NEIL ABERCROMBIE
GOVERNOR

RICHARD C. LIM
DIRECTOR

MARY ALICE EVANS
DEPUTY DIRECTOR

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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Statement of
RICHARD C. LIM
Director
Department of Business, Economic Development, and Tourism
before the

HOUSE COMMITTEE ON
ECONOMIC DEVELOPMENT & BUSINESS

Tuesday, March 18, 2014
9:00 a.m.
State Capitol, Conference Room 312
In consideration of

SB3082, SD2
RELATING TO TAXATION

Chair Tsuji, Vice Chair Ward, and Members of the Committee.

Thank you for the opportunity to testify on SB 3082, SD2, a bill that establishes an income tax credit for taxpayers who incur certain expenses for manufacturing products in Hawaii.

DBEDT supports this bill, but notes that it does not currently have the staffing or funding to fulfill the obligation requiring DBEDT to "certify" the tax credits. We also do not have access to the Department of Taxation's information on taxpayers nor do we have the ability or authority to maintain confidential taxpayer records.

Instead DBEDT prefers the approach taken in Act 270 (13) to provide the Legislature with information on the utilization of the tax credits to create jobs. The online form for the tax credit for research activities (Act 270 13) is currently available at http://dbedt.hawaii.gov.

We respectfully request that language from page 3, line 13 through page 4, line 10 be replaced with language as suggested on the attachment to this testimony.

DBEDT defers to the Department of Taxation on the tax implications and costs to their programs in carrying out this initiative.

Thank you for the opportunity to comment.

DBEDT's suggested language:

(e) The taxpayer that claims the credit under this section shall complete and file with the department of business, economic development, and tourism, through that department's website, an annual survey on electronic forms prepared and prescribed by the department of business, economic development, and tourism. The annual survey shall be filed before June 30 of each calendar year following the calendar year in which the credit may be claimed under this section. The department of business, economic development, and tourism may adjust the due date of the annual survey by rules adopted pursuant to chapter 91.

(1) The annual survey shall include the following information for the time period or periods specified by the department of business, economic development, and tourism:

(a) Total expenditures and the qualified expenditures, if any, expended in the previous taxable year;

(b) Revenue and expense data, including a breakdown of any licensing royalty or other forms of income generated;

(c) Hawaii employment and wage data, including the numbers of full-time and part-time employees retained, new jobs, temporary positions, external services procured by the business, and payroll taxes;

(d) Amount of tax credits claimed and total taxed paid; and

(e) Any other factors the department of business, economic development, and tourism deems relevant.

(2) The department of business, economic development, and tourism, in collaboration with the department of taxation, shall use the information collected to study the effectiveness of the tax credit under this section. The department of business, economic development, and tourism shall submit a report to the legislature on an annual basis.

SUBJECT: INCOME, Manufacturing tax credit

BILL NUMBER: SB 3082, SD-2

INTRODUCED BY: Senate Committee on Ways and Means

EXECUTIVE SUMMARY: Allow taxpayers to claim an income tax credit of ___% of the qualified manufacturing costs incurred in a taxable year, not to exceed $_______. This measure would allow taxpayers to claim the credit regardless of their need for tax relief. 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 recommend revisiting the criteria proposed by the 2001-2003 Tax Review Commission including periodic evaluations, relevant information reporting requirements, and a sunset provision.

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers to claim an income tax credit of ___% of the qualified manufacturing costs incurred in a taxable year provided that the total credit claimed per taxpayer shall not exceed $_______. Stipulates that the credit shall not be allowed for qualified costs that qualify for another state income tax credit.

In the case of a partnership, S corporation, estate, or trust the tax credit allowable is for qualified manufacturing costs incurred by the entity for the taxable year with distribution and share of the credit to be determined by rule; provided that distribution and share of the credit shall be determined by IRC section 704. If a deduction is taken under IRC section 179 (with respect to election to expense depreciable business assets), no credit shall be allowed for that portion for which the deduction is taken. The basis of eligible property for depreciation or accelerated cost recovery system purposes for state income tax purposes shall be reduced by the amount of credit allowable and claimed.

Credits in excess of a taxpayer's income tax liability may be applied to subsequent income tax liability. Claims for the credit, including any amended claims, must be filed on or before the end of the twelfth month following the close of the taxable year. The director of taxation may adopt rules pursuant to HRS chapter 91 and prepare the necessary forms to claim the credit and may require proof of the claim for the credit. Requires the director of business, economic development, and tourism (DBEDT) to: (1) maintain records of the total amount of the qualified manufacturing costs for each taxpayer claiming the credit; (2) verify the amount of the qualified manufacturing costs claimed; (3) total all qualified manufacturing costs claimed; and (4) certify the total amount of the tax credit for each taxable year. DBEDT shall issue a certificate to the taxpayer verifying the qualified manufacturing costs and the credit amount certified for each taxable year. Requires the taxpayer to file the certificate with the taxpayer's tax return with the department of taxation.

