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LATE TESTIMONY

HOUSE COMMITTEE ON LABOR & PUBLIC EMPLOYMENT
TESTIMONY REGARDING HB 2348
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 8, 2008
TIME: 8:30AM
ROOM: 309

This legislation amends Hawaii's Internal Revenue Code (Code or IRC) conformity provision to "decouple" from the Code for purposes of the tax-free treatment of deferred compensation rollovers used to purchase certain retirement service credit.

The Department of Taxation (Department) provides **comments** on this measure.

I. THIS LEGISLATION CLARIFIES THAT ALL WITHDRAWALS OF ERS RETIREMENT PLANS WILL BE STATE TAX FREE.

Currently, only ERS pensions and "traditional" employer-funded pension arrangements are state tax-free. Any retirement earnings or withdrawals made that relate to any employee-funded deposits will be taxed because the government or the employer did not make these deposits.

Under recent amendments to the IRC, the Code now specifically allows for the federal tax-free treatment of rolledover deferred compensation for purposes of purchasing service credit for certain retirement plans, including the State's hybrid plan. The State's hybrid plan includes both government and employee matching contributions—thus a "hybrid" plan. The issue that arises for administration purposes is that under Hawaii's income tax law, any amount contributed by the employee to a retirement plan will not be considered tax-free because only the government or employer contributions are tax-free. This results in an extremely complicated ratio factoring that must be done in order to trace the gains from employer/tax-free contributions and employee/taxable contributions.

It is an important tax policy concept to understand that the government seeks to tax transactions only once and to provide a tax benefit only once. For example, it is common where a cost is deductible by one taxpayer for making the expenditure; that revenue is taxable to another receiving the money. This parity is fundamental to Hawaii tax law. As applied to the retirement income situation, if revenues are taxed prior to being deposited into a tax-advantaged account, it is acceptable policy then to allow for distributions to be tax free when taken out of the account (such as an IRA). Vice versa, it is also applicable in the instance where a tax benefit is received up front and then taxed upon distribution (401(k)).

This legislation amends Hawaii's conformity to new IRC provisions that make purchase of service credits for retirement plans tax-free. If such contributions for purposes of obtaining service credits are taxable, then under Hawaii tax law, the amounts will be tax free upon withdrawal. If this amendment is not made, then any service credit purchased under Hawaii law will be taxable upon distribution because it is not an employer contribution, but a taxable employee contribution.

In short, this bill ensures that all distributions from an ERS plan are tax-free. This ensures consistency in state-administered plans, as well as ease for plan managers.

II. REVENUE ESTIMATE

This legislation will result in an indeterminate revenue impact.

HAWAII GOVERNMENT EMPLOYEES ASSOCIATION
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The Twenty-Fourth Legislature, State of Hawaii
Hawaii State House of Representatives
Committee on Labor and Public Employment

Testimony by
Hawaii Government Employees Association
February 8, 2008

H.B. 2348 – RELATING TO TAXATION

The Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO strongly opposes H.B. 2348. This bill imposes state income tax on rollovers made by state and county employees from qualifying deferred compensation plans to eligible state and county retirement plans.

State and county employees who make careers of public service use the rollover of deferred compensation plans to bolster modest pension benefits. The passage of this bill will penalize employees who have chosen to use deferred compensation plans to save additional monies for retirement. We believe government should be encouraging workers to save rather than penalizing them at a time when they need the income.

Thank you for the opportunity to testify in opposition of this measure.

Respectfully submitted,

LATE TESTIMONY

Nora A. Nomura
Deputy Executive Director