

ACT 62

H.B. NO. 1666

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 once again Congress has enacted major income tax legislation during the 1978 calendar year and that the State must continue in its efforts towards conforming the state income tax law with the Internal Revenue Code. The legislature also finds that during the interim since the regular session of 1978, the department of taxation has found additional amendments which should be made to the state tax law to fulfill the efforts of the legislative and executive branches in maintaining income tax conformity.

The purpose of this Act is to continue the efforts of the State in maintaining the conformity of the state income tax law with the federal Internal Revenue Code.

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

1. Section 235-2.3 is amended by amending subsections (a) to (c) to read:

“(a) For all taxable years beginning after December 31, 1978, 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, 1978 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 and except that amendments to the Internal Revenue Code made by Public Law 95-600, section 702 (with respect to technical, clerical, and conforming amendments to estate and gift tax provisions) shall be operative for the purposes of this chapter on the effective dates set forth in section 702.

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, except that amendments to the Internal Revenue Code made by Public Law 95-600, section 702 (with respect to technical, clerical, and conforming amendments to estate and gift tax provisions) shall be operative for the purposes of (1) and (2) of this subsection even if such determination was made or 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) 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).
- (10) Section 280C (with respect to portion of wages for which credit is claimed under section 44B).
- (11) Section 367 (with respect to foreign corporations).
- (12) Section 457 (with respect to deferred compensation plans with respect to service for state and local governments).
- (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 235-71(a).
- (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) and Public Law 95-600, section 101(b) (with respect to increase in zero-bracket amount) and any other present or future amendments to the Internal Revenue Code relating to zero-bracket amounts shall not be operative for the purposes of this chapter.”

2. Section 235-2.3 is amended by amending subsection (f) to read:

“(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.

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.”

3. Section 235-2.3 is amended by amending subsection (n) to read:

“(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 or 6, of the Internal

Revenue Code operative in this chapter and any administrative provisions of the Internal Revenue Code (subtitle F, section 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.”

4. By adding a new section to be appropriately designated and to read:

“**Sec. 235- Returns relating to unemployment.** (a) The state department of labor and industrial relations shall submit a return to the department of taxation according to the forms or rules prescribed by the director of taxation setting forth the aggregate amounts of payments of unemployment compensation and the name and address of the individual to whom paid under chapters 383 to 385.

(b) The department of labor and industrial relations shall furnish to each individual whose name is set forth in such return a written statement showing:

- (1) The name and address of the department of labor and industrial relations; and
- (2) The aggregate amount of payments to the individual as shown on such return.

The written statement required by this subsection shall be furnished to the individual on or before January 31 of the year following the calendar year for which the return under subsection (a) was made. No statement shall be required to be furnished to any individual under this subsection if the aggregate amount of payments to such individual shown on the return made under subsection (a) is less than \$10.”

5. Section 235-3 is amended by amending subsection (c) to read:

“(c) Where, under a provision of the Internal Revenue Code made operative in this chapter, the allowance or disallowance to a taxpayer of a deduction, exclusion, adjustment, credit, or exemption is dependent on whether, under the Internal Revenue Code or a prior applicable federal income tax law, the following was or was not, is or is not, in relation to the same taxpayer or another taxpayer, for the same taxable year or a prior taxable year, an operative factor: the imposition or payment of an income tax, an inclusion in gross income, an exclusion from gross income, or a deduction from gross income—the allowance or disallowance under this chapter of such deduction, exclusion, adjustment, credit, or exemption shall depend on the operativeness of such factor or factors under this chapter or a prior applicable income tax law of the State. This subsection shall govern the application of such sections of the Internal Revenue Code as, for example, sections 111, 215, 668(b), and 7852(c) and all matters of a similar nature.”

6. Section 235-7 is amended by amending subsection (a) to read:

“(a) There shall be excluded from gross income, adjusted gross income, and taxable income:

- (1) Income not subject to taxation by the State under the Constitution and laws of the United States;
- (2) Rights, benefits, and other income exempted from taxation by section 88-91, having to do with the state retirement system, and the rights, benefits, and other income, comparable to the rights, benefits, and other income exempted by section 88-91, under any other public retirement system;
- (3) Any compensation received in the form of a pension for past services, or

