

ACT 13

S.B. NO. 2963

A Bill for an Act Relating to Conformity to the Internal Revenue Code.

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

SECTION 1. Chapter 235, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

“§235- Innocent spouse relieved of liability in certain cases. (a) If a husband and wife have made a joint return under this chapter for a taxable year, and:

- (1) On the return there is a substantial understatement of tax attributable to grossly erroneous items of one spouse,
- (2) The innocent spouse establishes that in signing the return the innocent spouse did not know, and had no reason to know, that there was a substantial understatement, and
- (3) Taking into account all the facts and circumstances, it is inequitable to hold the innocent spouse liable for the deficiency in tax for the taxable year attributable to the substantial understatement,

then the innocent spouse shall be relieved of liability for tax (including interest, penalties, and other amounts) for the taxable year to the extent the liability is attributable to the substantial understatement.

(b) If the spouse's adjusted gross income for the preadjustment year is \$20,000 or less, this section shall apply only if the liability described in subsection (a) is greater than ten per cent of the spouse's adjusted gross income. If the spouse's adjusted gross income for the preadjustment year is more than \$20,000, this section shall apply only if the liability described in subsection (a) is greater

than twenty-five per cent of the spouse's adjusted gross income. If the spouse is married to another spouse at the close of the preadjustment year, the spouse's adjusted gross income shall include the income of the new spouse (whether or not they file a joint return).

(c) For purposes of this section,

"Grossly erroneous items" mean, with respect to any spouse, any item of gross income attributable to the spouse which is omitted from gross income and any claim of a deduction, credit, or basis by the spouse in an amount for which there is no basis in fact or law.

"Preadjustment year" means the most recent taxable year of the spouse ending before the date the deficiency notice is mailed.

"Substantial understatement" means any understatement which exceeds \$500.

"Understatement" means the excess of:

- (1) The amount of the tax required to be shown on the return for the taxable year, over
- (2) The amount of the tax imposed which is shown on the return, reduced by any abatement, credit, refund, or other repayment, as was made on the ground that the tax imposed by this chapter was less than the excess of the amount which is the sum of:
 - (A) The amount shown as the tax on the taxpayer's return, if a return was made by the taxpayer and an amount was shown as tax by the taxpayer on the return, plus
 - (B) The amounts previously assessed (or collected without assessment) as a deficiency, over the abatements, credits, refunds, or other repayments previously made."

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

"§235-2.3 Conformance to the federal Internal Revenue Code; general application. (a) For all taxable years beginning after December 31, [1992,] 1993, as used in this chapter "Internal Revenue Code" means subtitle A, chapter 1 of the federal Internal Revenue Code of 1954 as amended as of December 31, [1992,] 1993, as it applies to the determination of gross income, adjusted gross income, ordinary income and loss, and taxable income except those provisions of the Internal Revenue Code and federal Public Law which pursuant to this chapter, this section, and sections 235-2.4 and 235-2.5 do not apply or are otherwise limited in application; provided that section 1202 (with respect to deductions for capital gains) of the Internal Revenue Code of 1954 as amended as of December 31, 1986, shall be operative for the purposes of this chapter until March 31, 1987, and shall apply to any capital gains properly taken before April 1, 1987, except that the deduction provided in section 1202(a) shall be fifty-five per cent of the net capital gain.

Sections 235-2, 235-2.1, and 235-2.2 shall continue to be used to determine (1) the basis of property, if a taxpayer first determined the basis of property in a taxable year to which such sections apply, and if such determination was made before January 1, 1978, and (2) gross income, adjusted gross income, ordinary income and loss, and taxable income for a taxable year to which such sections apply where such taxable year begins before January 1, 1978.

(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 59A) (with respect to determination of tax liability), except section 42 (with respect to the low-income housing credit) and except sections 47 and 48, as amended, as of December 31, 1984 (with respect to certain depreciable tangible personal property). For treatment, see sections 235-110.7 and 235-110.8.
- (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 state and local bonds). For treatment, see section 235-7(b).
- (5) Section 120 (with respect to amounts received under qualified group legal services plans). For treatment, see section 235-7(a)(9) to (11).
- (6) Section 122 (with respect to certain reduced uniformed services retirement pay). For treatment, see section 235-7(a)(3).
- (7) Section 135 (with respect to income from United States saving bonds used to pay higher education tuition and fees). For treatment, see section 235-7(a)(1).
- (8) Subchapter B (sections 141 to 150) (with respect to tax exemption requirements for state and local bonds).
- (9) Section 151 (with respect to allowance of deductions for personal exemptions). For treatment, see section 235-54.
- (10) Section 196 (with respect to deduction for certain unused investment credits).
- (11) Sections 241 to 247 (with respect to special deductions for corporations). For treatment, see section 235-7(c).
- (12) Section 269A (with respect to personal service corporations formed or availed of to avoid or evade income tax).
- (13) Section 280C (with respect to certain expenses for which credits are allowable).
- (14) Section 291 (with respect to special rules relating to corporate preference items).
- (15) Section 367 (with respect to foreign corporations).
- (16) Section 501(c)(12), (15), (16) (with respect to exempt organizations).
- (17) Section 515 (with respect to taxes of foreign countries and possessions of the United States).
- (18) Section 521 (with respect to exemption of farmers cooperatives from tax). For treatment, see section 421-23.
- (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 848) (with respect to insurance companies). For treatment, see sections 431:7-202 and 431:7-204.
- (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) Subchapter Q (sections 1311 to 1351) (with respect to readjustment of tax between years and special limitations).
- (29) Subchapter T (sections 1381 to 1388) (with respect to cooperatives and their patrons). For treatment, see chapter 421.
- (30) Subchapter U (sections 1391 to 1397D) (with respect to designation and treatment of empowerment zones, enterprise communities, and rural development investment areas). For treatment, see chapter 209E."

SECTION 3. Statutory material to be repealed is bracketed. New statutory material is underscored.¹

SECTION 4. This Act shall take effect upon its approval; provided that section 1 shall apply to deficiency notices sent by the department of taxation to the taxpayers after December 31, 1990, for which relief of liability has been obtained pursuant to section 6013(e), of the Internal Revenue Code of 1986, as amended; and provided that section 2 shall apply to taxable years beginning after December 31, 1993.

(Approved April 12, 1994.)

Note

- 1. Edited pursuant to HRS §23G-16.5.