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To: The Honorable Marcus R. Oshiro, Chair
and Members of the House Committee on Finance

Date: Wednesday, February 15, 2012
Time: 2:00 p.m.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. 2328 Relating to the Taxation

The Department of Taxation (Department) supports this measure, as it will make it much easier for the Department to administer the estate tax chapter.

H.B. 2328 proposes to replace the current estate and generation skipping tax chapter with a completely rewritten chapter to correct the existing law. The Department supports this rewrite of the estate tax, which specifically sets forth the tax rate schedule, provides the necessary powers to the Department to enforce the tax, as well as providing the necessary protections for taxpayers. By tying the calculation of taxable estate to the federal return, the burden on taxpayers is lessened. In addition, this measure adds back the generation skipping tax in Hawaii, which has been dormant since 2005.

Act 60, Session Laws of Hawaii 2010 reenacted Hawaii's Estate & Transfer Tax under Chapter 236D, Hawaii Revised Statutes (HRS). It did so, however, by adopting certain conforming provisions of the Internal Revenue Code (IRC), Title 26, Subtitle B, Estate & Gift Tax, involving two separate points in time. While Act 60 attempted to create a stand-alone tax that is independent of the federal estate tax, among other things, it did not include the necessary powers for the Department to enforce the tax.

Prior to Act 60, Chapter 236D, HRS, included both an estate tax assessed against the taxable estate of persons dying as residents of Hawaii or as nonresidents with property interests in Hawaii and a generation-skipping transfer tax, which taxes certain transfers on the death of residents and nonresidents which skip at least one generation of the decedent to avoid paying estate taxes.

Prior law assessed an estate tax and a generation-skipping transfer tax in amounts equal to the federal credits for state taxes paid under Sections 2011 and 2604, IRC, respectively. This "pick-up" amount effectively reduced the amount of federal estate tax due. However, the federal Economic Growth & Tax Relief Reconciliation Act of 2001 (EGTRRA) phased out the credit for state estate taxes paid such that Hawaii's Estate & Transfer Tax became "dormant" beginning in

2005 when the federal credit for state taxes was completely eliminated. While EGTRRA originally provided that the federal estate and generation-skipping tax would be reenacted beginning on January 1, 2011 in a form similar to the law prior to the passage of EGTRRA, Congress has delayed such reenactment to at least until the end of 2013.
Because Hawaii's estate tax was based on an amount computed on a federal tax return, it was not necessary and the Department was not given powers to audit and adjust the estate tax report that was filed by a decedent. In addition, Chapter 236D contains no statute of limitations for refunds or adjustments.

While Act 60 provided for an applicable exclusion amount of $3.5 million, because of the interaction of the IRC as adopted by Act 60, the Hawaii estate tax currently does not become due until the estate exceeds $3.6 million. In addition, Act 60 adopted the tax rate schedule but not the method that was used in calculating the federal state tax credit, which has created confusion among practitioners.

Because Act 60 uses the IRC as of different points in time, the complexity to taxpayers has increased. The adoption of a fixed applicable exclusion amount of $3.5 million causes some taxpayers who are not required to file a federal estate tax return being required to file a Hawaii estate tax return. This measure would conform the Hawaii exclusion amount to the federal exclusion amount, which currently stands at $5 million for decedents dying in 2011 and $5,120,000 in 2012, and which will be $1 million thereafter, unless Congress acts to change it.

Thank you for the opportunity to provide comments.

L E G I S L A T I V E

TAXBILLSERVICE

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SUBJECT: MISCELLANEOUS, Estate and generation-skipping transfer tax

BILL NUMBER: HB 2328

INTRODUCED BY: Choy

BRIEF SUMMARY: Adds a new chapter to HRS to establish an estate and generation-skipping transfer tax.

An exclusion from a Hawaii taxable estate shall be allowed to the estate of every decedent against the tax imposed by this chapter. The applicable exclusion amount shall be the same as the federal applicable exclusion amount, or the exemption equivalent of the unified credit, without reduction for taxable gifts, as set forth for the decedent in chapter 11 of the Internal Revenue Code (IRC); provided that: (1) for residents the exclusion amount shall be 100% of the applicable exclusion amount; (2) for nonresidents, the exclusion amount shall be computed by multiplying the applicable exclusion amount by a fraction, the numerator of which is the value of the property in the state subject to tax under this chapter, and the denominator of which is the federal gross estate; and (3) for nonresidents not citizens, the exclusion amount shall be computed by multiplying the exemption equivalent of the unified credit by a fraction, the numerator of which is the value of the property in the state subject to tax under this chapter, and the denominator of which is the federal gross estate.

