

A Bill for an Act Relating to Election by Small Business Corporations for Income Tax Purposes and Amending Chapter 121 of the Revised Laws of Hawaii 1955, as Amended.

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

SECTION 1. Paragraph (1) of subsection 121-24.2(b), Revised Laws of Hawaii 1955, as amended, is hereby further amended by inserting the following phrase “(other than the tax imposed by section 121-24.8)” after the word “chapter” appearing therein.

SECTION 2. Paragraph (4) of subsection 121-24.2(e), Revised Laws of Hawaii 1955, as amended, is hereby further amended to read as follows:

“**Section 121-24.2(e) (4). Passive Investment Income.** (A) Except as provided in sub-paragraph (B) of this paragraph, an election under subsection (a) made by a small business corporation shall terminate if, for any taxable year of the corporation for which the election is in effect, such corporation has gross receipts more than 20 per cent of which is passive investment income. Such termination shall be effective for the taxable year of the corporation in

which it has gross receipts of such amount, and for all succeeding taxable years of the corporation.

(B) Subparagraph (A) shall not apply with respect to a taxable year in which a small business corporation has gross receipts more than 20 per cent of which is passive investment income, if—

(i) such taxable year is the first taxable year in which the corporation commenced the active conduct of any trade or business or the next succeeding taxable year; and

(ii) the amount of passive investment income for such taxable year is less than \$3,000.

(C) For purposes of this paragraph, the term ‘passive investment income’ means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (gross receipts from such sales or exchanges being taken into account for purposes of this paragraph only to the extent of gains therefrom).”

SECTION 3. Section 121-24.3, Revised Laws of Hawaii 1955, as amended, is hereby further amended by deleting the comma appearing after the words “Public Law 85-866” and by inserting the following phrase “and as further amended by Public Law 89-389,” immediately after the words “Public Law 85-866.”

SECTION 4. Section 121-24.5, Revised Laws of Hawaii 1955, as amended, is hereby further amended to read as follows:

“Subject to the other provisions of this chapter, long-term capital gain treatment shall be given in the manner and to the extent set forth in section 1375(a) of the Internal Revenue Code of 1954 and under section 121-24.8 of the Revised Laws of Hawaii 1955, as amended, dividends may be apportioned or allocated by the department as provided by section 1375 (c) of the Internal Revenue Code of 1954, and distributions of taxable income for prior years may, subject to regulations of the department as provided by section 1375 (c) of the Internal Revenue Code of 1954, and distributions of taxable income for prior years may, subject to regulations of the department, be made in the manner and with the effect set out in section 1375 (d) of the Internal Revenue Code of 1954, as amended by Public Law 85-866 and as further amended by Public Law 89-389.”

SECTION 5. Section 121-24.8, Revised Laws of Hawaii 1955, as amended, is hereby redesignated as section 121-24.9.

SECTION 6. There shall be added to chapter 121 of the Revised Laws of Hawaii 1955, as amended, a new section designated as section 121-24.8, to be inserted in its proper numerical order, and to read as follows:

“ **§121-24.8. Tax imposed on certain capital gains.** (a) General Rule. If for a taxable year of an electing small business corporation—

(1) the excess of the net long-term capital gain over the net short-term capital loss of such corporation exceeds \$25,000, and exceeds 50 per cent of its taxable income for such year, and

(2) the taxable income of such corporation for such year exceeds \$25,000—

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there is hereby imposed a tax (computed under subsection (b)) on the income of such corporation.

(b) Amount of Tax. The tax imposed by subsection (a) shall be an amount equal to 3.08 per cent of the amount by which the excess of the net long-term capital gain over the net short-term capital loss of the corporation for the taxable year exceeds \$25,000.

(c) Exceptions.

(1) In general. Subsection (a) shall not apply to an electing small business corporation for any taxable year if the election under section 121-24.2(a) which is in effect with respect to such corporation for such taxable year has been in effect for the three immediately preceding taxable years.

(2) New corporations. Subsection (a) shall not apply to an electing small business corporation if—

(A) it has been in existence for less than 4 taxable years, and

(B) an election under section 121-24.2(a) has been in effect with respect to such corporation for each of its taxable years.

(3) Property with substituted basis. If—

(A) but for paragraph (1) or (2), subsection (a) would apply for the taxable year,

(B) any long-term capital gain is attributable to property acquired by the electing small business corporation during the period beginning three years before the first day of the taxable year and ending on the last day of the taxable year, and

(C) the basis of such property is determined in whole or in part by reference to the basis of any property in the hands of another corporation which was not an electing small business corporation throughout all of the period described in subparagraph (B) before the transfer by such other corporation and during which such other corporation was in existence—

then subsection (a) shall apply for the taxable year, but the amount of the tax determined under subsection (b) shall not exceed 3.08 per cent of the excess of the net long-term capital gain over the net short-term capital loss attributable to property acquired as provided in subparagraph (B) and having a basis described in subparagraph (C).”

SECTION 7. Notwithstanding the adoption of Act 16, Session Laws of Hawaii 1968, this Act shall have full force according to its intent. Upon the taking effect of this Act or the Hawaii Revised Statutes, whichever occurs later, this Act shall be construed to be in amendment of or in addition to the Hawaii Revised Statutes, all references in this Act being construed to refer to the applicable or corresponding provisions of the Hawaii Revised Statutes.

The revisor of statutes may reword and renumber the references in this Act and make such other formal or verbal changes as may be necessary to conform with the Hawaii Revised Statutes.

SECTION 8. This Act upon its approval, shall apply with respect to taxable years of electing small business corporations beginning on or after January 1, 1969 and in no event shall any sales or exchanges occurring before January 1,

1969, be subject to this Act.
(Approved June 27, 1969.)