HB 2381, HD2, SD1

Testimony

EXECUTIVE CHAMBERS
HONOLULU

LINDA LINGLE
GOVERNOR

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

Before the
SENATE COMMITTEE ON WAYS AND MEANS
Wednesday, March 31, 2010, 9:30 a.m.
Room 211, State Capitol

HB2381 HD2 SD1 RELATING TO TAXATION

Chair Kim, Vice Chair Tsutsui, and Members of the Committee:

The Office of the Governor **requests that HB2381 HD2 SD1 be amended** to replace this measure with language from SB2712, an Administration measure establishing the Hotel Construction and Renovation Tax Credit. HB2381 provides an unspecified amount in nonrefundable tax credits for the construction and renovation of residential real property during an unspecified time period. Because the construction industry has been hit especially hard during this downturn, we believe a construction and renovation tax credit is necessary to stimulate the economy. However, we believe a hotel construction and renovation tax credit will stimulate the economy more than a residential construction and renovation tax credit since concentrated construction and renovation activity from big projects is more likely to have greater economic impact than residential projects.

HB2381 establishes a nonrefundable income tax credit, applicable to costs incurred in the construction or renovation of residential properties during an unspecified time period. This tax credit has an unspecified cap for costs per residential unit, but does not include an aggregate cap for the total amount of income tax credits provided, which is necessary to control cost impacts to the state budget. Thus the fiscal implications of this bill are unknown and outside the scope of the budget.

Unlike a hotel construction and renovation tax credit, which requires substantial investment in construction and renovation for credit claims, this residential construction and renovation tax credit allows credit claims for "any costs incurred...for plans, design, construction, and equipment that is permanently affixed to the building or structure." Arguably, credits can be claimed by homeowners for furniture and appliances that would not necessarily increase construction activity or create jobs.

Although some have argued that a hotel construction and renovation tax credit is ineffective because there is no financing for hotel construction, there are in fact signs of a rebound. Currently, Summit Capital is making $380 million in commercial mortgage-backed securities (CMBS) available for commercial and hotel properties. Other properties have indicated that cash is available to begin renovation and construction. We note that a similar tax credit was recommended in a 2010 report by the Construction Industry Task Force, which the Legislature established pursuant to SCR 132 (2009) for the purpose of developing and proposing actions to create new jobs in the construction industry.

As a result, we respectfully request the committee to consider amending this measure by replacing it with language from SB2712. SB2712 will spur up to $500 million in construction activity at a cost of $50 million per year, or up to $1.5 billion in construction activity for the three year period of the tax credit. It is estimated by the Department of Business, Economic Development, and Tourism that this tax credit will result in the creation of up to 23,000 jobs and the collection of $74 million in additional tax revenues between 2010 and 2012. The Hotel Construction and Renovation Tax Credit will provide a short-term incentive to move hotel construction and renovation projects that were stalled or are already planned, but would otherwise only begin construction after the economy rebounds.

Additionally, SB2712 also provides safeguards designed to maximize construction activity while minimizing the cost of the tax credit to the State:

1) SB2712 provides a non-refundable tax credit for hotel and resort construction occurring from January 1, 2010 to December 31, 2012, and places a cap of

$50 million on the amount that the Department of Taxation can award per year;

2) The tax credit sets a floor of $10 million and a cap of $100 million for qualifying costs per project, which ensures that substantial construction activity will occur with the capacity to create a critical mass of new jobs;
3) The tax credit limits qualifying construction and renovation costs to only include labor, material, and supply costs incurred in Hawaii, but do not include design, planning, or permitting costs. This provision ensures that the tax credit only incentivizes immediate construction activity, which must occur between 2010 and 2012; and
4) The tax credit cannot be taken for construction and renovation costs financed through government grants or loans, since such construction has already been incentivized by the government through other means.

The Hotel Construction and Renovation Tax Credit will help to revitalize the construction industry in the key sector of hotel and resort development while providing long-term enhancements to visitor accommodations in the State. As such, the Office of the Governor respectfully recommends that HB2381 HD2 SD1 be amended with language from SB2712.

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

STANLEY SHIRAKI
DEPUTY DIRECTOR

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SENATE COMMITTEE ON WAYS & MEANS
TESTIMONY REGARDING HB 2381 HD 2 SD 1
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 31, 2010
TIME: 9:30AM
ROOM: 211

This measure provides an undetermined nonrefundable income tax credit for residential construction or remodeling projects. As amended, this measure requires the Department of Taxation to submit a report studying the effect of various construction credits on jobs and the state budget.

The Department of Taxation (Department) **prefers the Administration measure HB 2559**.

SUPPORT FOR JOBS AND THE CONSTRUCTION INDUSTRY—The Department strongly supports efforts to stimulate the economy through incentives. This measure targets tax incentives at the construction industry, which is a large segment of Hawaii's economy. With many construction workers and suppliers impacted by the economic downturn, this measure will encourage taxpayers to invest in their homes and put people back to work.

PREFER ADMINISTRATION MEASURE—The Department prefers HB 2559, which provides for a 10% nonrefundable credit for construction or remodeling of hotel properties. This measure provides an additional incentive above and beyond a mere return of general excise taxes. HB 2559 also applies to commercial properties, which may be in a better position to deploy capital in the current economy than individual homeowners. The Administration measure is also immediate and has a 2012 end-date. The $50 million aggregate cap in credits also allows for budget certainty.

REQUESTED AMENDMENT REGARDING STUDY—The Department acknowledges the importance of studying various tax incentives. However, the Department has concerns regarding the mandated study with current budget limitations. In the interest of minimizing the impact on already-stretched resources, and at a time when the State can least afford additional resource drains, the Department believes that the duty of studying tax credits as contemplated by this measure is best left to the Tax Review Commission, which is constitutionally delegated this responsibility. The next Tax Review Commission will be seated on July 1, 2010—after this legislative session.

REVENUE LOSS—This measure will result in a revenue loss of an indeterminate amount because the credit amounts and caps are blank.

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, Residential construction and remodeling tax credit

BILL NUMBER: HB 2381, SD-1

INTRODUCED BY: Senate Committee on Education and Housing

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers who own residential real property to claim a residential construction and remodeling tax credit of ___% of the construction or renovation costs incurred during a taxable year; provided that the costs do not exceed $_____ in the aggregate for each residential unit and the costs are incurred before July 1, ______.

A husband and wife filing separately, or multiple owners of a property filing separately, may apportion the credit among themselves; provided the credit may be claimed only once for a single residential property. 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 construction or remodeling cost for which the deduction is taken.

Credits in excess of tax liability shall be applied to tax liability in subsequent years until exhausted. Requires all claims for the credit to be filed before the end of the twelfth month following the tax year. The director of taxation shall prepare forms as may be necessary to claim the credit and may adopt rules pursuant to chapter 91.

Requires the department of taxation to submit a report to the 2011 legislature that compares the impact on jobs and on the state budget that is produced by four separate tax credits for: (1) new construction to residential apartment units and houses; (2) renovations to residential apartment units and houses; (3) new construction to hotels and resorts; and (4) renovations to hotels and resorts.

Defines "construction or remodeling cost" and "net income tax liability" for purposes of the measure.

EFFECTIVE DATE: July 1, 2020 applicable to costs incurred in tax years beginning after December 31, 2010 and prior to January 1, 2014

STAFF COMMENTS: The legislature by Act 10, Third Special Session of 2001, established a nonrefundable tax credit equal to 4% of residential construction and remodeling costs up to $250,000 to spur private sector construction activity. Since the credit was scheduled to expire on July 1, 2002, the legislature by Act 174, SLH 2002, extended the credit to July 1, 2003. This measure proposes to resurrect a similar credit.

Although some may claim that the previous tax credit incentive "jump started" construction activity especially in the wake of 9/11, looking back, there is general agreement that the tax credit created artificial dislocations in the economy, creating demand that exceeded the industry's ability to respond, sending labor and material costs beyond reasonable limits. The result is that in the years following the termination of the credit, the cost of construction exceeded reason. As a result, when the credit crisis occurred, the cost of construction was so high that there was insufficient latitude in the availability of credit to meet the demand. Thus, construction activity came to a screeching halt that is now being experienced. Instead of the spike that the tax credit created, recovery in the construction industry should have been stimulated with public works projects that allowed government to take advantage of a skilled workforce available at reasonable rates. It would have allowed recovery with moderation. As many homeowners rushed to take advantage of the last tax credit boom, they found that workers became scarce and the added cost was only mitigated by the tax credit. Thus, care should be exercised in jumping on this bandwagon again.

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. This would merely result in a subsidy by government and plunge the state further into the red financially. While the adoption of this measure may alleviate some of the costs to entice homeowners to renovate their homes, it comes at a price to the state who is asked to provide public services with what little resources are available. The state cannot afford the enactment of this measure which will put it further in debt.

