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## **DEPARTMENT OF TAXATION ANNOUNCEMENT NO. 2018-13**

RE: Tax Law Changes from the 2018 Regular Legislative Session

This announcement lists and summarizes the measures passed during the Regular Legislative Session of 2018 that amend or affect the State tax law. Below is a list of the eighteen Acts and one proposed constitutional amendment addressed in this Announcement, with a short description of the contents of each:

- Act 11: Extends Time for Counties to Adopt a Surcharge on State Tax
- Act 18: Hawaii Revised Statutes Cleanup
- Act 27: Income and Estate Tax Conformity
- Act 39: General Excise Tax Exemption for Affordable Housing
- Act 41: Definition of Engaged in Business in the State
- Act 43: Establishes a Healthcare Preceptor Tax Credit
- Act 66: Electronic Filing of Tax Returns
- Act 87: Extends the Important Agricultural Land Qualified Agriculture Cost Tax Credit
- Act 122: Increases the Amount Required to be Withheld on Disposition of Hawaii Real Property
- Act 123: Tax Administration Special Fund
- Act 133: Amends the Income Tax Credit for Converting Cesspools
- Act 143: Amends the Renewable Fuels Production Tax Credit
- Act 166: General Excise Tax Law Cleanup
- Act 170: Amends the Income Tax Check-off for Libraries Special Fund
- Act 183: General Excise Tax and Use Tax on Intangible Property
- Act 206: Electronic Smoking Devices
- Act 211: Imposition of Transient Accommodations Tax on Transient Accommodations Booked at Noncommissioned Negotiated Contract Rates
- Act 215: Amends Rental Motor Vehicle and Tour Vehicle Surcharge Tax
- Senate Bill 2922: Proposed Amendment to the Hawaii Constitution to Allow a Surcharge on Investment Properties to Fund Education

### **Act 11: Extends Time for Counties to Adopt a Surcharge on State Tax**

Act 11 (House Bill 2587, H.D.1, S.D. 2, C.D. 1) is effective May 4, 2018. Act 11 extends the deadline for a county to adopt a surcharge on state tax (county surcharge) that can be collected beginning January 1, 2019 from March 31, 2018 to June 30, 2018. Act 11 also extends the overall deadline to adopt a county surcharge to March 31, 2019. A county surcharge adopted after June 30, 2018 can be levied no earlier than January 1, 2020. The rate is capped at 0.5%.

### **Act 18: Hawaii Revised Statutes Cleanup**

Act 18 (Senate Bill 2851, S.D. 1, H.D. 1, C.D. 1) is effective June 4, 2018. Act 18 makes technical amendments to sections 235-7, 235-110.7, 237-27, and 245-16 of the Hawaii Revised Statutes (HRS). These amendments do not result in any substantive changes to the law.

### **Act 27: Income and Estate Tax Conformity**

Act 27 (Senate Bill 2821, S.D. 1, H.D. 1, C.D. 1) is effective June 7, 2018 and applies to taxable years beginning and to decedents dying after December 31, 2017. 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 27 updates section 235-2.3(a), HRS, to conform to the operative sections of subtitle A, chapter 1, of the IRC, as amended as of February 9, 2018. Act 27 also updates section 236E-3, HRS, to conform Hawaii's estate tax to subtitle B of the IRC as amended as of December 31, 2017.

Act 27 makes numerous amendments to the way in which Hawaii conforms to the IRC in response to the Tax Cuts and Jobs Act, P.L. 115-97, enacted December 22, 2017 (TCJA). The TCJA restricted or eliminated the mortgage interest, state and local tax, personal casualty loss, and moving expense deductions. In addition, the TCJA eliminated the 2% reduction to miscellaneous itemized deductions in IRC section 67 and the overall limitation on itemized deductions in IRC section 68. Hawaii will continue to conform to the above provisions, but in the form the provisions existed in prior to the TCJA.

In addition, Hawaii will no longer fully conform to IRC section 529. Specifically, Hawaii will not conform to the provision defining qualified distributions to include distributions of up to \$10,000 used for elementary and secondary school expenses.

