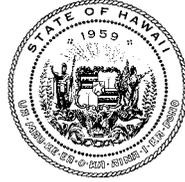


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July 29, 2010

## **TAX INFORMATION RELEASE NO. 2010-06**

Re: Act 74, Session Laws of Hawaii 2010; Estate & Transfer Tax

On April 29, 2010, the Legislature overrode Governor Linda Lingle's veto of House Bill 2866 HD 1 SD 1 CD 1, which became law as Act 74, Session Laws of Hawaii 2010.

Act 74 reenacts Hawaii's Estate & Transfer Tax under Chapter 236D, Hawaii Revised Statutes (HRS), in a form that adopts conforming provisions to the Internal Revenue Code (IRC), Title 26, Subtitle B, Estate & Gift Tax, involving two separate points in time. The mechanics of the conforming provisions is discussed in more detail below. Act 74 applies to decedents dying on or after May 1, 2010.

The purpose of this Tax Information Release (TIR) is to set forth the Department's interpretation of Act 74 and to provide guidance on its application.

### **HISTORY OF HAWAII'S ESTATE & TRANSFER TAX**

Prior to Act 74, Chapter 236D, HRS, included two estate and transfer taxes. The first tax was the estate tax assessed against the taxable estate of persons dying as residents of Hawaii or as nonresidents with property interests in Hawaii. The second tax was the generation-skipping transfer tax, which was a tax on certain transfers at death of residents and nonresidents to persons more than one generation from the decedent.

Prior law assessed an estate tax and a generation-skipping transfer tax in amounts equal to the federal credits for state taxes paid under Sections 2011 and 2604, IRC, respectively. For example, prior to Act 74, Section 2011, IRC, allowed a federal credit for state death taxes paid up to certain amounts based upon graduated rates. Whatever the state death tax credit allowable based upon the Section 2011 graduated rate table; Hawaii would "pick-up" as the Hawaii estate tax.

Beginning after the year 2000, the credits under Sections 2011 and 2604, IRC, which comprised the bases for Hawaii's Estate & Transfer Tax, began to phase out by operation of the Economic Growth & Tax Relief Reconciliation Act of 2001 (EGTRRA). As a matter of federal tax policy, EGTRRA was the means of slowly eliminating the federal estate and generation-skipping transfer taxes. As part of EGTRRA's phase out of the federal transfer taxes, the credits for state taxes paid likewise were slowly eliminated. Because Hawaii's Estate and Transfer Tax bases were the amounts equal to the federal credits available, once the credits began to phase out, so did Hawaii's tax under Chapter 236D, HRS. Ultimately, Hawaii's Estate & Transfer Tax became

“dormant” beginning in 2005 when the federal credits for state taxes paid were effectively repealed. Hawaii would continue without an Estate & Transfer Tax so long as the tax base remained tied to the federal credit for state taxes paid.

As part of EGTRRA, the federal estate and generation-skipping taxes terminated for persons dying in 2010. Under law existing as of the date of this TIR, the federal estate and generation-skipping taxes will be reenacted beginning on January 1, 2011 in a form similar to the law prior to EGTRRA; however with differing rates and exclusion amounts. The federal credits for state death taxes paid also reenact beginning on January 1, 2011.

### **ACT 74 APPLICABLE TO DECEDENTS ON OR AFTER MAY 1, 2010**

Act 74 and the Estate and Transfer Tax liability under Chapter 236D, HRS, applies to individuals dying on or after May 1, 2010.

### **UNIFIED CREDIT; APPLICABLE EXCLUSION AMOUNT**

Act 74 explicitly and independently provides for the entitlement of all applicable exclusion or exemption amounts available under the IRC as of December 31, 2009.

For example, before being subject to the Hawaii Estate Tax, the decedent will be entitled to the “applicable exclusion amount” under Section 2010, IRC. Under federal estate tax law, decedents are entitled to a “lifetime” unified credit with which the amount will be utilized to offset any estate and/or gift tax owed in their lifetime. The unified credit amount, when calculated and adjusted under federal law, results in an exclusion at death of a certain amount. This exclusion amount is referred to as the “applicable exclusion amount.”

The applicable exclusion amount is the threshold amount before a decedent’s taxable estate is subject to the federal estate tax, by computation of the applicable credit amount against the estate tax rates as provided in Section 2010, IRC. The applicable exclusion amount for purposes of Act 74, which is the applicable exclusion amount as of December 31, 2009, is \$3,500,000 per decedent. Therefore, decedents dying on or after May 1, 2010 with a taxable estate of \$3,500,000 or less are not subject to Chapter 236D, HRS.

