) Section 1055 (with respect to redeemable ground rents).
  - (27) Section 1057 (with respect to election to treat transfer to foreign trust, etc., as taxable exchange).
  - (28) Section 1201 (with respect to alternative tax). For treatment, see section 235-71(a).
  - (29) Subchapter Q (sections 1301 to 1351) (with respect to readjustment of tax between years and special limitations).
  - (30) Subchapter T (sections 1381 to 1388) (with respect to cooperatives and their patrons). For treatment, see chapter 421."

SECTION 3. Section 235-7, Hawaii Revised Statutes, is amended by amending subsections (a) and (b) to read as follows:

“(a) There shall be excluded from gross income, adjusted gross income, and taxable income:

- (1) Income not subject to taxation by the State under the Constitution and laws of the United States;
- (2) Rights, benefits, and other income exempted from taxation by section 88-91, having to do with the state retirement system, and the rights, benefits, and other income, comparable to the rights, benefits, and other income exempted by section 88-91, under any other public retirement system;
- (3) Any compensation received in the form of a pension for past services, or paid as a weekly benefit for unemployment up to but not in excess of the amount provided by the employment security law but the amount of the exclusion shall not exceed the exclusion allowed under section 85 of the Internal Revenue Code made operative for the purposes of this chapter (it being the intention of this provision to exempt that amount whether paid from a fund or account in the federal or state treasury or paid by an employer or by a trust or other means provided by an employer);
- (4) Compensation paid to a patient affected with Hansen’s disease employed by the State or the United States in any hospital, settlement, or place for the treatment of Hansen’s disease;
- (5) Except as otherwise expressly provided, payments made by the United States or this State, under an act of Congress or a law of this State, which by express provision or administrative regulation or interpretation are exempt from both the normal and surtaxes of the United States, even though not so exempted by the Internal Revenue Code itself;
- [(6)] All proceeds received by organizations enumerated under section 237-23(a)(5) to (8), resulting from the sale of brooms which are manufactured by blind persons working at the adult blind broom shop;
- (7) (6) Any income expressly exempted or excluded from the measure of the tax imposed by this chapter by any other law of the State, it being the intent of this chapter not to repeal or supersede any such express exemption or exclusion;
- [(8)] (7) The first \$500 received by each member of the reserve components of the army, navy, air force, marine corps, coast guard of the United States of America, and the Hawaii national guard as compensation for performance of duty as such;
- [(9)] (8) Income derived from the operation of ships or aircraft if such income is exempt under the Internal Revenue Code pursuant to the provisions of an income tax treaty or agreement entered into by and between the United States and a foreign country, provided that the tax laws of the local governments of that country reciprocally exempt from the application of all of their net income taxes, the income derived from the operation of ships or aircraft which are documented or registered under the laws of the United States;
- [(10)] (9) The value of legal services provided by a prepaid legal service plan to a taxpayer, the taxpayer’s spouse, and the taxpayer’s dependents;

[(11)] (10) Amounts paid, directly or indirectly, by a prepaid legal service plan to a taxpayer as payment or reimbursement for the provision of legal services to the taxpayer, the taxpayer's spouse, and the taxpayer's dependents;

[(12)] (11) Contributions by an employer to a prepaid legal service plan for compensation (through insurance or otherwise) to the employer's employees for the costs of legal services incurred by the employer's employees, their spouses, and their dependents.

(b) There shall be included in gross income, adjusted gross income, and taxable income: (1) unless excluded by this chapter relating to the uniformed services of the United States, cost-of-living allowances and other payments exempted by section 912 of the Internal Revenue Code, but section 119 of the Internal Revenue Code nevertheless shall apply; (2) unless expressly exempted or excluded as provided by subsection [(a)(7) of this section,] (a)(6), interest on the obligations of a State or a political subdivision thereof."

SECTION 4. Section 237-23, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) This chapter shall not apply to the following persons:

