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**HOUSE COMMITTEES ON WATER, LAND, OCEAN RESOURCES & HAWAIIAN
AFFAIRS AND AGRICULTURE**

**TESTIMONY REGARDING SB 2646 SD 2
RELATING TO IMPORTANT AGRICULTURAL LANDS**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 14, 2008
TIME: 9:15AM
ROOM: 325

This bill provides an income tax and general excise tax exemption for rental proceeds of certain leases of important agricultural lands. This bill also provides income tax credits for real property taxes paid and for costs incurred

The Senate Committees on Agriculture & Hawaiian Affairs and Water & Land made amendments unrelated to the tax components of this bill.

The Senate Committees on Economic Development & Taxation and Ways & Means made various substantive amendments to the bill.

The Senate passed this measure on third reading.

The Department of Taxation (Department) **has strong concerns with this legislation and requests technical amendments.**

I. INCOME TAX & GENERAL EXCISE TAX EXCLUSION.

This bill seeks to amend Chapter 235 and 237, relating to the income and general excise taxes respectively, to exclude from taxation income earned and proceeds received from certain important agricultural land leases with the following terms:

- 20 years; or
- Any other lease length term, mutually agreed upon by the parties if the lease rent is set by an independent appraisal using the lower of comparable value or agricultural

capitalization methodologies.

The Department's comments and concerns apply equally to both the income tax exclusion under Chapter 235 and the general excise tax exemption under Chapter 237 because these proposed amendments are nearly identical—

EXCLUSION/EXEMPTION OF LEASE RENT—In Part II, Section 2, the language of subsection (a) of the income tax exclusion should read as follows:

"§235- Rental income from agricultural leases on important agricultural lands excluded from gross income. (a) In addition to the exclusions in section 235-7, there shall be excluded from gross income, adjusted gross income, and taxable income, rental income, including lease rents, in an amount not to exceed \$ _____ that is received by a taxpayer subject to the taxes imposed by this chapter, that is derived from agricultural leases on lands identified and designated as important agricultural lands pursuant to part III of chapter 205, for the taxable year the rental income was realized; provided that:

(1) The minimum length of the initial lease term shall be:

(A) Twenty years or more; or

(B) A lease term of less than twenty years that is mutually agreeable to the lessor and lessee, if the amount of the lease rent is set by an independent appraisal using the lower of the comparable value or agricultural capitalization appraisal methodologies and the lease arrangement, including the amount of the lease rent determined by an appraisal, is reviewed and approved by the department of agriculture; and

(2) The lease is in effect and the lessee is continuously and substantially undertaking agribusiness on leased land, pursuant to chapter 205, as verified by the department of agriculture on a regular basis using a process determined by the department of agriculture; provided that the exclusion shall not apply if the lease is terminated or the department of agriculture determines that the leased land is not continuously and substantially used for agribusiness.

The rest of subsection (a) is unnecessary and confusing. The language in subsections (b) and (c) should remain the same.

Instead of rewriting the language from section 235-_____, from Section 2 of the bill, into chapter 237, the Department strongly suggests that the language used in Section 3, regarding the general excise

tax exemption for lease rentals, be changed to match the language in HB 2357, HD1: "**(4) Rental income, including lease rents as provided in section 235-_____ in an amount not to exceed \$_____.**"

II. THE DEPARTMENT OPPOSES THE REAL PROPERTY TAX CREDIT.

This legislation was amended to provide a tax credit equal to 100% of the real property tax assessed on the important agricultural land. The Department **opposes** the inclusion of this tax credit for the following reasons:

THE REAL PROPERTY TAX CREDIT, IN EFFECT, MERELY SUPPORTS THE COUNTIES—The Department believes that the 100% real property tax credit is ultimately a subsidy to the respective county assessing the tax. There are several unintended consequences from this legislation. First, a county would be in a position to consider increasing the tax on agricultural land because the State would be paying for the tax, regardless of the rate or amount. Second, no taxpayer would be interested in challenging any assessments because ultimately the State will pay the bill. The Department believes that this tax credit is poor tax policy because the counties enjoy the ultimate subsidy.

If the intent of this legislation is to provide relief for the real property taxes on important agricultural land, the Department suggests appropriating a set amount of revenue to the various counties and requiring the counties to adopt a direct real property tax credit.

RECAPTURE—Though the Department opposes the real property tax credit in this measure, the recapture provision may be unworkable. The Department suggests that the recapture provision be amended for only a three year period, which aligns recapture with the remaining open years under the statute of limitations.

Suggested language includes:

(d) If the classification of the important agricultural lands subject to the credit is redesignated within three years from the close of the taxable year in which the credit was claimed, the credits shall be recaptured. The recapture shall be equal to one hundred per cent of the aggregate credits claimed during the three-year period prior to recapture. The amount of the recaptured tax credits determined under this subsection shall be added to the taxpayer's tax liability for the taxable year in which the recapture occurs. There shall be no credit allowed in the taxable year of redesignation.

REFUNDABLE CREDIT—This tax credit is refundable. The Department questions whether a refundable tax credit is necessary.

III. IMPORTANT AGRICULTURAL LAND AGRICULTURAL BUSINESS TAX CREDIT FOR COSTS

CLARIFICATION OF CERTIFICATION PROCESS—The Department agrees that certain determinations should be made by an entity with more expertise in agriculture than the Department possesses. The Department also agrees that the Department of Agriculture, or a similar entity, should have primary responsibility for assessing and reporting on the effectiveness of this credit.

The current drafting of this bill suggest that a taxpayer "may" obtain a letter from the Department of Agriculture discussing the qualifying costs. This should be amended to require such a certification letter be issued.

TAXPAYER INFORMATION IS CONFIDENTIAL—It is important to keep in mind that taxpayer information is generally confidential and the Department cannot disclose that information to the Department of Agriculture (DOA); so the DOA must gather its own information. This can be accomplished by requiring that the taxpayer have its status pre-approved by the DOA, requiring that the taxpayer provide the DOA with information regarding the costs being claimed, and requiring the taxpayer to get a certificate from the DOA in order to properly claim the credit on its tax return. There is no confidentiality problem with the DOA providing information to the Department.

IV. ADDITIONAL APPROPRIATIONS.

Many of the bills coming before the legislature regarding taxation incentives relating to important agricultural lands require the Department to consult or provide other support to agencies primarily responsible for assessing the effectiveness of the tax incentive. The Department requests that an appropriation be made to the Department so that it can devote the proper resources to this support without adversely affecting its other responsibilities and obligations.

V. REVENUE ESTIMATE.

This legislation will result in the following revenue impact to the general fund, assuming the bill were effective for FY 2009:

Total Revenue Loss:	
Year	Total (millions)
FY2009	\$ 7.2
FY2010	\$ 25.1
FY2011	\$ 26.5
FY2012	\$ 27.9
FY2013	\$ 29.3
Annually thereafter	\$ 29.3



**Testimony to the House Committees on Water, Land, Ocean Resources & Hawaiian
Affairs and Agriculture
Friday, March 14, 2008 at 9:15 a.m.
Conference Room 325, State Capitol**

RE: SENATE BILL NO. 2646 SD2 IMPORTANT AGRICULTURE LANDS

Chairs Ito and Tsuji, Vice Chairs Karamatsu and Brower, and Members of the Committees:

My name is Christine H. H. Camp, Chair of the Chamber of Commerce of Hawaii, Land Use and Transportation Committee. The Chamber of Commerce of Hawaii supports the intent of S.B. No. 2646 SD 2 with specific amendments.

The Chamber is the largest business organization in Hawaii, representing 1100 businesses. Approximately 80% of our members are small businesses with less than 20 employees. The organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

S.B. No. 2646 SD 2 purposes to provide incentives and protections to establish and sustain viable agricultural operations on important agricultural lands. Several sections of the original bill have been deleted based on concerns raised over the possible financial impact to the state from proposed tax credits.

We note that Standing Committee Report No. 2789 from the Senate Committees on Economic Development and Taxation and Ways and Means, *cited a fiscal impact statement from the Department of Taxation that this measure, as introduced, would result in the following revenue losses to the State:*

<i>Fiscal year 2009</i>	<i>\$22,300,000;</i>
<i>Fiscal year 2010</i>	<i>\$25,100,000;</i>
<i>Fiscal year 2011</i>	<i>\$26,500,000;</i>
<i>Fiscal year 2012</i>	<i>\$27,900,000;</i>
<i>Fiscal year 2013</i>	<i>\$29,300,000;</i>
<i>Annually thereafter</i>	<i>\$29,300,000.</i>

The Department of Taxation's methodology on the estimated revenue losses is as follows:

Based upon 2002 Census of Agriculture data adjusted for inflation, the Department of Taxation estimates there to be approximately \$13,900,000 of qualifying farm expenses in 2008. The Department further

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estimates that annual real property tax collections from qualifying taxpayers to be approximately \$15,100,000. All estimations make the assumption that approximately one-sixth, or seventeen per cent, of all farmlands in Hawaii are important agricultural lands. That approximation is based upon an estimate provided by the Department of Agriculture in 2007. Although the maximum allowable credit for agricultural expenses was not specified, the Department assumes that there is no limit. According to Census of Agriculture data from 2002, approximately \$19,700,000 was received from grazing fees and for the rental of agricultural land and buildings.

