



**STATE OF HAWAII
DEPARTMENT OF TAXATION**

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To: The Honorable Donovan M. Dela Cruz, Chair
and Members of the Senate Committee on Ways and Means

Date: Tuesday, February 26, 2019
Time: 10:00 A.M.
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 1310, S.D. 1, Relating to Individual Housing Accounts

The Department supports the intent of this measure and provides the following comments regarding S.B. 1310, S.D. 1, for your consideration.

As originally written, S.B. 1310 established the Individual Housing Accounts Savings Program and Individual Housing Accounts Savings Board within the Department of Budget and Finance (B&F). The Senate Committee on Housing inserted provisions similar to those contained in S.B. 1311. S.D. 1 is effective on July 1, 2019. As it relates to tax, these provisions:

- Allows a taxpayer to open an individual housing account in the name of the taxpayer's dependent;
- Allows a taxpayer making a contribution to such account a deduction from gross income of up to \$5,000 per year (or \$10,000 if married filing jointly), but shall not exceed \$25,000 in the aggregate for all taxable years a contribution is made;
- Authorizes low-income residents to establish an individual housing account to make payments for first month's rent or a rental deposit, or to provide funding for down payment assistance or to fund closing costs and to provide assistance during economic hardships, for capital improvements for homeownership, cemetery and mortuary services, or senior housing;
- Provides that if a distribution is not used for an authorized purpose, the tax liability of the account holder is increased by ten percent of the amount of the distribution;
- Includes community development financial institutions as an authorized trustee;
- Imposes a ten percent penalty if contributions are withdrawn within 365 days of the date the contribution was made;
- Requires the account holder to report up to an unstated amount of any qualified distribution as income in the year such distribution is made and in subsequent years, until 100% of the amount distributed has been reported as income;
- Authorizes direct deposits into an individual housing account.

The Department first notes that the provision authorizing a taxpayer to open an individual housing account upon birth of a dependent creates an entirely new section in Hawaii Revised Statutes (HRS) chapter 235. The Department believes that it should simply be added into the current section 235-5.5, HRS, as an additional subsection, rather than an entirely new section.

Second, the deduction from gross income authorized under subsection (b) is allowed only if the taxpayer makes the contribution to his own individual housing account. This defeats the purpose of establishing an individual housing account at the birth of a dependent, since a taxpayer will not get any tax benefit for making a contribution to it. To address these concerns, the Department suggests including the following as a new subsection in HRS section 235-5.5:

A taxpayer may establish an individual housing account pursuant to this section in the name of a dependent of the taxpayer upon providing the dependent's birth certificate and Social Security number to the director of taxation. The individual housing account established pursuant to this section may be opened upon the birth of the dependent. Any contributions to the individual housing account, subject to the limitations in subsection (b), shall be deductible by the taxpayer until the child reaches age ____.

Third, the Department notes that there is an internal inconsistency in this measure. Subsection (b) in part requires that a taxpayer receiving a qualified distribution, report a portion “of the total distribution from the individual housing account used to obtain the rental housing or provide down payment assistance or closing costs as gross income in the taxable year in which the distribution is completed and in each taxable year thereafter until all of the distribution has been included in the individual's gross income”. Subsection (g) on the other hand provides that the distribution is taken into income ratably over the ten-year period starting with the year of distribution. In addition, subsection (g) requires inclusion in income only if the distribution is used to purchase a residential real property. It is not clear if there is an inclusion in income if a distribution is made for any other qualified purpose, such as providing assistance during economic hardships.

Fourth, the Department notes that the term “economic hardship” is not defined. The Department suggests adding a clear definition so that there is not ambiguity regarding the new allowable uses of the distributions that are proposed by this measure.

Fifth, the new uses are capital improvements for home ownership, cemetery and mortuary services, senior housing or any other use allowable under HRS section 235-5.5(b). The Department suggests clearly defining “capital improvement for home ownership,” so that there is not ambiguity regarding the new allowable uses of the distributions that are proposed by this measure.

Finally, the Department requests that the effective date be made for tax years beginning after December 31, 2020 to allow the Department sufficient time to make form and instruction changes and educate the public about the change.

Thank you for the opportunity to provide comments.

DAVID Y. IGE
GOVERNOR



RODERICK K. BECKER
DIRECTOR

ROBERT YU
DEPUTY DIRECTOR

EMPLOYEES' RETIREMENT SYSTEM
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ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND
MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

WRITTEN ONLY
TESTIMONY BY RODERICK K. BECKER
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE SENATE COMMITTEES ON JUDICIARY AND WAYS AND MEANS
ON
SENATE BILL NO. 1310, S.D. 1

February 26, 2019
10:00 a.m.
Room 211

RELATING TO INDIVIDUAL HOUSING ACCOUNTS

Senate Bill No. 1310, S.D. 1: establishes the Individual Housing Accounts Savings Program (Program) and Individual Housing Accounts Savings Board (Board) within the Department of Budget and Finance (B&F); requires the Board to adopt administrative rules for the Program; requires the Board to submit annual reports to the Legislature detailing the Board's activities for the previous fiscal year; allows taxpayers to open an Individual Housing Account (IHA) in the name of a dependent upon birth; authorizes the use of an IHA to provide assistance during economic hardships or for capital improvement for homes, cemetery and mortuary services, or senior housing; requires a taxpayer to pay a penalty of 10% of any amounts distributed before one year from the date the amounts were made as a contribution; authorizes the establishment of an IHA to make payments for the first month's rent or closing cost on a dwelling; includes community development institutions as authorized trustees of IHAs; establishes the Individual Housing Accounts Savings Administrative Fund

(Administrative Fund); and appropriates unspecified amounts of general and special funds in both FY 20 and FY 21 for the Board's administrative and operating expenses.

B&F appreciates the intent of this measure, but notes that according to data provided by the Department of Taxation, IHAs are not widely utilized by the public despite being offered by some financial institutions. Therefore, it may be difficult for the program to garner enough participants to be able to achieve economies of scale. Consequently, B&F strongly recommends that the Legislature have the Legislative Reference Bureau conduct a thorough analysis of the program as proposed in this bill to fully understand the costs, benefits and feasibility of implementation.

Thank you for your consideration of our comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Individual Housing Accounts

BILL NUMBER: SB 1310, SD-1

INTRODUCED BY: Senate Committee on Housing

EXECUTIVE SUMMARY: Increases the cap amounts of the tax deduction for individual housing accounts. Authorizes certain funds from an individual housing account to be used to obtain rental housing. Authorizes the accounts to be placed in a community development financial institution. The concept of reviving the IHA does appear to merit discussion given the curtailment of the mortgage interest deduction at the federal level.

SYNOPSIS: Adds a new chapter to the HRS titled Individual Housing Accounts Savings Program. Provides that the program shall:

- (1) Allow employees for compensation in the State to contribute to an account established under the program through payroll deduction;
- (2) Require an employer to offer its employees the opportunity to contribute to an account in the program through payroll deductions;
- (3) Provide for automatic enrollment of employees and allow employees to opt out of the program;
- (4) Offer a default contribution rate set by the board;
- (5) Offer default escalation of contribution levels that can be increased or decreased within the limits established by the board;
- (6) Provide for contributions to accounts in the program to be deposited directly with the investment administrator for the program;
- (7) Whenever possible, use existing employer and public infrastructure to facilitate contributions to the program, recordkeeping, and outreach;
- (8) Allow no employer contributions to employee accounts;
- (9) Have its records and its program accounts maintained and accounted for separately;
- (10) Provide reports on the status of program accounts to program participants at least annually;
- (11) Allow account owners to both maintain an account regardless of their place of employment and to roll over funds into other savings accounts;
- (12) Pool accounts established under the program for investment;

- (13) Be professionally managed;
- (14) Provide that the State and employers that participate in the program have no proprietary interest in the contributions to or earnings on amounts contributed to accounts established under the program;
- (15) Provide that the investment administrator for the program shall be the trustee of all contributions and earnings on amounts contributed to accounts established under the program;
- (16) Not impose on employers any duties that are otherwise prohibited under state or federal law;
- (17) Keep administration fees in the program low; and
- (18) Allow the use of private sector partnerships to administer and invest the contributions to the program under the supervision and guidance of the board.

Adds a new section to HRS chapter 235 to allow a taxpayer to establish an individual housing account in the name of a dependent that may be opened upon the birth of the dependent.

Amends HRS section 235-5.5(a) to allow withdrawals from an IHA not only to provide funding for the purchase of the individual's first principal residence, but also to provide assistance during economic hardships, for capital improvements for homeownership, cemetery and mortuary services, or senior housing.

Also provides that the taxpayer shall pay a 10% penalty on amounts distributed within one year after they were contributed to the IHA.

Adds a new subsection 235-5.5(b) to provide a separate deduction, not to exceed \$_____ paid in cash during the taxable year, for an account to provide funding for the first month's rent or a rental deposit on a dwelling place that is to be used by the individual or the individual's immediate family as the principal residence, or to provide funding for down payment assistance or closing costs on a principal residence. When funds from the IHA are withdrawn and used for these purposes, ___% of the distribution is included in the individual's gross income in the year of distribution and a similar amount is included every year thereafter until fully included in gross income.

Makes other technical and conforming changes.

EFFECTIVE DATE: July 1, 2019.

STAFF COMMENTS: Individual housing accounts were established by Act 285, SLH 1982. It was intended to operate like an individual retirement account, but it would be used for a housing purchase rather than retirement security.

There is no similar provision at the federal level, so the interest in these accounts has been quite limited. In the Department of Taxation's 2002 report "Hawaii Income Patterns – Individuals," it is reported that 83 tax returns took advantage of the IHA deduction, with an average of around

\$4,500 taken per tax return. That appears to be last year in which IHA statistics were reported separately.

The idea of reviving IHA accounts does merit discussion, given that federal tax benefits of home ownership were significantly curtailed in the 2017 Tax Cuts and Jobs Act. Specifically, the mortgage interest deduction was limited to the interest on no more than \$750,000 of home acquisition debt, and interest on home equity loans (not used for acquisition) was made entirely nondeductible.

This bill is confusing because it essentially provides for two (maybe three) kinds of IHA benefits.

- (1) If the individual makes a withdrawal to provide funding for the purchase of the individual's first principal residence, the bill requires the amount of the withdrawal to be included in the individual's gross income ratably over 10 years.
- (2) If the individual makes a withdrawal to provide assistance during economic hardships, for capital improvements for homeownership, cemetery and mortuary services, or senior housing, the bill apparently is intended to provide the same treatment, although section 235-5.5(g) needs to be amended to allow this.
- (3) If the individual makes a withdrawal to provide funding for the first month's rent or a rental deposit on a dwelling place that is to be used by the individual or the individual's immediate family as the principal residence, or to provide funding for down payment assistance or closing costs on a principal residence, then the bill requires the amount of the withdrawal to be included in the individual's gross income ratably over ___ years.

Note that (1) and (3) overlap, which could lead to confusion over what rules are to apply.

Digested 2/21/2019

SB-1310-SD-1

Submitted on: 2/21/2019 3:54:19 PM

Testimony for WAM on 2/26/2019 10:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Jeff Gilbreath	Testifying for Hawaiian Community Assets	Support	No

Comments:

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SB-1310-SD-1

Submitted on: 2/26/2019 2:58:15 AM

Testimony for WAM on 2/26/2019 10:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Melodie Aduja	Testifying for O`ahu County Committee on Legislative Priorities of the Democratic Party of Hawai`i	Support	No

Comments: