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HOUSE COMMITTEE ON FINANCE
TESTIMONY REGARDING SB 1934 SD 1 PROPOSED HD 1
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: APRIL 1, 2008
TIME: 2:30PM
ROOM: 308

This legislation, as amended, repeals the Ko Olina tax credit and provides various tax credits and exemptions, each of which will be discussed below.

The Department of Taxation's (Department) positions and comments are set forth accordingly—

I. KO OLINA TAX CREDIT

The Department opposes repealing the Ko Olina tax credit and prefers modifying the credit similar to HB 3125/SB 3047, expanding the existing credit to include incentives for revitalizing the Leeward Coast. The Department requests that the bill be amended to insert the text of this administration proposal.

A. General Comments

The Leeward Oahu has consistently experienced poverty levels in excess of 20% for several years. Despite high levels of poverty and homelessness on the Leeward Coast, interest in resort development has assisted with revitalizing certain parts of the region—though many areas remain in need of further focused revitalization efforts. The Ko Olina tax credit was a budgeted means of attracting the necessary development efforts in order to provide job creation and job training to the Leeward Coast.

The administration proposal seeks to amend the existing Ko Olina credit to expand the activities that qualify for the credit. Because the credit presently exists in law and therefore is already included in the budget, except for the additional year of eligibility provided by the proposal, the credit serves as the perfect foundation for the continued necessary targeted financial incentives for the Leeward Coast. This targeted relief will assure this region thrives and no longer struggles to

eradicate the poverty it has experienced for decades.

The administration proposal accomplishes the following—

- Maintains the current Ko Olina/Makaha Resort credit for any taxpayer that seeks to continue the existing efforts of the tax credit;

- Extends the activities that qualify for the credit to any taxpayer that has expended qualified costs for infrastructure or building improvements to commercial property utilized by a business within the Leeward Coast, for the purpose of revitalizing the Leeward Coast;

- Extends the activities that qualify for the credit to any taxpayer that has expended qualified costs to construct five or more units of affordable rental or saleable housing. By extending the credit to encourage affordable housing development, this tax incentive could greatly assist with the construction of much needed housing in this area;

- Provides for recapture of credits if the world-class aquarium, infrastructure or building improvements, or affordable housing units are not placed in service by December 31, 2013. This will serve as an incentive to ensure that if taxpayers or developers claim the credit and are encouraged by this incentive to utilize this tax benefit, the taxpayer or developer must actually "follow through" with the intended investment that the State has sought to encourage;

- Extends the eligibility for the credit for one year, allowing businesses and developers to rely on this credit through May 31, 2011; and

B. Revenue Impact

The administration's proposal will result in no revenue impact to the State general fund for the years through 2010. The additional year of eligibility will produce a $7.5 million revenue loss in fiscal year 2011.

II. LONG-TERM CARE INSURANCE CREDIT FOR INDIVIDUALS

The Department **strongly supports providing a refundable income tax credit for the purchase of long-term care insurance** contracts.

A. General Comments

The future of long-term care for Hawaii's senior and adult disabled population is one of the most critical health issues facing Hawaii in the twenty-first century. Persons sixty years of age and older presently account for almost one-fifth of the adult population in the State. By 2020, they will constitute more than one-fourth of Hawaii's adult population.

The rapid growth of the elderly and disabled populations will result in extraordinary demands on the delivery of long-term care services. While the majority of persons receiving long-term care are older adults, entire families are affected by the psychological, financial, and social costs of long-term care provided to those who are limited in the activities of daily living. As of 2003, the statewide average annual cost of a room in a skilled nursing facility was $105,028 for a private room and $95,597 for a semi-private room.

The individual long-term care tax credit accomplishes the following:

- Encourages Hawaii residents to purchase private long-term care insurance so that they will have more long-term care options when they require long-term care, and

- Averts the impending Medicaid crisis with the aging of a substantial segment of Hawaii's residents.

- Helps Hawaii residents with lower incomes afford the cost of long-term care insurance; and

- Provides a reasonable financial incentive for Hawaii residents with to purchase their own private long-term care insurance.

According to data obtained by the Department's Tax Research and Planning Office, the average long-term care insurance premium paid by married Hawaii residents totals $2,500 annually. The average long-term care premium paid by individual Hawaii residents totals $1,250.[1] Given these premium cost averages, this legislation will assist in minimizing the financial impact of purchasing privatized insurance, as well as encouraging persons to purchase this much-needed insurance coverage for the aging.

B. Revenue Impact

This legislation will result in a revenue loss to the general fund of approximately $6 million per year for FY 2010 and thereafter.

III. LONG-TERM CARE INSURANCE CREDIT FOR SMALL BUSINESSES

The Department s**trongly supports providing small business owners with a long-term care insurance income tax credit** to encourage small business employers to purchase long-term care insurance for their employees.

[1] Based upon aggregate data received from the Insurance Commissioner's Office in the Department of Commerce and Consumer Affairs.

A. General Comments

When employees provide long-term care to family members in need, businesses incur costs for lost productivity due to employee absenteeism, for replacing the absent employee, and in supervising temporary replacement workers. According to a 1997 study conducted by the National Alliance for Caregivers and the Metlife Mature Market Institute, the total cost of lost productivity to businesses nationally from these factors exceeded $29 billion annually.

This employer long-term care tax credit accomplishes the following:

- Encourages employers to purchase qualified long-term care insurance contracts for their employees;

- Extends long-term care insurance coverage to those individuals who generally could not otherwise obtain coverage and/or who could not obtain reasonably priced long-term care insurance coverage;
    - On most employer-sponsored plans, the insurers use less rigorous standards for determining a full-time employee's eligibility for coverage, which is a practice commonly referred to as "simplified short form underwriting."
    - Thus, a substantial number of Hawaii residents who could ordinarily not obtain coverage on an individual plan (or who could not obtain reasonably priced long-term care insurance coverage) will be able to obtain coverage on an employer-sponsored policy because of the less restrictive underwriting.
    - The employer's group plan allows a long-term care insurer to spread the underwriting risk among a group of covered individuals who work full-time.

- Encourages greater participation in employer-subsidized long-term care insurance plans by employees.
    - Employer-subsidized long-term care insurance plans generally see greater participation rates by employees.
    - Employee participation in employer-sponsored long-term care insurance plans is significantly greater when the employer pays for a small percentage, or "base coverage," of the employee's premium.

B. Technical Comments

The Department notes that the current drafting of the bill appears to apply at the entity level for partnerships and other flow-through business entities. The Department suggests that any reference to the credit claim for partnerships or limited liability companies clearly distinguish that the credit is determined at the entity level. The Department further points out that partnerships and limited liability companies treated as partnerships for tax purposes typically never receive tax treatment—*it is the owners that receive all incidences of taxation.* Under the current drafting of the bill, a statement providing that for partnerships or other flow-through entities the credit is determined at the entity level, this will allow the credit to be distributed to partners in proportion to

their partnership interests.

