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GOVERNOR

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

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DEPARTMENT OF BUDGET AND FINANCE
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BUDGET, PROGRAM PLANNING AND MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT

<u>WRITTEN ONLY</u>
TESTIMONY BY LUIS P. SALAVERIA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON
SENATE BILL NO. 142

February 27, 2023
10:35 a.m.
Room 211 and Videoconference

RELATING TO THE MORTGAGE INTEREST DEDUCTION

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

Senate Bill No. 142 proposes to eliminate the home mortgage interest deduction for second homes for individual income tax purposes. It also requires the Department of Taxation (TAX) to calculate annually the revenue gain from elimination of the deduction and report this information to B&F. B&F, in turn, is required to submit a report on administration of the Act to the Legislature for the 2024 through 2028 regular sessions.

B&F believes that it would be much simpler to amend the bill and have TAX submit a report on the revenue gain from elimination of the deduction directly to the Legislature for the required period.

Thank you for your consideration of our comments.

JOSH GREEN M.D.
GOVERNOR

SYLVIA LUKE
LT. GOVERNOR

GARY S. SUGANUMA
DIRECTOR

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TESTIMONY OF
GARY S. SUGANUMA, DIRECTOR OF TAXATION

TESTIMONY ON THE FOLLOWING MEASURE:
S.B. No. 142, Relating to the Mortgage Interest Deduction

BEFORE THE:
Senate Committee on Ways and Means

DATE:	Monday, February 27, 2023
TIME:	10:35 a.m.
LOCATION:	State Capitol, Room 211

Chair Dela Cruz, Vice-Chair Keith-Agaran, and Members of the Committee:

The Department of Taxation ("Department") offers the following comments regarding S.B. 142 for your consideration.

S.B. 142 seeks to eliminate the home mortgage deduction for second homes by amending section 235-2.4, Hawaii Revised Statutes, to exempt Hawaii from conforming to Internal Revenue Code (IRC) sections 163(h)(4)(A)(i)(II) and 163(h)(4)(A)(ii)(II). Section 3 of the bill requires the Department to calculate the revenue gained during the previous taxable year by making IRC sections 163(h)(4)(A)(i)(II) and 163(h)(4)(A)(ii)(II) non-operative, and report the amounts to the Director of Finance by September 1 of each year. Section 4 of the bill requires the Department of Budget and Finance, in consultation with the Department of Taxation, to submit a report to the Legislature no later than 20 days prior to the convening of the 2024, 2025, 2026, and 2027 regular sessions.

This measure is effective upon approval and applies to taxable years beginning after December 31, 2022.

The Department notes that it would not be able to calculate the amount of revenue gained during the previous taxable year as a result of making IRC sections 163(h)(4)(A)(i)(II) and 163(h)(4)(A)(ii)(II) non-operative, as doing so would require the calculation of alternative tax liabilities for each taxpayer. The Department therefore requests that sections 3 and 4 of the bill be deleted.

The Department estimates an expected revenue gain to the general fund as follows ($ millions):

FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
11.7	12.3	12.8	13.3	13.9	14.5

Finally, the Department notes that it is able to implement section 2 of this measure by the current effective date.

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

SUBJECT: INCOME, Disallows Home Mortgage Interest Deduction for Second Homes

BILL NUMBER: SB 142

INTRODUCED BY: CHANG, AQUINO, MCKELVEY, RHOADS, Kidani, Wakai

EXECUTIVE SUMMARY: Eliminates the mortgage interest deduction for second homes under Hawaiʻi income tax law. Requires the Department of Taxation to calculate the savings and report the revenue gained to the Director of Finance by September 1 of each year.

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

Requires the Department of Taxation to calculate the revenue gain annually and report to the Department of Budget & Finance. Annual reports are due to the Legislature before the sessions in 2024 through 2027.

EFFECTIVE DATE: Taxable years beginning after December 31, 2022.

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 be 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: 2/23/2023

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February 27, 2023

The Honorable Donovan Dela Cruz, Chair
Senate Committee on Ways and Means
State Capitol, Conference Room 211 & Videoconference

RE: Senate Bill 142, SD1, Relating to Taxation

HEARING: Monday, February 27, 2023, at 10:35 a.m.

Aloha Chair Dela Cruz, Vice Chair Keith-Agran, and Members of the Committee:

My name is Lyndsey Garcia, Director of Advocacy, testifying on behalf of the Hawaiʻi Association of REALTORS® ("HAR"), the voice of real estate in Hawaiʻi and its over 11,000 members. HAR strongly **opposes** Senate Bill 142, which eliminates the mortgage interest deduction for second homes under Hawaii income tax law. Requires the Department of Taxation to calculate the savings and report the revenue gained to the Director of Finance by September 1 of each year.

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. For home mortgage interest, one can deduct interest paid on up to $750,000 of home mortgage debt (or $1 million of debt for mortgages taken out before December 16, 2017.)

The Mortgage Interest Deduction encourages the 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. As such, 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 Hawaii's high cost of living and housing.

Additionally, it is uncertain whether there would be a significant revenue gain from this measure and it may not be worth the complexity and uncertainty to decouple the mortgage interest deduction for second homes in Hawaiʻi from the Internal Revenue Code.

For the foregoing reasons, Hawaiʻi Association of REALTORS® strongly opposes this measure. Mahalo for the opportunity to testify.

SB-142
Submitted on: 2/25/2023 4:09:22 PM
Testimony for WAM on 2/27/2023 10:35:00 AM

Submitted By	Organization	Testifier Position	Testify
Will Caron	Individual	Support	Written Testimony Only

Comments:

If folks have the resources to buy second and third homes, they can go ahead and do that. But it doesn't make sense—in the middle of a housing crisis that requires public resources to address—for the state to be subsidizing second-home mortgages. That's tax revenue that needs to be going toward investments in affordable housing development and rent relief subsidies instead, as well as expansion of houseless services. Please pass SB142.