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: INCOME, New markets tax credit

BILL NUMBER: HB 2168

INTRODUCED BY: Ito, Chang, Magaoay, Sagum, Yamane, and 1 Democrat

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to provide that a taxpayer who holds a qualified equity investment on a credit allowance which occurs during the taxable year, may claim a credit equal to the applicable percentage of the amount paid to the qualified community development entity for the investment at its original issue. "Applicable percentage " means: (1) 5% with respect to the first three credit allowance dates; and (2) 6% with respect to the remainder of the credit allowance dates.

Tax credits in excess of a taxpayer's net income tax liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted. All claims for a tax credit under this section shall be filed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. Failure to properly and timely claim the credit shall constitute a waiver of the right to claim the credit. Requires the application for a new markets tax credit to be submitted to the director of taxation on forms prescribed by the director of taxation.

IRC section 469 (with respect to passive activity losses and credits limited) shall be applicable to the credit and all references to IRC section 45D, to the extent it is not inconsistent with this section, shall be operative for purposes of this section.

Amends HRS section 235-2.45(d) to provide that IRC section 704 (with respect to a partner's distributive share) shall be operative for purposes of this chapter; except that section 704(b)(2) shall not apply to allocations of new markets tax credits among partners.

Makes conforming amendments to HRS section 235-2.3.

EFFECTIVE DATE: Tax years beginning after December 31, 2009

STAFF COMMENTS: On the federal level, the new markets tax credit was adopted as part of the Community Renewal Tax Relief Act of 2000 (P.L. 106-554) to address the lack of capital available to businesses and economic development ventures in low-income communities. The new markets tax credit is provided to individuals or corporations that invest in community development entities working in low-income communities. The credit is equal to 5% of the investment in a qualified community development entity for the first three allowance dates and 6% of the investment for the next four allowance dates with the total amount of credit available equal to 30% of the investment over seven years.

This measure proposes to adopt a new markets tax credit for Hawaii income tax purposes. While the amounts of the credit parallel the federal amounts, it should be remembered that Hawaii generally does not adopt any of the credits on the federal level, except for the low-income housing tax credit, as

Hawaii's income tax rates are not as onerous as those on the federal level.

It should be noted that in recent years, investors have shied away from the state low-income housing credits because there are much more generous state income tax credits available to the investor such as the high technology investment tax credit. Adding yet another state credit would merely detract from the low-income housing tax credit. Undoubtedly affordable housing is one of the priorities for lawmakers. Thus, adopting a state version of the new markets tax credit merely dilutes the attractiveness of the low-income housing tax credit. While the new markets tax credit does help to subsidize commercial and retail facilities in a distressed community, given the unbridled use of tax credits to encourage certain business activities, it is questionable whether or not Hawaii's treasury can afford another hit at this time. When and until the legislature decides what is state government's priority be it affordable housing, high technology development, alternate energy development, or agriculture, the uncontrolled issuance of back door subsidies is beyond the state's financial capacity.

What this proposal does represent is a lack of legislative understanding of what attracts capital investment to a low-income community and what it takes to retain that enterprise in the community. In some ways this proposal is the compliment of what the federal government did with its welfare programs of the 60's, designing model programs based on a particular city or town on the mainland and trying to replicate it throughout the nation. The cookie cutter approach, as many have learned, does not work. Buying into a federal income tax credit program designed to attract capital to a low-income community does not recognize the many unique hurdles that challenge such a venture in Hawaii.

Finally, it should be remembered that if this measure is adopted, moneys for the proposed tax credit will, no doubt, come out of the state's general fund and depending on the tax credit, will reduce the amount of available general funds without legislative intervention. These are funds that could be used to fund essential services or in the alternative reduce the tax burden on low and moderate-income families or the overall tax burden that plagues both families and businesses.

If it is the desire of the legislature to provide funding to revitalize economically depressed areas of the state, a direct appropriation would be preferable than adoption of the proposed measure. Better yet, lawmakers may want to look at ways to improve the overall business climate, from streamlining zoning and permitting to a reduction of the general excise tax on business-to-business transactions that will benefit all businesses in Hawaii.

Digested 2/1/10

ADVANTAGE
CAPITAL
PARTNERS

February 1, 2010

The Honorable Angus McKelvey
Chair, Committee on Economic Revitalization, Business & Military Affairs
The State of Hawaii, House of Representatives

SUBMITTED VIA ELECTRONIC EMAIL

Dear Representative McKelvey,

I write in support of HB 2168, Relating to New Markets Tax Credits. Nationally, the New Markets Tax Credit program has been a bi-partisan success story in attracting long-term, patient capital to companies and projects in low income communities. In a January, 2010 report on the program by the GAO based in Washington, DC, they found "projects with NMTC financing likely contribute employment and other benefits to low-income communities."

The federal credits are allocated on a competitive basis each year and CDEs (community development entities) choose which states and which companies ultimate receive the NMTC investment. Several states offer an additional incentive for NMTC investments in their state if they comply with the federal guidelines and any additional targeting done at the state level. This approach has been very successful for two primary reasons:

- The 39% federal subsidy has not always proved sufficient to complete a worthwhile project and the addition of state incentive can make the difference between getting a project done and it staying on the drawing board.

- The NMTC program investments are not distributed on a per capita basis like LIHTC or CDBG programs. When a state offers a matching credit or incentive, it makes the projects in that state relatively more attractive than other locations and may help it receive more than its per capita share.

Thank you for your interest in finding capital for small businesses and worthy projects in low income census tracts. We have been honored to participate in the NMTC program and five of the state match programs currently in operation and are happy to give additional testimony or answer questions at your request.

Sincerely,

Ryan Brennan
Managing Director

7733 Forsyth Blvd. • Suite 1850 • St. Louis, MO 63105 • Ph (314) 725-0800 • Fax (314) 725-4265
www.advantagecap.com

PETER L. FRITZ
414 KUWILI STREET, #104
HONOLULU, HAWAII 96814
TELEPHONE: (808) 532-7118
E-MAIL: PLFLEGIS@FRITZHQ.COM

THE HOUSE OF REPRESENTATIVES
THE TWENTY-FIFTH LEGISLATURE
REGULAR SESSION OF 2010

COMMITTEE ON ECONOMIC REVITALIZATION, BUSINESS, & MILITARY AFFAIRS
Hearing February 2, 2010
Testimony on H.B. 2168
(Relating to Tax Credits)

Chair McKelvey, Vice-Chair Choy and members of the Committee:

My name is Peter Fritz. I am an attorney specializing in tax matters and I am testifying in support of H.B. 2168. Adoption of a state credit that piggy backs on the federal credit will help diversify Hawaii's economy. It will stimulate economic development of depressed areas.

- The Federal New Markets Tax Credit (NMTC) is a federal subsidy for economic development of depressed areas.

- The NMTC is likely to leverage 2 to 4 times in additional investment.

- The NMTC is an incentive in the form of a tax credit to induce investors to invest in the funds of certain financial intermediaries called "community development entities", or "CDEs" which, in turn, invest in projects in targeted economically distressed areas.

- NMTC projects, formally known as "low-income community businesses" can range from manufacturing and service businesses, to commercial and industrial projects such as retail real estate developments, office buildings and warehouses, to mixed use commercial and housing developments to community facilities such as child care centers and charter schools.

- The NMTC provides an investor with tax credits over seven years equal to 39 percent of the amount invested. The project in which the funds are invested must generate significant economic benefits in order for an investor to recover the full amount of capital invested as well as a return on capital.

Piggy backing a state credit on the NMTC will help to attract additional investment that will help diversify Hawaii's economy and stimulate growth in underserved areas.

Thank you for the opportunity to testify.

Respectfully submitted,

Peter L. Fritz