NEIL ABERCROMBIE
GOVERNOR

PATRICIA McMANAMAN
DIRECTOR

BARBARA A. YAMASHITA
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES
P. O. Box 339
Honolulu, Hawaii 96809-0339

March 28, 2013

MEMORANDUM

TO: The Honorable Sylvia Luke, Chair
House Committee on Finance

FROM: Patricia McManaman, Director

SUBJECT: **S.B. 98, S.D. 1 - RELATING TO TAXATION**

Hearing: Thursday, March 28, 2013; 2:00 p.m.
Conference Room 308, State Capitol

PURPOSE: The purpose of S.B. 98, S.D. 1, is to reduce the tax liability for low-income taxpayers by creating a tax credit that will reduce a taxpayer's income tax to a minimum amount if the taxpayer's federal and Hawaii adjusted gross income falls below certain thresholds.

DEPARTMENT'S POSITION: The Department of Human Services (DHS) supports the intent of this bill, provided it does not adversely impact nor replace the priorities in the Executive Biennium Budget.

It is important that our working low-income families have the opportunity to make a livable wage, and to realize self-sufficiency through their earnings and ability to asset-build. We believe that this measure is a step towards creating such an opportunity, however, we respectfully defer to the Department of Taxation (DOTAX) on the feasibility of its implementation.

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

NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Thursday, March 28, 2013
Time: 2:00 p.m.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. 98, S.D.1, Relating to Taxation

The Department of Taxation (Department) **appreciates the intent of** S.B. 98, S.D. 1, and provides the following information and comments for your consideration.

S.B. 98, S.D.1: (1) replaces the refundable food/excise tax credit with non refundable low- income tax credit, (2) increases the amount of the credit that each qualified taxpayer could claim the credit to reduce their tax liability almost completely if their federal adjusted gross income (AGI) and Hawaii AGI falls below certain thresholds, and (3) accounts for the various filing statuses.

The Department appreciates the desire to provide financial support to low-income residents, who may fall below the federal poverty guidelines, but are still required to pay state income taxes. The Department, however, notes that the tax structure is not the most efficient method of providing financial support to certain individuals.

A tax return requires the reporting or not, of certain types of income and losses occurring in the immediately preceding taxable year, and is not necessarily reflective of whether an individual is rich or poor. For instance, a tax return does not take into account any assets that the taxpayer may have, and therefore, is not a reliable method of determining an individual's wealth.

If the Legislature would like to pursue tax-based relief for individuals through the tax system, the Department believes the S.D.1 amendments will provide a more directed application of financial support to low-income individuals. The non-refundable income tax credit proposed in S.D.1 could provide substantially more tax credit to the State's "working poor" by reducing or eliminating their tax liability. The Department notes, however, that residents who currently don't have any tax liability, but who may claim the refundable food/excise tax credit, would no longer qualify for any tax credit.

In recognition of the fact that the tax system is not able to efficiently target certain individuals for financial assistance, the Department also has had discussions with the Department of Human Services (DHS) to explore other avenues to identify and assist low-income individuals, particularly those who are not be covered by the current tax structure.

Finally, the Department notes that in a United States Treasury Inspector General for Tax Administration report entitled " Expansion of Controls Over Refundable Credits Could Help Reduce the Billions of Dollars of Improperly Paid Claims," dated September 7, 2012, the Inspector General observed that,

> "Refundable credits, unlike other tax credits, not only have the potential to reduce a taxpayer's tax liability to zero, but also allow the taxpayer to receive a cash payment of any remaining credit amount. This makes refundable tax credits more susceptible to fraud. Without proper controls, billions of taxpayer dollars are vulnerable to erroneous claims and fraudulent tax schemes".

For these reasons, the Department supports conversion of the refundable food/excise tax credit to a nonrefundable tax credit. Changing the tax credit from refundable to nonrefundable is also consistent with the original provisions of this measure.

Thank you for the opportunity to provide comments.

