

JULY 28, 2023

UPDATE: Hawaii Pass-Through Entity Tax

Background

This is an update to the [Tax Insights](#) that was issued on May 30, 2023. On June 1, 2023, [S.B. 1437, S.D. 1, H.D. 2, C.D. 1](#), was enacted into law as Act 50, Session Laws of Hawaii 2023. Act 50 is a SALT cap workaround measure that would allow partnerships and S-corporations to elect to pay Hawaii income tax at the entity level. By electing to pay Hawaii income tax on Hawaii PTE income at the entity level, partners and S-corporation shareholders would be able to avoid the SALT cap.

Department of Taxation Guidance

On July 21, 2023, the Department of Taxation (DOTAX) issued its initial guidance in Tax Information Release (TIR) 2023-01, however, as explained below, this guidance is likely to change before the law goes into effect. According to the current guidance, for the 2023 tax year:

- Estimated payments will not be required;
- PTE tax (PTET) payments will be accepted beginning on December 15, 2023; and
- PTET election must be made electronically no later than April 20, 2024.

On July 25, 2023, Accuity participated in an online forum hosted by DOTAX where tax practitioners were given an opportunity to provide feedback on the guidance contained in the TIR. As the forum was concluding, DOTAX announced that it would accept written comments until August 15, 2023. Thus, we anticipate that DOTAX will be updating its guidance sometime after the deadline to submit written comments has passed.

TIR 2023-01 is attached to this Tax Insights for your convenience.

What should you do now?

You do not need to take any action at this time, but we encourage you to start thinking about whether your partnership or S-corporation should make the Hawaii PTET election. We will continue to update you as more information becomes available.

If you have questions regarding how this measure may affect you, please don't hesitate to [contact us](#).

The information contained herein is general in nature and is not intended, and should not be construed, as legal, accounting or tax advice. This communication may not be applicable to your specific circumstances and may require consideration of non-tax and other tax factors if any action is to be contemplated. Please contact your tax professional prior to taking any action based on this information. Accuity LLP assumes no obligation to the reader of any changes in tax laws or other factors that could affect the information contained herein.

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July 21, 2023

TAX INFORMATION RELEASE NO. 2023-01

RE: Proposed Temporary Administrative Rules Relating to Pass-Through Entity Taxation as Enacted by Act 50, Session Laws of Hawaii 2023

The purpose of this Tax Information Release (TIR) is to provide guidance on the pass-through entity tax provided under Act 50, Session Laws of Hawaii 2023, and to provide notice of proposed temporary administrative rules relating to the pass-through entity tax and its accompanying credit.

On June 1, 2023, S.B. 1437, S.D. 1, H.D. 2, C.D. 1, was signed into law by Governor Josh Green, M.D. and became Act 50, Session Laws of Hawaii 2023 ("Act 50"). Act 50 adds a new section to part III of chapter 235, Hawaii Revised Statutes (HRS), allowing partnerships and S corporations to elect to pay Hawai'i income taxes at the entity level. Eligible members of an electing pass-through entity (PTE) will receive a Hawai'i income tax credit for the *pro rata* share of taxes paid.

Act 50 has an effective date of January 1, 2024, and applies to taxable years beginning after December 31, 2022.

Election for PTE Taxation

An election to be taxed at the PTE level must be made by the entity for each tax year it wishes to elect. Once an election is made, it is binding on all of the electing PTE's eligible members and cannot be revoked for that tax year. An authorized election requires either:

1. The signatures of each member of the entity; or
2. The signature of an authorized officer, manager, or member of the entity who must attest, under the penalty of perjury, that they have the authorization to make such an election on behalf of the members of the entity.

For tax year 2023, an election for PTE taxation must be filed with the Department by April 20, 2024. For taxable years beginning after December 31, 2023, an election for pass-through entity taxation must be filed with the Department by April 20 (or the 20th day of the 4th month for fiscal-year filers) of the taxable year.

