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HOUSE COMMITTEE ON FINANCE

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING HB 806 RELATING TO TAXATION

TESTIFIER:	**FREDERICK D. PABLO, DIRECTOR OF TAXATION (OR DESIGNEE)**
COMMITTEE:	**FIN**
DATE:	**FEBRUARY 25, 2011**
TIME:	**11:00AM**
POSITION:	**OPPOSED**

This measure temporarily modifies the trade or business expense income tax deduction by prohibiting deductions for out-of-state business travel and also by establishing a ceiling on the deduction for the remuneration of a highly paid employee.

The Department of Taxation (Department) opposes this measure because it unfairly penalizes certain businesses that may not have the choice of avoiding out-of-state travel in the course of ordinary business.

For example, this measure could negatively impact local businesses looking to expand into out-of-state markets by discouraging them from traveling to the mainland to market and promote their businesses.

The estimated revenue gain is $8.2 million per year in FY 2012 and FY 2013.

The Chamber of Commerce of Hawaii
The Voice of Business in Hawaii

Testimony to the House Committee on Finance
Friday, February 25, 2011 at 11:00 a.m.
Conference Room 308, State Capitol
Agenda #2

RE: HOUSE BILL NO. 806 RELATING TO TAXATION

Chair Oshiro, Vice Chair Lee, and Members of the Committee:

The Chamber of Commerce of Hawaii ("Chamber") opposes HB 806 relating to Taxation.

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.

Although the bill is intended to revitalize the local economy, we are concerned that it will have precisely the opposite effect.

First, the bill would disallow deductions for out-of-state travel expenses incurred in pursuit of a trade or business. Local businesses must often travel out-of-state in order to attract outside customers and investment. Eliminating the deductibility of such expenses will reduce local businesses' ability to travel. Without traveling, local businesses cannot hope to compete for outside customers and investment.

The bill would also severely limit the amount of compensation that publicly-traded corporations could deduct with respect to any single employee. This will impair the corporations' ability to attract qualified personnel, and severely limit their profits -- both of which are necessary to revitalize our local economy.

We respectfully ask that the committee holds this measure. Thank you for the opportunity to provide testimony.

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L E G I S L A T I V E

TAXBILLSERVICE

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SUBJECT: INCOME, Suspend business travel expense deduction; ceiling on deduction for highly paid employee

BILL NUMBER: HB 806

INTRODUCED BY: Say

BRIEF SUMMARY: Amends HRS section 235-2.4(a) to provide that section 162 (with respect to trade or business expenses) of the Internal Revenue Code (IRC) shall be operative for purposes of this chapter, except that no deduction shall be allowed for traveling expenses, as described under section 162(a)(2) of the IRC, while away from home and out-of-state in the pursuit of a trade or business. For the purpose of this paragraph, transportation expenses between a point in the state and a point outside the state in the pursuit of a trade or business shall be deemed to have been incurred while away from home and out-of-state.

Also provides that notwithstanding section 162(m)(1) of the IRC, for a publicly held corporation: (1) for tax year beginning after December 31, 2010, no deduction shall be allowed for employees whose wage exceeds $129,660; and (2) for the tax year beginning after December 31, 2011, no deduction shall be allowed for employees whose wage exceeds $143,748.

That subsection shall not be operative for the tax year beginning after December 31, 2012 and any subsequent taxable year.

This act shall be repealed on December 31, 2012 and provides that HRS section 235-2.4, shall be reenacted in the form in which it existed on the day before the date of approval of this act.

EFFECTIVE DATE: Tax years beginning after December 31, 2010

STAFF COMMENTS: This measure would temporarily: (1) disallow the deduction for out-of-state traveling business expenses; and (2) limit the amount of "high" employee wages that may be deducted by a publicly held corporation to $129,660 for tax years beginning after December 31, 2010 and $143,748 for tax years beginning after December 31, 2011.

While these "temporary" adjustments to the state income tax are proposed because according to the purpose clause of the bill the "legislature prefers to pursue policies that promote the circulation of money within the state to revitalize the local economy, rather than indirectly subsidizing expenditures made outside the state" it is questionable how much revenue will be generated by disallowing this provision for state income tax purposes. This statement ignores the fact that Hawaii is an island state that is already coming from behind when pursuing commerce on the global marketplace. In order to sustain business activity in the state, it almost always requires business travel out of the state. While in some lawmakers' minds, travel is a "frivolous" expense, they should look internally at the travel required of public employees. For example, when the state issues bonds, the budget director always has to travel to the bond markets - usually New York - to convince the people who rate the state's bonds that they are good investments and that the state will have the resources to repay bond holders. Perhaps in this day and age video conferencing might be considered, but there is nothing more convincing than an in-person face-to-face meeting with investors. At the local level, will the restriction of the deduction for interisland travel eventually have an impact on the local airlines as businesses cut back on their interisland travel? What will that mean to not only the company's viability but also the airline crews flying those trips between Honolulu and Hilo or the reservation positions and counter help at the airport? Though this part of the measure may be well-intended, it will, in fact, have the opposite effect on the economy.

The measure goes on to say that "the legislature finds that establishing a ceiling on the amount that publicly held corporations may deduct for the remuneration of highly paid employees should result in additional tax revenues that may be used to fund essential public health, safety, and education services." While the limitation on executive compensation at the federal level is $1 million, this measure would set the limit for the deduction for state purposes at less than $150,000. If the intent of this measure proposes to extract additional revenues from "business" taxpayers, then perhaps lawmakers should impose a surcharge on state workers who receive more than the deduction limits proposed by this bill. While lawmakers may believe this level of compensation is excessive, they should look internally at their own compensation schedules and determine whether or not compensation of some public employees is excessive. Are taxpayers willing to pay, for example, the University President six figures on top of the $5,000 housing allowance or should a salary for some of the University's athletic leaders, which approach the half million dollar mark, also be asked to contribute "to fund essential public health, safety, and education services?"

Since deduction provisions are available on the federal level, the disallowance or restriction on the state level will reduce Hawaii's effort to conform with the federal provisions. The adoption of this measure will also result in a tax increase for Hawaii businesses as they will not be able to deduct these costs as a business expense. While lawmakers may believe that they taking it out of the business, they should realize that in most, if not all, cases the added tax burden is reducing the amount of capital that is available to the company to invest in the company's operations that will create jobs, that is available for additional compensation for all other employees and, most importantly, reduces the company's ability to return earnings to its stockholders - the little guy on the street who depends on that dividend or interest income.

As noted earlier, it is questionable how much revenue will be gained by the adoption of this measure. While this measure is proposed to generate additional revenues to alleviate the state budget deficit, lawmakers are looking under the wrong rock. They should be looking in the direction of the various tax credits that have been adopted that have shot holes in the state revenue pot and plug those holes - that would result in a more favorable result than the adoption of this measure - as far as revenue generating schemes.

Digested 2/24/11