

ACT 187

H.B. NO. 3551

A Bill for an Act Relating to Income Taxation.

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

SECTION 1. 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, [1994,] 1995, as used in this chapter “Internal Revenue Code” means [subtitle A, chapter 1 of] the [federal] Internal Revenue Code of [1954] 1986, as amended as of December 31, [1994,] 1995. Chapter 1 of the Internal Revenue Code is made operative for purposes of this chapter 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] public laws 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] savings 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)] (12) Section 280C (with respect to certain expenses for which credits are allowable).
- [(14)] (13) Section 291 (with respect to special rules relating to corporate preference items).
- [(15)] (14) Section 367 (with respect to foreign corporations).
- [(16)] (15) Section 501(c)(12), (15), (16) (with respect to exempt organizations).
- [(17)] (16) 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)] (17) Subchapter G (sections 531 to 565) (with respect to corporations used to avoid income tax on shareholders).
- [(20)] (18) Subchapter H (sections 581 to 597) (with respect to banking institutions). For treatment, see chapter 241.
- [(21)] (19) Section 642(a)[,] and (b)[, and (d)] (with respect to special rules for credits and deductions[.]) applicable to trusts. For treatment, see sections 235-54(b) and 235-55.
- [(22)] (20) Section 668 (with respect to interest charge on accumulation distributions from foreign trusts).
- [(23)] (21) Subchapter L (sections 801 to 848) (with respect to insurance companies). For treatment, see sections 431:7-202 and 431:7-204.
- [(24)] (22) Section 853 (with respect to foreign tax credit allowed to shareholders). For treatment, see section 235-55.
- [(25)] (23) 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).] sections 985 to 989 (with respect to foreign currency transactions). For treatment, see sections 235-4, 235-5, [and] 235-7(b)[,], and 235-55.
- [(26)] (24) Section 1055 (with respect to redeemable ground rents).
- [(27)] (25) Section 1057 (with respect to election to treat transfer to foreign trust, etc., as taxable exchange).
- (26) Sections 1291 to 1297 (with respect to treatment of passive foreign investment companies).
- [(28)] (27) 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)] (28) 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 2. Section 235-2.4, Hawaii Revised Statutes, is amended to read as follows:

“§235-2.4 Operation of certain Internal Revenue Code provisions. (a)

Section 63 (with respect to taxable income defined) of the Internal Revenue Code shall be operative for the purposes of this chapter, except that the standard deduction amount in section 63(c) of the Internal Revenue Code shall instead mean:

- (1) \$1,900 in the case of:
 - (A) A joint return as provided by section 235-93, or
 - (B) A surviving spouse (as defined in section 2(a) of the Internal Revenue Code),
- (2) \$1,650 in the case of a head of household (as defined in section 2(b) of the Internal Revenue Code),
- (3) \$1,500 in the case of an individual who is not married and who is not a surviving spouse or head of household, or
- (4) \$950 in the case of a married individual filing a separate return.

Section 63(c)(4) shall not be operative in this State. Section 63(c)(5) shall be operative, except that the limitation on basic standard deduction in the case of certain dependents shall be the greater of \$500 or such individual's earned income. Section 63(f) shall not be operative in this State.

(b) Section 219 (with respect to retirement savings) of the Internal Revenue Code shall be operative for the purpose of this chapter. For the purpose of computing the limitation on the deduction for active participants in certain pension plans for state income tax purposes, adjusted gross income as used in section 219 as operative for this chapter means federal adjusted gross income.

(c) In administering the provisions of sections 410 to 417 (with respect to special rules relating to pensions, profit sharing, stock bonus plans, etc.), sections 418 to 418E (with respect to special rules for multiemployer plans), and sections 419 and 419A (with respect to treatment of welfare benefit funds) of the Internal Revenue Code, the department of taxation shall adopt rules under chapter 91 relating to the specific requirements under such sections and to such other administrative requirements under those sections as may be necessary for the efficient administration of sections 410 to 419A.

