JOSH GREEN M.D.
GOVERNOR

SYLVIA LUKE
LT. GOVERNOR

GARY S. SUGANUMA
DIRECTOR OF TAXATION

KRISTEN M.R. SAKAMOTO
DEPUTY DIRECTOR

STATE OF HAWAIʻI
DEPARTMENT OF TAXATION
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TESTIMONY OF
GARY S. SUGANUMA, DIRECTOR OF TAXATION

TESTIMONY ON THE FOLLOWING MEASURE:
S.B. No. 281, Relating to The College Savings Program

BEFORE THE:
Senate Committee on Higher Education

DATE: Thursday, February 2, 2023
TIME: 3:00 p.m.
LOCATION: State Capitol, Room 229

Chair Kim, Vice-Chair Kidani, and Members of the Committee:

The Department of Taxation ("Department") offers the following comments regarding S.B. 281 for your consideration.

S.B. 281 creates a deduction from income tax for contributions made to a HI529-Hawaii's College Savings Program (HI529) account, established pursuant to chapter 256, Hawaii Revised Statutes (HRS), and section 529 of the Internal Revenue Code (IRC). The deductions are capped at $4,000 for single and married couples filing separate returns and $8,000 for married filing joint returns, heads of household, and surviving spouses. The bill becomes effective upon approval and applies to taxable years beginning after December 31, 2022.

First, the Department notes that contributions to accounts established pursuant to section 529, IRC, grow tax free, and qualifying distributions from the account are not subject to tax. This bill will add another tax benefit to the HI529 account by making the contribution deductible from Hawaiʻi adjusted gross income.

Second, the Department suggests the following clarifying amendment to the new section 235-__(d):

> (d) If the amount of the contribution to the qualified taxpayer's account in the HI529-Hawaii's college savings program exceeds the maximum deduction for the taxable year in which the contribution is made pursuant to subsection (a), the excess deduction may be used as a deduction against the qualified taxpayer's Hawaii adjusted gross income for up to four subsequent tax years <u>or</u> until the excess deduction is exhausted[~~.~~]<u>, whichever occurs first.</u>

Finally, the Department 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.

JOSH GREEN, M.D.
GOVERNOR

LUIS P. SALAVERIA
DIRECTOR

SABRINA NASIR
DEPUTY DIRECTOR

EMPLOYEES' RETIREMENT SYSTEM
HAWAI'I EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER

STATE OF HAWAIʻI
DEPARTMENT OF BUDGET AND FINANCE
Ka ʻOihana Mālama Moʻohelu a Kālā
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ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT

WRITTEN ONLY

TESTIMONY BY LUIS P. SALAVERIA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE SENATE COMMITTEE ON HIGHER EDUCATION
ON
SENATE BILL NO. 281

February 2, 2023
3:00 P.M.
Room 229 and Videoconference

RELATING TO THE COLLEGE SAVINGS PROGRAM

Senate Bill No. 281 proposes to provide for an annual state income tax deduction of $4,000 per individual or $8,000 for a married couple filing jointly, against taxable income, for contributions made to the state of Hawaiʻi's college savings plan (HI529 Hawaiʻi's College Savings Program) established under section 529 of the Internal Revenue Code (commonly known as 529 college savings plans).

The Department provides comments and appreciates the intent of the bill to encourage and provide incentives for individuals and families to save and invest funds for higher education.

In 2002, the State of Hawaii legislature established the state's 529 college savings program pursuant to Chapter 256, Hawaii Revised Statutes (HRS). Administered by the Department of Budget & Finance, "HI529 Hawaii's College Savings Program" exists to assist and encourage families to set aside funds for future college and higher education expenses.

The bill limits the tax deduction to contributions made into the State of Hawaii's 529 plan, so the tax revenue loss can be estimated and limited. As of December 2022 HI529 program information available, if all Hawaii-based account owners with funds in their accounts, contributed the maximum deduction for a single state tax-filer at the maximum tax rate, the potential revenue loss would be about $1.5 million annually. This amount could increase as the income tax deduction would incentivize taxpayers to contribute to their HI529 accounts.

