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To: The Honorable Mark M. Nakashima, Chair
and Members of the House Committee on Labor and Public Employment

Date: Friday, February 13, 2015
Time: 9:30 A.M.
Place: Conference Room 309, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 35, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of H.B. 35 and provides the following comments for your consideration.

H.B. 35 amends conformity to the Internal Revenue Code (IRC) to limit the deduction for employee benefits paid to a specific employee to fifty times the State's median household income. The effect of the bill is to disincentivize paying large salaries; the bill does not disallow paying large salaries. The limit applies to tax years beginning after December 31, 2015.

The Department has concerns regarding the deviation from conformity from the IRC this bill represents. Conformity to the IRC is critical to the administration of Hawaii's income tax. Taxpayers' federal tax attributes, including many deductions, are imported directly onto Hawaii's state income tax forms. For each and every deviation from the IRC, the Department must instruct taxpayers to adjust their federal tax attributes when preparing their Hawaii income tax returns. This makes the income tax more difficult to comply with and more difficult to administer.

The Department also has concerns regarding the measurement of the deduction limit based on "median household income" which is not defined. If the proposed limit is based on a specific data that is published each year, the Department requests more specificity as to which data is to be used. This clarification is important because Department must recalculate and incorporate the new limits into its forms each year. If the Committee wishes to adopt this measure, the Department recommends that a fixed dollar limit be stated in the law.

The Department also notes that "employee benefits" is not defined. The Department suggests using the term "applicable employee remuneration" as defined in section 162(m)(4) of the Internal Revenue Code, rather than employee benefits.

Thank you for the opportunity to provide comments.

SUBJECT: INCOME, Limit on employer provided benefits

BILL NUMBER: SB 780; HB 35 (Identical)

INTRODUCED BY: SB by Shimabukuro and 2 Democrats; HB by Rhoads

BRIEF SUMMARY: Amends HRS section 235-2.4 to add a new paragraph (h) to provide that Section 162 (with respect to trade or business expenses) of the Internal Revenue Code shall be operative for Hawaii, except that, for taxable years beginning after December 31, 2015, no deduction shall be allowed for the provision of employee benefits if the value of such benefits exceeds an amount calculated by multiplying the state's median household income for the taxable year by fifty.

EFFECTIVE DATE: Tax years beginning after December 31, 2015

STAFF COMMENTS: This measure would disallow a business expense deduction for the provision of employee benefits if the value of such benefits exceeds 50 times the state's median household income for the taxable year. In 2013, the median household income for Hawaii was $68,020 according to the most recent U.S. Census (2014 numbers will be released in September 2015), so the measure would disallow the deduction to the extent that the value of employee benefits exceeds $3.4 million. That's an awfully big number! Is the intent to apply that number at the individual level, to disallow benefit deductions for pay to a select few C-suite employees? If so, why allow the compensation deduction and not the benefits? Or is the intent that the $3.4 million applies at the plan level, which would have the effect of discriminating against big companies with large staff counts? The present draft of the provision leaves more questions than answers.

It should be remembered that it is the intent of the legislature to maintain close conformity with the Internal Revenue Code in order to minimize differences and therefore compliance and administrative costs, so adopting this measure would run counter to that intent.

Digested 2/11/2015

Chamber of Commerce HAWAII
The Voice of Business

Testimony to the House Committee on Labor & Public Employment
Friday, February 13, 2015 at 9:30 A.M.
Conference Room 309, State Capitol

RE: HOUSE BILL 35 RELATING TO TAXATION

Chair Nakashima, Vice Chair Keohokalole, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") **opposes** HB 35, which limits the amount that an employer may deduct for benefits provided to an employee to 50 times the State's median household income.

The Chamber is the largest business organization in Hawaii, representing over 1,000 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

We believe that allowing a deduction for business expenses is a basic principle of tax. The federal government does a good job at figuring out when and where to break from basic principles, and they generally permit the deduction. We find it disturbing that there would be an informal disincentive type cap on employers compensating its employees. While the formula in this bill targets large compensation packages, our concern – if passed – is that it sets a precedent that discourages high compensation. Also, it can always be changed to a lower multiple, thereby encompassing more employees. It is these types of laws that discourage outside investment and more importantly, places high level managers in Hawaii rather than in another state.

From a general economic perspective, when employers pay big salaries, the employee pays income taxes at high rates on the income, other employment taxes, and also large spending in our economy.

We respectfully ask that this bill be deferred. Thank you for the opportunity to testify.

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