The following language would be helpful:

"(__) In the case of a partnership, S corporation, estate, or trust, the tax credit allowable shall be determined at the entity level. Distribution and share of credit shall be determined in accordance with section 235-2.45(d)."

C. Suggested Proposal Language

As an alterative to the text of the current bill, the Department offers the following tax credit language for the Committee's consideration:

"**§235- Employer's tax credit for long-term care premiums paid for employees.** (a) Subject to the limitations of this section, a small business employer subject to taxation under this chapter may claim a non-refundable tax credit for premium payments made by the small business employer during the taxable year to purchase a qualified long-term care insurance contract for its employees. The maximum tax credit per employee for whom qualified long-term care insurance is purchased shall be in the amount of the lesser:

(1) $500; or

(2) Fifty per cent of the qualified long-term care premiums paid annually for each employee.

(b) The credit allowed under this section shall be claimed against the net income tax liability for the taxable year. If the tax credit under this section exceeds the taxpayer's income tax liability, the excess of the credit may be carried forward until exhausted.

(c) If a taxpayer claims any other tax credit or deduction under title 14, including a deduction under sections 162 or 213 of the Internal Revenue Code, to which state law conforms, for premiums paid on a long-term care insurance policy, no credit shall be claimed under this section for the same premium payments.

(d) All claims, including any amended claims, for tax credits 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 this provision shall constitute a waiver of the right to claim the credit.

(e) The director of taxation shall prepare any forms that may be necessary to claim a credit under this section. The director may also require the taxpayer to furnish information to ascertain the validity of the claims for deductions made under this section and may adopt rules necessary to effectuate the purposes of this section pursuant to chapter 91.

(f) As used in this section:

"Activities of daily living" means eating, toileting, transferring, bathing, dressing, and continence.

"Chronically ill individual" means any individual who has been certified by a licensed healthcare practitioner within the preceding twelve-month period as meeting one of the following conditions:

(1) Being unable to perform at least two activities of daily living without substantial

assistance from another individual for a period of at least ninety days due to a loss of functional capacity;

(2) Having a level of disability similar to the disability set forth in the preceding paragraph; or

(3) Requiring substantial supervision to protect that individual from threats to health and safety due to a severe cognitive impairment for the preceding twelve-month period.

"Home and community-based care" means care provided under qualified long-term care services that meet or exceed the requirements set forth in section 431:10H-219.

"Licensed health care practitioner" means any licensed physician, registered nurse, licensed social worker, or other professional as may be provided by rules adopted by the director of taxation.

"Maintenance or personal care services" means any care the primary purpose of which is the provision of needed assistance with any of the disabilities that render a person to be a chronically ill individual, including the protection from threats to health and safety due to a severe cognitive impairment.

"Qualified long-term care insurance contract" means a contract that:

(1) Provides insurance coverage solely for qualified long-term care services;

(2) Does not pay or reimburse expenses incurred for services or items to the extent that those expenses are reimbursable under title XVIII of the Social Security Act or would be so reimbursable but for the application of a deductible or coinsurance amount, unless:

    (A) The expenses are reimbursable by medicaid as secondary payor; or

    (B) The contract makes qualified per diem or other periodic payments without regard to expenses, as defined below.

(3) Is guaranteed renewable;

(4) Provides that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract shall be used only to reduce future premiums or increase future benefits;

(5) Does not provide for a cash surrender value or any other money that may be paid, assigned, borrowed, or pledged as collateral for a loan; and

(6) Provides coverage for home- and community-based care services that meets or exceeds fifty per cent of the coverage for treatment in an intermediate care facility and skilled nursing facility.

"Qualified long-term care services" means necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance or personal care services, which are:

(1) Required by a chronically ill individual; and

(2) Provided pursuant to a plan of care prescribed by a licensed health care practitioner.

"Small business" means a for-profit enterprise consisting of fewer than one hundred full-time or part-time employees."

D. Revenue Impact

Assuming this measure takes effect immediately, annual revenue loss amounts to $782,000 for FY 2010 and thereafter.

IV. ORGAN DONOR TAX CREDIT

The Department takes **no position on the proposal to provide an income tax credit for donating organs**.

A. General Comments

LOST WAGES PROVISION—The Department suggests eliminating the lost wages category and simply provide taxpayers with a daily stipend to cover incidental losses. This will eliminate the need to substantiate lost wages. And, the daily stipend will allow those that are not employed (*i.e.*, a stay-at-home spouse) to also receive the benefit when incidental costs are likely in the event of an organ donation.

The provision could be clarified by the following amendments:

(c) A taxpayer may claim the tax credit only once per lifetime for the following unreimbursed related expenses incurred by the taxpayer:
(1) Travel expenses;
(2) Lodging expenses; and
(3) **[~~Lost wages~~] a daily stipend of $100 per day**.

NO CREDIT SHOULD BE ALLOWED IF EXPENSE IS DEDUCTED—To the extent the taxpayer took a medical expense deduction for the expense, no credit should be allowed under this section. However, the taxpayer should be entitled to count towards the credit under this section the amount of the expenses that did not exceed the 7.5% of adjusted gross income floor of the medical expense deduction.

COMPLIANCE WITH ALL LAW, REGULATIONS—In order to qualify for the tax credit, taxpayer must be "in compliance with all applicable federal, state and country statutes, rules and regulations and has donated one or more of the taxpayer's human organs for the purpose of an organ transplant during the taxable year." [emphasis added]. As this currently reads, a parking violation would disqualify a taxpayer from receiving the credit. Without further clarification as to which laws are applicable, the Department finds such compliance with this requirement to be unenforceable. The Department therefore suggests that the requirements for compliance with all applicable laws be clarified.

B. Revenue Estimate

It is estimated that there will be a revenue loss of approximately $15,000 per year.

V. **LAND CONSERVATION CREDIT**

Department also has **strong concerns with the land conservation credit** proposal.

A. General Comments

USE OF FAIR MARKET VALUE—QUALIFIED APPRAISAL IS ABSOLUTELY NECESSARY—The Department strongly suggests this measure be amended to require the fair market value of any donated land be pursuant to a federally qualified appraisals. The Department points out that a charitable donation of land typically requires an appraisal for federal tax purposes. There is no reason why a qualified appraisal should not be required for a generous state credit, especially if the taxpayer will likely leverage both the state and federal incentives.

The Department is always apprehensive when "fair market value" is used as the standard by which a tax credit or other tax incentive is calculated. Fair market value can mean something different to anyone, especially when a tax benefit is involved. The concern for the Department relates more to perceived frauds and abuses of land prices used to calculate the amount of the credit.