That said, this measure, by comparison to other measures that would also extend a tax credit for the construction or renovation of hotel facilities, is probably much more feasible due in large part to the condition of the credit markets. Trying to raise tens of millions of dollars in the current environment would be almost impossible. On the other hand, most owners who have any equity in their homes probably can access a line of credit sufficient to undertake some sort of modest repairs or renovations. Given that this tax credit is nonrefundable, the impact would only affect taxes that would have otherwise been paid. While both the amount of expenditures and the rate of the tax credit are unspecified consideration should be given to setting the rate of tax credit to not more than 4.5% in Honolulu and 4% on the Neighbor Islands. At least there will be some rationale for the rate of credit as it would mirror the general excise tax rates imposed in the respective county. That will also then help lawmakers to determine just how much in expenditures will qualify for the credit based on the utilization of the last home renovation credit.

Digested 3/29/10

BIA-HAWAII
BUILDING INDUSTRY ASSOCIATION

March 31, 2010

The Honorable Donna Mercado Kim, Chair
Committee on Ways and Means
State Capitol, Room 211
Honolulu, Hawaii 96813

RE: HB2381, SD1 Relating to Taxation

Dear Chair Kim and Members of the Committee on Ways and Means:

I am Karen Nakamura, Chief Executive Officer of the Building Industry Association of Hawaii (BIA-Hawaii) Chartered in 1955, the Building Industry Association of Hawaii is a professional trade organization affiliated with the National Association of Home Builders, representing the building industry and its associates. BIA-Hawaii takes a leadership role in unifying and promoting the interests of the industry to enhance the quality of life for the people of Hawaii.

BIA-Hawaii would like to offer comments on HB2381, SD1 Relating to Taxation.

HB 2381, SD1 provides a temporary tax credit for residential construction and remodeling projects. Requires a report to the legislature comparing the impact on jobs and the state budget for various tax credit schemes. Effective 7/1/2020. Sunsets 6/30/2013. (SD1).

While we appreciate the provision of a tax credit for residential construction and remodeling, fhe effective date of this bill, if it is not upon approval, could have a negative impact on our business for the remainder of the year. Many of our customers will delay their construction or remodeling plans to take advantage of such a credit. If the effective date is not "upon approval," we ask that the bill be held, rather than jeopardize our businesses for this year. It is such a critical time for the construction industry that any measure that would bring about unintended consequences would be devastating.

We appreciate the opportunity to share our views with you.

Karen T. Nakamura

Executive Vice President/CEO
BIA-Hawaii

From: Gerry Peters
To: WAM Testimony
Subject: TESTIMONY OF GERALD PETERS RE HB2381HD2SD1
Date: Tuesday, March 30, 2010 8:55:11 AM

Testimony of Gerald Peters and The Hawaii Lumber Products Association

(WAM) Senate Committee on Ways and Means
Wednesday March 31, 2010, Room 211, 9:30 am
RE: HOUSE BILL 2381HD2SD1 – RELATING TO TAXATION

Chair Kim and Members of WAM: I am submitting testimony in opposition to this bill due to timing problemsof SD1 seriously affecting 2010 revenues. This good idea, as you know, was featured in front page Sunday Advertiser story Sunday before last.

The effective date of the credits eligibility is already causing a significant number of people to hold off 2010 purchases. This unpleasant finding is based on our own 3 island licensed contracting business seeing more than a 50% drop in new inquiries in the last nine days compared to the previous 10 weeks (Oahu, Maui, Big Island), and comments from would be consumers.

If this is truly "revenue neutral" or better, then PLEASE move up effective date of purchases credits to upon signing. Otherwise, we in the construction industry predict a complete meltdown of barely recovering 2010 revenues while akamai home and condo owners wait for January or later 2011. Otherwise, sadly, it would be better for private sector and state revenues for you to hold this bill.

Thank you for your attention to this very worrisome unintended consequence.

Gerald Peters President/General Manager HPS Services,Inc. HPS Construction Services, Ltd.; Member of BIA-Hawaii Government Relations Committe and Hawaii Lumber Products Association Legislative representative.; Content Producer/Co-host of Fixitfridays Home Improvement Radio on The Mike Buck Show

HB2381 HD2 SD1

RELATING TO
TAXATION.

Report Title: Tax Credit; Residential Construction and Remodeling

SECTION 4. This Act shall take effect on July 1, 2020, shall apply to costs incurred in taxable years beginning after December 31, 2010 and prior to January 1, 2014.

