SB 790

Aloha United Way

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Aloha United Way

February 9, 2009

Senate Committee on Human Services
Senator Suzanne Chun Oakland, Chair
Senator Les Ihara, Jr., Vice Chair
Tuesday, February 10, 2009 at 2:15 P.M.
Conference Room 016

SB 790: Relating to Taxation: Written Testimony in Strong Support

Dear Chair Chun Oakland, Vice Chair Ihara and Committee Members:

Aloha United Way strongly encourages your favorable consideration of SB 790 which establishes a refundable state earned income tax credit.

In January 2009, The Department of Business, Economic Development & Tourism published a report titled "Self-Sufficiency Income Standard – Estimates for Hawaii 2007". This report looks at the critical issue of family and individual self-sufficiency. DBEDT defines self-sufficiency as the ability to meet basic needs without government or other subsidies. The report clearly shows the impact of the ever-increasing cost of living in Hawaii on a workforce as fully 24.8% of Hawaii's families have inadequate income to be self-sufficient.

The federal earned income tax credit has proven to be the most efficient and effective way of providing tax relief to low income working families. This credit has lifted over 4.4 million Americans out of poverty every year. SB 790 establishes a state earned income tax credit modeled after the federal credit and sets the state credit at 20% of the federal credit. While our current "income-support" based welfare system is important to ensure our most needy are cared for, moving families from support to self-sufficiency requires a comprehensive set of asset building strategies – and a state earned income tax credit is a powerful tool to target those who are emerging from reliance on state support programs. In addition, a state EITC would put needed consumer dollars into our economy at this critical time.

SB 790 provides an excellent start on a comprehensive set of programs that will eventually enable more of our citizens to enjoy a self-sufficient life and Aloha United Way strongly encourages favorable consideration of this important legislation.

Sincerely,

Susan Doyle

Susan Doyle
President & Chief Professional Officer

The Twenty-Fifth Legislature
Regular Session of 2009

THE SENATE
Committee on Human Services
Sen. Suzanne Chun Oakland, Chair
Sen. Les Ihara, Jr., Vice Chair

State Capitol, Conference Room 016
Tuesday, February 10, 2009; 2:15 p.m.

**STATEMENT OF THE ILWU LOCAL 142 ON S.B. 790
RELATING TO TAXATION**

The ILWU Local 142 supports S.B. 790, which provides a refundable state earned income tax credit equivalent to 20% of the federal earned income tax credit and requires the refundable portion to be reimbursed by federal or state TANF funds.

Due to low wages, lack of education, and large families, some working families are not able to move themselves into the "middle class" and find themselves struggling to stay afloat. Any financial help, especially in these desperate economic times, is much needed.

The federal earned income tax credit (EITC) has been shown to give working families a boost out of poverty. S.B. 790 will provide for a state EITC that could further aid working families to be self-sufficient. Use of TANF funds for the refundable portion of the state EITC makes sense. If the families were not working, they would likely be using far more TANF dollars that the small amount needed for EITC refunds.

The ILWU urges passage of S.B. 790. Thank you for the opportunity to testify on this measure.

HACBED

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February 10, 2009

Tuesday, February 10, 2009 2:15pm
Senate Committee on Human Services: Rm. 016
Testimony in **Support** of **SB790**
Creating a State Earned Income Tax Credit

Dear Chair Chun Oakland and Committee Members:

The Hawai`i Alliance for Community Based Economic Development (HACBED) is submitting testimony in support of **SB 790**.

EITC is part of a comprehensive public policy agenda to help people build assets. Asset Building is an approach to fostering financial independence. It provides individuals with tangible incentives to save, helping them to gain financial success. Adopting a state EITC would be an important economic development tool because in many cases families use these refunds to purchase their basic needs. In this manner the EITC creates a multiplier effect because those dollars circulate throughout the economy, thus part of the initial cost to the state is offset by general excise tax revenues. HACBED supports the efforts of the State Asset Building Task Force and strongly urge that **SB 790** be passed.

Assets are essential for three reasons:

1. To have **financial security** against difficult times
2. To create **economic opportunities** for oneself
3. To **leave a legacy** for future generations to have a better life

HACBED supports **SB 790** in that this bill is a major component of a larger asset building policy agenda. To date, there are 42 states that have an income tax and therefore eligible to create a state EITC. 24 states (including the District of Columbia) have enacted EITC's. These states will combine for close $2 billion to nearly 6 million families. **EITC's put money back into the community where it is needed most.**

For most tax payers, their annual refunds from both federal and state fillings are the largest lump sum of discretionary funds they ever see. These funds can be used for home down payments, debt reduction, creation of Individual Development Accounts, and rainy day funds.

How would a state EITC work?
SB 790 establishes a state EITC that is similar to the 24 other states that utilize the credit. Hawai`i individual filers that qualify for a federal EITC may claim 20% of the earned income credit allowed and reported on the individuals' federal income tax return. Filers have already been utilizing tax preparation assistance from Aloha United Way since the incorporation of the federal EITC and will be provided the same opportunity should a state EITC become available to them. It is key to note that these credits encourage timely filing and offer an opportunity to educate filers on the importance of early filing and financial planning.

In closing, Hawai`i families are struggling to provide for their families given the high cost of living across the state. They are overburdened by taxes and have few opportunities to build their assets and work toward self-sufficiency. A state EITC will help the working families in Hawai`i by providing targeted tax relief that stimulates the economy.

Thank you for your consideration.

Sincerely,

Brent Dillabaugh
Policy Coordinator

LINDA LINGLE
GOVERNOR

LILLIAN B. KOLLER, ESQ.
DIRECTOR

HENRY OLIVA
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES
P. O. Box 339
Honolulu, Hawaii 96809-0339

February 10, 2009

MEMORANDUM

TO: The Honorable Suzanne Chun Oakland, Chair
Senate Committee on Human Services

FROM: Lillian B. Koller, Director

SUBJECT: **S. B. 790 - RELATING TO TAXATION**

Hearing: Tuesday, February 10, 2009, 2:15 p.m.
Conference Room 016, State Capitol

PURPOSE: The proposed amendments will provide a refundable State earned income tax credit equivalent to twenty per cent of the Federal earned income tax credit. Requires the refundable portion of the earned income tax credit to be reimbursed by Federal or State Temporary Assistance for Needy Families (TANF) funds.

DEPARTMENT'S POSITION: The Department of Human Services (DHS) respectfully opposes this measure because it would adversely impact the priorities set forth in the Executive Biennium Budget for Fiscal Years 2009-2010.

We also defer to the Department of Taxation regarding the providing of a State earned income tax credit.

Further, the Department has concerns regarding the new procedures and system modifications required to periodically calculate the value of the refundable portion of the tax credits provided under the proposed measure that qualifies for reimbursement from TANF funds.

Finally, the Department respectfully requests that the $28.2 million in TANF Federal funds restricted in the current State fiscal year 2009 budget be restored for the biennium so that we can continue to fund the programs, services and benefits that have, among other positive outcomes, strengthened families and contributed to the reduction, by half, of child re-abuse and neglect since 2005. This is neither the time to freeze Federal funds nor divert Federal funds from the investment we have made that is working so well.

Thank you for the opportunity to provide comments on this bill.

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

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DIRECTOR OF TAXATION

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SENATE COMMITTEE ON HUMAN SERVICES

TESTIMONY REGARDING SB 790
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 10, 2009
TIME: 2:15PM
ROOM: 016

This Bill would provide qualified Hawaii taxpayers with an earned income tax credit (EITC) equal to a 20% of the federal EITC.

The Department of Taxation ("Department") **appreciates the intent of alleviating the tax burden of those who need it most; however has concerns regarding administration of this measure.**

This bill provides for a refundable tax credit equal to 20% of the EITC allowed under section 32 of the Internal Revenue Code (IRC) and reported on these qualified individuals' federal income tax returns. The bill requires the Department to alert eligible taxpayers of the proposed Hawaii EITC and prepare an annual report containing certain information.

I. INCREASING STANDARD DEDUCTION MORE EFFECTIVE

The Department strongly supports alleviating the tax burden on the poor. However, the Department suggests considering alternative measures such as increasing the standard deduction because it would help more Hawaii taxpayers. By increasing the standard deduction, it is estimated that 64% of Hawaii's taxpayers will benefit. Increasing the standard deduction also provides $30 million in tax relief per year and leaves this money in the pockets of those who need it most.

Based on former data presented to the Legislature, this legislation will only assist roughly 68,560 taxpayers or less than 13%. This legislation only provides approximately $23.8 million in total tax relief with a claimed benefit of $347 per taxpayer, assuming a 20% Hawaii earned income tax credit.

II. COMPLIANCE PROBLEMS.

The Internal Revenue Service (IRS) admits that the EITC has been plagued by persistent compliance problems. The IRS has been unable to reduce noncompliance problems significantly. Between $8.4 and $9.9 billion (27% to 32%) in EITC claims have been paid improperly as reported in a compliance study of tax year 1999 returns. The EITC credit is listed as a "*high risk area for the federal government*" by the General Accounting Office. *See EITC Reform Initiative*, FS-2003-14, June 2003). In its 2005 EITC Initiative Final Report to Congress, the IRS stated that although "the IRS has implemented a number of legal and administrative changes since [the 1999 study], IRS officials believe the error rate is still substantial." The 2005 report, in an analysis of preliminary data from tax year 2001 returns stated that EITC over claim estimates would not be "substantially different" than that of tax year 1999. *See http://www.irs.gov/pub/irs-utl/irs_earned_income_tax_credit_initiative_final_report_to_congress_october_2005.pdf.*

"The EITC credit is a social welfare program embedded in the tax code where the tax system primarily relies on self-reporting." (*See EITC Reform Initiative*, FS-2003-14, June 2003). Unlike other social welfare programs, no requirement is imposed for EITC eligibility proof prior to payments and the payments rely on the claimants' self-assessment for eligibility. Crucial EITC eligibility factors such as marital status, residency, and the relationship test of a claimed child, are difficult for the IRS to confirm. *See id.*

III. TAX BENEFITS TO TAXPAYERS DO NOT OUTWEIGH UNDUE ADMINISTRATIVE BURDEN.

IMPACTS TOO FEW—The EITC tax benefits do not outweigh the administrative burden. The Federal EITC is only available to taxpayers who meet the eligibility criteria. To name a few, the taxpayers must have earned income and cannot exceed the earned income ceiling; must be between 25 to 65 years old; and must not file "married filing separate returns".[1] The tax benefits provided by the EITC program do not cover the wide range of taxpayers, which is accomplished by increasing the standard deduction. For example, the EITC phases out at the following levels for 2008—

Number of Children	Filing Single	Filing Joint
0	**$12,880**	**$15,880**
1	**$33,995**	**$36,995**
2 or more	**$38,646**	**$41,646**

ADMINISTRATIVE BURDEN—The bill would place an administrative burden on the Department due to the high rate of noncompliance with respect to the Federal EITC claims. The requirement of the Department alerting eligible taxpayers of the proposed Hawaii EITC would also place an adverse administrative burden on the Department. Due to the unclear and incomplete annual

1 The Department suggests that the provision in the bill allowing a husband and wife to file separately and claim the credit be eliminated.

reporting requirements set forth in this bill and the existing annual reporting of tax credits claimed by Hawaii taxpayers, the Department would be unduly burdened in compiling duplicate reports.

IV. TANF MONEY SHOULD BE THE ONLY MONEY PUT AT-RISK.

The Department appreciates that this measure utilizes federal TANF money to accomplish its purpose. The Department has concerns with the new relationship with the Department of Human Services created by this measure. The Department has concerns over sharing tax information with this agency. However, if the information is limited to aggregate numbers representing the total amount claimed in credit, this will be more workable.

Also, the Department suggests that only TANF money be used for this program. This measure suggests that only the "refundable portion" of the credits will be paid with TANF money. The EITC will first be used to offset any taxable income with any extra being refunded. The Department suggests amending the bill to clarify that all monies representing the EITC will be paid for with TANF money.

Also, the Department is not the proper agency to receive the TANF monies. The Department believes that the Department of Budget & Finance would be more appropriate. The Department does not pay out tax incentives, rather administers them.

V. REQUEST FOR RESOURCES.

This bill requires the Department to alert taxpayers to the ability to claim this credit. Public outreach costs could be substantial in order to provide adequate notice of this tax credit. Moreover, given the high fraud costs associated with this bill, the Department will likely focus audit efforts toward fraudulently claimed EITC credits. As a result, the Department respectfully requests a reasonable resource allocation for the costs of implementing the public outreach and fraud mitigation efforts.

V. REVENUE ESTIMATE.

This legislation will result in revenue loss of approximately $25.8 million annually, assuming a 20% conformity to the federal EITC.

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, Earned income credit

BILL NUMBER: SB 790

INTRODUCED BY: Chun Oakland

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers to claim a state earned income tax credit equal to 20% of the federal earned income tax credit amount.

Credits in excess of tax liability shall be refunded to the taxpayer provided such amounts are over $1. Requires claims, including any amended claims, to be filed on or before the end of the twelfth month following the taxable year for which the credit may be claimed.

Requires the director of taxation, with the assistance of the director of human services, to determine the value of the refundable portion of the tax credits and notify the director of human services of this amount. The director of human services is to transfer temporary assistance for needy family funds (TANF) to pay for the refundable tax credits provided the transfer shall not apply to tax years after December 31, 2009.

Directs the director of taxation to: (1) prepare the necessary forms to claim the credit; (2) require proof of the claim for the tax credit; (3) alert eligible taxpayers of the tax credit; (4) prepare an annual report containing the number of credits granted for the prior calendar year, the total number of credits granted, and the average value of the credits granted to taxpayers whose earned income falls within various income ranges; and (5) adopt rules pursuant to HRS chapter 91 to effectuate this section.

The director of taxation, with the assistance of the director of human services, shall determine the value of the refundable portion of the tax credits and notify the director of human services of this amount along with the appropriate records and information to document this amount. The director of human services is to draw on temporary assistance for needy family funds (TANF) based on these calculations and shall deposit these funds to the credit of the general fund.

EFFECTIVE DATE: Tax years beginning after December 31, 2008

STAFF COMMENTS: The federal earned income tax credit (EITC) provides an incentive to low-income households to remain in the workforce. The credit is targeted at households with children but the credit is also available at a lower amount to low-income households without children. The credit is based on a number of tests for earned income, investment income, number of qualifying children, dependency, etc. Given the complexity of the credit, the IRS will optionally calculate the amount of the credit for taxpayers. The IRS reports an error rate of greater than 25% for this credit.

The proposed measure would adopt an earned income credit by merely taking a percentage of the amount that the taxpayer would be eligible for under the federal table or determination. It should be remembered that the federal EITC was established for low and moderate-income workers to offset the burden of

Social Security payroll taxes that might have otherwise been paid to them but were instead paid to the federal government by the employer. Enacted in 1975 at the federal level primarily as a means of tax relief, the credit was expanded three times during the 1980's and 1990's by the federal government to boost income from work and lessen poverty among families with children. In other words, it became a tool by which the federal government undertook social policy beginning with the first expansion of the credit in 1986. It is interesting to note the date of the first expansion because that was also the year that the federal Code was dramatically restructured, eliminating a number of tax benefits such as the deduction of consumer credit interest, deduction of state sales taxes, and institution of a minimum tax for those taxpayers receiving generally exempt income. It was also the year that rates were dramatically reduced, and together with the standard deduction and personal exemption, rates were indexed.

Thus, what started out as a mechanism to "refund" payroll taxes that might otherwise have been paid to low and moderate-income workers by the federal government has turned into a subsidy for these families. While federal policymakers have the luxury of expending millions of dollars to accomplish a social goal through the tax system, state lawmakers do not have the same level of resources.

If the intent of state lawmakers is to alleviate the burden on the low and moderate-income workers in Hawaii who claim the federal EITC, their efforts should focus on the state income tax burden as it affects these families. Hawaii has one of the lowest thresholds of the some 43 states that levy a state income tax. An income tax threshold is the income level at which families begin to pay the state income tax. Despite the reduction in personal income tax rates in 1998 and adoption of a low-income tax credit, as well as a modest increase in the standard deduction, much more work needs to be done to adjust the standard deduction and the personal exemptions. Rates and brackets are still much too high for all of Hawaii's working people.

