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To: The Honorable Sylvia Luke, Chair  
and Members of the House Committee on Finance

Date: Tuesday, February 26, 2019  
Time: 1:30 P.M.  
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director  
Department of Taxation

Re: H.B. 1216, H.D. 1, Relating to Taxation

The Department provides the following comments regarding H.B. 1216, H.D. 1, for your consideration.

H.B. 1216 establishes a nonrefundable income tax credit for taxpayers who own and operate a business from their principal residence. The House Committee on Economic Development & Business defected the effective date to December 31, 2112, but would otherwise apply to taxable years beginning after December 31, 2018.

First, the Department notes that this credit is available only for resident taxpayers. As such, it may discriminate against non-resident taxpayers who have a Hawaii tax liability and who also operate out of their homes. The Department ultimately defers to the Department of the Attorney General on the constitutionality of this residency requirement.

Second, the Department notes that this credit only requires a taxpayer to hold a Hawaii general excise tax license and to comply with any state and county registration requirements. There is no requirement that the taxpayer actually generate any revenue from the business. This may lead to taxpayers claiming the credit to offset other income.

Third, the Department suggests specifying the types of business that would qualify for the credit. As currently written, a bed and breakfast in a home would be a business activity eligible for the credit.

Fourth, the Department suggests disallowing the credit for any taxpayer that claims a home office deduction. This will prevent a potential for a double tax benefit.

Finally, the Department respectfully requests that this new credit be made available for taxable years beginning after December 31, 2019 to allow sufficient time to make the necessary form, instruction and computer system changes.

Thank you for the opportunity to provide comments.



**TESTIMONY OF  
THE DEPARTMENT OF THE ATTORNEY GENERAL  
THIRTIETH LEGISLATURE, 2019**

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**ON THE FOLLOWING MEASURE:**

H.B. NO. 1216, H.D. 1, RELATING TO TAXATION.

**BEFORE THE:**

HOUSE COMMITTEE ON FINANCE

**DATE:** Tuesday, February 26, 2019      **TIME:** 1:30 p.m.

**LOCATION:** State Capitol, Room 308

**TESTIFIER(S):** Clare E. Connors, Attorney General, or  
Patrick K. Kelly, Deputy Attorney General

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Chair Luke and Members of the Committee:

The Department of the Attorney General has concerns about this bill because it may be challenged as violating the Commerce Clause of the United States Constitution.

This bill establishes a home business income tax credit for small businesses operating from the taxpayer's principal residence. The tax credit is available only to a resident of the State. Thus, the bill appears to aid local home-based businesses over similar business operated elsewhere.

Commerce Clause jurisprudence provides that "[n]o State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'" Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 268 (1984), (citing Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318, 329 (1977)).

In this bill, only residents of the State would qualify for the tax credit. Since out-of-state businesses would not be eligible for the same tax credit, the proposal appears to have a discriminatory effect in favor of local businesses in violation of the Commerce Clause.

This potential constitutional concern could be avoided if the phrase "resident of the State" was changed to "taxpayer" in the definition of "qualified taxpayer." With that change, all persons or entities operating a business from the taxpayer's principal place of business (and who met the other qualifying parameters) would be treated the same in

terms of the tax credit. Thus, the constitutional concern of violation of the Commerce Clause would be removed.

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Home Business Tax Credit

BILL NUMBER: HB 1216, HD-1

INTRODUCED BY: House Committee on Economic Development & Business

EXECUTIVE SUMMARY: Establishes an income tax credit for taxpayers who own and operate a business from their principal residence. There does not appear to be a defensible rationale for the credit. Is it to encourage socially desirable behavior? Is it to provide relief for taxpayers who can't pay tax?

SYNOPSIS: Adds a new section to chapter 235, HRS, to allow a home business income tax credit, which is a nonrefundable credit of \$\_\_\_ but may be carried forward until exhausted.

A "qualified taxpayer" eligible for the credit is a resident of Hawaii who (1) owns a business that (A) maintains a general excise tax license and (B) meets all applicable state and county registration requirements; and (2) operates the business from the taxpayer's principal residence.

Contains usual and customary provisions for tax credits in Hawaii.

EFFECTIVE DATE: Taxable years beginning after December 31, 2018.

STAFF COMMENTS: Lawmakers need to keep in mind two things. First, the tax system is the device that raises the money that they, lawmakers, like to spend. Using the tax system to shape social policy merely throws the revenue raising system out of whack, making the system less than reliable as there is no way to determine how many taxpayers will avail themselves of the credit and in what amount. The second point to remember about tax credits is that they are nothing more than the expenditure of public dollars, but out the back door. If, in fact, these dollars were subject to the appropriation process, would taxpayers be as generous about the expenditure of these funds when our kids are roasting in the public school classrooms, there isn't enough money for social service programs, or our state hospitals are on the verge of collapse?

Here, it is questionable whether there is any social policy rationale for the proposed credit. What socially desirable behavior is this credit designed to encourage? Signing up for a general excise tax license and obeying other regulatory requirements, perhaps? If so, the credit should be made available to all businesses, not only ones operated out of a home. Is it an established fact that those running a business out of their home are too poor to pay tax? Of course not. Then what is the justification for having the rest of us taxpayers foot the bill for the revenue that is forgone by this bill?

Digested 2/23/2019

**HB-1216-HD-1**

Submitted on: 2/25/2019 1:21:23 PM

Testimony for FIN on 2/26/2019 1:30:00 PM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Melodie Aduja	O`ahu County Committee on Legislative Priorities of the Democratic Party of Hawai`i	Support	No

Comments:

**LATE**

**HB-1216-HD-1**

Submitted on: 2/25/2019 8:49:01 PM

Testimony for FIN on 2/26/2019 1:30:00 PM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Dale Sandlin	Hawaii Cattlemens Council	Support	No

Comments: