

**ACT 47**

**H.B. NO. 325**

**A Bill for an Act Relating to Income Taxation.**

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

**SECTION 1.** The legislature finds that with the enactment of Public Law 94-455 by the 94th United States Congress, extensive and far-reaching changes were made to the income tax laws of our nation. The legislature further finds that the state income tax law should be updated by adopting relevant provisions of such public law and other public laws that must be adopted due to adopting

certain provisions of such public law.

The purpose of this Act is to adopt federal changes to the income tax law.

SECTION 2. Chapter 235, Hawaii Revised Statutes, is amended by adding a new section to read as follows:

**"Sec. 235-2.2 Internal Revenue Code, further amendments adopted.** For each taxable year specified in column 1 below, the Internal Revenue Code meant is the Internal Revenue Code of 1954 as amended as of June 7, 1957 and as further amended by the acts of Congress, or portions thereof, enumerated in column 2 (section numbers in column 2 are inclusive). Amendments to the code not enumerated in section 235-2, 235-2.1, or herein shall not be operative for the purposes of this chapter unless specifically adopted.

**Column 1**

**Column 2**

Taxable years beginning on or after January 1, 1977.

Public Law 629, 84th Cong., 2d Session, section 5(a) (with respect to nontaxable exchanges for taxable years beginning after December 31, 1976).

Public Law 86-779, section 10(h) (with respect to constructive ownership of stock for taxable years beginning after December 31, 1976).

Public Law 86-781, section 6(a) (with respect to limitation on acceleration of accrual of taxes for taxable years beginning after December 31, 1976).

Public Law 87-876, section 3(a) (with respect to dividends or interest paid on certain deposits or withdrawable accounts for taxable years beginning after December 31, 1976).

Public Law 88-272, sections 218(a) and (b) (with respect to corporate reorganizations for taxable years beginning after December 31, 1976) and 226(a) and (b) (with respect to treatment in case of oil and gas wells for taxable years beginning after December 31, 1976).

Public Law 88-484, section 1(b)(1) and (2) (with respect to corporate distributions in taxable years beginning after December 31, 1976).

Public Law 88-539, section 3(a) and (b) (with respect to the installment method of accounting for taxable

years beginning after December 31, 1976).

Public Law 88-554, section 4(a) (with respect to constructive ownership of stock for taxable years beginning after December 31, 1976).

Public Law 88-563, section 5 (with respect to original issue discount for taxable years beginning after December 31, 1976).

Public Law 89-97, sections 106(a), (b), (c), and (d)(1) (with respect to medical deductions for taxable years beginning after December 31, 1976) and 313(b) (with respect to employee tips for taxable years beginning after December 31, 1976).

Public Law 89-570, section 1(b)(2) and (4) (with respect to corporate distributions in taxable years beginning after December 31, 1976).

Public Law 89-809, section 202(c) (with respect to methods of accounting for taxable years beginning after December 31, 1976).

Public Law 90-621, section 1(a) and (b) (with respect to corporate reorganizations for taxable years beginning after December 31, 1976).

Public Law 91-172, sections 211(a) and (b)(1) to (6) (with respect to gain from disposition of property used in farming where farm losses offset nonfarm income for taxable years beginning after December 31, 1976;

provided that provisions relating to the excess deduction account shall not apply), 214(a) (with respect to gain from disposition of farm land for taxable years beginning after December 31, 1976), 215(a) (with respect to crop insurance proceeds for taxable years beginning after December 31, 1976), 216(a) (with respect to capitalization of costs of planting and developing citrus groves for taxable years beginning after

December 31, 1976), 221(a) (with respect to definition of terms deduction attributable to investment indebtedness for taxable years beginning after December 31, 1976), 413(a) and (b) (with respect to bonds and other evidences of indebtedness for taxable years beginning after December 31, 1976), 511(a) (with respect to definition of terms applicable to capital gains and losses for taxable years beginning after December 31, 1976), 802(b)(1) and (2) (with respect to the determination of marital status for taxable years beginning after December 31, 1976), and 916(a) (with respect to methods of accounting for taxable years beginning after December 31, 1976). Public Law 91-680, section 1(a) (with respect to capitalization of costs of planting and developing almond groves for taxable years beginning after December 31, 1976).

