SB 769

NEIL ABERCROMBIE
GOVERNOR

BRIAN SCHATZ
LT. GOVERNOR

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SENATE COMMITTEE ON TOURISM

TESTIMONY OF THE DEPARTMENT OF TAXATION
REGARDING SB 769
RELATING TO ECONOMIC RECOVERY

*****WRITTEN TESTIMONY ONLY*****

TESTIFIER:	**FREDERICK D. PABLO, INTERIM DIRECTOR OF TAXATION (OR DESIGNEE)**
COMMITTEE:	**TSM**
DATE:	**FEBRUARY 15, 2011**
TIME:	**1:30PM**
POSITION:	**SUPPORT INTENT; CONCERN FOR COSTS**

This measure provides a nonrefundable hotel and resort remodeling and renovation tax credit of 7% or 10% of costs, depending upon the amount of construction costs.

The Department of Taxation (Department) **supports the intent** of this measure; however has **concerns regarding the revenue loss**.

SUPPORT FOR TOURISM INDUSTRY—The Department supports the tourism industry and the importance of the economic activity this important industry brings to Hawaii. The Department acknowledges that having modern and newly renovated rooms are an important factor in maintaining the flow of tourists to this State.

SUPPORT FOR JOBS AND THE CONSTRUCTION INDUSTRY—The Department supports efforts to stimulate the economy. This measure targets tax incentives at the construction industry, which is a large segment of Hawaii's economy.

CONCERN FOR REVENUE COST—As with all measures, the Department must be cognizant of the biennium budget and financial plan. This measure has not been factored into either.

L E G I S L A T I V E

TAXBILLSERVICE

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

SUBJECT: INCOME, Hotel construction and remodeling tax credit

BILL NUMBER: SB 769; HB 371 (Identical); HB 1653 (Similar)

INTRODUCED BY: SB by Fukunaga, Baker, Chun Oakland, Ige, 1 Democrat and 1 Republican; HB 371 by McKelvey; HB 1653 by Manahan, Brower, Ito, Tokioka, Yamane and 1 Democrat

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers subject to HRS chapter 235 and HRS chapter 237D to claim a refundable hotel construction and remodeling tax credit of the construction or renovation costs incurred before 12/31/16. The credit shall be 7% of the construction and renovations costs between $1 million and $10 million in the aggregate; or 10% of the construction or renovation costs over $10 million to a maximum of $100 million in the aggregate. The credit shall not be applicable to costs of construction or improvements for which another income tax credit was claimed for the taxable year. Establishes a total annual cap of tax credits of $50 million.

SB 769/HB371 provides that the tax credit shall be available for tax years beginning after December 31, 2010 and shall not be available for tax years beginning after December 31, 2016. HB 1653 provides that the tax credit shall be available for tax years beginning after December 31, 2010 and shall not be available for tax years beginning after December 31, 2015.

In the case of a partnership, S corporation, estate or trust, association of apartment owners of a qualified hotel facility, time share owners' association, or any developer of a time share project, the credit shall be based on qualified costs incurred by the entity with costs on which the credit is computed determined at the entity level. To qualify for the credit, the taxpayer shall be in compliance with all applicable federal, state, and county statutes, rules, and regulations. If a deduction is taken under IRC section 179 (with respect to election to expense depreciable business assets), no tax credit shall be allowed for such qualified costs for which the deduction was taken. The basis of eligible property for depreciation or accelerated cost recovery system purposes shall be reduced by the amount of credit allowable and claimed.

Credits in excess of a taxpayer's income tax liability shall be applied to subsequent tax liability. 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.

Defines "construction or renovation cost," "net income tax liability," "qualified hotel facility," "qualified resort area," and "taxpayer" for purposes of the measure.

EFFECTIVE DATE: July 1, 2011; applicable to tax years beginning after December 31, 2010

STAFF COMMENTS: The legislature by Act 195, SLH 2000, enacted a hotel construction and renovation tax credit of 4% for hotel renovations effective for tax years beginning after 12/31/98 but before

12/31/02. Act 10 of the Third Special Session of 2001 increased the hotel renovation tax credit to 10% for construction costs incurred before 7/1/03. Act 10 also provided that the credit shall revert back to 4% on 7/1/03 and sunset on 12/31/05. These measures propose a similar credit for hotel renovation costs incurred in a taxable year.

The original tax credit was promoted on the argument that the tax credit would be an incentive for hotels to refurbish their properties in order to remain competitive with other destinations around the world. The credit amount was set at 4% to seemingly offset the 4% general excise tax. When 9/11 hit, the momentum of the crisis fostered support for an increase in the credit to 10% to supposedly keep projects which were already in progress going. However, the governor objected and threatened to veto the sweetened credit. The legislature compromised and provided that the 10% credit would be nonrefundable.

While these measures propose to reestablish a hotel renovation tax credit, it should be noted that no evaluation has been done to validate the effectiveness of this credit in spurring substantial renovations of hotel resort properties. While some may argue that this credit is necessary to make their upcoming renovations pencil out, one must ask whether or not it is the role of government to subsidize private investments. While the credit might be viewed as critical to a taxpayer's project or to the continued renovation of the resort plant, one must ask how long must all other taxpayers suffer the heavy burden of taxation so that this subsidy can be extended to a few?

It would be a very different picture if those who are asking for the subsidy would be willing to forgo other public services or make recommendations on how government can rein in spending, but that is not the case. Now, more than ever, lawmakers need to recognize that they need to set priorities for what precious few dollars taxpayers can part with to run state and local government. One must ask how lawmakers can provide subsidies like these proposals while they raised the general excise tax on all other taxpayers to pay for a transit system in Honolulu? Taking care of a few taxpayers at the expense of all other taxpayers is certainly a cavalier attitude.

More importantly, if the intent of these measures is to entice hotel owners to undertake major renovations, then the sponsors do not understand what is happening to the nation's economy. In order to undertake large scale construction or renovations, either the hotel owner has to be cash rich or else have access to the credit markets. As the nation now knows, the credit markets froze beginning in late 2007 and hit a crisis at the end of 2008. The phenomenon was a major reason for the demise of Aloha Airlines and ATA which were highly dependent on credit lines to meet on-going expenditures. When the credit markets froze, there was no way to secure cash advances to meet current liabilities and the two airlines, along with thousands of other businesses, had to shut their doors.

Despite herculean efforts to thaw those credit markets and to cajole corporations that are still sitting on over a trillion dollars worth of cash to loosen up and spend that money, have all been for naught as there are still jitters about how firm a recovery is being had. Given that fact, it is doubtful that any hotel owner will undertake new renovation projects, in fact, some who had such projects underway have pulled back or completely shut down those projects for the time being. Thus, the sponsors of these proposals may find this incentive useless in this environment.

Instead of subsidizing construction in order to get construction workers off the bench, government can assist in a number of other ways. For private projects, the permitting and planning process can be accelerated. One developer recently reported that it had taken two years to subdivide two parcels into seven house lots in rural Oahu at which time the planning and permitting department deferred approval citing eight issues to be addressed regarding subdivision approval. The interest on the seller has amounted to more than $500,000 to this point and going forward, both the buyer and seller are shelling out more than $27,000 a month for interest alone, not to mention the other planning and engineering costs. These are costs that could be mitigated if permitting officials would just work with developers and owners in streamlining these requirements. Apparently officials are reticent to make decisions in fear that they might make the wrong decision. The result is costly delays while construction work goes begging.

In the public arena, both the state and counties need to take advantage of this window of opportunity of readily available labor and exceptionally low interest rates to undertake a massive capital improvement program. As economists on the Council on Revenues noted recently, when adjusted for inflation, the amount of public construction projects in the state is at its lowest level since statehood.

Thus, rather than tinkering with the economy, lawmakers should rein back the role of government, or in other words, get out of the way and let the market lead the way to recovery. If nothing else, these measures demonstrate that lawmakers do not understand what makes the economy run and how businesses make their decisions. It is certainly sad that groups of people who have little, if any, business experience are attempting to tell business how it should be run.

Digested 1/31/11

WAIKĪKĪ IMPROVEMENT ASSOCIATION

Statement of
Rick Egged, President
Waikīkī Improvement Association
Before the
SENATE COMMITTEE ON TOURISM
Tuesday, February 15, 2011, 1:30 PM
State Capitol, Conference Room 224
in consideration of

SB 769
RELATING TO ECONOMIC RECOVERY

Good afternoon Chair Kim, Vice Chair Kouchi and members of the Committee:

I am Rick Egged testifying on behalf of the Waikīkī Improvement Association. WIA is a nonprofit organization representing 150 leading businesses and stakeholders in Waikīkī.

The Waikīkī Improvement Association strongly supports SB 769.

Hotel Construction and Renovation Tax Credits work. Enacted to spur the updating of Hawaii's aging product tax credits helped to induce reinvestment. To determine the actual value of the credits, we must weigh their "costs" – or in the case of Tax Department terminology, "loss" - against the amount of economic activity they have spurred. A 2004 study prepared by Hospitality Associates, Inc. and economics professor Dr. James Mak did just that. It found that:

1. The tax credits have produced a sizable increase in hotel construction and renovation activity. Realize that prior to the establishment of the credits, hotel construction activity had been languishing. Against the backdrop of a sluggish State economy, the jobs, earnings, and tax revenues generated by this increase in construction activity are extremely significant.

2. The gain in tax revenues from increased hotel construction and renovation activity far exceed the estimated amount of the tax credits given. In addition to increased tax revenues from construction activities, the improvements are generating higher room rates, which translate into higher GET and TAT collections over time.

3. The renovations spurred by the credits are attracting higher spending visitors. The key to sustainable tourism in Hawaii is our ability to increase per capita visitor spending. By facilitating hotel renovations, the tax credits have proven to be an effective tool in helping to improve the quality of Hawaii's hotel and visitor market. Higher visitor spending, of course, produces even greater tax revenues.

The revitalization of Waikīkī is a huge success story. From 2001 to 2010 over three billion dollars in private funds have redeveloped large portions of Waikīkī. There are still areas of Waikīkī that remain in need of redevelopment. At a time when the economic recovery is fragile and project financing difficult to secure, tax credits are a proven factor that will enable the redevelopment to become a reality.

Thank you for this opportunity to provide these comments.

The Senate
The Twenty-Sixth Legislature
Committee on Tourism
February 15, 2011
1:30 p.m., Room 224

Statement of the Hawaii Carpenters Union on SB 769

The Hawaii Carpenters Union urges the passage of SB 769 by the Senate Committee on Tourism.

The tax credit for construction by hotel property owners is needed to grow our economy and tax base out of the deepest recession in our history. While the visitor industry must revitalize its facilities to compete in the world market, this Bill will have an even greater economic impact by stimulating construction sooner rather than later.

Putting construction workers back to work will in turn increase tax revenues and reduce dependence on social service spending. Construction employs a range of people, from trades workers to transport workers, to professionals and others. This Bill can help them get back to working and contributing, all in the course of building a better visitor industry plant.

Owners and developers who are waiting, or are facing daunting conditions laid down by financial institutions, need to be stimulated and enabled to move now. SB 769 will combine public and private resources and reap a return in the form of tax income.

That is all without counting the vitality of our community when working people have work, the foundation of their dignity and self-sufficiency. The visitor industry needs that, too.

Thank you for considering our testimony in support of SB 769.

The Pacific Resource
PARTNERSHIP

Testimony of C. Mike Kido
External Affairs
The Pacific Resource Partnership

Committee on Tourism
Senator Donna Mercado Kim, Chair
Senator Ronald D. Kouchi, Vice Chair

SB 769 – RELATING TO ECONOMIC RECOVERY
Tuesday, February 15, 2011
1:30 PM
Conference Room 224

Chair Kim, Vice Chair Kouchi and Members of the Committee on Tourism:

My name is C. Mike Kido, External Affairs of the Pacific Resource Partnership (PRP), a labor-management consortium representing over 240 signatory contractors and the Hawaii Carpenters Union.

PRP supports SB 769 – Relating to Economic Recovery which provides a seven to ten percent tax credit for construction and renovations costs on hotel property incurred after December 31, 2010, through December 31, 2016.

Senate Concurrent Resolution No.132 (2009) established a Construction Industry Task Force to determine the economic contributions of the construction industry in Hawaii and to develop a series of proposals for state actions to preserve as well as to create new jobs.

As an active participant in the Construction Industry Task Force, PRP believes it was and still is crucial to jump start Hawaii's economy with active pursuit construction and renovation plan that would otherwise be delayed by the prevailing financial climate.

With our economy in recession, stimulus and other initiatives are needed to counteract the negative impact on our state. A hotel construction and remodeling tax credit can provide excellent means to boost Hawaii's tourism and construction industries.

Thank you for the opportunity to share our views with you and we respectfully ask for your support on SB 769 – Relating to Economic Recovery.

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LAND USE RESEARCH
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February 15, 2011

Senator Donna Mercado Kim, Chair and Senator Ronald D. Kouchi, Vice Chair
Senate Committee on Tourism

<u>Strong Support of SB 769</u>, Relating to Economic Recovery. (Establishes a seven to ten percent tax credit for hotel and resort property construction and renovation costs through December 31, 2016; Total Annual Cap of $50,000,000.)

Tuesday, February 15, 2011 at 1:30 p.m. in CR 224

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 is in **strong support of SB 769**, which creates a seven to ten percent nonrefundable tax credit for construction or renovation costs incurred on a qualified hotel facility and qualified resort area through December 31, 2016.

<u>BACKGROUND</u>. SB 769 is one of the bills recommended by the Construction Industry Task Force (CITF), which was established in 2009 pursuant to Senate Concurrent Resolution (SCR) No. 132 (2009) to determine the economic contributions of Hawaii's construction industry and to develop proposals for state actions to preserve and create new jobs in the local construction industry. This bill proposes a nonrefundable seven to ten percent tax credit for construction and renovation costs on hotel and resort property incurred after December 31, 2010, through December 31, 2016. The credit, if not exhausted in the year claimed, can be carried over as credit for future years until exhausted. SB 769 was patterned after Act 10 (2001 Special Session).

<u>LURF'S POSITION</u>. LURF strongly supports SB 769, which creates a hotel and resort construction and remodeling tax credit, as the bill is intended to boost Hawaii's construction and visitor industries. The implementation of this legislation is therefore necessary and warranted, as substantiated by the following:

- **SCR 132 (2009) CITF Recommendations and Justifications for the Bill.** In 2009, the chair of the CITF's Resort/Hospitality/Private Sector Committee supported a draft bill which was anticipated to be introduced in 2010 that was conceptually identical to the subject bill, based on the following justifications, all of which are applicable to SB 769:

1. The hotel and resort tax credits were successful in instigating new construction, renovating existing projects, and generating employment which contributed to the prompt economic recovery after September 11, 2001;
2. The measure was also a profitable investment for the State and Counties of Hawaii;
3. The State and Counties continue to benefit from the residual effects of Act 10 (2001) as the projects and improvements created during this time period continue to generate tax revenues to the State and Counties; and
4. Tax credits similar to SB 769 were previously implemented by law (Act 10 in 2001), and therefore will be an easier and more timely remedy than creating a new program.

- **2009 Independent Quantitative Economic Analysis by Premiere Realty Advisors of Honolulu.** In 2009, Premiere Realty Advisors of Honolulu was retained to prepare an economic impact study of the CITF's proposal to re-enact Act 10 (2001). Act 10 (2001) differed from SB 769 in the amount of the tax credit and its nonrefundable nature (the CITF proposed a 10 percent tax "refundable" credit in Act 10, while SB 769 proposes a "non-refundable" 7 to 10 percent tax credit which could be carried over as credit for future years until exhausted). Despite these differences, the two bills are virtually identical in concept, and LURF understands that the estimated economic impact of the bills would also be similar.

  The following is a summary of the analysis prepared by Premiere Realty Advisors, estimating what the impact of the CITF proposal to reenact Act 10 (2001) as a 10% "refundable" tax credit from 2010 to 2015, would be on this State:
  - Induced construction spending estimated at $2,002,500,000.
  - Net tax cost estimated at $46,725,000.
  - Induced jobs estimated at 23,630.
  - Net tax cost per induced job estimated at $1,977.

CONCLUSION. As evidenced by the findings of the CITF and independent realty advisors, LURF believes that the implementation of this legislation is necessary and warranted, and that the objective of this bill (i.e., to create a hotel and resort construction and renovation tax credit to boost Hawaii's construction and visitor industries), would be satisfied and furthered by the enactment of SB 769.

Based on the above, LURF respectfully requests that **SB 769 be favorably considered and approved by your Committee.**

Thank you for the opportunity to testify in **strong support** of this bill.

THE RESORT GROUP

TO THE SENATE COMMITTEE ON TOURISM

TWENTY SIXTH LEGISLATURE
Regular Session of 2011

Testimony of Abbey S. Mayer, Vice President, Government Relations
THE RESORT GROUP

<u>In Support of SB 769,</u> Relating to Economic Recovery

Tuesday, February 15, 2011 -- Room 224

Aloha Chair Kim, Vice-Chair Kouchi, and Members of the Committee,

The Honolulu-based The Resort Group (TRG) acquires, master develops, repositions and markets domestic and international mixed use and master-planned resort communities. Led by Jeffrey R. Stone, TRG's resort development projects are carefully designed to balance resident, visitor and employee needs with community interests, local cultural values and adjacent land use requirements. Current projects include Ko Olina Resort & Marina and Makaha Valley Country Club on O'ahu, Princeville at Hanalei (Kaua'i), Lands of Kapua (Big Island), the Newport Beach Hotel in California and Cape Eleuthra, Bahamas.

<u>BACKGROUND</u>

In 2009, in response to the 'Great Recession' and economic crisis that began in mid-2008, Senate Concurrent Resolution No. 132 (SCR 132) established a Construction Industry Task Force, composed of sixteen industry leaders and community representatives. SCR 132 requested that the Task Force determine the economic contributions of the construction industry in Hawaii and to propose actions that would help preserve and create new jobs in the local construction industry.

Recommendation 1 (Hotel/Timeshare Construction and Remodeling Tax Credit) of the SCR 132 Final Report, noted that the attacks of September 11, 2001 had a devastating effect on the Hawaii Economy. In October, 2001 the Hawaii Legislature met in a special session to approve emergency measures in response to the attacks. One such measure was the enactment of Act 10, Third Special Session Laws of 2001. It amended the construction and remodeling tax credit (ACT 195 passed in 2000) from 4% refundable to 10% nonrefundable for construction and renovation costs incurred

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between January 1, 2001 and July 1, 2003 for hotels, hotel condos, timeshare facilities, apartment owner associations, and residential sectors. After July 1, 2003, the credit reverted back to the 4% refundable credit until its repeal in 2007.

Act 10 was an additional incentive to push development forward during a 36-month window by rewarding those who did with an increased credit. The purpose of this credit was to assist the visitor industry in creating and renovating projects in tourist destination areas throughout the state and to provide employment opportunities. This Act was crucial in Hawaii's economic recovery after September 11, 2001.

