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TESTIMONY OF
GARY S. SUGANUMA, DIRECTOR OF TAXATION

TESTIMONY ON THE FOLLOWING MEASURE:
S.B. No. 3382, Relating to Taxation.

BEFORE THE:
Senate Committee on Energy, Economic Development, and Tourism

DATE: Tuesday, February 13, 2024
TIME: 1:20 p.m.
LOCATION: State Capitol, Room 229

Chair DeCoite, Vice-Chair Wakai, and Members of the Committee:

The Department of Taxation ("Department") offers the following comments regarding S.B. 3382 for your consideration.

S.B. 3382 would add a new section to chapter 235, Hawaii Revised Statutes (HRS), creating a nonrefundable income tax credit for wildfire relief investment. The credit would be allowable for the taxable year in which an investment was made in a qualified business or redevelopment resiliency project, as well as the following four years, provided the credit is properly claimed. "Redevelopment resiliency project" means a project to redevelop areas damaged by the Lahaina wildfire of 2023; "qualified business" means a business, employing or owning capital or property, or maintaining an office, in the State, provided that:

(1) The business is registered to do business in the state;
(2) The business maintains its headquarters or principal place of business in the Lahaina District;
(3) The business shall have existed prior to August 8, 2023;
(4) The business can demonstrate that it has experienced financial hardship due to the Lahaina wildfire of 2023; and
(5) The business is a small business, as defined by section 201M-1, HRS.

The credit is structured as follows:

Tax Year	% of Investment	Maximum Allowed Credit
Year of Investment	35	$50M
First year following	35	$35M
Second year following	20	$25M
Third year following	10	$12.5M
Fourth year following	10	$12.5M

To claim the credit, taxpayers would be required to waive tax information confidentiality; the bill also provides that the credit may not be used to offset any tax liability incurred under the Public Utilities and Franchise Tax, the Banks and Financial Institutions Tax, or the Insurer's Tax (chapters 240, 241, and 431, HRS, respectively). The measure would also allow for the recapture of ten percent of the amount of the total tax credit claimed for the preceding two taxable years if, at the close of any taxable year in the five-year credit period, any of three criteria are met:

(1) The business no longer qualifies as a qualified business or redevelopment resiliency project;
(2) The business or an interest in the business has been sold by the taxpayer investing in the qualified business or redevelopment resiliency project; or
(3) The taxpayer has withdrawn the taxpayer's investment wholly or partially from the qualified business or redevelopment resiliency project.

S.B. 3382 would also charge the Department with certifying this new credit for each taxable year, as well as the cumulative amount of the credit, by verifying the nature and amount of a taxpayer's qualifying investments. There is also an annual reporting requirement for the Department to provide the legislature with an evaluation of the effectiveness of the tax credit, as well as findings and recommendations to improve the credit's effectiveness, prior to each regular legislative session.

The new credit would apply to taxable years beginning after December 31, 2023, and sunset for taxable years beginning after December 31, 2028.

The Department appreciates the intent of this measure and the importance of promoting recovery from the 2023 Lahaina wildfire, but notes that the breadth and scale of the credit may lead to increased incidents of fraud and abuse, as a taxpayer would be able to recover 110 percent of their investment, up to $50 million in the first year, with declining amounts to $12.5 million in the fifth year, and with indefinite carryforwards. The terms "investment" and "qualified investment" are not defined and do not have any limitations to lessen the risk of abusive transactions, such as limitations on related-party transactions. Similarly, the definition of "redevelopment resiliency project" is broad and does not include criteria as to the type of project that may qualify. The Department recommends that the bill be amended to provide definitions and criteria to outline the eligibility requirements for the credit.

Additionally, the Department does not have the subject-matter expertise or the administrative capability necessary to certify this proposed new credit or evaluate the effectiveness of the credit. The Department requests that a third-party with sufficient expertise in business matters or redevelopment resiliency be charged with certifying this credit.

Finally, the Department requests that the applicability date of this new credit be delayed until tax years beginning after December 31, 2024. This will help provide time to make the necessary form, instruction, and computer system changes, as well as to provide taxpayer education.

Thank you for the opportunity to provide comments on this measure.

SUBJECT: INCOME TAX; Wildfire Relief Investment Tax Credit

BILL NUMBER: SB 3382

INTRODUCED BY: MCKELVEY

EXECUTIVE SUMMARY: Establishes an income tax credit to encourage investment in businesses affected by the 2023 Lahaina wildfire, and in redevelopment resiliency projects occurring within the Lahaina District.

SYNOPSIS: Adds a new section to chapter 235, HRS, to establish the wildfire relief investment tax credit.

The amount of the credit is 110% of the investment made by the taxpayer in each qualified business or redevelopment resiliency project, spread over five years:

Year	Percentage
1	35%
2	35%
3	20%
4	10%
5	10%

The bill provides for a "maximum allowed credit" in the first year of $50 million; in the next year, $35 million; in the third year, $25 million; and in the fourth and fifth year, $12.5 million each.

Provides that the credit shall not be used to offset any tax liability incurred under chapter 240, 241, or 431.

Provides that the taxpayer shall waive tax return confidentiality in order to claim this credit.

The credit shall be claimed against the net income tax liability for the taxable year, defined as net income tax liability reduced by all other credits allowed under the Income Tax Law.

At-risk rules under section 49, IRC, shall apply.

