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TESTIMONY OF
GARY S. SUGANUMA, DIRECTOR OF TAXATION

TESTIMONY ON THE FOLLOWING MEASURE:
H.B. No.825, Relating to Taxation

BEFORE THE:
House Committee on Economic Development

DATE: Wednesday, February 8, 2023
TIME: 10:15 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 H.B. 825 for your consideration.

H.B. 825 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 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. In the alternative, under the State's hybrid retirement plan, 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 be received tax-free.

The Department further notes that due to the number of bills with tax law changes that have been introduced this year, the Department may not have the resources to implement all measures passed this session in time for tax year 2023. The Department will continue to monitor the status of proposed legislation and will advise whether some changes will require a later effective date.

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

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

BILL NUMBER: SB 597, HB 825

INTRODUCED BY: SB by DELA CRUZ, AQUINO, CHANG, INOUYE, KANUHA, LEE, MCKELVEY, Ihara, Kidani, Moriwaki; HB by KILA, AMATO, BELATTI, HASHIMOTO, HUSSEY-BURDICK, ICHIYAMA, KITAGAWA, LAMOSAO, MARTEN, MATAYOSHI, POEPOE, TAKENOUCHI, TAM

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: Taxable years beginning after December 31, 2022.

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: 1/26/2023

HB-825
Submitted on: 2/6/2023 6:17:17 PM
Testimony for ECD on 2/8/2023 10:15:00 AM

Submitted By	Organization	Testifier Position	Testify
Will Caron	Individual	Support	Written Testimony Only

Comments:

I support HB825.