THE SENATE
THIRTY-SECOND LEGISLATURE, 2024
STATE OF HAWAII

JAN 2 4 2024

S.B. NO. 3345

A BILL FOR AN ACT

RELATING TO THE ESTATE TAX.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. The legislature finds that there are significant challenges to running a business in Hawaii and, as a result, many local family-owned businesses are having difficulty maintaining their operations in Hawaii. Specifically, family businesses in Hawaii face an uncertain future maintaining their business and local roots in Hawaii due to significant tax burdens.

The legislature also finds that, in addition to the federal estate tax, Hawaii levies an additional state estate tax. Many other states do not impose state estate taxes or have significantly raised the exemption levels, in recognition that the imposition of state estate taxes, especially when an estate is not subject to the payment of federal estate taxes, negatively impact a state's economy and competitiveness by discouraging family business investment and encouraging the owners of these businesses to relocate to other states without an estate tax. Further, having to pay significant estate taxes diverts funds that could otherwise be reinvested in the businesses or community. If these funds were to remain as part of the state economy, additional jobs could be created.

The legislature further finds that Hawaii has one of the highest estate taxes in the nation due to its high estate tax rate and low exclusion amount. In contrast, the current federal exclusion amount applicable to gift and estate transfers is more than double the amount of the Hawaii estate tax exclusion amount. This difference has resulted in the need for complicated and technical estate planning. Further, because of the different exclusion amounts, the department of taxation must independently monitor and examine the filings of estate tax returns. In the past, the department of taxation could more easily rely upon determinations made by the Internal Revenue Service with respect to estate tax returns. Until 2018, the Hawaii estate tax exclusion amount had been coupled with the federal exclusion amount.

Under current law, the federal exclusion amount will be decreased by approximately one-half for decedents dying after December 31, 2025. Therefore, it is likely that the difference between the federal exclusion amount and the current Hawaii estate tax exclusion amount will not be significant. Instead, having the Hawaii estate tax exclusion amount conform with the federal exclusion amount would benefit the state economy because costs to monitor and audit for differences could be avoided.

It is of critical importance to the state economy to support our family businesses by ensuring that their owners are not overly burdened by a combined federal and state estate tax that could effectively cause the closure of family businesses or the sale of family businesses to an entity owned by persons outside of Hawaii.

Hawaii Business Magazine conducted a groundbreaking survey of owners of approximately one hundred forty family-owned local companies in 2017. The results of the survey found that family businesses are facing a huge challenge in the coming years, which impacts the state economy because Hawaii has so many family businesses. If the companies are not able to manage this transition well, they may be acquired by mainland corporations or, even worse, be forced to close down entirely.

Family businesses that are based in Hawaii are a critically important part of the state economy. As many economists have observed, small and medium-sized businesses, which are usually family businesses, are the biggest generators of jobs in the economy.

Family businesses also benefit the Hawaii community in other important ways. The companies and their employees provide a substantial portion of tax revenues to the State in income and excise taxes. Unlike companies that are based outside of the State, Hawaii family businesses attract, employ, and develop middle managers and executives who contribute to the intellectual capital of the Hawaii community and keep it vibrant. The owners of family businesses bring innovative ideas, high energy, and collaboration, and often serve voluntarily on governmental bodies and nonprofit boards. Family businesses also regularly support nonprofit organizations in donations and nonmonetary assistance to a far greater extent than companies owned by nonresidents and based outside of Hawaii.

Families who own family businesses typically have their family identities rooted in those businesses, see themselves as custodians of those businesses, and, as all healthy businesses must do, reinvest the great bulk of their profits into the family businesses to keep the companies competitive and growing.

As a result, most of the profits received by family businesses are reinvested into more employees, better facilities, and smarter technology, all of which are illiquid. The imposition of estate taxes upon the death of the owner of a family business has sometimes resulted in the sale of that business, as that is the only way sufficient cash can be raised to pay those taxes. In other cases, family businesses have sold key assets or operating divisions to raise cash for those taxes. Even if a family has prepared for those taxes by procuring life insurance for its members, the life insurance premiums are a major diversion of capital from the family businesses. This capital could be put to far better use by creating jobs and buildings in Hawaii, rather than being sent outside of the state economy to life insurance companies.

