SB 2277

Measure Title:	RELATING TO REAL PROPERTY.
Report Title:	Income Taxes; Credit for Loss on Sale of Home; Cash Discount; Short Sale
Description:	Allows an income tax credit on sales of principal residences that are less than the home's original purchase price, limited by the taxpayer's income, up to an annual statewide cap of $2,000,000. Allows for a taxpayer to elect to take a discounted amount as a cash refund.
Companion:	
Package:	None
Current Referral:	HOU, WAM
Introducer(s):	S. CHANG

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To: The Honorable Will Espero, Chair
and Members of the Senate Committee on Housing

Date: Tuesday, January 30, 2018
Time: 2:45 P.M.
Place: Conference Room 225, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 2277, Relating to Real Property

The Department of Taxation (Department) provides the following comments regarding S.B. 2277 for your consideration. This measure provides assistance to homeowners who sell their home for an amount less than what was paid for it originally. Specifically, the measure creates an income tax credit of up to 25% of the loss sustained on the sale of the taxpayer's principal residence subject to an annual statewide cap of $2,000,000. In the alternative, the taxpayer may elect to claim a refundable tax credit in a reduced amount.

First, the Department notes that administration of this new credit may be problematic. For example, the federal Housing and Economic Recovery Act of 2008 allowed taxpayers who purchased a principal residence after April 8, 2008, and before July 1, 2009, to claim a credit equal to 10 percent of the purchase price of the home, limited to $7,500. The Treasury Inspector General found that the Internal Revenue Service paid out more than $25 million in fraudulent claims, including to approximately 1,300 prison inmates (including 250 serving life sentences) as well as approximately 10,000 taxpayers who received credit for homes that was also claimed as a first-time purchase by another taxpayer. In one case, 67 people used the same house as their qualifying purchase.

This credit can also be easily manipulated by "selling" a home at a loss to a related person such as a friend or relative and subsequently purchasing it back. A taxpayer can therefore qualify the credit, without even physically having to move.

Second, the Department notes that pursuant to the Mortgage Debt Relief Act of 2007, cancellation of debt is excluded as taxable income for any debt discharge up to $2 million, including partial debt relief gained through mortgage restructuring as well as full foreclosure, and is set forth in Internal Revenue Code section 108(c). Although this provision technically expired on December 31, 2017, both chamber of the U.S. Congress have introduced bills to extend the discharge of qualified principal residence indebtedness, with the House version making the exclusion permanent. This provision is effective for purposes of State taxation, and strongly believes that any relief provided should be in accordance with this provision. This can be achieved by making the exclusion permanently effective in Hawaii.

Third, the measure as currently written is not limited to principal residences located in Hawaii. For example, a California taxpayer selling a principal residence before moving to Hawaii would be entitled to claim the credit.

Finally, the Department notes that to the extent that the credit is refundable, it creates a greater risk of improper claims and abuse. As a general rule, the Department prefers nonrefundable credits over refundable credits due to this potential.

Thank you for the opportunity to provide comments.

SUBJECT: INCOME, Credit on short sale of principal residence

BILL NUMBER: SB 2277

INTRODUCED BY: S. Chang

EXECUTIVE SUMMARY: Provides an income tax credit to homeowners who sell their principal residence at a price that is less than the original purchase price. We question the policy rationale for this proposed credit and point out its inconsistency with other areas of the tax law.

SYNOPSIS: Adds a new section to chapter 235, HRS, to provide a credit to a taxpayer who sells a principal residence for less than the purchase price.

The creditable percentage of the loss is based on Hawaii AGI, as follows:

AGI	Applicable Percentage
< $25,000	25%
$25,000 - $30,000	24%
$30,000 - $35,000	23%
$35,000 - $40,000	22%
$40,000 - $45,000	21%
$45,000 - $50,000	20%
> $50,000	15%

This amount is a nonrefundable credit, but it may be carried to a subsequent year. Alternatively, the taxpayer may elect to reduce the eligible credit by 30% and take the reduced amount as a refundable credit.

The total amount of tax credits allowed shall not exceed $2 million for all taxpayers in any taxable year. Any taxpayer whose claim is rejected because it is over the cap may claim the credit in the following year.

EFFECTIVE DATE: December 31, 2018

STAFF COMMENTS: The policy rationale for this credit is questionable. Typically, tax credits tip the economic playing field when there is some beneficial social behavior that we as a society want to encourage. Where is that here? Yes, the taxpayer has lost money on a primary home. The tax system, however, is not there to save everyone. We typically won't know how or why the taxpayer ended up in that predicament, and if we start going down that path we would have government intervene in the market far more than would be necessary or advisable. That is why the tax system normally does not allow benefits for losses on personal use property.

In addition, if society wants to deliver economic relief to this type of taxpayer, the tax system is not a very efficient way to accomplish this. If, for example, a taxpayer sold a home at a loss in

January 2019, no relief check would be in the taxpayer's pockets until early 2020 at the absolute earliest.

Digested 1/25/2018

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COMMITTEE ON HOUSING

TUESDAY, January 30, 2018, 2:45 PM, Conference Room 225
SB 2277, Relating to Real Property

TESTIMONY
Nina Eejima, Legislative Committee, League of Women Voters of Hawaii

Chair Espero, Vice-Chair Harimoto, and Committee Members:

The League of Women Voters of Hawaii supports SB 2277 that allows an income tax credit on sales of principal residences that are less than the home's original purchase price, limited by the taxpayer's income, up to an annual statewide cap of $2,000,000, and allows a taxpayer to elect to take a discounted amount as a cash refund.

We note that when home prices are falling, some homeowners must choose between selling their home at a loss or not selling their home at all. Such homeowners must consider the loss of equity in their home and severe negative personal wealth impacts. In turn, this often translates into further macro economic downturns.

We agree that an income tax credit is a viable means of providing financial relief to homeowners who sell their principal residence under these short sale circumstances. We defer to the committee and all relevant stakeholders with respect to the carrying out of a thorough technical analysis of this measure which necessarily includes an analysis of the provisions relating to the calculation of the credit, taking into account the taxpayer's net income tax liability and other relevant variables.

Thank you for the opportunity to submit testimony.