

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 the State of Hawaii adopted the federal Internal Revenue Code for the purpose of determining gross income, adjusted gross income, and taxable income in 1957. Since the Hawaii Constitution does not allow the adoption of federal Internal Revenue Code amendments on an as amended basis and since the State of Hawaii did not wish to relinquish control over its internal economic policies, the State has adopted amendments to the federal Internal Revenue Code on a periodic basis and over the period of twenty years in the philosophies of the executive and legislative branches in adopting such amendments have varied. In addition, many of the amendments made to the Internal Revenue Code during this twenty-year period, while not directly affecting the State of Hawaii have affected the Code in various ways and since they did not affect the State directly they were not adopted. Finally, due to either the complex nature of some of the amendments over the years or the quantity of some very technical amendments, such as those made in the Tax Reform Act of 1976, the legislature and the executive branches were unable to give appropriate consideration to their adoption.

The legislature finds that during this twenty-year period, the State adopted version of the federal Internal Revenue Code has become less and less parallel to the Code itself. This has resulted in increased costs to both government and the

private sector due to the necessity of determining which version of the Code Hawaii has adopted in a certain area.

In 1977, the legislature took a great step forward in conforming the state version of the Code with the federal version of the Code through the enactment of Act 47. At that time the legislature asked the department of taxation and the office of the legislative reference bureau with the assistance of the private sector to review the federal Internal Revenue Code and to suggest the appropriate Act to conform our state adopted version of the Code to the federal Code as closely as is desirable for the purposes of this State. This Act is the result of such effort. The legislature finds that adoption of this Act will reduce the cost of doing business for both government and the private sector while resulting in a slight increase in income tax revenues.

In enacting this Act, the legislature notes that in repealing the sections of chapter 235, Hawaii Revised Statutes, it is repealing redundant language in the statutes which are no longer necessary due to the adoption of the federal Internal Revenue Code in the manner in which this Act adopts that Code.

The purpose of this Act is to adopt the federal Internal Revenue Code as it existed on December 31, 1977, except for provisions of the Code which have been determined to be unnecessary or undesirable for the State of Hawaii at this time.

SECTION 2. Chapter 235, Hawaii Revised Statutes, is amended as follows:

1. By adding a new section to part I to be appropriately designated and to read as follows:

"Sec. 235- Conformance to the federal Internal Revenue Code. (a) For all taxable years beginning after December 31, 1977, as used in this chapter "Internal Revenue Code" means subtitle A, chapter 1 of the federal Internal Revenue Code of 1954 as amended as of December 31, 1977 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 which pursuant to this chapter and this section 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 58) (with respect to determination of tax liability).
- (2) Section 78 (with respect to dividends received from certain foreign corporations by domestic corporations choosing foreign tax credit).
- (3) Section 103 (with respect to interest on certain governmental obligations). For treatment, see section 235-7(b).

- (4) Section 116 (with respect to partial exclusion of dividends received by individuals). For treatment, see section 235-7(c).
- (5) Section 120 (with respect to amounts received under qualified group legal services plans). For treatment see subsection (g) of this section and sections 235-7(a) (10) to (12) and 235-9(a) (2) and (5).
- (6) Section 122 (with respect to certain reduced uniformed services retirement pay). For treatment, see section 235-7(a) (3).
- (7) Section 151 (with respect to allowance of deductions for personal exemptions). For treatment, see section 235-54.
- (8) Section 169 (with respect to amortization of pollution control facilities). For treatment, see section 235-11.
- (9) Section 218 (with respect to contributions to candidates for public office). For treatment, see section 235-7(g).
- (10) Subchapter B, part VIII (sections 241 to 250) (with respect to special deductions for corporations), except sections 248 (with respect to organizational expenditures) and 249 (with respect to limitation on deduction of bond premium on repurchase). For treatment, see section 235-7(c).
- (11) Section 280C (with respect to portion of wages for which credit is claimed under section 44B).
- (12) Section 367 (with respect to foreign corporations).
- (13) Subchapter F (sections 501 to 528) (with respect to exempt organizations), except as provided in subsection (g) of this section. For treatment, see section 235-9.
- (14) Subchapter G (sections 531 to 565) (with respect to corporations used to avoid income tax on shareholders).
- (15) Subchapter H (sections 581 to 596) (with respect to banking institutions). For treatment, see chapter 241.
- (16) Section 642(a), (b), and (d) (with respect to special rules for credits and deductions).
- (17) Section 668 (with respect to interest charge on accumulation distributions from foreign trusts).
- (18) Subchapter L (sections 801 to 844) (with respect to insurance companies). For treatment, see sections 431-318 and 431-320.
- (19) Section 853 (with respect to foreign tax credit allowed to shareholders). For treatment, see section 235-55.
- (20) Subchapter N (sections 861 to 999) (with respect to tax based on income from sources within or without the United States). For treatment, see sections 235-4, 235-5, and 235-7(b).
- (21) Section 1055 (with respect to redeemable ground rents).
- (22) Section 1057 (with respect to election to treat transfer to foreign trust, etc., as taxable exchange).
- (23) Section 1201 (with respect to alternative tax). For treatment, see section 235-51(c).
- (24) Subchapter Q (sections 1301 to 1351) (with respect to readjustment of tax between years and special limitations).
- (25) Subchapter T (sections 1381 to 1388) (with respect to cooperatives and

