

**HB 794**

**HD1**

# TAXBILLSERVICE

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**SUBJECT:** INCOME, Limit itemized deductions

**BILL NUMBER:** HB 794, HD-1

**INTRODUCED BY:** House Committee on Finance

**BRIEF SUMMARY:** Adds a new section to HRS chapter 235 to provide that itemized tax deductions under the state income tax shall not exceed: (1) \$50,000 for taxpayers filing a joint return or surviving spouse with adjusted gross income (AGI) of over \$300,000; (2) \$37,500 for taxpayers filing as a head of household with AGI of over \$225,000; (3) \$25,000 for taxpayers filing as unmarried individuals with AGI of over \$150,000; or (4) \$25,000 for taxpayers filing as a married individual filing separately with AGI of over \$150,000. This section shall be repealed on January 1, 2016.

This act shall apply retroactive to January 1, 2011.

**EFFECTIVE DATE:** July 1, 2011; applicable to tax years beginning after December 31, 2010

**STAFF COMMENTS:** At the federal level, taxpayers with high adjusted gross incomes may see some of their itemized deductions limited. The types of itemized deductions which are pared by the limit include deductions for taxes, interest paid, charitable contributions, job expenses and certain other miscellaneous deductions. Those itemized deductions which are not limited because of high incomes include: medical and dental expenses, investment interest expenses, casualty and theft losses, and gambling losses. If this is the goal of this particular proposal, then consideration might be given to patterning it after the federal application. At least this would be one step closer to conformity in this area although the legislature could set different adjusted gross income thresholds as the state income tax rates are not as high as the federal rates.

Although the federal limitation on certain itemized deductions as provided for under IRC Section 68 expired on December 31, 2009, the state administration is proposing in the annual conformity measure (HB 1089, HD-1/SB 1316, SD-1) to adopt the federal limitation by ignoring the sunset of the federal provision and making Section 68 operative for state income tax purposes. However, it should be noted that the thresholds at which the itemized deductions became limited for federal tax purposes were \$166,800 for single and joint returns and \$83,400 married individuals filing separately when the provision expired for 2009. The proposed income thresholds at which the itemized deductions would be limited for state tax purposes are substantially lower and there is no provision for indexing these thresholds as there was with the federal provision. If the federal provision is adopted as proposed by the state administration, it is not clear what amounts would be applicable for state tax purposes as the federal thresholds have been indexed over the years since it was initially adopted by Congress.

It should be noted that a similar measure to limit itemized deductions was vetoed by the governor last year. In her veto message, she stated "it is a defacto tax increase that will adversely hurt certain individuals and businesses at a time when we should be encouraging investment and spending to

recharge the economy. The tax increase not only impacts taxpayers, but also disincentivizes activities such as charitable giving and homeownership. Since itemized deductions are allowed for qualifying medical and dental expenses, contributions to qualifying charitable organizations, payment of certain taxes, home mortgage interest, and qualifying job-related expenses, capping the deduction will act to discourage these expenses. Nonprofits and charitable organizations that depend on contributions to serve needy populations are particularly concerned that their ability to raise funds through donations and charitable giving would be adversely affected.”

Digested 3/23/11