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To: The Honorable Angus L.K. McKelvey, Chair
and Members of the House Committee on Higher Education

Date: Tuesday, January 30, 2018
Time: 2:00 P.M.
Place: Conference Room 309, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 1881, Relating to Taxation

The Department of Taxation (Department) provides the following comments regarding H.B. 1881 for your consideration.

H.B. 1881 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, 2017.

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 committee wishes to limit the credit to $500 per taxpayer per taxable year, it may do so by 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 committee wishes 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, it may do so by 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 respectfully request that the new tax credit be made applicable to taxable years beginning after December 31, 2018. The Department is in the process of implementing individual income tax into its new computer system and additional time will allow the Department to properly implement new tax features such as credits.

Thank you for the opportunity to provide comments.

LEGISLATIVE TAX BILL SERVICE
TAX FOUNDATION OF HAWAII
126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, College Savings Program Tax Credit

BILL NUMBER: SB 2544; HB 1881 (Identical)

INTRODUCED BY: SB by KEITH-AGARAN, BAKER, ENGLISH, GALUTERIA, INOUYE, KIDANI, KIM, Gabbard, K. Rhoads; HB by WOODSON, BROWER, CREAGAN, EVANS, JOHANSON, KEOHOKALOLE, KONG, C. LEE, LOPRESTI, MCKELVEY, MORIKAWA, NAKASHIMA, NISHIMOTO, OHNO, QUINLAN, TAKUMI, TODD, Yamashita

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

SYNOPSIS: 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, 2017.

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. Note that in the recently passed Tax Cuts and Jobs Act of 2017, the provision relating to Coverdell savings accounts was merged into section 529 so that it now allows for benefits for beneficiaries in primary schools as well as secondary.

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 1/26/2018

HB-1881
Submitted on: 1/27/2018 1:37:23 PM
Testimony for HED on 1/30/2018 2:00:00 PM

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

Comments:

LATE

HB-1881
Submitted on: 1/29/2018 2:07:09 PM
Testimony for HED on 1/30/2018 2:00:00 PM

Submitted By	Organization	Testifier Position	Present at Hearing
Elton Mow		Support	No

Comments:

any proposal to help finance higher education will be helpful