



STATE OF HAWAII
DEPARTMENT OF TAXATION

P.O. Box 259
 HONOLULU, HAWAII 96809-0259

RICHARD F. KAHLE, JR.
 DIRECTOR OF TAXATION

GARY S. MIJO
 DEPUTY DIRECTOR

JOYCE T. OMINE
 DEPUTY DIRECTOR

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RE: Income Taxation and Eligibility for Credits of an Individual Taxpayer Whose Status Changes from Resident to Nonresident or from Nonresident to Resident.

This Tax Information Release (TIR) summarizes some of the Hawaii Income Tax Laws which may affect individual taxpayers whose status changes from resident to nonresident or from nonresident to resident during a taxable year. These laws include provisions to determine whether the status of an individual changes from resident to nonresident or from nonresident to resident; the taxation of the individual; and the eligibility of the individual for income tax credits. The Department urges all taxpayers, however, to review the statutes and rules or to consult with their tax advisors as the summary provided in this TIR is issued solely as a guide and is not intended to be complete.

I. IN GENERAL

- A. A resident is taxed on income from all sources, both in this State and outside the State. A nonresident, however, is taxed only on income from sources in the State.

All of the income of a resident, as defined in this TIR and the law, is subject to the net income tax imposed by chapter 235, Hawaii Revised Statutes (HRS). This includes income received or derived from property owned, personal services performed, trade or business carried on, and any and every other source both in the State and outside the State. If the source of the income is outside of the State and the income is taxed by another jurisdiction, a resident may be eligible for a credit under section 235-55, HRS, as discussed in Part IV of this TIR.

In the case of a nonresident, as defined in this TIR and the law, however, only the income from sources in the State is subject to the net income tax.

- B. Nonresidents must determine the sources of their income.

The law regarding the sources of income provides, generally, that the source of income derived from real or tangible personal property is the situs of the property; the source of income earned from intangible property is the place of the owner's domicile, unless the property has acquired a business situs elsewhere; the source of income from carrying on a trade or business is the place where the trade or business is carried on; and the source of income from the performance of personal services is the place where the services are performed.

C. The status of an individual as a resident or nonresident is determined by all the factual circumstances.

A resident is every individual domiciled in the State and every other individual whether or not domiciled in the State or who resides in the State. A nonresident is every individual other than a resident.

Domicile is the place of the individuals true, fixed, permanent home and principal establishment and to which place the individual has the intention of returning whenever the individual is absent. It is the place at which an individual has voluntarily fixed the habitation of himself or herself and family, not for a mere special or temporary purpose, but with the present intention of making a permanent home. An individual's domicile may change where the individual: (1) has the specific intent to abandon the old domicile; (2) has an intent to acquire a specific new domicile; and (3) has an actual physical presence in the new domicile.

In addition to establishing residence by domicile, residence may be established when an individual is in the State for other than a temporary or transitory purpose. There is a presumption that every individual who is in the State more than 200 days of the taxable year is in the State for other than a temporary or transitory purpose. This presumption may be overcome by evidence satisfactory to the Department of Taxation that the individual maintains a permanent place of abode outside of the State and is in the State for a temporary or transitory purpose.

The status of an individual as a resident or nonresident is determined by all the factual circumstances. No single factor, such as an individual's oral declarations of intention or the marriage of a resident and a nonresident, is controlling. Some of the relevant factors include the length of time spent in the State; leasing, buying, negotiating for or building a home; ownership of a motor vehicle; place of issuance of license to drive a motor vehicle; place where the motor vehicle is registered; place of marriage; where the residence of one spouse is in issue, the place of residence of the other spouse; residence of the family of the individual; place of schools attended by the individual's children; the presence of bank accounts; club memberships; place of voting; place of business interests, profession, or employment; contributions to local charities; declarations regarding residence made to public authorities, friends, relatives or employers, or in documents such as deeds, leases, mortgages, contracts, and insurance policies; proposed place of burial or acquisition of burial place for the individual or members of the individual's family; and the place to probate a will.

An individual's status as a resident or nonresident shall not change solely because of the individual's presence or absence in compliance with military or naval orders of the United States, while engaged in aviation or navigation, while a student at any institution of learning, or to discharge an employment obligation. Thus, a Hawaii resident who enters the military and does not change the individual's permanent residence is

subject to the Hawaii income tax on the individual's entire income regardless of the source of the income.

A student from another state who attends school in Hawaii is not a Hawaii resident unless the student establishes residence in Hawaii. Only the income received or derived from sources within the State by the student is subject to the Hawaii income tax. Similarly, when a Hawaii resident decides to attend school in another state, no single factor, such as the student being claimed as a dependent when the student's parents reside in Hawaii, is controlling on the issue of whether the student remains a resident of Hawaii.

II. INCOME TAX TREATMENT OF INDIVIDUALS WHOSE STATUS HAS CHANGED

In cases other than where joint returns are filed as described in Part III of this TIR, when an individual's status changes from resident to nonresident or from nonresident to resident during a taxable year, the individual shall be taxed on income from all sources while the individual is a resident of the State and only upon income received from sources within the State while the individual is a nonresident. Thus, where an individual establishes residence in the State on March 1 and earns wages outside of the State attributable to the period before March 1, the wages earned before March 1 are not subject to the Hawaii income tax. If the individual cannot determine whether income was received or derived during the period of residence or nonresidence, then the individual's taxable income from all sources shall be apportioned to the State based upon a ratio of the number of days of residence to the total number of days in the taxable year.

Nonresidents are taxed on income from sources in the State. If the individual in the previous example earned wages from sources in the State prior to establishing residence on March 1, those wages would be subject to the Hawaii income tax.