For estates of decedents dying on or after January 1, 2012, a tax based on the Hawaii net taxable estate shall be imposed as follows:

If the taxable estate is:	The tax shall be:
Up to $1,000,000	0
Over $1,000,000 but not over $2,000,000	$100,000 plus 11% over $1,000,000
Over $2,000,000 but not over $3,000,000	$210,000 plus 12% over $2,000,000
Over $3,000,000 but not over $4,000,000	$330,000 plus 13% over $3,000,000
Over $4,000,000 but not over $5,000,000	$460,000 plus 14% over $4,000,000
Over $5,000,000	$600,000 plus 15.7% over $5,000,000

Defines "Hawaii net taxable estate" as Hawaii taxable estate less the applicable exclusion amount. Defines "Hawaii taxable estate" as: (1) for residents, the federal taxable estate under section 2051, et. seq., of the IRC but without regards for the deduction for state death taxes paid under section 2058 of the Internal Revenue Code; (2) for nonresidents, the federal taxable estate under section 2051, et. seq., of the IRC, but without regard for the deduction for state death taxes paid under section 2058 of the IRC, multiplied by a fraction, the numerator of which is the value of the property in the state subject to tax under this chapter, and the denominator of which is the federal gross estate; and (3) for nonresidents not citizens, the federal taxable estate determined under section 2106 of the IRC, but without regard for the deduction for state death taxes paid under section 2106(a)(4) of the IRC, multiplied by a fraction, the

numerator of which is the value of the property with a situs in the state subject to tax under this chapter, and the denominator of which is the federal gross estate.

If any property of a resident is subject to a death tax imposed by another state and if the tax imposed by the other state is not qualified by a reciprocal provision allowing the property to be taxed in the state of the decedent's domicile, the amount of the tax due under this section shall be credited with the lesser of: (1) the amount of the death tax actually paid the other state; or (2) an amount computed by multiplying the Hawaii estate tax by a fraction, the numerator of which is the value of the property subject to the death tax imposed by the other state, and the denominator of which is the total value of the decedent's gross estate. Further delineates provisions relating to the filing of a Hawaii transfer tax return including the payment of taxes due, penalty provisions, filing extensions, amended returns, final settlement of account and final determination.

A Hawaii generation-skipping transfer tax shall be imposed on every taxable transfer involving: (1) transferred property located in the state; and (2) transferred property from a resident trust. The tax shall be the applicable generation-skipping transfer tax rate multiplied by the taxable amount as determined under chapter 13 of the IRC, multiplied by a fraction, the numerator of which is the taxable transfer subject to the tax under this chapter and the denominator of which is the total amount of taxable transfers subject to the federal generation-skipping tax. Defines "applicable generation-skipping transfer tax rate" as 2.25% multiplied by the inclusion ratio with respect to any property transferred in a generation-skipping transfer as determined under section 2642 of the IRC. Requires the person required to report and pay the federal generation-skipping transfer tax to file with the department of taxation on or before the date the federal generation-skipping transfer tax return is filed. Delineates provisions for the determination of the generation-skipping transfer tax if the taxable transfer is subject to a generation-skipping tax of another state and if the tax imposed by the other state is not qualified by a reciprocal provision allowing the property to be taxed in this state.

Defines "decedent," "department," "federal estate tax," "federal generation-skipping transfer tax," "federal return," "federal taxable estate," "federal transfer tax," "generation-skipping transfer," "gross estate," "Hawaii estate tax," "Hawaii generation-skipping transfer tax," "Hawaii transfer tax," "nonresident," "nonresident trust," "person," "personal representative," "property," "qualified heir," "release," "resident," "resident trust," "situs," "state," "transfer," "taxable transfer" and "transferee" for purposes of the measure.

EFFECTIVE DATE: Taxable transfers that occur after December 31, 2011; decedents dying or taxable transfers occurring after December 31, 2011.

STAFF COMMENTS: With the adoption of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGGTRA), the federal estate tax was phased out and ultimately repealed over a ten-year period. Along with that repeal, the credit that is allowable under the federal law recognizing that an estate may have incurred state death taxes is phased out over a three-year period beginning in 2002. Hawaii, like many other states, had utilized this amount as its state death tax since 1983 and is known as the "pick up" tax as the state merely picks up what the federal table allows as state death taxes.

The pick up tax was created in 1924 when Congress provided a credit against the federal estate tax which had been created in 1916 in recognition of the estate having been required to pay death taxes to the state. This dollar-for-dollar credit against state taxes paid enables the state to "pick up" some of the

federal tax liability without increasing the total liability of the estate. Thus, when the state chose to eliminate its old inheritance tax in favor of the pick up tax in 1983, it eliminated any additional state tax liability for the estate and made its tax revenues from this source completely dependent on the federal law. One of the pluses to utilizing the pick up tax is that it eliminated any additional paperwork that a separate state death tax would involve.

This measure establishes an estate and generation-skipping transfer tax applicable to decedents dying or taxable transfers occurring after December 31, 2011. After the determination of the Hawaii net taxable estate, that is the amount of the Hawaii taxable estate less the federal applicable exclusion, an estate tax shall be due and payable for Hawaii net taxable estates from 10% to 15.7% for amounts of $1 million and over.

