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To: The Honorable David Y. Ige, Chair
and Members of the Senate Committee on Ways and Means

Date: Tuesday, March 25, 2014
Time: 9:10 A.M.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. 2169, H.D. 1, Relating to Tourism Stimulus Incentives

The Department of Taxation (Department) appreciates the intent of H.B. 2169, H.D. 1, to support our State's tourism industry. However, the Department has serious concerns its ability to enforce the proper application of the proposed tax incentives and has summarized these concerns for the Committee's consideration.

H.B. 2169, H.D. 1, creates a non-refundable income tax credit for wages paid to certain qualified employees, creates a general excise tax exemption for hotel and resort construction and renovation, and creates a seven-year general excise tax exemption for the operation of such constructed or renovated hotels or resorts. H.D. 1 has a defective effective date of July 1, 2030.

First, in general, wages paid to employees are already deductible from the gross income of a business, lowering the total amount of income subject to tax; this proposed tax credit would create an additional tax benefit where a tax benefit already exists. However, the Department notes that the House Committee on Finance amended this measure to change the credit from refundable to non-refundable in the H.D. 1 version; the Department supports this amendment.

Second, the Department notes that the process for certifying facilities eligible for purposes of qualifying taxpayers for this tax credit is administratively problematic for the Department and could lead to significant abuse, with little recourse for the State, even if the abuse is discovered relatively quickly. In particular, the Department is concerned that the certification requirements requires little more than having employers provide to the Department of Business, Economic Development and Tourism (DBEDT), a report of estimated costs of the project.

The Department notes, however, that it would not be able to verify whether a taxpayer actually expended those estimated costs until 2021, at which point the statute of limitations would have expired; thus, there would be no way for the Department to audit, assess and reclaim any incorrectly claimed tax credits or general excise tax exemptions taken during those prior taxable years.

Lastly, the Department notes that "department" is defined as DBEDT in H.D. 1. Because these provisions would be added to chapters 235 and 237, which fall under the authority of the Department of Taxation, the Department recommends that "department" be defined to mean the Department of Taxation, and that references to DBEDT be specifically referenced where appropriate. Section 235-17, relating to the motion picture, digital media and film production income tax credits, is an example of a statute set forth in this manner.

Thank you for the opportunity to provide comments.



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Neil Abercrombie
Governor

Mike McCartney
President and Chief Executive Officer

Testimony of
Mike McCartney
President and Chief Executive Officer
Hawai'i Tourism Authority
on
H.B. 2169, H.D. 1
Relating to Tourism Stimulus Incentives.

Senate Committee on Ways and Means
Tuesday, March 25, 2014
9:10 a.m.
Conference Room 211

The Hawai'i Tourism Authority (HTA) supports H.B. 2169, H.D. 1, which proposes a nonrefundable tax credit of a percentage of wages paid to qualified employees for a period after completion of the construction or renovation of a hotel or resort facility.

The HTA is tasked with marketing and promoting Hawaii as a visitor destination, with the goal of increasing visitor spending. One of the keys to branding the Hawaii visitor industry product and increasing visitor spending is the improvement and enhancement of the tourism product, which includes the physical infrastructure. As such, the HTA supports H.B. 2169, H.D.1, which provides the private sector with investment incentives to improve hotel facilities. How the incentives are to be implemented and the amount and duration of the incentives are a matter for the Legislature to determine.

Thank you for the opportunity to offer these comments.

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SUBJECT: INCOME, GENERAL EXCISE, Employer tax credit; hotel construction and remodeling tax exemption

BILL NUMBER: HB 2169, HD-1

INTRODUCED BY: House Committee on Finance

EXECUTIVE SUMMARY: This measure proposes: (1) an income tax credit for the hiring of employees for the newly constructed or renovated hotel facility for a period of seven years after the completion of such construction or renovation; and (2) a general excise tax exemption for the gross income earned from the construction or renovation of a hotel facility or resort facility in the state that is completed by June 30, 2021. As a policy matter, an evaluation should be done of the prior version of this credit in order to give lawmakers data as to whether this one is likely to be effective. Instead of subsidizing construction in order to get construction workers off the bench, government can assist by streamlining the permitting process, allowing certification of building plans by professional architects and engineers instead of approval by the building departments.

As reported by the Committee on Tourism, we raised a concern about whether the bill as it now exists violates the Commerce Clause of the U.S. Constitution. We describe the issue further below and urge the Committee to seek appropriate legal advice before advancing the bill.

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to provide that each qualified employer shall be allowed a tax credit of ___% of the wages paid to each qualified employee during a tax year. The tax credit allowed under this section shall be available for the seven tax years following the end of the taxable year in which the certified facility was substantially completed as defined under HRS section 237-____. The tax credit shall be applicable to tax years beginning after December 31, 2014.

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

Defines "certified facility" as a hotel facility or resort facility that has been pre-certified by the department of business, economic development and tourism (DBEDT) under section 237- _____. Also defines "department," "qualified employee," "qualified employer" and "wages" for purposes of the measure.

Adds a new section to HRS chapter 237 to provide that gross income earned from the construction or renovation of the hotel or resort facility shall be exempt from the general excise tax. Defines "construction or renovation of a hotel facility or a resort facility" as the planning, design, construction, furniture and fixtures above routine maintenance, materials, and equipment related to new construction,

alterations, remediation, or modifications of a hotel facility or resort facility in the state that is substantially completed by June 30, 2021; provided that: (1) the costs exceed \$50 million by June 30, 2021; and (2) the general contractor and any subcontractors of the construction or renovation are signatory parties to collective bargaining agreements with the appropriate construction trade unions covering construction work in the state. The general excise tax exemption shall be applicable to taxable periods beginning after June 30, 2014.

