SB 831

L E G I S L A T I V E

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SUBJECT: INCOME, New markets tax credit

BILL NUMBER: SB 831, SD-1

INTRODUCED BY: Senate Committee on Economic Development and Technology

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to provide that Section 45D (with respect to new markets tax credit) of the Internal Revenue Code (IRC) shall be operative for state income tax purposes.

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. The applicable percentage shall be the amount in section 45D(a)(2) of the IRC.

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.

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.

Adds a new section to HRS chapter 241 and chapter 431 to make the new markets tax credit operative.

EFFECTIVE DATE: Tax years beginning after December 31, 2010

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 3 allowance dates and 6% of the investment for the next four allowance dates with the total amount of credit available equal to 39% of the investment over seven years.

This measure proposes to make the new markets tax credit operable for Hawaii income tax purposes. 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 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.

While the proposal picks up the federal definition of low-income community from the New Markets Tax Credit which defines that community as having a poverty rate of at least 20% or a census tract where the median family income does not exceed 80% of the statewide median family income, that definition would probably apply to every census tract in Hawaii save for some in the more affluent communities. Because of the cost of living is so high in Hawaii many families are not only two wage earner families, but in many cases both spouses work two or more jobs. As a result, the statewide median family income is much higher than what would be found on the mainland. In Hawaii the family of four meeting this criteria of 80% of statewide median family income would qualify if they earned $79,450, for a two member family, the qualifying income would be $63,600. These families would hardly be considered in poverty.

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 2/23/11

HTDC Cultivating Hawaii's tech sector
HIGH TECHNOLOGY DEVELOPMENT CORPORATION

Written Statement of

YUKA NAGASHIMA
Executive Director & CEO
High Technology Development Corporation
before the
SENATE COMMITTEE ON WAYS AND MEANS
February 24, 2011
9:00 AM
State Capitol, Conference Room 211

In consideration of
SB 831 SD1 RELATING TO HIGH TECHNOLOGY.

Chair Ige, Vice Chair Kidani, and Members of the Committee on Ways and Means.

The High Technology Development Corporation (HTDC) respectfully submits comments on SB 831 SD1. The federal new markets tax credit (NMTC) program was established as part of the Community Renewal Tax Relief Act of 2000, has assisted in many development projects in depressed communities. However, state level new market tax credit, is not seen by the developers as nearly as effective. Many cite increased level of complexity in their deal when pursuing projects with new market tax credits, where the transaction costs are higher, projects take longer[1] and require involvement of attorneys and third party reporting. Those factors limit the vehicle to be used only for larger projects, which may explain why NMTC has not been used in Hawaii.

If the purpose of the SB 831 SD1 is to result in more community development projects, we are told by the industry that their preference is for the government to engage in other initiatives that would reduce the overhead (both time and resources) of development projects, such as streamlining of the permitting process. While lack of capital remains a key challenge in any community development, the return on investment for the State government for the tax revenues it is giving up[2], may not be sufficiently high, esp. given the industry feedback that this tax credit, if enacted, would not be a key deciding factor to green light a project or not.

Thank you for the opportunity to submit testimony on this bill.

[1] The credit equals 39% of the investment paid out over seven years.
[2] Because credits are usually sold to investors, the market value of such credits can speak to how effective the State can leverage its tax credit. Unfortunately, low cost housing credit is not selling well, getting about 20% of its value