There is no data on "rental income," but the Department assumes cash out for these farmers implies rental income for another Hawaii farmer. The Department again assumes approximately one-sixth, or seventeen per cent, of the total farmland would qualify as important agricultural lands and that ninety per cent of the important agricultural lands would result in taxable income. The Department applied those amounts to an average tax rate of six per cent.

While we do not dispute the Department of Taxations analysis, we are concerned the methodology used in calculation does not necessarily conform to the philosophy and approach established in Act 183. The designation of Important Agricultural Lands in Act 183 was based on "Agricultural Viability." Based on that approach, we are unclear as to how the Department of Agriculture was able to determine that approximately one-sixth (333,333 acres) or 17% (340,000 acres) of all farm land in Hawaii (approximately 2,000,000 acres statewide are classified as Agriculture) are Important Agricultural Lands.

The incentives are to encourage existing agricultural lands to be designated IAL based on economic incentives that make the agricultural operations viable. If the concern is based on limiting the States impact on future tax revenues, and given the fact that the incentives are to encourage investment in agricultural operations, one approach would be to establish limits on the amount of tax credits available and review how and who are using the various tax credits over time. This allows for the legislature to adjust the IAL tax credit program to conform to anticipated financial projections.

We strongly supported the original comprehensive IAL Incentive Bill (SB 2646) in its entirety. We believe that meaningful incentives are needed to promote and the growth of agribusinesses in the State. It is through this growth that we will be able to preserve and protect viable agricultural operations in Hawaii.

Act 183, SLH 2005 established a process to identify important agricultural lands (IAL). The IAL designation was established during the 1978 Constitutional Convention. 27 years passed before Act 183 was passed.

Act 183 was based on the promoting agricultural viability and simply identification of agricultural lands believed to be important. Act 183 provides for incentives to be enacted that would assist in making agribusinesses viable and thus, allow for designation of IAL based on "growing" agribusiness.

Over the past two sessions, legislation has been introduced to create incentives to promote agricultural viability in Hawaii. In addition, attempts were also made to have the Counties enact incentives to promote agricultural viability in their respective counties. Neither of these efforts have resulted in meaningful

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incentives being put in place to stimulate interest in designating lands IAL.

The S.D. 1 deleted the Water Code amendments concerning the public trust doctrine. As presently drafted, the bill lacks any significant landowner incentives.

We understand that a similar action was taken in House on HB 2357; however, the House is also considering a significant incentive in HB 2807 which essentially will allow for reclassification of agricultural lands to rural or urban, consistent with County plans, in exchange for lands being designated IAL. Currently, the House bill allows for a 4:1 ratio or 80%/20% meaning that for every 4 acres of agricultural lands designed by the LUC as IAL, the LUC may reclassify 1 acre of agricultural lands to urban or rural, as long as the reclassified lands fall within areas identified for urban expansion by the Counties. We strongly support this as an incentive for IAL designation and suggest that while further discussions are occurring on the specific ratios, the Senate include this provision in SB 2646.

Passage of this bill without the suggested amendment should not constitute fulfilling the spirit and intent of Act 183 when it was drafted.

We strongly support SB 2646 with our proposed amendment. We believe that meaningful incentives are needed to promote and the growth of agribusinesses in the State. It is through this growth that we will be able to preserve and protect viable agricultural operations in Hawaii.

Thank you for this opportunity to express our views.



Sierra Club Hawai'i Chapter

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**HOUSE COMMITTEE ON WATER, LAND,
OCEAN RESOURCES & HAWAIIAN AFFAIRS
HOUSE COMMITTEE ON AGRICULTURE**
March 14th, 2008, 9:15 A.M.

(Testimony is 3 pages long)

TESTIMONY IN OPPOSITION TO SB 2646 SD2

Chairs Ito and Tsuji and members of the committees:

The Sierra Club, Hawai'i Chapter, with 5500 dues paying members statewide, has strong concerns with one of the parts of SB 2646 SD2. While we fully support efforts to increase the attractiveness and viability of farming in Hawai'i, we must balance those interests against other critical environmental and societal goals while minimizing the opportunity for commercial interests to exploit resources at the public's and future generations' expense. The troubling aspect of this measure is the invitation to allow residential housing on up to 20% of "important" agricultural lands. We have no comments on the other parts of SB 2646 SD2.

