

NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
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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: 9:05 a.m.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. No. 2626, H.D.2, S.D.1, Relating to Taxation

The Department of Taxation (Department) provides the following comments regarding H.B. 2626, H.D.2, S.D.1, for your consideration. The Department defers to the Department of Business, Economic Development, and Tourism regarding the certification and reporting requirements proposed under subsection (e).

H.B. 2626, H.D.2, S.D.1, establishes a nonrefundable income tax credit for taxpayers who incur certain expenses for manufacturing products in Hawaii. Specifically, this measure would provide a nonrefundable income tax credit of an unspecified percentage 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. The tax credit, as proposed, applies to taxable years beginning after December 31, 2014, and is repealed on January 1, 2023. S.D.1 has a defective effective date of July 1, 2050.

First, the Department notes that there is currently no time frame in which the installation and use be accomplished in order to qualify for the credit. The Department suggests adding such a requirement to ensure that the purpose of this credit is effectuated.

Second, the Department notes that as currently written, both the seller of equipment and machinery which would be used to manufacture tangible personal property in the State and the taxpayer actually placing the equipment in service, would be eligible for the credit. The Department recommends that this issue be clarified, as it does not seem to align with the purpose of the credit.

Third, the Department believes that the credit should apply only to the taxpayer who first places such equipment or machinery in service in this State, and not to any subsequent user if the equipment is later resold. This will prevent a taxpayer from selling equipment and machinery on which the credit has been obtained to another (possibly related) taxpayer, and then having the second taxpayer again claiming the credit based upon the amount that it paid.

To remedy the above-referenced concerns and ensure the Department is able to administer and enforce the terms of this measure, the Department recommends that "qualified manufacturing costs" be defined as follows:

- "Qualified manufacturing costs" means expenditures for:
- (1) Costs incurred to purchase equipment to be used by the taxpayer in manufacturing tangible personal property in the State and which is placed in service within one year after the date of purchase, provided that the credit under this section has not been previously claimed by any taxpayer in this State on such equipment; and
 - (2) Costs incurred to train employees to manufacture tangible personal property in the State."

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. However, to avoid disagreements with taxpayers over whether electricity generation is an eligible activity, 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) or in the definition of "qualified manufacturing costs" 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.



Written Statement of

KARL FOOKS
President

Hawaii Strategic Development Corporation

Before the
COMMITTEE ON WAYS & MEANS

March 25, 2014
9:05 AM
State Capitol, Conference Room 211

In consideration of
HB 2626 HD 2 SD 1 RELATING TO TAXATION

Chair Ige, Vice Chair Kidani, and Members of the Committee on Ways & Means:

The Hawaii Strategic Development Corporation (HSDC) respectfully submits testimony in support of the intent of HB 2626 HD 2 SD 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.



**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT & TOURISM**

NEIL ABERCROMBIE
GOVERNOR

RICHARD C. LIM
DIRECTOR

MARY ALICE EVANS
DEPUTY DIRECTOR

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Statement of
RICHARD C. LIM
Director

Department of Business, Economic Development, and Tourism
before the

SENATE COMMITTEE ON WAYS AND MEANS

Tuesday, March 25, 2014
9:05 a.m.
State Capitol, Conference Room 211
In consideration of

HB2626, HD2, SD1
RELATING TO TAXATION.

Chair Ige, Vice Chair Kidani, and Members of the Committee.

Thank you for the opportunity to testify on HB2626, HD2, SD1, 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 requiring DBEDT to “certify” the tax credits. We also do not have access to the Department of Taxation’s information on taxpayers nor do we have the ability or authority to maintain confidential taxpayer records.

Instead DBEDT prefers the approach taken in Act 270 (13) to provide the Legislature with information on the utilization of the tax credits to create jobs. The online form for the tax credit for research activities (Act 270 13) is currently available at <http://dbedt.hawaii.gov>.

We respectfully request that language from page 3, line 14 through page 4, line 12 be replaced with language as suggested on the attachment to this testimony.

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

Thank you for the opportunity to comment.

DBEDT's requested language:

(e) The taxpayer that claims the credit under this section shall complete and file with the department of business, economic development, and tourism, through that department's website, an annual survey on electronic forms prepared and prescribed by the department of business, economic development, and tourism. The annual survey shall be filed before June 30 of each calendar year following the calendar year in which the credit may be claimed under this section. The department of business, economic development, and tourism may adjust the due date of the annual survey by rules adopted pursuant to chapter 91.

