HB 2739 HD1

LINDA LINGLE
Governor

SANDRA LEE KUNIMOTO
Chairperson, Board of Agriculture

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DEPARTMENT OF AGRICULTURE
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LATE

TESTIMONY OF SANDRA LEE KUNIMOTO
CHAIRPERSON, BOARD OF AGRICULTURE

BEFORE THE SENATE COMMITTEE ON AGRICULTURE & HAWAIIAN AFFAIRS
TUESDAY, MARCH 11, 2008
2:45 P.M.
Room 224

HOUSE BILL NO. 2739, HD1
RELATING TO STATE ENTERPRISE ZONES

Chairperson Tokuda and Members of the Committee:

Thank you for the opportunity to comment on House Bill No. 2739, HD1. The purpose of this bill is to qualify agricultural businesses for enterprise zones and allow them to receive benefits in case of a force majeure event.

The Hawaii Department of Agriculture (HDOA) supports the intent of this bill as it allows qualified agricultural businesses in the Enterprise Zone (EZ) program to remain eligible for all tax incentives while experiencing a force majeure event and also extends the seven-year eligibility period by the duration of the loss.

This bill addresses concerns raised previously by defining the term "*force majeure*" and amends Section 4 (a)(4) (Page 5; lines 14-20) by allowing qualified businesses to stay eligible in subsequent years by maintaining a higher level of employment of at least 10 per cent in the first year, provided that value-added products are made from crops grown within the EZ or are engaged in producing or processing agricultural products.

However, we wish to point out that agribusinesses, in general, will still find it challenging to meet the increase in full-time employee requirements, especially when agricultural labor is in short supply. Rather than increasing the number of employees agricultural businesses seek to increase efficiency, an alternate performance measure such as an annual increase in gross income by two percent is more reasonable for agricultural enterprises. This was proposed by DBEDT in bills for several years and we suggest these criteria be included in House Draft 1.

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
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SENATE COMMITTEE ON AGRICULTURE & HAWAIIAN AFFAIRS

TESTIMONY REGARDING HB 2739 HD 1
RELATING TO STATE ENTERPRISE ZONES

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 11, 2008
TIME: 2:45PM
ROOM: 224

This bill would provide farmers with an alternative means of obtaining and maintaining enterprise zone (EZ) benefits.

The Joint House Committee on Economic Development & Taxation and Agriculture amended the measure by defining a "force majure" event, among other nonsubstantive changes.

The House Committee on Finance passed this measure unamended.

The House of Representatives passed this measure on third reading.

The Department of Taxation ("Department") **supports the intent** of this bill. The Department defers to the Department of Business, Economic Development and Tourism ("DBEDT") and the Department of Agriculture regarding this bill's merits.

The State currently provides tax breaks for qualifying businesses in an Enterprise Zone. Under section 209E-11, Hawaii Revised Statutes (HRS), certain types of businesses in the enterprise zone that satisfy hiring requirements are exempt from the state general excise and use tax for up to seven years. Qualified businesses can also claim two partial state income tax credits under section 209E-10, HRS:

1. **An income tax credit based on taxes due the State.** The tax credit is equal to 80 percent of the taxes due for the first tax year, which decreases by 10 percent for each year thereafter, over the next six years;

2. **An income tax credit based on unemployment taxes paid.** The tax credit is equal to 80 percent of the unemployment taxes paid during the first year, which decreases by 10 percent

for each year thereafter, over the next six years.

The Department notes that pursuant to HRS 209E-10, DBEDT has been tasked with certifying to the Department the applicability of the tax credit for a qualified business against any taxes due to the State.

This bill amends the requirements of the state enterprise zone program by:

1. Allowing the Department of Business, Economic Development, and Tourism to extend tax incentives to qualifying agricultural businesses for the duration of the effects of a *force majeure*;

2. Enabling agricultural businesses to remain eligible for the tax incentives under the Program during any period of interruption caused by a *force majeure* event;

3. Adds a definition of "force majure event," "leased employee," and "joint employment" to HRS § 209E-2, and amends HRS § 209E-2 to include "leased employees" and "joint employees" in the definition of "full-time employees";

4. Amends HRS § 209E-10 to allow agricultural business as the only businesses that could use retail sales of value-added products from crops grown within an EZ to count toward certification for the tax credit.

5. Adds clarifying language to HRS § 209E-11 that an agricultural business is not exempt from general excise tax on gross proceeds of agricultural retail sales.