The Department also provides the following comments:

1. On page 4, lines 4 to 7 of the bill, subsection(c) of the new section to be added to chapter 235, HRS, should be amended (underlined) to read: "Rollovers from <u>another state's college savings program</u> into <u>the HI529-Hawaii's</u> college savings program, shall not be considered as contributions eligible for the tax deduction under this section."
2. On page 5, lines 15 to 20 of the bill, within the definition of "Qualified taxpayer", the limit on adjusted gross income has yet to be determined.

In closing, the Department recognizes that a tax deduction would provide a significant incentive to Hawaii families to save for college. Thank you for your consideration of our comments.

TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
THIRTY-SECOND LEGISLATURE, 2023

ON THE FOLLOWING MEASURE:
S.B. NO. 281, RELATING TO THE COLLEGE SAVINGS PROGRAM.

BEFORE THE:
SENATE COMMITTEE ON HIGHER EDUCATION

DATE: Thursday, February 2, 2023 **TIME:** 3:00 p.m.

LOCATION: State Capitol, Room 229

TESTIFIER(S): Anne E. Lopez, Attorney General, or
Joshua J. Michaels, Deputy Attorney General

Chair Kim and Members of the Committee:

The Department of the Attorney General provides the following comments.

The purpose of this bill is to incentivize Hawaii taxpayers to participate in Hawaii's College Savings Program under section 529 of the Internal Revenue Code, known as the HI529 Program. The bill's preamble states, in pertinent part, "[t]he legislature further finds that most other states offer a state tax deduction or credit for contributions to state college savings programs as an incentive for their residents to participate." See page 1, lines 14-17. The preamble goes on to state, "[t]he legislature therefore finds that, as the cost of higher education continues to rise, it is appropriate for the State to provide a similar incentive to Hawaii taxpayers to participate in the HI529 Program, thus helping Hawaii families save for college instead of taking out educational loans." See page 1, line 17, through page 2, line 4. The bill therefore establishes "a state income tax deduction for Hawaii residents making contributions into the HI529 Program." See page 2, lines 5-7.

The deduction for contributions into the HI529 Program is available to resident taxpayers, but not to nonresident taxpayers. More specifically, a "qualified taxpayer" eligible to claim the HI529 Program deduction is defined, in part, as "a resident of the State who is an individual taxpayer or a married couple filing separate returns . . . ." See page 5, lines 15-17. Therefore, the deduction for contributions into the HI529 Program will be available to a resident of the State who is an individual taxpayer or a married couple filing separate returns, but it will not be available to a nonresident taxpayer.

As such, this bill may be subject to challenge under the Privileges and Immunities Clause of the United States Constitution. "The Privileges and Immunities Clause, U.S. Const., Art. IV, § 2, provides that the Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several states." Lunding v. New York Tax Appeals Tribunal, 522 U.S. 287, 290 (1998) (internal brackets and quotation marks omitted). "One right thereby secured is the right of a citizen of any State to 'remove to and carry on business in another without being subjected in property or person to taxes more onerous than the citizens of the latter State are subjected to.'" Id. at 296 (quoting Shaffer v. Carter, 252 U.S. 37, 56 (1920)).The Clause requires "substantial equality of treatment" for resident and nonresident taxpayers; "[w]here nonresidents are subject to different treatment, there must be 'reasonable grounds for . . . diversity of treatment.'" Id. at 297-98 (quoting Travis v. Yale & Towne Mfg. Co., 252 U.S. 60, 79 (1920)). Thus, "the Privileges and Immunities Clause bars 'discrimination against citizens of other States where there is no substantial reason for the discrimination beyond the mere fact that they are citizens of other states.'" Id. at 298 (quoting Toomer v. Witsell, 334 U.S. 385, 396 (1948)).

Here, it is questionable whether there is a "substantial reason" or "reasonable grounds" for treating resident and nonresident taxpayers differently with respect to the subject tax deduction. We recommend replacing "Hawaii residents" with "Hawaii taxpayers" in the preamble so that the bill therefore establishes a state income tax deduction for all Hawaii taxpayers making contributions into the HI529 Program. See page 2, line 6. Additionally, we recommend removing the word "resident of the State who is" from the definition of "qualified taxpayer" in section 2. See page 5, line 15. Specifically, with respect to the HI529 Program deduction, on page 5, lines 15 through 20, the definition of "qualified taxpayer" should read as follows:

> "Qualified taxpayer" means [~~a resident of the State who is~~] an individual taxpayer or married couple filing separate returns each with an adjusted gross income of less than $ ______ or a married couple filing a

joint return, head of household, or surviving spouse with an adjusted gross income of less than $ _____ .

