

# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Agricultural tax credits

BILL NUMBER: HB 2668, SD-1

INTRODUCED BY: Senate Committee on Agriculture

**BRIEF SUMMARY: Livestock feed tax credit** - Adds a new section to HRS chapter 235 to allow a qualified producer to claim a livestock feed income tax credit equal to the lesser of 15% of the livestock feed costs incurred by the producer or \$200,000. Defines “livestock feed costs” as the purchase amount of all edible materials consumed by a qualified producer’s cows, goats, poultry, sows, and beef cattle which contribute energy or nutrients to the animal’s diet and which are distributed or imported.

No other income tax credit may be claimed for qualified livestock feed costs for which a credit is claimed under this section for the taxable year. The cost upon which the tax credit is computed shall be determined at the entity level. In the case of a partnership, S corporation, estate, trust, or other pass through entity, distribution and share of the credit shall be determined pursuant to section 704(b) of the Internal Revenue Code. If a deduction is taken under section 179 (with respect to election to expense certain depreciable business assets) of the Internal Revenue Code, no tax credit shall be allowed for that portion of the qualified livestock feed cost for which a deduction was taken. The basis of eligible property for depreciation or accelerated cost recovery system purposes for state income taxes shall be reduced by the amount of credit allowable and claimed under this section. No deduction shall be allowed for that portion of otherwise deductible qualified livestock feed costs on which a credit is claimed under this section.

Credits in excess of a taxpayer’s income tax liability shall be refunded provided such amounts are in excess of \$1. 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 claim for the credit. Claims for the credit shall be on forms provided by the department of taxation.

Requires the department of agriculture to: (1) maintain records of the total amount of qualified livestock feed costs for each taxpayer claiming a credit; (2) verify the amount of the qualified livestock feed costs claimed; (3) calculate all livestock feed costs claimed; and (4) certify the total amount of the tax credit for each taxable year. The department shall issue a certificate to the taxpayer verifying the livestock feed costs and the credit amount certified for each taxable year. Requires the taxpayer to file the certificate with the taxpayer’s tax return with the department of taxation. This information shall be available for public inspection and dissemination under HRS chapter 92F.

If in the taxable year beginning after December 31, 2011, the annual amount of certified credits claimed under this section reaches \$1,500,000 in the aggregate, the department of agriculture shall immediately discontinue certifying credits and shall notify the department of taxation of the discontinuation.

Defines “qualified producer” as any person in the business of producing: (1) milk from a herd, located in the state, of not fewer than 350 cows or 100 lactating milking goats; (2) poultry products from a flock, raised and located in the state of at least 50 birds; (3) pork from a herd, raised and located in the state, of at least 50 sows; or (4) beef that is raised in the state; provided that producers who finish at least 100 head of beef cattle annually shall be eligible for this tax credit.

This section shall take effect on January 1, 2012 and be applicable to tax years beginning after December 31, 2011 and ending before January 1, 2013.

**Livestock feed development tax credit program** - Adds a new section to HRS chapter 235 to allow each qualified producer to claim a livestock feed development tax credit equal to: (1) 10% of livestock feed development costs incurred by the qualified producer, or \$225,000, for livestock feed development costs incurred by the qualified producer during the taxable year ending before January 1, 2014; and (2) the lesser of 5% of livestock feed development costs, or \$225,000, for the taxable year ending before January 1, 2015. Defines “feed development costs” as the purchase amount of materials or equipment needed to produce edible materials consumed by the qualified producer’s cows, goats, poultry, sows, and beef cattle, which contribute energy or nutrients to the animal’s diet, including seeds, fertilizer, insecticides, and fungicides used for the purposes of producing feed.

Requires the department of agriculture to: (1) maintain records of the total amount of qualified agriculture expenditures for livestock feed development for each taxpayer claiming a credit; (2) verify the amount of the livestock feed development costs claimed; (3) calculate all livestock feed development costs claimed; and (4) certify the total amount of the tax credit for each taxable year. The department shall issue a certificate to the taxpayer verifying the taxpayer’s qualifying producer status, the amount of qualified livestock feed development costs claimed and the credit amount certified for each taxable year. Requires the taxpayer to file the certificate with the taxpayer’s tax return with the department of taxation. This information shall be available for public inspection and dissemination under HRS chapter 92F.

If in the taxable year beginning after December 31, 2011, the annual amount of certified credits claimed under this section reaches \$500,000 in the aggregate, the department of agriculture shall immediately discontinue certifying credits and shall notify the department of taxation of the discontinuation.

No other income tax credit may be claimed for qualified livestock feed development costs for which a credit is claimed under this section for the taxable year. The cost upon which the tax credit is computed shall be determined at the entity level. In the case of a partnership, S corporation, estate, trust, or other pass through entity, distribution and share of the credit shall be determined pursuant to section 704(b) of the Internal Revenue Code. If a deduction is taken under section 179 (with respect to election to expense certain depreciable business assets) of the Internal Revenue Code, no tax credit shall be allowed for that portion of the qualified livestock feed cost for which a deduction was taken. The basis of eligible property for depreciation or accelerated cost recovery system purposes for state income taxes shall be reduced by the amount of credit allowable and claimed under this section. No deduction shall be allowed for that portion of otherwise deductible qualified livestock feed development costs on which a credit is claimed under this section.

Credits in excess of a taxpayer's income tax liability shall be refunded provided such amounts are in excess of \$1. 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. Claims for the credit shall be on forms provided by the department of taxation.

This section shall take effect on January 1, 2013, and be applicable to tax years beginning after December 31, 2012 and ending before January 1, 2015.

**Important agricultural land qualified agricultural cost tax credit** - Amends HRS section 235-110.3 to allow a taxpayer claiming the important agricultural land qualified agricultural cost tax credit to claim an additional refundable tax credit of 15% of the qualified credit amount received for expenditures for drought mitigation projects providing water for lands, the majority of which, excluding lands classified as conservation lands, are important agricultural lands.

The department of agriculture shall discontinue certifying tax credits if in any taxable year the annual amount of certified credits reaches the following: (1) \$5 million for the taxable year ending before January 1, 2013; (2) \$7 million per taxable year for the taxable years beginning after December 31, 2012, and ending before January 1, 2016; and (3) \$7.5 million per taxable year for all other successive taxable years.

This section shall apply to the tax years beginning after December 31, 2011 and ending before January 1, 2021 provided that on January 1, 2021, this section shall be repealed and HRS section 235-110.93 shall be reenacted in the form in which it read on the day prior to the effective date of this act.

EFFECTIVE DATE: Upon approval as noted

STAFF COMMENTS: This measure proposes income tax credits that may be used to: (1) offset costs of livestock feed in the amount of 15% or \$200,000, whichever is less; and (2) offset costs incurred by a qualified producer for livestock feed development costs incurred in the amount of 10% or \$225,000, whichever is less. Since these credits would be granted without regard to the taxpayer's need for tax relief, the adoption would merely result in a payout of state funds for these feed costs and it would do so at the expense of other taxpayers who do not qualify for any of the credits. It should be remembered that tax credits generally are designed to alleviate an undue burden on those who are unable to carry that burden, largely the poor and low income. If the intent of the legislature is to subsidize such operations, then an appropriation of general funds would be much more accountable and transparent. Taxpayers would know how much is being spent on the program and compare it with other public services and programs with respect to importance to the health and safety of the community.

Rather than merely handing out a tax preference where there is no indicator of financial or economic need for that tax break, state government should explore ways to support farmers in not only making important agricultural lands available for rent at reasonable costs, but also insure that the crops produced command a reasonable rate of return with such skills as marketing, packaging and distribution.

This measure would also provide that taxpayers that qualify for the important agricultural land qualified agricultural cost tax credit under HRS section 235-110.93, shall receive an additional tax credit of 15% of such amount if they have expenditures for drought mitigation projects which provide water for

important agricultural lands. While Act 233, SLH 2008, adopted various incentives to encourage the agricultural use of lands which qualify as important agricultural lands, it should be remembered that the tax system is not an efficient method to accomplish such social goals. Since the proposed measure would grant preferential treatment to an even more select group of taxpayers at the expense of other taxpayers who are ineligible for the exemption, its enactment cannot be justified.

If the ultimate goal is to perpetuate agricultural activity, then the problem needs to be approached from the opposite end, that is, what can state government do to support and encourage agricultural activity so that farmers can earn a profitable living farming the land? To date, all state government has done is to stand in the way of successful farming enterprises by burdening farmers with regulation upon regulation. The state has to be a part of the solution and not a part of the problem. Enacting tax incentives, as this measure proposes, does not address the problems faced by farmers today and in the future.

