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DEPARTMENT OF TAXATION ANNOUNCEMENT NO. 2004-02

RE: Act 89, Session Laws of Hawaii 2004, Relating to Conformity of the Hawaii Income Tax Law to the Internal Revenue Code (Act 89)

On May 26, 2004, the Governor signed S.B. No. 2983, SD 2, HD 1, into law as Act 89. Act 89 amends Hawaii's income tax law to conform with the changes to the Internal Revenue Code (IRC) made by Congress in 2003. The adoption of the amendments to the IRC sections for State income tax purposes assures continued State conformity with federal income tax law and minimizes taxpayers' burdens in complying with Hawaii's income tax law.

Section 2 of Act 89 amends HRS § 231-15.8(b) to extend the special filing extension rules for service personnel in combat zones to personnel deployed in contingency operations. This provision would provide conformity with the federal filing provisions in the Military Family Tax Relief Act of 2003.

Section 3 of Act 89 amends HRS § 235-2.3 (a) to conform the Hawaii Income Tax Law to the operative IRC sections of subtitle A, chapter 1, amended as of December 31, 2003. Generally, subtitle A, chapter 1, refers to IRC §§ 1 through 1400. For conformity purposes, the federal effective dates for amendments to operative IRC sections are adopted.

Section 4 of Act 89 amends HRS § 235-2.4(a) to clarify the application of IRC §§ 163, 168, and 179. HRS § 235-2.4 is amended to <u>not</u> conform to the definition of net investment income (IRC § 163), the bonus for first year depreciation (IRC § 168), and the increase in the expensing deduction (IRC § 179).

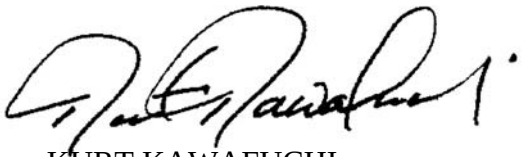
In addition to section 2 of the Act, the following provisions from the Military Family Tax Relief Act of 2003 are also adopted:

Retroactive (to September 11, 2001) increase of the military death benefit from $6,000 to $12,000;
Clarification that dependent care assistance will not be included in a taxpayer's income under IRC § 134;
An exception to the two-out-of-five year rule for certain uniformed and foreign service personnel with respect to the $250,000 gain exclusion for home sales;

An exclusion for certain amounts received under Department of Defense homeowners assistance program;
An above-the-line deduction for overnight travel expenses of national guard and reserve members;
Penalty-free withdrawals from Coverdell education savings accounts and qualified tuition programs made on account of the attendance of the beneficiary at certain military academies;
A loosening of the "substantially all" requirement with respect to membership requirements of veterans' organizations under IRC § 501(c)(19);[1]
Income tax and estate tax relief and assistance for families of Space Shuttle Columbia heroes; and
A suspension of an organization's tax-exempt status for any period during which the organization is designated or identified by U.S. federal authorities as a terrorist organization or supporter of terrorism

Act 89 also conforms to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 to allow the same tax benefits for health savings accounts (HSAs) under Hawaii law. HSAs provide tax-favored treatment for current medical expenses as well as the ability to save on a tax-favored basis for future medical expenses. In general, HSAs are tax-exempt trusts or custodial accounts created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents. HSAs are subject to rules similar to those applicable to individual retirement accounts.

Current forms and other tax information are available at the Department's website at: www.state.hi.us/tax. If you know which tax form or publication you need, please call the Department's request line at 808-587-7572, or toll-free from the neighbor islands and continental U.S. at 1-800-222-7572. This service is available 24 hours a day, 7 days a week.



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Director of Taxation

HRS Sections Explained: HRS sections 231-15.8, 235-2.3, and 235-2.4.

[1] The requirement pertains to veterans' organizations' qualification to secure and retain tax-exempt status.