- paid as a weekly benefit for unemployment up to but not in excess of the amount provided by the employment security law but the amount of the exclusion shall not exceed the exclusion allowed under section 85 of the Internal Revenue Code made operative for the purposes of this chapter (it being the intention of this provision to exempt that amount whether paid from a fund or account in the federal or state treasury or paid by an employer or by a trust or other means provided by an employer);
- (4) Compensation paid to a patient affected with leprosy employed by the State or the United States in any hospital, settlement, or place for the treatment of leprosy;
 - (5) Except as otherwise expressly provided, payments made by the United States or this State, under an act of Congress or a law of this State, which by express provision or administrative regulation or interpretation are exempt from both the normal and surtaxes of the United States, even though not so exempted by the Internal Revenue Code itself;
 - (6) All proceeds received by organizations enumerated under section 237-23(a)(5) to (8), resulting from the sale of brooms which are manufactured by blind persons working at the adult blind broom shop;
 - (7) Any income expressly exempted or excluded from the measure of the tax imposed by this chapter by any other law of the State, it being the intent of this chapter not to repeal or supersede any such express exemption or exclusion;
 - (8) The first \$500 received by each member of the reserve components of the army, navy, air force, marine corps, coast guard of the United States of America, and the Hawaii national guard as compensation for performance of duty as such;
 - (9) Income derived from the operation of ships or aircraft if such income is exempt under the Internal Revenue Code pursuant to the provisions of an income tax treaty or agreement entered into by and between the United States and a foreign country, provided that the tax laws of the local governments of that country reciprocally exempt from the application of all of their net income taxes, the income derived from the operation of ships or aircraft which are documented or registered under the laws of the United States;
 - (10) The value of legal services provided by a prepaid legal service plan to a taxpayer, his spouse, and his dependents;
 - (11) Amounts paid, directly or indirectly, by a prepaid legal service plan to a taxpayer as payment or reimbursement for the provision of legal services to the taxpayer, his spouse, and his dependents;
 - (12) Contributions by an employer to a prepaid legal service plan for compensation (through insurance or otherwise) to his employees for the costs of legal services incurred by his employees, their spouses, and their dependents.”
7. Section 235-7 is amended by amending subsection (d) to read:
- “(d) (1) For taxable years ending before January 1, 1967, the net operating loss deductions allowed as carry-backs 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 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) (C) 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. Section 235-9 is amended by amending subsection (a) to read:

"(a) Except as provided in sections 235-61 to 235-67 relating to withholding and collection of tax at source, and section 235-2.3(g) relating to "unrelated business taxable income", the following persons and organizations shall not be taxable under this chapter:

- (1) Banks, building and loan associations, industrial loan companies, and small business investment companies taxable under chapter 241; and insurance companies and agricultural cooperative associations, exclusively taxable under other laws;

- (2) Corporations, companies, associations, or trusts conducted solely for charitable, religious, educational, prepaid legal services, or scientific purposes within the State, including fraternal beneficiary societies;
 - (3) Corporations, companies, associations, or trusts organized for the establishment and conduct of cemeteries, no part of the net earnings of which inures to the financial benefit of any private shareholder or individual;
 - (4) Business leagues, chambers of commerce, real estate boards, or boards of trade, not organized for profit, and no part of the net earnings of which inures to the benefit of any private shareholder or individual;
 - (5) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare which shall include the operation of a prepaid legal service plan, or local associations of employees, the membership of which is limited to the employees of a designated person or persons, and the net earnings of which are devoted exclusively to charitable, educational, prepaid legal service, or recreational purposes within the State;
 - (6) Labor organizations;
 - (7) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofit purposes, no part of the net earnings of which inures to the benefit of any private shareholder;
 - (8) A trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries, and which meets the requirements of the Internal Revenue Code for exemption from the tax thereby imposed.”
9. Section 235-51 is amended to read:

“**Sec. 235-51 Tax on individuals; rate.** (a) There shall be assessed, levied, collected, and paid, for each taxable year on the taxable income of every individual, a tax in the following amounts:

If the taxable income is:	The tax shall be:
Not over \$500	2.25% of taxable income
Over \$500, but not over \$1,000	\$11.25 plus 3.25% of excess over \$500
Over \$1,000, but not over \$1,500	\$27.50 plus 4.5% of excess over \$1,000
Over \$1,500, but not over \$2,000	\$50.00 plus 5% of excess over \$1,500
Over \$2,000, but not over \$3,000	\$75.00 plus 6.5% of excess over \$2,000
Over \$3,000, but not over \$5,000	\$140.00 plus 7.5% of excess over \$3,000
Over \$5,000, but not over \$10,000	\$290.00 plus 8.5% of excess over \$5,000
Over \$10,000, but not over \$14,000	\$715.00 plus 9.5% of excess over \$10,000
Over \$14,000, but not over \$20,000	\$1,095.00 plus 10% of excess over \$14,000

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Over \$20,000, but not over \$30,000	\$1,695.00 plus 10.5% of excess over \$20,000
Over \$30,000	\$2,745.00 plus 11% of excess over \$30,000.

(b) Tax on head of household; rate. There shall be assessed, levied, collected, and paid, for each taxable year on the taxable income of every individual who is a head of household, a tax in the following amounts:

If the taxable income is:

The tax shall be:

Not over \$500	2.25% of taxable income
Over \$500, but not over \$1,000	\$11.25 plus 2.75% of excess over \$500
Over \$1,000, but not over \$1,500	\$25.00 plus 3.9% of excess over \$1,000
Over \$1,500, but not over \$2,000	\$44.50 plus 4.1% of excess over \$1,500
Over \$2,000, but not over \$3,000	\$65.00 plus 5.5% of excess over \$2,000
Over \$3,000, but not over \$5,000	\$120.00 plus 6.6% of excess over \$3,000
Over \$5,000, but not over \$10,000	\$252.00 plus 7.9% of excess over \$5,000
Over \$10,000, but not over \$20,000	\$647.00 plus 9.15% of excess over \$10,000
Over \$20,000, but not over \$30,000	\$1,562.00 plus 10.05% of excess over \$20,000
Over \$30,000, but not over \$40,000	\$2,567.00 plus 10.5% of excess over \$30,000
Over \$40,000, but not over \$60,000	\$3,617.00 plus 10.75% of excess over \$40,000
Over \$60,000	\$5,757.00 plus 11% of excess over \$60,000.

(c) Any taxpayer, other than a corporation, acting as a business entity in more than one state who is required by this chapter to file a return and whose only activities in this State consist of sales and who does not own or rent real estate or tangible personal property and whose annual gross sales in or into this State during the tax year is not in excess of \$100,000 may elect to report and pay a tax of .5 per cent of such annual gross sales.”

10. Section 235-55.6 is amended by amending subsection (f) to read:

“(f) Special rules. For purposes of this section:

- (1) Maintaining household. An individual shall be treated as maintaining a household for any period only if over half the cost of maintaining the household for such period is furnished by such individual (or, if such individual is married during such period, is furnished by such individual and his spouse).
- (2) Married couples must file joint return. If the taxpayer is married at the close of the taxable year, the credit shall be allowed under subsection (a) only if

the taxpayer and his spouse file a joint return for the taxable year.

- (3) Marital status. An individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.
- (4) Certain married individuals living apart. If:
 - (A) An individual who is married and who files a separate return:
 - (i) Maintains as his home a household which constitutes for more than one-half of the taxable year the principal place of abode of a qualifying individual, and
 - (ii) Furnishes over half of the cost of maintaining such household during the taxable year, and
 - (B) During the last six months of such taxable year such individual's spouse is not a member of such household, such individual shall not be considered as married.
- (5) Special dependency test in case of divorced parents, etc. If:
 - (A) A child (as defined in section 151(e)(3) of the Internal Revenue Code of 1954, as amended, who is under the age of fifteen or who is physically or mentally incapable of caring for himself receives over half of his support during the calendar year from his parents who are divorced or legally separated under a decree of divorce or separate maintenance or who are separated under a written separation agreement, and
 - (B) Such child is in the custody of one or both of his parents for more than one-half of the calendar year, in the case of any taxable year beginning in such calendar year such child shall be treated as being a qualifying individual described in subsection (c)(1)(A) or (B), as the case may be, with respect to that parent who has custody for a longer period during such calendar year than the other parent, and shall not be treated as being a qualifying individual with respect to such other parent.
- (6) Payments to related individuals. No credit shall be allowed under subsection (a) for any amount paid by the taxpayer to an individual:
 - (A) With respect to whom, for the taxable year, a deduction under section 151(e) of the Internal Revenue Code of 1954, as amended (relating to deduction for personal exemptions for dependents) is allowable either to the taxpayer or the taxpayer's spouse, or
 - (B) Who is a child of the taxpayer (within the meaning of section 151(e)(3) of the Internal Revenue Code of 1954, as amended) who has not attained the age of nineteen at the close of the taxable year.

