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To: The Honorable Silvia Luke, Chair
and Members of the House Committee on Finance

Date: Friday, February 23, 2018
Time: 3:30 P.M.
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 2747, H.D. 1, Relating to Homeownership

The Department of Taxation (Department) offers the following comments on H.B. 2747, H.D. 1 for the Committee's consideration.

H.B. 2747, H.D. 1, makes the following changes to individual housing accounts (IHAs):

- Changes the maximum deductible contribution to an IHA from $5,000 per year to an unspecified amount;
- Allows the taxpayer’s parents, grandparents, and siblings to make deductible contributions to the taxpayer’s individual housing account, up to an unspecified amount;
- Changes the deadline by which an IHA must distribute its entire interest from 120 months to an unspecified number of months;
- Changes the penalty for failure to file a report under the IHA law from $10 to an unspecified amount; and
- Authorizes community development financial institutions to administer IHAs accounts.

H.B. 2747, H.D. 1 has a defective effective date of January 1, 2050.

Generally, IHAs are savings vehicles that assist individuals in purchasing their first principal residence. Contributions to IHAs are deductible and distributions are taxed to the recipient. Contributions are limited by an annual limitation and by an aggregate limitation. This bill changes the annual limitation but does not change the aggregate limitation.

First, the Department notes that the original version of this bill changed the aggregate amount of contributions without changing the annual limitation. The H.D. 1 version does the opposite by changing the annual limitation, but not the aggregate limitation. The Department believes that an increase to the annual limitation without a corresponding increase to the aggregate limitation or vice versa may not effectuate the purpose of the bill as described in the preamble. The Department recommends that if the legislature intends to significantly expand the incentive to saving and buying a first principal residence, then an adjustment to the aggregate limitation be considered as well as the proposed adjustment to the annual limitation.

Second, the Department notes that the allowance of a deduction to immediate family members is a significant expansion of the deductible contribution base. If the legislature decides to allow deductible contributions for immediate family members, the Department recommends clarifying whether the contribution limit for immediate family members is an aggregate limit across all immediate family members or a per-immediate family member limit.

Finally, the Department is able to administer the substantive provisions of this bill. The Department notes the defective effective date and requests that if this bill moves forward it be made effective for tax years beginning after December 31, 2018 at the earliest. This will give the Department time to make the necessary changes to its forms, instructions, and computer system.

Thank you for the opportunity to provide comments.

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February 23, 2018

The Honorable Sylvia Luke, Chair
House Committee on Finance
State Capitol, Room 308
Honolulu, Hawaii 96813

RE: H.B. 2747, HD1, Relating to Homeownership

HEARING: Friday, February 23, 2018, at 3:30 a.m.

Aloha Chair Luke, Vice Chair Cullen and Members of the Committee,

I am Ken Hiraki, Director of Government Affairs, here to testify on behalf of the Hawai‘i Association of REALTORS® ("HAR"), the voice of real estate in Hawai‘i, and its almost 9,500 members. HAR **supports** House Bill 2747, HD1, which assists first-time homebuyers in saving to buy a home by changing the annual contribution amount, aggregate contribution amount and number of taxable months for an individual housing account. Allows immediate family members to contribute to an individual housing account. Allows Community Development Financial Institutions to administer individual housing accounts.

One of the biggest hurdles for a first-time homeowner is the down payment. To highlight this issue, as of January 2018, the following is the housing data by county and the down payment (20%) needed under conventional financing:

Condominiums:

County:	Median:	20% Down:
Island of Hawai‘i	$347,000	69,400
Kaua‘i	$287,500	57,500
Maui	$505,563	101,113
O‘ahu	$430,000	86,000

Single-Family:

County:	Median:	20% Down:
Island of Hawai‘i	$327,000	65,400
Kaua‘i	$770,000	154,000
Maui	$707,000	141,400
O‘ahu	$772,000	154,400

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This measure will increase the individual housing accounts to reflect today's higher cost of housing. As REALTORS®, we believe in the value of homeownership, which instills pride and a sense of community. As such, HAR supports efforts that help first-time homebuyers achieve their dream.

Mahalo for the opportunity to testify in support of this measure.

HB-2747-HD-1
Submitted on: 2/22/2018 2:47:40 PM
Testimony for FIN on 2/23/2018 3:30:00 PM

Submitted By	Organization	Testifier Position	Present at Hearing
Melodie Aduja	OCC Legislative Priorities Committee, Democratic Party of Hawai'i	Support	No

Comments:

LATE

OFFICE OF HAWAIIAN AFFAIRS

Legislative Testimony

HB2747 HD1

RELATING TO HOMEOWNERSHIP

House Committee on Housing

February 23, 2018 3:30 PM Room 308

The Office of Hawaiian Affairs (OHA) **SUPPORTS WITH AMENDMENTS** HB2747 HD1, which contains provisions similar to those provided under HB1746, a measure in OHA's 2018 Legislative Package. Both measures promote the economic self-sufficiency and housing security of Hawai‘i residents and families, including Native Hawaiians, by expanding existing tax deductions to include savings in community development financial institution (CDFI)-administered individual development accounts for housing (individual housing accounts, or IHAs), updating the annual amount allowed to be deducted, and updating the total aggregate amount allowed to be deduction. OHA respectively suggests that this measure reduce or eliminate the requirement to pay taxes on IHA distributions used to purchase a first principal residence, to further encourage participation in CDFI-based IHA programs.

IHAs constitute critical components of comprehensive, proven housing programs that have enabled individuals and families to purchase their first home, or to secure rental housing. IHAs generally provide incentives for account holders to meet savings goals, and require account funds to be expended for IHA purposes (i.e. making a down payment on a home, or paying a rental deposit and first month's rent). For example, IHA accounts held in a traditional banking institution are provided with a limited adjusted gross income (AGI) tax deduction, as recognized by this measure. **Meanwhile, IHA programs administered by community development financial institution (CDFI) service providers provide savings match incentives to encourage participation, require financial literacy education for participants, and offer one-on-one coaching.** These CDFI-administered IHA programs in particular have demonstrated high rates of success in enabling participating individuals and families to purchase their first home, or to obtain financially sustainable rental housing. As IHAs administered by CDFIs do not currently qualify for the AGI deduction available to IHAs held in traditional banks, OHA appreciates the amendments in HB2747 HD1, which would allow CDFI-administered accounts to also qualify for the deduction.

Expanding the AGI deduction to apply to CDFI administered IHAs is critical to achieving the purpose of this deduction, i.e. encouraging savings to ultimately achieve first-time homeownership. OHA research has been unable to identify any Hawai‘i based IHA programs administered by traditional banks whatsoever; the only IHAs currently in use appear to be those held as CDFI custodial accounts. Accordingly, the deduction expansion proposed in this measure appears necessary to realize the very purpose of the deduction.

Notably, CDFI IHA programs also include IHAs specifically designed to enable houseless individuals and families in securing rental housing, with high rates of success; given that contributions to these types of programs are not eligible, OHA encourages this committee to amend the measure to provide a similar tax deduction for rental IHAs, which may also encourage greater participation in such programs.

To better effectuate the intent of this measure and expand its potential benefits, OHA suggests inclusion of language similar to that found in HB1746 HD1, as found on page 6, lines 6-17; page 7, lines 7-18; page 8, lines 12-19; and page 9, line 20 thru page 10, line 1 of that bill; with corresponding amendments, additions, and deletions as found throughout HB1746 HD1. Such amendments would better reflect the structure of existing CDFI-administered IHA programs, and further establish tax incentives for rental IHA programs. **Such amendments would encourage and support Native Hawaiians and other Hawai'i residents in securing better financial futures for themselves and their families, by encouraging greater participation in highly successful and comprehensive CDFI-administered IHA programs.**

Additionally, OHA suggests amendments to remove the tax "recapture" provisions currently applied to IHA savings if they are ultimately expended for housing by a lower-income individual. OHA suggests that, similar to Department of Taxation suggested amendments, that the tax recapture could be limited to individuals who make more than 120% of the Area Median Income at the time they take their first tax deduction. **Removing provisions that IHA savings be taxed upon expenditure would further encourage account holders to save for their future housing needs, and would treat such savings as true deductions for lower-income individuals rather than a mere deferral of tax liability**. Accordingly, OHA respectfully suggests inserting the following language after page 11, line 10, to read as follows:

> "Notwithstanding paragraph (2) of this subsection, an individual shall not be required to report any distribution as gross income in any taxable year if at the time of the individual's first deduction, the individual's income was less than or equal to one hundred twenty percent of the area median income as published by the United States department of housing and urban development."

Notably, with these amendments, IHA savings that are spent for purposes other than for purchasing a first home housing would still be subject to "recaptured" tax liability, as well as a 10% tax penalty.

OHA recognizes that this bill, particularly with the above-described amendments, would reduce state income tax liability for some participating individuals and families, thereby potentially reducing general fund income tax revenues. However, any reductions in general fund revenue would likely be minimal, as these deductions are most likely to be claimed only by low-income families who qualify for and complete CDFI-administered IHA programs. Any tax revenue impacts would also be offset by IHA program participants' increased financial literacy and capacity. **In addition, every dollar of income not taxed under the above-recommended amendments will go into a regulated and monitored savings account, and will be cycled directly into the local housing market in the short term; deducted savings used for anything other than the purchase of a first primary residence or securing a rental unit would be subject to recaptured tax liability, and a tax penalty**. Accordingly, this bill has great potential to serve as a highly targeted, low-cost method of stabilizing Hawaiʻi's middle class, encouraging and directly supporting asset-building and housing security for our residents and families.

Finally, OHA again reiterates its support for the intent and overall approach behind this measure, which, particularly with the above-suggested amendments, would encourage Native Hawaiians and others to participate in highly successful, CDFI-administered IHA programs; directly supplement their efforts to obtain secure and sustainable housing; and hopefully encourage establishment of more IHA programs to meet Hawaiʻi residents' housing needs. OHA does note that the title of this bill may restrict expansion of the IHA deduction to rental IHAs, which help our most needy houseless, working families secure sustainable rental housing. Such provisions are, however, contained in HB1747 HD1. **As such, OHA suggests the Committee also consider furthering the HD1 draft of HB1746, as a vehicle that can provide a broad and comprehensive range of housing relief**.

Therefore, OHA urges the Committee to **<u>PASS WITH AMENDMENTS</u>** HB2747 HD1. Mahalo nui for the opportunity to testify on this measure.