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Subject: Tax Foundation Testimony
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TRANSMISSION OF TESTIMONY

DATE: Monday, February 7, 2011

TO: House Committee on Economic Revitalization & Business

FROM: Tax Foundation of Hawaii

Total Pages 1

FOR: Rep. Angus McKelvey, Chair

Testifier: Lowell L. Kalapa, President - Tax Foundation of Hawaii

(Mr. Kalapa will not appear in person at the hearing.)

Date of Hearing - Tuesday, February 8, 2011

Position: Comments

Time of Hearing - 8:00 am

HB 962, Proposed HD-1 - Relating to Economic Development (1 page)

Number of copies - 4

Thank you.

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SUBJECT: INCOME, Adopt small business expensing

BILL NUMBER: HB 962, Proposed HD-1

INTRODUCED BY: House Committee on Economic Revitalization and Business

BRIEF SUMMARY: Amends HRS section 235-2.4 (l) to provide that Internal Revenue Code (IRC) section 179 (with respect to the election to expense certain depreciable assets) shall be operable for state income tax purposes.

EFFECTIVE DATE: Tax years beginning after December 31, 2010

STAFF COMMENTS: The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (PL 111-312) provides that when the \$500,000 expensing rules applicable to tax years beginning in 2010 and 2011 expire, up to \$125,000 may be expensed by a qualifying taxpayer up to a limit of \$500,000 in 2012. These amounts are indexed for inflation. In 2013, the amounts will decrease to \$25,000 worth of assets with phase outs starting at \$200,000 of asset acquisitions.

It should be noted that not all provisions of IRC section 179 have been adopted by the legislature in the past since the adoption was estimated to have cost the state substantial revenues. At the federal level the intent of providing the expensing of certain depreciable assets is to spur economic activity as the current recession began its onslaught in 2007. Had Hawaii adopted these provisions at the time they became effective for federal tax purposes, causes one to wonder if some of the economic decline in Hawaii could have been avoided. What is known is that by not conforming to the federal provisions for expensing, local companies have had to maintain two sets of books in order to keep track of the depreciable value of assets. This runs contrary to the goal of conformity, that is to minimize differences in the definition of income for federal and state tax purposes.

However, on a relative basis had the state adopted these provisions to expense depreciable property, the revenue impact estimated to be about \$3.1 million in 2008 would have been paltry by comparison to the loss of revenues as a result of the Act 221 tax credits. Further, these provisions would have applied to all businesses and not just one segment of the economic base. Thus, lawmakers must weigh the adoption of this measure carefully. On one hand there is the loss of revenues and on the other hand the potential for stimulating investment and the creation of news jobs.

It should be noted that a number of Code amendments in the last few years focused on incentives to help jump start the economy with a variety of tax credits. Generally, Hawaii does not adopt these tax credits for state income tax purposes as these credits are a direct reduction of tax liability. Since federal tax rates are higher than state income tax rates, these credits are usually much more generous than what Hawaii can afford.

Digested 2/7/11