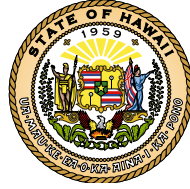


JOSH GREEN M.D.  
GOVERNOR

SYLVIA LUKE  
LT. GOVERNOR



GARY S. SUGANUMA  
DIRECTOR

KRISTEN M.R. SAKAMOTO  
DEPUTY DIRECTOR

STATE OF HAWAII  
**DEPARTMENT OF TAXATION**  
Ka 'Oihana 'Auhau  
P.O. BOX 259  
HONOLULU, HAWAII 96809  
PHONE NO: (808) 587-1540  
FAX NO: (808) 587-1560

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

**TESTIMONY ON THE FOLLOWING MEASURE:**

H.B. No. 1362, Relating to Pass-Through Entity Taxation

**BEFORE THE:**

House Committee on Economic Development

**DATE:** Friday, February 3, 2023  
**TIME:** 10:00 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 H.B. 1362 for your consideration.

H.B. 1362 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 measure is effective upon approval and applies to taxable years beginning after December 31, 2022.

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.

**HB-1362**

Submitted on: 2/1/2023 6:29:04 PM

Testimony for ECD on 2/3/2023 10:00:00 AM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Testify</b>
James E. Coon	Ocean Tourism Coalition	Support	Written Testimony Only

Comments:

The Ocean Tourism Coalition (OTC) strongly supports HB 1362. It would provide significant tax benefits to a majority of the 300 small family businesses in our industry.

Please pass this much needed tax relief measure.

Mahalo

James E. Coon, President OTC

# PACIFIC RIM LAND INC.



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

## **RE: H.B. 1362, RELATING TO PASS THROUGH ENTITY TAXATION**

**Friday, February 3, 2022**

**10:00 a.m**

**Room 423**

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

Pacific Rim Land, Inc. submits testimony in **support** to HB 1362.

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, 28 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. If Hawaii were to adopt a similar elective pass-through entity tax, the change would come at no revenue cost and would help small businesses that do business in the state.

Pacific Rim Land, Inc. supports the proposed legislation due to the significant benefits it will provide Hawaii taxpayers on their federal returns with no impact to State tax revenue. 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. 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.

The legislation will keep Hawaii on par with the other 28 states that have passed similar legislation. 9 states do not have income tax, that leaves 13 states including Hawaii currently without this enabling legislation.

If passed, this bill will provide significant benefit to Hawaii small businesses, who typically are structured as LLCs, receive a higher deduction on their federal income tax returns, in turn keeping more money in their pocket and in the State.

We humbly ask that you pass this measure unamended.

Mahalo for the opportunity to provide testimony.

**Testimony of Denver Saxton Coon on behalf of Trilogy Corporation, *in Strong Support* of HB 1362, Pass-Through Entities.**

COMMITTEE ON ECONOMIC DEVELOPMENT

Rep. Daniel Holt, Chair

Rep. Rachele F. Lamosao, Vice Chair

Rep. Natalia Hussey-Burdick      Rep. Sean Quinlan

Rep. Sam Satoru Kong      Rep. Elijah Pierick

Rep. Nadine K. Nakamura

NOTICE OF HEARING

DATE: Friday, February 3, 2023

TIME: 10 a.m.

PLACE: VIA VIDEOCONFERENCE

Conference Room 423

State Capitol

415 South Beretania Street

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Aloha. My name is Denver Saxton Coon. I am general counsel for Trilogy Corporation dba Trilogy Excursions on the island of Maui. Trilogy Excursions is an S-Corporation that has been operating in the county of Maui for 50 years and employs close to one hundred employees year-round. *Trilogy is writing in strong support to HB 1362.*

I am writing to express my strong support for the proposed Pass-Through Entity (PTE) Legislation. PTEs, which include S corporations, partnerships, and limited liability companies, are critical to the success of small businesses in Hawaii.

In recent years, the federal government, through the Tax Cuts and Jobs Act, has capped the deduction of state income taxes to \$10,000 per year. This has had a significant impact on individual owners of PTEs, increasing their federal tax burden, while not impacting C-Corporations. This has resulted in a significant financial burden for thousands of small businesses in Hawaii.

However, in 2020, the IRS announced in Notice 2020-75 that the \$10,000 cap on deductions claimed by PTEs would not apply if the state tax was paid by the entity itself, instead of the individual members. This has opened the door for states to change their tax laws to allow PTEs to pay state taxes directly and take full advantage of the federal deduction.

