SB 771

EDT

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SENATE COMMITTEE ON ECONOMIC DEVELOMPENT & TECHNOLOGY

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING SB 771 RELATING TO ECONOMIC RECOVERY

TESTIFIER:	**FREDERICK D. PABLO, INTERIM DIRECTOR OF TAXATION (OR DESIGNEE)**
COMMITTEE:	**EDT**
DATE:	**FEBRUARY 7, 2011**
TIME:	**1:15PM**
POSITION:	**SUPPORT INTENT; CONCERNED WITH COMPLEXITY**

This measure establishes a refundable Ohana residential housing income tax credit for qualified taxpayers who purchase a qualified principal residence on or after April 1, 2011, and before March 1, 2013. The credit is equal to 2% of the purchase price up to a maximum of $6,000 and is payable in two equal installments in the two taxable years following the purchase.

The Department of Taxation (Department) **supports the intent** of this policy; however has **concerns regarding the complexity of the provision**.

SUPPORT FOR CONSTRUCTION INDUSTRY—During current economic times, especially when the economy is beginning to rebound, incentives to stimulate certain industries, including the construction industry are important.

CONCERN OVER ADMINISTERING A 2-YEAR PAYOUT—The Department does not support that this credit is paid out over two years. With a cap at only $6,000, such an amount should be paid out once. Delaying the payout requires taxpayers and the government to maintain records and cross references to prior periods, which can lead to errors.

CONCERNS REGARDING "PURCHASE PRICE"— The stated credit is two percent of the purchase price of the residence, excluding land acquisition costs and escrow closing costs, up to a maximum credit of $6,000. Since land costs are not generally separately stated in a sales agreement, the Department envisions that taxpayers will attempt to limit the portion of the purchase price allocable to the land so as to maximize the amount of credit. The Department anticipates time consuming audits and litigation over the fair value of the land in any sales contract subject to the credit.

CONCERN WITH ADJUSTED GROSS INCOME DETERMINATION— The measure provides for income limitations based on adjusted gross income. Although it appears that the intent was to use federal adjusted gross income for measuring income qualification, the measure does not specifically so provide and the default would thereby be Hawaii adjusted gross income. It should be noted that social security benefits and many pension payments are not subject to Hawaii income tax and is therefore excluded from Hawaii adjusted gross income. The end result would be that some taxpayers may be eligible for the credit if Hawaii adjusted gross income is used but would not be if federal adjusted gross income were used. The inclusion of a grantor of a trust in the adjusted gross income limitation is confusing.

CONCERN WITH SPLIT IN CREDIT—This bill provides that, where multiple persons contribute to the purchase of a property, the credit is to be allocated evenly. The Department suggests that the credit should follow economics and be allocated pursuant to each purchaser's proportionate contribution to the purchase price. Why should someone who's name is placed on the deed, but pays no money, receive the credit?

NOT FACTORED INTO BUDGET—The Department must be cognizant of the biennium budget and financial plan. This measure has not been factored into either.

REVENUE IMPACT & METHODOLOGY—This measure will result in a revenue loss of approximately $15.5 million in FY 2012; $15.5 million in FY 2013 and $8.0 million in FY 2014.

The AGI eligibility requirements would be met by more than 90% of Hawaii taxpayers. The old residential construction and remodeling tax credit cost about $13 million per year. That credit was not refundable, included costs of remodeling, and did not have occupancy requirements. Also, the old credit was for 4% of eligible remodeling costs and had a lifetime cap of $250,000 on eligible costs per residential unit. This translates into a cap for the credit of $10,000 per residential unit. The lower cap, lower rate and restriction to new construction for the new credit are probably offset by the fact that the new credit will be refundable. On average from 2004 through 2009, permits were issued for new single family units at an average rate of 4,400 per year, new duplex units at an average rate of 275 per year, and new apartment units at an average rate of 2,300 per year. The numbers for 2009 are considerably lower, however. Also, not all permits are executed. Therefore, for purposes of the RIS, it is assumed that eligible single-family residences from new house and duplex construction will average 2,500 per year and that new apartments will average 1,000 per year. Thus, assuming the credit per housing and duplex unit averages $5,000 and for apartment units averages $3,000, the revenue cost of the bill would be $15.5 million per year (= 2,500 X $5,000 + 1,000 X $3,000).

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Ohana residential housing income tax credit

BILL NUMBER: SB 771; HB 369 (Identical)

INTRODUCED BY: SB by Fukunaga, Chun Oakland, Ige, 2 Democrats and 1 Republican; HB by McKelvey

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow a qualified taxpayer to claim an ohana residential housing income tax credit equal to the lesser of: (1) 2% of the purchase price of the qualified principal residence; or (2) $6,000 provided that the tax credit shall be payable in two equal installments over two consecutive taxable years beginning with the taxable year in which the binding contract to purchase the qualified principal residence is signed. If more than one qualified taxpayer claims the tax credit, then the applicable tax credit shall be divided equally between each qualified taxpayer. Stipulates that for purposes of this measure a married couple is considered to be one qualified taxpayer. The tax credit shall be limited to qualified principal residences with a purchase price of $625,000 or less.