In administering sections 401 to 419A (with respect to deferred compensation) of the Internal Revenue Code, Public Law 93-406, section 1017(i), shall be operative for the purposes of this chapter.

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

(d) Section 468B (with respect to special rules for designated settlement funds) shall be operative for the purposes of this chapter and the tax imposed therein is hereby imposed by this chapter at a rate equal to the maximum rate in effect for the taxable year imposed on estates and trusts under section 235-51.

(e) Section 469 (with respect to passive activities and credits limited) shall be operative for the purposes of this chapter. For the purpose of computing the offset for rental real estate activities for state income tax purposes, adjusted gross income as used in section 469 as operative for this chapter means federal adjusted gross income.

(f) Sections 512 to 514 (with respect to taxation of business income of certain exempt organizations) of the Internal Revenue Code shall be operative for the purposes of this chapter as provided in this subsection.

[The persons and organizations exempted by section 235-9 shall, if subject to tax under the Internal Revenue Code upon their “unrelated business taxable income”, be taxed thereon under this chapter. For the purposes of this subsection the

term “taxable income” as used in subsection (h)(2) of this section and section 235-71 shall be read as “unrelated business taxable income”.]

“Unrelated business taxable income” means the same as in the Internal Revenue Code, except that in the computation thereof sections 235-3 to 235-5, and 235-7 (except subsection (c)), shall apply, and in the determination of the net operating loss deduction [under section 235-7(d)] there shall not be taken into account any amount of income or deduction which is excluded in computing the unrelated business taxable income. Unrelated business taxable income shall not include any income from a prepaid legal service plan.

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

(g) Section 521 (with respect to cooperatives) and subchapter T (sections 1381 to 1388, with respect to cooperatives and their patrons) shall be operative for the purposes of this chapter as to any cooperative fully meeting the requirements of section 421-23, except that Internal Revenue Code section 521 cooperatives need not be organized in Hawaii.

[(g)] (h) Sections 527 (with respect to political organizations) and 528 (with respect to certain homeowners associations) shall be operative for the purposes of this chapter and the taxes imposed in each such section are hereby imposed by this chapter at the rates determined under section 235-71.

[(h)] (i) Section 641 (with respect to imposition of tax) of the Internal Revenue Code shall be operative for the purposes of this chapter subject to the following:

- (1) The deduction for exemptions shall be allowed as provided in section 235-54(b).
- (2) The deduction for contributions and gifts in determining taxable income shall be limited to the amount allowed in the case of an individual, unless the contributions and gifts are to be used exclusively in the State.
- (3) The tax imposed by section 1(e) of the Internal Revenue Code as applied by section 641 of the Internal Revenue Code is hereby imposed by this chapter at the rate and amount as determined under section 235-51 on estates and trusts.

[(i)] (j) Section 644 (with respect to special rule for gain on property transferred to trust at less than fair market value) of the Internal Revenue Code shall be operative for the purposes of this chapter and the tax imposed therein is hereby imposed by this chapter at the rate determined under this chapter; except that the determination of the interest rate established under section 6621 of the Internal Revenue Code referred to in section 644(a)(2) of the Internal Revenue Code shall instead be the interest rate established under section 231-39(b)(4).

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

[(k) Sections 991 to 997 (with respect to domestic international sales corporations) of the Internal Revenue Code shall be operative for the purposes of this chapter; provided that any corporation electing to be a domestic international sales corporation under this chapter shall be incorporated and have its principal place of business in this State.]

(l) Section 1034 (with respect to rollover of gain on sale of principal residence) of the Internal Revenue Code shall be operative for the purpose of this chapter; provided section 1034(a) (with respect to nonrecognition of gain) of the Internal Revenue Code shall apply only to:

- (1) A taxpayer who purchases a replacement residence which is located within the State;
- (2) A taxpayer who is a resident of the State, taxable upon the taxpayer's entire income, computed without regard to source within the State; or
- (3) A taxpayer (or the taxpayer's spouse if the old residence and the new residence are each used by the taxpayer and the taxpayer's spouse as their principal residence) who, while serving on extended active duty with the armed forces of the United States, purchased a residence in Hawaii and later sold the residence.

