
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 be taxed pursuant to
17 this section as an electing pass-through entity in any tax year;
18 provided that a separate election shall be made for each taxable



1 year. An election made pursuant to this subsection shall be
2 filed in the form and manner prescribed by the director of
3 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 provided that once the election is made, it shall be irrevocable
10 for that taxable year and shall be binding on all partners,
11 shareholders, and members of the electing pass-through entity.

12 (b) Notwithstanding any provision of law to the contrary,
13 the following tax is imposed on each electing pass-through
14 entity: the sum of all member's distributive shares and
15 guaranteed payments of Hawaii taxable income as calculated under
16 this chapter, multiplied by the highest rate of tax applicable
17 to the individual under section 235-51; provided that the
18 distributive shares and guaranteed payments of members who are
19 corporations shall not be included in the sum and shall not be
20 subject to the tax under this section. If the income calculated
21 pursuant to this subsection reflects a net loss for the electing



1 pass-through entity, the net loss may be carried forward to
2 subsequent tax years for as long as the electing pass-through
3 entity elects to be subject to the tax pursuant to this section
4 until exhausted.

5 (c) A nonresident individual who is a member of an
6 electing pass-through entity shall not be required to file an
7 income tax return pursuant to this chapter for a tax year if the
8 member's only source of Hawaii income is from electing
9 pass-through entities and the electing pass-through entity or
10 entities file and pay the tax due under this section.

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

14 (e) Each member of an electing pass-through entity whose
15 distributive share or guaranteed payment of Hawaii taxable
16 income is subject to tax under this section shall be entitled to
17 a credit equal to the member's share of the tax paid pursuant to
18 this section. If the amount of the credit authorized by this
19 subsection exceeds the member's tax liability imposed pursuant
20 to this chapter, the excess amount shall not be refundable to
21 the member. Any member claiming a credit shall not be entitled



1 to deduct from the member's Hawaii state taxable income those
2 amounts of Hawaii state income taxes paid by the member on the
3 member's distributive share or guaranteed payment of income from
4 the electing pass-through entity.

5 (f) Each member that is subject to the tax imposed by this
6 chapter as a resident or part-year resident of the State shall
7 be entitled to a credit for the direct member's or indirect
8 member's pro rata share of taxes paid to another state or to the
9 District of Columbia, on income of any partnership or S
10 corporation of which the person is a member; provided that the
11 taxes paid to another state or to the District of Columbia
12 result from a tax that the director of taxation determines is
13 substantially similar to the tax imposed pursuant to this
14 section. Any credit shall be calculated in a form and manner
15 prescribed by the director of taxation; provided that the
16 calculation is consistent with the provisions of this section.
17 If the amount of the credit authorized by this subsection
18 exceeds the member's tax liability for the tax imposed pursuant
19 to this chapter, the excess amount shall not be refundable and
20 shall not carry forward.



1 (g) The department of taxation may establish rules,
2 pursuant to chapter 91, to implement this section.

3 (h) For purposes of this section:

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

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

9 "Indirect member" means a member that itself holds an
10 interest, through a direct member or indirect member that is a
11 partnership or S corporation, in an electing pass-through
12 entity.

13 "Member" means:

14 (1) A shareholder of an S corporation;

15 (2) A partner in a general partnership, a limited
16 partnership, or a limited liability partnership; or

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

20 "Partnership" means the same as in the Internal Revenue
21 Code. "Partnership" includes a limited liability company that



1 is treated as a partnership for federal income tax purposes but
2 does not include any publicly traded partnership within the
3 meaning of section 7704 of the Internal Revenue Code.

4 "S corporation" means a corporation for which a valid
5 election under section 1362(a) of the Internal Revenue Code is
6 in effect."

7 SECTION 3. New statutory material is underscored.

8 SECTION 4. This Act shall take effect on January 1, 2024,
9 and shall apply to taxable years beginning after December 31,
10 2022.



Report Title:

Taxation; Pass-through Entity; S Corporations; Partnerships

Description:

Authorizes certain pass-through entities to elect to pay Hawaii income tax at the entity level. (CD1)

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