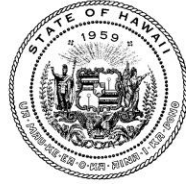




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MARIA E. ZIELINSKI
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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Wednesday, February 18, 2015
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 1092, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of H.B. 1092 and provides the following comments for your consideration.

H.B. 1092 excludes amounts received from deferred compensation retirement plans from Hawaii income tax, subject to adjusted gross income (AGI) limits. H.B. 1092 applies to taxable years beginning after December 31, 2014.

Under current law, distributions from employer-funded pension plans are exempted from Hawaii income tax. H.B. 1092 proposes to exempt distributions from other plans such as 401(k) and 403(b) plans for AGI-qualified individuals.

The Department notes that the use of federal AGI is not the best indicator of an individual's economic status. For example, if a taxpayer owns rental real property, due to non-cash expenses such as depreciation, the taxpayer may have negative taxable income. Even though such rental real property may have substantial value, the owner/taxpayer would be an eligible taxpayer under this measure merely because of the negative taxable income effect generated by such non-cash expenses of rental real property. Alternatively, a taxpayer could be receiving substantial amounts of tax exempt income (i.e., income from municipal bonds), and still qualify for the benefits under this measure since the exempt income would not be included in the taxpayer's federal AGI.

Thank you for the opportunity to provide comments.

TAXBILLSERVICE

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SUBJECT: INCOME, Exclusion for certain deferred compensation

BILL NUMBER: HB 1092

INTRODUCED BY: Ichiyama, Aquino, Belatti, Brower, Choy, Cullen, Har, Hashem, Ing, Ito, Johanson, Kawakami, Kong, LoPresti, McKelvey, Morikawa, Nakashima, Nishimoto, Ohno, Onishi, Oshiro, Saiki, San Buenaventura, Say, Takayama, Takumi, Tokioka, Tsuji, Yamane, Yamashita and 2 Democrats

EXECUTIVE SUMMARY: This bill proposes to exempt deferred compensation or similar retirement income from income taxation the same as employer funded retirement plans under present law, provided that the taxpayer's federal adjusted gross income (FAGI) is under certain thresholds. We question why relief is only provided for this type of income, and suggest that to ensure equal treatment of taxpayers who need the relief, it is preferable to establish a higher filing threshold based on the combination of the standard deduction and personal exemption.

BRIEF SUMMARY: Adds a new paragraph to HRS section 235-7 to exclude from state income taxation compensation received from deferred compensation retirement plans, including individual retirement accounts, those established under IRC 401(k) or 403(b), or any other retirement plan that defers compensation if a taxpayer's FAGI is less than: (1) \$30,000 for a taxpayer filing a single return or a married person filing separately; (2) \$45,000 for a taxpayer filing as a head of household; and (3) \$60,000 for a taxpayer filing a joint return or as a surviving spouse.

EFFECTIVE DATE: Tax years beginning after December 31, 2014

STAFF COMMENTS: Under current law, Hawaii taxpayers may exclude pension income from an employer-funded retirement plan, whether it be \$10,000 or \$1,000,000 per year. Many of these excludable pension plans were defined benefit plans, which were in vogue a long time ago but, in current economic conditions, became too costly for many private employers to fund. Many employers, as a result, jettisoned the defined benefit plans in favor of defined contribution plans such as plans established under 401(k) of the Code. At the encouragement of the federal tax laws, more and more workers are setting aside resources for their retirement years in the form of 401(k) plans, Simplified Employee Pension Plans (SEP) and Individual Retirement Accounts (IRA). Payments from these deferred compensation types of plans are taxable under both federal and Hawaii law.

This measure would provide that any compensation received from a deferred compensation retirement plan shall not be subject to state income taxation if a taxpayer's FAGI is below the threshold amounts proposed in this measure. This would be in addition to the exclusion already provided for employer-funded pension plan payments.

In simplistic terms, deferred compensation plans were designed to shield income while a taxpayer is employed, and when the taxpayer retires and receives the income the taxpayer would be taxed at that

time, but presumably would be in a lower income bracket so that the tax bite is deferred as well as mitigated. Under the proposed measure, such income may escape state income taxation altogether.

It appears that the intent of the measure is to reduce the income tax burden on seniors. If that is the case, we question, as a policy matter, why the tax system should discriminate between different kinds of income (pension income vs. other income) and why the existing system that discriminates between different kinds of pension income (employer funded pensions vs. 401(k) and other kinds of deferred compensation) should continue to do so. We suggest that in order to promote equality between taxpayers and reduce complexity of the tax return, it is preferable to establish a higher filing threshold (namely, the amount of income you need to make before an income tax return is required to be filed) based on the combination of the standard deduction and personal exemption.

Digested 2/17/15

From: mailinglist@capitol.hawaii.gov
Sent: Wednesday, February 18, 2015 9:42 AM
To: FINTestimony
Cc: trevor.tamashiro@gmail.com
Subject: *Submitted testimony for HB1092 on Feb 18, 2015 14:00PM*



HB1092

Submitted on: 2/18/2015

Testimony for FIN on Feb 18, 2015 14:00PM in Conference Room 308

Submitted By	Organization	Testifier Position	Present at Hearing
Trevor Tamashiro	Individual	Support	No

Comments:

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Cc: CathyTsauro@gmail.com
Subject: *Submitted testimony for HB1092 on Feb 18, 2015 14:00PM*



HB1092

Submitted on: 2/18/2015

Testimony for FIN on Feb 18, 2015 14:00PM in Conference Room 308

Submitted By	Organization	Testifier Position	Present at Hearing
Catherine Tsauro	Individual	Support	No

Comments:

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Cc: corietanida@hotmail.com
Subject: *Submitted testimony for HB1092 on Feb 18, 2015 14:00PM*

HB1092

Submitted on: 2/18/2015

Testimony for FIN on Feb 18, 2015 14:00PM in Conference Room 308



Submitted By	Organization	Testifier Position	Present at Hearing
Corie Tanida	Individual	Support	No

Comments:

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