Revenue losses are estimated to be $800,000 for fiscal year 2009, $2.4 million for fiscal year 2010, $800,000 for fiscal year 2011 and $550,000 per year thereafter.

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

LINDA LINGLE
GOVERNOR
THEODORE E. LIU
DIRECTOR
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Statement of
THEODORE E. LIU
Director
Department of Business, Economic Development, and Tourism
before the
SENATE COMMITTEE ON AGRICULTURE AND HAWAIIAN AFFAIRS

Tuesday, March 11, 2008
2:45 P.M.
State Capitol, Conference Room 224

in consideration of
HB 2739 HD 1
RELATING TO STATE ENTERPRISE ZONES

Chair Tokuda, Vice-Chair English, and Committee members:

The department supports the concept of HB 2739 HD 1, which allows agricultural businesses to continue to qualify for zone benefits in case of *force majeure* events; includes leased and jointly employed workers in hiring formulas; changes the timing of employee increases; and counts value-added agricultural product retail sales towards qualification for tax credits, while disallowing general excise tax exemption for agricultural product retail sales.

There have been many good ideas introduced this legislative session that support the State's economic development goals, and we note that no appropriation is associated with this bill.

Agriculture is a vital component of Hawaii's economy, preserving open space essential to tourism and helping to protect our environment. Currently, there are more than 5500 farms, but as of 2006, only 44 participated in the Enterprise Zone (EZ)

Partnership. In 2005, only 12 of the 44 firms qualified for benefits, 4 companies did not qualify and the remaining 21 farmers did not file their annual reports. Common reasons for not filing included closing the business or knowing that qualification criteria had not been met.

This bill also helps farmers cope with natural disasters by allowing them to retain EZ eligibility when their operation has been negatively affected and then resume production, with the time added to their full participation period. This change would have benefited many farmers affected by the Spring 2006 floods on Oahu and Kauai and a few on the Big Island whose water systems were damaged by the Kiholo earthquake.

The department, however, identifies two major changes contained on page 6, lines 8 through 19 that will have a negative impact on businesses and the department. The first impacts 'existing' businesses. The bill will require firms to increase the average annual number of full-time employees **by at least 15%** at the ends of the fourth, fifth, sixth and seventh years of eligibility. Presently, 'existing' EZ businesses need to increase employees by *10% each year* for the term of their eligibility. We feel that the *current language requiring the 10% increase is more realistic* and attainable given the State's low unemployment levels and positive impact results the current 10% increase already has. And 'existing' businesses will include and affect small mom-and-pop farms and businesses probably as much as large companies.

The second change contained on page 6, lines 17-19, establishes the base employee count from the time the business opened for operation and not when they applied into the EZ program as is currently practiced. The implication is that a business that has been around for 30, 40, or 50 years, can apply and use their base employee count from 30, 40, or 50 years ago, and if they increased their staff by 10% in the first year, and 15% in years two to seven, they would *automatically fulfill this requirement* for benefits that would apply 23, 33, or 43 years later. It will be difficult to obtain credible data from companies that have been for over 10 years. It would be difficult to verify and difficult to enforce. Furthermore, this would conflict with the purpose of the EZ program which is to encourage economic growth in our communities *today*. We would recommend not including the changes stated on lines 12 to 19.

Our last comment is the additions on page 7 lines 9 to 12. We appreciate the specific omission of agricultural retail sales from being GET exempt, however, we want to retain the inclusion of 'genetically-engineered... agricultural... products,' to encourage and promote biotechnology development and utilization in Hawaii. We suggest page 7 lines 9 through 12 state, ";provided that agricultural businesses <u>not engaged in genetically-engineered agricultural production</u> shall not be exempt from the payment of general excise taxes on the gross proceeds of agricultural retail."

Thank you for the opportunity to offer these comments.

HAWAII FARM BUREAU FEDERATION
2343 ROSE STREET
HONOLULU, HI 96819

MARCH 11, 2008

HEARING BEFORE THE
HOUSE COMMITTEE ON FINANCE

TESTIMONY ON HB 2739, HD 1
RELATING TO STATE ENTERPRISE ZONES

Chair Tokuda and committee members:

My name is Alan Takemoto, Executive Director, of the Hawaii Farm Bureau Federation, which is the largest non-profit general agriculture organization representing approximately 1,600 farm and ranch family members statewide.

The Hawaii Farm Bureau Federation supports the intent of HB 2739, HD 1. We support the provision that allows agricultural businesses to continue to be qualified in the event of any natural disaster. Agricultural businesses can be completely out of production for weeks and sometimes for months with strong winds, rain, and flooding. Also allowing value added agricultural products grown in the zone may also take advantage of these tax credits provided. This will encourage more value added production and help farmers to diversify their operation.

We are concerned over the labor requirements. With the labor shortage here in Hawaii, especially for agricultural operations, it has been very difficult to hire willing laborers to work on farms. Small family farms will continue to not participate in this program if this labor requirement becomes more difficult. We recommend that for agricultural operations, we add that revenues be an alternative if the farm operation cannot meet the labor requirement. With revenues as an added component, the agricultural operation will then have a realistic incentive mechanism to eventually hire more labor.

Thank you.

HARC

Hawaii Agriculture Research Center

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TESTIMONY BEFORE THE SENATE COMMITTEE ON AGRICULTURE AND HAWAIIAN AFFAIRS

HOUSE BILL 2739 HD1

RELATING TO STATE ENTERPRISE ZONES

March 11, 2008

Chair Tokuda and Members of the Committee:

My name is Stephanie Whalen. I am President and Research Director of the Hawaii Agriculture Research Center (HARC). I am testifying today on behalf of the center, our research and support staff, and our members and clients.

HARC supports the intent of House Bill 2739 HD1 Relating to State Enterprise Zones but prefers the language of HB2913 SD1. This bill worked out during the 2007 session seemed to have many of the affected parties agreement after 4 years of discussion.

It recognized the uniqueness of agricultural businesses and would be very helpful in maintaining the viability of agriculture. In the transition from large scale farming to smaller and more diverse farms it is imperative that the statutes also change and adapt to the needs of this situation. There is a demonstrated employment crunch in Hawaii and finding employees is often very difficult, especially for agriculture. While we recognize the original intent of this statute was to increase employment, times have changed, all sectors are scrambling to find and keep employees in a very financially difficult environment. Increasing revenues is an equally important contribution to the economic viability of our state. Agriculture has been faced with labor shortages from its beginnings and is forced to be entrepreneurial in maintaining and increasing output while faced with a dwindling workforce.

What HB 2739 HD1 does add over the HB2913 version, which is very progressive, is the employee sharing concept. Many of the newer crops do not require year-round labor but with the diversity developing shared or leased employees just makes sense. Whereas diversity existed under one employer in the past which allowed year round employment by one company, that diversity is now manifested in many independent farms where peak and shorter employment periods is the norm.

It would be most helpful and exciting to see these two proposed measures combined to support the diversification of agriculture that has been the goal for over three decades.

Thank you for the opportunity to testify.

Hawaii Aquaculture Association

To:

THE SENATE
THE TWENTY-FOURTH LEGISLATURE
REGULAR SESSION OF 2008

COMMITTEE ON AGRICULTURE & HAWAIIAN AFFARIS
Sen. Jill N. Tokuda, Chair
Sen. J. Kalani English, Vice Chair

HEARING

DATE: Tuesday, March 11, 2008
TIME: 2:45p.m.
PLACE: Conference Room 224, State Capitol
415 South Beretania Street

Agenda

From: Ronald P. Weidenbach, President, Hawaii Aquaculture Association
Cell: 429-3147, Email: hawaiifish@gmail.com

Re: **HB2739 HD1** - RELATING TO STATE ENTERPRISE ZONES

Chair Tokuda, Vice-Chair English, and Members of the Committees:

The Hawaii Aquaculture Association (HAA) **strongly supports the intent of HB2739 HD1** to qualify agricultural businesses for enterprise zones, to allow them to receive benefits in case of force majeure, to count leased employees and joint employment workers in hiring formulas, and to qualify certain value-added agricultural sales towards certification for income tax credit purposes.

However, HB2739 HD1 fails to address the needs of small agriculture operations and micro-enterprises in initially meeting and subsequently maintaining eligibility under current hiring requirements and clearly providing for the immediate needs of Hawaii's agriculture operations affected by one or more of the force majeure events of the last fifteen months that are currently seeking to maintain Enterprise Zone (EZ) eligibility. HAA therefore respectfully requests that HB2739 HD1 be amended to address these two concerns, as follows:

1. In Section 1. or elsewhere as appropriate, it should be stated that the effective date of eligible force majure events extend back to November 2006, the start of the 40 days of

rain in November/December 2006 so as to cover EZ agriculture operations severely affected by these rains and/or by subsequent earthquake, wind and fire natural disasters. This amendment is particularly important for agribusinesses producing crops that take one or more years to grow, such as aquaculture products, fruit trees, and forestry products, where losses in 2006 subsequently affected the agribusinesses' ability to meet increased employment requirements in 2007 thereby affecting EZ eligibility in 2008 and beyond.

2. In Section 4. (b), an agribusiness firm should be eligible to be designated a qualified business if the business increases its average annual number of full-time employees by 10% per year (not increasing by 15% per year in years 4, 5, 6, and 7 as indicated in HB2739 HD1), or, if an agribusiness firm increases its gross sales of agricultural crops or products produced within the enterprise zone by 2 %, as specified in last year's HB1923 HD2SD1 Relating to Enterprise Zones for Agriculture that was passed by EDB, AGR, and FIN. To make increased employment the only measure of initial and annual eligibility favors larger businesses whereas EZ start-ups are often small "Mom and Pop" micro-enterprise operations, many initially without employees. The inequity of this current situation is demonstrated in the following example:

   A business with 10 existing employees that is located within or moving into an EZ could be immediately eligible to be designated as a qualified business and would have to increase its average annual number of full-time employees by one (1) to meet the 10% annual increase requirement.

   In comparison, a micro-enterprise without employees would have to add one (1) employee just to become eligible for EZ designation, and this hire would not count towards the 10% annual increase requirement (under DBEDT's interpretation of the current EZ eligibility requirements). Therefore, once EZ designation is obtained, the micro-enterprise would then have to hire a second full-time employee to count towards the 10% annual increase requirement. However, if this second employee were hired two or three months after EZ designation, which is likely given the current shortage of available agricultural employees, then the micro-enterprise would have to hire a third employee at least two or three months before the end of the year in order to have 12 months of FTE new-hire employment for the year to meet the 10% annual increase requirement and maintain eligibility.

   The inequity of this situation for a micro-enterprise is clearly apparent with the micro-enterprise without employees having to hire three (3) employees in one year to meet EZ eligibility qualification requirements while the 10-employee business only has to hire one (1). This inequity could be corrected by adding the alternative eligibility criteria of increasing gross sales by 2% as defined in last year's HB 1923 HD2SD1.

The HAA strongly supports the EZ program but urges the amendments requested above to address the eligibility crisis for EZ agribusinesses affected by force majure events over the past fifteen months and to make the program equitable for micro-enterprises and agribusinesses with fewer than 10 employees by allowing firms to meet eligibility requirements by either a 10% annual employee increase or by a 2% increase in gross sales.

Thank you for the opportunity to testify.

Hawaii Crop Improvement Association

Growing the Future of Worldwide Agriculture in Hawaii

Testimony by: Sarah Styan
HB 2739hd1, State Enterprise Zones
Senate AHW Committee
Tuesday, March 11, 2008
Room 224: 2:45 pm

LATE

Position: Support

Chair Tokuda and Members of the Senate AWH Committee:

My name is Sarah Styan. I am a Kauai resident, President of HCIA and research scientist of Pioneer Hi-Bred International, Waimea Research Station. The HCIA represents seed production and research facilities operating in Hawaii for nearly 40 years. The HCIA is comprised of five member companies that farm an estimated 8,000 acres on four islands, valued at $97.6 million in operating budget (2006/2007 HASS). We are proud members of Hawaii's diversified agriculture and life sciences industries.

This is a measure that will facilitate the growth of Hawaii's agricultural industry by creating agricultural enterprise zones, in which farmers in specified rural areas may receive incentives for farming. It takes into account some of the unique challenges that farming brings to agricultural enterprise zones, primarily labor availability and weather conditions, and allows for certain value-added agricultural sales towards certification for this credit.

We support the provisions that allow for continued benefit of tax incentives during a force majeure event. The definitions for "joint employer" and "leased employee" are appreciated because in today's tight labor market, some of the agricultural employees are leased employees or may be employed by more than one farmer.

I can be reached at 808-338-8300 ext. 113 if there are any questions. Thank you for the opportunity to present testimony.

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L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, Enterprise zone agricultural businesses

BILL NUMBER: HB 2739, HD-1

INTRODUCED BY: House Committees on Economic Development and Business Concerns and Agriculture

BRIEF SUMMARY: Adds a new section to HRS chapter 209E to provide that if an agricultural business is: (1) prevented from maintaining enterprise zone eligibility requirements; or (2) interrupted due to a force majeure event, the business located in an enterprise zone shall not be disqualified as an eligible business. The seven-year eligibility period for such business shall be extended by the duration of the force majeure event.

Amends HRS section 209E-2 to add the definition of "force majeure," "joint employment," and "leased employee" for purposes of the measure. Amends the definition of "full-time" employee to include leased employees and employees under a joint employment relationship and the definition of "qualified business" to include a business engaged in processing agricultural products. Defines "force majeure" as an event including, but not limited to, damaging weather or natural disasters such as epidemic disease, pest outbreak, high wind, thunderstorm, hail storm, tornado, fire, flood, earthquake, lava flow or other volcanic activity, drought, tidal wave, hurricane, or any situation beyond the control of the agricultural business.

Amends HRS section 209E-9 to stipulate that receipts from value-added products made from crops grown within an enterprise zone and sold at retail pursuant to the enterprise zone requirements, shall count toward the gross receipts requirement for business firms engaged in producing or processing agricultural products. Also provides that a business shall be eligible as a "qualified business" if the business increases its average annual number of full-time employees employed at the business located within the enterprise zone by at least 10% by the end of the first year of operation; and by 15% by the end of each of the fourth, fifth, sixth, and seventh years of operation.

Amends HRS section 209E-11 to provide that agricultural businesses shall not be exempt from the payment of general excise taxes on the gross proceeds of agricultural retail sales.

EFFECTIVE DATE: Tax years beginning after December 31, 2034

STAFF COMMENTS: In an enterprise zone, businesses are attracted and encouraged to relocate to the zone through tax incentives, bonds, and other appropriate measures. Businesses located in an enterprise zone may claim a credit against taxes paid for a period of seven years and also allows the sale of items sold by such businesses to be exempt from the general excise tax. This measure proposes to allow an agricultural business located in an enterprise zone to maintain its eligibility requirements in the event of a force majeure and also to extend its enterprise zone benefits by the duration of the event.

While it is understandable that agricultural operations are perhaps more prone to suffer economic dislocation as a result of a natural disaster or severe weather conditions, one has to pose the question whether or not other businesses that suffer from a force majeure should also be granted the same leniency this measure proposes? What this measure does emphasize is the inequity created by enterprise zones by handing out more favorable treatment for those located in the zone, usually at the expense of those who are not.

The proposed measure also amends the eligibility requirements of an enterprise zone to include the processing of agricultural products. It should be remembered that in recent years, the type of businesses that have been included to receive enterprise zone benefits include call centers of disease management services, sale of wind farm generated electricity sold to a public utility, research, development and sale of genetically engineered medical, agricultural, or maritime biotechnology, etc. The proposed measure would singling out another business for preferential treatment merely conferring preferences for those businesses at the expense of all other taxpayers

It should be remembered that enterprise zones merely exacerbate what is already considered a poor climate in which to do business. Singling out specific areas of the state merely confers preferences for those businesses located within those geographic areas at the expense of all other taxpayers who are not so favored. It should be remembered that those taxpayers who live and work in the zone will demand the same public services as those who are not as fortunate to be located in the zone. Who then will pay for these services?

Concurrent efforts must be made to improve Hawaii's business climate to enhance the economic prospects for all businesses. Enterprise zones are merely an abdication of government's responsibility to create a nurturing and supportive business climate so that all businesses can thrive in Hawaii and provide the jobs the people of Hawaii need.

Finally, while Hawaii has had the enterprise zone concept on the books for years, no evaluation of how effective these zones have been in improving the well-being of those communities on which this status has been conferred. Before further corrupting the economic marketplace with added versions of the enterprise zone concept, an evaluation of the current zones should be undertaken. Instead of expanding the enterprise zone program, the program should be repealed in favor of across-the-board tax relief for all businesses in Hawaii. Indeed, has there not been a comprehensive evaluation of the program and do lawmakers know exactly how much enterprise zone businesses have benefitted and whether or not they have created the jobs promised when the program was first established? If the legislature is adamant about the designation of enterprise zones in the state, then the whole state should be designated an enterprise zone and the tax treatment will be equitable to all businesses

Digested 2/25/08