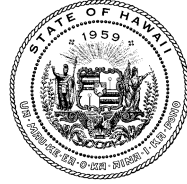


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DEPARTMENT OF TAXATION ANNOUNCEMENT NO. 2016-07

RE: Tax Law Changes from the 2016 Regular Legislative Session

This Announcement lists and summarizes the Acts, enacted as part of the State of Hawaii's 2016 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 the Act's contents:

- Act 33: Income and Estate Tax Conformity
- Act 52: Real Property Tax Law Cleanup
- Act 53: Income Tax Law Cleanup
- Act 76: Amends the Fuel Tax Rate for Naphtha Fuel Sold to a Power-Generating Facility
- Act 129: Amends the Low-Income Housing Tax Credit
- Act 182: Amends the Income Tax Credit for Converting Cesspools
- Act 202: Establishes Renewable Fuels Production Tax Credit; Repeals Ethanol Facility Tax Credit
- Act 222: Extends the Reporting Date of the 2015-2017 Tax Review Commission
- Act 230: Tax-Related Amendments and Clarification Related to the State's Medical Marijuana Dispensary Program
- Act 235: Amends the Income Tax Credit for Expenses for Household and Dependent Care Services Necessary for Gainful Employment
- Act 245: Requires the State Auditor to Periodically Review Tax Credits, Exclusions, and Deductions under Income Tax and Financial Institution Tax Laws
- Act 258: Organic Foods Production Tax Credit
- Act 261: Requires the State Auditor to Periodically Review Exemptions, Exclusions, and Credits under the General Excise, Use, Public Service Company, and Insurance Premium Tax Laws

Act 33: Income and Estate Tax Conformity

Act 33 (Senate Bill 2921, H.D. 1) is effective April 29, 2016 and applies to tax years beginning and to decedents dying after December 31, 2015. 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 33 updates section 235-2.3(a), Hawaii Revised Statutes (HRS), to conform to the operative IRC sections of subtitle A, chapter 1, as amended as of December 31, 2015. Act 33 also updates section 236E-3, HRS, to conform Hawaii's estate tax to subtitle B of the IRC as amended as of December 31, 2015. Finally, Act 33 updates the date in section 236E-3, HRS, to ensure that the updated provisions only apply to decedents dying after December 31, 2015.

Act 52: Real Property Tax Law Cleanup

Act 52 (House Bill 2217, H.D. 1, S.D. 1) is effective July 1, 2016. Act 52 repeals obsolete State law, which imposed a real property tax, by repealing chapters 246 and 246A, HRS, in their entirety. Act 52 also amends other sections of the HRS to remove cross-references to the real property tax under chapters 246 and 246A, HRS.

The Department reviewed the proposed repeal of chapters 246 and 246A, HRS, and the conforming amendments to ensure the changes had no substantive effect and were merely a cleanup of the statute. The power to tax real property was transferred to the counties by the Hawaii Constitution, therefore chapters 246 and 246A, HRS, have no effect and their repeal has no substantive effect.

Act 53: Income Tax Law Cleanup

Act 53 (House Bill 2218, H.D. 1, S.D. 1) is effective July 1, 2016. Act 53 repeals sections 235-2, 235-2.1, and 235-2.2, HRS, and amends section 235-2.3, HRS.

Sections 235-2, 235-2.1, and 235-2.2, HRS, conformed Hawaii income tax law to federal income tax law prior to January 1, 1978. Prior to January 1, 1978, Hawaii conformed to federal income tax law by addressing each tax-related federal public law individually through these sections. After January 1, 1978 Hawaii began to conform to federal income tax law by conforming to the entire IRC, as amended, rather than to individual public laws.

Due to this change in practice and to the passage of time, the sections conforming to the individual public laws (sections 235.2, 235-2.1, and 235-2.2, HRS) have become unnecessary. Act 53 repeals those sections. The Act also amends section 235-2.3, HRS, to provide that "prior law" will still apply to years prior to 1978. This is to ensure that those tax years continue to be governed by the law as it existed at the time.

Act 76: Amends the Fuel Tax Rate for Naphtha Fuel Sold to a Power-Generating Facility

Act 76 (Senate Bill 2131, S.D. 2, H.D. 2, C.D. 1) is effective June 20, 2016 and applies retroactively beginning January 1, 2016. It amends the fuel tax to add a special rate of 2 cents per gallon of naphtha fuel sold to a power-generating facility. It also adds a definition of "power-generating facility" and amends section 206M-15.5, HRS, pertaining to the high technology special fund.

Act 129: Amends the Low-Income Housing Tax Credit

Act 129 (Senate Bill 2833, S.D. 2, H.D. 2, C.D. 1) is effective January 1, 2017 and applies to buildings that are awarded low-income housing tax credits after December 31, 2016. It is repealed on December 31, 2021. Act 129 creates an additional incentive to encourage investment in buildings that are intended for low-income individuals and families by shortening the time over which the State tax credit is taken from ten years to five years. The Hawaii Housing Finance and Development Corporation (a division of the Department of Business, Economic Development, and Tourism) continues to have primary responsibility over selection of qualified buildings and the allocation of any tax credits thereto.

