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To: The Honorable David Y. Ige, Chair
and Members of the Senate Committee on Ways and Means

Date: Thursday, February 21, 2013
Time: 9:00 a.m.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. 573, S.D.1 Relating to Taxation

The Department of Taxation (Department) appreciates the intent of S.B. 573, S.D.1, and offers the following information and comments for your consideration.

S.B. 573, S.D.1 authorizes a state income tax credit of up to $250 for certain expenses paid or incurred by a school teacher during a taxable year. The measure is effective on July 1, 2050 and applies to taxable years beginning after December 31, 2012.

Under the 2012 American Taxpayer Relief Act, the federal deduction for elementary and secondary school teachers, which had expired at the end of 2011, was extended for 2012 and 2013. Through conformity, the State will generally adopt changes made to the Internal Revenue Code.

While the measure provides that no other credit can be taken with the expenses claimed for this credit, it would not prevent a taxpayer from claiming both a deduction and the credit at the same time. When completing Hawaii income tax returns, taxpayers start by reporting their federal adjusted gross income (AGI). The federal AGI is an amount that is determined after income and above-the-line deductions, such as this deduction, are claimed on the taxpayer's federal income tax return. Since this amount is reflected on the federal return, the Department is unable to know if the deduction had been previously claimed. Taxpayers could receive duplicate tax benefits as the amounts expended could be deducted in order to reach their federal AGI and the same expenses used to generate a tax credit that is used, dollar for dollar, to offset their tax liability.

The Department notes that, as written, the term "certain expenses" is extremely broad and should be more thoroughly defined to avoid future compliance problems. The Department also notes that due to technological and staffing constraints, the Department will have difficulty developing the required changes to the tax forms and instructions in time for the 2013 tax filing season.

Thank you for the opportunity to provide comments.

L E G I S L A T I V E

LATE

TAXBILLSERVICE

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SUBJECT: INCOME, Tax credit for expenses of school teachers

BILL NUMBER: SB 573, SD-1

INTRODUCED BY: Senate Committee on Education

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow qualified taxpayers to claim a tax credit of up to $250 for "certain expenses" which shall be deductible from the taxpayer's income tax liability for the taxable year the credit is properly claimed. Defines "qualified taxpayer" as a school teacher, special education teacher, school librarian, or counselor employed by the department of education, a charter school, or a private school in Hawaii that instructs students between junior kindergarten and twelfth grade. Defines "certain expenses" as expenses paid or incurred by a qualified taxpayer who incurs the expenses in connection with books, supplies (other than athletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and supplementary materials used by the qualified taxpayer in the classroom. The credit shall be available for tax years beginning after 12/31/12.

Credits in excess of a taxpayer's income tax liability shall be credited against a taxpayer's subsequent income tax liability. Claims for the credit, including any amended claims, must be filed on or before the end of the 12th month following the close of the taxable year. Allows the director of taxation to adopt necessary rules and forms pursuant to HRS chapter 91 to carry out this section.

EFFECTIVE DATE: July 1, 2050; applicable to tax years beginning after December 31, 2012

STAFF COMMENTS: This measure proposes a tax credit of $250 for out-of-pocket expenses incurred by a teacher. While the credit proposed in this measure would be granted without regard to a taxpayer's need for tax relief or for that matter undertaking any specific action other than to be a teacher, it can be characterized as a backdoor pay increase for teachers as the credit is a dollar-for-dollar reduction of state income tax liability. It should be remembered that using the tax system to achieve social goals, as this measure proposes, is an inefficient means of accomplishing such goals. Credits are appropriate for alleviating an undue tax burden which certainly is not the case.

It should be noted that state income tax law already recognizes the federal "above the line" deduction for educator expenses. This deduction is taken before determining adjusted gross income and allows up to $250 of qualified classroom expenses made by an educator ($500 if the spouse is also an educator). This deduction was scheduled to expire at the end of 2012, but the American Taxpayer Relief Act, which was signed into law on January 2, 2013, extended the deduction. Should state lawmakers update the conformity statute, the deduction will again be available for state income tax.

While there is much empathy for the anecdotal reports of teachers using their own funds for classroom materials, the problem is with the bureaucratic system of requesting the funds and having the system take as much as six moths to approve the money. The money has been appropriated, and it is the system that is frustrating. Thus, instead of using the tax system to "compensate" these teachers, first consideration should be given to "fixing the system."

The suggestion has been made time and time again to give teachers debit like cards for the classroom supplies budget under EDN 100. The cards could be credited with a predetermined amount and could be encoded so that only defined classroom supplies could be purchased with that debit card. Such a system already has been employed to administer the state's food stamp program, why can't a similar system be established for classroom supplies rather than "mucking up" the tax system?

Instead of just throwing money at a problem, which in this case uses a tax credit, lawmakers should demand that the department fix the problem with the money that is there. It is the bureaucracy that needs to be addressed. Since the tax credit is an indirect additional burden on all remaining taxpayers as it shifts the burden to those not so favored, this proposal amounts to a tax increase and steals money from other programs.

Should lawmakers adopt the proposed credit, then the federal deduction should be made inoperable as having both would provided a double benefit for the same expenses.

Digested 2/20/13