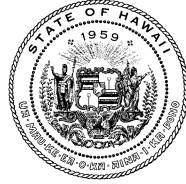


DAVID Y. IGE  
GOVERNOR

SHAN TSUTSUI  
LT. GOVERNOR



MARIA E. ZIELINSKI  
DIRECTOR OF TAXATION

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: 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. 1179, Relating to Inflation Adjustments to Chapter 235, Hawaii Revised Statutes

The Department of Taxation (Department) appreciates the intent of H.B. 1179 and provides the following comments for your consideration.

H.B. 1179 mandates inflation adjustments to the standard deduction, the individual personal exemption, and the individual income tax brackets. The bill does not apply to the personal exemption or brackets applicable to estates or trusts. The adjustment is calculated by dividing the Consumer Price Index (CPI) for the 12 months preceding the previous June 30 by the CPI for the 12 months preceding June 30, 2013.

The bill applies to taxable years beginning after December 31, 2014 and ending before January 1, 2020. The bill requires a report to the legislature on the effectiveness of the adjustment program. The report is due before the regular session of 2020.

The Department notes that the proposed automatic annual adjustments will make the income tax very difficult to administer. The bill will require the Department to annually adjust two personal exemption amounts, the personal exemption phaseout threshold amount, thirty-three tax bracket limits, and three standard deduction amounts. In addition, the required adjustments will necessitate extensive annual adjustments to tax forms, instructions, tax tables, and our computer system.

The Department also notes that passing this measure for purposes of the income tax brackets will require a large scale change to section 235-51, Hawaii Revised Statutes (HRS). This is because that section contains not only the tax brackets, but the tax rates and tax amounts

for each bracket. If the tax brackets are adjusted annually for inflation, the tax amounts must also be updated annually through legislation.

A possible alternative would be to delete the rates and amounts and insert a separate statement of the rates. Another possible alternative would be to further amend section 235-51, HRS, to require the Department to issue substitute tables for those contained in subsections (a), (b) and (c) of section 235-51, HRS. While the latter would be the easiest statutory amendment, the exclusion of adjustments to the estate and trust brackets may lead to confusion as to why section 235-51, HRS, contains specific tax rates for estates and trusts, but not for individuals.

The Department notes that the proposal is meant to be temporary, and followed by a report to the legislature on the program's effectiveness. Because of the apparent intent to rate the effectiveness of the program over its five taxable year period, the Department suggests limiting the mandated adjustments to the standard deduction amounts. If this is done, the Department will be required to adjust fewer amounts and will still be able to assess the effectiveness of the program and its administrative burden.

Finally, to clarify the proposal's effective dates, the Department suggests replacing the contents of Section 5, paragraph (1) with the following language:

- (1) This Act shall apply to taxable years beginning after December 31, 2014, and shall not apply to taxable years beginning after December 31, 2019.

Thank you for the opportunity to provide comments.



# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Inflation adjustments

BILL NUMBER: HB 1179

INTRODUCED BY: Johanson, Luke, Nishimoto

**EXECUTIVE SUMMARY:** This bill seeks to adjust the standard deduction, personal exemption, and income tax rate brackets for inflation. These measures should be considered as an important part of re-engineering our income tax brackets, which have not been adjusted in decades.

**BRIEF SUMMARY:** Adds a new section to HRS chapter 235 to adjust the standard deduction, personal exemption, and income tax rate brackets for inflation.

For taxable years beginning after December 31, 2014, the director of taxation shall apply the cost-of-living adjustment for the calendar year on: (1) The standard deduction amounts provided in section 235-2.4(a); (2) the minimum and maximum taxable income rate bracket dollar amounts provided in section 235-51(a), (b), and (c); provided that the rate applicable to each income bracket may not be changed; and (3) every personal exemption multiplier amount provided in section 235-54, except subsection (b). If any dollar amounts, as adjusted, are not multiples of \$50, any increase shall be rounded to the nearest \$50.

No adjustments shall be made when the consumer price index for the twelve-month period ending June 30 of the preceding calendar year is less than zero or when the cost-of-living adjustment would reduce the previously established standard deduction, personal exemption, and income tax bracket amounts and levels.

Requires the department of taxation to submit an evaluation and analysis of the implementation and effectiveness of the adjustments made to the standard deduction, personal exemption, and income tax brackets made by this act, including any proposed legislation, to the legislature no later than twenty days prior to the convening of the regular session of 2020.

Repeals this act on January 1, 2020.

**EFFECTIVE DATE:** Tax years beginning after December 31, 2014

**STAFF COMMENTS:** Every year the IRS adjusts more than forty tax provisions for inflation. This is done to prevent what is called “bracket creep.” This is the phenomenon by which people are pushed into higher income tax brackets or have reduced value from credits or deductions due to inflation instead of any increase in real income.

The IRS uses the Consumer Price Index (CPI) to calculate the past year’s inflation and adjusts income thresholds, deduction amounts, and credit values accordingly.



In 2014, the top marginal income tax rate of 39.6 percent will hit taxpayers with an adjusted gross income of \$406,751 and higher for single filers and \$457,601 and higher for married filers.

The standard deduction, which all taxpayers can claim if they want it, increased by \$100 from \$6,100 to \$6,200 for singles. For married couples filing jointly, it increased by \$200 from \$12,200 to \$12,400. The personal exemption amount, which is available for all persons living in a household including the filer, increased by \$50 to \$3,950.

What does Hawaii do? For some reason in 1978 when Hawaii adopted its present system of conforming to the federal Internal Revenue Code, inflation adjustments were left off the table. At that time, it took a lot of work and money to change our hard-coded computer systems to accept different rates and different threshold amounts. Over a long period of time, people's income rose, but our tax thresholds didn't.

As a result, today a single person making an amount equal to the 2014 federal poverty level, assuming they took one personal exemption (presently \$1,144) and the standard deduction (now \$2,200), would be taxed at our fourth tax bracket with a rate of 6.4%. Our top income tax rate, not counting the "temporary" rate increases adopted in 2009 and scheduled to sunset next year, is 8.25%.

What does that mean? We've been bracket creeped!

Being bracket creeped means that we are taxing the poor deeper into poverty. Fixing the issue, however, is not so simple because if we simply fixed the rates to tax lower income dollars at a lower rate, those rates would affect almost the entire population of our state and would result in massive revenue loss if we don't do it right. If we are going to do this right, we need to re-engineer our brackets to give relief to the people who need it, to be revenue neutral or close to it for those in the middle, and maybe ask a little more of the people now exposed to the 9%, 10%, and 11% rates. That would bring back the "progressivity," the principle of imposing the tax based on the ability to pay that has been slowly, but surely, vanishing from our income tax system as a result of bracket creep.

This measure would require the director of taxation to adjust the standard deduction, personal exemption, and income tax brackets to keep up with changes in the cost of living, which has been recommended by the Tax Review Commission.

It should also be noted that the federal system is indexed for inflation to prevent nominal price increases from eroding the benefit of the personal exemption and the standard deduction. Thus, by adjusting the standard deduction, personal exemption, and income tax brackets, this "indexing" of the state income tax system for inflation is a way to gradually maintain equity in the state tax system.

Digested 2/17/15





CATHOLIC CHARITIES HAWAII

**TESTIMONY IN SUPPORT OF HB 1179: RELATING TO INFLATION  
ADJUSTMENTS TO CHAPTER 235, HAWAII REVISED STATUTES**

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

FROM: Trisha Kajimura, Social Policy Director, Catholic Charities Hawaii

**Hearing: Wednesday, 2/18/15, 2:00 pm; Conference Room 308**

Thank you for the opportunity to testify in support of HB 1179, which provides for annual adjustments to the Hawaii standard deduction, income tax rate brackets, and personal exemption in response to increases in inflation as documented by the U.S. Department of Labor Consumer Price Index.

Catholic Charities Hawaii (CCH) is a tax exempt, non-profit agency that has been providing social services in Hawaii for over 60 years. CCH has programs serving elders, children, developmentally disabled, homeless and immigrants. Our mission is to provide services and advocacy for the most vulnerable in Hawaii.

Hawaii's high cost of living, including the highest cost of shelter in the country<sup>1</sup> and food costs for a family of four at 68% more than the mainland<sup>2</sup>, severely hampers the buying power of our residents. Additionally, the regressive design of our General Excise Tax means that the less you make, the greater the portion of your income is spent on taxes.

HB 1179 helps to alleviate the harm caused by Hawaii's high cost of living by annually adjusting the standard deduction, personal exemption and income tax rate brackets for inflation. Currently, without this indexing for inflation built into our system, taxpayers lose purchasing power as they end up in higher tax rate brackets without any real increase in their income. This impacts low and middle-income earners the greatest as they are still also paying our regressive GET on goods and services.

Please help us increase equity in our tax system by supporting HB 1179. Please contact me at (808)527-4810 or [trisha.kajimura@catholiccharitieshawaii.org](mailto:trisha.kajimura@catholiccharitieshawaii.org) if you have any questions.

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<sup>1</sup> Hawaii 2013 State Housing Profile, National Low Income Housing Coalition. <http://nlihc.org/sites/default/files/SHP-HI.pdf>.

<sup>2</sup> Based on the U.S. Department of Agriculture's Thrifty Food Plan, which is used as the basis for Supplemental Nutrition Assistance Program benefits. See <http://www.cnpp.usda.gov/usdafoodplanscostoffood.htm>.