Income earned, or an expense incurred, in a certain period is attributed to that period even though the income may be received or paid in a different period and reportable for tax purposes by a cash-basis taxpayer in such different period. If the taxpayer described in the first example in this part received a payment after March 1 for services performed in a prior taxable year when the taxpayer was a nonresident, that payment would not be subject to the Hawaii income tax.

When an individual's status changes from nonresident to resident during a taxable year, the individual may take the full deduction for personal exemptions for the individual, the individual's spouse and dependents and the full standard deduction on the Hawaii income tax resident return if the individual does not itemize deductions.

For other specified deductions or if the individual itemizes deductions on Schedule A, however, special rules are applicable. First, a deduction is not allowed if it can be tied to a specific investment,

property, or activity carried on outside of Hawaii or which results in income which is not subject to taxation by Hawaii. By way of example, this includes income taxes paid to a state other than Hawaii on wages earned by an individual in active duty service stationed in Hawaii and mortgage interest connected with property located outside of Hawaii.

Second, a deduction is allowed if it is connected with income arising in Hawaii and taxable to a nonresident under the Hawaii income tax law. This includes deductions for ordinary and necessary expenses of conducting a business and income tax paid to Hawaii.

Third, a deduction is allowed if it is connected with property, other than property in two above, with a tax situs in Hawaii. This includes deductions for the real property tax on a residence located in Hawaii, interest on a mortgage connected with property located in Hawaii, and casualty and theft losses on nonbusiness property located in Hawaii which exceed the ceilings specified in the law.

Fourth, if the deduction is not tied to a specific investment, property, or activity carried on outside Hawaii or which results in income not subject to taxation by Hawaii, and does not fall in either two or three above, it is allowed only to the extent of the ratio of adjusted gross income attributable to Hawaii to the total adjusted gross income attributable to worldwide sources. This includes deductions for medical expenses, personal interest, and contributions.

III. FILING OF JOINT RETURN BY A RESIDENT TAXPAYER AND NONRESIDENT SPOUSE

When a joint return is filed by a resident and a nonresident spouse, all of the income of both spouses must be included on the Hawaii income tax return, regardless of the source of the income, from the date that the resident spouse establishes residence in the State. Income tax credits, including the credits discussed in Parts IV and V of this TIR, however, are available only to residents. Thus, only the resident spouse may be eligible for those credits.

When a joint return is filed by persons who establish residence in the State at different times during the taxable year, all the income of both spouses must be included on the Hawaii income tax return, regardless of the source of the income from the earliest date that a spouse first establishes residence in the State.

IV. CREDIT ALLOWED RESIDENTS FOR INCOME TAXES PAID OTHER STATES AND COUNTRIES

Residents may receive credit against their Hawaii income tax for income taxes paid to another state, the District of Columbia, a territory or possession of the United States, a foreign country, or a political subdivision of any of the foregoing, (hereinafter referred to collectively as "other state") on income derived from sources outside Hawaii. (See section 235-55, HRS) If the resident individual has filed a return and

paid the tax to the other state before filing the Hawaii income tax return, the individual may claim the credit at the time of filing the Hawaii return or subsequently. The individual may request an extension of time for filing the Hawaii return to file a return and pay the tax to the other state before filing the Hawaii tax return. The individual who desires to file the Hawaii return before filing a return and paying the tax to the other state may pay the tax in full on the Hawaii return and claim a refund subsequently for the amount of the credit by filing an amended return or, with the permission of the Director of Taxation, claim a tentative credit for the tax paid to the other state.

Resident individuals who claim this credit are subject to the requirements of the income tax law, including the following: (1) the tax paid to the other state must be a net income tax; (2) the tax paid to the other state must be imposed on taxable income derived or received from sources outside Hawaii, as determined under Hawaii laws, by the other state; (3) the income taxed must be for the same taxable year as the year for which the Hawaii credit is claimed; (4) the tax paid to the other state must be equally applicable to both residents and nonresidents of the other state; and (5) the income taxed in the other state for which the Hawaii credit is claimed must be taxable income in Hawaii (e.g., pension income taxed in California is not taxed in Hawaii and no Hawaii credit may be claimed).

The Hawaii credit (1) is not allowed on income from intangible personal property unless the property has acquired a business situs outside of Hawaii; (2) does not apply if the resident individual became a resident of Hawaii after attaining the age of 65 and before July 1, 1976; (3) is not allowed on any income or tax which is or may be the subject of an exclusion, exemption, or credit under the Internal Revenue Code; (4) is not allowed against penalties or interest; and (5) cannot reduce the Hawaii income tax below what it would have been had the individual been taxable only on the income from property owned, services performed, trade, or business carried on, and other sources in Hawaii. The resident individual must file with the Hawaii tax return a copy of the tax return for the other state and a receipt of payment of the tax.

Nonresidents are not allowed a credit for taxes paid to other states.

V. OTHER CREDITS

Hawaii residents are eligible for credits on their individual income tax returns. Some of the credits that may be of the most interest to an individual whose status changes from resident to nonresident or from nonresident to nonresident are briefly discussed in this TIR. The time that must be spent in the State to qualify for these credits, however, may vary. To claim the food tax credit and the excise tax credit, an individual, among other things, must be a resident and must have physically resided in the State for more than 9 months during the taxable year. Thus, a resident who is not in the State for more than 9 months will not qualify

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for those credits. To claim the general income tax credit, an individual, among other things, must be a resident for at least 9 months, regardless of whether or not the individual was physically in the State for 9 months. To claim the dependent care credit, the low income household renter's credit, and the medical services excise tax credit, an individual, among other things, must be a resident taxpayer.


RICHARD F. KAHLE, JR.
Director of Taxation