The exemption is conditioned on the pre-certification by DBEDT of the construction or renovation of a hotel facility or resort facility based upon an application that: (1) is submitted by the owner, developer, or general contractor of the hotel facility or resort facility at any time before or during construction or renovation of the hotel facility or resort facility; (2) describes, in sufficient detail, the construction or renovation of the hotel facility or resort facility; (3) estimates the costs of construction or renovation and tax exemptions and credits to be claimed under this section and HRS section 235- ; and (4) includes all other information prescribed by the department.

Requires DBEDT to maintain records of the names of taxpayers claiming the exemption, the amount of the exemption claimed, and prepare an annual report of the records that shall be made public.

Defines “department,” “hotel facility,” “resort facility” and “substantially completed” for purposes of the measure.

EFFECTIVE DATE: July 1, 2030

STAFF COMMENTS: The legislature by Act 195, SLH 2000, enacted a hotel construction and renovation income 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.

The original income 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.

Rather than an income tax credit based on construction costs, this measure proposes a general excise tax exemption for: (1) the gross income earned from the construction or renovation of a hotel facility or resort facility in the state that is completed by June 30, 2021; and (2) an income tax credit for the hiring of employees for the newly constructed or renovated hotel facility for a period of seven years after the completion of such construction or renovation.

It should be noted that no evaluation has been done to validate the effectiveness of previous income tax credits 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.

It should be remembered that exemptions from the general excise tax that are not predicated on providing tax relief tend to skew the economic landscape, shifting not only tax burdens but economic activity from one period to another. Such was the case for the general excise tax exemption for the building of affordable housing in the early 1990's. The incentive was that the first 10,000 affordable housing units built before December 31, 1994 would be exempt from the state general excise tax. As a result, developers rushed in to build as many affordable housing units as they could before that deadline. Unfortunately, just as the deadline arrived, the Japanese bubble burst and the developers were left holding huge unsold inventories of housing as there were no buyers in the market for those units.

How the economic recovery will shake up is anyone's guess. Many of the hotel renovation projects which were shuttered are a by-product of not only tight capital markets but also a sluggish visitor market. Why renovate hotel rooms when the prospect for a pick-up in visitor count is dour?

Instead of subsidizing construction in order to get construction workers off the bench, government can assist in a number of other ways. Streamlining the permitting process, allowing certification of building plans by professional architects and engineers instead of approval by the building departments are but a few ways construction activity can be rejuvenated.

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.

In terms of technical comments, we note that the credit is awarded only if the general contractor and any subcontractors of the construction or renovation are signatory parties to collective bargaining agreements with the appropriate construction trade unions covering construction work in the state. *In re Hawaiian Flour Mills, Inc.*, 76 Haw. 1, 868 P.2d 419 (1994), struck down a general excise tax exemption for products grown, raised, or caught in Hawaii as unconstitutionally discriminating against other states' products in violation of the Commerce Clause of the U.S. Constitution. If the intent or effect of the bill is to restrict the credit to businesses with local contractors and subcontractors and thereby discriminate against contractors and subcontractors in other states, the credit may run afoul of the Commerce Clause. We would urge the Committee to get appropriate legal advice on this issue before moving the bill forward.

Digested 3/24/14

**Comments of
Gary M. Slovin / Mihoko E. Ito
on behalf of
Wyndham Vacation Ownership**

DATE: March 23, 2014

TO: Senator David Ige
Chair, Committee on Ways and Means
Submitted Via WAMTestimony@capitol.hawaii.gov

RE: **H.B. 2169 H.D.1 – Relating to Tourism Stimulus Incentives
Decision Making: Tuesday, March 25, 2014 at 9:10 a.m.
Conference Room: 211**

Dear Chair Ige and Members of the Committee on Ways and Means,

We submit these comments on behalf of Wyndham Vacation Ownership. Wyndham offers individual consumers and business-to-business customers a broad suite of hospitality products and services through its portfolio of world-renowned brands. Wyndham Vacation Ownership has a substantial presence in Hawaii through its Wyndham Vacation Resorts and WorldMark by Wyndham brands.

Wyndham **supports H.B. 2169 H.D.1**, which provides an income tax credit for employers that hire certain individuals at new or renovated hotel and resort facilities for seven years after substantial completion of construction and renovation, and a general excise tax exemption for hotel and resort construction and renovation projects.

The visitor industry is a very significant part of Hawaii's economy, and creates and supports many jobs for the State. Hawaii's hotel and resort infrastructure is aging, and traditional financing has not spurred necessary renovations and new construction. Providing this tax incentive will not only create new jobs, but will help create and maintain facilities that attract tourists and keep Hawaii's principal industry competitive in the global market.

For the above reasons, Wyndham supports this measure and respectfully requests that this Committee pass it for further consideration.

Thank you for the opportunity to submit comments on this measure.

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The Senate
The Twenty-Seventh Legislature
Committee on Ways and Means
March 25, 2014, 9:10 a.m.
Room 211



Statement of the Hawaii Regional Council of Carpenters on
H.B 2169 HD1, Relating to Tourism Stimulus Incentives

The Hawaii Regional Council of Carpenters supports the intent of the Bill, which is needed to keep a respectable market share in the highly competitive, worldwide visitor industry.

While there are hopeful projections for increased construction activity in Hawaii, financing for the construction and renovation of transient accommodations remains limited. Tax credits will support the feasibility of projects, increasing the possibility that private funding will be secured. Our visitor industry has found the lack of available rooms to be a handicap.

The tax credits are State resources through which construction projects will be undertaken, and we appreciate that the Bill gives attention to the accountability of recipient taxpayers to serving State purposes and meeting State requirements, as with any other State subsidy. The passage of the Bill will allow the refinement of a workable system for accountability.

Thank you for considering a stimulus to producing world class facilities for our visitor industry.