their patrons). For treatment, see chapter 421.

(c) The determinations, provisions, and requirements relating to zero-bracket amounts in the amendments to the Internal Revenue Code by Public Law 95-30, sections 101 (with respect to change in tax rates and tax tables to reflect permanent increase in standard deduction) and 102 (with respect to change in definition of taxable income to reflect change in tax rates and tables) shall not be operative for the purposes of this chapter.

(d) Sections 141 (with respect to standard deduction), 142 (with respect to individuals not eligible for standard deduction), and 144 (with respect to election of standard deduction) of the Internal Revenue Code, as amended, as of June 7, 1957, shall be operative for the purposes of this chapter, subsection (a) of this section to the contrary notwithstanding.

(e) Section 403 (with respect to taxation of employee annuities) of the Internal Revenue Code shall be operative for the purposes of this chapter; except the amendments to section 403 by Public Law 87-370, section 3 (with respect to employees of certain educational organizations) shall not be operative.

(f) In administering the provisions of sections 410 to 415 (with respect to special rules relating to pensions, profit sharing, stock bonus plans, etc.) 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 415.

In administering sections 401 to 415 (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.

(g) Sections 512 to 515 (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 income shall not include any income from a prepaid legal service plan.

(h) 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 on individuals as determined under section 235-51(a).

(i) Section 644 (with respect to special rule for gain on property transferred to trust at less than 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) 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) 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.

(1) Subchapter S (sections 1371 to 1379) (with respect to the election of certain small business corporations as to taxable status) of chapter 1 of the Internal Revenue Code shall be operative for the purposes of this chapter subject to the following:

- (1) The term small business corporation as defined in section 1371 of the Internal Revenue Code means a corporation which does not have:

- (A) A nonresident as a shareholder; or
- (B) A resident who is an individual who has taken up residence in the State after attaining the age of sixty-five years and before July 1, 1976 and who is taxed under this chapter only on the basis of income received or derived from property owned, personal services performed, trade or business carried on, and any and every other source in the State;

unless the individual resident in subparagraph (B) shall have waived the benefit of section 3, Act 60, Session Laws of Hawaii 1976, as to income includible in the individual's gross income under this chapter and as to such gross income shall have consented to the taxation thereof in the same manner as if the individual had taken up residence in the State after June 30, 1976.

- (2) An election under section 1372(a) of the Internal Revenue Code 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 derives more than eighty per cent of its gross receipts from sources outside the State of Hawaii. Such termination shall be effective for the

taxable year of the corporation in which it derives more than eighty per cent of its gross income from sources outside the State and for all succeeding taxable years;

- (3) An election under section 1372 of the Internal Revenue Code shall not be effective for any taxable year of the corporation unless there is also in effect for such taxable year an election for federal income tax purposes under subchapter S of chapter 1 of the Internal Revenue Code.
- (4) The tax imposed by section 1378(a) of the Internal Revenue Code is hereby imposed by this chapter at an amount equal to 3.08 per cent on the amount by which the net capital gain of the corporation exceeds \$25,000. For the purposes of section 1378(c) (3) of the Internal Revenue Code the amount of tax to be determined shall not exceed 3.08 per cent on the net capital gain attributable to property acquired as provided in section 1378(c) (3) (B) of the Internal Revenue Code and having a basis described in section 1378(c) (3) (C) of the Internal Revenue Code.

