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TESTIMONY OF
GARY S. SUGANUMA, DIRECTOR OF TAXATION

TESTIMONY ON THE FOLLOWING MEASURE:
S.B. No. 597, S.D.1, Relating to Taxation

BEFORE THE:
House Committee on Economic Development

DATE: Wednesday, March 22, 2023
TIME: 9:30 a.m.
LOCATION: State Capitol, Room 423

Chair Holt, Vice-Chair Lamosao, and Members of the Committee:

The Department of Taxation ("Department") offers the following comments regarding S.B. 597, S.D.1, for your consideration.

S.B. 597, S.D.1, excludes from State taxable income amounts received from deferred compensation retirement plans, including individual retirement accounts, and those established under section 401(k) or 403(b) of the Internal Revenue Code, or any other retirement plan that defers compensation for taxpayers who meet certain income requirements based upon federal Adjusted Gross Income (AGI).

The measure has a defective effective date of January 1, 2050 and applies to taxable years beginning after December 31, 2022.

The Department notes that employee contributions to a deferred compensation retirement plan are structured so that the earnings are excluded from the employee's taxable wages, grow tax-free, and the taxes are then paid upon eventual distribution from the fund. The general notion is that the income is taxed either when earned as a wage or upon distribution.

Under the State's hybrid retirement plan, State employees pay Hawaiʻi income tax on the amounts contributed to their retirement plan each year and, upon retirement, they will receive distributions from the plan tax-free. The initial taxation is to compensate for the fact that the distribution will later be received tax-free.

The Department further notes that it is able to administer this measure for taxable years beginning after December 31, 2022.

Thank you for the opportunity to provide comments on this measure.

TESTIMONY OF THE AMERICAN COUNCIL OF LIFE INSURERS
IN SUPPORT OF SB 597, SD 1, RELATING TO TAXATION

March 22, 2023

Honorable Representative Daniel Holt, Chair
Honorable Representative Rachele F. Lamosao, Vice-Chair
Committee on Economic Development
State House of Representatives
Hawaii State Capitol, Room 423 and Videoconference
415 South Beretania Street
Honolulu, Hawaii 96813

Dear Chair Holt, Vice-Chair Rachele F. Lamosao and Members of the Committee:

Our firm represents the American Council of Life Insurers ("ACLI"). The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States. Two hundred eighteen (218) ACLI member companies currently do business in the State of Hawaii; and they represent 94% of the life insurance premiums and 98% of the annuity considerations in this State.

Thank you for the opportunity to testify in support of SB 597, SD 1, Relating to Taxation.

The State of Hawaii should as a matter of policy encourage all of its residents to accumulate the savings they need to secure their own retirement,

ACLI supports policies and legislation that create a stronger retirement system and help more Americans plan for their long-term financial futures, including State incentives to encourage all of its residents to accumulate the savings they need to secure their own retirement.

Four in 10 older American employees are now expecting to retire later than originally planned due to inflation.

45% of working Americans are worried about not having enough money to last them through retirement.

Baby Boomer workers have saved $162,000 (estimated median) in total household retirement accounts. The current personal income tax imposes a significant burden on those with the smallest savings.

Everyone wants a secure tomorrow, and everyone deserves a chance to get there.

SB 597, SD 1, proposes to exclude retirement income from the State's income tax. Those entitled to the exclusion are single and married taxpayers filing separately having a federal adjusted gross income of less than $30,000; $45,000 for head of households; and $60,000 for taxpayers filing a joint return or as a surviving spouse.

Excluding retirement income from the State's income tax for those at the lower end of the income scale significantly closes the retirement income gap. For a married couple with $50,000 in retirement income, and only retirement income, will receive an immediate 5.7% pay increase because their income is excluded from the tax.

For the foregoing reasons ACLI supports SB 597, SD1, and urges this Committee's passage of this bill.

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LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Exclude deferred compensation retirement plan income for taxpayers earning less than $30,000 single / $60,000 joint.

BILL NUMBER: SB 597 SD 1

INTRODUCED BY: Senate Committee on Labor and Technology

EXECUTIVE SUMMARY: For lower income individuals, excludes income received from deferred compensation plans including IRAs, 401(k), and 403(b) plans.

SYNOPSIS: Amends section 235-7, HRS, to add a new exclusion for compensation received from deferred compensation retirement plans, including individual retirement accounts, and those established under section 401(k) or 403(b) of the Internal Revenue Code, or any other retirement plan that defers compensation. The exclusion is only effective for individuals whose federal AGI is less than $30,000 for single or married filing separately; $45,000 for head of household; or $60,000 for married filing jointly.

EFFECTIVE DATE: January 1, 2050.

STAFF COMMENTS: Section 235-7(a)(3), HRS, already provides an exclusion from income tax for income received as a "pension for past services." Current regulations under that section provide that the exclusion does not apply to "elective deferrals" such as are found in individual retirement accounts (IRAs), 401(k) plans, 403(b) plans, and similar. The rationale was that the individual was able to make a choice to contribute to a retirement plan and thereby escape current taxation of those contributed earnings but understood that the price for that was taxation of those earnings when the individual received them from the plan.

The preamble to the current version of the bill complains of inequity in the taxation of retirement income while many seniors in Hawaii are struggling to make ends meet. If, however, the problem is that we want to be sympathetic to those with lower incomes, a better way to respond is with lower rates or more equitable tax brackets, not with brackets dating back to the 1960s that are so narrow that a family of four earning the federal poverty line amount of $34,500 is thrust into the *fifth* bracket from the bottom.

We question why this tax relief is proposed only for those drawing income from retirement plans. Why should families of similar size and income level that are also struggling to make ends meet not be qualified for relief? If the answer is that the latter families are in the workforce and are thereby eligible for other credits such as the earned income tax credit (EITC), then we suggest that better outcomes can be achieved by broad-based bracket and rate relief, as opposed to adding to the complexity of the tax code by enacting yet another credit that is directed at lower income taxpayers.

Digested: 2/23/2023