On March 17, 2003 Hospitality Advisors, LLC of Honolulu, Hawaii published "*Overview Analysis of the Hotel Renovation Credit*", in response to a proposal to extend the Act 10 benefits for an additional 5-year period, to July 1, 2008. The Findings of this report were:

- The hotel tax credit did spur much-needed hotel renovation
- Hotel tax credits generate additional benefits beyond tax credit given
- Act 195 and Act 10 helped transform and reposition Hawaii's hotel and visitor industry

Undertaken at the request of the SCR 132 Task Force, an updated report by Premiere Realty Advisors of Honolulu, HI dated Nov. 15, 2009 presented a quantitative economic analysis of the Act 10 as a 10% refundable tax credit. The summary findings of this report were that a reenactment of Act 10:

- Would be greatly successful in instigating new construction, renovating existing projects, and generating employment
- The State and Counties would continue to benefit far beyond the period of reenactment from the residual effects of such a measure, as the projects and improvements created would continue to generate tax revenues to the State and Counties, and
- Act 10 was previously a law and therefore will be an easier and timelier remedy than creating a new program.

SB 769, RELATING TO ECONOMIC RECOVERY:

SB 769 currently proposes a nonrefundable seven to ten percent tax credit for construction and renovations costs on hotel property incurred after December 31, 2010, through December 31, 2016. The credit, if not exhausted in the year claimed, can be carried over as credit for future years until exhausted.

The amount of credits claimed under this section will be:

- **Seven percent of the construction or renovation costs between $1 and $10 million;**
- **Ten percent of the construction or renovation costs over $10 to a maximum of $100 million.**

Discussion:

TRG notes that the current draft of SB 769 would reduce both the cost to the State resulting from 'lost tax revenues' and also the quantity of induced construction from the SCR 132, 10% refundable proposal.

TRG stands in strong support of SB 769, and notes that the incentivized induction of increased economic activity is absolutely essential for achieving long-term economic recovery and sustainability. While TRG does not now have any pending projects that would qualify for this credit, we understand through direct experience the efficacy of Act 195 and Act 10 on helping to revitalize Hawaii's construction industry at a time of historic lows. SB 769 will also lead to tourism industry improvements which will serve the entire State for years to come.

Additionally, TRG feels this measure would bring relief to a battered construction industry, especially on Neighbor Islands, that will not directly benefit from the Rail construction spending on Oahu. At a time when financing for construction and renovation projects continues to be particularly challenging, TRG feels this legislation will be a key incentive to ensure the implementation and viability of shovel-ready projects.

TRG thanks the committee for the opportunity to testify on this measure.

kim5 - Deborah

From: Will at Page Marketing [will@pagemarketing.com]
Sent: Thursday, February 10, 2011 11:32 PM
To: TSM Testimony
Subject: Testimoney Against SB 769 Tuesday, February 15, 2011

This letter is to testify AGAINST SB 769.

The decisions to build and expand hotels and time-share accommodations are based on long-term economic assumptions that are much broader than the five years covered by SB 769. One may also wonder whether or not the business may be profitable enough to earn a state income tax liability against which the tax credit may be earned.

Why not allow the tax credit against GET or TAT obligations? These tax savings would be much more certain and therefore would provide a much more certain financial benefit to accommodations owners contemplating expansion.

It is also unfortunate that this bill is aimed strictly at overseas investors in the Hawaii tourism industry.

The tax benefits of SB 769 if any are not available to locally-owned and operated B&B's, vacation rentals and vacation homes.

It is unfortunate that the state legislature is so anxious to provide tax incentives to big international financial entities that operate global tourism accommodations businesses but will not extend these same benefits to the small, local operators.

B&B's and vacation rentals are Hawaii's favorite small businesses on all islands. There are far more local taxpayers operating short-stay accommodations businesses than any other type of business in the State. Why are these small local companies excluded from the tax benefits of this bill if any?

Small business is the heart of Hawaii's economy. Why are our small businesses excluded?

Why would the legislature not provide these incentives if any to those local taxpayers who would expand their small, local accommodations businesses? B&B's and vacation rentals are legal in the State of Hawaii and accommodate approximately 15% of Hawaii visitors. Why are they excluded?

Thank you for thinking about something other than civil unions and gambling. However there are too many questions about the effectiveness and fairness of SB 769 to make it viable.

Sincerely yours,

Will Page
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