(m) References 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 to time limits and other administrative provisions in subtitle F (sections 6001 to 7852) 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 (n). 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 operative 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 control.

(n) The director of taxation may adopt by rule under chapter 91 the rules and regulations promulgated by the United States Secretary of Treasury or a delegate of the Secretary relating to the provisions of subtitle A, chapter 1, of the Internal Revenue Code operative in this chapter and any administrative provisions of the Internal Revenue Code (subtitle F, sections 6001 to 7852) not in conflict with or similar to provisions contained in this chapter or chapter 231 or 232 either by reference or by setting them forth in full.

(o) The department of taxation shall submit to each regular session of the legislature a bill to amend subsection (a) of this section and such other sections and subsections of this chapter as may be necessary to adopt the Internal Revenue Code as it exists on the December 31 preceding such regular session. In submitting the bill the department may provide that certain amendments to the Internal Revenue Code by Congress during the preceding calendar year shall not be operative in this State or as operative are limited in their operation. The

department shall also prepare a digest and explanation of the amended provisions of the Internal Revenue Code recommended for operation, as well as those provisions which are limited in their operation, or which are not recommended for operation, and shall submit with the bill required by this subsection the digest, explanation, and a statement of revenue impact of the adoption of such bill. In preparing the bill, digest, and explanation the department may request the assistance of the office of the legislative reference bureau.

It is the intent of the legislature that it shall each year adopt all amendments to the Internal Revenue Code for the calendar year preceding the year in which the legislature meets; provided that the legislature may choose to adopt none of the amendments to the Internal Revenue Code or may provide that certain amendments are limited in their operation."

2. By adding a new section to part VI to be appropriately designated and to read as follows:

"Sec. 235- Return of electing small business corporation. Every electing small business corporation (as defined in section 1371 of the Internal Revenue Code) shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable by this chapter, the names and addresses of all persons owning stock in the corporation at any time during the taxable year, the number of shares of stock owned by each shareholder at all times during the taxable year, the amount of money and other property distributed by the corporation during the taxable year to each shareholder, the date of each such distribution, and such other information, for the purposes of carrying out this chapter, as the department of taxation may by forms or regulations prescribe. Any return filed pursuant to this section shall, for purposes of sections 235-111 and 235-112 (relating to limitations), be treated as a return filed by the corporation under section 235-92."

3. By adding the following new definitions to section 235-1 to be appropriately inserted and to read as follows:

"Employee" means the same as in the Internal Revenue Code.

"Husband and wife" means the same as in the Internal Revenue Code.

"Paid or incurred, paid or accrued" means the same as in the Internal Revenue Code.

"Stock" mean the same as in the Internal Revenue Code.

"Shareholder" means the same as in the Internal Revenue Code."

4. By amending the definition of "gross income", "adjusted gross income", and "taxable income" in section 235-1 to read as follows:

"Gross income", "adjusted gross income", "ordinary income", "ordinary loss", and "taxable income" respectively mean the same as gross income, adjusted gross income, ordinary income, ordinary loss, and taxable income as defined and determined under the Internal Revenue Code, except as otherwise provided in this chapter."

5. By amending the definition of "partnership" in section 235-1 to read as follows:

"Partnership" means the same as in the Internal Revenue Code."

6. By amending subsection (c) of section 235-5 to read as follows:

“(c) Deductions connected with income taxable under this chapter shall be allowed, but deductions connected with income not taxable under this chapter shall not be allowed. Deductions from adjusted gross income that are not connected with particular property or income, such as medical expenses, shall be allowed only to the extent of the ratio of the adjusted gross income attributed to this State to the entire adjusted gross income computed without regard to source in the State.

Deductions by individual taxpayers from gross income for alimony and separate maintenance payments under section 215 of the Internal Revenue Code shall be allowed only to the extent of the ratio of gross income attributed to this State to the entire gross income computed without regard to source in this State; provided that as used in this sentence “gross income” means gross income as defined in the Internal Revenue Code, minus the deductions allowed by section 62 of the Internal Revenue Code, other than the deductions for alimony and separate maintenance payments under section 215 of the Internal Revenue Code.

Deductions by individual taxpayers from gross income for pension, profit-sharing, stock bonus plans, and other plans qualified under sections 401 to 409 of the Internal Revenue Code, as such sections are operative for the purposes of this chapter, shall be allowed only to the extent that such deductions are attributed to compensation (including compensation as defined in section 401(j)(5)(C) of the Internal Revenue Code) earned in this State.”

7. By amending subsection (d) of section 235-7 to read as follows:

- “(d) (1) For taxable years ending before January 1, 1967, the net operating loss deductions allowed as carrybacks and carry-overs by the Internal Revenue Code shall not be allowed. In lieu thereof the net operating loss deduction shall consist of the excess of the deductions allowed by this chapter over the gross income, computed with the modifications specified in paragraphs (1) to (4) of section 172(d) of the Internal Revenue Code, and with the further modification stated in paragraph (3) hereof; and shall be allowed as a deduction in computing the taxable income of the taxpayer for the succeeding taxable year.
- (2) (A) With respect to net operating loss deductions resulting from net operating losses for taxable years ending after December 31, 1966, the net operating loss deduction provisions of the Internal Revenue Code shall apply, provided that there shall be no net operating loss deduction carried back to any taxable year ending prior to January 1, 1967.
- (B) In the case of a taxable year beginning in 1966 and ending in 1967, the entire amount of all net operating loss deductions carried back to the taxable year shall be limited to that portion of taxable income for such taxable year which the number of days in 1967 bears to the total days in the taxable year ending in 1967.
- (C) The computation of any net operating loss deduction for a taxable year covered by this subsection shall require the further modifications stated in paragraphs (3), (4), and (5) of this subsection.
- (3) In computing the net operating loss deduction allowed by this subsection

tion there shall be included in gross income the amount of interest which is excluded from gross income by subsection (a), decreased by the amount of interest paid or accrued which is disallowed as a deduction by subsection (e). In determining the amount of the net operating loss deduction under this subsection of any corporation, there shall be disregarded the net operating loss of such corporation for any taxable year for which the corporation is an electing small business corporation.

- (4) A net operating loss carryback shall be limited to each of three taxable years preceding the taxable year of such loss. A net operating loss carryover shall be limited to each of the five taxable years following the taxable year of such loss. No net operating loss carryback or carryover shall be allowed by this chapter if not allowed under section 172 of the Internal Revenue Code.
- (5) The election to relinquish the entire carryback period with respect to a net operating loss allowed under section 172(b) (3) (E) of the Internal Revenue Code shall be operative for the purposes of this chapter, subject to the limitations set forth in paragraph (4) of this subsection; provided that no taxpayer shall make such an election as to a net operating loss of a business where such net operating loss occurred in the taxpayer's business prior to the taxpayer entering business in this State."

8. By repealing section 235-10.

7. Section 235-11 is amended to read as follows:

"Sec. 235-11 Amortization of certified pollution control facilities. Subject to other provisions of this chapter, every person, at his election, shall be entitled to a deduction with respect to the amortization of the amortizable basis of any certified pollution control facility in the manner, for the period, and to the extent set out in section 169 of the Internal Revenue Code of 1954, as amended by section 704 of the Tax Reform Act of 1969 (P.L. 91-172); provided that the amortization deduction shall be available only with respect to a facility (1) the construction, reconstruction or erection of which is completed by the taxpayer after December 31, 1969, or, (2) which is acquired by the taxpayer after December 31, 1969, if the original use of the property commences with the taxpayer after December 31, 1969; provided further that the facility is placed in service by the taxpayer before January 1, 1976.

Any water or air pollution control facility, equipment, or device purchased, constructed, or reconstructed and installed pursuant to rules and regulations adopted by the department of health, or any ordinance, rules, and regulations of any governing body of a county consistent with the rules and regulations of the department of health, shall be certified by the state water or air pollution control agency as being in conformity with the state program or requirements for control of either water or air pollution.

Written notice of election to take the accelerated amortization deduction under this section shall be filed with the department of taxation on or before the filing date of the return for the first taxable year for which the election is made under this section. The notice shall be submitted on the form and in the manner as the department of taxation shall prescribe pursuant to chapter 91.

The taxpayer shall file with the department of taxation at the time of his election the certification of approval for the pollution control facility, equipment, or device issued by the state water or air pollution control agency, whichever is applicable, and such other documents and data relating thereto as the department of taxation may require."

10. By amending subsection (c) of section 235-51 to read as follows:

"(c) If for any taxable year a taxpayer other than a corporation has a net capital gain, then, in lieu of the tax imposed by subsection (a) or (b), there is imposed a tax (if such tax is less than the tax imposed by such subsections) which shall consist of the sum of:

(1) A tax computed on the taxable income reduced by an amount equal to fifty per cent of the net capital gain, at the rates and in the manner as if this subsection had not been enacted,

(2) A tax of four per cent of the lesser of:

(A) The sum of the long-term capital gains for the taxable year, or

(B) The amount of the net capital gain."

11. By repealing sections 235-58, 235-58.1, and 235-58.2.

12. By repealing section 235-60.

13. By amending subsection (d) of section 235-71 to read as follows:

"(d) In the case of a real estate investment trust there is imposed on the taxable income, computed as provided in sections 857 and 858 of the Internal Revenue Code but with the changes and adjustments made by this chapter (without prejudice to the generality of the foregoing, the deduction for dividends paid is limited to such amount of dividends as is attributable to income taxable under this chapter), a tax consisting in the sum of the following: 5.85 per cent if the taxable income is not over \$25,000, and on all over \$25,000, 6.435 per cent; 3.08 per cent on the amount of capital gain which is taxed under section 857(b) (3) (A) of the Internal Revenue Code. In addition to any other penalty provided by law any real estate investment trust whose tax liability for any taxable year is deemed to be increased pursuant to section 859(b) (2) (A) (relating to interest and additions to tax determined with respect to the amount of the deduction for deficiency dividends allowed) of the Internal Revenue Code shall pay a penalty in an amount equal to the amount of interest for which such trust is liable that is attributable solely to such increase. The penalty payable under this subsection with respect to any determination shall not exceed one-half of the amount of the deduction allowed by section 859(a) of the Internal Revenue Code for such taxable year."

14. By amending section 235-72 to read as follows:

"Sec. 235-72 Corporations carrying on business in partnership. Corporations carrying on business in partnership shall be treated in the same manner by this chapter as they are treated by the Internal Revenue Code."

15. By repealing part V.

16. By repealing section 235-91.

17. By amending section 235-92 to read as follows:

"Sec. 235-92 Returns, who shall make. For each taxable year, returns shall be made by the following persons to the department of taxation in such form and

manner as it shall prescribe:

- (1) Every person doing business in the State during the taxable year, whether or not he derives any taxable income therefrom. As used in this paragraph "doing business" includes all activities engaged in or caused to be engaged in with the object of gain or economic benefit, direct or indirect, except personal services performed as an employee under the direction and control of an employer. Every person receiving rents from property owned in the State is classed as "doing business" and shall make a return whether or not he derives taxable income therefrom.
- (2) Every corporation having for the taxable year gross income subject to taxation under this chapter; provided that an affiliated group of domestic corporations may make and file a consolidated return for the taxable year in lieu of separate tax returns in the manner and to the extent, so far as applicable, set forth in sections 1501 through 1505 and 1552 of the Internal Revenue Code of 1954, as amended.
- (3) Every individual, estate, or trust having for the taxable year gross income subject to taxation under this chapter, except as exempted from the filing of a return by regulations of the department.

The department may by regulation excuse the filing of a return by an individual, estate, or trust in cases not coming within paragraph (1), where the gross income and exemptions are such that no tax is expected to accrue under this chapter, or are such that substantially all the tax will have been collected through tax withholdings or at the source."

18. By amending subsection (b) of section 235-101 to read:

"(b) It shall be the duty of every person who is required by section 235-92 to make a return, to report to the department, as to any taxable year governed by the income tax law of 1957, if (1) the amount of taxable income as returned to the United States is changed, corrected, or adjusted by an officer of the United States or other competent authority, or (2) a change in taxable income results from a renegotiation of a contract with the United States or a subcontract thereunder, or (3) a recomputation of the income tax imposed by the United States under the Internal Revenue Code results from any cause, or (4) an amended income tax return is made to the United States. The report shall be made within ninety days after the change, correction, adjustment, or recomputation is finally determined or the amended return is filed, as the case may be, but in any event, even if such change, correction, adjustment, or recomputation has not been finally determined or the ninety days have not elapsed, such person shall make a report thereof to the department at the time of filing his next return under this chapter. The statutory period for the assessment of any deficiency or the determination of any refund attributable to this report shall not expire before the expiration of one year from the date the department is notified by the taxpayer or the Internal Revenue Service, whichever is earlier, of such a report in writing."

SECTION 3. Section 241-4, Hawaii Revised Statutes, is amended by amending subsection (b) to read as follows:

"(b) The "entire net income from all sources" shall be determined in the same manner as the "taxable income" of a corporation, as provided by chapter

235, with the following changes and adjustments:

- (1) There is included in gross income interest received upon the obligations of the United States or its possessions, or upon securities issued under the authority of an act of Congress, or upon state, territorial, municipal, county, or other bonds or securities whether or not the income from such obligations, bonds, or securities, is tax free. Section 235-7(a) (1), (6), and (7) do not apply.
- (2) Section 235-3(c), (d), and (e) does not apply.
- (3) In lieu of section 235-4, it is provided that there shall be excluded the gross income from property owned, trade or business carried on, and other sources outside the State.
- (4) Section 235-5 does not apply. The income excluded pursuant to paragraph (3) shall be determined by an allocation and separate accounting. Losses from property owned outside the State and from other sources outside the State shall not be deducted. Reserves shall be allocated to the State by the application of a fraction, the numerator of which consists of the gross income included in determining the "entire net income from all sources" pursuant to this chapter and the denominator of which consists in the gross income similarly ascertained but without regard to whether from sources within or without the State.
- (5) Deductions connected with income which by this chapter is required to be included in the computation of net income shall be allowed, but deductions connected with income which by this chapter is not to be included in the computation of net income shall not be allowed. Section 235-7(e) (1) does not apply.
- (6) One half of such amount of capital gain as, under the Internal Revenue Code, is entitled to the alternative tax treatment, is deductible in the determination of net income.
- (7) Section 166 of the Internal Revenue Code does not apply, except the provisions as to the basis for determining the amount of the deduction for a bad debt. Section 593 of the Internal Revenue Code does not apply. In lieu of the cited sections of the Internal Revenue Code, debts ascertained to be worthless and charged off on the books of the taxpayer within the income year may be deducted, or in the discretion of the department of taxation a reasonable addition to a reserve for bad debts; provided that when satisfied that a debt is recoverable only in part, the department may allow the debt to be charged off in part.
- (8) Federal income taxes upon income derived or received from sources in the State may be deducted.
- (9) In the case of any life insurance company (as defined by the Internal Revenue Code), which is determined to be a financial corporation as defined by this chapter, sections 802, 804, and 818 of the Internal Revenue Code do not apply. The total of the deductions allowed by sections 805 and 812 of the Internal Revenue Code shall not exceed the amount of the required interest, as defined by section 805, subsections (c) and (d), of the Internal Revenue Code.
- (10) In the case of the sale or exchange of a bond, debenture, note, or cer-

tificate or other evidence of indebtedness, section 433(a) and (b) of Public Law 91-172 shall apply.

- (11) Section 582(c) (with respect to bonds, etc., losses and gains of financial institutions) of the Internal Revenue Code shall be operative for the purposes of this chapter.”

SECTION 4. If any section, sentence, clause, or phrase of this Act, or its application to any person or circumstances, is for any reason held to be unconstitutional or invalid, the remaining portion of this Act, or the application of this Act to other persons or circumstances shall not be affected. The legislature declares that it would have passed this Act and each section, sentence, clause, or phrase thereof irrespective of the fact that any one or more other sections, sentences, clauses, or phrases is declared unconstitutional or invalid.

SECTION 5. All laws and parts of laws heretofore enacted which are in conflict with the provisions of this Act are amended to conform with this Act. All acts passed during this Regular Session of 1978, whether enacted before or after the effective date of this Act, shall be amended to conform to this Act, unless such acts specifically provide that this Act is being amended.

SECTION 6. Statutory material to be repealed is bracketed. New material is underscored. In printing this Act, the revisor of statutes need not include the brackets, the bracketed material, or the underscoring.*

SECTION 7. This Act shall, upon its approval, apply to taxable years beginning after December 31, 1977; provided that section 235- (1) (2) of Section 2(1) of this Act shall take effect on January 1, 1979 and shall apply to taxable years beginning on or after January 1, 1979.

(Approved June 2, 1978.)

*Edited accordingly.