

# 2023

(REV. 2023)

STATE OF HAWAII—DEPARTMENT OF TAXATION

## INSTRUCTIONS FOR FORM N-35

### HAWAII INCOME TAX RETURN FOR AN S CORPORATION

(Section references are to the Internal Revenue Code (IRC) unless otherwise specified.)

(NOTE: References to “married” and “unmarried” are also references to “in a civil union” and “not in a civil union,” respectively.)

#### ATTENTION:

Hawaii has not adopted the increased expensing deduction under section 179 (Hawaii limit is \$25,000) or the “bonus” depreciation provisions.

Hawaii has not adopted the domestic activities production deduction under section 199.

#### Where To Get Tax Forms

Hawaii tax forms, instructions, and schedules may be obtained at any taxation district office or from the Department of Taxation’s website at [tax.hawaii.gov](http://tax.hawaii.gov), or you may contact a customer service representative at: 808-587-4242 or 1-800-222-3229 (Toll-Free).

#### Changes You Should Note

##### Act 50, Session Laws of Hawaii (SLH) 2023

– The Pass-Through Entity (PTE) Tax Credit allows partnerships and S corporations to annually elect to pay Hawaii income taxes at the entity level. Eligible members of an electing PTE may claim a nonrefundable income tax credit for their pro rata share of PTE taxes paid by the entity. Effective January 1, 2024 for taxable years beginning after December 31, 2022.

**Act 56, SLH 2023** – This act amends Hawaii income tax law under chapter 235, Hawaii Revised Statutes (HRS), to conform to certain provisions of the IRC, as amended as of December 31, 2022.

**Act 217, SLH 2022** – This act amends the motion picture, digital media, and film production income tax credit for taxable years beginning after December 31, 2022 by (1) changing the repeal date from January 1, 2026 to January 1, 2033; (2) increasing the credit amount from 20% of qualified production costs to 22% in a county with a population of over 700,000, and from 25% of qualified production costs to 27% in a county with a population of 700,000 or less; (3) increasing the credit ceiling from \$15,000,000 per qualified production to \$17,000,000 per qualified production; (4) reducing the amount of qualified productions costs from \$200,000 to \$100,000; (5) removing the requirement for productions to submit a verification review by a qualified certified public accountant; (6) requiring the report by the Department of Business Economic Development and Tourism (DBEDT) to include the dollar amount claimed, name of the company, and name of the qualified production of the taxpayer; (7) changing the time frame for DBEDT to issue a letter to the taxpayer claiming the tax credit; and (8) requiring taxpayers to submit a fee to DBEDT.

#### General Instructions

Caution: *The attachment of a copy of a federal S Corporation return, Form 1120S, is not acceptable as a substitute for fully completing the Hawaii S Corporation return, Form N-35.*

- A valid S corporation election for federal purposes is automatically effective for Hawaii income purposes without a separate election.
- An S corporation having income attributable to sources both within the State of Hawaii and outside the State must attribute that income according to source for shareholder reporting.
- S corporations having nonresident shareholders are required to obtain from each nonresident shareholder, and file with the Department of Taxation (Department), an agreement (Schedule NS) that the shareholder will file a Hawaii return and make timely payment of all taxes imposed with respect to the shareholder’s share of the S corporation’s Hawaii income. Also, the shareholder will be subject to personal jurisdiction in the State for purposes of the collection of unpaid income tax, penalties, and interest. If the corporation fails to timely file these agreements on behalf of its nonresident shareholders, the corporation is required to pay to the State, on behalf of each shareholder for whom an agreement has not been timely filed, an amount equal to the highest marginal tax rate on individuals (presently 11%) multiplied by the shareholder’s pro rata share of the income attributable to the State. Any payments made will be considered to be a payment by the shareholder on account of the income tax imposed on the shareholder to be filed with the S corporation’s annual tax return.
- S corporations having nonresident shareholders may file composite returns and make composite payments on behalf of some or all of their nonresident shareholders.
- S corporations may make a yearly irrevocable election to pay taxes at the PTE level and the election shall be binding on all shareholders who are qualified members of an electing PTE and whose distributive shares are subject to PTE taxation for the taxable year.

#### Purpose of Form

Form N-35 is used to report the income, deductions, gains, losses, etc., of an S corporation doing business in Hawaii. Do not file Form N-35 until the corporation has been notified by the Internal Revenue Service (IRS) that the corporation’s election to be treated as an S corporation has been accepted. If the corporation’s election is not in effect for the tax year, use Form N-30, do not use Form N-35. Unless requested by the Department, it is not necessary to submit a copy of the corporation’s accepted federal Form 2553, Election by a Small Business Corporation.

#### Filing Requirements

If your corporation is an electing PTE, Form N-35 along with all schedules, statements, and other documents MUST be filed electronically for taxable years beginning after December 31, 2022, unless you obtain a waiver. Use Form L-110, Electronic Filing or Payment Exemption Application, to apply for a waiver. Failure to file electronically and/or submit an electronic funds transfer may result in cancellation of the election for PTE taxation.

#### Who Must File Form N-35

A corporation must file Form N-35 if it has elected, by filing federal Form 2553, to be treated as an S corporation for federal purposes, the IRS has accepted the election, and the election remains in effect. S corporations which are financial corporations subject to tax under chapter 241, Hawaii Revised Statutes (HRS), may not file Form N-35, but must file Form F-1, Franchise Tax Return. An S corporation cannot be included as part of a unitary group with C corporations. The S corporation must file a separate Form N-35.

#### Termination of Election

An S corporation’s status as such shall remain in effect for Hawaii income tax purposes as long as the corporation’s federal election remains effective. If the corporation’s federal election is terminated, the corporation’s S status for Hawaii purposes is also terminated.

#### Six-Month Automatic Extension of Time to File Corporate Return

Section 18-235-98, Hawaii Administrative Rules, allows an automatic six-month extension of time to file a return without filing an application for extension. This does not include an extension of time to pay. Use Form N-201V, Business Income Tax Payment Voucher, to make a payment (if applicable). File Form N-201V by the regular due date of the S corporation return. Form N-201V can be filed and payment made electronically through the State’s Internet portal at [hitax.hawaii.gov](http://hitax.hawaii.gov).

Federal Form 7004, Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns, may not be used in lieu of Form N-201V. Such automatic extension does not extend the time for payment of the tax. The corporation’s automatic extension does not affect the due date for the filing of the shareholders’ returns. The shareholders must apply for their own extensions, if needed. If a composite return is to be filed on behalf of nonresident shareholders, an extension must be obtained for this return if the return cannot be filed by the due date of the composite return.

#### Period to be Covered by 2023 Return

File the 2023 return for calendar year 2023 and fiscal years beginning in 2023 and ending in 2024. If the return is for a fiscal year, fill in the tax year spaces on the form.

**Note:** *Form N-35 for 2023 may also be used if: (1) the corporation has a tax year of less than 12 months that begins and ends in 2023 and (2) the 2024 Form N-35 is not available by the time the corporation is required to file its return. However, the corporation must show its 2024 tax year on the 2023 Form N-35 and incorporate any tax law changes that are effective for tax years beginning after December 31, 2023.*

#### Final Return

If the corporation ceases to exist, check box (2) “Final Return” near the top of the form. Also check box B(1) on each Schedule K-1 to indicate that it is a final Schedule K-1.

## Amended Return

To correct an error in a Form N-35 already filed, file an amended Form N-35, using the form for the year being amended, and check the "AMENDED Return" box at the top of the form. Schedule AMD, Explanation of Changes on Amended Return, must be attached to the amended Form N-35. Also, attach all schedules, forms, and attachments required to file a complete return. If the amended return results in a change to income, or a change in the distribution of any income or other information provided to shareholders, an amended Schedule K-1 (Form N-35) must also be filed with the amended Form N-35 and given to each shareholder. Check box B(2), to indicate that it is an amended Schedule K-1.

An electing PTE cannot file an amended return to revoke their PTE election. All PTE elections are irrevocable. An electing PTE who would like to request a refund for an overpayment of the PTE tax paid must file their request for refund on or before the due date prescribed, including an extended due date if an extension has been granted.

### Change in Federal Taxable Income

In general, a change to your federal return, whether it is made by you, or by the IRS, must be reported to the State of Hawaii.

- 1) Section 235-101(b), HRS, requires a report (an amended return) to the Director of Taxation if the amount of IRC taxable income is changed, corrected, adjusted or recomputed as stated in (3).
- 2) This report must be made:
  - a) Within 90 days after a change, correction, adjustment or recomputation is finally determined.
  - b) Within 90 days after a federal amended return is filed.
  - c) At the time of filing the next income tax return, if earlier than set forth in a) or b).
- 3) A report within the time set out in (2) is required if:
  - a) The amount of taxable income as returned to the United States is changed, corrected, or adjusted by an officer of the United States or other competent authority.
  - b) A change in taxable income results from a renegotiation of a contract with the United States or a subcontract thereunder.
  - c) A recomputation of the income tax imposed by the United States under the Internal Revenue Code results from any cause.
  - d) An amended income tax return is made to the United States.
- 4) The report referred to above shall be in the form of an amended Hawaii income tax return.
- 5) The statutory period for the assessment of any deficiency or the determination of any refund attributable to the report shall not expire before the expiration of one year from the date the Department is notified by the taxpayer or the IRS, whichever is earlier, of such a report in writing. Before the expiration of this one-year period, the Department and the taxpayer may agree in writing to the extension of this period. The period so agreed upon may be further extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

## IRS Adjustment

If the corporation is filing an amended return due to an IRS adjustment, check box (5) "IRS Adjustment" near the top of the form and check the "AMENDED Return" box at the top of the form. Also complete and attach Schedule AMD, Explanation of Changes on Amended Return, to the amended Form N-35 and all schedules, forms, and attachments required to file a complete return. An amended Schedule K-1 (Form N-35) must also be filed with the amended Form N-35 and given to each shareholder. Check box B(2), to indicate that it is an amended Schedule K-1.

### Electing PTE

If the corporation elects to be taxed at the PTE level for the taxable year, check box (6) "Electing PTE" near the top of the form. Schedule PTE(s) must be attached to Form N-35.

### Upper-Tier PTE

If the corporation is an upper-tier PTE (i.e., a PTE that is a member of another PTE) that received a PTE tax credit as a member of a lower-tier PTE (i.e., a PTE that has at least one member that is a PTE) that is either an electing PTE or an upper-tier PTE, check box (7) "Upper-Tier PTE" near the top of the form. Schedule PTE-U(s) must be attached to Form N-35.

### Protective Claim

A protective refund claim is a claim filed to protect a taxpayer's right to a potential refund based on a contingent event for a taxable period for which the statute of limitations is about to expire. A protective claim is usually based on contingencies such as pending litigation or an ongoing federal income tax audit or an audit in another state. For more information see Tax Facts 2021-2.

### Designation of Tax Matters Person (TMP)

An S corporation may designate a shareholder as the TMP for the tax year for which the return is filed by completing the Designation of Tax Matters Person section at the bottom of page 4 of the return.

### When to File and Where to File

Returns must be filed on or before the 20th day of the fourth month following the close of the taxable year. If this date falls on a Saturday, Sunday, or holiday, the due date for the return is extended to the next business day.

If you are enclosing a check or money order with your tax return, mail your **return with payment** to:

Hawaii Department of Taxation  
P.O. Box 1530  
Honolulu, HI 96806-1530

If you are **not enclosing a payment** with your tax return, mail your return to:

Hawaii Department of Taxation  
P.O. Box 3559  
Honolulu, Hawaii 96811-3559

**Note:** Under Hawaii Income Tax Law, certain tax credits must be claimed within 12 months from the close of the tax year.

If you are filing your return after the prescribed due date, the refund shown may be limited or disallowed due to the statute of limitations. In general, a claim for refund or credit for overpaid income taxes must be filed within three years after the return is filed for the taxable year, within three years of the due date for filing the return, or within two years from when the tax is paid, whichever is later. For purposes of determining whether a

refund or credit is allowed, taxes paid on or before the due date of the return (e.g. taxes withheld from an employee's pay, or estimated tax payments) are considered paid on the due date of the return, without considering an extension of time to file the return.

Hawaii has adopted the IRC provision to allow documents and payments delivered by a designated private delivery service to qualify for the "timely mailing treated as timely filing/paying rule." The Department will conform to the IRS listing of designated private delivery service and type of delivery services qualifying under this provision. Timely filing of mail which does not bear the U.S. Post Office cancellation mark or the date recorded or marked by the designated delivery service will be determined by reference to other competent evidence. The private delivery service can tell you how to get written proof of the mailing date.

### Accounting Methods

Figure ordinary income using the method of accounting regularly used in keeping the corporation's books and records. In all cases, the method adopted must clearly reflect income. (See section 446.)

Unless the law specifically states otherwise, a corporation may change the method of accounting used to report income in earlier years (for income as a whole or for any material item) by first filing an approved copy of **federal Form 3115, Application for Change in Accounting Method**, with the Department. If the change qualifies for an automatic change request on federal Form 3115, attach a copy of the Form 3115 filed with the IRS to the first Hawaii return affected by the change.

### Rounding Off to Whole Dollars

The Department is requiring taxpayers to round off cents to the nearest whole dollar for all dollar entries on the tax return and schedules. To do so, drop amounts under 50 cents and increase amounts from 50 to 99 cents to the next dollar. For example: \$1.39 becomes \$1 and \$2.69 becomes \$3. If you have to add two or more amounts to figure the amount to enter on a line, schedule, or worksheet, you may choose to use one of two methods. Once a method of rounding is established, you must use the same method throughout the return. The first method is to include the cents when adding and round off only the total. The other method is to round off each entry. For example: You received two 1099-INT forms, one showing interest of \$50.55 and one showing interest of \$185.73. For rounding method 1, show your total interest as \$236 (\$50.55 + \$185.73 = \$236.28 rounded to \$236). For rounding method 2, show your total interest as \$237 (\$50.55 rounded to \$51 + \$185.73 rounded to \$186 = \$51 + \$186 = \$237).

### Change in Accounting Period

To change an accounting period, see IRC Regulations section 1.442-1 and **federal Form 1128, Application to Adopt, Change, or Retain a Tax Year**.

### Paying the Tax

The corporation must pay the tax due (line 27, page 2) in full on or before the 20th day of the fourth month after the end of the tax year. Amounts due on any Form N-4(s) (line 22c, page 2) and Schedule PTE(s) (line 22f, page 2) attached to the S corporation's return are also due at this time. As a reminder, extensions allowed for filing a return do NOT extend the time for paying the tax due on the return. If the corporation cannot pay the full amount that is owed, you can ask

to enter into a payment agreement once you receive a billing notice for the balance due. Please be aware that penalty and interest continue to accrue on the unpaid tax amount even though you have not yet received a billing notice. Payments will be accepted and applied to the corporation's tax liability; however, to ensure that the corporation's payments are applied correctly, your check or money order must have: (1) the corporation's name as shown on the return clearly printed on the check, (2) the corporation's federal employer identification number (FEIN), and (3) the tax year and form number being filed (e.g., 2023 N-35). If a payment is being made with this return, attach your check or money order where indicated on the front of Form N-35. Form N-201V is no longer required when making a payment with your return.

## Estimated Tax

If an S corporation expects to have a tax liability of \$500 or more on its tax return or is an electing PTE for the taxable year, submit Form N-201V with payment to the Department. Estimated payments are paid in four installments. These installments are due on or before the 20th day of the fourth, sixth, and ninth months of the tax year and on or before the 20th day of the first month following the taxable year. See the instructions for line 23b and Form N-201V for more information. Form N-201V can be filed and payment made electronically through the State's Internet portal at [hitax.hawaii.gov](http://hitax.hawaii.gov).

## Electronic Funds Transfer (EFT)

Section 231-9.9, HRS, authorizes the Department to require those taxpayers whose tax liability exceeds \$100,000 during the past year to pay the tax by EFT instead of by check. The Department reviews the filing records of taxpayers and will mail notices to taxpayers who meet this criterion. Any taxpayer who does not meet this criterion may still voluntarily pay by EFT. If an EFT payment is dishonored, a \$25 service fee will be assessed. For more information on paying taxes by EFT, see [tax.hawaii.gov/eservices/](http://tax.hawaii.gov/eservices/) and Tax Information Release Nos. 95-6 and 99-1.

Failure for PTEs to submit by EFT shall result in cancellation of the election for PTE taxation.

## Penalty and Interest

**Late Filing of Return** – The penalty for failure to file a return on time is assessed on the tax due at a rate of 5% per month, or part of a month, up to a maximum of 25%.

**Failure to Pay Tax After Filing Timely Return** – The penalty for failure to pay the tax after filing a timely return is 20% of the tax unpaid within 60 days of the prescribed due date.

**Failure to Timely Pay by EFT** – The penalty for failure to timely pay by EFT is 2% of the total tax unless you obtain a waiver. Use Form L-110, Electronic Filing or Payment Exemption Application, to apply for a waiver.

**Interest** at the rate of 2/3 of 1% per month or part of a month shall be assessed on unpaid taxes and penalties beginning with the first calendar day after the date prescribed for payment, whether or not that first calendar day falls on a Saturday, Sunday, or legal holiday.

## Net Operating Loss and Other Deductions

An S corporation may not take the deduction for net operating losses provided by section 172 and the special deductions in sections 241 through 250 (except section 248), unless the corporation is an electing PTE. If the corporation is an electing PTE, the net operating losses may be

carried forward as long as the entity continues to elect to be taxed as a PTE every taxable year until exhausted.

The corporation's net operating loss is allowed as a deduction from the shareholder's gross income (section 1366), unless the corporation is an electing PTE. If the corporation is an electing PTE, the net operating loss is not allowed as a deduction from the shareholder's gross income.

## Attachments

Attach schedules in alphabetical order and other forms in numerical order.

If the corporation is filing any Forms N-4, Statement of Withholding For a Nonresident Shareholder of an S Corporation, attach these forms to the front of Form N-35 in the left margin as indicated on Form N-35.

If the corporation owes any tax, attach the check or money order to the front of Form N-35 where indicated on top of any Form N-4s being submitted.

Attach any Schedule NS(s) at the back of the return.

If the corporation is an electing PTE, attach the election Form N-362E with all required signature(s) and Schedule PTE at the back of the return.

If the corporation is an upper-tier PTE, attach Schedule PTE-U at the very back of the return behind all other Schedules.

If you need more space on the forms or schedules, attach separate sheets and show the same information in the same order as on the printed forms as instructed, but show your totals on the printed forms. Please use sheets that are the same size as the forms and schedules. Attach these separate sheets after all the schedules and forms. Be sure to put the corporation's name and FEIN on each sheet.

## Signature

The return must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or any other corporate officer (such as tax officer) authorized to sign.

A receiver, trustee, or assignee must sign and date any return he or she is required to file on behalf of a corporation.

If a corporate officer fills in Form N-35, the Paid Preparer's space under "Signature of Officer" should remain blank. If someone prepares Form N-35 and does not charge the corporation, that person should not sign the return. Certain others who prepare Form N-35 should not sign. For example, a regular, full-time employee of the corporation such as a clerk, secretary, etc., does not have to sign.

In general, anyone paid to prepare Form N-35 must sign the return and fill in the other blanks in the Paid Preparer's Information area of the return. The preparer may furnish his or her alternative identifying number for income tax return preparers (PTIN) instead of his or her social security number.

The preparer required to sign the return MUST:

- Complete the required preparer information.
- Sign in the space provided for the preparer's signature.
- Give a copy of Form N-35 to the taxpayer in addition to the copy to be filed with the Department.

The corporation may authorize the Department to discuss its tax return with its paid pre-

parer by checking the "Yes" box above the paid preparer's signature. Checking "Yes" will allow the Department to contact the paid preparer to answer any questions that may arise during the processing of the corporation's return. This designation does not allow your third party designee to call the Department for information about the processing of the return or for other issues relating to the return. This does not replace Form N-848, Power of Attorney.

## Transfers to Corporation Controlled by Transferor

If a person acquires stock or securities of a corporation in exchange for property, and no gain or loss is recognized under section 351, the transferor and transferee must attach the information required by IRC Regulations section 1.351-3.

## Information Returns That May be Required

**Form N-196**, Annual Summary and Transmittal of Hawaii Information Returns.

**Federal Form 966**, Corporate Dissolution or Liquidation.

**Federal Forms 1099-DIV, INT, K, MISC, OID, PATR and R**. You may have to file these information returns to report certain dividends, interest payments, payment card and third party network transactions, medical and health care payments, miscellaneous income, original issue discount, patronage dividends, and total distributions from profit-sharing plans, retirement plans, and individual retirement arrangements.

Use federal Form 1099-DIV to report actual dividends paid by the corporation. Only distributions from accumulated earnings and profits are classified as dividends. Do not issue federal Form 1099-DIV for dividends received by the corporation that are allocated to shareholders on line 5 of Schedule K-1 (Form N-35).

## Specific Instructions Line by Line

**Federal Employer I.D. No. & Hawaii Tax I.D. No.**— Enter the Federal Employer I.D. No. & Hawaii Tax I.D. No. in the space provided.

**S Corporation's Address** — If the corporation's address is outside the United States or its possessions or territories, enter the information on the line for "City or town, State and Postal/ZIP Code" in the following order: city, province or state, postal code, and the name of the country. Do not abbreviate the country name.

If your mailing address has changed, you must notify the Department of the change by completing Form ITPS-COA, Change of Address Form, or log in to your Hawaii Tax Online account at [hitax.hawaii.gov](http://hitax.hawaii.gov). Failure to do so may prevent your address from being updated, any refund due to you from being delivered (the U.S. Postal Service is not permitted to forward your State refund check), and delay important notices or correspondence to you regarding your return.

## Enter the number of Schedules NS attached to this return

Enter, in this space provided, the number of Schedules NS, Hawaii S Corporation Agreement of Nonresident Shareholder, which are attached to the return. See the instructions for Schedule NS later in these instructions for more information.

## Passive Activity Limitations

See the instructions for federal Form 1120S for information regarding limitations for passive activities.



## Income

**Caution:** Report only trade or business activity income or loss on lines 1a through 5. Do not report rental activity income or portfolio income or loss on these lines. Rental activity income and expenses and portfolio income and expenses are reported separately on Schedule K.

Refer to the instructions for federal Form 1120S for further guidance.

**Note:** Do not include any income that is tax-exempt on lines 1 through 5 or any nondeductible expenses on lines 7 through 19. These income and expense items are used, however, in figuring the accumulated adjustments account and the other adjustments.

A corporation that receives any exempt income other than interest, or holds any property or engages in an activity that produces exempt income, must attach to its return an itemized statement showing the amount of each type of exempt income and the expenses allocated to each type.

### Line 1a - Gross Receipts

Enter gross receipts or sales from all business operations except those you report on lines 4 and 5. For reporting advance payments, see Treasury Regulations section 1.451-5. To report income from long term contracts, see section 460.

Generally, the installment method cannot be used for dealer dispositions of property. See section 453(l) for details and exceptions. Enter on line 1a the gross profit on collections from installment sales for any of the following:

- Dealer dispositions of property before March 1, 1986,
- Dispositions of property used or produced in the trade or business of farming, and
- Certain dispositions of timeshares and residential lots reported under the installment method.

Attach a schedule showing for the current year and 3 preceding years:

- Gross sales,
- Cost of goods sold,
- Gross profit,
- Percentage of gross profit to gross sales,
- Amount collected, and
- Gross profit on amount collected.

Amounts received by a qualified high technology business as royalties and other income derived from patents, copyrights, and trade secrets owned by the qualified high technology business and developed and arising out of a qualified high technology business are excluded from Hawaii income. Expenses related to this income are deductible. "Qualified high technology business" means a business conducting more than 50% of its activities in qualified research. "Qualified research" means (1) the same as in section 41(d) of the Internal Revenue Code, (2) the development and design of computer software for ultimate commercial sale, lease, license or to be otherwise marketed, for economic consideration. With respect to the software's development and design, the business shall have substantial control and retain substantial rights to the resulting intellectual property; (3) biotechnology, (4) performing arts products, (5) sensor and optic technologies, (6) ocean sciences, (7) astronomy, or (8) nonfossil fuel energy-related technology. All income earned and proceeds derived from stock options or stock, including stock issued through the exercise of stock options or warrants, from a qualified high technology business or from a

holding company of a qualified high technology business by an employee, officer or director of the qualified high technology business, or investor who qualified for the high technology business investment tax credit is excluded from income. If the corporation is a qualified high technology business and has included royalties and other income derived from patents, copyrights, and trade secrets the corporation owns in the income reported on line 1, these amounts should be included in the deductions shown on line 19. If the amount reported on line 19 includes these royalties and other income from patents, copyrights, and trade secrets, these amounts should be identified by attaching a separate schedule or listing.

### Line 2 - Cost of Goods Sold

See the instructions for Schedule A.

### Line 5 - Other Income

Enter any other trade or business income not listed above and explain its nature on an attached schedule. Examples of other income are recoveries of bad debts deducted in earlier years under the specific charge-off method, and refunds of taxes deducted in earlier years. Do not include those items requiring separate computations by shareholders that must be reported on Schedule K. (See the instructions for Schedules K and K-1). Do not offset current year's taxes with tax refunds.

If "other income" consists of only one item, identify it by showing the account caption in parentheses on line 5. A separate schedule need not be attached to the return in this case.

