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STATE OF HAWAIʻI
DEPARTMENT OF TAXATION
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TESTIMONY OF
GARY S. SUGANUMA, DIRECTOR OF TAXATION

TESTIMONY ON THE FOLLOWING MEASURE:
H.B. No. 1620, Relating to Pass-Through Entity Taxation.

BEFORE THE:
House Committee on Economic Development

DATE: Wednesday, February 07, 2024
TIME: 10:30 a.m.
LOCATION: State Capitol, Room 423

Chair Holt, Vice-Chair Lamosao, and Members of the Committee:

The Department of Taxation ("Department") offers the following comments regarding H.B. 1620 for your consideration.

H.B. 1620 amends section 235-51.5, Hawaii Revised Statutes (HRS), which allows pass-through entities (PTEs) to elect to be taxed at the entity level and provides a credit to members whose distributive share or guaranteed payment of Hawaiʻi taxable income is subject to the tax. This bill lowers the PTE tax rate from the highest rate of tax applicable to the individual under section 235-51, HRS, currently 11 percent, to 9 percent. This bill also amends the tax base, which under current law is equal to the sum of the distributive shares and guaranteed payments of Hawaiʻi taxable income of all members, except for members that are corporations, by also excluding the distributive shares and guaranteed payments of members that are partnerships, S corporations, tax-exempt entities, and other taxpayers designated by the Department. This bill also allows the PTE credit to be carried forward. This measure takes effect upon approval and applies to taxable years beginning after December 31, 2023.

As explained above, the PTE tax is calculated based on the sum of distributive shares and guaranteed payments of all members, except members that are corporations;

and the PTE credit is available to members whose distributive shares or guaranteed payments are subject to the PTE tax. This has caused administrative difficulty for the Department in implementing the PTE tax and credit for multi-tiered entities (*i.e.*, pass-through entities that have members that are also pass-through entities), as the Department would potentially need to track PTE credits that are passed from a lower-tier PTE to an upper-tier PTE through multiple tier layers. The proposed amendment to exclude the distributive shares and guaranteed payments of members that are partnerships and S corporations from the tax base will ease the administrative burden of tracking the credits for multi-tiered entities. The Department therefore supports this amendment.

The Department further notes that it would be able to administer this bill as drafted.

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

Date: February 7, 2024

To: Chair Daniel Holt
Vice Chair Rachele F. Lamosao, and
Members of the House Committee on Economic Development

From: Cory Kubota, Managing Partner
Accuity LLP

Re: H.B. 1620 - Relating to Pass-Through Entity Taxation – **SUPPORT**

My name is Cory Kubota and I am the managing partner at Accuity LLP, a public accounting firm based in Honolulu.

As part of the federal Tax Cuts and Jobs Act (TCJA) that became law in 2017, the federal deduction for state and local taxes paid was limited to $10,000 for individuals (SALT cap) through the 2025 tax year. Unlike a C-corporation, the income tax liability of a pass-through entity (PTE) is not paid at the entity level and flows through to its partners and shareholders. Without a workaround, state income taxes that partners and S-corporation shareholders pay would be subject to the SALT cap. The State Legislature adopted a Hawaii Pass-Through Entity Tax (PTET) law during the 2023 Regular Session, however, certain attributes make it difficult for small businesses to take advantage of the existing law. This measure addresses these issues by:

- Reducing the PTET rate from 11% to 9%;
- Excluding partnerships, S-corporations, and tax-exempt entities to address potential PTET double taxation of flow-through income; and
- Allowing any unused credit to be carried over to subsequent tax years to prevent.

As currently written, this measure is effective beginning with tax year 2024. It is important that this effective date be maintained as the SALT applies to the 2024 and 2025 tax years. If the effective date were to be pushed out to the 2025 tax year, Hawaii small business would only be able to take advantage of the Hawaii PTET law for one tax year.

I urge you to advance this measure as it will greatly benefit Hawaii small businesses without any cost to the State. Thank you for the opportunity to testify in strong support of this measure.

