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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Wednesday, February 12, 2014
Time: 2:00 p.m.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. No. 1870, Relating to Taxation

The Department of Taxation (Department) provides the following comments regarding H.B. 1870 for your consideration.

H.B. 1870 establishes a non refundable tax credit of an unstated amount based on an unstated percentage of the costs incurred by a taxpayer for the purchase of a residential backup generators. The measure applies to taxable years beginning after December 31, 2013.

First, the Department notes that it is unclear whether "residential backup generator" is intended to include both portable electrical generators and fixed or stationary electrical generators. If it is intended to include the former, the Department suggests the addition of language to the measure so that a taxpayer cannot also claim the Capital Goods Excise Tax Credit under section 235-110.7, Hawaii Revised Statutes (HRS).

Under section 235-110.7, HRS, taxpayers are entitled to claim a refundable tax credit of four percent of the cost of eligible depreciable tangible personal property placed in service during the taxable year. Because a portable generator could also be used in a trade or business (i.e. construction or swap meet based business), it is conceivable that such equipment could also be subject to the capital goods excise tax credit. Under such circumstances, the Department believes that the taxpayer should be allowed to claim only one of the credits.

Second, if the measure is intended to include fixed or stationary residential backup generators, the Department is unclear on whether the cost of such generator includes the cost of installation of the generator and any required prefatory work required that may be necessary for the machinery to be mounted and operated, such as installation of a concrete slab or work required to strengthen a foundation.

Finally, the Department notes that the tax credit, as written, can be claimed multiple times by simply purchasing a new residential backup generator every year. Unless the measure was intended to allow for this possibility, the Department recommends that this credit be limited to once per taxpayer.

The Department suggests the following changes to subsection (a) to address the above-mentioned issues:

> (a) There shall be allowed to each individual taxpayer subject to the taxes imposed by this chapter, a residential backup generator tax credit that shall be deductible from the taxpayer's net income tax liability, if any, imposed by this chapter for the taxable year in which the credit is properly claimed.
>
> The amount of the credit shall be equal to ______ per cent of the actual cost of a new residential backup generator, <u>and shall not include the costs of installation or prefatory work required for installation of such generator</u>. The maximum allowable tax credit for a taxpayer ~~during any taxable year~~ shall be $_______ <u>, and shall be claimed only once. The cost of any residential backup generator shall not include any costs for which another credit is claimed under this chapter</u>.

Thank you for the opportunity to provide comments.

L E G I S L A T I V E

TAXBILLSERVICE

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SUBJECT: INCOME, Credit for residential backup generator

BILL NUMBER: HB 1870

INTRODUCED BY: Tokioka, Ichiyama, Jordan, Kawakami, Takayama

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow a taxpayer to claim an income tax credit of ___% for the purchase of a residential backup generator; provided the maximum allowable tax credit shall not exceed $ ____.

Defines "residential backup generator" as an electrical generator purchased by a taxpayer and operated for the purpose of providing emergency power to the residence of a taxpayer.

Tax credits in excess of a taxpayer's tax liability shall be applied to subsequent income tax liability until exhausted. Requires all claims, including amended claims, to 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 comply with the foregoing provision shall constitute a waiver of the right to claim the credit. Directs the director of taxation to prepare the necessary forms to claim a credit under this section.

EFFECTIVE DATE: Taxable years beginning after December 31, 2013

STAFF COMMENTS: This measure proposes a tax credit for the purchase of a residential backup generator. While the measure allows taxpayers to claim the credit regardless of a taxpayer's need for tax relief, the proposed credit is nothing more than a partial subsidy by the state to taxpayers for the purchase of such equipment with absolutely no indication of the taxpayer's need for that subsidy. This type of targeted tax incentive creates winners and losers, the winners being those in the favored industry who receive the incentives and the losers being the rest of us who have to pay for them.

When judging targeted tax incentives such as this one, we all should be mindful of these observations of the 2001-2003 Tax Review Commission:

> Targeted tax incentives are generally only demonstrably good for those relatively few taxpayers that qualify for the benefits, and may not be demonstrably good for anyone else. They are not supported by rules of sound tax policy. In the first instance, they decrease State revenue and add complexity to the tax system. They may also be unfair to other businesses. Almost all of the present incentives lack accountability, and therefore create something of a "black hole" in State fiscal responsibility. A targeted tax incentive does not appropriate hard earned and increasingly scarce revenues. Rather, it creates a tax benefit of unknown proportions against future revenues, before the revenues are collected and subjected to the legislative appropriation process.

Appropriations to favored businesses, or subsidies, are rarely enacted. Every public appropriation is publicly scrutinized. A tax incentive is a potential “black hole”, because it is a future benefit of unknown proportions, which is determined by the favored taxpayer’s interpretation of what the tax credit should be, and is claimed on a tax return which is confidential.

Digested 2/11/14