

ACT 50

S.B. NO. 1437

A Bill for an Act Relating to Pass-Through Entity Taxation.

Be It Enacted by the Legislature of the State of Hawaii:

SECTION 1. The purpose of this Act is to establish a state tax law to permit certain entities to elect to pay Hawaii income tax at the entity level. This Act will help Hawaii's small businesses by allowing taxpayers to deduct Hawaii state income taxes paid on their federal income tax returns. These deductions from federal taxable income were eliminated through changes to the federal tax code in 2017, which deprived Hawaii taxpayers of significant federal tax benefits. This Act will bring Hawaii into conformity with the majority of other

states that already permit similar elections by so-called “pass-through entities” to pay state income taxes.

SECTION 2. Chapter 235, Hawaii Revised Statutes, is amended by adding a new section to part III to be appropriately designated and to read as follows:

“§235- Pass-through entity taxation election. (a) A partnership or S corporation may elect to be taxed pursuant to this section as an electing pass-through entity in any tax year; provided that a separate election shall be made for each taxable year. An election made pursuant to this subsection shall be filed in the form and manner prescribed by the director of taxation and signed by:

- (1) Each member of the entity who is a member at the time the election is filed; or
- (2) Any officer, manager, or member of the entity who is authorized to make the election and who attests to having such authorization under penalty of perjury;

provided that once the election is made, it shall be irrevocable for that taxable year and shall be binding on all partners, shareholders, and members of the electing pass-through entity.

(b) Notwithstanding any provision of law to the contrary, the following tax is imposed on each electing pass-through entity: the sum of all member’s distributive shares and guaranteed payments of Hawaii taxable income as calculated under this chapter, multiplied by the highest rate of tax applicable to the individual under section 235-51; provided that the distributive shares and guaranteed payments of members who are corporations shall not be included in the sum and shall not be subject to the tax under this section. If the income calculated pursuant to this subsection reflects a net loss for the electing pass-through entity, the net loss may be carried forward to subsequent tax years for as long as the electing pass-through entity elects to be subject to the tax pursuant to this section until exhausted.

(c) A nonresident individual who is a member of an electing pass-through entity shall not be required to file an income tax return pursuant to this chapter for a tax year if the member’s only source of Hawaii income is from electing pass-through entities and the electing pass-through entity or entities file and pay the tax due under this section.

(d) Each electing pass-through entity shall report to each of its members, for each tax year, the member’s pro rata share of the tax imposed pursuant to this section.

(e) Each member of an electing pass-through entity whose distributive share or guaranteed payment of Hawaii taxable income is subject to tax under this section shall be entitled to a credit equal to the member’s share of the tax paid pursuant to this section. 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. Any member claiming a credit shall not be entitled to deduct from the member’s Hawaii state taxable income those amounts of Hawaii state income taxes paid by the member on the member’s distributive share or guaranteed payment of income from the electing pass-through entity.

(f) Each member that is subject to the tax imposed by this chapter as a resident or part-year resident of the State shall be entitled to a credit for the direct member’s or indirect member’s pro rata share of taxes paid to another state or to the District of Columbia, on income of any partnership or S corporation of which the person is a member; provided that the taxes paid to another state

or to the District of Columbia result from a tax that the director of taxation determines is substantially similar to the tax imposed pursuant to this section. Any credit shall be calculated in a form and manner prescribed by the director of taxation; provided that the calculation is consistent with the provisions of this section. If the amount of the credit authorized by this subsection exceeds the member's tax liability for the tax imposed pursuant to this chapter, the excess amount shall not be refundable and shall not carry forward.

(g) The department of taxation may establish rules, pursuant to chapter 91, to implement this section.

(h) For purposes of this section:

“Direct member” means a member that holds an interest directly in an electing pass-through entity.

“Electing pass-through entity” means any eligible partnership or S corporation that elects to be subject to tax pursuant to subsection (a).

“Indirect member” means a member that itself holds an interest, through a direct member or indirect member that is a partnership or S corporation, in an electing pass-through entity.

“Member” means:

- (1) A shareholder of an S corporation;
- (2) A partner in a general partnership, a limited partnership, or a limited liability partnership; or
- (3) A member of a limited liability company that is treated as a partnership or S corporation for federal income tax purposes.

“Partnership” means the same as in the Internal Revenue Code. “Partnership” includes a limited liability company that is treated as a partnership for federal income tax purposes but does not include any publicly traded partnership within the meaning of section 7704 of the Internal Revenue Code.

“S corporation” means a corporation for which a valid election under section 1362(a) of the Internal Revenue Code is in effect.”

SECTION 3. New statutory material is underscored.¹

SECTION 4. This Act shall take effect on January 1, 2024, and shall apply to taxable years beginning after December 31, 2022.

(Approved June 1, 2023.)

Note

1. Edited pursuant to HRS §23G-16.5.