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HOUS COMMITTEE ON FINANCE

TESTIMONY REGARDING SB 2153 SD 1 RELATING TO INCOME TAX CREDIT

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: MARCH 26, 2008

TIME: 10:00AM

ROOM: 308

This bill proposes a one-time tax credit identical to the constitutionally mandated tax relief passed by Act 210, Session Laws of Hawaii 2007.

The Committee on Economic Development & Taxation passed this measure unamended.

The Senate Committee on Ways & Means defected the measure's effective date.

The Department of Taxation (Department) **supports the concept of this legislation; however strongly prefers the Lingle-Aiona Administration bill SB 3112.** The Administration measure provides for a one-time tax refund, versus this bill's tax credit.

The Hawaii Constitution requires the Legislature to provide a tax credit or tax refund when the state general fund balance at the close of each of two successive fiscal years exceeds 5% of the general fund revenues for each of two fiscal years. The Department finds that these conditions have been satisfied because of the surplus in general fund revenues realized these past two fiscal years.

I. COMMENT ON THE PROPOSED TAX CREDIT

The Department supports the concept of this legislation, which is to return to *certain* taxpayers, the excess revenues realized by the State for the past two fiscal years. The Department has the following concepts.

ONLY CERTAIN TAXPAYERS BENEFIT—The Department understands that targeted tax relief to those that need it most is of the utmost importance. However, the Department believes the spirit of the constitutionally mandated credit is to return excess tax revenues to all taxpayers. The Department recalls public sentiment regarding only providing relief to certain taxpayers from the most recent credit from last session. There were comments that at least something should have

gone to everyone. The Department suggests amending the measure to provide tax relief to all Hawaii taxpayers.

CREDIT vs. REFUND—This bill provides for an income tax credit that may be refunded to the taxpayer if the taxpayer has no tax liability. The Department prefers the Administration measure that provides a refund beginning as soon as December 1, 2008. A credit must be taken against tax liability; whereas a refund provides taxpayers with cash-in-hand. *Given recent events in Congress where a bipartisan effort from both the Democrats and Republicans overwhelmingly support the notion of a cash rebate to taxpayers to assist with a commensurate boost in the economy, rather than a credit on a return, the same should be considered given the economic slowing in Hawaii. Under the proposed legislation, relief will have to wait until April of 2009 at the earliest.*

RELIEF WILL NOT HELP THOSE WITH ADDITIONAL EXEMPTIONS—The Department points out an inherent flaw with the proposal is that it provides the same amount of relief for taxpayers with no children as taxpayers with a dozen children because the credit is on a per-return basis. The Department suggests that the Legislature reconsider the proposed format and utilize a per-exemption format in order to provide additional relief to taxpayers based on the number of persons the taxpayer supports in their family.

II. THE DEPARTMENT PREFERS A ONE-TIME INCOME TAX REFUND FOR QUALIFYING TAXPAYERS, AS PROVIDED IN SB 3112.

TARGETED RELIEF TO THE LOWER AND MIDDLE CLASS—The Department strongly prefers the Administration's one-time tax refund. Contained in SB 3112 is the preferred framework that will allow for a one-time cash refund that can be infused into the economy as soon as December of this year. This refund proposal is a "targeted" refund to those taxpayers who need tax relief the most—the *average* family or individual taxpayer. The Administration measure provides for unspecified amounts. The Department and Administration defer to the Legislature to decide the amount of the refund based upon the budgetary priorities. The framework for the targeted relief is as follows:

<i>Filing Status</i>	<i>Adjusted Gross Income(AGI) Ceiling</i>	<i>Refund</i>
• Single, Married Filing Separately	\$50,000 or less	\$___
• Head of Household	\$75,000 or less	\$___
• Married Filing Jointly	\$100,000 or less	\$___

For all other taxpayers, *i.e.*, those earning more than the amounts shown on the schedule above, will be entitled to a refund in an amount also to be decided by the Legislature.

REFUND INCREASES PER DEPENDENT—The refund amount under SB 3112 is multiplied by the number of qualified exemptions that the taxpayer claimed on the taxpayer's 2006 individual income tax return.

This legislation will result in a revenue loss of approximately \$26.1 million for FY 2009. The revenue estimate was arrived at by calculating the fact that residents, including dependents, filed

a total of 554,563 Hawaii income tax returns for the 2005 tax year.

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SUBJECT: INCOME, Tax refund credit

BILL NUMBER: SB 2153, SD-1

INTRODUCED BY: Senate Committee on Ways and Means

BRIEF SUMMARY: Provides that each resident individual taxpayer may claim a general income tax credit in addition to any other credits allowed under HRS chapter 235. The credit amount shall be based on a taxpayer's adjusted gross income with joint taxpayers with adjusted gross income of under \$60,000 receiving between \$160 to \$90; head of households with adjusted gross income of under \$60,000 between \$70 and \$140, and individuals or married taxpayers filing separately with adjusted gross income of under \$30,000 receiving between \$25 and \$65.

The credit shall be paid to each person who has been a resident of the state for at least nine months as defined in HRS section 235-1, whether or not such qualified resident was physically in the state for nine months. The credit shall be deductible from income tax liability for the 2008 tax year. Stipulates that this measure meets the constitutional provisions of Article VII, section 6, mandating the disposition of excess revenues.

EFFECTIVE DATE: July 1, 2050; applicable to tax years beginning after December 31, 2007

STAFF COMMENTS: The "disposition of excess revenues" provision was adopted in tandem with the general fund expenditure ceiling in the belief that if the state adhered to the spending ceiling, Hawaii's generous tax system would produce substantial surplus revenues. Although the refund provision was not a part of the initial discussion of the ceiling, with the realization that revenues would far exceed the needs under the ceiling, the provision was added to insure the return of the funds rather than allowing bureaucrats to sit on these excess funds.

Under the constitutional provision, whenever the general fund balance at the end of a fiscal year exceeds 5% of the general fund revenues received in that year, for two consecutive years, the legislature, at the next regular session following the second consecutive year of excess balances, must provide for a tax refund or credit. This has occurred and a return of excess revenues is necessary.

While the constitutionally mandated tax refund may be viewed as tax relief, it is actually a signal that the state's tax structure is generating more than what is needed to operate state government. It is a signal that more than likely the tax rates and structure are taking too much in tax dollars from the economy and that lawmakers need to address that issue. While the immediate response to an "over productive" income tax structure would be to adjust the income tax rates and brackets, the legislature may wish to implement the recommendation of the Tax Review Commission which is to index the standard deduction, the personal exemption, and the tax brackets for inflation. The Commission found that by the use of indexing, the average income tax bill will not be affected by inflation and income tax revenues will grow automatically with inflation. On the other hand, without indexing, inflation will cause the average income

tax bill to increase and income taxes will rise by more than inflation.

Finally, while this measure mirrors Act 210, SLH 2007, that enacted last year's refund, lawmakers need to rethink limiting the return of excess revenues to only those at the lower end of the income scale. All taxpayers contributed to that excess of revenues. And while lawmakers may want to take credit for handing out extraordinary assistance for the poor, they should not forget that many of the middle-income families are also struggling with Hawaii's high cost of living and heavy burden of taxes. Many of those families might have fallen into the "poor" category but for the fact that many are holding two or more jobs just to make ends meet. And that is what is appalling about the legislature's response last year, certainly arrogance, if not ignorance, of how Hawaii's middle class continues to struggle and in the end many decide to leave the state.

Digested 3/25/08