



GOV. MSG. NO. 852

EXECUTIVE CHAMBERS
HONOLULU

LINDA LINGLE
GOVERNOR

July 16, 2009

The Honorable Colleen Hanabusa, President
and Members of the Senate
Twenty-Fifth State Legislature
State Capitol, Room 409
Honolulu, Hawaii 96813

Dear Madam President and Members of the Senate:

Re: House Bill No. 1550 HD2 SD1 CD1

On July 15, 2009, House Bill No. 1550, entitled "A Bill for an Act Relating to Taxation" became law without my signature, pursuant to Section 16 of Article III of the State Constitution.

The purpose of this bill is to amend Hawaii's income tax law to impose a State income tax on rollovers or transfers made by State and county employees from qualifying deferred compensation plans and qualifying annuity plans to eligible retirement plans.

However, although it was the intent of the legislative conference committee to tax both rollovers and transfers, as stated in the committee report, the actual language of House Bill No. 1550 only imposes a State tax liability on moneys that are rolled over from a qualifying account to the Employees' Retirement System plan. This inadvertent mistake may result in unequal treatment of those State and county employees who choose to purchase Employees' Retirement System hybrid plan credits in a lump sum via a rollover of funds, as defined in the Internal Revenue Code, sections 403 and 457, versus those employees who elect to transfer funds in accordance with the definitions contained in these sections of the Internal Revenue Code.

I encourage the Department of Taxation and the Employees' Retirement System to implement this measure fairly by ensuring equal tax treatment of all public employees using deferred-compensation and annuity plans for their hybrid plan upgrade. In addition, I also encourage the Legislature to fix this technical error in the bill language during the 2010 legislative session.

The Honorable Colleen Hanabusa, President
and Members of the Senate
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For the foregoing reasons, I allowed House Bill No. 1550 to become law as Act 181,
effective July 15, 2009, without my signature.

Sincerely,

A handwritten signature in black ink, appearing to read "Linda Lingle", with a large, stylized loop at the end of the name.

LINDA LINGLE

A BILL FOR AN ACT

RELATING TO TAXATION.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. Section 235-2.4, Hawaii Revised Statutes, is
2 amended to read as follows:

3 "§235-2.4 Operation of certain Internal Revenue Code
4 provisions; sections 63 to 530. (a) Section 63 (with respect
5 to taxable income defined) of the Internal Revenue Code shall be
6 operative for the purposes of this chapter, except that the
7 standard deduction amount in section 63(c) of the Internal
8 Revenue Code shall instead mean:

9 (1) \$4,000 in the case of:

10 (A) A joint return as provided by section 235-93; or

11 (B) A surviving spouse (as defined in section 2(a) of
12 the Internal Revenue Code);

13 (2) \$2,920 in the case of a head of household (as defined
14 in section 2(b) of the Internal Revenue Code);

15 (3) \$2,000 in the case of an individual who is not married
16 and who is not a surviving spouse or head of
17 household; or



1 (4) \$2,000 in the case of a married individual filing a
2 separate return.

3 Section 63(c)(4) shall not be operative in this [~~State-~~]
4 state. Section 63(c)(5) shall be operative, except that the
5 limitation on basic standard deduction in the case of certain
6 dependents shall be the greater of \$500 or such individual's
7 earned income. Section 63(f) shall not be operative in this
8 [~~State-~~] state.

9 The standard deduction amount for nonresidents shall be
10 calculated pursuant to section 235-5.

11 (b) Section 72 (with respect to annuities; certain
12 proceeds of endowment and life insurance contracts) of the
13 Internal Revenue Code shall be operative for purposes of this
14 chapter and be interpreted with due regard to section 235-7(a),
15 except that the ten per cent additional tax on early
16 distributions from retirement plans in section 72(t) shall not
17 be operative for purposes of this chapter.

18 (c) Section 121 (with respect to exclusion of gain from
19 sale of principal residence) of the Internal Revenue Code shall
20 be operative for purposes of this chapter, except that for the
21 election under section 121(f), a reference to section 1034



1 treatment means a reference to section 235-2.4(n) in effect for
2 taxable year 1997.

