DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR

ISAAC W. CHOY
DIRECTOR OF TAXATION

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
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To: The Honorable Mike Gabbard, Chair;
The Honorable Clarence K. Nishihara, Vice Chair;
and Members of the Senate Committee on Agriculture and Environment

From: Isaac W. Choy, Director
Department of Taxation

Date: Friday, February 11, 2022
Time: 1:30 P.M.
Place: Via Video Conference, State Capitol

Re: S.B. 2353, Relating to Farms

The Department of Taxation (Department) offers the following comments on S.B. 2353 for the committee's consideration.

S.B. 2353 amends section 235-7, Hawaii Revised Statutes (HRS), to add a new income tax exclusion for income earned by a farmer from farming activities. The exclusion amount is equal to an unspecified percentage of the farmer's gross annual income or an unspecified dollar cap, whichever is less. The bill defines "farmer" as a person earning more than an unspecified percentage of their annual gross income from farm products or value-added farm products grown, raised, and value-added by the person, with "farm products" defined as products not for personal use that are produced from:

- Cultivation of crops, including crops for bioenergy, flowers, vegetables, foliage, fruits, forage, and timber;
- Game and fish propagation; and
- Raising of livestock, including poultry, bees, fish, or other animal or aquatic life that are propagated for economic use.

The measure is effective on July 1, 2022, and applies to taxable years beginning after December 31, 2021.

First, the Department notes that the defining a "farmer" as "a person" would allow all entities that pay income tax, such as corporations, partnerships, and estates and trusts, to qualify for this new exclusion. If this is not the intent of the measure, the Department recommends amending the definition as follows:

"Farmer" means an individual earning more than   per cent of the individual's annual gross income from the sale of farm products and value-added farm products grown, raised, and value-added by the individual.

Second, the Department notes that the exclusion is for income "earned by a farmer from farming activities," however, the term "farming activities" is not defined. Thus, it is not clear what income would be exempted.

Third, the Department notes that the definition of "farm products" is very broad. As currently drafted, the definition would basically include all grains, fruits, vegetables, poultry, fish, and meat regardless of whether the farmer actually produced these items. Furthermore, it is unclear how "farm products" fits in into the proposed exclusion for "farming activities." The Department strongly suggests clarifying the connection between the terms.

Fourth, the Department notes that this measure as currently written does not disallow the deduction for ordinary and necessary business expenses associated with the production of income from the exempted business activities. As a result, qualifying farmers will be able to use these deductions to offset other income that is not exempted by this measure. For example, qualifying farmer could also have a part-time job and earn wages. The business deductions could be used to offset the wage income. The Department suggests amending this measure to disallow the deduction for any ordinary and necessary business expenses incurred in producing the income excluded by this measure.

Fifth, the Department suggests replacing the term "gross annual income" with "federal adjusted gross income." The term "gross annual income" is not defined by this measure or under federal/State income tax law. Conversely, "federal adjusted gross income" is defined in detail by the Internal Revenue Code/Treasury Regulations and will therefore not require a definition that is specific to this exclusion.

Finally, notwithstanding the comments discussed above, the Department is able to administer the measure with its current effective date.

Thank you for the opportunity to provide testimony on this measure.

DAVID Y. IGE
Governor

JOSH GREEN
Lt. Governor

PHYLLIS SHIMABUKURO-GEISER
Chairperson, Board of Agriculture

MORRIS M. ATTA
Deputy to the Chairperson

State of Hawaii
DEPARTMENT OF AGRICULTURE
1428 South King Street
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TESTIMONY OF PHYLLIS SHIMABUKURO-GEISER
CHAIRPERSON, BOARD OF AGRICULTURE

BEFORE THE SENATE COMMITTEE ON AGRICULTURE AND ENVIRONMENT

FRIDAY, FEBRUARY 11, 2022
1:30 P.M.
VIA VIDEO CONFERENCE

SENATE BILL NO. 2353
RELATING TO FARMS

Chairperson Gabbard and Members of the Committee:

Thank you for the opportunity to testify on Senate Bill No. 2353 that creates an exclusion from income tax for a to-be-determined percentage of gross annual income, or a to-be-determined dollar amount of gross annual income earned by a farmer from agricultural activities. A “farmer” is defined as a person earning more than a to-be-determined percentage of the person’s annual gross income from farm products and value-added farm products sold, raised, and value-added by the person. “Farm products” is defined as production from agricultural activities enumerated in Section 205-4.5(a)(1) through (3) and excludes farm products for personal use. The Department supports the intent of this measure and otherwise defers to the Department of Taxation.

As written, the bill would improve the bottom line for start-up farming operations that meet the percentage gross income threshold. For qualified farmers, according to the 2012 Census of Agriculture (Hawaii, Volume 1, Chapter 1: State Level Data, Table 60, page 44, Selected Farm Characteristics by Race of Principal Operator: 2012 and 2007), of Hawaii’s then-7,000 farmers (includes all business entities), approximately 618

(9 percent) earn more than 75 percent of their total household income from farming. Reducing the qualifying percentage of total household income from farming to more than 50 percent will increase the number of qualifying farmer households to 1,190 or 17 percent of Hawaii's farmers. There is no more recent information on the percentage of total household income from farming as the National Agricultural Statistics Service discontinued the gathering of this particular data set as of 2012.

Thank you for the opportunity to comment on this measure.

HAWAI'I FARM BUREAU

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Phone: (808) 848-2074; Fax: (808) 848-1921
e-mail info@hfbf.org; www.hfbf.org

FEBRUARY 11, 2022

HEARING BEFORE THE
SENATE COMMITTEE ON AGRICULTURE AND ENVIRONMENT

TESTIMONY ON SB 2353
RELATING TO FARMS

Conference Room 224 & Videoconference
1:30 PM

Aloha Chair Gabbard, Vice-Chair Nishihara, and Members of the Committee:

I am Brian Miyamoto, Executive Director of the Hawaii Farm Bureau (HFB). Organized since 1948, the HFB is comprised of 1,800 farm family members statewide and serves as Hawaii's voice of agriculture to protect, advocate and advance the social, economic, and educational interests of our diverse agricultural community.

The Hawaii Farm Bureau supports SB 2353, which creates an exclusion from income tax for the lesser of a percentage of gross annual income or an amount of gross annual income earned by a farmer from farming activities.

Farming is a tough business. High production costs are a major driver of narrow profit margins for Hawaii's farmers. Land, water, labor, taxes, transportation, utilities, inputs, invasive species, and food safety regulations are all costs of doing business that often results in our farmers just being able to break even. HFB supports any initiative that reduces the cost of production so that locally produced goods can compete with imported products, strengthening our local economy.

Hawaii Farm Bureau Policy states:

> "State tax and monetary policies should be designed to encourage private initiative to help stabilize farm economics in the State of Hawaii, to promote employment and economic growth, and to distribute the tax burden equitably. Further such policy should be used by the state, when appropriate, to encourage agricultural growth and expansion."

This measure falls in the "encourage agricultural growth and expansion." category.

This measure defines "farmer" as a person which means the exemption is limited to individuals This definition may exclude other forms of farm ownership. Thank you for this opportunity to testify on this important subject.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Exclusion for Farming Activities

BILL NUMBER: SB 2353, HB 2043

INTRODUCED BY: SB by KEITH-AGARAN, GABBARD, Riviere; HB by SAIKI by request

EXECUTIVE SUMMARY: Creates an exclusion from income tax for the lesser of a percentage of gross annual income or an amount of gross annual income earned by a farmer from farming activities.

SYNOPSIS: Amends section 235-7, HRS, to add an exclusion of the lesser of __ per cent of gross annual income or $______ of gross annual income earned by a farmer from farming activities.

Defines "farmer" as a person earning more than __ per cent of the person's annual gross income from the sale of farm products and value-added farm products grown, raised, and value-added by the person.

Defines "farm products" as products produced from: (A) The cultivation of crops, including crops for bioenergy, flowers, vegetables, foliage, fruits, forage, and timber; (B) Game and fish propagation; and (C) The raising of livestock, including poultry, bees, fish, or other animal or aquatic life that are propagated for economic use;

provided that "farm products" shall not include products for personal use."

EFFECTIVE DATE: July 1, 2022, applicable to taxable years beginning after December 31, 2021.

STAFF COMMENTS: The idea of providing a tax incentive to encourage investments may have been acceptable when the economy was on a roll and advocates could point to incentives to encourage the use of or investment in emerging technologies. But what lawmakers and administrators have learned in these past few years is that unbridled tax incentives, where there is no accountability or limits on how much can be claimed, are irresponsible.

It should also be noted that an income exclusion affects taxpayers differently depending on the amount of net income they otherwise have. For example, a $50,000 income exclusion would create a maximum $5,500 tax benefit to an individual making over $200,000 in adjusted gross income, where the same individual with $35,000 adjusted gross income and $15,000 net profit would see a benefit of perhaps $725.