- (1) Banks taxable under chapter 241;
- (2) Public service companies (as that term is defined in section 239-2), with respect to the gross income, either actual gross income or gross income estimated and adjusted, which is included in the measure of the tax imposed by chapter 239;
- (3) Public utilities owned and operated by the State or any county or other political subdivision thereof;
- (4) Insurance companies which pay the State a tax upon their gross premiums under chapter 431;
- (5) Fraternal benefit societies, orders, or associations, operating under the lodge system, or for the exclusive benefit of the members of the fraternity itself, operating under the lodge system, and providing for the payment of death, sick, accident, prepaid legal services, or other benefits to the members of such societies, orders, or associations, and to their dependents;
- (6) Corporations, associations, trusts, or societies organized and operated exclusively for religious, charitable, scientific, or educational purposes, as well as that of operating senior citizens housing facilities qualifying for a loan under the laws of the United States as authorized by section 202 of the Housing Act of 1959, as amended by the Housing Act of 1961, the Senior Citizens Housing Act of 1962, the Housing Act of 1964, and the Housing and Urban Development Act of 1965 as well as that of operating a prepaid legal services plan;
- (7) Business leagues, chambers of commerce, boards of trade, civic leagues, and organizations operated exclusively for the benefit of the community and for the promotion of social welfare which shall include the operation of a prepaid legal service plan, and from which no profit inures to the benefit of any private stockholder or individual;
- (8) Hospitals, infirmaries, and sanatoria;
- (9) Cooperative associations now or hereafter incorporated under and pursuant to chapter 421 or 422 and which fully meet the requirements of section 421-23 or section 422-33 (provided that

the exemption shall apply only to the gross income derived from its activities authorized by chapter 421 or 422; and that the exemption shall not relieve any person who receives any proceeds of sale from the association of the duty of returning and paying the tax on the total gross proceeds of the sales on account of which the payment was made, in the same amount and at the same rate as would apply thereto had the sales been made directly by the person, and all such persons shall be so taxable);

- (10) Building and loan associations taxable under chapter 241;
- (11) Persons affected with Hansen's disease and kokuas, with respect to business within the county of Kalawao;
- (12) Corporations, companies, associations, or trusts organized for the establishment and conduct of cemeteries no part of the net earnings of which inures to the financial benefit of any private stockholder or individual (provided that the exemption shall apply only to the activities of such persons in the conduct of cemeteries and not to any activity the primary purpose of which is to produce income, even though the income is to be used for or in the furtherance of the exempt activities of such persons);
- (13) Industrial loan companies taxable under chapter 241; provided that the exemption shall apply only to the income from the "engaging in the business of an industrial loan company" as defined in section 408-2;
- [(14) Businesses which are organized for the purpose of broadcasting radio programs to areas outside of the State to promote the Hawaiian tourist industry and which are solely supported by state funds;
- (15) (14) Development companies taxable under chapter 241; provided that the exemption shall apply only to gross income derived as interest on loans made to borrowers as provided by Title V of the federal Small Business Investment Act of 1958, Public Law 699, as amended;
- [(16) (15) Nonprofit shippers associations operating under part 296 of the Civil Aeronautics Board Economic Regulations;
- [(17) (16) Small business investment companies taxable under chapter 241; provided that the exemption shall apply only to the income derived from activities engaged in as provided by the federal Small Business Investment Act of 1958, Public Law 699, as amended; provided further that the exemption shall not apply to consulting and advisory services engaged in under the first sentence of section 308(b) of Public Law 699."

SECTION 5. Section 237-24, Hawaii Revised Statutes, is amended to read as follows:

**"§237-24 Amounts not taxable.** This chapter shall not apply to the following amounts:

- (1) Amounts received under life insurance policies and contracts paid by reason of the death of the insured;
- (2) Amounts received (other than amounts paid by reason of death of the insured) under life insurance, endowment, or annuity contracts, either during the term or at maturity or upon surrender of the contract;
- (3) Amounts received under any accident insurance or health insurance policy or contract or under workers' compensation acts or employers' liability acts, as compensation for personal injuries,