**LATE**

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

**Board of Directors**

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Alan Shinn*

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

FROM: Scott Morishige, MSW  
Executive Director, PHOCUSED

HEARING: **Tuesday, February 18th, 2015 at 2:00 p.m. in Conf. Rm. 308**

**Testimony in Support of HB1179, Relating to Inflation  
Adjustments to Chapter 235, Hawaii Revised Statutes.**

Thank you for the opportunity to provide testimony in **support** of HB1179, which provides for annual adjustments to the Hawaii standard deduction, income tax rate brackets, and personal exemption in response to increases in inflation. PHOCUSED is a nonprofit membership and advocacy organization that works together with community stakeholders to impact program and policy change for the most vulnerable in our community, including low-income individuals and families.

It is an indisputable fact that as cost of living goes up, households incomes generally go up also, partially because of inflation. However, despite this, many state tax systems are not designed to take account of inflation. The result is that income taxes often grow faster than incomes. Indexing income taxes for inflation is one solution to address this challenge in a way that ensures the tax system treats people in roughly the same way from year to year.

To help ensure fairness throughout our tax system, PHOCUSED supports HB1179 and urges you to pass this bill out of committee. If you have any questions, please do not hesitate to contact PHOCUSED at 521-7462 or by e-mail at [admin@phocused-hawaii.org](mailto:admin@phocused-hawaii.org).

The Twenty-Eighth Legislature  
Regular Session of 2015

HOUSE OF REPRESENTATIVES  
Committee on Finance  
Rep. Sylvia Luke, Chair  
Rep. Scott Y. Nishimoto, Vice Chair  
State Capitol, Conference Room 308  
Wednesday, February 18, 2015; 2:00 p.m.

**LATE**

**STATEMENT OF THE ILWU LOCAL 142 ON H.B. 1179, H.B. 1181, H.B. 1182  
RELATING TO INFLATION ADJUSTMENTS TO HRS CHAPTER 235  
AND TAXATION**

The ILWU Local 142 supports the following measures: H.B. 1179, which provides for annual adjustments to the Hawaii standard deduction, income tax rate brackets, and personal exemption in response to increases in inflation; H.B. 1181, which amends the state income tax by changing the amounts of the basic standard deduction and personal exemption; and H.B. 1182, which amends the income tax credit for expenses for household and dependent care services necessary for gainful employment by changing the manner in which the taxpayer's applicable percentage is determined.

All three bills attempt to bring fairness and equity to Hawaii's tax structure, which is said to be among the highest in the nation. These measures will help low-wage workers pay taxes in proportion to their income and in recognition of the high cost of living in Hawaii. To do otherwise would unfairly penalize those who diligently work yet are unable to bring themselves out of the ranks of the working poor.

Obviously, the best solution would be to increase the wages and salaries of all who work for a living, but the Legislature is not in a position to dictate to employers how much they should pay to their employees—other than setting a minimum wage. However, the Legislature is in a position to help working people in Hawaii with a fair tax structure and possibly an Earned Income Tax Credit such as provided by the federal government. With a more equitable tax structure, low-wage workers may be able to accumulate some savings with which to pay rent deposits, provide for a rainy day, and develop some financial security.

The ILWU urges passage of all three bills for the sake of low-income taxpayers and their families. Thank you for considering our testimony.

**LATE**

**TESTIMONY OF GINO SOQUENA  
GOVERNMENT RELATIONS DIRECTOR  
LABORERS' INTERNATIONAL UNION OF NORTH AMERICA LOCAL 368**

HOUSE OF REPRESENTATIVES  
THE TWENTY-EIGHTH LEGISLATURE  
REGULAR SESSION OF 2015

COMMITTEE ON FINANCE  
Rep. Sylvia Luke, Chair  
Rep. Scott Nishimoto, Vice Chair

NOTICE OF HEARING

DATE: Wednesday, February 18, 2015  
TIME: 2:00 PM  
PLACE: Conference Room 308  
State Capitol  
415 South Beretania Street

**TESTIMONY ON HOUSE BILL NO. 1179, RELATING TO INFLATION ADJUSTMENTS TO CHAPTER 235,  
HAWAII REVISED STATUTES.**

TO THE HONORABLE SYLVIA LUKE, CHAIR, SCOTT NISHIMOTO, VICE CHAIR, AND MEMBERS OF THE  
FINANCE COMMITTEE:

My name is Gino Soquena, and I am the Government and Community Relations Director of the Laborers' International Union of North America Local 368, which represents almost 5,000 members throughout the State of Hawaii.

Thank you for the opportunity to submit testimony in support of House Bill No. 1179.

The Hawaii Laborers' Union has long supported measures that would lower the cost of living for low income individuals. This bill would improve life for people at the margins of each of the tax brackets (especially on the lower end), and is fairer in the long run by being indexed to inflation.

For these reasons, we support House Bill 1179, and ask that it be passed.

Gino Soquena  
Hawaii Laborers Union Local 368  
(808) 673-0441