DAVID Y. IGE
GOVERNOR

SHANTSUTSUI
LT. GOVERNOR

MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

JOSEPH K. KIM
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

To: The Honorable Jill N. Tokuda, Chair
and Members of the Senate Committee on Ways and Means

Date: February 11, 2016
Time: 9:00 A.M.
Place: Conference Room 211, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 2454, Relating to Taxation.

The Department of Taxation (Department) offers the following comments regarding S.B. 2454 for your consideration.

S.B. 2454 changes the individual income tax rates by: (1) raising the lowest rate from 1.4% to 5.5% for taxable income under $9,600 for single filers, taxable income under $19,200 for joint filers, and taxable income under $14,400 for head of household; and (2) adding new rates of 9%, 10%, and 11% for single filers with taxable income above $150,000, joint filers with taxable income above $300,000, and head of household with taxable income above $225,000. S.B. 2454 applies to taxable years beginning after December 31, 2015.

First, the Department notes that a retroactive effective date may cause administrative issues for employers, taxpayers and the Department as the income tax withholding during the year, up to the date that this measure becomes law, would be based on lower rates.

Second, in order to implement the changes proposed in this S.B.2454, the Department requests that the effective date be amended to taxable years beginning after December 31, 2017, to provide the Department with sufficient time to implement the form, instruction and computer system changes. The Department notes, however, it is able implement the income tax rates that had been enacted by Section 2 of Act 60, Session Laws of Hawaii 2009, for taxable years beginning after December 31, 2015.

The estimated annual revenue gain is $155.6 million for FY17, with a 5% annual increase thereafter.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII
126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Tax Rate Increase

BILL NUMBER: SB 2454

INTRODUCED BY: KEITH-AGARAN, ENGLISH, Baker, Dela Cruz, Kidani, Shimabukuro, Wakai

EXECUTIVE SUMMARY: This bill reinstates the 9%, 10%, and 11% individual income tax rates that were in place prior to 2016. Higher individual tax rates create a drag on the economy primarily because most businesses operate in sole proprietorship, partnership, or S corporation form and are thus subject to the individual income tax rates. Hawaii is already famous for having heavy taxes and a hostile business climate, and this measure would perpetuate this conception.

BRIEF SUMMARY: Amends HRS section 235-51 to provide that for any taxable year beginning after December 31, 2015, the following tax rate schedules shall apply:

Filing Status: Married Filing Joint Return and Surviving Spouse

Not over $19,200	5.50% of taxable income
Over $19,200 but not over $28,800	$1,056.00 plus 6.40% over $19,200
Over $28,800 but not over $38,400	$1,670.00 plus 6.80% over $28,800
Over $38,400 but not over $48,000	$2,323.00 plus 7.20% over $38,400
Over $48,000 but not over $72,000	$3,014.00 plus 7.60% over $48,000
Over $72,000 but not over $96,000	$4,838.00 plus 7.90% over $72,000
Over $96,000 but not over $300,000	$6,734.00 plus 8.25% over $96,000
Over $300,000 but not over $350,000	$23,564.00 plus 9.00% over $300,000
Over $350,000 but not over $400,000	$28,064.00 plus 10.00% over $350,000
Over $400,000	$33,064.00 plus 11.00% over $400,000

Filing Status: Unmarried Head of Household

Not over $14,400	5.50% of taxable income
Over $14.400 but not over $21,600	$792.00 plus 6.40% over $14.400
Over $21,600 but not over $28,800	$1,253.00 plus 6.80% over $21,600
Over $28,800 but not over $36,000	$1,743.00 plus 7.20% over $28,800

Over $36,000 but not over $54,000	$2,261.00 plus 7.60% over $36,000
Over $54,000 but not over $72,000	$3,629.00 plus 7.90% over $54,000
Over $72,000 but not over $225,000	$5,051.00 plus 8.25% over $72,000
Over $225,000 but not over $262,500	$17,674.00 plus 9.00% over $225,000
Over $262,500 but not over $300,000	$21,049.00 plus 10.00% over $262,500
Over $300,000	$24,799.00 plus 11.00% over $300,000

