

A Bill for an Act Relating to Taxation.

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

**SECTION 1. Purpose.** The State of Hawaii has adopted the federal Internal Revenue Code of 1954, as amended, for the purpose of determining gross income and taxable income. By Act 62, Session Laws of Hawaii 1979, the legislature further conformed the income tax law of the State of Hawaii with the Internal Revenue Code as amended to December 31, 1978, as it applies to the determination of gross income, adjusted gross income, ordinary income and loss, and taxable income, except for certain provisions which were not made operative or which have been limited in operation. Public Law 95-30, effective for taxable years beginning with

1977, amended the Internal Revenue Code by redefining taxable income by replacing the percentage standard deduction and low-income allowance with the zero-bracket amount as a flat standard deduction, and also replaced the optional tax tables with tax tables for individuals.

Under the current zero-bracket amount allowed by the Internal Revenue Code, tax table income for individuals who do not itemize deductions is the same as adjusted gross income. For taxpayers who itemize deductions, tax table income is computed by subtracting the zero-bracket amount from the individual's total itemized deductions, and subtracting the excess itemized deductions from adjusted gross income.

The zero-bracket and tax table income provisions, however, are not operative for the State and the difference in the method of arriving at taxable income has caused confusion to many taxpayers with the possible result there may have been numerous occasions of overpayment of state taxes.

The purpose of this Act is to conform the method of arriving at taxable income for state purposes with the zero-bracket and tax table income provisions now allowed under the Internal Revenue Code.

SECTION 2. Section 235-2.3, Hawaii Revised Statutes, is amended to read:

**“§235-2.3 Conformance to the federal Internal Revenue Code.** (a) For all taxable years beginning after December 31, 1979, 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, 1979 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 (f) 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 (f) 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) Section 63 (with respect to taxable income defined) of the Internal Revenue Code shall be operative for the purposes of this chapter, except that the zero-bracket amount in section 63(d) of the Internal Revenue Code shall instead mean:

- (1) \$1,000 in the case of:
  - (A) A joint return as provided by section 235-93, or
  - (B) A surviving spouse (as defined in section 2(a) of the Internal Revenue Code),
- (2) \$800 in the case of an individual who is not married and who is not a surviving spouse (as so defined),
- (3) \$500 in the case of a married individual filing a separate return, or
- (4) Zero in any other case.

(d) 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.

(e) 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.

(f) 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 (g)(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.

(g) 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).

(h) 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).

(i) 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.

(j) Section 1034 (with respect to rollover of gain on sale of principal residence) of the Internal Revenue Code shall be operative for the purpose of this chapter; provided section 1034(a) (with respect to nonrecognition of gain) of the Internal Revenue Code shall apply only to:

- (1) A taxpayer who purchases a replacement residence which is located within the State, or
- (2) A taxpayer who is a resident of the State, taxable upon the taxpayer's entire income, computed without regard to source within the State.

(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.

(l) 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 or 6, 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.”

SECTION 3. Section 235-53, Hawaii Revised Statutes, is amended to read:

“§235-53 Tax tables for individuals. (a) Imposition of tax table tax:

- (1) In general. In lieu of the tax imposed by section 235-51, there is hereby imposed for each taxable year on the tax table income of every individual whose tax table income for such year does not exceed the ceiling amount, a tax determined under tables, applicable to such taxable year, which shall be prescribed by the director. In the tables so prescribed, the amounts of tax shall be computed on the basis of the rates prescribed by section 235-51.
- (2) Ceiling amount defined. For purposes of paragraph (1), the term “ceiling amount” means, with respect to any taxpayer, the amount (not less than \$20,000) determined by the director for the tax rate category in which such taxpayer falls.
- (3) Certain taxpayers with large number of exemptions. The director may exclude from the application of this section taxpayers in any tax rate category having more than the number of exemptions for that category determined by the director.
- (4) Tax table income defined. For purposes of this section, the term “tax table income” means adjusted gross income:
  - (A) Reduced by the excess itemized deductions, and

- (B) Increased (in the case of a married individual filing a separate return where either spouse itemizes deductions) by the unused zero-bracket amount.
- (b) Section inapplicable to certain individuals. This section shall not apply to:
  - (1) An individual making a return for a period of less than twelve months on account of a change in annual accounting period, and
  - (2) An estate or trust.
- (c) Tax treated as imposed by section 235-51. For purposes of this chapter, the tax imposed by this section shall be treated as tax imposed by section 235-51.
- (d) Taxable income. Whenever it is necessary to determine the taxable income of an individual to whom this section applies, the taxable income shall be determined under section 63 (with respect to taxable income defined) of the Internal Revenue Code as made operative in this chapter.”

SECTION 4. It is not the intent of this Act to supersede in any manner the substantive amendments contained in H.B. No. 794, H.D. 2,† or S.B. No. 788, H.D. 1,†† passed by this regular session of 1981.

SECTION 5. Statutory material to be repealed is bracketed. New material is underscored.\*

SECTION 6. This Act, upon its approval, shall apply to taxable years beginning after December 31, 1981.

(Approved June 19, 1981.)

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†Enacted as Act 3.

††Enacted as Act 209.

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