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Testimony of the Department of Commerce and Consumer Affairs

Before the
Senate Committees on Commerce and Consumer Protection
and
Public Safety and Military Affairs
Wednesday, February 5, 2025
9:30 a.m.
State Capitol, Conference Room 229 and via videoconference

On the following measure:
S.B. 376, RELATING TO TAX CREDITS

Chair Keohokalole, Chair Elefante, and Members of the Committee:

My name is Jerry Bump, and I am the Acting Insurance Commissioner of the Department of Commerce and Consumer Affairs' (Department) Insurance Division. The Department appreciates the intent of this bill and offers the following comments.

The purpose of this bill is to establish a refundable income tax credit for taxpayers who construct or install improvements to their residence that increase the residence's fire safety rating as calculated by the taxpayer's homeowner's insurance policy, applicable to taxable years beginning after December 31, 2025.

While we appreciate the intent of the bill, the Department notes that the Insurance Division does not possess the expertise necessary to provide a certificate of approval for qualified home fire safety improvements implemented by taxpayers as requested in Section 1, subsection (d), page 3, lines 10-14. The Insurance Division would need funding to hire consultants to develop the certification requirements.

Additionally, the Department would likely have to contract with certified inspectors to verify the improvements were made as required in Section 1, subsection (e), page 3, lines 15-17. The amount of funding needed to contract with certified inspectors is difficult to estimate, since the number of inspections required is dependent on the number of tax credit applications.

Thank you for the opportunity to testify.

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TESTIMONY OF
GARY S. SUGANUMA, DIRECTOR OF TAXATION

TESTIMONY ON THE FOLLOWING MEASURE:
S.B. No. 376, Relating to Tax Credits.

BEFORE THE:
Senate Committees on Public Safety and Military Affairs and Commerce and Consumer Protection

DATE:	Wednesday, February 5, 2025
TIME:	9:30 a.m.
LOCATION:	State Capitol, Room 229

Chairs Keohokalole and Elefante, Vice-Chairs Fukunaga and Wakai, and Members of the Committees:

The Department of Taxation (DOTAX) offers the following <u>comments</u> regarding S.B. 376 for your consideration.

S.B. 376 adds a new section to chapter 235, Hawaii Revised Statutes (HRS), establishing a refundable Home Fire Safety Improvement Tax Credit to incentivize taxpayers to increase the fire safety of their residences.

Under this bill, the tax credit would be calculated as an unspecified percentage of "qualified costs" incurred for the construction or installation of improvements that increase a residence's fire safety rating.

DOTAX notes the following key provisions of the proposed tax credit:

- The credit is refundable, subject to an unspecified annual cap per taxpayer and an aggregate cap for all taxpayers per fiscal year.

- If the aggregate cap is reached, any unused credit amount may be carried forward until fully utilized.

- Taxpayers must file claims within 12 months following the end of the taxable year in which the costs were incurred.

- Taxpayers are required to submit a statement to DOTAX identifying qualified costs.

- DOTAX is responsible for verifying the submitted costs and issuing a letter to the taxpayer confirming the eligible credit amount.

- Taxpayers must include DOTAX's verification letter when claiming the credit on their tax return.

- DOTAX retains the authority to audit and adjust the credit as necessary.

The bill designates the Insurance Commissioner as the certifying authority for qualified home fire safety improvements. A recapture provision applies if the Insurance Commissioner does not certify the qualified costs within 180 days of project completion.

The bill is effective upon approval for taxable years after December 31, 2025.

First, DOTAX recommends making the credit nonrefundable, as refundable credits are more susceptible to waste, fraud, and abuse. Additionally, as currently drafted, the bill may allow persons without any tax liability in the State to claim the tax credit and obtain a refund. Amending the bill to make the credit nonrefundable would preclude refunds in those instances.

Second, DOTAX recommends including a limit on the carryforward period for unused credits. This will enable effective tracking of credits carried forward and mitigate potential abuse. Credit claims made farther away from the year in which costs are incurred are inherently more difficult to verify.

Third, DOTAX notes that it is unable to administer credit caps when taxpayers file their actual returns and credit claims, and it lacks the personnel and subject matter expertise to perform the certification process.

Fourth, if certification of the credit can be done by a third party, the recapture provision can be removed from the bill. Certification before the filing of tax returns would eliminate the risk of conflicting determinations or delayed certifications. The recapture provision—which was intended to address cases where previously verified credits were later disqualified—would become unnecessary, streamlining administration and ensuring a more consistent and efficient process.

Fifth, the bill repeats the 12-month filing deadline to claim the credit in subsections (g) and (i). DOTAX recommends consolidating the provision for clarity.

Thank you for the opportunity to provide comments on this measure.

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

735 Bishop Street, Suite 417 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME TAX; Tax Credit for Home Fire Safety Improvement

BILL NUMBER: SB 376

INTRODUCED BY: MCKELVEY, AQUINO, CHANG, HASHIMOTO, KANUHA, Fevella, Wakai

EXECUTIVE SUMMARY: Establishes a refundable income tax credit for taxpayers who construct or install improvements to their residence that increase the residence's fire safety rating as calculated by the taxpayer's homeowner's insurance policy. Applies to taxable years beginning after 12/31/2025.

SYNOPSIS: Adds a new section to chapter 235, HRS, to create a new refundable tax credit for ____% of the taxpayer's "qualified costs" incurred in constructing or installing a "Qualified home safety improvement".

"Qualified home safety improvement" is defined as an improvement to a taxpayer's residence that increases the residence's fire safety rating as calculated by the taxpayer's homeowner's insurance policy.

For a partnership, S corporation, estate, or trust, the tax credit allowable shall be for qualified expenses incurred by the entity for the taxable year. The costs upon which the tax credit is computed shall be determined at the entity level. Distribution and share of credit shall be determined by rule pursuant to IRC section 704(b).

The income tax credit shall be equal to ___ % of the taxpayer's qualified costs, up to a maximum of $_____in any taxable year.

The total amount of tax credits allowed under this section for all taxpayers in any fiscal year shall not exceed $_____; if exceeded, the credit shall be allowed based on the date of certification by the insurance commissioner on a first come, first serve basis. Any taxpayer who is certified by the insurance commissioner but is ineligible to claim the credit due to the cap having been exceeded for that fiscal year shall be eligible to claim the credit in the subsequent taxable year with priority over taxpayers who receive certification in the subsequent fiscal year.

Recapture equal to ___% of the tax credit claimed in the preceding three taxable years shall be added to the taxpayer's tax liability for the year in which recapture occurs. Recapture applies if qualified costs are not certified by the Insurance Commissioner within 180 days of completion of construction or installation.

Subsection (b) requires taxpayers submit a written, sworn statement to the Department of Taxation no later than 90 days following the taxable year in which qualified costs were paid or incurred that identifies "qualifying costs", if any, paid or incurred in the previous taxable year and the amount of tax credits claimed.

Subsection (c), the Department of Taxation shall:

1) Maintain records of the names and addresses of taxpayers claiming the credit and the total amount of qualified costs upon which the tax credit is based;
2) Verify the amount of qualified costs;
3) Total all qualified costs that the Department of Taxation certifies; and
4) Provide a letter to the Director of Taxation specifying the amount of the tax credit for each taxable year and cumulative amounts for all years claimed.

The Department of Taxation shall issue a letter to the taxpayer verifying the information submitted and the amount of credit claimed. The letter shall be filed with the taxpayer's tax return.

Subsection (d) the Insurance Commissioner shall provide a certificate of approval for the qualified home fire safety improvements implemented by the taxpayer and adopt rules to implement the certification requirements.

The taxpayer shall not claim any other credits under this chapter for the same qualified costs claimed under this section.

The director of taxation shall prepare forms necessary to claim the tax credit, may require proof of claim, and may adopt rules pursuant to chapter 91.

EFFECTIVE DATE: Upon approval, shall apply to taxable years beginning after December 31, 2025.

STAFF COMMENTS: This bill, firstly, contains too many blanks and is impossible to vet in its current form.

Lawmakers need to keep in mind two things. First, the tax system is the device that raises the money that they, lawmakers, like to spend. Using the tax system to shape social policy merely throws the revenue raising system out of whack, making the system less than reliable as there is no way to determine how many taxpayers will avail themselves of the credit and in what amount.

The second point to remember about tax credits is that they are nothing more than the expenditure of public dollars, but out the back door. If, in fact, these dollars were subject to the appropriation process, would taxpayers be as generous about the expenditure of these funds when we need money to support victims of natural disasters like the Maui wildfires, there isn't enough money for social service programs, or our state hospitals are on the verge of collapse?

In any event, a direct appropriation to create a subsidy program, as is now done for energy saving devices, would be more accountable and transparent. Furthermore, the additional credit would require changes to tax forms and instructions, reprogramming, staff training, and other costs that could be massive in amount. A direct appropriation may be a far less costly method to accomplish the same thing.

We also have technical concerns, as follows:

- The definition of "Qualified home fire safety improvement" is an improvement to "a taxpayer's residence." Does it really mean "*any* taxpayer's residence"? If what was meant was "*the* taxpayer's residence," there is an inconsistency because the tax credit is allowed to partnerships, S corporations, estates and trusts, none of which have a residence because they are not human beings.
- Along that line, should there be more clarification on what kind of residence is meant? Is it sufficient for the claimant to live in the property for one day out of the year, must it be the taxpayer's primary residence, or is the cutoff somewhere in between, such as allowing second homes and not allowing third homes?
- To trigger the credit proposed, a "qualified home fire safety improvement" needs to increase the residence's fire safety rating as calculated by the taxpayer's homeowner's policy insurer. Is there a minimum amount that the rating must increase? None is specified in the bill. And what if the taxpayer *doesn't have* homeowner's insurance, for example because the taxpayer's insurer is refusing to insure the house unless certain improvements are made (which appears to be a situation where the credit should logically apply)?

Digested: 2/3/2025