Do not net any expense item (such as interest) with a similar income item. Report all trade or business expenses on lines 7 through 19.

## Deductions

### Limitations on Deductions

**Caution:** Report only trade or business activity related expenses on lines 7 through 19. Do not report rental activity expenses or expenses related to portfolio income on these lines. Expenses related to rental activities and portfolio income are reported directly on Schedule K.

Refer to federal instructions for Form 1120S for further guidance on limitations on deductions.

### Line 7 - Compensation of Officers

Enter on line 7 the total compensation of all officers except compensation reported elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement.

### Line 8 - Salaries and Wages

Enter on line 8 the amount of total salaries and wages (other than salaries and wages deducted elsewhere on the return) paid or incurred for the tax year. If the corporation is claiming the credit for the employment of vocational rehabilitation referrals, total wages paid must be reduced by the amount of the credit taken.

If a shareholder or a member of the family of one or more shareholders of the corporation renders services or furnished capital to the corporation for which reasonable compensation is not paid, the Department may make adjustments in the items taken into account by such individuals and such shareholders as is necessary to reflect the value of such services or capital. See section 1366(e).

### Line 9 - Repairs and Maintenance

Enter the cost of incidental repairs, such as labor and supplies, and maintenance that do not add to the value of the property or appreciably prolong its life. New buildings, machinery, or permanent improvements that increase the value of the property are not deductible. They are chargeable to capital accounts and may be depreciated or amortized.

Do not include section 179 expense items. Report this amount on Schedule K, line 12, and each shareholder's share on Schedule K-1, line 12.

### Line 10 - Bad Debts

Enter the total debts that became worthless in whole or in part during the year, but only to the extent such debts relate to a trade or business activity.

### Line 11 - Rents

Generally, if the gross income from an activity consists of amounts paid principally for the use of real or personal tangible property held by the corporation, the activity is a rental activity. There are several exceptions to this general rule. Refer to the Instructions to federal Form 1120S for guidance.

### Line 12 - Taxes and Licenses

Enter taxes and licenses paid or incurred in the trade or business activities of the corporation, if not reflected in cost of goods sold. Taxes incurred in the production or collection of income, or for the management conservation, or maintenance of property held for the production of income may be considered to be deductible only under section 212. These are not deductible on line 12; they are reported separately on Schedules K and K-1, line 14.

Do not deduct taxes assessed against local benefits that increase the value of the property assessed (such as for paving, etc.), federal income taxes, estate, inheritance, legacy, succession, and gift taxes, or taxes reported elsewhere, such as in Schedule A.

### Line 13 - Interest

Include on line 13 only interest incurred in the trade or business activity(ies) of the corporation that is not claimed elsewhere on the return.

Do not include interest expense on debt used to purchase rental property or debt used in rental activities for which income or loss is reported on lines 2 and 3 of Schedule K.

Do not include interest expense which is clearly and directly allocable to gross income that is portfolio or investment income which is reported separately on line 15a of Schedule K.

Do not include interest on debt proceeds allocated to distributions made to shareholders during the tax year. Instead, report such interest on line 14 of Schedules K and K-1. To determine the amount to allocate to distributions to shareholders, see federal Notice 89-35, 1989-1, C.B. 675.

Do not include interest expenses on debt required to be allocated to the production of designated property. Interest that is allocable to certain property produced by an S corporation for its own use or for sale must be capitalized. In addition, the corporation must also capitalize any interest on debt that is allocable to an asset used to produce the above property. A shareholder may have to capitalize interest that the shareholder incurs during the tax year with respect to the production expenditures of the S corporation. Similarly, interest incurred by an S corporation may have to be capitalized by a shareholder with respect to the shareholder's own production expenditures. The

information required by the shareholder to properly capitalize interest for this purpose must be provided by the corporation in an attachment for line 29, of Schedule K-1. See section 263A(f) and Treasury Regulations sections 1.263A-8 through 1.263A-15 for more information.

Federal temporary regulations section 1.163-8T gives rules for allocating interest expense among activities so that the passive activity limitation, investment interest limitation, and the personal interest limitation can be properly figured. Generally, interest expense is allocated in the same manner as debt is allocated. Debt is allocated by tracing disbursements of the debt proceeds to specific expenditures. These regulations give rules for tracing debt proceeds to expenditures.

See federal temporary regulations section 1.163-8T for special rules on allocation of interest expense, transitional rules, and other details.

Generally, prepaid interest can only be deducted over the period to which the prepayment applies. See section 461(g) for details.

#### **Line 14 - Depreciation**

Enter depreciation expense from federal Form 4562 claimed on assets used in a trade or business activity that is not claimed elsewhere on the return.

As noted on page 1 of these instructions, Hawaii has not adopted federal "bonus" depreciation provisions. If a depreciation deduction is claimed for Hawaii tax purposes, the corporation must: (a) complete a federal Form 4562 for Hawaii tax purposes using the federal depreciation guidelines in effect before the adoption of the "bonus" depreciation provisions and (b) attach the completed federal Form 4562 to the Hawaii tax return. The corporation must also keep records of the differences in the asset's depreciable basis for federal and Hawaii tax purposes.

Do not include any expense deduction for recovery property (section 179) on this line. This amount is not deductible by the corporation. Instead, it is passed through to the shareholders on Schedules K and K-1, line 12.

#### **Line 15 - Depletion**

If the corporation claims a deduction for timber depletion, complete and attach federal Form T, Forest Activities Schedule.

Do not report depletion deductions for oil and gas properties on this line. Each shareholder figures depletion on these properties under section 613A(c)(13). See the instructions for federal Form 1120S, Schedule K-1, box 17, code R, for information on oil and gas depletion that must be supplied to the shareholders by the corporation.

#### **Line 18 - Employee Benefit Programs**

Enter the amount of contributions to employee benefit programs (such as insurance and health and welfare programs) that are not an incidental part of a pension, profit-sharing, etc., plan included in line 17.

See instructions for federal Form 1120S for more information.

#### **Line 19 - Other Deductions**

Enter any other allowable deductions related to any trade or business activity for which there is no line on page 1 of the return. Do not include those items requiring separate computations which must be reported on Schedules K and K-1. Do not deduct losses incurred in transactions which were not connected with the corporation's trade or business. Report these losses separately to the shareholders on Schedules K and K-1,

line 14. Do not take the section 199 deduction for U.S. production activities.

Include in line 19 the deduction taken for amortization. See instructions for federal Form 4562 for more information.

In most cases, you may not take a deduction for any part of any item allocable to a class of exempt income. (See section 265 for exceptions). Items directly attributable to wholly exempt income must be allocated to that income. Items directly attributable to any class of taxable income must be allocated to that taxable income.

If an item is indirectly attributable both to taxable income and to exempt income, allocate a reasonable proportion of the item to each, based on all the facts in each case.

Attach a statement showing (1) the amount of each class of exempt income and (2) the amount of expense items allocated to each such class. Show the amount allocated by apportionment separately.

The deductions for business meals and entertainment expenses are limited to 50%. Meal expenses are deductible only if the expenses are directly related or associated with the active conduct of a trade or business. In addition, the amount that may be deducted for entertainment tickets, skyboxes, or other private luxury boxes is limited. See federal Publication 463 for details.

#### **Line 21 - Ordinary Income (loss)**

This is nonseparately computed income or loss as defined in section 1366(a)(2). This income or loss is entered on Schedule K, line 1.

Line 21 income is not used in figuring line 22a or 22b tax. See instructions for line 22a for figuring taxable income for purposes of line 22a or 22b tax.

#### **Line 22a - Excess Net Passive Income Tax**

If the corporation has always been a subchapter S corporation, the line 22a tax does not apply.

S corporations that have accumulated earnings and profits at the end of the taxable year, passive investment income totaling over 25% of gross receipts, and have taxable income are subject to a tax imposed at the rate of 6.4%. This tax is applied against the smaller of the S corporation's excess net passive income or taxable income. See the worksheet for Excess Net Passive Income Tax in federal instructions for Form 1120S for the computation of these amounts. Use Hawaii Form N-30 for the taxable income computation. Attach a schedule to your Hawaii S corporation return, following the format of the worksheet to show your tax computation.

For tax years beginning after May 25, 2007, gains from sales or exchanges of stock or securities will not be treated as an item of passive investment income when figuring the excess net passive income tax on Form N-35, line 22a.

#### **Line 22b**

Refer to instructions for Schedule D (Form N-35).

#### **Line 22c**

Enter the number of N-4's attached to the corporation's return. On line 22c, enter the total amount of taxes withheld as shown on the Forms N-4 attached.