Defines "qualified manufacturing costs" as costs incurred to: (1) purchase equipment to be used in manufacturing tangible personal property in the state; and (2) train employees to manufacture tangible personal property in the state.

This act shall be repealed on January 1, 2023.

EFFECTIVE DATE: July 1, 2050; applicable to tax years beginning after December 31, 2014

STAFF COMMENTS: It appears that this measure is intended to provide an incentive in the form of an income tax credit to encourage manufacturing in the state. It should be noted that tax credits generally are designed to reduce the tax burdens of certain groups by refunding a portion of taxes paid on purchases of essential items and services. This credit of ___% of qualified manufacturing costs amounts to nothing more than a partial subsidy of state funds as there is no obvious undue burden of taxes.

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 a taxpayer 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 recommend revisiting the criteria proposed by the 2001-2003 Tax Review Commission:

(i) *Cost-benefit studies*. Cost-benefit studies should be required prior to inaugurating new or revised tax credit programs. Policy makers should use only those programs with quantifiable and demonstrable benefits over costs. Such costs and benefits should not only look at fiscal and economic effects, but should examine social ones as well.

(ii) *Periodic evaluations* of all tax incentive programs should be required.

(iii) *Truth and disclosure reporting* separate and apart from a taxpayer's tax returns should generally be required of all taxpayers benefitting from tax incentive programs, making public all aspects of these subsidies for private investment.

(iv) *Strategic planning*. Embed tax incentives in strategic plans, leveraging as much of the State's scarce resources as possible. Rather than promoting diverse incentives in search of a cohesive strategy, the State should employ only incentives that make strategic sense.

(v) *Public participation*. Encourage public participation in and comment on tax incentive use to foster public accountability. There should at least be as much public discussion over generous multi-million dollar business incentive tax credits as there is over $50,000 renovations to school libraries.

(vi) *Sunset provisions* should be required to ensure that the above processes will be implemented before an incentive can be extended. It should be demonstrated to the Legislature that the targeted benefit to the State was in fact received, what the tax cost of that benefit was, and whether the continuation of the tax incentive is appropriate and necessary.

(vii) *Enforcement*. Given the magnitude and the complexity of these business incentive tax credits, the small chance of audit, ambiguous statutory requirements as to what can be claimed as a credit, there must be legislative oversight of these credits. In addition, the Department of Taxation must be given sufficient resources to police these credits.

Rather than singling out a particular group for tax relief, concurrent efforts must be made to improve Hawaii's business climate to enhance the economic prospects for all businesses.

Digested 3/17/14

NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
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To: The Honorable Clift Tsuji, Chair
and Members of the House Committee on Economic Development & Business

Date: Tuesday, March 18, 2014
Time: 9:00 a.m.
Place: Conference Room 312, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. No. 3082, S.D.2, Relating to Taxation

The Department of Taxation (Department) provides the following comments regarding S.B. 3082, S.D.2, for your consideration.

S.B. 3082, S.D.2, establishes a nonrefundable income tax credit for taxpayers who incur certain expenses for manufacturing products in Hawaii. Specifically, this measure would provide a nonrefundable income tax credit of an unstated percentage of the costs incurred to purchase equipment to be used in the manufacture of tangible personal property in the State, as well as costs incurred to train employees in the manufacturing process. The tax credit, as proposed, applies to taxable years beginning after December 31, 2014, and is repealed on January 1, 2023. S.D. 2 has a defective effective date of July 1, 2050.

First, the Department notes that in this measure, there is no requirement that the equipment actually be installed and put to use in order to qualify for the credit, nor that the installation and use by accomplished within a certain time frame.

Second, as currently written, both the seller of equipment and machinery which would be used to manufacture tangible personal property, and the taxpayer who actually utilizes the equipment and machinery to manufacture goods in the State, would be eligible for the credit.

In addition, the Department believes that the credit should only apply to the taxpayer who **first** places such equipment or machinery in service in this State, and not to any subsequent user if the equipment is later resold. This will prevent a taxpayer from selling equipment and machinery for which the credit has been claimed to another (possibly related) taxpayer, and then having the second taxpayer claim the credit for the same equipment or machinery, based upon the amount that it paid.

To remedy the above-referenced concerns and ensure the Department is able to administer and enforce the terms of this measure, the Department recommends that "qualified manufacturing costs" be defined as follows:

"Qualified manufacturing costs" means expenditures for:
(1) Costs incurred to purchase equipment to be used by the taxpayer in manufacturing tangible personal property in the State and which is placed in service within one year after the date of purchase, provided that the credit under this section has not been previously claimed by any taxpayer in this State on such equipment; and
(2) Costs incurred to train employees to manufacture tangible personal property in the State."

Finally, the Department notes that some jurisdictions consider electricity to be tangible personal property. Historically, the Department has not deemed electricity to be tangible personal property. However, to avoid disagreements with taxpayers over whether electricity generation is an eligible activity, and in light of the existing Renewable Energy Technologies Income Tax Credit at Hawaii Revised Statutes section 235-12.5, and the tax credit for energy storage being considered by the Legislature this year, the Department suggests that a provision be added to specifically exclude costs related to the production of electricity. The following language should be added after the last sentence in subsection (a) to accomplish the preclusion:

Provided that qualified manufacturing costs shall not include any costs related to the production of electricity.

Thank you for the opportunity to provide comments.

Testimony to the House Committee on Economic Development and Business
Tuesday, March 18, 2014 at 9:00 A.M.
Conference Room 312, State Capitol

RE: SENATE BILL 3082 SD2 RELATING TO TAXATION

Chair Tsuji, Vice Chair Ward, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") **strongly supports** and asks for some **amendments** on SB 3082 SD2, which establishes an income tax credit for taxpayers who incur certain expenses for manufacturing products in Hawaii.

The Chamber is the largest business organization in Hawaii, representing over 1,000 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

The Chamber supports this bill as part of its economic development package. There are approximately 1,000 active manufacturers in the state that employ almost 17,000 people at an average compensation rate of $42,896 or over $6,000 more than the average private non-farm employee. Manufacturers helped Hawaii's economy by contributing nearly $570 million in manufactured goods exported in 2012.

The bill gives a 20% tax credit to companies on their expenditures for manufacturing equipment and the training of their employees. We believe that this credit will help fuel manufacturing in Hawaii to grow and provide more products for both local consumption and export. There is movement to begin to manufacture more back in the U.S. At the same time Hawaii still has some competitive disadvantages. This credit will help companies in Hawaii to start or grow their operations.

According to the National Association of Manufacturers, every new manufacturing job created adds another 1.6 jobs to the local service economy, and for every dollar in manufacturing sales, another $1.34 is added to the economy. Investments in manufacturing have a stronger impact than investments in most other economic sectors.

While we understand the Department of Taxation's concern over double dipping, we ask that this **not** apply for businesses planning to use the tax benefits of the Enterprise Zone

Program. Many businesses utilize this program to start or help grow their business. While there may be some overlap with the manufacturing credit in this bill, the manufacturing credit is an investment credit for equipment and training, which for many will be a onetime expense. The Enterprise Zone Program is to attract and support businesses who invest in rural or depressed areas and is based on operational income. Limiting businesses to one tax program may hamper efforts to support manufacturing especially on the neighbor islands and certain parts of Oahu. Therefore we ask that the bill be amended to allow companies to utilize both tax programs.

Thank you for the opportunity to testify on this matter. Mahalo.

Chamber of Commerce Hawaii
1132 Bishop Street, Suite 402
Honolulu, Hawaii 96813

HFIA
HAWAII FOOD INDUSTRY ASSOCIATION

Executive Officers:
Stanley Brown, ConAgra Foods - Chairperson
John Schilf, RSM Hawaii - Vice Chair
Derek Kurisu, KTA Superstores - Treasurer
Lisa DeCoito, Aloha Petroleum - Secretary
Lauren Zirbel, Executive Director

1050 Bishop St. PMB 235
Honolulu, HI 96813
Fax : 808-791-0702
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TO:
HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT AND BUSINESS
Rep. Tsuji, Chair
Rep. Ward, Vice Chair

FROM: HAWAII FOOD INDUSTRY ASSOCIATION
Lauren Zirbel, Executive Director

DATE: March 18, 2014
TIME: 9am
PLACE: Conference Room 312

RE: SB 3082

Position: Support

The Hawaii Food Industry Association is comprised of two hundred member companies representing retailers, suppliers, producers and distributors of food and beverage related products in the State of Hawaii.

The tax credit proposed in this bill would help grow and diversify our economy, keep more dollars in Hawaii, decrease our dependence on imports, and grow and strengthen the Made in Hawaii brand.

Research has shown that a diversified economy and a business friendly tax climate are both key factors in keeping unemployment low. This bill could allow current manufacturers in our state to grow their businesses and can open the door for even more production here in Hawaii. This means more jobs and a stronger economy for the entire state.

Increasing manufacturing will also mean we are less reliant on imported goods. We currently import over 90% of the products we use here in the state. This situation leaves us vulnerable to any supply chain interruptions, adds shipping cost to almost all goods, and sends millions of dollars a year out of the state. Importing less and making more can have wide reaching positive impacts for everyone from the manufacturers to the consumers.

This bill will also open the door for more products to earn the distinction of being Made in Hawaii. The products we currently make here in the state have a worldwide reputation for quality and excellence. There is strong demand both in and out of the state for more products of that high caliber, and this bill can help grow our manufacturing industry to meet that demand.
For these reasons we ask that you please vote yes on this measure.

Thank you for the opportunity to testify.

HTDC Cultivating Hawaii's tech sector
HIGH TECHNOLOGY DEVELOPMENT CORPORATION

Written Statement of
ROBBIE MELTON
Executive Director & CEO
High Technology Development Corporation
before the
HOUSE COMMITTEE ON
ECONOMIC DEVELOPMENT & BUSINESS

Tuesday, March 18, 2014
9:00 a.m.
State Capitol, Conference Room 312
In consideration of

SB 3082 SD2 RELATING TO TAXATION.

Chair Tsuji, Vice Chair Ward, and Members of the Committee on Economic Development and Business.

The High Technology Development Corporation (HTDC) **supports** SB 3082 SD2 relating to Taxation. HTDC's Innovate Hawaii program offers business support to local manufacturers, helping them grow in Hawaii. SB3082 SD2 has the potential to financially benefit businesses that are investing in Hawaii manufacturing and allow others the opportunity to consider manufacturing their products in Hawaii. Hawaii needs more manufacturers to decrease our dependence on imported goods and increase our export revenues. Furthermore, current federal grant funding has been targeted at advanced manufacturing and re-shoring opportunities which translates into leverage for State led initiatives.

HTDC defers to DBEDT and DOTAX on the reporting requirements included in the bill and the tax implications. HTDC requests correction of the defective effective date.

Thank you for the opportunity to offer these comments.

HSDC HAWAII STRATEGIC DEVELOPMENT CORPORATION

Written Statement of

KARL FOOKS
President
Hawaii Strategic Development Corporation

Before the
COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS

March 18, 2014
9:00 AM
State Capitol, Conference Room 312

In consideration of
SB 3082 SD 2 RELATING TO TAXATION

Chair Ige, Vice Chair Kidani and Members of the Committee on Economic Development & Business:

The Hawaii Strategic Development Corporation (HSDC) respectfully submits testimony in support of the intent of SB 3082 SD 2.

A vibrant manufacturing sector will be important to grow a viable and sustainable export economy. HSDC supports efforts that can help to develop Hawaii's manufacturing capacity.

We recommend the Legislature consider a comprehensive strategy to link support for the manufacturing sector with entrepreneurial development and investment capital to stimulate an entire ecosystem that supports the goal of this legislation of building a globally competitive manufacturing sector.

Thank you for the opportunity to provide testimony.

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e-mail info@hfbf.org; www.hfbf.org

March 18, 2014

HEARING BEFORE THE
HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS

TESTIMONY ON SB 3082, SD2
RELATING TO TAXATION

Room 312
9:00 AM

Aloha Chair Tsuji, Vice Chair Ward, and Members of the Committee:

I am Christopher Manfredi, President of the Hawaii Farm Bureau Federation (HFB). Organized since 1948, the HFB is comprised of 1,832 farm family members statewide, and serves as Hawaii's voice of agriculture to protect, advocate and advance the social, economic and educational interest of our diverse agricultural community.

HFB supports SB 3082, SD2, which is part of the Chamber of Commerce's economic development package. There are approximately 1000 active manufacturers in the state that employ almost 17,000 people at an average compensation rate of $42,896 or over $6,000 more than the average private non-farm employee. Manufacturers helped Hawaii's economy by contributing nearly $570 million in manufactured goods exported in 2012.

The bill gives a tax credit to companies on their expenditures for manufacturing equipment and the training of their employees. We believe that this credit will help fuel manufacturing in Hawaii to grow and provide more products for both local consumption and export. There is movement to begin to manufacture more back in the U.S. At the same time Hawaii still has some competitive disadvantages. This credit will help companies in Hawaii to start or grow their operations.

According to the National Association of Manufacturers, every new manufacturing job created adds another 1.6 jobs to the local service economy, and for every dollar in manufacturing sales, another $1.34 is added to the economy. Investments in manufacturing have a stronger impact than investments most other economic sector. This is a wise investment for Hawaii.

Please support SB 3082 SD2.

Thank you.