

JOSH GREEN M.D.  
GOVERNOR

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LT. GOVERNOR



STATE OF HAWAII  
DEPARTMENT OF TAXATION

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GARY S. SUGANUMA  
DIRECTOR

KRISTEN M.R. SAKAMOTO  
DEPUTY DIRECTOR

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

**TESTIMONY ON THE FOLLOWING MEASURE:**

S.B. No.1437, S.D.1, Relating to Pass-Through Entity Taxation

**BEFORE THE:**

House Committee on Economic Development

**DATE:** Wednesday, March 22, 2023

**TIME:** 9:30 a.m.

**LOCATION:** State Capitol, Room 423

Chair Holt, Vice-Chair Lamosao, and Members of the Committee:

The Department of Taxation ("Department") offers the following comments regarding S.B. 1437, S.D.1, for your consideration.

S.B. 1437, S.D.1, adds a new section to chapter 235, Hawaii Revised Statutes (HRS), allowing a partnership or S corporation to annually elect to file as a pass-through entity, but requiring that election to be made every tax year that the entity wishes to file as a pass-through entity. This bill also allows the partnership or S corporation to pay the Hawaii income tax at the entity level and allow nonresident partners, whose only Hawaii income comes from electing to file as a pass-through entity, to claim a credit for taxes paid by the partnership or S corporation. The amount of credit will be applied to each partner's Hawaii tax liability, but the excess is nonrefundable and cannot be carried over to a subsequent year. The credit is not deductible from a partner's Hawaii state taxable income as an itemized deduction. The credit is refundable for any member of an electing pass-through entity for the member's pro rata share of taxes paid to another state. The measure has a defective effective date of July 1, 2050 and applies to taxable years beginning after December 31, 2022.

Under current federal law, individual taxpayers are subject to a \$10,000 limit on the federal deduction for state and local taxes (SALT). The stated purpose of this measure

is to permit certain entities to elect to pay Hawaii income tax at the entity level, thereby allowing the entity to deduct Hawaii state income taxes on their federal income tax returns.

First, the Department notes that the federal limit on the SALT deduction is set to expire on December 31, 2025, after which time individual taxpayers would be allowed to fully deduct state and local taxes.

Second, the Department strongly suggests that the provision in subsection (f), that provides a refundable credit for taxes paid to another jurisdiction, be made nonrefundable so that the State of Hawaii would not be refunding a taxpayer for taxes paid to another jurisdiction. Specifically, the Department suggests that the last sentence in subsection (f), on page 4, lines 11 through 14, be amended to read:

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.

The member's pro rata share should be used to offset the taxpayer's Hawaii tax liability only on the same income that was taxed by the other jurisdiction. Any amount of tax above the Hawaii tax liability would generally be attributable to the difference in tax rates between Hawaii and the other jurisdiction.

Finally, because this bill will require significant tax form and system changes, the Department requests that the effective date of the bill be amended to no earlier than January 1, 2025.

Thank you for the opportunity to provide testimony on this measure.

# PACIFIC RIM LAND INC.

ESTABLISHED 1988

House Committee on Economic Development  
Rep. Daniel Holt, Chair  
Rep. Rachele F. Lamosao, Vice Chair

**RE: S.B. 1437\_SD1, RELATING TO PASS THROUGH ENTITY TAXATION**

**Wednesday, March 22, 2023**

**9:30 am**

**Room 423**

Aloha Chair Holt, Vice Chair Lamosao and Members of the Committee:

Pacific Rim Land, Inc. submits testimony in **strong support** of SB 1437\_SD1.

Legislation is required to allow Hawaii taxpayers to take full deductions of state taxes paid on their federal income tax returns.

For many years, the federal government granted a deduction for state income taxes paid by individuals and businesses. Congress, in 2017 with the enactment of the Tax Cuts and Jobs Act, capped the deduction of state taxes to \$10,000 per year (“SALT Cap”). This limitation significantly impacted individual owners of pass-through entities – S corporations, partnerships, and LLCs. This cap did not apply to taxes paid by businesses such as C corporations.