Assuming fair market value is the only measure that can be used for this credit and use of an appraisal is the preferred method, the Department strongly suggests that the bill be amended to incorporate a penalty similar to Internal Revenue Code § 6695A that will penalize an appraiser who is complicit in a fraudulent land deal for purposes of this credit. An additional penalty similar to that provided under § 6662 of the Internal Revenue Code would prohibit taxpayers from similarly misusing any appraisals.

"**§231-A Accuracy-related penalty on underpayments due to substantial valuation misstatements.** (a) There shall be added to tax an amount of twenty per cent of the portion of an underpayment of tax required to be shown on a return if the portion of underpayment is due to a substantial valuation misstatement.

(b) There is a substantial valuation misstatement if the value of any property (or the adjusted basis of any property) claimed on any return of tax is one hundred and fifty per cent or more of the amount determined to be the correct amount of such valuation or adjusted basis, as the case may be.

(c) No penalty shall be imposed by a person under this section unless that portion of the underpayment for the taxable year attributable to the substantial

valuation misstatement exceeds $1,000.

§231-B Substantial valuation misstatements attributable to incorrect appraisals. (a) There shall be assessed a penalty upon any person:

(1) Who prepares an appraisal of the value of property and such person knows, or reasonably should have known, that the appraisal would be used in connection with a return or a claim for refund; and

(2) The claimed value on a return or claim for refund which is based on such appraisal results in a substantial valuation misstatement under section 231-A.

(b) The penalty assessable under subsection (a) shall be equal to the lesser of:

(1) The greater of:

(i) Ten per cent of the amount of the underpayment attributable to the misstatement under subsection (a); or

(ii) $1,000; or

(2) One hundred and twenty-five per cent of the gross income received by the person described in subsection (a) from the preparation of the appraisal.

(c) No penalty shall be imposed under this section if the person establishes that the value established in the appraisal was more likely than not the proper value."

PROPERTY CLASS STANDARDS—The Department is concerned about certain of the definitions used with the credit. For example, "conservation and preservation purpose" and "cultural property" are both very broad terms and the express definitions only increase the expanse of these definitions. The Department recognizes the rulemaking authority; however settling the issue in statute is the preferred method.

PUBLIC OR PRIVATE CONSERVATION AGENCY—There is concern over who will be running any conservation program. In order to ensure continuity and consistency, the Department suggests amending the bill to ensure some specific government agency be charged with implementing the conservation program before any tax credit is available.

PASS-THROUGH ENTITY PROVISION—Subsection (g) is unnecessary and confusing. Well-settled principles of partnership (pass-through) entity law typically do not allow any tax consequences for the "entity." All tax attributes of a partnership flow through to the partners that realize the tax consequences on individual tax returns. When an election is made by a partnership or limited liability company to be taxed at the entity level as a corporation, the entity is then considered a corporation for tax purposes and no longer a pass-through. The Department strongly suggests that

subsection (g) be eliminated entirely. The Department submits that existing conformity to partnership and corporate tax principles is sufficient.

All that is needed is the following language:

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"(g) In the case of a partnership, S corporation,
estate, or trust, the tax credit allowable shall be
determined at the entity level. Distribution and share
of credit shall be determined in accordance with section
235-2.45(d)."
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POSSIBLE LOSS OF FEDERAL AND STATE CHARITABLE CONTRIBUTION DEDUCTION—In its prior testimony, the Department had concerns with a potential double benefit by receiving the credit under this bill and a state charitable deduction. After further analysis, the loss of a generous federal benefit as a result of this credit is of greater concern. Generally, the taxpayer would receive a charitable contribution deduction for the donation of the property to a government entity or a nonprofit entity. The Internal Revenue Service has indicated that an issue exists as to whether providing a state tax credit in exchange for a donation of a conservation easement qualifies as a deductible charitable contribution and recommended public guidance be published on this issue. *See CCA 200238041.* The IRS has yet to publish any guidance on this issue. Therefore, it is unclear whether donors would lose their federal and state charitable contribution deduction if the donor utilizes the credit. In addition, any requirement that conditions the credit on qualifying for the Section 170 charitable contribution deduction may be unworkable.

RULEMAKING—The Department already has broad rulemaking authority. Subsection (h) is unnecessary. There is also a conflict between subsection (h) and (i). Do both agencies get to make concurrent rules? Will one agency's rules trump the other?

CERTIFICATION PROCESS—In light of the Department's concerns, the Department also suggests a certification process whereby, rather than the Board of Land & Natural Resources being authorized to make rules for this credit, the DLNR could be authorized to certify credits, maintain information, and simply send a certificate to the Department to process the credit. Other similar certification processes are currently administered with the Department of Business, Economic Development & Tourism and the Hawaii Film Office. *See e.g.*, HRS § 235-17.

TRANSACTIONS SUBJECT TO POTENTIAL ABUSE—The Department mentions that the IRS has highlighted possible abusive transactions relating to donations of conservation easements. In certain cases, the IRS has disallowed deductions and assessed penalties on transactions it has found to be shams. The Committee should be aware that conservation easements have been used in the past in allegedly abusive tax transactions.

B. Revenue Impact

This legislation will result in a revenue loss of approximately $3.2 million for FY 2009.

VI. HOTEL REMODEL TAX CREDIT

The Department of Taxation has **strong concerns with the refundable hotel remodel tax credit** proposal.

A. General Comments

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.

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.

THE PROPOSAL 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.

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.

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.

B. Technical Comments

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.

C. 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**

VII. CREDIT FOR IMPROVEMENTS TO FEDERALLY QUALIFIED HEALTH CENTER

The Department has **concerns with the income tax credit for entities that are federally qualified health centers**.

A. General Comments

NOT FACTORED INTO EXECUTIVE BUDGET—This bill is not within the Executive Budget and has not been factored into its tax relief priorities.

NONPROFITS DO NOT QUALIFY FOR TAX CREDITS—Importantly, the Department points out language in the bill that suggests Hawaii's federally qualified facilities are nonprofit organizations. These nonprofit entities are ordinarily disqualified from claiming tax credits under Chapter 235 because these entities do not have taxable income and are exempt from tax. There is some doubt as to whether a nonprofit would be able to qualify for the credit under this bill with the current provisions.

B. Revenue Impact

Annual average loss is about $7.0 million.

VIII. INCOME AND GENERAL EXCISE TAX EXEMPTION FOR 501(c)(12) ENTITIES

The Department of Taxation (Department) takes **no position** on the proposal to provide income and general excise tax exemptions for 501(c)(12) entities.

A. General Comments

Currently, a nonprofit organization recognized under § 501(c)(12) of the IRC is subject to both Hawaii income and general excise tax because § 501(c)(12) is not operative for Hawaii income tax purposes and the general excise tax also does not recognize this entity for purposes of the existing exemptions. Under § 501(c)(12), certain tax benefits are available under federal law where the company receives 85% of its income for the sole purpose of meeting losses and expenses in pursuit of its exempt purpose, which can include obtaining water for communities.

The Department points out that this legislation has not been factored into the Executive Budget and is outside the executive priorities for tax relief this legislation session.

B. Revenue Impact

Given the lack of information on entities that could qualify under this bill, this bill will result in an indeterminate revenue loss.

IX. MODIFYING THE RENEWABLE ENERGY TECHNOLOGIES INCOME TAX CREDIT TO BE REFUNDABLE

The Department **strongly supports the proposal to modify the existing renewable energy technologies income tax credit to be refundable** for certain persons of lower income levels.

Under current Hawaii law, pension income, including social security is not taxable. This population includes retirees that may have little Hawaii taxable income (investment income) due to the exclusion, but would otherwise have the resources to invest in these technologies. This legislation will allow those with the resources to obtain a refundable incentive for installations of renewable energy technologies. This legislation also extends to any taxpayer with less than $20,000 of adjusted gross income. This would provide incentives for the lower- and middle-class to invest in these technologies.

Annual revenue loss is estimated to be $41,000, starting in fiscal year 2009.

X. ONE-TIME NONREFUNDABLE CREDIT FOR VICTIMS OF DECEMBER 2007 FLOOD AND WIND STORMS IN UPCOUNTRY MAUI

The Department takes **no position** on the proposal to provide a one-time nonrefundable income tax credit for those suffering losses as a result of the December 2007 Maui flood and wind storms.

A. General Comments

COSTS NOT LOSSES—The Department raises the issue that the credit, as drafted, characterizes the credit for "losses" for what are specified as costs. The Department suggests changing the term "losses" to read "costs."

"(b) The amount of the nonrefundable tax credit shall be per cent of the [~~losses~~] costs incurred by the taxpayer for repairs, insurance, rental, or other expenses or costs related to the damage caused to the taxpayer's real or personal property in the upcountry Maui area and other affected areas in the twelfth representative district by the flood and wind storm of December of 2007, provided that:..."

B. Revenue Impact

This legislation will result in an indeterminate revenue loss due to the unspecific credit amounts.

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, Miscellaneous tax credits

BILL NUMBER: SB 1934, Proposed HD-1

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: **Part I:** Adds a new section to HRS chapter 235 to allow taxpayers to claim a tax credit for the amount paid for a long-term care insurance premium. The maximum amount of credit for an individual taxpayer or a husband and wife filing jointly shall be the lesser of: (1) $2,500; or (2) 50% of the cost of any long-term care insurance premium payments provided that a husband and wife filing separately for which a joint return may be filed shall only be entitled to the amount of credit if they had filed jointly. Stipulates that the tax credit shall be available to taxpayers with adjusted gross income of: (1) $100,000 or less for a married couple filing jointly; or (2) $50,000 or less for individual taxpayers.

Delineates what premium payments shall be eligible for the credit and specifies persons, besides the taxpayer and immediate dependents, whose premiums may be eligible for the credit. Credits properly claimed and in excess of tax liability shall be refunded to the taxpayer.

If the taxpayer takes a deduction under IRC section 213 (with respect to medical, dental, etc., expenses) no tax credit may be claimed for that portion of the cost for which the deduction was taken. Claims for the credit must be filed within twelve months of the close of the taxable year or be waived if not filed on time.

Part II: Adds a new section to HRS chapter 235 to allow taxpayers who own a small business to claim a small business long-term insurance premium credit of the lesser of $500 per employee or 50% of the premiums paid for each employee. Credits in excess of a taxpayer's income tax liability may be applied to subsequent liability. Defines "small business" as a for-profit enterprise consisting of fewer than one hundred full-time or part-time employees.

Stipulates that the tax credit when claimed by: (1) either an individual resident taxpayer or a husband and wife filing a joint return that own a small business, provided that a resident husband and wife filing separate tax returns for a taxable year for which a joint return could have been filed by them, shall claim only the tax credit to which they would have been entitled under this section had a joint return been filed; or (2) a small business that is a corporation, partnership, limited liability company, or other form of business entity, may be claimed only once in the taxable year with respect to the small business.

Claims for the credit must be filed within twelve months of the close of the taxable year or be waived if not filed on time. Requires the director of taxation to prepare the necessary forms to claim and validate a claim for the credit.

Part III: Adds a new section to HRS chapter 235 to establish a refundable tax credit for the expenses incurred relating to the donation of human organs. The credit shall be available to individual taxpayers

with adjusted gross income of less than $50,000 or $100,000 in the case of those filing a joint return. The credit shall not exceed $_______ per taxpayer per year and $________ for all taxpayers per year for unreimbursed travel expenses, lodging expenses, and lost wages. The taxpayer shall be entitled to one credit in a lifetime. Requires the donor to be a full-time resident of the state and have donated one or more organs to another human being, and shall not apply to organs sold for monetary or other consideration.

Defines "human organ" as all or part of a liver, pancreas, kidney, intestine, lung or bone marrow.

The director of taxation may adopt rules pursuant to HRS chapter 91, prepare the necessary forms to claim the credit, may require proof of the claim, and allocate the credit on a first-come, first-served basis.

If any other tax credit or deduction under Title 14, including a deduction under IRS sections 162 or 213 is taken, than no credit shall be allowed under this section for the same costs.

Part IV: Adds a new section to HRS chapter 235 to allow an eligible taxpayer who is the owner of land to claim a land conservation incentives tax credit if the taxpayer: (1) donates the land in perpetuity or completes a bargain sale in perpetuity to the state or public or private conservation agency that fulfills a conservation or preservation purpose; provided that any donation or sale that represents a less-than-fee interest qualifies as a charitable contribution deduction under IRC section 170(h); or (2) voluntarily invests in the management of land to protect or enhance a conservation or preservation purpose under a land protection, conservation, or management agreement. Donations of land for open space to fulfill density requirements to obtain subdivision or building permits do not qualify for the credit.

The amount of the tax credit shall be 50% of the fair market value of the land that the eligible taxpayer donates in perpetuity on or after January 1, 2008 for a conservation or preservation purpose to the state or public or private conservation agency; or 50% of the amount invested in the management of land. Limits the credit to $2.5 million per donation regardless of the value or interest in the land. The credit may be claimed only once per tax year. Delineates procedures for the claiming of the credit by a pass-through entity.

Credits in excess of a taxpayer's income tax liability may be applied to subsequent income tax liability. 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 to claim the credit. Allows the chairperson of the board of land and natural resources to adopt rules pursuant to HRS chapter 91 to effectuate this section.

Defines "bargain sale," "conservation or preservation purpose," "cultural property," "eligible taxpayer," "interest in land or real property," "land" and "public or private conservation agency" for purposes of the measure.

Part V: 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.

Part VI: 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.

Part VII: Amends HRS section 235-2.3 (b) to provide that companies that provide potable water under IRC section 501(c) (12) shall not be subject to state income taxation.

Amends HRS section 237-23 (a) to provide that companies that provide potable water under IRC section 501(c) (12) shall not be subject to the general excise tax.

Part VIII: Amends HRS section 235-12.5 to provide that the renewable energy technologies income tax credit claimed by taxpayers with no taxable income or with adjusted gross income of under $20,000 or less, shall be refundable.

Part IX: Repeals HRS section 235-110.46 which establishes the attractions and educational facilities tax credit at Ko Olina Resort and Marina.

Part X: Allows taxpayers in the upcountry Maui area and other areas in the 12th representative district to claim a one-time tax credit of ____% of the costs incurred by the taxpayer for repairs, insurance, rental, or other expenses or costs related to the damage caused to the taxpayer's real or personal property by flood and wind storm damage in December of 2007 provided: (1) the expenses or costs are not reimbursable by insurance proceeds or disaster relief payments; (2) the tax credit shall not exceed $___ per taxpayer; and (3) no refund or payment of the credit shall be made for amounts under $1.

Credits in excess of a taxpayer's income tax liability may be applied to subsequent income tax liability until exhausted. Delineates provisions for the distribution and share of the credit in the case of a partnership, S corporation, estate, trust or association of apartment owners. Disallows the credit if a deduction is taken pursuant to section 179 of the IRC (with respect to election to expense certain depreciable business assets). 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 the credit allowed and claimed, otherwise the taxpayer shall treat the amount of the credit as a taxable income item for the taxable year in which it is properly recognized under the accounting method used to compute taxable income.

Claims for the credit, including any amended claims, must be filed on or before the end of 12/31/08. The director of taxation: (1) shall determine the applicability of this act with respect to the boundaries and locations of flood and wind storm damage in December of 2007 in the upcountry Maui area and other affected areas in the 12th representative district; (2) shall prepare the forms necessary to claim the credit; (3) may require proof of the claim for the credit; and (4) may adopt rules pursuant to HRS chapter 91.

EFFECTIVE DATE: July 1, 2020

STAFF COMMENTS: **Part I:** This part provides an incentive to taxpayers to purchase long-term care (LTC) insurance premiums by allowing taxpayers to claim a credit for amounts paid for such insurance.

To the extent that this is an alternative to a state-run, long-term care insurance program, it is a proposal that deserves serious consideration. The question is whether or not individuals will plan ahead for their needs in time to make such insurance reasonable and affordable. Encouraging taxpayers to acquire LTC insurance now will insure that the state will not be burdened with supporting persons as the need arises.

The question now is whether or not the state can afford an incentive given all the other competing interests. It should be noted that, as drafted, it would appear that the credit limits are per return. Thus, the 50% or $2,500, whichever is less, applies to all insurance paid by the taxpayer filing that return. Thus, if a couple bought policies for themselves and one of the spouse's parents, the maximum amount that could be claimed would be $2,500 even though the premiums for all three policies total more than $5,000. On the other end, with an unknown impact, the legislature may want to take it slow and phase-in the credit to assess the impact that this credit will have on the state treasury.

It should be noted that the proposed measure limits the availability of the credit to those joint filers with $100,000 or less and single filers with $50,000 or less of adjusted gross income. If the intent is to get as many people to take out private, long-term care policies, then the credit should not be limited to only those with a certain amount of income. A couple at the high end of the income scale may have the resources to take out policies for themselves as well as for an aging parent. They should be provided the same incentive to do so as it will save the state in the long run from having to provide long-term care for any one of them. Consideration might be given to an inversely graduated amount of credit such that the amount of the credit gets smaller as income grows larger.

That said, there are two provisions of the bill which are not clear. First, is the amount of the credit equal to the lesser of 50% of the long-term care insurance premiums paid or $2,500? Or does the bill mean to say the credit is 50% of the long-term care insurance premium paid up to a maximum of $2,500 per return? If it is the latter, then the bill should state so. The other is that it is unclear whether or not the credit is refundable. It seems to imply that it is refundable by stating that no refunds of amounts less than one dollar shall be made, but other than that, it does not specifically provide that the credit is refundable or non-refundable. If the latter is the case, then there is no provision directing that any excess credit can be applied to subsequent tax years liability until exhausted.

Given that many advocates of a previously proposed state run long-term care insurance system noted that to do nothing about providing for such coverage will, in the end, cost the state more to provide that care, the credits proposed in this bill can be viewed as a long-term investment on the part of taxpayers that will insure that future taxpayers will not be asked to pick up the tab for long-term care for a growing segment of the population.

That said, lawmakers should not overlook the fact that unless the necessary services and facilities are available and in ample supply, no amount of insurance or money will be able to access the needed care. Like early childhood care and education the same trilemma of affordability, accessibility and quality apply to long-term care as well.

Part II: This part provides an incentive in the form of an income tax credit to encourage employers to purchase long-term care insurance premiums for their employees by allowing the employer to claim a credit for a portion of the premium costs for such insurance. While the credit may seem minimal, buying a group coverage for the minimal level of coverage would open the door of awareness for more

employees of the need for this type of care in the future. Accessing this type of insurance will not only increase awareness of this need, but may allow employees to trade up by paying an additional premium, then this may be a way that the state addresses the challenge of long-term care.

That said, one has to question whether or not taxpayers should subsidize the cost of such insurance without any indication of need on behalf of the small business for financial assistance. Perhaps the sponsors of the bill envision that this would encourage mom and pop stores to secure this coverage or perhaps a lunch wagon owner. However, the bill defines a small business as one that has less than 100 full-time employees. That definition could fit a brokerage firm, a software developer, or a private physician's office. If the intent is to make the public aware of the need to secure this type of insurance, then there are means for informing and educating the public. One of the chief reasons for consumer reticence in this area is the fear of the unknown, that is not knowing anything about the options from which they can choose.

Part III: This part allows taxpayers to claim a credit for expenses incurred as a result of donating a human organ to another person. It should be remembered that this measure would grant preferential tax treatment to a select group of taxpayers and it does so without the taxpayer's need for tax relief. Generally, preferential tax treatments are designed to alleviate an undue burden on those who are unable to carry that burden, largely the poor and low income. An example is the general excise tax food credit for purchases made by the poor. If this measure is enacted, it would merely result in a subsidy by the state to encourage taxpayers to donate their organs without regard to a taxpayer's need for tax relief.

In a sense this proposal is insulting in that it attempts to reward a person for having made a donation of a human organ in order to save a life, a humanitarian act that has been reduced to an income tax credit. It should be remembered that the word "donation" has its genesis in the Latin word "*donare*" which means to give or give freely without contingency and, as such, donations of human organs should be given without consideration for compensation.

If the intent is to cover some of the costs associated with the donation of a human organ, then just appropriate the money to a department that can then judge what are appropriate costs to reimburse the donor. Why complicate the tax forms and instructions for a handful of taxpayers?

That said, there are some major flaws in this proposal. The term "full-time resident" is inconsistent with the definition of "resident" and "non-resident" as provided for in HRS 235-1. Under that definition, a person is considered a resident for tax purposes if Hawaii is his/her domicile, that is Hawaii is the place which the person has singled out as home base. One can only have one domicile. So what is meant by full-time resident is unclear as one can reside in Hawaii but not declare Hawaii as his/her domicile. In this latter case, that person would not be considered a resident for state tax purposes. As a result, a nonresident who happens to reside in Hawaii "full-time" could claim this credit even though that person may have no Hawaii sourced income as the credit is refundable.

There is a limitation on adjusted gross income for single filers of $50,000 or $100,000 for joint filers, but no provisions made with respect to married taxpayers filing separate returns. Finally, the proposal does not specify how the credit is to be calculated. Is it, in fact, a 100% reimbursement of the costs listed in the bill or is it a fraction thereof? As noted above, if it is a complete reimbursement of expenditures incurred for the donation of a human organ, then why involve the tax department which has no expertise

in this area to make a determination of reasonable costs. This is truly an inappropriate use of the state tax system.

Part IV: This part proposes an incentive in the form of an income tax credit to encourage a landowner to donate, complete a bargain sale to the state or a conservation agency, or voluntarily invest in the management of land to protect or enhance a conservation or preservation purpose.

While the credit may be intended as an incentive, it lacks accountability. In considering this measure, lawmakers should ask themselves just how much will this program cost the state treasury? If this program required an appropriation, how much would lawmakers be willing to appropriate for this program? The financial impact of the proposed credit is no different from the expenditure of public dollars albeit out the back door and hidden from public scrutiny.

Tax credits generally are designed to mitigate the tax burden of those individuals or businesses that do not have the ability to pay their share of the tax burden. These credits are justified on the basis that low-income taxpayers should be relieved of the burden imposed by taxes which are not based on the income of the taxpayer, such as the general excise tax. The proposed credit contained in this measure bears no relationship to the tax burden of the landowner. Thus, the credit amounts to nothing more than a subsidy by state government. Such subsidies are more accountable if funded with a direct appropriation of state funds.

As drafted, it appears that the taxpayer donating this property can take the charitable contribution deduction currently available for donations to government or a not-for-profit organization thereby reducing taxable income AND take the proposed credit reducing whatever income tax liability the taxpayer may have. Thus, the taxpayer could possibly get a double benefit. Advocates point to the fact that the federal government recognizes such donations without pointing out that Hawaii law picks up the same recognition of charitable contributions to not-for-profit organizations or to government and allows the valuation of such contributions as a deduction against taxable income. Thus, the credit is a redundant incentive. It should be noted that in those states where the advocates say the credit is available, the land values are very low by comparison and therefore the value of the deduction may not be as attractive. The very opposite is true in Hawaii where land values are very high and thus the deduction would be more meaningful in reducing taxable income. Thus, the tax credit would further reduce state tax revenues.

It is difficult to imagine that given the current dour outlook for the state's economy that lawmakers believe that they can hand out such generous tax incentives while state programs will go begging for the lack of state tax revenues. Such actions are irresponsible and merely commit lawmakers to raising taxes on all other taxpayers to keep the state operating.

Part V: 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 part 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.

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.

Part VI: This part 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?

Part VII: This measure would exempt from state income and general excise taxation an IRC 501(c)(12) organization that provides potable water. Under current law, IRC 501(c) (12) organizations, while exempt from federal income taxation, are taxable under the state income tax provisions. It is unclear who this particular measure would benefit and how the operation is structured. If, in fact, a separate nonprofit has been set up to provide potable water, it is not what the federal law originally addressed in (c)(12) which applies to benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone or electric companies. Ditch and irrigation companies do not provide potable water and, therefore, it is curious to whom this proposal would apply. If, in fact, the (c)(12) company is being used to pass through income to a profit making company which in turn is covering the losses and expenses of the nonprofit, the expansion of the defined activity should be questioned.

As proposed, this exemption would provide preferential tax treatment to a very select group of taxpayers. From the standpoint of equity, such preferential treatment should be granted to all IRC 501(c)(12) organizations with a sunset date of one year to allow the legislature to determine the effects and outcome of the exemption and whether it should be continued or repealed. At the very least, the department of taxation should be tasked with explaining whether or not such organizations should or should not be recognized as being exempt for state tax purposes.

Part VIII: While this part would allow residential taxpayers with no tax liability or those with low incomes to purchase a renewable energy system to help offset the up front cost, it underscores the fact that such renewable energy systems are still not affordable to everyone. If it is the intent of the legislature to encourage a greater use of renewable energy systems by all taxpayers, as an alternative, consideration should be given to a program of low-interest loans available to all income levels.

The combination of a low-interest loan which can be repaid with energy savings would have a much more broad-base application than a credit which amounts to nothing more than a "free monetary handout" or subsidy by state government for those taxpayers who more than likely can afford to make the conversion. A program of low or no-interest loans such as those proposed in HB 2101 would do much more to increase the acquisition of these devices. Persons of all income levels could borrow the funds, make the acquisition, and repay the state program in an amount equal to the avoided cost that their utility bills would now reflect.

To reiterate, if lawmakers truly want to provide a financial incentive for taxpayers to make the switch to using these alternative energy devices while taking advantage of the credit, then a program of no-interest, or low-interest loans would be far more effective. The state could provide the capital to acquire these devices, and the taxpayer could receive a discount of 30% provided by the federal tax credit. The amount of the state loan could then be amortized by the energy savings realized by the taxpayer.

Finally, it appears that there are some taxpayers for whom there is no state tax liability and therefore a nonrefundable tax credit such as the renewable energy tax credit provides no incentive. Again, this is one of the inherent flaws of using tax credits to entice certain behaviors. To change the credit now for some people and not for others from a nonrefundable to a refundable credit sets poor tax policy as it lacks consistency.

Part IX: The legislature by Act 100, SLH 2003, established tax credits of up to $75 million to encourage the taxpayers to make investments in the Ko Olina resort area. The proposed measure would repeal these tax credits. It should be remembered 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 amounts to nothing more than a subsidy as there is no obvious undue burden of taxes. If one development is blessed with a substantial tax credit, like those adopted for Ko Olina, why shouldn't the next proposal be just as serious a consideration? As such, project specific tax credit proposals violate the integrity of the tax system, setting a precedent with bad tax policy.

