

SB 570

SD 1

NEIL ABERCROMBIE
GOVERNOR

BRIAN SCHATZ
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1530
FAX NO: (808) 587-1584

FREDERICK D. PABLO
DIRECTOR OF TAXATION

RANDOLF L. M. BALDEMOR
DEPUTY DIRECTOR

SENATE COMMITTEE ON WAYS & MEANS

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING SB 570 SD1 RELATING TO TAXATION

TESTIFIER: **FREDERICK D. PABLO**, DIRECTOR OF TAXATION (OR
DESIGNEE)
COMMITTEE: WAM
DATE: MARCH 3, 2011
TIME: 10:30AM
POSITION: **SUPPORT**

This measure eliminates the state income tax deduction with a phase-out for taxpayers with modest income. It starts in the 2011 tax year.

The Department of Taxation (Department) supports this measure.

SOUND TAX POLICY—It is a fundamental tax policy to eliminate an absurd deduction allowed by the same source that is taxing the income. The current deduction is irrational and poor tax policy. It also simplifies the tax code. Only a handful (approximately 5) other states allow a state tax deduction for state income tax paid.

PHASE-OUT THE REPEAL FOR THOSE WITH MODEST INCOME—

Eliminates the deduction for the 2011 tax year for those earning:

- \$75,000 or more for single or married filing separately;
- \$112,500 or more for head of household or surviving spouse;
- \$150,000 or more for joint returns.

Phases-out the deduction by reducing it over two taxable years for all others:

- 50% reduction for 2011
- 75% reduction for 2012
- 100% reduction for 2013.

TECHNICAL CORRECTION—The Department would like to suggest the following correction:

(2) For a taxpayer filing as a head of household ~~or surviving~~

spouse

(3) For a taxpayer filing a joint return or surviving spouse

REVENUE GAIN—This measure will result in an estimated revenue gain of \$63.7 million for FY 2012, \$79.0 million for FY 2013, \$94.4 million for FY 2014 and thereafter.

TESTIMONY BY **KALBERT K. YOUNG**
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON
SENATE BILL NO. 570, S.D. 1

March 3, 2011

RELATING TO TAXATION

Senate Bill No. 570, S.D. 1, phases-out and repeals the deduction for State income taxes paid, depending upon the taxpayer's federal adjusted gross income and filing status, and is identical to the Administration's proposal found in Senate Bill No. 1319 and House Bill No. 1092, with the same phase-out and threshold provisions.

The Department of Budget and Finance strongly **supports** this bill as the repeal of the State income tax deduction corrects a peculiarity in the State tax code and is a major component of the Abercrombie Administration's approach to addressing the general fund budget shortfall.

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Repeal deduction for state income taxes

BILL NUMBER: SB 570, SD-1

INTRODUCED BY: Senate Committee on Ways and Means

BRIEF SUMMARY: Amends HRS section 235-2.4(h) to phase-out the deduction for state taxes to provide that for: (1) a taxpayer filing a single return or a married person filing separately with FAGI of under \$75,000: the deduction shall be reduced by 50% for tax years beginning after December 31, 2010; 75% for tax years beginning after December 31, 2011; and 100% for tax years beginning after December 31, 2012; for those with FAGI of \$75,000 and over - no deduction for tax years beginning after December 31, 2010; (2) for a taxpayer filing as a head of household or surviving spouse with FAGI of under \$112,500, the deduction shall be reduced by 50% for tax years beginning after December 31, 2010; 75% for tax years beginning after December 31, 2011; and 100% for tax years beginning after December 31, 2012; for those with FAGI of \$112,500 and over - no deduction for tax years beginning after December 31, 2010; (3) for a taxpayer filing a joint return with FAGI of under \$150,000, the deduction shall be reduced by 50% for tax years beginning after December 31, 2010; 75% for tax years beginning after December 31, 2011; and 100% for tax years beginning after December 31, 2012; for those with FAGI of \$150,000 and over - no deduction for tax years beginning after December 31, 2010.

EFFECTIVE DATE: Tax years beginning after December 31, 2010

STAFF COMMENTS: Under the existing law, taxpayers are allowed to deduct for state tax purposes, the state taxes paid. This measure proposes to eliminate this provision and phases out the deduction for the middle class and lower-income earners.

This is a proposal that has been floated by the administration which has characterized this deduction as “absurd” noting that only a handful of states allow the deduction of state taxes paid and withheld to be deducted from that adjusted gross income. Hawaii’s provision for this deduction is part of its effort to maintain conformity between the federal and state definition of taxable income. Hawaii is one of three states which recognizes the deductibility of state income or sales taxes paid during the taxable year. Six other states allow for the deduction of the state income taxes and another nine states allow for the deduction of state sales taxes paid. So, a total of 18 states allow for the deduction of the state income and/or sales taxes paid.

The deduction of state income tax withheld and paid recognizes - for federal income taxes - the fact that the federal tax would be imposed on what taxpayers are paying their state government, an indirect tax of the state government. It also allows the taxpayer to shift some of the burden of the state tax to the federal government as it reduces federal taxable income. On the other hand, the federal income tax is imposed on federal taxes withheld and paid as to allow the deduction of federal income taxes would not only reduce the amount of federal taxes paid, but it would also reduce the amount of taxable income that the state could tax should they decide to conform to a deduction of federal taxes. Currently there are six

states that allow federal income taxes to be deducted from their state adjusted gross income.

At the state level, on the other hand, the primary reason for allowing the deductibility of state income tax withheld and paid is that it conforms the federal treatment. Conformity to the federal code for state income tax purposes has been a high priority minimizing the number of differences between the federal and state law to facilitate administration and compliance. Further, the deduction recognizes that in the case of withheld taxes, the taxpayer did not have use of the funds between the time the wages were earned and the time the annual return was filed. Withholding taxes must be paid at the time the income is earned and, therefore, the taxpayer has no alternative to otherwise use those funds.

While it is obvious that this nothing more than a means of raising additional resources for the state general fund, it is a back door and less than honest approach. If, in fact, lawmakers want to raise more money from the state income tax, then by all means raise the income tax rates or adjust the brackets so that taxpayers can see the impact of the increase up front. While taxpayers may know they have lost a deduction, they will not fully comprehend the impact on the bottom line in tax liability had they been able to deduct the state income tax.

From an economic standpoint, any tax increase in this time of economic malaise will only slow the state's economic recovery, taking even more dollars out of the marketplace. Given that this bill takes effect for the current tax year, one also has to ask how the change will affect taxpayers who withheld on the basis that state taxes would continue to be deductible. Should this bill become law, more than half the year will have passed and if taxpayers are to have withheld sufficient amounts, they will have to make up for being under withheld in the last six months of the year or make sure they set an additional sum aside when they file their return next April.

Digested 2/28/11

From: mailinglist@capitol.hawaii.gov
Sent: Thursday, March 03, 2011 3:17 AM
To: WAM Testimony
Cc: swartzg001@hawaii.rr.com
Subject: Testimony for SB570 on 3/3/2011 10:30:00 AM

L A T E

Testimony for WAM 3/3/2011 10:30:00 AM SB570

Conference room: 211
Testifier position: oppose
Testifier will be present: No
Submitted by: gregory swartz
Organization: Individual
Address:
Phone:
E-mail: swartzg001@hawaii.rr.com
Submitted on: 3/3/2011

Comments: