

ACT 113

S.B. NO. 3004

A Bill for an Act Relating to Conformity of the Hawaii Income Tax Law to the Internal Revenue Code.

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, [1996,] 1997, as used in this chapter “Internal Revenue Code” means subtitle A, chapter 1 of the federal Internal Revenue Code of 1986, as amended as of December 31, [1996,] 1997, 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 laws which pursuant to this chapter do not apply or are otherwise limited in application.

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 1(h)(3) (relating to net capital gain reduced by the amount taken into account as investment income), except section 42 (with respect to 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 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 280C (with respect to certain expenses for which credits are allowable)[.];
- (13) Section 291 (with respect to special rules relating to corporate preference items)[.];
- (14) Section 367 (with respect to foreign corporations)[.];
- (15) Section 501(c)(12), (15), (16) (with respect to exempt organizations)[.];
- (16) Section 515 (with respect to taxes of foreign countries and possessions of the United States)[.];
- (17) Subchapter G (sections 531 to 565) (with respect to corporations used to avoid income tax on shareholders)[.];
- (18) Subchapter H (sections 581 to 597) (with respect to banking institutions), except section 584 (with respect to common trust funds). For treatment, see chapter 241[.];
- (19) Section 642(a) and (b) (with respect to special rules for credits and deductions applicable to trusts). For treatment, see sections 235-54(b) and 235-55[.];
- (20) Section 668 (with respect to interest charge on accumulation distributions from foreign trusts)[.];
- (21) Subchapter L (sections 801 to 848) (with respect to insurance companies). For treatment, see sections 431:7-202 and 431:7-204[.];
- (22) Section 853 (with respect to foreign tax credit allowed to shareholders). For treatment, see section 235-55[.];
- (23) Subchapter N (sections 861 to 999) (with respect to tax based on income from sources within or without the United States), except sections 985 to 989 (with respect to foreign currency transactions). For treatment, see sections 235-4, 235-5, and¹ 235-7(b), and 235-55[.];
- (24) Section 1042(g) (with respect to sales of stock in agricultural refiners and processors to eligible farm cooperatives);
- [24] (25) Section 1055 (with respect to redeemable ground rents)[.];
- [25] (26) Section 1057 (with respect to election to treat transfer to foreign trust, etc., as taxable exchange)[.];
- [26] (27) Sections 1291 to [1297] 1298 (with respect to treatment of passive foreign investment companies)[.];
- [27] (28) Subchapter Q (sections 1311 to 1351) (with respect to readjustment of tax between years and special limitations)[.]; and
- [28] (29) Subchapter U (sections 1391 to [1397D] 1397F) (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 72 (with respect to annuities; certain proceeds of endowment and life insurance contracts) of the Internal Revenue Code shall be operative for purposes of this chapter and be interpreted with due regard to section 235-7(a), except that the ten per cent additional tax on early distributions from retirement plans in section 72(t) shall not be operative for purposes of this chapter.

(c) Section 121 (with respect to exclusion of gain from sale of principal residence) of the Internal Revenue Code shall be operative for purposes of this chapter, except that for the election under section 121(f), a reference to section 1034 treatment means a reference to section 235-2.4(n) in effect for taxable year 1997.

[(b)] (d) Section 213 (with respect to medical, dental, etc., expenses) of the Internal Revenue Code shall be operative, except that subsections (d)(1)(C) with respect to long-term care services, (d)(1)(D) as it applies to long-term care insurance contract premiums, (d)(7) as it applies to long-term care insurance contract premiums, and (d)(10) as it applies to eligible long-term care premiums[,] shall not be operative in this State.

[(c)] (e) 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.

[(d)] (f) Section 220 (with respect to medical savings accounts) of the Internal Revenue Code shall be operative for the purpose² of this chapter, but only with respect to medical services accounts that have been approved by the secretary of the Treasury of the United States.

[(e)] (g) 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.

[(f)] (h) Section 468B (with respect to special rules for designated settlement funds) 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 a rate equal to the maximum rate in effect for the taxable year imposed on estates and trusts under section 235-51.

[(g)] (i) Section 469 (with respect to passive activities and credits limited) of the Internal Revenue Code 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.

[(h)] (j) 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.

“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 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.

[(i)] (k) Section 521 (with respect to cooperatives) and subchapter T (sections 1381 to 1388, with respect to cooperatives and their patrons) of the Internal Revenue Code 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.

[(j)] (l) Sections 527 (with respect to political organizations) and 528 (with respect to certain homeowners associations) of the Internal Revenue Code 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.

[(k)] (m) 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.

[(l)] (n) 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).

[(m)] (o) 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.

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

[n) 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.

(o) (q) 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.

[p] (r) 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.

[q] (s) 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.

[r) 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.]

(t) Subchapter D (sections 6240 to 6255) (with respect to simplified audit procedures for electing large partnerships) of the Internal Revenue Code shall be operative for the purposes of this chapter, with due regard to chapter 232 relating to tax appeals.

[s] (u) 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 235-71.5, Hawaii Revised Statutes, is amended to read as follows:

“§235-71.5¹ Alternative tax for corporations. Section 1201 (with respect to alternative tax for corporations) of the Internal Revenue Code of 1986, as amended as of December 31, 1996, shall be operative for the purposes of this chapter and shall be applied as set forth in this section. If for any taxable year a corporation, regulated investment company, or real estate investment trust has a net capital gain, then, in lieu of the tax imposed by section 235-71, there is hereby imposed a tax (if

such tax is less than the tax imposed under section 235-71) which shall consist of the sum of:

- (1) A tax computed on the taxable income reduced by the amount of the net capital gain, at the rates and in the manner as if this section had not been enacted, plus
- (2) The sum of:
 - (A) 3.08 per cent of the lesser of:
 - (i) The net capital gain determined by including only the gain or loss which is properly taken into account for the portion of the taxable year before April 1, 1987 (i.e., the amount in paragraph (1)), or
 - (ii) The net capital gain for the taxable year, plus,³
 - (B) 4 per cent of the excess (if any) of:
 - (i) The net capital gain for the taxable year, over
 - (ii) The amount of the net capital gain taken into account under subparagraph (A)."

SECTION 4. Section 235-97, Hawaii Revised Statutes, is amended by amending subsection (f) to read as follows:

“(f) In the case of any underpayment of estimated tax, except as provided by this subsection, there shall be added to the tax for the taxable year an amount determined at the rate of two-thirds of one per cent a month or fraction of a month upon the amount of the underpayment for the period of the underpayment.

- (1) The amount of the underpayment shall be the excess of:
 - (A) The required installment, over
 - (B) The amount, if any, of the installment paid on or before the due date for the installment.
- (2) The period of the underpayment shall run from the due date for the installment to whichever of the following dates is the earlier:
 - (A) The twentieth day of the fourth month following the close of the taxable year, or
 - (B) With respect to any portion of the underpayment, the date on which the portion is paid. For purposes of this paragraph, a payment of estimated tax on any installment date shall be credited against unpaid required installments in the order in which the installments are required to be paid.
- (3) For the purposes of this section, the term “tax” means the tax imposed under this chapter reduced by any credits available to the taxpayer⁴ other than the credit for amounts withheld from the taxpayers wages or taxes withheld at the source, if any, for the taxable year.
- (4) Sections 6654(d), (e)(2), (e)(3), (h), (i), (j), (k), and (l), (with respect to failure by an individual to pay estimated income tax), and 6655(d), (e), (g)(2), (g)(3), (g)(4), and (i) (with respect to failure by a corporation to pay estimated income tax) of the Internal Revenue Code, as of the date set forth in section 235-2.3(a), shall be operative for the purposes of this section; provided that the due dates contained in any of the preceding Internal Revenue Code sections shall be deemed to be the twentieth day of the applicable month[.]; and provided further that, for purposes of this chapter in applying section 6654(d), if the adjusted gross income shown on the return of the individual for the preceding taxable year exceeds \$150,000, the required annual payment shall be the lesser of ninety per cent of the tax shown on the return for the taxable year (or, if no return is filed, ninety per cent of the tax for the

taxable year) or one hundred ten per cent of the tax shown on the return of the individual for the preceding taxable year.”

SECTION 5. Statutory material to be repealed is bracketed. New statutory material is underscored.

SECTION 6. This Act, upon its approval, shall apply to taxable years beginning after December 31, 1997.

(Approved June 12, 1998.)

Notes

1. So in original.
2. Prior to amendment “purposes” appeared here.
3. Comma should be underscored.
4. Prior to amendment “taxpayer’s” appeared here.