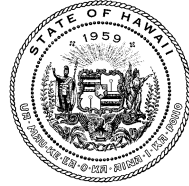


JOSH GREEN, M.D.
GOVERNOR

SYLVIA LUKE
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION

Ka 'Oihana 'Auhau

P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1530
FAX NO: (808) 587-1584

August 15, 2024

GARY S. SUGANUMA
DIRECTOR OF TAXATION

KRISTEN M.R. SAKAMOTO
DEPUTY DIRECTOR

TAX INFORMATION RELEASE NO. 2024-01

RE: Proposed Temporary Administrative Rules Relating to Pass-Through Entity Taxation as Enacted by Act 50, Session Laws of Hawaii 2024

The purpose of this Tax Information Release (TIR) is to provide guidance on changes to the pass-through entity (PTE) tax provided under Act 50, Session Laws of Hawaii 2024 ("2024 Act 50"), and to provide notice of proposed temporary administrative rules relating to the PTE tax and its accompanying credit.

This TIR replaces and supersedes TIR 2023-03 (Amended) for taxable years beginning after December 31, 2023.

On June 19, 2024, S.B. 2725, H.D. 1, C.D. 1, was signed into law by Governor Josh Green, M.D., and became 2024 Act 50. 2024 Act 50 amends section 235-51.5, Hawaii Revised Statutes (HRS), which allows PTEs to elect to be taxed at the entity level and provides a credit to members whose distributive share or guaranteed payment of Hawai'i taxable income is subject to the tax.

2024 Act 50 amends the PTE tax base by imposing the tax on the sum of the distributive shares and guaranteed payments of all "qualified member[s]." A "qualified member" is now defined as a member of an electing PTE that is an individual, trust, or estate. Accordingly, PTEs without qualified members are no longer eligible to elect PTE taxation.

2024 Act 50 also amends the PTE tax rate from the highest rate of tax applicable to the individual under section 235-51, HRS, to 9 percent and allows the PTE credit to be carried forward in subsequent years until exhausted. 2024 Act 50 is effective upon approval and applies to taxable years beginning after December 31, 2023.

Definitions

For purposes of this TIR:

"Electing PTE" means a Qualified PTE that elects PTE taxation for the taxable year.

"Qualified Member" means a member of an Electing PTE that is an individual, trust, or estate whose distributive shares and guaranteed payments are subject to PTE taxation for the taxable year. A single-member limited liability company (LLC) treated as a disregarded entity for federal tax purposes shall constitute an individual for purposes of the PTE tax and shall be

considered a Qualified Member.

“Qualified PTE” means a PTE that is eligible to elect PTE taxation for the taxable year.

Entities That May Elect PTE Taxation

Qualified PTEs include partnerships and S corporations. The term "partnership" means the same as in the Internal Revenue Code (IRC) and includes an LLC that is treated as a partnership for federal income tax purposes, but does not include any publicly traded partnership as defined in IRC section 7704. Single-member LLCs are not eligible to elect PTE taxation. However, a single-member LLC that elects to be taxed as an S corporation is eligible to elect PTE taxation. The term "S corporation" means a corporation for which a valid election under IRC section 1362(a) is in effect.

Certain multi-tiered entities, including formerly Qualified PTEs that do not have any Qualified Members, are not eligible for PTE taxation even if they have already elected PTE taxation or made estimated payments for tax years after December 31, 2023. Multi-tiered entities that are no longer eligible for PTE taxation should contact the Department regarding changes in their eligibility due to 2024 Act 50.

Election for PTE Taxation

An election to be taxed at the PTE level must be made on or before the 20th day of the 4th month following the close of the taxable year. An automatic six-month extension is 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. The election must be made on the form and in the manner prescribed by the Department. A separate election for PTE taxation must be made for each tax year. Once an election is made, it is binding on all of the Electing PTE's Qualified 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 penalty of perjury, that they have the authorization to make such an election on behalf of the members of the entity.

Calculation of PTE Tax

An Electing PTE will be liable for Hawai'i state income tax on the sum of all Qualified Members' distributive shares and guaranteed payments of Hawai'i taxable income, multiplied by 9 percent. There is no separate tax rate for capital gains. The distributive shares and guaranteed payments of all Qualified Members must be included in calculating the PTE tax.

Qualified Members are all members that hold an interest in the Electing PTE that are an individual, trust, or estate. 2024 Act 50 does not allow a Qualified Member of an Electing PTE to opt out of PTE taxation.