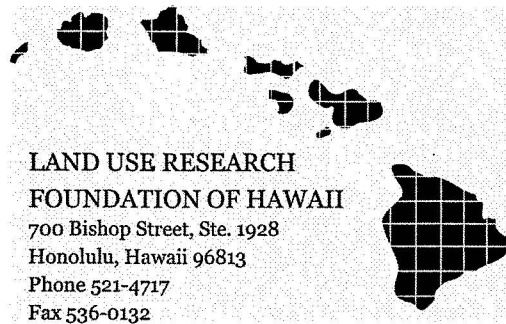
The Sierra Club is concerned about the amendment that would allow more development on lands that are identified as the best ("important") agricultural lands—particularly occupying up to 20% of the important agricultural land (IAL) as specified in SB 2646 SD2.

First, the counties historically have been lax in defending the land use law and preventing rural sprawl on agricultural lands. Due to weak enforcement of agricultural land protection, farmland has been subject to the type of real estate speculation that drives up the price of land further out of reach for local residents and local farmers. It has made it difficult to effectively plan Hawaii's future and ensure orderly development. Further, residential developments on ag-zoned lands do not allow for adequate public input on the impact on our community. Although this measure contains controls on what type of housing may be built, it still may open the door to further abuse unless additional protection is put into place. This committee has considered measures in the past that would effectively close some of the loopholes exploited by developers to create "ag housing." Those measures should be reexamined this session.

Second, while we understand that housing for farm workers is important to support farm activities, why does the residential housing need to be built on lands designated as "important?" Such housing should be put on adjacent rural lands or, if absolutely necessary, on agricultural lands that are not designated as "important."

Finally, allowing a percentage of the important agricultural lands to be covered with development is antithetical to the constitutional charge to protect agricultural lands.

Thank you for the opportunity to testify.



March 14, 2008

BY E-MAIL

The Honorable Representative Ken Ito, Chair and Members,
House Committee on Water, Land, Ocean Resources & Hawaiian Affairs
The Honorable Representative Clift Tsuji, Chair, and Members
House Committee on Agriculture
State Senate, Room 325
Honolulu, Hawaii 96813

**Re: SB 2646, SD1 Relating to Important Agricultural Lands
(IAL Incentives Omnibus Bill)**

Dear Chair Ito, Chair Tsuji and Committee Members:

My name is Dave Arakawa, and I am the Executive Director of the Land Use Research Foundation of Hawaii (LURF), a private, non-profit research and trade association whose members include major Hawaii landowners, developers and a utility company. One of LURF's missions is to advocate for reasonable and rational land use planning, legislation and regulations affecting common problems in Hawaii.

LURF is providing our testimony **in strong support of the Important Agricultural lands ("IAL") Omnibus Bill, SB 2646 SD1**, which provides incentives for farmers. We would also **strongly recommend that your Committees approve three amendments to the bill**, relating to: (1) tax credits for the costs of applications and appeals relating to water allocations for IAL; (2) requiring that information regarding IAL water use be provided to the Department of Agriculture ("DOA") for consideration in their development and master plans; and (3) an incentive for designating IAL, whereby landowners may also petition the Land Use Commission ("LUC") for reclassification of portions of their other agricultural lands to rural or urban, as long as the reclassification is already consistent with existing County plans.

Background relating to Act 183 and IAL Incentives. Thirty years ago, during the 1978 Constitutional Convention, the concept of incentives to encourage the designation and farming of IAL was made a part of Hawaii's Constitution. Twenty-seven years later, in 2005, the Legislature passed Act 183, Relating to Important Agricultural Lands. The Act emphasizes farmers, land owners and the government working together to incentivize the creation and promotion of viable agricultural operations on IAL, as opposed to merely focusing on designating a certain number of acres of land based solely on soil classifications. Act 183 was a direct result of building consensus among the

agricultural stakeholders on areas of agreement as opposed to focusing on areas of disagreement. Act 183 represents a collaboration of a variety of different interests groups, community representatives and agricultural stakeholders, including the Hawaii Farm Bureau Federation (“Farm Bureau”), LURF and the DOA.

