

JOSH GREEN M.D.
GOVERNOR

SYLVIA LUKE
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION

Ka 'Oihana 'Auhau
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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, Relating to Pass-Through Entity Taxation

BEFORE THE:

Senate Committee on Ways and Means

DATE: Monday, February 27, 2023

TIME: 10:35 a.m.

LOCATION: State Capitol, Room 211

Chair Dela Cruz, Vice-Chair Keith-Agaran, and Members of the Committee:

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

S.B. 1437 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.

The measure does not materially change the net income liability of taxpayers who would elect to use this provision, and therefore, the Department estimates that there will be no material impact on general fund revenues.

Department of Taxation Testimony
S.B. 1437
February 27, 2023
Page 2 of 2

However, 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.

**Testimony of Denver Saxton Coon on behalf of Trilogy Corporation, in Strong Support of SB 1437,
Pass-Through Entities.**

THE THIRTY-SECOND LEGISLATURE
REGULAR SESSION OF 2023

COMMITTEE ON WAYS AND MEANS

Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair

NOTICE OF HEARING

DATE: Monday, February 27, 2023
TIME: 10:35 AM
PLACE: Conference Room 211 & Videoconference
State Capitol
415 South Beretania Street

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 SB 1437.*

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,

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

Denver Saxton Coon
Trilogy Corporation
General Counsel
denver.coon@sailtrilogy.com

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

SB-1437

Submitted on: 2/24/2023 8:30:55 PM

Testimony for WAM on 2/27/2023 10:35:00 AM

Submitted By	Organization	Testifier Position	Testify
Chad Goodfellow	Testifying for Goodfellow Bros Inc	Support	Written Testimony Only

Comments:

To whom it may concern,

Thank you for taking the time to schedule this important bill. The potential benefits are significant for family owned businesses like ours. By allowing pass-through entities to pay their taxes at the entity level they will be able to have the same benefits that larger corporations currently enjoy. This change does not cost the state any tax revenue and will ensure more dollars can be reinvested in our Hawaii businesses and our employees. I am grateful that you each continue to support ideas that will make our communities even more resilient and competitive!

Mahalo for all that you do,

Chad Goodfellow

CEO

Goodfellow Bros. Inc.

PACIFIC RIM LAND INC.

ESTABLISHED 1988

Senate Committee on Ways and Means
Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair

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

Monday, February 27, 2023

10:35

Room 211

Aloha Chair Dela Cruz, Vice Chair Keith-Agaran and Members of the Committee:

Pacific Rim Land, Inc. submits testimony in support with amendment to SB 1437.

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.

We request the following amendment to ensure that owners, partners, or shareholders in S Corporations, Partnerships, or LLC’s that fall in lower tax brackets do not end up overpaying their state taxes.

Page 3, (e), line 9-12: amend the following:

“If the amount of the credit authorized by this subsection exceeds the member’s tax liability imposed pursuant to this chapter, the excess amount shall ~~not~~ be refundable to the member.”

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

PACIFIC RIM LAND INC.



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, 29 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.**

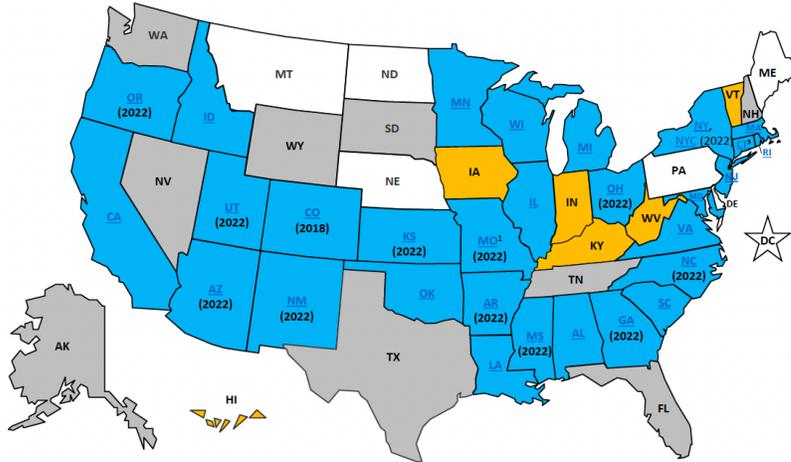
Pacific Rim Land, Inc. supports the proposed legislation due to the significant benefits for Hawaii small businesses, who typically structured as LLCs by allowing them receive a higher deduction on their federal income tax returns, in turn keeping more money in the State.

We humbly ask that you pass this measure.

Mahalo for the opportunity to provide testimony.

States with Enacted or Proposed Pass-Through Entity (PTE) Level Tax

As of February 7, 2023



- 29 states (& 1 locality) that enacted a PTE tax since TCJA SALT deduction limitation, effective for 2021 (or earlier) unless noted:
[AL](#), [AR](#)¹, [AZ](#)¹, [CA](#), [CO](#)², [CT](#)³, [GA](#)¹, [ID](#), [IL](#), [KS](#)¹, [LA](#), [MA](#), [MI](#), [MD](#), [MN](#), [MO](#)¹, [MS](#)¹, [NC](#)¹, [NJ](#), [NM](#)¹, [NY](#), [OH](#)¹, [OK](#), [OR](#)¹, [RI](#), [SC](#), [UT](#)¹, [VA](#), [WI](#), and [NYC](#)¹
¹ Effective in 2022 or later – on map (2022) or (2023)
² Retroactive to 2018
³ Mandatory
- 6 states with proposed PTE tax bills:
HI – [HB1362](#), [SB 1437](#), in committee
IA – [HSB 69](#), in committee
IN – [SB 2](#), passed Senate 2/6/23
KY – [HB 37](#), in committee
VT – [HB61/SB45](#), [HB 153](#), in committee
WV – [HB 2608/SB 151](#), [HB 2934/SB 496](#), [HB 3245/SB 442](#) in committee
- 9 states with no owner-level personal income tax on PTE income:
AK, FL, NH, NV, SD, TN, TX, WA, WY
- 10 states with an owner-level personal income tax on PTE income that have not yet proposed or enacted PTE taxes:
DC, DE, HI, IA, ME, MT, NE, ND, PA, VT





Senate Committee on Ways and Means
Senator Donovan M. Dela Cruz, Chair
Senator Gilbert S.C. Keith-Agaran, Vice Chair

RE: SB1437, RELATING TO PASS THROUGH ENTITY TAXATION

Monday, February 27, 2023

10:35

Room 211

Pas de Deux Hawaii submits testimony in **strong support** of SB1437, 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.



Feb. 27, 2023

10:35 a.m.

Conference Room 211 & Videoconference

To: Senate Committee on Ways and Means

Sen. Donovan Dela Cruz, Chair

Sen. Gilbert Keith-Agaran, Vice Chair

From: Grassroot Institute of Hawaii

Joe Kent, Executive vice president

RE: SB1437 — 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](#), 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.¹

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

¹ [“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.²

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 2022.³

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.⁴ 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.⁵ 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

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

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

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

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

CRAFT *Ohana*

February 26, 2023

Senate Committee on Ways and Means
SB1437 Relating to Pass-Through Entity (PTE) taxation
February 27th, 2023 at 10:35am

Re: **IN STRONG SUPPORT OF SB1437**

Aloha Chair Senator Dela Cruz, Vice Chair Senator 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 —



LATE

Uploaded via Capitol Website

February 27, 2023

TO: HONORABLE DONOVAN M. DELA CRUZ, CHAIR, HONORABLE GILBERT S.C. KEITH-AGARAN, VICE CHAIR, COMMITTEE ON WAYS AND MEANS

SUBJECT: **SUPPORT OF S.B. 1437, 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: Monday, February 27, 2023
TIME: 10:35 a.m.
PLACE: Capitol Room 211

Dear Chair Dela Cruz, Vice Chair Keith-Agaran 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 S.B. 1437, 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.

QUALITY PEOPLE. QUALITY PROJECTS



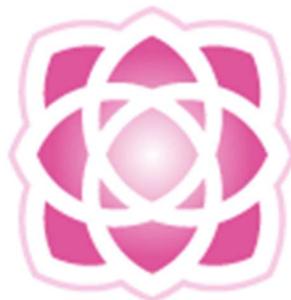
28 states have enacted these types of pass-through entity tax elections, including California, New York, Illinois, Georgia, North Carolina, Ohio, Oregon, Arizona, Idaho, and Utah.

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.

LATE



MAUI
CHAMBER OF COMMERCE
VOICE OF BUSINESS

**HEARING BEFORE THE SENATE COMMITTEE ON
WAYS AND MEANS
HAWAII STATE CAPITOL, SENATE CONFERENCE ROOM 211
MONDAY, FEBRUARY 27, 2023 AT 10:35 A.M.**

To The Honorable Senator Donovan M. Dela Cruz, Chair
The Honorable Senator Gilbert S.C. Keith-Agaran, Vice Chair
Members of the committee on Ways and Means

SUPPORT SB1437 RELATING TO PASS-THROUGH ENTITY TAXATION

The Maui Chamber of Commerce **supports SB1437** 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 29 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 SB1437**.

Sincerely,

Pamela Tumpap
President