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# A BILL FOR AN ACT

RELATING TO PASS-THROUGH ENTITY TAXATION.

**BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:**

1           SECTION 1. The legislature finds that pass-through  
2 entities, such as S corporations, partnerships, and limited  
3 liability companies, are a vital part of Hawaii's economy and  
4 comprise a significant portion of the State's business sector.  
5 These entities play a critical role in job creation, innovation,  
6 and economic growth, and are, in many cases, Hawaii's small  
7 businesses and startups.

8           The legislature further finds that Act 50, Session Laws of  
9 Hawaii 2023 (Act 50), allowed certain pass-through entities to  
10 elect to pay Hawaii income tax at the entity level. Act 50 was  
11 enacted to help Hawaii's small businesses by allowing taxpayers  
12 to deduct Hawaii state income taxes paid on their federal income  
13 tax returns. These deductions from federal taxable income had  
14 been eliminated by changes to the federal tax code in 2017,  
15 which deprived Hawaii taxpayers of significant federal tax  
16 benefits.

17           Under Act 50, the entity level tax is calculated by  
18 applying the highest individual income tax rate to the taxable



1 income to be distributed, entitling members to receive a  
2 nonrefundable income tax credit that cannot be carried forward  
3 to a subsequent year if the credit exceeds the member's income  
4 tax liability. The legislature finds that, due to the inability  
5 to carryforward the tax credit, many pass-through entity members  
6 remain unable to benefit from Act 50 as intended.

7 Accordingly, the purpose of this Act is to, for taxable  
8 years beginning after December 31, 2023:

- 9 (1) Add a definition for "qualified member" and repeal the  
10 definitions for "direct member" and "indirect member"  
11 as used in the State's pass-through entity taxation  
12 election law;
- 13 (2) Amend the pass-through entity level tax rate to be the  
14 sum of all qualified member's distributive shares and  
15 guaranteed payments of Hawaii taxable income, as  
16 calculated under chapter 235, Hawaii Revised Statutes,  
17 multiplied by nine per cent; and
- 18 (3) Allow certain qualified members entitled to a tax  
19 credit to use the credit against the member's net  
20 income tax liability in subsequent years until  
21 exhausted.



1 SECTION 2. Section 235-51.5, Hawaii Revised Statutes, is  
2 amended as follows:

3 1. By amending subsections (b) through (f) to read:

4 "(b) Notwithstanding any provision of law to the contrary,  
5 the following tax is imposed on each electing pass-through  
6 entity: the sum of all qualified member's distributive shares  
7 and guaranteed payments of Hawaii taxable income as calculated  
8 under this chapter, multiplied by [~~the highest rate of tax~~  
9 ~~applicable to the individual under section 235-51; provided that~~  
10 ~~the distributive shares and guaranteed payments of members who~~  
11 ~~are corporations shall not be included in the sum and shall not~~  
12 ~~be subject to the tax under this section.] nine per cent. If  
13 the income calculated pursuant to this subsection reflects a net  
14 loss for the electing pass-through entity, the net loss may be  
15 carried forward to subsequent tax years for as long as the  
16 electing pass-through entity elects to be subject to the tax  
17 pursuant to this section until exhausted.~~

18 (c) A nonresident individual who is a qualified member of  
19 an electing pass-through entity shall not be required to file an  
20 income tax return pursuant to this chapter for a tax year if the  
21 member's only source of Hawaii income is from electing



1 pass-through entities and the electing pass-through entity or  
2 entities file and pay the tax due under this section.

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

6 (e) Each qualified member of an electing pass-through  
7 entity whose distributive share or guaranteed payment of Hawaii  
8 taxable income is subject to tax under this section shall be  
9 entitled to a credit equal to the qualified member's share of  
10 the tax paid pursuant to this section. If the amount of the  
11 credit authorized by this subsection exceeds the qualified  
12 member's tax liability imposed pursuant to this chapter, the  
13 excess [~~amount shall not be refundable to the member.~~] of the  
14 credit over liability may be used as a credit against the  
15 member's net income tax liability in subsequent years until  
16 exhausted. Any qualified member claiming a credit shall not be  
17 entitled to deduct from the member's Hawaii state taxable income  
18 those amounts of Hawaii state income taxes paid by the member on  
19 the qualified member's distributive share or guaranteed payment  
20 of income from the electing pass-through entity.



1 (f) Each qualified member that is subject to the tax  
2 imposed by this chapter as a resident or part-year resident of  
3 the State shall be entitled to a credit for the [~~direct~~  
4 qualified member's [~~or indirect member's~~] pro rata share of  
5 taxes paid to another state or to the District of Columbia, on  
6 income of any partnership or S corporation of which the person  
7 is a member; provided that the taxes paid to another state or to  
8 the District of Columbia result from a tax that the director of  
9 taxation determines is substantially similar to the tax imposed  
10 pursuant to this section. Any credit shall be calculated in a  
11 form and manner prescribed by the director of taxation; provided  
12 that the calculation is consistent with the provisions of this  
13 section. If the amount of the credit authorized by this  
14 subsection exceeds the qualified member's tax liability for the  
15 tax imposed pursuant to this chapter, the excess amount shall  
16 not be refundable and shall not carry forward."

17 2. By amending subsection (h) to read:

18 "(h) For purposes of this section:

19 [~~"Direct member" means a member that holds an interest~~  
20 ~~directly in an electing pass through entity.~~]



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

4 [~~"Indirect member" means a member that itself holds an~~  
5 ~~interest, through a direct member or indirect member that is a~~  
6 ~~partnership or S corporation, in an electing pass-through~~  
7 ~~entity.]~~

8 "Member" means:

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

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

20 "Qualified member" means a member of an electing  
21 pass-through entity that is an individual, trust, or estate.



1 "S corporation" means a corporation for which a valid  
2 election under section 1362(a) of the Internal Revenue Code is  
3 in effect."

4 SECTION 3. Statutory material to be repealed is bracketed  
5 and stricken. New statutory material is underscored.

6 SECTION 4. This Act, upon its approval, shall apply to  
7 taxable years beginning after December 31, 2023.



**Report Title:**

Taxation; Pass-Through Entities; S Corporations; Partnerships;  
Qualified Members

**Description:**

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. Amends the pass-through entity level tax rate to be the sum of all qualified member's distributive shares and guaranteed payments of Hawaii taxable income, as calculated under chapter 235, HRS, multiplied by 9%. For pass-through entities electing to pay Hawaii 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. (CD1)

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