However, in 2020, the IRS – in Notice 2020-75, announced the IRS would not apply the \$10,000 SALT Cap to pass-through entities if the state income tax was imposed directly on the entity. If Hawaii allows an election to move its point of taxation from the individual owners of a pass-through entity to the entity itself, the federal government will not impose the \$10,000 cap on deductions claimed by the entity.

**This change would not impact the State’s tax revenue.**

The federal government provides the deduction for Hawaii income taxes paid by the entity. This federal deduction doesn’t impact the state as long as the state disallows the deduction for state income taxes in computing Hawaii income. So far, 30 states have enacted these types of pass-through entity tax elections, including California, New York, Illinois, Georgia, North Carolina, Ohio, Oregon, Arizona, Idaho, and Utah. The federal government is, in essence, allowing a restored tax deduction to support small businesses and place them on an equal position compared to C corporations. **Please see the attached information sheet with a map highlighting the states that have passed similar legislation.**

House Committee on Economic Development  
SB1437\_SD1  
Pg. 2

Pacific Rim Land, Inc. supports the proposed legislation due to the significant benefits for Hawaii small businesses, who typically structured as LLCs by allowing them to receive a higher deduction on their federal income tax returns, in turn keeping more money in the State.

We humbly ask that you pass this measure **unamended**.

Mahalo for the opportunity to provide testimony.

# UNDERSTANDING SB1437 & HB1362

## What are PTEs?

PTEs, or Pass Through Entities, are S Corporations, Partnerships, and Limited Liability Companies.

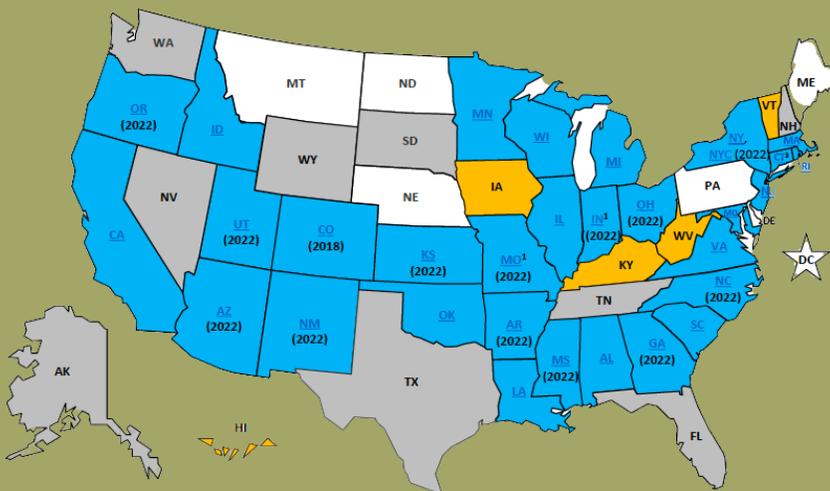
## What is being proposed?

Currently, PTE tax liabilities are paid through each of their owners, partners or shareholders. The proposed legislation will allow individuals to elect to have their taxes paid through the PTE itself.

## What happens if we pass this legislation?

If the legislation is passed and signed into law, Hawaii PTE owners will be able to deduct the full amount of their state tax on their federal taxes, lifting a \$10,000 cap on their federal tax deductions per year. The State's tax revenue will not be impacted.

## States with Enacted or Proposed PTE Level Tax AS OF MARCH 2023



**HB1362 and SB1437 are in committee in Hawaii.**

It is one of five states with proposed PTE tax bills this year.

30 states and one locality have enacted PTE Tax since Tax Cuts & Jobs Act (TCJA) State & Local Tax (SALT) deduction limitation or earlier.

States with no owner-level personal income tax on PTE income.

States that have not yet proposed or enacted PTE taxes.

For more information, please contact Allicia Thompson  
at [alliciat@strategies360.com](mailto:alliciat@strategies360.com) or (808) 542-9643.

