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LATE TESTIMONY

To: The Honorable Gilbert S.C. Agaran, Chair
and Members of the Senate Committee on Judiciary and Labor

Date: Monday, March 13, 2017
Time: 9:30 A.M.
Place: Conference Room 016, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 943, Relating to Economic Development

The Department of Taxation (Department) appreciates the intent of the measure, defers to the Department of Business, Economic Development, and Tourism (DBEDT) on the merits of this bill and provides the following comments regarding H.B. 943 for your consideration.

Among other things, H.B. 944 creates a new tax credit for qualifying businesses under the Kapolei Jobs Initiative pilot program. The measure is effective upon its approval and applies to taxable years beginning after December 31, 2017, and is repealed on December 31, 2024.

First, the Department notes that this proposed program is very similar to the current Enterprise Zone program found at chapter 209E, Hawaii Revised Statutes (HRS). Because of its similarity, and because the Kapolei region is already in an existing Enterprise Zone, the Department believes that it may be more efficient to amend the definition of "eligible business activity" under section 209E-2, HRS, rather than creating a new program which will require new rules, procedures, and forms. In addition, changes to the definition of "eligible business activity" would also benefit other economically depressed areas, rather than just Kapolei.

Second, the Department notes that proposed section 235-___(b)(2), HRS, would provide for a decreasing income tax credit based on "the amount of unemployment insurance accrued or paid by an employer under chapter 383." This differs from the current Enterprise Zone program by allowing unemployment insurance premiums accrued but unpaid to be counted in determining the income tax credit. The Department strongly recommends that this measure be amended to eliminate the reference to accrued unemployment insurance to prevent an employer from obtaining an income tax credit based on amounts which have not actually been paid.

Third, the Department notes that there is an aggregate cap of an unspecified amount in subsection (b). The Department has serious concerns about its ability to administer an aggregate cap. Additionally, certifying an amount that a taxpayer may claim gives the wrong impression that the credit will not be examined and possibly reduced. The Department strongly suggests that the aggregate cap be deleted, or that the duty of managing the aggregate cap be assigned to another agency.

In addition, procedures as to administering the aggregate cap should be specific, such as on a first come first served basis, or some sort of division of the allowed credit for requests that are received before a specified date.

Fourth, the Department recommends that once the cap is reached, any excess claims be allowed in the following year, but in no event beyond the sunset of the credit. The Department suggests the following language, instead of proposed section (h)(3), as follows:

> (3) The taxpayer shall file such certificate with the taxpayer's return. Any taxpayer who is not eligible to claim the credit in a taxable year due to the $__________ cap having been exceeded for that taxable year shall be eligible to claim the credit in the subsequent taxable year, but in no event after December 31, 2024.

Finally, the Department notes that it is able to administer this measure with the current effective date.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

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LATE TESTIMONY

SUBJECT: INCOME, UNEMPLOYMENT, Kapolei jobs initiative program

BILL NUMBER: HB 943, SB1192 (Identical)

INTRODUCED BY: HB by CULLEN, AQUINO, LOPRESTI, SAY, YAMANE; SB by GABBARD, ESPERO, SHIMABUKURO, S. Chang, Ihara, Inouye, Keith-Agaran, Kidani, Ruderman

EXECUTIVE SUMMARY: Enacts a Kapolei jobs initiative similar to the current Enterprise Zone program, but with different requirements. We question why this program is not being made available to other localities in the State.

BRIEF SUMMARY: Adds a new HRS chapter called Kapolei Jobs Initiative.

Defines a "full-time employee" as any employee, including a leased employee and an employee under a joint employment arrangement, for whom the employer is legally required to provide employee fringe benefits.

Defines a "qualified business" as a business that: (1) establishes or opens a new location within the designated geographic area (defined as the zip codes 96706, 96707, and 96709); (2) if opening a new location within the designated geographic area, has a minimum of ten full-time employees working at the establishment in the designated geographic area; or, if already established in the designated geographic area and expanding or building a new establishment in the same area, has a net gain of ten full-time employees; (3) provides gross annual salaries of $25,000 or more to at least half of its employees at the establishment in the designated geographic area; (4) earns at least half of its gross annual revenue from its establishment in the designated geographic area; (5) is not participating in the state enterprise zone program pursuant to chapter 209E; and (6) excludes retail, except when greater than fifty per cent of sales are to Hawaii general excise tax licensees.

Adds a new section in HRS chapter 235 that provides for an income tax credit equal to __% of the taxpayer's net income tax liability (liability attributable to activity in Kapolei) in the year of qualification, and a credit of __% less in each of the subsequent four years for any income tax due.

Provides for an additional credit equal to __% of the taxpayer's unemployment insurance contributions (attributable to activity in Kapolei) in the year of qualification, and a credit of _% less for each of the subsequent four years.

Provides that a maximum of $_____ of tax credits in the aggregate for all eligible taxpayers may be used in any one taxable year.

Provides that the credit is not refundable, but may be carried forward a maximum of five consecutive years. Establishes an aggregate maximum of $_____ per year that may be used by all eligible taxpayers. States that all credit claims, including amended claims, shall 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 do so constitutes a waiver of the right to claim the tax credit.

In the case of a partnership, S corporation, estate, or trust, the tax credit allowable is for the qualified costs incurred by the entity for the taxable year. The cost upon which the tax credit is computed shall be determined at the entity level. Distribution and share of the tax credit shall be determined pursuant to section 704(b) (with respect to partner's distributive share) of the Internal Revenue Code.

Provides that the director of taxation shall prepare any forms that may be necessary to claim a credit under this section, may require the taxpayer to furnish information to ascertain the validity of the claim for the tax credit made, and may adopt rules under chapter 91.

EFFECTIVE DATE: Effective upon approval; shall apply to taxable years beginning after December 31, 2017; and shall be repealed on June 30, 2024.

STAFF COMMENTS: The enterprise zone program in chapter 209E, HRS, was enacted as a cooperative program between the state and the counties to promote jobs in areas of high unemployment. Certain areas are designated as enterprise zones through joint action of the state and counties. In a zone, the state offers an income tax credit for the tax attributable to the eligible business conducted in the zone, which is normally applied on a sliding scale – 80% for the first year, 70% for the second, and so on until the credit is 20% for the seventh and last year in the program. It also offers an unemployment tax credit for the tax attributable to employees doing the eligible business in the zone, on the same sliding scale. Finally, the state offers a general excise tax exemption for the eligible business attributed to the zone. The counties also offer incentives, which vary by county. In return, the business commits to either maintain or increase the number of employees in the zone doing the eligible activity, depending on whether it was already in the zone upon designation or moved to the zone.

As business incentives go, the enterprise zone program is better than most. The incentive applies to a specific activity (here, creating and maintaining employment) targeted to the problem the program seeks to address. The incentive tapers off over time and then stops. It requires accountability, namely required reports to DBEDT, for a business to retain its eligibility. The business itself may need a different kind of assistance, such as financing, but the state is focusing on creating and maintaining jobs in areas that need them.

The program established by this bill is separate from the enterprise zone program, as one of the requirements to qualify for this program is no participation in the enterprise zone program.

We question why Kapolei is so unique and special as to merit an extraordinary incentive. Aren't jobs also necessary or desirable in Puna, or Hana, or Princeville, all of which have been designated enterprise zones because of the relatively high unemployment there?

Digested 3/9/2017