

ACT 16

S.B. NO. 3116

A Bill for an Act Relating to S Corporations.

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

SECTION 1. Chapter 235, Hawaii Revised Statutes, is amended by adding a new part to be appropriately designated and to read as follows:

“PART . HAWAII S CORPORATION INCOME TAX ACT

§235-A Title; definitions; federal conformity; construction. (a) The title of this part shall be the Hawaii S corporation income tax act.

(b) For purposes of this part, the following terms shall have the following meanings:

“C corporation” means a corporation which is not an S corporation.

“Income attributable to the State” means items of income, loss, deduction, or credit of the S corporation apportioned to this State pursuant to part II of this chapter or allocated to this State pursuant to section 235-5.

“Income not attributable to the State” means all items of income, loss, deduction, or credit of the S corporation other than income attributable to the State.

“Internal Revenue Code” has the meaning set forth in section 235-2.3 and as it applies to the taxable period; section references of the Internal Revenue Code shall be deemed to refer to corresponding provisions of prior and subsequent federal tax laws.

“Post-termination transition period” means that period defined in section 1377(b)(1) of the Internal Revenue Code.

“Pro rata share” means the share determined with respect to an S corporation shareholder for a taxable period in the manner provided in section 1377(a)(1) or (2) or 1362(e)(2) or (3) or (6)(D), as the case may be, of the Internal Revenue Code.

“S corporation” means a corporation for which a valid election under section 1362(a) of the Internal Revenue Code is in effect.

“Taxable period” means any taxable year or portion of a taxable year during which a corporation is an S corporation.

(c) Except as otherwise expressly provided or clearly appearing from the context, any term used in this part shall have the same meaning as when used in a comparable context in the Internal Revenue Code, or in any statute relating to federal income taxes, in effect for the taxable period. Due consideration shall be given in the interpretation of this part to applicable sections of the Internal Revenue Code in effect from time to time and to federal rulings and regulations interpreting those sections, provided the Internal Revenue Code rulings and regulations do not conflict with this part or other provisions of this chapter.

(d) This part shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject matter of this part among states enacting it.

§235-B Taxation of an S corporation and its shareholders. (a) An election under section 1362(a) of the Internal Revenue Code shall be effective for the purposes of this chapter. Evidence of a valid election for federal purposes shall be submitted to the department in such form and at such time the department may prescribe.

(b) Except as provided in the following sentence, an S corporation shall not be subject to the tax imposed by section 235-71. If income of an S corporation is subject to federal income tax, then such income as modified by section 235-C, to the extent it constitutes income attributable to the State, shall be taxed at the highest marginal rate of tax imposed on the net income of corporations. If an S corporation is required to pay a tax to this State by reason of the preceding sentence, then the income attributable to the State of the S corporation shall be reduced by the amount of the tax.

(c) Each shareholder's pro rata share of income attributable to the State and each resident shareholder's pro rata share of income not attributable to the State, to the extent modified pursuant to section 235-C, shall be taken into account by the shareholder in the manner provided in section 1366 of the Internal Revenue Code for the purposes of section 235-4 and shall be taxable under section 235-51.

§235-C Modification and characterization of income. (a) The pro rata share of each resident and nonresident shareholder in the income attributable to the State of an S corporation, for the purposes of section 235-B(c), shall be subject to the modifications to corporate income provided by this chapter.

(b) The pro rata share of each resident shareholder in the income not attributable to the State of an S corporation, for the purposes of section 235-B(c), shall be subject to the modifications to individual income provided by this chapter.

(c) S corporation items taken into account by a shareholder pursuant to section 235-B(c) shall be characterized as though received or incurred by the corporation and not its shareholder.

§235-D Basis and adjustments. (a) The initial basis of a resident shareholder in the stock of an S corporation and in any indebtedness of the corporation owed to the shareholder shall be determined in the manner provided under the Internal Revenue Code. The initial basis shall be determined as of the last to occur of the date (which may be before the effective date of this part) on which:

- (1) The shareholder last became a resident of this State;
- (2) The shareholder acquired the stock or the indebtedness of the corporation; or
- (3) The corporation became an S corporation.

ACT 16

(b) The initial basis of a resident shareholder in the stock and indebtedness of an S corporation shall be adjusted after the date specified in subsection (a) in the manner and to the extent required by section 1011 of the Internal Revenue Code except that, with respect to any taxable period during which the shareholder was a resident of this State:

- (1) Any modification made (other than for income exempt from federal or this State's taxation) pursuant to section 235-C shall be taken into account; and
- (2) Any adjustments made pursuant to section 1367 of the Internal Revenue Code for a taxable period during which this State did not measure S corporation shareholder income by reference to the corporation's income shall not be taken into account.

