



The New Hawaii Estate Tax (June 2010)

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There is now a new Hawaii estate tax. The bill proposing the tax (House Bill 2866) was vetoed by Governor Lingle on April 25, 2010. The Hawaii legislature overrode the veto on April 29, 2010, and the bill became Act 74 on April 30, 2010. It imposes a tax on the estates of persons dying after April 30, 2010.

Let me first explain the history of the Hawaii inheritance tax and the Hawaii estate tax. An estate tax is a tax on the property of someone who has died. The federal death tax is an estate tax. An inheritance tax is a tax on property that is inherited by each beneficiary or heir. When I first became an attorney in 1976, there was a Hawaii inheritance tax. I remember preparing Hawaii inheritance tax returns. Then Hawaii adopted The Estate and Transfer Tax Reform Act of 1983. When this law was adopted, the Hawaii death tax became an estate tax. Hawaii's estate tax was called a "pick-up tax." It allowed the State of Hawaii to pick up (or collect) for itself part of the estate tax which the federal government could collect. The amount that Hawaii could collect was the maximum amount that the federal government allowed as a credit for state death taxes against the federal estate tax. Later, the federal government passed the Economic Growth and Tax Reconciliation Act of 2001. This tax act phased out the state death tax credit at the rate of 25% a year starting in 2002. This meant that the amount of the federal death tax which Hawaii got to keep was reduced each year, until it became zero. Since 2005, there has been no Hawaii death tax, until now.

The new Hawaii estate tax law is poorly written. It would be difficult for someone to understand the new law without doing some tax research and without knowing the history of the federal estate tax and the Hawaii estate tax. When you first read the new law, it sounds like the tax only affects nonresidents who are not citizens of the United States. After researching the federal and state tax laws referred to, you realize that the new law affects Hawaii residents and citizens as well.

It appears that under the new law, there will be no Hawaii estate tax to pay unless you die with a taxable estate of more than \$3,600,000. Although the new law allows a \$3,500,000 tax free amount, when you actually calculate the tax, another \$100,000 is tax free, for a total of \$3,600,000. For the first \$50,000 over \$3,600,000, the tax rate is only .8%. For those who die with a taxable estate of more than \$10,100,000 the tax rate goes as high as 16%.

If a married person with an A-B trust with more than \$3,600,000 dies in 2010, since there is no federal estate tax this year, the entire estate would go into the B trust, and nothing would go into the A trust (the marital trust). Everything going into the B trust in excess of \$3,600,000 would be subject to the new Hawaii estate tax. Some or all of that tax could be avoided by changing the trust to cause some assets to go into the A trust. In 2011 or later years, under current law only \$1,000,000 will be exempt from the federal estate tax but \$3,600,000 will be exempt from the Hawaii estate tax. Depending on the size of the estate, there may be tax savings by arranging the estate plan so that some tax is paid when the first spouse dies, instead of deferring all taxes until the second spouse dies. Anyone with assets large enough to be taxed should have their estate plan reviewed to see if any changes are warranted as a result of the new Hawaii estate tax or the reduction in 2011 of the federal tax free amount to only \$1,000,000.