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TESTIMONY OF
GARY S. SUGANUMA, DIRECTOR OF TAXATION

TESTIMONY ON THE FOLLOWING MEASURE:
S.B. No. 597, Relating to Taxation

BEFORE THE:
Senate Committee on Labor and Technology

DATE: Monday, January 30, 2023
TIME: 3:00 p.m.
LOCATION: State Capitol, Room 224 & Videoconference

Chair Moriwaki, Vice-Chair Lee, and Members of the Committee:

The Department of Taxation ("Department") offers the following comments regarding S.B. 597 for your consideration.

S.B. 597 excludes from State taxable income amounts received from deferred compensation retirement plans, including individual retirement accounts, and those established under section 401(k) or 403 (b) of the Internal Revenue Code, or any other retirement plan that defers compensation for taxpayers who meet certain income requirements based upon federal Adjusted Gross Income (AGI). The measure applies to taxable years beginning after December 31, 2022.

The Department notes that employee contributions to a deferred compensation retirement plan are structured so that the earnings are excluded from the employee's taxable wages, grow tax-free, and the taxes are then paid upon eventual distribution from the fund. The general notion is that the income is taxed either when earned as a wage or upon distribution. In the alternative, under the State's hybrid retirement plan, employees pay Hawaiʻi income tax on the amounts contributed to their retirement plan each year and, upon retirement, they will receive distributions from the plan tax-free. The initial taxation is to compensate for the fact that the distribution will be received tax-free.

The Department further notes that due to the number of bills with tax law changes that have been introduced this year, the Department may not have the resources to implement all measures passed this session in time for tax year 2023. The Department will continue to monitor the status of proposed legislation and will advise whether some changes will require a later effective date.

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

TAX FOUNDATION OF HAWAII

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SUBJECT: INCOME, Exclude deferred compensation retirement plan income for taxpayers earning less than $30,000 single / $60,000 joint.

BILL NUMBER: SB 597

INTRODUCED BY: DELA CRUZ, AQUINO, CHANG, INOUYE, KANUHA, LEE, MCKELVEY, Ihara, Kidani, Moriwaki

EXECUTIVE SUMMARY: For lower income individuals, excludes income received from deferred compensation plans including IRAs, 401(k), and 403(b) plans.

SYNOPSIS: Amends section 235-7, HRS, to add a new exclusion for compensation received from deferred compensation retirement plans, including individual retirement accounts, and those established under section 401(k) or 403(b) of the Internal Revenue Code, or any other retirement plan that defers compensation. The exclusion is only effective for individuals whose federal AGI is less than $30,000 for single or married filing separately; $45,000 for head of household; or $60,000 for married filing jointly.

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

STAFF COMMENTS: Section 235-7(a)(3), HRS, already provides an exclusion from income tax for income received as a "pension for past services." Current regulations under that section provide that the exclusion does not apply to "elective deferrals" such as are found in individual retirement accounts (IRAs), 401(k) plans, 403(b) plans, and similar. The rationale was that the individual was able to make a choice to contribute to a retirement plan and thereby escape current taxation of those contributed earnings, but understood that the price for that was taxation of those earnings when the individual received them from the plan.

The preamble to the current version of the bill complains of inequity in the taxation of retirement income while many seniors in Hawaii are struggling to make ends meet. If, however, the problem is that we want to be sympathetic to those with lower incomes, a better way to respond is with lower rates or more equitable tax brackets, not with brackets dating back to the 1960s that are so narrow that a family of four earning the federal poverty line amount of $34,500 is thrust into the *fifth* bracket from the bottom.

We question why this tax relief is proposed only for those drawing income from retirement plans. Why should families of similar size and income level that are also struggling to make ends meet not be qualified for relief? If the answer is that the latter families are in the workforce and are thereby eligible for other credits such as the earned income tax credit (EITC), then we suggest that better outcomes can be achieved by broad-based bracket and rate relief, as opposed to adding to the complexity of the tax code by enacting yet another credit that is directed at lower income taxpayers.