The argument at the time of the adoption of this tax incentive was that this would help to support the further development of the Leeward side of the island, creating hundreds of the jobs for those on that side of the island. Without the building of the aquarium as an attraction, development would not proceed. In order to prepare the people of the Leeward side, training was promised at a facility that would be

acquired for that purpose. That has not occurred. What has happened is that as a result of demand, the various developments have proceeded at substantial profits for the developer even without the building of the aquarium. So was the tax incentive necessary? Apparently not, it totally ignored market demand and assumed that in order for the development to proceed the tax break was critical.

This measure proposes to repeal the tax credit. Before lawmakers decide to take this tax incentive back, legal opinion should be sought as to the possible exposure the state might incur as a result of breaking essentially what amounts to a contract, especially if the taxpayer has already undertaken actions that met the criteria in order to claim the credit. On the other hand, if repeal is not possible because of liability exposure, consideration might be given to adding provisions that repay Hawaii taxpayers by sharing some of the profits of the project. Consideration should also be given to requiring the disclosure of those taxpayers who claim the credit and in what amounts and for what purposes. Taxpayers should have a right to know how their tax dollars are being spent and who is benefitting from this incentive.

If lawmakers are concerned about this tax incentive, then the same concern should apply to the plethora of targeted business tax credits adopted in recent years. With everything from investments in high technology to ethanol producing plants to tax credits for hotel construction and home renovation and construction, taxpayers have been asked to pay for projects for which there are just promises that jobs will be created or new businesses will be attracted to provide those jobs. At the end of the day, while the beneficiaries laugh all the way to the bank with their profits, the taxpayer is left empty-handed. For the beneficiaries of these tax incentives to able to secure these breaks with only promises of jobs should be unacceptable. At the very least, those who benefit from these incentives should be asked to validate their promises by providing the information that documents those promises. Should there be financial gain resulting from those tax incentives, those gains should benefit all taxpayers.

It should be remembered that giving tax breaks to one select group of taxpayers comes at the expense of all other taxpayers. As such, it is an insult to all other taxpayers that they are not deserving of such tax preferences. Rather than singling out a particular area for tax relief, concurrent efforts must be made to improve Hawaii's business climate to enhance the economic prospects for all businesses. In short, this tax incentive, along with the host of others adopted in recent years, represents poor tax policy and comes at the expense of the working stiff who can barely make ends meet.

If lawmakers want to subsidize this specific project, then an appropriation of funds is far more accountable as taxpayers will then know who is to receive the subsidy, how much is being spent and can then judge whether or not this is an appropriate use of state taxpayer dollars

Part X: This part would grant a one-time tax credit to victims of the upcountry Maui area and other areas of the sixth senatorial/12th representative district that sustained flood and wind storm damage. If the intent is to compensate flood and wind victims for some of their unreimbursed expenses due to the casualty, consideration should be given to appropriating the funds and administering the aid based on the need for reimbursement and allow each and every occurrence to be judged on its merits and the need for assistance. Given that the intent of this proposal is to provide financial assistance payments for flood and wind damage, using the tax system in this manner is a poor and inefficient means of accomplishing that goal.

Digested 4/1/08

House Committee on Finance
Representative Marcus Oshiro, Chair

Comments for Hearing on April 1, 2008 Agenda #2 at 2:30 PM

RE: SB 1934, SD 1 – Proposed HD 1 – Relating to Taxation

Chair Oshiro and members of the Committee, my name is Cynthia Hayakawa, Executive Director of NAIFA (National Association of Insurance and Financial Advisors) Hawaii, an organization made up of insurance and financial advisors across Hawaii.

We support the Proposed HD1 of SB 1934, SD1, in providing our **citizens and employers with a tax incentive to purchase LTC (long term care) insurance.**

For individuals, the tax credit will apply to married couples filing jointly with an adjusted gross income of up to $100,000 and up to $50,000 for an individual taxpayer. The tax credit shall be the **lesser** of $2500.00 for a joint return or 50% of the LTC insurance premium for an individual for the taxable year which payments are made.

The tax credit for LTC insurance premium payments will allow our residents to use this tax incentive **either as a tax credit or a tax deduction**. The tax deduction is allowed under the Internal Revenue Code and Hawaii tax law for medical services and premium payments, provided that these expenses exceed 7.5% of the taxpayer's adjusted gross income.

In Part 1, Section 2 of the bill, under (e), allows for the taxpayer to claim the tax credit for the various relatives listed under this section. We question whether the taxpayer who pays the LTC insurance premium for **non-dependent relatives** as stated above, should be able to receive the credit for the relative(s) in addition to his/her own tax credit? If the non-dependent relative is also paying part of the premium on the same policy, that non-dependent relative will also qualify for the tax credit. We suggest that the language be specific in that these non-dependent relatives cannot be claimed by the taxpayer if the taxpayer is taking the credit.

For the employer tax credit, it will allow the lesser of $500 for each employee or 50% of the insurance premium for each employee. This will afford the employer to insure every employee at a base level and in turn, the employees will be able to purchase added coverage.

Employers, if they are paying LTC premiums as a benefit to their employees, can also deduct the entire LTC insurance premium expense on their corporate tax return. This measure can provide a very worthwhile incentive to employers to encourage them to make this benefit available since most employee benefits (health insurance, TDI, disability income, retirement, Social Security, Medicare, etc.) are delivered at the workplace. Employers could provide one of the best venues in educating our citizens about their future LTC needs.

This credit will afford the employer to insure every employee at a base level and in turn, the employees will be able to purchase added coverage. We believe that this kind of incentive is integral to get the "ball rolling" and the bulk of the LTC premium will be borne by employees.

Additionally, there are numerous benefits for a group purchase of LTC insurance:

- Group LTC insurance policies are approximately 10% to 40% less than individual LTC policies subject to underwriting requirements (age, health, etc.).
- Premiums are level, based on age purchased, which encourages younger employees to participate. Employees receive guaranteed issue coverage (no medical questions) up to certain limits.
- Employees can customize the coverage beyond the employer paid base plan, at highly discounted rates. Employees can add to their coverage at anytime.
- Employee's **entire extended family** (parents, grandparents, in-laws, siblings, adult children) can participate in the discounted group rates.
- Employees can take their coverage with them should they retire or terminate their employment at same rate with the exact same coverage and extended family members retain their coverage.
- Premiums are level, based on age purchased, which encourages younger employees to participate. Employees receive guaranteed issue coverage (no medical questions) up to certain limits.
- 40% of employees will purchase additional discounted coverage out of their own pocket.

Government's support of a tax incentive in encouraging individual responsibility for long term care financing is a step towards solving this complex issue. Our citizens will have these products to protect themselves against catastrophic long term care expenses. The expansion of this market will reduce Medicaid outlays and future costs to both the federal and state governments.

