

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

BEFORE THE:

House Committee on Finance

DATE: Thursday, February 22, 2024

TIME: 10:00 a.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. 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.



Date: February 22, 2024

To: Chair Kyle T. Yamashita
Vice Chair Lisa Kitagawa, and
Members of the House Committee on Finance

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 strong support of this measure.

999 Bishop Street
Suite 2300
Honolulu, HI 96813

OFFICE 808.531.3400
FAX 808.531.3433
accuityllp.com



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

Board of Directors

Jesse Aguinaldo
Keoni Ahlo
Lee Anderson
Noa Aoki
Javier Barberi
Tim Januszewski
Tom Jones
Felix Koeppenkastrop
Victor Lim
Keith Mallini
Don Murphy
Conan Paik-Rosa
Mike Palmer
Tyler Roukema
Michael Skededeski
Alison "Bo" Tanaka
Katy Tanaka
Tina Wang
Nicolas Ware
Anthony Wong
Nicholas Wong
Paul Yokota

Allied Members

Louis Chun
Robert Gutierrez
James Idemoto
Christopher Lee
Raymond Orozco
Bryan Pearl
Randy Sagon
David Yoshioka

Advisory Board

Jerry Agrusa
Jamie Brown
Richard Rand
John Richards
Richard Turbin

Date: February 20, 2024

To Rep. Kyle T. Yamashita, Chair
Rep. Lisa Kitagawa, Vice Chair

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.



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 Consumer Protection & Commerce

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

Feb. 22, 2024, 10 a.m.
Hawaii State Capitol
Conference Room 308 and Videoconference

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

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.

21 February 2024

Aloha Members of the Committee,

I am writing to express my full support for Hawaii HB1803, which addresses the taxation of pass-through entities in our state. This bill is crucial for ensuring fairness and alignment with national standards while also fostering a supportive environment for local business owners.

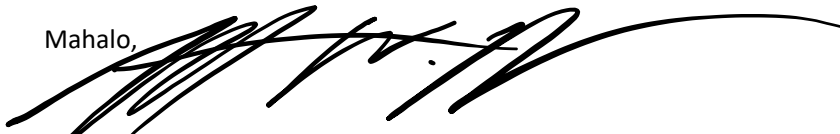
HB1803 is designed to bring Hawaii in line with the rest of the country regarding pass-through entity taxation. By adopting consistent practices, we can eliminate confusion and create a more level playing field for businesses operating both locally and nationally. This alignment will not only simplify compliance for businesses but also enhance our state's reputation as a place conducive to entrepreneurship and investment.

Furthermore, it's important to note that HB1803 will have zero impact on state revenues. This ensures that our tax system remains balanced and sustainable while still providing the necessary support for local businesses to thrive. By not burdening businesses with additional taxes, we encourage growth, job creation, and economic prosperity across Hawaii.

In conclusion, Hawaii HB1803 is a common-sense measure that promotes fairness, simplicity, and economic growth. I urge you to support this bill for the benefit of our state's businesses and economy.

Please vote to pass this bill.

Mahalo,



Garrett W. Marrero, CEO
Garrett@craftohana.com



Chamber of Commerce HAWAII

The Voice of Business

**Testimony to the House Committee on Finance
Thursday, February 22, 2024, at 10AM
Conference Room 308**

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

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

The Chamber of Commerce Hawaii Supports (“The Chamber”) **supports HB1803**, 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: 2/20/2024 11:41:23 AM

Testimony for FIN on 2/22/2024 10:00:00 AM

Submitted By	Organization	Testifier Position	Testify
James E. Coon	Individual	Support	Written Testimony Only

Comments:

Chair Yamashita, Vice Chair Kitagawa, Members of the House Committee on Finance:

My name is James Coon and I STRONGLY SUPPORT HB1660. This bill would help most small businesses across the State with the positive consequence of reducing the tax bill for many families without any loss of revenue to the State. Similar pass-through measures have been adopted by many other states across America. There is no downside and much positive upside to this commonsense measure. Please pass this bill as written to help reduce our already heavy tax burden.

Aloha

James E. Coon,

HB-1803-HD-1

Submitted on: 2/20/2024 3:35:33 PM

Testimony for FIN on 2/22/2024 10:00:00 AM

Submitted By	Organization	Testifier Position	Testify
Darryl Nitta	C&Y CPAs LLC	Support	Written Testimony Only

Comments:

In full support. As a tax practitioner this amended Hawaii PTE bill will positively help the people of Hawaii as initially intended.

HB-1803-HD-1

Submitted on: 2/20/2024 4:15:48 PM

Testimony for FIN on 2/22/2024 10:00:00 AM

Submitted By	Organization	Testifier Position	Testify
Tim Moore	Individual	Support	Written Testimony Only

Comments:

Mahalo for your leadership. I ask for your support of this bill HB1803. As a business that has been effected by the Lahaina wildfire. We are barely hanging on financially. We will survive and again be strong. This bill helps us regain financial stability. Please consider supporting this bill! Mahalo

HB-1803-HD-1

Submitted on: 2/21/2024 9:35:25 PM

Testimony for FIN on 2/22/2024 10:00:00 AM

Submitted By	Organization	Testifier Position	Testify
Nicholas Zehr	Individual	Support	Written Testimony Only

Comments:

I support HB1803. Many small businesses were not previously able to benefit due to a high tax rate and the inability to carry the credit forward. Your vote in support of this supports small businesses in Hawaii.