SB 831

EDT

NEIL ABERCROMBIE
GOVERNOR

BRIAN SCHATZ
LT. GOVERNOR

FREDERICK D. PABLO
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SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TECHNOLOGY

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING SB 831 RELATING TO TAXATION

TESTIFIER:	**FREDERICK D. PABLO, INTERIM DIRECTOR OF TAXATION (OR DESIGNEE)**
COMMITTEE:	**EDT**
DATE:	**FEBRUARY 7, 2011**
TIME:	**1:15PM**
POSITION:	**COMMENTS; CONCERNED WITH COSTS**

This bill proposes an addition to Chapter 235, Hawaii Revised Statutes, conforming to Section 45D, Internal Revenue Code, providing for a New Markets Tax Credit. This bill applies to taxable years beginning after December 31, 2010.

The Department of Taxation (Department) **offers comments**.

I. NEW MARKETS TAX CREDIT, GENERALLY.

The purpose of the New Markets Tax Credit is to encourage investment in qualifying entities that provide business and economic development in targeted low-income communities. The tax credit is provided to the investors in these entities.

In order to claim the New Markets Tax Credit, the development entity must be certified before the credits may be claimed. Once certified, the entities may apply for allocation of the credits.

II. <u>COMMENTS REGARDING THE PROPOSED HAWAII NEW MARKETS TAX CREDIT.</u>

The Department has the following comments regarding a proposed conforming amendment to Section 45D, Internal Revenue Code—

HAWAII CONNECTION—It is unclear from the bill whether the credit only applies to investments that benefit low-income communities in Hawaii. Does the qualified community development entity need to be located in Hawaii or does it apply to any qualified community development entity that services Hawaii? The Department is concerned that the bill as currently drafted does not adequately tie the credit to activity in Hawaii.

IS THIS CREDIT A NEW STATE PROGRAM; OR SIMPLY AN ADDITIONAL CREDIT FOR FEDERAL PROGRAMS—The Department is unclear from this measure whether the State is supposed to be implementing a Hawaii New Markets Tax Credit program; or whether this credit is merely an additional credit for federal programs. If a Hawaii program is intended, this measure needs to be amended to provide for the program oversight, as well as the necessary resources. The Hawaii New Markets Tax Credit should likely be managed by an expert state agency on low-income and business development issues.

STUDY OTHER STATES—The Department suggests looking at the approach taken by other states, including Ohio, Illinois, and Louisiana.

NOT FACTORED INTO BUDGET—The Department must be cognizant of the biennium budget and financial plan. This measure has not been factored into either.

REVENUE IMPACT & METHODOLOGY—This bill will result in an indeterminate revenue impact at this time.

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LEROY E. COLOMBE
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THE SENATE
THE TWENTY-SIXTH LEGISLATURE
Regular Session of 2011

COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY
Chair Fukunaga, Vice Chair Wakai, Members of the Committee:

Hearing date: Monday, February 7, 2011
Testimony on SB 831
(Relating to Taxation)
New Markets Tax Credit

Chair Fukunaga, Vice Chair Wakai, Members of the Committee:

We urge your support of this measure, which provides for conformity to the federal new markets tax credit, based on a certain percentage of an amount paid to a qualified community development entity for a qualified equity investment.

The new markets tax credit ("NMTC") program uses federal income tax credits to attract private-sector capital investment to low-income areas in the United States to help finance community development projects, stimulate economic growth, and create jobs.

Section 45D of the Internal Revenue Code of 1986 allows the tax credit to be claimed for a taxpayer's investment in a qualified development entity. These entities, in turn, invest or lend the capital they raise to qualified businesses located in low-income communities. These entities must be attentive to the low-income community which they serve, , such as having residents of low-income communities serve on their boards. The program is administered by the United States Treasury Department and the credits are allocated on a competitive basis.

The tax credit is equal to 39% of the qualified equity investment, is claimed over seven years, and is nonrefundable. Corporations, non-profit organizations, and others can create community development entities and apply for the NMTCs. The credit was originally passed by Congress in 2000 as part of the Community Renewal Tax Relief Act to stimulate investment in low income communities.

NMTC proceeds have financed activities in distressed urban and rural communities, such as alternative energy companies, charter schools, health care facilities, child care providers, supermarkets, manufacturers, processors, distributors and business incubators. Certain business activities do not qualify as NMTC qualified activities, e.g., small farms, residential rental, gambling, country clubs, suntan facility, massage parlors, golf courses. There is a recapture of the credits if substantially all of the investments are not used for qualified activities.

Every dollar of NMTC investment can be leveraged into multiple expenditures through bank loans in conjunction with equity investments. With the budget deficit and loss of federal earmarks, the NMTC program will help to infuse outside capital into Hawaii, generate jobs and income, which generate tax dollars. The addition of Hawaii tax credits will provide further incentives to locate NMTC investments in Hawaii.

We offer technical amendments to include insurance companies and banks to offset their insurance premiums and franchise taxes by the NMTC credits. See attached proposed SD1.

Very truly yours,

CHUN, KERR, DODD, BEAMAN & WONG,
a Limited Liability Law Partnership

Ray Kamikawa

RKK/lmt : 140465.1
Enclosure

(2) Allocations of net operating loss pursuant to section 235-111.5;

(3) Allocations of the attractions and educational facilities tax credit allowed by section 235-110.46; [~~or~~]

(4) Allocations of low-income housing tax credits among partners under section 235-110.8[~~.~~]; or

(5) Allocations of the new markets tax credit allowed by section 235- ."

SECTION ~~4~~ 6. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION ~~5~~ 7. This Act, upon its approval, shall apply to taxable years beginning after December 31, 2010.

INTRODUCED BY: ______________________

SECTION 4. Chapter 241, Hawaii Revised Statues, is amended by adding a new section to be appropriately designated and to read as follows:
"§ 241 - New markets tax credit. The new markets tax credit provided under section 235-_____ shall be operative for this chapter."

SECTION 5. Chapter 431, Hawaii Revised Statues, is amended by adding a new section to be appropriately designated and to read as follows:
"§ 241 - New markets tax credit. The new markets tax credit provided under section 235-_____ shall be operative for this chapter."

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February 3, 2011

Senator Carol Fukunaga
Chair, Committee on Economic Development and Technology
Hawaii State Capitol, Room 216
Honolulu, Hawaii 96813

Via Facsimile (808-586-6659)

RE: HAWAII NEW MARKETS TAX CREDIT LEGISLATION

Dear Senator Fukunaga,

I am writing to ask you to express support for the inclusion of a State New Markets Tax Credit (NMTC) program in Hawaii's 26th legislature. Senate Bill 831 creates a Hawaii version of the Federal NMTC program that would facilitate investment in both rural and urban low-income communities.

United Fund Advisors, LLC (UFA) and its affiliates have been actively involved in the Federal NMTC program since inception. UFA has received $275 million of NMTC allocation and assisted our clients in receiving $500 million in NMTC allocation. Across 14 states, UFA and its affiliates have financed over 80 projects and businesses with total development costs exceeding $2.1 billion. We have witnessed first-hand the catalytic effect of the investments in our state of Oregon and across the nation.

The NMTC program is a vital stimulus for improving low-income communities no matter what the economic environment, but it is an especially helpful tool in the current credit crisis. Benefits of the program include access to capital for small businesses, increased tax revenue for governments, and – most importantly – jobs in low-income communities.

SB 831 will work to will attract millions of dollars into Hawaii's low-income urban and rural neighborhoods, where it is more difficult to finance small businesses through purely conventional means, enabling more bank-financed projects to close, assisting Hawaii small businesses, and ultimately leading to the creation of more jobs and additional tax revenue.

Thank you for your consideration for expressing support for this important effort to bring new capital and jobs to Hawaii's low-income communities.

Sincerely,

Chris Hasle
Principal

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Written Statement of
YUKA NAGASHIMA
Executive Director & CEO
High Technology Development Corporation
before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY
February 7, 2011
1:15 PM
State Capitol, Conference Room 016

In consideration of
SB 831 RELATING TO TAXATION.