(c) The initial basis of a nonresident shareholder in the stock of an S corporation and in any indebtedness of the corporation to the shareholder shall be zero. The initial basis shall be determined as of the last to occur of the date (which may be before the effective date of this part) on which:

- (1) The shareholder acquired the stock or the indebtedness of the corporation;
- (2) The corporation became an S corporation; or
- (3) The shareholder last became a nonresident of this State.

(d) The initial basis of a nonresident shareholder in the stock and indebtedness of an S corporation shall be adjusted after the date specified in subsection (c) in the manner provided in section 1367 of the Internal Revenue Code, except that adjustments to basis shall be limited to the income attributable to the State taken into account by the shareholder pursuant to section 235-B(c). In computing income attributable to the State for purposes of the preceding sentence, any modification made for income exempt from federal or this State's taxation shall not be taken into account.

(e) The basis of a resident shareholder in the stock of a corporation shall be reduced by the amount allowed as a loss or deduction pursuant to section 235-E(d).

(f) The basis of a resident shareholder in the stock of a corporation shall be reduced by the amount of any cash distribution which is not taxable to the shareholder as a result of the application of section 235-G(b).

(g) For purposes of this section, a shareholder shall be considered to have acquired stock or indebtedness received by gift at the time the donor acquired the stock or indebtedness, if the donor was a resident of this State at the time of the gift.

§235-E Carryforwards and carrybacks; loss limitation. (a) Carryforwards and carrybacks to and from taxable periods of an S corporation shall be restricted in the manner provided in section 1371(b) of the Internal Revenue Code.

(b) The aggregate amount of losses or deductions of an S corporation taken into account by a shareholder pursuant to section 235-B(c) shall not exceed the combined adjusted bases, determined in accordance with section 235-D, of the shareholder in the stock and indebtedness of the S corporation.

(c) Any loss or deduction which is disallowed for a taxable period pursuant to subsection (b) shall be treated as incurred by the corporation in the succeeding taxable period with respect to the shareholder.

- (d) (1) Any loss or deduction which is disallowed pursuant to subsection (b) for the corporation's last taxable period as an S corporation shall be treated as incurred by a shareholder on the last day of any post-termination transition period.

- (2) The aggregate amount of losses and deductions taken into account by a shareholder pursuant to paragraph (1) shall not exceed the adjusted basis of the shareholder in the stock of the corporation (determined in accordance with section 235-D at the close of the last day of any post-termination transition period and without regard to this subsection).

§235-F Part-year residence. For purposes of this part if a shareholder of an S corporation is both a resident and nonresident of this State during any taxable period, the shareholder's pro rata share of the S corporation's income attributable to the State and income not attributable to the State for the taxable period shall be further prorated between the shareholder's periods of residence and nonresidence, in accordance with the number of days in each period.

§235-G Distributions. (a) Subject to subsection (c), a distribution made by an S corporation with respect to its stock to a resident shareholder shall be taken into account by the shareholder for purposes of section 235-4 and shall be taxable under section 235-51 to the extent that the distribution is treated as a dividend or as gain from the sale or exchange of property pursuant to section 1368 of the Internal Revenue Code.

(b) Subject to subsection (c), a distribution of money made by a corporation with respect to its stock to a resident shareholder during a post-termination transition period shall not be taken into account by the shareholder for purposes of section 235-4 to the extent the distribution is applied against and reduces the adjusted basis of the stock of the shareholder in accordance with section 1371(e) of the Internal Revenue Code.

(c) In applying sections 1368 and 1371(e) of the Internal Revenue Code to any distribution referred to in subsection (a) or (b):

- (1) The term "adjusted basis of the stock" means the adjusted basis of the shareholder's stock as determined under section 235-D; and
- (2) The accumulated adjustments account for this State shall be equal to, and shall be adjusted in the same manner as, the S corporation's accumulated adjustments account defined in section 1368(e)(1)(A) of the Internal Revenue Code, except that the account shall also be adjusted by any modifications required to be made pursuant to section 235-C(a).

§235-H Returns; shareholder agreements; mandatory payments. (a) An S corporation which engages in activities in this State which would subject a C corporation to the requirement to file a return under section 235-92 shall file with the department an annual return, in the form prescribed by the department, on or before the due date prescribed for the filing of C corporation returns by section 235-97.

Every S corporation shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable by this chapter, the name, address, and social security or federal identification number of each person 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 income attributable to the State and income not attributable to the State with respect to each shareholder as determined under this part, the modifications required by section 235-C, 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 as the department may by form or rule prescribe.