3 (d) Section 163 (with respect to interest) of the Internal
4 Revenue Code shall be operative for the purposes of this
5 chapter, except that provisions in section 163(d)(4)(B)
6 (defining net investment income to exclude dividends) shall not
7 be operative for the purposes of this chapter.

8 (e) Section 165 (with respect to losses) of the Internal
9 Revenue Code shall be operative for purposes of this chapter.
10 Section 165 as operative for this chapter shall also apply to
11 losses sustained from the sale of stocks or other interests
12 issued through the exercise of the stock options or warrants
13 granted by a qualified high technology business as defined in
14 section 235-7.3.

15 (f) Section 168 (with respect to the accelerated cost
16 recovery system) of the Internal Revenue Code shall be operative
17 for purposes of this chapter, except that provisions relating to
18 property on Indian reservations in section 168(j) and special
19 allowance for certain property acquired after September 10,
20 2001, and before January 1, 2005 (including the extension of the
21 qualifying aircraft placed in service before January 1, 2006),



1 in section 168(k) shall not be operative for purposes of this
2 chapter.

3 (g) Section 179 (with respect to the election to expense
4 certain depreciable business assets) of the Internal Revenue
5 Code shall be operative for purposes of this chapter, except
6 that provisions relating to:

- 7 (1) The increase of the maximum deduction to \$100,000 for
8 taxable years beginning after 2002 and before 2008,
9 and the increase of the maximum deduction to \$125,000
10 for taxable years beginning after 2006 and before
11 2011, in section 179(b)(1);
- 12 (2) The increase of the qualifying investment amount to
13 \$400,000 for taxable years beginning after 2002 and
14 before 2008, and the increase of the qualifying
15 investment amount to \$500,000 for taxable years
16 beginning after 2006 and before 2011, in section
17 179(b)(2);
- 18 (3) Defining section 179 property to include computer
19 software in section 179(d)(1);
- 20 (4) Inflation adjustments in section 179(b)(5); and
- 21 (5) Irrevocable election in section 179(c)(2);
- 22 shall not be operative for the purposes of this chapter.



1 (h) Section 219 (with respect to retirement savings) of
2 the Internal Revenue Code shall be operative for the purpose of
3 this chapter. For the purpose of computing the limitation on
4 the deduction for active participants in certain pension plans
5 for state income tax purposes, adjusted gross income as used in
6 section 219 as operative for this chapter means federal adjusted
7 gross income.

8 (i) Section 220 (with respect to medical savings accounts)
9 of the Internal Revenue Code shall be operative for the purpose
10 of this chapter, but only with respect to medical services
11 accounts that have been approved by the Secretary of the
12 Treasury of the United States.

13 (j) Section 265 (with respect to expenses and interest
14 relating to tax-exempt income) of the Internal Revenue Code
15 shall be operative for purposes of this chapter; except that it
16 shall not apply to expenses for royalties and other income
17 derived from any patents, copyrights, and trade secrets by an
18 individual or a qualified high technology business as defined in
19 section 235-7.3. Such expenses shall be deductible.

20 (k) Section 408A (with respect to Roth Individual
21 Retirement Accounts) of the Internal Revenue Code shall be
22 operative for the purposes of this chapter. For the purposes of



1 determining the aggregate amount of contributions to a Roth
2 Individual Retirement Account or qualified rollover contribution
3 to a Roth Individual Retirement Account from an individual
4 retirement plan other than a Roth Individual Retirement Account,
5 adjusted gross income as used in section 408A as operative for
6 this chapter means federal adjusted gross income.

7 (1) In administering the provisions of sections 410 to 417
8 (with respect to special rules relating to pensions, profit
9 sharing, stock bonus plans, etc.), sections 418 to 418E (with
10 respect to special rules for multiemployer plans), and sections
11 419 and 419A (with respect to treatment of welfare benefit
12 funds) of the Internal Revenue Code, the department of taxation
13 shall adopt rules under chapter 91 relating to the specific
14 requirements under such sections and to such other
15 administrative requirements under those sections as may be
16 necessary for the efficient administration of sections 410 to
17 419A.

