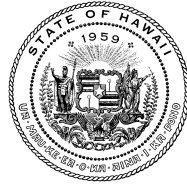


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To: The Honorable Scott Y. Nishimoto, Chair  
and Members of the House Committee on Judiciary

Date: Wednesday, March 15, 2017  
Time: 2:00 P.M.  
Place: Conference Room 325, State Capitol

From: Maria E. Zielinski, Director  
Department of Taxation

Re: S.B. 1006, S.D. 1, Relating to the Estate and Generation Skipping Transfer Taxes

The Department of Taxation (Department) strongly supports S.B. 1006, S.D. 1, an Administration measure, which seeks to close a loophole whereby nonresidents can completely or substantially avoid the estate tax by the use of a single member limited liability company (SMLLC) which has not elected to be taxed as a corporation. The Department provides the following comments for your consideration.

S.B. 1006, S.D. 1, clarifies that if Hawaii real property is held by a SMLLC, that SMLLC will be disregarded for estate tax purposes. This means that the estate tax will be applied the same as if the nonresident decedent owned the Hawaii real property directly. A nonresident would not be able to avoid the estate tax by using a SMLLC to hold title to the Hawaii real property. The measure has a defective effective date, but would otherwise apply to decedents dying after December 31, 2016.

The estate tax applies to both residents and nonresidents, whose property owned at death exceeds certain thresholds. For residents, that amount for 2017 is \$5,490,000; for nonresidents, it is a proportionate amount based on the amount of property with situs in Hawaii, compared to the total federal gross estate. For residents, all property wherever located is subject to the tax, whereas for nonresidents, only property located in Hawaii is subject to tax.

Under income tax law, if a SMLLC does not elect to be taxed as a corporation, the SMLLC is disregarded for income taxes and the assets of the SMLLC are deemed to be owned by the SMLLC's owner directly. However, for all other purposes including estate tax, the SMLLC is recognized. Intangible property such as stocks, bonds, ownership interests in a business, and the like are deemed to have the situs of the decedent's domicile. This rule determining the situs of intangible property is what creates the loophole that this measure is intended to address.

Under current law, when Hawaii real property and/or personal property is placed into a SMLLC by a nonresident owner, no Hawaii estate tax is will ever be due upon the death of the owner because the decedent did not directly own the Hawaii real property. Instead, the intangible property rule would apply, and the ownership interest in the SMLLC will be deemed to have the situs of the decedent's domicile. This measure would eliminate this loophole by disregarding the SMLLC by imposing the estate tax on real property and/or personal property that would have been subject to the tax as if the property been owned by the decedent directly.

It is clear that the estate tax was intended to apply to Hawaii real property owned by nonresidents, as well as personal property located in the State, and this measure reflects and is consistent with that intent. The measure also creates consistent application between the income tax and the estate tax.

Accordingly, the Department strongly supports this measure, and requests that the measure be amended to be effective upon approval.

Thank you for the opportunity to provide comments.

JUDtestimony

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From: mailinglist@capitol.hawaii.gov  
Sent: Tuesday, March 14, 2017 9:54 AM  
To: JUDtestimony  
Cc: tfh@tfhawaii.org  
Subject: Submitted testimony for SB1006 on Mar 15, 2017 14:00PM  
Attachments: s1006d17.pdf

Categories: Green Category

**SB1006**

Submitted on: 3/14/2017

Testimony for JUD on Mar 15, 2017 14:00PM in Conference Room 325

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Thomas Yamachika	Tax Foundation of Hawaii	Comments Only	Yes

Comments: Please see the attached.

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

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# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: ESTATE/GSTT, Look-Through of Single-Member LLCs

BILL NUMBER: SB 1006, SD-1

INTRODUCED BY: Senate Committee on Ways and Means

EXECUTIVE SUMMARY: Now, the estate tax or generation-skipping transfer tax applies if the decedent is a Hawaii resident or has Hawaii real or personal property in the gross estate. The bill would look through single member LLCs that are disregarded for income tax purposes. That treatment is not justified, and treats other passthrough entities differently.

BRIEF SUMMARY: Amends HRS section 236E-8 to require a Hawaii estate tax return to be filed if the decedent is the sole owner of a single member limited liability company that has not elected to be taxed as a corporation, and the LLC has Hawaii real estate or tangible personal property.

EFFECTIVE DATE: Jan. 1, 2050. Applies to decedents dying after December 31, 2016.

STAFF COMMENTS: This is an administration measure submitted by the department of taxation TAX-05 (17). The bill, ostensibly to close a loophole, looks through an entity depending on its treatment under the income tax law.

It should be remembered that the income tax and the estate tax are different beasts. The former has quite a few provisions designed to shift the tax burden that otherwise would fall on business entities to their owners. Some that come to mind are the tax treatment of partnerships, S corporations, trusts (grantor trusts and otherwise), and REITs. The estate tax has provisions clawing back into the estate gifts made within three years of death (IRC section 2035), purported gifts with retained interests (IRC section 2036), transfers taking effect at death (IRC section 2037), revocable transfers (IRC section 2038). Entities are not looked through for estate tax purposes. However, the gross estate does include intangible property such as stock shares.

If the decision is to look through single member LLCs that have not elected to be taxed as a corporation, then what about single member LLCs that do elect to be taxed as a corporation and then make a subchapter S election? And why exclude partnerships or S corporations with multiple owners? A consistent rationale needs to be developed to prevent the estate tax law from being mucked up by income tax concepts, and vice versa.

Digested 3/11/2017