ACT 16

The S corporation, on or before the day on which such return is filed, shall furnish to each person who was a shareholder during the year a copy of the information shown on the return as the department may by form or rule prescribe. Any return filed pursuant to this section, for purposes of sections 235-111 and 235-112, shall be treated as a return filed by the corporation under section 235-92. The S corporation shall also maintain the accumulated adjustments account described in section 235-G(c)(2).

(b) The department shall permit S corporations to file composite returns and to make composite payments of tax on behalf of some or all of its nonresident shareholders. The department may permit composite returns and payments to be made on behalf of resident shareholders.

(c) An S corporation shall file with the department, in the form prescribed by the department, the agreement of each nonresident shareholder of the corporation:

- (1) To file a return and make timely payment of all taxes imposed by this State on the shareholder with respect to the income of the S corporation; and
- (2) To be subject to personal jurisdiction in this State for purposes of the collection of unpaid income tax, together with related interest and penalties.

If the corporation fails to timely file the agreements required by paragraphs (1) and (2) on behalf of each of its nonresident shareholders, then the corporation, at the times set forth in subsection (d), shall pay to this State on behalf of each nonresident shareholder in respect of whom an agreement has not been timely filed an amount equal to the highest marginal tax rate in effect under section 235-51 multiplied by the amount of the shareholder's pro rata share of the income attributable to the State reflected on the corporation's return for the taxable period. An S corporation shall be entitled to recover a payment made pursuant to the preceding sentence from the shareholder on whose behalf the payment was made.

(d) The agreements required to be filed pursuant to subsection (c) shall be filed at the following times:

- (1) At the time the annual return is required to be filed for the first taxable period for which the S corporation became subject to this part, and
- (2) At the time the annual return is required to be filed for any taxable period in which the corporation had a nonresident shareholder on whose behalf such an agreement has not been previously filed.

(e) Any amount paid by the corporation to this State pursuant to subsection (b) or (c) shall be considered to be a payment by the shareholder on account of the income tax imposed on the shareholder for the taxable period.

(f) Any officer of any S corporation who wilfully fails to provide any information, file any return or agreement, make any payment, or maintain any account as required by this section or by section 231-15.6 shall be guilty of a misdemeanor.

§235-I Tax credits. (a) For purposes of section 235-55, each resident shareholder shall be considered to have paid a tax imposed on the shareholder in an amount equal to the shareholder's pro rata share of any net income tax paid by the S corporation to a state which does not measure the income of S corporation shareholders by the income of the S corporation. For purposes of the preceding sentence, the term "net income tax" means any tax imposed on or measured by a corporation's net income.

(b) Each shareholder of an S corporation shall be allowed a credit against the tax imposed by section 235-51 in an amount equal to the shareholder's pro rata share of the tax credits described in sections 209E-10, 235-12, 235-71(c), 235-110.6, 235-110.7, and 235-110.8. With the exception of the credit allowed by section 235-12, nonresident shareholders shall be allowed the credits allowed to resident shareholders which are earned by the S corporation in this State. The credit allowed by section 235-12 shall be allowed to nonresident shareholders to the extent the credit is earned by virtue of property purchased and placed in service in this State.

§235-J LIFO recapture. If an S corporation is subject to last in first out (LIFO) recapture pursuant to section 1363 of the Internal Revenue Code, then:

- (1) Any increase in the tax imposed by section 235-71 by reason of the inclusion of the LIFO recapture amount in its income shall be payable in four equal installments;
- (2) The first installment shall be paid on or before the due date (determined without regard to extensions) for filing the return for the first taxable year for which the corporation was subject to the LIFO recapture;
- (3) The three succeeding installments shall be paid on or before the due date (determined without regard to extensions) for filing the corporation's return for the three succeeding taxable years; and
- (4) For purposes of computing interest on underpayments, the last three installments shall not be considered underpayments until after the payment due date specified above."

SECTION 2. Section 235-2.4, Hawaii Revised Statutes, is amended 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.] as provided in part .”

SECTION 3. Section 235-97, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

- “(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 the individual’s 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.”

SECTION 4. Section 235-94.5, Hawaii Revised Statutes, is repealed.

SECTION 5. In codifying the new part added to chapter 235, Hawaii Revised Statutes, by section 1 of this Act, the revisor of statutes shall substitute appropriate section numbers for the letters used in the new sections' designations in this Act.

SECTION 6. Statutory material to be repealed is bracketed. New statutory material is underscored.¹

SECTION 7. This Act, upon its approval, shall apply to taxable years beginning after December 31, 1989.

(Approved April 17, 1990.)

Note

1. Edited pursuant to HRS §23G-16.5.