# CRAFT *Ohana*

March 20, 2023

House Committee on Economic Development  
SB1437 Relating to Pass-Through Entity (PTE) taxation

Re: **IN STRONG SUPPORT OF SB1437**

Aloha Chair Representative Holt, Vice Chair Representative Keith-Agaran, and members of the Committee,

My name is Garrett W. Marrero, I live in Kihei, HI. Maui Brewing Co. has locations on Maui in Lahaina and Kihei, and on Oahu in Waikiki and Kailua. We distribute across Hawaii, 19 other States, and 10 countries. We are a fairly large employer within the State and contribute immensely to Hawai'i and its people.

I am writing on behalf of myself and our local family-operated business in **STRONG SUPPORT** of **SB1437** for the following reasons:

1. This bill will allow taxpayers to deduct Hawaii state income taxes paid on their federal income tax returns beyond the current limit of \$10,000 imposed by changes to the federal tax code in 2017.
2. This will have no impact to State tax revenue as the tax is still being paid to the state, albeit at the entity level, not the individual level.
3. A majority of other states have already passed similar legislation.
4. If passed, this bill will provide significant benefit to Hawaii small businesses, who are typically LLCs, receive a higher deduction on their federal income tax returns keeping more money in their pocket.

Mahalo for your consideration. We urge you to pass this bill and show your support of Hawaii's small businesses. Thank you for the opportunity to provide testimony in support of **SB1437**.

Mahalo,

  
Garrett W. Marrero  
CEO/Founder

**MAUI**  
HARD SELTZER

*Modern  
Times*  
BEER

**MAUI**  
BREWING CO

*Modern  
Times*  
COFFEE

**KUPU**  
— SPIRITS —



House Committee on Economic Development  
Rep. Daniel Holt, Chair  
Rep. Rachele F. Lamosao, Vice Chair

**RE: SB1437\_SD1, RELATING TO PASS THROUGH ENTITY TAXATION**

**Wednesday, March 22, 2023**  
**9:30 am**  
**Room 423**

Pas de Deux Hawaii submits testimony in **strong support** of SB1437\_SD1, Pass-Through Entity Taxation.

Pas de Deux Hawaii is a performing art studio located in Central Oahu serving performers from across the island. We are dedicated and committed to preserving culture and the arts in our local community by training young performers to the highest level of skill in their desired genre of dance, music, and theatre. As a small business it can be challenging to maintain a high quality of service while keeping consumer costs at an affordable level.

Passage of this bill would create a huge positive financial benefit for us as small businesses in the state and, since the bill only seeks to change the method by which the state income tax is paid, the state's tax revenue is not affected in any way. However, it would allow us to continue to grow and serve more of Hawaii's keiki.

Thank you for the opportunity to submit testimony on this measure.

**SB-1437-SD-1**

Submitted on: 3/20/2023 8:32:29 PM

Testimony for ECD on 3/22/2023 9:30:00 AM

| <b>Submitted By</b> | <b>Organization</b>     | <b>Testifier Position</b> | <b>Testify</b>            |
|---------------------|-------------------------|---------------------------|---------------------------|
| Jim Coon            | Ocean Tourism Coalition | Support                   | Written Testimony<br>Only |

Comments:

The Ocean Tourism Coaliton represents over 300 small ocean related companies across the State of Hawaii. Most of these are organized as a pass through entity.

We humbly ask you to pass this important legislation which will bring much needed relief to many small businesses in Hawaii.

March 21, 2023

Committee on Economic Development  
Representative Daniel Holt, Chair  
Representative Rachele F. Lamasao, Vice Chair



*Working together for Kapolei*

Wednesday, March 22, 2023, 9:30 a.m.  
Conference Room #423 and Videoconference

**RE: SB 1437 SD1, Relating to pass-through entity taxation**

Dear Chair Holt, Vice Chair Lamasao and members of the Committee,

My name is Kiran Polk, and I am the Executive Director of the Kapolei Chamber of Commerce. The Kapolei Chamber of Commerce is an advocate for businesses in the Kapolei region and West O'ahu. The Chamber works on behalf of its members and the entire business community to improve the regional and State economic climate and help Kapolei businesses thrive. We are a member-driven, member-supported organization representing the interests of all types of business: small, medium or large, for profit or non-profit businesses or sole proprietorship.