While advocates point to a variety of national articles that hail the EITC as a means of helping the poor out of poverty and encouraging the poor to go to work, they miss the point that taking a percentage of the federal amount bears no relationship to the tax burden imposed by the state. Thus, the EITC amounts to nothing more than a back door welfare program, handing out money merely because a person falls into a low-income category and has joined the workforce with a dependent or two. So while welfare advocates may point to tomes of literature that praise the EITC as a way to lift the poor out of the abyss of poverty, there is just as much material that decries the EITC as poor tax policy and one that is fraught with errors and compliance difficulties. In other words, if the poor are to be helped, don't do it through the tax system as there is very little transparency and accountability. And despite claims that many of these problems have been resolved, there is general agreement from administrators and practitioners that this is one of the most difficult and complicated federal tax credits with which to administer and comply, with increasing errors and inaccuracies.

Like many of the targeted tax credits aimed at encouraging business activities, the EITC comes with all of the problems outlined with those targeted business tax credits. There is no oversight as to how these refunds are aiding families, whether or not outcomes are being achieved or for that matter whether a family is getting sufficient assistance to actually leave the welfare rolls and become self-sufficient. As a recent study reported, nearly one-third of Hawaii's families are not self-sufficient. What will the EITC do for those families who are working two or three jobs to make ends meet but, as a result, make too much money to qualify for the EITC? Where is the tax relief for those families? Lawmakers can make much more of a difference by making the needed structural changes to the state income tax rates and brackets and by boosting the standard deduction. Again, one must ask what is the relationship between taking

20% of the federal credit amount and the amount of state tax burden relieved?

Lawmakers should also consider the interaction of a state tax credit that produces negative income and how that will affect the amount of income that would then be exposed to the federal rate structure. There are comprehensive studies on the interaction of the credit with the overall federal income tax system. Adopting the credit willy-nilly for state tax purposes may disrupt the incentive to remain employed or to increase the number of hours worked. It should be noted that an EITC has not been recommended by the latest state Tax Review Commission (TRC). The TRC examined the effects of what would have happened if an EITC was enacted equal to 20% of the federal EITC in 2006. Based on 2003 tax returns, the staff of the Tax Research and Planning Office of the department of taxation found that fewer than half of the Hawaii resident income tax returns would have benefitted from a Hawaii EITC. Of the 308,652 returns with AGI of under $30,000, only 68,845 or 22.3% claimed the federal EITC. They also estimated that there would be a $23.2 million decline in tax collections if the EITC were adopted.

Finally, lawmakers should understand that by taking a percentage of a number calculated at the federal level, they are surrendering their oversight over this tax policy to Congress. What is even scarier is that Congress could choose to substantially increase the amount of the credit such that the result at the state level may mean a huge unexpected impact on state resources. Such is the case with the state inheritance taxes which were tied into the tax credit offered under the federal law which calculated an amount the federal government assumed the state took in death taxes. However, this provision was eliminated by EGTRRA in 2001, phasing out the state death tax credit completely over four years such that Hawaii has no tax on inheritance and estates.

Finally, where would the revenue loss generated by this credit be taken? Which program would be cut or not funded at all? What is known in the social services community is that unless the poor are given the tools and skills to become self-sufficient they will remain on welfare. The funds lost in this tax credit program would be far better spent on services that assist those especially in public housing in gaining the skills they need to hold gainful employment, provide child care so that those who need to go to work will have childcare, and learn how to manage what money they earn. Without these skills, merely subsidizing their earned income with a tax credit will not hold a promise of self-sufficiency. Rather than duplicating the federal earned income tax credit, the state should use its resources to instead complement the effort with more skill building and family support so these families can hold gainful employment. This would be a far better use of the TANF funds being proposed to fund the EITC in this proposal.

More important, the earned income tax credit amounts to nothing more than a back door welfare payment. This is validated by the fact that the proposed measure would have any amount that is refunded to the taxpayer reimbursed by TANF monies. If that is the result, then why not just have these taxpayers apply for additional TANF funds rather than using the tax system to make that determination and mechanism by which these temporary assistance funds are paid. It is questionable whether or not TANF monies can be used for all refundable portions as taxpayers who may not have children qualify for the earned income tax credit and TANF monies are intended to assist families.

Digested 2/9/09