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**HOUSE COMMITTEE ON FINANCE
TESTIMONY REGARDING HB 2869
RELATING TO TAX DEDUCTIONS**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: FEBRUARY 10, 2010

TIME: 3PM

ROOM: 308

This measure seeks to expressly conform to Section 68 of the Internal Revenue Code, relating to overall limitations on deductions, and modifies the caps contained therein for Hawaii tax purposes.

The Department of Taxation (Department) **opposes this measure.**

PREFERENCE FOR STRAIGHT-UP CONFORMITY—The Department also prefers the current overall deduction limits contained in §68, IRC, to which Hawaii already conforms. Given Hawaii's high cost of living, the current \$100,000 phase-out for joint filers accurately reflects the high cost of living and the struggle Hawaii families experience to pay, for example, mortgage interest payments, to minimize the tax drain on their income. Itemized deductions include the medical expense deduction and the charitable contribution deduction. This cap would penalize taxpayers with large uninsured medical expense deduction limitations and also discourage people from making charitable contributions.

REVENUE IMPACT—The Department acknowledges that this measure increases revenue. However, the Legislature needs to be cautious as to whether this measure is the appropriate revenue raiser when Hawaii families are struggling and they depend upon their itemized deductions to pay their tax bills.

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SUBJECT: INCOME, Limit itemized tax deductions

BILL NUMBER: HB 2869

INTRODUCED BY: Say

BRIEF SUMMARY: Amends HRS section 235-2.4(a) to provide that IRC section 68 (with respect to the overall limitation on itemized tax deductions) shall be operative for Hawaii income tax purposes, except that from July 1, 2010 to December 31, 2015, the applicable amount in section 68(b)(1) shall be \$35,000 for a single filer, \$60,000 for a head of household filer, and \$70,000 for joint filers.

EFFECTIVE DATE: July 1, 2010; applicable to tax years beginning after December 31, 2009 and ending before January 1, 2016

STAFF COMMENTS: On the federal level, taxpayers with adjusted gross income above a certain amount may lose part of their deduction for personal exemptions and itemized deductions. The provision began in the early 1990's and is set to be repealed in 2010. The itemized deduction reduction initially called for a reduction of itemized deductions of 3% of the amount that a taxpayer's adjusted gross income (AGI) exceeds the threshold amount. The amount the taxpayer can claim as a deduction is reduced once AGI goes above a certain level for the taxpayer's filing status. The threshold is indexed annually for inflation and for 2009 the levels are: married filing joint/single - \$166,800; and married filing separately - \$83,400.

The adjusted gross income thresholds being proposed in this measure fail to recognize that in many cases some of the largest itemized deductions would necessitate income of greater than these proposed incomes. For example, a couple with adjusted gross income of \$70,000 probably could not qualify for a loan to purchase a house in Hawaii, thus those taxpayers who have mortgage interest deductions will probably be adversely impacted by the low thresholds.

The itemized deductions that would be limited include state and local income taxes, real property taxes, and depending on what the federal code sustains to some degree certain sales taxes. Mortgage interest payments, gifts to charity as well as job related and other miscellaneous expenses are also limited. Thus, the two largest deductions, especially here in Hawaii, would be the limitation on taxes and mortgage interest expenses. These are the most costly expenses for families in Hawaii where income taxes are already especially high and the cost of purchasing a home is substantial resulting in high mortgage interest payments.

While this measure proposes to temporarily adopt a similar limitation for Hawaii income tax purposes for a six-year period, it should be noted that while the federal provisions are indexed for inflation, there is no similar adjustment in the proposed measure and the limitations adopted by this measure may not be appropriate for taxpayers in the years leading up to the 12/31/15 expiration date.

Digested 2/9/10