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ISLAND
FILM GROUP

House of Representatives
The Thirty-Second Legislature
Regular Session of 2023

COMMITTEE ON ECONOMIC DEVELOPMENT
Rep. Daniel Holt, Chair
Rep. Rachele F. Lamosao, Vice Chair

RE: HB 1620 RELATING TO PASS-THROUGH ENTITY TAXATION

Date: Friday, February 7, 2024
Time: 10:30 a.m.
VIA VIDEOCONFERENCE
Conference Room 423
State Capitol
415 South Beretania Street

February 6, 2023

From: Roy Tjioe and Ricardo Galindez
Island Film Group
99-1245 Halawa Valley St.
Aiea, HI 96701
808-536-7955

Aloha Chair Holt, Vice Chair Lamosao, and Members of the Committee:

Our Background

Island Film Group is a locally owned and operated production company. We began working in Hawaii's film and television industry in 2001 as attorneys at Goodsill Anderson Quinn & Stifel, where we represented filmmakers and other production companies. Since our formation of Island Film Group in 2007, we have been working full-time as producers of feature films such as "Princess Ka`iulani" and "Soul Surfer", network and cable television movies and series, as well as a variety of commercial productions.

We SUPPORT HB 1620, which reduces the pass-through entity level tax rate and allows the nonrefundable tax credit to be carried forward to subsequent years.

Me ke aloha,

Roy Tjioe and Ricardo Galindez
Co-Founders
Island Film Group
Honolulu, Hawaii

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LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME TAX, Technical Changes to Pass-through Entity Election

BILL NUMBER: HB 1620

INTRODUCED BY: KITAGAWA

EXECUTIVE SUMMARY: Reduces the pass-through entity level tax rate and allows the nonrefundable tax credit to be carried forward to subsequent years.

SYNOPSIS: Amends section 235-51.5, HRS, to provide that a pass-through entity electing to pay tax on behalf of its individual owners or partners pays at a rate of 9%, not 11%, that the department may designate taxpayers that shall not be included in the sum (namely, owners that aren't counted) and that the credit on the owner's or partner's return that results from the payment is nonrefundable but may be carried forward until exhausted.

EFFECTIVE DATE: Upon approval, applicable to taxable years beginning after December 31, 2023.

STAFF COMMENTS: The pass-through entity election provided by section 235-51.5, HRS, allows a pass-through entity to elect to pay tax on behalf of its owners or partners. This is because federal law currently allows individuals to deduct no more than $10,000 of state or local taxes, but taxes paid by the pass-through do not count toward this limit.

Current law makes an electing pass-through entity pay tax at 11%, the maximum individual rate.

Most individuals don't pay that much, however, because the 11% rate kicks in at $200K single and $400K joint.

Under current law, the pass-through pays the 11% tax on behalf of a particular partner or owner. That owner then gets credit for the tax paid. But if the owner doesn't owe that much tax, tough luck! The excess credit can't be refunded and doesn't carry forward. The State just keeps it.

In that respect, the current law heavily favors wealthy taxpayers with plenty of income from sources other than the pass-through. For those taxpayers, any excess credit can be used to offset the tax that otherwise would be owed on the other income, giving them an effective tax rate far lower than the 11%. Taxpayers of more modest means with the pass-through as their only income source, however, are effectively taxed at 11%, what the pass-through paid on the taxpayers' behalf, even if their net income would not be anywhere near the 11% bracket.

These inequities, perhaps unintended by last year's Legislature, are what this bill is trying to fix.