For purposes of this paragraph, the term "taxable year" means the taxable year of the taxpayer in which the service is performed.
- (7) Student. The term "student" means an individual who during each of five calendar months during the taxable year is a full-time student at an educational organization.
- (8) Educational organization. The term "educational organization" means a school operated by the department of education or licensed under chapter 298, or a university, college, or community college."

11. Section 235-71 is amended by amending subsection (d) to read:

“(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) or 860(c)(1)(A) after December 31, 1978 (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), or 860(a) after December 31, 1978, of the Internal Revenue Code for such taxable year.”

12. Section 235-97 is amended by amending subsections (a) and (b) to read:

- “(a) (1) Individuals and corporations, but not estates or trusts, shall annually furnish the department of taxation with a declaration of estimated tax for the current taxable year. Declarations of estimated tax shall, except as otherwise provided by regulation, be governed by the provisions as to returns contained in sections 235-94, 235-94.5, 235-98, and 235-99. The declaration shall be filed, in the case of individuals on the calendar year basis on or before April 20, and in the case of corporations on the calendar year basis on or before September 20. In the case of a husband and wife who are entitled to make a joint declaration for federal purposes, a single declaration may be made by them jointly, in which case the liability with respect to the estimated tax shall be joint and several; if a joint declaration is made but a joint return is not made for the taxable year, the estimated tax for such year may be treated as the estimated tax of either the husband or the wife or may be divided between them.
- (2) Each individual shall transmit, with his declaration, payment of one-quarter of the estimated tax for the current taxable year. In determining this quarterly payment and all other installments, there first shall be deducted from the total estimated tax the amount of estimated tax withholding or collection at source for the taxable year. Thereafter, on the twentieth day of June and September, the individual shall pay one-quarter of the estimated tax. The fourth quarter of the estimated tax shall be paid by January 20 of the year following the taxable year for which the estimate was made.
- (3) Each corporation shall transmit, with its declaration, payment of one-half of the estimated tax for the current taxable year. The second half of the estimated tax shall be paid by January 20 of the year following the taxable year for which the estimate was made.
- (4) Individuals and corporations operating on a fiscal year basis shall make

similar estimates and tax payments, on or before the twentieth day of the fourth month of the fiscal year in the case of individuals and the ninth month of the fiscal year in the case of corporations, and periodically thereafter so as to conform to the payments and returns required in the case of those on a calendar year basis.

- (5) The department may by regulation excuse individuals from filing an estimate in those cases 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 be collected through tax withholding or at the source, or are such that the total estimated tax is less than \$40 after deducting the total estimated credits allowed.
- (6) In the case of a foreign corporation, the department may excuse the filing of an estimate and the payment of estimated tax if it is satisfied that less than fifteen per cent of the corporation's business for the taxable year will be attributable to the State. For the purposes of this paragraph, fifteen per cent of a corporation's business shall be deemed attributable to the State if fifteen per cent or more of the entire gross income of the corporation (which for the purposes of this paragraph means gross income computed without regard to source in the State) is under section 235-5 and the other provisions of this chapter attributable to the State.
- (7) In the case of a domestic corporation whose tax liability is less than \$40, the department may excuse the filing of an estimate and the payment of estimated tax.

(b) Net income returns for the taxable year shall be filed with the department on or before the twentieth day of the fourth month following the close of the taxable year, and shall be accompanied by payment of the balance of the tax for the taxable year, or the entire tax for the taxable year, as the case may be. These returns shall be filed both by persons required to make declarations of estimated tax pursuant to this section and by persons not required to make declarations of estimated tax."

13. Section 235-112 is amended by amending subsection (a) to read:

"(a) If a taxpayer has made the election provided in section 1033(a)(2)(A) of the Internal Revenue Code, the rules stated in this section apply."

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

"(b) The "entire net income from all sources" shall be determined in the same manner and† 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) does not apply.
- (2) Section 235-3(c), (d), and (e) does not apply.

†So in original. Probably should read "as".

- (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) 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 1979, 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.*

SECTION 7. This Act, upon its approval, shall apply to taxable years beginning after December 31, 1978, except as otherwise provided in this Act.

(Approved May 16, 1979.)

*The text has been edited pursuant to HRS §23G-16.5, authorizing omission of the brackets, bracketed material, and underscoring.