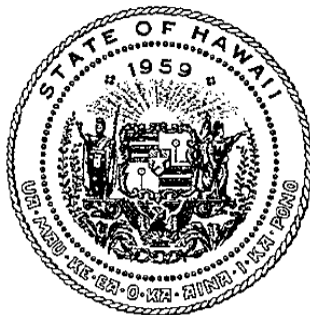


**REPORT TO THE TWENTY-NINTH LEGISLATURE  
2017 REGULAR SESSION**

**REPORT ON THE STATE'S PROGRESS TOWARD MEETING THE MILESTONES  
AND OBJECTIVES OF THE IMPORTANT AGRICULTURAL LAND TAX CREDIT  
PROGRAM**

**IN RESPONSE TO ACT 233, SESSION LAWS OF HAWAII 2008**



**Prepared by:**

**THE STATE OF HAWAII  
DEPARTMENT OF AGRICULTURE**

**DECEMBER 2016**

## IAL TAX CREDIT PROGRAM

### Annual Report to the Legislature for Calendar Year 2016

#### Legislative Background

Section 235-110.93, Hawaii Revised Statutes (HRS), enacted pursuant to Act 233, Session Laws of Hawaii 2008, provides in full as follows:

**§235-110.93 Important agricultural land qualified agricultural cost tax credit.** (a) There shall be allowed to each taxpayer an important agricultural land qualified agricultural cost tax credit that may be claimed in taxable years beginning after the taxable year during which the tax credit under section 235-110.46 is repealed, exhausted, or expired. The credit shall be deductible from the taxpayer's net income tax liability, if any, imposed by this chapter for the taxable year in which the credit is properly claimed. The tax credit amount shall be determined as follows:

- (1) In the first year in which the credit is claimed, the lesser of the following:
  - (A) Twenty-five per cent of the qualified agricultural costs incurred by the taxpayer after July 1, 2008; or
  - (B) \$625,000;
- (2) In the second year in which the credit is claimed, the lesser of the following:
  - (A) Fifteen per cent of qualified agricultural costs incurred by the taxpayer after July 1, 2008; or
  - (B) \$250,000; and
- (3) In the third year in which the credit is claimed, the lesser of the following:
  - (A) Ten per cent of the qualified agricultural costs incurred by the taxpayer after July 1, 2008; or
  - (B) \$125,000.

The taxpayer may incur qualified agricultural costs during a taxable year in anticipation of claiming the credit in future taxable years during which the credit is available. The taxpayer may claim the credit in any taxable year after the taxable year during which the taxpayer incurred the qualified agricultural costs upon which the credit is claimed. The taxpayer also may claim the credit in consecutive or inconsecutive taxable years until exhausted.

(b) No other credit may be claimed under this chapter for qualified agricultural costs for which a credit is claimed under this section for the taxable year.

(c) The amount of the qualified agricultural costs eligible to be claimed under this section shall be reduced by the amount of funds received by the taxpayer during the taxable year from the irrigation repair and maintenance special fund under section 167-24.

(d) The cost upon which the tax credit is computed shall be determined at the entity level. In the case of a partnership, S corporation, estate, trust, or other pass through entity, distribution and share of the credit shall be determined pursuant to section 235-110.7(a).

If a deduction is taken under section 179 (with respect to election to expense depreciable business assets) of the Internal Revenue Code, no tax credit shall be allowed for that portion of the qualified agricultural cost for which a deduction was taken.

The basis of eligible property for depreciation or accelerated cost recovery system purposes for state income taxes shall be reduced by the amount of credit allowable and claimed. No deduction shall be allowed for that portion of otherwise deductible qualified agricultural costs on which a credit is claimed under this section.

(e) If the credit under this section exceeds the taxpayer's net income tax liability for the taxable year, the excess of the credit over liability shall be refunded to the taxpayer; provided that no refunds or payments on account of the credits allowed by this section shall be made for amounts less than \$1.

All claims for a tax credit under this section, including amended claims, shall be filed on or before the end of the twelfth month following the close of the taxable year for which the credit is claimed. Failure to comply with the foregoing provision shall constitute a waiver of the right to claim the credit.

(f) The director of taxation:

(1) Shall prepare any forms that may be necessary to claim a credit under this section;

(2) May require the taxpayer to furnish information to ascertain the validity of the claim for credit made under this section; and

(3) May adopt rules pursuant to chapter 91 to effectuate this section.

(g) The department of agriculture shall:

(1) Maintain records of the total amount of qualified agricultural costs for each taxpayer claiming a credit;

(2) Verify the amount of the qualified agricultural costs claimed;

(3) Total all qualified agricultural costs claimed; and

(4) Certify the total amount of the tax credit for each taxable year.

Upon each determination, the department of agriculture shall issue a certificate to the taxpayer verifying the qualifying agricultural costs and the credit amount certified for each taxable year. For a taxable year, the department of agriculture may certify a credit for a taxpayer who could have claimed the credit in a previous taxable year, but chose not to because the maximum annual credit amount under subsection (h) was reached in that taxable year.

The taxpayer shall file the certificate with the taxpayer's tax return with the department of taxation. Notwithstanding the department of agriculture's certification authority under this section, the director of taxation may audit and adjust certification to conform to the facts.

Notwithstanding any other law to the contrary, the information required by this subsection shall be available for public inspection and dissemination under chapter 92F.

(h) If in any taxable year the annual amount of certified credits reaches \$7,500,000 in the aggregate, the department of agriculture shall immediately discontinue certifying credits and notify the department of taxation. In no instance shall the department of agriculture certify a total amount of credits exceeding \$7,500,000 per taxable year. To comply with this restriction, the department of agriculture shall certify credits on a first come, first served basis.

The department of taxation shall not allow the aggregate amount of credits claimed to exceed that amount per taxable year.

(i) The department of agriculture, in consultation with the department of taxation, shall annually determine the information necessary to provide a quantitative and qualitative assessment of the outcomes of the tax credit.

Every taxpayer, no later than the last day of the taxable year following the close of the taxpayer's taxable year in which the credit is claimed, shall submit a certified written statement to the department of agriculture. Failure to provide the information shall result in ineligibility and a recapture of any credit already claimed for that taxable year. The amount of the recaptured tax credit shall be added to the taxpayer's tax liability for the taxable year in which the recapture occurs.

Notwithstanding any law to the contrary, a statement submitted under this subsection shall be a public document.

(j) The department of agriculture, in consultation with the department of taxation, shall annually submit a report evaluating the effectiveness of the tax credit. The report shall include but not be limited to findings and recommendations to improve the effectiveness of the tax credit to further encourage the development of agricultural businesses.

(k) As used in this section:

"Agricultural business" means any person with a commercial agricultural, silvicultural, or aquacultural facility or operation, including:

- (1) The care and production of livestock and livestock products, poultry and poultry products, apiary products, and plant and animal production for nonfood uses;
- (2) The planting, cultivating, harvesting, and processing of crops; and
- (3) The farming or ranching of any plant or animal species in a controlled salt, brackish, or freshwater environment;

provided that the principal place of the agricultural business is maintained in the State and more than fifty per cent of the land the agricultural business owns or leases, excluding land classified as conservation land, is important agricultural land.

"Important agricultural lands" means lands identified and designated as important agricultural lands pursuant to part III of chapter 205.

"Net income tax liability" means income tax liability reduced by all other credits allowed under this chapter.

"Qualified agricultural costs" means expenditures for:

- (1) The plans, design, engineering, construction, renovation, repair, maintenance, and equipment for:
  - (A) Roads or utilities, primarily for agricultural purposes, where the majority of the lands serviced by the roads or utilities, excluding lands classified as conservation lands, are important agricultural lands;
  - (B) Agricultural processing facilities in the State, primarily for agricultural purposes, where the majority of the crops or livestock processed, harvested, treated, washed, handled, or packaged are from agricultural businesses;
  - (C) Water wells, reservoirs, dams, water storage facilities, water pipelines, ditches, or irrigation systems in the State, primarily for agricultural purposes, providing water for

lands, the majority of which, excluding lands classified as conservation lands, are important agricultural lands; and

(D) Agricultural housing in the State, exclusively for agricultural purposes; provided that:

(i) The housing units are occupied solely by farmers or employees for agricultural businesses and their immediate family members;

(ii) The housing units are owned by the agricultural business;

(iii) The housing units are in the general vicinity, as determined by the department of agriculture, of agricultural lands owned or leased by the agricultural business; and

(iv) The housing units conform to any other conditions that may be required by the department of agriculture;

(2) Feasibility studies, regulatory processing, and legal and accounting services related to the items under paragraph (1);

(3) Equipment, primarily for agricultural purposes, used to cultivate, grow, harvest, or process agricultural products by an agricultural business; and

(4) Regulatory processing, studies, and legal and other consultant services related to obtaining or retaining sufficient water for agricultural activities and retaining the right to farm on lands identified as important agricultural lands.

(l) The department of agriculture shall cease certifying credits pursuant to this section after the fourth taxable year following the taxable year during which the credits are first claimed; provided that a taxpayer with accumulated, but unclaimed, certified credits may continue claiming the credits in subsequent taxable years until exhausted.

[(m)] The department of taxation, in consultation with the department of agriculture, shall submit to the legislature an annual report, no later than twenty days prior to the convening of each regular session, beginning with the regular session of 2010, regarding the quantitative and qualitative assessment of the impact of the important agricultural land qualified agricultural cost tax credit. [L 2008, c 233, §§4, 5; am L 2014, c 101, §1]

### **IAL Qualified Agricultural Cost Tax Credit Program Milestones and Objectives: Reportable Activities for the period of January 1, 2016-December 31, 2016.**

Under Section 235-110.93, HRS, costs cannot be claimed on an IAL tax credit form until the State of Hawaii Department of Taxation (DoTAX) releases an IAL tax credit form for the year the costs were incurred. For example, an applicant would not be able to claim a cost incurred in 2016, until the 2016 IAL Tax credit form is released by DoTAX. DoTAX usually releases an updated tax credit application form shortly after a new calendar year. For example, DoTAX will most likely release the 2016 IAL Tax credit form sometime in early 2017. As such, the reportable activities in this section of the report deal with costs/certification incurred during the 2015 tax year.

The level of activity and interest in the Important Agricultural Land (IAL) Qualified Agricultural Cost Tax Credit program declined slightly from 2015 compared to 2014.

The total applications received by the Department of Agriculture (the Department) for the 2015 tax year was 2 compared to 3 in 2014. The Department issued \$375,000 in certified tax credits.

The Department did not issue a large amount of certified tax credits for the 2015 tax year, because the two applicants that submitted 2015 IAL Tax credit forms had previously been issued IAL Tax credits for the 2014 and 2013 tax years. Under Section 235-110.93, HRS, the maximum amount of tax credits able to be issued is reduced during the second and third years of claiming the credit.

The maximum amount of tax credits the Department is able to certify in a taxable year is \$7,500,000. One reason why there were not a lot of applicants for this credit is because none of the counties have submitted their approved plans and maps identifying potential IAL to the Land Use Commission for IAL designation as required under Section 205-47, HRS. As of December 2016, seven private land owners have applied for and received designation of their lands as IAL from the Land Use Commission. The total area designated as IAL as of December 2016 was 131,555 acres.

The two applicants in 2015 did not need to submit new costs to the Department to be considered “qualified agricultural costs”, because both applicants were able to claim the maximum allowable tax credit from qualified agricultural costs from previous years of claiming the credit.

### **Findings and Recommendations to improve the effectiveness of the tax credit to further encourage the development of agricultural businesses**

#### Sunset Date

The Department began certifying claims for IAL Qualified Agricultural Cost tax credits in the 2013 tax year. Under section 235-110.93(l), HRS, the Department shall cease certifying IAL tax credits after the 2017 tax year. The Department believes that the sunset date should be extended to give landowners/farmers the opportunity to seek voluntary IAL designation for their agricultural lands and apply for IAL tax credits as well as to accommodate the delay in county identification of potential IAL and designation by the Land Use Commission via the process described in Section 205-47, HRS. No county has yet to complete the county IAL designation process.

As of the date this report was written, the Department is proposing to submit a bill for the 2017 State Legislative Session to extend the sunset date of the IAL Tax credit.