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To: The Honorable Mike Gabbard, Chair
and Members of the Senate Committee on Agriculture & Environment

Date: January 31, 2018

Time: 1:30 P.M.

Place: Conference Room 224, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 3031, Relating to the Organic Foods Production Tax Credit.

The Department of Taxation (Department) defers to the Department of Agriculture (DOA) regarding the merits of S.B. 30131 and its ability to continue certifying the organic foods production tax credit (credit) and offers the following comments for your consideration.

S.B. 3031 amends the credit by amending Hawaii Revised Statutes (HRS) section 235-110.94, as follows:

- Specifies that when the \$2 million aggregate cap is exceeded, taxpayers may claim the credit on a pro rata basis;
- Authorizes the DOA to assess and collect a fee to offset the cost of certifying tax credit claims, but exempts any rules related to the fee from HRS chapter 91; and
- Amends the definitions of “qualified expenses” to exclude the production of organic foods.

First, the Department notes that it is unclear how exactly the credit on a “pro rata basis” will be calculated and administered if the \$2 million total cap on credits is exceeded in a taxable year. If the intent of this amendment is to divide the credit based on each taxpayer’s claim amount, the allocation calculation should be specified in the statute.

Second, the Department notes that it is unclear why the measure exempts DOA certification fees from HRS chapter 91. If the intent of this provision is to prevent taxpayers from challenging the fee in a contested case proceeding under HRS section 91-9, the Department suggests expressly stating this.

Finally, the Department is able to administer the credit as amended by this measure for taxable years beginning after December 31, 2017.

Thank you for the opportunity to provide comments.

DAVID Y. IGE
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SCOTT E. ENRIGHT
Chairperson, Board of Agriculture

PHYLLIS SHIMABUKURO-GEISER
Deputy to the Chairperson

**TESTIMONY OF SCOTT E. ENRIGHT
CHAIRPERSON, BOARD OF AGRICULTURE**

BEFORE THE SENATE COMMITTEE ON AGRICULTURE & ENVIRONMENT

**JANUARY 31, 2018
1:30 P.M
CONFERENCE ROOM 224.**

**SENATE BILL NO. 3031
RELATING TO ORGANIC FOODS PRODUCTION TAX CREDIT**

Chairperson Gabbard and Members of the Committee:

Thanks for the opportunity to testify on Senate Bill No.3031 relating to organic foods production tax credit. This bill clarifies and strengthens the organic foods production tax credit. The Department supports this bill.

Act 258, SLH 2017 established a tax credit of farmers, ranchers, and producers seeking to obtain organic certification and requires the Department to certify the qualified expenses submitted by the taxpayer. In developing the qualification criteria, the Department identified questionable language within the Act that needed to be clarified and strengthened. The Department feels that this bill includes the necessary changes needed to properly administer the qualification process.

Thank you for the opportunity to testify on this measure.



TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: INCOME, Modify Organic Foods Production Tax Credit

BILL NUMBER: SB 3031

INTRODUCED BY: GABBARD, KEITH-AGARAN, SHIMABUKURO, Ihara, Nishihara, Riviere, Taniguchi

EXECUTIVE SUMMARY: Makes technical amendments to the existing organic foods production tax credit.

SYNOPSIS: Amends HRS section 235-110.94, the organic foods production tax credit, as follows:

Clarifies that the ceiling on the amount of the credit is \$50,000 per qualified taxpayer.

Reinforces the overall state ceiling by providing that in a taxable year where the total \$2 million for all qualified taxpayers has been exceeded, all taxpayers eligible to claim the credit shall be credited on a pro rata basis.

Defines a qualified taxpayer as a producer as defined in 7 U.S.C. section 6502. Disqualifies a handler or handling operation as defined in the same federal statute. A producer is defined as a person who engages in the business of growing or producing food or feed. A handler or a handling operation is a business that does not grow or produce food, but processes, packages, or stores it.

States that the department of agriculture may assess and collect a user fee for certifying tax credit claims, but that any rules related to the fee shall not be subject to HRS chapter 91 (the Hawaii Administrative Procedure Act).

EFFECTIVE DATE: Applies to taxable years beginning after ____, 2017, and is repealed on December 31, 2021.

STAFF COMMENTS: The organic foods production tax credit, enacted in 2016, is a One Hundred Percent (100%) state tax credit for qualified expenses, which include expenses incurred to obtain organic certification from the USDA. The maximum credit allowed is \$50,000 per qualified taxpayer.

One troubling aspect of this tax credit has been that there was no hearing held on the bill in the Senate in the year it was enacted. This bill in 2016 started as one that would have replaced the ethanol production tax credit with a tax credit for the production of other renewable fuels. After first crossover, the House inserted this organic foods production credit into this bill's Senate counterpart. Both the House and Senate versions went to conference, and the conference committee reported out both bills, one with a renewable fuel production credit and another one

with only the organic foods production credit. That procedure limited the opportunity for discussion and public comment on the matter before the Senate.

Thus, the Senate considering substantive changes to the credit is helpful.

The technical amendments proposed in the bill appear to be consistent with the bill's original intent. Three issues, however, deserve special mention.

The credit now is a 100% credit, meaning, at least for expenses under the limit, the business pays nothing and the Hawaii taxpayers pay everything. In 2016, proponents asserted that the costs of organic certification far exceed the ceiling amount provided in statute, so as a practical matter both the state and the beneficiary business would have "skin in the game." If and when the organic certification process becomes less cumbersome, the credit percentage should be reconsidered.

The bill now requires all credit claims in a year to be filed before the amount of credit allowable to each taxpayer can be determined. This could slow down the tax returns for all affected taxpayers greatly, especially if some of them go on extension; early filers for the credit would have to wait an inordinate amount of time for their returns to be processed. If the intent is to gather all claims for the year and prorate the credit, the department of agriculture should be directed to do that when it certifies the amount of tax credit for each taxpayer under section 235-110.94(f)(4), HRS.

The bill now allows the department of agriculture to determine administrative fees for credit certification without regard to chapter 91. We are sympathetic to concerns that the chapter 91 rulemaking process takes too long, but believe there should be some checks and balances to ensure that taxpayers are not getting gouged. We suggest language similar to that in HRS section 36-30, relating to departmental administrative expense assessments, instead of the current language.

Digested 1/28/2018

SB-3031

Submitted on: 1/31/2018 5:29:53 AM

Testimony for AEN on 1/31/2018 1:30:00 PM

Submitted By	Organization	Testifier Position	Present at Hearing
Randy Cabral	Hawaii Farm Bureau	Support	Yes

Comments: