EXECUTIVE CHAMBERS

HONOLULU

LINDA LINGLE
GOVERNOR

Testimony of Linda L. Smith
Senior Policy Advisor to the Governor

Before the

Senate Committee on Human Services and Public Housing

Saturday, February 2, 2008, 1:15 p.m.
State Capitol, Conference Room 16

SB 3111 Relating to Taxation

Chair Chun Oakland, Vice Chair Ihara, and Members of the Committee:

On behalf of Governor Lingle, I want to express our appreciation for scheduling an early hearing on this measure, known as the Ohana Tax Relief Act of 2008. This bill is targeted at what we call the "squeeze generation" -- working families who have children under 18 years of age and are also helping an aging parent or parents who need some assistance as they grow older.

Currently Hawaii tax laws provide for personal exemptions of $1,040 per individual under 65 years of age and $2,080 per individual 65 years of age or older. In addition, State laws allow a credit for child and dependent care expenses of up to $2,400 for one qualifying individual and $4,800 for two or more qualifying individuals with respect to the taxpayer.

This bill will allow families with qualified dependents age 18 and younger to claim additional tax exemptions (Ohana Exemption) as follows:

Federal Adjusted Gross Income	Ohana Exemption Amount per Dependent
$100,000 and under	$1,000
$100,001 up to $200,000	$500
Over $200,000	$0

The bill will also remove the current two or more qualifying dependent cap and set the dollar limit to not exceed $5,000 for each qualifying dependent. This proposed amendment is aimed at easing the burden of the cost of caring for children, disabled dependents, and dependent elderly parents.

Governor Lingle believes that tax relief is one of the most important actions this Legislature can take in 2008. The Policy Office has done a recent analysis that looked at the cost of living increases Hawaii families are facing. We looked at just four basic costs -- electricity, property taxes, water and sewer rates, and gasoline. Between 2002 and 2007 -- just five short years -- the costs of these items has risen 86.5% on Oahu, 74.4% on Kauai, 56.2% on Maui, and 49.6% on the Big Island.

These cost of living increases have far outstripped the wages and are hurting all of us who call Hawaii home. The Governor frequently talks about the number of people who approach her at meetings and events, talking about their growing difficulties in making ends meet. The hurt is genuine -- the pain is real.

The bill before you will help an estimated 165,000 tax filers, would save these families $34.9 million over two years, and is targeted at those who need money back in their pockets now. For example, for a single mom making $31,500 per year, this bill, combined with Governor Lingle's other tax relief measures, would save this mother $591 per year -- a 73% reduction in her tax burden. For a family of four with two wage earners and a combined income of $80,500, this family would save $704, an 18% tax burden reduction.

Democrats and Republicans in Congress realize that tax relief is the best way to save our economy and help people. They are poised to pass a $150 billion economic stimulus package. We hope that Democrats will join with our Governor to do the same for the people of Hawaii.

Thank you for the opportunity to testify.

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

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SENATE COMMITTEE ON HUMAN SERVICES & PUBLIC HOUSING

TESTIMONY REGARDING SB 3111
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 2, 2008
TIME: 1:15PM
ROOM: 016

This bill seeks to provide an additional personal exemption of up to $1,000 for taxpayers with dependents aged 18 and under, to be known as the "Ohana Exemption." This bill also increases the dependent care employment-related expense credit expenditure ceiling to $5,000 per dependent. Finally, this bill makes several conforming amendments to § 235-55.6 to conform to the Internal Revenue Code. This bill takes effect upon approval, provided that the "Ohana Exemption" applies to taxable years beginning after December 31, 2008 and the increased dependent care credit applies to taxable years beginning after December 31, 2007.

The Department of Taxation (Department) **strongly supports** this Lingle-Aiona Administration measure and urges the Committee to pass this measure.

The purpose of this legislation, known as the Ohana Tax Reduction Act, is to provide meaningful tax relief to the families of Hawaii that struggle with the day-to-day financial burdens of providing the daily necessities of life of their children and dependents, including adult-aged dependents. The Department strongly supports providing targeted financial relief to the ohana of Hawaii. This legislation is a novel and unique approach to providing simple and meaningful relief to these families.

I. ADDITIONAL PERSONAL EXEMPTION FOR SCHOOL-AGED DEPENDENTS.

This legislation provides for what is known as the "Ohana Exemption". This exemption is an additional exemption that may be claimed by a taxpayer with any dependent, as defined by the Internal Revenue Code, aged 18 and under. The Ohana Exemption is provided on a sliding scale basis to provide those families with less income a greater benefit. The means testing of the exemption is as follows:

Federal Adjusted Gross Income	Ohana Exemption Amount
$100,000 and under	$1,000
$100,001 to $200,000	$500
Over $200,000	$0

Currently, there is no relief provided for the direct costs parents incur for their children to attend school or other costs associated with raising a child. Parents can spend hundreds or thousands of dollars providing the necessary food, clothing, shelter, supplies, equipment, and other fees associated with raising a child.

As a result of this legislation, an average family of four in Hawaii would be entitled to claim a personal exemption of $1,040 for each spouse and child; plus an additional $1,000 exemption for each child. Rather than a personal exemption of $4,160, the family would be entitled to exclude from gross income $6,160—a 68% increase in benefit.

The above-mentioned federal income amounts were used because most families in Hawaii have both spouses working, which results in a large gross income for tax purposes; however only enough to get-by financially with Hawaii's high cost of living. It is the Department's position that the $100,000 and $200,000 income thresholds are rational and realistic given Hawaii's high cost of living.

The Department urges the Committee to pass this measure because this bill recognizes the costs associated with caring for the children of Hawaii and provides simple, meaningful tax relief through the operation of the personal exemption. Families should not be punished for having children. It should be the place of government to reward Hawaii's ohana by providing relief for the costs of raising and educating Hawaii's youth.

