DAVID Y. IGE
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MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

STATE OF HAWAII
DEPARTMENT OF TAXATION
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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Wednesday, April 2, 2015
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 1001 S.D. 2, H.D. 1, Relating to Manufacturing

The Department of Taxation (Department) appreciates the intent of S.B. 1001, S.D. 2, H.D. 1 and provides the following comments for your consideration.

S.B. 1001, S.D. 2, H.D. 1 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 unspecified percentage of the costs incurred to purchase equipment to be used in the manufacture of tangible personal property in the State and the costs incurred to train employees in the manufacturing process. The maximum credit is capped at an unspecified amount per taxpayer per year. The tax credit, as proposed, applies to taxable years beginning after December 31, 2015, and is repealed on January 1, 2023, and is effective upon approval.

The Department defers to the Department of Business, Economic Development, and Tourism on the merits of this measure.

The House Committee on Economic Development and Tourism deleted the original version of this measure and instead replaced it with a tax credit similar to that found in H.B. 1454. For greater clarity, and to provide that no other credit may be taken for the costs used in calculating this credit, the Department recommends that subsection (b) be rewritten as follows:

(b) The amount of the tax credit allowed under subsection (a) shall be _________ per cent of the qualified manufacturing costs incurred during the taxable year, provided that:

(1) The total credit claimed per taxpayer shall not exceed $__________;

(2) The qualified manufacturing costs qualify for a deduction under section 167 (with respect to

depreciation) of the Internal Revenue Code, as amended; and

(3) The qualified manufacturing costs do not include any costs related to the production of electricity <u>or to the production of professional and personal services</u>.

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. The cost upon which the tax credit is calculated shall be determined at the entity level. Distribution and share of credit shall be determined by rule.

If a deduction is taken under section 179 (with respect to election to expense depreciable business assets) of the Internal Revenue Code of 1986, as amended, no tax credit shall be allowed for those costs for which the deduction is taken.

The bases for eligible property for depreciation of accelerated cost recovery system purposes for state income taxes shall be reduced by the amount of the credit allowable and claimed.

<u>Qualified manufacturing costs shall not include amounts for which another credit is claimed.</u>

The Department also 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 <u>by the taxpayer</u> within one year after the date of purchase, and further provided that the credit under this section has not been previously claimed by any taxpayer in this State on such equipment; and

(2) Reasonable and necessary costs incurred to train employees to manufacture tangible personal property in the State."

Thank you for the opportunity to provide comments.

Written Statement of
ROBBIE MELTON
Executive Director & CEO
High Technology Development Corporation
before the
HOUSE COMMITTEE ON FINANCE
Thursday, April 2, 2015
2:00 p.m.
State Capitol, Conference Room 308
In consideration of

SB1001 SD2 HD1 RELATING TO MANUFACTURING.

Chair Luke, Vice Chair Nishimoto, and Members of the Finance.

The High Technology Development Corporation (HTDC) **supports** SB1001 SD2 HD1 relating to Manufacturing.

HTDC supports local manufacturers through our INNOVATE Hawaii program which annually receives $500,000 of federal funds from the Department of Commerce National Institutes for Standards and Technology. The Hawaii manufacturing industry receives limited support from the state. There are approximately 1,000 manufacturers in Hawaii. The industry provides export and import substitution opportunities to improve our economy and has been identified nationally as a key driver for innovation. Hawaii manufacturers face the additional challenge of the high cost of energy and shipping. The tax credit can assist to make Hawaii manufacturers more competitive globally and train Hawaii's future manufacturing workforce.

HTDC supports incentives for manufacturers to improve their capacity - reducing Hawaii's imports and increasing exports. HTDC defers to the appropriate departments regarding the impact of administering the tax credit.

Thank you for the opportunity to offer these comments.

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Manufacturing tax credit

BILL NUMBER: SB 1001, HD-1

INTRODUCED BY: House Committee on Economic Development and Business

EXECUTIVE SUMMARY: Establishes an income tax credit of ___% of qualified manufacturing costs incurred in a taxable year not to exceed _________. The adoption of this credit would result in a subsidy of state funds. Lawmakers should consider the criteria established by the 2001-2003 Tax Review Commission (discussed below) before enacting this or any other new business incentive that operates through the tax system. Specifically, we recommend amendments that would add:

- A reasonable per-taxpayer credit limit, and
- A date certain by which this credit will be evaluated.

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 $_________; provided that such costs qualify for a deduction under section 167 (with respect to depreciation) of the Internal Revenue Code, as amended, and the costs do not include any costs related to the production of energy.

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. 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 credits allowable and claimed.

Credits in excess of a taxpayer's income tax liability shall be applied to subsequent tax liability until exhausted. 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) obtain information on self-verified 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 that is placed in service within one year after the date of purchase and the credit has not been previously claimed on such equipment; and (2) train employees to manufacture tangible personal property in the state; provided that tangible personal property shall not include professional or personal services. This act shall be repealed on 1/1/2023.

EFFECTIVE DATE: Tax years beginning after December 31, 2015

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 subsidy of state funds as there is no obvious undue burden of taxes.

It should be remembered that the 2001-2003 Tax Review Commission set forth recommended requirements for new tax incentives such as this one:

(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.

If lawmakers are inclined to enact this credit, amendments should be considered addressing the criteria set forth above.

Digested 4/1/15

Chamber of Commerce HAWAII
The Voice of Business

Testimony to the House Committee on Finance
Thursday, April 2, 2015 at 2:00 P.M.
Conference Room 308, State Capitol

RE: SENATE BILL 1001 SD2 HD1 RELATING TO MANUFACTURING

Chair Luke, Vice Chair Nishimoto, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") **strongly supports** SB 1001 SD2 HD1, which establishes an income tax credit for taxpayers who incur certain expenses for manufacturing products in Hawaii and applies to taxable years beginning after December 31, 2015.

The Chamber is Hawaii's leading statewide business advocacy organization, representing about 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 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.

The Chamber is committed to working together with others in the business and innovation community to grow Hawaii's manufacturing sector and the economy.

Thank you for the opportunity to testify.

1132 Bishop Street, Suite 402 • Honolulu, Hawaii 96813 • Phone: (808) 545-4300 • Facsimile: (808) 545-4369

HAWAII FOOD INDUSTRY ASSOCIATION

Executive Officers:
John Schilf, RSM Hawaii - Chairperson
Derek Kurisu, KTA Superstores - Vice Chair
Lisa DeCoito, Aloha Petroleum - Treasurer
John Erickson, Frito-Lay - Secretary
Lauren Zirbel, Executive Director

1050 Bishop St. PMB 235
Honolulu, HI 96813
Fax : 808-791-0702
Telephone : 808-533-1292

TO:
COMMITTEE ON FINANCE
Representative Sylvia Luke, Chair
Representative Scott Y. Nishimoto, Vice Chair

FROM:
HAWAII FOOD INDUSTRY ASSOCIATION
Lauren Zirbel, Executive Director

DATE: April 2, 2015
TIME: 2pm
PLACE: Conference Room 308

RE: SB1001 SD2 HD1

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.

SB1001hd1, Relating to Manufacturing
House FIN Committee
Thursday, April 2, 2015
2:00 pm, Room 308
Written Testimony By: Glenn Muranaka

Position: Support

Chair Luke and Members of the House FIN Committee:

My name is Glenn Muranaka, President and General Manager of Meadow Gold Dairies. Our company has been in Hawaii since 1897—118 years, providing Hawaii consumers with a variety of milk products and juices. Meadow Gold's long history has not come without effort. We continually adapt to our customers' and consumers' ever-changing needs, and we constantly evolve along with our industry, our community and our market. Over the years, this has required that we struggle, tighten our belts, innovate and work extremely hard, making us a better company in the process. The foundation of this work rests with the 330 employees that are committed to providing superior quality products.

We appreciate the continuing discussion about providing Hawaii manufacturers a temporary tax credit for qualified manufacturing costs. It is the preferred option for assisting the growth of manufacturing in Hawaii. 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 proposed temporary tax credit for the specific purposes of manufacturing tangible personal property, excluding the production of electricity, and to train employees to manufacture such tangible personal property 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 in the continental United States. At the same time, Hawaii still has some competitive disadvantages. This program will help companies in Hawaii start or grow their operations.

Your support of this measure is appreciated. Thank you for the opportunity to submit testimony

Meadow Gold Dairies – Hawaii | 925 Cedar Street | Honolulu, HI 96814 | PO Box 1880 | Honolulu, HI 96805
p: 808.949-6161 | f: 808.944.5901 | toll free: 1.800.362.8539 | website: www.lanimoo.com

KYD, Inc. dba k. yamada distributors
An independent leader in packaging and wholesale distribution
P.O. BOX 29669, Honolulu, Hawaii 96820 Phone: (808) 836-3221 Fax: (808) 833-8995

SB1001hd1, Relating to Manufacturing
House FIN Committee
Thursday, April 2, 2015
2:00 pm - Room 308
Written Testimony by: Dexter Yamada
Position: Support

Chair Luke and Members of the House FIN Committee:

I am Dexter Yamada, President of KYD, Inc. dba: K. Yamada Distributors. KYD, Inc. is a local family run business that originated in the 1940's as a florist and florist supply distributor, and in 1958, evolved into a packaging company. Today, KYD, Inc and its sister company, Hawaii Foam Products, LLC, employ about 90 to 100 employees and contribute to Hawaii's economy through taxes and payroll. Our companies manufacture packaging materials such as food-grade EPS (Expanded Polystyrene) food containers, and distribute a variety of supplies, to include compostable containers, for food processors, food establishments, supermarkets, hotels hospitals and other institutions.

We appreciate the continued discussion about manufacturing companies in Hawaii which many do not realize exists. Support is expressed for SB1001hd1's proposed temporary tax credit for qualified manufacturing expenses. Locally manufactured products contribute to import replacement, and help with local job creation. The proposed temporary tax credit for expenditures to be used in manufacturing tangible personal property in the State and for costs incurred to train employees to manufacture tangible personal property in the State will be of help to local manufacturing businesses. This in turn, lends to greater efficiency and reduction in the cost of products to customers.

We ask that consideration be given, perhaps in the administrative rules, to include equipment modification as a qualified expense as it will help established manufacturers with needed upgrades for local manufacturing. It will help local manufacturers offset some of the costs of manufacturing products that replace imports, create jobs and add to Hawaii's self-sufficiency.

Thank you for the opportunity to testify.

WILL CALL, G&A, AND WAREHOUSE OFFICES: 2949 Koapaka Street, Honolulu, Hawaii 96819-1923 Phone: (808) 836-3221 Fax: (808) 833-8995

MANUFACTURING FACILITIES: 747 Umi Street, Honolulu, Hawaii 96819-2394 Phone: (808) 836-3221 Fax: (808) 845-7754

TESTIMONY IN SUPPORT OF SB1001 HD1

TO: COMMITTEE ON FINANCE

Representative Sylvia Luke, Chair

Representative Scott Y. Nishimoto, Vice Chair

DATE: Thursday, April 2, 2015

TIME: 2pm

PLACE: Conference Room 308

State Capitol

415 South Beretania Street

RE: SB 1001 HD1 RELATING TO MANUFACTURING - Establishes an income tax credit for taxpayers who incur certain expenses for manufacturing products in Hawaii.

Position: Support

Chair Luke, Vice Chair Nishimoto, and Members of the Committee;

I am a Hawaii manufacturer and I believe this bill will have a wide range of positive impacts not only for Hawaii businesses like mine, but also for Hawaii consumers and for Hawaii's economy as a whole.

Manufacturers here in Hawaii face a range of challenges. Our state's tax climate can be difficult for businesses, we often have to import equipment and raw materials from the mainland, and we incur added expenses in getting our products to market on different islands. These challenges are enough to prevent some from even trying to manufacture here in Hawaii, and companies like mine that do make the commitment to creating Made in Hawaii goods often can't grow as they should.

This bill will help create opportunities for Hawaii manufacturing that will encourage new businesses to start making new products here in our state, and can allow businesses like mine to grow, provide more jobs, be more efficient, and get my Made in Hawaii products to even more customers.

Supporting this bill means supporting Made in Hawaii products, Made in Hawaii businesses, and Made in Hawaii jobs.

I urge you to vote yes on this measure and I thank you for the opportunity to testify.

Sincerely,

Adrian Hong, President

Island Plastic Bags, Inc.