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## LATE TESTIMONY

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To: The Honorable Angus L. K. McKelvey, Chair  
and Members of the House Committee on Economic Revitalization and Business

Date: Tuesday, February 7, 2012

Time: 8:30 a.m.

Place: Conference Room 312, State Capitol

From: Frederick D. Pablo, Director  
Department of Taxation

Re: H.B. No. 2239 Relating to Taxation

The Department of Taxation (Department) opposes this measure.

H.B. 2239 establishes a tax credit for certain investments in a small business enterprise equal to ten per cent of a qualifying investment. The credit is taken at the end of a required holding period, and monies generated by the investment can be used for only certain enumerated items.

The Department believes that the administration of this measure will be very problematic. The measure defines a small business as one that under Generally Accepted Accounting Principles (GAAP) has assets not exceeding \$50 million or sales not exceeding \$10 million. GAAP is a series of complex rules which have developed over time on how to account for various transactions, and requires a company to make various assumptions that affect the reported amounts of assets, liabilities, income and expenses in any given reporting period. GAAP allows a range of reasonable treatments, leaving the choice among alternatives to management. GAAP is not a codification in law and is required only when an entity is publicly traded.

Financial accounting and tax accounting are distinct systems of reporting information. Where tax and GAAP provisions differ, provisions of the Internal Revenue Code or regulations prevail over GAAP. In Thor Power Tool Co. v. Commissioner, 439 U.S. 522, 542 (1979), the Supreme Court emphasized the primary goal of financial accounting is to provide useful information to management, shareholders, creditors, and others interested parties and the major responsibility of the accountant is to protect these parties from being misled. The primary goal of the income tax system, in contrast, is the equitable collection of revenue and the major responsibility of the Internal Revenue Service (IRS) is to protect the public's interest.

The IRS does not require the use of GAAP except for certain information returns that must be prepared for U.S. owned foreign corporations, foreign partnerships and foreign disregarded entities. Small privately owned businesses are not required to maintain their books according to GAAP and do not do so because of the enormous cost required, since two sets of books will be required: one for tax income and one for book (accounting) income. For the Department to make

the determinations necessary to see if a company is a qualified business would require extensive reworking of the tax accounting data and require substantial audit time, with an inevitable appeal if it is determined against the taxpayer.

The measure requires the small business to use the funds invested within six months of the investment in various allowed expenditures, including the purchase of tangible personal property and motor vehicles used in this State. This would allow the small business entity to claim the capital goods excise tax credit at the same time that the investor is allowed the tax credit for the investment.

The measure also would allow for the employment of related parties at inflated salaries, allow for the opening and closing of businesses purely to generate additional tax credits, and permit numerous related party transactions. The language is so broad, that tax credit could be claimed without generating any real underlying economic activity or benefit to the State.

Thank you for the opportunity to provide comments.