18 In administering sections 401 to 419A (with respect to
19 deferred compensation) of the Internal Revenue Code, Public Law
20 93-406, section 1017(i), shall be operative for the purposes of
21 this chapter.



1 In administering section 402 (with respect to the
2 taxability of beneficiary of employees' trust) of the Internal
3 Revenue Code, the tax imposed on lump sum distributions by
4 section 402(e) of the Internal Revenue Code shall be operative
5 for the purposes of this chapter and the tax imposed therein is
6 hereby imposed by this chapter at the rate determined under this
7 chapter.

8 (m) In administering section 403 (with respect to taxation
9 of employee annuities) of the Internal Revenue Code, any funds
10 that represent pre-tax employee deferrals or contributions that
11 are distributed from the annuity and used solely to obtain
12 retirement credits under the state employee retirement system
13 shall not be treated as a rollover for purposes of section
14 403(b)(8)(A) of the Internal Revenue Code, and such funds shall
15 be subject to income tax under this chapter.

16 (n) In administering section 457 (with respect to
17 compensation plans of state and local governments and tax-exempt
18 organizations) of the Internal Revenue Code, any funds that
19 represent pre-tax employee deferrals or contributions that are
20 distributed from the deferred compensation plan and used solely
21 to obtain retirement credits under the state employee retirement
22 system shall not be treated as a rollover for purposes of



1 section 457(e)(16)(A) of the Internal Revenue Code and such
2 funds shall be subject to income tax under this chapter.

3 ~~(m)~~ (o) Section 468B (with respect to special rules for
4 designated settlement funds) of the Internal Revenue Code shall
5 be operative for the purposes of this chapter and the tax
6 imposed therein is hereby imposed by this chapter at a rate
7 equal to the maximum rate in effect for the taxable year imposed
8 on estates and trusts under section 235-51.

9 ~~(n)~~ (p) Section 469 (with respect to passive activities
10 and credits limited) of the Internal Revenue Code shall be
11 operative for the purposes of this chapter. For the purpose of
12 computing the offset for rental real estate activities for state
13 income tax purposes, adjusted gross income as used in section
14 469 as operative for this chapter means federal adjusted gross
15 income.

16 ~~(o)~~ (q) Sections 512 to 514 (with respect to taxation of
17 business income of certain exempt organizations) of the Internal
18 Revenue Code shall be operative for the purposes of this chapter
19 as provided in this subsection.

20 "Unrelated business taxable income" means the same as in
21 the Internal Revenue Code, except that in the computation
22 thereof sections 235-3 to 235-5, and 235-7 (except subsection



1 (c)), shall apply, and in the determination of the net operating
2 loss deduction there shall not be taken into account any amount
3 of income or deduction that is excluded in computing the
4 unrelated business taxable income. Unrelated business taxable
5 income shall not include any income from a prepaid legal service
6 plan.

7 For a person described in section 401 or 501 of the
8 Internal Revenue Code, as modified by section 235-2.3, the tax
9 imposed by section 235-51 or 235-71 shall be imposed upon the
10 person's unrelated business taxable income.

11 [~~(p)~~] (r) Section 521 (with respect to cooperatives) and
12 subchapter T (sections 1381 to 1388, with respect to
13 cooperatives and their patrons) of the Internal Revenue Code
14 shall be operative for the purposes of this chapter as to any
15 cooperative fully meeting the requirements of section 421-23,
16 except that Internal Revenue Code section 521 cooperatives need
17 not be organized in Hawaii.

18 [~~(q)~~] (s) Sections 527 (with respect to political
19 organizations) and 528 (with respect to certain homeowners
20 associations) of the Internal Revenue Code shall be operative
21 for the purposes of this chapter and the taxes imposed in each



