Are We In For a Replay of the High Tech Tax Credit Debacle?

One of the recommendations made by consultants to the current Tax Review Commission is almost an after thought, you know like closing the barn door after the horses have escaped.

The recommendation made by the consultant was to either cap certain tax credits or replace those credits with grant programs. The consultants noted that Hawaii has in the past decade adopted a number of tax incentives in the form of tax credits. They point out that these tax credits have no maximum limit which has made it difficult to maintain revenue stability and sufficiency over time. They suggest as a viable alternative that is used by many other states to impose a cap or eliminate the broad-based credits and replace them with a grant, loan and/or forgivable loan. As the consultant pointed out, these can be more targeted at specific types of projects and activities and can be controlled through the application and approval process.

Not only do these credits have no cap, but there is no way of determining whether or not the tax credits achieve the purported outcomes. This is because lawmakers for years refused to require reporting of outcomes, like how many jobs were created, how many new businesses were established as a result of these credits, what kind of payroll was created or how much new investment and infrastructure was realized. Only after the horses were out of the barn did some lawmakers realize that these credits were spinning out of control.

Such was the case with the high technology investment, research and infrastructure tax credits. When the question was raised whether or not those credits were, in fact, creating the high paying jobs that were promised or whether new businesses were being created, the advocates reeled back and said if they had to share that information it would create a “pall” over the investment community and all investments would come to a screeching halt. So lawmakers didn’t push the envelope, after all, advocates argued, if the credits were being taken that meant they were achieving the goals of the credits in creating those high paying jobs and new businesses in Hawaii.

Of course, those investors who were getting a 100% return on their investment didn’t want the gravy train to stop and saw anyone who raised a question about the tax credits as the mortal enemy. They characterized those opponents as being against these credits that would create higher paying jobs, jobs that would stop the brain drain. Little did they admit that they were greedily raking in the tax breaks for themselves.

Only when lawmakers were told that the revenue losses were beginning to amount to nearly a billion dollars did the push come to add to the law the requirement for all investors to report information as to the amount of payroll, the number of jobs created and the amounts invested. But it was too late, millions of dollars had already been claimed and the winners were all theaccountants and lawyers who carefully designed the deals to meet the vague parameters of the law.

More recently the Council on Revenues was startled to learn that claims for the alternate energy credit were spiraling out of control and that it is expected that claims for solar water heating systems and photovoltaic installations would contribute another $80 million in lost revenues for the current fiscal year. That loss would grow to another $150 million in the next fiscal year, dragging down the expected revenue growth rates for this and next year. Even though caps are imposed on the amount of credit that can be claimed, the limit is per “system” which was so loosely defined that a homeowner or business could claim multiple credits. This is because the limit on the amount of credits is so unrealistic that in order to achieve what is known as “net-metering,” taxpayers must install much larger systems than the limit on a single system would allow.

All of these problems could have been avoided had the incentive been handed out as a grant or appropriation. At least there would be oversight and officials would know whether or not the investment or venture would produce the desired results. Unlike the tax credits, administrators of a grant program would know how much in public subsidies are handed out and policymakers would have a better idea of just how much demand there was for those subsidies and whether or not the installations met standards established by experts.

Unlike the tax credits which have basically no oversight, grants or appropriations would be subject to close scrutiny before being granted and upon implementation would be evaluated. At least taxpayers would be sure that their hard-earned tax dollars are being used wisely.

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Jeffrey Au
9/18/12 Comment

It is very ironic that people like Mr. Kalapa, who have advocated for years to lower taxes to enable the private sector and market forces to allocate resources and make more rational business decisions are now advocating to raise taxes by getting rid of tax credits and replacing such successful models of private/public partnerships with more government spending.

Tax credits can be a more efficient way for government to support business and economic growth because tax credits do not require huge bureaucracies of more government employees to deploy the money. If properly structured, they use market forces to provide checks and balances to ensure that the tax credits are appropriately advancing the government's policy objectives. Most importantly, with tax credits, our State government only has to fund a fraction of the costs, with most of the costs being funded by the PRIVATE SECTOR and possibly matching federal tax benefits.

In the case of the solar credits, in addition to the import substitution and tax revenue benefits of replacing imported petroleum with locally produced solar energy, Mr. Kalapa also ignores the fact that for every ONE dollar in State solar credit, our local economy and businesses receive about TWO dollars of federal tax reductions and credits.

Some may prefer across the board tax rate reductions. But such tax cuts are MUCH more expensive from a State budgetary standpoint in terms of tax revenue loss, and the benefits to taxpayers are too small to change behavior in a positive way. Does anyone really think that reducing State taxes enough to enable every taxpayer to buy a few extra bentos a year would have grown local industries such as solar, film/TV production and high tech as tax credits have done?

In the case of the Act 221 high tech credit, it is easy for political opponents and critics to make it sound scandalous by saying that it was a 100% tax credit. However, this is just a half-truth.

The full truth is that without Act 221, EVERYONE can get a 100% tax credit right away. How? By simply writing a check to the government and getting an IMMEDIATE 100% tax credit against your tax liability. Under Act 221, however, if a taxpayer wrote the same check to a tech company, it would take 5 years to get the same 100% credit against his tax liablity, and the credit could be less if the company failed or there was another recapture event during the five year period. Therefore, the 100% Act 221 tax credit was only attractive if an investor believed that he could potentially earn a return on the investment in addition to the tax credits. Otherwise, he would be better off just paying his taxes.

Opponents also have blamed tax credits as a scapegoat for the State's budgetary problems. They use a "Cost-Cost" analysis rather than a "Cost-Benefit" analysis. They choose to ignore the additional tax revenues that are generated from the General Excise Taxes and Income Taxes paid by employees of companies (in addition to the companies themselves) that are created and grow because of these tax incentives.

Tax credits have not created the State's budget deficit. A bad economy and excessive government spending, appropriations and grants (which Mr. Kalapa advocates more of) have. At the peak of Act 221 in 2006, our State budget had an $800 million SURPLUS. Act 221 did not create the Great Recession of 2008 that created budget deficits from reduced tax collections from a slowing economy. Yet, critics choose to scapegoat tax credits for the budget deficit caused by the recession while ignoring MUCH larger drains on the State budget, such as deficits from the State Employee Retirement System and EUTF.

According to Tax Department data, over 10 years, Act 221 attracted more than $1.7 billion in private sector investment, which was invested in at least 417 companies, and it created more than 3,000 jobs, with a cost to the State budget of less than $1 billion, so our local economy is ahead of the game by more than $700 million, even before considering economic multipliers.

Do we really think that our State budget, economy and community would be better off if in place of Act 221, the State government gave away grants and appropriations of more than $1.7 billion and hired more than 3,000 additional State workers instead??