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To: The Honorable Justin H. Woodson, Chair
and Members of the House Committee on Higher Education

Date: Thursday, February 2, 2017
Time: 2:00 P.M.
Place: Conference Room 309, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 128, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of H.B. 128 and provides the following comments for your consideration.

H.B. 128 creates a non-refundable income tax credit for contributions made to the account of a designated beneficiary in the college savings program under chapter 256, Hawaii Revised Statutes (HRS). The amount of the credit is limited to $500 for contributions made on behalf of each beneficiary during each taxable year and is calculated as follows:

Filing Status	**Amount of Credit**
Joint or as surviving spouse	10% of the first $5,000 contributed
Individual	10% of the first $2,500 contributed
Head of household	10% of the first $3,750 contributed

The bill further provides that if the taxpayer cancels the tuition savings agreement under chapter 256, HRS, or if the taxpayer makes a nonqualified withdrawal, the taxpayer's tax liability for that taxable year shall be increased by the amount claimed for the college savings program tax credit, in that year and in all prior years. The bill is effective upon approval and applies to taxable years beginning after December 31, 2016.

First, the Department suggests adding the following language to subsection (a) to clarify that the credit shall be deductible from the taxpayer's net income tax liability and shall be based on contributions made by the taxpayer:

> There shall be allowed to each taxpayer subject to the tax imposed under this chapter, a college savings program tax credit equal to the amount determined under subsections (b), (c), and (d)[~~.~~], that shall be deductible from the taxpayer's net income tax liability, if any, imposed by this chapter for the taxable year in which the credit is properly claimed. The tax credit shall apply to any contribution made by the taxpayer on or after January 1, 2017, to the account of a designated beneficiary in the college savings program under chapter 256; provided that the credit shall apply to rollover distributions from college savings programs in other states.

Second, the Department notes that the term "individually" in subsection (c) is ambiguous. Assuming that the intent of this bill is for subsection (c) to apply to persons filing as single or married filing separately, the Department suggests the following amendment:

> For taxpayers filing [~~individually,~~] a single return or a married person filing separately, the tax credit shall be equal to ten per cent of the first $2,500 contributed during the taxable year.

Third, the Department notes that the maximum amount that may be claimed in a taxable year is ambiguous. Subsection (b) provides that the amount of the credit shall be equal to "ten per cent of the first $5,000 contributed during the taxable year." Subsection (e), however, provides that the amount of the tax credit "shall not exceed $500 for contributions made on behalf of each designated beneficiary during each taxable year." Accordingly, if a taxpayer who files a joint return contributes $5,000 to one beneficiary's account and $5,000 to another beneficiary's account in a taxable year, the taxpayer's credit will be equal to $500 pursuant to subsection (b), but $1,000 pursuant to subsection (e).

If the intent of this bill is to limit the credit to $500 per taxpayer per taxable year, the Department suggests editing subsection (e) as follows:

> The amount of the tax credit taken by a taxpayer shall not exceed $500 for [~~contributions made on behalf of each designated beneficiary during~~] each taxable year.

If, on the other hand, the intent of this bill is to limit the credit to $500 for each contribution to a beneficiary without any limitation on the total amount that may be claimed by a taxpayer, the Department suggests editing subsections (b), (c), and (d) as follows:

(b) For taxpayers filing jointly or as a surviving spouse, the tax credit shall be equal to, for each designated beneficiary on whose behalf a contribution is made, ten per cent of the first $5,000 contributed during the taxable year.

(c) For taxpayers filing individually, the tax credit shall be equal to, for each designated beneficiary on whose behalf a contribution is made, ten per cent of the first $2,500 contributed during the taxable year.

(d) For taxpayers filing as head of household, the tax credit shall be equal to, for each designated beneficiary on whose behalf a contribution is made, ten per cent of the first $3,750 contributed during the taxable year.

Finally, the Department requests that this new credit be applicable to taxable years beginning after December 31, 2017 to allow for the necessary instruction, form and computer modifications.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, College Savings Program Tax Credit

BILL NUMBER: HB 128

INTRODUCED BY: MIZUNO

EXECUTIVE SUMMARY: Provides an annual tax credit of up to $500 per year, for contributions made to the Hawaii college savings program.

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to provide a tax credit for contributions made to a designated beneficiary's Hawaii college savings program account under HRS chapter 256. The credit also is allowed for rollover distributions from college savings programs in other states.

For taxpayers filing jointly or as a surviving spouse, the tax credit shall be equal to ten per cent of the first $5,000 contributed during the taxable year.

For taxpayers filing individually, the tax credit shall be equal to ten per cent of the first $2,500 contributed during the taxable year.

For taxpayers filing as head of household, the tax credit shall be equal to ten per cent of the first $3,750 contributed during the taxable year.

The amount of the tax credit taken shall not exceed $500 for contributions made on behalf of each designated beneficiary during each taxable year.

The credit is nonrefundable but may be carried forward until exhausted.

No tax credit shall be allowed when the value of the beneficiary's account at the time of the contribution equals or exceeds the maximum investment level referred to under section 256-4(l).

All tax credits under this section taken, whether in the current or prior years, are recaptured if the taxpayer cancels the tuition savings account, or makes a nonqualified withdrawal.

Claims for credit, including any amended claims, shall be filed on or before the end of the twelfth month following the taxable year for which the credit may be claimed. Failure to properly and timely claim the credit shall constitute a waiver of the credit.

EFFECTIVE DATE: Applies to taxable years beginning after December 31, 2016.

STAFF COMMENTS: Section 529 of the IRC provides special treatment for qualified tuition programs. Such plans are generally exempt from income tax, but contributions to them are generally not deductible because of the private benefit, namely the education of the donor's children or other family members. The IRC does provide favorable gift tax treatment in that any contributed amounts more than the annual gift tax exclusion may be spread over five years.

Act 81, SLH 1999, and Act 90, SLH 2000, established the Hawaii college savings account program in chapter 256, HRS. At the time, the intent was for the accounts established by this law to comply with section 529(b)(1) of the IRC.

This measure would allow taxpayers a credit for contributions to a college savings account. Presumably, the social policy behind this deduction is to encourage higher education by giving an incentive to taxpayers who commit resources to higher education expenses.

Lawmakers need to keep in mind two things. First, the tax system is the device that raises the money that they, lawmakers, like to spend. Using the tax system to shape social policy merely throws the revenue raising system out of whack, making the system less than reliable as there is no way to determine how many taxpayers will avail themselves of the credit and in what amount. Second, tax credits are nothing more than the expenditure of public dollars, but out the back door. If, in fact, these dollars were subject to the appropriation process, would taxpayers be as generous about the expenditure of these funds when our kids are roasting in the public school classrooms, there isn't enough money for social service programs, or our state hospitals are on the verge of collapse?

Utilizing tax credits to drive social policy in this manner is of a questionable benefit relative to the cost for all taxpayers. A direct appropriation of grant funding to colleges and universities would be more accountable and transparent. At least we would know the amount of the appropriation, while the fiscal impact of the credit would be a great big question mark.

Furthermore, the additional credit would require changes to tax forms and instructions, reprogramming, staff training, and other costs that could be massive in amount compared to the benefit expected to accrue because of the creditable activity.

Digested 1/31/2017

From:	mailinglist@capitol.hawaii.gov
Sent:	Tuesday, January 31, 2017 4:14 PM
To:	HEDtestimony
Cc:	mendezj@hawaii.edu
Subject:	*Submitted testimony for HB128 on Feb 2, 2017 14:00PM*

HB128
Submitted on: 1/31/2017
Testimony for HED on Feb 2, 2017 14:00PM in Conference Room 309

Submitted By	Organization	Testifier Position	Present at Hearing
Javier Mendez-Alvarez	Individual	Support	No

Comments:

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WRITTEN ONLY

TESTIMONY BY WESLEY K. MACHIDA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE HOUSE COMMITTEE ON HIGHER EDUCATION
ON
HOUSE BILL NO. 128

February 2, 2017
2:00 P.M.
Conference Room 309

LATE

RELATING TO TAXATION.

House Bill No. 128, proposes amending HRS Chapter 235, to allow an income tax credit for contributions made by taxpayers into the account of a designated beneficiary in the college savings program authorized under HRS Chapter 256. The tax credit is a stated percentage of money contributed during the taxable year, with the contribution amount subject to the percentage varying by tax filing status, but not to exceed $500.

HRS Chapter 256 establishes the state of Hawaii's college savings program and authorizes the Director of Finance to implement the program. We support the intent of the bill to provide an incentive for residents to participate in HI529, Hawaii's college savings plan to help families save for higher education expenses. However we would prefer the Administration's proposal to provide for a reduction of gross income instead. HB1074 and its companion bill SB940 relating to the State of Hawai'i Section 529 College Savings Program, provides for a tax deduction of up to $5,000 for individual taxpayers and $10,000 for couples filing joint returns, heads of households or surviving spouses.

Thank you for the opportunity to provide testimony on this measure.