The applicable exclusion amount will include any additional adjustments made under Section 2010, IRC, including any reduction in the applicable exclusion amount due to taxable gifts made during a person’s lifetime.

As stated above, all exclusion or exemption amounts available in Subtitle B, IRC, are available to decedents subject to Chapter 236D, HRS. Additional exemptions include the exemption for generation-skipping transfer taxes available under Section 2631, IRC, in the amount of \$3,500,000 per decedent. Further, nonresident decedents not citizens of the United States are entitled to the unified credit available under Section 2102, IRC, which results in an exemption equivalent amount of \$60,000.

**CONFORMITY TO FEDERAL ESTATE TAX—US CITIZENS**

Act 74 amends Chapter 236D, HRS, by “reenacting” Hawaii’s previously-dormant estate tax. Act 74 adds a new definition of “Internal Revenue Code,” which makes the IRC operative for purposes of the Estate and Transfer Tax as of December 31, 2009. However, Section 2011, IRC, which provides for the federal estate tax credit for state death taxes paid, is made operative as of December 31, 2000.

The effect of this new definition of “Internal Revenue Code” is that decedents are entitled to utilize the higher applicable exclusion amount to determine whether an estate is subject to Chapter 236D as of December 31, 2009 (*i.e.*, \$3,500,000 per decedent). However, to maintain the prior tax base for Hawaii estate tax purposes, which was the prior federal estate tax credit for state death taxes paid that phased out in 2005, Act 74 picks up the prior version of the state death tax credit prior to its phase out as it applied on December 31, 2000.

The Hawaii Estate and Transfer Tax is intended to operate similar to how the tax was determined prior to becoming dormant in 2005—the primary substantive adjustment being the threshold where estates become subject to the tax. The legislature determined that the \$3,500,000 per decedent exclusion amount was in the best interest of the State—rather than the \$675,000 exclusion that was available for deaths occurring in 2000.

One additional substantive amendment made by Act 74 that impacts the calculation of Hawaii estate tax is that the deduction for state death taxes paid is not made operative. As part of EGTRRA, the federal estate tax credit for state death taxes paid was phased out in favor of a deduction for state death taxes paid. Chapter 236D, HRS, does not conform to the deduction for state death taxes paid when calculating Hawaii estate tax liability.

Except for the Section 2011, IRC, credit for state death taxes and the Section 2058, IRC, deduction for state death taxes, the determination of gross estate, taxable estate, and adjusted taxable estate will be determined in all other respects under the IRC as Subtitle B existed on December 31, 2009.

Nonresident decedents with property interests taxable in Hawaii under Chapter 236D will continue to apportion the credit based upon property interests with a situs in Hawaii as provided in HRS § 236D-4.

**CONFORMITY TO FEDERAL ESTATE TAX—NONRESIDENTS NOT US CITIZENS**

Act 74 adds a new provision to Chapter 236D, HRS, which provides for the assessment of the estate tax on transfers made by nonresidents who are not United States citizens. Patterned after the estate tax on transfers made by residents and nonresidents under prior law, Act 74 imposes an estate transfer tax on transfers of property interests located in Hawaii made by the estates of nonresident decedents not citizens of the United States.

The amount of the tax is arrived at by apportioning the amount of the federal credit based upon property interests with a situs in Hawaii over the value of the decedent’s gross estate. Specifically, noncitizen transfers subject to the tax are transfers of real property with a situs in

Hawaii, whether or not held in trust; a beneficial interest in a land trust that owns Hawaii property; and tangible and intangible personal property having a situs in Hawaii.

Act 74 defines “noncitizen transfer” as a transfer defined under Section 2101, IRC. “Nonresident not a citizen” means a nonresident who is not of United States citizenship.

Act 74 defines “situs” as meaning the location of a decedent’s property within the meaning of Section 2104, IRC. However, in implementing the definition of situs for Hawaii estate tax purposes, the term “Hawaii” is substituted for the phrase “the United States.”

As amended, Section 2104, IRC, for purposes of the Hawaii estate tax will be implemented as follows:

**§ 2104 Property within Hawaii**

**(a) Stock in corporation.** For purposes of this subchapter shares of stock owned and held by a nonresident not a citizen of the United States shall be deemed property within Hawaii only if issued by a Hawaii corporation.

**(b) Revocable transfers and transfers within 3 years of death.** For purposes of this subchapter, any property of which the decedent has made a transfer, by trust or otherwise, within the meaning of sections 2035 to 2038, inclusive, shall be deemed to be situated in Hawaii, if so situated either at the time of the transfer or at the time of the decedent's death.

**(c) Debt obligations.**

For purposes of this subchapter, debt obligations of—

- (1) a Hawaii person, or
- (2) Hawaii or any political subdivision thereof,

owned and held by a nonresident not a citizen of the United States shall be deemed property within Hawaii. With respect to estates of decedents dying after December 31, 1969, deposits with a Hawaii branch of a foreign corporation, if such branch is engaged in the commercial banking business, shall, for purposes of this subchapter, be deemed property within Hawaii. This subsection shall not apply to a debt obligation to which section 2105(b) applies or to a debt obligation of a domestic corporation if any interest on such obligation, were such interest received by the decedent at the time of his death, would be treated by reason of section 861(a)(1)(A) as income from sources without Hawaii.

**CONFORMITY TO FEDERAL GENERATION-SKIPPING TRANSFER TAX**

Act 74 also amends Chapter 236D, HRS, by reenacting Hawaii’s previously dormant generation-skipping transfer tax. Act 74 makes the definition of Section 2604, IRC, operative as of December 31, 2000, which provides for the federal credit for state generation-skipping transfer taxes paid.

The effect of this new definition of “Internal Revenue Code” is that decedents are entitled to utilize the higher exemption amount of \$3,500,000 available under Section 2631, IRC, to determine whether a transfer is subject to Chapter 236D (versus the prior \$1,000,000 exemption indexed for inflation). However, to maintain the prior tax base for Hawaii generation skipping transfer tax purposes, which was the prior federal credit for state generation skipping transfer taxes paid that phased out in 2005, Act 74 picks up the prior version of the state tax credit prior to phase out as it applied on December 31, 2000.

The application of the Hawaii Estate and Transfer Tax is intended to operate similar to how the tax was determined prior to becoming dormant in 2005, with the only substantive adjustment being the threshold where generation-skipping transfers become subject to the tax.

### **HAWAII ESTATE AND GENERATION-SKIPPING TRANSFER TAXES STAND ALONE**

Prior to Act 74, Hawaii's Estate and Transfer Tax was directly tied to federal law as it was amended from time-to-time. This direct relation to federal law resulted in the Hawaii tax becoming dormant when the federal credits for state taxes paid were suspended. Without the credit, there was no tax base for Hawaii.

Under current federal law, for example, the estate tax does not apply to decedents dying in 2010. However, the federal estate tax is set to resurrect on January 1, 2011. Presently, there have been several formal and informal proposals in Congress that are intended to amend the federal estate tax in varying ways. Some of the policies propose to retroactively tax decedents dying as early as January 1, 2010. Other proposals eliminate the federal credit for state death taxes paid on a going-forward basis. Still, other proposals seek to offer a choice between paying federal estate tax in 2010 and enjoying the stepped-up basis for beneficiaries; or opting to forego federal estate tax for 2010 with the current carryover basis for beneficiaries. In sum, as of the date of this TIR, it is unclear how Congress intends to pursue federal estate tax policy in the near future.

Due to the uncertainty of what form the federal estate tax and generation-skipping tax will take, Act 74 avoids this issue by adopting the federal estate tax and generation-skipping tax at certain fixed times where the tax law was certain. Generally, Act 74 adopts the IRC as of December 31, 2009; except for the federal credits for state death or transfer taxes paid, which are adopted for Hawaii tax purposes as written on December 31, 2000. Because specific provisions were adopted at fixed points in time, the projected uncertainty regarding federal estate tax law has no impact on Hawaii Estate and Transfer Tax under Chapter 236D, HRS. Whatever policies become law federally will no longer have any impact on Hawaii law. As the federal estate and generation-skipping transfer tax laws exist today, the taxes will resurrect on January 1, 2011 with a provision for a federal tax credit for state death taxes paid. This credit will no longer have a direct impact on Hawaii law. Administration of the Hawaii Estate and Transfer Tax will be dictated as the law provides on December 31, 2009, with the credits for taxes provided on December 31, 2000.

### **DECEMBER 31, 2000 FEDERAL CREDITS FOR STATE TAXES PAID**

Due to potential issues with sourcing federal law as it existed in the year 2000, set forth at the end of this TIR are the December 31, 2000 versions of the federal credits for transfer taxes paid, which are made operative under Act 74. The most recent December 31, 2009 federal estate and generation-skipping transfer tax laws are widely available and remain in usable form from many sources.

**FORMS & ADDITIONAL GUIDANCE**

The Department is presently working on updating the Hawaii Estate and Transfer Tax forms and instructions.

