NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1530
FAX NO: (808) 587-1584

To: The Honorable Mele Carroll, Chair
and Members of the House Committee on Human Services

Date: Tuesday, February 11, 2014
Time: 9:30 a.m.
Place: Conference Room 329, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. No. 2429, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of H.B. 2429 to increase the standard deduction and personal exemption, and provides the following comments.

H.B. 2429 increases the standard deduction for all filing statuses. The bill also increases the personal exemption amount; increases the number of personal exemptions allowed to a taxpayer over the age of 65, subject to certain adjusted gross income (AGI) limits; and becomes effective upon its approval, applying to taxable years beginning after December 31, 2014.

The Department notes that under current law, all taxpayers over the age of 65 already receive an additional personal exemption. The proposal to add AGI limits to the proposed additional personal exemptions will require extensive changes to the tax forms and instructions. Personal exemptions are independent of AGI, and therefore are listed and calculated before AGI is calculated on the form. Thus, the incorporation of AGI into the personal exemption would require a full rearrangement of the individual income tax forms. These changes would require a substantial commitment of resources which the Department does not currently have.

Additionally, the Department suggests clarifying the operation of subsections (a)(3) and (a)(4) under Section 3 of the bill. It is the Department's position that for any type of individual income tax benefit which uses a taxpayer's AGI for qualification, that the taxpayer's federal *and* Hawaii AGIs, be considered. Although AGI is not a good indicator of a taxpayer's financial status, considering both the taxpayer's federal and state AGI is a better measure than only considering either federal or Hawaii AGI alone.

The Department also recommends clarification regarding whether the additional personal exemption provided by subsection (a)(4) is in addition to the one provided by (a)(3). The Department suggests that subsections (a)(3) and (a)(4) be merged, with one federal and Hawaii AGI limit per filing status. The Committee may still provide more than one additional exemption for qualifying taxpayers under this amendment.

Thank you for the opportunity to provide comments.

SUBJECT: INCOME, Increase standard deduction, additional personal exemption

BILL NUMBER: HB 2429

INTRODUCED BY: Ichiyama, Aquino, Awana, Belatti, Brower, Cabanilla, Choy, Creagan, Cullen, Hashem, Ing, Ito, Jordan, Kawakami, Kobayashi, Lowen, Luke, Morikawa, Nakashima, Nishimoto, Ohno, Onishi, Say, Takayama, Tokioka, Yamane, Yamashita

BRIEF SUMMARY: Amends HRS section 235-2.4(a) to increase the standard deduction: (1) from $4,400 to $5,200 for taxpayers filing a joint return or a surviving spouse; (2) from $3,212 to $3,796 for taxpayers filing as a head of household; (3) from $2,200 to $2,600 for those filing as an unmarried individual; or (4) from $2,200 to $2,600 for taxpayers filing as a married individual filing a separate return.

Amends HRS section 235-54 to allow taxpayers age 65 and over to: (1) claim an additional exemption if *federal* adjusted gross income is less than: (A) $24,000 for a taxpayer filing a single return or a married person filing separately, (B) $36,000 for a taxpayer filing as a head of household, or (C) $48,000 for a taxpayer filing a joint return or as a surviving spouse; and (2) claim another additional exemption if *federal and state* adjusted gross income is less than: (A) $30,000 for a taxpayer filing a single return or a married person filing separately; (B) $45,000 for a taxpayer filing as a head of household, or (C) $60,000 for a taxpayer filing a joint return or as a surviving spouse.

Amends HRS section 235-54 to increase the personal exemption amount from $1,144 to $2,144.