Instead, lawmakers should consider an appropriation of a specific number of taxpayer dollars. At least lawmakers would have a better idea of what is being funded. A direct appropriation would be preferable to the income exclusion as it would: (1) provide some accountability for the taxpayers' funds being utilized to support this effort; and (2) not be a blank check.

Digested: 2/8/2022

DAVID Y. IGE
GOVERNOR

CRAIG K. HIRAI
DIRECTOR

GLORIA CHANG
DEPUTY DIRECTOR

EMPLOYEES' RETIREMENT SYSTEM
HAWAI'I EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER

STATE OF HAWAI'I
DEPARTMENT OF BUDGET AND FINANCE
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ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND
MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

WRITTEN ONLY
TESTIMONY BY CRAIG K. HIRAI
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE SENATE COMMITTEE ON AGRICULTURE AND ENVIRONMENT
ON
SENATE BILL NO. 2353

February 11, 2022
1:30 p.m.
Room 224 and Videoconference

RELATING TO FARMS

The Department of Budget and Finance (B&F) offers comments on this bill.

Senate Bill No. 2353 amends Section 235-7, HRS, to exclude from State income tax, the lesser of an unspecified percentage of gross annual income or an unspecified amount of gross annual income earned by a farmer from farming activities.

B&F notes that the federal American Rescue Plan (ARP) Act restricts states from using ARP Coronavirus State Fiscal Recovery Funds (CSFRF) to directly or indirectly offset a reduction in net tax revenue resulting from a change in law, regulation, or administrative interpretation beginning on March 3, 2021, through the last day of the fiscal year in which the CSFRF have been spent. If a state cuts taxes during this period, it must demonstrate how it paid for the tax cuts from sources other than the CSFRF, such as:

- By enacting policies to raise other sources of revenue;
- By cutting spending; or
- Through higher revenue due to economic growth.

If the CSFRF provided have been used to offset tax cuts, the amount used for this purpose must be repaid to the U.S. Treasury.

The U.S. Department of Treasury has issued rules governing how this restriction is to be administered. B&F will be working with the money committees of the Legislature to ensure that the State of Hawaiʻi complies with this ARP restriction.

Thank you for your consideration of our comments.

Email: communications@ulupono.com

SENATE COMMITTEE ON AGRICULTURE & ENVIRONMENT
Friday, February 11, 2022 — 1:30 p.m.

Ulupono Initiative supports SB 2353, Relating to Farms.

Dear Chair Gabbard and Members of the Committee:

My name is Micah Munekata, and I am the Director of Government Affairs at Ulupono Initiative. We are a Hawai'i-focused impact investment firm that strives to improve the quality of life throughout the islands by helping our communities become more resilient and self-sufficient through locally produced food; renewable energy and clean transportation; and better management of freshwater and waste.

Ulupono supports SB 2353, which creates an exclusion from income tax for the lesser of a percentage of gross annual income or an amount of gross annual income earned by a farmer from farming activities.

Ulupono supports local food production for local consumption, which we believe will help support our state's food security. A policy such as this may go a long way toward influencing Hawai'i's farmers and ranchers to produce food for our community while also keeping money within the state to support our economy.

Thank you for the opportunity to testify.

Respectfully,

Micah Munekata
Director of Government Affairs

HAWAII FOOD INDUSTRY ASSOCIATION

1050 Bishop St. PMB 235 | Honolulu, HI 96813
P: 808-533-1292 | e: info@hawaiifood.com

TO: Committee on Agriculture and the Environment
Senator Mike Gabbard, Chair
Senator Clarence K. Nishihara, Vice Chair

FROM: HAWAII FOOD INDUSTRY ASSOCIATION
Lauren Zirbel, Executive Director

DATE: February 11, 2022
TIME: 1:30pm
PLACE: Via Videoconference

RE: SB2353 Relating to Farms

Position: Support

The Hawaii Food Industry Association is comprised of two hundred member companies representing retailers, suppliers, producers, and distributors of food and beverage related products in the State of Hawaii.

HFIA is in support of this measure to create an exclusion from income tax for the lesser of a percentage of gross annual income or an amount of gross annual income earned by a farmer from farming activities. Incentivizing farming is one important aspect of increasing our local food production. An income tax credit is a positive way to encourage potential new farmers to begin working in this field, and make it easier for Hawaii's current farmers to keep growing food for our state. We urge you to vote yes on this measure and we thank you for the opportunity to testify.