

JOSH GREEN M.D.
GOVERNOR

SYLVIA LUKE
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION

Ka 'Oihana 'Auhau
P.O. BOX 259

HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

GARY S. SUGANUMA
DIRECTOR

KRISTEN M.R. SAKAMOTO
DEPUTY DIRECTOR

**TESTIMONY OF
GARY S. SUGANUMA, DIRECTOR OF TAXATION**

TESTIMONY ON THE FOLLOWING MEASURE:

H.B. No. 1362, H.D.1, Relating to Pass-Through Entity Taxation

BEFORE THE:

House Committee on Finance

DATE: Wednesday, March 1, 2023

TIME: 2:30 p.m.

LOCATION: State Capitol, Room 308

Chair Yamashita, Vice-Chair Kitagawa, and Members of the Committee:

The Department of Taxation ("Department") offers the following comments regarding H.B. 1362, H.D.1, for your consideration.

H.B. 1362, H.D.1, amends chapter 235, Hawaii Revised Statutes (HRS), allowing a partnership or S corporation to annually elect to file as a pass-through entity, but requiring that election to be made every tax year that the entity wishes to file as a pass-through entity. This bill also allows the partnership or S corporation to pay the Hawaii income tax at the entity level and allow nonresident partners whose only Hawaii income comes from electing to file as a pass-through entity to claim a credit for taxes paid by the partnership or S corporation. The amount of credit will be applied to each partner's Hawaii tax liability, but the excess is nonrefundable and cannot be carried over to a subsequent year. The credit is not deductible from a partner's Hawaii state taxable income as an itemized deduction. The measure has a defective effective date of June 30, 3000.

Because this bill will require significant tax form and system changes, and may require the promulgation of administrative rules, the Department requests that if the effective date of the bill is updated, it be amended to no earlier than January 1, 2025.

The Department estimates no material revenue impact from this measure.

Thank you for the opportunity to provide comments on this measure.

CRAFT *Ohana*

February 28, 2023

House Committee on Finance
HB1362 Relating to Pass-Through Entity (PTE) Taxation

Re: **IN STRONG SUPPORT OF HB1362**

Aloha Chair Representative Yamashita, Vice Chair Representative Kitagawa, and members of the Committee,


My name is Garrett W. Marrero, I live in Kihei, HI. Maui Brewing Co. has locations on Maui in Lahaina and Kihei, and on Oahu in Waikiki and Kailua. We distribute across Hawaii, 19 other States, and 10 countries. We are a fairly large employer within the State and contribute immensely to Hawai'i and its people. We support HB1362 and ask that you amend the effective date to be immediately upon passing and further allow it to be retroactive back to TY 2018. Zero opposition and Zero cost to the State.

I am writing on behalf of myself and our local family-operated business in **STRONG SUPPORT** of **HB1362** for the following reasons:

1. This bill will allow taxpayers to deduct Hawaii state income taxes paid on their federal income tax returns beyond the current limit of \$10,000 imposed by changes to the federal tax code in 2017.
2. This will have no impact to State tax revenue as the tax is still being paid to the state, albeit at the entity level, not the individual level.
3. A majority of other states have already passed similar legislation.
4. If passed, this bill will provide significant benefit to Hawaii small businesses, who are typically LLCs, receive a higher deduction on their federal income tax returns keeping more money in their pocket.

Mahalo for your consideration. We urge you to pass this bill and show your support of Hawaii's small businesses. Thank you for the opportunity to provide testimony in support of **HB1362**.

Mahalo,



Garrett W. Marrero
CEO/Founder

MAUI
HARD SELTZER

*Modern
Times*
BEER

MAUI
BREWING CO

*Modern
Times*
COFFEE

KUPU
— SPIRITS —



House Committee on Finance
Rep. Kyle T. Yamashita, Chair
Rep. Lisa Kitagawa, Vice Chair

RE: HB1362_HD1, RELATING TO PASS THROUGH ENTITY TAXATION

Wednesday, March 1, 2023

2:30 pm

Room 308

Pas de Deux Hawaii submits testimony in **strong support** of HB1362_HD1, Pass-Through Entity Taxation.