The Department projects that it may be some months before the forms are finalized. Tax returns under Chapter 236D, HRS, are generally due nine months from the decedent's date of death. A six month extension is available and is routinely granted.

The Department welcomes calls or questions from executors or tax practitioners who, in the interim before forms are completed, may be dealing with issues related to Hawaii's Estate and Transfer Tax. The Department will use its best efforts to assist with tax-related matters while the forms are being developed so as not to materially impact the administration, distribution, and/or probate of taxable estates.

For additional information, please contact the Technical Section at 587-1577.



STANLEY SHIRAKI  
Acting Director of Taxation

**SECTION 2011, IRC, AS OF DECEMBER 31, 2000—****§ 2011 Credit for State death taxes.****(a) In general.**

The tax imposed by section 2001 shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia, in respect of any property included in the gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent).

**(b) Amount of credit.****(1) In general.**

Except as provided in paragraph (2), the credit allowed by this section shall not exceed the appropriate amount stated in the following table:

If the adjusted taxable estate is:	The maximum tax credit shall be:
Not over \$90,000	8/10ths of 1% of the amount by which the adjusted taxable estate exceeds \$40,000.
Over \$90,000 but not over \$140,000.	\$400 plus 1.6% of the excess over \$90,000.
Over \$140,000 but not over \$240,000.	\$1,200 plus 2.4% of the excess over \$140,000.
Over \$240,000 but not over \$440,000.	\$3,600 plus 3.2% of the excess over \$240,000.
Over \$440,000 but not over \$640,000.	\$10,000 plus 4% of the excess over \$440,000.
Over \$640,000 but not over \$840,000.	\$18,000 plus 4.8% of the excess over \$640,000.
Over \$840,000 but not over \$1,040,000.	\$27,600 plus 5.6% of the excess over \$840,000.
Over \$1,040,000 but not over \$1,540,000.	\$38,800 plus 6.4% of the excess over \$1,040,000.
Over \$1,540,000 but not over \$2,040,000.	\$70,800 plus 7.2% of the excess over \$1,540,000.

Over \$2,040,000 but not over \$2,540,000.	\$106,800 plus 8% of the excess over \$2,040,000.
Over \$2,540,000 but not over \$3,040,000.	\$146,800 plus 8.8% of the excess over \$2,540,000.
Over \$3,040,000 but not over \$3,540,000.	\$190,800 plus 9.6% of the excess over \$3,040,000.
Over \$3,540,000 but not over \$4,040,000.	\$238,800 plus 10.4% of the excess over \$3,540,000.
Over \$4,040,000 but not over \$5,040,000.	\$290,800 plus 11.2% of the excess over \$4,040,000.
Over \$5,040,000 but not over \$6,040,000.	\$402,800 plus 12% of the excess over \$5,040,000.
Over \$6,040,000 but not over \$7,040,000.	\$522,800 plus 12.8% of the excess over \$6,040,000.
Over \$7,040,000 but not over \$8,040,000.	\$650,800 plus 13.6% of the excess over \$7,040,000.
Over \$8,040,000 but not over \$9,040,000.	\$786,800 plus 14.4% of the excess over \$8,040,000.
Over \$9,040,000 but not over \$10,040,000.	\$930,800 plus 15.2% of the excess over \$9,040,000.
Over \$10,040,000	\$1,082,800 plus 16% of the excess over \$10,040,000.

For purposes of this section, the term “adjusted taxable estate” means the taxable estate reduced by \$60,000.

**(c) Period of limitations on credit.**

The credit allowed by this section shall include only such taxes as were actually paid and credit therefor claimed within 4 years after the filing of the return required by section 6018, except that—

**(1)** If a petition for redetermination of a deficiency has been filed with the Tax Court within the time prescribed in section 6213(a), then within such 4-year period or before the expiration of 60 days after the decision of the Tax Court becomes final.

(2) If, under section 6161 or 6166, an extension of time has been granted for payment of the tax shown on the return, or of a deficiency, then within such 4-year period or before the date of the expiration of the period of the extension.

(3) If a claim for refund or credit of an overpayment of tax imposed by this chapter has been filed within the time prescribed in section 6511, then within such 4-year period or before the expiration of 60 days from the date of mailing by certified mail or registered mail by the Secretary to the taxpayer of a notice of the disallowance of any part of such claim, or before the expiration of 60 days after a decision by any court of competent jurisdiction becomes final with respect to a timely suit instituted upon such claim, whichever is later.

Refund based on the credit may (despite the provisions of sections 6511 and 6512) be made if claim therefor is filed within the period above provided. Any such refund shall be made without interest.