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, Low-income tax credit

BILL NUMBER: SB 98, SD-1

INTRODUCED BY: Senate Committee on Ways and Means

BRIEF SUMMARY: Amends HRS section 235-55.85 to replace the refundable food/excise tax credit with a nonrefundable, low-income tax credit. Repeals the existing tax credit schedule and provides that a taxpayer filing a singe return shall be eligible for a credit of:

Adjusted gross income	Credit per exemption
Under $15,000	$300
$15,000 under $25,000	150
$25,000 and over	0

For all other taxpayers:

Adjusted gross income	Credit per exemption
Under $15,000	$300
$15,000 under $25,000	150
$25,000 under $50,000	100
$50,000 and over	0

For the purposes of this section, "adjusted gross income" shall mean adjusted gross income as defined by the Internal Revenue Code or as defined under HRS section 235-1, whichever is greater.

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

STAFF COMMENTS: It should be remembered that the legislature by Act 134, SLH 1995, reduced the food tax credit from $55 to $27 and eliminated the general excise and medical services tax credits also in response to the state's financial crisis. Subsequently, the legislature by Act 157, SLH 1998, repealed the food tax credit and established a low-income refundable tax credit which grants a maximum tax credit of $35 for taxpayers with under $10,000 in adjusted gross income and a credit of $10 for those with income under $20,000. The legislature by Act 211, SLH 2007, further expanded the credit and renamed it the refundable food/excise tax credit to increase the number of people who qualify for the credit and raised the amount of the tax credit for each bracket to provide tax relief to lower-income families. As the conference committee reported, "the new brackets and credit amounts more accurately reflect current needs and incomes of those who are struggling to pay for necessities."

Under the existing food/excise tax credit schedule an individual taxpayer filing a single return with an adjusted gross income of $49,999 would be eligible for a food/excise tax credit of $25 while under the proposed measure, that taxpayer would not qualify for any tax credit, individual taxpayers with adjusted gross income of $25,000 and over filing a single return would not be eligible for any tax credit.

It should be remembered that the intent of the credits is to provide relief from the general excise tax imposed on the necessities of life, like food, proprietary drugs, and clothing. These taxpayers would receive no relief. Because the proposed credit can be used only to offset net income tax liability, the existing mechanism to mitigate the regressivity of the general excise tax is repealed.

This proposal takes a novel approach in that the tax credit is nonrefundable and may not be applied to any other year than the year for which it is claimed. Thus, the proposed credit can only be used to offset or reduce income tax liability. That said, then sponsors of the proposal need to address the issue of offsetting the regressive features of the general excise tax, the original purpose of the general excise tax credit when it was initiated in 1973. While this proposal would address the problem of imposing the state income tax on the low- income person, it fails to offset the total tax burden that plagues the low-income person or family. However, this proposal is a good beginning of the discussion that should take place about providing relief to low-income taxpayers. However, given that it has been more than 50 years since the state income tax rates and brackets have been truly adjusted to recognize the changes in the economic and financial landscape, that adjustment should take precedence over the quick fix that this proposal represents. This proposal would virtually wipe out any person with taxable income of less than $12,000 for single filers and $19,000 for joint filers. Note well, the qualifying income for the credit is based on federal adjusted gross income or state adjusted gross income, whichever is greater. Thus, retirees who would likely have less reportable adjusted gross income for taxable purposes would more than likely have to utilize their federal adjusted gross income as federal AGI which includes pension income that would otherwise be exempt under the state definition of AGI.

It should be noted that Hawaii's threshold for the state income tax is one of the lowest in the nation of those states that impose an income tax. If it is the intent to provide relief from that threshold, then the more appropriate approach is to establish a threshold before which state income taxes are due based on the combination of the standard deduction and personal exemption as well as an adjustment in the income tax rates.

Digested 3/11/13

CATHOLIC CHARITIES HAWAI'I

TESTIMONY IN SUPPORT OF SB 98, SD1 with comments: RELATING TO TAXATION

TO: Representative Sylvia Luke, Chair, Representative Scott Nishimoto, Vice Chair, Representative Aaron Johanson, Vice Chair, and Members, Committee on Finance

FROM: Trisha Kajimura, Social Policy Director, Catholic Charities Hawai'i

Hearing: Thursday, March 28, 2013, 2:00 pm; Conference Room 308

Thank you for the opportunity to testify on SB 98, which reduces the tax liability for low-income people. **Catholic Charities Hawaii supports the original language of this bill prior to the current Senate Draft (S.D.1). The original language of the bill creates a tax credit that will reduce a person's income tax to zero if their federal adjusted gross income falls below federal poverty guidelines, as well as reducing a person's tax liability by 50% if their income falls between 100% to 125% of the poverty line.** We are a member of Partners in Care, Oahu's coalition of homeless providers, which supports this bill as a homelessness prevention strategy.

Catholic Charities Hawai'i has a strong commitment to decreasing poverty. Poverty is clearly linked to poor social and health outcomes. People living below the poverty line are especially hard hit in Hawaii, with the highest cost of living in the U.S. A family of four in Hawaii pays 61% more for food than families on the mainland. Our cost for housing is also the highest in the nation. 75% of people at or below the poverty line spend more than 50% of their income on housing. This population is frequently teetering at the brink of homelessness. Any change to their financial situation like a decrease in wages or increase in rent will tip them over into homelessness. Increasing their resources through this measure is much more cost-effective than trying to help them out of homelessness once they have lost everything.

Hawaii's working poor families pay higher taxes than in all but 5 other states. In fact, Hawaii is one of only 15 states that tax full-time workers in families of three making the minimum wage ($15,080). In 2011, this family would have owed $258 in taxes. Hawaii's poorest taxpayers pay an average tax rate of 12% of their income (including the GET tax), while those earning over $400,000 pay closer to 4% of their earnings. Exempting those living in poverty from paying income tax would not only make the tax system fairer, it will help them with their basic survival.

Families just above the poverty line are also struggling to make ends meet and avoid homelessness. This bill would also provide a reduced tax credit of 50% if their incomes fall between 100% and 125% of the poverty line.

We thank you for your concern and dedication to helping the poor in our community become more financially stable. We urge your support for this bill in its original form.

Goodwill
Industries of Hawaii, Inc.

To: The Honorable Sylvia Luke, Chair of the House Finance Committee,
The Honorable Scott Nishimoto, Vice Chair of the House Finance Committee
The Honorable Aaron Ling Johansen, Vice Chair of the House Finance Committee

From: Laura Smith, President/CEO
Scott Fuji, Assistant Director of Community Services
Goodwill Industries of Hawaii, Inc.

Date: March 28th, 2013

Re: **Testimony with Comments For SB98 SD1– Relating to Taxation**

Goodwill Industries of Hawaii, Inc. (Goodwill) is among the largest human service non-profit organizations in Hawaii. Our mission is to help people find and succeed in employment, to become self-sufficient. With a Statewide footprint, and offices on Oahu, Maui, Hilo, Kona and Kauai, last year Goodwill served over 15,000 people, placing more than 1,500 into jobs in our community.

Goodwill submits this testimony with comments and concerns on the current form of Senate Bill 98 SD1. Goodwill Industries of Hawaii supports the original intent of SB 98 because of the importance that asset building can have on an individual's life. For individuals falling at, around, or below the federal poverty line a refundable tax credit is the most direct and proven method to put assets into the hands of those who need it the most.

While Goodwill does not contest that eliminating the tax liability for low-income individuals and households is a worthy endeavor we are concerned with the elimination of the refundable food and excise tax credit. While eliminating the tax liability may appear to be more generous, in practice it is less advantageous for the lowest two tax brackets. For example, a family earning just under $10,000, well below the federal poverty line, would incur a maximum tax liability of $242 but receive a $300 refundable Food and Excise tax credit. This puts $58 into the hands of the people at the lowest end of the tax bracket. A family earning just under $10,000 would incur a maximum tax liability of $242 but receive a $300 refundable Food and Excise tax credit. This puts $58 into the hands of the people at the lowest end of the tax bracket. Eliminating this tax credit takes money directly out of the hands of the people whose income cannot spare any further cuts.

As a final point, many senior citizens will lose out on the refundable Food and Excise tax credit. If their income is fixed to their social security payments every dollar counts and the loss of this $85 can be an additional hardship that requires painful sacrifices. The purpose of the Food and Excise tax credit is to eliminate the regressive tax burden placed on vulnerable populations, such as low-income families and senior citizens that the General Excise Tax places upon their every purchase.