A "qualified taxpayer" is an individual that signs a binding contract to purchase a qualified principal residence on or after April 1, 2011, and before January 1, 2013; provided that the individual closes on the purchase of their newly constructed principal residence on or after April 1, 2011 and before March 1, 2013. Further provides that a qualified taxpayer shall be: (1) an individual with adjusted gross income of $75,000 or less; (2) a married couple with adjusted gross income of $150,000 or less; or (3) a grantor of any trust with adjusted gross income of $75,000 or less. A "qualified principal residence" is a principal residence that is a newly constructed principal residence, whether detached or attached, that: (1) received a certificate of completion on or after April 1, 2011; (2) is used by the taxpayer as the taxpayer's principal residence for the immediately following two years; and (3) is eligible for the homeowner's exemption. Defines "newly constructed principal residence" as a dwelling or residential unit that did not previously exist and that will result in a new structure that will be built from the ground up. A newly constructed principal residence includes a single-family home, duplex, condominium, manufactured home, or townhouse.

If a qualified taxpayer sells or no longer uses the qualified principal residence as the taxpayer's principal residence within 730 days after closing on the qualified principal residence, then the taxpayer shall be subject to recapture of the credit on a pro-rata, dollar-for-dollar basis.

Credits in excess of a taxpayer's income tax liability shall be refunded provided such amount is over $1. Requires all claims for a tax credit, including amended claims, shall be filed on or before the end of the twelfth month following the close of the taxable year for which the tax credit may be claimed. Failure to comply with the foregoing provision shall constitute a waiver of the right to claim the tax credit. Directs the director of taxation to prepare the necessary forms to claim a credit, may require the taxpayer to furnish information to validate a claim for credit, and adopt rules pursuant to HRS chapter 91.

Also defines "principal residence" and "purchase price" for purposes of the measure.

EFFECTIVE DATE: Tax years beginning after December 31, 2010

STAFF COMMENTS: This measure proposes to establish a state income tax credit to encourage taxpayers to purchase a newly constructed principal residence costing up to $625,000. Unlike the federal tax credit that allows the purchase of any type of new or existing residence, this proposed credit is applicable to only newly constructed residences and is not applicable to any land acquisition costs.

It should be noted 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. As proposed by this measure, this credit amounts to nothing more than a depletion of state funds as there is no obvious undue burden of taxes. As such, the tax credit proposed by this measure violates the integrity of the tax system setting a precedent with bad tax policy. 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.

While the adoption of this measure would appear to be politically motivated, adoption is unrealistic as there is no limit to the dollar amount of credits that may be paid out and it is questionable whether the state can afford to divert revenues needed for essential programs and services to assist taxpayers in acquiring a newly constructed residence.

Note well that this is a refundable credit, that is any credit amount in excess of the taxpayer's liability will be refunded to the taxpayer, a payment directly out of the general fund. At a time when the state is faced with the worst shortfall in its history, it makes little sense to adopt another "back door" expenditure of state general funds. While the federal government may be able to afford such a credit, it can do so only because it can print more money and run trillion dollar deficits. The state, unfortunately, must maintain a balanced budget. This measure merely contributes to a much larger shortfall.

It is doubtful that a tax credit of this magnitude will spur the construction of new housing as long as the credit markets remain frozen. Home buyers are reporting the slow pace of financing as financial institutions exercise increased caution in making home loans in the wake of the subprime debacle which brought the financial industry to its knees along with the national economy. While there is indeed demand for more housing, getting the financing to secure that home is proving to be a challenge. Until the credit markets thaw, financing a home purchase, let alone a new home purchase, will be challenging.

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February 4, 2011

The Honorable Carol Fukunaga, Chair
Senate Committee on Economic Development & Technology
State Capitol, Room 016
Honolulu, Hawaii 96813

RE: S.B. 771 Relating to Economic Recovery

HEARING: Monday, February 7, 2011 at 1:15 p.m.

Aloha Chair Fukunaga, Vice Chair Wakai and Members of the Committee:

I am Myoung Oh, Government Affairs Director, here to testify on behalf of the Hawai‘i Association of REALTORS® ("HAR"), the voice of real estate and its 8,500 members in Hawai‘i. HAR **supports** S.B. 771 which establishes a refundable ‘ohana residential housing income tax credit for qualified taxpayers that purchase a qualified residence.

In February 2009, President Obama signed into law the American Recovery and Reinvestment Act. This measure provided an $8,000 tax credit for first-time home buyers on the purchase of their principal residence on or after January 1, 2009 and before December 1, 2009. In November 2009, Congress extended the home buyer tax credit through April 2010, and expanded the tax credit of up to $6,500 to include long time homeowners who purchase a new home.

Although the federal tax credit expired in April 2010, HAR believes that S.B. 771 will help stimulate the construction industry, to the extent that it will apply to all newly constructed principal residences completed after April 1, 2011, and before January 1, 2013.

Mahalo for the opportunity to testify.