Chair Fukunaga, Vice Chair Wakai, and Members of the Committee on Economic Development and Technology.

The High Technology Development Corporation (HTDC) respectfully submits comments on SB 831. The federal new markets tax credit (NMTC) program was established as part of the Community Renewal Tax Relief Act of 2000, has assisted in many development projects in depressed communities. However, state level new market tax credit, is not seen by the developers as nearly as effective. Many cite increased level of complexity in their deal when pursuing projects with new market tax credits, where the transaction costs are higher, projects take longer[1] and require involvement of attorneys and third party reporting. Those factors limit the vehicle to be used only for larger projects, which may explain why NMTC has not been used in Hawaii.

If the purpose of the SB 831 is to result in more community development projects, we are told by the industry that their preference is for the government to engage in other initiatives that would reduce the overhead (both time and resources) of development projects, such as streamlining of the permitting process. While lack of capital remains a key challenge in any community development, the return on investment for the State government for the tax revenues it is giving up[2], may not be sufficiently high, esp. given the industry feedback that this tax credit, if enacted, would not be a key deciding factor to green light a project or not.

Thank you for the opportunity to submit testimony on this bill.

[1] The credit equals 39% of the investment paid out over seven years.
[2] Because credits are usually sold to investors, the market value of such credits can speak to how effective the State can leverage its tax credit. Unfortunately, low cost housing credit is not selling well, getting about 20% of its value

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FEB 04 2011

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THE SENATE
THE TWENTY-SIXTH LEGISLATURE
REGULAR SESSION OF 2011

COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY
Hearing February 7, 2011
Testimony on S.B. 831
(Relating to Taxation)

Chair Fukunaga, Vice-Chair Wakair and members of the Committee:

My name is Peter Fritz. I am an attorney specializing in tax matters. I am testifying in strong support of S.B. 831.

This bill would create a state credit that mirrors the federal New Markets Tax Credit. This bill would help stimulate economic development in economically distressed areas. A state credit would make Hawaii more attractive to Community Development Entities.

New Markets Tax Credits are meant to provide a subsidy to marginal projects - -- those that in the absence of the subsidy provided by the credits generate some economic returns but not a sufficient level of returns to make the project economically feasible, and further, those projects which will be rendered economically feasible by the addition of the tax credits. The credit is supposed to make marginally doable projects into doable projects.

The New Markets Tax Credit is an incentive in the form of a credit against federal taxes provided to investors to induce them to invest in economically distressed areas where capital for a broad range of investments has not been available. The NMTC works through a three phase process. In the first, the Allocation Phase, the U. S. Treasury (through the CDFI Fund, its arm which administers the program) allocates credits through a competitive process to financial intermediaries known as "community development entities", or "CDEs". In the second, the Fund Investment Phase, the financial intermediaries draw down cash investments from investors in exchange for tax credits and the prospect of other economic benefits. In the third, the Business Investment Phase, the CDEs select, close and monitor investments in businesses located in targeted geographic areas which are projected to generate economic returns for the CDE and the investor. The CDE reports on its activities to the CDFI Fund. (See attached chart)

The NMTC provides investors with a tax credit equal to 39 percent of their investment over seven years: 5 percent each year for the first three years and 6 percent each year for the next four years. The present value of the credit is about 30 percent of the amount invested.

An investor must therefore be comfortable that the project(s) in which the funds are ultimately invested can provide a return of capital and an appropriate risk-adjusted return on capital in addition to the tax benefits. This is a major difference from the Low Income Housing Credit, where the investor is able to receive its entire return in the form of tax benefits. The bottom line is that the projects in which the NMTC funds are invested must have significant ability to generate economic returns.

The CDFI Fund. The responsibility for administering the program rests with the U. S. Department of the Treasury, which has assigned it to the CDFI Fund.

CDEs. The CDFI Fund awards New Markets Tax Credits to organizations known as Community Development Entities (CDEs), which are meant to function as financial institutions sensitive to the needs of targeted communities; the CDEs raise capital from investors in exchange for the tax credits and other economic benefits, and invest that capital into projects they select.

