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To: The Honorable Jill N. Tokuda, Chair
and Members of the Senate Committee on Ways and Means

Date: Tuesday, March 24, 2015
Time: 9:00 A.M.
Place: Conference Room 211, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 1091, H.D. 1, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of H.B. 1091, H.D. 1 and provides the following comments for your consideration.

H.B. 1091, H.D. 1 increases the standard deduction for all filing statuses. The bill also increases the personal exemption amount and the number of personal exemptions a taxpayer over the age of 65 may claim, subject to adjusted gross income (AGI) limits. H.D. 1 has a defective effective date of July 1, 2030 and applies to taxable years beginning after December 31, 2015.

The Department notes that under current law, taxpayers over the age of 65 already receive an additional personal exemption. The proposal to add AGI limits to the proposed additional personal exemptions will require extensive changes to the tax forms, instructions, and computer system. Personal exemptions are generally independent of AGI, and therefore are listed and calculated before AGI is calculated on the form. Thus, the incorporation of AGI into the personal exemption would require a full rearrangement of the individual income tax forms.

Additionally, the Department suggests clarifying the operation of subsections (a)(3) and (a)(4) under Section 3 of the bill. It is the Department's position that for any type of individual income tax benefit which uses a taxpayer's AGI for qualification, that the taxpayer's federal and Hawaii AGIs be considered. Although AGI is not a good indicator of a taxpayer's financial status, taking into consideration both the taxpayer's federal and Hawaii AGI is a better measure of the taxpayer's financial status, rather than only considering the federal or the Hawaii AGI alone.

The Department also recommends clarifying whether the additional personal exemption provided by subsection (a)(4) is in addition to the one provided by subsection (a)(3). The Department suggests that subsections (a)(3) and (a)(4) be merged, with one federal and Hawaii AGI limit per filing status. The Committee may still provide more than one additional exemption for qualifying taxpayers under this amendment.

Due to the defective start date, there is no budgetary impact. However, if the original effective date were inserted, the estimated revenue loss would be approximately $57 million per year, starting in FY 2017.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

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SUBJECT: INCOME, Increase standard deduction, additional personal exemption

BILL NUMBER: HB 1091, HD-1

INTRODUCED BY: House Committee on Finance

EXECUTIVE SUMMARY: This bill increases the standard deduction amounts and adds a complex personal exemption system designed to give relief to elderly taxpayers. We are concerned that taxpayers over 65 will not handle the increased complexity well, and that considerable administrative costs are required to make the system work. Instead, we believe it preferable to raise the filing thresholds and take these people off the tax system entirely.

BRIEF SUMMARY: Amends HRS section 235-2.4(a) to increase the standard deduction: (1) from $4,400 to $5,200 for taxpayers filing a joint return or a surviving spouse; (2) from $3,212 to $3,796 for taxpayers filing as a head of household; (3) from $2,200 to $2,600 for those filing as an unmarried individual; or (4) from $2,200 to $2,600 for taxpayers filing as a married individual filing a separate return.

Amends HRS section 235-54 to allow taxpayers age 65 and over to: (1) claim an additional exemption if *federal* adjusted gross income is less than: (A) $24,000 for a taxpayer filing a single return or a married person filing separately, (B) $36,000 for a taxpayer filing as a head of household, or (C) $48,000 for a taxpayer filing a joint return or as a surviving spouse; and (2) claim another additional exemption if *federal and state* adjusted gross income is less than: (A) $30,000 for a taxpayer filing a single return or a married person filing separately; (B) $45,000 for a taxpayer filing as a head of household, or (C) $60,000 for a taxpayer filing a joint return or as a surviving spouse.

Amends HRS section 235-54 to increase the personal exemption amount from $1,144 to $2,144.

EFFECTIVE DATE: July 1, 2030; applicable to tax years beginning after December 31, 2015

STAFF COMMENTS: The legislature by Act 60, SLH 2009, provided for an increase in the standard deduction from $4,000 to $4,400 for joint returns or surviving spouses, from $2,920 to $3,212 for head of households; and from $2,000 to $2,200 for individuals or married taxpayers filing separately. Act 60 also provided for an increase in the personal exemption from $1,040 to $1,144. This measure would increase the standard deduction from $4,400 to $5,200 for joint returns or surviving spouses, from $3,212 to $3,796 for head of households; and from $2,200 to $2,600 for individuals or married taxpayers filing separately, and increase the personal exemption from $1,144 to $2,144.

In all, the increase in standard deduction and personal exemption amounts will result in an increase in the filing threshold (namely the income level below which the taxpayer won't need to file a return). Hawaii has one of the lowest filing thresholds in the United States, and having a higher filing threshold will result in considerable administrative cost savings. Why? Tax returns are complex documents. They are expensive to process. The more people are kicked off the tax system, the more savings will result.

The measure would also provide additional income tax relief to taxpayers age 65 and older if they meet certain income levels. Under current law, a taxpayer is able to receive one exemption for themselves and an additional exemption if they are over 65. As proposed, a taxpayer age 65 and older would be able to claim up to four exemptions if they are under the income thresholds in the measure. This system raises additional issues.

First, the income thresholds use different measures. The first additional exemption uses federal AGI thresholds. The second one uses "federal and state" AGI thresholds. Federal and state AGI are not identical, and could be very different for people receiving retirement income (under HRS section 235-7(a)(2) and (3), pension income may be exempt for state purposes but taxable for federal purposes). Was this intended, or a drafting error that needs to be fixed?

Second, these additional exemptions have the effect of adding complexity to the tax returns that our kupuna need to file. We suggest that they, on average, would not be in the best position to cope with increased complexity and may wind up failing to claim the benefits that this legislation would give them. And on the government side, additional administrative costs would be incurred as the department of taxation would need to reach out to educate the taxpaying public on their entitlement to these additional exemptions.

Third, what is so magic about age 65 that justifies four exemptions when others, younger people with similar income and also struggling to make ends meet, would only be entitled to one exemption?

If it is desirable to grant additional relief to these taxpayers, then the more appropriate and simple approach is to raise the filing threshold and get them off the system. That would be a relief in more ways than one, as the people would not have to deal with the tax system and the tax department would not have to incur the processing and operational costs associated with those people.

Digested 3/20/15