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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 taxable year; provided that a



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

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

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

10 (b) Notwithstanding any provision of law to the contrary,  
11 the following tax is imposed on each electing pass-through  
12 entity: the sum of each member's distributive share of Hawaii  
13 taxable income, as calculated under this chapter, multiplied by  
14 the highest rate of tax applicable to the individual under  
15 section 235-51.

16 If the income calculated pursuant to this subsection  
17 reflects a net loss for the electing pass-through entity, the  
18 net loss may be carried forward to subsequent taxable years for  
19 as long as the electing pass-through entity elects to be subject  
20 to the tax pursuant to this section until exhausted.



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

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

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

20       (f) Each member of an electing pass-through entity that is  
21 subject to the tax imposed by this chapter as a resident or



1 part-year resident of the State shall be entitled to a credit  
2 for the direct member's or indirect member's pro rata share of  
3 taxes paid to another state or to the District of Columbia, on  
4 income of any partnership or S corporation, of which the person  
5 is a member; provided that the taxes paid to another state or to  
6 the District of Columbia result from a tax that the director of  
7 taxation determines is substantially similar to the tax imposed  
8 pursuant to this section.

9 Any credit shall be calculated in a form and manner  
10 prescribed by the director; provided that the calculation is  
11 consistent with the provisions of this section. If the amount  
12 of the credit authorized by this subsection exceeds the member's  
13 tax liability for the tax imposed pursuant to this chapter, the  
14 excess amount shall be refundable to the member.

15 (g) The department of taxation may adopt rules under  
16 chapter 91 to implement this section.

17 (h) For purposes of this section:

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



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

4       "Indirect member" means a member that itself holds an  
5 interest, through a direct or indirect member that is a  
6 partnership or S corporation, in an electing pass-through  
7 entity.

8       "Member" means:

- 9       (1) A shareholder of an S corporation;  
10       (2) A partner in a general partnership, a limited  
11       partnership, or a limited liability partnership; or  
12       (3) A member of a limited liability company that is  
13       treated as a partnership or S corporation for federal  
14       income tax purposes.

15       "Partnership" means the same as in the Internal Revenue  
16 Code. "Partnership" includes a limited liability company that  
17 is treated as a partnership for federal income tax purposes, but  
18 does not include any publicly traded partnership within the  
19 meaning of section 7704 of the Internal Revenue Code.



1        "S corporation" means a corporation for which a valid  
2 election under section 1362(a) of the Internal Revenue Code is  
3 in effect."

4        SECTION 3. New statutory material is underscored.

5        SECTION 4. This Act shall take effect on July 1, 2050, and  
6 shall apply to taxable years beginning after December 31, 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. Effective 7/1/2050. (SD1)

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