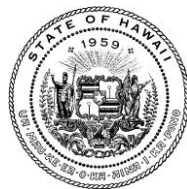


JOSH GREEN M.D.
GOVERNOR

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
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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. 1803, H.D. 1, Relating to Pass-Through Entity Taxation.

BEFORE THE:

Senate Committee on Commerce and Consumer Protection

DATE: Thursday, March 14, 2024

TIME: 9:30 a.m.

LOCATION: State Capitol, Room 229

Chair Keohokalole, Vice-Chair Fukunaga, and Members of the Committee:

The Department of Taxation ("Department") offers the following comments regarding H.B. 1803, H.D. 1, for your consideration.

H.B. 1803, H.D. 1, 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 Hawai'i 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 Hawai'i 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 has a defective effective date of December 31, 3000 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 notes that if this Committee wishes to insert a functional effective date and advance this measure, the Department would be able to administer H.B. 1803, H.D. 1, if made effective upon approval for taxable years beginning after December 31, 2023.

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

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME TAX, Lowers Passthrough Rate for Pass-through Entity Election

BILL NUMBER: HB 1803 HD 1

INTRODUCED BY: House Committee on Finance

EXECUTIVE SUMMARY: Reduces the pass-through entity level tax rate to 9% and allows the 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%, 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, 3000.

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: 2/20/2024



**TESTIMONY OF TINA YAMAKI, PRESIDENT
RETAIL MERCHANTS OF HAWAII
MARCH 13, 2023**

Re: HB 1803 HD1 RELATING TO PASS-THROUGH ENTITY TAXATION.

Good morning, Chair Keohokalole and members of the Senate Committee on Commerce & Consumer Protection. I am Tina Yamaki, President of the Retail Merchants of Hawaii and I appreciate this opportunity to testify.

The Retail Merchants of Hawaii was founded in 1901 and is a statewide, not for profit trade organization committed to supporting the growth and development of the retail industry in Hawaii. Our membership includes small mom & pop stores, large box stores, resellers, luxury retail, department stores, shopping malls, on-line sellers, local, national, and international retailers, chains, and everyone in between.

We support HB 1803 HD1. This measure reduces the pass-through entity level tax rate and allows the tax credit to be carried forward to subsequent years; is effective 12/31/3000; and applies to taxable years beginning after 12/31/2023.

This measure amends Act 50 that was intended to help Hawaii's small businesses by allowing taxpayers to deduct Hawaii state income taxes paid on their federal income tax returns. However as currently written, Act 50 unintentionally hurt many small businesses as they are NOT able to benefit from the tax credit.

HB1803 HD1 corrects this oversight by aligning the intent of Act 50 by reducing the pass –through entity rate and allows any unused credit to be carried forward to future years.

This is a positive step to ensure and support our local retail businesses.

We urge you to pass this bill.

Mahalo again for this opportunity to testify.



Ave Kwok, Chairman - Jade Dynasty

Andy Huang, Incoming Chair - L&L Hawaiian Barbeque **Tambara Garrick, Secretary** – Hawaii Farm Project

Kahili Soon, Treasurer – Hukilau Marketplace

Ryan Tanaka, Past Chairman – Giovanni Pastrami

Sheryl Matsuoka, Executive Director **Ginny Wright**, Operations Associate **Holly Kessler**, Director of Membership Relations

2023-24

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Date: March 9, 2024

To Sen. Jarrett Keohokalole, Chair
Sen. Carol Fukunaga, Vice Chair
Committee on Commerce and Consumer Protection

From: Victor Lim, Legislative Lead

Subj: HB 1803, HD1 Relating to Pass-thru Entity Taxation

The Hawaii Restaurant Association, representing 4,000 Eating and Drinking Place locations in Hawaii, supports HB 1803, HD1 which amends Act 50 to accommodate the reduction of the pass-through entity level tax rate and allows the tax credit to be carried forward, and better serve the small business community.

Thank you very much for allowing us to share our industry's view.



March 14, 2024, 9:30 a.m.

Hawaii State Capitol

Conference Room 229 and Videoconference

To: Senate Committee on Commerce and Consumer Protection

Sen. Jarrett Keohokalole, Chair

Sen. Carol Fukunaga, Vice-Chair

From: Grassroot Institute of Hawaii

Ted Kefalas, Director of Strategic Campaigns

RE: TESTIMONY IN SUPPORT OF HB1803 HD1 — RELATING TO PASS-THROUGH ENTITY TAXATION

Aloha Chair Keohokalole, Vice-Chair Fukunaga and members of the Committee,

The Grassroot Institute would like to offer its **comments in support** of [HB1803 HD1](#), 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. This technical change lets 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.

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

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. 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.

HB-1803-HD-1

Submitted on: 3/11/2024 2:46:37 PM

Testimony for CPN on 3/14/2024 9:30:00 AM

Submitted By	Organization	Testifier Position	Testify
Jason Higa	Testifying for Zippy's Restaurants	Support	Written Testimony Only

Comments:

To Sen. Jarrett Keohokalole, Chair
Sen. Carol Fukunaga, Vice Chair
Committee on Commerce and Consumer Protection

Subj: HB 1803, HD1 Relating to Pass-thru Entity Taxation

Zippy's Restaurants fully supports this legislation which will benefit not just individual Hawaii entities, but the entire State of Hawaii, by keeping millions of dollars in Hawaii without costing the state any tax revenue. The State of Hawaii will benefit from the millions of dollars which will continue to circulate in Hawaii's economy for years to come.

Thank you for your consideration,

Jason Higa

CEO, Zippy's Restaurants

HB-1803-HD-1

Submitted on: 3/10/2024 11:33:18 AM

Testimony for CPN on 3/14/2024 9:30:00 AM

Submitted By	Organization	Testifier Position	Testify
Ryan Churchill	Testifying for Pacific Rim Land, Inc.	Support	Written Testimony Only

Comments:

Aloha Chair Keohokalole, Vice Chair Fukunaga and Members of the Committee:

Pacific Rim Land Supports HB 1803, HD1 which amends Act 50 to accommodate the reduction of the pass-through entity level tax rate and allows the tax credit to be carried forward. This modification will help Hawaii small businesses take advantage of Act 50 and allow the Administration to more effectively administer this bill. Mahalo for your support.



Date: March 14, 2024

To: Chair Jarrett Keohokalole
Vice Chair Carol Fukunaga, and
Members of the Senate Committee on Commerce and Consumer Protection

From: Cory Kubota, Managing Partner
Accuity LLP

Re: H.B. 1803, H.D. 1 - 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.

Notwithstanding the defective effective date, this measure applies 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 strongly 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 support of this measure.

999 Bishop Street
Suite 2300
Honolulu, HI 96813

OFFICE 808.531.3400
FAX 808.531.3433
accuityllp.com



Chamber of Commerce HAWAII

The Voice of Business

Testimony to the Senate Committee on Commerce and Consumer Protection

Thursday, March 14, 2024, at 9:30AM

Conference Room 229 & Videoconference

RE: HB 1803 HD1 Relating to Pass-Through Entity Taxation

LATE

Aloha Chair Keohokalole, Vice Chair Fukunaga, and Members of the Committee:

The Chamber of Commerce Hawaii Supports (“The Chamber”) **supports HB1803 HD1**, which amends Act 50 to accommodate the reduction of the pass-through entity level tax rate and allows the tax credit to be carried forward to subsequent years and better serve the state’s small business community.

The Chamber supports this bill as 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.

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-1803-HD-1

Submitted on: 3/13/2024 7:07:00 AM

Testimony for CPN on 3/14/2024 9:30:00 AM

Submitted By	Organization	Testifier Position	Testify
Glen Kagamida	Individual	Support	Written Testimony Only

Comments:

SUPPORT.

MAHALO!