

EXECUTIVE CHAMBERS

HONOLULU

June 24, 2002

CRIBINAL

STATEMENT OF OBJECTIONS TO SENATE BILL NO. 2383

Honorable Members
Twenty-First Legislature
State of Hawaii

Pursuant to Section 16 of Article III of the Constitution of the State of Hawaii, I am returning herewith, without my approval, Senate Bill No. 2383, entitled "A Bill for an Act Relating to Taxation to Stimulate the Economy."

The purpose of the bill is to promote Hawaii's tourism and construction industries by establishing a non-refundable, carry-forward net income tax credit of 4 percent for commercial construction, and expanding the hotel construction tax credit to include related commercial and recreational facilities, infrastructure, and offsite improvements.

OBJECTIONS. Senate Bill No. 2383 is flawed because it defines a "qualified project" eligible for the four percent commercial construction credit too broadly, allowing virtually any nonresidential construction project to qualify. The bill is not targeted to assist any particular industry or to create new ones. Thus it establishes credits with no real strategic purpose for improving or diversifying the State's economy.

Senate Bill No. 2383 also allows other indirect construction costs to qualify, such as infrastructure, amenities, telecommunications, and information technology costs. These are not costs that are traditionally eligible

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under other construction tax credit provisions. Moreover, it is very difficult to calculate the additional tax revenue loss.

When tax credits are given to stimulate the economy, other taxpayers may end up carrying a larger tax burden because of the loss in revenues. Thus, a fiscally responsible government will use the tax credits as incentives to attract new investment, to create new industries, diversify and grow the economy. When properly employed, tax credits, waivers, or incentives may even help generate more revenue than they cost in the long run. I do not believe that Senate Bill No. 2383 accomplishes these goals.

This bill is estimated to cost the State more than \$100 million over four years, based on an annual commercial construction base average of \$753.8 million over the past five years. But State estimates show that commercial construction would have to increase by more than 52 percent in order for the State to "break even" on the cost of this tax credit.

In this regard, it makes little sense for the State to give such generous tax credits to boost private construction. First, construction is one of the few sectors of Hawaii's economy that successfully withstood the post September 11, 2001, downturn and is still strong. Second, interest rates are at an all time low -- a strong incentive for investors to incur debt to build their projects.

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Moreover, proponents of this bill overlook the fact that five years ago, the State enacted a \$2 billion tax cut over six years, one of the biggest tax cuts in the nation at the time. Also overlooked is the fact that tax incentive measures such as Act 221, the current hotel renovation and construction tax credits, were all enacted only a few years ago. Last year, I approved the homebuyer's tax credit, which provides Hawaii's homeowners with a maximum tax credit of \$10,000 for the purchase of each new home or renovation of an existing home.

Additionally, Hawaii's construction industry has received other tax breaks, including a subcontractor deduction to eliminate pyramiding and exemptions from the general excise tax on low-income housing projects, scientific contracts, scientific contracts, exported services, contracting, and construction within an enterprise zone for qualified businesses.

Cumulatively, these tax credits and cuts have helped Hawaii's economy withstand the post September 11 downturn better than most expected. This is reflected in part by the fact Hawaii's unemployment rate is 4.4 percent -- significantly lower than the national average of 6 percent.

At the same time, however, this multitude of tax cuts, waivers, and tax credits have reduced state tax revenues, causing the severe reduction in state services and budget cuts now reflected in the supplemental appropriations bill, House Bill No. 1800 (the state budget bill).

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Many of the projects cited as benefiting from this bill are projects that were already being developed before this tax credit was proposed. It makes little sense to now provide a tax credit for projects that would have been built anyway.

The bill contains more problems in that it contains ambiguities that potentially invite abuse and make it bad tax policy. The qualified project tax credit is available to "each taxpayer" subject to state income tax. A "taxpayer" may be the "owner, developer, lessee, or permittee of real property relating to the qualified project." Conceivably, more than one taxpayer could claim this tax credit at the same time. A taxpayer also could potentially "double dip" by claiming another tax credit, in addition to the qualified project tax credit, for the same project. For example, if a company builds a manufacturing center here and installs \$25 million in new manufacturing equipment, it could qualify for both the 4 percent qualified project tax credit and the 4 percent capital goods excise tax credit -- an aggregate of 8 percent in credits.

Finally, the bill contains a provision that expands the hotel tax credit to include any expenses incurred by a hotel for renovation or construction, even those that are only tangentially related to hotel operations including non-hotel projects. For example, the construction or renovation of a convenience store at a hotel might qualify for the hotel tax credit. This is

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another overly broad definition that will lead to ambiguity and more potential revenue loss through abuse.

Senate Bill No. 2383 is just one of several tax credit bills passed by the 2002 Legislature with no coherent strategy or plan. Moreover, our analysis is that this poorly thought-out bill will cost the State much more revenue than it will generate.

As expressed by the chairperson of the House Committee On Economic Development, the purpose of the multitude of tax credit bills approved by the 2002 State Legislature is to "spur development and investment in a manner that won't use State funds." On this score, I believe Senate Bill No. 2383 fails.

For the foregoing reasons, I am returning Senate Bill No. 2383 without my approval.

Respectfully,


BENJAMIN J. CAYETANO
Governor of Hawaii

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P R O C L A M A T I O N

WHEREAS, under Section 16 of Article III of the Constitution of the State of Hawaii, the Governor is required to give notice, by a proclamation, of the Governor's plan to return with the Governor's objections any bill presented to the Governor less than ten days before adjournment sine die or presented to the Governor after adjournment sine die of the Legislature; and

WHEREAS, Senate Bill No. 2383, entitled "A Bill for an Act Relating to Taxation to Stimulate the Economy," passed by the Legislature, was presented to the Governor within the aforementioned period; and

WHEREAS, Senate Bill No. 2383 is unacceptable to the Governor of the State of Hawaii;

NOW, THEREFORE, I, BENJAMIN J. CAYETANO, Governor of the State of Hawaii, do hereby issue this proclamation, pursuant to the provisions of Section 16 of Article III of the Constitution of the State of Hawaii, giving notice of my plan to return Senate Bill No. 2383 with my objections thereon to the Legislature as provided by said Section 16 of Article III of the Constitution.

DONE at the State Capitol,
Honolulu, State of Hawaii,
this 24th day of June, 2002.



BENJAMIN J. CAYETANO
Governor of Hawaii