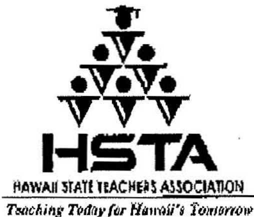


1200 Ala Kapuna Street • Honolulu, Hawaii 96819
Tel: (808) 833-2711 • Fax: (808) 839-7106 • Web: www.hsta.org

Wil Okabe
President

Karolyn Mossman
Vice President

Joan Kamila Lewis
Secretary-Treasurer

Jim Williams
Interim Executive Director

TESTIMONY BEFORE THE HOUSE COMMITTEE ON FINANCE

RE: HB 2991 – RELATING TO PUBLIC FINANCE.

February 17, 2010

WIL OKABE, PRESIDENT
HAWAII STATE TEACHERS ASSOCIATION

Chair Oshiro and Members of the Committee:

The Hawaii State Teachers Association strongly supports HB 2991 and asks this committee to advance this bill.

This bill is needed because the State does not have the revenue to maintain education and other vital services at levels that will meet the needs of our citizens. In order to meet vital and essential needs in the areas of education, health and safety, and social services, the State of Hawaii must increase tax revenues. There will be no solution to "furlough Fridays," other education cut backs, reductions in mental health services, slashed programs for the needy and elderly, and the many other worthy programs that have felt the ax without a **tax increase**. The question is not **whether** additional revenue is needed, but **how** to raise that additional revenue in the most equitable way.

The HSTA advocates HB 2991 as the most equitable approach to increasing taxes and providing the revenue the State needs to meet its obligations to our citizens—especially our children, the elderly, the poor and the needy.

To summarize, this bill has the following features:

A. Adjust the income tax for those in the bracket with earnings greater than $200,000 but less than $400,000 and to adjust the income tax for those in the bracket with earnings more than $400,000.
B. Tax capital gains at ordinary income tax rates.
C. Begin to eliminate corporate tax loopholes.
   a. Repeal NOL - NOL (Net Operating Loss) carry-back provision, which allows businesses to take current-year losses against a previous year's profits (and hence receive a retroactive tax break).
   b. Establish a minimum Corporate Tax of $250.
D. Create a commission with the following purposes:
   a. Increase school capacity and accountability by improving the adequacy and equity of school funding in the state; and
   b. Promote school success by improving the foundation of financial support provided by the economy and tax structure of the state.

Currently the bottom 20 percent of Hawaii's taxpayers pay 12.2 percent of their income in state and local taxes; while the top 1 percent pay only 6.3 percent; and the next 4 percent pay only 6.6 percent. Attached to this testimony is a graph that illustrates this disparity more clearly and fully. The citizens who have benefited the most from Hawaii's past prosperity and who have been affected the least by the current recession now must be relied upon to address the urgent needs of our state This bill could be appropriately named the "Fair Share Tax Act," because it would require those at the top of the income scale to pay the same share in taxes as those on the bottom rung.

This bill provides for capital gains to be taxed at ordinary income rates. This is a matter of simple equity. It means that the carpenter, nurse, teacher, janitor and other wage earners will no longer subsidize those who earn large sums through buying and selling stocks and other investments.

This bill also provides for a minimum corporate tax and closing the net loss carry-back loophole. The ordinary person who falls on hard times does not get a tax refund from previous years, and corporations should not have that advantage either.

Finally, this bill would establish a special commission to examine how our State funds education, including the equity of our tax structure. Given the current crisis in education finances, this commission would have the potential to identify a way out of our State's financial wilderness.

There are those who argue that any tax increase is negative, because taxes take money out of the economy. Taxes do NOT hurt the economy, because the money is immediately spent by the government on goods and services provided by the private or nonprofit sectors, thereby putting the money back into circulation. Money spent by the government is just as powerful as money spent in the private sector; and in some ways it is even more economically beneficial. For one thing, government expenditures go almost entirely to Hawaii citizens and businesses. On the other hand, private expenditures may often go to investments outside the State, mainland or foreign travel, or other non-Hawaii purposes. One important way that government spending can help the economy more than private spending is by **investing in Hawaii's future**—meaning in our public schools. Most economists agree that investments in public education and educating a state's work force pay off in future economic growth.

What about raising the excise tax? From a tax policy point of view, an excise tax hike would only increase the regressive nature of Hawaii's tax system, because if affects those least able to pay the most. From a political point of view, raising taxes on everyone is much more difficult than raising taxes on the 5 percent of the population who earn the most. This bill, if passed, would represent better policy and better politics.

Some maintain that taxpayers won't support tax increases to maintain essential services. Oregon voters recently proved that conventional wisdom wrong. According to news reports, the Oregon "referendum's 1.2 million voters decisively passed Measures 66 and 67 by margins of over 53 to 46. Briefly, those measures explicitly protected state outlays for education, medical care and public safety over the next two years by raising over $700 million in additional taxes on corporations and on wealthy individuals." Certainly, Hawaii's voters are just as enlightened as those in Oregon.

The president of the Tax Foundation told the Star-Bulletin that if you "tax the rich; you drive them out of the State." (He also sent a letter to the editor of the paper, insulting the intelligence of public school teachers; yet he says he has "no ax to grind.") Hopefully, the members of this Committee can see through these kinds of cynical remarks.

Does anyone seriously believe that the architects, CPAs, lawyers, doctors, business executives and other high-income individuals will abandon their investment of time and money here, investments which provide them the ability to maintain their obviously successful careers, practices, or businesses in Hawaii? Would they pick up and move to another location and go to the expense and effort of re-establishing their lives merely because their taxes go up marginally?

Are we to believe that the professional who has adjusted gross income of $600,000 and has to pay additional taxes will walk away from that career, practice or business? They will abandon their green pastures in Hawaii and go where? To California, which has laid off over 20,000 teachers, almost went bankrupt, and is seeing out-migration? To Oregon, where the taxpayers just passed a tax bill comparable to the one being considered here today? To Las Vegas, to live in the desert and have their children grow up closer to gambling? Why would those who are doing best in our economy suddenly uproot their families, careers and businesses, move away from Hawaii Loa Ridge, Kahala, Nuuanu, Lanikai or other wonderful neighborhoods here in paradise to a less desirable mainland location all because their marginal tax rate increased?

In our current economic climate, the real danger to our State of losing citizens is if they give up on our education system, if they fear for the safety of their families as they watch those who need mental health assistance go un-served, if they watch much needed government services providing for health and safety deteriorate due to loss of funding. This committee has heard testimony (on other bills) from professionals committed to our public schools who have expressed just such sentiments.

Last year the Legislature and this committee took a first step toward having those in the high-income group pay their fair share. HSTA's proposal would meet that objective. Attached to this testimony is a table comparing the changes made last year to those proposed in this bill.

Last week, when this committee considered a bill to use the "rainy day fund" to end furlough Fridays, we saw the spectacle of retirees and social services advocates pitted against teachers and parents, with both sides making stirring arguments for their priorities. The HSTA—as teacher advocate—views education as the top priority, but not the only priority. In these troubled times, we need to generate enough revenue to fund all essential services, not just one. Shame on us if we are unable to do so.

The chair of the Council on Revenues has stated that we are not going to cut our way out of the state's budget deficit. Increasing some taxes has to be part of the solution. Estimates provided to HSTA indicate that this proposal would generate enough revenue to end furlough Fridays, restore cuts made to the education budget, and fund other important services, such as health and human services programs.

Some who have testified before this committee on other bills regarding funding of education have pleaded with this committee and this legislature to provide leadership. It may be helpful to step back and look at the underlying reasons for these pleas. We are accustomed to getting leadership from the executive branch—meaning our governor.

Unfortunately, the governor has not stepped up to the plate and, in fact, has even put up roadblocks to efforts to find balanced solutions. By taking taxes off the table and only recently and reluctantly giving in to calls for use of the "Rainy Day" fund and the Hurricane Relief fund; by using across the board furloughs even for federally funded and trust fund positions that do not rely on the general

fund; and by failing to set priorities and instead slashing programs across the board, our governor has failed the test of leadership.

Understandably, those in pain have turned to this body as the last resort. While we recognize the difficulty the legislature faces in developing consensus and overcoming gubernatorial opposition, those of us who represent the needs of education, health and safety and social services in our community turn to you in the hope that you can expand on your traditional role and fill the current vacuum of leadership.

The president of the Tax Foundation says this bill "has gotten buried." Thank goodness the Chair schedules bills for hearing without regard to pronouncements by the Tax Foundation. We ask that this committee reject the undertaker's metaphor and give this bill the life it deserves.

Thank you for this opportunity to testify.

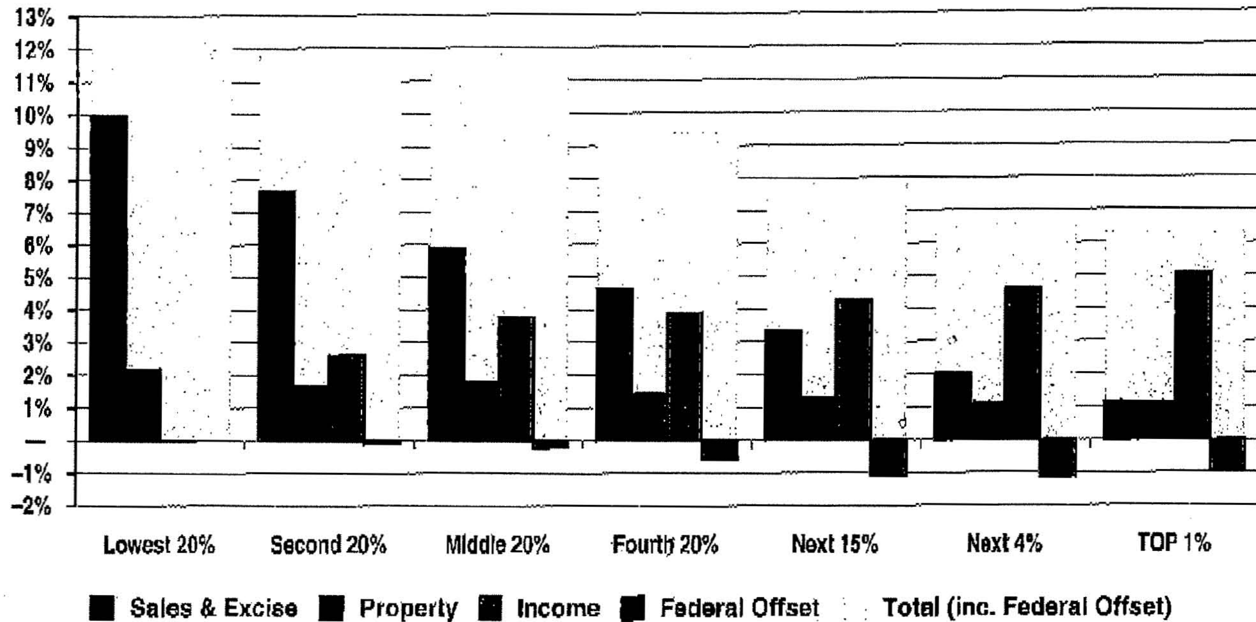
HB 2991
Finance Committee
February 17, 2010
3:00 p.m.

Hawaii

HSTA Testimony
Attachment 1

State & Local Taxes in 2007

Shares of family income for non-elderly taxpayers



Sales & Excise | Property | Income | Federal Offset | Total (inc. Federal Offset)

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%: Next 15%	Top 20%: Next 4%	Top 20%: TOP 1%
Income Range	Less than $18,000	$18,000 – $33,000	$33,000 – $51,000	$51,000 – $85,000	$85,000 – $176,000	$176,000 – $400,000	$400,000 or more
Average Income in Group	$9,800	$24,700	$41,400	$65,900	$117,800	$251,100	$1,040,300
Sales & Excise Taxes	**10.0%**	**7.7%**	**5.9%**	**4.7%**	**3.3%**	**2.0%**	**1.1%**
General Sales—Individuals	4.5%	3.5%	2.7%	2.1%	1.5%	0.9%	0.5%
Other Sales & Excise—Ind.	2.2%	1.5%	1.1%	0.8%	0.5%	0.3%	0.1%
Sales & Excise on Business	3.3%	2.7%	2.1%	1.7%	1.3%	0.8%	0.5%
Property Taxes	**2.2%**	**1.7%**	**1.8%**	**1.4%**	**1.3%**	**1.1%**	**1.1%**
Property Taxes on Families	2.1%	1.6%	1.7%	1.4%	1.2%	0.9%	0.4%
Other Property Taxes	0.0%	0.0%	0.1%	0.1%	0.1%	0.2%	0.7%
Income Taxes	**0.0%**	**2.6%**	**3.8%**	**3.9%**	**4.3%**	**4.6%**	**5.1%**
Personal Income Tax	0.0%	2.6%	3.8%	3.9%	4.3%	4.6%	5.0%
Corporate Income Tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%
TOTAL TAXES	**12.2%**	**11.9%**	**11.4%**	**10.0%**	**8.9%**	**7.7%**	**7.3%**
Federal Deduction Offset	—	–0.1%	–0.2%	–0.6%	–1.1%	–1.1%	–1.0%
TOTAL AFTER OFFSET	**12.2%**	**11.8%**	**11.2%**	**9.4%**	**7.8%**	**6.6%**	**6.3%**

Note: Table shows 2007 tax law updated to reflect permanent changes in law enacted through October 2009.

HB 2991
Finance Committee
February 17, 2010
3:00 p.m.

HSTA Testimony
Attachment 2

UPPER INCOME TAX RATES
(Taxpayers Filing Jointly)

	BEFORE 2009	2009 (ACT 60)	2010 (PROPOSED)
$96k - $200k	8.25%	8.25%	8.25%
$200k - $300k	8.25%	8.25%	10.55%
$300k - $350k	8.25%	9.00%	10.55%
$350k - $400k	8.25%	10.00%	10.55%
Over $400k	8.25%	11.00%	12.85%

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, Adjust income tax rates and other income adjustments

BILL NUMBER: HB 2991

INTRODUCED BY: Say

BRIEF SUMMARY: Amends HRS section 235-51 to amend the tax rate schedules for tax years beginning after 12/31/09 as follows:

Joint filers: 1.4% over $4,800 taxable income to 13.55% over $400,000 - 11 steps
Head of Household: 1.4% over $3,600 taxable income to 13.55% over $400,000 - 12 steps
Single, Married filing separate: 1.4% over $2,400 taxable income to 13.55% over $400,000 - 11 steps
Estates and trusts: 1.4% over $2,000 taxable income to 13.55% over $400,000 - 11 steps

Amends HRS section 235-7 to provide that no net operating loss carryback or carryover shall be allowed after December 31, 2010.

Amends HRS section 235-71 to provide that after December 31, 2010, the minimum tax on corporations shall be $250.

Amends HRS section 235-125 to provide that carrybacks for an S corporation shall be prohibited after December 31, 2010.

Amends HRS section 235-51 to provide that after December 31, 2010, all capital gains shall be taxed according to the tax filing status and tax brackets applicable to the taxpayer.

Requires the department of education to conduct a study by June 30 in every even-numbered year, on the adequacy and equity of school funding in the state and the extent that adequacy and equity have increased or declined over the previous two years. The study shall include an analysis of the factors contributing to inadequacy and inequity. Requires the department to publish the data on which the study is based and report its findings and recommendations to the legislature convening of every odd numbered year regular session.

Directs the department of taxation to conduct a study by June 30 in every odd-numbered year on the equity and progressivity of state and local taxes, including: (1) an analyses of the equity and progressivity of types of tax and the level of government that levies the tax; (2) an analyses of the aggregate impact of taxes on taxpayers, grouped by quintile according to income or property ownership, as appropriate, expressed as a percent of the aggregate income or property holdings of that group; and (3) the data used to determine the equity and progressivity of state and county taxes. The study shall also include other indicators and analyses of equity and progressivity as the department deems appropriate. Requires the department to report its findings and recommendations to the legislature prior to the convening of every even numbered year regular session.

Requires the department of taxation to conduct an annual study on tax expenditures related to business tax incentives and abatements, including explicit information about the individuals or entities that receive business tax incentives or abatements, amounting to, or projected to amount to, over $2 million in any five-year period. The department shall include the source and nature of the tax incentive or abatement in each case in its study and shall report its findings and recommendations to the legislature at every regular session.

Establishes a state tax structure, economic development, and funding for schools commission, that shall be an independent agency of state government that shall be administratively attached to the department of business, economic development and tourism. The commission shall: (1) oversee the design and data analyses of studies with respect to: (A) adequacy and equity in school funding; (B) equity and progressivity of state and county taxes; and (C) existing and prospective tax expenditures related to business tax incentives and abatements and their impact on state and local economies; (2) publish the studies and any other additional reports on: (A) equity and progressivity of state and local taxes; and (B) business tax incentives and abatements; and (3) disclose and publish information relevant to any proposed tax incentives or abatements in a timely manner, in proceedings of state or local governments or otherwise, including analyses of the impact of any proposed changes in tax laws or rules on: (A) adequacy and equity of school funding; and (B) the equity and progressivity of state and county tax structures.

Amendments made to HRS section 235-51(a),(b), and (c) under this act shall not be repealed when that section is reenacted on December 31, 2015 pursuant to Act 60, SLH 2009.

EFFECTIVE DATE: July 1, 2010

STAFF COMMENTS: This measure proposes to impose higher income tax rates on higher income taxpayers, close corporate loopholes, and provide that capital gains shall be taxed at regular income tax rates to generate additional revenue and establish a commission to evaluate Hawaii's tax structure and means of financing public education.

It should be noted that an increase in income tax rates for higher income taxpayers was passed by the 2009 legislature and sent to the governor who subsequently vetoed the measure. In the veto message, the governor stated that the bill would "increase the tax burden on Hawaii's families and small businesses by increasing the marginal income tax rate by as much as 33.3%. Hawaii has the highest top personal income tax rate in the United States. By increasing the top marginal tax rate from 8.25 to 11 percent, this bill will make Hawaii the state with the highest personal income tax rate in the nation. Although there is the misconception that only wealthy people will be affected, this bill will adversely impact almost 37,000 persons, of which about 27,000 are sole proprietors, partnerships, or subchapter S corporations whose owners report their business income through personal income tax returns. In this broad recession which affects both the wealthy and poor and where recovery depends on people investing, buying consumer goods, and donating to charities, a tax increase will put an unnecessary strain on everyone's pocket book. Small business owners who count their business income as personal income will find it more difficult to support and grow their enterprises. This could mean more business closures, layoffs, and fewer job opportunities."

While the proposed measure would result in another tax increase for higher income taxpayers, this would send a signal that it is okay to target higher income taxpayers for a tax increase and its okay to do it even

though they were targeted in the prior year.

While the measure also proposes to close corporate loopholes by permanently providing that no net operating loss carryback or carryover shall be allowed after December 31, 2010, they would still be available under the federal Internal Revenue Code, and the adoption of this provision would be contrary to the state's intent to conform to the federal Code for easy of compliance. Further, if the legislature believes that by closing this loophole and the adoption of this provision that it will generate additional revenues, it is flawed.

Under the existing law, a company which experiences a net operating loss may deduct such losses from the profits of the previous three years. The company would then be eligible for a refund of the taxes it paid on the previous profits which have been deducted by the present losses. The proposed law would discontinue this practice. The practice of taxing net income on an annual basis arose through convenience, the need for standardization, and to allow businesses whose profits fluctuate to average out their losses and profits over a fair period of time. For certain businesses such as fishing, agriculture, and construction, it is often impossible to achieve an annual profit. Cyclical businesses, businesses extremely dependent on nature, and businesses particularly susceptible to the mood or whim of the customers cannot depend on an annual profit.

The current law acknowledges this and, therefore, permits a three-year carryback of loss deductions, allowing a firm to offset its present losses against previous as well as future profits. Even though the state must refund money due to the carryback provision, the loss in revenues is not as significant to the state as the loss in capital is to companies coping with a financial crisis. The refunds could mean an increase in revenue for the state if the company is able to survive and become profitable. The net operating loss carryback provision can also prove to be extremely valuable for the entire state's economy during periods of recession and slow growth. This provision allows tax refunds precisely when a financially troubled company needs the added funds and serves as a cushion for normally sound businesses during periods of extreme or unusual hardship. The adoption of this provision to disallow net operating loss carrybacks or carryovers may result in decreased revenues due to business closings and the resultant loss of jobs, adding more people to the unemployment rolls.

The measure proposes several studies to be performed by: (1) the department of education on the adequacy and equity of school funding and whether such adequacy and equity has increased or decreased in the last two years; (2) the department of taxation on the equity and progressivity of state and local taxes; (3) the department of taxation on tax expenditures related to business tax incentives and abatements, including explicit information about individuals or entities that receive over $2 million in any five-year period. The measure also establishes a state tax structure, economic development and funding for schools commission to oversee, analyze, and publish the various studies. While it appears that the commission is targeted at ensuring that there is adequate funding for schools, it should be remembered that other state programs are also competing for the same tax revenue which are in short supply. Finally, it should be remembered that the state constitution calls for the convening of a tax review commission every five years for the purpose of conducting a systematic review of the tax structure and recommend tax revenue policy. Thus, to some extent points two and three above already have a mechanism in place to conduct such a review of the state tax system.

Digested 2/16/10

Testimony to the House Committee on Finance
Wednesday, February 17, 2010
3:00 p.m.
Conference Room 308
Agenda #3

RE: HOUSE BILL NO. 2991 RELATING TO PUBLIC FINANCE

Chair Oshiro, Vice Chair Lee, and members of the committee:

My name is Jim Tollefson and I am the President and CEO of The Chamber of Commerce of Hawaii ("The Chamber"). The Chamber does not support HB 2991.

The Chamber is the largest business organization in Hawaii, representing more than 1,100 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of its members, which employ more than 200,000 individuals, to improve the state's economic climate and to foster positive action on issues of common concern.

We do not support for the following reasons:

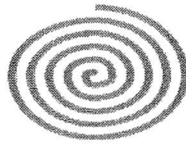
1. The bill would raise the highest marginal income tax rate to 13.55%, which would one of the highest, if not the very highest, rate in the country. Taxpayers in Hawaii already struggle with one of the highest costs of living in the nation. Raising their tax rates to this level would put an enormous strain on both individuals and businesses. Furthermore, this could potentially drive high-income earning, consumer spending and job-producing people away from our state. For example, in New Jersey, high-income earning people moved elsewhere at a faster rate than they were being replaced between 2004-2008. Economists attributed this to changes in the state's tax structure, including increases in the income tax. Studies showed that this resulted in a significant decline in the state's wealth.

2. The bill would eliminate capital gain rates for all taxpayers. This would dramatically increase the tax on investments made in Hawaii. In the current economic climate, Hawaii needs to do everything it can to attract more investment in our state. Raising taxes on capital transactions would have the exact opposite effect.

3. The bill would eliminate net operating loss deductions for corporations. This would impose a major new tax burden on struggling companies, in effect increasing their taxes when they are most vulnerable. It would also discourage new companies, which often need a few years to become profitable, from choosing Hawaii as a place to do business. Now is the time to support the struggling businesses we currently have, and to encourage new businesses to come to Hawaii. This bill would undermine those goals, and discourage the creation of new jobs.

While we understand the current budgetary situation and appreciate the Legislature's efforts in looking at alternatives, we feel that this measure will have trickling consequences.

Thank you for the opportunity to submit testimony.



PHOCUSED

PROTECTING HAWAII'S OHANA, CHILDREN, UNDER SERVED, ELDERLY AND DISABLED

Board of Directors

Joanne Lundstrom, Chair
Howard Garval, Vice Chair
Victor Geminiani, Vice Chair
Debbie Shimizu, Secretary
Alan Shinn, Treasurer
Susan Chandler
Jan Dill
Marya Grambs
Kathi Hasegawa
Nanci Kreidman
Ruthann Quitiquit
Jerry Rauckhorst
Sandra Yoro

Executive Director

Alex Santiago

DATE: February 17, 2010

TO: Representative Marcus Oshiro

FROM: Alex Santiago, Executive Director
PHOCUSED (Protecting Hawai'i's Ohana, Children, UnderServed, Elderly and Disabled)

RE: HB 2991 Relating to Public Finance

Representative Marcus Oshiro, Chair of the Finance Committee, I am Alex Santiago, Executive Director of PHOCUSED, a coalition of health, housing, human service agencies and individual advocates voicing the needs of the marginalized and underserved in Hawai'i. **PHOCUSED supports HB 2991 and appreciates the efforts by the legislature to produce the needed revenues to ensure core support for the poor and needy.** In addition, PHOCUSED believes that a discussion is needed on how best to allocate these funds, and respectfully offers to be part of that discussion.

As advocates for the Health, Housing, and Human Services sector we are also concerned about balancing the budget at an enormous social cost to our children, as well as our disabled citizens, the frail elderly, families who are a heartbeat away from homelessness, victims of domestic abuse, infants and toddlers who need special attention at the start of their lives, and others among us who are particularly vulnerable at a time of fiscal restraint. Recent surveys have indicated that the needs of our most vulnerable residents have risen alarmingly, while services to address their needs continue to be cut by the State. We trust this measure and its resulting funds will be used as means to preserve essential safety net and core services.

We appreciate the opportunity to share our concerns with you, and offer to be a resource to you in future deliberations.

Mahalo for the opportunity to testify.

1188 Bishop Street, Suite 1204 · Honolulu, HI 96813 · P: 808.521.7462
www.phocused-hawaii.org

TESTIMONY – HB 2991
A BILL FOR AN ACT RELATING TO PUBLIC FINANCE
HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCE
FEBRUARY 17, 2010

Testifier's name with position/title and organization:

Dwight Holmes
Sr. Policy Analyst
National Education Association, Research Dept.

The Committee the comments are directed to:

Committee on Finance, House of Representatives

The date and time of the hearing:

February 17, 2010, 3 p.m.

Measure number:

HB 2991: RELATING TO PUBLIC FINANCE

TESTIMONY – HB 2991
A BILL FOR AN ACT RELATING TO PUBLIC FINANCE
HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCE
FEBRUARY 17, 2010, 3 p.m.

The National Education Association strongly supports HB 2991. Passage of this bill would go a long way towards giving Hawaii a tax and revenue structure that is sound, not just for today, in this time of economic recession, but in the long run as well. It would enable the state to make the kinds of investments in education and other services and infrastructure that are crucial and necessary to diversify and modernize the state's economy, and to place its citizens, entrepreneurs, and businesses in an advantageous position to prosper in the new knowledge-based economy of the 21st Century.

In particular, this bill wins on two counts: 1) It would result in taxes in Hawaii being fairer than they are currently; and 2) it would result in significant new revenues that would be available for investing in education and other sectors. This would help grow the economy, and would produce a greater return on the investment than would, say, comparable tax cuts.

First, however, we should say that the legislature is to be commended for taking the bold and important step last year of passing HB 1747. This represented a strong, initial step in the process of improving the ability of the state to fund and invest in the services and infrastructure necessary to building and maintaining a prosperous economy for all of its citizens.

The balanced-budget constraint

Hawaii, like nearly every state in the union, is experiencing economic challenges more formidable than any since the 1930s. As property values, personal incomes and corporate profits plummet, so do the sources of revenues that are needed in order to fund all of the services provided by state government. And all the while that revenues are declining, the services they fund are more critical than ever. Constrained as it is by the requirement to balance the budget year in and year out, the legislature is under intense pressure, needing to maintain vital services on the one hand, while on the other hand, contending with the reality that the current tax and revenue structures are not sufficient to support even the current level of services.

In short, in times of recessions, states face the dilemma of whether to fill budget shortfalls by cutting expenditures or raising taxes. A recent Center on Budget & Policy Priorities article put it this way: "States that rely solely or primarily on widespread budget cuts to close deficits are harming residents and businesses that need immediate assistance; they also are reducing demand in the economy and impeding their state's economic recovery."[1] Given the trade-off between raising taxes and cutting expenditures, Nobel Prize-winning economist Joseph Stiglitz, together with now-Congressional Budget Office chair Peter Orszag wrote as the recession began that, "if

---

[1] Iris Lav, "A Balanced Approach to Closing State Deficits," February 16, 2010, available at: http://www.cbpp.org/cms/index.cfm?fa=view&id=3084

anything, tax increases on higher-income families are the least damaging mechanism for closing state fiscal deficits in the short run. Reductions in government spending on goods and services, or reductions in transfer payments to lower-income families, are likely to be more damaging to the economy in the short run than tax increases focused on higher-income families."[2]

Government expenditures provide investment that is critical to economic growth

In short, we believe the great preponderance of evidence supports the idea that it is more efficient, and will do more to stimulate future economic growth, to increase (or at the very least, maintain) rather than decrease spending during a recession. We are now far enough into the recession – and recovery – to begin to see clear evidence in support of this. One vital piece of the American Recovery and Reinvestment Act of 2009 (ARRA) was to provide direct assistance to states for the specific purpose of shoring up state budgets for vital services including education. Just last week, Christina Romer, Chairperson of President Obama's Council of Economic Advisers, was asked what part of the $787 billion ARRA stimulus package did she like best. In her reply, Romer made it clear that the portion of the ARRA stimulus that went to provide direct fiscal relief to the states has been "one of the triumphs" and that it has even had "more bite than we would have thought."[3]

While we can hope that the federal government will step in and continue (beyond the period covered by the current ARRA stimulus program) to assist Hawaii and the other states in getting through this economic crisis, clearly it is incumbent on you, the members of this Committee, and the legislature as a whole, to take the necessary steps to ensure that Hawaii does not fail in making adequate and necessary investments. We believe that, at this time, smart policy for Hawaii is to raise new revenues, as this bill would do, that will allow the state to not only come through these hard times in as good a shape as possible, but also to begin investing now in a brighter future for the state and its citizens. The question then is, how best to pay for this? We believe the best policy is to ask those who can best afford to do so, to contribute their fair share of the revenues that Hawaii needs to make those sound investments.

Hawaii's tax system is regressive and unable to keep pace with growth in the economy

At present, even after the changes implemented last year, Hawaii's tax system is regressive. It places an undue burden on those with the least ability to pay. In fact, if you look at the poorest one-fifth of households in the state, in terms of annual income, you will find that they pay nearly 1 out of every 8 dollars they earn in state and local taxes. That means that the average household in this lower 20% is earning $9800 and paying nearly $1200 of that in state and local taxes. That

---

[2] Quoted in Nicholas Johnson, "Budget Cuts or Tax Increases at the State Level: Which is Preferable During a Recession?" updated January 12, 2009, available at: http://www.cbpp.org/cms/?fa=view&id=1032#_ftnref3

[3] Jill Lawrence, "Christina Romer on Why We Don't Need a New WPA," *Politics Daily,* February 12, 2010. Available at: http://www.politicsdaily.com/2010/02/12/christina-romer-on-putting-workers-on-sale-and-why-we-dont-ne/

is nearly *double* the share of income paid by those who earn more than $400,000 per year (6.3%).[4]

One reason the burden is so skewed against the poor is that Hawaii relies heavily on its excise taxes to pay for the costs of government. And while it's a good thing that Hawaii actually leads the nation in sensible sales/excise tax policy – it applies the tax to a broader range of services than any other state – still, the fact remains that excise taxes are by their nature highly regressive, and take a good chunk of money out of the pockets of people who, out of necessity, spend nearly every penny that they earn. In fact, as measured by the Institute on Taxation & Economic Policy – the unchallenged expert on such matters – Hawaii's excise taxes alone eat up fully 10% of the income of households in the bottom fifth of income earners, versus just 1.1% for the top 1% of income earners in the state. In other words, while everyone in the top 1% of Hawaii's income earners pays a penny of every dollar in general excise taxes, those in the bottom 20% are paying a dime out of every dollar on the same taxes. Only one state – Washington – places a heavier excise tax burden on its poorest citizens.

Hawaii's tax revenue structure is not only regressive, it is also "inelastic" relative to growth in its economy. This means that the revenue system isn't able to keep pace with the economy. As a result, revenues are constantly falling behind, which in turn necessitates frequent "fixes" – even in good times. For every 1% of growth in the state's economy, revenues grow at only .93%. This explains why you are constantly having to play catch up just to maintain the current level of services desired by Hawaii's citizens – and why that is true even when the economy is not in crisis. In this current downturn, it is all that more difficult to raise the needed revenues. Of all the available tax sources, the income tax is the only one that is "elastic" to growth in the economy: Income tax revenues grow faster than the rate of economic growth. So, from a practical standpoint, and from the standpoint of building long-term stability into the tax system it only makes sense to look to the income tax – and to the upper income earners – for the additional revenues. This is also the best policy choice from the tax equity standpoint, as well.

The rationale for creating new income tax brackets for the highest income earners

Calling on those most able to pay to contribute an additional share during times of widespread economic distress is a time-honored and rational fiscal policy option. Last year, six of the 10 states with the highest income tax rates – Oregon, California, New York, New Jersey and North Carolina – as well as Hawaii – raised their levies on the highest earners, at least temporarily. In addition, the middle tax rate states of Connecticut and Delaware also raised rates on high-income taxpayers.

A major point to consider is that since the proposed tax on upper-income residents applies only to incomes of $200,000 or higher (for a couple married filing jointly), a large proportion of any new taxes paid by the state's residents would be deducted from their federal income taxes.

---

[4] These data are from the report "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States," Institute on Taxation & Economic Policy, 2009; available at: http://www.itepnet.org/whopays.htm

While incomes of $200,000 are taxed federally at a marginal rate of 28%, that goes up to 33% on earnings in the $208,850 to $373,950 range, and to 35% on income earned over and above the amount of $373,950. Since almost all taxpayers earning over $200,000 file itemized tax returns, and since state income taxes paid are deductable against federal income taxes, any additional state income tax paid by Hawaii's upper-income residents reduces their federal tax obligation by about one-third of the amount paid to the state of Hawaii. By contrast, none of the excise taxes paid by Hawaii's citizens, rich or poor, is deductable against federal income taxes.

In other words, the income tax increase will be one-third subsidized by the taxpayers in the other 49 states! After filing their federal returns and itemizing deductions, only two-thirds of the additional taxes paid will actually come out of the pockets of Hawaii's citizens. By contrast, any increase in sales or excise taxes would not be so subsidized, since excise taxes paid are not federally deductable. Further, any increase in sales or excise taxes disproportionately adds to the already-unfair burden placed on the state's low-income taxpayers.

It may also be helpful to put the scope of this proposed increase into some perspective: What is being discussed is, at most, a rate increase of from 1.85 - 2.3%, applied only to those portions of a resident's taxable income that fall into the new brackets (from $200,000 up to more than $400,000). Recall that after adjusting those rates to account for the federal income tax offset, the true effective rate increase is closer to 1.2 – 1.5%. Are Hawaii's wealthiest residents actually likely to leave the state and move to, say, Alaska, or South Dakota, or Wyoming (or one of the handful of other low income tax states) because of an increase of 1.5% or less in the tax applied only to their earnings over and above $200,000? (*See addendum for an extended discussion of this question, "If we tax them, won't the wealthy flee?"*)

From an equity standpoint, keep in mind that even with the passage of the tax increases proposed in this measure, Hawaii residents earning over $200,000 a year would still be paying substantially less of their income in state and local taxes than do Hawaii's citizens earning $50,000 or less.

If not HB2991, then What?

Finally, the alternative of failing to pass this, or some similar revenue measure, will itself lead directly to a loss of jobs and income in the state in the near-term, and a loss of economic competitiveness and a dimmer future for our children over the longer-term. The National Education Association has estimated that based on historical economic patterns and relationships, $300 million in funding for public schools would result in 4,900 new jobs in the state. These new positions would be roughly one-third education professionals, one-third other employment in or in support of education (including vendors, contractors, and support service workers), and one-third in the broader economy (in businesses that provide goods and services to customers whose jobs and income traces back to education funding).

Cutting public budgets during an economic downturn compounds the negative job impacts of the downturn, slowing the recovery, and making the pain deeper. Failure to fund vital public services, such as education, because of a downturn is not only bad economics, it passes the cost on to the future and robs our young people of the resources and support that they deserve and

that we need for our own long-term competitiveness. If Hawaii is to succeed in becoming a more diversified economy with wider opportunities and a greater ability to compete in the new global and knowledge-based economy, it must invest in its own future by supporting its educational system and thereby investing in Hawaii's human capital. Committing to make that investment is the best investment you can make for Hawaii's economic growth and vitality.

****

AN ADDENDUM FROM THE CENTER ON BUDGET AND POLICY PRIORITIES[5]

If We Tax Them, Won't the Wealthy Flee?

Opponents of raising tax rates on high-income households often argue that sensitivity to marginal tax rates is so extreme that those affected will vote with their feet and depart for states where they would pay lower income taxes or none at all. The result, they contend, is to diminish, or even eliminate, the revenue potential of such tax increases.

This argument is highly exaggerated and not based on real-world evidence. Research in New Jersey and California shows conclusively that tax rate increases for high-income residents in fact raise significant amounts of revenue. And recent analysis also shows that tax increases have, at most, only a small impact on interstate migration patterns.

In fact, attempts to measure the relationship between interstate migration and tax progressivity have yielded mixed results. The most recent studies have found that higher marginal income tax rates have a very small impact on where people decide to live. Other factors such as crime rates and the natural environment play a very significant role.

For example, a September 2008 Princeton University study concluded, "the 'half-millionaire tax,' at least in New Jersey, appears to be an effective and efficient revenue-generation mechanism, having little impact on migration patterns among half-millionaire households." The study estimated that New Jersey lost $37.7 million a year from people leaving the state because of the 2004 tax increase. They called this "a small opportunity cost of a tax policy that generated more than $1 billion for Tax Year 2006." Furthermore, the study found that household income has grown rapidly among wealthy New Jerseyans in recent years despite the tax. From 2002 to 2006, the number of New Jersey households with incomes of $500,000 or more grew to 44,000 from 26,000, an increase of 70 percent.[a]

Similarly, an analysis by the California Budget Project found that the number of high-income households in that state has grown substantially during periods in which higher top income tax rates were in effect. According to CBP's findings, "the number of California's joint personal income tax filers with incomes of $200,000 or more rose by 33.4 percent between 1991 and 1995 — a period in which California temporarily imposed 10 percent and 11 percent tax rates on high income earners." More recently, California enacted a 1 percentage point increase on income over $1 million. The tax generated new revenue totaling about $1.5 billion in fiscal year 2008 alone. Much like the pattern observed following the tax increases of the early 1990s, the CBP analysis

[5] Elizabeth McNichol, Andrew Nicholas and Jon Shure, "Raising State Income Taxes on High-Income Taxpayers," November 11, 2009; available at: http://www.cbpp.org/cms/index.cfm?fa=view&id=2792

showed the number of taxpayers with incomes over $1 million increased — by 37.8 percent from 2004 to 2006.[b]

An analysis by the Institute on Taxation and Economic Policy in May 2009 calls into question the claim that the higher tax rates passed in Maryland in 2007 and 2008 have caused millionaires to leave the state. It suggests, rather, that a drop in the number of tax returns with income greater than $1 million was due to the recession's impact on people's holdings. Using data from the state Comptroller's office, ITEP found that the second highest tax bracket – for incomes between $500,000 and $999,999 – saw a rise in returns, as did the bracket immediately below it. Since tax rates were raised on all three of these tax brackets in 2007 and 2008, ITEP states: "a far more likely explanation for the alleged disappearance of Maryland's millionaires is that, for 2008 at least, they are no longer millionaires. Instead, their incomes may now fall in lower ranges of the distribution, thus potentially accounting for some portion of the increase in the number of returns in those ranges." [c]

Other research suggests that tax changes alone have little, if any, impact on interstate migration trends. A recent study by the Harvard-trained economist Andrew Leigh, now a professor of economics at the Australian National University, found no significant relationship between income tax changes and migration patterns among U.S. states. According to Leigh, "...tax changes do not impact interstate population flows, nor do they affect the relative wages of movers." As part of a broader examination of wage inequality and the extent to which tax structures are based on the ability to pay, Leigh analyzed migration patterns of workers along all points of the income scale. Published in the March 2008 edition of the *National Tax Journal,* his work concluded that people are not deterred from moving to states with tax systems under which upper-income residents pay more.[d]

Other studies have found that factors ranging from crime to climate play key roles in explaining state-to-state migration. For instance, Richard J. Cebula found that "non-economic factors play a very significant role in determining migration patterns." Cebula examined the effect of both economic and non-economic conditions on interstate migration. According to his study, non-economic or "quality-of-life factors" explain much of the recent trends in cross-state migration. Recent migrants were shown to be attracted to states with large amounts of sunshine, warmer winters, and numerous state parks; the study also found that people were less likely to move to states where there are many hazardous waste sites and higher rates of violent crime.[e]