- death, or sickness, including also the amount of any damages or other compensation received, whether as a result of action or by private agreement between the parties on account of the personal injuries, death, or sickness;
- (4) The value of all property of every kind and sort acquired by gift, bequest, or devise, and the value of all property acquired by descent or inheritance;
  - (5) Amounts received by any person as compensatory damages for any tort injury to the person, or to the person's character reputation, or received as compensatory damages for any tort injury to or destruction of property, whether as the result of action or by private agreement between the parties (provided that amounts received as punitive damages for tort injury or breach of contract injury shall be included in gross income);
  - (6) Amounts received as salaries or wages for services rendered by an employee to an employer;
  - (7) Amounts received as alimony and other similar payments and settlements;
  - (8) Amounts collected by distributors as fuel taxes on "liquid fuel" imposed by chapter 243, and the amounts collected by such distributors as a fuel tax imposed by any act of the Congress of the United States;
  - (9) Taxes on liquor imposed by chapter 244D on dealers holding permits under that chapter;
  - (10) The amounts of taxes on tobacco products imposed by chapter 245 on wholesalers or dealers holding licenses under that chapter and selling the products at wholesale, and the amounts of taxes on tobacco products collected from a wholesaler by another where the wholesaler makes separate charges for the amounts so collected from the wholesaler and collects the same from those purchasing from the wholesaler as provided by chapter 245;
  - (11) Federal excise taxes imposed on articles sold at retail and collected from the purchasers thereof and paid to the federal government by the retailer;
  - (12) The amounts of federal taxes under chapter 37 of the Internal Revenue Code, or similar federal taxes, imposed on sugar manufactured in the State, paid by the manufacturer to the federal government;
  - (13) An amount up to, but not in excess of, \$2,000 a year of gross income received by any blind, deaf, or totally disabled person engaging, or continuing, in any business, trade, activity, occupation, or calling within the State;
  - [(14) Amounts received by an organization enumerated under section 237-23(a)(5) to (8) from the sale of brooms which are manufactured by blind persons working at the adult blind broom shop;
  - (15)] (14) Amounts received by a producer of sugarcane from the manufacturer to whom the producer sells the sugarcane, where (A) the producer is an independent cane farmer, so classed by the secretary of agriculture under the Sugar Act of 1948 (61 Stat. 922, Chapter 519) as the Act may be amended or supplemented, and (B) the value of the sugar, and other products manufactured from the sugarcane, is included in the measure of the tax levied on the manufacturer under section 237-13(1), and (C) the producer's gross proceeds of sales are dependent upon the actual value of the products manufactured therefrom or the average

value of all similar products manufactured by the manufacturer, and (D) the producer's gross proceeds of sales are reduced by reason of the tax on the value of the manufactured products;

- [(16)] (15) Money paid by the State or eleemosynary child-placing organizations to foster parents for their care of children in foster homes;
- [(17)] (16) Amounts received by a cooperative housing corporation from its shareholders in reimbursement of funds paid by such corporation for lease rental, real property taxes, and other expenses of operating and maintaining the cooperative land and improvements, provided that such a cooperative corporation is a corporation:
  - (A) Having one and only one class of stock outstanding;
  - (B) Each of the stockholders of which is entitled solely by reason of the stockholder's ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building owned or leased by the corporation;
  - (C) No stockholder of which is entitled (either conditionally or unconditionally) to receive any distribution not out of earnings and profits of the corporation except in a complete or partial liquidation of the corporation;
- [(18)] (17) Amounts received from the loading, transportation, and unloading of agricultural commodities shipped for a producer or produce dealer on one island of this State to a person, firm, or organization on another island of this State. The terms "agricultural commodity", "producer", and "produce dealer" shall be defined in the same manner as they are defined in section 147-1;
- [(19)] (18) Amounts received from sales of (A) intoxicating liquor as defined in chapter 244D, (B) tobacco products as defined in chapter 245, and (C) agricultural, meat, or fish products grown, raised, or caught in Hawaii, when such sales are made to any person or common carrier in interstate or foreign commerce, or both, whether ocean-going or air, for consumption out-of-state by such person, crew, or passengers on such shipper's vessels or airplanes;
- [(20)] (19) Amounts received by the manager or board of directors of an association of apartment owners of a horizontal property regime established in accordance with chapter 514A in reimbursement of sums paid for common expenses;
- [(21)] (20) Any provision of law to the contrary notwithstanding, exemptions or exclusions from tax under this chapter allowed on or before April 1, 1978, for amounts received by any person or common carrier engaged in interstate or foreign commerce, or both, whether ocean-going or air, shall continue undiminished and be available thereafter to the extent and under the conditions such exemptions or exclusions have theretofore been previously allowed in the State under the provisions of the Constitution of the United States or an act of the Congress of the United States;
- [(22)] (21) Amounts received by an employee benefit plan by way of contributions, dividends, interest, and other income; and amounts received by a nonprofit organization or office, as payments for costs and expenses incurred for the administration of an employee benefit plan. For the purposes of this paragraph,

