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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 purpose of this Act is to establish a state  
2 tax law to permit certain entities to elect to pay Hawaii income  
3 tax at the entity level. This Act will help Hawaii's small  
4 businesses by allowing taxpayers to deduct Hawaii state income  
5 taxes paid on their federal income tax returns. These  
6 deductions from federal taxable income were eliminated through  
7 changes to the federal tax code in 2017, which deprived Hawaii  
8 taxpayers of significant federal tax benefits. This Act will  
9 bring Hawaii into conformity with the majority of other states  
10 that already permit similar elections by so-called "pass-through  
11 entities" to pay state income taxes.

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

15           "§235-           Pass-through entity taxation election. (a) A  
16 partnership or S corporation may elect to become an electing  
17 pass-through entity in any tax year; provided that a separate



1 election shall be made for each taxable year. An election made  
2 pursuant to this subsection shall be filed in the form and  
3 manner prescribed by the director of taxation and signed by:

4 (1) Each member of the entity who is a member at the time  
5 the election is filed; or

6 (2) Any officer, manager, or member of the entity who is  
7 authorized to make the election and who attests to  
8 having such authorization under penalty of perjury.

9 (b) Notwithstanding any provision of law to the contrary,  
10 the following tax is imposed on each electing pass-through  
11 entity: the sum of each member's distributive share of Hawaii  
12 taxable income as calculated under this chapter, multiplied by  
13 the highest rate of tax applicable to the individual under  
14 section 235-51. If the income calculated pursuant to this  
15 subsection reflects a net loss for the electing pass-through  
16 entity, the net loss may be carried forward to subsequent tax  
17 years for as long as the electing pass-through entity elects to  
18 be subject to the tax pursuant to this section until exhausted.

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



1 member's only source of Hawaii income is from electing pass-  
2 through entities and the electing pass-through entity or  
3 entities file and pay the tax due under this section.

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

7 (e) Each member of an electing pass-through entity shall  
8 be entitled to a credit equal to the member's share of the tax  
9 paid pursuant to this section. If the amount of the credit  
10 authorized by this subsection exceeds the member's tax liability  
11 imposed pursuant to this chapter, the excess amount shall not be  
12 refundable to the member. Any member claiming a credit shall  
13 not be entitled to deduct from the member's Hawaii state taxable  
14 income those amounts of Hawaii state income taxes paid by the  
15 member on the member's distributive share of income from the  
16 electing pass-through entity.

17 (f) Each member that is subject to the tax imposed by this  
18 chapter as a resident or part-year resident of the State shall  
19 be entitled to a credit for the direct member's or indirect  
20 member's pro rata share of taxes paid to another state or to the  
21 District of Columbia, on income of any partnership or S



1 corporation of which the person is a member; provided that the  
2 taxes paid to another state or to the District of Columbia  
3 result from a tax that the director of taxation determines is  
4 substantially similar to the tax imposed pursuant to this  
5 section. Any credit shall be calculated in a form and manner  
6 prescribed by the director of taxation; provided that the  
7 calculation is consistent with the provisions of this section.  
8 If the amount of the credit authorized by this subsection  
9 exceeds the member's tax liability for the tax imposed pursuant  
10 to this chapter, the excess amount shall not be refundable and  
11 shall not carry forward.

12 (g) The department of taxation may establish rules to  
13 implement this section.

14 (h) For purposes of this section:

15 "Direct member" means a member that holds an interest  
16 directly in an electing pass-through entity.

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

20 "Indirect member" means a member that itself holds an  
21 interest, through a direct member or indirect member that is a



1 partnership or S corporation, in an electing pass-through  
2 entity.

3 "Member" means:

4 (1) A shareholder of an S corporation;

5 (2) A partner in a general partnership, a limited  
6 partnership, or a limited liability partnership; or

7 (3) A member of a limited liability company that is  
8 treated as a partnership or S corporation for federal  
9 income tax purposes.

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

15 "S corporation" means a corporation for which a valid  
16 election under section 1362(a) of the Internal Revenue Code is  
17 in effect."

18 SECTION 3. New statutory material is underscored.

19 SECTION 4. This Act shall take effect on June 30, 3000.



**Report Title:**

Taxation; Pass-through Entity; S Corporations; Partnerships

**Description:**

Authorizes certain entities to elect to pay Hawaii income tax at the entity level through pass-through entities. Effective 6/30/3000. (HD1)

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