LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

LATE

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON EDUCATION

TESTIMONY REGARDING SB 3000
RELATING TO TAXATION

TESTIFIER: **KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)**
DATE: **JANUARY 28, 2008**
TIME: **3:45pm**
ROOM: **225**

This bill proposes a deduction from gross income for contributions made to Hawaii's "TuitionEDGE" 529 College Savings Plan.

The Department of Taxation (Department) **strongly supports this Lingle-Aiona Administration measure**.

I. HAWAII'S 529 PLAN, GENERALLY

Section 529 of the Internal Revenue Code allows states to sponsor programs that allow contributions to qualifying educational accounts that grow tax-free for purposes of financing certain qualifying education costs. Hawaii's 529 college savings plan is vested in Chapter 256, Hawaii Revised Statutes, and is overseen by the Department of Budget & Finance. With the high costs of post-secondary education, it is important that investment vehicles with tax benefits be provided for those saving for college.

II. DEDUCTIONS ARE IMPORTANT TO ENCOURAGE INVESTMENT

To ensure Hawaii taxpayers take advantage of Hawaii's TuitionEDGE 529 program, it is important that tax incentives are available to taxpayers. The benefits of tax incentives are twofold:

(1) Additional investment is attracted to Hawaii's plan, which commensurately lowers the cost of administering the fund for the fund participants; and
(2) Additional investment is encouraged from taxpayers so that additional revenue will be saved for the plan beneficiaries, which will help lower the financial burden of college tuition and other costs.

This bill, as well as the Administration measure, seeks to provide meaningful tax incentives for individuals to participate in Hawaii's TuitionEDGE 529 program.

III. OTHER JURISDICTIONS ALLOW INCENTIVES

Many other states offer similar tax incentives for contributions to their respective 529 college savings plans. Incentives include both deductions and a credit. By providing a tax incentive to encourage investment in Hawaii's plans, Hawaii's TuitionEDGE 529 plan will become even more attractive for Hawaii residents.

IV. TECHNICAL CONSIDERATIONS

Based upon input received regarding implementation of a tax incentive such as that provided in this legislation in other States, the Department offers the following technical suggestions for the Committee's consideration—

RECAPTURE PROVISION—The Department suggests that a recapture provision be included in this measure, which would require any deducted amount of income to be included in income in a subsequent year if the plan is rolled-over into a non-Hawaii plan.

PROHIBITED DEPOSITS—The Committee may also want to consider adding provisions that specify any "circular" use of account funds will be precluded from qualifying for the deduction. For example, if an account holder withdraws funds and uses those funds to "re-deposit" funds in the account, no deduction should be allowed for the "re-deposit."

In sum, this bill provides targeted tax incentives to those trying to effectively save for the financial burdens of a college education. Hawaii should capitalize on these investment vehicles by providing incentives for its taxpayers to assure that every person can effectively save for education.

This bill will result in a revenue loss of approximately $2 million per year.

The Department strongly recommends the Committee pass this measure.

LEGISLATIVE

TAXBILLSERVICE LATE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Deduction for college savings program

BILL NUMBER: SB 3000; HB 3078 (Identical); SB 2087; SB 2251; SB 2660; HB 2458 Similar

INTRODUCED BY: SB 3000 by Hanabusa by request; HB 3078 by Say by request; SB 2087 by Espero, Sakamoto, Tokuda & 4 Democrats; SB 2251 by Kim, Chun Oakland, English, Gabbard, Sakamoto, Tokuda, Tsutsui, 6 Democrats & 1 Republican; SB 2660 by Sakamoto, Chun Oakland, Hooser, & Kim; HB 2458 by Caldwell & Lee

BRIEF SUMMARY: SB 3000/HB 3078 and HB 2458 amend HRS section 235-7 to provide that the annual deductions from gross income for contributions to the Hawaii college savings program shall be: (1) up to $10,000 for individual taxpayers; (2) up to $10,000 for married couples filing separately provided that each spouse may claim a deduction up to $10,000; and (3) up to $20,000 for married couples filing joint returns, individuals filing as head of households, or individuals filing as surviving spouses.

SB 2087 amends HRS section 235-7 to provide that the annual deductions from gross income for contributions to the Hawaii college savings program shall be: (1) up to $2,000 for individual taxpayers; (2) up to $2,000 for married couples filing separately provided that each spouse may claim a deduction up to $2,000; and (3) up to $4,000 for married couples filing joint returns, individuals filing as head of households, or individuals filing as surviving spouses. Further stipulates that the adjusted gross income of a taxpayer who qualifies for a deduction under this section shall not exceed $100,000 or $200,000 in the case of a married couple. The amendments made to this section shall not be repealed when this section is reenacted on January 1, 2013 pursuant to section 3 of Act 166, SLH 2007. Deductions in excess of a taxpayer's liability shall be applied to subsequent tax liability until exhausted.

SB 2251 adds a new section to HRS section 235 to allow taxpayers to take a tax deduction for contributions made to a college savings account under HRS chapter 256 provided that the deduction shall not exceed $5,000 for taxpayers filing individually and $10,000 for taxpayers filing jointly. Requires the director of taxation to prepare the necessary form to claim the deduction, may require proof of the claim for the tax deduction, and may adopt rules pursuant to HRS chapter 91.

SB 2660 amends HRS section 235-7 to provide that the annual deductions from gross income for contributions to a qualified tuition program established pursuant to IRC section 529 shall be: (1) up to $5,000 for individual taxpayers; (2) up to $5,000 for married couples filing separately provided that each spouse may claim a deduction up to $5,000; and (3) up to $10,000 for married couples filing joint returns, individuals filing as head of households, or individuals filing as surviving spouses.

EFFECTIVE DATE: Tax years beginning after December 31, 2007

STAFF COMMENTS: SB 3000 and HB 3078 are administration measures submitted by the department of budget and finance BUF-02(08). The legislature by Act 81, SLH 1999, established a college savers program on the state level to allow taxpayers to save for a child's college education by participating in a state college savings program. This plan is patterned on the rules governing such plans established under Section 529 of the federal Internal Revenue Code. Under that section, contributions made to such qualified programs receive no special tax treatment but the law specifies that when the distribution is made from the account for the beneficiary, the amount in excess of the contribution is taxable as part of the beneficiary's income. There is no benefit or incentive for the contributor, in other words the contribution is made with after tax dollars.

These measures propose an income tax deduction from $2,000/$4,000 to $10,000/$20,000 annually to encourage taxpayers to participate in the college savers program. In the administration's justification sheet, it is estimated that the potential revenue loss for this proposal is $2.8 million; however, if the measure is successful in encouraging more participation in the program, then the revenue loss would be significant.

It should be remembered that it has long been the intent of the state legislature to maintain conformity between Hawaii's income tax law and the federal Code to insure that administration and compliance costs will be minimized. Given that there is no similar provision on the federal level, this proposal would create yet another difference in the definition of income for state income tax purposes.

If it is the intent of the legislature and administration to encourage families to set money aside for their children's higher education, the deduction, as proposed, is regressive in that it favors those at the high end of the income scale who probably would have the discretionary income to set aside funds and punishes those at the bottom end of the income scale as those families are less likely to put the maximum aside to qualify for the deduction. Inasmuch as the proposed deduction is a back door expenditure of tax dollars, it would be far more efficient for lawmakers to set up a subsidy program that would provide a sliding scale of percentages to subsidize or "match" contributions made to a qualified college savings account where the percentage of match would be inversely graduated. Thus, those lower income families with less discretionary income would see their small contributions matched at a higher percentage while those higher income families would see the match phase-out after a certain level of contribution is made. This would take the onus of administering the program out of the tax department and places it within the financial institutions who would benefit from the use of the money. This would also insure that the contributions are made to a local institution that would participate in the state matching program. This would be far more efficient and accountable that utilizing the tax system to encourage parents to save for their children's college education.

Digested 1/28/08

LATE

Hawaii Association of Independent Schools

January 28, 2008
3:45 p.m.
Conference Room 225

TESTIMONY TO
THE SENATE COMMITTEE ON EDUCATION

SB 3000 – Relating to the State of Hawaii Section 529 College Savings Program

Dear Chair Sakamoto, Vice-Chair Tokuda, and Members of the Committee:

My name is Robert Witt, executive director of the Hawaii Association of Independent Schools, which represents approximately 100 private and independent schools and educates over 30,000 elementary and secondary school students in our state.

Our association strongly supports the intent of SB 3000, which is to provide taxpayers with a state tax deduction for contributions to Hawaii's college savings program.

Most prominent among our reasons for supporting this measure is the recently adopted goal of the Hawaii P-20 initiative to work strenuously over the next decade to significantly increase the percentage of adults living in Hawaii with a four-year college degree. This measure would provide significant financial incentives for parents, grandparents and family members to save the funds necessary to send more high school graduates to college over the next ten years than have ever attended before.

Our association has supported the 529 College Savings Program for many years, posting information about the program on our website and allocating space in our annual private school guide to present families with information about how to participate. We have recently renewed our commitment to advancing this program with an even greater number of families and, working together with the State Department of Budget and Finance, will continue to add value to the program in the years ahead, beginning by advocating for the tax deduction proposed by this bill.

Thank you for this opportunity to testify.

LATE

To: The Honorable Norman Sakamoto
Senator and Chair Hawaii State Senate Education Committee

My name is Fred Rohlfing. I am a lifelong resident of Hawaii and am a current resident of Kula, Maui. I write to express my support for SB 3000 which, if enacted will provide Hawaii taxpayers with an annual state tax deduction (up to $20,000 for married couples filing jointly) against their taxable income in Hawaii for contributions to the Hawaii 529 college savings program.

My wife and I funded 529 plans beginning in the mid-90's for our 6 grandchildren with the state of California's program called "Scholarshare". Being non-residents of CA we could not take advantage of the deduction they had on State income taxes. We would have changed over to the HI funds when finally created, but had no incentive financially to do so. With enactment of this bill, we will have that incentive. We would thereby increase our state resident participation in the Hawaii program thereby enabling our state to have a lower program management fee in the future.

The bottomline: this bill if passed will help to educate Hawaii's youth. SB 3000 deserves to be expeditiously moved out of committee to the floor of the Senate.

Thank you,

Fred & Patty Rohlfing
2807 Kekaulike Ave
Kula, Hi 96790-8478
ph 808-878-6927