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HOUSE COMMITTEE ON FINANCE
TESTIMONY REGARDING HB 42 HD 1
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 2, 2009
TIME: 4:44PM
ROOM: 308

This measure amends current conformity law to conform to Sections 168 and 179 of the Internal Revenue Code, which allows for bonus depreciation and accelerated expensing for certain business expenditures, specifically the increase in the maximum deduction.

The Department of Taxation (Department) **opposes the unbudgeted revenue loss** contemplated by this measure.

SUPPORT FOR CONFORMITY GENERALLY—As a general matter, the Department strongly supports conforming to the Internal Revenue Code in all respects. As a conformity jurisdiction, the more in line the state is with the federal government, the simpler Hawaii's income tax laws are to enforce and to comply with for taxpayers.

OPPOSED TO UNBUDGETED REVENUE LOSS—Though the Department supports conformity, the Department cannot support the unbudgeted revenue loss contemplated by this measure. Hawaii has decoupled from the Internal Revenue Code deduction limits because they are extremely costly. The Department cannot support the tax provision in this measure because it is not factored into the budget. The Department must be cognizant of the biennium budget and financial plan. This measure has not been factored into either. Given the forecasted decrease in revenue projections, this measure would add to the budget shortfall.

However, the Department would be open to conforming to these provisions in the future when the State is better able to afford these changes.

THIS MEASURE WILL LIKELY NOT STIMULATE ANY MORE BUSINESS THAN WILL BE STIMULATED BY THE FEDERAL GOVERNMENT—If the intent of this measure is to encourage stimulating the economy, the Department doubts that taxpayers will change their behavior as a result of this measure. With the federal government's 30+% tax on most small businesses, the immediate expensing provisions of Section 179 of the Internal Revenue Code are much more valuable and therefore sufficient incentive alone to get taxpayers to invest in their businesses. The State doubling-up by conforming will not change taxpayers' behavior through this measure. Stated another way, taxpayers will already invest in their business through the federal incentive with or without the State counterpart. The State would see a better return on its investment if it were to incentivize behavior that the federal government does not stimulate.

REVENUE LOSS—This bill will result in a revenue loss of approximately $15.2 million in fiscal year 2009.

L E G I S L A T I V E

TAXBILLSERVICE

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SUBJECT: INCOME, Adopt bonus depreciation and small business expensing

BILL NUMBER: HB 42, HD-1

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Amends HRS section 235-2.4 (f) to provide that IRS section 168 (with respect to the accelerated cost recovery system) relating to IRC section 168(k) with respect to the special allowance for certain property acquired after December 31, 2007 and before January 1, 2010, shall be made operative for Hawaii income tax purposes.

Amends HRS section 235-2.4 (g) to provide that IRC section 179 (with respect to the election to expense certain depreciable assets) of: (1) the increase of the maximum deduction to $100,000 for taxable years beginning after 2002 and before 2008, and the increase of the maximum deduction to $125,000 for taxable years beginning after 2006 and before 2011, in section 179(b)(1); and (2) the increase of the qualifying investment amount to $400,000 for taxable years beginning after 2002 and before 2008, and the increase of the qualifying investment amount to $500,000 for taxable years beginning after 2006 and before 2011, in section 179(b)(2) shall be operable for Hawaii income tax purposes.

EFFECTIVE DATE: Tax years beginning after December 31, 2007

STAFF COMMENTS: The Small Business and Work Opportunity Act of 2007 increased the IRC Section 179 deduction limit to $125,000 for tax years beginning after 2006. It also increases the $400,000 phaseout threshold amount to $500,000 for tax years beginning after 2006. The Act also extended, for an additional year (through tax years beginning before January 1, 2011), the increased $125,000 amount that a taxpayer can deduct as a section 179 expense and the increased $500,000 phaseout threshold amount. The Act also indexed the $125,000 amount that can be expensed and the $500,000 phaseout threshold for inflation in tax years beginning in a calendar year after 2007 and before 2011. The Act also extended the inflation adjustment for the $125,000 maximum expensing amount and the $500,000 phaseout threshold for one year to tax years beginning in a calendar year before January 1, 2011.

It should be noted that these provisions were not not adopted by the legislature last year but specifically excluded in the conformity measure adopted as Act 93, SLH 2008, as it was estimated that the adoption of these provisions would have resulted in a loss of approximately $3.1 million for the 2007 tax year. While these provisions would provide an economic stimulus to businesses in Hawaii, the revenue impact may result in a revenue loss of at least $3.1 million, if not more, it is questionable whether the state can afford this measure.

It should be noted that if a business elects to take the bonus depreciation proposed by this bill, the tangible personal property for which the election is made would not be eligible for the state's capital goods excise tax credit. However, the bonus depreciation would probably be a larger benefit than the capital goods excise tax credit at 4%.

Finally, it should be noted that the economic stimulus package recently approved by the President extended these provisions for the 2009 year. However because the annual conformity bill usually picks up the Code as it existed on December of the previous year, it is questionable whether or not the extension of these provisions would apply for the current calendar year.

Digested 3/2/09