

ACT 120

H.B. NO. 2426

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 Act 99, Session Laws of Hawaii 1990, which amended section 235-5.5(f), Hawaii Revised Statutes, neglected to take into consideration individuals who established an individual housing account prior to January 1, 1990, and had yet to purchase a residential property with distributions from the account. Prior to enactment of Act 99, all individuals who purchased their first principal residence with distributions from their individual housing account incurred an increase in gross income and a tax liability only upon the sale of the residential property. Many individuals invested in the individual housing account based on these gross income deferral and tax liability provisions.

With the enactment of Act 99, two categories of individuals were created. The first category, described in 235-5.5(f)(1), Hawaii Revised Statutes, included individuals who purchased their residential property prior to January 1, 1990. These

individuals incurred an increase in gross income and a tax liability as they would have prior to Act 99. The second category of individuals, described in section 235-5.5(f)(2), Hawaii Revised Statutes, included individuals who purchased their residential property after December 31, 1989. These individuals were required to report increases in gross income over a ten-year period based on the amount distributed from the individual housing account upon purchase of the residential property rather than upon sale as provided in section 235-5(f)(1), Hawaii Revised Statutes.

The legislature also finds that individuals who invested in an individual housing account based on the law prior to enactment of Act 99 and had not purchased a residential property by December 31, 1989, are subject to the gross income and tax liability provisions of the second category described in section 235-5.5(f)(2), Hawaii Revised Statutes, which did not exist at the time the individuals originally invested in the individual housing account. Therefore, these individuals who have yet to purchase their first principal residence with distributions from their individual housing account are subject to gross income and tax liability provisions that did not exist when they originally opened the account prior to enactment of Act 99. Instead of being able to defer gross income increases until the sale of the residential property or even indefinitely if the individual never sells, these individuals are now required to report gross income increases upon purchase with no deferment. The legislature believes that many individuals would not have invested in an individual housing account prior to enactment of Act 99 in 1990 had the gross income increase deferment not existed.

The legislature also finds that individuals who invested in an individual housing account claim to have been informed by various financial institutions, including banks that service individual housing accounts, that upon sale or conveyance of a residential property purchased with a housing account, an additional ten per cent of the distribution would be included in the gross income of the individual under section 235-5.5(f), Hawaii Revised Statutes, when applicable. The department of taxation also issued rules under section 235-5.5(f), Hawaii Revised Statutes, similarly interpreting section 235-5.5(f) in 1983, which continue to be effective. This interpretation was incorrect. Under section 235-5.5(f), Hawaii Revised Statutes, an additional ten per cent of the distribution would be included in the tax liability, not the gross income, of the individual. The legislature cannot determine exactly how many individuals relied on these interpretations. However, the legislature finds that it is reasonable to believe that a substantial number of people did not read the actual statute but reasonably relied on the incorrect interpretations of certain banks and of the department of taxation rules published in 1983. Furthermore, the legislature finds that many individuals would not have invested in an individual housing account had the true intent of section 235-5.5(f), Hawaii Revised Statutes, been correctly communicated to the individuals.

The purpose of this Act is to allow individuals who opened an individual housing account prior to enactment of Act 99 in 1990 to elect to be subject to the gross income deferment and tax liability provisions effective when they originally invested in their individual housing account and to conform section 235-5.5(f), Hawaii Revised Statutes, to the widely accepted and published interpretation of the statute.

SECTION 2. Section 235-5.5, Hawaii Revised Statutes, is amended by amending subsection (f) to read as follows:

“(f) If the individual for whose benefit the individual housing account was established purchases a residential property in Hawaii with the distribution from the individual housing account:

- (1) Before January 1, 1990, and if the individual sells in any manner or method or by use of any instrument conveying or transferring the

residential property, the gross income of the individual under this chapter for the taxable year in which the residential property is sold, conveyed, or transferred, whichever is applicable, shall include an amount equal to the amount of the distribution from the individual housing account, and in addition, the [tax liability] gross income of the individual shall be increased by an amount equal to ten per cent of the total distribution from the individual housing account[.]; or

- (2) After December 31, 1989, the individual shall report one-tenth of the total distribution from the individual housing account used to purchase the residential property as gross income in the taxable year in which the distribution is completed and in each taxable year thereafter until all of the distribution has been included in the individual's gross income at the end of the tenth taxable year after the purchase of the residential property. If the individual sells in any manner or method or by use of any instrument conveying or transferring the residential property, the gross income of the individual under this chapter for the taxable year in which the residential property is sold, conveyed, or transferred, whichever is applicable, shall include an amount equal to the amount of the distribution from the individual housing account not previously reported as gross income, and in addition, the tax liability of the individual shall be increased by an amount equal to ten per cent of the total distribution from the individual housing account. If the individual sells the residential property in any manner as provided in this paragraph after all of the distribution has been included in the individual's gross income at the end of the tenth taxable year after the purchase of the residential property, the tax liability of the individual shall not be increased by an amount equal to ten per cent of the total distribution from the individual housing account.

An individual who purchased a residential property in Hawaii with the distribution from an individual housing account before January 1, 1990, who is subject to paragraph (1) may elect to report as provided in paragraph (2). The election shall be made before January 1, 1991. If the individual makes the election, the individual shall report one-tenth of the total distribution from the individual housing account as gross income in the taxable year in which the election occurs and in each taxable year thereafter until all of the distribution has been included in gross income as provided by paragraph (2). If the individual making the election sells the residential property in any manner as provided in paragraph (2), then the individual shall include as income the amount of the distribution not previously reported as income and increase the individual's tax liability as provided in the second sentence of paragraph (2), except when the third sentence of paragraph (2) applies.

In the alternative, any individual subject to paragraph (2) who established the individual housing account before January 1, 1990, may elect within one year after the date of purchase, to be subject to paragraph (1)."

SECTION 3. This Act shall not apply to the purchase or sale of a residential property subject to section 235-5.5(f)(2) Hawaii Revised Statutes, occurring prior to January 1, 1997.

SECTION 4. Statutory material to be repealed is bracketed. New statutory material is underscored.

SECTION 5. This Act, upon its approval, shall apply to taxable years beginning after December 31, 1996.

(Approved June 22, 1998.)