Pas de Deux Hawaii is a performing art studio located in Central Oahu serving performers from across the island. We are dedicated and committed to preserving culture and the arts in our local community by training young performers to the highest level of skill in their desired genre of dance, music, and theatre. As a small business it can be challenging to maintain a high quality of service while keeping consumer costs at an affordable level.

Passage of this bill would create a huge positive financial benefit for us as small businesses in the state and, since the bill only seeks to change the method by which the state income tax is paid, the state's tax revenue is not affected in any way. However, it would allow us to continue to grow and serve more of Hawaii's keiki.

Thank you for the opportunity to submit testimony on this measure.

PACIFIC RIM LAND INC.



House Committee on Finance
Rep. Kyle T. Yamashita, Chair
Rep. Lisa Kitagawa, Vice Chair

RE: H.B. 1362_HD1, RELATING TO PASS THROUGH ENTITY TAXATION

Wednesday, March 1, 2023

2:30 pm

Room 308

Aloha Chair Yamashita, Vice Chair Kitagawa, and Members of the Committee:

Pacific Rim Land, Inc. submits testimony in support with amendment to HB1362_HD1.

Legislation is required to allow Hawaii taxpayers to take full deductions of state taxes paid on their federal income tax returns.

For many years, the federal government granted a deduction for state income taxes paid by individuals and businesses. Congress, in 2017 with the enactment of the Tax Cuts and Jobs Act, capped the deduction of state taxes to \$10,000 per year (“SALT Cap”). This limitation significantly impacted individual owners of pass-through entities – S corporations, partnerships, and LLCs. This cap did not apply to taxes paid by businesses such as C corporations.

However, in 2020, the IRS – in Notice 2020-75, announced the IRS would not apply the \$10,000 SALT Cap to pass-through entities if the state income tax was imposed directly on the entity. If Hawaii allows an election to move its point of taxation from the individual owners of a pass-through entity to the entity itself, the federal government will not impose the \$10,000 cap on deductions claimed by the entity.

We request the following amendment to ensure that owners, partners, or shareholders in S Corporations, Partnerships, or LLC’s that fall in lower tax brackets do not end up overpaying their state taxes.

Page 3, (e), line 9-12: amend the following:

*“If the amount of the credit authorized by this subsection exceeds the member’s tax liability imposed pursuant to this chapter, the excess amount shall **not** be refundable to the member.*

This change would not impact the State’s tax revenue.

The federal government provides the deduction for Hawaii income taxes paid by the entity. This federal deduction doesn’t impact the state as long as the state disallows the deduction for state income taxes in computing Hawaii income. So far, 29 states have enacted these types of pass-through entity tax elections, including California, New York, Illinois, Georgia,

North Carolina, Ohio, Oregon, Arizona, Idaho, and Utah. The federal government is, in essence, allowing a restored tax deduction to support small businesses and place them on an equal position compared to C corporations. **Please see the attached information sheet with a map highlighting the states that have passed similar legislation.**

Pacific Rim Land, Inc. supports the proposed legislation due to the significant benefits for Hawaii small businesses, who typically structured as LLCs by allowing them to receive a higher deduction on their federal income tax returns, in turn keeping more money in the State.

We humbly ask that you pass this measure.

Mahalo for the opportunity to provide testimony.

UNDERSTANDING SB1437 & HB1362

What are PTEs?

PTEs, or Pass Through Entities, are S Corporations, Partnerships, and Limited Liability Companies.