Deadline to Remit PTE

Each Electing PTE must pay the balance of the PTE tax (the total tax less any estimated tax payments made) on or before the 20th day of the 4th month following the close of the taxable year. Penalties and interest, as provided in section 231-39, HRS, shall be added to and become part of the PTE tax.

Estimated Tax Payments

For tax years beginning after December 31, 2023, Electing PTEs must make estimated tax payments in four equal amounts as follows:

| Estimated Tax Payment | Due Date for Calendar Year Taxpayers | Due Date for Fiscal Year Taxpayers |
|------------------------------|---|--|
| 1st Payment | 4/20 of the current year | 20th day of the 4th month of the fiscal year |
| 2nd Payment | 6/20 of the current year | 20th day of the 6th month of the fiscal year |
| 3rd Payment | 9/20 of the current year | 20th day of the 9th month of the fiscal year |
| 4th Payment | 1/20 of the next year | 20th day of the 1st month following the close of the fiscal year |

Underpayment penalties will apply in accordance with section 235-97(f), HRS.¹

For tax year 2024, Electing PTEs will not be penalized for failing to make the first two estimated payments or making unequal payments due to recent changes in the PTE tax rate under 2024 Act 50. Electing PTEs that have not made the first two estimated payments must timely remit the final two estimated payments for tax year 2024. Electing PTEs that have already made estimated payments based on the prior PTE tax rate should adjust subsequent estimated payments to account for the new 9 percent PTE tax rate.

¹ Taxpayers are responsible for calculating their own estimated payments. The Department will not be advising taxpayers on how the timing of PTE tax payments may affect the federal deduction for state and local income taxes.

Required Filing of Schedules

Each Electing PTE must file a schedule detailing each Qualified Member's share of PTE tax paid on or before 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, HAR, are met, including payment of the properly estimated tax liability for the taxable year. Failure to timely file the schedule may result in cancellation of the election for PTE taxation.

Trusts or estates that receive PTE credits as Qualified Members of Electing PTEs and pass those credits on to beneficiaries on Form N-40 Schedule K-1 must file Schedule PTE-U to report the allocation of the PTE credit received from the Electing PTEs to the trust's beneficiaries.

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 shall 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.

A list of approved software vendors supporting the required forms and schedules for electing PTEs is found on the Department's website: <https://tax.hawaii.gov/eservices/software/>.

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 filed the schedule detailing each member's share of PTE tax paid, Qualified Members may claim a credit equal to the member's *pro rata* share of the tax paid. Any credits that exceed the member's tax liability are non-refundable to the member and excess credits may be carried forward for tax years following December 31, 2023. 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. Pursuant to section 235-111, HRS, the deadline for Qualified Members to claim the credit for PTE taxes paid is three years from the date the return was filed or from the due date prescribed for the filing of the return, whichever is later.

Credit for PTE Taxes Paid to Another State

Residents and part-year residents who are qualified members of a 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 2024 Act 50.

Amendments and Refunds

No amendments to the schedule detailing each member’s share of PTE tax paid, and no refunds of PTE taxes paid, will be allowed after the 20th day of the 4th month following the close of the taxable year, or the 20th day of the 10th month following the close of the taxable year if an extension is granted.

An Electing PTE may, however, request a refund for any amount of paid PTE taxes exceeding the amount claimed on the schedule within the time provided in section 235-111, HRS. An Electing PTE may also amend its income tax return in accordance with applicable law. Overpayments may also be carried forward and applied as estimated payments for subsequent years.

A PTE that makes estimated tax payments, but does not elect PTE taxation, may request a refund within the time provided in section 235-111, HRS. Entities without Qualified Members that are no longer eligible to elect PTE taxation but have already made estimated payments may request a refund of amounts paid within the time provided in section 235-111, HRS.

Income Tax Returns

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. An election for PTE taxation does not affect other applicable requirements, including requirements to file income tax returns, schedules, and other documents provided under the law.

Summary of Filing Deadlines (Calendar Year Taxpayers)

| Deadline | Description |
|--|-------------------------------------|
| 4/20 of the taxable year | 1st estimated tax payment due |
| 6/20 of the taxable year | 2nd estimated tax payment due |
| 9/20 of the taxable year | 3rd estimated tax payment due |
| 1/20 following the close of the taxable year | 4th estimated tax payment due |
| 4/20 following the close of the taxable year | Balance of PTE tax due |
| | Election due |
| | Schedule due |
| 10/20 following the close of the taxable year: | Election due (if extension granted) |
| | Schedule due (if extension granted) |

If you have any questions about this TIR, please contact the Rules Office at 808-587-1530, or via email 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. §18-235-200-01 is repealed.
2. §18-235-200-02 is repealed.
3. §18-235-200-03 is repealed.
4. §18-235-200-04 is repealed.
5. §18-235-200-05 is repealed.
6. §18-235-200-06 is repealed.

7. §18-235-200-07 is repealed.
8. §18-235-200-08 is repealed.
9. §18-235-200-09 is repealed.
10. New §18-235-201-01 is added.
11. New §18-235-201-02 is added.
12. New §18-235-201-03 is added.
13. New §18-235-201-04 is added.
14. New §18-235-201-05 is added.
15. New §18-235-201-06 is added.
16. New §18-235-201-07 is added.
17. New §18-235-201-07.01 is added.
18. New §18-235-201-08 is added.
19. New §18-235-201-09 is added.

§§18-235-200-01 to 18-235-200-09 Repealed. [R]

§18-235-201-01 Pass-through entity election. (a) An election for pass-through entity taxation must be made on or before the due date prescribed for the filing of the schedule for the taxable year as provided in section 18-235-201-05, including any extensions thereof.

(b) Failure to timely make an election on the form prescribed by the director shall constitute a waiver of the election of pass-through entity taxation for the taxable year. [Eff] (Auth: HRS §§231-10.7; §235-51.5) (Imp: HRS §235-51.5)

Historical note: §18-235-201-01 is based substantially upon §18-235-200-01. [Eff 2/16/24; R]

§18-235-201-02 Electronic filing. (a) All returns, schedules, statements, and other documents required to be filed under chapter 235, HRS, and chapter 18-235, HAR, shall be filed electronically by an electing pass-through entity for the taxable year in which an election for pass-through entity taxation 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; 235-51.5) (Imp: HRS §235-51.5)

Historical note: §18-235-201-02 is based substantially upon §18-235-200-02. [Eff 2/16/24; R]

§18-235-201-03 Electronic funds transfer. (a) All payments required to be remitted 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 an election for pass-through entity taxation 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; 235-51.5) (Imp: HRS §235-51.5)

Historical note: §18-235-201-03 is based substantially upon §18-235-200-03. [Eff 2/16/24; R]

§18-235-201-04 Estimated pass-through entity tax payments.

(a) For tax year 2024, each electing pass-through entity shall transmit payment of the estimated tax for the current taxable year as follows:

- (1) One-half of the estimated tax shall be paid on or before the twentieth day of the ninth month of the taxable year; and
- (2) One-half 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) For tax years beginning after December 31, 2024, 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.

(c) For purposes of this section, "estimated tax for the current taxable year" means the lesser of:

- (1) 100 per cent of the tax shown on the return for the taxable year or, if no return is filed, 100 per cent of the tax for the taxable year; or
- (2) 100 per cent of the tax shown on the return for the preceding taxable year;

provided that subsection (c)(2) shall not apply if the preceding taxable year was not a taxable year of 12 months or an election for pass-through entity taxation was not made for the preceding taxable year.

(d) 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; 235-51.5) (Imp: HRS §235-51.5)

Historical note: §18-235-201-04 is based substantially upon §18-235-200-04. [Eff 2/16/24; R]

§18-235-201-05 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, including payment of the properly estimated tax liability on or before the due date prescribed for the filing of the schedule in subsection (a), are met.

(c) Amendments to the schedule shall not be allowed after the due date prescribed in this section, including any extensions thereof.

(d) The department may, in its discretion, cancel the election for pass-through entity taxation if an electing pass-through entity fails to file the schedule within the time provided for in this section.

Example 1:

Partnership1, a calendar-year taxpayer, pays the properly estimated tax liability on April 20 following the close of the tax year. On October 20, Partnership1 makes an election for pass-through entity taxation and files the required schedule. On November 1, Partnership1 discovers that there were additional distributive shares of income owed to its members for which it failed to report and pay PTE tax.

Partnership1 will not owe additional pass-through entity tax on the additional distributive shares of income and may not amend the schedule of pass-through entity tax to report the additional distributive shares of income. Partnership1 must, however, report the additional distributive shares of income on its income tax return. [Eff _____] (Auth: HRS §§231-10.7; 235-51.5) (Imp: HRS §235-51.5)

Historical note: §18-235-201-05 is based substantially upon §18-235-200-05. [Eff 2/16/24; R _____]

§18-235-201-06 Refund of pass-through entity tax. Any claim for refund of the pass-through entity tax shall be filed by the electing pass-through entity, on a form prescribed by the director, on or before the due date prescribed for the filing of the schedule of pass-through entity tax provided in section 18-235-201-05, including any extensions thereof; provided that if the amount of pass-through entity tax paid by an electing pass-through entity exceeds the amount claimed on the schedule required to be filed under section 18-235-201-05, any claim for refund of the overpayment shall be filed within the time prescribed by section 235-111, HRS.

Example 1:

Partnership1, a calendar year taxpayer, pays \$25,000, the properly estimated tax liability, on April 20 following the close of the tax year. On October 20, Partnership1 makes an election for pass-through entity taxation and files the required schedule, which details each member's share of the \$25,000 pass-through entity tax paid. On November 1, Partnership1 attempts to amend the schedule to decrease the amount of pass-through entity tax from \$25,000 to \$20,000 and requests a \$5,000 refund. Partnership1 may not amend the schedule and may not receive the \$5,000 refund, as the amended schedule and refund claim were not timely filed by October 20.

Example 2:

Partnership2, a calendar-year taxpayer, pays \$30,000, the properly estimated tax liability, on

April 20 following the close of the tax year. On October 20, Partnership2 makes an election for pass-through entity taxation and files the required schedule. The schedule details each member's share of \$25,000 of the pass-through entity tax paid. On November 1, Partnership2 requests a refund of \$5,000 for the overpayment of pass-through entity tax paid. Partnership2 may receive a refund of \$5,000 because the refund claim was timely filed within the time prescribed by section 235-111, HRS.

Example 3:

Partnership3, a calendar-year taxpayer, makes estimated tax payments throughout the year and pays the properly estimated tax liability on April 20 following the close of the tax year. Partnership3 does not make an election for pass-through entity taxation. On November 1, Partnership3 requests a refund of the estimated tax payments made. Because Partnership3 did not make an election for pass-through entity taxation, section 18-235-201-06, HAR, does not apply. Partnership3 may receive a refund of the estimated tax payments made; provided the request is made within the time prescribed by section 235-111, HRS. [Eff] (Auth: HRS §§231-10.7; 235-51.5) (Imp: HRS §235-51.5)

Historical note: §18-235-201-06 is based substantially upon §18-235-200-06. [Eff 2/16/24; R]

§18-235-201-07 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. For the purposes of this subsection, the amount of pass-through entity taxes paid does not include any amounts paid as penalties or interest.

(b) 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, files 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 due date prescribed for the filing of the direct member's return under chapter 235, HRS, including any extensions.

(c) This section shall apply to taxable years beginning after December 31, 2022, but shall not apply to taxable years beginning after December 31, 2023.

Example 1:

For tax year 2023, 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 and does not file a schedule detailing each member's share of the pass-through entity tax paid. PTE3, a pass-through entity whose members include Individual D and Individual E, does not elect pass-through entity taxation, but timely files a schedule detailing each member's share of the pass-through entity tax paid. Individual A may claim a credit or 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 file the required schedule. Individual D and Individual E may claim a credit for pass-through entity taxes paid by PTE1 because PTE3 filed the required schedule. [Eff _____] (Auth: HRS §§231-10.7; 235-51.5) (Imp: HRS § 235-51.5; Act 50, SLH 2024)

Historical note: §18-235-201-07 is based substantially upon §18-235-200-07. [Eff 2/16/24; R _____]

§18-235-201-07.01 Pass-through entity tax credit; allowed.

(a) Each qualified member of an electing pass-through entity may claim a nonrefundable income tax credit equal to the qualified member's share of pass-through entity taxes paid. For the purposes of this subsection, the amount of pass-through entity taxes paid does not include any amounts paid as penalties or interest.

(b) No credit may be claimed by a beneficiary of a trust or estate that is a qualified member of an electing pass-through entity unless the trust or estate files a schedule detailing each beneficiary's share of the pass-through entity tax paid, on a form prescribed by the director, on or before the due date prescribed for the filing of the trust's or estate's return under chapter 235, HRS, including any extensions.

(c) This section shall apply to taxable years beginning after December 31, 2023. [Eff] (Auth: HRS §§231-10.7; 235-51.5) (Imp: HRS § 235-51.5; Act 50, SLH 2024)

Historical note: §18-235-201-07.01 is based substantially upon §18-235-200-07. [Eff 2/16/24; R]

§18-235-201-08 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 the taxpayer's share of taxes paid. [Eff] (Auth: HRS §§231-10.7; 235-51.5) (Imp: HRS § 235-51.5)

Historical note: §18-235-201-08 is based substantially upon §18-235-200-08. [Eff 2/16/24; R]

§18-235-201-09 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; 235-51.5)
(Imp: HRS §235-91.5)

Historical note: §18-235-201-09 is based substantially upon §18-235-200-09. [Eff 2/16/24; R]