BIA-HAWAII

BUILDING INDUSTRY ASSOCIATION

February 7, 2011

LATE

Senator Carol Fukunaga, Chair
Committee on Economic Development and Technology
State Capitol, Room 016
Honolulu, Hawaii 96813

RE: SB771 "Relating to Economic Recovery"

Dear Chair Fukunaga and Members of the Committee on Economic Development and Technology:

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 supports the passage of SB771 "Relating to Economic Recovery". SB771 establishes a refundable ohana residential housing income tax credit for qualified taxpayers that purchase a qualified principal residence on or after April 1, 2011, and before January 1, 2013, that is payable to the qualified taxpayer in two equal installments over the immediately following two taxable years.

The construction industry is one of the hardest hit segments of the economy and any measure of support for increasing the number of homes built in the near future will help. While the UHERO forecast indicated growth in our industry, we will still be unable to all or even a significant portion of the workers laid off due to the bad economy. The fact that the proposed housing income tax credit will be paid in the immediately following two years would be encouraging to buyers. We therefore express our support for this measure.

Thank you for the opportunity to share our views with you. Thank you also for including our industry in the Small Business Committee established last year.

Karen T. Nakamura

Chief Executive Officer

BIA=Hawaii

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LATE

February 7, 2011

Senator Carol Fukunaga, Chair and Senator Glenn Wakai, Vice Chair
Committee on Economic Development & Technology

Testimony of the Land Use Research Foundation of Hawaii in support of SB 771, Relating to Economic Recovery. (Establishes onetime tax credit for new home purchase payable over two years)

Monday, February 7, 2011 at 1:15 p.m. in CR 016

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 appreciates the opportunity to provide our testimony **in support of the SB 771** which establishes a refundable ohana residential housing income tax credit for qualified taxpayers who purchase a qualified principal residence, on or after April 1, 2011, and before January 1, 2013, that is payable to the qualified taxpayer in two equal installments over the immediately following two taxable years.

SB 771. This bill establishes a refundable Hawaii residential housing income tax credit for qualified taxpayers who purchase a qualified principal residence defined as "residence in the State where the individual lives for more than 270 days", on or after April 1, 2011, and before January 1, 2013. The tax credit is payable to the qualified taxpayer in two equal installments over the immediately following two taxable years. The bill's effective date is December 1, 2010. This bill is similar to the State of California's legislation effective May 1, 2010, which allocated $100 million for state tax credits to buyers of new, unoccupied homes. See more about California's new law below and on attached article from *Sacramento Bee*.

Background. In 2009 Senate Concurrent Resolution No. 132, S.D. 1 (2009) (SCR 132, SD1), established a Construction Industry Task Force to determine the economic contributions of the construction industry in Hawaii. As directed in the SCR 132, SD1 the Task Force developed a series of proposals for state actions to preserve and create new jobs in the local construction industry. This bill was introduced in the 2009 session as SB 2578 and the intent of the bill was to implement one of the Task Force's proposals.

Similarly, in 2010 this Committee and the house committee on economic revitalization, business, and military affairs convened an informal small business discussion group to address the most critical issues facing the small business sectors. This bill is a product of that working group which included representatives from the business sector, construction and trade industries, food and restaurant industries, retailing, the science and technology sector, the commercial transportation industry and interested stakeholders.

Accordingly, the purpose of this bill is to establish a refundable state income tax credit that is similar to the federal income tax credit but limits the tax credit to qualified taxpayers who purchase a qualified residence on or after April 1, 2011, and before January 1, 2013.

Moreover, the lack of affordable housing remains a significant problem affecting Hawaii. This bill will assist those first time homebuyers who want to own their own home and invest in their futures. 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 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. **SB 771 <u>supports</u>** the legislative recommendations of that task force.

There is an immense need for funding of affordable housing and the issuance of general obligation bonds to create infrastructure for affordable housing is in the public interest and general welfare of the state.

<u>LURF's Position</u>. LURF supports this bill because it will incentivize those investing in a new home and will allow these homebuyer's to qualify for a tax credit similar to the federal tax credit. Last year, the State of California and Governor Arnold Schwarzenegger implemented a similar tax credit plan and the results are telling. <u>See</u> attached article. In the article, Assemblywoman Anna Caballero says "[t]his tax credit has a *Sacramento Bee* proven track record. California's construction industry reported a 39 percent increase in building permits after the first round of tax credits began in March 2009 and proved even more popular than expected." Governor Schwarzenegger said in his January 2010 State of the State Address that the proposed housing stimulus would "help revive the California economy. The new tax credit would take effect one day after expiration of a federal $8,000 tax credit for first time homebuyers."

This bill would be a local version created at a minimum to fill that impeding Federal void would greatly assist our ability to continue to move our housing projects forward on the islands of Hawaii, Oahu and Maui.

There is an immense need for funding of affordable housing and the issuance of general obligation bonds to create infrastructure for affordable housing is in the public interest and general welfare of the state.

LURF is in **<u>support</u>** of SB 771, we respectfully urge your favorable consideration. The opportunity to present our testimony regarding this matter is greatly appreciated.