PTE Tax

An electing PTE will be liable for Hawai'i state income tax on the sum of all eligible members' distributive shares and guaranteed payments of Hawai'i taxable income, multiplied by the highest rate of tax applicable to the individual under section 235-51, HRS (11% at the time of this publication). Eligible members include members that hold an interest in the electing PTE, except for C corporations.

Any net loss to the electing PTE may be carried forward until exhausted for as long as the entity continues to elect pass-through taxation.

Each electing PTE must pay the balance of the PTE tax and file a schedule detailing each member's share of PTE tax paid on or before April 20 (or the 20th day of the 4th month) following the close of the taxable year. A six-month extension for the filing of the schedule is automatically granted, provided the conditions in section 18-235-98, Hawaii Administrative Rules (HAR), are met, including payment of the properly estimated tax liability for the taxable year.

Estimated Tax Payments

For tax year 2023, estimated taxes are not required. The Department, however, will accept estimated tax payments for PTEs via Hawaii Tax Online, at <https://hitax.hawaii.gov>, beginning on December 15, 2023.

For tax years beginning after December 31, 2023, electing PTEs are required to make estimated tax payments in four equal amounts on or before the relevant due date as follows:

Payment	Due Date
1st Payment	April 20 of the current year (20th day of the 4th month of the fiscal year)
2nd Payment	June 20 of the current year (20th day of the 6th month of the fiscal year)
3rd Payment	September 20 of the current year (20th day of the 9th month of the fiscal year)
4th Payment	January 20 of the next year (20th day of the 1st month following the close of the fiscal year)

Each estimated tax payment must be accompanied by a statement detailing each member's share of the PTE tax paid. Underpayment penalties will apply in accordance with section 235-97(f), HRS.

Electronic Filing and Payments

Electing PTEs are required to file all returns, schedules, statements, and other documents, and remit all payments, electronically. Failure to electronically file and/or submit an electronic funds transfer may result in cancellation of the election for PTE taxation. The Department may grant an exemption to the electronic filing and/or payment requirement(s) for good cause upon the electing PTE's submission of a Form L-110 Electronic Filing or Payment Exemption Application.

Credit for PTE Taxes Paid

Electing PTEs are required to report to each member, for each tax year, the member's *pro rata* share of the PTE tax paid. Once an electing PTE has paid all applicable tax and has filed the schedule detailing each member's share of PTE tax paid, the PTE's eligible members may claim a credit equal to the member's *pro rata* share of the tax paid.¹ Any credits that exceed the member's tax liability are non-refundable to the member and excess credits cannot be carried forward. Members who claim the credit may not claim a deduction for amounts of Hawai'i state income tax that the member paid on their own distributive shares or guaranteed payment of income from the electing PTE.²

A member of an electing PTE who is itself a pass-through entity must also make an election for PTE taxation in order to pass any PTE credit from its parent to its members.

Credit for PTE Taxes Paid to Another State

Residents and part-year residents who are members of an electing PTE are entitled to a credit for the member's *pro rata* share of taxes paid to another state or to the District of Columbia, on income of any partnership or S corporation, so long as the taxes paid to the other state are found to be "substantially similar" to the taxes imposed by Act 50.

Amendments

Any entity wishing to claim a refund for an overpayment of the PTE tax must file their claim for refund on or before the due date prescribed for the filing of the schedule detailing each member's share of PTE tax paid, including any extension thereof (the 20th day of the 10th month following the close of the taxable year, if an extension is granted).

No amendments to the schedule detailing each member's share of PTE tax paid will be allowed after the due date, and no credit will be allowed for any PTE taxes paid after that date. However, electing PTEs and their members may amend their income tax returns, and pay any additional tax owed, in accordance with applicable law.

¹ Although single-member LLCs cannot elect PTE treatment themselves, they may receive the credit for taxes paid by a parent PTE.

² Please note: non-resident members of an electing PTE, who have no other source of Hawai'i income, are not required to file a Hawai'i income tax return for any tax year in which the PTE elects and pays tax.