Digested: 1/26/2023

SB-597
Submitted on: 1/27/2023 9:57:25 AM
Testimony for LBT on 1/30/2023 3:00:00 PM

Submitted By	Organization	Testifier Position	Testify
Ilima DeCosta	Individual	Support	Written Testimony Only

Comments:

27 January 2023

Committee on Labor and Technology

Chair Moriwaki, Vice Chair Lee

Re: Testimony Supporting SB597 Relating to Taxation

Mahalo for the opportunity to testify in strong SUPPORT of SB597, Relating to Taxation.

The cost of living in Hawaii is sharply rising and wages are not keeping pace.

In 2010, I was experiencing domestic violence as a result of a second marriage to my spouse – an active duty, high ranking Coastguardsman - and I decided to file for divorce to end his abuse against me.

Unfortunately, because the Hawaii family court system appears antagonistic toward abused women who want to obtain a divorce and also recoup our pre-marital assets, I was exposed to years of added financial abuse, as I was forced to chase my divorce settlement award through the Hawaii family court system.

Following my divorce settlement in September of 2011, I had to file fraud charges against my own attorney – one of whom is now a sitting Judge – as the document drafted by my ex-spouse's counsel (and approved by my former counsel and the Judge) was not properly drafted.

This "legal techincality" caused my request for a distribution to be denied by the Thrift Savings Administration for several years.

It was not until after a successful result in my fraud claims against my former counsel (2014) that I was then able to convince another Judge (since the original Judge appears to have been complicit with the financial abuse and fraud against me) to correct the errors in the original settlement document.

In September 2015 I was finally able to file a successful claim for distribution with the Thrift Savings Administration.

Since the settlement was being distributed from my ex-spouse's TSP, and because those monies were my ex-spouse's tax deferred income and the original family court Judge assessed the divorce award as "income", I was held statutorily liable for deferred taxes on behalf of my ex-spouse.

This meant that my divorce award – which had already been reduced to ~70% of my pre-marital assets – was further reduced to ~25% of my pre-marital assets due to my ex-spouse's tax liabilities.

Not much of a recoupment, especially considering my ex-spouse earned ~$125,000 in 2015, compared to my ~$30,000. It does make me wonder why I was the one the Judge decided to saddle with the tax liabilities.

It wasn't October 2015 that I was able to finally obtain the financial proceeds of my divorce award.

Because the (reduced) payout came a week before I was assaulted by a homeless person - and because the award came a few weeks before my daughter was found dead due to a single gun shot to the back of her head – I was not in a state of mind to handle my financial affairs (I wasn't managing my mail) and I failed to notice that I had to include my divorce settlement as income.

After my 2011 divorce, the 2015 assault against me, and the 2015 death of my daughter, I lived in at least eight different locations, including Alaska and Hawaii Island, and experienced periods of homelessness.

Ultimately, because the *State of Hawaii Department of Taxation is statutorily allowed to use a taxpayers last known tax filing address and the Department IS NOT required to engage in greater due diligence in locating errant tax payers,* I did not receive notice of my tax liability in time to appeal the ruling and I am being held liable for the original ~$5000 in state taxes (based on a $38,000 divorce award), as well as the taxes and fees incurred.

Had the following provisions been in place in 2015 – when I was experiencing extreme crisis - the following passage in the proposed legislation would have helped me to avoid financial devastation through no fault of my own.

It's not too late to make things right and to help other Hawaii residents to avoid unnecessary financial crisis, just because we may experience domestic violence or lose a loved one to gun violence.

"Compensation received from deferred compensation retirement plans, including individual retirement accounts, and those established under section 401(k) or 403(b) of the Internal Revenue Code, or any other retirement plan that defers compensation; provided that this paragraph shall apply only to individuals whose federal adjusted gross income is less than: (A) $30,000 for a taxpayer filing a single return or a married person filing separately."