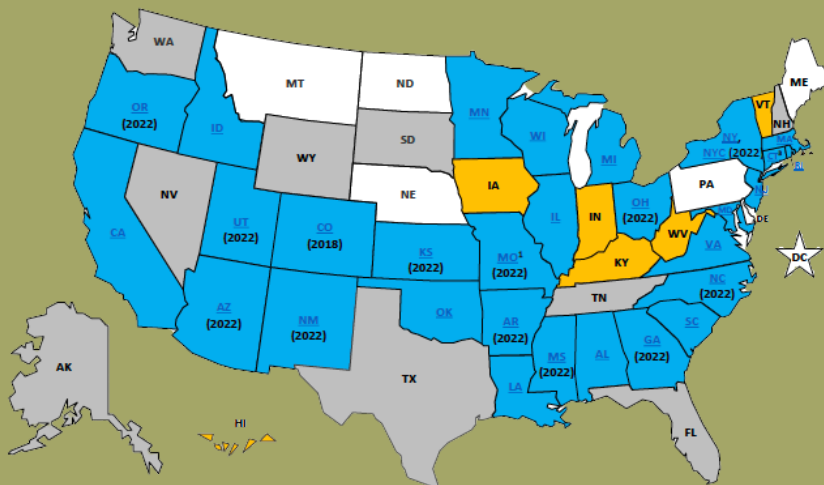
What is being proposed?

Currently, PTE tax liabilities are paid through each of their owners, partners or shareholders. The proposed legislation will allow individuals to elect to have their taxes paid through the PTE itself.

What happens if we pass this legislation?

If the legislation is passed and signed into law, Hawaii PTE owners will be able to deduct the full amount of their state tax on their federal taxes, lifting a \$10,000 cap on their federal tax deductions per year. The State's tax revenue will not be impacted.

States with Enacted or Proposed PTE Level Tax AS OF FEBRUARY 7, 2023



HB1362 and SB1437 are in committee in Hawaii.

It is one of six states with proposed PTE tax bills this year.

29 states and one locality have enacted PTE Tax since Tax Cuts & Jobs Act (TCJA) State & Local Tax (SALT) deduction limitation or earlier.

States with no owner-level personal income tax on PTE income.

States that have not yet proposed or enacted PTE taxes.

For more information, please contact Allicia Thompson
at alliciat@strategies360.com or (808) 542-9643.



January 31, 2023

TO: HONORABLE KYLE T. YAMASHITA, CHAIR, HONORABLE LISA KITAGAWA, VICE CHAIR, COMMITTEE ON FINANCE

SUBJECT: **SUPPORT OF H.B. 1362 HD1, RELATING TO PASS THROUGH ENTITY TAXATION.** Authorizes certain entities to elect to pay Hawaii income tax at the entity level through pass-through entities.

HEARING

DATE: Wednesday, March 1, 2023
TIME: 2:30 p.m.
PLACE: Capitol Room 308

Dear Chair Yamashita, Vice Chair Kitagawa and Members of the Committee,

The General Contractors Association of Hawaii (GCA) is an organization comprised of approximately five hundred (500) general contractors, subcontractors, and construction related firms. The GCA was established in 1932 and is the largest construction association in the State of Hawaii. Our mission is to elevate Hawaii’s construction industry and strengthen the foundation of our community.

GCA is in support of H.B. 1362 HD1, which authorizes certain entities to elect to pay Hawaii income tax at the entity level through pass-through entities.

For many years, the federal government granted a deduction for state income taxes paid by individuals and businesses.

However, Congress, in 2017 with the enactment of the Tax Cuts and Jobs Act, capped the deduction of state taxes to \$10,000 per year. This limitation significantly impacted individual owners of pass-through entities – S corporations, partnerships, and LLCs. This cap did not apply to taxes paid by businesses such as C corporations.

In 2020, the IRS – in Notice 2020-75, announced the IRS would not apply the \$10,000 “SALT Cap” to pass-through entities if the state income tax was imposed directly on the entity.

Therefore, if Hawaii allows an election to move its point of taxation from the individual owners of a pass-through entity to the entity itself, the federal government will not impose the \$10,000 cap on deductions claimed by the entity.

It is important to note that this change would not cost Hawaii. The federal government provides the deduction for Hawaii income taxes paid by the entity. This federal deduction doesn’t impact the state as long as the state disallows the deduction for state income taxes in computing Hawaii income.



**GENERAL
CONTRACTORS
ASSOCIATION
OF HAWAII**

28 states have enacted these types of pass-through entity tax elections, including California, New York, Illinois, Georgia, North Carolina, Ohio, Oregon, Arizona, Idaho, and Utah.

The federal government is, in essence, allowing a restored tax deduction to support small businesses and place them on an equal position compared to C corporations. If Hawaii were to adopt a similar elective pass-through entity tax, the change would come at no revenue cost and would help small businesses that do business in the state.

GCA believes that this would alleviate some of the burden that small businesses face in the State and allow more revenue to be pumped back into our economy.

Thank you for the opportunity to testify in support of this measure.

QUALITY PEOPLE. QUALITY PROJECTS



March 1, 2023

2:30 p.m.

VIA VIDEOCONFERENCE

Conference Room 423

To: House Committee on Finance

Rep. Kyle Yamashita, Chair

Rep. Lisa Kitagawa, Vice Chair

From: Grassroot Institute of Hawaii

Joe Kent, Executive vice president

RE: HB1362 HD1 — RELATING TO PASS-THROUGH ENTITY TAXATION

Comments Only

Dear Chair and Committee Members:

The Grassroot Institute of Hawaii would like to offer its comments on [HB1362 HD1](#), which would allow the members of partnerships and S corporations to elect to pay the state individual income tax at the pass-through entity level.

Essentially, this bill would allow members of certain Hawaii businesses to deduct their state income tax liabilities from their federal income tax liabilities.

In the past, federal law allowed for these “state and local tax” (SALT) deductions. For example, partnership members who paid \$40,000 in state income taxes could deduct that figure from their federal income tax.

In 2017, however, the federal Tax Cuts and Jobs Act changed the law to impose a \$10,000 cap on such deductions. This cap will expire in 2025 unless Congress extends it.¹

¹ [“IRS permits SALT deduction pass-through workarounds,”](#) GrantThornton, Nov. 13, 2020; [“State and Local Tax \(SALT\) Deduction,”](#) Tax Foundation, accessed Feb. 28, 2023.

In response, several states passed legislation to allow members of pass-through entities, such as partnerships and S corporations, to pay their income taxes at the entity level instead of the personal level. These laws created an avenue through which members of pass-through entities could still deduct their state income taxes from their federal income taxes. To date, 29 states have passed such legislation.²

According to an analysis from The Wall Street Journal, these laws are creating big savings for businesses.

“Business owners are likely saving more than \$10 billion annually in federal taxes through state laws that circumvent the \$10,000 cap on state and local tax deductions,” the newspaper reported in 2022.³

If Hawaii adopts this measure, probably not all businesses would make use of it. The bill provides that businesses can voluntarily elect to use or pass on the new policy on an annual basis.

This provision makes sense, as pass-through entity taxation poses businesses and their accountants with several financial questions and not all partnership and S corps may opt to use it.⁴ However, this measure would give business owners a valuable new tool in reducing their overall tax burden — all at no cost to the state.

Currently, Hawaii is one of the worst states for entrepreneurs. A 2022 CNBC analysis ranked Hawaii as the 46th worst state in which to start a business.⁵ This bill would help offset some of the state’s high tax burden and make it easier to start and expand a business in Hawaii, providing additional employment opportunities and fueling the economy.

Thank you for the opportunity to testify.

Joe Kent
Executive vice president
Grassroot Institute of Hawaii

² [“States with Enacted or Proposed Pass-Through Entity \(PTE\) Level Tax,”](#) American Institute of CPAs, Jan. 24, 2023.

³ Richard Rubin, [“States Help Business Owners Save Big on Federal Taxes With SALT-Cap Workarounds,”](#) Wall Street Journal, May 31, 2022.

⁴ Bruce Wood, [“SALT Workarounds Carry Consequences for Tax Affected Earnings,”](#) Bloomberg Tax, Sept. 23, 2022.

⁵ [“America’s Top States for Business 2022: The full rankings,”](#) CNBC, July 13, 2022.