Finally, as a matter of tax policy, the Hawaii estate tax may not be the most efficient way to raise long-term revenue. While the estate tax does yield revenue, it does so by depriving growth capital from businesses and, in some cases, destroying those businesses. Over time, the income and excise tax revenues provided by a growing, healthy family business and its employees will exceed the immediate revenues produced by the estate tax.

Accordingly, the State should take reasonable steps to ensure that family businesses in Hawaii are able to continue their operations upon the death of their owners.

The purpose of this Act is to:

(1) Conform Hawaii estate tax laws to the operative provisions of the Internal Revenue Code to decrease the burden on taxpayers and increase efficiencies in the department of taxation's monitoring and auditing of estate tax returns; and

(2) Establish an estate tax deduction for the value of closely held business interests that will help ensure that locally-owned family businesses can continue to contribute to the Hawaii economy and assist families to retain the ownership interest in their family businesses.

SECTION 2. Chapter 236E, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

"**§236E- Deductions.** (a) For all taxable years beginning after December 31, 2023, and for the purposes of determining a tax due under this chapter, a deduction is allowed for the value of the decedent's qualified family-owned business interests. The estate of a decedent shall be allowed a deduction from the gross estate of the decedent for the value of any qualified family-owned business interest held by the decedent at the time of death; provided that:

(1) Interest in a closely held business was owned by the decedent or a qualified heir of the decedent; and

(2) There was material participation by the decedent or the decedent's qualified heir in the operation of the trade or business to which the interest relates.

(b) If the estate tax due on an estate includes tax attributable to the value of a qualified family-owned business interest, the estate shall be allowed a deduction from the gross estate of the decedent equal to the value of the interest in a closely held business.

(c) For the purpose of this section:

"Interest in a closely held business" means the same as it is used in section 6166 of the Internal Revenue Code.

"Material participation" means the same as it is used in section 2032A(e)(6) of the Internal Revenue Code.

"Qualified family-owned business interest" means any interest in a closely held business that meets the following requirements:

(1) The decedent had a material participation in the trade or business for at least five of the eight years preceding the date of death;

(2) The value of the trade or business, including the value of the decedent's interest in the trade or business, shall be at least thirty-five per cent of the adjusted gross estate of the decedent; and

(3) At least fifty-one per cent of the voting stock of the corporation shall be owned by members of two or more families who are related by blood, marriage, or adoption."

SECTION 3. Section 236E-6, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) An exclusion from a Hawaii taxable estate shall be allowed to the estate of every decedent against the tax imposed by section 236E-8. For the purpose of this section, the applicable exclusion amount is equal to:

(1) The federal applicable exclusion amount;

S.B. NO. 3345

(2) The exemption equivalent of the unified credit reduced by the amount of taxable gifts made by the decedent that reduces the amount of the federal applicable exclusion amount; or

(3) The exemption equivalent of the unified credit on the decedent's federal estate tax return,

as set forth for the decedent in chapter 11 of the Internal Revenue Code [~~as amended as of December 21, 2017, as if the decedent died on December 31, 2017, and~~] as further adjusted pursuant to subsection (b)."

SECTION 4. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 5. This Act shall take effect upon its approval and shall apply to decedents dying or taxable transfers occurring after December 31, 2023.

INTRODUCED BY: ______________________

By Request

S.B. NO. 3345

Report Title:
Estate Tax; DOTAX; Exclusion Amount; Deduction; Family Businesses

Description:
Conforms Hawaii estate tax laws to the operative provisions of the Internal Revenue Code to decrease the burden on taxpayers and increase efficiencies in the Department of Taxation's monitoring and auditing of estate tax returns. Establishes an estate tax deduction for the value of closely held business interests that will help ensure that locally-owned family businesses can continue to contribute to the Hawaii economy and assist families to retain the ownership interest in their family businesses.

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