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HOUSE COMMITTEE ON FINANCE
TESTIMONY REGARDING HB 2285
RELATING TO ESTATE & TRANSFER TAX

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 10, 2010
TIME: 3PM
ROOM: 308

This measure amends Chapter 236D, the Estate & Transfer Tax, to "pick up" the estate tax contained in the Internal Revenue Code as it existed on December 31, 2000.

The Department of Taxation (Department) **opposes** this measure as a tax increase.

CURRENT ESTATE TAX IS DORMANT—When Congress passed the Economic Growth & Tax Relief Reconciliation Act of 2001, Hawaii's estate and transfer tax under Chapter 236D effectively went "dormant" when the credit for state estate taxes paid was phased out into a deduction. Hawaii's estate tax was equal to the federal credit. Where the credit was repealed in favor of a deduction, the Hawaii estate tax ceased.

This measure effectively resurrects the Estate & Transfer Tax as of December 31, 2000.

OPPOSED TO AN UNWARRANTED TAX INCREASE—The Department opposes this measure as a tax increase. The Department cannot support a tax increase of this type. This measure has a very punitive effect on even the middle class in Hawaii because it resurrects the estate tax at 2001 levels, which means a person dying in Hawaii with an estate of more than $675,000 will be subject to the estate tax. A person in Hawaii with a retirement fund, with life insurance, who owns a home would be subject to estate tax in Hawaii. Certainly almost all small business owners will be subject to this tax.

PRE-2001 LEVELS ARE UNREASLISTIC FOR HAWAII—If the Committee continues with a discussion of this measure, the Department recommends at least considering tax rates and taxable estates that are reasonable. For example, if the most recent amounts for federal estate tax estates were used, it will only tax estates in excess of $3,500,000—a much more reasonable number than $675,000. Any discussion of a Hawaii estate tax should have reasonable amounts to conform to the inherently high value of Hawaii land and other values.

L E G I S L A T I V E

TAXBILLSERVICE

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SUBJECT: INHERITANCE AND ESTATE, Preserve state credits

BILL NUMBER: HB 2285

INTRODUCED BY: B. Oshiro, Chong, M. Oshiro and Say

BRIEF SUMMARY: Amends HRS section 236D-2 by amending the definition of "federal credit" to provide that for a generation-skipping transfer the maximum amount of credit for state taxes allowed by IRC section 2604 shall be as it existed on December 31, 2000.

Amends the definition of "gross estate" to mean gross estate as defined and used in IRC sections 2031 to 2046.

Amends the definition of IRC section 2011 to provide that it shall mean IRC section 2011 as it existed on December 31, 2000.

Amends the definition of "taxable estate" to provide that it shall mean taxable estate as defined in IRC sections 2051 to 2057 and section 2058, with respect to estates of decedents dying and generation-skipping transfers after December 31, 2004.

Makes conforming amendments to the definitions of "generation-skipping transfer," "personal representative" and "transfer." Also updates the definition of "Internal Revenue Code."

This act shall be applicable to property or interests that pass from any individual who dies after December 31, 2009 and to generation-skipping transfers after December 31, 2009.

This act shall be repealed on December 31, 2010 provided that HRS section 236D-2 shall be reenacted in the form in which it read prior to the day before the effective date of this act.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: The proposed measure would preserve the credit for state death taxes paid, allowed under the federal estate tax. With the adoption of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) the federal estate tax is phased out and ultimately repealed over a ten-year period. Along with that repeal, the credit that is allowable under the federal law recognizing that an estate may have incurred state death taxes is phased out over a three-year period beginning in 2002. Hawaii, like many other states, has utilized this amount as its state death tax since 1983 and is known as the "pick up" tax as the state merely picks up what the federal table allows as state death taxes.

The pick up tax was created in 1924 when Congress provided a credit against the federal estate tax which had been created in 1916 in recognition of the estate having been required to pay death taxes to the state. This dollar-for-dollar credit against state taxes paid enables the state to "pick up" some of the federal tax liability without increasing the total liability of the state. Thus, when the state chose to eliminate its old inheritance tax in favor of the pick up tax in 1983, it eliminated any additional state tax liability for the estate and made its tax revenues from this source completely dependent on the federal law. One of the pluses to utilizing the pick up tax is that it eliminated any additional paperwork that a separate state death tax would involve.

However, now that the federal law will phase out and has eliminated the state death tax credit which is the basis for the "pick up" tax, Hawaii has lost a small, but important, source of revenue. This measure proposes to preserve the state death tax credit or pick up tax as it stood on December 31, 2000 prior to the adoption of EGTRRA.

While some may decry the fact that this is a tax that would otherwise have been eliminated, one can only argue that point if one assumes that the state must follow federal tax policy. If lawmakers believe that the state policy should continue to tax the transfer of assets from a decedent's estate to beneficiaries, then they must de-couple it from the federal law but retain the ease of administration and compliance by freezing the federal provision. However, since the credit has already been eliminated, reinstatement of the "pick up" tax to 100% of the state death tax credit to what it was prior to EGTRRA would amount to a tax increase in the eyes of beneficiaries of the decedent. In that sense, this would be a difficult measure to adopt.

Lawmakers should exercise care in adopting this proposal noting that it would be operative only for calendar year 2010 for persons dying on January 1, 2010 but before January 1, 2011. Inasmuch as this measure, if approved, would become law sometime during mid-year, one would have to ask whether it was fair to those who died this year, but before enactment, to be subject to the tax. Further, it should be noted that under the federal law, the estate tax exemption is not operative for this year and technically there are no estate tax rates. Thus, instead of an estate adjusted for federal tax purposes by the federal estate tax exemption which stood at $3.5 million through calendar year 2009, the estate of a Hawaii resident would be calculated without the benefit of the first $3.5 million being exempt. Thus, the state tax credit would be calculated on the basis that all of the decedent's estate was subject to tax beginning with dollar one. While the absence of the federal estate tax rates has little impact, the absence of the federal estate tax exemption will have a significant impact on trying to figure out what the federal credit for state death taxes paid and will have a significant impact on Hawaii residents.

Digested 2/9/10

HAWAII GOVERNMENT EMPLOYEES ASSOCIATION
AFSCME Local 152, AFL-CIO

AFSCME
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The Twenty-Fifth Legislature, State of Hawaii
Hawaii State House of Representatives
Committee on Finance

Testimony by
Hawaii Government Employees Association
February 10, 2010

H.B. 2285 – RELATING TO THE
ESTATE AND TRANSFER TAX

The Hawaii Government Employees' Association, AFSCME Local 152, AFL-CIO supports the purpose and intent of H.B. 2285 – Relating To The Estate and Transfer Tax. This bill proposes to restore the state estate tax that was eliminated by federal tax laws. The estate tax does more than raise revenue. It also helps reduce concentrations of power and promotes equality of economic opportunity.

A tax at the federal level that gets all its revenues from the wealthiest 1.2%, and over 60% of its revenues from the wealthiest 0.1%, is very progressive. Progressivity allows most people to pay less because those with the highest incomes pay more. It is worth noting that the bulk of the largest wealth accumulations have never been touched by the income tax because they are mainly unrealized capital gains. Without the estate tax, those gains would remain untaxed forever since the income tax forgives those deferred taxes at death.

Reinstating the estate tax at the state level will generate an estimated $10-20 million per year. Given the extent of the state's projected budget deficit, we must consider ways to generate additional revenues to the state.

Thank you for the opportunity to testify in support of H.B. 2285.

Respectfully submitted,

N.A. Nomura

Nora A. Nomura
Deputy Executive Director