Digested: 2/5/2024

GRASSROOT
INSTITUTE OF HAWAII

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Removing barriers to Hawaii's prosperity

Feb. 7, 2024 , 10:30 a.m.
Hawaii State Capitol
Conference Room 225 and Videoconference

To: House Committee on Consumer Protection and Commerce
Rep. Mark Nakashima, Chair
Rep. Jackson Sayama, Vice-Chair

From: Grassroot Institute of Hawaii
Ted Kefalas, Director of Strategic Campaigns

RE: COMMENTS IN SUPPORT OF HB1620 — RELATING TO PASS-THROUGH ENTITY TAXATION

Aloha Chair Nakashima, Vice-Chair Sayama and members of the Committee,

Thank you for considering HB1620, which would lower the tax rate applied to pass-through entities that opt to be taxed at the entity level under Act 50, SLH 2023, and would allow the credit under that law to be applied to multiple tax years.

Act 50, SLH 2023 allowed the owners of partnerships, S corps and other pass-through entities to pay income tax at the entity level instead of the personal level. By making this change, the 2023 law let the owners deduct their state income taxes from their taxable income for federal income tax purposes.[1]

However, as the findings in this bill note, small business owners who want to use this mechanism must pay tax at the highest individual income tax rate — currently 11%. This rate applies to single filers making $200,000 or more and joint filers making $400,000 or more.

The business owner gets a tax credit on their individual income tax equal to the amount the pass-through entity paid in taxes, but the credit is nonrefundable and cannot be applied to future tax years.

Because many small business owners electing to pay tax at the entity level might not owe a lot in individual income taxes, this can result in them not receiving the full value of the pass-through-entity mechanism.

[1] "Final Guidance for the 2023 Tax Year: Hawaii Pass-Through Entity Tax," Accuity, Nov. 3, 2023.

Section 1 of the bill notes that "the high tax rate and inability to carry the credit forward made it difficult for many small businesses to benefit from Act 50 as originally intended."

For example, if Owner A had $100,000 in taxable income from his S Corp and elected to pay tax at the entity level, the S Corp would owe the state of Hawaii $11,000 — 11% of $100,000. If Owner A also had $40,000 in taxable income from another source, he would pay $2,317 — an effective rate of 5.79%.[2] He would then receive a credit of $2,317. The difference between the $11,000 and the $2,317 would not be refunded to Owner A.

On the other hand, if Owner B had $100,000 in taxable income to be paid by her partnership and worked a corporate job making $150,000 in taxable income, she would receive the full value of her credit. The partnership would pay $11,000 — generating a $11,000 credit — and she would pay $11,353 in individual income taxes. The credit would lower her individual income taxes to $353.

HB1803 would fix this problem for small businesses by lowering the tax rate to 9% and allowing the credit to be applied to multiple tax years.

Thank you for the opportunity to testify.

Ted Kefalas
Director of Strategic Campaigns
Grassroot Institute of Hawaii

[2] "Hawaii Income Tax Calculator," SmartAsset, accessed Jan. 27, 2024. Calculated as a single-filer with one personal exemption.

Testimony to the House Committee on Economic Development
Wednesday, February 7, 2024, at 10:30AM
Conference Room 423

RE: HB1620 Relating to Pass-through Entity Taxation

Chair Holt, Vice Chair Lamosao, and Members of the Committee:

The Chamber of Commerce Hawaii Supports ("The Chamber") **supports HB1620**, which reduces the pass-through entity level tax rate and allows the nonrefundable tax credit to be carried forward to subsequent years.

The Chamber supports this bill it makes necessary amendments to the law to ensure small businesses can benefit from Act 50 as originally intended. The bill would provide significant benefits to Hawaii's small businesses by expanding the pool of those eligible to receive the tax credit on their federal income tax returns and allow the tax credit to be carried forward to subsequent years, benefitting Hawaii's small businesses in particular.

The Chamber is Hawaii's leading statewide business advocacy organization, representing about 2,000+ businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

On behalf of The Chamber, thank you for this opportunity to testify.

HB-1620
Submitted on: 2/4/2024 9:55:54 PM
Testimony for ECD on 2/7/2024 10:30:00 AM

Submitted By	Organization	Testifier Position	Testify
Darryl Nitta	Individual	Support	Written Testimony Only

Comments:

This bill is much better than the previous. A lot more people in Hawaii will benefit from the carryover aspect. Thank you.