These changes to the preamble and the definition of a "qualified taxpayer" should sufficiently address a possible Privileges and Immunities challenge. Alternatively, if it is the Legislature's intent that only Hawaii residents should be eligible for this tax deduction, we recommend providing substantially more information in the preamble to explain reasonable grounds justifying the difference between residents and non-residents.

Thank you for the opportunity to comment on this bill.

TAX FOUNDATION OF HAWAII

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

SUBJECT: INCOME, Deduct contributions to HI529 college savings program

BILL NUMBER: SB 281

INTRODUCED BY: DELA CRUZ, AQUINO, CHANG, INOUYE, KANUHA, KEITH-AGARAN, KIM, MCKELVEY, SHIMABUKURO, Kidani, Moriwaki, Richards, Wakai

EXECUTIVE SUMMARY: Establishes a state income tax deduction for eligible contributions made by residents of the State into the HI529-Hawai‘i's College Savings Program

SYNOPSIS: Adds a new section to chapter 235, HRS, to allow a deduction for a contribution to an account established in the Hawaii college savings program under chapter 256, HRS.

The amount deductible is not to exceed $4,000 ($8,000 for married taxpayers filing a joint return, heads of household, or surviving spouses). Only amounts contributed within the taxable year count; if a contribution is mailed in, it counts if it is postmarked within the taxable year.

The deduction is “above the line,” meaning that it is deducted when computing the taxpayer’s Hawaii adjusted gross income, unlike most itemized deductions.

The deduction is not allowed for a contribution that is rolled over from another state’s college savings program.

If the amount of the deduction exceeds the taxpayer’s taxable income, the excess may be used as a deduction in subsequent taxable years until exhausted.

Provides for recapture of the deduction if the taxpayer makes a nonqualified withdrawal from the program.

Defines "qualified taxpayer" as a resident of the State who is an individual taxpayer or a married couple filing separate returns each with an adjusted gross income of less than $_____or a married couple filing a joint return, head of household, or surviving spouse with an adjusted gross income of less than $_____.

Makes conforming amendments.

EFFECTIVE DATE: Taxable years beginning after December 31, 2022.

STAFF COMMENTS: The Hawaii college savings program under chapter 256, HRS, is a college savings program intended to qualify under section 529, IRC.

Under the IRC, contributions to a 529 plan are not deductible, but the monies in the plan can earn income tax-free and will not be taxed when the money is taken out to pay for college.

Hawaii income tax law conforms to IRC section 529, with minor modifications such as a withdrawal is nonqualified for Hawaii purposes if it is used to purchase software. See section 235-2.4(ii), HRS, which decouples from IRC section 529(e)(3)(A)(iii).

According to savingforcollege.com, https://www.savingforcollege.com/intro-to-529s/name-the-top-7-benefits-of-529-plans, over 30 states currently offer a full or partial tax deduction or credit for 529 plan contributions. Hawaii offers none of those incentives.

Digested: 2/1/2023

Committee on Higher Education
The Hawaii State Senate
415 S Beretania St.
Honolulu, HI 96813

Re: SUPPORT SB 281

January 31, 2023

Dear Chair Kim, Vice Chair Kidani, and esteemed members of the Higher Education Committee,

I am writing to ask that you SUPPORT BILL **SB 281**, which seeks to create an income tax deduction for HI 529 accounts.

As an educator in higher education and a parent of two children of my own, I am continually seeking to support our community's ability to pay for a college education, as higher education is shown to improve quality of life in terms of earnings potential, job security, networking, and both civic and community engagement. Giving our residents this tax-deferred college savings option will match the benefits seen by a number of other states, and help make the college experience. Because we live in the state with the highest cost of living, this bill becomes even more crucial to helping more afford college educations.

For all these reasons and more, I strongly SUPPORT BILL **SB 281**. Mahalo nui for introducing and hearing this bill!

Sincerely,

Erika Molyneux
Instructor, New Media Arts
Leeward Community College