EXECUTIVE CHAMBERS

HONOLULU

LINDA LINGLE
GOVERNOR

Testimony of Linda L. Smith
Senior Policy Advisor to the Governor

Before the

Senate Committee on Economic Development and Taxation and the
Senate Committee on Commerce, Consumer Protection, and Affordable Housing

Thursday, February 7, 2008
9:00 AM

SB 3047 Relating to Tax Credits

Chairs Fukunaga and Kokubun, Vice Chairs Espero and Ige, and Members of the Committees:

Thank you for scheduling a hearing on this important legislation. Senate Bill 3047 is an Administration bill that proposes to re-designate the existing $75 million in tax credits available under current law for the development of affordable housing, educational and training facilities, and commercial projects within the Leeward Coast area. The bill is similar to House Bill 1277 which was introduced by the Administration last year. Provisions have been added to this year's bill that would 1) extend eligibility for the credit by one year to 2011; and 2) provide for a recapture of credits if the facilities are not in operation by December 31, 2013.

As you know, the Leeward Coast of Oahu has experienced levels of poverty in excess of twenty percent for more than 40 years despite the efforts of various federal, state, and county programs. The Administration strongly believes that the tax incentives provided in this bill will spur job growth and provide an opportunity for lasting revitalization of the region. The Department of Taxation has prepared detailed testimony on the bill. We look forward to working with the Committees on this important legislation. Thank you for the opportunity to testify.

LINDA LINGLE
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SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION AND COMMERCE, CONSUMER PROTECTION & AFFORDABLE HOUSING

TESTIMONY REGARDING SB 3047 RELATING TO TAX CREDITS

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 7, 2008
TIME: 9:00AM
ROOM: 229

This bill proposes to expand the current Ko Olina tax credit provided at HRS §235-110.46, to allow for additional activities to qualify for the credit on the Leeward Coast.

The Department of Taxation **strongly supports** this Lingle-Aiona administration and requests the Committee to pass this measure.

I. CENTRALIZED REVITALIZATION EFFORTS FOR LEEWARD OAHU IS CRITICAL.

As the bill suggests, 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.

This bill 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 this bill, 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.

This bill 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;

- Maintains the current \$7,500,000 cap per year with a \$75,000,000 cap in the aggregate;

- 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;

- Requires the Department of Business, Economic Development & Tourism (DBEDT) to certify credits in the order the credits are received. By certifying the credit on a first-come-first-served basis, the credit encourages commitment to revitalization in an efficient manner. Moreover, administration of the credit is streamlined. The bill also requires DBEDT to notify the public once the caps have been met;

- Identifies Leeward Coast as the area defined by the City & County of Honolulu Waianae sustainable community plan;

- 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

- Prohibits "double dipping" by disallowing a claim for another credit for the same expenditure.

Simply stated, this bill is the most effective means of providing targeted tax incentives to the Leeward Coast because the tax credit already exists; it is budgeted in the State's financial plan; and is now equitably extended to provide for any business to assist with revitalizing the Leeward Coast—the area most in need on the Island of Oahu.

II. REVENUE ESTIMATE

This legislation 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.

LINDA LINGLE
GOVERNOR
THEODORE E. LIU
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MARK K. ANDERSON
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DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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Statement of
THEODORE E. LIU
Director
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before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
and
SENATE COMMITTEE ON CONSUMER PROTECTION AND AFFORDABLE HOUSING

Thursday, February 7, 2008
9:00 AM
State Capitol, Conference Room 229

in consideration of
SB 3047
RELATING TO TAX CREDITS

Chair Fukunaga, Chair Kokubun and Members of the Senate Committees on Economic Development and Taxation, and Consumer Protection and Affordable Housing.

The Department of Business Economic Development and Tourism (DBEDT) supports SB 3047, a measure that would expand the existing attractions and educational facilities tax credit in Section 235-110.46, HRS, to support investment and job creation in the entire leeward coast region. DBEDT administers the certification of credits under this tax credit provision.

The Leeward area is perhaps the most disadvantaged community in the State. While some of the following characteristics date back to the 2000 Census, we have no reason to believe there has been significant improvement. For instance:

- The unemployment rate in 2000 was 14.9% for Leeward Oahu, more than twice the state average at the time of 6.3%.
- Nearly 30% of individuals were below the poverty level in the Leeward area, compared with 11% statewide for 2000.

- The high school dropout rate for Leeward during 2003-2005 was 28%, nearly twice the state average of 15%.

- Only 78% of the Leeward population 25 years and above had high school diplomas or higher in 2000, compared to 85% for the state as a whole.

- The crime rate is also high for this region. While the Leeward area accounts for less than 4% of Oahu's population it accounted for nearly 5% of crimes in 2004.

- Significantly, 88% of the working residents of the Leeward area worked outside of the area in 2000.