HB-1362-HD-1

Submitted on: 2/28/2023 11:52:49 AM

Testimony for FIN on 3/1/2023 2:30:00 PM

Submitted By	Organization	Testifier Position	Testify
Antoinette M Davis	Activities & Attractions Association of Hawaii	Support	Written Testimony Only

Comments:

The Activities & Attractions Association of Hawaii (A3H) strongly supports HB 1362 HD1. This change provides significant tax benefits to our members and all business in the State. Please pass this needed tax relief measure - especially needed for our small businesses.

Mahalo

Antoinette M Davis
Executive Director
A3H

HB-1362-HD-1

Submitted on: 2/28/2023 12:50:16 PM

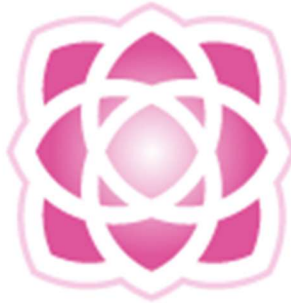
Testimony for FIN on 3/1/2023 2:30:00 PM

Submitted By	Organization	Testifier Position	Testify
John M Kevan	Maui Paradise Properties	Support	Written Testimony Only

Comments:

This is an overdue change to catch up to other states, we fully support this as it has no negative impact on Hawaii on positive impact on Hawaii LLC's.

John Kevan



MAUI

CHAMBER OF COMMERCE

VOICE OF BUSINESS

**HEARING BEFORE THE HOUSE COMMITTEE ON
FINANCE
HAWAII STATE CAPITOL, HOUSE CONFERENCE ROOM 308
WEDNESDAY, MARCH 1, 2023 AT 2:30 P.M.**

To The Honorable Kyle T. Yamashita, Chair
The Honorable Lisa Kitagawa, Vice Chair
Members of the Committee on Finance

SUPPORT HB1362 HD1 RELATING TO PASS-THROUGH ENTITY TAXATION

The Maui Chamber of Commerce **Supports HB1362 HD1** which authorizes certain entities to elect to pay Hawaii income tax at the entity level through pass-through entities.

The Chamber supports this bill because it will have no impact to State tax revenue as the tax is still being paid to the state, albeit at the entity level, not the individual level. This bill will provide significant benefit to Hawaii small businesses, who are typically LLCs, receive a higher deduction on their federal income tax returns.

The Chamber notes that 28 states have already enacted this type of pass-through legislation and this bill would help bring Hawaii into conformity with those who have already passed legislation.

For these reasons, we **support HB1362 HD1**.

Sincerely,

Pamela Tumpap
President

To advance and promote a healthy economic environment for business, advocating for a responsive government and quality education, while preserving Maui's unique community characteristics.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Pass-through Entity Tax Election

BILL NUMBER: HB 1362 HD 1

INTRODUCED BY: House Committee on Economic Development

EXECUTIVE SUMMARY: Authorizes certain pass-through entities to elect to pay Hawai'i income tax at the entity level.

SYNOPSIS: Adds a new section to chapter 235, HRS, that allows a partnership or S corporation to elect to pay tax that otherwise would be paid by its partners or owners. A separate election shall be made for each taxable year.

If an election is made, the passthrough entity pays tax equal to the sum of each member's distributive share of Hawaii taxable income, multiplied by the maximum individual rate (currently 11%). The individuals are then given credit on their own returns for their shares of tax paid by the entity.

EFFECTIVE DATE: June 30, 3000.

STAFF COMMENTS: At the federal level, the Tax Cuts and Jobs Act (TCJA) capped the state and local tax (SALT) deduction for individuals at \$10,000 for the 2018-2025 tax years. The limit generally applies to any SALT liability, including tax on income received from a partnership or S corporation. This limitation causes the most hardship in states with higher income tax rates, a classification to which Hawaii most definitely belongs.

In response, several states enacted laws designed to provide individuals with SALT deductions notwithstanding the \$10,000 limitation by imposing tax directly at the passthrough entity level. The entity, not the individual, pays the tax and is not burdened with the \$10,000 limit.