There are three statutory criteria for qualification as a CDE. First, "the primary mission of the entity [must be] serving, or providing investment capital for, low-income communities or low income persons;" second, "the entity [must] maintain accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory board to the entity;" and, third "the entity [must be] certified by the Secretary . . . as being a qualified community development entity." IRC Sec. 45D (c) (1) (A) – (C). Organizations apply to the CDFI Fund to be certified as CDEs. CDFIs and SSBICs (Specialized Small Business Investment Companies) automatically qualify as CDEs.

Investments are made in eligible low-income community is generally a census tract with a poverty rate of twenty percent or greater, or a census tract in which the median family income is less than eighty percent of either the metropolitan area median or the statewide median, whichever is less. About 39 percent of all census tracts are eligible, and about 36 percent of the nation's population live in eligible census tracts. Examples of areas with greater economic distress would be:

- areas with poverty rates greater than 30 percent;
- areas with median incomes of less than 60 percent of area median income;
- areas with unemployment rates at least 1.5 times the national average;
- federally designated Empowerment Zones, Enterprise Communities, or Renewal Communities;
- SBA designated HUB Zones;
- brownfields redevelopment areas; and
- several other categories of distressed communities.

Recapture Provisions.

The statute specifies conditions under which the tax credits may be recaptured from investors, and these recapture provisions of the statute have played a significant role in the way the NMTC program has been implemented. The statute specifies three recapture events:

- the CDE ceases to be a qualified CDE;
- the requirement that "substantially all" of the qualified equity investments received by the CDE be invested in qualified businesses ceases to be met; or
- the equity investment into the CDE is redeemed by the CDE.

The amount of the recapture is the total amount of tax credits claimed plus penalties and interest. This is generally considered to be a severe if not draconian provision. This is for two reasons. Recapture is triggered if a CDE ceases to have substantially all of investor funds invested in eligible projects. A business that received an investment and then moved out of the target area would no longer be eligible, potentially triggering recapture.

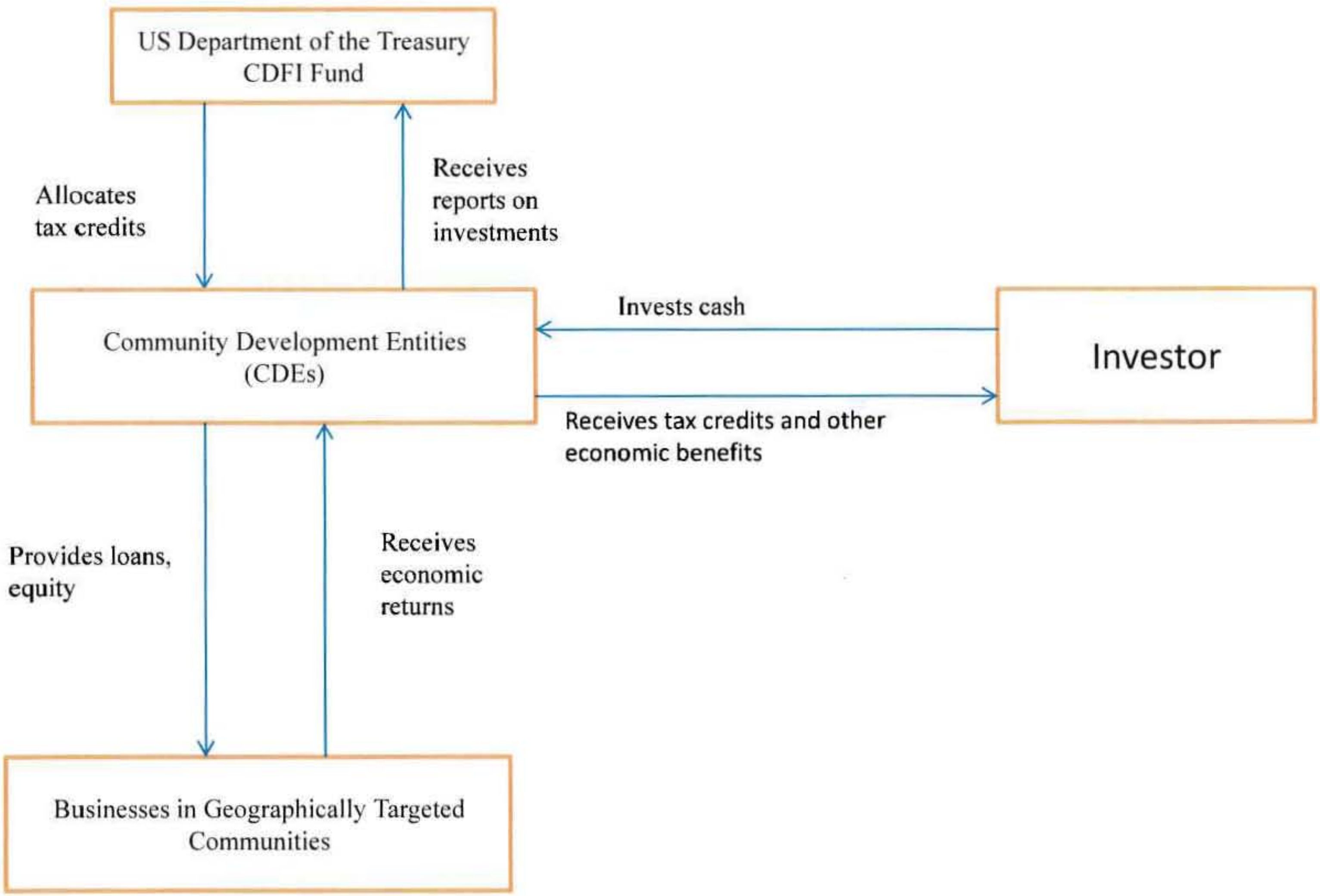
Combining the NMTC with other federal tax credits.