We humbly ask you to consider amending this bill so that the refundable Food and Excise tax credit remains in place.

PHOCUSED

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

P13:022T:LKR

March 26, 2013

TO: Representative Sylvia Luke, Chair
Representative Scott Nishimoto, Vice Chair
Members, Committee on Finance

FROM: Laura Kay Rand, Interim Executive Director, PHOCUSED

HEARING: Committee on Finance
March 28, 2013 at 2:00 p.m.

Testimony with COMMENTS in Support of SB98
Relating to Taxation

Thank you for the opportunity to provide testimony with comments in support of SB98, which creates a poverty tax credit for families/individuals living in poverty. PHOCUSED is a coalition of health, housing, human services agencies and individual advocates voicing the needs of the marginalized and underserved in Hawaii.

We respectfully request a **return to the original language of SB98** as it best develops an anti-poverty strategy for working families/individuals, created through **the elimination of all state income tax for impoverished residents, while preserving the refundable food/excise tax credit as currently provided in HRS** § 235-55.85. The development of a poverty tax credit in SB's original language reduced a person's income tax to zero if their federal adjusted gross income falls below the federal poverty guidelines and reduces a person's tax liability by 50% if their income falls between 100% and 125% of the poverty guidelines.

If the committee decides to **retain the SD1 language**, we request, please **preserve the refundable food/excise tax credit**.

Working families and individuals in Hawaii are striving towards financial self-sufficiency against powerful economic realities. Yet, they are working and they are striving. Should we not do everything we can to support them? Our residents experience the highest cost of living in the United States, paying significantly more for food and shelter than comparable families on the mainland. And they pay these elevated costs while earning the lowest adjusted income among all of the mainland states and experiencing among the highest tax rates for low-income households in the nation.

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www.phocused-hawaii.org admin@phocused-hawaii.org

PHOCUSED

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

With SB98 and the creation of a poverty tax credit, we have an opportunity to help Hawaii families escape the crippling effects of poverty and change their financial family tree for generations to come. The Poverty Tax Credit will support families who are working hard toward self-sufficiency through the elimination of personal income tax liability entirely for working poor families and individuals in poverty while also reducing the tax liability for families and individuals who are living just above the poverty line.

Thank you for your dedication to helping our employed families and individuals who are working hard with a belief that employment is the road towards financial self-sufficiency. I urge your support of SB98 and the creation of a poverty tax credit. We appreciate the opportunity to testify in support of this measure and provide these comments respectfully requesting these amendments.

Sincerely,
Laura Kay Rand
Interim Executive Director

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To: Representative Sylvia Luke, Chair
Representative Scott Y. Nishimoto, Vice-Chair
Representative Aaron Ling Johanson, Vice-Chair

House Committee on Finance

From: Liz Chun, Early Education Policy Consultant

Date: Thursday, March 28, 2013, 2:00 pm
Conference Room 308

Subject: SB 98 SD1, Relating to Taxation

I submit this testimony **to recommend amendments to SB 98 SD1, Relating to the Poverty Tax Credit.** Hawaii must recognize and be deeply concerned about the ability of our low-income families to afford the necessities of life. Families with young children would especially benefit from a poverty tax credit.

While I support the intent of this legislation and urge you to consider the following **proposed amendments**:

- **Revert to the original language of Senate Bill 98**, which creates a Poverty Tax Credit that would eliminate all state income taxes for those living in poverty while preserving the refundable food/excise tax credit as currently provided in HRS § 235-55.85.

- Should your committee choose to keep the language of SD 1 creating a nonrefundable low-income credit, please **preserve the refundable food/excise tax credit.** Removing this refundable credit and replacing it with a nonrefundable income tax credit would actually increase the tax burden on the lowest-income households.

Hawaii will be stronger when it provides adequate supports to help struggling families move toward empowerment and self-sufficiency. I strongly urge the passage of this progressive and proven legislation – with the above amendments.

Contact Information: lizchun@hawaii.rr.com; 808-226-2619.