DAVID Y. IGE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1530
FAX NO: (808) 587-1584

August 7, 2017

DEPARTMENT OF TAXATION ANNOUNCEMENT NO. 2017-08

RE: Tax Law Changes from the 2017 Regular Legislative Session

This Announcement lists and summarizes the Acts, enacted as part of the State of Hawaii's 2017 Legislative Session, amending or affecting the State tax law. Below is a list of the Acts addressed in this Announcement, with a short description of each Act's contents:

- Act 3: Income Tax Law Cleanup
- Act 7: Change in Withholding Tax Return Filing Frequency
- Act 54: General Excise Tax Exemption for Affordable Housing
- Act 95: Income and Estate Tax Conformity
- Act 107: Establishes a State Earned Income Tax Credit; Reinstates Income Tax Rates and Brackets for High-Income Earners; and Makes Permanent Changes to Refundable Food/Excise Tax Credit
- Act 125: Amends the Income Tax Credit for Converting Cesspools
- Act 132: Criminal History Record Checks
- Act 142: Certification Process for Renewable Fuels Production Tax Credit
- Act 143: Amends the Motion Picture, Digital Media, and Film Production Tax Credit
- Act 156: Amends the Estate and Generation-Skipping Transfer Tax by Applying Tax to Single-Member LLCs that Do Not Elect to be Taxed as Corporations
- Act 177: Provides State Auditor Access to Tax Information and Modifies Tax Credit and Exemption Review Schedule
- Act 213: Amends the Capital Infrastructure Tax Credit

Act 3: Income Tax Law Cleanup

Act 3 (House Bill 147, H.D. 1) is effective April 26, 2017. Act 3 repeals sections 235-109.5 and 235-110.46, Hawaii Revised Statutes (HRS).

Section 235-109.5, HRS, imposed limits on the amount that may be claimed for the technology infrastructure renovation tax credit and the high technology business investment tax credit. These two credits expired December 31, 2010. The limits imposed by section 235-109.5, HRS, only apply to the initial claim of the credit and not to carryovers; thus, repeal of section 235-109.5, HRS, has no effect on any credit amounts.

Section 235-110.46, HRS, provided an income tax credit for development of certain attractions at Ko Olina Resort and at Mahaka resort (the Ko Olina credit). The Ko Olina credit expired May 31, 2009. There are no consequences to repealing the Ko Olina credit.

Act 7: Change in Withholding Tax Return Filing Frequency

Act 7 (Senate Bill 1007, S.D. 1) is effective January 1, 2018. Act 7 changes the filing frequency for withholding tax to a uniform quarterly filing frequency. Prior to this Act, only employers with withholding tax liabilities of $5,000 or less were allowed to file returns quarterly. Act 7 does not change the payment frequency of withholding taxes in any way for any taxpayers.

Act 54: General Excise Tax Exemption for Affordable Housing

Act 54 (House Bill 1179, H.D. 2, S.D. 2, C.D. 1), which applies to taxable years beginning after December 31, 2017, is effective July 1, 2017 and shall be repealed on June 30, 2022, at which time the previous law shall be reenacted in the form in which it read before July 1, 2017.

Act 54 adds an additional category of affordable housing projects which is exempt from the general excise tax where the Hawaii Housing Finance and Development Corporation (HHFDC) has approved and certified the project and there is a project labor agreement for the laborers and mechanics employed on the project, provided that:

- All available units are for households with incomes at or below 140 percent of the area median family income as determined by the United States Department of Housing and Urban Development (HUD); and

- At least 20 percent of available units are reserved for households with incomes at or below 80 percent of the area median family income as determined by HUD.

Act 54 also grants to the contractors an exemption from general excise tax and use tax for the contracting costs in building such a project, up to a maximum aggregate tax exemption of $7 million per year for all such projects approved by HHFDC.

Act 95: Income and Estate Tax Conformity

Act 95 (Senate Bill 1002, S.D. 1, H.D. 1) is effective July 5, 2017 and applies to taxable years beginning and to decedents dying after December 31, 2016. Retroactive amendments to operative Internal Revenue Code (IRC) sections are adopted for Hawaii income tax and estate and generation-skipping transfer tax (estate) tax laws.

Act 95 updates section 235-2.3(a), HRS, to conform to the operative IRC sections of subtitle A, chapter 1, as amended as of December 31, 2016. Act 95 also updates section 236E-3, HRS, to conform Hawaii's estate tax to subtitle B of the IRC as amended as of December 31, 2016.