Section 469, IRC, with respect to passive activity losses and credits, shall apply.

The credit is nonrefundable but may be carried forward until exhausted.

Every claim, including amended 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 comply with the foregoing provision shall constitute a waiver of the right to claim the credit.

Recapture occurs if, at the end of any taxable year in the five-year credit period: (1) The business no longer qualifies as a qualified business or redevelopment resiliency project; (2) The business or an interest in the business has been sold by the taxpayer investing in the qualified business or redevelopment resiliency project; or (3) The taxpayer has withdrawn the taxpayer's investment wholly or partially from the qualified business or redevelopment resiliency project. The recapture will be equal to 10% of the credit claimed in the prior two taxable years.

The taxpayer is to submit to the Department, before March 31 of each year wherein a qualified investment was made in the previous taxable year, an application. The Department is to certify the application and send the taxpayer a certificate which shall then be filed with the taxpayer’s income tax return.

"Lahaina district" means the same as in section 4-1(2)(D), HRS.

"Qualified business" means a business, employing or owning capital or property, or maintaining an office, in this State; provided that:

(1) The business is registered to do business in the State;

(2) The business maintains its headquarters or principal place of business in the Lahaina district;

(3) The business shall have existed prior to August 8, 2023;

(4) The business can demonstrate that it has experienced financial hardship due to the Lahaina wildfire of 2023; and

(5) The business is a small business.

"Redevelopment resiliency project" means a project to redevelop areas damaged by the Lahaina wildfire of 2023.

"Small business" means the same as in section 201M-1, HRS.

EFFECTIVE DATE: Upon approval, applicable to taxable years beginning after December 31, 2023.

STAFF COMMENTS:

Defining the Creditable Investment

The first, and considerable, hurdle is to define what investments are going to be eligible for this credit. The definition of “qualified business” has some soft spots like “experienced financial hardship,” which could be tricky to define. “Redevelopment resiliency project” is also open to different interpretations. Having a loose definition or two tends to attract lots of attention, not necessarily from the businesses intended to be benefited, especially when the credit amount is substantial, as it is here.

Next, the Legislature should be thinking long and hard about its experience with the QHTB investment credit in section 235-110.9, HRS, the structure of which resembles that in this bill.

For those who think that the QHTB businesses took the people of Hawaii for a ride with this credit, are we to expect that the same experiences will not befall us this time as well?

Utilizing tax credits to drive economic policy in this manner is of a questionable benefit relative to the cost for all taxpayers. A direct appropriation of grant funding to builders or putative investors would be more accountable and transparent. At least we would know the amount of the appropriation, while the fiscal impact of the credit would be a great big question mark.

We also question if it is wise to have a credit that is 110%. For qualifying investments, the investor can be thought of as paying nothing where the Hawaii taxpayers pay more than everything. There is currently nothing to indicate that the investor seeking the credits would have "skin in the game," and thus does not create any incentive for the investor to do due diligence and make sure the investment monies are deployed efficiently.

Furthermore, the additional credit would require changes to tax forms and instructions, reprogramming, staff training, and other costs that could be massive in amount compared to the benefit expected to accrue because of the creditable activity.

Technical Comments

The provisions in the bill stating that the credit does not offset franchise tax or premium tax appear to be superfluous. The only reason that franchise tax and premium tax payers could participate in the old QHTB credit is that there were provisions in the Franchise Tax Law and the Insurance Code that made the credit provisions applicable there. No such provisions are being proposed by this bill.

We also were surprised at the broad statement in the bill that those electing the credit "shall waive tax information confidentiality." Would that be only for the parts of the return pertaining to the credit, or would it be for the whole return? It might be advisable to follow tax-exempt organization law, which currently provides that most of a Form 990 can be made publicly available but prescribes certain kinds of information, such as investor lists, that stay confidential.

To be consistent with current law, drafters should note that current law, including sections 235-116 and 237-34, HRS, prohibits the disclosure of tax return information by any person or any officer or employee of the State. Violation of the law is punishable as a class C felony. If the Legislature decides, as a policy matter, that it is better to make such a public disclosure, then appropriate amendments need to be made to the tax return confidentiality statutes to allow for the disclosure here contemplated.

Digested: 2/10/2024

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COUNTY COUNCIL

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February 12, 2024

TO: The Honorable Senator Lynn DeCoite, Chair, and
Members of the Senate Committee on Energy, Economic Development, and Tourism

FROM: Alice L. Lee
Council Chair

SUBJECT: **HEARING OF FEBRUARY 13, 2024; TESTIMONY IN SUPPORT OF SB3382, RELATING TO TAXATION**

I **support** this measure to establish an income tax credit to encourage investment in businesses affected by the 2023 Lahaina wildfire and in redevelopment resiliency projects occurring within the Lahaina District.

I am providing this testimony in my capacity as an individual member of the Maui County Council.

I support this measure for the following reasons:

1. The Department of Business, Economic Development & Tourism estimates that more than 800 businesses have been destroyed or damaged as a result of the wildfire resulting in an estimated $2.7 million lost in daily total business revenue.
2. An income tax credit will encourage investments in affected businesses and in redevelopment resiliency by reducing the economic risks associated with these investments.
3. The economic impact of the wildfires has extended beyond Lahaina to the rest of Maui County and even the rest of the State. The more support Lahaina businesses receive, the faster the economy at large will recover.

Thank you for your consideration.

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