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Subject: Testimony for HB2328 on 3/20/2012 9:00:00 AM
Date: Monday, March 19, 2012 1:02:15 PM

Testimony for WAM 3/20/2012 9:00:00 AM HB2328

Conference room: 211
Testifier position: Support
Testifier will be present: Yes
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Comments:

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SUBJECT: MISCELLANEOUS, Estate and generation-skipping transfer tax

BILL NUMBER: HB 2328, HD-1

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Adds a new chapter to HRS to establish an estate and generation-skipping transfer tax. Provides that a direct skip that is a transfer subject to chapter 12 of the Internal Revenue Code (IRC) shall not be treated as a taxable transfer.

An exclusion from a Hawaii taxable estate shall be allowed to the estate of every decedent against the tax imposed by this chapter. The applicable exclusion amount shall be the same as the federal applicable exclusion amount, or the exemption equivalent of the unified credit, without reduction for taxable gifts, as set forth for the decedent in chapter 11 of the IRC; provided that: (1) for residents the exclusion amount shall be 100% of the applicable exclusion amount; (2) for nonresidents, the exclusion amount shall be computed by multiplying the applicable exclusion amount by a fraction, the numerator of which is the value of the property in the state subject to tax under this chapter, and the denominator of which is the federal gross estate; and (3) for nonresidents not citizens, the exclusion amount shall be computed by multiplying the exemption equivalent of the unified credit by a fraction, the numerator of which is the value of the property in the state subject to tax under this chapter, and the denominator of which is the federal gross estate.

For estates of decedents dying on or after January 1, 2012, a tax based on the Hawaii net taxable estate shall be imposed as follows:

If the taxable estate is:	The tax shall be:
Up to \$1,000,000	10% of net taxable estate
Over \$1,000,000 but not over \$2,000,000	\$100,000 plus 11% over \$1,000,000
Over \$2,000,000 but not over \$3,000,000	\$210,000 plus 12% over \$2,000,000
Over \$3,000,000 but not over \$4,000,000	\$330,000 plus 13% over \$3,000,000
Over \$4,000,000 but not over \$5,000,000	\$460,000 plus 14% over \$4,000,000
Over \$5,000,000	\$600,000 plus 15.7% over \$5,000,000

Defines "Hawaii net taxable estate" as Hawaii taxable estate less the applicable exclusion amount. Defines "Hawaii taxable estate" as: (1) for residents, the federal taxable estate under section 2051, et. seq., of the IRC but without regards for the deduction for state death taxes paid under section 2058 of the Internal Revenue Code; (2) for nonresidents, the federal taxable estate under section 2051, et. seq., of the IRC, but without regard for the deduction for state death taxes paid under section 2058 of the IRC, multiplied by a fraction, the numerator of which is the value of the property in the state subject to tax under this chapter, and the denominator of which is the federal gross estate; and (3) for nonresidents not citizens, the federal taxable estate determined under section 2106 of the IRC, but without regard for the deduction for state death taxes paid under section 2106(a)(4) of the IRC, multiplied by a fraction, the

numerator of which is the value of the property with a situs in the state subject to tax under this chapter, and the denominator of which is the federal gross estate.

If any property of a resident is subject to a death tax imposed by another state and if the tax imposed by the other state is not qualified by a reciprocal provision allowing the property to be taxed in the state of the decedent's domicile, the amount of the tax due under this section shall be credited with the lesser of: (1) the amount of the death tax actually paid the other state; or (2) an amount computed by multiplying the Hawaii estate tax by a fraction, the numerator of which is the value of the property subject to the death tax imposed by the other state, and the denominator of which is the total value of the decedent's gross estate. Further delineates provisions relating to the filing of a Hawaii transfer tax return including the payment of taxes due, penalty provisions, filing extensions, amended returns, final settlement of account and final determination.

