L E G I S L A T I V E

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SUBJECT: INCOME, Manufacturing tax credit

BILL NUMBER: SB 3082, SD-1

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

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 taxpayer shall not exceed $200,000. Stipulates that the credit shall not be allowed for qualified costs that qualify for another state income tax credit.

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 rule; provided that distribution and share of the credit shall be determined by IRC section 704. 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 credit allowable and claimed.

Credits in excess of a taxpayer's income tax liability may be applied to subsequent income tax liability. 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. 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.

While the measure allows taxpayers to claim the credit regardless of a taxpayer's need for tax relief, the proposed credit is nothing more than a partial subsidy by the state to a taxpayer with absolutely no indication of the taxpayer's need for that subsidy. This type of targeted tax incentive creates winners and losers, the winners being those in the favored industry who receive the incentives and the losers being the rest of us who have to pay for them.

When judging targeted tax incentives such as this one, we recommend revisiting the criteria proposed by the 2001-2003 Tax Review Commission:

(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.

Rather than singling out a particular group for tax relief, concurrent efforts must be made to improve Hawaii's business climate to enhance the economic prospects for all businesses.

Digested 2/18/14