(1) The annual survey shall include the following information for the time period or periods specified by the department of business, economic development, and tourism:

- (a) Total expenditures and the qualified expenditures, if any, expended in the previous taxable year;
- (b) Revenue and expense data, including a breakdown of any licensing royalty or other forms of income generated;
- (c) Hawaii employment and wage data, including the numbers of full-time and part-time employees retained, new jobs, temporary positions, external services procured by the business, and payroll taxes;
- (d) Amount of tax credits claimed and total taxed paid;
and
- (e) Any other factors the department of business, economic development, and tourism deems relevant.

(2) The department of business, economic development, and tourism, in collaboration with the department of taxation, shall use the information collected to study the effectiveness of the tax credit under this section. The department of business, economic development, and tourism shall submit a report to the legislature on an annual basis.

Written Statement of
ROBBIE MELTON
Executive Director & CEO
High Technology Development Corporation
before the
SENATE COMMITTEE ON WAYS AND MEANS

Tuesday, March 25, 2014
9:05 a.m.
State Capitol, Conference Room 211
In consideration of

HB 2626 HD2 SD1 RELATING TO TAXATION.

Chair Ige, Vice Chair Kidani, and Members of the Committee on Ways and Means.

The High Technology Development Corporation (HTDC) **supports** HB 2626 HD2 SD1 relating to Taxation. HTDC supports the growth of manufacturing in Hawaii and this bill has the potential to financially benefit businesses and incentivize 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.



**Testimony to the Senate Committee on Ways and Means
Tuesday, March 25, 2014 at 9:05 A.M.
Conference Room 211, State Capitol**

RE: HOUSE BILL 2626 HD2 SD1 RELATING TO TAXATION

Chair Ige, Vice Chair Kidani, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") **strongly supports** and asks for some **amendments** on HB 2626 HD2 SD1 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.

We ask that the bill give 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 the double dipping provision **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 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



Chamber *of* Commerce HAWAII
The Voice of Business

certain rural parts of Oahu. Therefore we ask that the bill be amended to allow companies to utilize both tax programs. Also we would appreciate language to make the credit refundable.

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



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March 25, 2014

HEARING BEFORE THE
SENATE COMMITTEE ON WAYS AND MEANS

TESTIMONY ON HB 2626, HD2, SD1
RELATING TO TAXATION

Room 211
9:00 AM

Aloha Chair Ige, Vice Chair Kidani, and Members of the Committee:

I am Christopher Manfredi, President of the Hawaii Farm Bureau Federation (HFB). Organized since 1948, the HFB is comprised of 1,832 farm family members statewide, and serves as Hawaii's voice of agriculture to protect, advocate and advance the social, economic and educational interest of our diverse agricultural community.

HFB supports HB 2626, HD2, SD1, which is 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 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 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.

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 most other economic sector. This is a wise investment for Hawaii.

Please support HB 2626, HD2, SD1.

Thank you.



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

HB2626hd2, sd1, Relating to Taxation
Senate WAM Committee – Decision Making Hearing
Tuesday, March 25, 2014 – 9:05am
Room 211
Written Testimony by: Dexter Yamada
Position: Support

Chair Ige and Members of the Senate WAM 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. 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. Your consideration of this measure is requested.
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



Meadow Gold Dairies



HB2626hd2, sd1, Relating to Taxation
Senate WAM Decision Making Hearing
Tuesday, March 25, 2014
9:05am – Room 221

Written Testimony By: Glenn Muranaka

Position: Support

Chair Ige and Members of the Senate WAM 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.

We believe that this tax 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 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 continued discussion and 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.

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, SD-1

INTRODUCED BY: Senate Committee on Economic Development, Government Operations and Housing

EXECUTIVE SUMMARY: Establishes an income tax credit of ___% of qualified manufacturing costs incurred in a taxable year, not to exceed \$_____. The adoption of this credit would result in a subsidy of state funds. Lawmakers should consider the criteria established by the 2001-2003 Tax Review Commission (discussed below) before enacting this or any other new business incentive that operates through the tax system.

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

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 applied to subsequent tax liability 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. 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: July 1, 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. The credit proposed by this measure amounts to nothing more than a 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.

In addition, we note that the bill awards credit for training costs. We wonder if that may be a little too loose; after all, isn't everyone who is employed in a manufacturing operation being trained to manufacture tangible personal property? If the intent is to award credit on something less than total payroll, appropriate clarifying language would appear to be needed.