Filing Status: Single and Married Filing Separately

Not over $9,600	5.50% of taxable income
Over $9,600 but not over $14,400	$528.00 plus 6.40% over $9,600
Over $14,400 but not over $19,200	$835.00 plus 6.80% over $14,400
Over $19,200 but not over $24,000	$1,161.00 plus 7.20% over $19,200
Over $24,000 but not over $36,000	$1,507.00 plus 7.60% over $24,000
Over $36,000 but not over $48,000	$2,419.00 plus 7.90% over $36,000
Over $48,000 but not over $150,000	$3,367.00 plus 8.25% over $48,000
Over $150,000 but not over $175,000	$11,782.00 plus 9.00% over $150,000
Over $175,000 but not over $200,000	$14,032.00 plus 10.00% over $175,000
Over $200,000	$16,532.00 plus 11.00% over $200,000

EFFECTIVE DATE: Tax years beginning after December 31, 2015.

STAFF COMMENTS: This measure proposes to increase the individual income tax. The two lowest brackets under current law are eliminated, and the tax starts from 5.50%. The highest rate brackets contain 9%, 10%, and 11% rates that are comparable to the three highest rate brackets established by Act 60, SLH 2009.

The increase in income tax rates for higher income taxpayers was approved by the 2009 legislature but was vetoed by the governor. In the veto message, the governor stated that the bill would:

> increase the tax burden on Hawaii's families and small businesses by increasing the marginal income tax rate by as much as 33.3%. Hawaii has the highest top personal income tax rate in the United States. By increasing the top marginal tax rate from 8.25 to 11 percent, this bill will make Hawaii the state with the highest personal income tax rate in the nation. Although there is the misconception that only wealthy people will be affected, this bill will adversely impact almost 37,000 persons, of which about 27,000 are sole proprietors, partnerships, or subchapter S corporations whose owners report their

> business income through personal income tax returns. In this broad recession which affects both the wealthy and poor and where recovery depends on people investing, buying consumer goods, and donating to charities, a tax increase will put an unnecessary strain on everyone's pocket book. Small business owners who count their business income as personal income will find it more difficult to support and grow their enterprises. This could mean more business closures, layoffs, and fewer job opportunities.

The 2009 legislature overrode the governor's veto and the measure became Act 60, SLH 2009. Act 60 sunset on December 31, 2015, but this measure would enact comparable income tax rates retroactively to January 1, 2016.

The higher tax rates create an image that Hawaii is a poor place to live, work, and invest, underscoring the poor business climate.

In December 2012, the national Tax Foundation conducted a review of economic studies on how taxation affects economic growth. That study states:

> Nearly every empirical study of taxes and economic growth published in a peer reviewed academic journal finds that tax increases harm economic growth. In my review, I examine twenty-six such studies going back to 1983…. All but three of those studies, and every study in the last fifteen years, find a negative effect of taxes on growth.
>
> ….
>
> This review of empirical studies of taxes and economic growth indicates that there are not a lot of dissenting opinions coming from peer-reviewed academic journals. More and more, the consensus among experts is that taxes on corporate and personal income are particularly harmful to economic growth, with consumption and property taxes less so. This is because economic growth ultimately comes from production, innovation, and risk-taking.

William McBride, Ph. D., What Is the Evidence on Taxes and Growth? at 2, 7 (2012) (accessible at http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr207.pdf).

To similar effect is a study sponsored by the American Legislative Exchange Council (ALEC), which states:

> State personal income taxes provide one of the most problematic areas where the tax wedge affects the incentives of individuals in harmful ways. Personal income taxes are collected on the wages of employees, the investment income of those savers directing capital toward productive ends and all business earnings from those firms not organized as C-corporations, known as "pass-through" income. In all three cases, these items represent the fruit of productive labor. When these elements are taxed, the incentive to engage in these productive activities is diminished, leading to less work, less investment and less business activity.

As noted previously, numerous studies conclude that taxing the various forms of personal income and corporate taxes are the most damaging taxes for economic growth and economic performance. But the simple comparison of those nine states refraining from taxing personal income against those nine states taxing income at the highest level is telling of this economic connection. Table 7 details this comparison for the most recent available decade’s worth of data on population growth, net domestic migration, non-farm payroll employment growth, personal income growth, gross state product growth and even the growth of government revenue. It should be noted that though Tennessee and New Hampshire decline to collect taxes on personal wage income, they do tax investment income. The contrast between these two groupings of nine states is quite telling on the dangers of personal income taxation as a means for collecting government revenue. On every metric, the states without a personal income tax are outperforming their high tax counterparts, and are doing so in a significant way.

These numbers in a table fail to tell the full story of this comparison in sufficient detail with respect to quality of life. The boost to economic performance, unlocked by avoiding taxation of personal income, provides citizens faster income growth, more opportunity to find a job or climb the career ladder and even faster government revenue growth, which allows for greater public capacity to meet social needs through greater economic growth, not higher tax rates.

This reality is also true for those states choosing to tax personal income at lower levels and to tax income with one flat rate, instead of graduated rates that see highly productive workers facing increased rates of taxation as they earn greater levels of income. Though many taxpayers avoid paying top marginal rates of state income taxes due to various carve-out provisions and graduated rates, there are many taxpayers that do face those rates, or must fear the possibility of facing those top marginal rates, and make economic decisions based on that possibility. The expectations and uncertainties of taxpayers have a major impact on their decisions to produce, invest or grow their businesses.

This effect of top marginal rates is particularly true for investors and pass-through businesses subject to the personal income tax code. Many advocates of high income taxes like to portray high earners as gilded millionaires undeserving of their large incomes. These advocates of “soak the rich” taxation ignore that investors directing capital or businesses reinvesting profits toward hiring expansion or wage enhancing capital investments, grow opportunity for all citizens of a given state. Figure 10 shows the share of employment in each state coming from pass-through firms. In fact, 54.8 percent of all workers employed by a private business work for a firm that files in the personal income tax code, which amounts to 66.6 million workers.

TABLE 7 | **The Nine States with the Lowest and Highest Marginal Personal Income Tax (PIT) Rates (10-Year Economic Performance)**

	1/1/15	2004-2014	2005-2014	2004-2014	2004-2014	2004-2014	2002-2012
State	**Top Marginal PIT Rate****	**Population**	**Net Domestic Migration†**	**Non-Farm Payroll Employment**	**Personal Income**	**Gross State Product**	**State & Local Tax Revenue‡**
Alaska	0.0%	11.7%	-2.9%	11.2%	65.5%	60.7%	318.8%
Florida	0.0%	14.2%	4.4%	4.6%	43.1%	31.8%	44.0%
Nevada	0.0%	21.0%	7.0%	5.4%	35.9%	27.7%	65.1%
South Dakota	0.0%	10.7%	2.8%	10.3%	57.4%	49.0%	57.2%
Texas	0.0%	20.4%	5.4%	21.7%	75.9%	78.6%	65.7%
Washington	0.0%	14.3%	4.3%	12.3%	54.5%	57.2%	50.8%
Wyoming	0.0%	14.7%	4.9%	14.6%	76.4%	86.4%	111.5%
New Hampshire^	0.0%	2.8%	-0.3%	3.3%	43.0%	34.6%	46.5%
Tennessee^	0.0%	10.8%	4.5%	4.0%	45.6%	36.3%	54.0%
Average of 9 No Income Tax States*	0.0%	13.4%	3.3%	9.7%	55.3%	51.4%	90.4%
50-State Average*	**5.6%**	**8.8%**	**0.7%**	**6.1%**	**48.4%**	**43.6%**	**63.0%**
Average of 9 Highest Income Tax States*	10.4%	6.8%	-2.1%	4.7%	44.3%	40.1%	58.4%
Kentucky	8.2%	6.4%	1.3%	3.9%	42.7%	38.7%	39.4%
Maryland	9.0%	7.7%	-2.5%	4.0%	42.1%	40.9%	52.0%
Vermont	9.0%	1.1%	-1.5%	2.3%	41.8%	31.4%	63.6%
Minnesota	9.9%	7.3%	-1.3%	4.9%	41.7%	36.4%	52.3%
New Jersey	10.0%	3.5%	-6.0%	-0.9%	36.5%	29.5%	55.5%
Oregon	10.6%	11.2%	5.1%	7.2%	46.7%	51.3%	64.3%
Hawaii	11.0%	11.5%	-2.6%	7.2%	52.9%	45.2%	74.8%
New York	12.7%	3.0%	-7.5%	7.4%	47.3%	47.2%	70.7%
California	13.3%	9.1%	-3.4%	6.3%	47.1%	40.6%	52.5%

