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, Manufacturing tax credit

BILL NUMBER: HB 2626, HD-1

INTRODUCED BY: House Committee on Economic Development and Business

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers to claim an income tax credit of 20% of the qualified manufacturing costs incurred in a taxable year provided that the total credit claimed per a taxpayer shall not exceed $200,000.

In the case of a partnership, S corporation, estate, or trust the tax credit allowable is for qualified manufacturing costs incurred by the entity for the taxable year with distribution and share of the credit to be determined by section 704(b) of the Internal Revenue Code. If a deduction is taken under IRC section 179 (with respect to election to expense depreciable business assets), no credit shall be allowed for that portion for which the deduction is taken. The basis of eligible property for depreciation or accelerated cost recovery system purposes for state income tax purposes shall be reduced by the amount of credits allowable and claimed.

Credits in excess of a taxpayer's income tax liability shall be refunded provided such amounts are over $1. 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. 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. Requires the director of business, economic development, and tourism (DBEDT) to: (1) maintain records of the total amount of the qualified manufacturing costs for each taxpayer claiming the credit; (2) verify the amount of the qualified manufacturing costs claimed; (3) total all qualified manufacturing costs claimed; and (4) certify the total amount of the tax credit for each taxable year. DBEDT shall issue a certificate to the taxpayer verifying the qualified manufacturing 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.

Defines "qualified manufacturing costs" as costs incurred to: (1) purchase equipment to be used in manufacturing tangible personal property in the state; and (2) train employees to manufacture tangible personal property in the State.

This act shall be repealed on January 1, 2023.

EFFECTIVE DATE: January 20, 2050; applicable to tax years beginning after December 31, 2014

STAFF COMMENTS: It appears that this measure is intended to provide an incentive in the form of an income tax credit to encourage manufacturing in the state. It should be noted that tax credits generally are designed to reduce the tax burdens of certain groups by refunding a portion of taxes paid on purchases of essential items and services. This credit of 20% of qualified manufacturing costs amounts to nothing more than a partial subsidy of state funds as there is no obvious undue burden of taxes.

It should be remembered that the 2001-2003 Tax Review Commission set forth recommended requirements for new tax incentives such as this one:

(i) *Cost-benefit studies*. Cost-benefit studies should be required prior to inaugurating new or revised tax credit programs. Policy makers should use only those programs with quantifiable and demonstrable benefits over costs. Such costs and benefits should not only look at fiscal and economic effects, but should examine social ones as well.

(ii) *Periodic evaluations* of all tax incentive programs should be required.

(iii) *Truth and disclosure reporting* separate and apart from a taxpayer's tax returns should generally be required of all taxpayers benefitting from tax incentive programs, making public all aspects of these subsidies for private investment.

(iv) *Strategic planning*. Embed tax incentives in strategic plans, leveraging as much of the State's scarce resources as possible. Rather than promoting diverse incentives in search of a cohesive strategy, the State should employ only incentives that make strategic sense.

(v) *Public participation*. Encourage public participation in and comment on tax incentive use to foster public accountability. There should at least be as much public discussion over generous multi-million dollar business incentive tax credits as there is over $50,000 renovations to school libraries.

(vi) *Sunset provisions* should be required to ensure that the above processes will be implemented before an incentive can be extended. It should be demonstrated to the Legislature that the targeted benefit to the State was in fact received, what the tax cost of that benefit was, and whether the continuation of the tax incentive is appropriate and necessary.

(vii) *Enforcement*. Given the magnitude and the complexity of these business incentive tax credits, the small chance of audit, ambiguous statutory requirements as to what can be claimed as a credit, there must be legislative oversight of these credits. In addition, the Department of Taxation must be given sufficient resources to police these credits.

If lawmakers are inclined to enact this credit, amendments should be considered addressing the criteria set forth above.

Digested 2/23/14

NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1530
FAX NO: (808) 587-1584

To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Tuesday, February 25, 2014
Time: 11:15 A.M.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. No. 2626, H.D. 1, Relating to Taxation

The Department of Taxation (Department) provides the following comments regarding H.B. 2626, H.D.1, for your consideration.