From a planning point of view, because the designation of important agricultural lands is being left up to the landowner who happens to be engaged in agricultural activity basically on a commercial scale, it precludes taking a holistic approach to the future of Hawaii. Instead of being able to step back and decided what the current and future needs of the people of Hawaii are and will be, there will be a willy-nilly approach to land use planning. Instead of policymakers setting directions for the future, they are throwing out carrots of tax incentives so they can abdicate their responsibility for setting land use planning priorities. Even the Final Report on Incentives for Important Agricultural Land would have preferred that important agricultural lands been designated, but acknowledges that no policymaking body has had the will, if not the courage, to undertake the task in the more than 30 years since that amendment was added to the constitution. Thus, this proposal is not only fiscally irresponsible, but it is a demonstration of how elected officials shrink from their responsibility to make a decision.

It is interesting to note that the measure sets aggregate ceilings on the amount that may be handed out or certified, \$1.5 million in the case of the livestock feed tax credit; \$0.5 million in the case of the livestock feed development tax credit; and \$5 million to \$7.5 million in the case of the important agricultural land tax credit. No doubt this is an effort to limit the amount of revenue loss and it would appear that certification would be issued on a first come, first serve basis. If such is the case, then the credit does not recognize the merit of the agricultural operation or research. Thus, the “reward” of the tax credit may be handed out to an operation that has no prospect of succeeding or producing research that will actually benefit future agricultural activity. Lawmakers may want to rethink how the credit is granted and set qualifying criteria that would help to prioritize the recipients.

Digested 3/28/12

**HB 2668 HD2 SD1  
RELATING TO AGRICULTURE**

**PAUL T. OSHIRO  
MANAGER – GOVERNMENT RELATIONS  
ALEXANDER & BALDWIN, INC.**

**MARCH 29, 2012**

Chair Ige and Members of the Senate Committee on Ways & Means:

I am Paul Oshiro, testifying on behalf of Alexander & Baldwin, Inc. (A&B) and its agricultural company Hawaiian Commercial & Sugar Company on HB 2668 HD2 SD1, “A BILL FOR AN ACT RELATING TO AGRICULTURE.” We support this bill.

After over twenty five years of debate, negotiation, and compromise, the IAL Law and process was finally enacted in July 2008. After years of pursuing a land-use approach to this constitutional mandate, the IAL Law that was successfully passed (Act 183 (2005) and Act 233 (2008)) was premised on the principle that the best way to preserve agricultural lands is to preserve agricultural businesses and agricultural viability. As such, the IAL Law not only provides the standards, criteria, and processes to identify and designate important agricultural lands to fulfill the intent and purpose of Article XI, Section 3 of the Hawaii State Constitution, it also provides for a package of incentives designated to support and encourage sustained, viable agricultural activity on IAL. With the enactment of this comprehensive package of IAL incentives, the long awaited IAL identification and designation process was finally started in July 2008.

The IAL Law authorizes the identification and designation of IAL in one of two ways --- by voluntary petition to the State Land Use Commission by the landowner or

farmer; or subsequently by the Counties filing a petition to designate lands as IAL pursuant to a County identification and mapping process. In either case, the LUC determines whether the petitioned lands qualify for IAL designation pursuant to the standards, criteria, objectives, and policies set forth in the IAL Law. To date, the IAL Law has resulted in the designation by the LUC of over 89,000 acres of agricultural lands as IAL from voluntary petitions by Alexander & Baldwin, Parker Ranch, Castle & Cooke, and Mahaulepu (Grove) Farm. We believe that additional acres will be designated through the voluntary landowner and County petition process in the years to come.

This bill establishes a tax credit for drought mitigation projects that service important agricultural lands. We believe that this tax credit will assist IAL agricultural operations in the development and effective utilization of drought mitigation infrastructure and facilities to enhance the cost effective irrigation of their crops and livestock. In addition, these drought mitigation projects will also assist in providing much needed irrigation water for these IAL agricultural operations during dry weather periods, which will add to the long term viability and sustainability of their operations.

Based on the aforementioned, we respectfully request your favorable consideration on this bill.

Thank you for the opportunity to testify.