Yes, it is true that the older one gets, a LTC insurance policy becomes less affordable due to chronic ailments or unavailable due to sickness. A tax credit for employers and individuals will encourage the young to purchase their LTC insurance when they are healthy and rates are most affordable.

Medicaid began as a safety net for the less fortunate but over the past 30 years loopholes have "saved" family assets through "Medicaid planning" that we see in advertising announcements. By purchasing LTC insurance policies, Medicaid will serve those truly in need. The burden on state and federal governments continues to grow and we need to address this complex problem before the baby boomers wind their way through their golden years.

We support the tax credit for LTC insurance premiums for Hawaii's citizens. We realize the fiscal constraints on the general fund but urge that this LTC insurance premium tax credits continue to move forward.

Thank you for allowing us to share our views.

Hawai'i Energy Policy Forum

Mr. Robbie Alm, HECO
Ms. Amy Asselbaye, Ofc of US Rep. Neil Abercrombie
Ms. Madeleine Austin, World Business Academy
Ms. Catherine Awakuni, Div. of Consumer Advocacy
Mr. Warren Bollmeier Hi Renewable Energy Alliance
Mr. Carlito Caliboso, PUC (Observer)
Mr. Albert Chee, Chevron
Mr. Kyle Datta, U.S. Biofuels
Sen. Kalani English, Hi State Senate
Mr. Mitch Ewan, UH HNEI
Mr. Carl Freedman Haiku Design and Analysis
Mr. Mark Glick, OHA
Mr. Steve Golden, The Gas Company
Dr. Michael Hamnett, RCUH
Ms. Paula Helfrich, EDAH
Mr. William Kaneko, HI Institute for Public Affairs
Mr. Maurice Kaya, DBEDT
Mr. Darren Kimura, Energy Industries Holdings
Mr. Mike Kitamura, Ofc of US Sen. Daniel K. Akaka
Mr. Kal Kobayashi, Maui County
Mr. Laurence Lau, DOH
Ms. Yvonne Lau, Ofc of US Rep. Mazie Hirono
Mr. Allyn Lee, C&C of HNL
Mr. Aaron Leong, Ofc of US Senator Daniel K. Inouye
Dr. Stephen Meder, AIA-Honolulu
Sen. Ron Menor, Hi State Senate
Mr. Jeff Mikulina, Sierra Club
Dr. Bruce Miller, UH Ofc of Sustainability
Dr. Sharon Miyashiro, Social Sciences Public Policy Ctr.
Rep. Hermina Morita, HI State House of Representatives
Mr. Tim O'Connell, USDA/Rural Development
Mr. Richard Paglinawan Pa Ku'i A Lua
Ms. Melissa Pavlicek, Western States Petroleum Assn
Mr. Randy Perreira, HI State AFL-CIO
Mr. Rick Reed, Inter-Island Solar Supply
Dr. Rick Rocheleau, UH HNEI
Mr. Peter Rosegg, HECO
Mr. Steven Rymsha, KIUC
Mr. Riley Saito, PowerLight Corp.
Mr. Glenn Sato, Kauai County OED
Ms. Carilyn Shon, DBEDT
Mr. Bill Short, BIA of Hawaii
Mr. Ray Starling, HI Energy Grp
Mr. Lance Tanaka, Tesoro HI Corp
Dr. Don Thomas, UH Center for the Study of Active Volcanoes
Mr. Murray Towill, Hawai'i Hotel Assn
Ms. Joan White, Hon Community Action Program

Testimony of
Warren Bollmeier
Co-Chair – Renewable Energy Working Group
Hawai'i Energy Policy Forum

House Committee on Finance
Tuesday, April 1, 2008
2:30 pm; Agenda #2
Conference Room 308

IN SUPPORT OF Part VIII of SB 1934, Proposed HD 1 - Relating to Taxation

I am Warren Bollmeier, Co-Chair of the Renewable Energy Working Group of the Hawaii Energy Policy Forum ("Forum"). The Forum is comprised of 45 representatives from the electric utilities, oil and natural gas suppliers, environmental and community groups, renewable energy industry, and federal, state and local government, including representatives from the neighbor islands. We have been meeting since 2002 and have adopted a common vision and mission, and a comprehensive "10 Point Action Plan," which serves as a framework and guide for meeting our preferred energy vision and goals.

The Forum supports Part VIII of the proposed HD 1 of SB 1934, as it helps achieve the goal of Point One - expand renewable energy opportunities. The purpose of Part VIII of the proposed draft is to allow a taxpayer whose income consists solely of pension benefits or has an adjusted gross income of $20,000 or less to qualify for a refundable tax credit for the purchase and installation of a renewable energy technology, including solar water heating, photovoltaic systems, and wind systems.

Thank you for this opportunity to testify.

This testimony reflects the position of the Forum as a whole and not necessarily of the individual Forum members or their companies or organization

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TESTIMONY OF THE AMERICAN COUNCIL OF LIFE INSURERS
IN SUPPORT OF S. B. 1934, S.D. 1, PROPOSED HD 1, RELATING TO TAXATION

April 1, 2008

Representative Marcus R. Oshiro, Chair
Committee on Finance
State House of Representatives
Hawaii State Capital, Conference Room 308
415 S. Beretania Street
Honolulu, HI 96813

Dear Chair Oshiro and Committee Members:

Thank you for the opportunity to testify in support of S. B. 1934, S.D. 1, Proposed HD 1, relating to taxation.

Our firm represents the American Council of Life Insurers ("ACLI"), a national trade association whose three hundred fifty-three (353) member companies account for 93% of the life insurance premiums and 94% of the annuity considerations in the United States among legal reserve life insurance companies. ACLI member company assets account for 93% of legal reserve company total assets. Two hundred sixty-one (261) ACLI member companies currently do business in the State of Hawaii.

ACLI supports the proposed amendment to S. B. 1934, S.D. 1, which provides an income tax credit to qualified resident individual taxpayers in an amount equal to the lesser of $2,500 or 50% of the premium cost for long-term care insurance policies covering the taxpayers and other defined parties related to the tax payers. Married couples filing jointly may qualify for the tax credit only if their adjusted gross income is $100,000 or less; individual taxpayers qualify only if their adjusted gross income is $50,000 or less. In addition, the proposed amendment would provide an income tax credit to small business employers (having less than 100 employees) regardless of their adjusted gross income, in an amount equal to the lesser of $500 for each employee or 50% of the cost of the long-term care insurance premium for each employee.

ACLI generally believes that as a matter of public policy the State of Hawaii should encourage families to provide for their own financial well-being. If a family is unable to support its long-term care needs, the State will need to spend its scare resources for that purpose. Accordingly, ACLI supports the proposed amendment.

Again, thank you for the opportunity to testify in support of S. B. 1934, S.D. 1, Proposed HD 1.

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