For corporate income tax, there are two new deviations from conformity to federal income tax. The first is the deduction for fines and penalties. Hawaii law will no longer fully conform to the restriction on the deduction for fines and penalties. Hawaii will conform to the restriction but without the exceptions for restitution payments, court-ordered payments in a suit in which no governmental entity is a party, and amounts paid as taxes due. The second is the deduction for entertainment expenses. The TCJA eliminated the deduction for most entertainment expenses, leaving only the deduction for food and beverage expenses. Hawaii will continue to allow the deduction for entertainment expenses in the form it existed prior to the TCJA.

Additionally, Hawaii estate and generation-skipping transfer tax will no longer perfectly track the federal transfer tax laws. The TCJA increased the exemption amount for federal transfer taxes. Hawaii will not adopt this change; for Hawaii estate and generation-skipping transfer tax law the exemption amount will remain at the amount available to decedents dying during 2017.

Finally, Act 27 updates conformity to the partnership audit rules in the IRC. The Bipartisan Budget Act of 2015, P.L. 114-74, enacted November 2, 2015, repealed the partnership audit rules enacted in 1982 as part of the Tax Equity and Fiscal Responsibility Act (TEFRA). The TEFRA rules were replaced with new partnership audit rules that became fully effective on January 1, 2018. The major change of the new rules is to require that partnerships not only be audited and assessed at the partnership level but must be liable for any underpayment at the partnership level. Hawaii will conform to the substantive provisions of the new partnership audit rules similar to the way Hawaii previously conformed to the TEFRA rules.

### **Act 39: General Excise Tax Exemption for Affordable Housing**

Act 39 (House Bill 2748, H.D. 2 S.D. 2 C.D. 1) is effective July 1, 2018. Part I of the measure directs the Hawaii Housing Finance and Development Corporation (HHFDC) to study and report on housing for populations with access and functional needs.

Part II of the measure extends and expands one subcategory of the exemption from general excise tax for development costs of affordable rental housing. The affected subcategory was first enacted in 2017. Specifically, Part II of the measure extends the sunset date of the subcategory from June 30, 2022 to June 30, 2030. Part II of the measure also increases the \$7 million aggregate cap applied to the subcategory to \$30 million and prohibits discrimination against tenants based solely on receipt of assistance under section 8 of the United States Housing Act of 1937, as amended. Part II applies to taxable years beginning after December 31, 2017.

Part III requires a report be submitted to the Legislature by HHFDC regarding the activities related to the general excise tax provisions noted above not later than January 2, 2019.

Part IV appropriates \$200,000,000 to the rental housing revolving fund established pursuant to section 201H-202, HRS.

### **Act 41: Definition of Engaged in Business in the State**

Act 41 (Senate Bill 2514, S.D. 1, H.D. 1, C.D. 1) is effective July 1, 2018 and applies to taxable years beginning after December 31, 2017. Act 41 defines when a person is engaged in business in the State and therefore subject to the general excise tax. Specifically, Act 41 provides that a person is engaging in business in the State, regardless of whether the person is physically present in the State, if the person has gross income of \$100,000 or more in the State or has entered into 200 or more transactions in the State in the current or preceding calendar year. For more information *see* Tax Announcement 2018-10.

### **Act 43: Establishes a Healthcare Preceptor Tax Credit**

Act 43 (Senate Bill 2298, S.D. 2, H.D. 3, C.D. 1) is effective June 13, 2018 and applies to taxable years beginning after December 31, 2018.

Act 43 establishes an income tax credit for advanced practice registered nurses, pharmacists, and physicians who supervise volunteer-based supervised clinical training rotations. The credit is equal to \$1,000 per rotation supervised by the taxpayer, up to a maximum of \$5,000 per taxpayer per year. Additionally, the credit is subject to an aggregate cap of \$1,500,000 per year.

Act 43 also establishes the Preceptor Credit Assurance Committee. The Committee certifies all claims for the credit and issues taxpayers a certificate verifying the number of rotations supervised. The Department is authorized to require taxpayers to furnish this certificate to claim the credit. The Committee is also tasked with ceasing certifications if total claims for certification reach the aggregate cap during any year.

### **Act 66: Electronic Filing of Tax Returns**

Act 66 (House Bill 2395, S.D. 1) is effective June 29, 2018. Act 66 authorizes the Department to require the following taxpayers to file tax returns electronically:

- Employers with annual withholding tax liability of more than \$40,000;
- Taxpayers with annual general excise tax or transient accommodations tax liability of more than \$4,000 (monthly filers); and
- All taxpayers for corporate income tax, estate tax, public service company tax (utilities), franchise tax (financial institutions), fuel tax, liquor tax, cigarette and tobacco tax, and rental motor vehicle, tour vehicle, and car-sharing tax.

Act 66 does not mandate electronic filing, but merely allows the Department to require the taxpayers listed above to file electronically. The Department must provide written notice of its intention to require electronic filing no less than 90 days prior to enforcing the requirement.

Act 66 also imposes a penalty of two percent of the amount of the tax required to be shown on the return for failure to file electronically and provides a reasonable cause exception to this penalty.

### **Act 87: Extends the Important Agricultural Land Qualified Agricultural Cost Tax Credit**

Act 87 (Senate Bill 2074, S.D.1, H.D. 1, C.D.1) is effective June 29, 2018. Act 87 extends the Important Agricultural Land Qualified Agricultural Cost Tax Credit through taxable year 2021.

**Act 122: Increases the Amount Required to be Withheld on Disposition of Hawaii Real Property**

Act 122 (Senate Bill 508, S.D. 1, H.D.1, C.D. 1) is effective July 5, 2018 and applies to dispositions of Hawaii real property occurring after September 15, 2018. It increases the amount that must be withheld from 5% to 7.25% where no exemption to the withholding applies and/or the seller has not been granted a reduction in the amount to be withheld. The amount withheld is an estimated tax payment for the benefit of the seller and is applied when such taxpayer files an income tax return for the year in which the disposition occurred. For more information *see* Tax Announcement 2018-11.

**Act 123: Tax Administration Special Fund**

Act 123 (House Bill 2396, H.D. 1, S.D. 1) is effective July 1, 2018. Act 123 increases the amount of revenues deposited into the Tax Administration Special Fund that may be retained by the Department from \$700,000 to \$2,000,000. The Department's Special Enforcement Section (SES) is funded through this special fund, therefore, the increase is effectively a budget increase for SES. In addition, Act 123 also authorizes five new positions to be created within SES.

**Act 133: Amends the Income Tax Credit for Converting Cesspools**

Act 133 (House Bill 1802, H.D. 1, S.D. 1, C.D. 1) is effective July 5, 2018 and applies to taxable years beginning after December 31, 2017. Act 133 eliminates the provision preventing certification of more than two residential large capacity cesspools as qualified cesspools.

**Act 143: Amends the Renewable Fuels Production Tax Credit**

Act 143 (Senate Bill 3077, S.D.2, H.D. 1, C.D.1) is effective July 5, 2018 and applies to taxable years beginning after December 31, 2017. Act 143 amends the renewable fuels production tax credit (RFPTC), as follows:

- Lowers the production threshold for eligibility for the credit from 15 billion British thermal units of renewable fuels per calendar year to 2.5 billion British thermal units per calendar year;
- Adds logs, wood chips, wood pellets, wood bark, and other renewable organic material to the definition of "Renewable feedstocks" which qualify for the credit; and
- Deletes the sunset date of December 31, 2021 to make the RFPTC permanent.

**Act 166: General Excise Tax Law Cleanup**

Act 166 (House Bill 1605, H.D. 1, S.D. 1) is effective July 1, 2018. Act 166 deletes various provisions in section 237-13, HRS, that are obsolete or unnecessary, including provisions relating to the tax on manufacturers and producers for sales of products delivered outside the State; provisions excluding stocks, bonds, and other evidence of indebtedness from the imposition of tax on the sale of tangible personal property; and provisions making the

subcontractor deduction applicable to specialty contractors. The amendments do not result in any substantive changes to the law.

### **Act 170: Amends the Income Tax Check-off for Libraries Special Fund**

Act 170 (House Bill 2354, H.D. 1, S.D. 2, C.D. 1) is effective July 1, 2018 and applies to taxable years beginning after December 31, 2017. Act 170 increases the amounts that taxpayers may designate from their individual income tax refunds to the libraries special fund. Specifically, it increases the amount from \$2 to \$5 for any individual return and from \$4 to \$10 for any joint return.

### **Act 183: General Excise Tax and Use Tax on Intangible Property**

Act 183 (House Bill 2416, H.D. 1, S.D. 1, C.D. 1) is effective July 10, 2018 and applies to taxable years beginning after December 31, 2018. Act 183 creates a general excise tax exemption for intangible property used outside the State. Act 183 also imposes use tax on intangible property imported into the State at the rate of four percent.

### **Act 206: Electronic Smoking Devices**

Act 206 (House Bill 1895, H.D. 1, S.D. 1, C.D. 1) is effective July 1, 2018. Act 206 amends the Cigarette and Tobacco Tax Law by making it unlawful to conduct a delivery sale or otherwise ship or transport an electronic smoking device to a person under the age of 21. Persons making deliveries of electronic smoking devices are required to verify the recipient's age. Violators are subject to fines.

Act 206 does not require retailers or wholesalers of electronic smoking devices to pay the Cigarette or Tobacco Tax, nor does it require them to secure Cigarette or Tobacco Tax licenses or permits.

### **Act 211: Imposition of Transient Accommodations Tax on Transient Accommodations Booked at Noncommissioned Negotiated Contract Rates**

Act 211 (Senate Bill 2868, S.D. 3, H.D. 1) is effective July 1, 2018 and applies to taxable years beginning after December 31, 2018. Act 211 imposes the TAT on transient accommodations brokers, travel agencies, and tour packagers who arrange transient accommodations at noncommissioned negotiated contract rates on their share of the proceeds.

Pursuant to Act 211, brokers, travel agencies, and tour packagers who arrange transient accommodations at noncommissioned negotiated contract rates are required to obtain a certificate of registration from the Department upon payment of a one-time fee of \$15, file periodic and annual returns, remit the TAT to the Department, and are subject to all other requirements in chapter 237D, HRS, that are imposed on operators.

Under previous law, when transient accommodations were furnished through arrangements made by a travel agency or tour packager at noncommissioned negotiated contract rates, the transient accommodations tax (TAT) was imposed solely on the operator on its share of

the proceeds; the TAT was not imposed on the travel agency or tour packager's share of the proceeds.

**Act 215: Amends the Rental Motor Vehicle and Tour Vehicle Surcharge Tax**

Act 215 (House Bill 2601, H.D. 1, S.D. 2, C.D. 2) is effective January 1, 2019. Act 215 imposes a new rental car surcharge on any rental for which the lessor does not have a valid Hawaii driver's license. Act 215 also directs the revenue from the new surcharge into newly created special funds for each county within the state highway fund. Lessors are required to provide county-by-county breakdowns of their rentals to facilitate the allocation.

Act 215 also increases the tour vehicle surcharge by \$1 per day for tour vehicles in both the 8-25 passenger capacity and over 25 passenger capacity categories.

**Senate Bill 2922: Proposes an Amendment to the Hawaii Constitution to Allow a Surcharge on Investment Properties to Fund Education**

Senate Bill 2922, S.D. 1, H.D. 1, proposes an amendment to the Constitution of the State of Hawaii to authorize the legislature to establish a surcharge on investment real property to fund education. This measure authorizes the following question to be placed on the ballot "Shall the legislature be authorized to establish, as provided by law, a surcharge on investment real property to be used to support public education?" The proposed authorization is not effective until the question is ratified pursuant to article XVII, sections 2 and 3, of the Constitution of the State of Hawaii.

For more information, please contact the Rules Office at (808) 587-1530 or by email at [Tax.Rules.Office@hawaii.gov](mailto:Tax.Rules.Office@hawaii.gov).

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