On January 1, 2010, the federal estate tax was officially repealed by EGGTRA, but on December 17, 2010, it was reinstated retroactively to January 1 by Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (PL 111-312). The federal estate tax is now 35% with a $5 million individual exemption for the 2010, 2011 and 2012 tax years. On January 1, 2013, the exemption and rates are scheduled to revert back to the numbers that were in effect in 2002 - a $1,000,000 exemption and 55% estate tax rate.

Locally, the 2010 legislature adopted Act 74 which recognized the federal state tax credit as it was operable before the phased-out repeal enacted by EGGTRA, but adopted an exclusion of $3.5 million for all estates. This law is in effect currently. This proposal does not address this fact as there is no provision for repeal of HRS Chapter 236D. Thus, this proposal would be a tax in addition to the pick up tax currently in effect. If the intent of this measure is to replace the current pick up tax, then the current law should be repealed.

Unlike the current law, this proposal would tie the exclusion amount to the exclusion amount granted under the federal death tax and establish a graduated tax scheme independent of the federal law. Under this proposal and given the current federal estate exclusion of $5 million, estate of less than $6 million would be exempt from paying the Hawaii estate tax. Given that this proposal still relies on the federal definitions of taxable estate property with an allocation of property should the estate have ownership in another state, the compliance problems should be minimal. Unlike the state inheritance tax that existed prior to the adoption of the pick up approach in 1983 which focused on the beneficiaries of the estate, this proposal tracks the federal law by focusing on the estate and not the beneficiaries.

Given that Hawaii currently has an estate tax in effect, the effective date of this proposal should be set prospectively as those dying after January 1, 2012 based their estate planning on the current law and not on this proposal should it be adopted.

Digested 2/13/12

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February 15, 2012

The Honorable Marcus R. Oshiro, Chair
House Committee on Finance
State Capitol, Room 308
Honolulu, Hawaii 96813

RE: H.B. 2328, Relating to Taxation

HEARING: Wednesday, February 15, 2012, at 2:00 p.m.

Aloha Chair Oshiro, Vice Chair Lee, and Members of the Committee:

I am Craig Hirai, Member of the Tax Finance Subcommittee of the Government Affairs Committee, here to testify on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its 8,500 members. HAR **supports** H.B. 2328, which adds a chapter to the HRS entitled "Estate and Generation-Skipping Transfer Tax".

H.B. 2328 is intended to clarify and to prospectively conform current HRS Chapter 236D to current federal Internal Revenue Code provisions. By conforming to current federal law exemption provisions, Hawaii estate and generation-skipping transfer tax returns should only have to be filed when federal returns are required to be filed.

Because Hawaii has never had a gift tax, HAR requests that the definition of "transfer or taxable transfer" in H.B. 2328 be amended to read as follows in order to clarify that the Hawaii generation-skipping tax does not apply to "direct skip" transfers that are subject to federal gift tax.

> "Transfer" or "taxable transfer" means:
>
> (1) A transfer as defined and used in section 2001(a) of the Internal Revenue Code and shall include the disposition of or failure to use property for a qualified use under section 2032A(c) of the Internal Revenue Code; or
>
> (2) A generation-skipping transfer as defined and used in section 2611 of the Internal Revenue Code; excluding, however, direct skips described in section 2612(c)(1) of the Internal Revenue Code which are subject to the gift tax imposed by chapter 12 of the Internal Revenue code.

Mahalo for the opportunity to testify.

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February 14, 2012

VIA FAX

The Honorable Marcus R. Oshiro
Chair, Committee on Finance
House of Representatives
State of Hawaii
State Capitol, Room 306
Honolulu, Hawaii 96813

Re: Support for HB 2328

Dear Representative Oshiro:

I am a lawyer and have worked primarily in the estate and tax planning area for the past 30 years.

I am writing to support HB 2328 relating to taxation to add a chapter to the Hawaii Revised Statutes entitled "Estate and Generation-Skipping Transfer Tax". This bill, if enacted, would simplify the filing of returns and minimize the taxpayers' burden in complying with the Hawaii estate and generation-skipping transfer tax law.

However, for the reason explained below, the definition in paragraph (2) of "transfer" or "taxable transfer" (on page 5, lines 11-12) should be revised to read as follows: "A generation-skipping transfer as defined and used in section 2611 of the Internal Revenue Code, except that a direct skip that is a transfer subject to the tax imposed by chapter 12 of the Internal Revenue Code shall not be treated as a taxable transfer." Hawaii does not have a gift tax. This revision would provide an exception to the Hawaii generation-skipping transfer tax in the case of generation-skipping transfers that are subject to the federal gift tax.

Thank you for your consideration.

Sincerely yours,

Joy M. Miyasaki

JMM:atl