H.B. 2626, H.D.1, establishes a refundable income tax credit for taxpayers who incur certain expenses for manufacturing products in Hawaii. Specifically, the measure would provide a refundable tax credit of twenty percent of the costs incurred to purchase equipment to be used in the manufacture of tangible personal property in the State, as well as costs incurred to train employees in the manufacturing process. This measure has a defective effective date of January 20, 2050.

As a general matter of tax policy, the Department prefers nonrefundable tax credits for administration and enforcement purposes. Non-refundable tax credits can only be used against a taxpayer's tax liability which generally means that the business is at least solvent. It has been the Department's experience with refundable tax credits, that taxpayers without Hawaii tax liability who claim refundable tax credits, tend to generate substantially greater audit and compliance issues.

Moreover, refundable tax credits end up diverting the Department's limited resources to determining whether state funds should be paid out to taxpayers, rather than focused on tax revenue collection. The Department also notes that refundable tax credits do not always develop sustainable business activity once the tax subsidy is eliminated; many times, business activity is generated for tax purposes only. The Department defers to the Department of Business, Economic Development, and Tourism regarding the certification and reporting requirements proposed under subsection (e).

Finally, the Department notes that some jurisdictions consider electricity to be tangible personal property. Historically, the Department has not deemed electricity to be tangible personal property. To clarify this position, and in light of the existing Renewable Energy Technologies Income Tax Credit at Hawaii Revised Statutes section 235-12.5, and the tax credit for energy storage being considered by the Legislature this year, the Department suggests that a provision be added to specifically exclude costs related to the production of electricity. The following language could be added after the last sentence in subsection (a) to accomplish the preclusion:

> Provided that qualified manufacturing costs shall not include any costs related to the production of electricity.

Thank you for the opportunity to provide comments.

NEIL ABERCROMBIE
GOVERNOR

RICHARD C. LIM
DIRECTOR

MARY ALICE EVANS
DEPUTY DIRECTOR

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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Statement of
RICHARD C. LIM
Director
Department of Business, Economic Development, and Tourism
before the

HOUSE COMMITTEE ON FINANCE

Tuesday, February 25, 2014
11:15 a.m.
State Capitol, Conference Room 308
In consideration of

HB 2626, HD1
RELATING TO TAXATION.

Chair Luke, Vice Chairs Nishimoto and Johanson, and Members of the Committee.

Thank you for the opportunity to testify on HB 2626, HD1, a bill that establishes an income tax credit for taxpayers who incur certain expenses for manufacturing products in Hawaii.

DBEDT supports this bill, but notes that it does not currently have the staffing or funding to fulfill the obligation in Section 235(e) that requires DBEDT to “maintain records” for each taxpayer, “verify” the amounts, and “certify” the amount of the tax credits.

Additionally, DBEDT does not have access to the Department of Taxation’s information on taxpayers and we do not have the ability to maintain confidential taxpayer records.

DBEDT defers to the Department of Taxation on the tax implications and fiscal impacts on their programs in carrying out this initiative.

Thank you for the opportunity to comment.

Chamber of Commerce HAWAII
The Voice of Business

Testimony to the House Committee on Finance
Tuesday, February 25, 2014 at 11:15 A.M.
Conference Room 308, State Capitol

RE: HOUSE BILL 2626, HD1 RELATING TO TAXATION

Chair Luke, Vice Chairs Nishimoto and Johanson, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") **strongly supports** and asks for some **amendments** on HB 2626, HD1 Relating to Taxation.

The Chamber is the largest business organization in Hawaii, representing over 1,000 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

The Chamber supports this bill as part of its economic development package. There are approximately 1,000 active manufacturers in the state that employ almost 17,000 people at an average compensation rate of $42,896 or over $6,000 more than the average private non-farm employee. Manufacturers helped Hawaii's economy by contributing nearly $570 million in manufactured goods exported in 2012.

The bill gives a 20% tax credit to companies on their expenditures for manufacturing equipment and the training of their employees. We believe that this credit will help fuel manufacturing in Hawaii to grow and provide more products for both local consumption and export. There is movement to manufacture more back in the U.S. At the same time, Hawaii still has some competitive disadvantages. This credit will help companies in Hawaii to start or grow their operations.

According to the National Association of Manufacturers, every new manufacturing job created adds another 1.6 jobs to the local service economy, and for every dollar in manufacturing sales, another $1.34 is added to the economy. Investments in manufacturing have a stronger impact than investments in most other economic sectors.

While we understand the Department of Taxation's concern over double dipping, we ask that this tax credit **not** apply for businesses planning to use the tax benefits of the Enterprise Zone Program. Many businesses utilize this program to start or help grow their business. While there may be some overlap with the manufacturing credit in this bill, the manufacturing credit is

Chamber of Commerce Hawaii
1132 Bishop Street, Suite 402
Honolulu, Hawaii 96813

an investment credit for equipment and training, which for many will be a onetime expense. The Enterprise Zone Program is to attract and support businesses who invest in rural or depressed areas and is based on operational income. Limiting businesses to one tax program may hamper efforts to support manufacturing especially on the neighbor islands and certain parts of Oahu. Therefore we ask that the bill be amended to allow companies to utilize both tax programs.

Thank you for the opportunity to testify on this matter. Mahalo.

HTDC Cultivating Hawaii's tech sector
HIGH TECHNOLOGY DEVELOPMENT CORPORATION

Written Statement of
ROBBIE MELTON
Executive Director & CEO
High Technology Development Corporation
before the
HOUSE COMMITTEE ON FINANCE
Tuesday, February 25, 2014
11:15 a.m.
State Capitol, Conference Room 308
In consideration of

HB 2626 RELATING TO TAXATION.

Chair Luke, Vice Chairs Nishimoto and Johanson, and Members of the Committee on Finance.

The High Technology Development Corporation (HTDC) **supports** HB 2626 HD1 relating to Taxation. HTDC supports the growth of manufacturing in Hawaii and this bill has the potential to financially benefit businesses and incent others to manufacture products in Hawaii. Hawaii needs more "Made in Hawaii" to decrease our dependence on imported goods as well as export revenues.

HTDC defers to DBEDT and DOTAX on the reporting and filing requirements included in the bill. HTDC respectfully requests the correction of the defective effective date.

Thank you for the opportunity to offer these comments.

HAWAII STRATEGIC DEVELOPMENT CORPORATION

Written Statement of

KARL FOOKS
President
Hawaii Strategic Development Corporation

Before the
COMMITTEE ON FINANCE

February 25, 2014
11:15 AM
State Capitol, Conference Room 308

In consideration of
HB 2626 HD 1 RELATING TO TAXATION

Chair Luke, Vice Chair Nishimoto, Vice Chair Johanson and Members of the Committee on Finance:

The Hawaii Strategic Development Corporation (HSDC) respectfully submits testimony in support of the intent of HB 2626 HD 1.

A vibrant manufacturing sector will be important to grow a viable and sustainable export economy. HSDC supports efforts that can help to develop Hawaii's manufacturing capacity.

We recommend the Legislature consider a comprehensive strategy to link support for the manufacturing sector with entrepreneurial development and investment capital to stimulate an entire ecosystem that supports the goal of this legislation of building a globally competitive manufacturing sector.

Thank you for the opportunity to provide testimony.

HFIA
HAWAII FOOD INDUSTRY ASSOCIATION

Executive Officers:
Stanley Brown, ConAgra Foods - Chairperson
John Schilf, RSM Hawaii - Vice Chair
Derek Kurisu, KTA Superstores - Treasurer
Lisa DeCoito, Aloha Petroleum - Secretary
Lauren Zirbel, Executive Director

1050 Bishop St. PMB 235
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TO:
HOUSE COMMITTEE ON FINANCE
Rep. Luke, Chair
Rep. Nishimoto and Rep. Johanson, Vice Chairs

FROM: HAWAII FOOD INDUSTRY ASSOCIATION
Lauren Zirbel, Executive Director

DATE: February 25, 2014
TIME: 11:15am
PLACE: Conference Room 308

RE: HB 2626

Position: Support

The Hawaii Food Industry Association is comprised of two hundred member companies representing retailers, suppliers, producers and distributors of food and beverage related products in the State of Hawaii.

The tax credit proposed in this bill would help grow and diversify our economy, keep more dollars in Hawaii, decrease our dependence on imports, and grow and strengthen the Made in Hawaii brand.

