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HOUSE COMMITTEE ON HUMAN SERVICES

TESTIMONY REGARDING HB 736
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 5, 2009
TIME: 8:15AM
ROOM: 329

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.

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February 5, 2009

MEMORANDUM

TO: The Honorable John M. Mizuno, Chair
House Committee on Human Services

FROM: Lillian B. Koller, Director

SUBJECT: **H.B. 736 - RELATING TO TAXATION**

Hearing: Thursday, February 5, 2009; 8:15 a.m.
Conference Room 329, State Capitol

PURPOSE: The purpose of H.B. 736 is to 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 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. 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 temporary assistance for needy families funds.

The Department also 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.

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

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

HACBED

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January 20, 2009

Dear Chair and Committee Members:

The Hawai`i Alliance for Community Based Economic Development (HACBED) is submitting testimony in support of **HB 736**.

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.

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 **HB 736** 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?
HB 736 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