In November 2020, the IRS released Notice 2020-75 (<https://www.irs.gov/pub/irs-drop/n-20-75.pdf>), in which the agency stated that it intended to publish regulations stating that the strategy works. The Notice cited a 1958 revenue ruling, Rev. Rul. 58-25, 1958-1 C.B. 95, which held that a partnership level tax levied by Cincinnati reduced the partnership's taxable income or loss, and did not preclude its individual owners from claiming the standard deduction.

As the preamble to the bill recites, many other states have jumped on the bandwagon; a majority of states now have passthrough entity tax laws.

As a technical matter, the statute does not now provide for the possibility that a passthrough entity may have one or more corporate members, for which the maximum tax rate is 6.4%, not 11%. Certainly, the corporation is given credit for the tax paid if this happens, but the State may reap a windfall if the corporation has no profitable business activities other than its ownership in the passthrough, because this credit is not refundable and cannot be carried forward.

In addition, the Committee should consider making the election available to limited liability companies that are now classified under the IRC as disregarded entities. There would seem to be no substantial difference between a small business with more than one owner classified as a partnership for tax purposes, and a small business with one owner classified as a disregarded entity for tax purposes, for purposes of meriting this election.

Digested: 2/28/2023

HB-1362-HD-1

Submitted on: 2/27/2023 3:58:39 PM

Testimony for FIN on 3/1/2023 2:30:00 PM

Submitted By	Organization	Testifier Position	Testify
Sean Uezu	Individual	Support	Written Testimony Only

Comments:

This bill really is a no brainer it will have no impact to State tax revenue as the tax is still being paid to the state, albeit at the entity level, not the individual level. it will save Hawaii residents money that they will be able to put back into the economy.

Most states have already passed similar legislation.

HB-1362-HD-1

Submitted on: 2/28/2023 12:49:28 PM

Testimony for FIN on 3/1/2023 2:30:00 PM

Submitted By	Organization	Testifier Position	Testify
Wakon Childers	Individual	Support	Written Testimony Only

Comments:

Dear Members of the State of Hawaii House Finance Committee,

I am writing to express my strong support for House Bill 1362 (HB1362), which will allow Pass-Thru Entities such as LLCs and S Corporations to pay income tax directly to the State of Hawaii. As a business owner in Hawaii, I believe that this bill will provide significant benefits to small businesses in the state, particularly LLCs who are typically impacted by the limitations on deductions for state income taxes under the current federal tax code.

By allowing pass-through entities to pay income tax directly to the State of Hawaii, this bill will provide an option for taxpayers to deduct Hawaii state income taxes paid on their federal income tax returns beyond the current limit of \$10,000 imposed by changes to the federal tax code in 2017. This will result in a higher deduction on their federal income tax returns, keeping more money in their pocket. Importantly, this change will not impact State tax revenue as the tax is still being paid to the state, albeit at the entity level, not the individual level.

Moreover, a majority of other states have already passed similar legislation. For instance, 29 states have enacted these types of pass-through entity tax elections, including California, New York, Illinois, Georgia, North Carolina, Ohio, Oregon, Arizona, Idaho, and Utah. Hawaii's adoption of a similar elective pass-through entity tax would help small businesses that do business in the state and place them on an equal position compared to C corporations, restoring a tax deduction to support small businesses.

In conclusion, I urge you to support HB1362 and help small businesses in Hawaii by allowing pass-through entities to pay income tax directly to the State of Hawaii. This change will come at no revenue cost to the state, but will help support small businesses and place them on equal footing with other corporations. Thank you for considering my perspective.

Sincerely,

Wakon J. Childers, M.Ed.

HB-1362-HD-1

Submitted on: 2/28/2023 3:01:43 PM

Testimony for FIN on 3/1/2023 2:30:00 PM

Submitted By	Organization	Testifier Position	Testify
Kit Okazaki	Individual	Support	Written Testimony Only

Comments:

I support this bill, it will help small business owners here in Hawaii who employ such a large percentage of our workforce. Please help small business owners with this bill, it will not lower revenue to the State at all.