Public Law 91-687, section 1 (with respect to determining when stock of a corporation shall not be treated as a capital asset for taxable years beginning December 31, 1976).

Public Law 91-693, section (a) and (b) (with respect to corporate reorganizations for taxable years beginning after December 31, 1976).

Public Law 92-178, sections 304(a)(2), (c), and (d) (with respect to excess investment interest for taxable years beginning after December 31, 1976) and 305(a) (with respect to farm losses of electing small business corporations for taxable years beginning after December 31, 1976; provided that provisions relating to the excess deduction account shall not apply).

Public Law 93-406, sections 1013(c)(2) (with respect to when certain contributions may be made

for taxable years beginning after December 31, 1976) and 2004(a)(2) (with respect to limitations on benefits and contributions under qualified plans for taxable years beginning after December 31, 1976). Public Law 93-483, sections 4 (with respect to application of section 117 of the Internal Revenue Code to certain educational programs for members of the uniformed services for taxable years beginning after December 31, 1976) and 6(a) (with respect to penalties forfeited because of premature withdrawal of funds from time-savings accounts or deposits for taxable years beginning after December 31, 1976).

Public Law 94-12, section 207 (with respect to extension of period for replacing old residence for purpose of nonrecognition of gain for taxable years beginning after December 31, 1976).

Public Law 94-267, sections (a)(1), (2), and (3) and (b)(1), (2), and (3) (with respect to termination of employee trusts and annuity plans for taxable years beginning after December 31, 1976).

Public Law 94-455, sections 201(a) (with respect to the capitalization and amortization of real property construction period interest and taxes, in the case of (1) nonresidential real property, for taxable years beginning after December 31, 1976, and (2) residential real property, other than low-income housing for taxable years beginning after December 31, 1977, and (3) low-income housing, for taxable years beginning after December 31, 1981; provided that the transitional rule for 1976 (section 189(f) of the Internal Revenue Code as added by section 201(a) shall not apply)), 202(a), (b),

and (c) (with respect to the recapture of depreciation on real property for taxable years beginning after December 31, 1976; provided that section 202(b) shall apply with respect to proceedings and operations of law referred to in section 1250(d)(10) of the Internal Revenue Code which begins after December 31, 1976), 203(a) (with respect to the depreciation of expenditures to rehabilitate low-income rental housing for taxable years beginning after December 31, 1976; provided that (1) section 167(k) of the Internal Revenue Code as adopted by this State is amended by striking out "January 1, 1975" in paragraph (1) and inserting in lieu thereof "January 1, 1978", (2) the amendments made by section 203(a)(1), (3), and (4) shall apply to expenditures paid or incurred after December 31, 1976, and before January 1, 1978, and expenditures made pursuant to a binding contract entered into before January 1, 1978, and (3) the amendment made by section 203(a)(2) shall apply to expenditures incurred after December 31, 1976), 204(a) and (c)(2) and (3)(A) and (B) (with respect to limitations on deductions for expenses for taxable years beginning after December 31, 1976; provided that the amendments made by section 204(a) shall apply to losses attributable to amounts paid or incurred in taxable years beginning after December 31, 1976, and for this purpose, any amount allowed or allowable for depreciation or amortization for any period shall be treated as an amount paid or incurred in such period; provided further that as adopted by this State (1) the date September 11, 1975 in

