

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



LATE TESTIMONY

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

**TESTIMONY REGARDING SB 591, PROPOSED SD1
RELATING TO TAXATION**

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

DATE: FEBRUARY 5, 2008

TIME: 8:30AM

ROOM: 325

This is a short form bill. This testimony relates to the proposed Senate Draft 1.

The Department of Taxation (Department) supports this legislation which amends, in text only, the capital goods excise tax credit at section 235-110.7.

I. THIS IS THE DEPARTMENT'S RESPONSE TO SCR 115, SLH 2007.

Senate Concurrent Resolution 115, Session Laws of Hawaii 2007, requested that the Department "redraft the capital goods excise tax credit to remedy old references to repealed law and to incorporate the current status of the Internal Revenue Code." This bill represents the Department's response to that request.

II. THIS IS NOT A SUBSTANTIVE AMENDMENT OF THE LAW.

This bill is an amendment in text only. The Department has made no substantive amendments to the current law whatsoever. Instead, this bill is the Department's effort to eliminate references to repealed Internal Revenue Code sections, and replace them with text that accurately describes how the Department currently enforces this law. Enactment of this law will have no effect on how the law is administered by the Department.

III. THE DEPARTMENT STRONGLY RECOMMENDS THE LAW REMAIN CODIFIED AT SECTION 235-110.7.

Currently, a significant number of Hawaii Administrative Rules as well as guidance by the Department, such as Tax Information Releases reference, section 235-110.7. Because this legislation does not represent a substantive change in the law, all references contained in these documents will remain valid. Changing the codification of this statute would result in the

Department needing to re-issue and re-promulgate all such guidance and Administrative Rules.

IV. THIS BILL MAKES THE LAW SIMPLER AND MORE ACCESSIBLE.

This bill represents significant clarification regarding the capital goods excise tax credit. The current law is extremely difficult to access, as it requires knowledge of Internal Revenue Code statutes that have been repealed for over 20 years. This bill eliminates that burdensome need.

V. IMPORTANT COMMITTEE REPORT CONSIDERATION

The Department requests that the Committee Report issued by this Committee clearly set forth that the intent of this legislation is not to amend the law in any substantive form so that the record is clear that this legislation is a mere recodification. This will assist the Department with administering any amendments to the credit between any transition period. This will also give taxpayers comfort during this period. As the Committee is likely aware, a majority of Hawaii businesses claim this credit on a routine basis for capital assets placed in service.

VI. NO REVENUE IMPACT.

Because this bill does not represent a substantive change in the law and merely represents a clarification of the text, the Department anticipates that this legislation would have no revenue impact.

CRAIG K. HIRAI, CPA
733 Bishop Street, Suite 2020
Honolulu, Hawaii 96813
Telephone: (808) 526-2020
Facsimile: (808) 526-2021

FEB 7 2008

February 12, 2008

The Honorable Carol Fukunaga, Chair
Senate Committee on Economic Development and Taxation
State Capitol, Room 224
415 South Beretania Street
Honolulu, Hawaii 96813

RE: S.B. 591, S.D. 1, Relating to Taxation
Hearing Date: February 12, 2008 @ 9:25 a.m., Room 224

I am Craig Hirai, a practicing certified public accountant, who was a practicing tax attorney when I served as the Chair of the 2001-2003 Tax Review Commission. I am submitting this testimony in **support of S.B. 591, S.D. 1**, which repeals and reenacts the capital goods excise tax credit in order to reflect the definitions and other references to the Internal Revenue Code of 1954, as amended.

I would respectfully request that you note that Part II, Section K, Item 1, of the Report of the 2001- 2003 Tax Review Commission reads as follows:

1. Overhaul and Update the Capital Goods Excise Tax Credit.

The four percent capital goods excise tax credit was originally enacted in 1987. The effect of the credit is essentially to refund the GET and Use Tax paid on capital goods by businesses.

The credit was designed to alleviate the cost of acquiring capital goods which has long been acknowledged to be important for the creation of jobs, and was patterned after the federal investment tax credit with references to former IRC §§38 and 48, which have now been repealed for over ten years. As a result, administration and compliance with the provisions of the capital goods excise tax credit have been less than forthright. Recent interpretations of the credit have resulted in applications that may stray from the original intent and letter of the former Federal statutes.

The Commission therefore recommends that HRS §235-110.7 be revised or rewritten as a whole to provide contemporary definitions and provisions under State law, rather than relying on outdated Federal statutes.

I believe that S.B. 591, S.D. 1, is consistent with the above recommendation, and I therefore urge you to pass this bill.

Mahalo for the opportunity to testify.

A handwritten signature in black ink, appearing to read "Craig K. Hirai", written over a horizontal line.

Craig K. Hirai, CPA/ABV, MBA, LLM

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, Capital goods excise tax credit

BILL NUMBER: SB 591, SD-1

INTRODUCED BY: Senate Committee on Economic Development and Taxation

BRIEF SUMMARY: Amends HRS section 235-110.7 to recodify the capital goods excise tax credit with updated references to the Internal Revenue Code.

EFFECTIVE DATE: Tax years beginning after December 31, 2008

STAFF COMMENTS: The 2007 legislature adopted Senate Concurrent Resolution No. 115 which requested the department of taxation to "redraft the capital goods excise tax credit to remedy old reference to the repealed law and to incorporate the current status of the Internal Revenue Code." It should be noted that the capital goods excise tax credit was originally adopted in recognition that the general excise tax imposed on capital goods made the purchase of goods, that are imperative to the creation of new jobs and greater efficiency and productivity, all that more costly. Thus, the refund of the tax was viewed as mitigating the burden of the tax on the goods and equipment essential to the creation of new jobs.

While the resolution further requested the department of taxation to submit proposed legislation to the 2008 legislature, it appears that the initial submission by the department of taxation is a very preliminary draft which not only updates references to the Internal Revenue Code but also appears to incorporate the administrative rules of the capital goods excise tax credit. While the intent of the resolution was to make the capital goods excise tax credit easier to comply with by practitioners and certified public accountants, as proposed, it appears that the adoption of this draft would complicate compliance with the capital goods excise tax credit.

While the committee report submitted with this SD-1 considers this measure to be a "work in progress" - that it is. To ease compliance with the capital goods excise tax credit, administrative rules should be deleted and definitions relocated from the latter part of the proposed measure and incorporated throughout the law. Another area which begs further work is the definition of "cost" and "basis" so that they complement one another. The definition of "cost" appears to have been brought over from the existing law, perpetuating the problem that has plagued the capital good excise tax credit and that is the cost of installation should be included in the calculation of the credit. As drafted, since the credit is the lesser of the invoice price of the property or the deduction taken under Section 167 or 168, the invoice of the property will always be the lesser and not include the cost of installation.

While the department of taxation has had a little more than six months to comply with the resolution, perhaps more time is necessary to produce an updated capital goods excise tax credit law that is easy with which to comply. Finally, with more than a year of administering the county surcharge of 0.5% making the general excise tax rate 4.5% in Honolulu, the department offers the credit in this bill at the rate of 4%.