LINDA LINGLE
GOVERNOR
THEODORE E. LIU
DIRECTOR
MARK K. ANDERSON
DEPUTY DIRECTOR

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Web site: www.hawaii.gov/dbedt
Telephone: (808) 586-2355
Fax: (808) 586-2377

Statement of
THEODORE E. LIU
Director
Department of Business, Economic Development, and Tourism
before the
COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
Tuesday, March 18, 2008
1:15 P.M.
State Capitol, Conference Room 224

in consideration of
HB 2415 HD1 Proposed SD1
RELATING TO HIGH TECHNOLOGY

Chair Fukunaga, Vice Chair Espero and Members of the Committee on Economic Development and Taxation.

The Department of Business, Economic Development and Tourism (DBEDT) supports Part I Section 1 of HB 2415 HD 1 Proposed SD1. However, DBEDT opposes Part I Section 2 and Part II Section 3 of HB 2415 HD 1 Proposed SD1.

The Hawaii Innovation Initiative encourages technological innovation and understands that small businesses are the true innovators. The Hawaii Matching Grant Program helps support Hawaii companies by matching federal awards at 50 per cent, but not to exceed $25,000. This matching formula was created when the maximum Phase I federal award was $50,000.

HB 2415 HD 1 Proposed SD1 Part I Section 1 would remove this cap and the Hawaii matching grant would be at 50 per cent of the federal award. This is a vital improvement as the present Phase I federal award ceiling is $100,000. The current $25,000 Hawaii match has not kept up with the increased federal funding levels and this amendment would remedy the imbalance.

HB 2415 HD 1 Proposed SD1 Part I Section1 also amends the current statute to give preference to qualified companies receiving their first award over previous awardees. This revision would be in the spirit of the SBIR Program investing in and fostering Hawaii's small businesses.

As mentioned above, DBEDT opposes HB 2415 HD 1 Proposed SD1 Part I Section 2 and Part II Section 3, which proposes to disband the High Technology Innovation Corporation (HTIC). HTIC plays an important role in promoting high technology in conjunction with the High Technology Development Corporation (HTDC). With its non-profit status, HTIC executes programs and projects that allow for tax deductible foundation contributions toward the development of the State's high technology industry. In addition, HTIC manages programs such as the National Governors Association Science, Technology, Engineering, and Math (STEM) Grant. Disbanding HTIC would adversely affect this grant and other HTIC programs.

Thank you for the opportunity to provide these comments.

Hawaii Aquaculture Association

To: THE SENATE
THE TWENTY-FOURTH LEGISLATURE
REGULAR SESSION OF 2008

COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION
Sen. Carol Fukunaga, Chair
Sen. Will Espero, Vice Chair

<u>HEARING</u>

DATE: Tuesday, March 18, 2008
TIME: 1:15 PM
PLACE: Conference Room 224, State Capitol
415 South Beretania Street

From: Ron Weidenbach, President, Hawaii Aquaculture Association
Phone: 429-3147, Email: hawaiifish@gmail.com

Re: **HB 2415 HD1 Proposed SD1** RELATING TO HIGH TECHONLOGY

Chair Fukunaga, Vice Chair Espero, and Committee Members:

The Hawaii Aquaculture Association (HAA) **<u>strongly supports HB 2415 HD1 Proposed SD1</u>**, relating to high technology that in Part I removes the $25,000 limit on HTCD grants to recipients of federal Small Business Innovation Research Phase I awards or contracts, or federal Small Business Technology Transfer Program awards, retains limits of 50 percent of the federal award or contract, requires HTDC to expend any remaining 2006-2007 funds on grants in 2008 and 2009 and to report to the 2009 and 2010 legislature on expenditures, and in Part II repeals chapter 206M, Part IV, HRS.

Many members of the Hawaii aquaculture industry have been successful in competing nationally for Federal SBIR and SBTT grants to support the development of new aquaculture technologies and products. The HTDC grants help Hawaii's technology companies to better compete nationally, to purchase specialized research equipment, and to hire international consultants not otherwise covered by the Federal SBIR/SBTT programs, so as to enable them to be more successful in meeting Federal research objectives and in subsequent commercialization efforts, and helps Hawaii companies bridge the funding gap between the Phase I grants and follow-on Phase II grants thereby enabling companies to retain critical staff and live research plants and animals.

In summary, HTDC's grant program is very beneficial to Hawaii's technology companies and, as such, HAA strongly supports passage of HB 2415 HD1 Proposed SD1. Thank you for the opportunity to testify.

HTDC Cultivating Hawaii's tech sector
HIGH TECHNOLOGY DEVELOPMENT CORPORATION

Statement of
YUKA NAGASHIMA
Executive Director & CEO
High Technology Development Corporation
and
President
High Technology Innovation Corporation
before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
Tuesday, March 18, 2008
1:15 PM
State Capitol, Conference Room 224

In consideration of
HB 2415 HD1 PROPOSED SD1 RELATING TO HIGH TECHNOLOGY.

Chair Fukunaga, Vice Chair Espero, and Members of the Senate Committee on Economic Development and Taxation.

The High Technology Development Corporation strongly supports only PART I SECTION 1 and opposes PART I SECTION 2 and PART II SECTION 3 of HB 2415 HD1 Proposed SD1.

1. We offer these comments in support of PART I SECTION 1:

Hawaii SBIR Matching Grant Program Results

The State's Hawaii Small Business Innovation Research (HSBIR) Program which is a matching grant program shows that 67 local companies were awarded 305 federal SBIR Phase I and Phase II grants totaling nearly $71 million to date. During this same period the State awarded $4.5 million in matching grants to local companies and these companies have attracted $57.5 million in federal SBIR Phase III commercialization funding. Generally, for every State dollar ($1) invested in SBIR matching grant program, Hawaii companies have attracted over fifteen dollars ($15) in federal SBIR awards or twenty-eight dollars ($28) in total federal SBIR monies when you include funding for technology commercialization.

Future Trend Estimate for Hawaii SBIR Matching Grant Program

There is an increase in federal SBIR awards won by Hawaii companies and this is a trend that is likely to continue to increase. In the first 14 years of the program, local companies won an average of 10 federal Phase I awards per year, with a total value of $10.5 million over the 14 years. These local companies attracted another $21.7 million in follow-on federal SBIR funding to Hawaii. Within the past five years of the program, local companies won an average of 18 federal awards per year (27 in 2006 alone), with a total value of $12.5 million over five years. These companies attracted another $25.5 million in follow-on federal SBIR funding to Hawaii in just the past five years.

Summary of PART I SECTION 1 of HB 2415 HD 1, Proposed SD1

The bill makes "housekeeping" modifications to three sections of HTDC enabling legislation (HRS Section 206M-15). This statute provides state matching grant funding to Hawaii companies that have been awarded federal Small Business Innovation Research (SBIR) Phase I awards and federal Small Business Technology Transfer (STTR) Phase I awards.

SBIR is a three-phase federal program that provides small businesses the opportunity to win federal R&D grants and contracts. In Phase I, the small business explores the technical merit or feasibility of an idea or technology. In Phase II, the small business expands upon Phase I results. In Phase III, the project matures and is commercialized. No SBIR funds support Phase III activities. STTR is a sister R&D funding program to SBIR and is similarly organized in three phases. STTR primarily differs in that the small business must partner with a research organization to carry out the research, thus encouraging greater collaboration between the university and industry. The SBIR and STTR programs provide the necessary funding for innovative research and development efforts that is normally not available from traditional sources.

Hawaii companies that receive SBIR and STTR Phase I feasibility study awards can apply for state Hawaii SBIR and STTR matching grants. The state grants enhance a company's Phase I project development while helping it to develop stronger proposals for the more lucrative federal Phase II awards (normally $750,000 or more to build a prototype), and ultimately to commercialize their innovations successfully and profitably. Ultimately the goal of the matching grant helps Hawaii companies launch new commercial products into the marketplace.

(1) First Housekeeping Amendment

The first requested change is to adjust the ceiling of the Hawaii SBIR grant to be consistent with the original intent of section 206M-15. When the Hawaii SBIR grant program was created nineteen years ago, the federal SBIR Phase I award was $50,000. The state matching grant was based upon 50-percent of the federal Phase I amount, which happened to be $25,000. Currently the federal SBIR Phase I awards average $100,000 and up. The state matching grant has not proportionately increased or kept up with the federal award due to the $25,000 ceiling in the existing statute. Therefore, we request that the $25,000 cap be removed, so as to allow the higher amounts to be awarded. The ceiling increase does not mean that larger grants will be regularly awarded, but rather that they can be awarded particularly for exceptional research projects.

(2) Second Housekeeping Amendment

The second requested change redefines award priority for small businesses that receive an SBIR award for the first time. Currently the statute reads that an SBIR Phase I awarded company will receive funding preference if it applies for the state grant for the first time in a fiscal year. This clause provides the same level of preference to a multiple-SBIR award winner so long as it was their first time in a fiscal year, as it would to a first-time-ever SBIR awardee. Since HTDC places priority on supporting new companies to the SBIR program, we would like to revise the language to read: "Give preference to all qualified businesses receiving their first award over multiple award grantees".

(3) Third Housekeeping Amendment

The third requested change relates to the situation when there is not sufficient Hawaii SBIR budget available to fulfill the applicants' requests. The current language states that HTDC "shall apply for funds to be transferred from the Hawaii capital loan revolving fund" if the budget is inadequate to satisfy all qualified requests. In effect, HTDC must request the loan. HTDC prefers fiscal oversight and the choice to borrow funds from the state loan program in case of a budget shortfall, as opposed to "automatically" borrowing from the loan program. Therefore, HTDC would like to replace the word "shall" to "may", so the language reads "the development corporation may apply for funds to be transferred from the Hawaii capital loan revolving fund".

To summarize PART I, SECTION 1, the requested language changes strengthen the successful Hawaii SBIR and STTR programs by allowing small businesses with exceptional SBIR/STTR projects to receive larger state grants to accelerate commercialization; placing priority on awarding true first-time SBIR and STTR companies; and allowing HTDC the flexibility in times of budget shortfall, to *choose* to borrow other state funds instead of making it a requirement.

2. And, we offer these comments in opposition to PART I SECTION 2 and PART II SECTION 3:

Part I Section 2 of HB 2415 HD1 Proposed SD1 proposes to dissolve the High Technology Innovation Corporation (HTIC) then redirect remaining funds appropriated from Act 255, Session Laws of Hawaii 2006, relating to the establishment of an international business and technology incubator program with Hawaii and China technology businesses through the state's HTIC, a non-profit state agency. We believe the proposed SD1 is not feasible for these reasons:

(a) State's Efforts to Grow Tech Industry Abruptly Stopped: HTIC was created by the legislature in 2005 without funding or resources to further support the state's efforts to grow its emerging technology industry. HTIC applied and is a 501(c) (3) state operated non-profit corporation and is not exempt from the state procurement code (103D). HTIC plans, creates and implements programs and projects of HTDC that are assigned to HTIC by HTDC including federal funded programs and projects. HTIC non-profit status would allow entities such as foundations to make contributions to grow the state's technology industry that would also be tax deductible.

(b) Current Contracts Would Be Negatively Impacted: HTIC currently manages contracts for HTDC that includes the National Governors' Association STEM Grant. The State (HTIC) is not able to assign, sublet or transfer all or any portion of this agreement without prior written approval of the NGA. HTIC also maintains a small representative office in China as part of its International Incubator Program; further, there are current plans to expand this program to Japan. There is also the UCERA agreement, to perform consulting work for the Triple Helix Project, to survey entities in China on best practices for academia, government and industry to work together.

(c) Funds Remaining from Act 255: Based on discussions with Budget & Finance, funding from Act 255 which created the International Incubator Program lapsed on 6/30/07. Language in Section 2 Part I and Section 3 Part II repeals the HTIC leaving the funds remaining from Act 255, SLH 2006 to be redirected to the Hawaii Small Business Innovation Research program. The State accounting system reflects a remaining unobligated balance that lapsed from Act 255 as of June 30, 2007 was approximately $29.00. Also, if the intent of Section 2 Part I and Section 3 Part II is to redirect the remaining unspent balance in the international business and technology incubator program contract between HTDC and HTIC, we further understand that if the contract was dissolved the remaining funds in the contract would lapse, revert to the general treasury and not be available for the Hawaii Small Business Innovation Research Program. In order to carry out the purpose of these sections, a new appropriation for fiscal year 2009 and 2010 would be needed to be able to carry out the intent of PART I SECTION 2 and PART II SECTION 3 of HB2415 HD1 Proposed SD1.

(d) Loss of Opportunity to further develop the International Business and Technology Incubation Program, and future projects requiring non-profit status: The process of establishing a non-profit state entity (since July 2005) as well as establishing the International Incubator Program (since July 2006) has been an excellent opportunity of learning how to do business internationally; and in this case with China as its first office. Learning from this process we hope to extend the program and include Japan; however, if HTIC were repealed as proposed in SD1, that opportunity would be lost. Further, the establishment of a state non-profit entity is new among state departments. This effort was without startup funding through state appropriations and has been in existence for less than 18 months. The NGA grant HTIC now administers allows Dept. of Education (DOE) to benefit from the funding the grant provides while being able to concentrate on its core mission of education. Having an external fiscal agency attached to the state but having a non-profit status, provided comfort to NGA and other stakeholders for this grant to be properly administered. With STEM being such a fundamental piece to the workforce development challenge, the State would be losing a valuable partner should we lose HTIC's State-associated non-profit structure. If we are to succeed, we will need to allow the HTIC to continue its operations.

Thank you for the opportunity to submit comments in strong support of PART I SECTION 1 and in opposition to PART I SECTION 2 and PART II SECTION 3 of HB 2415 HD1 Proposed SD1.

LINDA LINGLE
GOVERNOR
THEODORE E. LIU
DIRECTOR
MARK K. ANDERSON
DEPUTY DIRECTOR

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Web site: www.hawaii.gov/dbedt

Telephone: (808) 586-2355
Fax: (808) 586-2377

Statement of
THEODORE E. LIU
Director
Department of Business, Economic Development, and Tourism

before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION
Tuesday, March 18, 2008
1:15 p.m.
State Capitol, Conference Room 224

in consideration of
HB 3358 HD1
RELATING TO HIGH TECHNOLOGY.

Chair Fukunaga, Vice Chair Espero, and Members of the Committee.

The Department of Business, Economic Development, and Tourism (DBEDT) supports the intent of HB 3358, which requires DBEDT to consult with the High Technology Development Corporation (HTDC) to plan for the establishment of a high technology park on the island of Oahu, and work with the department of land and natural resources to identify public or private lands that may be acquired for the park. The bill also would appropriate funds for infrastructure to build the park. There have been many good ideas introduced this legislative session that support the State's economic development goals. We note, however, that this appropriation was not included in the Executive's Supplemental Budget, and request that this appropriation not displace the priorities contained in that budget.

The Administration recognizes that there is a critical need for additional, appropriate infrastructure to support the growth of Hawaii's emerging technology and defense-related industries, which can provide Hawaii with a source of high wage jobs and a way to ensure the State's future prosperity and global competitiveness. We express our unqualified support for this sector and the entrepreneurs and companies in it.

As I noted in my testimony on a similar proposal last year, I am concerned that a State investment should be the right amount and at the right time. If this measure is adopted as a priority of the State and its policymakers, as I believe it should be, then I suggest that the required plan be developed in a partnership that would include other State and federal agencies, non-profits and private sector firms, including developers, in addition to HTDC. The planning process should include the development of a specific business plan (not a mere plan) with siting, sizing, lay-out and design parameters, project budget and financials, cash flows, and project timeline.

I continue to support the concept that private or other non-State general fund sources of financing should be tapped to the fullest extent possible and that the State's support, in cash[1] or in-kind, be the "tipping point" of getting a project built. If there is a "gap" in capital that justifies public funds, the business plan, projections and numbers should make that clear. The Legislature – and the public – would then know the basis of any public subsidy and the basis of appropriating the same in any particular budget year.

On that basis, we suggest that any appropriation for FY 2009 should be for the hiring of consultants or other professional services to assist in the development of the plan, provided, as indicated above that the appropriation does not displace the priorities contained in the Executive Supplemental Budget. General funds, if determined to be necessary, could be appropriated based on the findings in the report.

Thank you for the opportunity to provide these comments.

[1] Should project NOI (net operating income) be sufficient, a state tax exempt revenue or project bond may be a possibility.

HTDC Cultivating Hawaii's tech sector
HIGH TECHNOLOGY DEVELOPMENT CORPORATION

Statement of
YUKA NAGASHIMA
Executive Director & CEO
High Technology Development Corporation
before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
Tuesday, March 18, 2008
1:15 PM
State Capitol, Conference Room 224

In consideration of
HB 3358 HD1 RELATING TO HIGH TECHNOLOGY.

Chair Fukunaga, Vice Chair Espero, and Members of the Senate Committee on Economic Development and Taxation.

The High Technology Development Corporation strongly supports HB 3358 HD1 which provides for a technology park on Island of Oahu. There have been many good ideas introduced this legislative session that support the State's economic development goals. We note, however, that this appropriation was not included in the Executive's Supplemental Budget, and request that this appropriation not displace the priorities contained in that budget.

We envision the employment of engineers, life and physical scientists, mathematical specialists, science technicians, and similar technical position counts in the private sector will begin to exceed the numbers currently in State government with initiatives such as HB 3358 HD1. And, the economic opportunities that come with growth of technology parks will contribute to the number of higher paying and sustainable jobs in our local economy.

Oahu is the only island without a technology park and yet it has the largest critical mass needed to support and fill a park. Big Island has two technology parks – one adjacent to the university's Hilo campus and the other at NELHA, in Kihei you have the Maui Research & Technology Park, Kauai has one in Waimea, but Oahu does not. The Big Island's technology parks have utilized local community and natural resources; Maui has succeeded with federal contractors and the Maui Supercomputing Center; and, Kauai with federal contractors and close proximity to the Pacific Missile Range Facility. Oahu has Manoa Innovation Center which is a successful incubation and innovation center, but its land lease with the University of Hawaii will expire in seven (7) years and the Manoa site lacks available adjacent land for expansion into a technology park. The Mililani Technology Park financial structure of selling off fee simple lots is not conducive to developing a technology industry and should not be defined as a technology park.

There already are many national and international studies that support the need for technology parks to contribute to economic competitiveness of regions, states and nations. To quote:

- "A survey of 134 university research parks in the United States and Canada revealed that: More than 300,000 workers in North America work are located in a university research park. Every job in a research park generates an average of 2.57 jobs in the economy resulting in a total employment impact of more than 750,000 jobs."
- "A new model is emerging," said Walter H. Plosila, Vice-President, Battelle TPP. "What we're seeing are strategically planned, mixed-use campuses designed to create an environment that fosters collaboration and innovation and promotes the development, transfer and commercialization of technology," he said. Research parks have become a key element of the technology infrastructure supporting the growth of today's knowledge economy."
- "Research parks are key drivers of regional development," said J. Michael Bowman, President of the Association of University Research Parks (AURP) Board of Directors and Chairman & President, Delaware Technology Park. Research parks were traditionally established to recruit R&D and technology companies to locate near a university in order to build a cluster of high technology companies.
- "Research and technology parks have exhibited a strong ability to attract and retain talent, which in turn, allows us to create a critical mass that can yield high economic opportunities for our regions," said Dale Gann, President of AURP Canada and Vice President-Technology Parks, Vancouver Island Technology Park.

Today, research parks increasingly spur homegrown business startups, retention and expansion with a focus on providing commercialization and business development support in addition to space for talent retention and innovation infrastructure. Technology parks are emerging as strong sources of entrepreneurship, talent and economic competitiveness.

We offer these additional comments: (a) in addition to the Department of Land and Natural Resources, we suggest that all other state departments and agencies assist to facilitate technology parks when it is appropriate and proper given their mission and purpose; (b) it is vital that each community be represented in this initiative because technology projects (incubators, innovation centers, research centers, technology parks, etc.) succeed when there is buy-in and collaboration within the community; and, (c) the Island of Oahu has sufficient critical mass to start a technology park today as a planned incremental development, and current site planning needs to contain growth and expansion needs.

Thank you for the opportunity to submit comments in support of HB 3358 HD1.

94-587 Ukee Street
Waipahu, Hawaii 96797-4214
Phone: (808) 676-5400
Fax: (808) 676-7811
huoa@huoa.org
www.huoa.org

March 17, 2008

The Honorable State Senator Carol Fukunaga, Chairman, and
Honorable State Senator Will Espero, Vice Chair
And Members
Economic Development and Taxation
Hawai'i State Capitol
Honolulu, Hawaii 96813

RE: <u>Testimony in support of HB 3279 HD1</u>
<u>Relating to the Hawaii United Okinawa Association</u>

Chair Fukunaga, Vice Chair Espero and Members of the Committee:

Thank you for this opportunity to present testimony in support of HB 3279 HD1 on behalf of the Hawaii United Okinawa Association.

Recently, it was brought to our attention by the Department of Budget and Finance that the Legislative appropriation passed in 2006 to benefit the Hawaii United Okinawa Association, should be clarified to specifically state the public purpose and benefit of Act 160 (2006), as specifically related to the Hawaii United Okinawa Association and to transfer the administration of the appropriation to the Department of Accounting and General Services, specifically the State Foundation on Culture and the Arts. Time is of the essence. Due to the need for this clarification, the appropriation has not been released and funds will soon lapse in July 2008.

As provided in the text of the current HB 3279 HD1, the Hawaii United Okinawa Association ("HUOA") is a 501(c)3 non-profit organization founded in 1951, created to promote, preserve and perpetuate the Okinawan culture, provide community services and to support and encourage the education of culture and heritage.

The Hawaii Okinawa Center ("HOC"), in Waipio, was built in 1990 and still serves as the symbol of Uchinanchu (Okinawan) heritage and perseverance here in Hawaii. The HUOA, however, struggles to accommodate additional needs related to cultural events and community service programs. The 2006 budget Act 160 appropriation was intended to further a public purpose by providing assistance in the form of a grant to continue providing an opportunity to expand the HOC to allow for cultural classes for performing arts, language, children's education and international exchange for the general public and not held exclusively for HUOA members.

HUOA has maintained a positive presence in the community for over 50 years. The annual Okinawa Festival is the State's largest cultural festival that depends solely on volunteers and attracts over 70,000 visitors from Hawaii and abroad. Our statewide annual Okinawan Cultural Summer Day Camps for Children hosts cultural education classes for over 200 of Hawaii's children across all of the neighbor islands. HUOA recently coordinated and sponsored various community outreach projects like a good old fashion Okinawan Picnic for needy families at homeless shelters in East and West Oahu. This program has specifically contributed to over 300 families in Waimanalo and Waianae.

Pursuant to Article VII, section 4 of the State Constitution, any allocation of public money shall be used for a "public purpose." The physical expansion of the Hawaii Okinawa Center is vital and necessary to continue the mission of HUOA to serve its members and the public. Additional space and programs are critical to maintain HUOA's support for cultural education, genealogy, crafts, ikebana, music, dance and to maintain the Okinawan cultural significance and preservation here in Hawaii.

Programs and additional space is required to address identified current and future community needs and HUOA seeks to develop innovative programs such as adult day care and pre-school systems to allow members and community residents to avoid long commutes into Honolulu. Additional parking is also a priority. Currently, members and guests are walking from remote locations when there are large HUOA or conflicting events. Health and safety concerns necessitate the need to provide additional parking to accommodate members, guests and community residents who use HOC's facilities.

This measure currently contains language providing the public purpose declaration from the Legislature representing that the grant to the Hawaii United Okinawa Association is in the public interest.

Therefore, we respectfully request that the Senate Committee on Economic Development and Taxation support passage of HB 3279 HD1 seeking to amend Act 160 by clarifying the legislative intent and provide a public purpose declaration and to transfer the administration of the appropriation to the Department of Accounting and General Services. Specifically, we believe that the State Foundation on Culture and Arts is the appropriate administrator of the appropriation.

Please accept our sincerest Mahalo for this opportunity to provide this testimony to demonstrate our support for HB 3279 HD1.

Jon Itomura	Alan Chinen
President, HUOA	Capital Campaign Chairman
Hawaii United Okinawa Assn.	Hawaii United Okinawa Assn.

testimony

From: Chinen, Alan [ChinenA@CA-FG.com]

Sent: Monday, March 17, 2008 3:26 PM

To: testimony

Subject: HB 3279, HD1

To The Senate Committee on Economic Development & Taxation
Senator Carol Fukunaga, Chair
Senator Will Espero, Vice Chair

Notice of Hearing
Tuesday, March 18,2008
1:15 PM
Conference room 224
State Capitol

Please support the Hawaii United Okinawa Association in it's efforts to amend the appropriation for fiscal year 2006-2007 (HB3279, HD1)

Alan M. Chinen
President & C.E.O.
Chinen & Arinaga Financial Group, Inc.
(808)548-2234 x801 fax (808)524-6781 Cell (808) 352-0410
email: chinena@ca-fg.com

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2137 HD 2 SD 1
RELATING TO HEALTH

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This bill provides a tax credit up to an unspecified amount for the costs associated with the donation of an organ.

The House Committee on Health amended the bill by providing the Department with the authority to issue credits on a first-to-file basis.

The House Committee on Finance amended the measure requiring maximum adjusted gross incomes in order to claim the credit, as well as unspecifying the credit amounts.

The House of Representatives passed this measure on third reading.

The Senate Committee on Health amended the measure by providing a lost wage stipend in lieu of lost wages and by precluding any cost from qualifying for the credit if the credit was reimbursed with insurance proceeds. The Committee on Health also precluded any cost from qualifying to the extent a deduction or other credit was claimed.

The Department of Taxation **provides comments** on this legislation.

I. TECHNICAL COMMENTS

Live Organs Only—The Department recognizes that the intent of the measure is to provide a tax credit for live donors only. The Department points out for the Committee that deceased organ donors have tax liabilities after death as well. Though a deceased person's credit calculation would be unworkable under the current bill (*i.e.*, likely no travel, lodging or wage loss to claim); the Department suggests that the Committee clarify the measure by inserting language that the credit is for live donors only.

(b) To qualify for the tax credit, the taxpayer shall be a full-time resident of the State with an adjustable gross income of less than $50,000, or less than $100,000 in the case of a joint return, who has donated one or more of the taxpayer's human organs**, not in contemplation of death,** for the purpose of an organ transplant during the taxable year; provided that this section shall not apply to organs sold for monetary or other consideration.

Lost Wages Provision—The Department supports the intent of eliminating the "lost wages" category of losses that qualify for the credit in exchange for a flat dollar amount. However, the Department believes that the current language may be unworkable and confusing. Because the language provides that the taxpayer can claim a stipend of $100 per day "or less," it is unclear whether the person must claim the actual amount of wage loss if less or the $100. The provision could be clarified by the following amendments:

(c) A taxpayer may claim the tax credit only once per lifetime for the following unreimbursed related expenses incurred by the taxpayer:

(1) Travel expenses;
(2) Lodging expenses; and
(3) A lost wages stipend of one hundred dollars **[~~or less~~]** per day**, or actual lost wages, whichever is less[~~; provided that the lost wages are actual and not reimbursable or due to leave without pay~~]**.

The Department believes that the foregoing amendments will be simpler for taxpayers to understand. The Department does not object to a flat amount that constitutes lost wages if the legislative intent is to provide some degree of relief for such losses. By having a flat amount, the Department's prior concerns relating to fraud or abuse are mitigated.

II. REVENUE ESTIMATE.

This bill is estimated to result in an indeterminate revenue loss due to unspecified limits. However, assuming the previous $1,000 cap per individual, it is estimated that there will be a revenue loss of approximately $15,000 per year. There have been on average 17 living donors per year. Taking into consideration that the number of living donors is increasing in Hawaii, and taking into account the AGI limitations of the credit, it is estimated that approximately 15 people will qualify for the credit each year.

TESTIMONY OF THE STATE ATTORNEY GENERAL
TWENTY-FOURTH LEGISLATURE, 2008

ON THE FOLLOWING MEASURE:
H.B. NO. 2137, H.D. 2, S.D. 1, RELATING TO HEALTH.

BEFORE THE:
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

DATE: Tuesday, March 18, 2008 **TIME:** 1:15 PM
LOCATION: State Capitol, Room 224
Deliver to: State Capitol, Room 216, 1 Copy

TESTIFIER(S): Mark J. Bennett, Attorney General
or Mary Bahng Yokota, Deputy Attorney General

Chair Fukunaga and Members of the Committee:

The Department of the Attorney General provides these comments to bring to your attention that this bill may be subject to constitutional challenge.

This bill provides "full-time residents of the State" with an income tax credit for expenses related to organ donation.

This bill is facially discriminatory in that it restricts the tax credit to Hawaii residents. A court may conclude that the credit is unconstitutional because the bill does not expressly articulate a legitimate government interest served by the legislation sufficient to withstand constitutional challenge based on the Equal Protection and/or Privileges and Immunities Clauses of the United States Constitution.

The Equal Protection Clause prohibits discrimination against a nonresident based solely on residency. See, e.g., Williams v. Vermont, 472 U.S. 14 (1985) (use tax credit for sales taxes paid on cars purchased in other states invalidated because it was only available to Vermont residents). The Hawaii Supreme Court has recognized that the Equal Protection Clause applies where a tax operates unequally on persons or property of the same class. In re Swann, 7 Haw. App. 390, 776 P.2d 395 (1989).

Similarly, under the Privileges and Immunities Clause, a state may not impose higher taxes on a nonresident individual than it imposes on its own citizens. However, a discriminatory tax could be sustained if legitimate reasons for the tax exist and the discrimination bears a substantial relation to those reasons. Lunding v. New York Tax Appeals Tribunal, 522 U.S. 287 (1998) (alimony deduction for residents only struck down as violating Privileges and Immunities Clause).

The wording in the bill that creates this potential constitutional problem is the "full-time resident of the State" requirement on page 1, lines 12 through 13, and the definition of the term "full-time resident of the State" on page 3, lines 20 through 22.

The residency requirement arguably violates the Equal Protection and Privileges and Immunities Clauses because it expressly favors residents over nonresidents, as noted above. To insulate the bill from a possible constitutional challenge, we recommend either of two possible remedies: (1) that the bill be amended to provide that the credit is available to taxpayers subject to chapter 235, Hawaii Revised Statutes -- deleting the "full-time resident of the State" requirement (on page 1, lines 12 through 13) and the definition for the term (on page 3, lines 20 through 22) should remedy this possible constitutional problem; or (2) that a legitimate government purpose substantially related to that purpose is articulated within the preamble of the bill.

We are aware that prior tax refunds or credits may have had residency requirements but have not been subject to constitutional challenge yet. However, this does not preclude the possibility of such a challenge in the future.

March 17, 2008

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice Chair
Committee on Economic Development and Taxation
Hawaii State Capitol
Conference Room 224
Honolulu, HI 96813

RE: H.B. No. 2137. SD1 – Relating to Health (Tax Credit; Organ Donation)

Dear Chairman Fukunaga, Vice Chair Espero and members of the Senate Committee on Economic Development and Taxation:

I am Glen Hayashida, CEO, National Kidney Foundation of Hawaii (NKFH) and member of the Hawaii Coalition on Donation. It is my privilege to support HB 2137. SD1. This bill is designed to help reduce a financial barrier for people who are considering giving a second chance at life to someone by becoming a living organ donor. This legislation would create a state income tax credit for living donors who incur expenses because of travel, lodging and lost wages associated with organ donation. For this purpose, living donor is defined as anyone who donates a kidney, bone marrow, or part of a liver, lung, intestine, or pancreas.

It is well known that we have a serious shortage of organs for transplantation in the United States, including Hawaii. We are adding patients to the transplant waiting lists faster than organs can be found for them. There are about 98,000 people in America on the waiting list to receive organ transplants. Nationwide, over 5,000 of these individuals will die each year because the organ which could have saved their life was not available. In Hawaii alone, there are close to 400 people on the waiting list today; as many as 16 people this year will die while on the transplant waitlist.

P.O. Box 10009 • Honolulu, HI 96814
Phone: (808) 737-1719 • Fax: (808) 737-1733 • www.donatelifehawaii.org

Since 2002, in Hawaii we have had a total of 104 living donors. This is an average of 17 living donors per year. Nationwide, the number of living organ donors exceeds the number of donations received from deceased individuals. While, this only happened once in Hawaii, in 2005, the percentage of living donors has increased significantly. This trend is predicted to continue, making the need for legislation providing partial relief of the costs of donating making more important than ever.

There is additional value to be had from living donations. The quality of transplant is often better when the organ comes from a living donor. Many times there are fewer infections, fewer complications, longer working-life of the organ, and generally better outcomes.

HB 2137.SD1 is modeled after similar laws (more commonly known as "Cody's Law") in Arkansas, Georgia, Iowa, Minnesota, New Mexico, New York, North Dakota, Oklahoma, Utah, and Wisconsin (where it originated). In Idaho, a version of the law was adopted in 2006 that allows a $5,000 tax credit. Overall, Cody's Law provides financial assistance to living organ donors through a tax deduction or a tax credit to cover travel, lodging expenses and lost wages, it also completely conforms to federal law. This bill reiterates the fact that in section 301 of the National Organ Transplant Act of 1984, Congress specified "the term 'valuable consideration' does not include the reasonable payments associated with the removal, transportation, implantation, processing, preservation, quality control, and storage of a human organ or the expenses of travel, housing, and lost wages incurred by the donor of a human organ in connection with the donation of the organ." HB 2137.SD1 uniquely provides a monetary helping-hand to those who choose to donate organs.

P.O. Box 10009 • Honolulu, HI 96814
Phone: (808) 737-1719 • Fax: (808) 737-1733 • www.donatelifehawaii.org

HAWAI'I COALITION ON DONATION

HB 2137.SD1 is a unique bill in several ways. It is the first of its kind to provide for reimbursement of expenses for organ donation in a way that conforms completely with federal law. This bill creates a state income tax credit for living donors. This is a way to facilitate the gift of those who bravely and generously choose to become living organ donors. It fully is within the limits of federal law which prohibit a person from acquiring, receiving, or otherwise transferring an organ for valuable consideration for use in human transplantation.

This bill is designed to help save lives. This bill is relevant; there is a genuine and increasing need for living organ donations. Most importantly, this legislation can save lives by lending a helping hand to those who selflessly choose to give the gift of life.

Thank you for your consideration

Talk Decide

P.O. Box 10009 • Honolulu, HI 96814
Phone: (808) 737-1719 • Fax: (808) 737-1733 • www.donatelifehawaii.org

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Credit for organ donation

BILL NUMBER: HB 2137, SD-1

INTRODUCED BY: Senate Committee on Health

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to establish a refundable tax credit for the expenses incurred relating to the donation of organs. The credit shall be available to individual taxpayers with adjusted gross income of less than $50,000 or $100,000 in the case of those filing a joint return. The credit shall not exceed $_______ per taxpayer per year and $________ for all taxpayers per year for unreimbursed travel expenses, lodging expenses, and a lost wages stipend of $100 or less per day provided that the lost wages are actual and not reimbursable or due to leave without pay. The taxpayer shall be entitled to one credit in a lifetime. Requires the donor to be a full-time resident of the state and have donated one or more organs to another human being, and shall not apply to organs sold for monetary or other consideration.

Defines "human organ" as all or part of a liver, pancreas, kidney, intestine, lung or bone marrow.

The director of taxation may adopt rules pursuant to HRS chapter 91, prepare the necessary forms to claim the credit, may require proof of the claim, and allocate the credit on a first-come, first-served basis.

If any other tax credit or deduction under Title 14, including a deduction under IRS sections 162 or 213, is taken than no credit shall be allowed under this section for the same costs.

The credit shall sunset on December 31, 2012 and be repealed on June 30, 2014.

EFFECTIVE DATE: July 1, 2020; applicable to tax years beginning after December 31, 2007

STAFF COMMENTS: This measure allows taxpayers to claim a credit for expenses incurred as a result of donating a human organ to another person.

It should be remembered that this measure would grant preferential tax treatment to a select group of taxpayers and it does so without the taxpayer's need for tax relief. Generally, preferential tax treatments are designed to alleviate an undue burden on those who are unable to carry that burden, largely the poor and low income. An example is the general excise tax food credit for purchases made by the poor. If this measure is enacted, it would merely result in a subsidy by the state to encourage taxpayers to donate their organs without regard to a taxpayer's need for tax relief.

In a sense this proposal is insulting in that it attempts to reward a person for having made a donation of a human organ in order to save a life, a humanitarian act that has been reduced to an income tax credit. It should be remembered that the word "donation" has its genesis in the Latin word "*donare*" which means to give or give freely without contingency and, as such, donations of human organs should be given without consideration for compensation.

If the intent is to cover some of the costs associated with the donation of a human organ, then just appropriate the money to a department that can then judge what are appropriate costs to reimburse the donor. Why complicate the tax forms and instructions for a handful of taxpayers?

That said, there are some major flaws in this proposal. For example, the bill does not define "lost wages." For a salaried employee, that might not be such a difficult calculation, but when it comes to hourly workers, does that calculation take into hourly differentials like overtime or those who are paid more for shift work? What about those employees who are commissioned or perhaps receive bonuses for work output and performance? The term "full-time resident" is inconsistent with the definition of "resident" and "non-resident" as provided for in HRS 235-1. Under that definition a person is considered a resident for tax purposes if Hawaii is his/her domicile, that is Hawaii is the place which the person has singled out as home base. One can only have one domicile. So what is meant by full-time resident is unclear as one can reside in Hawaii but not declare Hawaii as his/her domicile. In this latter case, that person would not be considered a resident for state tax purposes. As a result, a nonresident who happens to reside in Hawaii "full-time" could claim this credit even though that person may have no Hawaii sourced income as the credit is refundable.

There is a limitation on adjusted gross income for single filers of $50,000 or $100,000 for joint filers, but no provisions made with respect to married taxpayers filing separate returns. Finally, the proposal does not specify how the credit is to be calculated. Is it, in fact, a 100% reimbursement of the costs listed in the bill or is it a fraction thereof? As noted above, if it is a complete reimbursement of expenditures incurred for the donation of a human organ, then why involve the tax department which has no expertise in this area to make a determination of reasonable costs. This is truly an inappropriate use of the state tax system.

Digested 3/17/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2306 HD 2 SD 1
RELATING TO GENERAL EXCISE TAX

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This legislation provides a general excise tax exemption for managed care support contractors of the TRICARE program that is established under 10 United States Code chapter 55.

The House Committee on Public Safety & Military Affairs amended the measure to clarify that the exemption applies to reimbursements.

The House Committee on Finance amended the measure's effective date.

The House of Representatives passed this measure on third reading.

The Senate Committee on Health amended the measure by making its effective date retroactive.

The Department of Taxation has **no comments** on this legislation other than citing that this was not factored into the Executive Budget or any of its fiscal priorities this session.

Because this measure was amended to provide retroactive tax relief for any contractors that participate in the TRICARE program, the Department is precluded from providing a specific estimate because of the limited taxpayer population of which the Department utilizes to arrive at its revenue estimates. The Department suggests that the Committee determine the revenue loss of any proposed retroactive tax relief by discussing the matter directly with taxpayers that will benefit from the measure.

HMSA

Blue Cross Blue Shield of Hawaii

An Independent Licensee of the Blue Cross and Blue Shield Association

MAR 17 2008

March 18, 2008

The Honorable Carol Fukunaga, Chair
The Honorable Will Espero, Vice Chair

Senate Committee on Economic Development and Taxation

Re: HB 2306 HD2 SD1 – Relating to General Excise Taxation

Dear Chair Fukunaga, Vice Chair Espero and Members of the Committee:

The Hawaii Medical Service Association (HMSA) appreciates the opportunity to testify in support of HB 2306 HD2 SD1 which would exempt from the general excise tax amounts received by managed care support contractors as reimbursements of costs or advances made pursuant to a contract for the administration of the federal TriCare program.

This measure would clarify that any amounts received by a managed care support contractor for reimbursements of costs made by the contractor, made pursuant to the contract with the federal government for the administration of the TriCare program, are exempt from the Hawaii General Excise Tax. It seems, at this time, it is unclear as to whether or not TriCare reimbursements are indeed subject to the GET.

HB 2306 HD2 SD1 would clear up any confusion on this issue and bring Hawaii in line with every other state in the U.S. (except Texas), that has put this exemption into law. This exemption will truly support the continued availability and strength of the TriCare program and ensure that it is able to provide coverage to the approximately 150,000 current and former military personnel and their family members who reside in Hawaii.

Thank you for the opportunity to provide testimony on HB 2306 HD2 SD1.

Sincerely,

Jennifer Diesman
Assistant Vice President
Government Relations

Hawaii Medical Service Association 818 Keeaumoku St. • P.O. Box 860 Honolulu, HI 96808-0860 (808) 948-5110 Branch offices located on Hawaii, Kauai and Maui Internet address www.HMSA.com

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Exempt reimbursements for TRICARE program

BILL NUMBER: HB 2306, SD-1

INTRODUCED BY: Senate Committee on Health

BRIEF SUMMARY: Amends HRS section 237-24.75 to clarify that amounts received by a managed care support contractor of the TRICARE program established under the 10 United States Code chapter 55 for reimbursement of costs or advances made to health care providers pursuant to a contract with the United States shall be exempt from general excise taxation.

EFFECTIVE DATE: Retroactive to January 1, 2005

STAFF COMMENTS: The TRICARE program was established by the U.S. Department of Defense (DOD) as the managed care component of the Military Health Care system to augment the health care services provided to DOD personnel at military treatment facilities. TRICARE contracts with third-party administrators (managed care support contractors) to establish and maintain networks of TRICARE-authorized civilian health care providers. These managed care support contractors make advances to health care providers for the services they provide to TRICARE beneficiaries and are reimbursed by the DOD for the amounts of such advances.

This measure clarifies that amounts received by the managed care support contractors as reimbursements from the DOD for advances they made on behalf of the DOD for TRICARE program purposes are not taxable under Hawaii's general excise tax law.

While an understanding of HRS section 237-20 which delineates the cost reimbursement provision under the general excise tax law appears to dictate that such reimbursements are not taxable unless the person making the advance receives additional monetary consideration for the services provided, the adoption of this measure may be unnecessary.

On the other hand, if the third party administrator receives a fee for handling these reimbursements, then it runs into the ban that HRS 237-20 imposes where the fee taints the entire amount received from the DOD. Hawaii law has already set precedent, providing that amounts received as reimbursements for wages, salaries and benefits of hotel workers paid by a hotel operator on behalf of the hotel owner are exempt as are reimbursements made on behalf of the city for the operations of the city's bus system by a third party operator even though additional consideration is received in both cases. It should be noted that the fee paid to the third party administrator would continue to be subject to the general excise tax as the fee is gross income to the third party administrator.

Digested 3/17/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 584 HD 2 SD 1
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

The purpose of this bill is to provide a refundable net income tax credit to Hawaii residents for the purchase of long-term care insurance.

The Senate Committee on Human Services & Public Housing amended the measure by inserting a current effective date for taxable years beginning after December 31, 2008.

The Department of Taxation **strongly supports** this bill

I. THE NEED FOR LONG-TERM CARE INSURANCE CONTRACTS.

The future of long-term care for Hawaii's senior and adult disabled population is one of the most critical health issues facing Hawaii in the twenty-first century. Persons sixty years of age and older presently account for almost one-fifth of the adult population in the State. By 2020, they will constitute more than one-fourth of Hawaii's adult population.

The rapid growth of the elderly and disabled populations will result in extraordinary demands on the delivery of long-term care services. While the majority of persons receiving long-term care are older adults, entire families are affected by the psychological, financial, and social costs of long-term care provided to those who are limited in the activities of daily living. As of 2003, the statewide average annual cost of a room in a skilled nursing facility was $105,028 for a private room and $95,597 for a semi-private room.

II. INDIVIDUAL LONG-TERM CARE TAX CREDIT

This bill creates a refundable long-term care tax credit for individual taxpayers. This tax credit is based upon a taxpayer's filing status and adjusted gross income. The credit is available to married taxpayers who file a joint return and who have adjusted gross incomes of $100,000 or less; for all other individual taxpayers who file a return, including married couples filing a separate return, the credit is available for those with adjusted gross incomes of $50,000 or less.

Subject to the cap on the total amount of the credit, the taxpayer may claim the tax credit for qualified long-term care insurance that the taxpayer purchases for the taxpayer, a spouse, a son or daughter, a stepson or stepdaughter, a father or mother, a stepfather or stepmother, or a dependent (as defined in tax law) living in the taxpayer's home.

This individual long-term care tax credit accomplishes the following:

- Encourages Hawaii residents to purchase private long-term care insurance so that they will have more long-term care options when they require long-term care, and
- Averts the impending Medicaid crisis with the aging of a substantial segment of Hawaii's residents.
- Helps Hawaii residents with lower incomes afford the cost of long-term care insurance; and
- Provides a reasonable financial incentive for Hawaii residents with to purchase their own private long-term care insurance.

According to data obtained by the Department's Tax Research and Planning Office, the average long-term care insurance premium paid by married Hawaii residents totals $2,500 annually. The average long-term care premium paid by individual Hawaii residents totals $1,250.[1] Given these premium cost averages, this legislation will assist in minimizing the financial impact of purchasing privatized insurance, as well as encouraging persons to purchase this much-needed insurance coverage for the aging.

III. REVENUE IMPACT

This legislation will result in a revenue loss to the general fund of approximately $6 million per year for FY 2010 and thereafter. The DCCA data indicated that the estimated long-term care premiums were about $39.1 million in CY2003. Average premium per person is assumed to be about $2,500 per year and the number of insured persons is 15,640 from very preliminary discussion with DCCA. Based on AGI class, the participation rate for single, head of household, and qualifying widower is assumed to be 30% of the DCCA estimated number of insured persons; joint, 60%; married filing separate, 10%; resulting in a total of 6,506 qualifying taxpayers. The Department also assumed that 50% of qualifying taxpayers purchased long-term care policies through their employers and paid 50% of the premium.

[1] Based upon aggregate data received from the Insurance Commissioner's Office in the Department of Commerce and Consumer Affairs.

TESTIMONY OF THE AMERICAN COUNCIL OF LIFE INSURERS
IN SUPPORT OF H. B. 584, HD 2, SD 1, RELATING TO TAXATION

March 18, 2008

Senator Carol Fukunaga, Chair
Committee on Economic Development and Taxation
State Senate
Hawaii State Capital, Conference Room 016
415 S. Beretania Street
Honolulu, HI 96813

Dear Chair Fukunaga and Committee Members:

Thank you for the opportunity to testify in support of House Bill 584, HD 2, SD 1, relating to taxation.

Our firm represents the American Council of Life Insurers ("ACLI"), a national trade association whose three hundred fifty-three (353) member companies account for 93% of the life insurance premiums and 94% of the annuity considerations in the United States among legal reserve life insurance companies. ACLI member company assets account for 93% of legal reserve company total assets. Two hundred sixty-one (261) ACLI member companies currently do business in the State of Hawaii.

ACLI supports House Bill 584, HD 2, SD 1, which provides an income tax credit to qualified resident individual taxpayers in an amount equal to the lesser of $2,500 or 50% of the cost of the long-term care insurance premium. Married couples filing jointly may qualify for the tax credit only if their adjusted gross income is $100,000 or less; individual taxpayers qualify only if their adjusted gross income is $50,000 or less.

ACLI generally believes that as a matter of public policy the State of Hawaii should encourage families to provide for their own financial well-being. If a family is unable to support its long-term care needs, the State will need to spend its scare resources for that purpose.

CHAR HAMILTON
CAMPBELL & YOSHIDA
Attorneys At Law, A Law Corporation

Oren T. Chikamoto
737 Bishop Street, Suite 2100
Honolulu, Hawaii 96813
Telephone: (808) 524-3800
Facsimile: (808) 523-1714

Senate Committee on Economic Development & Taxation
Senator Carol Fukunaga, Chair

Date of Hearing: **March 18, 2008**
Time: **1:15 PM**

RE: HB 584, HD 2, SD 1 -- Relating to Taxation

Chair Fukunaga and members of the Committee, the NAIFA (National Association of Insurance and Financial Advisors) Hawaii, an organization made up of insurance and financial advisors across Hawaii **supports HB 584, HD 2, SD 1,** in providing our citizens with an incentive to purchase LTC (long term care) insurance.

This measure will allow Hawaii residents to qualify for a LTC insurance premium tax credit. The tax credit will apply to married couples filing jointly with an adjusted gross income of up to $100,000 and up to $50,000 for an individual taxpayer. The tax credit shall be the **lesser** of $2,500.00 for a joint return or 50% of the LTC insurance premium for an individual for the taxable year which payments are made.

The tax credit for LTC insurance premium payments will allow our residents to use this tax incentive **either as a tax credit or a tax deduction**. The tax deduction is allowed under the Internal Revenue Code and Hawaii tax law for medical services and premium payments, provided that these expenses exceed 7.5% of the taxpayer's adjusted gross income.

Section 2 of the bill on page 6, lines 4 to 13, regarding the tax credit to the son/daughter, stepson/stepdaughter, father/mother, stepfather/stepmother **may not track** as it relates to page 4, lines 9 to 16, "Each individual taxpayer who files an individual income tax return for a taxable year, and who is not claimed or is not otherwise eligible to be claimed as a dependent by another taxpayer of Hawaii state individual income tax purposes..."

We question the taxpayer who pays the LTC insurance premium for **non-dependent relatives** as stated above. If the non-dependent relative is also paying part of the premium on the same policy, that non-dependent relative will also qualify for the tax credit. We suggest that the language be specific in that these non-dependent relatives cannot be claimed by the taxpayer if the non-dependent is also taking the credit on the same policy.

Medicaid began as a safety net for the less fortunate but over the past 30 years loopholes have "saved" family assets through "Medicaid planning" that we see advertised. By purchasing LTC insurance policies, the original Medicaid "safety net" can serve those truly in need. The burden on state and federal governments continues to grow and we need to address this complex problem before the baby boomers wind their way through their golden years.

We support a tax credit for LTC insurance premiums for Hawaii's citizens. We realize the fiscal constraints on the general fund but urge that this LTC insurance premium tax credit measure continue to move forward.

Thank you for allowing us to share our views.

Cynthia Hayakawa
Executive Director

NAIFA
HAWAII

TO: Senator Carol Fukunaga, Chair
Senator Will Espero, Vice Chair
Committee on Economic Development and Taxation

FROM: David Nixon, Associate Professor
Social Science Public Policy Center
University of Hawaii at Manoa

COLLEGE OF SOCIAL SCIENCES
public policy center
UNIVERSITY OF HAWAI'I AT MĀNOA

RE: HB 584, HD2, SD1 providing a long term care insurance tax credit
scheduled for testimony 3.18.2008 at 1:15pm, Conference Room 224

Thank you for the opportunity to testify about HB584, a bill to provide a long term care insurance tax credit.

The Social Science Public Policy Center exists to provide non-political research-based contributions to the public policy debate. As HB584 rightly notes, long term care is a critical public policy challenge for Hawaii in the coming decades. As a result, aging policies are an important component of the research agenda for the Policy Center. Last year, we conducted research about long term care insurance tax credits that is specifically relevant to the provisions of HB584.

One of the primary reasons for the failure of every other state tax incentive for long term care insurance is that the subsidies provided by those states are paltry in magnitude, and insufficient to induce new purchases of this somewhat expensive insurance product. As the right hand column of Table A1 makes clear (next two pages, from our full paper), states are providing subsidies in the range of 3-25%. Our research (a Policy Brief is attached at the end of this testimony) shows unequivocally that the state income tax subsidies in that range have not induced more widespread private purchase of long term care insurance there.

HB584 HD2 SD1 provides a level of subsidy that is **much more generous** than has been provided by any other state, and it therefore presents the **potential for successfully encouraging more private purchase of long term care insurance**. Because a 50% subsidy has never been attempted in any other state, the research we conducted does not speak to whether HB584 HD2 will be successful. I can tell you only, and without hesitation that, **if the subsidy level is reduced in subsequent legislative negotiations, it raises the risk that the bill will fail to achieve its policy goals**. Specifically, a Hawaii tax credit of below 25% is virtually certain to be a failure, based on the clear evidence from other states. Please keep that in mind as budget planning proceeds. Furthermore, **there is some significant risk that even the 50% credit will be insufficient to induce NEW purchases of long term care insurance**. The committee might therefore consider amending the legislation, to sunset the credit after two or three years. A sunset provision would allow the credit to lapse without specific legislation, unless clear evidence can be marshaled for its success. I can assure you that if HB584 passes with a 50% credit, the Public Policy Center will be carefully scrutinizing its success or failure.

Thank you for your consideration.

Table A1: State Tax Incentives for Long-Term Care Insurance
(from D. Nixon, 2007)

State	Provisions[1]	State Subsidy for $1000 long-term care insurance premium[2]	
Alabama	an individual may deduct all premium costs from state adjusted gross income	$50	**(5%)**
Colorado	an individual may take a tax credit of 25% of premium, or $150, whichever is less	$150	**(15%)**
Indiana	an individual may deduct all premium costs from state adjusted gross income	$34	**(3.4%)**
Iowa	an individual may deduct all premium costs from state adjusted gross income that are not already deducted on their federal return	$79.20[3]	**(7.9%)**
Kentucky	an individual may deduct all premium costs from state adjusted gross income	$60	**(6%)**
Maine	an individual may deduct all premium costs from state adjusted gross income	$85	**(8.5%)**
	an employer may take a tax credit of 20% of premium, or $100 per employee, whichever is less	$100	**(10%)**
Maryland	an employer may take a tax credit of 20% of premium, or $100 per employee, whichever is less	$100	**(10%)**
Minnesota	an individual may take a tax credit of 25% of premium, or $100, whichever is less, and only for costs not already deducted on their federal return	$100	**(10%)**
Missouri	an individual may deduct 50% of premium costs from state	$30	**(3%)**

[1] adapted from Grooters, 1999, and updated to 2002, the most recent year of available insurance sales data..

[2] data on state tax rates, necessary for calculating the value of a state tax deduction, comes from salary.com [http://swz.salary.com/salarywizard/layouthtmls/swzl_statetaxrate_AL.html]. Because taxes paid to state governments are deductible on federal tax returns, the value of the tax subsidy for any individual is technically reduced by the percentage of their federal tax rate (Claveria 1987).

[3] based on income tax rate for an individual earning between $37,261 and $55,890 (taxed at 7.92%). If an individual earned more than $55,890, their tax rate (the top rate in the state) would be 8.98%, translating into an effective tax subsidy of $89.80 on every one thousand dollars of long-term care insurance. The next lowest rate (for earnings between $24,841 and $37,260) is 6.8%.

	adjusted gross income		
Montana	an individual may deduct all premium costs from state adjusted gross income	$90[4]	**(9%)**
North Carolina	an individual may take a tax credit of 15% of premium	$150	**(15%)**
North Dakota	an individual may take a tax credit of 25% of premium	$250	**(25%)**
Ohio	an individual may deduct all premium costs from state adjusted gross income	$52.01[5]	**(5.2%)**
Utah	an individual may deduct all premium costs from state adjusted gross income	$70	**(7%)**
West Virginia	an individual may deduct all premium costs from state adjusted gross income	$60[6]	**(6%)**
Wisconsin	an individual may deduct all premium costs from state adjusted gross income that are not already deducted on their federal return	$65	**(6.5%)**

[4] based on income tax rate for an individual earning between $32,100 and $40,000 (taxed at 9.0%). The top tax rate (10.0%) applies to those earning more than $40,000, and would translate into an effective tax subsidy of $100 for every $1000 of long-term care insurance. The next lowest rate (for earnings between $22,900 and $32,100) is 8.0%.

[5] based on income tax rate for an individual earning between $40,000 and $80,000 (taxed at 5.201%). The top tax rate (7.5%) applies to those earning more than $200,000, and would translate into an effective tax subsidy of $75 for every $1000 of long-term care insurance. The next lowest rate (for earnings between $20,000 and $40,000) is 4.457%.

[6] based on income tax rate for an individual earning between $40,000 and $60,000 (taxed at 6%). If an individual earned more than $60,000, their tax rate (the top rate in the state) would be 6.5%, translating into an effective tax subsidy of $65 on every one thousand dollars of long-term care insurance. The next lowest rate (for earnings between $25,000 and $40,000) is 4.5%.

COLLEGE OF SOCIAL SCIENCES
public policy center
UNIVERSITY OF HAWAI'I AT MĀNOA

POLICY BRIEF number 001, November 2006

State Programs to Encourage Long Term Care Insurance

This policy brief summarizes a detailed report available on our website about the impacts of state incentive programs on an individual's decision to purchase long term care insurance.

State governments across the nation are becoming acutely aware of the increasing costs of medical care for the elderly and disabled. Many observers see a significant financial crisis looming. As the baby boom generation ages, and Medicaid costs grow, states will be spending more and more of their budgets to cover these costs. Hawaii's share of Medicaid expenditures will more than double between now and 2020. Encouraging individuals to purchase private long term care insurance has been seen as one solution to this crisis. If individuals purchase long term care insurance in the private market, the state's Medicaid expenditures may not grow as quickly.

Our report examines two efforts by state governments to encourage people to buy long term care insurance for themselves: (a) tax incentives for either individuals or employers who buy long term care insurance, and (b) an experimental program sponsored by state governments and the private sector insurers and implemented in four states, called the Long Term Care Insurance Partnership. The Partnership programs encourage long term care insurance sales by allowing people who buy long term care insurance for themselves to avoid the asset rules for Medicaid eligibility, if they exhaust their private insurance benefits. The insurance policies eligible for the Partnership provide extensive long term care benefits, so the program potentially encourages more long term care insurance sales without exposing the state Medicaid program to additional claimants. Recent federal legislation allows any state to establish a Partnership program patterned on the pilot programs through a Medicaid waiver request.

Key Findings

- State tax incentives for long term care insurance premiums of a magnitude offered in about a dozen U.S. states have **not** induced additional sales of insurance beyond what could be expected without the incentives.
- The Long Term Care Partnership program implemented in four states has similarly failed to induce additional sales of private insurance for long term care beyond what could have been predicted from demographic factors alone.

We examined the number of private sector long term care insurance policies sold in each state, as reported in 2004 by America's Health Insurance Plans (formerly the Health Insurance Association of America). There is significant variation across the states in the size of the local long term care insurance market. In Alabama, less than 2% of the over-50 population is insured for long term care with a private policy, while over 15% of the over-50 population in South Dakota is so insured.

Policy analysts and policy makers hope to move those market figures above 50%, in order to avoid the huge Medicaid claims that will impact governments in the coming decades.

Results of a statistical model to predict sales of long term care insurance policies demonstrates that income, expected health, and family support factors are significant determinants of the size of the long term care insurance market in each state. When a state's population has higher income, a greater expectation of experiencing old-age disabilities, and lower incidence of living with their children in old age, sales of long term care insurance are significantly higher.

Our findings demonstrate that the availability of one's children as potential long term care givers has a very strong influence on one's decision to purchase long term care insurance. Family support has a strong direct effect on aggregate long term care insurance sales. A more integrated family structure also reduces the degree to which older people incorporate health expectations into their long term care insurance purchase decisions.

For example, in state populations with limited availability of children as caregivers, such as midwestern rural states, expectations about one's health in old age are a significant factor in one's decision to purchase long term care insurance. But in states where the older population more frequently lives with its children, such as Hawaii, expectations about one's health in old age are not significantly related to long term care insurance sales.

We conclude by pointing out that the subsidies provided in the state incentive plans we examined are very limited, relative to the typical cost of premiums. Even though a 50 year old might expect to pay $2000 a year or more for long term care insurance, existing state subsidies would defray no more than $500 of that cost, and more typically about $200. It turns out incentives in this range are insufficient, by themselves, to prompt anyone to buy a long term care insurance policy. Several tax plans considered by the Hawaii legislature in recent years have been within this range of subsidy.

While state subsidies are meager for individuals, the sum total of such incentives are costly to the states. Because they are not prompting new purchases of insurance, those tax dollars are being wasted on people who would have purchased long term insurance anyway. Unless states enact substantially more generous subsidies *and* focus the subsidies on more price-conscious potential buyers of insurance, the programs are counterproductive. They draw resources away from state coffers that could be better spent preparing for the approaching long term care crisis.

About the Author

David C. Nixon is a Visiting Associate Professor of Public Policy at University of Hawaii and Associate Professor of Political Science at Georgia State University. He earned a Ph.D. in political science from Washington University in St. Louis, and specializes in policymaking by appointed officials.

A copy of this Policy Brief or the full Report on which it is based can be found at www.publicpolicycenter.hawaii.edu/reports.html

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Credit for long-term care insurance premiums

BILL NUMBER: HB 584, SD-1

INTRODUCED BY: Senate Committee on Human Services and Public Housing

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers to claim a tax credit for the amount paid for a long-term care insurance premium. The maximum amount of credit for an individual taxpayer or a husband and wife filing jointly shall be the lesser of: (1) $2,500; or (2) 50% of the cost of any long-term care insurance premium payments provided that a husband and wife filing separately for which a joint return may be filed shall only be entitled to the amount of credit if they had filed jointly. Stipulates that the tax credit shall be available to taxpayers with adjusted gross income of: (1) $100,000 or less for a married couple filing jointly; or (2) $50,000 or less for individual taxpayers.