section 204(c)(2)(A) shall read January 1, 1977, (2) the dates December 31, 1975 and September 10, 1975, respectively, in section 204(c)(2)(B) shall read December 31, 1976 and January 1, 1977, respectively, (3) the date January 1, 1976 in section 204(c)(3)(A) shall read January 1, 1977, (4) the date December 31, 1975 in section 204(c)(3)(B) shall read December 31, 1976, and (5) the dates contained in section 204(c)(3)(C) shall be disregarded), 205(a), (b), and (c) (with respect to gain from the disposition of interest in oil or gas property for taxable years beginning after December 31, 1976; provided that section 1254 of the Internal Revenue Code as adopted by this State is amended by striking out "December 31, 1975" therein and inserting in lieu thereof "December 31, 1976"), 206(a) and (b) (with respect to gain from disposition of property used in farming where farm losses offset nonfarm income for taxable years beginning after December 31, 1976; provided that the adoption of section 206(a) shall not result in application of the excess deduction account for taxable years beginning before January 1, 1977), 207(a)(1), (b)(1) and (2) and (c)(1)(A), and (c)(3) (with respect to limitations on deductions in case of farming syndicates; capitalization of certain orchard and vineyard expenses; and method of accounting for corporations engaged in farming for taxable years beginning after December 31, 1976), 208(a) (with respect to prepaid interest for taxable years beginning after December 31, 1976); 209(a) and (b)(2) (with respect to limitation on interest deduction for taxable years beginning after

December 31, 1976, except where otherwise provided in section 209(b)(2); provided that as adopted by this State (1) the date "September 11, 1975" in section 209(b)(2) shall read "January 1, 1977", and (2) the date "September 10, 1975" in section 209(b)(2) shall read "December 31, 1976", 210(a) (with respect to amortization of motion pictures, books, records, and other similar property for taxable years beginning after December 31, 1976), 212(a)(1) and (b)(1) (with respect to basis limitation for and recapture of depreciation on player contracts for taxable years beginning after December 31, 1976), 213(a) (with respect to dollar limitations in the case of partnerships with respect to additional first-year depreciation allowance for taxable years beginning after December 31, 1976), (b)(1) and (3) (with respect to treatment of organization and syndication fees for taxable years after December 31, 1976), (c)(1) and (2) (with respect to allocation of partnership income and losses for taxable years beginning after December 31, 1976), (d) (with respect to determination of partner's distributive shares for taxable years beginning after December 31, 1976), and (e) (with respect to treatment of partnership liabilities with respect to which the partner is not personally liable for taxable years beginning after December 31, 1976), 214(a) (with respect to scope of waiver of statute of limitations in case of activities not engaged in for profit for taxable years beginning after December 31, 1976), 502(a) (with respect to deductions for alimony allowed in determining adjusted gross income for taxable years



beginning after December 31, 1976), 506(a), (b), and (c) (with respect to moving expenses for taxable years beginning after December 31, 1976), 601(a) (with respect to deductions for expenses attributable to business use of home, rental of vacation homes, etc. for taxable years beginning after December 31, 1976), 602(a) (with respect to deductions for attending conventions for taxable years beginning after December 31, 1976), 605(a) (with respect to deductions for guarantees of business bad debts to guarantors not involved in business for taxable years beginning after December 31, 1976), 701(a)(2) and (3), (b), (c), (d), and (e)(2) (with respect to accumulation trusts for taxable years beginning after December 31, 1976; provided that the reference in section 668 of the Internal Revenue Code to section 667 of the Internal Revenue Code shall be deemed a reference to section 235- relating to the treatment of amounts deemed distributed by trust in preceding years and the reference in section 641 of the Internal Revenue Code to section 644(b) of the Internal Revenue Code shall be deemed a reference to section 235- (b) relating to the special rule for gain on property transferred to trusts at less than fair market value), 806(e), (f), as to special limitations on capital losses, and (g)(2) (with respect to limitations on net operating loss carryovers and capital losses effective for taxable years as provided in section 806(g)(2)), 1401(a) and (b) (with respect to amounts of ordinary income against which capital loss may be offset for taxable years beginning after December 31, 1976), 1402(a), (b), (c), and (d) (with respect to increases in holding period