The proposed temporary administrative rules discussed in this Tax Information Release are attached for reference. For more information, please contact the Rules Office at 808-587-1530 or by e-mail at Tax.Rules.Office@hawaii.gov.

GARY S. SUGANUMA
Director of Taxation

TEMPORARY ADMINISTRATIVE RULES

THESE ADMINISTRATIVE RULES ARE TEMPORARY RULES ISSUED PURSUANT TO SECTION 231-10.7, HAWAII REVISED STATUTES.

AS TEMPORARY RULES, THESE ADMINISTRATIVE RULES BECOME EFFECTIVE SEVEN DAYS AFTER PUBLIC NOTICE IS ISSUED. THESE TEMPORARY ADMINISTRATIVE RULES TAKE EFFECT ON

_____.

TEMPORARY ADMINISTRATIVE RULES ARE EFFECTIVE FOR EIGHTEEN MONTHS. THESE TEMPORARY ADMINISTRATIVE RULES WILL EXPIRE ON

_____.

PERMANENT ADMINISTRATIVE RULES, SUBJECT TO THE PROCEDURAL REQUIREMENTS OF CHAPTER 91, HAWAII REVISED STATUTES (THE HAWAII ADMINISTRATIVE PROCEDURES ACT), ARE SIMULTANEOUSLY BEING PROPOSED FOR FORMAL ADOPTION.

DEPARTMENT OF TAXATION

Amendments to Chapter 18-235
Hawaii Administrative Rules

Effective: _____

SUMMARY

1. §18-235-__-01 through §18-235-__-08 are added.
2. §18-235-91.5 is added.

§18-235-__-01 Pass-through entity election.

(a) For the tax year beginning after December 31, 2022, but not after December 31, 2023, election for pass-through entity taxation must be made on or before the twentieth day of the fourth month following the close of the taxable year.

(b) For tax years beginning after December 31, 2023, election for pass-through entity taxation must be made on or before the twentieth day of the fourth month of the taxable year.

(c) Failure to timely make an election on the form prescribed by the director shall constitute a waiver of pass-through entity taxation for the taxable year. [Eff] (Auth: HRS §231-10.7) (Imp: HRS §235-)

§18-235-__-02 Electronic filing.

(a) All returns, schedules, statements, and other documents required to be filed by an electing pass-through entity under chapter 235, HRS, and chapter 18-235, HAR, shall be filed electronically with the department for the taxable year in which a PTET election is made.

(b) The date of filing shall be the date the return, schedule, statement, or other document is successfully transmitted to the department in the form and manner prescribed by the director.

(c) Failure by an electing pass-through entity to electronically file as required in this section shall result in the cancellation of the election of pass-through entity taxation for the taxable year.

(d) The director may exempt any electing pass-through entity from the requirements in this section. [Eff] (Auth: HRS §231-10.7) (Imp: HRS §235-)

§18-235-__-03 Electronic funds transfer.

(a) All payments required to be filed by an electing pass-through entity under chapter 235, HRS, and chapter 18-235, HAR, shall be made by electronic funds transfer for the taxable year in which a PTET election is made.

(b) The date of payment shall be the date the funds are deposited with the State.

(c) Failure by an electing pass-through entity to submit payment by electronic funds transfer as

required in this section shall result in the cancellation of the election of pass-through entity taxation for the taxable year.

(d) The director may exempt any electing pass-through entity from the requirements in this section. [Eff] (Auth: HRS §231-10.7) (Imp: HRS §235-)

§18-235-__-04 Estimated pass-through entity tax payments. (a) For tax years beginning after December 31, 2023, each electing pass-through entity shall transmit payment of the estimated tax for the current taxable year as follows:

- (1) One-quarter of the estimated tax shall be paid on or before the twentieth day of the fourth month of the taxable year;
- (2) One-quarter of the estimated tax shall be paid on or before the twentieth day of the sixth month of the taxable year;
- (3) One-quarter of the estimated tax shall be paid on or before the twentieth day of the ninth month of the taxable year; and
- (4) One-quarter of the estimated tax shall be paid on or before the twentieth day of the first month following the close of the taxable year.

(b) Each estimated tax payment shall be accompanied by a statement detailing each member's share of the pass-through entity tax paid on a form prescribed by the director.

(c) The penalties provided in section 235-97(f), HRS, shall apply to any underpayment of estimated tax provided in this section. [Eff] (Auth: HRS §231-10.7) (Imp: HRS §235-)

§18-235-__-05 Pass-through entity tax payment; schedule of pass-through entity tax paid. (a) Each electing pass-through entity shall file with the department a schedule detailing each member's share of the pass-through entity tax paid, on a form prescribed by the director, on or before the twentieth day of the fourth month following the close of the taxable year. The schedule shall be accompanied by payment of the balance of the tax for the taxable year.

(b) Each electing-pass through entity shall be

granted an automatic six-month extension for the filing of the schedule; provided the conditions in section 18-235-98 are met.

(c) Amendments to the schedule shall not be allowed after the due date prescribed in this section, including any extensions thereof. [Eff _____]
(Auth: HRS §231-10.7) (Imp: HRS §235-)

§18-235-__-06 Refund of overpayments. Any claim for refund of an overpayment of the pass-through entity tax shall be filed by the electing pass-through entity on or before the due date prescribed for the filing of the schedule of pass-through entity tax provided in section 18-235-__-05, including any extensions thereof. [Eff _____] (Auth: HRS §231-10.7) (Imp: HRS §235-)

§18-235-__-07 Pass-through entity tax credit; allowed. (a) Each member of an electing pass-through entity whose distributive share or guaranteed payment of Hawaii taxable income is subject to the pass-through entity tax may claim a nonrefundable income tax credit equal to the member's share of pass-through entity taxes paid.

(b) No credit may be allowed for any pass-through entity taxes paid after the due date for the filing of the schedule provided in section 18-235-__-05, including any extensions thereof.

(c) No credit may be claimed by any indirect member of an electing pass-through entity unless the direct member of the electing pass-through entity, of which the indirect member is a member, also elects pass-through entity taxation for itself.

Example 1: PTE1, a pass-through entity whose members include Individual A, PTE2, and PTE3, makes an election for pass-through entity taxation, timely files the required schedule, and timely pays the pass-through entity tax. PTE2, a pass-through entity whose members include Individual B and Individual C, does not elect pass-through entity taxation. PTE3, a pass-through entity whose members include Individual D

and Individual E, makes an election for pass-through entity taxation, timely files the required schedule, and timely pays the pass-through entity tax. Individual A may claim a credit for pass-through entity taxes paid by PTE1. Individual B and Individual C may not claim a credit for pass-through entity taxes paid by PTE1 because PTE2 did not elect pass-through entity taxation. Individual D and Individual E may claim a credit for pass-through entity taxes paid by PTE1 because PTE3 properly elected, filed, and paid the pass-through entity tax as required. [Eff] (Auth: HRS §231-10.7) (Imp: HRS §235-)

§18-235-__-08 Credit for substantially similar taxes paid to another state or to the District of Columbia. A taxpayer claiming the credit for the pro rata share of taxes paid to another state or to the District of Columbia on income of any partnership or S corporation of which the taxpayer is a member shall attach to the taxpayer's income tax return for the taxable year a copy of the pass-through entity's tax return filed in the other state or District of Columbia, and all available schedules showing taxpayer's share of taxes paid. [Eff] (Auth: HRS §231-10.7) (Imp: HRS §235-)

§18-235-91.5 Income tax credits; ordering of credit claims. In the offsetting of a taxpayer's income tax liability, tax credits shall be applied in the following order:

- (1) Tax credits that may be refunded or paid to a taxpayer who has no income tax liability;
- (2) Nonrefundable tax credits that may not be carried forward; and
- (3) Nonrefundable tax credits that may be used as a credit against taxes in subsequent years until exhausted. [Eff] (Auth: HRS §231-10.7) (Imp: HRS §235-91.5)