- “employee benefit plan” means any plan as defined in section 1002(3) of title 29 of the United States Code, as amended;
- [(23)] (22) Amounts received for purchases made with United States Department of Agriculture food coupons if the United States Secretary of Agriculture determines under Public Law 99-198 that the tax imposed by this chapter will disqualify the State of Hawaii from participation in the federal food stamp program. If such a determination is made, and upon being so informed by the United States Secretary of Agriculture, the director of taxation shall immediately inform the general public by public notice of the exempt status;
- [(24)] (23) Amounts received by a hospital, infirmary, medical clinic, health care facility, pharmacy, or a practitioner licensed to administer the drug to an individual for selling prescription drugs or prosthetic devices to an individual. This paragraph shall not apply to any amounts received for services provided in selling prescription drugs or prosthetic devices. As used in this section: “Prescription drugs” are those drugs required to be prescribed by a practitioner licensed under law to administer the drug and which are dispensed and sold by a licensed pharmacist under section 328-16. “Prosthetic device” means any artificial device or appliance used to replace a missing or surgically removed part of the human body prescribed by a licensed practitioner of medicine, osteopathy, or podiatry; provided that “prosthetic device” shall not mean any auditory, ophthalmic, dental, or ocular device or appliance;
- [(25)] (24) Taxes on transient accommodations imposed by chapter 237D and passed on and collected by operators holding certificates of registration under that chapter; and
- [(26)] (25) Amounts received as dues by an unincorporated merchants association from its membership for advertising media, promotional, and advertising costs for the promotion of the association for the benefit of its members as a whole and not for the benefit of an individual member or group of members less than the entire membership.”

SECTION 6. Section 241-4, Hawaii Revised Statutes, is amended by amending subsection (b) to read as follows:

“(b) The “entire net income from all sources” shall be determined in the same manner as the “taxable income” of a corporation, as provided by chapter 235, with the following changes and adjustments:

- (1) There is included in gross income interest received upon the obligations of the United States or its possessions, or upon securities issued under the authority of an act of Congress, or upon state, territorial, municipal, county, or other bonds or securities whether or not the income from such obligations, bonds, or securities, is tax free. Section 235-7(a)(1)[.] and (6)[.] and (7)] does not apply.
- (2) Section 235-3(c), (d), and (e) does not apply.
- (3) In lieu of section 235-4, it is provided that there shall be excluded the gross income from property owned, trade or business carried on, and other sources outside the State.



- (4) Section 235-5 does not apply. The income excluded pursuant to paragraph (3) shall be determined by an allocation and separate accounting. Losses from property owned outside the State and from other sources outside the State shall not be deducted. Reserves shall be allocated to the State by an application of a fraction, the numerator of which consists of the gross income included in determining the "entire net income from all sources" pursuant to this chapter and the denominator of which consists in the gross income similarly ascertained but without regard to whether from sources within or without the State.
- (5) Deductions connected with income which by this chapter is required to be included in the computation of net income shall be allowed, but deductions connected with income which by this chapter is not to be included in the computation of net income shall not be allowed. Section 235-7(e)(1) does not apply.
- (6) One-half of such amount of capital gain as, under the Internal Revenue Code, is entitled to the alternative tax treatment, is deductible in the determination of net income.
- (7) Section 166 of the Internal Revenue Code does not apply, except the provisions as to the basis for determining the amount of the deduction for a bad debt. Section 593 of the Internal Revenue Code does not apply. In lieu of the cited sections of the Internal Revenue Code, debts ascertained to be worthless and charged off on the books of the taxpayer within the income year may be deducted, or in the discretion of the department of taxation a reasonable addition to a reserve for bad debts; provided that when satisfied that a debt is recoverable only in part, the department may allow the debt to be charged off in part.
- (8) Federal income taxes upon income derived or received from sources in the State may be deducted.
- (9) In the case of any life insurance company (as defined by the Internal Revenue Code), which is determined to be a financial corporation as defined by this chapter, sections 801, 811, and 812 of the Internal Revenue Code do not apply. The total of the deductions allowed by sections 807 and 810 of the Internal Revenue Code shall not exceed the amount of the required interest, as defined by section 807 of the Internal Revenue Code.
- (10) Section 582(c) (with respect to bonds, etc., losses and gains of financial institutions) of the Internal Revenue Code shall be operative for the purposes of this chapter."

SECTION 7. Section 421G-4, Hawaii Revised Statutes, is amended by amending subsection (c) to read as follows:

"(c) The membership shares and cooperative fees are interests in real property for purposes of:

- (1) Cooperative housing corporations under section 216 of the federal Internal Revenue Code of 1954, as amended;
- (2) Exemption from state general excise tax under section [237-24(17);] 237-24(16); and
- (3) Exemption from real property tax under sections 246-26 and 246-27(3)."

SECTION 8. Section 237-28, Hawaii Revised Statutes, is repealed.

## **ACT 39**

SECTION 9. Statutory material to be repealed is bracketed. New statutory material is underscored.<sup>1</sup>

SECTION 10. This Act shall take effect on July 1, 1987 except for sections 2 and 3, which shall apply to the taxable years beginning after December 31, 1986.

(Approved May 19, 1987.)

### **Note**

1. Edited pursuant to HRS §23G-16.5.