** Equal-weighted averages.*
*** Top marginal PIT rate is the top marginal tax rate on personal earned income imposed as of 1/1/2015 using the tax rate of each state's largest city as a proxy for the local tax. The deductibility of federal taxes from state tax liability is included where applicable.*
† Net domestic migration is calculated as the ten-year (2005-2014) sum of net domestic in-migrants divided by the mid-year (2010) population.
‡ 2002-2012 due to Census Bureau data release lag.
^ Tennessee and New Hampshire tax interest and dividend income but not ordinary wage income.

Source: Laffer Associates, U.S. Census Bureau, Bureau of Labor Statistics and Bureau of Economic Analysis

> The map and overall figures should make clear that personal income taxation is often, in fact, better thought of as business taxation, and as businesses have increasingly high levels of their profits taken by government taxation, they have less funds to increase their employees' wages, hire additional employees or engage in innovation that creates new products for customers or reduces the cost of their current products.

Laffer, Williams, and Moore, Rich States, Poor States 35-37 (8th ed. 2016) (accessible at http://www.alec.org/app/uploads/2015/10/RSPS_8th_Edition-Final.pdf).

For these reasons, we recommend that lawmakers think twice before continuing the high individual rates that have put Hawaii on the map for all the wrong reasons.

Digested 2/6/16

Chamber of Commerce HAWAII
The Voice of Business

Testimony to the Senate Committee on Ways and Means
Thursday, February 11, 2016 at 9:00 A.M.
Conference Room 211, State Capitol

<u>RE: SENATE BILL 2454 RELATING TO TAXATION</u>

Chair Tokuda, Vice Chair Dela Cruz, and Members of the Committee:

The Chamber of Commerce Hawaii ("The Chamber") **opposes** SB 2454, which changes the income tax brackets and rates.

The Chamber is Hawaii's leading statewide business advocacy organization, representing about 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.

Hawaii already has a very high tax burden. This bill would increase taxes on many high income tax filers. This could affect many small businesses in their financial ability to grow their company. According to one report on Hawaii income, approximately 5% of tax filers have over 43% of the tax liability. We believe that high income earners already pay their fair share. Also it appears that this bill seeks to raise the rates for other middle income tax filers.

Thank you for the opportunity to testify.

1132 Bishop Street, Suite 2105 • Honolulu, Hawaii 96813 • Phone: (808) 545-4300 • Facsimile: (808) 545-4369

From:	mailinglist@capitol.hawaii.gov
To:	WAM Testimony
Cc:	lawrencejholbrook@gmail.com
Subject:	Submitted testimony for SB2454 on Feb 11, 2016 09:00AM
Date:	Friday, February 05, 2016 9:13:12 PM

SB2454

Submitted on: 2/5/2016

Testimony for WAM on Feb 11, 2016 09:00AM in Conference Room 211

Submitted By	Organization	Testifier Position	Present at Hearing
Lawrence J Holbrook	Individual	Oppose	No

Comments: AGAINST SB2454, Complex and Inequitable Tax Rate Changes I've never understood why Hawaii has such a complex and inequitable individual income tax rate schedule. SB2454 makes the individual income tax rates even more inequitable by cutting out lower rates for low income people. If Hawaii changes it's tax rate schedule, it should be in line with the Federal Individual Income Tax rate schedules. Five tax rates that roughly reflect Federal taxable income reported. Raising taxes is justified when the needs of a society are not being met. Raising taxes on the poor is never justified. If the personal exemption amount was raised to allow low income earners 0% tax rate in this new schedule, I could support it. Lawrence J. Holbrook Nuuanu, HI 808-735-8426

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.