#### **Line 22d - LIFO Recapture Tax**

The corporation may be liable for the additional tax due to LIFO recapture under Regulations section 1.1363-2 if:

1. The corporation used the LIFO inventory method for its last tax year as a C corporation, or
2. A C corporation transferred LIFO inventory to the corporation in a nonrecognition transaction in which those assets were transferred basis property.

The additional tax due to LIFO recapture is figured for the corporation's last tax year as a C corporation or for the tax year of the transfer, whichever applies. See the Instructions for Form N-30 to figure the tax. The tax is paid in four equal installments. The C corporation must pay the first installment by the due date (not including extension) of Form N-30 of the corporation's last tax year as a C corporation or for the tax year of the transfer, whichever applies. The S corporation must pay each of the remaining installments by the due date (not including extensions) of Form N-35 for the three succeeding tax years. Enter on line 22d the amount of the LIFO tax installment.

#### **Line 22e - Interest due under the look-back method for completed long-term contracts**

If the corporation used the look-back method under section 460(b)(2) for certain long-term contracts, complete federal Form 8697, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts. If you will owe interest on an unpaid amount, calculate the amount due using the rate of 2/3 of 1% per month, or part of a month, beginning the first calendar day after the date prescribed for payment whether or not that first calendar day falls on a Saturday, Sunday, or legal holiday. Include the amount of interest due on line 22e. Attach Form 8697 with a check made payable to "Hawaii State Tax Collector" to Form N-35. Write the corporation's FEIN, daytime phone number, and "Form 8697 interest" on the check. If you are due a refund, do not attach Form 8697 to your Form N-35. Instead, file federal Form 8697 separately with the Department. Complete the signature section of federal Form 8697 following the instructions for the signature section of Form N-35. File federal Form 8697 by the date you are required to file your Form N-35 (including extensions).

#### **Line 22f - Pass-Through Entity Tax**

If the corporation is not an electing PTE for the taxable year, line 22f does not apply to the corporation.

Electing PTEs are liable for the income tax on the sum of all qualified members' distributive shares multiplied by the highest rate of tax applicable to the individual under section 235-51, HRS, with no separate tax rate for capital gains. The PTE tax rate is 11% for the 2023 taxable year. Attach Schedule PTE(s), showing all the qualified members' shares of qualified net income and calculated PTE tax amount reported on line 22f.

#### **Line 23b**

If the S corporation is a Hawaii corporation with an expected corporate tax liability of \$500 or more, the corporation must file a declaration of estimated income tax and pay the estimated tax liability in four installments. See Form N-201V for more information. If the S corporation is not a Hawaii corporation and less than 15% of the corporation's business for the taxable year is attributed to Hawaii, the filing of an estimate and the payment of estimated tax may be excused upon application to the Department. Form N-201V can be filed and payment made electronically through the State's Internet portal at [hitax.hawaii.gov](http://hitax.hawaii.gov).

Estimated taxes which are paid by the corporation on behalf of its nonresident shareholders in anticipation of the filing of a composite re-



turn should be made on Form N-201V. See the instructions for filing composite returns later in these instructions for more information. Form N-201V can be filed and payment made electronically through the State's Internet portal at [hitax.hawaii.gov](http://hitax.hawaii.gov).

Any amount that was paid on an S corporation's Form N-201V for the tax year should be indicated in the N-201V space on line 23b and included in the line total.

If the corporation is not a Hawaii corporation and it sold any Hawaii real property and Hawaii State income taxes were withheld from the sales proceeds, the amount of tax so withheld, or the amount of tax remaining with the Department if the corporation filed a Form N-288C, Application for Tentative Refund of Withholding on Dispositions by Nonresident Persons of Hawaii Real Property Interests, should be entered in the N-288A space on line 23b if the corporation is subject to Hawaii tax on the sale of property. If the sale of Hawaii property is not taxed at the corporate level, the amount of tax held by the Department is to be passed through to the shareholders on line 16n of Schedules K and K-1.

#### Line 24 - Underpayment of Estimated Tax Penalty

A corporation that fails to make estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. Use Form N-220, Underpayment of Estimated Tax by Corporations, to see if the corporation owes a penalty and to figure the amount of the penalty.

#### Line 27 - Tax Due

Enter on line 27 the sum of lines 22g and 24 minus 23d. If this amount is zero or less, enter 0. If this amount is more than zero, pay this amount by certified or cashier's check made payable to "Hawaii State Tax Collector" and attach the check to the front of Form N-35.

If the corporation cannot pay the full amount that is owed, you can ask to enter a payment agreement **after** you receive a billing notice for the balance due. Please be aware that penalty and interest continue to accrue on the unpaid tax amount even though you have not yet received a billing notice. Payments will be accepted and applied to the corporation's tax liability; however, to ensure that the corporation's payments are applied correctly, your check or money order must have: (1) the corporation's name as shown on the return clearly printed on the check, (2) the corporation's FEIN, and (3) the tax year and form number being filed (e.g., 2023 N-35).

**NOTE:** Any payment made with Form N-4, Statement of Withholding for a Nonresident Shareholder of an S corporation, must be included in the total taxes paid with Form N-35. For more information on Form N-4, see page 8.

#### Line 28 - Amount of Payment

Enter the amount of payment. Attach your check or money order where indicated on the front of Form N-35. Make your check or money order payable to "Hawaii State Tax Collector."

#### For Amended Returns

#### Line 29 - Amount paid (overpaid) on original return

Enter on line 29 the amount paid on the corporation's original return (from line 27 on the **original** return) or the amount overpaid (from line 25 on the **original** return). Place a minus sign, "-", before the amount of any overpayment.

#### Line 30 - BALANCE DUE (REFUND) with amended return

If no amount was entered on line 29, enter on line 30 the amount, if any, from line 25 or line 27 of the **amended** return. If there is an amount on line 29, and that amount is:

- A payment and there is an amount on line 25 of the **amended** return, add these amounts and enter the total on line 30 with a minus sign, "-", before the amount.
- A payment and there is an amount on line 27, subtract the amount on line 29 from the amount on line 27 and enter the difference on line 30. If the difference is a negative amount, show the negative amount on line 30 with a minus sign, "-".
- An overpayment and there is an amount on line 25, consider the amount on line 25 a negative amount and subtract the amount on line 29 from the amount on line 25, and enter the difference on line 30. If the difference is a negative amount, show the negative amount on line 30 with a minus sign, "-". If there is an overpayment on the amended return, do NOT enter this amount on line 26b.
- An overpayment and there is an amount on line 27, subtract the amount on line 29 from the amount on line 27, and enter the result on line 30. This is the amount the corporation owes on its amended return.

If the corporation has an amount due on its amended return, make check or money order payable to "Hawaii State Tax Collector" and attach the check or money order to the front of Form N-35.

### Schedule A Cost of Goods Sold

#### Inventory valuation methods

Your inventories can be valued at: (a) cost, (b) cost or market value (whichever is lower), or (c) any other method approved by the Director of Taxation, if that method conforms to the provisions of the applicable regulations cited below.

Taxpayers using erroneous valuation methods must change to a method permitted for Hawaii income tax purposes.

On line 9a, check the method(s) used for valuing inventories. Under "lower of cost or market," market generally applies to normal market conditions when there is a current bid price prevailing at the date the inventory is valued. When no regular open market exists or when quotations are nominal because of inactive market conditions, use fair market prices from the most reliable sales or purchase transactions that occurred near the date the inventory is valued. For additional requirements, see Treasury Regulations section 1.471-4.

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are "subnormal" (that is, because of damage, imperfections, show wear, etc.) within the meaning of Treasury Regulations section 1.471-2(c). Such goods may be valued at a current bona fide selling price less direct cost of disposition (but not less than scrap value) when the taxpayer can establish such a price. See Treasury Regulations section 1.471-2(c) for additional requirements.

If this is the first year the "Last-in First-out" (LIFO) inventory method was either adopted or extended to inventory goods not previously valued under the LIFO method, as provided in section 472, attach a copy of **federal Form 970**, Application to Use LIFO Inventory Method, or a

statement with Form N-35 and check the LIFO box on line 9c. On line 9d, enter the amount or percent (estimates may be used) of total closing inventories covered under section 472.

If you have changed or extended your inventory method to LIFO and have had to "writeup" your opening inventory to cost in the year of election, report the effect of this writeup as income (line 5, page 1) proportionately over a 3-year period that begins in the tax year you made this election. (section 472(d).)

If you are engaged in manufacturing or production, you must use the full absorption method of inventory costing. If you are not using it, you must change to this method. Under it, both direct and certain indirect production costs are included for inventory valuation purposes. Use federal Form 3115 to change to full absorption.

See federal Publication 538 for more information on inventory valuation methods.

### Schedule K and Schedule K-1 Shareholder's Share of Income, Credits, Deductions, etc.

#### Purpose

Schedule K is a summary schedule of all the shareholders' share of the corporation's income, deductions, credits, etc. and shows the amounts of these items that are attributable to Hawaii sources. Schedule K-1 shows each shareholder's distributive share. A copy of each shareholder's K-1 must be attached to the Form N-35 filed with the Department. A copy is kept as a part of the corporation's records and each shareholder receives his or her own separate copy with attached instructions.

#### General Instructions

The corporation is liable for taxes on Form N-35, page 2, lines 22a, 22b, 22d, 22e, and 22f. Resident shareholders are liable for income tax on their share of the corporation's total income (reduced by any taxes paid by the corporation on that income) and must include their share of the income on their tax return whether or not it is distributed to them. Nonresident shareholders are liable for Hawaii income tax on their share of the corporation's income attributable to Hawaii (reduced by any taxes paid by the corporation on that income). Part-year resident shareholders are liable for Hawaii income tax on their share of the corporation's total income while a resident plus Hawaii income tax on their share of the corporation's income attributable to Hawaii while a nonresident (reduced by any taxes paid by the corporation on those income amounts).

The total distributive share items (columns b and c) of all Schedule K-1s should equal the amount reported on Schedule K.

#### Attributable to Hawaii

Each S corporation must state specifically the income attributable to the State and income not attributable to the State with respect to each shareholder.

Ordinary income or (loss) from trade or business activities shall be attributed to the State by the use of the apportionment of business income allocation provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA), section 235-29, HRS. Business income, including rent, capital gains, and portfolio income that appears on Schedule K, shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three. If the denominator of

the property factor, payroll factor, or sales factor is zero, the denominator of the fraction in section 235-29, HRS, is reduced by the number of factors with a zero denominator, and the numerator of that fraction shall not include any factor with a zero denominator. The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned or rented and used in this State during the tax period, and the denominator of which is the average value of all the corporation's real and tangible personal property owned or rented and used during the tax period. Property owned by the corporation is valued at its original cost. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period. The use of monthly values may be required if necessary to properly reflect the average value of the corporation's property. Property rented by the corporation is valued at eight times the net annual rental rate. Where property is rented for less than a 12-month period, the rent paid for the actual period of rental shall constitute the annual rental rate for the tax period. The payroll factor is a fraction, the numerator of which is the total amount paid in this State during the tax period by the corporation for compensation, and the denominator of which is the total compensation paid everywhere during the tax period. The sales (gross receipts) factor is a fraction, the numerator of which is the total sales of the corporation in this State during the tax period, and the denominator of which is the total sales of the corporation everywhere during the tax period. If this apportionment does not fairly represent the extent of the corporation's business activity in this State, the corporation may request the use of separate accounting, the exclusion of one or more of the factors, the inclusion of one or more additional factors, or the use of any other method to accurately reflect the corporation's business activity in the State. Complete Schedules O and P on page 4 of Form N-35 to show this computation.

Non-business items are attributed as follows:

Net rents and royalties from real property located in Hawaii are attributed to Hawaii. Federal Form 8825 may be attached to Form N-35 as a schedule of expenses.

Net rents and royalties from tangible personal property are attributed to Hawaii if, and to the extent that, the property is utilized in Hawaii.

Capital gains and losses from sale of real property located in Hawaii are attributed to Hawaii.

Capital gains and losses from sales of tangible personal property are attributable to Hawaii if the property had a situs in Hawaii at the time of the sale.

Interest and dividends are attributed to Hawaii if the corporation's commercial domicile is in Hawaii.

Patent and copyright royalties are attributed to Hawaii if, and to the extent that, the patent or copyright is utilized by the payer in Hawaii. Amounts received by a qualified high technology business as royalties and other income derived from patents, copyrights, and trade secrets owned by the qualified high technology business and developed and arising out of a qualified high technology business are excluded from Hawaii income. Expenses related to this income are deductible.

### Shareholder's Distributive Share Items

Items of income, loss, deductions, etc., are allocated to a shareholder on a daily basis, according to the number of shares of stock held by the shareholder on each day during the tax year

of the corporation. See Item A in the specific instructions below.

A transferee shareholder (rather than the transferor) is considered to be the owner of stock on the day it is transferred.

**Special rule**—If a shareholder terminates his or her interest in a corporation during the tax year, the corporation, with the concurrence of all affected shareholders, may elect to allocate income and expenses, etc., as if the corporation's tax year consisted of two tax years, the first which ends on the date of the shareholder's termination. To make the election, the corporation must file a statement of election with the return for the tax year of election and attach a statement of consent signed by all affected shareholders. If the election is made, write "IRC section 1377(a)(2) Election Made" at the top of each Schedule K-1. See section 1377(a)(2) and Treasury Regulations section 1.1377-1 for details and a definition of affected shareholders.

### Specific Instructions (Schedule K-1 only)

Prepare and give to each shareholder a Schedule K-1 on or before the day on which the corporation's return is filed. On each Schedule K-1, enter the names, addresses, and identifying numbers of the shareholder and corporation, complete items A and B and enter the shareholder's distributive share of each item.

#### Item A (Schedule K-1 only)

If there was no change in shareholders or in the relative interest in stock the shareholders owned during the tax year, enter the percentage of total stock owned by each shareholder during the tax year. For example, if shareholders X and Y each owned 50% for the entire tax year, enter 50% in item A for each shareholder. Each shareholder's distributive share items (lines 1-29 of Schedule K-1) are figured by multiplying the annual amount on Schedule K by the percentage in A.

If there was a change in stock ownership during the tax year, each shareholder's percentage of ownership is weighted for the number of days in the tax year that stock was owned. For example, A and B each held 50% for half the tax year and A, B, and C held 40%, 40% and 20% respectively for the remaining half of the tax year. The percentage of ownership for the year for A, B, and C is figured as shown in the table below and is then entered in item A.

	a. % of total stock owned	b. % of tax year held	c. (a x b) % of ownership for the year	
A	50%	50%	25%	45%
	40	50	+20	
B	50	50	25	
	40	50	+20	45%
C	20	50	10%	
Total.....				100%

If there was a change in stock ownership during the tax year, each shareholder's distributive share items (lines 1-29 of Schedule K-1) are figured on a daily basis, based on the percentage of stock held by the shareholder on each day. See section 1377(a)(1) and (2) for details.

### Schedules K and K-1

#### Lines 1 through 15

Refer to the instructions for federal Schedules K and K-1 (Form 1120S).

Enter the amount attributable to Hawaii and the amount attributable elsewhere for each applicable item listed.

**Note:** Actual dividends distributions paid out of retained earnings (accumulated earnings and profits) of the S corporation are not reported on Schedule K-1. However, these dividends are reported to shareholders on federal Form 1099-DIV. These distributions do not increase or decrease a shareholder's basis in stock.

**Also note:** All income earned and proceeds derived from stock options or stock, including stock issued through the exercise of stock options or warrants, from a qualified high technology business or from a holding company of a qualified high technology business by an employee, officer or director of the qualified high technology business, or investor who qualifies for the high technology business investment tax credit is excluded from income.

#### Line 16

Any S corporation doing business in Hawaii may qualify for Hawaii's Fuel Tax Credit for Commercial Fishers, the Capital Goods Excise Tax Credit, the Enterprise Zone Tax Credit, the Hawaii Tax Credit for Low-Income Housing, the Credit for Employment of Vocational Rehabilitation Referrals, the Motion Picture, Digital Media and Film Production Income Tax Credit, the Credit for School Repair and Maintenance, the Renewable Energy Technologies Income Tax Credit, the Important Agricultural Land Qualified Agricultural Cost Tax Credit, the Tax Credit for Research Activities, the Historic Preservation Income Tax Credit, the Renewable Fuels Production Tax Credit for Years After 1/1/22, and the Pass-Through Entity Tax Credit. The benefits of these credits may be passed through to the shareholders of the corporation.

**Report the shareholder's pro rata share of credits on Schedule K-1.** Attach the appropriate credit form to the S corporation's return.

For the **Fuel Tax Credit for Commercial Fishers**, enter the credit amount on line 16a. Shareholders will use Form N-163 to claim their credit.

For the **Capital Goods Excise Tax Credit**, report the cost of qualifying property, not the credit amount, on line 16b of Schedules K and K-1.

For the **Enterprise Zone Tax Credit**, the S corporation is to prepare a separate Form N-756A for each shareholder.

