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HOUSE COMMITTEE ON FINANCE

TESTIMONY REGARDING HB 3008 HD 1
RELATING TO QUALIFIED IMPROVEMENT TAX CREDIT

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 26, 2008
TIME: 10:00AM
ROOM: 308

The Department of Taxation (Department) provides **comments** on this legislation, which amends chapter 235 by adding a tax credit for qualified improvements to health centers.

The House Committees on Human Services & Housing and Health amended the bill by removing an unnecessary rulemaking provision pursuant to the Department's request.

I. TECHNICAL CONSIDERATION – AMOUNT OF CREDIT

Section 2 of the bill, subsection (d), describing how the credit is calculated, is unclear for two reasons. First, an amount of $2,000,000 is included in both paragraphs (1) and (2). The amount of $5,000,000 is included in both paragraphs (2) and (3). Second, it is unclear whether the percentage amounts associated with each paragraph apply fully to the entire amount of expenditure by the qualified health center, or whether the paragraphs are meant to create a graduated credit. For instance, according to the current language, an expenditure of $1,999,999 would yield a credit of 25% of that amount, or $499, 999. An expenditure of $3,000,000, according to the current language, would yield a credit of 15% of that amount, or $450,000. Thus, higher expenditures can result in lower tax credits. If it is the intention of the legislature that the credit be graduated so that higher expenditures cannot result in lower tax credits, the language should be amended as follows:

<u>(d) The amount of the qualified improvement tax credit shall be equal to:</u>
<u>(1) Twenty-five per cent of the qualified improvement costs incurred up to and including $2,000,000; plus</u>
<u>(2) Fifteen per cent of amount of the qualified improvement costs greater than $2,000,000 ,up to and including $5,000,000; plus</u>
<u>(3) Ten per cent of the amount of qualified improvement costs greater than $5,000,000.</u>

III. REVENUE IMPACT

Total revenue loss for a 10-year period would range from $4.9 million to $130.0 million. Annual average loss is about $7.0 million.

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Qualified improvement tax credit

BILL NUMBER: HB 3008, HD-1

INTRODUCED BY: House Committees on Human Services and Housing and Health

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow each taxpayer who operates a federally qualified health center to claim a credit which shall be deductible from the taxpayer's net income tax liability. To claim a qualified improvement tax credit, the taxpayer must incur qualified improvement costs that exceed $150,000 in the taxable year for which the credit is claimed provided that: (1) all qualified improvement costs including the first $150,000 shall be eligible for the qualified improvement credit; and (2) qualified improvement costs shall be reduced by the amount of state or county funding received during the year the credit is claimed.

The amount of the credit shall be 25% of the qualified improvement costs incurred up to $2 million; 15% of the qualified improvement costs incurred that total between $2 million and $5 million or 10% of the qualified improvement costs incurred that total $5 million or more.

The total tax credits claimed during the ten consecutive taxable years beginning after 12/31/08 and before 1/1/19 shall not exceed $_____ in the aggregate for each federally qualified health center.

No credit shall be allowed for the portion of the qualified improvement cost for which a deduction is taken under IRC section 179 (with respect to election to expense certain depreciable assets). The basis of eligible property for depreciation or ACRS purposes for state income taxes shall be reduced by the amount of the credit allowable and claimed.

The credit shall be claimed against net income tax liability for a taxable year with any credit in excess of tax liability refunded to the taxpayer provided such amount is over $1. Requires all claims for the credit to be filed before the end of the twelfth month following the close of the tax year. The director of taxation shall prepare forms as may be necessary to claim the credit.

The credit shall be available for qualified improvement costs incurred during taxable years beginning after 12/31/08 and before 1/1/19.

Defines "federally qualified health center," "qualified equipment," "qualified facility" and "qualified improvement costs" for purposes of the measure.

EFFECTIVE DATE: Tax years beginning after December 31, 2008

STAFF COMMENTS: It appears the proposed measure allows owners of a federally qualified health facility to claim an income tax credit for a percentage of the qualified improvement costs made to that facility. A similar measure was approved in 2002 but was subsequently vetoed by the governor. The convoluted determination of how much of a credit could be claimed raised questions about what the credit is supposed to accomplish. If the intent of this measure is to subsidize the cost of the renovations or improvements to the health care facility, then it would seem more accountable for lawmakers to subject the project to the appropriation process. Depending on how many health care facilities would qualify (the veto message indicated that there were nine such facilities that would have qualified under that measure), the loss of revenues could be substantial given the aggregate limit per facility in that legislation was $9 million.

As the then governor noted in the veto message, the refundable aspect of this tax credit granted to nonprofit organizations who pay no income taxes in effect makes this proposal an in-lieu grant-in-aid. As noted in the veto message, the state constitution provides that grants of public money shall be made pursuant to standards of law which in this case is the appropriation process. Thus, the credit proposed in this measure seeks to circumvent the constitution and the standard set for the granting of public funds.

It should be remembered that the tax system is an inefficient means to accomplish this goal as the proposed measure would grant a credit regardless of a taxpayer's need for tax relief. Thus, as a subsidy, a more efficient solution would be through a grant-in-aid or a direct appropriation to these organizations rather than an inefficient tax credit. Providing tax expenditures out the back door with the use of tax credits is hardly accountable or transparent. And because of confidentiality issues, taxpayers will never know who received the credits and how effective they were in achieving the purported outcomes. The appropriation process would be particularly more precise as it appears lawmakers have a specific project or projects in mind. As a tax credit, the incentive would be available to any and all qualified health facilities. With the appropriation process, lawmakers can set the criteria for funding and select each facility on its merits and know what the entire price tag will be before approving the final appropriation.

Finally, lawmakers should heed the words of the latest Tax Review Commission. Such credits beg for a cost benefit analysis before being enacted. What is the benefit to be realized by the public and will the dollar investment in the form of the credit produce benefits many times more than the amount of the credit? If not, then are there ways that a greater benefit can be realized other than the use of the tax credit?

Digested 2/25/08

Hawai'i Primary Care Association
345 Queen Street, Suite 601 Honolulu, HI 96813
Tel (808) 536-8442 Fax (808) 524-0347

To: **House Committee on Finance**
The Hon. Marcus R. Oshiro, Chair
The Hon. Marilyn B. Lee, Vice Chair

Testimony in Support of House Bill 3008, HD 1
Relating to Qualified Improvement Tax Credit
Submitted by Beth Giesting, CEO
February 26, 2008, 10:00 a.m. agenda, Room 308

The Hawai'i Primary Care Association strongly endorses this measure.

Federally qualified health centers (FQHCs or Community Health Centers) are an important element in Hawai'i's health care system. They are growing to meet more community needs and this requires that they build or expand facilities, obtain equipment, and upgrade technology systems. Community Health Centers focus their efforts on low-income and underserved groups; they operate on thin margins and depend heavily on federal and state funding to sustain their services. This makes it very difficult to fund building and other capital needs since land and building costs are so high all over Hawai'i. We believe the tax credit that would be created by this bill would provide a means for the State to provide predictable support for essential capital improvements for these health centers.

We would also bring to your attention the benefits that FQHCs bring to their communities besides the obvious and important one of delivering essential health care to underserved people. Community Health Centers are substantial economic engines. In 2006, the economic impact of Hawai'i's FQHCs included $168 million in activity and 1,768 jobs supported. They directly controlled $84 million dollars and employed 1,043 people. In their respective communities they are major employers, provide training and career ladders, and through their community-based boards, offer civic leadership opportunities.

We estimate that over the course of five years, the refundable tax credit proposed in this bill would be limited to about $25 million but would stimulate nearly $130 million in much needed capital improvements and expansion for Community Health Centers. The increased facility space would allow the FQHCs to increase their capacity by nearly 60%. This is clearly a public good since Community Health Centers target underserved areas and people who otherwise wouldn't get the care they need. At the same time, this growth would have a positive economic impact both initially, with construction and equipment purchases, and after expansion where growth translates into expanded employment and other operating costs.

This is a most important measure. We ask that the committee consider its full impact and pass it.

KOKUA KALIHI VALLEY
Comprehensive Family Services
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TESTIMONY IN SUPPORT OF HB 3008:
RELATING TO QUALIFIED IMPROVEMENT TAX CREDIT
Tuesday, February 26, 10:00 a.m. agenda, Room 308

Submitted to: Committee on Human Services and Housing and Committee on Health
The Honorable Marcus R. Oshiro, Chair
The Honorable Marilyn B. Lee, Vice Chair

Submitted by: David D Derauf MD MPH
Executive Director
Kokua Kalihi Valley

Kokua Kalihi Valley strongly supports HB 3008 which would provide matching funds for development programs for healthcare infrastructure in Hawaii's federally designated medically underserved communities.

Community health centers are critical safety net providers for Hawaii. The 14 community health centers in Hawaii are facing a relentless increase in demand for free and discounted medical, dental, behavioral health, pharmaceutical and other services. The proposed tax credit has been designed to provide incentives to low income communities to capitalize on existing private fundraising initiatives.

This bill would provide an important incentive to increase private fundraising by our non-profits and assist in leveraging that fundraising to encourage expansion of facilities designed to serve the very poor.

This approach, using tax credits, has precedent in Hawaii, and sets up a systematic approach to seeking State grant-in-aid for non-profit organizations. The process will help assure Hawaii of a high success rate for completion of projects, leverage State dollars, and limit total State exposure to project costs.

We urge your passage of HB 3008.

Waianae Coast Comprehensive Health Center

TESTIMONY IN SUPPORT OF HB 3008 HD 1:
RELATING TO QUALIFIED IMPROVEMENT TAX CREDIT
Submitted to: Committee on Finance

Submitted by: Richard P. Bettini, Chief Executive Officer
Waianae Coast Comprehensive Health Center
Contact: 696-1457

The Waianae Coast Comprehensive Health Center strongly supports HB 3008 HD 1 which would provide matching funds for development programs for healthcare infrastructure in Hawaii's federally designated medically underserved communities, with the amendments described below.

In reviewing the State Department of Taxation February 7, 2008 testimony to the Committee on Human Services and Housing and Committee on Health, we concur with their recommendation that the bill language be clarified that the tax credit be graduated. This has been the intent of the community health centers.

We recommend amending the language (with the language provided by the Department of Taxation) in Section 2 of the bill, subsection (c), as follows:

(d) The amount of the qualified improvement tax credit shall be equal to:
(1) Twenty-five per cent of the qualified improvement costs incurred up to and including $2,000,000; plus
(2) Fifteen per cent of the amount of the qualified improvement costs greater greater than $2,000,000, up to and including $5,000,000; plus
(3) Ten per cent of the amount of qualified improvement costs greater than $5,000,000.

Without this amendment, the current language can result in lower tax credits for higher expenditures.

Community health centers are important safety net providers in Hawaii. The 14 community health centers in Hawaii face increasing demand for free and discounted medical, dental, behavioral health, pharmaceutical and other services. The proposed tax credit has been designed to provide incentives to low income communities to capitalize on existing private fundraising initiatives and seek non-State dollars to build new facilities; improve/meet health and safety codes; as well as improve health care technology.

We urge your passage of HB 3008 HD 1 with the amendment stated above.

WAIKIKI HEALTH CENTER

REACHING OUT FROM THE HEART OF WAIKIKI.

To: **House Committee on Finance**
The Honorable Marcus R. Oshiro, Chair
The Honorable Marilyn B. Lee, Vice Chair

Re: **Testimony in Support of House Bill 3008, HD 1**
Relating to Qualified Improvement Tax Credit

Submitted by: **Sheila Beckham**
Executive Director

Date: **February 26, 2008; 10:00 am agenda; Room 308**

Waikiki Health Center strongly supports this bill. As a federally qualified health center (FQHC), in operation for over 40 years, our focus is on individuals and families that are low income, underserved, and at-risk. The large majority of our funding comes from federal and state sources to provider services for individuals that are homeless or at-risk for homelessness. This reliance on government funding makes it difficult to support needed building and capital improvements—especially with our location in the heart of Waikiki.

Waikiki Health Center estimates that over the course of five years, the maximum amount of capital improvements to its facilities would be approximately $7 million, with $1.3 million in tax credits. The additional facility space would allow Waikiki Health Center to expand its capacity by 50%--providing much-needed medical and social services to its vulnerable populations. The growth would positively impact the overall economy through construction and equipment purchases, as well as by offering additional employment opportunities in community health.

We urge you to support this measure.