

**HB 2866,  
HD1  
Testimony**

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**SENATE COMMITTEE ON WAYS & MEANS  
TESTIMONY REGARDING HB 2866 HD 1  
RELATING TO TAXATION**

**TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)**  
**DATE: MARCH 16, 2010**  
**TIME: 10AM**  
**ROOM: 211**

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As amended, this measure amends Chapter 236D, the Estate & Transfer Tax, to "pick up" the estate tax contained in the Internal Revenue Code as it existed on December 31, 2000; however for estates as they exist on December 31, 2009.

The Department of Taxation (Department) **opposes** this measure as a tax increase.

**CURRENT ESTATE TAX IS DORMANT**—When Congress passed the Economic Growth & Tax Relief Reconciliation Act of 2001, Hawaii's estate and transfer tax under Chapter 236D effectively went "dormant" when the credit for state estate taxes paid was phased out into a deduction. Hawaii's estate tax was equal to the federal credit. When the credit was repealed in favor of a deduction, the Hawaii estate tax ceased.

**OPPOSED TO AN UNWARRANTED TAX INCREASE**—The Department opposes this measure as a tax increase. The Department cannot support a tax increase of this type.

**THE HAWAII ESTATE TAX WILL COME BACK IF CONGRESS DOESN'T ACT**—As a technical matter, the federal estate tax does not exist in 2010. There is currently no estate tax. However, there is considerable speculation that Congress may act with a retroactive estate tax to pick up decedents dying in 2010. If no action is taken; however, Hawaii's dormant estate tax will resurrect in 2011 as had been the case before it expired. The Department points out that if no estate tax is passed on the state level, and no action is taken congressionally (which may be the case), Hawaii's estate tax law will become effective January 1, 2011.

**REVENUE IMPACT**—Assuming an enforceable and effective estate tax is passed, with taxable estates starting at \$3.5 million per person, this measure will result in a revenue gain of approximately \$19.6 million.

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**SUBJECT:** INHERITANCE AND ESTATE, Preserve state credits

**BILL NUMBER:** HB 2866, HD-1

**INTRODUCED BY:** House Committee on Finance

**BRIEF SUMMARY:** Amends HRS section 236D-2 by amending the definition of “federal credit” to provide that for a generation-skipping transfer the maximum amount of credit for state taxes allowed by IRC section 2604 shall be as it existed on December 31, 2000.

Amends the definition of “gross estate” to mean gross estate as defined and used in IRC sections 2031 to 2046.

Amends the definition of IRC section 2011 to provide that it shall mean IRC section 2011 as it existed on December 31, 2000.

Amends the definition of “taxable estate” to provide that it shall mean taxable estate as defined in IRC sections 2051 to 2056 and section 2058, with respect to estates of decedents dying and generation-skipping transfers after December 31, 2004.

Makes conforming amendments to the definitions of “generation-skipping transfer,” “personal representative” and “transfer.” Also updates the definition of “Internal Revenue Code.”

This act shall be applicable to property or interests that pass from any individual who dies after December 31, 2009 and to generation-skipping transfers after December 31, 2009.

**EFFECTIVE DATE:** Upon Approval

**STAFF COMMENTS:** The proposed measure would preserve the credit for state death taxes paid allowed under the federal estate tax. With the adoption of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) the federal estate tax is phased out and ultimately repealed over a ten-year period. Along with that repeal, the credit that is allowable under the federal law recognizing that an estate may have incurred state death taxes is phased out over a three-year period beginning in 2002. Hawaii, like many other states, has utilized this amount as its state death tax since 1983 and is known as the “pick up” tax as the state merely picks up what the federal table allows as state death taxes.

The pick up tax was created in 1924 when Congress provided a credit against the federal estate tax which had been created in 1916 in recognition of the estate having been required to pay death taxes to the state. This dollar-for-dollar credit against state taxes paid enables the state to “pick up” some of the federal tax liability without increasing the total liability of the state. Thus, when the state chose to eliminate its old inheritance tax in favor of the pick up tax in 1983, it eliminated any additional state tax liability for the estate and made its tax revenues from this source completely dependent on the federal law. One of the

pluses to utilizing the pick up tax is that it eliminated any additional paperwork that a separate state death tax would involve.

However, now that the federal law will phase out and has eliminated the state death tax credit which is the basis for the "pick up" tax, Hawaii has lost a small, but important, source of revenue. This measure proposes to preserve the state death tax credit or pick up tax as it stood on December 31, 2000 prior to the adoption of EGTRRA.

While some may decry the fact that this is a tax that would otherwise have been eliminated, one can only argue that point if one assumes that the state must follow federal tax policy. If lawmakers believe that the state policy should continue to tax the transfer of assets from a decedent's estate to beneficiaries, then they must de-couple it from the federal law but retain the ease of administration and compliance by freezing the federal provision. However, since the credit has already been eliminated, reinstatement of the "pick up" tax to 100% of the state death tax credit to what it was prior to EGTRRA would amount to a tax increase in the eyes of beneficiaries of the decedent. In that sense, this would be a difficult measure to adopt.

Lawmakers should exercise care in adopting this proposal noting that it would be operative only for calendar year 2010 for persons dying on January 1, 2010 but before January 1, 2011. Inasmuch as this measure, if approved, would become law sometime during mid-year, one would have to ask whether it was fair to those who died this year, but before enactment, to be subject to the tax. Further, it should be noted that under the federal law, the estate tax exemption is not operative for this year and technically there are no estate tax rates. Thus, instead of an estate adjusted for federal tax purposes by the federal estate tax exemption which stood at \$3.5 million through calendar year 2009, the estate of a Hawaii resident would be calculated without the benefit of the first \$3.5 million being exempt. Thus, the state tax credit would be calculated on the basis that all of the decedent's estate was subject to tax beginning with dollar one. While the absence of the federal estate tax rates has little impact, the absence of the federal estate tax exemption will have a significant impact on trying to figure out what the federal credit is for state death taxes paid and will have a significant impact on Hawaii residents.

As drafted, the provisions of the bill are in conflict. The definition of "Internal Revenue Code" in section 1 of the measure provides that Sections 2011 and 2604 shall be as they existed on December 31, 2009. On the other hand, section 2 of the measure provides that "Section 2011" shall mean as it existed on December 31, 2000. If the drafters wanted to pick up the tax credit for state death taxes paid, then Section 2011 should be referenced as it existed on December 31, 2000, before the phased-out repeal of that provision.

Digested 3/15/10