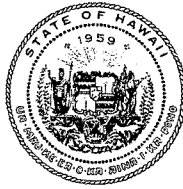


LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

**HOUSE COMMITTEE ON FINANCE
TESTIMONY REGARDING HB 1545
RELATING TO TAX DEDUCTIONS**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: FEBRUARY 26, 2009

TIME: 1PM

ROOM: 308

This measure seeks to expressly conform to Section 68 of the Internal Revenue Code, relating to overall limitations on deductions, and modifies the caps contained therein for Hawaii tax purposes.

The Department of Taxation (Department) **provides comments.**

PREFERENCE FOR STRAIGHT-UP CONFORMITY—The Department understands the purpose of this measure; however prefers that any conformity in Hawaii tax law be similar to that of the Internal Revenue Code in all respects. Every decoupling of Hawaii law begins to further erode the conforming nature of Hawaii law. Decoupling can create confusion for taxpayers between the two tax jurisdictions. Decoupling can also lead to administrative difficulties when trying to administer the same idea in two different ways.

The Department also prefers the current overall deduction limits contained in §68, IRC, to which Hawaii already conforms. Given Hawaii's high cost of living, the current \$100,000 phase-out for joint filers accurately reflects the high cost of living and the struggle Hawaii families experience to pay, for example, mortgage interest payments, to minimize the tax drain on their income. Itemized deductions include the medical expense deduction and the charitable contribution deduction. This cap would penalize taxpayers with large uninsured medical expense deduction limitations and also discourage people from making charitable contributions.

REVENUE IMPACT—The Department acknowledges that this measure increases revenue. However, the Legislature needs to be cautious as to whether this measure is the appropriate revenue raiser when Hawaii families are struggling and they depend upon their itemized deductions to pay their tax bills. This measure is anticipated to result in a revenue gain of approximately \$41.7 million per year for FY10 to FY15.

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Limit itemized tax deductions

BILL NUMBER: HB 1545

INTRODUCED BY: Chong and Yamashita

BRIEF SUMMARY: Amends HRS section 235-2.4(a) to provide that IRC section 68 (with respect to the overall limitation on itemized tax deductions) shall be operative for Hawaii income tax purposes, except that the applicable amount in section 68(b)(1) shall be \$35,000 for a single filer, \$60,000 for a head of household filer, and \$70,000 for joint filers.

This act shall be repealed on June 30, 2015 and HRS section 235-2.4 shall be reenacted in the form in which it read on the day before the effective date of this act.

EFFECTIVE DATE: Tax years beginning after December 31, 2008

STAFF COMMENTS: On the federal level, taxpayers with adjusted gross income above a certain amount may lose part of their deduction for personal exemptions and itemized deductions. The provision began in the early 1990's and is set to be repealed in 2010. The itemized deduction reduction initially called for a reduction of itemized deductions of 3% of the amount that a taxpayer's adjusted gross income (AGI) exceeds the threshold amount. The amount the taxpayer can claim as a deduction for exemptions is reduced once AGI goes above a certain level for the taxpayer's filing status. The threshold is indexed annually for inflation and for 2008 the levels are: married filing jointly - \$239,950; single - \$159,975; head of household - \$199,950; and married filing separately - \$119,975.

The adjusted gross income thresholds being proposed in this measure fail to recognize that in many cases some of the largest itemized deductions would necessitate income of greater than these proposed incomes. For example, a couple with adjusted gross income of \$70,000 probably could not qualify for a loan to purchase a house in Hawaii, thus those taxpayers who have mortgage interest deduction will probably be adversely impacted by the low thresholds.

While this measure proposes to temporarily adopt a similar limitation for Hawaii income tax purposes for a six-year period, it should be noted that while the federal provisions are indexed for inflation, there is no similar adjustment in the proposed measure and the limitations adopted by this measure may not be appropriate for taxpayers in the years leading up to the 6/30/15 repeal date.

Digested 2/25/09