The statute directed that the Secretary of the Treasury develop regulations on a number of issues, including regulations that limit the use of the NMTC for investments subsidized by the LIHTC and other Federal tax benefits. IRS Notice 2002-64 provided guidance that said that the LIHTC limited the availability of the NMTC.

The NMTC will spur development in economically distressed areas. This economic development will create jobs which will create new him him him him him him him him him him him him him him him him him tax revenue. I respectfully ask you to support this bill.

Thank you for the opportunity to testify.

Peter L. Fritz


US Department of the Treasury
CDFI Fund
Allocates tax credits
Receives reports on investments
Community Development Entities (CDEs)
Invests cash
Investor
Receives tax credits and other economic benefits
Provides loans, equity
Receives economic returns
Businesses in Geographically Targeted Communities

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, New markets tax credit

BILL NUMBER: SB 831; HB 451 - Identical

INTRODUCED BY: SB by English; HB by Keith Agaran

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to provide that Section 45D (with respect to new markets tax credit) of the Internal Revenue Code (IRC) shall be operative for state income tax purposes.

A taxpayer who holds a qualified equity investment on a credit allowance which occurs during the taxable year, may claim a credit equal to the applicable percentage of the amount paid to the qualified community development entity for the investment at its original issue. The applicable percentage shall be the amount in section 45D(a)(2) of the IRC.

Tax credits in excess of a taxpayer's net income tax liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted. All claims for a tax credit under this section shall be filed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. Failure to properly and timely claim the credit shall constitute a waiver of the right to claim the credit. Requires the application for a new markets tax credit to be submitted to the director of taxation on forms prescribed by the director of taxation. The credit may be claimed whether or not the taxpayer claims a federal credit under 45D of the IRC.

IRC section 469 (with respect to passive activity losses and credits limited) shall be applicable to the credit.

Amends HRS section 235-2.45(d) to provide that IRC section 704 (with respect to a partner's distributive share) shall be operative for purposes of this chapter; except that section 704(b)(2) shall not apply to allocations of new markets tax credits among partners.

Makes conforming amendments to HRS section 235-2.3.

EFFECTIVE DATE: Tax years beginning after December 31, 2010

STAFF COMMENTS: On the federal level, the new markets tax credit was adopted as part of the Community Renewal Tax Relief Act of 2000 (P.L. 106-554) to address the lack of capital available to businesses and economic development ventures in low-income communities. The new markets tax credit is provided to individuals or corporations that invest in community development entities working in low- income communities. The credit is equal to 5% of the investment in a qualified community development entity for the first three allowance dates and 6% of the investment for the next four allowance dates with the total amount of credit available equal to 30% of the investment over seven years.

This measure proposes to make the new markets tax credit operable for Hawaii income tax purposes. It should be remembered that Hawaii generally does not adopt any of the credits on the federal level, except for the low-income housing tax credit, as Hawaii's income tax rates are not as onerous as those on the federal level.

It should be noted that in recent years investors have shied away from the state low-income housing credits because there are much more generous state income tax credits available to the investor such as the high technology investment tax credit. Adding yet another state credit would merely detract from the low-income housing tax credit. Undoubtedly, affordable housing is one of the priorities for lawmakers. Thus, adopting the new markets tax credit merely dilutes the attractiveness of the low-income housing tax credit. While the new markets tax credit does help to subsidize commercial and retail facilities in a distressed community, given the unbridled use of tax credits to encourage certain business activities, it is questionable whether or not Hawaii's treasury can afford another hit at this time. When and until the legislature decides what is state government's priority, be it affordable housing, high technology development, alternate energy development, or agriculture, the uncontrolled issuance of back door subsidies is beyond the state's financial capacity.

What this proposal does represent is a lack of legislative understanding of what attracts capital investment to a low-income community and what it takes to retain that enterprise in the community. In some ways this proposal is the compliment of what the federal government did with its welfare programs of the 60's, designing model programs based on a particular city or town on the mainland and trying to replicate it throughout the nation. The cookie cutter approach, as many have learned, does not work. Buying into a federal income tax credit program designed to attract capital to a low-income community does not recognize the many unique hurdles that challenge such a venture in Hawaii.

Finally, it should be remembered that if this measure is adopted, moneys for the proposed tax credit will, no doubt, come out of the state's general fund and depending on the tax credit, will reduce the amount of available general funds without legislative intervention. These are funds that could be used to fund essential services or in the alternative reduce the tax burden on low and moderate-income families or the overall tax burden that plagues both families and businesses.

If it is the desire of the legislature to provide funding to revitalize economically depressed areas of the state, a direct appropriation would be preferable than adoption of the proposed measure. Better yet, lawmakers may want to look at ways to improve the overall business climate, from streamlining zoning and permitting to a reduction of the general excise tax on business-to-business transactions that will benefit all businesses in Hawaii.

Digested 2/4/11

LATE

February 7, 2011

Senator Carol Fukunaga
Chair, Committee on Economic Development and Technology
Hawaii State Capitol, Room 216
Honolulu, Hawaii 96813

Aloha Senator Fukunaga,

I am writing to express my support for Senate Bill 831. Enterprise Honolulu considers our responsibility in the Hawaii community as the Oahu Economic Development Board crucial to revitalizing our economic condition.

In so doing we are considering all opportunities to bring greater monies into Hawaii and deployed in a responsible manner. This last May Enterprise Honolulu and American Savings Bank established a new entity Punawai O Pu'uhonua as a Community Development Entity so that we could apply to the CDFi for an allocation of $125 million of Federal New Market Tax Credits for Hawaii. We remain hopeful that Punawai O Pu'uhonua will receive an allocation and expect a response by late February of this year.

As President and CEO for Enterprise Honolulu and a life long resident of Hawaii who's family ties run deep in public service I believe that we all share the burden that our economy finds us. The low income and rural communities of Hawaii too often find that it is the most difficult areas to receive economic funding to stimulate job development. SB 831 is a state sponsored legislative piece that will work to attract private capital to match the federal legislation. This is key to inspire revitalization investment.

I ask for your consideration to support SB831 as we do our part to work in concert.

Please feel free to contact me directly should you have any questions.

Sincerely,

Pono Shim
President & CEO
Enterprise Honolulu, Oahu Economic Development Board

ENTERPRISE
HONOLULU
THE BUSINESS CLIMATE OF PARADISE

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