Research has shown that a diversified economy and a business friendly tax climate are both key factors in keeping unemployment low. This bill could allow current manufacturers in our state to grow their businesses and can open the door for even more production here in Hawaii. This means more jobs and a stronger economy for the entire state.

Increasing manufacturing will also mean we are less reliant on imported goods. We currently import over 90% of the products we use here in the state. This situation leaves us vulnerable to any supply chain interruptions, adds shipping cost to almost all goods, and sends millions of dollars a year out of the state. Importing less and making more can have wide reaching positive impacts for everyone from the manufacturers to the consumers.

This bill will also open the door for more products to earn the distinction of being Made in Hawaii. The products we currently make here in the state have a worldwide reputation for quality and excellence. There is strong demand both in and out of the state for more products of that high caliber, and this bill can help grow our manufacturing industry to meet that demand.
For these reasons we ask that you please vote yes on this measure.

Thank you for the opportunity to testify.

KYD, Inc. dba k. yamada distributors
An independent leader in packaging and wholesale distribution
P.O. BOX 29669, Honolulu, Hawaii 96820 Phone: (808) 836-3221 Fax: (808) 833-8995

HB2626hd1, Relating to Taxation
House Finance Committee – Tuesday, February 25, 2014
Agenda 2 – 11:15am
Room 308
Written Testimony by: Dexter Yamada
Position: Support

Chair Luke and Members of the House Finance Committee:

I am Dexter Yamada, President of KYD, Inc. dba: K. Yamada Distributors. KYD, Inc. is a local family run business that originated in the 1940's as a florist and florist supply distributor, and in 1958, evolved into a packaging company. Today, KYD, Inc and its sister company, Hawaii Foam Products, LLC, employ about 100 employees and contribute to Hawaii's economy through taxes and payroll based on $35 million annual revenue. Our companies manufacture packaging materials such as food-grade EPS (Expanded Polystyrene) food containers, and distribute a variety of supplies, to include compostable containers, for food processors, food establishments, supermarkets, hotels hospitals and other institutions.

We appreciate this measure that supports Hawaii's manufacturing industry. Locally manufactured products contribute to import replacement, and help with local job creation. The temporary tax credit will encourage companies to invest in equipment purchases and train employees to manufacture locally made products. This in turn, lends to greater efficiency and reduction in the cost of products to customers.

Thank you for the opportunity to testify.

WILL CALL, G&A, AND WAREHOUSE OFFICES: 2949 Koapaka Street, Honolulu, Hawaii 96819-1923 Phone: (808) 836-3221 Fax: (808) 833-8995

HB2626hd1, Relating to Taxation
House Finance Hearing – Agenda 2
Tuesday, Feb. 25, 2014
11:15 am – Room 308

Written Testimony By: Glenn Muranaka

Position: Support

Chair Luke and Members of the House Finance Committee:

My name is Glenn Muranaka, President and General Manager of Meadow Gold Dairies. Our company has been in Hawaii since 1897—117 years, providing Hawaii consumers with a variety of milk products and juices. Meadow Gold's long history has not come without effort. We continually adapt to our customers' and consumers' ever-changing needs, and we constantly evolve along with our industry, our community and our market. Over the years, this has required that we struggle, tighten our belts, innovate and work extremely hard, making us a better company in the process. The foundation of this work rests with the 330 employees that are committed to providing superior quality products.

I support this bill as part of the Chamber of Commerce's economic development package. There are approximately 1000 active manufacturers in the state that employ almost 17,000 people at an average compensation rate of $42,896 or over $6,000 more than the average private non-farm employee. Manufacturers helped Hawaii's economy by contributing nearly $570 million in manufactured goods exported in 2012.

The bill gives a 20% tax credit, not to exceed $200,000, to companies on their expenditures for manufacturing equipment and the training of their employees. We believe that this credit will help fuel manufacturing in Hawaii to grow and provide more products for both local consumption and export. There is movement to begin to manufacture more back in the U.S. At the same time Hawaii still has some competitive disadvantages. This credit will help companies in Hawaii to start or grow their operations.

Your support of this measure is appreciated. Thank you for the opportunity to submit testimony. I can be reached at 944-5911 if there are any questions.