- Finally, the difficulties and challenges experienced in Leeward Oahu fall disproportionately on Native Hawaiians. In 2000 Native Hawaiians (and other Pacific Islanders) made up 62% of Leeward Oahu, compared with 23% of the state resident population as a whole.

We believe that the tax credits under Section 235-110.46, HRS have had a significant impact on helping to reverse these trends and on building an economy in Leeward Oahu that will support the need for local jobs and expand opportunity for both businesses and residents.

The plans announced by the Disney group to build a world-class family hotel in Ko'Olina will accelerate that process. This landmark Disney hotel will not only provide jobs in the hospitality sector, but high quality jobs and careers in the creative and digital media; arts, music and entertainment; and science and technology sectors as well. These opportunities will result from the past investments made in Ko'Olina and from the new partnerships the various companies under the Disney world-wide umbrella. We understand that plans are being made for investments in education and workforce training facilities to meet the demand for these new highly-skilled jobs, as contemplated by Section 235-110.46, HRS. We are pleased to see that these investments are still encouraged and eligible for the tax credits and would urge that they remain qualified under any revisions the legislature makes to Section 235-110.46, HRS

Thank you for the opportunity to offer these comments.

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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Statement of
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Department of Business, Economic Development, and Tourism
before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
AND
SENATE COMMITTEE ON COMMERCE, CONSUMER PROTECTION, AND AFFORDABLE HOUSING
Thursday, February 7, 2008
9:00 a.m.
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in consideration of
SB 3047
RELATING TO TAX CREDITS.

Chairs Fukunaga and Kokubun, Vice Chairs Espero and Ige, and Members of the Senate Committees on Economic Development and Taxation, and Commerce, Consumer Protection and Affordable Housing.

The Office of Planning (OP) supports SB 3047. The proposed bill would enable qualified building and infrastructure system improvements to commercial structures or for the construction of affordable for sale or rental housing within the Leeward Coast to be eligible for a tax credit against net income tax liability. The Department of Business, Economic Development, and Tourism (DBEDT) would administer the certification of credits under this provision, and we defer to DBEDT on the technical aspects of the bill.

This bill is one of several measures that were identified as being able to readily expand the resources and incentives available to support economic investment and revitalization in the Leeward Coast region. The Waianae region is the focal point for an Administration initiative that illustrates one way the Administration is moving forward in its effort to facilitate the restructuring of the State's economy.

Over the years, funds and programs have been directed to assist the Waianae region, but these efforts have met with limited overall success. In response, the Administration launched the Leeward Coast Initiative, which is a multi-agency effort to develop a model for a State-community partnership, whose purpose is to generate and support community-based economic development and the ability of community residents to meaningfully participate in the regional economy. The focus is on strengthening community human resources and improving the effectiveness of State programs that serve the community.

The Administration would welcome your support of this bill to expand the tools and resources that can be tapped in the implementation of State-community economic development strategies in this region of the Leeward Coast.

Thank you for the opportunity to testify.

L E G I S L A T I V E

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SUBJECT: INCOME, Extend attractions and educational facilities tax credit for K. Alana for Leeward Coast revitalization

BILL NUMBER: SB 3047; HB 3125 (Identical)

INTRODUCED BY: SB by Hanabusa by request; HB by Say by request

BRIEF SUMMARY: Amends HRS section 235-110.46 to extend the attractions and educational facilities tax credit for Ko Olina for Leeward Coast revitalization efforts. Extends the expiration date of the credit from May 31, 2009 to May 31, 2010 and permits a taxpayer to claim the credit if he has expended qualified costs: (1) for infrastructure or building improvements to commercial property utilized by a business within the geographic boundary of the Leeward Coast for revitalization purposes, excluding infrastructure or building improvements to a business located within a residence; or (2) to construct five or more affordable housing units for rent or sale on the Leeward Coast provided that such taxpayers may deduct any excess credits against only their income tax liability credit but are not eligible to apply the credit to any tax liability imposed by HRS chapters 237, 237D, 238, 239, 241, and 431. Extends the date by which a taxpayer may claim the tax credit from June 1, 2009 to June 1, 2010.

Provides for the recapture of credits: (1) if any time during the seven-year period in which the tax credits earned under this section no longer meet the definition of qualified costs; (2) the world-class aquarium and marine science and mammal research facility at Ko Olina Resort and Marina is not placed in service by December 31, 2013; (3) the infrastructure or building improvements to the commercial property utilized by a business within the geographic boundary of the Leeward Coast are not placed in service by December 31, 2013; or (4) the affordable housing units are not placed in service by December 31, 2013. The recapture shall be 100% of the total tax credits claimed under this section for all taxable years the credit was claimed. Further stipulates that the recapture provision shall only apply to those costs that no longer meet the definition of qualified costs for the preceding taxable year.

Requires the department of business, economic development and tourism to certify credits in the order in which claims for the credit are received. Once the maximum aggregate amount of credits have been certified, the department shall notify the public that the maximum amount of certifiable credits has been issued.

Defines "Leeward Coast" as the geographic area encompassed in the city and county of Honolulu's Waianae sustainable community plan. Defines "affordable for rent" and "affordable for sale" for purposes of the measure. Makes conforming amendments to the definitions of "qualified costs" including the extension of the credit from June 1, 2009 to June 1, 2010. Amends the definition of "qualified taxpayer" to stipulate that taxpayers with qualified costs for infrastructure or building improvements to commercial property utilized by a business within the Leeward Coast boundaries shall be eligible to a tax credit deductible from their income tax liability but are not eligible to apply the credit to any tax liability imposed by HRS chapters 237, 237D, 238, 239, 241, and 431.

SB 3047; HB 3125 - Continued

EFFECTIVE DATE: Tax years beginning after December 31, 2008

STAFF COMMENTS: This is an administration measure submitted by the office of the governor GOV-16(08). The legislature by Act 100, SLH 2003, established tax credits of up to $75 million to encourage taxpayers to make investments in the Ko Olina resort area. The proposed measure would extend these provisions to include the Leeward Coast revitalization efforts.

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 other areas be included as evidenced by this measure. As such, project specific tax credit proposals violate the integrity of the tax system, setting a precedent with bad tax policy. The Ko Olina tax credit has been recognized over and over as being poor tax policy, this proposal only perpetuates that poor tax policy.

The argument at the time of the adoption of the Ko Olina tax incentive was that this would help to support the further development of the Leeward side of the island, creating hundreds of jobs for those on that side of the island. Without the building of the aquarium as an attraction, development would not proceed. What has happened is that as a result of demand, the various developments have proceeded with 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. What it does underscore is that the success or failure of a project or development is not because of a tax incentive or the lack thereof, but what forces the marketplace brings to bear. In the case of Ko Olina, the market was just beginning to come back anyway and as has been witnessed, the interest in resort development continues to peak with or without tax credits.

It should be noted that due to market forces, the Ko Olina developer was able to develop the resort and surrounding area without the $75 million in tax credits and will be returning the credits that this measure proposes to utilize to revitalize the leeward area. As evidenced by the return of the tax credits, it should be questioned whether the proposed tax credits are necessary or, more importantly, what other state programs could use the $75 million.

While this measure would perpetuate the use of tax credits, it should be remembered that the legislature has enacted a plethora of targeted business tax credits 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 be 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.

The credit, as amended, would be available to any qualified costs for infrastructure or building improvements to commercial property utilized by a business within the Leeward area as defined. Thus, Hawaiian Electric building a new power plant in the Leeward area or Hawaiian Telcom building a new transmitter in the geographic area would qualify. Since there is no other criteria to define the expected outcome, even a shave-ice stand could qualify for the credit.

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 a specific project that has measurable outcomes, 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.

It should be noted that section two of the measure provides that taxpayers that have expended qualified costs to construct affordable housing units may use the revitalization tax credits to offset their income tax liability but not to any tax liability under HRS chapters 237, 237D, 238, 239, 241, and 431. However, in that same paragraph, which excludes builders of affordable housing from applying the tax credits against taxes other than income tax, it permits all other activities to apply the credits to those chapters. This contradicts a later definition of "qualified taxpayer" which prohibits costs for infrastructure or building improvements to commercial property utilized by a business within the Leeward Coast boundary to apply the credits against tax liability under HRS chapters 237, 237D, 238, 239, 241, and 431. This provision should be clarified as it is not apparent which claimants of the credit can claim it against which of their tax liabilities.

Instead of hoping and wishing some taxpayer will undertake any of the qualified activities, lawmakers should consider expending the $75 million that would go toward this tax credit on addressing some of the more apparent problems on the Leeward Coast, from housing to substance abuse, to job training, to health issues, all of which beg for solutions.

Digested 2/06/08

OFFICE OF HAWAIIAN AFFAIRS
Legislative Testimony

SB 3047 Relating to Tax Credits
Senate Committee on Economic Development and Taxation
Committee on Commerce, Consumer Protection, and Affordable Housing

February 7, 2008 9:00 am Room 229

The Office of Hawaiian Affairs **supports** the purpose and intent of SB 3047.

The growing affordable housing problem is one of the most critical issues faced by our communities, especially our Native Hawaiian communities in the entire Leeward (Waianae) Coast. This issue seems to have many of our families struggling to find adequate ehousing and to make ends meet.

The continued increased pressure on government to provide financing assistance for the development of affordable housing will not end until government can show what has been done to attract partnerships to assist with the developments. The expansion of eligible activities to qualify for region tax credits and extending the period of time when these credits may be claimed is a viable option that developers could use. The outreach to developers for the Leeward (Waianae) Coast will need to be implemented as soon as bill is passed.

We recognize that physical solutions by themselves will not solve social and economic problems, but neither can economic vitality, community stability, and environmental health be sustained without a coherent and supportive physical framework.

Mahalo nui loa for the opportunity to provide this testimony.