

## ACT 13

S.B. NO. 1899

A Bill for an Act Relating to Conformity to the Internal Revenue Code.

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

SECTION 1. Section 235-2.3, Hawaii Revised Statutes, is amended to read as follows:

**“§235-2.3 Conformance to the federal Internal Revenue Code; general application.** (a) For all taxable years beginning after December 31, [1987,] 1988, 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, [1987,] 1988, 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, this section, and sections 235-2.4 and 235-2.5 do not apply or are otherwise limited in application; provided that section 1202 (with respect to deductions for capital gains) of the Internal Revenue Code of 1954 as amended as of December 31, 1986, shall be operative for the purposes of this chapter until March 31, 1987, and shall apply to any capital gains properly taken before April 1, 1987, except that the deduction provided in section 1202(a) shall be fifty-five per cent of the net capital gain.

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 [59] 59A) (with respect to determination of tax liability), except section 42 (with respect to the low-income housing credit) and except sections 47 and 48, as amended, as of December 31, 1984 (with respect to certain depreciable tangible personal property). For treatment, see sections 235-110.7 and 235-110.8.
- (2) Section 78 (with respect to dividends received from certain foreign corporations by domestic corporations choosing foreign tax credit).
- (3) Section 86 (with respect to social security and tier 1 railroad retirement benefits).
- (4) Section 103 (with respect to interest on state and local bonds). For treatment, see section 235-7(b).
- (5) Section 120 (with respect to amounts received under qualified group legal services plans). For treatment, see sections 235-2.4 and 235-7(a)(9) to (11).

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- (6) Section 122 (with respect to certain reduced uniformed services retirement pay). For treatment, see section 235-7(a)(3).
- (7) Section 135 (with respect to income from United States saving bonds used to pay higher education tuition and fees). For treatment, see section 235-7(a)(1).
- [(7)] (8) Subchapter B (sections 141 to 150) (with respect to tax exemption requirements for state and local bonds).
- [(8)] (9) Section 151 (with respect to allowance of deductions for personal exemptions). For treatment, see section 235-54.
- [(9)] (10) Section 196 (with respect to deduction for certain unused investment credits).
- [(10)] (11) 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)] (12) Section 269A (with respect to personal service corporations formed or availed of to avoid or evade income tax).
- [(12)] (13) Section 280C (with respect to certain expenses for which credits are allowable).
- [(13)] (14) Section 280D (with respect to portion of chapter 45 taxes for which credit or refund is allowable under section 6429).
- [(14)] (15) Section 291 (with respect to special rules relating to corporate preference items).
- [(15)] (16) Section 367 (with respect to foreign corporations).
- [(16)] (17) Section 501(c)(12), (15), (16) (with respect to exempt organizations).
- [(17)] (18) Section 515 (with respect to taxes of foreign countries and possessions of the United States).
- [(18)] (19) Section 521 (with respect to exemption of farmers cooperatives from tax). For treatment, see section 421-23.
- [(19)] (20) Subchapter G (sections 531 to 565) (with respect to corporations used to avoid income tax on shareholders).
- [(20)] (21) Subchapter H (sections 581 to [596] 597) (with respect to banking institutions). For treatment, see chapter 241.
- [(21)] (22) Section 642(a), (b), and (d) (with respect to special rules for credits and deductions).
- [(22)] (23) Section 668 (with respect to interest charge on accumulation distributions from foreign trusts).
- [(23)] (24) Subchapter L (sections 801 to [846] 847) (with respect to insurance companies). For treatment, see sections [431-318 and 431-320.] 431:7-202 and 431:7-204.
- [(24)] (25) Section 853 (with respect to foreign tax credit allowed to shareholders). For treatment, see section 235-55.
- [(25)] (26) Subchapter N (sections 861 to 999) (with respect to tax based on income from sources within or without the United States), except part IV (sections 991 to 997) (with respect to domestic international sales corporations). For treatment, see sections 235-4, 235-5, and 235-7(b).
- [(26)] (27) Section 1055 (with respect to redeemable ground rents).
- [(27)] (28) Section 1057 (with respect to election to treat transfer to foreign trust, etc., as taxable exchange).
- [(28)] (29) Subchapter Q (sections 1311 to 1351) (with respect to readjustment of tax between years and special limitations).

[(29)] (30) Subchapter T (sections 1381 to 1388) (with respect to cooperatives and their patrons). For treatment, see chapter 421.”

SECTION 2. Section 235-2.4, Hawaii Revised Statutes, is amended as follows:

1. By amending subsection (a) to read as follows:

“(a) 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 standard deduction amount in section 63(c) of the Internal Revenue Code shall instead mean:

- (1) \$1,700 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) \$1,500 in the case of a head of household (as defined in section 2(b) of the Internal Revenue Code),
- (3) \$1,000 in the case of an individual who is not married and who is not a surviving spouse or head of household, or
- (4) \$850 in the case of a married individual filing a separate return.

Section 63(c)(4) shall not be operative in this State. Section 63(c)(5) shall be operative, except that the limitation on basic standard deduction in the case of certain dependents shall be the greater of \$500 or such individual’s earned income. Section 63(f) shall not be operative in this State.”

2. By amending subsection (n) to read as follows:

“(n) Subchapter S (sections 1361 to 1379) (with respect to tax treatment of S corporations and their shareholders) of chapter 1 of the Internal Revenue Code shall be operative for the purposes of this chapter subject to the following:

- (1) The term S corporation as defined in section 1361 of the Internal Revenue Code means a corporation which does not have 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 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 1362 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.
- (3) The tax imposed by section 1374 of the Internal Revenue Code is hereby imposed by this chapter at an amount equal to 6.4 per cent of the net recognized built-in gain.
- (4) The tax imposed by section 1375(a) of the Internal Revenue Code is hereby imposed by this chapter at an amount equal to 6.4 per cent of the amount of the excess net passive income for the taxable year.”

SECTION 3. Section 235-2.5, Hawaii Revised Statutes, is amended by amending subsections (a) and (b) to read as follows:

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“(a) Reference 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]) 7873 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 (b). 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.

Retroactive provisions in federal Public Laws amending sections of the federal Internal Revenue Code operative in this chapter affecting taxable years beginning or ending before the December 31 date in section 235-2.3 shall be operative for the purposes of this chapter; provided that the effective dates in Public Law 96-471 placing it in effect for the taxable year 1980 shall be operative for the purposes of this chapter.

(b) 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 [7872]) 7873 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.”

SECTION 4. Section 235-7.5, Hawaii Revised Statutes, is amended to read as follows:

“~~[[~~**§235-7.5**~~]]~~ **Certain unearned income of minor children taxed as if parent’s income.** (a) In the case of any child to whom this section applies, the tax imposed by this chapter shall be equal to the greater of:

- (1) The tax imposed by section 235-51 without regard to this section, or
- (2) The sum of:

- (A) The tax which would be imposed by section 235-51 if the taxable income of such child for the taxable year were reduced by the net unearned income of such child, plus

- (B) Such child’s share of allocable parental tax.

(b) This section shall apply to any child for any taxable year if:

- (1) Such child has not attained age fourteen before the close of the taxable year, and
- (2) Either parent of such child is alive at the close of the taxable year.

(c) For the purpose of this section:

- (1) The term “allocable parental tax” means the excess of:
  - (A) The tax which would be imposed by section 235-51 on the parent’s taxable income if such income included the net unearned income of all children of the parent to whom this section applies, over,

(B) The tax imposed by section 235-51 on the parent without regard to this section.

For purposes of subparagraph (A), net unearned income of all children of the parent shall not be taken into account in computing any exclusion, deduction, or credit of the parent.

(2) A child's share of any allocable parental tax of a parent shall be equal to an amount which bears the same ratio to the total allocable parental tax as the child's net unearned income bears to the aggregate net unearned income of all children of such parent to whom this section applies.

