SB 2829

EDT

ADVANTAGE
CAPITAL
PARTNERS

February 5, 2010

The Honorable Carol Fukunaga
Chair, Senate Committee on Economic Development and Technology
The State of Hawaii

SUBMITTED VIA ELECTRONIC EMAIL

Dear Senator Fukunaga,

I write in support of SB 2829, Relating to New Markets Tax Credits. Nationally, the New Markets Tax Credit program has been a bi-partisan success story in attracting long-term, patient capital to companies and projects in low income communities. In a January, 2010 report on the program by the GAO based in Washington, DC, they found "projects with NMTC financing likely contribute employment and other benefits to low-income communities."

The federal credits are allocated on a competitive basis each year and CDEs (community development entities) choose which states and which companies ultimate receive the NMTC investment. Several states offer an additional incentive for NMTC investments in their state if they comply with the federal guidelines and any additional targeting done at the state level. This approach has been very successful for two primary reasons:

- The 39% federal subsidy has not always proved sufficient to complete a worthwhile project and the addition of state incentive can make the difference between getting a project done and it staying on the drawing board.

- The NMTC program investments are not distributed on a per capita basis like LIHTC or CDBG programs. When a state offers a matching credit or incentive, it makes the projects in that state relatively more attractive than other locations and may help it receive more than its per capita share.

Thank you for your interest in finding capital for small businesses and worthy projects in low income census tracts. We have been honored to participate in the NMTC program and five of the state match programs currently in operation and are happy to give additional testimony or answer questions at your request.

Sincerely,

Ryan Brennan
Managing Director

7733 Forsyth Blvd. • Suite 1850 • St. Louis, MO 63105 • Ph (314) 725-0800 • Fax (314) 725-4265
www.advantagecap.com

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

STANLEY SHIRAKI
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 & TECHNOLOGY
TESTIMONY REGARDING SB 2829
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 5, 2010
TIME: 1:30PM
ROOM: 016

This bill a new section proposes conforming to Section 45D, Internal Revenue Code, providing for a New Markets Tax Credit.

The Department of Taxation (Department) **opposes this measure because it has not been factored into the Executive Budget.**

I. NEW MARKETS TAX CREDIT, GENERALLY.

The purpose of the New Markets Tax Credit is to encourage investment in qualifying entities that provide business and economic development in targeted low-income communities. The tax credit is provided to the investors in these entities.

In order to claim the New Markets Tax Credit, the community development entity (CDE) must be certified at the federal level before the credits may be claimed. Once certified, the entities may apply to the United States Treasury Department for allocation of the credits. The Internal Revenue Code provides the aggregate amount of New Markets Tax Credits that can be allocated each year.

II. COMMENTS REGARDING THE PROPOSED HAWAII NEW MARKETS TAX CREDIT.

The Department has the following comments regarding a proposed conforming amendment to Section 45D, Internal Revenue Code—

Hawaii Connection—The Department opposes that this measure does not have a Hawaii connection. This measure should be amended to connect this credit activity with Hawaii. The intent of tax incentives paid out of the Hawaii treasury should be to provide benefits to entities that benefit Hawaii.

Recapture—To insure that the benefit to Hawaii remains in order to qualify for the credit, the bill needs to provide some form of recapture provisions. While section 45D of the Internal Revenue Code has recapture provisions, these provisions will not insure the connection to Hawaii.

Multiple Issue—This bill will allow multiple allocation amongst investors. The Department opposes decoupling from well-settled principles of partnership taxation. Though tax credits do not inherently have economic effect, credit allocations should follow something that does have economic effect. Moreover, there is added concern over the decoupling from partnership tax principles from experiences with the High Technology Business Investment Tax Credit under Act 221. Businesses abused the concept of allocating credits amongst partners, which led to law changes to reign-in wild allocations. The Department recommends eliminating this provision.

Limited Impact Program—The Department points out that this bill is far narrower than other New Markets Tax Credit proposals. This bill allows a credit only for those taxpayers that hold a federal claim. Though this may be simpler to administer, the Department raises the issue for the Committee because it could be that only one or two taxpayers in the entire State may qualify. When it appears that the general public cannot reasonably qualify, a tax credit begins to look more like a directed subsidy to those few that qualify. The Department suggests the Committee determine whether this is a strict "piggy back" credit or if a new "stand-alone" New Markets Tax Credit is desired.