Currently, 28 states, including California, New York, Illinois, Oregon, and Arizona, have already enacted this type of legislation, with only 13 states, including Hawaii, yet to address this issue. If Hawaii were to allow an election to move the point of taxation from the individual owners to the entity itself, the state would not only bring itself in line with the majority of other states, but it would also provide a significant financial boost to small businesses in the state.

I strongly encourage the Legislature to pass this PTE Legislation, which is based on language from other states that have recently passed similar legislation. This change would not impact the tax income to the State of Hawaii, as the federal government would still provide a deduction for Hawaii income taxes paid by the entity, as long as the state disallows the deduction for state income taxes in computing Hawaii income.

This proposed PTE Legislation is a win-win situation, providing significant benefits to small businesses in Hawaii with no impact to the state's tax income. I urge you to pass this important legislation and help ensure the success of small businesses in our state.

*Mahalo,*

Denver Saxton Coon  
Trilogy Corporation  
General Counsel  
[denver.coon@sailtrilogy.com](mailto:denver.coon@sailtrilogy.com)

A handwritten signature in black ink, appearing to read 'D. Coon', with a long horizontal line extending to the right.



January 31, 2023

TO: HONORABLE DANIEL HOLT, CHAIR, HONORABLE RACHELE LAMOSAO, VICE CHAIR, COMMITTEE ON ECONOMIC DEVELOPMENT

SUBJECT: **SUPPORT OF H.B. 1362, RELATING TO PASS THROUGH ENTITY TAXATION.** Authorizes certain entities to elect to pay Hawaii income tax at the entity level through pass-through entities.

HEARING

DATE: Friday, February 3, 2023  
TIME: 10:00 a.m.  
PLACE: Capitol Room 423

Dear Chair Holt, Vice Chair Lamosao and Members of the Committee,

The General Contractors Association of Hawaii (GCA) is an organization comprised of approximately five hundred (500) general contractors, subcontractors, and construction related firms. The GCA was established in 1932 and is the largest construction association in the State of Hawaii. Our mission is to elevate Hawaii's construction industry and strengthen the foundation of our community.

GCA is in support of H.B. 1362, which authorizes certain entities to elect to pay Hawaii income tax at the entity level through pass-through entities.

For many years, the federal government granted a deduction for state income taxes paid by individuals and businesses.

However, Congress, in 2017 with the enactment of the Tax Cuts and Jobs Act, capped the deduction of state taxes to \$10,000 per year. 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.

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.

Therefore, 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.

It is important to note that this change would not cost Hawaii. 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.



**GENERAL  
CONTRACTORS  
ASSOCIATION  
OF HAWAII**

28 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. If Hawaii were to adopt a similar elective pass-through entity tax, the change would come at no revenue cost and would help small businesses that do business in the state.

GCA believes that this would alleviate some of the burden that small businesses face in the State and allow more revenue to be pumped back into our economy.

Thank you for the opportunity to testify in support of this measure.

QUALITY PEOPLE. QUALITY PROJECTS





Feb. 3, 2023

10 a.m.

VIA VIDEOCONFERENCE

Conference Room 423

**To: House Committee on Economic Development**

**Rep. Daniel Holt, Chair**

**Rep. Rachele Lamosao, Vice Chair**

**From: Grassroot Institute of Hawaii**

**Jonathan Helton, Policy Researcher**

RE: HB1362 — 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 [HB1362](#), 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

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

personal level. These laws created an avenue through which members of pass-through entities 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.

Jonathan Helton  
Policy Researcher  
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.

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Pass-through Entity Tax Election

BILL NUMBER: HB 1362, SB 1437

INTRODUCED BY: HB by YAMASHITA; SB by KEITH-AGARAN

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 credit on their own returns for their shares of tax paid by the entity.

