H.B. NO. 3194

A BILL FOR AN ACT

RELATING TO INCOME TAXATION EXCLUSION FOR INDIVIDUAL TAXPAYERS AGED 65 AND OVER.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The purpose of this Act is to provide parity
2 amongst the retired persons of Hawaii in the tax treatment of
3 income received by these individuals, no matter what the source.
4 Under current law, only participants in a state-financed pension
5 plan or other qualified employer-funded private pension plan are
6 entitled to an income tax exclusion on income received from
7 these plans. Persons who have saved diligently in employee-
8 funded retirement vehicles do not receive this state income tax
9 exclusion. In reality, only government employees and those with
10 traditional private pensions receive this state income tax
11 exclusion.
12 As the retirement savings effort becomes more and more
13 privatized over time, the likelihood that a substantial number
14 of Hawaii taxpayers will benefit from the private employer
15 pension income tax exclusion is dwindling rapidly. With fewer
16 employers offering traditional pensions and many only assisting
17 employee retirement hopes by making contributions to tax

1 benefited accounts, it is not inconceivable that in the near
2 future only government employees will benefit from this income
3 tax exclusion.
4 Simultaneously with the privatization of retirement
5 benefits is the ever-increasing cost of living in Hawaii. It is
6 simply unfair for retired persons to be taxed materially
7 differently simply because of the source of retirement income.
8 If the disparity in taxation of similarly situated retired
9 persons continues, the struggle to make ends meet for retired
10 persons will only worsen. The legislature intends to bring
11 parity to the taxation of all Hawaii taxpayers by excluding the
12 first $25,000 of income earned by a single person or married
13 person filing separately from Hawaii income tax; and increasing
14 this amount to $50,000 for persons filing a joint income tax
15 return. These amounts phase out as a taxpayer's income
16 increases. This benefit will apply to those aged sixty-five and
17 over and will begin in the tax year that the retired person
18 attains the requisite age.
19 This Act shall be known as the "Retirement with Dignity Tax
20 Relief Act of 2008."
21 SECTION 2. Section 235-7, Hawaii Revised Statutes, is
22 amended by amending subsection (a) to read as follows:

1 "(a) There shall be excluded from gross income, adjusted
2 gross income, and taxable income:
3 (1) Income not subject to taxation by the State under the
4 Constitution and laws of the United States;
5 (2) Rights, benefits, and other income exempted from
6 taxation by section 88-91, having to do with the state
7 retirement system, and the rights, benefits, and other
8 income, comparable to the rights, benefits, and other
9 income exempted by section 88-91, under any other
10 public retirement system;
11 (3) Any compensation received in the form of a pension for
12 past services;
13 (4) Any income received by a taxpayer over age sixty-five
14 or attaining age sixty-five before the close of the
15 taxable year, up to a maximum of:
16 (A) $25,000 for a taxpayer filing a single return or
17 a married person filing separately;
18 (B) $42,500 for a taxpayer filing as a head of
19 household or surviving spouse; or
20 (C) $50,000 for a taxpayer filing a joint return;
21 provided that the maximum amounts allowed under this
22 paragraph shall be reduced by the amount of any

rights, benefits, compensation, or other income received in the taxable year under paragraph (2) or (3); provided further that the maximum amounts allowed under this paragraph shall also be reduced at a rate of fifty cents for every dollar of income earned in excess of the maximum amounts, such that the maximum amounts are reduced to zero dollars when a taxpayer's income is $75,000 for the exemption provided in subparagraph (A); $127,500 for the exemption provided in subparagraph (B); and $150,000 for the exemption provided in subparagraph (C). For purposes of this paragraph, a husband and wife filing a joint return shall be considered one taxpayer so long as at least one spouse is age sixty-five or has attained age sixty-five before the close of the taxable year;

[~~(4)~~] (5) Compensation paid to a patient affected with Hansen's disease employed by the State or the United States in any hospital, settlement, or place for the treatment of Hansen's disease;

[~~(5)~~] (6) Except as otherwise expressly provided, payments made by the United States or this State, under an act of Congress or a law of this State, which by express

provision or administrative regulation or interpretation are exempt from both the normal and surtaxes of the United States, even though not so exempted by the Internal Revenue Code itself;

[~~(6)~~] (7) Any income expressly exempted or excluded from the measure of the tax imposed by this chapter by any other law of the State, it being the intent of this chapter not to repeal or supersede any express exemption or exclusion;

[~~(7)~~] (8) Income received by each member of the reserve components of the Army, Navy, Air Force, Marine Corps, or Coast Guard of the United States of America, and the Hawaii national guard as compensation for performance of duty, equivalent to pay received for forty-eight drills (equivalent of twelve weekends) and fifteen days of annual duty, at an:

(A) E-1 pay grade after eight years of service; provided that this subparagraph shall apply to taxable years beginning after December 31, 2004;

(B) E-2 pay grade after eight years of service; provided that this subparagraph shall apply to taxable years beginning after December 31, 2005;

(C) E-3 pay grade after eight years of service; provided that this subparagraph shall apply to taxable years beginning after December 31, 2006;

(D) E-4 pay grade after eight years of service; provided that this subparagraph shall apply to taxable years beginning after December 31, 2007; and

(E) E-5 pay grade after eight years of service; provided that this subparagraph shall apply to taxable years beginning after December 31, 2008;

[~~(8)~~] (9) Income derived from the operation of ships or aircraft if the income is exempt under the Internal Revenue Code pursuant to the provisions of an income tax treaty or agreement entered into by and between the United States and a foreign country; provided that the tax laws of the local governments of that country reciprocally exempt from the application of all of their net income taxes, the income derived from the operation of ships or aircraft that are documented or registered under the laws of the United States;

[~~(9)~~] (10) The value of legal services provided by a prepaid legal service plan to a taxpayer, the taxpayer's spouse, and the taxpayer's dependents;

[~~(10)~~] (11) Amounts paid, directly or indirectly, by a prepaid legal service plan to a taxpayer as payment or reimbursement for the provision of legal services to the taxpayer, the taxpayer's spouse, and the taxpayer's dependents;

[~~(11)~~] (12) Contributions by an employer to a prepaid legal service plan for compensation (through insurance or otherwise) to the employer's employees for the costs of legal services incurred by the employer's employees, their spouses, and their dependents;

[~~(12)~~] (13) Amounts received in the form of a monthly surcharge by a utility acting on behalf of an affected utility under section 269-16.3 shall not be gross income, adjusted gross income, or taxable income for the acting utility under this chapter. Any amounts retained by the acting utility for collection or other costs shall not be included in this exemption; and

[~~(13)~~] (14) One hundred per cent of the gain realized by a fee simple owner from the sale of a leased fee interest

in units within a condominium project, cooperative project, or planned unit development to the association of apartment owners or the residential cooperative corporation of the leasehold units.

For purposes of this paragraph:

"Fee simple owner" shall have the same meaning as provided under section 516-1; provided that it shall include legal and equitable owners;

"Legal and equitable owner", and "leased fee interest" shall have the same meanings as provided under section 516-1; and

"Condominium project" and "cooperative project" shall have the same meanings as provided under section 514C-1."

SECTION 3. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 4. This Act shall take effect upon approval and shall apply to taxable years beginning after December 31, 2007; provided that amendments made to section 235-7, Hawaii Revised Statutes, by section 2 of this Act shall not be repealed when section 235-7(a) is reenacted by section 3 of Act 166, Session Laws of Hawaii 2007.

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2 INTRODUCED BY: Calvin K.Y. Say

3 BY REQUEST

JAN 22 2008

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Report Title:
Income Tax Relief; Exclusion from Tax for Retirees; Retirement with Dignity Tax Relief Act

Description:
Excludes the first $25,000 of income from income taxation for Hawaii taxpayers age 65 and over. Phases out the exemption amount for income received over $25,000 and for currently exempt retirement income received on a graduated basis.

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JUSTIFICATION SHEET

DEPARTMENT: TAXATION

TITLE: A BILL FOR AN ACT RELATING TO INCOME TAXATION EXCLUSION FOR INDIVIDUAL TAXPAYERS AGED 65 AND OVER.

PURPOSE: To exempt a specific amount of income from taxation for retired persons.

MEANS: Amend section 235-7(a), Hawaii Revised Statutes(HRS).

JUSTIFICATION: Currently, there is a disparity in Hawaii's income tax law relating to the taxation of retirement income. The retirement income of all Employees' Retirement System of the State of Hawaii participants is entirely exempt from income taxation. Also, all employer contribution "pension" income is exempt from income taxation.

The disparity in retirement income taxation arises due to the modern shift from true pension income retirement plans to self-managed retirement plans, such as 401(k) plans and Individual Retirement Accounts. The income distributions from these latter plans that are from employee savings are fully taxable for Hawaii income tax purposes. Because of the shift from employer pensions to privatized retirement accounts in the private sector, there are fewer retired individuals that qualify for Hawaii income tax exemption for retirement income than in years past. The intent of Hawaii's retirement income tax exclusion was to minimize the financial burden on retired persons, who are typically living on fixed-income and in a more vulnerable financial position.

This legislation amends Hawaii tax law by excluding the first $25,000 of taxable income earned for persons filing as single

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or married filing separately; $42,500 for persons filing as head of household or surviving spouse; and $50,000 for persons filing a joint return, provided that the taxpayer (or at least one spouse) is 65 years old or has attained age 65 by the close of the taxable year. The maximum exemption amounts phase out based upon a sliding scale, reducing the exemption amount by fifty cents for every dollar of income in excess of the exemption amount.

Persons that are participants of the Employee Retirement System or whom have employer-funded pensions will be required to reduce the general exclusion amount by the amount of otherwise currently excluded retirement income. This allows for parity amongst all retirees in Hawaii.

Impact on the public:
Persons age 65 and older will enjoy parity in the taxation of retirement income from whatever source. Persons on currently exempt retirement plans will remain exempt entirely; however must reduce the general retiree exclusion by the amount of otherwise currently exempt retirement income.

Impact on the department and other agencies:
The Department of Taxation is currently charged with administering tax-exempt retirement income for purposes of the income tax law.

GENERAL FUND: $20,300,000 per year.

OTHER FUNDS: None.

PPBS PROGRAM DESIGNATION: TAX 100.

OTHER AFFECTED AGENCIES: None.

EFFECTIVE DATE: Taxable years beginning after December 31, 2007.