A Hawaii generation-skipping transfer tax shall be imposed on every taxable transfer involving: (1) transferred property located in the state; and (2) transferred property from a resident trust. The tax shall be the applicable generation-skipping transfer tax rate multiplied by the taxable amount as determined under chapter 13 of the IRC, multiplied by a fraction, the numerator of which is the taxable transfer subject to the tax under this chapter and the denominator of which is the total amount of taxable transfers subject to the federal generation-skipping tax. Defines "applicable generation-skipping transfer tax rate" as 2.25% multiplied by the inclusion ratio with respect to any property transferred in a generation-skipping transfer as determined under section 2642 of the IRC. Requires the person required to report and pay the federal generation-skipping transfer tax to file with the department of taxation on or before the date the federal generation-skipping transfer tax return is filed. Delineates provisions for the determination of the generation-skipping transfer tax if the taxable transfer is subject to a generation-skipping tax of another state and if the tax imposed by the other state is not qualified by a reciprocal provision allowing the property to be taxed in this state.

Defines "decedent," "department," "federal estate tax," "federal generation-skipping transfer tax," "federal return," "federal taxable estate," "federal transfer tax," "generation-skipping transfer," "gross estate," "Hawaii estate tax," "Hawaii generation-skipping transfer tax," "Hawaii transfer tax," "nonresident," "nonresident trust," "person," "personal representative," "property," "qualified heir," "release," "resident," "resident trust," "situs," "state," "transfer," "taxable transfer" and "transferee" for purposes of the measure.

EFFECTIVE DATE: Taxable transfers that occur after December 31, 2011; decedents dying or taxable transfers occurring after December 31, 2011.

STAFF COMMENTS: With the adoption of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGGTRA), the federal estate tax was 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, had 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 estate. 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.

This measure establishes an estate and generation-skipping transfer tax applicable to decedents dying or taxable transfers occurring after December 31, 2011. After the determination of the Hawaii net taxable estate, that is the amount of the Hawaii taxable estate less the federal applicable exclusion, an estate tax shall be due and payable for Hawaii net taxable estates from 10% to 15.7% for amounts of \$1 million and over.

On January 1, 2010, the federal estate tax was officially repealed by EGGTRA, but on December 17, 2010 it was reinstated retroactively to January 1 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (PL 111-312). The federal estate tax is now 35% with a \$5 million individual exemption for the 2010, 2011 and 2012 tax years. On January 1, 2013, the exemption and rates are scheduled to revert back to the numbers that were in effect in 2002 - a \$1,000,000 exemption and 55% estate tax rate.

Locally, the 2010 legislature adopted Act 74 which recognized the federal state tax credit as it was operable before the phased-out repeal enacted by EGGTRA, but adopted an exclusion of \$3.5 million for all estates. This law is in effect currently. This proposal does not address this fact as there is no provision for repeal of HRS Chapter 236D. Thus, this proposal would be a tax in addition to the pick up tax currently in effect. If the intent of this measure is to replace the current pick up tax, then the current law should be repealed or provide that its application is for those dying before the enactment of this proposal. That said, the effective date of this proposal should be made prospective as those dying after December 31, 2011 did not know that this proposal was being considered and, therefore, did not base their estate plans on the provisions of this proposal. Finally, inasmuch as Hawaii has adopted legislation recognizing civil unions, this proposal should be amended to recognize that status with respect to the spousal exclusion under the federal law. Since the federal law does not recognize civil unions, the spousal exemption would not be applicable under the federal code, however, lawmakers must decide if the spousal exemption should be recognized with respect to this new estate tax law.

Unlike the current law, this proposal would tie the exclusion amount to the exclusion amount granted under the federal death tax and establish a graduated tax scheme independent of the federal law. Under this proposal and given the current federal estate exclusion of \$5 million, estates of less than \$6 million would be exempt from paying the Hawaii estate tax. Given that this proposal still relies on the federal definitions of taxable estate property with an allocation of property should the estate have ownership in another state, the compliance problems should be minimal. Unlike the state inheritance tax that existed prior to the adoption of the pick up approach in 1983 which focused on the beneficiaries of the estate, this proposal tracks the federal law by focusing on the estate and not the beneficiaries.

Given that Hawaii currently has an estate tax in effect, the effective date of this proposal should be set prospectively as those dying after January 1, 2012 as their estate planning was based on the current law and not on this proposal, should it be adopted.

Digested 3/19/12