(3) If tax is imposed under section 644(a)(1) (with respect to special rule for gain on property transferred to trust at less than fair market value) of the Internal Revenue Code with respect to the sale or exchange of any property of which the parent was the transferor, for purposes of applying paragraph (1) to the taxable year of the parent in which such sale or exchange occurs:

(A) Taxable income of the parent shall be increased by the amount treated as included in gross income under section 644(a)(2)(A)(i) of the Internal Revenue Code, and

(B) The amount described in paragraph (1)(B) shall be increased by the amount of the excess referred to in section 644(a)(2)(A) of the Internal Revenue Code.

Section 644 (with respect to special rule for gain on property transferred to trust at less than fair market value) of the Internal Revenue Code shall be operative for this section as provided in section 235-2.4.

(4) Except as provided in rules, if the parent does not have the same taxable year as the child, the allocable parental tax shall be determined on the basis of the taxable year of the parent ending in the child's taxable year.

(d) For purposes of this section:

(1) The term "net unearned income" means the excess of:

(A) The portion of the adjusted gross income for the taxable year which is not attributable to earned income as defined in the Internal Revenue Code, over,

(B) The sum of:

(i) The amount in effect for the taxable year under section 63(c)(5)(A) (relating to the limitation on standard deduction in the case of certain dependents) of the Internal Revenue Code as operative under section 235-2.4(a), plus

(ii) The greater of the amount described in clause (i) or, if the child itemizes the child's deductions for the taxable year, the amount of the itemized deductions allowed by this chapter for the taxable year which are directly connected with the production of the portion of adjusted gross income referred to in subparagraph (A).

(2) The amount of the net unearned income for any taxable year shall not exceed the individual's taxable income for such taxable year.

(e) For purposes of this section, the parent whose taxable income shall be taken into account shall be:

(1) In the case of parents who are not married (within the meaning of section 235-93), the custodial parent (within the meaning of section 152(e) (with respect to the support test in case of child of divorced parents, etc.) of the Internal Revenue Code) of the child, and

- (2) In the case of married individuals filing separately, the individual with the greater taxable income.

(f) The parent of any child to whom this section applies for any taxable year shall provide the social security number of such parent to such child and such child shall include such parent's social security number on the child's return of tax imposed by this section for such taxable year.

(g) Election to claim certain unearned income of child on parent's return.

(1) If:

(A) Any child to whom this section applies has gross income for the taxable year only from interest and dividends (including Alaska Permanent Fund dividends).

(B) Such gross income is more than \$500 and less than \$5,000.

(C) No estimated tax payments for such year are made in the name and social security number of such child, and no amount has been deducted and withheld under section 3406 (with respect to backup withholding) of the Internal Revenue Code, and

(D) The parent of such child (as determined under subsection (e)) elects the application of paragraph (2).

such child shall be treated as having no gross income for such year and shall not be required to file a return under this chapter.

(2) In the case of a parent making the election under this subsection:

(A) The gross income of each child to whom such election applies (to the extent the gross income of such child exceeds \$1,000) shall be included in such parent's gross income for the taxable year.

(B) The tax imposed by this section for such year with respect to such parent shall be the amount equal to the sum of:

(i) The amount determined under section 235-51 after the application of subparagraph (A) plus

(ii) For each such child, the lesser of \$75 or fifteen per cent of the excess of the gross income of such child over \$500.

(3) The director shall prescribe such rules as may be necessary or appropriate to carry out the purposes of this subsection."

SECTION 5. Section 235-55.6, Hawaii Revised Statutes, is amended as follows:

1. By amending subsections (b) and (c) to read as follows:

"(b) Definitions of qualifying individual and employment-related expenses.

For purposes of this section:

(1) Qualifying individual. The term "qualifying individual" means:

(A) A dependent of the taxpayer who is under the age of [fifteen] thirteen and with respect to whom the taxpayer is entitled to a deduction under section 235-54(a),

(B) A dependent of the taxpayer who is physically or mentally incapable of caring for oneself, or

(C) The spouse of the taxpayer, if the spouse is physically or mentally incapable of caring for oneself.

(2) Employment-related expenses.

(A) In general. The term "employment-related expenses" means amounts paid for the following expenses, but only if such expenses are incurred to enable the taxpayer to be gainfully employed for any period for which there are one or more qualifying individuals with respect to the taxpayer:

- (i) Expenses for household services, and
- (ii) Expenses for the care of a qualifying individual.