[a] Cristobal Young, Charles Varner, and Douglas S. Massey, "Trends in New Jersey Migration: Housing, Employment, and Taxation," Princeton University, Woodrow Wilson School of Public and International Affairs, Policy Research Institute for the Region, September, 2008. Available on-line at www.princeton.edu/prior/.
[b] The California Budget Project, "The Number of High-Income Taxpayers Increased Significantly During a Period With 10 Percent and 11 Percent Tax Rates on High-Income Earners," August 2008. Available on-line at www.cbp.org.
[c] The Institute on Taxation and Economic Policy, "Where Have All of Maryland's Millionaires Gone?," May 2009.
[d] Andrew Leigh, "Do Redistributive Taxes Reduce Inequality?" National Tax Journal, Vol. LXI, 1, March 2008.
[e] Richard J. Cebula, "Internal Migration Determinants: Recent Evidence," International Advances in Economic Research, 11:267–274, 2005.

TO : COMMITTEE ON FINANCE
Representative Marcus R. Oshiro, Chair
Representative Marilyn B. Lee, Vice chair

FROM: Eldon L. Wegner, Ph.D.
Policy Advisory Board for Elder Affairs (PABEA)

HB 2991 RELATING TO PUBLIC FINANCE

3:00 pm Wednesday, February 17, 2010
Conference Room 308, Hawaii State Capitol

PABEA supports passage of HB 2991.

for Elder Affairs has a statutory obligation to advocate on behalf of the senior citizens of Hawaii. While we advise the Executive Office on Aging, we do not speak on behalf of the Executive Office of Aging.

During this time of economic crisis and revenue shortfalls for our state government, we need to find alternative revenue in a way that assures that everyone shares in the cost rather than to further cut the programs and services needed by our most vulnerable populations.

Our current tax system is highly regressive and contributes to the extreme inequalities in our community. This bill would help correct this imbalance.

Especially in this time of revenue crisis, we need to look to those who can most afford to pay higher revenue. This bill would eliminate some corporate tax exemptions and privileged rates for capital gains income. The income tax is the most transparent way to assure that the fiscal burden is shared by those most able to afford more taxes.

Thank you for allowing me to testify.

TESTIMONY – HB 2991
A BILL FOR AN ACT RELATING TO PUBLIC FINANCE
HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCE
FEBRUARY 17, 2010, 3 p.m.

I agree with NEA's position on this bill when they stated...

"In particular, this bill wins on two counts: 1) It would result in taxes in Hawaii being fairer than they are currently; and 2) it would result in significant new revenues that would be available for investing in education and other sectors. This would help grow the economy, and would produce a greater return on the investment than would, say, comparable tax cuts.

First, however, we should say that the legislature is to be commended for taking the bold and important step last year of passing HB 1747. This represented a strong, initial step in the process of improving the ability of the state to fund and invest in the services and infrastructure necessary to building and maintaining a prosperous economy for all of its citizens."

I feel the Hawaii needs to find a source of revenue directed to education. This bill is a GREAT step in that direction. This way education does not risk having to compete with other unions for funding. This also supplements the annual budget and kids won't risk being furloughed in a down economy.

The 400 million in repair and maintenance deficit has not gone down over the past four years. I have witnessed kids dodging parts of the ceiling falling on them. I have witnessed kids taking the state assessment in their class while being rained on because of holes in the ceiling. The DOE use to spend 20 million a year to train and recruit highly qualified teachers to fill the teacher shortage but there is no money for this. The cuts to education have created an increase in the price of school lunch. I was asked a week ago if I would pay for a third graders juice because she did not have anymore money in her account. Kids now have to walk to school because of elimination of bus routes due to no money. The DOE use does not have the funding to renew the lease on computers. Teachers or schools individually will have to come up with funds on their own to have a computer. Teachers have scene a massive decrease in their pay over the years. Teachers use to receive an annual pay increase for each year teaching in Hawaii-that stopped. Teachers pay lag was suppose to be temporary but we still get paid on the 5th and the 20th. With the furloughs a lot of legislators don't know that teachers don't work we don't get paid. My pay check went from 1300 to 970 every two weeks after taxes. Average rent here in Lahaina is roughly 1000 for a studio. I have no work a second job as a server just so I can have the luxury of being a teacher. Sometimes I have to work five days a week. My manager informed me that he doesn't care I am a teacher-it is all about what I bring to the table for the restaurant. I know one teacher who got pregnant, didn't want to have

an abortion so she actually was thinking of giving her child up for adoption because she could not afford it have a child!

The state of education in Hawaii is third world because no one respects it. No one is funding it. I have looked at different parts of the budget and found that Lingle has cut about 828 million from education.

Why is it that when the economy falls, the kids are the ones who get hit the hardest? Why aren't the rich taking the blow? Oregon State raised the taxes on people making more than 250 thousand a year. An investment on education in an investment on human capital. Please vote yes on this bill.

Mahalo,
Justin Hughey

James Urbaniak
84-575 Kili Drive, Apt 308
Waianae, HI 96792

February 16, 2010

To Whom It May Concern:

As a concerned citizen, taxpayer, and teacher, I'm writing this letter today to not only express my support of HB2991, but to also express how its very premise ensures fairness and equity in dealing with Hawaii's financial crisis.

All citizens of Hawaii need to pay their fair share in helping to solve the financial crisis; sadly, those at the bottom of Hawaii's economic latter have suffered enough. With lost jobs, layoffs, furloughs, and other staff-reducing measures, those residents at the bottom of the financial schema have felt the reality of what this crisis truly means.

It's time for those who have benefited when Hawaii has prospered to pay their equal share in taxes. It's unfair that the tax-burden is lower for those making significantly more than others. The top 5% should not be paying half of what the bottom 95% pay in taxes – that's just unacceptable.

There truly needs to be a comprehensive approach in addressing this financial crisis; while raising the GET may be part of it, I feel more citizens would rally behind a solution that equally places the burden on all individuals – and not just those struggling to make it day by day.

Sincerely,
James Urbaniak