Resources—Administration of the New Markets Tax Credit is extremely complex. Taxpayers need advice from experienced attorneys and consultants to apply and qualify for this credit. Likewise, in order to assure maximum compliance and minimize revenue leakage, the Department would need an unbudgeted appropriation to staff its compliance and legal offices with training on this federal tax credit. The New Markets Tax Credit is as complicated, if not more complicated than the state high technology credit; therefore additional personnel would be needed.

III. OPPOSED TO UNBUDGETED REVENUE LOSS

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.

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, New markets tax credit

BILL NUMBER: SB 2829

INTRODUCED BY: Sakamoto

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to provide that a taxpayer who holds a qualified equity investment on a credit allowance which occurs during the taxable year, may claim a credit equal to the applicable percentage of the amount paid to the qualified community development entity for the investment at its original issue. "Applicable percentage " means: (1) 5% with respect to the first three credit allowance dates; and (2) 6% with respect to the remainder of the credit allowance dates.

Tax credits in excess of a taxpayer's net income tax liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted. All claims for a tax credit under this section shall be filed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. Failure to properly and timely claim the credit shall constitute a waiver of the right to claim the credit. Requires the application for a new markets tax credit to be submitted to the director of taxation on forms prescribed by the director of taxation.

IRC section 469 (with respect to passive activity losses and credits limited) shall be applicable to the credit and all references to IRC section 45D, to the extent it is not inconsistent with this section, shall be operative for purposes of this section.

Amends HRS section 235-2.45(d) to provide that IRC section 704 (with respect to a partner's distributive share) shall be operative for purposes of this chapter; except that section 704(b)(2) shall not apply to allocations of new markets tax credits among partners.

Makes conforming amendments to HRS section 235-2.3.

EFFECTIVE DATE: Tax years beginning after December 31, 2009

STAFF COMMENTS: On the federal level, the new markets tax credit was adopted as part of the Community Renewal Tax Relief Act of 2000 (P.L. 106-554) to address the lack of capital available to businesses and economic development ventures in low-income communities. The new markets tax credit is provided to individuals or corporations that invest in community development entities working in low-income communities. The credit is equal to 5% of the investment in a qualified community development entity for the first three allowance dates and 6% of the investment for the next four allowance dates with the total amount of credit available equal to 30% of the investment over seven years.

This measure proposes to adopt a new markets tax credit for Hawaii income tax purposes. While the amounts of the credit parallels the federal amounts, it should be remembered that Hawaii generally does not adopt any of the credits on the federal level, except for the low-income housing tax credit, as Hawaii's income tax rates are not as onerous as those on the federal level.

It should be noted that in recent years, investors have shied away from the state low-income housing credits because there are much more generous state income tax credits available to the investor such as the high technology investment tax credit. Adding yet another state credit would merely detract from the low-income housing tax credit. Undoubtedly, affordable housing is one of the priorities for lawmakers. Thus, adopting a state version of the new markets tax credit merely dilutes the attractiveness of the low-income housing tax credit. While the new markets tax credit does help to subsidize commercial and retail facilities in a distressed community, given the unbridled use of tax credits to encourage certain business activities, it is questionable whether or not Hawaii's treasury can afford another hit at this time. When and until the legislature decides what is state government's priority, be it affordable housing, high technology development, alternate energy development, or agriculture, the uncontrolled issuance of back door subsidies is beyond the state's financial capacity.

What this proposal does represent is a lack of legislative understanding of what attracts capital investment to a low-income community and what it takes to retain that enterprise in the community. In some ways this proposal is the compliment of what the federal government did with its welfare programs of the 60's, designing model programs based on a particular city or town on the mainland and trying to replicate it throughout the nation. The cookie cutter approach, as many have learned, does not work. Buying into a federal income tax credit program designed to attract capital to a low-income community does not recognize the many unique hurdles that challenge such a venture in Hawaii.

Finally, it should be remembered that if this measure is adopted, moneys for the proposed tax credit will, no doubt, come out of the state's general fund and depending on the tax credit, will reduce the amount of available general funds without legislative intervention. These are funds that could be used to fund essential services or in the alternative reduce the tax burden on low and moderate-income families or the overall tax burden that plagues both families and businesses.

If it is the desire of the legislature to provide funding to revitalize economically depressed areas of the state, a direct appropriation would be preferable than adoption of the proposed measure. Better yet, lawmakers may want to look at ways to improve the overall business climate, from streamlining zoning and permitting to a reduction of the general excise tax on business-to-business transactions that will benefit all businesses in Hawaii.

Digested 2/4/10