(m) Section 1212 (with respect to capital loss carrybacks and carryforwards) of the Internal Revenue Code shall be operative for the purposes of this chapter; except that for the purposes of this chapter the capital loss carryback provisions of section 1212 shall not be operative and the capital loss carryforward allowed by section 1212(a), shall be limited to five years.

(n) 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.

(o) Subchapter C (sections 6221 to 6233) (with respect to tax treatment of partnership items) of chapter 63 of the Internal Revenue Code shall be operative for the purposes of this chapter.

(p) Subchapter D (sections 6241 to 6245) (with respect to tax treatment of subchapter S items) of chapter 63 of the Internal Revenue Code shall be operative for the purposes of this chapter, and shall be interpreted with due regard to part VII.

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

SECTION 3. Section 235-2.5, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

“(a) Reference in provisions of [subtitle A, chapter 1, of] the Internal Revenue Code which are operative in this State to provisions in the Internal Revenue Code which are not operative in this State shall be considered inoperative for the purposes of determining gross income, adjusted gross income, ordinary income and loss, and taxable income; provided that [references]:

- (1) References to time limits and other administrative provisions in subtitle F (sections 6001 to 7873) of the Internal Revenue Code contained in operative sections of [subtitle A, chapter 1, of] the Internal Revenue Code shall be deemed references to applicable provisions of this chapter or chapter 231 or 232, and in the absence of applicable provisions in this chapter or chapter 231 or 232, then to rules adopted by the director of taxation under subsection (b)[.];
- (2) If inoperative provisions of [subtitle A, chapter 1, of] the Internal Revenue Code have been codified in this chapter such references shall be deemed references to the codified provisions in this chapter. Transitory and savings provisions in federal Public Laws amending sections of the Internal Revenue Code operative in this chapter shall be opera-

tive for the purposes of this chapter. Provisions in this chapter or chapter 231 or 232 in conflict with the Internal Revenue Code or transitory or savings provisions in federal Public Law shall controll[.]; and

- (3) Retroactive provisions in federal Public Laws amending sections of the federal Internal Revenue Code operative in this chapter affecting taxable years beginning or ending before the December 31 date in section 235-2.3 shall be operative for the purposes of this chapter; provided that the effective dates in Public Law 96-471 placing it in effect for the taxable year 1980 shall be operative for the purposes of this chapter."

SECTION 4. Section 235-3, Hawaii Revised Statutes, is amended by amending subsection (b) to read as follows:

"(b) The Internal Revenue Code, so far as made [applicable] operative by this chapter, is a statute adopted and incorporated by reference. [Whenever, in] The Internal Revenue Code shall be applied using changes in nomenclature and other language, including the omission of inapplicable language, where necessary to effectuate the intent of this section. In the Internal Revenue Code, [the words] references to terms such as:

- (1) "Secretary or his delegate"[.], or words of like import are used, such words mean] shall refer to the director of taxation and the director's duly authorized subordinates[.], and the words "estate];
- (2) "Estate taxes" [mean] shall refer to the estate and transfer tax imposed by chapter 236D[.];
- (3) "The highest rate of tax imposed upon individuals" or "39.6 per cent" shall refer to the highest rate imposed upon individuals under section 235-51;
- (4) "The highest rate of tax imposed upon corporations" shall refer to the highest rate imposed upon corporations under section 235-71; and
- (5) "Interest at the underpayment rate" or "interest at the overpayment rate" shall refer to the interest rate set forth in section 231-39(b)(4) or section 231-23(d)(1), as the case may be."

