



**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT & TOURISM**

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Statement of
RICHARD C. LIM
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Department of Business, Economic Development, and Tourism
before the

HOUSE COMMITTEE ON ECONOMIC REVITALIZATION & BUSINESS

Tuesday, February 07, 2012

8:30 a.m.

State Capitol, Conference Room 312

in consideration of
HB 2239
RELATING TO TAXATION.

Chair McKelvey, Vice Chair Choy and Members of the House Committee on Economic Revitalization & Business.

The Department of Business, Economic Development, and Tourism (DBEDT) offers the following comments regarding House Bill 2239, which seeks to establish the small business investment tax credit program under DBEDT.

We appreciate the over-all concept of this bill but we are concerned about the cost implications generated by this proposal. Furthermore, due to budget cuts and reductions-in-force, DBEDT does not have the resources or core competency to administer the small business investment tax credit. We defer to the appropriate agency to determine the tax revenue implications of this bill.

Thank you for the opportunity to offer these comments.

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SUBJECT: INCOME, Small business investment tax credit

BILL NUMBER: HB 2239

INTRODUCED BY: Ward, Ching, 1 Democrat and 1 Republican

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow a taxpayer to claim a tax credit equal to 10% of the taxpayer's qualifying investment in a small business enterprise provided that: (1) the taxpayer may claim a credit upon the conclusion of the holding period of the qualifying investment for which a credit is claimed; and (2) the total amount of tax credits claimed under this section by a taxpayer shall not exceed \$5 million per taxable year.

Defines "small business enterprise" as a corporation, pass-through entity, or other person: (1) that has assets that do not exceed \$50 million or annual sales that do not exceed \$10 million; (2) that employs at least 50 full-time employees in the state for whom the enterprise is required to withhold taxes under HRS section 235-61 or more than one-half of the enterprise's total number of full-time employees employed in the United States are employed in this state and are subject to the withholding requirement; and (3) the enterprise, within six months of the taxpayer's qualifying investment, invests in or incurs cost for one or more of the following in an amount equal to or greater than the amount of the qualifying investment: (A) tangible personal property, other than motor vehicles operated on public roads and highways, used in business and physically located in the state from the time of its acquisition by the enterprise until the end of the investor's holding period; (B) motor vehicles operated on public roads and highways; provided that, from the time of acquisition by the enterprise until the end of the investor's holding period, the motor vehicles are: (i) purchased in the state; (ii) registered in the state; (iii) used primarily for business purposes; and (iv) necessary for the operation of the enterprise's business; (C) real property located in the state that is used in business from the time of its acquisition by the enterprise until the end of the holding period; (D) intangible personal property used in business primarily in the state, from the time of its acquisition by the enterprise until the end of the holding period; (E) compensation for new employees of the enterprise for whom the enterprise is required to withhold taxes under section 235-61.

Defines "holding period" as: (1) for qualifying investments made on or after July 1, 2012, but before July 1, 2014, the two-year period beginning on the day the investment was made; and (2) for qualifying investments made on or after July 1, 2014, the five-year period beginning on the day the investment was made. Defines "qualifying investment" as an investment of money made on or after July 1, 2012, to acquire capital stock or other equity interest in a small business enterprise and shall not include any investment of money the taxpayer derives, directly or indirectly, from a grant or loan from the federal government, the state, or a political subdivision.

Delineates requirements to obtain a business investment certificate from the department of business, economic development and tourism (DBEDT) as a prerequisite to claim the tax credit. Upon each determination, DBEDT shall issue a certificate to the taxpayer verifying the qualifying investment

amounts and the credit amount certified. The taxpayer shall file the certificate with the taxpayer's tax return for the taxable year that a credit under this section is properly claimed with the department of taxation. The annual amount of certified credits shall not exceed \$50 million in the aggregate.

Credits in excess of a taxpayer's income tax liability shall be applied to subsequent tax liability until exhausted. Claims for the credit, including any amended claims, must be filed on or before the end of the twelfth month following the close of the taxable year. The director of taxation may adopt rules pursuant to HRS chapter 91 and prepare the necessary forms to claim the credit and may require proof of the claim for the credit. In the case of a partnership, S corporation, estate, or trust, the tax credit allowable is for every qualifying investment in a small business enterprise. The cost upon which the tax credit is computed shall be determined at the entity level. Distribution and share of credit shall be determined pursuant to section 235-110.7(a).

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: It appears that this measure is intended to provide an incentive in the form of an income tax credit to encourage taxpayers to make investments in a small business enterprise. While the effort is commendable, it fails to recognize that investments are made with the prospect that the venture will yield a profit. If the prospects for making a profit are absent, no amount of tax credit will attract investment. People do not invest to lose money. Unfortunately, Hawaii's tax and regulatory environment have proven to be a difficult one in which to make a profit and until that environment is improved, the investment outlook will continue to remain bleak.

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 intent of the measure is to entice taxpayers to make investments in a small business enterprise, it should be remembered that all businesses regardless of size would welcome any qualifying investment in their business.

As proposed, the adoption of this measure may result in a recordkeeping nightmare. Since the credit may not be claimed by the taxpayer until after a holding period, records must be maintained and verified after the holding period. Another provision that must be verified is the time wherein the small business enterprise makes an expenditure or investment from a qualifying investment since the measure specifies that an expenditure or investment must be done within six months of a qualifying investment.

Finally, 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. The proposed investment tax credit amounts to nothing more than a partial subsidy of state funds as there is no obvious undue burden of taxes that is to be addressed.

If the intent of this proposal is to encourage and support small business enterprises in Hawaii, then the focus should be on the hurdles that stand in the way of small businesses, from the cost of permitting to the cost of compliance, to the deluge of paperwork with which a small business owner must cope. These are but a few of the factors that work against the establishment and survival of small businesses in Hawaii.

Digested 2/6/12