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OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

TESTIMONY BY RODERICK K. BECKER
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE HOUSE COMMITTEE ON FINANCE
ON
SENATE BILL NO. 1310, S.D. 2, H.D. 1

March 28, 2019
2:00 p.m.
Room 308

RELATING TO INDIVIDUAL HOUSING ACCOUNTS

Senate Bill No. 1310, S.D. 2, H.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.



**STATE OF HAWAII
DEPARTMENT OF TAXATION**

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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Thursday, March 28, 2019
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 1310, S.D. 2, H.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. 2, H.D. 1, for your consideration.

S.B. 1310, S.D. 2, H.D. 1, establishes the Individual Housing Accounts Savings Program and Individual Housing Accounts Savings Board within the Department of Budget and Finance (B&F), and reinstates the deduction for contributions made to an Individual Housing Account under section 235-5.5, Hawaii Revised Statutes (HRS). H.D. 1 has a defective effective date of July 1, 2050. As it relates to tax, these provisions:

- Allow 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 to provide funding for purchase of a first principal residence, to provide assistance during economic hardships, for capital improvements for homeownership, for cemetery and mortuary services, or for 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; and
- Authorizes direct deposits into an individual housing account.

First, the Department notes that there are internal inconsistencies in this measure. Subsection (a) sets forth the allowable uses of the account as being “to provide funding for the purchase of the individual's first principal residence, or to provide assistance during economic hardships, for capital improvements for homeownership, cemetery and mortuary services, or senior housing”. Subsection (b) on the other hand provides a tax deduction for contributions made to an account when used for “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.” It is not clear how the funding for homeownership differs between the two subsections. For subsection (a), withdrawals made within 365 days of the contribution causes the deduction for the contribution to be lost, as well as causing the imposition of a ten percent penalty. Under subsection (b), withdrawals within 24 months of the contribution causes the deduction to be lost, although there is no penalty. Subsection (b) also provides that interest on the account is not includible in the gross income of the taxpayer.

Second, subsection (b) in part requires that a taxpayer receiving a qualified distribution report an unstated amount 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 when used to purchase a home is taken into income ratably over a ten year period, starting with the year of distribution. It is not clear if this provision only applies to the purchase of a home under subsection (a), subsection (a) and (b), or for any distribution for any qualified purpose, such as providing assistance during economic hardships.

Third, subsection (c)(4) requires that the entirety of the account must be distributed within 10 years of the first contribution to the account. This conflicts with subsection (j), which allows a contributions on behalf of a dependent child (whose account may be opened at birth) until the child reaches an unstated age. The Department suggests subsection (c)(4) be written as follows:

(4) The entire interest of an individual or married couple for whose benefit the trust is maintained shall be distributed to the individual or couple no later than one hundred twenty months after the date on which the first contribution is made to the trust, provided that an account opened for a dependent child under subsection (j) shall be distributed to the child not later than the child attaining ____ years of age.

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, an authorized use of the account is for “capital improvements for home ownership”, which is not defined. The Department suggests clearly defining “capital improvement for home ownership,” so that there is no ambiguity regarding the new allowable uses of the distributions that are proposed by this measure.

Finally, if a non-defective date is inserted, the Department respectfully 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.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: INCOME, Individual Housing Accounts

BILL NUMBER: SB 1310, HD-1

INTRODUCED BY: House 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.

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.

Adds a new subsection 235-5.5(j) 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.

Makes other technical and conforming changes.

EFFECTIVE DATE: January 1, 2050.

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 provides for different kinds of IHA benefits.

- (1) Under new subsection (b), interest paid or accrued in an IHA is not included in gross income.
- (2) Under subsection (b), if the individual makes a withdrawal for use 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.
- (3) Under subsection (d), if the individual makes a withdrawal for use exclusively in connection with the purchase of the first principal residence in Hawaii, to provide assistance during economic hardships, for capital improvement for homeownership, cemetery and mortuary services, or senior housing, the bill apparently allows exclusion from gross income altogether.
- (4) Under subsection (g)(2), if the individual makes a withdrawal to purchase residential property in Hawaii, the bill requires the amount of the withdrawal to be included in the individual's gross income ratably over 10 years.

Note that (2), (3), and (4) overlap, so it is unclear what rules are to apply.

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Testimony to the House Committee on Finance
Thursday, March 28, 2019
Hawaii State Capitol, Room 308

LATE

Comments on SB 1310, Relating to Individual Housing Accounts

To: The Honorable Sylvia Luke, Chair
The Honorable Ty Cullen, Vice-Chair
Members of the Committee

My name is Stefanie Sakamoto, and I am testifying on behalf of the Hawaii Credit Union League, the local trade association for 51 Hawaii credit unions, representing over 800,000 credit union members across the state. We offer the following comments on SB 1310, Relating to Individual Housing Accounts.

While we understand and appreciate the intent of this bill, there are unanswered questions as to the administration of this concept. Opening the account would not be the issue; the question would be who would have the responsibility of “policing” the account if/when the funds are withdrawn. There would have to be safeguards or specific “triggers” in place to ensure that the funds from an IHA are not spent in an unauthorized manner. Further, it is unclear how the funds would need to be treated when applying them towards a mortgage loan. We would suggest that amendments be made to reduce the burden on the “trustees”, which would be the financial institutions holding the accounts.

Further, we have concerns regarding the employee “opt-out” section of the bill. Because this program would only be available to those who qualify, it would make more sense for the program to be “opt-in”.

Thank you for the opportunity to provide comments.