LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

STANLEY SHIRAKI
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

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DEPARTMENT OF TAXATION ANNOUNCEMENT NO. 2010-10

RE: Act 112, Session Laws of Hawaii 2010, Relating to Conformity of the Hawaii Income Tax Law to the Internal Revenue Code.

On May 17, 2010, Governor Linda Lingle signed into law House Bill 2594, H.D.2, S.D.1, C.D. 1, as Act 112, Session Laws of Hawaii 2010.

NEW INFORMATION REPORTING REQUIREMENTS

Section 2 of Act 112 adds a new section to chapter 235, which adopts certain information reporting requirements for Hawaii tax purposes that are part of the Internal Revenue Code ("Code"). The Department will use this additional information to identify delinquent taxpayers by matching the new information provided with the gross receipts or gross income reported on a taxpayer's tax return. The Department plans to allow taxpayers to use the forms or attached statements required for filing with the Internal Revenue Service to be filed with the Department to satisfy these new reporting requirements. Specifically, the Department would receive the following information reporting that will be provided to the IRS:

- §6041(h) (information at source) -- conforms to a requirement in the Patient Protection and Affordable Care Act of 2010 that requires businesses to issue Form 1099s for payments of $600 or more to corporations that are not exempt from tax under Code Section 501(a). Previously, corporations were exempt from information reporting requirements as the payee. This reporting requirement is effective for payments made after December 31, 2011.

- §6038D (information with respect to foreign financial assets)-- conforms to a requirement in the Hiring Incentives to Restore Employment Act of 2010 that any individual with "specified foreign financial assets" of $50,000 or more must report to the Department. "Specified foreign financial assets" include foreign bank accounts, stock or securities issued by a foreign entity, and any investment or interest in a foreign entity. This reporting requirement applies to tax years beginning after March 18, 2010.

- §6045B (returns relating to actions affecting basis of specified securities.) -- conforms to a requirement in the Energy Improvement and Extension Act of 2008

that requires the issuers of certain securities to report certain information that affects the basis of the securities. The effective date of this new provision is January 1, 2011.

- §6050W (returns relating to payments made in settlement of payment card third party network transactions) -- conforms to a requirement in the Housing Assistance Tax Act of 2008 that requires information reporting regarding credit card transactions. The requirement applies to calendar years beginning after December 31, 2010.

NEW INTEREST RATE FOR FUNDS HELD IN LITIGATED CLAIMS FUND

Section 3 of the Act reduces the interest rate to be paid to taxpayers on funds held in the litigated claims fund from 8 percent to 4 percent. In 2009, Act 40, SLH 2009, reduced the interest rate for interest paid to taxpayers on overpayments from 8 percent to 4 percent.

CONFORMITY TO THE INTERNAL REVENUE CODE AS OF DECEMBER 31, 2009

In 2009, Congress enacted tax measures with the hope of stimulating the economy and providing taxpayer relief. The tax measures that impact the state's conformity to the Internal Revenue Code are the American Recovery and Reinvestment Act of 2009 (P.L. 111-5), ("ARRA") enacted on February 17, 2009, and the Worker, Homeownership, and Business Assistance Act of 2009 (P.L. 111-92) ("WHBA") enacted on November 6, 2009.

Section 4 of the Act amends section 235-2.3(a), HRS, to conform the Hawaii income tax law to the operative Code sections of subtitle A, chapter 1, amended as of December 31, 2009. Generally, subtitle A, chapter 1, refers to Code sections 1 through 1400T. Section 4 also provides that, for purposes of the Hawaii income tax law, with respect to the following sections of the Code:

- §48(d)(3) (energy grants) -- **conforms** to the provision that excludes from gross income a federal energy grant paid under section 1603 of the ARRA (ARRA provision);

- §139C (COBRA premium assistance) -- does not conform to the exclusion from gross income for a taxpayer's subsidy for continuation of COBRA coverage (ARRA provision);

- §853A (Credits from tax credit bonds allowed to shareholders) – does not conform to the pass-through of the credit from tax credit bonds to shareholders of Regulated Investment Companies and Real Estate Investment Trusts (ARRA provision);

- §1400U-1 (allocation of recovery zone bonds) – does not conform to national limitations on recovery zone bonds since this provision does not affect Hawaii state tax (ARRA provision);

- §1400U-2 (recovery zone economic development bonds) – does not conform to issuance of economic development bonds since this provision does not affect Hawaii state tax (ARRA provision); and

- §1400U-3 (recovery zone facility bonds) -- does not conform to issuance of economic development bonds since this provision does not affect Hawaii state tax (ARRA provision).

Section 5 of the Act amends section 235-2.4, HRS, with respect to conformity provisions for the following sections of the Code:

- §63 (standard deduction) – does not conform to the addition of motor vehicle sales taxes to the standard deduction. If adopted, this provision would have allowed individuals who cannot itemize deductions to deduct the general excise tax on a motor vehicle purchase as part of the standard deduction (ARRA provision);

- §85 (unemployment compensation) – does not conform to the exclusion from gross income of up to $2,400 of unemployment compensation benefits for 2009 (ARRA provision);

- §108 (income from discharge of indebtedness) – does not conform to section 108(i), which provides that income from reacquisitions of business debt at a discount in 2009 and 2010 is deferred for up to five years, then included ratably over five years (ARRA provision);

- §132 (fringe benefits) – does not conform to section 132(f)(2) that provides that the monthly exclusion for employer-provided transit passes and vanpooling benefits increased to the same level as employer-provided parking for 2009 and 2010 (ARRA provision). In addition, Hawaii does not conform to section 132(n) that provides an income tax exclusion for United States Department of Defense Homeowners Assistance Program payments authorized by the ARRA (WHBA provision);

- §163 (interest deduction) – does not conform to section 163(i)(1) and 163(e)(5)(F), which relax interest deduction rules for applicable high-yield discount obligations to address distressed conditions in the debt capital markets (ARRA provision);

- §164 (deduction for state and local taxes) – does not conform to section 164(a)(6) and 164(b)(6), which provide an itemized deduction for general excise tax on sales of most new motor vehicles purchased on or after February 17, 2009 and before January 1, 2010 (ARRA provision);

- §168 (depreciation) – does not conform to the special allowances (e.g., bonus depreciation) for certain property. Hawaii has consistently not conformed to special allowance provisions (ARRA provision);

- §179 (election to expense certain depreciable assets) – does not conform to the increased maximum deduction and phaseout amounts for 2009 (as is consistent with historical practice) (ARRA provision);

- §265 (expenses and interest related to tax-exempt income) – does not conform to the expansion of tax-exempt interest safe harbors for banks and small issuers for obligations issued in 2009 and 2010 (ARRA provision);

- §382 (limitation on net operating loss carryforwards) – does not conform to elimination of certain loss limitation rules for restructurings under the Troubled Asset Relief Program ("TARP") authorized by the Emergency Economic Stabilization Act of 2008 (ARRA provision);.

- §408A (Roth Individual Retirement Accounts) – does not conform to section 408A(d)(3)(A)(iii) that provides for the ratable inclusion of the income from conversion of a traditional IRA to a Roth IRA over a 2-year period. For Hawaii income tax purposes, the income will all be included in the year of conversion. This provision was enacted in 2006 but was not effective until 2010; and

- §529 (tuition programs) – does not conform to including computer technology equipment and internet access and related services as qualifying higher education expenses for section 529 college savings plans for 2009 and 2010. (ARRA provision).

Section 7 of the Act amends section 235-2.45, by clarifying that:

- §1202 (exclusion for gain from certain small business stock) – does not conform to the increase of the amount of gain on the sale or exchange of qualified small business stock that noncorporate taxpayers can exclude from 50% or 60% to 75% (ARRA provision); and

- §1374 (tax imposed on S-Corporation built-in gains) – does not conform to the reduction of the built-in gain recognition period to 7 years from 10 years.

Section 8 of the Act amends section 235-7(d) by providing that the net operating loss carryback period for Hawaii state tax purposes will remain at 2 years. The Act specifically provides that Hawaii does not conform to the election to allow electing small businesses to carryback net operating losses up to 5 years for 2008, which was part of the ARRA, and the expansion of the 5-year carryback election to most businesses, not just small businesses, for 2009, which was part of the WBHA.

For more information on this Act, please contact the Rules Office at 808-587-1577.

KURT KAWAFUCHI
Director of Taxation