

Honolulu, Hawaii

FEB 20 2009

RE: S.B. No. 1247
S.D. 1

Honorable Colleen Hanabusa
President of the Senate
Twenty-Fifth State Legislature
Regular Session of 2009
State of Hawaii

Madam:

Your Committee on Economic Development and Technology, to which was referred S.B. No. 1247 entitled:

"A BILL FOR AN ACT RELATING TO THE ECONOMY,"

begs leave to report as follows:

The purpose of this measure is to require the Department of Taxation to evaluate certain tax credits and tax exemptions and to report their recommendations to the Legislature. This measure also requires the Legislature to implement the Department of Taxation's recommendations prior to the sunset date for each tax credit and tax exemption that is evaluated.

Testimony in support of this measure was submitted by Department of Taxation, Department of Business, Economic Development and Tourism, Hawaii Government Employees Association, Hawaii Science and Technology Council, Honolulu Film Office, Hawaii Film and Entertainment Board, IATSE, Local 665, and Screen Actors Guild Hawaii. Testimony in opposition of this measure was submitted by Hawaii Housing Finance and Development Corporation, Hawaiian Telcom, Chamber of Commerce of Hawaii, Hawaii Association of Realtors, Housing Hawaii, Hawaii Pacific Health, and EAH Housing. Comments on this measure were submitted by Hawaii Bioenergy. Copies of written testimony presented to your Committee are available for review on the Legislature's website.

Your Committee finds that the evaluation requirements in this measure for the Department of Taxation, with the assistance of the Department of Business, Economic Development, and Tourism, and the



subsequent reporting of recommendations to the Legislature, comprise the first comprehensive review on the usage and fiscal impacts of various tax credits and tax exemptions since the 2001-2003 and 2005-2007 Tax Review Commissions encouraged the Legislature to undertake a thorough evaluation of the costs and benefits of various credits and exemptions to determine whether they were fulfilling the purpose for which they had been adopted.

In recent years, the Legislature has been troubled by the lack of comprehensive data on various tax credits and tax exemptions being compiled by the Department of Taxation and submitted to the Legislature. For example, the Department's last complete report on usage of tax credits was in 2005. During the seven years since the enactment of Act 221, Session Laws of Hawaii, 2001, Department of Taxation has made many complaints about Act 221, but has never adopted administrative rules to address the range of abuses that the Department asserts are commonplace among users of the tax credit. Instead, it has relied on periodic Tax Information Releases (TIR) that provide only partial guidance to potential Act 221 investors and companies as to the behavior that is permitted and that which is not. Some taxpayers have noted that the Department's responses to inquiries about the appropriate interpretation of its TIR's are not always timely nor are they complete.

In 2007, the Legislature adopted Act 206 to require the Department of Taxation to compile data to evaluate the usage, costs and benefits of Act 221's High Technology Business Investment Tax Credit, so that a proper evaluation of the actual costs and benefits associated with the tax incentives could be undertaken. That evaluation would also ensure that the tax incentives met their intended objectives. Department of Taxation worked closely with representatives of tech industry, Act 221 businesses and Department of Business, Economic Development, and Tourism to develop a new form to report on the economic benefits (e.g., jobs created, investments made, etc.) under the new law.

The Department of Taxation published two recent reports on Act 221 credits, one dated September 2008 and the other dated December 2008. However, the two reports have not fulfilled the needs of the Legislature, which was to obtain a clear picture of whether the manner in which Act 221 credits are awarded, administered and reported on is done in a manner to establish a strong sense of trust that the public is getting "good value" for the loss of tax revenues. In particular, the December 2008 report



contains analyses that do not provide a fair and accurate comparison of the costs and benefits of Act 221 since its date of enactment. Specifically, the December 2008 report compares one year of benefits reported by new applicants for the tax credit in 2007, but evaluates the reported benefits against costs attributable to all users of Act 221 credits for the past six years.

In the absence of sufficient data with which to make a thorough evaluation of the costs and benefits of credits and exemptions, your Committee proposes a framework in this measure to evaluate all existing credits and exemptions over an initial five-year period, coupled with automatic sunset dates that could be accepted or extended by the Legislature pursuant to a recommendation from the Department of Taxation, based on its review and compilation of relevant data. Those tax credits with statutory sunset dates would be evaluated and reported on during the year prior to the sunset of the credit.

During the hearing on the measure, several users of existing credits strongly objected to the automatic sunset dates in the measure, which would adversely impact their operations - e.g., affordable housing agencies and advocates, a health care provider, and a telecommunications provider. While sympathetic to the concerns raised by testifiers, particularly involving "social incentives" like affordable housing and hospitals, your Committee believes that the bill's framework for comprehensive evaluation of credits and exemptions should be advanced to give the Senate Committee on Ways and Means the opportunity to review the fiscal impact and economic benefits of all credits and exemptions in conjunction with specific sunset dates.

To relieve some of the concerns of industry testifiers, your Committee proposes to move those tax credits or exemptions whose sunsets were strongly opposed to the group of incentives with the last sunset date. Your Committee further offers the following overview on usage of these specific credits and exemptions:

- (1) Renewable energy technologies tax credit, Section 235-12.5, Hawaii Revised Statutes, in 2005, Department of Taxation reported revenue losses of \$2,615,387, whereas in 2006, the department reported revenue losses of \$6.18 million. The cost and benefits of this credit has also been carefully evaluated in the *Report of the Energy-Efficiency Policy Task Force, January 2002*. As such,



your Committee believes that the level of data and analysis for this credit serves as a useful model of the type of fiscal and economic impacts review that is required for legislative oversight and review.

- (2) General excise tax exemption granted to qualifying hospitals, Section 237-23(6), Hawaii Revised Statutes, in response to the committee's inquiry, Department of Taxation reported that the amount of qualifying income that tax-exempt hospitals exclude from taxation is not captured by the Department. It referenced Appendix H of the *Report of the 2005-2007 Tax Review Commission*, which examined the impact of eliminating the tax-exempt status granted to a broader category of non-profit organizations.

The Tax Review Commission's report identified a revenue loss of \$225.2 million for 2005, and hypothesized that, since hospitals represented 31% of that total, approximately \$69.7 million would be attributable to elimination of the tax exemption granted to qualifying hospitals. In its testimony, Hawaii Pacific Health pointed to the adverse impact that repeal of the tax exemption granted to qualifying hospitals would have on its operations, citing a deficit of 20-21% on all Medicaid and QUEST reimbursements paid by the State of Hawaii to Hawaii hospitals, as well as the chilling effect that loss of the exemption would have on a hospital's credit rating and ability to obtain financing at reasonable cost.

- (3) Low-Income Housing Tax Credit, section 235-110.8, Hawaii Revised Statutes; general excise tax exemptions for certified housing projects, section 237-29, Hawaii Revised Statutes; and low-income housing tax credits used by banks and financial institutions, section 241-4.7, Hawaii Revised Statutes, Department of Taxation reported usage of low-income housing tax credit resulted in a \$5.4 million revenue loss in 2005, with claims by financial institutions using section 241-4.7, Hawaii Revised Statutes, were an additional \$2.4 million in revenue losses.

In response to your Committee's inquiry, Hawaii Housing Finance Development Corporation and Department of



Taxation reported the following awards for low-income housing: projects with a total of 364 housing units obtained \$2,121,595 in credits in 2006, projects with a total of 961 units obtained \$3,750,430 in credits in 2007, and projects with a total of 595 units obtained \$4,311,789 in credits in 2008. Accordingly, among the projects awarded low-income housing tax credits from the state's annual volume cap, and those awarded low-income housing tax credits in addition to the state's annual volume cap yielded projects with a total of 1,456 units, with a revenue loss of \$6,268,851.

- (4) Capital goods excise tax credit, section 235-110.7, Hawaii Revised Statutes, as reported by Department of Taxation, the capital goods tax credit is a refundable credit for purchases of eligible depreciable tangible personal property used in a trade or business in Hawaii. In 2005, \$23.5 million was claimed, while a total of \$34,334,925 was claimed by businesses in 2006.
- (5) General excise tax exemption for services to related entities, section 237-23.5, Hawaii Revised Statutes, : Department of Taxation reported that this data is not available because the Department does not capture this information; the Department referenced Appendix H of the *Report of the 2005-2007 Tax Review Commission* in reporting that usage of the exemption resulted in an \$11 million revenue loss for 2005.
- (6) Lifeline tax credit, section 239-6.5, Hawaii Revised Statutes, Department of Taxation reported that \$163,672 in credits was claimed for 2006; no data was furnished by the department for 2005.

As your Committee sought information on the economic impacts or benefits accruing from use of various tax credits and exemptions, it became obvious that Department of Taxation could not compile this information unless it relied upon the Department of Business, Economic Development and Tourism's Research Division for assistance in developing the appropriate economic models for an evaluation of the economic benefits. For example, Department of Business, Economic Development, and Tourism objected to the automatic sunset of the renewable energy technologies tax credit because the department had undertaken a specific cost-benefit analysis for the renewable energy technologies. See *Report of the*



Energy-Efficiency Policy Task Force, January 2002.

<http://www.state.hi.us/dbedt/ert/symposium/preface.html>.

Similarly, your Committee acknowledges the State of New Mexico's January 2009 study entitled *Economic and Fiscal Impacts of the New Mexico Film Production Tax Credit* as a useful example of the type of concise economic impacts reports sought by the Legislature.

<http://www.nmfilm.com/locals/downloads/nmfilmCreditImpactAnalysis.pdf>

Accordingly, your Committee proposes to establish parameters for Department of Taxation's reporting on fiscal impacts (e.g., costs) of tax credits or exemptions, and parameters for Department of Business, Economic Development and Tourism's reporting on economic impacts (e.g., benefits) of tax credits or exemptions for each of the credits and exemptions outlined within this measure to insure that the Legislature has data reflecting the dynamic impacts of each tax credit and tax exemption that is studied or evaluated

It is the intent of your Committee to require the Department of Taxation to evaluate and report recommendations to the Legislature for certain tax credits and tax exemptions under chapters 209E, 235, 237, 239, 241, and 244D, Hawaii Revised Statutes, and require the Legislature to implement those recommendations prior to the sunset date for each tax credit and tax exemption that is evaluated. To address the issue of lack of access to pertinent tax data that is timely, comprehensive, and accurate, the Legislature will require the Department of Taxation to post all usage data on tax credits and tax exemptions on the Department of Taxation's website with an explanation of the Department's methodology used to calculate revenue losses and other fiscal impacts.

Your Committee has amended this measure by:

- (1) Requiring the Department of Business, Economic Development, and Tourism to provide dynamic economic impact statements to the Department of Taxation for each tax credit and tax exemption identified in this measure;
- (2) Moving the potential repeal for certain tax credits and tax exemptions to a later date;
- (3) Clarifying that potential repeal of the tax credits under sections 235-110.8 and 241-4.7, Hawaii Revised



Statutes, and the tax exemption under section 237-29, Hawaii Revised Statutes, shall not apply to those projects approved before January 1, 2014; and

- (4) Making technical, nonsubstantive amendments for the purpose of clarity.

As affirmed by the record of votes of the members of your Committee on Economic Development and Technology that is attached to this report, your Committee is in accord with the intent and purpose of S.B. No. 1247, as amended herein, and recommends that it pass Second Reading in the form attached hereto as S.B. No. 1247, S.D. 1, and be referred to the Committee on Ways and Means.

Respectfully submitted on
behalf of the members of the
Committee on Economic
Development and Technology,


CAROL FUKUNAGA, Chair



The Senate
Twenty-Fifth Legislature
State of Hawaii

Record of Votes
Committee on Economic Development and Technology
EDT

Bill / Resolution No.:* SB 1247	Committee Referral: EDT, WAM	Date: 2-13-09		
<input type="checkbox"/> The committee is reconsidering its previous decision on this measure. If so, then the previous decision was to: _____				
The Recommendation is: <input type="checkbox"/> Pass, unamended 2312 <input checked="" type="checkbox"/> Pass, with amendments 2311 <input type="checkbox"/> Hold 2310 <input type="checkbox"/> Recommit 2313				
Members	Aye	Aye (WR)	Nay	Excused
FUKUNAGA, Carol (C)	✓			
BAKER, Rosalyn H. (VC)	✓			
HEE, Clayton				✓
IGE, David Y.	✓			
SLOM, Sam	✓			
TOTAL	4	—	—	1
Recommendation: <input checked="" type="checkbox"/> Adopted <input type="checkbox"/> Not Adopted				
Chair's or Designee's Signature: <div style="text-align:center; font-family: cursive; font-size: 1.2em;">Rosalyn H Baker</div>				
Distribution: Original Yellow Pink Goldenrod File with Committee Report Clerk's Office Drafting Agency Committee File Copy				

*Only one measure per Record of Votes