Such term shall not include any amount paid for services outside the taxpayer's household at a camp where the qualifying individual stays overnight.

- (B) Exception. Employment-related expenses described in subparagraph (A) which are incurred for services outside the taxpayer's household shall be taken into account only if incurred for the care of:
  - (i) A qualifying individual described in paragraph (1)(A), or
  - (ii) A qualifying individual (not described in paragraph (1)(A)) who regularly spends at least eight hours each day in the taxpayer's household.
- (C) Dependent care centers. Employment-related expenses described in subparagraph (A) which are incurred for services provided outside the taxpayer's household by a dependent care center (as defined in subparagraph (D)) shall be taken into account only if:
  - (i) Such center complies with all applicable laws, rules, and regulations of this State, and
  - (ii) The requirements of subparagraph (B) are met.
- (D) Dependent care center defined. For purposes of this paragraph, the term "dependent care center" means any facility which:
  - (i) Provides care for more than six individuals (other than individuals who reside at the facility), and
  - (ii) Receives a fee, payment, or grant for providing services for any of the individuals (regardless of whether such facility is operated for profit).

(c) Dollar limit on amount creditable. The amount of the employment-related expenses incurred during any taxable year which may be taken into account under subsection (a) shall not exceed:

- (1) \$2,400 if there is one qualifying individual with respect to the taxpayer for such taxable year, or
- (2) \$4,800 if there are two or more qualifying individuals with respect to the taxpayer for such taxable year.

The amount determined under paragraph (1) or (2) (whichever is applicable) shall be reduced by the aggregate amount excludable from gross income under section 129 (with respect to dependent care assistance programs) of the Internal Revenue Code for the taxable year.

2. By amending subsection (e) to read as follows:

"(e) 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 the individual's 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 the taxpayer's spouse file a joint return for the taxable year.
- (3) Marital status. An individual legally separated from the individual's spouse under a decree of divorce or of separate maintenance shall not be considered as married.

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- (4) Certain married individuals living apart. If:
  - (A) An individual who is married and who files a separate return:
    - (i) Maintains as the individual's 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) Paragraph (2) or (4) of section 152(e) of the Internal Revenue Code of 1954, as amended, applies to any child with respect to any calendar year; and
  - (B) Such child is under age [fifteen] thirteen or is physically or mentally incompetent of caring for the child's self;in the case of any taxable year beginning in such calendar year, such child shall be treated as a qualifying individual described in subsection (b)(1)(A) or (B) (whichever is appropriate) with respect to the custodial parent (within the meaning of section 152(e)(1) of the Internal Revenue Code of 1954, as amended), and shall not be treated as a qualifying individual with respect to the noncustodial 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(c) 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(c)(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.
- (9) Identifying information required with respect to service provider. No credit shall be allowed under subsection (a) for any amount paid to any person unless:
  - (A) The name, address, taxpayer identification number, and general excise tax license number of such person are included on the return claiming the credit, or
  - (B) If such person is an organization described in section 501(c)(3) of the Internal Revenue Code and exempt from tax under section 501(a) of the Internal Revenue Code, the name and address of such person are included on the return claiming the credit.

In the case of a failure to provide the information required under the preceding sentence, the preceding sentence shall not apply if it is shown that the taxpayer exercised due diligence in attempting to provide the information so required."



SECTION 6. Section 235-110.8, Hawaii Revised Statutes, is amended by amending subsection (f) to read as follows:

“(f) The state housing credit ceiling under section 42(h) shall be zero for [any] the calendar year [after 1989,] immediately following the expiration of the federal low income housing tax credit program and for any calendar year thereafter, except for the carryover of [the 1989 limit] any credit ceiling amount for certain projects in progress which, at the time of the federal expiration, meet the requirements of section 42[(n)].”

SECTION 7. Statutory material to be repealed is bracketed. New statutory material is underscored.

SECTION 8. This Act, upon its approval, shall apply to taxable years beginning after December 31, 1988.

(Approved April 11, 1989.)