The Kapolei Chamber of Commerce **supports SB 1437 SD1**, which authorizes certain entities to elect to pay Hawaii income tax at the entity level through pass-through entities.

This bill seeks to allow pass-through entities: S corporations, partnerships, and limited liability companies (LLC) to elect to have their state tax liability be paid at entity level versus as individuals. Many small businesses in Hawai'i are organized as an LLC, as they typically receive a higher deduction on their taxes. The proposed bill would allow pass-through entities to deduct the entirety of their state tax liability from their federal taxes. For many years, individuals and businesses were allowed to deduct the entirety of their state income taxes from their federal tax liability. The Tax Cut and Jobs Act (2017) capped the amount of state taxes that could be deducted at \$10,000 and significantly impacts individual owners of pass-through entities. *Note: this cap does not apply to taxes paid by C corporations.* However, in 2020 the IRS announced that this \$10,000 tax deduction cap would not apply if the state income tax was imposed directly on the entity rather than the individual. Since then, 28 states have enacted these types of pass-through entity tax elections to the benefit of many small businesses.

**Our small businesses would benefit the most by this measure and since the bill only seeks to change the method by which the state income tax is paid, the state's tax revenue is not affected in any way.**

Thank you for this opportunity to provide testimony.

Best,

A handwritten signature in black ink that reads "K. Polk".

Kiran Polk  
Executive Director

1001 Kamokila Boulevard, Campbell Building Suite 250, Kapolei, Hawaii 96707

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Pass-through Entity Tax Election

BILL NUMBER: SB 1437 SD 1

INTRODUCED BY: Senate Committee on Ways and Means

EXECUTIVE SUMMARY: Authorizes certain pass-through entities to elect to pay Hawai'i income tax at the entity level.

SYNOPSIS: Adds a new section to chapter 235, HRS, that allows a partnership or S corporation to elect to pay tax that otherwise would be paid by its partners or owners. A separate election shall be made for each taxable year.

If an election is made, the passthrough entity pays tax equal to the sum of each member's distributive share of Hawaii taxable income, multiplied by the maximum individual rate (currently 11%). The individuals are then given nonrefundable credit on their own returns for their shares of Hawaii tax paid by the entity. They are also given refundable credit for income taxes paid to other States or the District of Columbia.

EFFECTIVE DATE: July 1, 2050; applicable to taxable years beginning after December 31, 2022.

STAFF COMMENTS: At the federal level, the Tax Cuts and Jobs Act (TCJA) capped the state and local tax (SALT) deduction for individuals at \$10,000 for the 2018-2025 tax years. The limit generally applies to any SALT liability, including tax on income received from a partnership or S corporation. This limitation causes the most hardship in states with higher income tax rates, a classification to which Hawaii most definitely belongs.

In response, several states enacted laws designed to provide individuals with SALT deductions notwithstanding the \$10,000 limitation by imposing tax directly at the passthrough entity level. The entity, not the individual, pays the tax and is not burdened with the \$10,000 limit.

In November 2020, the IRS released Notice 2020-75 (<https://www.irs.gov/pub/irs-drop/n-20-75.pdf>), in which the agency stated that it intended to publish regulations stating that the strategy works. The Notice cited a 1958 revenue ruling, Rev. Rul. 58-25, 1958-1 C.B. 95, which held that a partnership level tax levied by Cincinnati reduced the partnership's taxable income or loss, and did not preclude its individual owners from claiming the standard deduction.

As the preamble to the bill recites, many other states have jumped on the bandwagon; a majority of states now have passthrough entity tax laws.

As a technical matter, the bill does not now provide for the possibility that a passthrough entity may have one or more corporate members, for which the maximum tax rate is 6.4%, not 11%. Certainly, the corporation is given credit for the tax paid if this happens, but the State may reap a

windfall if the corporation has no profitable business activities other than its ownership in the passthrough, because this credit is not refundable and cannot be carried forward.

In addition, the Committee should consider making the election available to limited liability companies that are now classified under the IRC as disregarded entities. There would seem to be no substantial difference between a small business with more than one owner classified as a partnership for tax purposes, and a small business with one owner classified as a disregarded entity for tax purposes, for purposes of meriting this election.

Digested: 3/21/2023



March 22, 2023

9:30 a.m.

Conference Room 423 and Videoconference

**To: House Committee on Economic Development**

**Rep. Daniel Holt, Chair**

**Rep. Rachele F. Lamasao, Vice Chair**

**From: Grassroot Institute of Hawaii**

**Joe Kent, Executive vice president**

RE: SB1437 SD1 — RELATING TO PASS-THROUGH ENTITY TAXATION

***Comments Only***

Dear Chair and Committee Members:

The Grassroot Institute of Hawaii would like to offer its comments on [SB1437 SD1](#), which would allow the members of partnerships and S corporations to elect to pay the state individual income tax at the pass-through entity level.

Essentially, this bill would allow members of certain Hawaii businesses to deduct their state income tax liabilities from their federal income tax liabilities.

In the past, federal law allowed for these “state and local tax” (SALT) deductions. For example, partnership members who paid \$40,000 in state income taxes could deduct that figure from their federal income tax.

In 2017, however, the federal Tax Cuts and Jobs Act changed the law to impose a \$10,000 cap on such deductions.<sup>1</sup>

In response, several states passed legislation to allow members of pass-through entities, such as partnerships and S corporations, to pay their income taxes at the entity level instead of the personal level. These laws created an avenue through which members of pass-through entities

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<sup>1</sup> [“IRS permits SALT deduction pass-through workarounds,”](#) GrantThornton, Nov. 13, 2020.

could still deduct their state income taxes from their federal income taxes. To date, 29 states have passed such legislation.<sup>2</sup>

According to an analysis from The Wall Street Journal, these laws are creating big savings for businesses.

“Business owners are likely saving more than \$10 billion annually in federal taxes through state laws that circumvent the \$10,000 cap on state and local tax deductions,” the newspaper reported in 2022.<sup>3</sup>

If Hawaii adopts this measure, probably not all businesses would make use of it. The bill provides that businesses can voluntarily elect to use or pass on the new policy on an annual basis.

This provision makes sense, as pass-through entity taxation poses businesses and their accountants with several financial questions and not all partnership and S corps may opt to use it.<sup>4</sup> However, this measure would give business owners a valuable new tool in reducing their overall tax burden — all at no cost to the state.

Currently, Hawaii is one of the worst states for entrepreneurs. A 2022 CNBC analysis ranked Hawaii as the 46th worst state in which to start a business.<sup>5</sup> This bill would help offset some of the state’s high tax burden and make it easier to start and expand a business in Hawaii, providing additional employment opportunities and fueling the economy.

Thank you for the opportunity to testify.

Sincerely,

Joe Kent  
Executive vice president  
Grassroot Institute of Hawaii

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<sup>2</sup> [“States with Enacted or Proposed Pass-Through Entity \(PTE\) Level Tax,”](#) American Institute of CPAs, Jan. 24, 2023.

<sup>3</sup> Richard Rubin, [“States Help Business Owners Save Big on Federal Taxes With SALT-Cap Workarounds,”](#) Wall Street Journal, May 31, 2022.

<sup>4</sup> Bruce Wood, [“SALT Workarounds Carry Consequences for Tax Affected Earnings,”](#) Bloomberg Tax, Sept. 23, 2022.

<sup>5</sup> [“America’s Top States for Business 2022: The full rankings,”](#) CNBC, July 13, 2022.