LAND USE RESEARCH
FOUNDATION OF HAWAII
700 Bishop Street, Ste. 1928
Honolulu, Hawaii 96813
Phone 521-4717
Fax 536-0132

Via: Capitol Website

March 31, 2010

Support of HB 2381, HD2, SD1 Relating to Taxation
(Provides a tax credit for residential construction and remodeling projects)

Senate Committee on Ways and Means
Wednesday, March 31, 2010 at 9:30 a.m. in CR 211

Honorable Chair Donna Mercado Kim, Vice Chair Shan Tsutsui and Members of the Senate Committee on Ways and Means:

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, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources and public health and safety.

LURF is in **support of HB 2381, HD2, SD1,** which will provide a temporary tax credit for residential and remodeling projects. This bill will provide much-needed affordable and market housing and will benefit the construction industry as well as the overall economy.

HB 2381, HD2, SD1. The purpose of this bill is to increase construction jobs and stimulate the economy by establishing a Residential Construction and Remodeling Tax Credit equal to an unspecified percent of the cost of residential construction or remodeling, capped at an unspecified amount and limited to construction costs incurred before an unspecified date.

HB 2381, HD2, SD1 would add a new section to Chapter 235 of the Hawaii Revised Statutes extending a residential construction and remodeling tax credit to homeowners. As defined, construction or remodeling cost means any costs for plans, design, construction, and equipment that is permanently affixed to the building or structure related to new construction, alternations, or modification to a residential apartment unit or house. Section 2 of the bill also requires the Department of Taxation (DoTAX) to submit a report to the legislature that compares the impact on jobs and on the state budget that is produced by four separate tax credits for:

(1) New construction to residential apartment units and houses;
(2) Renovations to residential apartment units and houses;

(3) New construction to hotels and resorts; and
(4) Renovations to hotels and resorts.

DoTAX must submit the report no later than twenty days prior to the convening of the regular session of 2011.

Background. The lack of affordable housing remains a significant problem affecting Hawaii. Finding ways to provide sufficient affordable housing and market housing for Hawaii's residents has been a major objective for our elected officials, and state and county agencies, and members of the housing industry and business community.

For the past two years, LURF has participated in a statewide task force comprised of representatives from all four counties, business, labor, developers, architects, nonprofit providers of services, the State, and the legislature, whose purpose was to identify, address and propose regulatory reform and solutions to remove the barriers to the production of affordable housing. The Task Force made a number of legislative recommendations which would assist in increasing the amount of state-wide affordable housing units,

In addition to providing much-needed affordable and market housing, HB 2381, HD2, SD1 will not only stimulate the economy but assist in getting people back to work. This measure will increase construction jobs and in turn bring relief to the State's unemployment resources. Hawaii is in an economic recession. Economic stimulus and other initiatives are needed to counteract the negative impact that the world's economy has had on our state. LURF agrees that a generous tax credit is an excellent means to boost Hawaii's tourism and construction industries.

According to recent economic forecasts by the First Hawaiian Bank and the University of Hawaii Economic Research Organization, the construction industry will continue to be impacted for some time before a gradual recovery ensues.

The effects of the September 11, 2001 terrorist attacks upon the United States had a devastating effect on Hawaii's economy. In October 2001, the legislature met in special session to approve emergency measures in response to the attacks. One such response was the enactment of Act 10, Third Special Session Laws of Hawaii 2001, which enhanced the then-existing hotel construction and remodeling tax credit. Act 10 raised the tax credit from four to ten per cent for costs incurred prior to July 1, 2003 to assist the tourism industry in its efforts to attract more visitors to Hawaii. Act 10 provided the stimulus needed to boost Hawaii's workforce and economy during difficult economic times.

Last session, Senate Concurrent Resolution No. 132, S.D. 1 (2009), established a Construction Industry Task Force to determine the economic contributions of the construction industry in Hawaii. As directed in the concurrent resolution, the Task Force has developed a series of proposals for state actions to preserve and create new jobs in the local construction industry. This bill implements one of the Task Force's proposals and incentivizes new residential construction and remodeling projects.

LURF's Position. LURF supports the purpose of this bill, which is to create a construction and renovation tax credit for residential construction and remodeling projects and to stimulate the construction industry and create jobs in Hawaii. This bill would provide much-needed affordable housing and benefit the construction industry as well as the overall economy.

The implementation of HB 2381 HD2, SD1 is necessary and warranted.

Thank you for the opportunity to express our **support to HB 2381 HD2, SD1.**