LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

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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