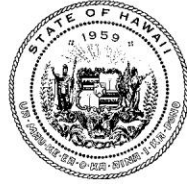


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DEPUTY DIRECTOR

To: The Honorable Roy M. Takumi, Chair  
and Members of the House Committee on Education

Date: Wednesday, January 30, 2013

Time: 2:00 p.m.

Place: Conference Room 309, State Capitol

From: Frederick D. Pablo, Director  
Department of Taxation

Re: H.B. 569 Relating to a Tax Credit for After-School Programs

The Department appreciates the intent of H.B. 569 and provides the following information and comments for your consideration.

H.B. 569 establishes a tax credit against corporate income tax for sponsoring after-school programs. The credit is equal to the costs required to develop and implement an after-school program. The credit is limited by a percentage of the taxpayer's net tax liability for that year. The unused credit can be carried forward until exhausted.

As stated previously, the Department appreciates the intent of the bill; however, the Department finds several technical issues with the bill as drafted.

First, it is not clear whether the credit is intended to be nonrefundable or refundable. The bill limits the credit by stating the maximum credit as a percentage of the corporation's net tax liability. To the extent this refers to Hawaii state income tax liability (see below), and if the percentage is 100 per cent or less, then the credit is effectively a nonrefundable credit. The bill further provides that any credit exceeding a percentage of the corporation's income tax liability may be carried forward. This also suggests the intent of the bill is to create a nonrefundable credit. However, this language could effect a refundable credit if both percentages exceed 100 per cent. If the intent of the bill is to create a nonrefundable credit the Department recommends including an explicit statement to that effect.

Second, the intent of the bill is clouded by the structure of the credit's operation. In subsection (b) the bill uses a percentage to limit the amount of the credit for each taxable year; the bill then uses a percentage in subsection (c) to allow carry forward of unused credit. If it is the intent of the bill that these percentages be equal, thus allowing all unused credit to carry forward, then the Department recommends removing the reference to the percentage in subsection (c) and replacing it with a reference to subsection (b). This would define the amount of the credit carry forward in the same terms that define the credit itself. This recommendation is to simplify and clarify the operation of the credit and to avoid the necessity of amending both subsections each time the percentage is adjusted.

Third, the tax bases the bill refers to are unclear. Subsection (b) refers to 'the corporation's net tax liability' while subsection (c) refers to 'net corporation income tax liability'. Neither refers specifically to Hawaii's state income tax on corporations; neither is defined. Subsection (b) does not refer to any specific tax; therefore the percentage could apply to the corporation's liability to all taxes, both federal and state. Subsection (c) does not specify the Hawaii state income tax and thus could refer to both federal and state income tax. If it is the intent to determine the amount and timing of the credit based on the percentage of the corporation's Hawaii state income tax liability, then it is recommended that the references be amended to refer to that tax specifically. This recommendation is to clarify the basis of the percentage used to calculate the proposed credit.

Finally, subsection (c) allows the credit to be carried forward, regardless of whether the taxpayer continues to sponsor any after-school program. The Department recommends limiting carry forward only for tax years during which the taxpayer actually sponsors an after-school program. This recommendation will ensure that the tax credit does not outlive the program that generated it, and will limit the potential for abuse.

Thank you for the opportunity to provide comments.

# TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

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**SUBJECT:** INCOME, Tax credit for sponsorship of after-school program

**BILL NUMBER:** HB 569

**INTRODUCED BY:** Ichiyama, Hanohano, Har, Hashem, Ito, Kawakami, Morikawa, Nakashima, Ohno, Say, Takayama, Takumi, Yamashita

**BRIEF SUMMARY:** Adds a new section to HRS chapter 235 to allow a corporate taxpayer, including a corporation carrying on business in partnership, to claim a tax credit for sponsoring an after-school program in conjunction with a public school. The tax credit shall be equal to 100% of the qualified cost of sponsoring an after-school program provided that the credit shall not exceed \_\_\_% of the corporation's net tax liability for the tax year the credit is claimed.

Defines "after-school program" as a program that takes place when school is not in session or outside of regular school hours and is for the educational, enrichment, and recreational activities of children enrolled in a public school. Such programs do not include a program whose primary mission is childcare. Defines "qualified costs" as the costs of materials and labor required to develop and implement an after-school program.

Credits in excess of \_\_\_% of a corporation's income tax liability may be used as a credit against tax liability in subsequent years until exhausted. 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 every claim for the credit, including amended claims, to be filed on or before the end of the twelfth month following the close of the taxable year for which the tax credit may be claimed; failure to meet such requirements shall constitute a waiver of the right to claim the tax credit.

**EFFECTIVE DATE:** Tax years beginning after December 31, 2012

**STAFF COMMENTS:** The proposed measure would permit certain corporate taxpayers to claim an income tax credit of 100% of the cost of materials and labor to develop and implement an after-school program for children enrolled in public schools. It should be remembered that the use of the tax system to promote or encourage social goals is an inefficient use of the system. If enacted, this proposal would result in nothing more than a total subsidy by the state and would not in any way address the taxpayer's need for tax relief.

Unless there is some sort of tax burden associated with the provision of such programs, there is absolutely no relationship between the provision of such services and the burden that the tax system imposes on the taxpayer. If this measure is enacted, it will open the door for similar requests for tax subsidies that will deplete the state funds.

In addition, it should be noted that these proposed credits are worthless to any business that is not making a profit as any excess credits over tax liability will not be refunded to the taxpayer. Thus, unless

a corporation is profitable, there will be no profits to tax and there will be no tax liability against which to apply the proposed credits.

Finally, given that the amount of the credit is equal to the cost of the after school program, why even involve the business as it is nothing more than an expenditure of public dollars to fund that program. Further, the bill provides no oversight or evaluation of the “after school program” and the proposal only specifies that it be for “educational, enrichment, and recreational activities of children enrolled in public school in Hawaii.” The only prohibition is that it not be for “childcare.” Who is to judge whether or not the after school program meets the criteria and is appropriate? Note also that it is only for children enrolled in public school. So does that mean no child who may be enrolled in a private school may participate in such a program or does participation of a private school child in the program disqualify the corporation for the credit?

Again, this is a poorly drafted bill to which little thought has been given to the unbridled backdoor expenditures of precious public resources.

Digested 1/28/13