For the **Hawaii Tax Credit for Low-Income Housing**, enter the credit amount on line 16d. Shareholders will use Form N-586 to claim their credit.

For the **Credit for Employment of Vocational Rehabilitation Referrals**, enter the credit amount on line 16e. Shareholders will use Form N-884 to claim their credit.

For the **Motion Picture, Digital Media, and Film Production Income Tax Credit**, report the shareholder's share of the qualified production costs on line 16f of Schedules K and K-1. Shareholders will use Form N-340 to claim their credit.

For the **Credit for School Repair and Maintenance**, report the credit amount on line 16g. Shareholders will use Form N-330 to claim their credit.

For the **Renewable Energy Technologies Income Tax Credit**, report the credit amount on line 16h. Shareholders will use Form N-342 to claim their credit.



For the **Important Agricultural Land Qualified Agricultural Cost Tax Credit**, report the credit amount on line 16i of Schedules K and K-1.

For the **Tax Credit for Research Activities**, report the credit amount on line 16j of Schedules K and K-1. Shareholders will use Form N-346 to claim their credit.

For the **Historic Preservation Income Tax Credit**, report the credit amount on line 16k of Schedules K and K-1. Shareholders will use Form N-325 to claim their credit.

For the **Renewable Fuels Production Tax Credit for Years After 1/1/22**, report the credit amount on line 16l of Schedules K and K-1. Shareholders will use Form N-360 to claim their credit.

For the **Pass-Through Entity Tax Credit**, report the credit amount on line 16m of Schedules K and K-1. Shareholders will use Form N-362 to claim their credit.

For more information on the various credits, including the deadline to claim the credits, please refer to the applicable credit form.

### Line 16n

Enter the amount of Hawaii taxes held by the Department from the sale of Hawaii real property that is not taxed at the corporate level.

### Lines 17 through 22

Refer to the instructions for federal Schedule K (Form 1120S).

Amounts paid to shareholders who are residents of Hawaii are to be entered in columns b and c. Amounts paid to shareholders who are not residents of Hawaii are to be entered in column b.

## Schedules L, M-1, and M-2 and Schedule M-3 (Form N-35)

Attach a copy of page 4 of federal Form 1120S to the corporation's Hawaii return. The corporation must also maintain a State Accumulated Adjustments Account.

If the corporation is required to file Schedule M-3 on its federal return, attach a copy of that schedule to the corporation's Hawaii return.

## Schedule NS

### Hawaii S Corporation Agreement of Nonresident Shareholders

S corporations having nonresident shareholders are required to obtain from each nonresident shareholder, and file with the Department, an agreement that the shareholder will file a Hawaii return and make timely payment of all taxes imposed with respect to the shareholder's share of the S corporation's Hawaii income. Also, the shareholder will be subject to personal jurisdiction in the State for purposes of the collection of unpaid income tax, penalties, and interest. Schedule NS is used for this purpose. If the corporation fails to timely file these agreements on behalf of its nonresident shareholders, the corporation is required to pay to the State, on behalf of each shareholder for whom an agreement has not been timely filed, an amount equal to the highest marginal tax rate on individuals, currently 11%, multiplied by the shareholder's pro rata share of the income attributable to the State (lines 1 through 10, column b, of the shareholder's Schedule K-1). Form N-4 is used for reporting this withholding by the corporation to the Department. The nonresident shareholder is notified of the amount withheld on Schedule K-1, line

16o. Any payments so made will be considered to be a payment by the shareholder on account of the income tax imposed on the shareholder for the taxable period. The corporation is entitled to recover a payment from the shareholder on whose behalf the payment was made. These agreements are to be filed with the corporation's return for the first period for which the corporation is subject to this provision and for any period in which the corporation had a nonresident shareholder on whose behalf such an agreement has not been previously filed. A shareholder may revoke, in writing, an agreement previously made. The revocation will be effective for the year of the corporation's return to which the statement of revocation is attached and subsequent years, thereby subjecting the shareholder to the withholding provisions. The revocation cannot be made retroactive.

### Form N-4, Statement of Withholding for a Nonresident Shareholder of an S Corporation

Form N-4 is to be completed for each nonresident shareholder for whom a Schedule NS has not been filed on a timely filed N-35 and for nonresident shareholders who have revoked a previously filed Schedule NS. In box 1, fill in the S corporation's full name and mailing address. Show the shareholder's social security number or other tax identification number in box 2. Enter the amount of Hawaii tax that was withheld for the nonresident shareholder in box 3 (11% of the amount shown in box 6). Show the S corporation's FEIN in box 4. Enter the shareholder's name and complete mailing address in box 5. In box 6, enter the shareholder's share of the S corporation's income attributable to Hawaii, the sum of lines 1 through 10 of the shareholder's Schedule K-1. Attach Copy A of Form N-4 to the S corporation's Form N-35. Retain Copy B for the corporation's records. Copy C is for the shareholders' records. Copy D is to be attached to the shareholder's Form N-15.

### Composite Returns for Nonresident Shareholders

S corporations may file composite returns on behalf of some or all of its nonresident shareholders. In order to be included in a composite return, the shareholder must be an individual, the shareholder must have a signed Schedule NS in effect, and the shareholder's only Hawaii source of income is from the S corporation.

The corporation must obtain a statement from each nonresident shareholder electing to be included in the composite return stating that the shareholder elects to be included in the return, that the income of the S corporation attributable to Hawaii is the shareholder's only Hawaii income, and the shareholder is not otherwise required to file a Hawaii income tax return. The corporation must also get a power of attorney from the shareholder for the purpose of filing the return. These statements should be retained by the corporation.

Once a shareholder elects to be part of a composite return, the shareholder cannot elect out of the return for that year unless other Hawaii source income is received by the shareholder. If this occurs, the shareholder must notify the corporation and the corporation must amend the composite return to remove the shareholder from the return. The shareholder must then file his or her own Hawaii nonresident return, Form N-15.

The composite return for nonresident shareholders is to be filed on Form N-15, Individual Income Tax Return Nonresident and Part-Year Resident.

1. Fill in the oval indicating this is a composite return.
2. The first name on the composite return shall be "Shareholders," the last name shall be the corporation's name. The corporation's FEIN shall be used in place of the taxpayer's social security number. Enter the corporation's FEIN in social security number format (i.e., 123-45-6789). Indicate the corporation's mailing address as the taxpayer's address.
3. Do NOT indicate filing status or number of exemptions.
4. On line 17, Column A of Form N-15, enter the total distributive share of the corporation's total income and on line 17, Column B, the total of Hawaii income for the shareholders included in the composite return.
5. Enter these same amounts on line 35.
6. On line 37, enter zero for the ratio of Hawaii adjusted gross income to Total adjusted gross income.
7. On lines 41 and 43, enter the total of the shareholders' taxable incomes; on line 44, enter the total amount of tax on the taxable incomes entered on line 43, including the total amount of other taxes from Forms N-152, N-312, N-325, N-338, N-344, N-348, N-405, N-586, and N-814. The amount on line 44 should be the sum of the tax computed for each of the individual shareholders included on the return.
8. Any Hawaii credits available to the included shareholders should be claimed on the return.
9. Any tax due on the return, line 65, is to be paid by the corporation on behalf of the shareholders.
10. Overpayments (line 59), if any (if not applied to estimated taxes for the subsequent year (line 63)), will be refunded (line 64) to the corporation which will make the refund distribution to the shareholders.
11. The return is to be signed by the Tax Matters Person.

Attach to the return a schedule listing the names, addresses, social security numbers, the filing status, the distributive share of Hawaii income or (loss), the individual shareholder's allowable itemized deductions, each shareholder's Hawaii taxable income, the tax due computed on the taxable income of the individual shareholders, credits if applicable, and the tax due or overpayments for each of the shareholders included in the return.

Filing status for each individual shareholder may be indicated on the schedule using the following codes: S - single, MJ - married filing a joint return, MS - married filing separately, HH - head of household, and QS - qualifying surviving spouse with dependent child.

The individual shareholder's taxable income is computed by subtracting allowable itemized deductions from the shareholder's distributive share of the corporation's income. Allowable itemized deductions are those allowed for Hawaii income tax purposes which are not determined by using the ratio of Hawaii adjusted gross income to total gross income. No standard deduction or personal exemption is allowed.

Nonresident shareholders who have made Hawaii estimated tax payments during the 2023 tax year and are allowed to be included on the composite return may have those payments credited to the composite return. The S corporation may claim these payments on Form N-15, line 55, by entering the total of the estimated tax payments along with "see attached schedule" in



the amount column of line 55 and attaching a schedule of the estimated tax payments by stating each individual's name, address, social security number, and each type of estimated payment and amount of payment (e.g., N-200V, 1st quarter - \$200; N-200V, 2nd quarter - \$300, etc.) made by the individual.

Note: Please **do not** attach Form N-15 to the S corporation income tax return, Form N-35. The S corporation's nonresident shareholders filing Form N-15 are considered a taxpayer separate and apart from the S corporation; thus, Form N-15 must be filed separately.

If it is expected that there will be taxes due on the composite return, estimated taxes may be paid for the composite return using Form N-200V. Form N-200V can be filed and payment made electronically through the State's Internet portal at [hitax.hawaii.gov](http://hitax.hawaii.gov).

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## Schedule PTE and Schedule PTE-U Pass-Through Entity Tax

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### Purpose

Schedule PTE is used to calculate the PTE tax of an electing PTE at the PTE level and report their qualified members' net income and PTE tax credit amounts under section 235-\_\_\_\_, HRS. Schedule PTE-U is used by upper-tier PTEs to report their eligible shareholders' distributive shares of a PTE tax credit amount received from an electing PTE or lower-tier PTE.

### Definitions

"Electing pass-through entity" means a Qualified PTE that elects PTE taxation for the taxable year.

"Lower-Tier PTE" means a PTE that has at least one member that is a PTE.

"Qualified Member" means a direct member of an Electing PTE whose distributive shares are subject to PTE taxation for the taxable year. Qualified members do not include shareholders who are C corporations of an electing PTE.

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

"Upper-Tier PTE" means a PTE that is a member of an electing PTE or lower-tier PTE.

### General Instructions

S corporations who make a yearly irrevocable election to pay taxes at the PTE level for the taxable year are liable for PTE tax on Form N-35, page 2, line 22f. The electing PTE must attach Schedule PTE listing all qualified members and their distributive shares subject to PTE tax for the taxable year.

S corporations that are upper-tier PTEs and received a PTE tax credit from an electing PTE or lower-tier PTE for the taxable year must attach Schedule PTE-U listing all their eligible shareholders and their distributive shares of the PTE tax credit.

For more information, see Tax Information Release No. 2023-03, "Temporary Administrative Rules Relating to Pass-Through Entity Taxation as Enacted by Act 50, Session Laws of Hawaii 2023."

## Specific Instructions Schedule PTE only

If the corporation is an electing PTE for the taxable year, Schedule PTE must be attached to Form N-35. Schedule PTE is a summary of all the qualifying members that an electing PTE uses to calculate the total amount of elective tax on the electing PTE's qualified net income. Schedule PTE requires the electing PTE to identify their qualified members by entering their names, identification numbers, pro rata share or distributive share of qualified net income amounts and to calculate the elective tax credit amounts.

If you need more space on the Schedule PTE to report more qualified members, attach additional Schedule PTEs as needed and check the "Supplement to Part II Only" box at the top of the form and continue with the remaining qualified members in Part II.

The total number of all qualified members, their qualified net income, and their elective tax credit amounts (Part II, lines 1 through 3) of all Schedule PTEs should equal the amount reported in Part I, lines 1, 2, and 4.

Schedule PTE, Part II, lines 1 through 3, should be the total of the amount of qualified members, income, and tax credit amount per form.

### Schedule PTE-U only

**Note:** *An upper-tier PTE's "qualified members" are eligible shareholders of the upper-tier PTE who qualify to claim the PTE tax credit.*

If the corporation is an upper-tier PTE that has received a PTE tax credit from an electing PTE or a lower-tier PTE that the corporation is a member of, Schedule PTE-U must be attached to Form N-35. Schedule PTE-U is a summary generated by upper-tier PTEs of the tax credit amount(s) received and distributive shares of the tax credit amount allocated to its eligible shareholders reported per electing PTE or lower-tier PTE separately. Schedule PTE-U requires the upper-tier PTE to identify their eligible shareholders by entering their names, identification numbers, and their distributive shares of the PTE tax credit.

If you need more space on the Schedule PTE-U to report additional eligible shareholders, attach additional Schedule PTE-Us as needed and check the "Supplement to Part II Only" box at the top of the form and continue with the remaining eligible shareholders in Part II.

Total PTE tax credit amount(s) received from an electing PTE or lower-tier PTE that were allocated to an upper-tier PTE's eligible shareholders (Part II, line 2) of all Schedule PTE-Us should equal each reported electing PTE or lower-tier PTE tax credit amount(s) in Part I, line 1.

Schedule PTE-U, Part II, lines 1 and 2, should be the total of the amount of qualified members and tax credit amount per form.

## The Application of Hawaii Income Taxes to Qualified Subchapter S Subsidiary Corporations (QSub), Qualified Subchapter S Trusts (QSST), and Electing Small Business Trusts (ESBT)

Hawaii's Income Tax Law adopts the provisions of section 1361 under which a parent S

corporation may elect to treat a wholly-owned corporation as a QSub.

A QSub is a corporation that: (1) is 100 percent owned by a parent S corporation; (2) is eligible to make an S corporation election; (3) the parent S corporation elects to treat as a QSub; and (4) is not an ineligible corporation as defined in section 1361(b)(2). For income tax purposes, a QSub is treated like a division of the parent S corporation and is not recognized as a separate entity. The assets, liabilities, income, deductions, and credits of a QSub are treated as those of the parent S corporation.

If a QSub election is made for an existing corporation, the corporation is deemed to have liquidated into the parent S corporation in a tax-free liquidation under sections 332 and 337 immediately before the election is effective. The QSub election on federal Form 8869 is recognized as a Hawaii QSub election pursuant to section 235-122(a), HRS. The parent S corporation must attach a copy of the federal Form 8869 to the first Hawaii S corporation tax return filed following the federal QSub election.

## Hawaii Income Tax Return Filing Requirements for a QSub

The parent S corporation must file a single Hawaii income tax return (Form N-35) using the parent's FEIN. The parent's return should include the assets, liabilities, income, deductions, and credits of the QSub.

## Hawaii Income Tax Return Filing Requirements for a QSST and an ESBT

A QSST must file a fiduciary tax return (Hawaii Form N-40) to report the income taxable to its beneficiary. The sole beneficiary of the QSST is treated as the S corporation shareholder for the S corporation qualification requirements, as well as for the pass-through of income, losses, credits, distributions, and adjustment to the basis of the stock. The beneficiary must file an individual Hawaii income tax return to report the income, losses, and credits distributed by the QSST to the beneficiary.

An ESBT must file a Hawaii fiduciary tax return to pay the income tax on the income attributable to the S corporation stock held by the ESBT. The taxable income of the ESBT includes the income, loss or deduction, and credits attributable to the S corporation stock, gain or loss from the sale of S corporation stock and any Hawaii income taxes and administrative expenses properly allocable to the S corporation stock. The income is taxed at the highest Hawaii income tax rate for estates and trusts. The ESBT's income distributable to a beneficiary does not include the income attributable to the S corporation stock. A beneficiary must file a Hawaii income tax return to report the income, losses and credits distributed by the ESBT to the beneficiary.

**STATE OF HAWAII — DEPARTMENT OF TAXATION  
RELATED FEDERAL/HAWAII S CORPORATION TAX FORMS**

<b>Federal Form Number</b>	<b>Title or Description of Federal Form</b>	<b>Use Hawaii Form</b>	<b>Copy of Fed. Form May Be Used*</b>
1120-S	U.S. Income Tax Return for an S Corporation	N-35	No
Schedule D	Capital Gains and Losses and Built-In Gains	Schedule D	No
Schedule K-1	Shareholder's Share of Income, Deductions, Credits, Etc.	Schedule K-1	No
970	Application to Use LIFO Inventory Method	None	Yes
1128	Application to Adopt, Change, or Retain a Tax Year	None	Yes
2220	Underpayment of Estimated Tax by Corporations	N-220	No
2553	Election By a Small Business Corporation	None	No
3115	Application for Change in Accounting Method	None	Yes
4562	Depreciation and Amortization	None	Yes
4684	Casualties and Theft	None	Yes
6252	Installment Sale Income	None	Yes
8023	Elections Under Section 338 for Corporations Making Qualified Stock Purchases	None	Yes
8697	Interest Computation Under the Look-Back Method for Completed Long-Term Contracts	None	Yes
8824	Like-Kind Exchanges	None	Yes
8825	Rental Real Estate Income and Expenses of a Partnership or an S Corporation	None	Yes
8949	Sales and Other Dispositions of Capital Assets	None	Yes

\*If there is no Hawaii equivalent form, the federal form must be used.