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SENATE COMMITTEE ON ECONOMIC DEVELOMPENT & TAXATION

TESTIMONY REGARDING SB 3111 SD 1
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 12, 2008
TIME: 9:25AM
ROOM: 224

This bill seeks to provide an additional personal exemption of up to $1,000 for taxpayers with dependents aged 18 and under, to be known as the "Ohana Exemption." This bill also increases the dependent care employment-related expense credit expenditure ceiling to $5,000 per dependent. Finally, this bill makes several conforming amendments to § 235-55.6 to conform to the Internal Revenue Code. This bill takes effect upon approval, provided that the "Ohana Exemption" applies to taxable years beginning after December 31, 2008 and the increased dependent care credit applies to taxable years beginning after December 31, 2007.

The Committee on Human Services & Public Housing made technical, nonsubstantive amendments to this measure.

The Department of Taxation (Department) **strongly supports** this Lingle-Aiona Administration measure and urges the Committee to pass this measure.

The purpose of this legislation, known as the Ohana Tax Reduction Act, is to provide meaningful tax relief to the families of Hawaii that struggle with the day-to-day financial burdens of providing the daily necessities of life of their children and dependents, including adult-aged dependents. The Department strongly supports providing targeted financial relief to the ohana of Hawaii. This legislation is a novel and unique approach to providing simple and meaningful relief to these families.

I. ADDITIONAL PERSONAL EXEMPTION FOR SCHOOL-AGED DEPENDENTS.

This legislation provides for what is known as the "Ohana Exemption". This exemption is an additional exemption that may be claimed by a taxpayer with any dependent, as defined by the Internal Revenue Code, aged 18 and under. The Ohana Exemption is provided on a sliding scale basis to provide those families with less income a greater benefit. The means testing of the exemption is as follows:

Federal Adjusted Gross Income	Ohana Exemption Amount
$100,000 and under	$1,000
$100,001 to $200,000	$500
Over $200,000	$0

Currently, there is no relief provided for the direct costs parents incur for their children to attend school or other costs associated with raising a child. Parents can spend hundreds or thousands of dollars providing the necessary food, clothing, shelter, supplies, equipment, and other fees associated with raising a child.

As a result of this legislation, an average family of four in Hawaii would be entitled to claim a personal exemption of $1,040 for each spouse and child; <u>plus an additional $1,000 exemption for each child</u>. Rather than a personal exemption of $4,160, the family would be entitled to exclude from gross income $6,160—<u>a 68% increase in benefit</u>.

The above-mentioned federal income amounts were used because most families in Hawaii have both spouses working, which results in a large gross income for tax purposes; however only enough to get-by financially with Hawaii's high cost of living. It is the Department's position that the $100,000 and $200,000 income thresholds are rational and realistic given Hawaii's high cost of living.

The Department urges the Committee to pass this measure because this bill recognizes the costs associated with caring for the children of Hawaii and provides simple, meaningful tax relief through the operation of the personal exemption. Families should not be punished for having children. It should be the place of government to reward Hawaii's ohana by providing relief for the costs of raising and educating Hawaii's youth.

II. DEPENDENT CARE CREDIT EXPENDITURE CEILING INCREASE.

Hawaii currently conforms to the Internal Revenue Code, which provides for a dependent care credit for employment-related costs associated with providing dependent care. *See* HRS § 235-55.6. This tax credit applies to both children and adult-aged dependent care. The tax credit is a percentage of the dependent care expenses. The percentage is a sliding scale based upon income. The expenditures are capped at a ceiling amount.

The purpose of this legislation is to help offset the high cost of dependent care in Hawaii. Because of Hawaii's high cost of dependent care for both children and adults, many families are forced to have two-worker, two-job families only to cover the cost of care, effectively separating the family for several hours per week. Moreover, the revenue generated by these additional jobs many times only goes to pay for dependent care. This bill increases the dependent care credit employment-related expense ceiling from a two-tiered amount to a flat-per-dependent amount. Under current law, the credit may be used to offset the following amounts—

One qualifying dependent	Up to $2,400
More than one qualifying dependent	Up to $4,800

This bill seeks to eliminate the two-tiered dependent expenditure maximums, in favor of a flat $5,000 ceiling per dependent.

For example, under current law, a family with three children can only claim a credit based on a sliding scale for a percentage of the dependent care costs of up to $4,800 per year—or the same amount that can be claimed for a family with only two children. Whereas under this legislation, a family of three can obtain a credit based on a sliding scale percentage of up to $15,000 in dependent care costs and the family of two can claim up to $10,000. In short, this bill eliminates the penalty for having additional children and provides meaningful relief commensurate with the number of children.

This legislation applies to dependent adults in the same manner.

Lastly, this bill makes several conforming amendments to recent changes made to the same credit in the Internal Revenue Code.

III. REVENUE ESTIMATE.

The legislation will result in revenue loss of approximately $9,000,000 for FY 2009; $25,900,000 ($16.9 million Ohana Exemption + $9.0 million Dependent Care Tax Credit) for FY 2010 and thereafter.

The estimates are based on the 2004 individual returns. The number of child/dependent exemptions totaled 345,161 and the dependent care tax credit amounted to $8.6 million for TY2004. We assumed all child/dependent exemptions qualified for the Ohana Exemption.

As a result of the foregoing, the Department strongly supports this legislation as meaningful tax relief to the ohana of Hawaii. The Department urges the Committee to pass this measure as-is.