Act 107: Establishes a State Earned Income Tax Credit; Reinstates Tax Rates and Brackets for High-Income Earners; and Makes Permanent Changes to Refundable Food/Excise Tax Credit

Act 107 (House Bill 209, H.D. 1, S.D. 1, C.D. 1) is effective July 10, 2017. Act 107 amends the income tax law by reducing the income tax burden of lower-income taxpayers and increasing the income tax burden for the highest-income taxpayers. Specifically, Act 107 contains three income tax changes:

First, Act 107 establishes a state nonrefundable earned income tax credit (EITC) equal to 20 percent of the federal EITC allowed and properly claimed under section 32, IRC, and reported on the taxpayer's federal income tax return. The state EITC applies to taxable years beginning after December 31, 2017, but shall not apply to taxable years beginning after December 31, 2022.

Second, Act 107 reinstates three tax rates and brackets for the highest-income taxpayers imposed by Act 60, Session Laws of Hawaii (SLH) 2009. For these taxpayers, this means that for taxable years beginning after December 31, 2017:

- Taxpayers who file a joint return will pay:
  - 9.00% on taxable income over $300,000, but not over $350,000;
  - 10.00% on taxable income over $350,000, but not over $400,000; and
  - 11.00% on taxable income over $400,000.

- Heads of a household will pay:
  - 9.00% on taxable income over $225,000, but not over $262,500;
  - 10.00% on taxable income over $262,500, but not over $300,000; and
  - 11.00% on taxable income over $300,000.

- Unmarried individuals and married individuals who file separately will pay:
  - 9.00% on taxable income over $150,000, but not over $175,000;
  - 10.00% on taxable income over $175,000, but not over $200,000; and
  - 11.00% on taxable income over $200,000.

Third, Act 107 repeals the sunset date for the amendments made to the refundable food/excise tax credit by Act 223, SLH 2015.

Act 125: Amends the Income Tax Credit for Converting Cesspools

Act 125 (House Bill 1244, H.D. 1, S.D. 2, C.D. 1) is effective July 1, 2017 and expands the class of cesspools for which a tax credit may be claimed on costs to upgrade them to septic systems or aerobic treatment unit systems or to connect to a sewer system.

Act 125 expands the class of cesspools which are eligible to claim the credit to include:

- A cesspool within 500 feet (increased from the current 200 feet) of a shoreline, perennial stream, or wetland;
- A cesspool shown to impact drinking water supplies or recreational waters; or
- A cesspool certified by a county or private sewer company to be appropriate for connection to its existing sewer system.

Cesspools within a source water assessment program area and residential large capacity cesspools remain eligible for the credit, with the Department of Health certifying all credit claims.

Act 132: Criminal History Record Checks

Act 132 (House Bill 1031, H.D. 1, S.D. 1, C.D. 1) is effective July 10, 2017. Act 132 allows the Department, as well as the Department of Labor and Industrial Relations (DLIR), the Department of Human Services (DHS), and the Child Support Enforcement Agency (CSEA), to conduct criminal history record checks on employees with access to federal tax information (FTI).

The Internal Revenue Service (IRS), through Section 5 of Publication 1075, Tax Information Security Guidelines for Federal, State and Local Agencies, recently mandated all agencies that receive FTI perform background checks, including an FBI fingerprint search, on all employees who access FTI. Act 132 gives the Department (as well as DLIR, DHS and CSEA) the power necessary to perform the required background checks and thus continue receiving FTI from the IRS.

Act 142: Certification Process for Renewable Fuels Production Tax Credit

Act 142 (House Bill 1044, H.D. 1, S.D. 2, C.D. 1) is effective July 10, 2017 and applies to taxable years beginning after December 31, 2017. Act 142 changes the certification process for the renewable fuels production tax credit. Taxpayers claiming a credit must file a third-party-certified statement with the Department of Business, Economic Development, and Tourism (DBEDT) within 30 days after the close of the calendar year with information on the type and amount of qualified fuel, type of feedstock used, amount of the credit, number and residency of employees of the facility, and number and location of all renewable fuel production facilities. DBEDT will thereafter issue a certificate to the taxpayer with the amount of renewable fuels produced and sold, amount of credit the taxpayer is entitled to claim for the previous calendar year, and the cumulative amount of the credit during the period.

Act 143: Amends the Motion Picture, Digital Media, and Film Production Tax Credit

Act 143 (House Bill 423, H.D. 2, S.D. 2, C.D. 1) is effective December 31, 2018 and applies to taxable years beginning after December 31, 2018. Act 143 amends the motion picture, digital media, and film production income tax credit under section 235-17, HRS (the film credit),

by:

- Adding a requirement to provide evidence when claiming products or services acquired outside of the State that reasonable efforts were made to secure and use comparable products or services within the State;
- Deleting the provision that failure to prequalify by registering with DBEDT during the development or preproduction state may constitute a waiver to claim the film credit;
- Requiring all qualified production companies to obtain a verification review by a qualified certified public accountant using procedures prescribed by DBEDT to be submitted with the statement of qualified production costs;
- Limiting the total film credit to $35 million per year, provided that if the total amount of credits applied for in any year exceeds the aggregate amount, the excess will be treated as having been applied for in the subsequent year and must be claimed in such year. No excess film credit can be claimed after December 31, 2025;
- Extending the sunset date of Act 88, SLH 2006, as amended by Act 89, SLH 2013, from January 1, 2019 to January 1, 2026;
- Prohibiting the adoption of rules pursuant to chapter 91, HRS, that expand the scope of the film credit if the rules conflict with the legislative intent of the film credit;
- Requiring each qualified production company with production expenditures of $1 million or more to obtain an independent third-party certification of qualified production costs eligible for the film credit in the form of a tax opinion beginning no later than January 1, 2018; and
- Requiring DBEDT in collaboration with the Department of Taxation to submit to the Governor and Legislature an annual report on the number of jobs created in the State by the film productions receiving the film credit beginning January 1, 2018.

Act 156: Amends the Estate and Generation-Skipping Transfer Tax by Applying Tax to Single-Member LLCs that Do Not Elect to be Taxed as Corporations

Act 156 (Senate Bill 1006, S.D. 1, H.D. 1, C.D. 1) is effective July 10, 2017 and applies to decedents dying or taxable transfers occurring after December 31, 2016. Act 156 closes a loophole in the Estate and Generation-Skipping Transfer Tax whereby nonresidents were able to completely or substantially avoid the tax by the use of a single member limited liability company (SMLLC) which had not elected to be taxed as a corporation. Such an SMLLC will be disregarded for estate and generation-skipping transfer tax purposes and the nonresident decedent is deemed to own any property held in the name of the SMLLC directly. This measure has no effect on resident taxpayers.

Act 177: Provides State Auditor Access to Tax Information and Modifies Tax Credit and Exemption Review Schedule

Act 177 (Senate Bill 100, S.D. 2, H.D. 1, C.D. 1) is effective July 11, 2017. Act 177 requires the Department to provide the State Auditor with access to any tax records that are required for the State Auditor to conduct its review of tax credits, exemptions, exclusions, and

deductions. Act 177 delays the review schedule by a year, adds the organic foods production tax credit to the review schedule, and makes other amendments to the State Auditor's review.

Act 213: Amends the Capital Infrastructure Tax Credit

Act 213 (H.B. 591, H.D. 1, S.D. 2, C.D. 1) became effective without the Governor's signature on July 12, 2017.

Act 213 expands the capital infrastructure tax credit under section 235-17.5, HRS, by:

- Doubling the amount of credit per taxable year from $1.25 million to $2.5 million;
- Including structures, machinery, equipment, and capital assets in the definition of "capital infrastructure costs";
- Allowing any costs that cannot be used in any tax year due to the credit cap limitation to be carried over to the following year until exhausted, but in no event after December 31, 2019;
- Allowing a qualified infrastructure tenant to create Special Purpose Entity (SPE), provided that the qualified infrastructure tenant as well as all of its SPEs may claim only one credit;
- Relaxing certain IRC provisions to assist the taxpayer in obtaining financing;
- Adding as an event of recapture any qualified infrastructure tenant who fails to relocate within 90 days after executing a lease with the Department of Transportation; and
- Adding a taxpayer reporting requirement with a penalty for failure to comply.

For more information, please contact the Rules Office at 808-587-1530 or by email at Tax.Rules.Office@hawaii.gov.

MARIA E. ZIELINSKI
Director of Taxation