required for capital gain or loss to be long term from six to nine months for taxable years beginning after December 31, 1976 and from nine months to one year for taxable years beginning after December 31, 1977), 1404(a) (with respect to sales of residences by the elderly for taxable years beginning after December 31, 1976), 1501(a) and (b)(1) to (6) and (10) (with respect to retirement savings for certain married individuals for taxable years beginning after December 31, 1976), 1502(a)(1) and (2) (with respect to limitations on contributions to certain pension, etc., plans for taxable years beginning after December 31, 1976), 1503(a) (with respect to participation by members of reserves or national guard, and volunteer firefighters in individual retirement accounts, etc. for taxable years beginning after December 31, 1976), 1901(a)(22) (with respect to determination of marital status for taxable years beginning after December 31, 1976), (a)(66) (with respect to accounting methods for taxable years beginning after December 31, 1976), (a)(87) (with respect to the definition of property for taxable years beginning after December 31, 1976), (a)(128) (with respect to involuntary conversion for taxable years beginning after December 31, 1976), and (a)(136) (with respect to definition of terms applicable to capital gains and losses for taxable years beginning after December 31, 1976), and (b)(3)(I) (with respect to taxable years beginning after December 31, 1976), and (b)(3)(K) (with respect to ordinary income for taxable years beginning after December 31, 1976; provided that provisions relating to

the excess deduction account shall not apply), and (b)(14)(D) (with respect to taxable years beginning after December 31, 1976), 1904(b)(10)(C) (with respect to taxable years beginning after January 31, 1977), 1951(b)(7) (with respect to accounting methods for taxable years beginning after December 31, 1976; provided that notwithstanding the amendment made by section 1951(b)(7), in the case of installment payments received during taxable years beginning after December 1976, on account of a sale or other disposition made during a taxable year beginning before January 1, 1954, subsection (b)(1) of section 453 of the Internal Revenue Code (relating to sales of realty and casual sales of personalty) shall apply only if the income was (by reason of section 44(b) of the Internal Revenue Code of 1939), returnable on the basis and in the manner prescribed in section 44(a) of the Internal Revenue Code of 1939), 2004(e) (with respect to requirements for capital gain on stock redemptions to pay estate taxes for taxable years beginning after December 31, 1976; provided that the reference in section 303(b)(1) of the Internal Revenue Code to the time limits in sections 6213, 6501(a), 6166, and 6166A of the Internal Revenue Code or the election under sections 6166 and 6166A of the Internal Revenue Code shall be followed by the State even though the State has not adopted such sections), 2005(a) (with respect to carryover basis of inherited property for taxable years beginning after December 31, 1976; provided that the amendment of section 1014(d) of the Internal Revenue Code made by section 2005(a) shall for the purposes of this

State be considered an addition of new subsection (d) to section 1014 of the Internal Revenue Code as adopted by this State), (b) (with respect to the use of certain appreciated carryover basis property to satisfy pecuniary request for taxable years beginning after December 31, 1976), and (c) (with respect to increases in basis for gift tax paid to that portion of gift tax attributable to net appreciation in value for taxable years beginning after December 31, 1976), 2101(b) (with respect to allowances of depreciation deduction by a cooperative housing corporation for taxable years beginning after December 31, 1976), 2102(a) and (b) (with respect to treatment of certain disaster payments for taxable years beginning after December 31, 1976), 2104(a) (with respect to deductions for bad debts owed by a political party for taxable years beginning after December 31, 1976), 2110(a) (with respect to application of franchise rules to partnerships for taxable years beginning after December 31, 1976; provided that the amendments made by section 2110(a) shall apply to transactions described in section 731, 736, 741, or 751 of the Internal Revenue Code which occur after December 31, 1976, in taxable years ending after that date), 2118(a) (with respect to treatment of gain or loss on sales or exchanges in connection with simultaneous liquidation of a parent or subsidiary corporation for taxable years beginning after December 31, 1976), 2122(a) and (b)(2), (3), and (4) (with respect to allowances of deduction for eliminating architectural and transportation barriers for the handicapped for taxable years

