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STATE OF HAWAII  
DEPARTMENT OF TAXATION

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GARY S. SUGANUMA  
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DEPUTY DIRECTOR

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

**TESTIMONY ON THE FOLLOWING MEASURE:**

S.B. No. 2725, Relating to Pass-Through Entity Taxation.

**BEFORE THE:**

House Committee on Finance

**DATE:** Wednesday, April 3, 2024

**TIME:** 2:15 p.m.

**LOCATION:** State Capitol, Room 308

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

The Department of Taxation ("Department") supports S.B. 2725 and offers the following comments for your consideration.

S.B. 2725 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. The bill 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 imposing the tax on the sum of the distributive shares and guaranteed payments of all "qualified member[s]." The term "qualified member" is defined as a member of an electing pass-through entity that is an individual, trust, or estate. The bill also allows the PTE credit to be carried forward. The bill is effective upon approval and applies to taxable years beginning after December 31, 2023.

As explained above, under current law, 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 limit the tax base and corresponding credit to the distributive shares and guaranteed payments of members that are individuals, trusts, or estates 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: April 3, 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: **SUPPORT** - S.B. 2725 - Relating to Pass-Through Entity Taxation

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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:

- Limiting PTE participation to “qualified members” who are individuals, trusts, and estates; 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 cap 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.

In addition, the Committee may consider reducing the rate of PTE taxation. At the 11% rate, many taxpayers will be required to overpay their taxes as the 11% rate applies only to taxable income that *exceeds* \$200,000 for single and \$400,000 for joint filers.

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 support of this measure.

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Date: April 1, 2024

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

From: Victor Lim, Legislative Lead

Subj: SB 2725 Relating to Pass-thru Entity Taxation

The Hawaii Restaurant Association representing 4,000 Eating and Drinking Place locations in Hawaii supports HB 2725.

This 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.





Chamber of Commerce HAWAII  
*The Voice of Business*

**Testimony to the House Committee on Finance  
Wednesday, April 3, 2024, at 2:15PM  
Conference Room 308 & Video Conference**

**RE: SB2725 Relating to Pass-Through Entity Taxation**

**supports SB2725**

April 3, 2024, 2:15 p.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: Ted Kefalas, Director of Strategic Campaigns**  
**Grassroot Institute of Hawaii**

RE: SUPPORTING SB2725 — RELATING TO PASS-THROUGH ENTITY TAXATION

Aloha Chair Yamashita, Vice-Chair Kitagawa and other Committee members,

The Grassroot Institute of Hawaii would like to offer its **support** for the portions of [SB2725](#) that would allow the credit created by Act 50, SLH 2023 to be applied to multiple tax years.

Act 50, SLH 2023 allowed the owners of partnerships, S corporations 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.<sup>1</sup>

However, 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.

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

For example, if Owner A had \$100,000 in taxable income from his S corporation and elected to pay tax at the entity level, the S corporation would owe the state \$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%.<sup>2</sup> 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.

This bill would help fix this issue by allowing the credit to apply to multiple years.

We would also ask the committee to consider lowering the tax rate to 9%, as proposed by HB1620 and HB1803. A lower tax rate would make this tax program more attractive to smaller companies.

Thank you for the opportunity to testify.

Ted Kefalas  
Director of Strategic Campaigns  
Grassroot Institute of Hawaii

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<sup>2</sup> ["Hawaii Income Tax Calculator,"](#) SmartAsset, accessed Jan. 27, 2024. Calculated as a single-filer with one personal exemption.

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

**SUBJECT: INCOME TAX; Allow Credit to Electing Pass-Through Entity Owners to Carry Forward**

**BILL NUMBER: SB 2725**

**INTRODUCED BY: SB by MORIWAKI, FEVELLA, HASHIMOTO, MCKELVEY, Kidani**

**EXECUTIVE SUMMARY:** For taxable years beginning after 12/31/2023, adds a definition for "qualified member" and repeals the definitions for "direct member" and "indirect member" as used in the State's pass-through entity taxation election law. For pass-through entities electing to pay Hawai'i income taxes at the entity level, allows certain qualified members entitled to a tax credit to use the credit against the member's net income tax liability in subsequent years until exhausted.

**SYNOPSIS:** Amends section 235-51.5, HRS, to provide that an electing pass-through entity can elect to pay tax on behalf of its qualified members, which are defined to be individuals, trusts, or estates. Provides that the credit to its qualified members that are so generated may be carried forward until exhausted.

Makes conforming amendments.

**EFFECTIVE DATE:** Upon approval, shall apply 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.



Re: SB 2725

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This bill clarifies that the pass-through entity election only works on behalf of individual, trust, and estate members or partners. But it does not change the 11% rate at which the tax is calculated, which is a big problem because most individuals' effective tax rates are lower, and because estates and trusts are taxed at a maximum rate of 8.25%, per section 235-51(d), HRS.

Digested: 2/25/2024



**TESTIMONY OF TINA YAMAKI, PRESIDENT  
RETAIL MERCHANTS OF HAWAII  
MARCH 13, 2023  
Re: SB 2725 RELATING TO PASS-THROUGH ENTITY TAXATION.**

Good afternoon, Chair Yamashita and members of the House Committee on Finance. 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 SB 2725. This measure for taxable years beginning after 12/31/2023, adds a definition for "qualified member" and repeals the definitions for "direct member" and "indirect member" as used in the State's pass-through entity taxation election law; for pass-through entities electing to pay Hawai'i income taxes at the entity level, allows certain qualified members entitled to a tax credit to use the credit against the member's net income tax liability in subsequent years until exhausted.

This amendment revises Act 50, originally aimed at aiding Hawaii's small businesses by enabling taxpayers to deduct Hawaii state income taxes paid on their federal returns. However, as it stands, Act 50 inadvertently harms numerous small businesses, rendering them ineligible for the tax credit.

SB 2725 addresses this oversight by realigning Act 50's purpose, reducing the pass-through entity rate, and permitting the carryover of unused credits to subsequent years.

This initiative marks a favorable stride in safeguarding and bolstering our local retail enterprises.

We urge you to pass this bill.

Mahalo again for this opportunity to testify.