Act 182: Amends the Income Tax Credit for Converting Cesspools

Act 182 (Senate Bill 3084, S.D. 1, H.D. 2, C.D. 1) is effective upon approval and applies to taxable years beginning after December 31, 2015. Act 182 corrects an oversight made when section 235-16.5, HRS, was enacted last session, and permits large capacity cesspools to qualify for the credit, with each tax map key parcel associated with the large capacity cesspool eligible for the credit of up to \$10,000. The Department of Health continues to have primary responsibility over certification of eligible cesspools and the associated amount of any tax credits which may be claimed in relation thereto.

Act 202: Establishes Renewable Fuels Production Tax Credit; Repeals Ethanol Facility Tax Credit

Act 202 (Senate Bill 2652, S.D. 2, H.D. 2, C.D. 1) is effective July 5, 2016, applies to taxable years beginning after December 31, 2016. Act 202 repeals the ethanol facility tax credit and creates a new, nonrefundable income tax credit for production of renewable fuels. The credit is available for five consecutive years beginning with the first taxable year in which the taxpayer claiming the credit begins producing at least 15 billion British thermal units of renewable fuel per year. To qualify as renewable fuels, fuels must be produced from renewable feedstocks, including various agricultural crops and various types of waste. The Department of Business, Economic Development, and Tourism must certify all claims for the credit. The credit amount is 20 cents per 76,000 British thermal units of renewable fuel sold for distribution in Hawaii, up to a maximum credit amount for any given taxpayer of \$3,000,000 per taxable year. The amount of credits certified in any given tax year cannot exceed \$3,000,000.

Act 222: Extends the Reporting Date of the 2015-2017 Tax Review Commission

Act 222 (Senate Bill 2922, H.D. 1, C.D. 1) is effective July 6, 2016, though its appropriation is effective July 1, 2016. It provides the 2015-2017 Tax Review Commission an extension of one year to submit its report to the Legislature and appropriates \$250,000 to be used by the Commission to conduct an evaluation of the State's tax structure and recommend revenue and tax policy.

Act 230: Tax-Related Amendments and Clarification Related to the State's Medical Marijuana Dispensary Program

Act 230 (House Bill 2707, H.D. 1, S.D. 2, C.D. 1) is effective July 1, 2016. The income tax provisions of Act 230 apply to taxable years beginning after December 31, 2015. Act 230 is an omnibus medical marijuana cleanup act. The Act contains three tax-related changes:

First, of the three changes, the change to conformity to IRC section 280E is the most complicated. IRC section 280E denies deductions and credits to any taxpayer trafficking in a Schedule I or Schedule II substance. Prior to January 1, 2016, Hawaii conformed to this section for Hawaii income tax purposes, meaning taxpayers engaged in medical marijuana businesses could not account for Hawaii income tax the same as other legitimate businesses by deducting business expenses and claiming tax credits. Act 230 relaxes application of this section only for medical marijuana businesses operating under Hawaii's medical marijuana dispensary program. This means that these businesses may account for Hawaii income tax the same as other legitimate businesses in Hawaii.

Second, Act 230 amends the Enterprise Zone (EZ) law to deny all EZ benefits to medical marijuana businesses. Generally, businesses located in enterprise zones that satisfy certain requirements are exempt from general excise tax (GET) and eligible for income tax credits.

Finally, Act 230 clarifies that the GET exemption for prescription drugs does not apply to sales of medical marijuana. This amendment makes the exemption clear and unambiguous as applied to sales of medical marijuana. The amendment is consistent with the Department's prior interpretation of the prescription drug exemption.

Act 235: Amends the Income Tax Credit for Expenses for Household and Dependent Care Services Necessary for Gainful Employment

Act 235 (House Bill 1702, H.D. 1, S.D. 1, C.D. 1) is effective July 12, 2016 and applies to taxable years beginning after December 31, 2015. Act 235 increases the credit amount that certain taxpayers may claim for expenses for household and dependent care services necessary for gainful employment. Act 235 amends the credit by modifying the phasedown of percentage of expenses on which the credit can be claimed at various AGI thresholds. The table below shows the percentages and AGI thresholds for the current credit and for the credit as amended by this bill.

Prior law		As amended by Act 235	
AGI	Applicable percentage	AGI	Applicable percentage
\$22,000 or less	25%	\$25,000 or less	25%
\$22,001 to \$24,000	24%	\$25,001 to \$30,000	24%
\$24,001 to \$26,000	23%	\$30,001 to \$35,000	23%
\$26,001 to \$28,000	22%	\$35,001 to \$40,000	22%
\$28,001 to \$30,000	21%	\$40,001 to \$45,000	21%
\$30,001 to \$32,000	20%	\$45,001 to \$50,000	20%
\$32,001 to \$34,000	19%	Over \$50,000	15%
\$34,001 to \$36,000	18%		
\$36,001 to \$38,000	17%		
\$38,001 to \$40,000	16%		
Over \$40,000	15%		

Under prior law, the highest percentage was 25% and was reduced to 15% beginning at AGI of \$22,000. As amended by Act 235, the highest percentage is still 25% but is reduced to 15% beginning at AGI of \$25,000.

Further, under prior law, the percentage was reduced by one percentage point for every \$2,000 in AGI over \$22,000, down to a minimum of 15%. The minimum rate of 15% applied to taxpayers with AGI over \$40,000. As amended, the percentage is reduced by one percentage point for every \$5,000 in AGI over \$25,000, down to a minimum of 15%. The minimum rate of 15% applies to taxpayers with AGI over \$50,000.

Act 245: Requires the State Auditor to Periodically Review Tax Credits, Exclusions, and Deductions under Income Tax and Financial Institution Tax Laws

Act 245 (House Bill 1527, H.D. 1, S.D. 1, C.D. 1) is effective July 1, 2018. It requires the State Auditor (Auditor) to periodically review certain tax credits, exclusions, and deductions for the income tax under chapter 235, HRS, and financial institutions tax under chapter 241, HRS, beginning in 2019.

Specifically, Act 245 requires the Auditor to: (1) determine the amount of tax expenditure for the credit, exclusion, or deduction for each of the previous three fiscal years; (2) estimate the amount of tax expenditure for the credit, exclusion, or deduction for the current fiscal year and the next two fiscal years; (3) determine whether the credit, exclusion, or deduction has achieved and continues to achieve the purpose for which it was enacted by the Legislature; (4) determine whether the credit, exclusion, or deduction is necessary to promote or preserve tax equity or efficiency; (5) determine whether an economic benefit has resulted, and if so, quantify the estimated benefit directly attributable to the credit, exclusion, or deduction; and (6) estimate the annual cost of the credit, exclusion, or deduction per low-income resident of the State.

Act 245 also requires the Auditor to recommend whether a credit, exclusion, or deduction should be retained without modification, amended, or repealed.

Act 258: Organic Foods Production Tax Credit

Act 258 (House Bill 1689, H.D. 2, S.D. 2, C.D. 1) is effective July 12, 2016, applies to taxable years beginning after December 31, 2016 and is repealed on December 31, 2021. It creates a nonrefundable income tax credit for qualified expenses associated with the production or handling of organic foods. Qualified expenses include application fees, inspection costs, fees related to arranging inspections, and costs for equipment, materials or supplies necessary for organic certification or production of organic agricultural products.

To qualify for the tax credit, a taxpayer must be a producer, handler, or handling operation as defined by federal regulations, must sell agricultural products in adherence to the federal Organic Foods Production Act, must have applied for certification in accordance with the Organic Foods Production Act, and must receive gross income from the sale of organically produced agricultural products of no more than \$500,000 in the most recently reported fiscal year.

The Department of Agriculture is responsible for certifying all credit claims and may charge a fee for certification. The credit amount is 100% of qualified expenses up to a maximum of \$50,000 per taxpayer. The amount of tax credits certified in any given tax year cannot exceed \$2,000,000.

Act 261: Requires the State Auditor to Periodically Review Exemptions, Exclusions, and Credits under the General Excise, Use, Public Service Company, and Insurance Premium Tax Laws

Act 261 (Senate Bill 2547, S.D. 1, H.D. 1, C.D. 1) is effective July 1, 2017. It requires the Auditor to periodically review certain tax exemptions, exclusions, and credits under the GET and use tax (chapters 237 and 238, HRS), public service company tax (chapter 239, HRS), and insurance premium tax (chapter 431, HRS), beginning in 2018.

Specifically, Act 261 requires the Auditor to: (1) determine the amount of tax expenditure for the exemptions, exclusions, and credits for each of the previous three fiscal years; (2) estimate the amount of tax expenditure for the exemptions, exclusions, and credits for the current fiscal year and the next two fiscal years; (3) determine whether the exemptions, exclusions, and credits have achieved and continue to achieve the purpose for which they were enacted by the Legislature; (4) determine whether the exemptions, exclusions, and credits are necessary to promote or preserve tax equity or efficiency; (5) determine whether an economic benefit has resulted, and if so, quantify the estimated benefit directly attributable to the exemptions, exclusions, and credits; and (6) estimate the annual cost of the exemptions, exclusions, and credits per low-income resident of the State.

Act 261 also requires the Auditor to recommend whether an exemption, exclusion, or credit should be retained without modification, amended, or repealed.

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

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