beginning after December 31, 1976 and before January 1, 1980), 2124(a)(1), (2), and (3) (with respect to the rehabilitation of certified historic structures with respect to additions to capital accounts made after December 31, 1976 and before June 15, 1981), (b)(1) (with respect to demolition of certain historic structures commencing after December 31, 1976 and before January 1, 1981), (c)(1) (with respect to depreciation of rehabilitation expenditures of certified historical structures on that portion of the basis which is attributable to construction, reconstruction, or erection after December 31, 1976 and before January 1, 1981; provided that section 167(n) of the Internal Revenue Code as adopted by this State is amended by striking out "June 30, 1976" and inserting in lieu thereof "January 1, 1977"), (d)(1) (with respect to depreciation of rehabilitation expenditures of certified historical structures with respect to additions to capital account occurring after December 31, 1976 and before July 1, 1981), and (e)(1) (with respect to deductions for charitable contributions of partial interests in property for conservation purposes with respect to contributions made after December 31, 1976 and before June 14, 1977), 2127(a) (with respect to outdoor advertising displays for taxable years beginning after December 31, 1976), 2129(a) (with respect to gain from sale of depreciable property between related parties for taxable years beginning after December 31, 1976; provided the amendments made by section 2129(a) shall apply to sales or exchanges after December 31, 1976; and provided that a sale or exchange

is considered to have occurred on or before such date if such sale or exchange is made pursuant to a binding contract entered into on or before such date), 2130 (with respect to application of section 117 of the Internal Revenue Code to certain education programs for members of the uniformed services), 2131(a), (b), (c), (d), and (e)(1) (with respect to exchange fund transfers made in taxable years ending after December 31, 1976; provided that (1) except as provided in (2) following, the amendment made by section 2131(a) shall apply to transfers made after December 31, 1976, in taxable years ending after such date; provided further that (2) the amendment made by section 2131(a) shall not apply to transfers made in accordance with a ruling issued by the Internal Revenue Service before February 18, 1976, holding that a proposed transaction would be a reorganization described in paragraph (1) of section 368(a) of the Internal Revenue Code; and (3) except as provided in the (4) following, the amendments made by section 2131(b) and (c) shall apply to transfers made after December 31, 1976, in taxable years ending after such date; provided further that (4) the amendments made by section 2131(b) and (c) shall not apply to transfers made on or before January 2, 1977 if: (A) either (i) a ruling request with respect to such transfers was filed with the federal Internal Revenue Service before March 27, 1976, or (ii) a registration statement with respect to such transfers was filed with the federal Securities and Exchange Commission before March 27, 1976 (B) the securities transferred were deposited on or before December 3, 1976, and (C)

either (i) the aggregate value (determined as of the close of December 3, 1976, or, if earlier, the close of the deposit period) of the securities so transferred does not exceed \$100,000,000, or (ii) the securities transferred were all on deposit on February 29, 1976, pursuant to a registration statement referred to in (A)(ii) preceding; provided further that (5) if no registration statement was required to be filed with the federal Securities and Exchange Commission with respect to the transfer of securities to any partnership, then (4) preceding shall be applied to such transfers (A) as if (4) preceding did not contain (4)(A)(ii) preceding, and (B) by substituting "\$25,000,000" for "\$100,000,000" in (4)(C)(i) preceding; and provided further that (6) the amendments made by section 2131(d) and (e) shall take effect on January 1, 1977, in taxable years ending on or after such date), 2132(a) (with respect to contributions of certain government publications for taxable years beginning after December 31, 1976), 2135(a) (with respect to charitable contributions of inventory and other property for taxable years beginning after December 31, 1976), 2136(a) (with respect to treatment of grantor of options of stock, securities, and commodities for taxable years beginning after December 31, 1976), 2139(a) (with respect to support test for dependent children of divorced, etc. parents for taxable years beginning after December 31, 1976), 2140(a) (with respect to involuntary conversions of real property for taxable years beginning after December 31, 1976; provided that the amendments made by section 2140(a)

shall apply with respect to any disposition of converted property (within the meaning of section 1033(a)(2) of the Internal Revenue Code) after December 31, 1976, unless a condemnation proceeding with respect to such property began before such effective date), and 2141(a) (with respect to livestock sold on account of drought for taxable years beginning after December 31, 1976).

For taxable years beginning on or after January 1, 1978.

Public Law 94-455, section 505(a) and (b) (with respect to changes in exclusions for sick pay and certain military, etc., disability pensions; certain disability income for taxable years beginning after December 31, 1977; provided that where disability or annuity payments are excluded from taxation by section 235-7 the adoption of section 505(a) and (b) shall not make such payments taxable under this chapter)."