II. DEPENDENT CARE CREDIT EXPENDITURE CEILING INCREASE.

Hawaii currently conforms to the Internal Revenue Code, which provides for a dependent care credit for employment-related costs associated with providing dependent care. *See* HRS § 235-55.6. This tax credit applies to both children and adult-aged dependent care. The tax credit is a percentage of the dependent care expenses. The percentage is a sliding scale based upon income. The expenditures are capped at a ceiling amount.

The purpose of this legislation is to help offset the high cost of dependent care in Hawaii. Because of Hawaii's high cost of dependent care for both children and adults, many families are forced to have two-worker, two-job families only to cover the cost of care, effectively separating the family for several hours per week. Moreover, the revenue generated by these additional jobs many times only goes to pay for dependent care. This bill increases the dependent care credit employment-related expense ceiling from a two-tiered amount to a flat-per-dependent amount. Under current law, the credit may be used to offset the following amounts—

One qualifying dependent	Up to $2,400
More than one qualifying dependent	Up to $4,800

This bill seeks to eliminate the two-tiered dependent expenditure maximums, in favor of a flat $5,000 ceiling per dependent.

For example, under current law, a family with three children can only claim a credit based on a sliding scale for a percentage of the dependent care costs of up to $4,800 per year—or the same amount that can be claimed for a family with only two children. Whereas under this legislation, a family of three can obtain a credit based on a sliding scale percentage of up to $15,000 in dependent care costs and the family of two can claim up to $10,000. In short, this bill eliminates the penalty for having additional children and provides meaningful relief commensurate with the number of children.

This legislation applies to dependent adults in the same manner.

Lastly, this bill makes several conforming amendments to recent changes made to the same credit in the Internal Revenue Code.

III. REVENUE ESTIMATE.

The legislation will result in revenue loss of approximately $9,000,000 for FY 2009; $25,900,000 for FY 2010 and thereafter.

As a result of the foregoing, the Department strongly supports this legislation as meaningful tax relief to the ohana of Hawaii. The Department urges the Committee to pass this measure as-is.

L E G I S L A T I V E

TAXBILLSERVICE

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SUBJECT: INCOME, Additional personal exemption; amend qualifications for dependent care credit

BILL NUMBER: SB 3111; HB 3189 (Identical)

INTRODUCED BY: SB by Hanabusa by request; HB by Say by request

BRIEF SUMMARY: Amends HRS section 235-54 to allow taxpayers to claim an additional "ohana" exemption in addition to any other exemptions in this section. The additional exemption may be claimed for each qualified dependent, age 18 and under, which the taxpayer may claim for federal income tax purposes based on the taxpayer's federal adjusted gross income:

Federal adjusted gross income	Ohana exemption amount
$100,000 and under	$1,000
$100,001 up to $200,000	$500
Over $200,000	$0

For purposes of this section, including the determination of the adjusted gross income limitation, a married couple filing jointly will be treated as one taxpayer. A husband and wife filing separately for which they could have filed jointly shall only be entitled to the additional exemptions they would have been entitled to if they filed jointly. This section shall apply to tax years beginning after December 31, 2008.

Amends HRS section 235-55.6 to increase the dollar amount of expenses that may be eligible for the dependent care credit to $5,000 for each qualifying individual. This section shall apply to tax years beginning after December 31, 2007.

EFFECTIVE DATE: Upon approval as noted

STAFF COMMENTS: This is an administration measure submitted by the department of taxation TAX-03 (08). The proposed measure permits taxpayers with federal adjusted gross incomes of under $200,000 with qualified dependent children age 18 and under to claim an additional "ohana" exemption of $1,000 or $500 per qualified exemption.

While section 1 of the measure states that "taxpayers with children in Hawaii face a daunting challenge due to Hawaii's high cost of living" it should be remembered that not only do taxpayers with dependent children have to contend with Hawaii's high cost of living but so do all taxpayers at all income levels.

While the measure provides welcome tax relief to a select group of taxpayers, it is reminiscent of Act 210, SLH 2007, which complied with the constitutional mandate to return excess funds back to taxpayers but to only those with adjusted gross incomes of under $60,000/$30,000 for joint/single taxpayers.

SB 3111; HB 3189 - Continued

Taxpayers with adjusted gross incomes over the threshold amount did not receive any tax relief similar to those taxpayers without dependent children as proposed by this measure.

The measure also proposes to increase the qualifying expenses eligible to claim the dependent care credit from $2,400 for one qualifying individual or $4,800 for two or more qualifying individuals to $5,000 per qualifying individual. Currently, on the federal level, the qualifying expenses are $3,000 for one qualifying individual or $6,000 for two or more.

It should be noted that presently state statutes reflect lower income tax rates at the state level as compared to those imposed at the federal level. Thus, while the intent of this measure is commendable in view of the rising cost of dependent care and the increasing number of two wage-earner families, raising the amount of the qualifying expenses to a level higher than those granted under the federal income tax law where the tax rates are substantially higher cannot be justified.

While this proposal will probably appeal to parents with young children, it is just that, politically driven. Although there has been little success in the recent past, an increase in the standard deduction would be far more equitable that an increase in the personal exemption or in this case, an additional personal exemption. Politically driven given the fact that the additional personal exemption applies to dependents under the age of 18. What is so magical about that age especially when one realizes that those children going on to higher education are probably a more costly burden to their parents as they try to meet the challenges of tuition. Instead of resorting to these gimmicks, which are not reflected in the federal law, lawmakers should undertake the tried and true and increase the standard deduction and make an adjustment to the income tax rates and brackets.

Digested 2/01/08