

LINDA LINGLE
GOVERNOR

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SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2739 HD 1 SD 1 RELATING TO STATE ENTERPRISE ZONES

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: MARCH 18, 2008

TIME: 1:15PM

ROOM: 224

This bill would provide farmers with an alternative means of obtaining and maintaining enterprise zone (EZ) benefits.

The Joint House Committee on Economic Development & Taxation and Agriculture amended the measure by defining a "force majeure" event, among other nonsubstantive changes.

The House Committee on Finance passed this measure unamended.

The House of Representatives passed this measure on third reading.

The Senate Committee on Agriculture & Hawaiian Affairs amended the agriculture general excise tax provision of this measure to provide that entities not conducting genetically-engineered agricultural production shall not be exempt from the payment of general excise taxes.

The Department of Taxation ("Department") **supports the intent** of this bill. The Department defers to the Department of Business, Economic Development and Tourism ("DBEDT") and the Department of Agriculture regarding this bill's merits.

The State currently provides tax breaks for qualifying businesses in an Enterprise Zone. Under section 209E-11, Hawaii Revised Statutes (HRS), certain types of businesses in the enterprise zone that satisfy hiring requirements are exempt from the state general excise and use tax for up to seven years. Qualified businesses can also claim two partial state income tax credits under section 209E-10, HRS:

1. **An income tax credit based on taxes due the State.** The tax credit is equal to 80 percent of the taxes due for the first tax year, which decreases by 10 percent for each year thereafter,

over the next six years;

2. **An income tax credit based on unemployment taxes paid.** The tax credit is equal to 80 percent of the unemployment taxes paid during the first year, which decreases by 10 percent for each year thereafter, over the next six years.

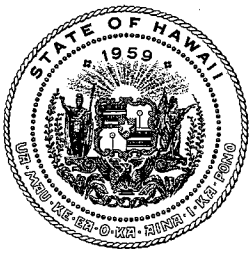
The Department notes that pursuant to HRS 209E-10, DBEDT has been tasked with certifying to the Department the applicability of the tax credit for a qualified business against any taxes due to the State.

This bill amends the requirements of the state enterprise zone program by:

1. Allowing the Department of Business, Economic Development, and Tourism to extend tax incentives to qualifying agricultural businesses for the duration of the effects of a *force majeure*;
2. Enabling agricultural businesses to remain eligible for the tax incentives under the Program during any period of interruption caused by a *force majeure* event;
3. Adds a definition of "force majeure event," "leased employee," and "joint employment" to HRS § 209E-2, and amends HRS § 209E-2 to include "leased employees" and "joint employees" in the definition of "full-time employees";
4. Amends HRS § 209E-10 to allow agricultural business as the only businesses that could use retail sales of value-added products from crops grown within an EZ to count toward certification for the tax credit.
5. Adds clarifying language to HRS § 209E-11 that an agricultural business is not exempt from general excise tax on certain gross proceeds of non-genetically engineered agricultural retail sales.

If the defective date were removed (and assuming approval before June 30, 2008) the revenue losses are estimated to be \$200,000 for fiscal year 2009, \$400,000 for fiscal year 2010, \$600,000 for fiscal year 2011 and \$550,000 per year thereafter.

It is estimated that the construction of facilities for the agricultural and processing facilities would cost \$25 million over three years, with \$5 million being incurred in the first and third years and \$15 million being incurred in the second year. (The figure for construction was revised downward after consulting with DBEDT. Apparently much of the construction is already in place). In the fourth year and thereafter, the facilities are assumed to generate \$50 million in gross receipts and to increase the enterprise zone tax credit by 20%. GET is foregone at the rate of 4% on the construction costs and at ½% on the gross receipts from the new agricultural and processing facilities.



DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

LINDA LINGLE
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THEODORE E. LIU
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Statement of
THEODORE E. LIU
Director
Department of Business, Economic Development, and Tourism
before the
**SENATE COMMITTEE ON ECONOMIC DEVELOPMENT
AND TAXATION**

Tuesday, March 18, 2008
1:15 P.M.
State Capitol, Conference Room 224

in consideration of
HB 2739 HD1 SD1
RELATING TO STATE ENTERPRISE ZONES

Chair Fukunaga, Vice-Chair Espero, and Committee members:

The department supports the concept of HB 2739 HD 1 SD1, which allows agricultural businesses to continue to qualify for zone benefits in case of *force majeure* events; includes leased and jointly employed workers in hiring formulas; changes the timing of employee increases; counts value-added agricultural product retail sales towards qualification for tax credits, and allows ag producers to qualify for certification based upon an increase in gross sales rather than employee increases.

There have been many good ideas introduced this legislative session that support the State's economic development goals, and we note that no appropriation is associated with this bill.

Agriculture is a vital component of Hawaii's economy, preserving open space essential to tourism and helping to protect our environment. Currently, there are more than 5500 farms, but as of January 2007, only 32 participated in the Enterprise Zone (EZ)

Program. In 2006, only 12 of the 32 firms qualified for benefits, 4 companies did not qualify and the remaining 16 farmers did not file their annual reports. Common reasons for not filing included closing the business or knowing that certification criteria had not been met.

This bill also helps farmers cope with natural disasters by allowing them to retain EZ eligibility when their operation has been negatively affected and then resume production, with the time added to their full participation period. This change would have benefited many farmers affected by the Spring 2006 floods on Oahu and Kauai and a few on the Big Island whose water systems were damaged by the Kiholo earthquake.

The department, however, identifies two areas that need to be addressed. The first is on page 5, Section 4 subsection (a). This describes the requirement for qualification for a “new” business. For new ag businesses, they can include their retail value-added receipts for certification. but do not have the option to increase their gross sales instead of hiring more workers. Whereas page 6 subsection (b) states the criteria for “existing” ag businesses as allowing the gross sales option, but not the ability to include value-added retail receipts. The changes on the attachment will sync the two new proposals.

The second change contained on page 6, lines 14-16, establishes the base employee count from the time the business opened for operation and not when they applied into the EZ program as is currently practiced. The implication is that a business that has been around for 30, 40, or 50 years, can apply and use their base employee count from 30, 40, or 50 years ago, and if they increased their staff by 10% in the first year, and 15% in years two to seven, they would *automatically fulfill this requirement* for benefits that would apply 23, 33, or 43 years later. It will be difficult to obtain credible data from

companies that have been for over 10 years. It would be difficult to verify and difficult to enforce. Furthermore, this would conflict with the purpose of the EZ program which is to encourage economic growth in our communities *today*. We would recommend omitting the changes stated on lines 14 to 16.

Thank you for the opportunity to offer these comments.

ATTACHMENT TO DBEDT TESTIMONY ON HB 2739 H.D. 1 S.D.1 3/14/08

SECTION 4. Section 209E-9, Hawaii Revised Statutes, is amended by amending subsections (a) and (b) to read as follows:

(a) Any business firm may be eligible to be designated a qualified business for purposes of this chapter if the business:

- (1) Begins the operation of a trade or business within an enterprise zone;
- (2) During each taxable year has at least fifty per cent of its enterprise zone establishment's gross receipts attributable to the active conduct of trade or business within the enterprise zone;
- (3) Increases its average annual number of full-time employees by at least ten per cent by the end of its first tax year of participation; and

[(4)] (A) During each subsequent taxable year at least maintains that higher level of employment[-]; or

(B) Increases its gross sales of agricultural crops or agricultural products produced within the enterprise zone by two per cent annually."

provided that receipts from value-added products made from crops grown within an enterprise zone and sold at retail pursuant to the limits of subsection (e) shall count towards the gross receipts required under paragraph (2) for business firms engaged in producing or processing agricultural products.

(b) A business firm also may be eligible to be designated a qualified business for purposes of this chapter if the business:

- (1) Is actively engaged in the conduct of a trade or business in an area immediately prior to an area being designated an enterprise zone;
- (2) Meets the requirements of subsection (a)(2); and
- (3) (A) Increases its average annual number of full-time employees employed at the business' establishment or establishments located within the enterprise zone by at least ten per cent annually[-]; **[provided that the percentage increase shall be based upon the employee count at the beginning of the initial year of operation;]or**

} Remove text in brackets

(B) Increases its gross sales of agricultural crops or **agricultural** products produced within the enterprise zone by two per cent annually."

provided that receipts from value-added products made from crops grown within an enterprise zone and sold at retail pursuant to the limits of subsection (e) shall count towards the gross receipts required under paragraph (2) for business firms engaged in producing or processing agricultural products.



**Hawaii
Aquaculture
Association**

To:

THE SENATE
THE TWENTY-FOURTH LEGISLATURE
REGULAR SESSION OF 2008

COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION
Sen. Carol Fukunaga, Chair
Sen. Will Espero, Vice Chair

HEARING

DATE: Tuesday, March 18, 2008
TIME: 1:15p.m.
PLACE: Conference Room 224, State Capitol
415 South Beretania Street

From: Ronald P. Weidenbach, President, Hawaii Aquaculture Association
Cell: 429-3147, Email: hawaiiifish@gmail.com

Re: **HB2739 H.D.1 S.D.1 - RELATING TO STATE ENTERPRISE ZONES**

Chair Fukunaga, Vice-Chair Espero, and Members of the Committee:

The Hawaii Aquaculture Association (HAA) **strongly supports the intent of HB2739 H.D.1 S.D.1** to qualify agricultural businesses for enterprise zones, to allow them to receive benefits in case of force majeure, to add a second qualification option based in a 2% annual increase in gross revenues, to count leased employees and joint employment workers in hiring formulas, and to qualify certain value-added agricultural sales towards certification for income tax credit purposes.

However, the HAA has noted one apparent oversight in the current wording of HB2739 H.D.1 S.D.1 that we would like to bring to the attention of the Committee and request appropriate amendment. On page 1, lines 11-16, the bill was amended to state: "The business shall remain eligible for all tax incentives under this chapter for any period of time while experiencing conditions under paragraph (1) or (2) caused by a force majeure event, and the seven-year eligibility time shall be extended by an equivalent period of time." Yet on page 7, lines 13-18, the original and seemingly inconsistent wording states: "The gross proceeds received by a contractor licensed under chapter 444 shall be exempt from the general excise tax for construction within an enterprise zone performed for a qualified business within the enterprise zone. The exemption shall extend for a period not to exceed seven years."

The HAA requests that the wording on line 18 be amended to say approximately "The exemption shall extend for a period not to exceed seven years except as noted on page 1, lines 11-16 above." Such an amendment would enable agriculture operations recovering from force majeure events to still be able to attract contractors with this incentive during the duration of their recovery period and their subsequent extended period of eligibility, thereby better supporting the goals of the EZ Program and the spirit of force majeure language on page 1.

The HAA strongly supports the EZ program and HB2739 H.D.1 S.D.1 with the requested amendment. This legislation is urgently needed by the EZ farms recovering from the numerous force majeure events of the last two years. The HAA urges the Committee to pass of this important bill and respectfully requests this Committee to indicate to WAM that this is a priority bill urgently needed by the agricultural community.

Thank you for the opportunity to testify.



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TESTIMONY BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

HB 2739 HD1 SD1

RELATING TO STATE ENTERPRISE ZONES

March 18, 2008

Chair Fukunaga and Members of the Committee:

My name is Stephanie Whalen. I am President and Research Director of the Hawaii Agriculture Research Center (HARC). I am testifying today on behalf of the center, our research and support staff, and our members and clients.

HARC strongly supports HB 2739 HD1 SD1 Relating to State Enterprise Zones.

It recognized the uniqueness of agricultural businesses and would be very helpful in maintaining the viability of agriculture. In the transition from large scale farming to smaller and more diverse farms it is imperative that the statutes also change and adapt to the needs of this situation. There is a demonstrated employment crunch in Hawaii and finding employees is often very difficult, especially for agriculture. While we recognize the original intent of this statute was to increase employment, times have changed, all sectors are scrambling to find and keep employees in a very financially difficult environment. Increasing revenues is an equally important contribution to the economic viability of our state. Agriculture has been faced with labor shortages from its beginnings and is forced to be entrepreneurial in maintaining and increasing output while faced with a dwindling workforce. Providing for either employment or revenue increases will allow for more agricultural businesses to support in the business tax incentives.

The employee sharing concept is very progressive. Many of the newer crops do not require year-round labor but with the diversity developing, shared or leased employees just makes sense. Whereas diversity existed under one employer in the past which allowed year-round employment by one company, that diversity is now manifested in many independent farms where peak and shorter employment periods are the norm.

It is exciting to see this proposed measure combining ideas to support the diversification of agriculture that has been the goal for over three decades.

Thank you for the opportunity to testify.

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, Enterprise zone agricultural businesses

BILL NUMBER: HB 2739, SD-1

INTRODUCED BY: Senate Committee on Agriculture and Hawaiian Affairs

BRIEF SUMMARY: Adds a new section to HRS chapter 209E to provide that if an agricultural business is: (1) prevented from maintaining enterprise zone eligibility requirements; or (2) interrupted due to a force majeure event, the business located in an enterprise zone shall not be disqualified as an eligible business. The seven-year eligibility period for such business shall be extended by the duration of the force majeure event.

Amends HRS section 209E-2 to add the definition of “force majeure,” “joint employment,” and “leased employee” for purposes of the measure. Amends the definition of “full-time” employee to include leased employees and employees under a joint employment relationship and the definition of “qualified business” to include a business engaged in processing agricultural products. Defines “force majeure” as an event including, but not limited to, damaging weather or natural disasters such as epidemic disease, pest outbreak, high wind, thunderstorm, hail storm, tornado, fire, flood, earthquake, lava flow or other volcanic activity, drought, tidal wave, hurricane, or any situation beyond the control of the agricultural business.

Amends HRS section 209E-9 to stipulate that receipts from value-added products made from crops grown within an enterprise zone and sold at retail pursuant to the enterprise zone requirements, shall count toward the gross receipts requirement for business firms engaged in producing or processing agricultural products. Also provides that a business shall be eligible as a “qualified business” if the business increases its average annual number of full-time employees employed at the business located within the enterprise zone by at least 10% by the end of the first year of operation; provided the increase shall be based on the employee count at the beginning of the initial year of operation; or increases its gross sales of agricultural crops or products within the enterprise zone by 2% annually.

Amends HRS section 209E-11 to provide that agricultural businesses not engaged in genetically engineered agricultural production shall not be exempt from the payment of general excise taxes on the gross proceeds of agricultural retail sales.

EFFECTIVE DATE: July 1, 2034

STAFF COMMENTS: In an enterprise zone, businesses are attracted and encouraged to relocate to the zone through tax incentives, bonds, and other appropriate measures. Businesses located in an enterprise zone may claim a credit against taxes paid for a period of seven years and also allows the sale of items sold by such businesses to be exempt from the general excise tax. This measure proposes to allow an agricultural business located in an enterprise zone to maintain its eligibility requirements in the event of a force majeure and also to extend its enterprise zone benefits by the duration of the event.

While it is understandable that agricultural operations are perhaps more prone to suffer economic dislocation as a result of a natural disaster or severe weather conditions, one has to pose the question whether or not other businesses that suffer from a force majeure should also be granted the same leniency this measure proposes? What this measure does emphasize is the inequity created by enterprise zones by handing out more favorable treatment for those located in the zone, usually at the expense of those who are not.

The proposed measure also amends the eligibility requirements of an enterprise zone to include the processing of agricultural products. It should be remembered that in recent years, the type of businesses that have been included to receive enterprise zone benefits include call centers of disease management services, sale of wind farm generated electricity sold to a public utility, research, development and sale of genetically engineered medical, agricultural, or maritime biotechnology, etc. The proposed measure would singling out another business for preferential treatment merely conferring preferences for those businesses at the expense of all other taxpayers

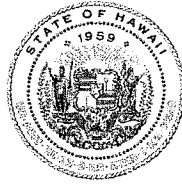
It should be remembered that enterprise zones merely exacerbate what is already considered a poor climate in which to do business. Singling out specific areas of the state merely confers preferences for those businesses located within those geographic areas at the expense of all other taxpayers who are not so favored. It should be remembered that those taxpayers who live and work in the zone will demand the same public services as those who are not as fortunate to be located in the zone. Who then will pay for these services?

Concurrent efforts must be made to improve Hawaii's business climate to enhance the economic prospects for all businesses. Enterprise zones are merely an abdication of government's responsibility to create a nurturing and supportive business climate so that all businesses can thrive in Hawaii and provide the jobs the people of Hawaii need.

Finally, while Hawaii has had the enterprise zone concept on the books for years, no evaluation of how effective these zones have been in improving the well-being of those communities on which this status has been conferred. Before further corrupting the economic marketplace with added versions of the enterprise zone concept, an evaluation of the current zones should be undertaken. Instead of expanding the enterprise zone program, the program should be repealed in favor of across-the-board tax relief for all businesses in Hawaii. Indeed, has there been a comprehensive evaluation of the program and do lawmakers know exactly how much enterprise zone businesses have benefitted and whether or not they have created the jobs promised when the program was first established? If the legislature is adamant about the designation of enterprise zones in the state, then the whole state should be designated an enterprise zone and the tax treatment will be equitable for all businesses

Digested 3/17/08

LINDA LINGLE
Governor



SANDRA LEE KUNIMOTO
Chairperson, Board of Agriculture

DUANE OKAMOTO
Deputy to the Chairperson

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MAR 17 2008

**TESTIMONY OF SANDRA LEE KUNIMOTO
CHAIRPERSON, BOARD OF AGRICULTURE**

**BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
TUESDAY, MARCH 18, 2008
1:15 P.M.
Room 224**

**HOUSE BILL NO. 2739, HD1, SD1
RELATING TO STATE ENTERPRISE ZONES**

Chairperson Fukunaga and Members of the Committee:

Thank you for the opportunity to comment on House Bill No. 2739, HD1, SD1. The purpose of this bill is to qualify agricultural businesses for enterprise zones and allow them to receive benefits in case of a force majeure event.

The Hawaii Department of Agriculture (HDOA) supports this bill as it allows qualified agricultural businesses in the Enterprise Zone (EZ) program to remain eligible for all tax incentives while experiencing a force majeure event and also extends the seven-year eligibility period by the duration of the loss.

This bill addresses concerns raised previously on the challenges of meeting the increase in full-time employee requirements, especially when agricultural labor is in short supply. We are in support of the new language in Section 4 (b)(3)(B) [Page 6, lines 17-19] which allows businesses to qualify by increases in gross sales of agricultural crops or products produced within the enterprise zone by two per cent annually.

Thank you for the opportunity to testify on this bill.

**HAWAII FARM BUREAU FEDERATION
2343 ROSE STREET
HONOLULU, HI 96819**

MARCH 18, 2008

HEARING BEFORE THE
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

TESTIMONY ON HB 2739, HD 1, SD 1
RELATING TO STATE ENTERPRISE ZONES

Chair Fukunaga and committee members:

My name is Alan Takemoto, Executive Director, of the Hawaii Farm Bureau Federation, which is the largest non-profit general agriculture organization representing approximately 1,600 farm and ranch family members statewide.

The Hawaii Farm Bureau Federation supports the intent of HB 2739, HD 1, SD 1. We support the provision that allows agricultural businesses to continue to be qualified in the event of any natural disaster. Agricultural businesses can be completely out of production for weeks and sometimes for months with strong winds, rain, and flooding. Also allowing value added agricultural products grown in the zone may also take advantage of these tax credits provided. This will encourage more value added production and help farmers to diversify their operation.

We are concerned over the labor requirements. With the labor shortage here in Hawaii, especially for agricultural operations, it has been very difficult to hire willing laborers to work on farms. Small family farms will continue to not participate in this program if this labor requirement becomes more difficult. We recommend that for agricultural operations, we add that revenues be an alternative if the farm operation cannot meet the labor requirement. With revenues as an added component, the agricultural operation will then have a realistic incentive mechanism to eventually hire more labor.

Thank you.