EFFECTIVE DATE: 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 statute 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: 2/1/2023



February 2, 2023

Chair Holt  
Vice Chair Lamosao  
Members of the House Committee on Economic Development

Subject: TESTIMONY IN SUPPORT OF HB1362  
February 3, 2023 at 10:00 am  
Via Video Conference/Conference Room 423

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

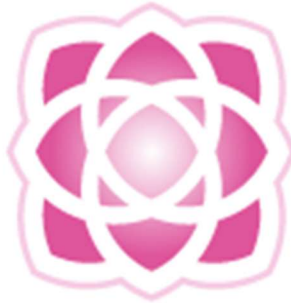
I am testifying in support of HB1362. HB1362 will allow taxpayers to deduct Hawaii state income taxes paid on their federal income tax returns beyond the current limit of \$10,000 imposed by changes to the federal tax code in 2017. This will provide significant benefits to Hawaii small businesses, but will have no impact on the State's tax revenue. Many other states have passed similar legislation to support their small businesses.

Thank you for the opportunity to provide testimony in support of HB1362.

Sincerely,

A handwritten signature in blue ink, appearing to read "Everett R. Dowling".

Everett R. Dowling  
President



**MAUI**  
CHAMBER OF COMMERCE  
VOICE OF BUSINESS

**LATE**

**LATE**

**HEARING BEFORE THE HOUSE COMMITTEE ON  
ECONOMIC DEVELOPMENT  
HAWAII STATE CAPITOL, HOUSE CONFERENCE ROOM 423  
FRIDAY, FEBRUARY 3, 2023 AT 10:00 A.M.**

To The Honorable Daniel Holt, Chair  
The Honorable Rachele F. Lamosao, Vice Chair  
Members of the committee on Economic Development

**SUPPORT HB1362 RELATING TO PASS-THROUGH ENTITY TAXATION**

The Maui Chamber of Commerce **Supports HB1362** which authorizes certain entities to elect to pay Hawaii income tax at the entity level through pass-through entities.

The Chamber supports this bill because it 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. This bill will provide significant benefit to Hawaii small businesses, who are typically LLCs, receive a higher deduction on their federal income tax returns.

The Chamber notes that 28 states have already enacted this type of pass-through legislation and this bill would help bring Hawaii into conformity with those who have already passed legislation.

For these reasons, we **support HB1362**.

Sincerely,

Pamela Tumpap  
President

To advance and promote a healthy economic environment for business, advocating for a responsive government and quality education, while preserving Maui's unique community characteristics.

**HB-1362**

Submitted on: 2/1/2023 3:16:26 PM

Testimony for ECD on 2/3/2023 10:00:00 AM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Testify</b>
Sean Uezu	Individual	Support	Written Testimony Only

Comments:

This bill is a no-brainer! It will not cost Hawaii a single dollar in tax revenues and put back money into the pockets of hard working Hawaii residents.

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.

**HB-1362**

Submitted on: 2/1/2023 8:36:06 PM

Testimony for ECD on 2/3/2023 10:00:00 AM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Testify</b>
James Haynes	Individual	Support	Written Testimony Only

Comments:

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

I am James Haynes, a businessman and small business owner on the island of Maui, and support House Bill 1362. I encourage you to vote in favor of HB1362 for the following reasons.

- Similar laws currently exist in 28 states including California, New Your, Illinois, Oregon, Utah, Idaho and Arizona.
- The bill will be revenue neutral for the State of Hawaii.
- The bill would significantly help small businesses in Hawaii.
- The bill will encourage investment in Hawaii.

Thank you for allowing me the opportunity to submit testimony on this bill.



February 2, 2023

The Honorable State House of Representative Daniel Holt, Chair  
House of Representatives Committee on Economic Development

Re: House Bill 1362 Relating to Pass-Through Entity Taxation

Dear Representative Holt:

I am in support of the passage of HB 1362 as it relates to pass-through entity taxation matters.

As a small business owner and having multiple enterprises organized in Hawaii under the rules and regulations of limited liability companies, I see the benefit of the limited liability company being taxed on the entity level rather than at the individual member level as this gives the member an opportunity to garner a lower taxable income on the federal level and thus potentially provide more after-tax income.

As I understand, the tax will be at the 11% rate to the entity (the highest personal income tax in Hawaii) and thus the net effect to the State tax collections is zero.

I see this as a win-win proposal for the State and its Residents who have businesses organized under pass-through entity rules and regulations.

Mahalo and thank you for your consideration of this matter,



Glenn Yamasaki  
Kihei, Maui Hawaii

**LATE**

**LATE**

**HB-1362**

Submitted on: 2/3/2023 9:23:28 AM

Testimony for ECD on 2/3/2023 10:00:00 AM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Testify</b>
Andrew Crossland	Individual	Support	Written Testimony Only

Comments:

I support this Bill.