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HOUSE COMMITTEE ON FINANCE

TESTIMONY REGARDING HB 1508
RELATING TO INCOME TAX

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 26, 2009
TIME: 1PM
ROOM: 308

This legislation provides an income tax exemption for individuals who earn less than 100 percent of the current Federal Poverty Income Guideline for Hawaii as determined under 42 United States Code Section 9902(2).

The House Committee on Human Services passed this measure unamended.

While the Department of Taxation (Department) **supports the intent and purpose of the legislation which is to assist low-income families** in this State, the Department **opposes the tax provision in this measure due to the budget impact** as this was not factored into the Executive Budget or any of its fiscal priorities this session. The Department also offers **comments** on this legislation.

IMPACT ON THE BUDGET—The Department cannot support this measure at this time because it is not factored into the budget. The Department must be cognizant of the biennium budget and financial plan. This measure has not been factored into either. And, given the forecasted decrease in revenue projections, this measure would add to the budget shortfall. The Department suggests that the matter be revisited at such time that the budget is better able to afford the relief sought.

GENERAL COMMENTS--- Because the poverty guidelines increase with each additional person in the family, the income tax exemption threshold will vary with the number of persons in the family. To accommodate the increasing exemption amounts, the Department's computer system programming will have to undergo extensive modification. It is unclear at this time whether the current system resources will allow this modification to occur. If it does not, the Department will have to upgrade the computer to accommodate such modification as well as resources to support the exhaustive testing that will be required to insure system reliability.

In addition, the poverty guidelines are updated periodically in the Federal Register by the U.S. Department of Health and Human Services under the authority of 42 U.S.C. 9902(2). Each time the guidelines are updated, the Department would be forced to incur additional costs to update the computer system to reflect the new thresholds.

The Department also noted that an inequality will exist between persons whose income do not exceed the federal poverty level and those who do. For example, the federal poverty level for a family of three for Hawaii for 2008 is $20,240. Families of three that do not exceed this amount would be exempt from income tax under this measure. On the other hand, a family of three whose family income happened to be $20,241 would not be exempted under this measure and would have taxable income of $13,121 (assuming the standard deduction is used) and would pay income tax of $415, all because the family income exceeded by $1 the federal poverty guidelines.

Finally, the Department notes that the measure uses **taxable income** to determine if the individual is under the federal poverty guidelines, rather than gross income or adjusted gross income. This measure would allow individuals who have a large gross income and who also have large deductions or other losses to offset such income such that the taxable income falls below the federal poverty guidelines to escape taxation. For example, a single person who has gross income of $40,000 but pays mortgage interest of $28,001 on a home that he is able to deduct as an itemized deduction would have taxable income of $10,959. Because the amount of taxable income is under the federal poverty guideline of $10,960 for a single person, that individual would be exempt form tax.

The Department would suggest that it would be more efficient to simply raise the standard deduction for taxpayers based on their filing status (single, married, or head of household) rather than having a system based on an increasing exemption level with each additional dependant.

This measure is projected to result in a revenue loss to the general fund of $202 million.

L E G I S L A T I V E

TAXBILLSERVICE

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

SUBJECT: INCOME, No tax on low-income individuals

BILL NUMBER: SB 723; HB 1508 (Identical)

INTRODUCED BY: SB by Fukunaga and Chun Oakland, 1 Democrat and 1 Republican; HB by Brower, Finnegan, Herkes, Manahan, Marumoto, Mizuno, Morita, Pine, Shimabukuro, Souki, Takai, Takumi, Thielen, Wakai, Wooley, 26 Democrats and 1 Republican

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to provide that notwithstanding HRS section 235-51, no state income tax shall be imposed on individuals whose taxable income is less than 100% of the federal poverty income guideline for that year, issued pursuant to Title 42 United State code Section 9902(2), beginning after December 31, 2008.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: The proposed measure would provide that individuals with taxable income less than 100% of the federal poverty level for a tax year shall not be subject to any state income tax. The 2009 federal poverty guideline for Hawaii is $12,460 for one person and $16,760 for two persons.

While it appears that the intent of this measure is to provide that low-income persons shall not be subject to the state income tax, an increase in the standard deduction or an adjustment to the state income tax brackets would achieve similar results.

The legislature by Act 110, SLH 2006, increased the amounts of the standard deduction to 40% of the federal standard deduction at that time. Increasing the standard deduction has been a continual litany of every Tax Review Commission since the body was established in the state constitution, including the most recent Tax Review Commission of 2005-2007.

The standard deduction basically raises the floor before families have to begin paying the income tax. While the specific dollar amounts or the ratio to the federal standard deduction is a legislative prerogative, raising the standard deduction is the most simple and direct means of aiding poor and lower middle-income families. Upper income families generally itemized their deductions as those deductions are probably greater than the standard deduction amount. This measure, while well-intended, fails to recognize the fact that those just above the poverty line are also struggling to make ends meet but would not benefit from the proposal. Thus a couple earning $17,000 would have to pay the state income tax on $13,000 of that income which is only $240 above the poverty line for two persons.

Indexing the standard deduction which was also recommended by the most recent Commission is another consideration. It should also be noted that the federal system is indexed for inflation to prevent nominal price increases from eroding the benefit of the personal exemption and the standard deduction. Thus, in addition to adjusting the standard deduction, lawmakers should also consider indexing the state income tax system for inflation as a way to gradually maintain equity in the state tax system.

Digested 2/4/09

Testimony in **Support** of House Bill 1508
Relating to Income Tax

For FIN Hearing on February 26, 2009, 1 p.m., agenda #4, Room 308

Aloha Chair Oshiro, Vice-Chair Lee, and Members of the Finance Committee:

I am writing in support of HB 1508.

This bill would help the people hit hardest by this economic recession keep more of their earned income in their pockets:

- Tipped workers (especially those who worked in the tourist industry)
- Part-time workers who have family or school obligations preventing them from working full-time.

With less government resources going to services that help economically-disadvantaged individuals and their families, they are left without a safety net.

We know that these times will only get harder.

The next best thing is to give them every opportunity to keep more of their dollars to sustain themselves: to put food on the table, a roof over their heads, and provide healthcare for their family.

On the flipside, taxpayers like myself who make beyond that minimum tax threshold would like to see more of our taxpayer money go towards keeping our schools open, maintaining services to the elderly, expanding healthcare and protecting our beaches.

This is smart economic policy.
This isn't about taking from Peter to pay Paul. It is about helping people become self-sufficient so we can get through these tough years ahead of us.

Thank you for the opportunity to testify in support of this measure.

Submitted by Jonathan Choi
Honolulu