SECTION 3. Chapter 235, Hawaii Revised Statutes, is amended by adding two new sections to be inserted after section 235-58, to be appropriately designated, and to read as follows:

**"Sec. 235- Treatment of amounts deemed distributed by trust in preceding years.** (a) General rule. The total of the amounts which are treated under section 666 of the Internal Revenue Code of 1954, as amended (hereinafter referred to as "Code"), as having been distributed by a trust in a preceding taxable year shall be included in the income of a beneficiary of the trust when paid, credited, or required to be distributed to the extent that such total would have been included in the income of such beneficiary under section 662(a)(2) of the Code (and, with respect to any tax-exempt interest to which section 235-7 applies, under section 662(b) of the Code) if such total had been paid to such beneficiary on the last day of such preceding taxable year. The tax imposed by this chapter on a beneficiary for a taxable year in which any such amount is included in his income shall be determined only as provided in this section and shall consist of the sum of:

- (1) A partial tax computed on the taxable income reduced by an amount equal to the total of such amounts, at the rate and in the manner as if this section had not been enacted, and
  - (2) A partial tax determined as provided in subsection (b) of this section.
- (b) Tax on distribution.



(1) In general. The partial tax imposed by subsection (a)(2) shall be determined:

- (A) By determining the number of preceding taxable years of the trust on the last day of which an amount is deemed under section 666(a) of the Code to have been distributed.
- (B) By taking from the five taxable years immediately preceding the year of the accumulation distribution the one taxable year for which the beneficiary's taxable income was the highest and the one taxable year for which his taxable income was the lowest.
- (C) By adding to the beneficiary's taxable income for each of the three taxable years remaining after the application of subparagraph (B) an amount determined by dividing the amount deemed distributed under section 666 of the Code and required to be included in income under subsection (a) by the number of preceding taxable years determined under subparagraph (A), and
- (D) By determining the average increase in tax for the three taxable years referred to in subparagraph (C) resulting from the application of such subparagraph.

The partial tax imposed by subsection (a)(2) shall be the excess (if any) of the average increase in tax determined under subparagraph (D), multiplied by the number of preceding taxable years determined under subparagraph (A), over the amount of taxes deemed distributed to the beneficiary under section 666(b) and (c) of the Code.

- (2) Treatment of loss years. For purposes of paragraph (1), the taxable income of the beneficiary for any taxable year shall be deemed not to be less than zero.
- (3) Certain preceding taxable years not taken into account. For purposes of paragraph (1), if the amount of the undistributed net income deemed distributed in any preceding taxable year of the trust is less than twenty-five per cent of the amount of the accumulation distribution divided by the number of preceding taxable years to which the accumulation distribution is allocated under section 666(a) of the Code, the number of preceding taxable years of the trust with respect to which an amount is deemed distributed to a beneficiary under section 666(a) of the Code shall be determined without regard to such year.
- (4) Effect of other accumulation distributions. In computing the partial tax under paragraph (1) for any beneficiary, the income of such beneficiary for each of his prior taxable years shall include amounts previously deemed distributed to such beneficiary in such year under section 666 of the Code as a result of prior accumulation distributions (whether from the same or another trust).
- (5) Multiple distributions in the same taxable year. In the case of accumulation distributions made from more than one trust which are includible in the income of a beneficiary in the same taxable year, the distributions shall be deemed to have been made consecutively in whichever order the beneficiary shall determine.

## (c) Special rule for multiple trusts.

- (1) In general. If, in the same prior taxable year of the beneficiary in which any part of the accumulation distribution from a trust (hereinafter in this paragraph referred to as "third trust") is deemed under section 666(a) of the Code to have been distributed to such beneficiary, some part of prior distribution by each of two or more other trusts is deemed under section 666(a) of the Code to have been distributed to such beneficiary, then subsections (b) and (c) of section 666 of the Code shall not apply with respect to such part of the accumulation distribution from such third trust.
- (2) Accumulation distributions from trust not taken into account unless they equal or exceed \$1,000. For purposes of paragraph (1), an accumulation distribution from a trust to a beneficiary shall be taken into account only if such distribution, when added to any prior accumulation distributions from such trust which are deemed under 666(a) of the Code to have been distributed to such beneficiary for the same prior taxable year of the beneficiary, equals or exceeds \$1,000.