SECTION 5. Section 235-55, Hawaii Revised Statutes, is amended to read as follows:

"§235-55 Tax credits for resident taxpayers. (a) Whenever an individual or person liable to the taxes imposed upon individuals, who is a resident of the State[,], or who has filed a joint resident return under section 235-93, has become liable for income taxes to a state, or to the District of Columbia, Puerto Rico, or any other territory or possession of the United States, or to a foreign country upon any part of the individual's or person's taxable income for the taxable year, derived or received from sources without the State and taxed under the laws of such other jurisdiction irrespective of the residence or domicile of the recipient, there shall be credited against the tax payable by the individual or person under this chapter the tax so paid by the individual or person to the other jurisdiction upon the individual's or person's producing for the department of taxation satisfactory evidence:

- (1) [of] Of such tax payment[.]; and
- (2) [that] That the laws of the other jurisdiction do not allow the individual or person a credit against the taxes imposed by such jurisdiction for the taxes paid or payable under this chapter, or do allow such credit in an amount which has been deducted in computing the amount of credit sought under this section.

(b) The application of such credit, however:

- [(A)] (1) Shall not be allowed with respect to any taxable income or any tax which under subchapter N of chapter 1 of the Internal Revenue Code of 1954 (which is applicable for federal purposes but not for state purposes) is or may be the subject of an exclusion, exemption, or tax credit; and
- [(B)] (2) Shall not operate to reduce the tax payable under this chapter to an amount less than that which would have been payable had the taxpayer been taxable only on the income from property owned, personal services performed, trade or business carried on, and other sources in the State.

[(b)] (c) If any taxes paid to another jurisdiction for which a taxpayer has been allowed a credit under this section are at any time credited or refunded to the taxpayer, such fact shall be reported by the taxpayer to the department within twenty days after the credit or refund. Failure to make such report shall be deemed failure to make a return and subject to the penalties imposed by law in such cases. A tax equal to the credit allowed for the taxes so credited or refunded shall be due and payable from the taxpayer upon notice and demand from the department. If the amount of such tax is not paid within ten days from the date of the notice and demand, the taxpayer shall be subject to the usual penalties and interest for delinquency in payment.

[(c)] (d) Nothing in this section shall be construed to permit a credit against the taxes imposed by this chapter on account of federal income taxes.”

SECTION 6. Section 235-61, Hawaii Revised Statutes, is amended by amending subsection (c) to read as follows:

“(c) For each withholding period (whether weekly, biweekly, monthly, or otherwise) the amount of tax to be withheld under this section shall be at a rate which, for the taxable year, will yield the tax imposed by section 235-51 upon each employee’s annual wage, as estimated from the employee’s current wage in any withholding period[.], but (for the purposes of this subsection of the rates provided by section 235-51 the maximum to be taken into consideration shall be eight per cent. The tax for the taxable year shall be calculated upon the following assumptions:

- (1) That the employee’s annual wage, as estimated from the employee’s current wage in the withholding period, will be the employee’s sole income for the taxable year;
- (2) That there will be no deductions therefrom in determining adjusted gross income;
- (3) That in determining taxable income there shall be a standard deduction allowance which shall be an amount equal to one exemption (or more than one exemption if so prescribed by the director) unless (A) the taxpayer is married and the taxpayer’s spouse is an employee receiving wages subject to withholding, or (B) the taxpayer has withholding exemption certificates in effect with respect to more than one employer. For the purposes of this section, any standard deduction allowance under this paragraph shall be treated as if it were denominated a withholding exemption;
- (4) That in determining taxable income there also will be deducted the amount of exemptions and withholding allowances granted to the employee in the computation of taxable income, as shown by a certificate to be filed with the employer as provided by subsection (f); and

- (5) If it appears from the certificate filed pursuant to subsection (f) that the employee, under section 235-93, is entitled to make a joint return, that the employee and the employee's spouse will so elect.''

SECTION 7. Statutory material to be repealed is bracketed. New statutory material is underscored.

SECTION 8. This Act, upon its approval, shall apply to taxable years beginning after December 31, 1995.

(Approved June 17, 1996.)