

ACT 172

S.B. NO. 1394

A Bill for an Act Relating to Conformity of the Hawaii Income Tax Law to the Internal Revenue Code.

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

SECTION 1. The purpose of this Act is to comply with section 235-2.5, Hawaii Revised Statutes, which mandates that the department of taxation submit a bill to each regular session of the legislature that amends Hawaii income tax law to conform with changes to the Internal Revenue Code.

SECTION 2. 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, [~~2001,~~] 2002, as used in this chapter “Internal Revenue Code” means subtitle A, chapter 1 of the federal Internal Revenue Code of 1986, as amended as of December 31, [~~2001,~~] 2002, 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 laws which pursuant to this chapter do not apply or are otherwise limited in application.

Sections 235-2, 235-2.1, and 235-2.2 shall continue to be used to determine:

- (1) The basis of property, if a taxpayer first determined the basis of property in a taxable year to which such sections apply, and if such determination was made before January 1, 1978; and
 - (2) Gross income, adjusted gross income, ordinary income and loss, and taxable income for a taxable year to which such sections apply where such taxable year begins before January 1, 1978.
- (b) The following Internal Revenue Code subchapters, parts of subchapters, sections, subsections, and parts of subsections shall not be operative for the purposes of this chapter, unless otherwise provided:

- (1) Subchapter A (sections 1 to 59A) (with respect to determination of tax liability), except section 1(h)(3) (relating to net capital gain reduced by the amount taken into account as investment income), except section 41 (with respect to the credit for increasing research activities), except section 42 (with respect to 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 235-110.91, 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 114 (with respect to extraterritorial income);
- ~~(5)~~ (6) Section 120 (with respect to amounts received under qualified group legal services plans). For treatment, see section 235-7(a)(9) to (11);
- ~~(6)~~ (7) Section 122 (with respect to certain reduced uniformed services retirement pay). For treatment, see section 235-7(a)(3);
- ~~(7)~~ (8) Section 135 (with respect to income from United States savings bonds used to pay higher education tuition and fees). For treatment, see section 235-7(a)(1);
- ~~(8)~~ (9) Subchapter B (sections 141 to 150) (with respect to tax exemption requirements for state and local bonds);
- ~~(9)~~ (10) Section 151 (with respect to allowance of deductions for personal exemptions). For treatment, see section 235-54;
- ~~(10)~~ (11) Section 196 (with respect to deduction for certain unused investment credits);
- ~~(11)~~ (12) Section 222 (with respect to qualified tuition and related expenses);
- ~~(12)~~ (13) Sections 241 to 247 (with respect to special deductions for corporations). For treatment, see section 235-7(c);

- [(13)] (14) Section 280C (with respect to certain expenses for which credits are allowable). For treatment, see section 235-110.91;
- [(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) Subchapter G (sections 531 to 565) (with respect to corporations used to avoid income tax on shareholders);
- [(19)] (20) Subchapter H (sections 581 to 597) (with respect to banking institutions), except section 584 (with respect to common trust funds). For treatment, see chapter 241;
- [(20)] (21) Section 642(a) and (b) (with respect to special rules for credits and deductions applicable to trusts). For treatment, see sections 235-54(b) and 235-55;
- [(21)] (22) Section 646 (with respect to tax treatment of electing Alaska Native settlement trusts);
- [(22)] (23) Section 668 (with respect to interest charge on accumulation distributions from foreign trusts);
- [(23)] (24) Subchapter L (sections 801 to 848) (with respect to insurance companies). For treatment, see sections 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 sections 985 to 989 (with respect to foreign currency transactions). For treatment, see sections 235-4, 235-5, and 235-7(b), and 235-55;
- [(26)] (27) Section 1042(g) (with respect to sales of stock in agricultural refiners and processors to eligible farm cooperatives);
- [(27)] (28) Section 1055 (with respect to redeemable ground rents);
- [(28)] (29) Section 1057 (with respect to election to treat transfer to foreign trust, etc., as taxable exchange);
- [(29)] (30) Sections 1291 to 1298 (with respect to treatment of passive foreign investment companies);
- [(30)] (31) Subchapter Q (sections 1311 to 1351) (with respect to readjustment of tax between years and special limitations);
- [(31)] (32) Subchapter U (sections 1391 to 1397F) (with respect to designation and treatment of empowerment zones, enterprise communities, and rural development investment areas). For treatment, see chapter 209E; and
- [(32)] (33) Subchapter W (sections 1400 to 1400C) (with respect to District of Columbia enterprise zone).”

SECTION 3. Section 235-2.4, Hawaii Revised Statutes, is amended to read as follows:

“§235-2.4 **Operation of certain Internal Revenue Code provisions; sections 63 to 530.** (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) \$1,900 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) \$1,650 in the case of a head of household (as defined in section 2(b) of the Internal Revenue Code);
- (3) \$1,500 in the case of an individual who is not married and who is not a surviving spouse or head of household; or
- (4) \$950 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.

The standard deduction amount for nonresidents shall be calculated pursuant to section 235-5.

(b) Section 72 (with respect to annuities; certain proceeds of endowment and life insurance contracts) of the Internal Revenue Code shall be operative for purposes of this chapter and be interpreted with due regard to section 235-7(a), except that the ten per cent additional tax on early distributions from retirement plans in section 72(t) shall not be operative for purposes of this chapter.

(c) Section 121 (with respect to exclusion of gain from sale of principal residence) of the Internal Revenue Code shall be operative for purposes of this chapter, except that for the election under section 121(f), a reference to section 1034 treatment means a reference to section 235-2.4(n) in effect for taxable year 1997.

(d) Section 165 (with respect to losses) of the Internal Revenue Code shall be operative for purposes of this chapter. Section 165 as operative for this chapter shall also apply to losses sustained from the sale of stocks or other interests issued through the exercise of the stock options or warrants granted by a qualified high technology business as defined in section 235-7.3.

(e) Section 168 (with respect to the accelerated cost recovery system) of the Internal Revenue Code shall be operative for purposes of this chapter, except that provisions relating to property on Indian reservations in section 168(j) and special allowance for certain property acquired after September 10, 2001, and before September 11, 2004, in section 168(k) shall not be operative for purposes of this chapter.

[(e)] (f) Section 219 (with respect to retirement savings) of the Internal Revenue Code shall be operative for the purpose of this chapter. For the purpose of computing the limitation on the deduction for active participants in certain pension plans for state income tax purposes, adjusted gross income as used in section 219 as operative for this chapter means federal adjusted gross income.

[(f)] (g) Section 220 (with respect to medical savings accounts) of the Internal Revenue Code shall be operative for the purpose of this chapter, but only with respect to medical services accounts that have been approved by the Secretary of the Treasury of the United States.

[(g)] (h) Section 265 (with respect to expenses and interest relating to tax-exempt income) of the Internal Revenue Code shall be operative for purposes of this chapter; except that it shall not apply to expenses for royalties and other income derived from any patents, copyrights, and trade secrets by an individual or a qualified high technology business as defined in section 235-7.3. Such expenses shall be deductible.

[(h)] (i) Section 408A (with respect to Roth Individual Retirement Accounts) of the Internal Revenue Code shall be operative for the purposes of this chapter. For the purposes of determining the aggregate amount of contributions to a Roth Individual Retirement Account or qualified rollover contribution to a Roth Individual Retirement Account from an individual retirement plan other than a Roth

Individual Retirement Account, adjusted gross income as used in section 408A as operative for this chapter means federal adjusted gross income.

~~[(i)]~~ (j) In administering the provisions of sections 410 to 417 (with respect to special rules relating to pensions, profit sharing, stock bonus plans, etc.), sections 418 to 418E (with respect to special rules for multiemployer plans), and sections 419 and 419A (with respect to treatment of welfare benefit funds) 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 419A.

In administering sections 401 to 419A (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.

~~[(j)]~~ (k) Section 468B (with respect to special rules for designated settlement funds) 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 a rate equal to the maximum rate in effect for the taxable year imposed on estates and trusts under section 235-51.

~~[(k)]~~ (l) Section 469 (with respect to passive activities and credits limited) of the Internal Revenue Code shall be operative for the purposes of this chapter. For the purpose of computing the offset for rental real estate activities for state income tax purposes, adjusted gross income as used in section 469 as operative for this chapter means federal adjusted gross income.

~~[(l)]~~ (m) Sections 512 to 514 (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.

"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 there shall not be taken into account any amount of income or deduction that is excluded in computing the unrelated business taxable income. Unrelated business taxable income shall not include any income from a prepaid legal service plan.

For a person described in section 401 or 501 of the Internal Revenue Code, as modified by section 235-2.3, the tax imposed by section 235-51 or 235-71 shall be imposed upon the person's unrelated business taxable income.

~~[(m)]~~ (n) Section 521 (with respect to cooperatives) and subchapter T (sections 1381 to 1388, with respect to cooperatives and their patrons) of the Internal Revenue Code shall be operative for the purposes of this chapter as to any cooperative fully meeting the requirements of section 421-23, except that Internal Revenue Code section 521 cooperatives need not be organized in Hawaii.

~~[(n)]~~ (o) Sections 527 (with respect to political organizations) and 528 (with respect to certain homeowners associations) of the Internal Revenue Code shall be operative for the purposes of this chapter and the taxes imposed in each such section are hereby imposed by this chapter at the rates determined under section 235-71.

~~[(o)]~~ (p) Section 529 (with respect to qualified tuition programs) shall be operative for the purposes of this chapter, except that section 529(c)(6) shall not be operative.

~~(p)~~ (q) Section 530 (with respect to education individual retirement accounts) of the Internal Revenue Code shall be operative for the purposes of this chapter. For the purpose of determining the maximum amount that a contributor could make to an education individual retirement account for state income tax purposes, modified adjusted gross income as used in section 530 as operative for this chapter means federal modified adjusted gross income as defined in section 530.”

SECTION 4. Section 235-7, Hawaii Revised Statutes, is amended by amending subsection (d) to read as follows:

- “(d) (1) For taxable years ending before January 1, 1967, the net operating loss deductions allowed as carrybacks and carryovers 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[-]; and
- (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) 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; 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[-]; and
- (6) The five-year carryback period for net operating losses for any taxable year ending during 2001 and 2002 in section 172(b)(1)(H) of the

Internal Revenue Code shall not be operative for purposes of this chapter.”

SECTION 5. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 6. This Act, upon its approval, shall apply to taxable years beginning after December 31, 2002, except as otherwise provided in this Act.

(Approved June 16, 2003.)