**Sec. 235- Special rule for gain on property transferred to trust at less than fair market value.** (a) Imposition of tax.

## (1) In general. If:

(A) A trust (or another trust to which the property is distributed) sells or exchanges property at a gain not more than two years after the date of the initial transfer of the property in trust by the transferor, and

(B) The fair market value of such property at the time of the initial transfer in trust by the transferor exceeds the adjusted basis of such property immediately after such transfer,

there is hereby imposed a tax determined in accordance with paragraph (2) on the includible gain realized on such sale or exchange.

- (2) Amount of tax. The amount of the tax imposed by paragraph (1) on any includible gain realized on the sale or exchange of any property shall be equal to the sum of:

## (A) The excess of:

- (i) The tax which would have been imposed under this chapter for the taxable year of the transferor in which the sale or exchange of such property occurs had the amount of the includible gain realized on such sale or exchange, reduced by any deductions properly allocable to such gain, been included in the gross income of the transferor for such taxable year, over

- (ii) The tax actually imposed under this chapter for such taxable year on the transferor, plus

- (B) If such sale or exchange occurs in a taxable year of the transferor which begins after the beginning of the taxable year of the trust in which such sale or exchange occurs, an amount equal to the amount determined under subparagraph (A) multiplied by the interest rate established under section 231-39(b)(4).

- (3) Taxable year for which tax imposed. The tax imposed by paragraph (1) shall be imposed for the taxable year of the trust which begins with or within the taxable year of the transferor in which the sale or exchange occurs.
- (4) Tax to be in addition to other taxes. The tax imposed by this subsection for any taxable year of the trust shall be in addition to any other tax imposed by this chapter for such taxable year.
- (b) Definition of includible gain. For purposes of this section, the term "includible gain" means the lesser of:
  - (1) The gain realized by the trust on the sale or exchange of any property, or
  - (2) The excess of the fair market value of such property at the time of the initial transfer in trust by the transferor over the adjusted basis of such property immediately after such transfer.
- (c) Character of includible gain. For purposes of subsection (a):
  - (1) The character of the includible gain shall be determined as if the property had actually been sold or exchanged by the transferor; and any activities of the trust with respect to the sale or exchange of the property shall be deemed to be activities of the transferor, and
  - (2) The portion of the includible gain subject to the provisions of section 1245 of the Internal Revenue Code of 1954, as amended (hereinafter referred to as "Code"), and section 1250 of the Code shall be determined in accordance with rules adopted by the director of taxation.
- (d) Special rule for short sales. If the trust sells the property referred to in subsection (a) in a short sale within the two-year period referred to in such subsection, such two-year period shall be extended to the date of the closing of such short sale.
- (e) Exceptions. Subsection (a) shall not apply to property:
  - (1) Acquired by the trust from a decedent or which passed to a trust from a decedent (within the meaning of section 1014 of the Code), or
  - (2) Acquired by a pooled income fund (as defined in section 642(c)(5) of the Code), or
  - (3) Acquired by a charitable remainder annuity trust (as defined in section 664(d)(1) of the Code) or a charitable remainder unitrust (as defined in section 664(d)(2) and (3) of the Code), or
  - (4) If the sale or exchange of the property occurred after the death of the transferor.
- (f) Special rule for installment sales. If the trust elects to report income under section 453 of the Code on any sale or exchange to which subsection (a) applies, under rules adopted by the director of taxation:
  - (1) Subsection (a) shall be applied as if each installment were a separate sale or exchange of property to which such subsection applies, and
  - (2) The term "includible gain" shall not include any portion of an installment received by the trust after the death of the transferor."

SECTION 4. New statutory material is underscored. In printing this Act, the revisor of statutes need not include the underscoring.\*

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\*Edited accordingly.

**SECTION 5.** This Act, upon its approval, shall apply to taxable years beginning after December 31, 1976.

(Approved May 6, 1977.)