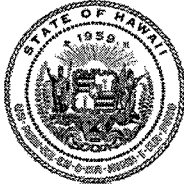


LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
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SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2985 HD 1 RELATING TO TAXATION

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

DATE: MARCH 18, 2008

TIME: 1:15PM

ROOM: 224

This legislation provides for an income tax credit equal to 15% of the costs of hotel renovations between 2014 and 2019.

Previously, the law allowed for a credit for the renovation costs incurred by a qualified hotel facility through December 31, 2005. This credit was allowed at rates of 10% and 4%, depending upon the taxable year. At that time, "qualified hotel facility" included a hotel-condo and time-share facility or project.

The House Committee on Tourism & Culture amended the measure by defecting the effective date.

The House Committee on Finance passed this measure unamended.

The House of Representatives passed this measure on third reading.

The Senate Committee on Tourism & Government Operations passed this bill unamended.

The Department of Taxation has **strong concerns** with this measure; offers comments, and provides the revenue estimate.

I. SUPPORT FOR THE TOURISM INDUSTRY, GENERALLY

The Department supports the tourism industry and the importance of the economic activity this important industry brings to Hawaii. The Department acknowledges that having modern and newly renovated rooms are an important factor in maintaining the flow of tourists to this State.

II. FISCAL PRIORITY OF SUBSIDIZING THIS INDUSTRY QUESTIONABLE

The Department's primary concern relates to the fiscal priority of subsidizing the hotel industry at this time. The hotel industry is comprised of highly capable entities that have capitalized on a booming tourism industry over the past few years to improve several facilities throughout the State. Though there is evidence suggesting tourism is stabilizing, the Department requests that the Committee strictly evaluate the fiscal priority of subsidizing this industry.

III. THE MEASURE MAY CAUSE HOTEL FACILITIES TO DEFER RENOVATIONS

Because the credit as set forth in this measure applies only to costs incurred beginning in calendar year 2014 through calendar year 2019, hotels may opt to defer needed renovations until such time the costs become eligible for the credit. This would be counter-productive to insuring modern and updated hotel rooms being available for the tourism industry. The Department also raises other timing issues with the bill since "renovation" is defined to include costs incurred after December 31, 2007 and subsection (h) seems to prohibit double-dipping with Chapter 235D, which expired on December 31, 2005.

IV. THE LEGISLATION IS PREMATURE AT THIS TIME

The Department believes that the current legislation is premature at this time. The state of the economy in 2013 and beyond can only be the subject of conjecture and educated guesses. Whether a hotel renovation tax credit is appropriate at that time is better suited for later Legislatures, with more current information as to the status of the construction industry, the tourism industry, and the economic health of the State as a whole.

V. ANY TAX INCENTIVE SHOULD BE NONREFUNDABLE

The Department points out that this legislation provides for a refundable income tax credit. The Department suggests that the Committee consider amending the measure to make the credit nonrefundable. In order for a company to enjoy a nonrefundable credit, the company must be generating income. With a refundable credit, on the other hand, there is no incentive or encouragement to be profitable. Having a nonrefundable credit would encourage the hotel industry to both invest in their operations, as well as generate sufficient revenues to ensure that a nonrefundable credit was worthwhile. At the same time, revenue growth from the hotels will translate into commensurate growth within the tourism industry, generally.

VI. RECONCILE TECHNICAL AMBIGUITY

This legislation currently contains an ambiguity over which costs may be utilized for the credit. "Renovation" for purposes of the credit is defined as follows:

"Renovation" means any costs incurred after December 31, 2007, for plans, design, construction, and equipment related to renovations, alterations, or modifications to a hotel facility.

However, the credit is available for taxable years beginning several years after this date:

(i) The tax credit allowed under this section shall be available for taxable years beginning after December 31, 2013, for building permits submitted to the appropriate county agency before December 31, 2014, and shall not be available for taxable years beginning after December 31, 2019.

Because of this ambiguity, taxpayers could read the bill to allow expenditures incurred after 2007 for "renovations" that are the basis of the credit during the time beginning after December 31, 2013. The Department suggests clarifying whether costs incurred after December 31, 2007 are allowed to be claimed during 2014; or if for all practicable purposes, the credit is allows for renovation costs incurred after December 31, 2013.

VII. REVENUE ESTIMATE

Assuming this legislation takes effect prior to 2014 two possible scenarios can happen. Scenario 2 is much more probable.

Scenario 1: Construction continues as normal from now until 2015:

- **FY2015 (loss): \$9.1 million.**
- **FY2016 (loss): \$9.4 million.**
- **FY2017 (loss): \$9.7 million.**

Scenario 2: Hotels delay construction to take advantage of the credit:

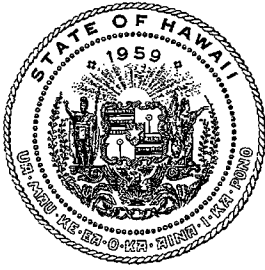
- **FY2012 (loss): \$2.2 million**
- **FY2013 (loss): \$2.2 million**
- **FY2014 (loss): \$2.3 million**
- **FY2015 (loss): \$11.7 million**
- **FY2016 (loss): \$12.0 million**
- **FY2017 (loss): \$12.4 million**
- **FY2018 (loss): \$12.7 million**

Scenario 1:

The amount of eligible existing hotel stock was taken, and assuming annual depreciation of 2.0%, it is estimated that 2% of eligible units will be renovated in any given year. Assuming a renovation cost of \$63,000 (based on inflation-adjusted renovation costs in 2002), it is estimated that the estimated renovation costs will total \$60.9 million in 2014. With a 15% tax credit, the tax credit will result in a revenue loss of \$9.1 million in FY2015.

Scenario 2:

It is assumed that any renovation after 2010 will be postponed until after 2014 to take advantage of the credit. Thus, the loss in revenue from FY2011-2014 will be the forgone GE revenue from the construction that otherwise would have happened. The loss in revenue from FY2015 onwards will be the credit cost of the now-increased construction, less the additional GE that was displaced from FY2011-FY2014.



Hawai'i Tourism Authority

Hawai'i Convention Center, 1801 Kalākaua Avenue, Honolulu, Hawai'i 96815
Website: www.hawaitourismauthority.org

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Governor

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President and Chief Executive Officer

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Testimony of
Rex Johnson
President and Chief Executive Officer
Hawai'i Tourism Authority

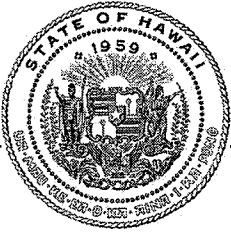
on
H.B. 2985, H.D. 1
Relating to Taxation

Senate Committee on Economic Development and Taxation
Tuesday, March 18, 2008
1:15 p.m.
Conference Room 224

The Hawai'i Tourism Authority (HTA) supports H.B. 2985, H.D. 1, which proposes a tax credit for the renovation of hotel facilities, equal to fifteen percent of the renovation costs beginning in the taxable years after December 31, 2013 and ending before January 1, 2020.

The HTA is tasked with marketing and promoting Hawai'i as a visitor destination, with the goal of increasing visitor spending. One of the keys to branding the Hawai'i visitor industry product and increasing visitor spending is the improvement and enhancement of the tourism product, which includes the physical infrastructure. As such, the HTA supports H.B. 2985, H.D. 1, which provides a tax credit of 15 percent of the costs of renovation of a hotel facility. The credit will be an incentive for the private sector to improve hotel facilities for visitors.

Thank you for the opportunity to provide these comments.



LINDA LINGLE
GOVERNOR
MARSHA WIENERT
TOURISM LIAISON

TOURISM LIAISON

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Written statement of
MARSHA WIENERT
Tourism Liaison
Department of Business, Economic Development & Tourism
before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION
Tuesday, March 18, 2008
1:15 p.m.
State Capitol, Conference Room 224

in consideration of
HB 2985 HD1
RELATING TO TAXATION.

Chair Fukunaga and Members of the Senate Committee on Economic Development & Taxation.

The Department of Business, Economic Development and Tourism appreciates the overall concept of HB 2985 HD1, which provides a tax credit for hotel renovations. However, we have strong concerns about the cost implications that may be generated by this proposal.

Reinvestment in our tourism product and hotel inventory is vital to maintaining a successful visitor industry, but due to the advanced date of the tax credit within this measure, hotel companies may choose to postpone needed renovations in order for the credit to apply. Furthermore, we believe that it would be more appropriate to discuss the necessity of a hotel renovations tax credit in 2014 at a later date, as we can only guess at the budgetary effects that such a credit may have at that time.

Therefore, we respectfully request that this measure be deferred.

Thank you for the opportunity to comment on HB 2985 HD1.

UNITE HERE!

LOCAL 5 HAWAII

Eric Gill, Financial Secretary-Treasurer

Hernando Ramos Tan, President

Godfrey Maeshiro, Senior Vice-President

Friday, March 14, 2008

Senator Carol Fukunaga, Chair
 Senator Will Espero, Vice Chair
 Senate Committee on Economic Development & Taxation

Testimony regarding HB 2985 HD 1; *relating to taxation.*

Chair Fukunaga, members of the Senate Committee on Economic Development & Taxation, I submit this testimony on behalf of UNITE HERE! Local 5 – a local labor organization representing nearly 12,000 hotel and health care workers throughout our State.

House Bill 2985 HD 1 would provide for an income tax credit equal to 15% of the costs of hotel renovations between 2014 and 2019.

UNITE HERE! Local 5 would like to offer comments on this measure.

While we believe it is worthy to support measures that speak to the importance of the economic activity generated by Hawaii's tourism industry, we wish to echo the concerns already articulated by the Department of Taxation before the House Committee on Tourism & Culture regarding the "fiscal priority of subsidizing this industry."

Nonetheless and as we engage ourselves in these discussions surrounding the economic viability and future of our hotel industry, we humbly suggest that we first remind ourselves of the important role our unionized hotel workers have and continue to play in securing a future for middle-class families in Hawaii. Consequently, the sacrifices made by our members and other hotel workers whose properties have and continue to undergo hotel renovations must not be overlooked in these discussions. In other words, if we are to provide financial incentives for the improving of hotel facilities for our visitors then we must also be confident that such initiatives are mutually beneficial for the workers and taxpayers of our State. As such, we must pay close attention to and advocate for strict qualification guidelines that protect workers' rights that can in return be applied to the process those seeking the tax credit must eventually abide by.

Thank you for the opportunity to provide these comments.

Sincerely,



Cade M. Watanabe
 Community/Political Organizer



**HAWAII HOTEL & LODGING
ASSOCIATION**

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30th Anniversary
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May 17, 2008
(Always the 3rd Saturday in May)
www.charitywalkhawaii.org

**TESTIMONY OF MURRAY TOWILL
PRESIDENT
HAWAII HOTEL & LODGING ASSOCIATION**

March 18, 2008

RE: HB 2985 HD 1 Relating to Taxation

Good afternoon Chairperson Fukunaga and members of the Senate Committee on Economic Development & Taxation. I am Murray Towill, President of the Hawaii Hotel & Lodging Association.

The Hawaii Hotel & Lodging Association is a statewide association of hotels, condominiums, timeshare companies, management firms, suppliers, and other related firms and individuals. Our membership includes over 170 hotels representing over 47,300 rooms. Our hotel members range from the 2,523 rooms of the Hilton Hawaiian Village to the 4 rooms of the Bougainvillea Bed & Breakfast on the Big Island.

The Hawaii Hotel & Lodging Association supports HB 2785 HD 1 Relating to Taxation. This bill would provide a future tax credit for the renovations of hotels.

This measure is timely in that it would help encourage renovations at a time when the economy is slowing and the industry is expecting fewer customers. Stimulating construction activity will not only assist construction jobs but will help to position the visitor industry to be competitive in the future.

An additional advantage of a hotel renovation tax credit is that it would help to offset the financial incentive of converting hotels to timeshares or condominium developments. In recent years conversions of this type have made great economic sense due to consumer demand and the ability to obtain a more immediate return for developers and investors. The net effect of this incentive would be to help maintain the hotel room inventory.

One of the limitations of this bill is that the tax credit does not take effect until 2014. We would be concerned that this measure might encourage owners to delay investment to a time closer to the availability of the tax credit.

Again, mahalo for this opportunity to testify.

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Hotel renovation tax credit

BILL NUMBER: HB 2985, HD-1

INTRODUCED BY: House Committee on Tourism and Culture

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers subject to HRS chapter 235 and 237D to claim a hotel renovation tax credit of 15% of the renovation costs incurred after December 31, 2007. Stipulates that it shall not include the construction or renovations cost for which another income tax credit was claimed for the taxable year.

In the case of a partnership, S corporation, estate or trust, the credit shall be determined at the entity level. If a deduction is taken under IRC section 179 (with respect to election to expense depreciable business assets), no tax credit shall be allowed for that portion of the renovation cost for which the deduction was taken. The basis of eligible property for depreciation or accelerated cost recovery system shall be reduced by the amount of credit allowable and claimed.

The credit shall be deductible from the taxpayer's income tax liability with any excess credit in an amount greater than \$1 refunded to the taxpayer. 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 credit shall be applied for on forms provided by the tax department.

The tax credit shall be available for tax years beginning after December 31, 2013 for building permits submitted to the appropriate county agency before December 31, 2014, and shall not be available for tax years beginning after December 31, 2019.

Defines "hotel facility," "net income tax liability," "renovation" and "taxpayer" for purposes of the measure. "Hotel facility" shall not include any building that is used or contains any room that is used as a condominium or timeshare unit.

EFFECTIVE DATE: July 1, 2025

STAFF COMMENTS: The legislature by Act 195, SLH 2000, enacted a hotel construction and renovation tax credit of 4% for hotel renovations effective for tax years beginning after December 31, 1998 but before December 31, 2002. Act 10 of the Third Special Session of 2001 increased the hotel renovation tax credit to 10% for construction costs incurred before July 1, 2003. Act 10 also provided that the credit shall revert back to 4% on July 1, 2003 and sunset on December 31, 2005. This measure proposes a similar credit for a five-year period between December 31, 2014 and December 31, 2019.

The original tax credit was promoted on the argument that the tax credit would be an incentive for hotels to refurbish their properties in order to remain competitive with other destinations around the world. The credit amount was set at 4% to seemingly offset the 4% general excise tax. When 9/11 hit, the

momentum of the crisis fostered support for an increase in the credit to 10% to supposedly keep projects which were already in progress going. However, the governor objected and threatened to veto the sweetened credit. The legislature compromised and provided that the 10% credit would be nonrefundable.

While this measure proposes to reestablish a hotel renovation tax credit, it should be noted that no evaluation has been done to validate the effectiveness of this credit in spurring substantial renovations of hotel resort properties. While some may argue that this credit is necessary to make their upcoming renovations pencil out, one must ask whether or not it is the role of government to subsidize private investments. While the credit might be viewed as critical to a taxpayer's project or to the continued renovation of the resort plant, one must ask how long must all other taxpayers suffer the heavy burden of taxation so that this subsidy can be extended to a few?

It would be a very different picture if those who are asking for the subsidy would be willing to forgo other public services or make recommendations on how government can rein in spending, but that is not the case.

Now more than ever lawmakers need to recognize that they need to set priorities for what precious few dollars taxpayers can part with to run state and local government. One must ask how lawmakers can provide subsidies like this proposal when they raised the general excise tax on all other taxpayers to pay for a transit system in Honolulu? Taking care of a few taxpayers at the expense of all other taxpayers is certainly a cavalier attitude for which taxpayers have long suspected comes with the legislature.

Instead of perpetuating these targeted tax incentives and subsidies, lawmakers should look at the broader picture and enact tax relief that will benefit all taxpayers. Perpetuating targeted tax credits, like this, merely perpetuates the high burden of taxes in Hawaii which, in turn, places a barrier on any recovery. From a global perspective, what effect will these credits have on the cost of construction in Hawaii?

In retrospect, lawmakers should examine what their past actions accomplished in this area. Told that tax credits to stimulate construction would encourage renovation of hotel facilities prior to 9/11 and then after that tragedy to get construction workers off the bench and help the economy in the aftermath, the credit for hotel construction and renovation tax credit was boosted on a temporary basis and a 4% residential renovation and construction tax credit was adopted. But what drove the construction activity after 9/11 was really the fall in interest rates creating new homeowners and homeowners who traded up. On the hotel renovation side, with cheaper financing, projects began to pencil out as feasible. Thus, the tax credits became nothing more than additional savings and profit as homeowners renovated in preparation for sale and for the hotel side, the cost of renovation brought the potential rental income into a reasonable territory.

It is interesting to note that in the committee report attached to HD-1 there is growing concern about the conversion of hotels to timeshares and condominiums, especially for non-beachfront properties which can't command the same room rates as beachfront properties. The committee report notes that as a result, beachfront properties can pay for needed renovation costs where as non-beachfront properties may not be able to afford to upgrade their facilities. If that is the case, then the tax may just be a windfall for beachfront properties while the non-beachfront properties will still have to struggle with amassing the capital to undertake the renovation. It should be remembered that the credit can only be claimed if the activity is undertaken. Thus, the credit is of no use if a property cannot pull the financing together.

What should be learned is that while well-intended, government intervention into the economic cycle merely skews the economy out of kilter and into artificial growth patterns. The outcome of the tax credit subsidy is that construction costs will become even more costly in the future and again skew the economic marketplace. This fooling around with the economic marketplace came at a dear price as state tax resources were stretched thin. Raising taxes while providing such subsidies to specific taxpayers should be unacceptable. Lawmakers should not allow this to happen.

Digested 2/25/08