EFFECTIVE DATE: Tax years beginning after December 31, 2014

STAFF COMMENTS: The legislature by Act 60, SLH 2009, provided for an increase in the standard deduction from $4,000 to $4,400 for joint returns or surviving spouses, from $2,920 to $3,212 for head of households; and from $2,000 to $2,200 for individuals or married taxpayers filing separately. Act 60 also provided for an increase in the personal exemption from $1,040 to $1,144. This measure would increase the standard deduction from $4,400 to $5,200 for joint returns or surviving spouses, from $3,212 to $3,796 for head of households; and from $2,200 to $2,600 for individuals or married taxpayers filing separately, and increase the personal exemption from $1,144 to $2,144.

In all, the increase in standard deduction and personal exemption amounts will result in an increase in the filing threshold (namely the income level below which the taxpayer won't need to file a return). Hawaii has one of the lowest filing thresholds in the United States, and having a higher filing threshold will result in considerable administrative cost savings. Why? Tax returns are complex documents. They are expensive to process. The more people are kicked off the tax system, the more savings will result.

The measure would also provide additional income tax relief to taxpayers age 65 and older if they meet certain income levels. Under current law, a taxpayer is able to receive one exemption for themselves and an additional exemption if they are over 65. As proposed, a taxpayer age 65 and older would be able to claim up to four exemptions if they are under the income thresholds in the measure. This system raises additional issues.

First, the income thresholds use different measures. The first additional exemption uses federal AGI thresholds. The second one uses "federal and state" AGI thresholds. Federal and state AGI are not identical, and could be very different for people receiving retirement income (under HRS section 235-7(a)(2) and (3), pension income may be exempt for state purposes but taxable for federal purposes). Was this intended, or a drafting error that needs to be fixed?

Second, these additional exemptions have the effect of adding complexity to the tax returns that our kupuna need to file. We suggest that they, on average, would not be in the best position to cope with increased complexity and may wind up failing to claim the benefits that this legislation would give them. And on the government side, additional administrative costs would be incurred as the department of taxation would need to reach out to educate the taxpaying public on their entitlement to these additional exemptions.

Third, what is so magic about age 65 that justifies four exemptions when other, younger people with similar income, and thus also struggling to make ends meet, would only be entitled to one exemption?

If it is desirable to grant additional relief to these taxpayers, then the more appropriate and simple approach is to raise the filing threshold and get them off the system. That would be a relief in more ways than one, as the people would not have to deal with the tax system and the tax department would not have to incur the processing and operational costs associated with those people. And if it is desirable to put more money in the hands of these taxpayers, and there is some concern that simply writing them a check would result in them spending the money on inappropriate things, a better solution may be to put the money into relief programs administered by state agencies that are used to dealing with low-income people and that are already equipped to channel the aid into some type of monitored benefit such as AFDC.

Digested 2/6/14

HPCA
HAWAI'I PRIMARY CARE ASSOCIATION

House Committee on Human Services
The Hon. Mele Carroll, Chair
The Hon. Betrand Kobayashi, Vice Chair

Testimony on House Bill 2429

<u>Relating to Human Services</u>
Submitted by Robert Hirokawa, Chief Executive Officer
February 11, 2014, 9:30 am, Room 329

The Hawaii Primary Care Association (HPCA), which represents the federally qualified community health centers in Hawaii, supports House Bill 2429, providing an income tax exemption for seniors.

The HPCA is a staunch believer in the social determinants of health, those economic and social conditions that influence an individual and a community's health status. These conditions serve as risk factors endemic to a person's living and working environment, rather than their behavioral or genetic histories. Factors such as income, education, access to recreation and healthy foods, housing, and employment, can and do have measurable impacts on a person and a community, both in health and financial outcomes.

Seventy-three percent of the patients seen by community health centers live below one hundred percent of the federal poverty limit. Eighty-Nine percent reside under two hundred percent of the federal poverty limit. This living situation has been shown to manifest in poorer health outcomes, often as a direct result the social determinants associated therein, such as lack of adequate housing or access to fresh produce. When coupled with health complications that arise with advancing age, the measures in this bill speak to a clear and certifiable need here in Hawaii.

For these reasons, the HPCA support this measure and thanks you for the opportunity to testify.