Act 183 established policies and procedures for the identification of IAL and provides a process to develop protection, incentive measures and agricultural viability for IAL. It also established certain “milestones” for performance on the part of the legislature, administration, private landowners, farmers, and the Counties. Most importantly, Act 183 calls for a **comprehensive package of meaningful incentives for both farm operators and landowners** at the state and county level. The process of the approval of IAL incentives is ongoing, and we anticipate further work to be done by the agricultural and landowner stakeholders, by state legislators, as well as by county administrators and council members with respect to incentive legislation. Act 183 requires a complete set of incentives for both the farm operators and the land owners, before a declaration of satisfaction can be issued to confirm that the requirements of HRS §205-46 and Part II, §9 of Act 183, SLH 2005 have been fully met. “The clock should not start” on IAL designations until there is a comprehensive IAL incentive package that addresses both incentives for farming interests and landowners.

SB 2646, SD1 lacks significant landowner incentives. This bill provides incentives and protections for farmers to establish and sustain viable agricultural operations on IAL; however, it does not presently include any significant landowner incentives to designate IAL. The current SD1 includes the following:

- **PART II State Income Tax Exclusion and General Excise Tax (“GET”) Exemption.** Provides for an exclusion from income tax and exemption from GE tax collected on IAL leases;
- **PART III IAL Real Property Tax (“RPT”) Credit.** Provides for a 100% State tax credit for the actual county RPT paid on IAL;
- **PART IV Agricultural Workforce Housing.** The agricultural workforce dwelling units on IAL lands are strictly limited to farmers, employees and their immediate family who actively and currently farm on the IAL lands;
- **PART V Important Agricultural Lands Agricultural Business Tax Credits.** Provides tax credits for qualified agricultural costs for plans, design, engineering, construction, renovation, repair, maintenance and equipment primarily for agricultural purposes: roads, utilities, agricultural processing facilities, water wells, reservoirs, dams, water storage facilities, pipelines, ditches or irrigation systems, agricultural workforce housing, other related professional costs;
- **PART VI Guaranty Loan Program.** This would allow the Chairperson of the Board of Agriculture, after consultation with the Director of Finance, to guarantee loans made by commercial lenders to agricultural producers to develop and implement agricultural projects on IAL. The maximum amount of the loan shall not exceed \$2.5 million; and
- **PART VII State Priority Permit Processing.** Requires any applicable state agency issuing permits to establish and implement a procedure for the priority processing of permit applications and renewals, at no additional costs, for agricultural processing facilities which process crops or livestock from an agribusiness with a majority of lands held, owned, or used as IAL.

Recommendation for amendments to SB 2646, SD1. LURF has worked with the Farm Bureau and both have agreed to propose the following three amendments, which provide incentives relating to irrigation water to assist in maintaining viable agricultural operations and other measures to provide significant incentives for landowners to designate IAL:

- **Addition to Part V**, allowing tax credits for expenses with respect to applications and appeals relating to agricultural water allocations. We understand that the Hawaii Farm Bureau will provide the language for this addition.
- **A new PART VIII**, which would require that the State Department of Agriculture's Agricultural Water Use and Development Plan and Master Irrigation Inventory Plans include information relating to the water use on IAL lands. This new section should be identical to the language in Part VI of HB 2357, HD1.
- **A new PART IX**, which would be very similar to the language in HB 2807, HD2, which would allow a landowner, who has been granted a declaratory order from the LUC) to designate all or some of the landowner's land as IAL, to fulfill a state or county affordable housing assessment (assessment) by providing affordable housing in lands zoned as rural in lieu of satisfying the assessment in the urban district; revises the landowner petition process for IAL designation by specifying that a farmer or landowner may petition LUC for declaratory order to designate lands as IAL and allowing farmers or landowners that petition the LUC for declaratory order to seek, in the same petition, a reclassification of land from the agricultural district to the rural district, urban district, or a combination of both, if said reclassification is consistent with the relevant county general plan, and subject to other certain conditions. This new section should be almost identical to the language in HB 2807, HD2, except for the following revisions: deletion of references to "in perpetuity," deletion of land classification criteria that is inconsistent with Act 183, and allowing for future credits for landowners who designate IAL. We understand that Castle & Cooke will submit these revisions in their testimony regarding this SB 2646, SD1.

Conclusion. Act 183 calls for a comprehensive package of meaningful incentives for both farmers and landowners at the state and county level, however, the current version of SB 2646, SD1 does not include meaningful landowner incentives. Thus, LURF would respectfully request that your Committees to approve S.B. No. 2646, SD1, and also to add the amendments proposed by the Farm Bureau, LURF and Castle & Cooke, which will then create a comprehensive IAL incentive package that addresses both incentives for farmers and landowners to develop viable agricultural operations throughout the State of Hawaii.