

DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR



ISAAC W. CHOY
DIRECTOR OF TAXATION

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

To: The Honorable Stanley Chang, Chair;
The Honorable Dru Mamo Kanuha, Vice Chair;
and Members of the Senate Committee on Housing

From: Isaac W. Choy, Director
Department of Taxation

Date: Tuesday, February 15, 2022
Time: 1:00 P.M.
Place: Via Video Conference, State Capitol

Re: S.B. 2255, Relating to the Mortgage Interest Deduction

The Department of Taxation (Department) offers the following comments regarding S.B. 2255 for your consideration.

S.B. 2255 eliminates the home mortgage interest deduction for second homes by decoupling to the Internal Revenue Code sections 163(h)(4)(A)(i)(II) and 163(h)(4)(A)(ii)(II). S.B. 2255 also directs the revenue gains from the elimination of home mortgage interest deduction for second homes into the rental housing revolving fund (RHRF). The bill is effective upon its approval and applies to taxable years beginning after December 31, 2021.

The Department is able to implement the elimination of the home mortgage interest deduction for second homes for taxable years beginning after December 31, 2021. However, as a matter of policy, specific individual taxpayers' information should not be used to direct tax revenues to any specific funds. If the Legislature wishes to direct additional tax revenues to the RHRF, the Department suggests that it be done via appropriation of a specific amount from the general fund to the RHRF.

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

DAVID Y. IGE
GOVERNOR



CRAIG K. HIRAI
DIRECTOR

GLORIA CHANG
DEPUTY DIRECTOR

EMPLOYEES' RETIREMENT SYSTEM
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
P.O. BOX 150
HONOLULU, HAWAII 96810-0150

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

WRITTEN ONLY
TESTIMONY BY CRAIG K. HIRAI
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE SENATE COMMITTEE ON HOUSING
ON
SENATE BILL NO. 2255

February 15, 2022
1:00 p.m.
Room 225 and Videoconference

RELATING TO THE MORTGAGE INTEREST DEDUCTION

The Department of Budget and Finance (B&F) offers comments on this bill.

Senate Bill No. 2255 amends Section 235-2.4, HRS, to eliminate the mortgage interest housing deduction for second homes under State income tax law; and requires the Department of Taxation to annually calculate the amount of revenue gained in the previous taxable year by eliminating the deduction and to transmit an equivalent amount of income taxes to the Director of Finance for deposit into the Rental Housing Revolving Fund.

As a matter of general policy, B&F does not support the earmarking of the two major sources of general fund tax revenues for any specific purpose. With limited general fund revenues, the State must first pay such legal obligations as public employee pensions and health fund benefits, debt service on borrowed funds for facilities repair and maintenance, and provide for basic health and human services to those in need. Earmarking of the two major sources of general funds is not sound fiscal policy and will negatively impact the Administration's and Legislature's ability to fund other priorities and make adjustments in program funding when faced with economic downturns.

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, Disallows Home Mortgage Interest Deduction for Second Homes

BILL NUMBER: SB 2255

INTRODUCED BY: CHANG, RHOADS, Kidani, Moriwaki

EXECUTIVE SUMMARY: Eliminates the home mortgage interest deduction for second homes under Hawaii income tax law.

SYNOPSIS: Amends section 235-2.4, HRS, to eliminate the home mortgage interest deduction for second homes for Hawaii income tax purposes.

Requires the director of taxation to calculate the revenue gain from this provision and pay it to the rental housing revolving fund (section 201H-22, HRS).

EFFECTIVE DATE: Applies to taxable years beginning after December 31, 2021.

STAFF COMMENTS: Section 235-3(a), HRS, explains that it is the intent of the Income Tax Law, “in addition to the essential purpose of raising revenue, to conform the income tax law of the State as closely as may be with the Internal Revenue Code in order to simplify the filing of returns and minimize the taxpayer's burdens in complying with the income tax law. The rules and regulations, forms and procedures adopted and established under this chapter shall conform as nearly as possible, and unless there is good reason to the contrary, to the rules and regulations, forms and procedures adopted and established under the Internal Revenue Code.”

This bill proposes to decouple from the Internal Revenue Code in disallowing a deduction allowable for federal purposes. The issue before this body is whether the incremental revenue raised by doing so justifies the added compliance costs and complexity.

As an example of this complexity, consider that Hawaii requires certain deduction limits including the so-called Pease limitation in IRC section 68. (The section 68 limitations operate for federal purposes, but at different thresholds; the State thresholds are those that were used by the IRS in calendar year 2009.) IRC section 68 reduces itemized deductions by 3% of the excess of the taxpayer's AGI over the threshold, up to 80% of the amount of itemized deductions otherwise allowable. For Hawaii income tax purposes, HRS section 235-2.4(c) provides that the threshold is \$166,800 for all taxpayers except married taxpayers filing separately, for which it is \$83,400. For higher income taxpayers, against whom this provision is probably directed, the Pease limitation will be considerable. Such taxpayers will probably claiming other itemized deductions as well, so there will be issues arising as to which deductions were limited by the Pease provision and to what extent. Further, it is highly uncertain whether there would be significant revenue gain from this provision because the mortgage interest deduction may be reduced or denied because of the Pease limitation.

Digested 2/12/2022

February 15, 2022

The Honorable Stanley Chang, Chair

Senate Committee on Housing

Via Videoconference

RE: S.B. 2255, Relating to the Mortgage Interest Deduction

HEARING: Tuesday, February 15, 2022, at 1:00 p.m.

Aloha Chair Chang, Vice Chair Kanuha, and Members of the Committee,

I am Ken Hiraki, Director of Government Affairs, testifying on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its over 10,000 members. HAR **opposes** Senate Bill 2255, which eliminates the mortgage interest deduction for second homes under Hawai'i income tax law. Requires the Department of Taxation to calculate the savings and transfer an equivalent amount of income taxes to the Director of Finance for deposit into the Rental Housing Revolving Fund.

The Mortgage Interest Deduction (MID) on state and federal income taxes was introduced along with the income tax itself in 1913. The MID allows homeowners who itemize deductions on their taxes to deduct mortgage interest attributable to primary residence and second-home debt, and interest paid on home equity debt.

The Mortgage Interest Deduction encourages the American Dream of homeownership and gives people financial security through homeownership. The deduction helps home purchasers make their mortgage payments more affordable and is vital to the health and stability of housing markets.

In today's real estate environment, more homeowners are purchasing a second home for their elderly parents or their adult children who cannot otherwise afford to pay for a home.

HAR believes that the MID for second homes is an important opportunity for individuals to use to invest for retirement or to support their families with Hawai'i's high cost of living and housing.

Mahalo for the opportunity to testify.