**(d) Basic estate tax.**

The basic estate tax and the estate tax imposed by the Revenue Act of 1926 shall be 125 percent of the amount determined to be the maximum credit provided by subsection (b). The additional estate tax shall be the difference between the tax imposed by section 2001 or 2101 and the basic estate tax.

**(e) Limitation in cases involving deduction under section 2053(d).**

In any case where a deduction is allowed under section 2053(d) for an estate, succession, legacy, or inheritance tax imposed by a State or the District of Columbia upon a transfer for public, charitable, or religious uses described in section 2055 or 2106(a)(2), the allowance of the credit under this section shall be subject to the following conditions and limitations:

(1) The taxes described in subsection (a) shall not include any estate, succession, legacy, or inheritance tax for which such deduction is allowed under section 2053(d).

(2) The credit shall not exceed the lesser of—

(A) the amount stated in subsection (b) on an adjusted taxable estate determined by allowing such deduction authorized by section 2053(d), or

(B) that proportion of the amount stated in subsection (b) on an adjusted taxable estate determined without regard to such deduction authorized by section 2053(d) as (i) the amount of the taxes described in subsection (a) as limited by the provisions of paragraph (1) of this subsection, bears to (ii) the amount of the taxes described in subsection (a) before applying the limitation contained in paragraph (1) of this subsection.

(3) If the amount determined under subparagraph (B) of paragraph (2) is less than the amount determined under subparagraph (A) of that paragraph, then for purposes of subsection (d) such lesser amount shall be the maximum credit provided by subsection (b).

**(f) Limitation based on amount of tax.**

The credit provided by this section shall not exceed the amount of the tax imposed by section 2001, reduced by the amount of the unified credit provided by section 2010.

**SECTION 2102, IRC, AS OF DECEMBER 31, 2000—**

**§ 2102 Credits against tax.**

**(a) In general.**

The tax imposed by section 2101 shall be credited with the amounts determined in accordance with sections 2011 to 2013, inclusive (relating to State death taxes, gift tax, and tax on prior transfers), subject to the special limitation provided in subsection (b).

**(b) Special Limitation.**

The maximum credit allowed under section 2011 against the tax imposed by section 2101 for State death taxes paid shall be an amount which bears the same ratio to the credit computed as provided in section 2011(b) as the value of the property, as determined for purposes of this chapter, upon which State death taxes were paid and which is included in the gross estate under section 2103 bears to the value of the total gross estate under section 2103. For purposes of this subsection, the term 'State death taxes' means the taxes described in section 2011(a).

**(c) Unified credit.**

**(1) In general.**

A credit of \$13,000 shall be allowed against the tax imposed by section 2101.

**(2) Residents of possessions of the United States.**

In the case of a decedent who is considered to be a "nonresident not a citizen of the United States" under section 2209, the credit under this subsection shall be the greater of—

(A) \$13,000, or

(B) that proportion of \$46,800 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated.

**(3) Special rules.**

(A) Coordination with treaties. To the extent required under any treaty obligation of the United States, the credit allowed under this subsection shall be equal to the amount which bears the same ratio to the applicable credit amount in effect under section 2010(c) for the calendar year which includes the date of death as the value of the part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated. For purposes of the preceding sentence, property shall not be treated as situated in the United States if such property is exempt from the tax imposed by this subchapter under any treaty obligation of the United States.

(B) Coordination with gift tax unified credit. If a credit has been allowed under section 2505 with respect to any gift made by the decedent, each dollar amount contained in paragraph (1) or (2) or subparagraph (A) of this paragraph (whichever applies) shall be reduced by the amount so allowed.

**(4) Limitation based on amount of tax.**

The credit allowed under this subsection shall not exceed the amount of the tax imposed by section 2101.

**(5) Application of other credits.**

For purposes of subsection (a), sections 2012 and 2013 shall be applied as if the credit allowed under this subsection were allowed under section 2010.

**SECTION 2604, IRC, AS OF DECEMBER 31, 2000—**

**§ 2604 Credit for certain State taxes.**

**(a) General rule.**

If a generation-skipping transfer (other than a direct skip) occurs at the same time as and as a result of the death of an individual, a credit against the tax imposed by section 2601 shall be allowed in an amount equal to the generation-skipping transfer tax actually paid to any State in respect to any property included in the generation-skipping transfer.

**(b) Limitation.**

The aggregate amount allowed as a credit under this section with respect to any transfer shall not exceed 5 percent of the amount of the tax imposed by section 2601 on such transfer.