Delineates what premium payments shall be eligible for the credit and specifies persons, besides the taxpayer and immediate dependents, whose premiums may be eligible for the credit. Credits properly claimed and in excess of tax liability shall be refunded to the taxpayer.

If the taxpayer takes a deduction under IRC section 213 (with respect to medical, dental, etc., expenses) no tax credit may be claimed for that portion of the cost for which the deduction was taken. Claims for the credit must be filed within twelve months of the close of the taxable year or be waived if not filed on time.

EFFECTIVE DATE: July 1, 2008; applicable to tax years beginning after December 31, 2008

STAFF COMMENTS: This measure provides an incentive to taxpayers to purchase long-term care (LTC) insurance premiums by allowing taxpayers to claim a credit for amounts paid for such insurance. To the extent that this is an alternative to a state-run, long-term care insurance program, it is a proposal that deserves serious consideration. The question is whether or not individuals will plan ahead for their needs in time to make such insurance reasonable and affordable. Encouraging taxpayers to acquire LTC insurance now will insure that the state will not be burdened with supporting persons as the need arises.

The question now is whether or not the state can afford an incentive given all the other competing interests. It should be noted that, as drafted, it would appear that the credit limits are per return. Thus, the 50% or $2,500, whichever is less, applies to all insurance paid by the taxpayer filing that return. Thus, if a couple bought policies for themselves and one of the spouse's parents, the maximum amount that could be claimed would be $2,500 even though the premiums for all three policies total more than $5,000. On the other end, with an unknown impact, the legislature may want to take it slow and phase-in the credit to assess the impact that this credit will have on the state treasury.

It should be noted that the proposed measure limits the availability of the credit to those joint filers with $100,000 or less and single filers with $50,000 or less of adjusted gross income. If the intent is to get as many people to take out private, long-term care policies, then the credit should not be limited to only those with a certain amount of income. A couple at the high end of the income scale may have the resources to take out policies for themselves as well as for an aging parent. They should be provided the same incentive to do so as it will save the state in the long run from having to provide long-term care for any one of them. Consideration might be given to an inversely graduated amount of credit such that the amount of the credit gets smaller as income grows larger.

That said, there are two provisions of the bill which are not clear. First, is the amount of the credit equal to the lesser of 50% of the long-term care insurance premiums paid or $2,500? Or does the bill mean to say the credit is 50%of the long-term care insurance premium paid up to a maximum of $2,500 per return? If it is the latter, then the bill should state so. The other is that it is unclear whether or not the credit is refundable. It seems to imply that it is refundable by stating that no refunds of amounts less than one dollar shall be made, but other than that, it does not specifically provide that the credit is refundable or non-refundable. If the latter is the case, then there is no provision directing that any excess credit can be applied to subsequent tax years liability until exhausted.

Given that many advocates of a previously proposed state run long-term care insurance system noted that to do nothing about providing for such coverage will, in the end, cost the state more to provide that care, the credits proposed in this bill can be viewed as a long-term investment on the part of taxpayers that will insure that future taxpayers will not be asked to pick up the tab for long-term care for a growing segment of the population.

That said, lawmakers should not overlook the fact that unless the necessary services and facilities are available and in ample supply, no amount of insurance or money will be able to access the needed care. Like early childhood care and education the same trilemma of affordability, accessibility and quality apply to long-term care as well.

Digested 3/17/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2778 HD 2 SD 1
RELATING TO TAX CREDITS

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This bill creates an income tax credit to encourage Hawaii employers to purchase qualified long-term care insurance for their employees. This tax credit is phased-in over two years and will be equal to the greater of $500 or 50% of qualified long-term care premiums paid per employee.

The Senate Committee on Human Services & Public Housing amended the measure by inserting a current effective date applying to taxable years beginning after December 31, 2008.

The Department of Taxation (Department) **strongly supports** this measure.

I. THE NEED FOR LONG-TERM CARE INSURANCE CONTRACTS.

The future of long-term care for Hawaii's senior and adult disabled population is one of the most critical health issues facing Hawaii in the twenty-first century. Persons sixty years of age and older presently account for almost one-fifth of the adult population in the State. By 2020, they will constitute more than one-fourth of Hawaii's adult population.

The rapid growth of the elderly and disabled populations will result in extraordinary demands on the delivery of long-term care services. While the majority of persons receiving long-term care are older adults, entire families are affected by the psychological, financial, and social costs of long-term care provided to those who are limited in the activities of daily living. As of 2003, the statewide average annual cost of a room in a skilled nursing facility was $105,028 for a private room and $95,597 for a semi-private room.

When employees provide long-term care to family members in need, businesses incur costs for lost productivity due to employee absenteeism, for replacing the absent employee, and in supervising temporary replacement workers. According to a 1997 study conducted by the National

Alliance for Caregivers and the Metlife Mature Market Institute, the total cost of lost productivity to businesses nationally from these factors exceeded $29 billion annually.

II. EMPLOYER TAX CREDIT

This employer long-term care tax credit accomplishes the following:

- Encourages employers to purchase qualified long-term care insurance contracts for their employees;

- Ensures that such qualified long-term care insurance contracts provide a requisite level of home and community-based care in addition to coverage for long-term care in intermediate care facilities and skilled nursing facilities;

- Extends long-term care insurance coverage to those individuals who generally could not otherwise obtain coverage and/or who could not obtain reasonably priced long-term care insurance coverage;
    - On most employer-sponsored plans, the insurers use less rigorous standards for determining a full-time employee's eligibility for coverage, which is a practice commonly referred to as "simplified short form underwriting."
    - Thus, a substantial number of Hawaii residents who could ordinarily not obtain coverage on an individual plan (or who could not obtain reasonably priced long-term care insurance coverage) will be able to obtain coverage on an employer-sponsored policy because of the less restrictive underwriting.
    - The employer's group plan allows a long-term care insurer to spread the underwriting risk among a group of covered individuals who work full-time.

- Encourages greater participation in employer-subsidized long-term care insurance plans by employees.
    - Employer-subsidized long-term care insurance plans generally see greater participation rates by employees.
    - Employee participation in employer-sponsored long-term care insurance plans is significantly greater when the employer pays for a small percentage, or "base coverage," of the employee's premium.

II. TECHNICAL ISSUES

The Department notes that the current drafting of the bill appears to apply at the entity level for partnerships and other flow-through business entities. The Department suggests that any reference to the credit claim for partnerships or limited liability companies clearly distinguish that the credit is determined at the entity level. The Department further points out that partnerships and limited liability companies treated as partnerships for tax purposes typically never receive tax treatment—*it is the owners that receive all incidences of taxation*. Under the current drafting of the bill, a statement providing that for partnerships or other flow-through entities the credit is determined at the entity level, this will allow the credit to be distributed to partners in proportion to their partnership interests.

The following language would be helpful:

"(__) In the case of a partnership, S corporation, estate, or trust, the tax credit allowable shall be determined at the entity level. Distribution and share of credit shall be determined in accordance with section 235-2.45(d)."

III. SUGGESTED BILL LANGUAGE

As an alterative to the text of the current bill, the Department offers the following tax credit language for the Committee's consideration:

"§235- **Employer's tax credit for long-term care premiums paid for employees.** (a) Subject to the limitations of this section, a small business employer subject to taxation under this chapter may claim a non-refundable tax credit for premium payments made by the small business employer during the taxable year to purchase a qualified long-term care insurance contract for its employees. The maximum tax credit per employee for whom qualified long-term care insurance is purchased shall be in the amount of the lesser:

(1) $500; or
(2) Fifty per cent of the qualified long-term care premiums paid annually for each employee.

(b) The credit allowed under this section shall be claimed against the net income tax liability for the taxable year. If the tax credit under this section exceeds the taxpayer's income tax liability, the excess of the credit may be carried forward until exhausted.

(c) If a taxpayer claims any other tax credit or deduction under title 14, including a deduction under sections 162 or 213 of the Internal Revenue Code, to which state law conforms, for premiums paid on a long-term care insurance policy, no credit shall be claimed under this section for the same premium payments.

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

(e) The director of taxation shall prepare any forms that may be necessary to claim a credit under this section. The director may also require the taxpayer to furnish information to ascertain the validity of the claims for deductions made under this section and may adopt rules necessary to effectuate the purposes of this section pursuant to chapter 91.

(f) As used in this section:

"Activities of daily living" means eating, toileting, transferring, bathing, dressing, and continence.

"Chronically ill individual" means any individual who has been certified by a licensed healthcare practitioner within the preceding twelve-month period as meeting one of the following conditions:

(1) Being unable to perform at least two activities of daily living without substantial assistance from another individual for a period of at least ninety days due to a loss of functional capacity;
(2) Having a level of disability similar to the disability set forth in the preceding paragraph; or
(3) Requiring substantial supervision to protect that individual from threats to health and safety due to a severe cognitive impairment for the preceding twelve-month period.

"Home and community-based care" means care provided under qualified long-term care services that meet or exceed the requirements set forth in section 431:10H-219.

"Licensed health care practitioner" means any licensed physician, registered nurse, licensed social worker, or other professional as may be provided by rules adopted by the director of taxation.

"Maintenance or personal care services" means any care the primary purpose of which is the provision of needed assistance with any of the disabilities that render a person to be a chronically ill individual, including the protection from threats to health and safety due to a severe cognitive impairment.

"Qualified long-term care insurance contract" means a contract that:

(1) Provides insurance coverage solely for qualified long-term care services;
(2) Does not pay or reimburse expenses incurred for services or items to the extent that those expenses are reimbursable under title XVIII of the Social Security Act or would be so reimbursable but for the application of a deductible or coinsurance amount, unless:
    (A) The expenses are reimbursable by medicaid as secondary payor; or
    (B) The contract makes qualified per diem or other periodic payments without regard to expenses, as defined below.
(3) Is guaranteed renewable;
(4) Provides that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract shall be used only to reduce future premiums or increase future benefits;

(5) Does not provide for a cash surrender value or any other money that may be paid, assigned, borrowed, or pledged as collateral for a loan; and

UU(6) Provides coverage for home- and community-based care services that meets or exceeds fifty per cent of the coverage for treatment in an intermediate care facility and skilled nursing facility.

"Qualified long-term care services" means necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance or personal care services, which are:

(1) Required by a chronically ill individual; and

(2) Provided pursuant to a plan of care prescribed by a licensed health care practitioner.

"Small business" means a for-profit enterprise consisting of fewer than one hundred full-time or part-time employees."

IV. REVENUE IMPACT

Assuming this measure takes effect immediately, annual revenue loss amounts to $900,000 for FY 2010 and thereafter. Based on the best estimate from the long-term care industry, employers pay $5 to $15 per employee per month for long-term care premium. Their employers cover about 50,000 of the employee's long-term care insurance.

Employers are assumed to pay $120 per employee annually for long-term care premium. A tax credit at 50% of premiums is $60.

According to the Hawaii State Data Book 2006, all businesses employed 490,682 workers in 2005 and 59% of which were employed by small businesses. The Department assumed employers purchased long-term care insurance for 50% of small business employment share (30%). About 15,000 employees' long-term care insurance was covered by their employers [50,000 x 30%]. Total tax credit amounted to $900,000 [15,000 x $60].

TESTIMONY OF THE AMERICAN COUNCIL OF LIFE INSURERS
IN SUPPORT OF H. B. 2778, HD 2, SD 1, RELATING TO TAX CREDITS

March 18, 2008

Senator Carol Fukunaga, Chair
Committee on Economic Development and Taxation
State Senate
Hawaii State Capital, Conference Room 016
415 S. Beretania Street
Honolulu, HI 96813

Dear Chair Fukunaga and Committee Members:

Thank you for the opportunity to testify in support of House Bill 2778, HD 2, SD 1, relating to taxation.

Our firm represents the American Council of Life Insurers ("ACLI"), a national trade association whose three hundred fifty-three (353) member companies account for 93% of the life insurance premiums and 94% of the annuity considerations in the United States among legal reserve life insurance companies. ACLI member company assets account for 93% of legal reserve company total assets. Two hundred sixty-one (261) ACLI member companies currently do business in the State of Hawaii.

ACLI supports House Bill 2778, HD 2, SD 1, which provides an income tax credit to a qualified resident individual or a corporate "small business" employer (defined as having less than 100 employees) in an amount equal to the lesser of $500 or 50% of the cost of the long-term care insurance premium for each employee.

ACLI generally believes that as a matter of public policy the State of Hawaii should encourage individuals to provide for their own financial well-being. If a family is unable to support its long-term care needs, the State will need to spend its scare resources for that purpose.

CHAR HAMILTON
CAMPBELL & YOSHIDA
Attorneys At Law, A Law Corporation

Oren T. Chikamoto
737 Bishop Street, Suite 2100
Honolulu, Hawaii 96813
Telephone: (808) 524-3800
Facsimile: (808) 523-1714

KOKUA COUNCIL Laura Manis Testifier

COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

Senator Carol Fukunaga, Chair

Senator Will Espero, Vice Chair

Tuesday, March 18, 2008, 1:15 p.m. Conference Room 224

HB 2778, HD2 RELATING TO TAX CREDITS. Grants tax credit to small businesses at the lesser of 50% of premiums or $500 per employee for purchase of long-term care insurance for its employees. Defines small business as businesses employing less than 100 full-time or part-time workers.

SUPPORT WITH COMMENTS
Kokua Council realizes that this is a new perspective to providing an incentive for buying Long Term Care Insurance. Providing a tax credit to employers of small businesses who purchase the insurance for their employees is worth a trial.

For this reason we suggest that a sunset date be included in the bill to give time to evaluate whether or not it did indeed increase the purchase of Long Term Care Insurance. Also of concern, is who pays for the insurance if the employee changes jobs.

Laura G. Manis, Legislative Chair, Kokua Council
tel. 597-8838

Senate Committee on Economic Development & Taxation
Senator Carol Fukunaga, Chair

Date of Hearing: **March 18, 2008**
Time: **1:15 PM**

RE: HB 2778, HD 2, SD 1 – Relating to Tax Credits

Chair Fukunaga and members of the Committee, NAIFA (National Association of Insurance and Financial Advisors) Hawaii, an organization made up of insurance and financial advisors across Hawaii **supports HB 2778, HD 2, SD 1**, in providing Hawaii employers with fewer than 100 full or part time employees and small business owners with an incentive to purchase LTC (long term care) insurance.

The tax credit proposed will be the lesser of $500 for each employee or 50% of the insurance premium for each employee. Employers will be able to insure employees at a base level and in turn, the employees will be able to purchase added coverage. We believe that this incentive is integral to get the "ball rolling" and the bulk of the LTC premium will be borne by employees.

Employers, if they are paying LTC premiums as a benefit to their employees, can also deduct the entire LTC insurance premium expense on their corporate tax return. This measure can provide a very worthwhile incentive to employers to encourage them to make this benefit available since most employee benefits (health insurance, TDI, disability income, retirement, Social Security, Medicare, etc.) are delivered at the workplace. Employers can provide one of the best venues in educating our citizens about their future LTC needs.

Additionally, there are numerous benefits for a group purchase of LTC insurance:

- Group LTC insurance policies are approximately 10% to 40% less than individual LTC policies subject to underwriting requirements (age, health, etc.).
- Premiums are level, based on age purchased, which encourages younger employees to participate. Employees receive guaranteed issue coverage (no medical questions) up to certain limits.
- Employees can customize the coverage beyond the employer paid base plan, at highly discounted rates. Employees can add to their coverage at anytime.
- Employee's **entire extended family** (parents, grandparents, in-laws, siblings, adult children) can participate in the discounted group rates.

- Employees can take their coverage with them should they retire or terminate their employment at same rate with the exact same coverage and extended family members retain their coverage.
- Premiums are level, based on age purchased, which encourages younger employees to participate. Employees receive guaranteed issue coverage (no medical questions) up to certain limits.

Government's support of a tax incentive in encouraging individual responsibility for long term care financing is a step towards solving this complex issue. Our citizens will have these products to protect themselves against catastrophic long term care expenses. The expansion of this market will reduce Medicaid outlays and future costs to both the federal and state governments.

Yes, it is true that the older one gets, a LTC insurance policy becomes less affordable due to chronic ailments or unavailable due to sickness. A tax credit for employers and individuals will encourage the young to purchase their LTC insurance when they are healthy and rates are most affordable.

Medicaid began as a safety net for the less fortunate but over the past 30 years it has become a way for many families to keep their assets. The term "spending down" is well understood in qualifying for Medicaid. We believe that through the purchase of long term care insurance from the marketplace, we can save Medicaid for what it was truly intended. The burden on the state and federal government is enormous and continues to grow.

We urge your support for this measure. Mahalo for allowing us to share our viewpoint.

Cynthia Hayakawa
Executive Director

NAIFA
HAWAII

The Chamber of Commerce of Hawaii
Since 1850

Testimony to the Senate Committee on Economic Development and Taxation
Hawaii State Capitol
Conference Room 224
415 South Beretania Street
Tuesday, March 18, 2008 at 1:15 p.m.

SUBJECT: HOUSE BILL 2778, HD2, SD1 - RELATING TO TAX CREDITS

Chair Fukunaga, Vice Chair Espero, and Members of the Committee:

My name is Jim Tollefson and I am the President and CEO of The Chamber of Commerce of Hawaii ("The Chamber"). I appreciate the opportunity to state The Chamber's support of HB 2778, HD2, SD1, relating to Tax Credits.

The Chamber is the largest business organization in Hawaii, representing over 1100 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

The measure grants tax credits to small businesses at the lesser of fifty per cent of premiums or $500 per employee for the purchase of long-term care insurance for its employees. The measure defines small business as businesses employing less than 100 full-time or part-time workers.

The Chamber commends the Legislature for seeking ways to address the current situation of long-term care for Hawaii's senior and adult disabled population and supports a statewide effort to address this growing population through various voluntary initiatives such as tax credit incentives, especially for small businesses.

Small employers provide a majority of the jobs in Hawaii. As the cost of doing business continues to rise and the economy begins to slow down, small businesses will be forced to make prudent and sound decisions on providing benefits to employees while managing costs. However, many recognize the current and growing problem of long-term care and realize that in order to retain quality employees, they will need to offer benefits. This measure provides an option and incentive for small businesses to offer benefits such as long-term care insurance for their employees.

In light of this, The Chamber asks for your favorable consideration of this measure. Thank you for the opportunity to testify.

1132 Bishop Street, Suite 402 • Honolulu, Hawaii 96813 • Phone: (808) 545-4300 • Facsimile: (808) 545-4369

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Small business long-term care insurance premium tax credit

BILL NUMBER: HB 2778, SD-1

INTRODUCED BY: Senate Committee on Human Services and Public Housing

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers who own a small business to claim a small business long-term insurance premium credit of the lesser of $500 per employee or 50% of the premiums paid for each employee. Credits in excess of a taxpayer's income tax liability may be applied to subsequent liability. Defines "small business" as a for-profit enterprise consisting of fewer than one hundred full-time or part-time employees.

Stipulates that the tax credit when claimed by: (1) either an individual resident taxpayer or a husband and wife filing a joint return that own a small business, provided that a resident husband and wife filing separate tax returns for a taxable year for which a joint return could have been filed by them, shall claim only the tax credit to which they would have been entitled under this section had a joint return been filed; or (2) a small business that is a corporation, partnership, limited liability company, or other form of business entity, may be claimed only once in the taxable year with respect to the small business.

Claims for the credit must be filed within twelve months of the close of the taxable year or be waived if not filed on time. Requires the director of taxation to prepare the necessary forms to claim and validate a claim for the credit.

EFFECTIVE DATE: July 1, 2008; applicable to tax years beginning after December 31, 2008

STAFF COMMENTS: This measure provides an incentive in the form of an income tax credit to encourage employers to purchase long-term care insurance premiums for their employees by allowing the employer to claim a credit for a portion of the premium costs for such insurance. While the credit may seem minimal, buying a group coverage for the minimal level of coverage would open the door of awareness for more employees of the need for this type of care in the future. Accessing this type of insurance will not only increase awareness of this need, but may allow employees to trade up by paying an additional premium, then this may be a way that the state addresses the challenge of long-term care.

That said, one has to question whether or not taxpayers should subsidize the cost of such insurance without any indication of need on behalf of the small business for financial assistance. Perhaps the sponsors of the bill envision that this would encourage mom and pop stores to secure this coverage or perhaps a lunch wagon owner. However, the bill defines a small business as one that has less than 100 full-time employees. That definition could fit a brokerage firm, a software developer, or a private physician's office. If the intent is to make the public aware of the need to secure this type of insurance, then there are means for informing and educating the public. One of the chief reasons for consumer reticence in this area is the fear of the unknown, that is not knowing anything about the options from which they can choose.

Digested 3/17/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 3059 HD 1 SD 1
RELATING TO LOW-INCOME HOUSING CREDITS

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This legislation modifies Hawaii's conformity to the federal Low-Income Housing Tax Credit provided by Section 42 of the Internal Revenue Code, by reducing the number of years over which the credit may be claimed.

The House Committee on Human Services & Housing passed this measure unamended.

The House Committee on Finance amended the effective date of the measure.

The House of Representatives passed this measure on third reading.

The Senate Committee on Human Services & Public Housing amended the measure to read similar to its companion.

The Department **supports** this Lingle-Aiona Administration bill and encourages the Committee to **pass this measure with the Department's requested amendments**.

I. THE DEPARTMENT DEFERS TO THE HOUSING AGENCIES ON THE MERITS.

The Department defers to the various executive housing agencies on the merits of this bill in general. Hawaii is currently facing an affordable housing crisis. It will take meaningful initiatives in order to eliminate the shortage of affordable housing suitable for Hawaii residents.

II. THE ISSUE OF AFFORDABLE HOUSING IS IMPORTANT AND MAKING HAWAII'S CREDIT MORE ATTRACTIVE IS CRITICAL.

The Department recognizes that affordable housing is an important issue. To properly eliminate the affordable housing crisis, sufficient incentives must also be available in order to leverage public-private partnerships to construct additional housing in Hawaii. Through the use of the Low-Income Housing Tax Credit, partnerships between the state and private developers are leveraged through attractive tax incentives that subsidize investments in projects.

This legislation is a positive solution. This legislation effectively reduces the horizon of years over which the Low-Income Housing Tax Credit must be claimed. Currently, the Hawaii credit must be claimed over a 10-year period. This bill reduces that period to 5 years. The reduction in the claim period makes the credit far more attractive to investors. The reduction also makes the credit more useful to project partnerships because cash from the government is released in a much shorter time.

III. PREFERENCE FOR DEPARTMENT'S AMENDMENTS

After further consideration, the Department believes that its suggested amendments below will allow for this measure to function properly. As a state credit that otherwise conforms to federal law, it is critical that the decoupling feature contemplated by this measure be able to properly operate on its own. The amendments below are important to ensure proper implementation of the credit calculation:

SECTION 1. Section 235-110.8, Hawaii Revised Statutes, is amended to read as follows:

"**§235-110.8 Low-income housing tax credit.** (a) Section 42 (with respect to low-income housing tax credit) of the Internal Revenue Code shall be operative for the purposes of this chapter as provided in this section.

(b) Each taxpayer subject to the tax imposed by this chapter, who has filed [+]a[+] net income tax return for a taxable year may claim a low-income housing tax credit against the taxpayer's net income tax liability. The amount of 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 on a timely basis. A credit under this section may be claimed whether or not the taxpayer claims a federal low-income housing tax credit pursuant to section 42 of the Internal Revenue Code.

(c) The low-income housing tax credit shall be [~~fifty~~] one hundred per cent of the applicable percentage of the qualified basis of each building located in Hawaii. The applicable percentage shall be calculated as provided in section 42(b) of the Internal Revenue Code.

(d) For the purposes of this section, the determination of:

(1) Qualified basis and qualified low-income building shall be made under section 42(c);

(2) Eligible basis shall be made under section 42(d);

(3) Qualified low-income housing project shall be made under section 42(g);

(4) Recapture of credit shall be made under section 42(j), except that the tax for the taxable year shall be increased under section 42(j)(1) only with respect to credits that were used to reduce state income taxes;

(5) Application of at-risk rules shall be made under section 42(k);

of the Internal Revenue Code.

(e) As provided in section 42(e), rehabilitation expenditures shall be treated as separate new building and their treatment under this section shall be the same as in section 42(e). [~~The definitions and special rules relating to credit period in section 42(f) and the~~] The definitions and special rules in section 42(i) shall be operative for the purposes of this section.

(f) The definitions and special rules relating to credit periods in section 42(f) shall be operative for the purposes of this section; except that section 42(f)(1) of the Internal Revenue Code shall be modified as follows: the term "credit period" means, with respect to any building, the period of five taxable years beginning with:

(1) The taxable year in which the building is placed in service; or

(2) At the election of the taxpayer, the succeeding taxable year;

provided that the building is a qualified low-income building as of the close of the first year of such period. The election under paragraph (2), once made, shall be irrevocable.

~~(f)~~ (g) The state housing credit ceiling under section 42(h) shall be zero for the calendar year immediately following the expiration of the federal low-income housing tax credit program and for any calendar year thereafter, except for the carryover of any credit ceiling amount for certain projects in progress which, at the time of the federal expiration, meet the requirements of section 42.

~~(g)~~ (h) The credit allowed under this section shall be claimed against net income tax liability for the taxable year. For the purpose of deducting this tax credit, net income tax liability means net income tax liability reduced by all other credits allowed the taxpayer under this chapter.

A tax credit under this section which exceeds the taxpayer's income tax liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted. All claims for a tax credit under this section must be filed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. Failure to properly and timely claim the credit shall constitute a waiver of the right to claim the credit. A taxpayer may claim a credit under this section only if the building or project is a qualified low-income housing building or a qualified low-income housing project under section 42 of the Internal Revenue Code.

Section 469 (with respect to passive activity losses and credits limited) of the Internal Revenue Code shall be applied in claiming the credit under this section.

[~~(h)~~] (i) The director of taxation may adopt any rules under chapter 91 and forms necessary to carry out this section."

SECTION 2. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 3. This Act shall take effect on January 1, 2009, and apply to buildings placed in service after December 31, 2008.

IV. EFFECTIVE DATE.

The effective date should be changed so that the bill applies to buildings placed in service after December 31, 2008.

V. REVENUE ESTIMATE.

Assuming this measure were given a current effective date, this measure will result in the following revenue loss if amended as requested above:

- **FY2009 (loss): none**
- **FY2010 (loss): $1.25M**
- **FY2011 (loss): $2.50M**
- **FY2012 (loss): $3.13M**
- **FY2013 (loss): $3.25M**

Absent this proposal, state low-income housing tax credits for new developments issued in 2007 would total $1.25 million in Tax Year 2009. The proposal would increase this to $5.0 million, which would result in net decreased tax revenue of $3.75 million for FY 2010. The net cost for additional years includes the additional credit from new investments in that particular year, along with the additional credits awarded from previous years investments.

MAR 17 2008

Linda Lingle
GOVERNOR

ORLANDO "DAN" DAVIDSON
EXECUTIVE DIRECTOR

STATE OF HAWAII

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT AND TOURISM
HAWAII HOUSING FINANCE AND DEVELOPMENT CORPORATION
677 QUEEN STREET, SUITE 300
Honolulu, Hawaii 96813
FAX: (808) 587-0600

IN REPLY REFER TO

Statement of
Orlando "Dan" Davidson
Hawaii Housing Finance and Development Corporation
Before the

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

March 18, 2008, 1:15 p.m.
Room 224, State Capitol

In consideration of
H.B. 3059, H.D. 1, S.D. 1
RELATING TO LOW-INCOME HOUSING TAX CREDITS.

The HHFDC supports H.B. 3059, H.D. 1, S.D. 1, which reduces the period over which state low-income housing tax credits are taken from 10 years to 5 years. The low income housing tax credit (LIHTC) program promotes the development and rehabilitation of low-income rental housing by providing equity to developers of eligible affordable housing projects. The program is a powerful financing tool for affordable rental housing development, especially when leveraged with state rental housing trust funds.

The LIHTCs provide a dollar-for-dollar credit against annual income tax liability over a 10 year period. Developers typically sell the tax credits to tax payers/investors to raise equity for the development of a rental housing project. Unfortunately, the sale of State LIHTCs generates less than half of the "equity" than that of the federal LIHTC, or approximately $0.35 to $0.50 for every $1.00 of state credit. By shortening the time period over which the State credits can be taken (i.e., from 10 years to 5 years), the value of the State LIHTC could be enhanced and more equity could be generated for the development of rental housing.

The HHFDC supports the Department of Taxation's proposed Senate Draft 2, which proposes technical amendments to this bill that are intended to improve the ease of administering the LIHTCs, while retaining the provisions to improve their value to investors and affordable housing developers.

Thank you for the opportunity to testify.

Harry Kim
Mayor

Edwin S. Taira
Housing Administrator

County of Hawaii
OFFICE OF HOUSING AND COMMUNITY DEVELOPMENT
50 Wailuku Drive • Hilo, Hawai'i 96720-2484
V/TT (808) 961-8379 • FAX (808) 961-8685

March 14, 2008

The Honorable Carol Fukunaga, Chair
The Honorable Will Espero, Vice Chair
and Committee Members
Committee on Economic Development and Taxation

Twenty-Fifth Legislature
Regular Session of 2008

SUBJECT: **House Bill 3059 HD1 SD1**
Hearing Date: 03-18-08
Time: 1:15 PM
Conference Room: 224

The Office of Housing and Community Development (OHCD) strongly supports House Bill 3059 HD1 SD1, which reduces the period over which state low-income housing tax credits (LIHTC) are taken from 10 years to 5 years.

The LIHTCs are an important financing tool for low-income rental housing projects that would otherwise not be financially feasible. Currently, LIHTCs provide a dollar-for-dollar credit against an annual income tax liability over a ten-year period. Developers typically need to sell the tax credits to investors with tax liabilities to help cover the gap in financing the development of low-income rental projects. With the tax credits taken over a 10 year period, investors demand deep discounts to offset the time value of their upfront investment. By reducing the period from 10 years to 5 years, the value of the credits is significantly enhanced and will generate more equity to further the development of affordable, low-income rental housing.

Thank you for the opportunity to provide testimony.

Edwin S. Taira
Housing Administrator

0102tasr

EQUAL HOUSING OPPORTUNITY
"HAWAI'I COUNTY IS AN EQUAL OPPORTUNITY PROVIDER AND EMPLOYER"

Bryan J. Baptiste
Mayor

Gary K. Heu
Administrative Assistant

Kenneth N. Rainforth
Housing Director

Gary A. Mackler
Development Coordinator

KAUA'I COUNTY HOUSING AGENCY
Pi'ikoi Building 4444 Rice Street Suite 330
Līhu'e Hawai'i 96766

March 14, 2008

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice Chair
and Committee Members
Committee on Economic Development and Taxation

The Senate
The Twenty-Fourth Legislature
Regular Session of 2008

SUBJECT: Testimony in Support of House Bill 3059, HD 1, SD1 Relating to Low-Income Housing Tax Credits
Committee: EDT
Hearing: March 18, 2008 1:15 PM *Conference Room 224*

The Kaua'i County Housing Agency strongly supports House Bill 3059, HD1, SD1. The Bill would effectively reduce the time period for which state Low-Income Housing Tax Credits are taken from ten years to five years. Shorter term LIHTC should be more attractive to investors, thereby facilitating funding of affordable rental housing development. Thank you for the opportunity to provide testimony.

Sincerely,

KENNETH N. RAINFORTH
Housing Director

Hawaii Association of REALTORS®
www.hawaiirealtors.com

The REALTOR® Building
1136 12th Avenue, Suite 220
Honolulu, Hawaii 96816

Phone: (808) 733-7060
Fax: (808) 737-4977
Neighbor Islands: (888) 737-9070
Email: har@hawaiirealtors.com

March 15, 2008

The Honorable Carol Fukunaga, Chair
Senate Committee on Economic Development and Taxation
State Capitol, Room 224
Honolulu, Hawaii 96813

RE: H.B. 3059, H.D.1, S.D.1, Relating to Low-Income Housing Tax Credits
Hearing Date: March 18, 2008 @ 1:15 p.m., Room 224

On behalf of our 10,000 members in Hawaii, the Hawaii Association of REALTORS® (HAR) **supports H.B. 3059, H.D.1, S.D.1,** which reduces the period over which state low-income housing tax credits are taken from 10 years to 5 years.

We believe Smart Growth is our road map to sustaining and enhancing the quality of life in our communities and we believe that this bill aligns with our core principle of ***providing housing opportunities.***

HAR has historically supported mechanisms to help increase the supply of low and moderate income affordable housing such as the Rental Housing Trust Fund Program which can help integrate the use of mixed-income and mixed-use projects, special purpose revenue bonds, low-interest loans, block grants, low-income housing tax credit programs and deferred loan programs to provide rental housing opportunities.

Amending the period over which state low-income housing tax credits are taken from ten years to five years would increase the present value of the credits when sold to investors, and provide a more attractive financing incentive to potential developers of affordable rental housing.

HAR looks forward to working with our state lawmakers in building better communities by supporting quality growth, seeking sustainable economies and housing opportunities, embracing the cultural and environmental qualities we cherish, and protecting the rights of property owners.

Mahalo for the opportunity to testify.

Sincerely,

Craig Hirai, Member
Subcommittee on Taxation and Finance
HAR Government Affairs Committee

testimony

From: Kevin Carney [kcarney@eahhousing.org]
Sent: Friday, March 14, 2008 2:04 PM
To: testimony
Cc: Kevin Carney
Subject: Testimony on HB3059 HD1 SD1, Hearing March 18, 2008 at 1:15pm

Dear Chair Fukunaga, Vice Chair Espero and members of the Economic Development and Taxation Committee:

Thank you for this opportunity to submit testimony in strong support of HB3059. EAH is a non-profit housing corporation that has been developing, managing and preserving affordable rental housing since 1968. Our most powerful tool in developing and acquiring affordable rental housing is the Low Income Housing Tax Credit (LIHTC) program – Section 42 of the Internal Revenue Code.

HB3059 is a great bill and a very critical bill for our industry! It is creative and hopefully will have a direct impact on our ability to develop and preserve affordable rental properties. State LIHTC's exist in a very limited marketplace – only companies who do business in Hawaii can purchase these credits. These credits also compete with other State tax credit programs such as the Film Industry credit. The idea of shortening the take down period from 10 years to 5 years should make the credits more competitive and therefore more appealing to investors. The more appealing they are, the more value they generate and value is directly transferable into equity. The greater the equity that is derived from the sale of LIHTC's, the less debt the property has to carry. This equates to making it more feasible to develop and/or acquire low-income rental housing projects.

The average low-income rental property has seven (7) different layers of financing on it and each layer brings a different set of rules and regulations that must be adhered to. The passage of this bill will not be a cure-all for affordable rental housing. The marketplace will determine the impact on production and preservation. But, we strongly believe that this bill will increase the value of these credits so that they remain a powerful tool in our toolbox of financing options. Please give it your full support. Thank you.

Sincerely yours,
Kevin

Kevin R. Carney, (B)
Vice President, Hawaii
EAH Housing
841 Bishop Street, Suite 2208
Honolulu, Hawaii 96813
Phone: 808-523-8826
Fax: 808-523-8827
Email: kcarney@eahhousing.org
Website: www.eahhousing.org

Castle & Cooke
Hawai'i

100 Kahelu Avenue
Mililani, Hawaii 96789-3997
P.O. Box 898900
Mililani, Hawaii 96789-8900
(808) 548-4811 Fax (808) 548-6670

March 18, 2008

To: Honorable Carol Fukunaga, Chair
Senate Committee on Economic Development and Taxation

Fr: Bruce Barrett, Executive Vice President of Residential Operations
Castle & Cooke Homes Hawaii

Re: <u>HB 3059, HD1, SD 1 - Relating to Low-Income Housing Tax Credits – SUPPORT</u>

<u>Senate Committee on Economic Development and Taxation</u>
<u>Tuesday, March 18, 2008 – 1:15 PM, Conference Room 224</u>

On behalf of Castle and Cooke Homes Hawaii, we would like to offer our testimony in support and our comments in regards to HB 3059, HD1, SD1.

The lack of housing inventory and supply for a wide range of housing needs plagues the industry. By providing an important financing tool, this bill supports the production of low income rental housing, which is a vital component for the overall housing supply.

The Low-Income Housing Tax Credit program is a critical tool of the State's program to produce low income affordable rental housing. Along with federal tax credits, this credit offers a significant boost in helping to finance the development of lower rent affordable rental projects.

For these reasons we ask your committee to support the passage of HB 3059, HD1, SD1.

Should you have any questions, feel free to contact me at 548-3746 or Carleton Ching, Vice President of Government and Community Relations, at 548-3793

CATHOLIC CHARITIES HAWAI'I

TESTIMONY IN SUPPORT OF HB 3059, HD1, SD1: RELATING TO LOW INCOME HOUSING TAX CREDITS

TO: Senator Carol Fukunaga, Chair, Senator Will Espero, Vice Chair, And Members, Committee on Economic Development and Taxation

FROM: Betty Lou Larson, Housing Programs Director, Catholic Charities Hawai'i

HEARING: Tuesday, March 18, 2008; 1:15 pm; Conf. Rm. #224

Chair Fukunaga, Vice Chair Espero, and Members of the Committee on Economic Development and Taxation:

Thank you for the opportunity to testify on HB 3059. I am Betty Lou Larson, from Catholic Charities Hawai'i. We support this bill which provides a creative way to leverage additional funds for affordable housing projects.

Construction costs are rising which will make the development of new affordable rental housing projects more expensive. Yet, the need for these units is also growing. More elders, more low and moderate income families, more disabled, more of the workforce need affordable housing. We know the housing crisis well at Catholic Charities Hawai'i. We get calls every day from families who are desperately seeking to avoid homelessness and need to find housing. The age wave of seniors is fast approaching Hawai'i as the Baby Boomers age into their 60's and retirement means reduced income. The need for affordable senior housing will explode. Already, the Housing Assistance Program at Catholic Charities Hawai'i finds that about half of the current seniors seeking help are at risk for homelessness.

This bill before you is a creative way to get "more bang for the buck" with the State Low Income Housing Tax Credits. This change will enable the State credits to generate more money to the affordable housing projects, if granted over a shorter time period. Currently the annual credit award is for over a 10 year period. By changing the timeframe to 5 years, the projects can sell the credits for more money since the purchaser get the same tax credit but over 5 years. Since time is money, this would be more attractive to the buyers.

The State's long term revenue does not change, but the value to the project is greater when sold to get equity for the project. The total amount of state tax credits will remain the same.

With fast rising construction, we have to seek ways to support affordable housing in new ways. This is a creative way to gain more equity for the projects. This is another way to leverage funding. It will translate into more units produced over time than under the current system.

We thank you for your consideration of this bill as one more step to support the development of more affordable rental units across our State.

2745 Pali Highway • Honolulu, Hawai'i 96817 • Phone (808) 595-0077 • Fax (808) 595-0811
www.CatholicCharitiesHawaii.org

LEGISLATIVE

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Low-income housing credit

BILL NUMBER: HB 3059, SD-1

INTRODUCED BY: Senate Committee on Human Services and Public Housing

BRIEF SUMMARY: Amends HRS section 235-110.8 to provide that for a low-income housing project placed in service beginning on January 1, 2009: (1) pursuant to IRC section 42(b)(2)(B) the state housing credit shall be 100% of the applicable percentage of the qualified basis of each building located in Hawaii; and (2) pursuant to IRC section 42(f)(1) the credit period for the low-income housing credit shall be taken over a five-year period instead of the current 10-year period.

EFFECTIVE DATE: January 1, 2009

STAFF COMMENTS: This is an administration measure submitted by the department of business, economic development, and tourism BED-06(08). The legislature by Act 216, SLH 1988, adopted the federal low-income rental housing credit which was part of the Tax Reform Act of 1986. The credit was enacted to offset the repeal of tax shelters and other incentives to build rental housing under prior law, such as accelerated depreciation, capital gains preference, certain tax-exempt bonds, etc., and to specifically target low-income rentals.

The federal credit is a 70% present value credit for qualified new construction and rehabilitation expenditures which are not federally subsidized, and 30% for those which are federally subsidized. While the existing state credit allows for a credit of 50% of the "applicable percentage of the qualified basis" allowed under federal law taken over a period of 10 years, the proposed measure would increase the state credit to 100% and shorten the time period to five years. The justification sheet submitted with this measure states that by shortening the time period over which the low-income housing tax credits are taken would increase the present value of the credits when sold to investors. This would, the justification argues, provide a more attractive alternative financing incentive to potential developers of affordable rental housing.

While this is just one incentive to encourage developers to build affordable housing, consideration should be given to a number of strategies including the debt financing, partnerships with financial institutions who could then turn around and sell the credits, and the use of federal private activity bonds. Finally, apparently public officials still have not recognized that one of the greatest contributors to the cost of housing in Hawaii is the draconian maze of permitting and regulatory processes in order to bring those homes to market. While those regulatory guidelines are to insure the health and safety of the public, streamlining the process would accelerate the time needed to secure those permits thereby reducing the cost of financing. This savings would go a long way toward reducing the final cost of the house to the consumer. For example, for one housing project on Kauai, it took nearly five years to secure the necessary permits to build 14 affordable homes.

Digested 3/17/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2514 HD 1 RELATING TO CONVEYANCE TAX

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This bill proposes to extend the increased amount of conveyance tax deposited into the Rental Housing Trust Fund from Act 100, Session Laws of Hawaii 2006. Act 100 increased the amount of conveyance tax deposited to 50% of revenues realized through June 2008.

The House Committee on Finance amended the measure to extend the conveyance tax increase to an unspecified date.

The House of Representatives passed this measure on third reading.

The Senate Committees on Commerce, Consumer Protection & Affordable Housing and Human Services & Public Housing passed this measure unamended.

The Department of Taxation ("Department") **supports this measure, however prefers the administration measure HB 3057**.

I. THE DEPARTMENT DEFERS TO THE HOUSING AGENCIES ON THE MERITS.

The Department defers to the various executive housing agencies on the merits of this bill in general. Hawaii is currently facing an affordable housing crisis. It will take meaningful initiatives on behalf of the Legislature, as well as the Governor, in order to eliminate the shortage of affordable housing suitable for Hawaii residents.

II. THE ISSUE OF AFFORDABLE HOUSING IS IMPORTANT.

The Department recognizes that affordable housing is an important issue. To properly eliminate the affordable housing crisis, sufficient money must also be available for administration initiatives.

This legislation is a positive solution. The Department appreciates that this bill extends the conveyance tax revenues increase for an unspecified period of years. Providing sufficient funding will assist in remedying the housing shortages in Hawaii. The Department prefers HB 3057 because this bill makes the conveyance tax deposit increase permanent.

III. REVENUE IMPACT.

If this bill should take effect in FY2009, there will be no impact on overall tax collections, however the allocation of funds will be affected. There is an expected General Fund tax revenue loss of approximately $9.4 million for FY 2009 and annually thereafter. The Rental Housing Trust Fund will increase by the same amount. According to the Department of Taxation's Annual Report, total conveyance tax revenue for FY2007 was $46.9 million. It was expected that after Act 100, SLH 2006 was repealed, an additional 20% of the conveyance tax revenue would be deposited into the General Fund. This amount is therefore assumed to be the revenue lost.

MAR 17 2008

Linda Lingle
GOVERNOR

ORLANDO "DAN" DAVIDSON
EXECUTIVE DIRECTOR

STATE OF HAWAII

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT AND TOURISM
HAWAII HOUSING FINANCE AND DEVELOPMENT CORPORATION
677 QUEEN STREET, SUITE 300
Honolulu, Hawaii 96813
FAX: (808) 587-0600

IN REPLY REFER TO

Statement of
Orlando "Dan" Davidson
Hawaii Housing Finance and Development Corporation
Before the

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

March 18, 2008, 1:15 p.m.
Room 224, State Capitol

In consideration of
H.B. 2514, H.D. 1
RELATING TO THE CONVEYANCE TAX.

The HHFDC supports H.B. 2514, H.D. 1 which extends for an unspecified period the sunset date of the allocation of 50 percent of the conveyance tax to the Rental Housing Trust Fund, after which the allocation reverts to 30 percent. However, we would prefer that the 50 percent allocation is made permanent.

The Rental Housing Trust Fund provides equity gap financing for the construction or preservation of affordable rental housing projects throughout the State. Through the end of calendar year 2007, the HHFDC has leveraged the Rental Housing Trust Fund to facilitate the development or preservation of 2,391 rental housing units in 32 projects statewide.

Pursuant to section 247-7, HRS, 30 percent of conveyance tax revenues is deposited into the Rental Housing Trust Fund. Legislation enacted in 2006 and 2007 increased the share of conveyance tax revenues for the Rental Housing Trust Fund from 30 percent to 50 percent until June 30, 2008. As a result of this increase, along with an appropriation of $15 million in 2007, there are 1,021 additional rental units in 12 projects in the production pipeline.

A permanent dedication of 50 percent of conveyance tax revenues, along with an infusion of $25 million into the Rental Housing Trust Fund as requested in the Executive Supplemental Budget will allow the HHFDC to continue to finance a substantial amount of affordable rental housing units.

Thank you for the opportunity to testify.

Bryan J. Baptiste
Mayor

Gary K. Heu
Administrative Assistant

Kenneth N. Rainforth
Housing Director

Gary A. Mackler
Development Coordinator

KAUA'I COUNTY HOUSING AGENCY
Pi'ikoi Building 4444 Rice Street Suite 330
Līhu'e Hawai'i 96766

March 14, 2008

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice Chair
and Committee Members
Committee on Economic Development and Taxation

The Senate
The Twenty-Fourth Legislature
Regular Session of 2008

SUBJECT: Testimony in Support of House Bill 2514 HD 1, Relating to the Conveyance Tax
Committee: EDT
Hearing: March 18, 2008 1:15 PM *Conference Room 224*

The Kaua'i County Housing Agency strongly supports House Bill 2514 HD1. The Rental Housing Trust Fund is a valuable resource in the development of affordable rental housing. Making the 50 per cent allocation of the conveyance tax to the Trust Fund permanent would provide reliable, much needed funding for the ongoing development of affordable rental housing. Thank you for the opportunity to provide testimony.

Sincerely,

KENNETH N. RAINFORTH
Housing Director

Hawaii Association of REALTORS®
www.hawaiirealtors.com

The REALTOR® Building
1136 12th Avenue, Suite 220
Honolulu, Hawaii 96816

Phone: (808) 733-7060
Fax: (808) 737-4977
Neighbor Islands: (888) 737-9070
Email: har@hawaiirealtors.com

March 15, 2008

The Honorable Carol Fukunaga, Chair
Senate Committee on Economic Development and Taxation
State Capitol, Room 224
Honolulu, Hawaii 96813

RE: H.B. 2514, H.D.1, Relating to the Conveyance Tax
Hearing Date: Tuesday, March 18, 2008 @ 1:15 p.m., Room 224

On behalf of our 10,000 members in Hawaii, the Hawaii Association of REALTORS® (HAR) **supports H.B. 2514, H.D.1,** which extends the sunset date for the allocation of 50% of the Conveyance Tax to the Rental Housing Trust Fund from June 30, 2008 to June 30 of an unspecified year.

We believe Smart Growth is our road map to sustaining and enhancing the quality of life in our communities and we believe that this bill aligns with our core principle of ***providing housing opportunities.***

HAR supports mechanisms to help increase the supply of low and moderate income affordable housing such as the Rental Housing Trust Fund Program which can help integrate the use of mixed-income and mixed-use projects, special purpose revenue bonds, low-interest loans, block grants, low-income housing tax credit programs and deferred loan programs to provide rental housing opportunities.

HAR looks forward to working with our state lawmakers in building better communities by supporting quality growth, seeking sustainable economies and housing opportunities, embracing the cultural and environmental qualities we cherish, and protecting the rights of property owners.

Mahalo for the opportunity to testify.

Sincerely,

Craig Hirai, Member
Subcommittee on Taxation and Finance
HAR Government Affairs Committee

2116628.1

OFFICE OF HAWAIIAN AFFAIRS
Legislative Testimony

HB 2514 HD1
Relating to the Conveyance Tax
Senate Committee on Economic Development and Taxation

March 18, 2008 1:15 pm Room 224

The Office of Hawaiian Affairs **supports** the purpose and intent of HB 2514, HD 1(SSCR 2914).

The growing affordable housing problem is one of the most critical issues faced by our communities, especially our Native Hawaiian communities. This issue seems to have many of our families struggling to find adequate housing and to make ends meet.

The 2006 Housing Study confirms the need to do affordable rental housing and doing innovative housing types. Policies addressing the need to develop and create partners to do affordable rentals timely need to be adopted. The resources obtained need to be able to devote full time attention to this process along with the appropriate funding. The needed rental housing units have not been met, therefore, more time is needed to accumulate the necessary funding.

OHA also advocates a commitment to reestablishing the relationship between the art of building and the making of community, through citizen-based participatory planning and design. Therefore, the resources obtained to devote full time attention to the process of developing partners to do affordable rentals timely need to include the related communities.

Mahalo nui loa for the opportunity to provide this testimony.

testimony

From: Kevin Carney [kcarney@eahhousing.org]

Sent: Friday, March 14, 2008 2:24 PM

To: testimony

Cc: Kevin Carney

Subject: Testimony on HB2514 HD1, Hearing March 18, 2008 at 1:15pm

Dear Chair Fukunaga, Vice Chair Espero and members of the Economic Development and Taxation Committee:

Thank you for this opportunity to submit testimony in strong support of HB2514. EAH is a non-profit housing corporation that has been developing, managing and preserving affordable rental housing since 1968. The Rental Housing Trust Fund is one of a limited variety of financing options that are available to us in developing and preserving affordable rental housing. When planning to develop or acquire a property we need to have the assurance that when needed, the funding will be available. We rely on that knowledge and that is why it is so critical to extend the fifty percent of the conveyance tax funding to a date as far as possible into the future.

The development process takes a great deal of time, patience, money and the willingness to take certain calculated risks. Knowing that the funding will be there when we need it will help to reduce some of the risk taking inherent in our business. Reducing risk increases the likelihood that a project will make it to completion. Our State continues to be in a housing crisis, particularly as it applies to rental housing for those at 80% and below of the Area Median Income. Passing this bill will help in the continued production of rental housing to service this income group. Please give it your full support. Thank you.

Sincerely yours,
Kevin

Kevin R. Carney, (B)
Vice President, Hawaii
EAH Housing
841 Bishop Street, Suite 2208
Honolulu, Hawaii 96813
Phone: 808-523-8826
Fax: 808-523-8827
Email: kcarney@eahhousing.org
Website: www.eahhousing.org

CATHOLIC CHARITIES HAWAI'I

TESTIMONY IN SUPPORT OF HB 2514, HD1: RELATING TO THE CONVEYANCE TAX

TO: Senator Carol Fukunaga, Chair, Senator Will Espero, Vice Chair, And Members, Committee on Economic Development and Taxation

FROM: Betty Lou Larson, Housing Programs Director, Catholic Charities Hawai'i

HEARING: Tuesday, March 18, 2008; 1:15 pm; Conf. Rm. #224

Chair Fukunaga, Vice Chair Espero, and Members of the Committee on Economic Development and Taxation:

Thank you for the opportunity to provide testimony on this housing bill. I am Betty Lou Larson, from Catholic Charities Hawai'i. We also are members of Partners in Care and Housing Hawaii. We strongly support this bill, which would extend the sunset date for the conveyance tax allocation to the Rental Housing Trust Fund.

It is critical to stabilize the funding for the Rental Housing Trust Fund (RHTF). Consistent and adequate funding is critical for development of more affordable projects. This fund is a vital resource to expand the number of rental units that can be created in the next 5 years. Catholic Charities Hawai'i receives hundreds of calls each month for housing help. Over half of the seniors who come to Catholic Charities Hawai'i's Housing Assistance Program are facing homeless. Families with children are still ending up on beaches or in cars. We need to continue to focus on creating a large number of affordable housing units.

We also **urge you to delete the Sunset Date for the allocation to the RHTF make this allocation permanent.** This repeal of the sunset date would enhance developers' ability to look for land and other funds needed to make affordable projects pencil out. Establishing ongoing funding is critical for developers to continue to seek opportunities for affordable housing. Due to the long time frame needed to create these projects, developers need to know that funds will be available in the future to ensure feasibility. The Legislature always has the right and opportunity to review this allocation of funds in the future, as needed. Repeal of the sunset date sends a signal now that the State intends to address the affordable housing crisis on a long-term basis.

We also urge you to **increase the allocation to the Trust Fund to 65%, from the current 50% of the conveyance tax.** The RHTF has allocated virtually all the funds from last year. More funding is needed to address the crisis in affordable housing. The Trust Fund is unique in that it mandates that 5% of the units built must be targeted to persons at 30% of the median income or below. These units are the only new rental units being produced to help our elders on SSI, or families earning the minimum wage or other low income families.

Thank you for your support to address the increasing need for affordable housing. As the Baby Boomers age, there will be increased needs for senior housing. We need to prepare now in order to ensure that our seniors are not left in substandard housing or homeless due to a lack of rentals.

2745 Pali Highway • Honolulu, Hawai'i 96817 • Phone (808) 595-0077 • Fax (808) 595-0811
www.CatholicCharitiesHawaii.org

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: CONVEYANCE, Earmarking for rental housing trust fund

BILL NUMBER: HB 2514, HD-1

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Amends Act 100, SLH 2006, as amended by Act 222, SLH 2007, to extend the sunset date of the increase in the earmarking of the conveyance tax revenues to the rental housing trust fund from June 30, 2008 to June 30, _____.

EFFECTIVE DATE: June 29, 2020

STAFF COMMENTS: The legislature by Act 195, SLH 1993, earmarked 25% of the conveyance tax revenues to the rental housing trust fund and another 25% to the natural area reserve fund. In 2005, the legislature by Act 156, SLH 2005, increased this earmarking to 30%. The legislature by Act 100, SLH 2006, again increased the earmarking to 50% until June 30, 2007 and provided that the earmarked amount was to revert back to 30% on June 30, 2007. Last year the legislature by Act 222, SLH 2007, extended the sunset date to June 30, 2008. The proposed measure continues the increased earmarking of conveyance tax revenues to the rental housing trust fund.

The conveyance tax was enacted by the 1966 legislature after the repeal of the federal law requiring stamps for transfers of real property. It was enacted for the sole purpose of providing the department of taxation with additional data for the determination of market value of properties transferred. This information was also to assist the department in establishing real property assessed values and at that time the department stated that the conveyance tax was not intended to be a revenue raising device. The conveyance tax is imposed each time property changes title or ownership.

It should be remembered that the conveyance tax is one of the least dependable sources upon which to rely for funding with collections rising and falling with the fortunes of the real estate market. Any amount collected under this tax will depend on activity in the real estate market. If the housing market slows down, revenues may not be sufficient to meet the expectations of the fund. If the additional revenues are not sufficient or another "important" program needs funding, will the conveyance tax be increased to generate even more revenue?

If the legislature deems affordable housing to be such a high priority, then it should maintain the accountability for these funds by appropriating the funds as it does with other programs. Earmarking revenues merely absolves elected officials from setting priorities. When the legislature dipped into housing special funds to maintain funding for programs like education and social services, that was poor tax policy. This proposal represents the obverse, lawmakers are stealing from the general fund all in the name of affordable housing. When general fund revenues wane, will elected officials once more dip into special funds or repeal this earmarking or in the alternative raise taxes? Earmarking revenues restricts the flexibility in utilizing these revenues. The question that lawmakers must ask themselves is whether or not all of the currently earmarked funds are being used wisely and accomplishing the intended goals. With earmarked funds that can only be used for a designated purpose, lawmakers tend to overlook how those earmarked funds are being used.

Before earmarking any more funds for affordable rental housing, lawmakers should assess the success of the affordable rental housing program. Further, they should take into consideration the fact that during the past decade the homes revolving fund was raided to shore up general fund expenditures and that if the concern is affordable housing in Hawaii, then the homes revolving fund should be made whole again with an appropriation of general funds.

While the fortunes of the rental housing fund, natural area reserves program, and the legacy lands program have been greatly enhanced because of the recent boom in the real estate market, the ebullience of the collections of this tax have also been bolstered by the fact that lawmakers enacted a schedule of rates that basically punishes larger transactions be they residential or nonresidential and if residential, higher rates if the residence is not to be owner-occupied. This strategy of trying to punish larger transactions and transactions of residential property that will not be owner-occupied is childish and reflects the ignorance of lawmakers about the reality of the real estate market. First, not all transactions of $1 million or more involved residential property. As a result, the higher rates on transactions of $1 million or more penalize the transfer of commercial, industrial, and agricultural property - all types of nonresidential property - most of which are of values greater than $1 million.

Thus, lawmakers have added yet another nail in the coffin for businesses in Hawaii. Second, just because residential property that is sold is not to be owner-occupied does not infer that something bad is taking place. Do lawmakers realize where rental housing comes from - it does not just drop out of the sky. With policies like this there is no wonder that there is such a scarcity of rental housing in Hawaii. Further, the highest conveyance tax rate is imposed on residential real property that will not be owner-occupied where the transaction value is more then $1 million. A recent transaction of dilapidated rental housing which the purchaser proposes to redevelop into affordable rentals was subject to this highest rates. Thus, all the punitive conveyance tax will do is make this affordable housing development less affordable. So as long as the rental housing trust fund is dependent on this earmarking, there is no likelihood that the conveyance tax will ever be looked upon as anything but a cash cow ripe for even more tax increases.

What is so characteristic of the legislature is reflected in the conflicting and contradictory policies embodied in the conveyance tax law. On one hand, lawmakers seem to make a “commitment” to affordable rental housing by earmarking the receipts of the tax for the trust fund while at the same time punishing those purchasers of residential property that will not be owner-occupied with higher confiscatory rates. This type of thinking is an indication of the lack of understanding of where the state’s rental inventory originates. As long as this thought pattern continues, taxpayers can rest assured that the legislature will never truly address the problem, let alone come up with rational solutions.

Digested 3/10/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 3196 HD 1 SD 1
RELATING TO RENTAL MOTOR VEHICLE SURCHARGE TAX

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

As amended by the Committee on Commerce, Consumer Protection & Affordable Housing, this legislation amends the rental motor vehicle surcharge tax to an unspecified amount.

The Department of Taxation (Department) **supports the intent** of this measure.

Currently, there is a rental motor vehicle surcharge of $3 per day, which will drop to $2 per day after August 31, 2008. Potentially increasing the surcharge indefinitely will be extremely useful in building reserves in the State Highway Fund. Maintaining a consistently sufficient revenue stream for the state highways is critical to maintaining Hawaii's infrastructure.

This legislation will result in no revenue impact to the general fund. The State Highway Fund will receive an indeterminate revenue impact because the amount of tax is unspecified. However, assuming the $3 per day surcharge is extended, the State Highway Fund will increase by $13.3 million in FY 2009 (10 months), and $16.0 million in FY 2010 and thereafter. The $3 a day rental vehicle surcharge tax now yields about $48 million annually. This total includes the taxes on other tour vehicles (vans and buses), but the taxes on these other vehicles account for less than 1% of the total. Hence, an increase of $1 a day (from $2 after the reversion to $3) would yield $16 million annually.

As a result of the foregoing, the Department supports this legislation.

LINDA LINGLE
GOVERNOR

BRENNON T. MORIOKA
DIRECTOR

Deputy Directors
MICHAEL D. FORMBY
FRANCIS PAUL KEENO
BRIAN H. SEKIGUCHI

IN REPLY REFER TO:

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION
869 PUNCHBOWL STREET
HONOLULU, HAWAII 96813-5097

March 18, 2008

TESTIMONY OF THE DEPARTMENT OF TRANSPORTATION

HOUSE BILL NO. 3196, HD1, SD1

COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

We support this bill. Currently, Section 251-2(a), HRS, provides for a rental motor vehicle surcharge of $3.00 per day from September 1, 1999 to August 31, 2008. The Department of Transportation (DOT) supports the repealing of the sunset date and maintaining the $3 per day surcharge on a permanent basis. This dedicated revenue will help support the Highways Division's expenditures for the operation, maintenance and construction of state highways.

Each dollar collected through the rental vehicle surcharge provides approximately $14 million in annual revenues for the State Highway Fund. If the $3 per day surcharge is not extended, the Highways Division will need to cut its maintenance program by almost 10%.

avis budget group

Martin Mylott
Hawaii Regional Manager

808-840-5500 T
808-836-7803 F
Martin.mylott@avisbudget.
com

Honorable Carol Fukunaga, Chair
Committee on Economic Development
and Taxation
Hawaii State Senate
State of Hawaii
Room 224

Hearing: March 18, 2008, 1:15 pm., Conf.

Re: HB 3196, SD1 --- Relating To The Rental Motor Vehicle Surcharge Tax

Honorable Chair Fukunaga and Honorable Committee Members:

My name is Martin Mylott and I am the Hawaii Regional Manager with Avis Rent A Car & Budget Rent A Car.

Our company opposes this bill in its present form and supports the amendments to the bill recommended by Catrala Hawaii.

This bill amended by the prior Committee is problematic in several aspects:

a) <u>It does not require the DOT to follow the request of your Joint Senate and House Task Force which asked the DOT to study the Highway Fund and report back to the Legislature in 2009.</u>

b) <u>By leaving the amount blank, this bill suggests a TAX INCREASE when the DOT in its testimony is only seeking to maintain the amount of $3 daily which is the present daily amount.</u> If the DOT is only seeking $3 why is the dollar figure blank?

c) <u>This bill unfairly singles out the u-drive industry for a PERMANENT TAX INCREASE</u> since the present daily surcharge tax should be $2 and not the present temporary $3 which some seek to make permanent. About 8 years ago the u-drive industry was singled out for a "temporary" tax increase from $2 to $3 daily to help with the needs of the General Fund. The surcharge tax was scheduled to sunset back from $3 daily to $2 in 2007 but was temporarily extended while studies were conducted. The industry should not be singled out again for an increase.

avis budget group

Martin Mylott
Hawaii Regional Manager

808-840-5500 T
808-836-7803 F
Martin.mylott@avisbudget.
com

A study by the DOT needs to be done as to how to "fairly raise revenues" from all who benefit from the use of the highways and not just u-drive vehicles.   Isn't this fair?

While as study is being done, the u-drive industry is agreeable to extending the temporary daily tax of $3 daily for another year so the DOT does not suffer any loss of revenues while the study is being done. This is a fair solution to addressing a serious problem. A study needs to be done.

Please do not unfairly burden or tax our industry. Thank you for allowing us to testify.

AVIS Budget

The Hertz Corporation
Hawai'i Area
677 Ala Moana Blvd., Suite 916, Honolulu, HI 96813
Phone: (808)529-6850 Fax: (808)529-6866

Honorable Carol Fukunaga, Chair
Committee on Economic Development
and Taxation
Hawaii State Senate
State of Hawaii

Hearing: March 18, 2008, 1:15 pm., Conf. Room 224

Re: HB 3196, SD1 — Relating To The Rental Motor Vehicle Surcharge Tax

Honorable Chair Fukunaga and Honorable Committee Members:

My name is Aaron Medina and I am the General Manager, Hawaii, for The Hertz Corporation.

Our company opposes this bill in its present form and supports the amendments to the bill recommended by Catrala Hawaii.

This bill amended by the prior Committee is problematic in several aspects:

a) It does not require the DOT to follow the request of your Joint Senate and House Task Force which asked the DOT to study the Highway Fund and report back to the Legislature in 2009.

b) By leaving the amount blank, this bill suggests a TAX INCREASE when the DOT in its testimony is only seeking to maintain the amount of $3 daily which is the present daily amount. If the DOT is only seeking $3, why is the dollar figure blank?

c) This bill unfairly singles out the u-drive industry for a PERMANENT TAX INCREASE. Since the present daily surcharge tax should be $2 and not the present temporary $3, which some seek to make permanent. About 8 years ago the u-drive industry was singled out for a "temporary" tax increase from $2 to $3 daily to help with the needs of the General Fund. The surcharge tax was scheduled to sunset back from $3 daily to $2 in 2007 but was temporarily extended while studies were conducted. The industry should not be singled out again for an increase.

A study by the DOT needs to be done as to how to "fairly raise revenues" from all who benefit from the use of the highways and not just u-drive vehicles.

While a study is being done, the u-drive industry is agreeable to extending the temporary daily tax of $3 daily for another year so the DOT does not suffer any loss of revenues while the study is being done. We feel this is a fair solution to addressing a serious problem. A study needs to be done.

Please do not unfairly burden or tax our industry. Thank you for allowing us to testify.

enterprise

544 Ohohia Street
Honolulu, HI 96819
808-836-0130
www.enterprise.com

Honorable Carol Fukunaga, Chair
Committee on Economic Development
and Taxation
Hawaii State Senate
State of Hawaii

Hearing: March 18, 2008, 1:15 pm., Conf. Room 224

Re: HB 3196, SD1 --- Relating To The Rental Motor Vehicle Surcharge Tax

Honorable Chair Fukunaga and Honorable Committee Members:

My name is Wayne Tanaka and I am the V.P. / General Manager with Enterprise Rent-A-Car Company of Hawaii.

Our company opposes this bill in its present form and supports the amendments to the bill recommended by Catrala Hawaii.

This bill amended by the prior Committee is problematic in several aspects:

a) <u>It does not require the DOT to follow the request of your Joint Senate and House Task Force which asked the DOT to study the Highway Fund and report back to the Legislature in 2009.</u>

b) <u>By leaving the amount blank, this bill suggests a TAX INCREASE when the DOT in its testimony is only seeking to maintain the amount of $3 daily which is the present daily amount.</u> If the DOT is only seeking $3 why is the dollar figure blank?

c) <u>This bill unfairly singles out the u-drive industry for a PERMANENT TAX INCREASE</u> since the present daily surcharge tax should be $2 and not the present temporary $3 which some seek to make permanent. About 8 years ago the u-drive industry was singled out for a "temporary" tax increase from $2 to $3 daily to help with the needs of the General Fund. The surcharge tax was scheduled to sunset back from $3 daily to $2 in 2007 but was temporarily extended while studies were conducted. The industry should not be singled out again for an increase.

<u>A study by the DOT needs to be done as to how to "fairly raise revenues" from all who benefit from the use of the highways and not just u-drive vehicles.</u> <u>Isn't this fair?</u>

While as study is being done, the u-drive industry is agreeable to extending the temporarily daily tax of $3 daily for another year so the DOT does not suffer any loss of revenues while the study is being done. This is fair solution to [illegible] serious problem. A study needs to be done.

Please do not unfairly burden [illegible]dustry. Thank you for allowing us to testify.

Fueled By Passion

Honorable Carol Fukunaga, Chair
Committee on Economic Development
and Taxation
Hawaii State Senate
State of Hawaii

Hearing: March 18, 2008, 1:15 pm., Conf. Room 224

Re: HB 3196, SD1 --- Relating To The Rental Motor Vehicle Surcharge Tax

Honorable Chair Fukunaga and Honorable Committee Members:

My name is Wayne Tanaka and I am the chair of the Legislative Committee for Catrala-Hawaii. Catrala's membership consists of the major u-drive (car and truck rental leasing) companies in Hawaii and the many businesses which support our industry.

Catrala supports this bill with amendment attached hereto as Exhibit A. Exhibit A is a copy of HB 3196, HD1 passed from the House to the Senate. We believe Exhibit A is a much better bill. This bill in its present form as amended by the prior Senate Committee <u>is unfair and has problems in several respects</u>:

a) <u>It does not require the DOT to follow the request of your Joint Senate and House Task Force which asked the DOT to study the Highway Fund and report back to the Legislature in 2009.</u> The present form of this bill <u>eliminates</u> the requirement that the DOT to do such a study as requested by the Joint Senate and House Task Force. Why is this when everyone knows the Highway Fund is in need of revenues for various reasons including federal cutbacks starting as of 2009? The recommendation of the Joint Senate and House Task Force was:

> *"The Task Force defers to the Forum and the DOT for now and requests that the DOT report to the Legislature when the Forum finalizes its recommendations, with the expectation that the matter will result in proposed legislation for consideration for the 2009 Regular Session".*

b) <u>By leaving the amount blank, this bill suggests a TAX INCREASE when the DOT in its testimony is only seeking to maintain the amount of $3 daily which is the present daily amount.</u> If the DOT is only seeking $3 why is the dollar figure blank?

c) <u>This bill unfairly singles out the u-drive industry for a PERMANENT TAX INCREASE</u> since the present daily surcharge tax should be $2 and not the present $3 which many seek to make permanent. About 8 years ago the u-drive industry was singled out for a "temporary" tax increase from $2 to $3 daily to help with the needs of the General Fund. Some monies going into the Highway Fund were transferred to the General Fund. The surcharge tax was scheduled to sunset back from $3 daily to $2 in 2007 when State revenues were hopefully better. This should have occurred due to the reported "surplus revenues" in 2007. Due to growing surplus in revenues the Governor prior to 2007 stopped the transfer of revenues from the Highway Fund to the General Fund. In fact due to reported transfer of $150,000,000 or more out of the Highway Fund, the Governor in 2007 recommended using some of surplus revenues to repay the Highway Fund given its anticipated future needs and federal cut backs. Such repayment was not authorized.

As one can see from the foregoing, the Highway Fund is apparently in desperate need of revenues. However, the u-drive industry should not be singled out for "permanent tax increase" when after 8 years the surcharge tax was suppose to sunset back from $3 to $2 daily in 2007 which was a year of surplus revenues.

A study by the DOT needs to be done as to how to "fairly raise revenues" from all who benefit from the use of the highways. Isn't this fair? To unfairly single out the u-drive industry is not fair. If the study finds that the u-drive industry should contribute additional funds like others then the starting base for such increase payments by the u-drive industry should start at $2 daily and not $3 daily which was suppose to sunset back to $2 daily in 2007. While as study is being done, the u-drive industry is agreeable to extending the temporarily daily tax of $3 daily for another year so the DOT does not suffer any loss of revenues while the study is being done. This is fair solution to addressing a serious problem. A study needs to be done.

Catrala firmly believes the daily surcharge tax is already high and must be kept as low as possible. Hawaii is primarily a family oriented tourist destination which competes with places such as Florida. Florida's surcharge tax is $2 daily and we believe Hawaii should be the same if not lower.

The 2004 study by the DOT which the prior Committee referred to is a flawed study that does not substantiate any national average. Regardless, you don't compare cities/States who are not dependent on tourism like Hawaii and use the figures from such cities/States. It's like comparing apples with oranges. The 2004 study is a misleading and poor study. For example, the sales tax in Cleveland is 7.5%. Does that mean that Hawaii's GET tax should be raised to 5% or 6%? Obviously not. The circumstances in Cleveland are not the same as Hawaii. The same should apply when tries to compare or use surcharge taxes from other cities/States.

Further, u-drive vehicles provide the tourists the freedom to explore on their own schedule and repeatedly, if they so desire, the many wonders throughout Hawaii which are heavily advertised and promoted. High daily taxes will discourage the rental of vehicles. This in turn will reduce overall tourist satisfaction.

In addition, the reduction in daily rental of vehicles will also result in economic hardship to the many local restaurants and shops which benefit from tourists who stop, eat and shop as they explore along the way the beauties and enjoy the many activities Hawaii has to offer.

We respectfully urge you to pass this bill as Exhibit A. Thank you for allowing us to testify.

EXHIBIT A BELOW

Report Title:

Rental motor vehicle; surcharge; surcharge tax; State Highway Fund

Description:

Extends the $1 per day surcharge on rental motor vehicles beyond September 1, 2008 and deposits the money into the State Highway Fund. (HB3196 HD1)

HOUSE OF REPRESENTATIVES
TWENTY-FOURTH LEGISLATURE, 2008
STATE OF HAWAII

H.B. NO. 3196 H.D. 1 S.D. 2

A BILL FOR AN ACT

RELATING TO RENTAL MOTOR VEHICLE SURCHARGE TAX.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. Section 251-2, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) There is levied and shall be assessed and collected each month a rental motor vehicle surcharge tax of $2 a day, except that for the period of September 1, 1999, to August 31, [~~2008,~~] 2009, the tax shall be $3 a day, or any portion of a day that a rental motor vehicle is rented or leased. The rental motor vehicle surcharge tax shall be levied upon the lessor; provided that the tax shall not be levied on the lessor if:

(1) The lessor is renting the vehicle to replace a vehicle of the lessee that is being repaired; and

(2) A record of the repair order for the vehicle is retained either by the lessor for two years for

verification purposes or by a motor vehicle repair dealer for two years as provided in section 437B-16."

SECTION 2. (a) The department of transportation shall study the financial requirements of the state highway fund, with an emphasis of the adequacy and equity of revenues generated by one or more revenues sources pursuant to section 251-2, Hawaii Revised Statutes, compared with other revenue sources contributing to or that could be contributing to the highway fund.

(b) The study may include discussions and meetings with representatives of different interest groups and present contributors of revenues to the highway fund.

(c) The study may include a review of:

(1) Past, present, and projected revenues of the state highway fund;

(2) The ability of the department of transportation to plan, implement, and expend funds on a timely basis;

(3) An analysis of the actual revenue needs of the department of transportation;

(4) Other revenue sources of the state highway fund and their nexus to the fund; and

(5) Other governmental matching funds.

(d) The study shall include data from the 2000-2001 fiscal year to the present fiscal year and may include any data, information, or conclusions by task forces or groups that have discussed or met in the past to evaluate at least in part the fiscal needs, revenue sources, or viability of the state highway fund.

(e) The department of transportation shall submit a final report, including proposed legislation for increasing revenue sources for the state highway fund to meet its ongoing and future needs, to the legislature no later than twenty days prior to the convening of the regular session of 2009.

SECTION 3. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 4. This Act shall take effect upon its approval.

EXHIBIT A ABOVE

Alamo

Honorable Carol Fukunaga, Chair
Committee on Economic Development
and Taxation
Hawaii State Senate
State of Hawaii

Hearing: March 18, 2008, 1:15 pm., Conf. Room 224

Re: HB 3196, SD1 --- Relating To The Rental Motor Vehicle Surcharge Tax

Honorable Chair Fukunaga and Honorable Committee Members:

My name is Randy Monturi and I am the Regional Vice President with Alamo Rent A Car Company of Hawaii.

Our company supports this bill with amendment attached hereto as Exhibit A. Exhibit A is a copy of HB 3196, HD1 passed from the House to the Senate. We believe Exhibit A is a much better bill. This bill in its present form as amended by the prior Senate Committee is unfair and has problems in several respects:

a) It does not require the DOT to follow the request of your Joint Senate and House Task Force which asked the DOT to study the Highway Fund and report back to the Legislature in 2009. The present form of this bill eliminates the requirement that the DOT to do such a study as requested by the Joint Senate and House Task Force. Why is this when everyone knows the Highway Fund is in need of revenues for various reasons including federal cutbacks starting as of 2009? The recommendation of the Joint Senate and House Task Force was:

"The Task Force defers to the Forum and the DOT for now and requests that the DOT report to the Legislature when the Forum finalizes its recommendations, with the expectation that the matter will result in proposed legislation for consideration for the 2009 Regular Session".

b) By leaving the amount blank, this bill suggests a TAX INCREASE when the DOT in its testimony is only seeking to maintain the amount of $3 daily which is the present daily amount. If the DOT is only seeking $3 why is the dollar figure blank?

c) This bill unfairly singles out the u-drive industry for a PERMANENT TAX INCREASE since the present daily surcharge tax should be $2 and not the present $3 which many seek to make permanent. About 8 years ago the u-drive industry was singled out for a "temporary" tax increase from $2 to $3 daily to help with the needs of the General Fund. Some monies going into the Highway Fund were transferred to the General Fund. The surcharge tax was scheduled to sunset back from $3 daily to $2 in 2007 when State revenues were hopefully better. This should have occurred due to the reported "surplus revenues" in 2007. Due to growing surplus in revenues the Governor prior to 2007 stopped the transfer of revenues from the Highway Fund to the General Fund. In fact due to reported transfer of $150,000,000 or more out of the Highway Fund, the Governor in 2007 recommended using some of surplus revenues to repay the Highway Fund given its anticipated future needs and federal cut backs. Such repayment was not authorized.

As one can see from the foregoing, the Highway Fund is apparently in desperate need of

Alamo Rent A Car, 3015 Koapaka Street, Suite G, Honolulu, HI 96819 808.839.5116 fax 808.839.5143

Alamo

revenues. However, the u-drive industry should not be singled out for "permanent tax increase" when after 8 years the surcharge tax was suppose to sunset back from $3 to $2 daily in 2007 which was a year of surplus revenues.

A study by the DOT needs to be done as to how to "fairly raise revenues" from all who benefit from the use of the highways. Isn't this fair? To unfairly single out the u-drive industry is not fair. If the study finds that the u-drive industry should contribute additional funds like others then the starting base for such increase payments by the u-drive industry should start at $2 daily and not $3 daily which was suppose to sunset back to $2 daily in 2007. While as study is being done, the u-drive industry is agreeable to extending the temporarily daily tax of $3 daily for another year so the DOT does not suffer any loss of revenues while the study is being done. This is fair solution to addressing a serious problem. A study needs to be done.

Our company firmly believes the daily surcharge tax is already high and must be kept as low as possible. Hawaii is primarily a family oriented tourist destination which competes with places such as Florida. Florida's surcharge tax is $2 daily and we believe Hawaii should be the same if not lower.

The 2004 study by the DOT which the prior Committee referred to is a flawed study that does not substantiate any national average. Regardless, you don't compare cities/States who are not dependent on tourism like Hawaii and use the figures from such cities/States. It's like comparing apples with oranges. The 2004 study is a misleading and poor study. For example, the sales tax in Cleveland is 7.5%. Does that mean that Hawaii's GET tax should be raised to 5% or 6%? Obviously not. The circumstances in Cleveland are not the same as Hawaii. The same should apply when tries to compare or use surcharge taxes from other cities/States.

Further, u-drive vehicles provide the tourists the freedom to explore on their own schedule and repeatedly, if they so desire, the many wonders throughout Hawaii which are heavily advertised and promoted. High daily taxes will discourage the rental of vehicles. This in turn will reduce overall tourist satisfaction.

In addition, the reduction in daily rental of vehicles will also result in economic hardship to the many local restaurants and shops which benefit from tourists who stop, eat and shop as they explore along the way the beauties and enjoy the many activities Hawaii has to offer.

We respectfully urge you to pass this bill as Exhibit A. Thank you for allowing us to testify.

EXHIBIT A BELOW

Report Title:

Rental motor vehicle; surcharge; surcharge tax; State Highway Fund

Description:

Extends the $1 per day surcharge on rental motor vehicles beyond September 1, 2008 and deposits the money into the State Highway Fund. (HB3196 HD1)

HOUSE OF REPRESENTATIVES
TWENTY-FOURTH LEGISLATURE, 2008
STATE OF HAWAII

H.B. NO. 3196 H.D. 1 S.D. 2

Alamo Rent A Car, 3015 Koapaka Street, Suite G, Honolulu, HI 96819 808.839.3116 fax 808.839.5143

Alamo

A BILL FOR AN ACT

RELATING TO RENTAL MOTOR VEHICLE SURCHARGE TAX.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. Section 251-2, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) There is levied and shall be assessed and collected each month a rental motor vehicle surcharge tax of $2 a day, except that for the period of September 1, 1999, to August 31, [~~2008,~~] 2009, the tax shall be $3 a day, or any portion of a day that a rental motor vehicle is rented or leased. The rental motor vehicle surcharge tax shall be levied upon the lessor; provided that the tax shall not be levied on the lessor if:

(1) The lessor is renting the vehicle to replace a vehicle of the lessee that is being repaired; and

(2) A record of the repair order for the vehicle is retained either by the lessor for two years for verification purposes or by a motor vehicle repair dealer for two years as provided in section 437B-16."

SECTION 2. (a) The department of transportation shall study the financial requirements of the state highway fund, with

Alamo

an emphasis of the adequacy and equity of revenues generated by one or more revenues sources pursuant to section 251-2, Hawaii Revised Statutes, compared with other revenue sources contributing to or that could be contributing to the highway fund.

(b) The study may include discussions and meetings with representatives of different interest groups and present contributors of revenues to the highway fund.

(c) The study may include a review of:

(1) Past, present, and projected revenues of the state highway fund;

(2) The ability of the department of transportation to plan, implement, and expend funds on a timely basis;

(3) An analysis of the actual revenue needs of the department of transportation;

(4) Other revenue sources of the state highway fund and their nexus to the fund; and

(5) Other governmental matching funds.

(d) The study shall include data from the 2000-2001 fiscal year to the present fiscal year and may include any data, information, or conclusions by task forces or groups that have discussed or met in the past to evaluate at least in part the

Alamo

fiscal needs, revenue sources, or viability of the state highway fund.

(e) The department of transportation shall submit a final report, including proposed legislation for increasing revenue sources for the state highway fund to meet its ongoing and future needs, to the legislature no later than twenty days prior to the convening of the regular session of 2009.

SECTION 3. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 4. This Act shall take effect upon its approval.

EXHIBIT A ABOVE

Alamo Rent A Car, 3015 Koapaka Street, Suite G, Honolulu, HI 96819 808.839.5116 fax 808.839.5143

National Car Rental

Honorable Carol Fukunaga, Chair
Committee on Economic Development
and Taxation
Hawaii State Senate
State of Hawaii

Hearing: March 18, 2008, 1:15 pm., Conf. Room 224

Re: HB 3196, SD1 --- Relating To The Rental Motor Vehicle Surcharge Tax

Honorable Chair Fukunaga and Honorable Committee Members:

My name is Randy Monturi and I am the Regional Vice President with National Car Rental Company of Hawaii.

Our company supports this bill with amendment attached hereto as Exhibit A. Exhibit A is a copy of HB 3196, HD1 passed from the House to the Senate. We believe Exhibit A is a much better bill. This bill in its present form as amended by the prior Senate Committee is unfair and has problems in several respects:

a) It does not require the DOT to follow the request of your Joint Senate and House Task Force which asked the DOT to study the Highway Fund and report back to the Legislature in 2009. The present form of this bill eliminates the requirement that the DOT to do such a study as requested by the Joint Senate and House Task Force. Why is this when everyone knows the Highway Fund is in need of revenues for various reasons including federal cutbacks starting as of 2009? The recommendation of the Joint Senate and House Task Force was:

> *"The Task Force defers to the Forum and the DOT for now and requests that the DOT report to the Legislature when the Forum finalizes its recommendations, with the expectation that the matter will result in proposed legislation for consideration for the 2009 Regular Session".*

b) By leaving the amount blank, this bill suggests a TAX INCREASE when the DOT in its testimony is only seeking to maintain the amount of $3 daily which is the present daily amount. If the DOT is only seeking $3 why is the dollar figure blank?

c) This bill unfairly singles out the u-drive industry for a PERMANENT TAX INCREASE since the present daily surcharge tax should be $2 and not the present $3 which many seek to make permanent. About 8 years ago the u-drive industry was singled out for a "temporary" tax increase from $2 to $3 daily to help with the needs of the General Fund. Some monies going into the Highway Fund were transferred to the General Fund. The surcharge tax was scheduled to sunset back from $3 daily to $2 in 2007 when State revenues were hopefully better. This should have occurred due to the reported "surplus revenues" in 2007. Due to growing surplus in revenues the Governor prior to 2007 stopped the transfer of revenues from the Highway Fund to the General Fund. In fact due to reported transfer of $150,000,000 or more out of the Highway Fund, the Governor in 2007 recommended using some of surplus revenues to repay the Highway Fund given its anticipated future needs and federal cut backs. Such repayment was not authorized.

As one can see from the foregoing, the Highway Fund is apparently in desperate need of

National CarRental

revenues. However, the u-drive industry should not be singled out for "permanent tax increase" when after 8 years the surcharge tax was suppose to sunset back from $3 to $2 daily in 2007 which was a year of surplus revenues.

A study by the DOT needs to be done as to how to "fairly raise revenues" from all who benefit from the use of the highways. Isn't this fair? To unfairly single out the u-drive industry is not fair. If the study finds that the u-drive industry should contribute additional funds like others then the starting base for such increase payments by the u-drive industry should start at $2 daily and not $3 daily which was suppose to sunset back to $2 daily in 2007. While as study is being done, the u-drive industry is agreeable to extending the temporarily daily tax of $3 daily for another year so the DOT does not suffer any loss of revenues while the study is being done. This is fair solution to addressing a serious problem. A study needs to be done.

Our company firmly believes the daily surcharge tax is already high and must be kept as low as possible. Hawaii is primarily a family oriented tourist destination which competes with places such as Florida. Florida's surcharge tax is $2 daily and we believe Hawaii should be the same if not lower.

The 2004 study by the DOT which the prior Committee referred to is a flawed study that does not substantiate any national average. Regardless, you don't compare cities/States who are not dependent on tourism like Hawaii and use the figures from such cities/States. It's like comparing apples with oranges. The 2004 study is a misleading and poor study. For example, the sales tax in Cleveland is 7.5%. Does that mean that Hawaii's GET tax should be raised to 5% or 6%? Obviously not. The circumstances in Cleveland are not the same as Hawaii. The same should apply when tries to compare or use surcharge taxes from other cities/States.

Further, u-drive vehicles provide the tourists the freedom to explore on their own schedule and repeatedly, if they so desire, the many wonders throughout Hawaii which are heavily advertised and promoted. High daily taxes will discourage the rental of vehicles. This in turn will reduce overall tourist satisfaction.

In addition, the reduction in daily rental of vehicles will also result in economic hardship to the many local restaurants and shops which benefit from tourists who stop, eat and shop as they explore along the way the beauties and enjoy the many activities Hawaii has to offer.

We respectfully urge you to pass this bill as Exhibit A. Thank you for allowing us to testify.

EXHIBIT A BELOW

Report Title:

Rental motor vehicle; surcharge; surcharge tax; State Highway Fund

Description:

Extends the $1 per day surcharge on rental motor vehicles beyond September 1, 2008 and deposits the money into the State Highway Fund. (HB3196 HD1)

HOUSE OF REPRESENTATIVES
TWENTY-FOURTH LEGISLATURE, 2008
STATE OF HAWAII

H.B. NO. 3196 H.D. 1 S.D. 2

National Car Rental

A BILL FOR AN ACT

RELATING TO RENTAL MOTOR VEHICLE SURCHARGE TAX.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. Section 251-2, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) There is levied and shall be assessed and collected each month a rental motor vehicle surcharge tax of $2 a day, except that for the period of September 1, 1999, to August 31, [~~2008,~~] 2009, the tax shall be $3 a day, or any portion of a day that a rental motor vehicle is rented or leased. The rental motor vehicle surcharge tax shall be levied upon the lessor; provided that the tax shall not be levied on the lessor if:

(1) The lessor is renting the vehicle to replace a vehicle of the lessee that is being repaired; and

(2) A record of the repair order for the vehicle is retained either by the lessor for two years for verification purposes or by a motor vehicle repair dealer for two years as provided in section 437B-16."

SECTION 2. (a) The department of transportation shall study the financial requirements of the state highway fund, with

National Car Rental

an emphasis of the adequacy and equity of revenues generated by one or more revenues sources pursuant to section 251-2, Hawaii Revised Statutes, compared with other revenue sources contributing to or that could be contributing to the highway fund.

(b) The study may include discussions and meetings with representatives of different interest groups and present contributors of revenues to the highway fund.

(c) The study may include a review of:

(1) Past, present, and projected revenues of the state highway fund;

(2) The ability of the department of transportation to plan, implement, and expend funds on a timely basis;

(3) An analysis of the actual revenue needs of the department of transportation;

(4) Other revenue sources of the state highway fund and their nexus to the fund; and

(5) Other governmental matching funds.

(d) The study shall include data from the 2000-2001 fiscal year to the present fiscal year and may include any data, information, or conclusions by task forces or groups that have discussed or met in the past to evaluate at least in part the fiscal needs, revenue sources, or viability of the state highway fund.

(e) The department of transportation shall submit a final report, including proposed legislation for increasing revenue sources for the state highway fund to meet its ongoing and future needs, to the legislature no later than twenty days prior to the convening of the regular session of 2009.

SECTION 3. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 4. This Act shall take effect upon its approval.

EXHIBIT A ABOVE

SUBJECT: RENTAL MOTOR VEHICLE AND TOUR VEHICLE SURCHARGE, Make increase permanent

BILL NUMBER: HB 3196, SD-1

INTRODUCED BY: Senate Committee on Commerce, Consumer Protection and Affordable Housing

BRIEF SUMMARY: Amends HRS section 251-2 to repeal the provision reducing the $3 rental motor vehicle surcharge tax to $2 on September 1, 2008 and provides that the $3 per day surcharge shall be $_____.

EFFECTIVE DATE: July 1, 2050

STAFF COMMENTS: The legislature by Act 263, SLH 1991, adopted a $2 per day tax on rental motor vehicles as part of the state administration's plan to bail out the state's ailing highway fund. This action was in contrast to a citizen's task force that had been convened in 1988 to address the looming shortfall in the state highway fund that the fuel and weight tax rates be increased as well as continuing to transfer the collections of the general excise tax imposed on the sale of fuel for highway use from the general fund to the state highway fund. This latter source of revenue provided a relatively accurate gauge of highway use given the ease of administration and compliance and represented a user-based activity charge. However, by the time the issue of sustaining the highway fund garnered the attention of the legislature in 1990, there was evidence that the state general fund finances were also in trouble following the burst of the Japanese "bubble."

Rather than beginning the process to adjust the growth of state government to available revenues, lawmakers and the administration felt it expedient to "take back" the general excise tax collected on the sale of gasoline by allowing the transfer enacted by Act 239, SLH 1985, to lapse. Given the deleterious impact the lapsing of this transfer of general excise tax revenues may have had on the highway fund and the politically difficult challenge of raising the fuel tax on gasoline, lawmakers devised the rental motor vehicle/tour vehicle surcharge tax which was enacted with Act 263, SLH 1991. Aimed primarily at visitors, the attempt was intended to make this segment of the de facto population pay a larger share of the cost of maintaining the highways. It also allowed lawmakers to avoid raising the tax on gasoline even higher than the additional five cents they adopted with the 1991 legislation.

Since the early 1980's a number of citizens' task forces have been convened to evaluate the fiscal viability of the state highway fund. In all cases, these task forces came to the conclusion that the state motor vehicle tax, fuel and weight taxes would have to be periodically increased because the per unit taxes used to fund the state highway program were based on consumption and are not inflation sensitive like the costs of repairing and maintaining the highway system.

The failing fiscal health of the state highway fund became very apparent by 1999 after the legislature began raiding the fund to pay for general fund programs. Over the years since this began, more than

$155 million was taken from the highway fund to keep general fund programs running. The then administration revealed the projected failure of the state highway fund when it submitted its budget in 1999 which forecast that the state highway fund would be in the red to the tune of more than $70 million by the end of fiscal year 2003. But opportunity also struck that session when the rental car industry sought approval to show out the multitude of fees and user charges imposed by the state on the industry and for concessions at the airports. In return, the industry agreed to a temporary seven-year increase in the per day rental car fee going from $2 per day to $3 per day. This deal is embodied in Act 223, SLH 1999, which increased the amount of the surcharge to $3 between 11/1/99 to 8/31/07. Act 258, SLH 2007, extended the 8/31/07 sunset date to 8/31/08. This measure proposes that the rental motor vehicle and tour vehicle surcharge shall be permanently set at $_____ per day.

Obviously keeping the burden on non-voting visitors is politically driven especially in the wake of public complaints about the high cost of motor fuel in Hawaii. But is it necessarily the most accountable approach or for that matter transparent? Is this bill doing nothing more than hiding, if not forestalling, the problems facing the state highway fund? Does it perpetuate the inefficiencies that are inherent in a program that is entirely special-fund financed where the majority of the beneficiaries are not being asked to shoulder their fair share of the cost of operating this program?

What would highway users say if, indeed, the fuel tax rates were increased to cover the forecasted shortfalls? Would they demand more accountability from highway officials for the repair and maintenance of the state roads? Would they ask more often why highway users are being asked to pay for so much when so little seems to be done to keep the roadways in good repair? Administration officials and lawmakers may think that visitors will not notice because it is a continuance of the rate that was adopted in 1999, but what will happen when the surcharge doesn't keep up with costs and a substantial hike will be needed in the fuel tax rate regardless of these strategies?

If, indeed, the highway fund is in dire straits, then the money that was taken to supplement the general fund in the 1990's should be returned. Further, small incremental increases in the fuel tax should be undertaken to ease the burden of taxes that will be needed over time to keep the fund solvent. Consideration might be given to reestablishing the transfer of general excise taxes collected on the sale of fuel for highway use to the highway fund as those taxes are paid by highway users. While the $3 per day rental surcharge may still be needed to balance the fund, it by no means should be the only source to be tapped as it merely postpones the day of reckoning. It should be remembered that unlike the other resources of the state highway fund, the fortunes of the motor vehicle surcharge are highly dependent on the utilization of rental cars which in turn is dependent on the fortunes of the visitor industry and the number of those visitors electing to rent those vehicles. Thus, the motor vehicle rental surcharge is the least reliable of those revenue resources available to the state highway fund.

Digested 3/17/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2456 HD 2
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This legislation amends Hawaii income tax law to exclude from gross income those amounts provided to an employee who is a reciprocal beneficiary, which are in excess of benefits provided to a single employee.

The Department of Taxation (Department) takes **no position** on this legislation.

ISSUE OVER "DIRECT OR INDIRECT"—The Department raises the issue of whether identifying the benefits and payments subject to this exclusion necessarily must be "direct or indirect." The Department suggests that simply identifying the terms is sufficient and will not raise unnecessary confusion over whether a benefit is or is not direct or indirect.

(14) The value of health insurance and other **[~~direct or indirect~~]** benefits provided by an employer to an employee in excess of what the employer provides to single employees, or would provide to single employees, when such benefits are provided to the employee based on the employee's status as a reciprocal beneficiary as defined in chapter 572C or a domestic partner as defined in the administrative rules of the Hawaii employer-union health benefits trust fund. For the purposes of this paragraph "single employee" means an employee who:

(A) Is compensated by the employer **[~~directly or indirectly~~]**;
(B) Is not married;
(C) Has no reciprocal beneficiary as defined in chapter 572C; and

(D) Has no domestic partner as defined in the administrative rules of the Hawaii employer-union health benefits trust fund."

REVENUE IMPACT—Assuming this bill is amended to take effect immediately, this legislation will result in a revenue loss of approximately $800,000 for FY2009 and thereafter.

Since the 1st house draft eliminates the exemption allowed for a taxpayer's reciprocal beneficiary, the Department assumes reciprocal beneficiaries can decrease their tax liability by 5%. According to the Hawaii Family Forum, the Department of Health reported there were 1,284 individuals who registered as reciprocal beneficiaries (2006). This amounts to approximately 1% of the state population. The Department then assumed that reciprocal beneficiaries would decrease their tax liability by 10%. According to the Department of Taxation Annual Report (2005-2006), the state collected approximately $1.6 billion in individual income tax collections in 2006.

HAWAI'I CIVIL RIGHTS COMMISSION

830 PUNCHBOWL STREET, ROOM 411 • HONOLULU, HI 96813-5095 • PHONE: (808) 586-8636 • FAX: (808) 586-8655 • TDD: (808) 586-8692

March 18, 2008
Rm. 224, 1:15 p.m.

To: The Honorable Carol Fukunaga, Chair, and Members of the Senate Committee on Economic Development and Taxation

From: Sara Banks, Acting Chair, and Commissioners of the Hawai'i Civil Rights Commission

Re: H.B. No. 2446, H.D. 2

The Hawai'i Civil Rights Commission (HCRC) has enforcement jurisdiction over state laws prohibiting discrimination in employment, housing, public accommodations, and access to state and state-funded services. The HCRC carries out the Hawai'i constitutional mandate that "no person shall be discriminated against in the exercise of their civil rights because of race, religion, sex or ancestry". Art. I, Sec. 5.

The HCRC supports the intent of H.B. No. 2456, H.D. 2, which excludes from gross income, adjusted gross income, and taxable income the value of health insurance and other direct or indirect benefits provided by an employer to an employee in excess of what the employer provides or would provide to single employees when such benefits are provided to the employee due to the employee's status as a reciprocal beneficiary or a domestic partner.

The HCRC has previously expressed its support for state laws concerning reciprocal beneficiaries, until such time that domestic partnerships are recognized. To the extent that this proposed legislation does not adversely affect current reciprocal beneficiaries and/or domestic partners, the HCRC supports H.B. No. 2456, H.D. 2.

March 17, 2008

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice-chair
Committee on Economic Development and Taxation

Re: Support of HB 2456, HD2, Relating to Taxation

Mahalo for reviewing the Hawaii income tax status of reciprocal beneficiaries and domestic partners. HB 2456, HD2, would remedy an area where the State of Hawaii discriminates against reciprocal beneficiaries and domestic partners:

1. Employer-subsidized health insurance for an employee's domestic partner or reciprocal beneficiary is reported on the W-2 and is treated as taxable income by the State of Hawaii.
2. However, the State of Hawaii does not treat as income the same employer-provided subsidy to married persons.
3. This discrimination is compounded by the fact that the State of Hawaii has denied the status of civil marriage to same-sex couples who have indeed made a family.

HB 2456, HD2, would remedy this problem. On line 16 of page 16 of HD2, the effective date is given as January 1, 2020. Please change this to January 1, 2009.

There are other, similar, issues in the tax code that HB 2456, HD2, does not address. For example, reciprocal beneficiaries are not allowed to file Hawaii income tax forms jointly---a right available to married couples. If you can address the issue of filing status, that would help greatly.

Again, thank you for thinking about these issues. It helps everyone, partly by lowering the demand for costly social services, when you make it possible for people to take care of one another.

Respectfully yours,

Tom Ramsey

Tom Ramsey
www.math.hawaii.edu/~ramsey

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Exclude health insurance of domestic partner

BILL NUMBER: HB 2456, HD-2

INTRODUCED BY: House Committee on Finance

STAFF COMMENTS: Amends HRS section 235-7(a) to provide that the value of health insurance and other benefits provided by an employer to an employee in excess of what the employer provides to single employees, when such benefits are provided to the employee due to the employee's status as a reciprocal beneficiary as defined in chapter 572C or a domestic partner as defined in the administrative rules of the Hawaii employer-union health benefits trust fund, shall be excluded from income.

EFFECTIVE DATE: January 1, 2020; applicable to tax years beginning after December 31, 2008

STAFF COMMENTS: Currently neither the state nor federal tax laws recognize reciprocal beneficiaries or domestic partners for income tax purposes. As a result, employer subsidized health insurance for an employee's reciprocal beneficiary or domestic partner is treated as taxable income. This measure proposes that such benefits provided by an employer for an employee's reciprocal beneficiary or domestic partner shall not be taxable under the state income tax law.

In states that recognize same sex marriages, reciprocal beneficiaries or domestic partners, the taxability of the benefits received by an employee for the reciprocal beneficiary or domestic partner generally is not taxable in those states but remains taxable on the federal level. The adoption of this measure would extend similar tax treatment for Hawaii income tax purposes, although Hawaii does not recognize reciprocal beneficiaries or domestic partners. Its adoption would be contrary to the state's intent to conform to the federal Internal Revenue Code for ease of compliance.

While advocates of this proposal may argue that it is unfair to be taxed on such benefits, they should realize that if this amount is exempt for state tax purposes, thereby reducing the state tab, it will increase the amount of income exposed to federal income tax rates which are substantially higher than the state rates. Thus, what is saved on the state tax return winds up being taxed on the federal return as there is no similar exemption at the federal level. Unless the taxpayer can meet the federal dependency test, the federal law will not recognize such amounts as being excluded.

Digested 3/12/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2518 HD 1 SD 1
RELATING TO LAND CONSERVATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This legislation provides a nonrefundable income tax credit for bargain sales or contributions of land for purposes of preservation.

The Senate Committee on Water & Land amended the measure by inserting the text of SB 2198. The Department's comments are made accordingly.

The Department of Taxation defers to the Department of Land & Natural Resources on the policy merits of this legislation; however the Department also has **strong concerns** with this measure and **requests amendments.** Though the Department has strong concerns with this measure, it has been and will continue to work with other interested parties to resolve these issues.

The Department initially points out that this measure has not been factored into the Executive Budget and is not one of its tax relief priorities this session.

The Department very much recognizes the importance of preserving conservation and culturally relevant lands in order to maintain Hawaii's priceless lands. However, the Department has issues with administering this tax credit.

I. TECHNICAL COMMENTS

The following technical issues are apparent:

USE OF FAIR MARKET VALUE—The Department is always apprehensive when "fair market value" is used as the standard by which a tax credit or other tax incentive is calculated. Fair market value can mean something different to anyone, especially when a tax benefit is involved. The concern for the Department relates more to perceived frauds and abuses of land prices used to calculate the amount of the credit.

This bill was amended to clarify that fair market value for purposes of the credit is to be determined pursuant to federal law regulating appraisals for charitable purposes. Assuming fair market value is the only measure that can be used for this credit and use of an appraisal is the preferred method, the Department strongly suggests that the bill be amended to incorporate a penalty similar to Internal Revenue Code § 6695A that will penalize an appraiser who is complicit in a fraudulent land deal for purposes of this credit. An additional penalty similar to that provided under § 6662 of the Internal Revenue Code would prohibit taxpayers from similarly misusing any appraisals.

"**§231-A Accuracy-related penalty on underpayments due to substantial valuation misstatements.** (a) There shall be added to tax an amount of twenty per cent of the portion of an underpayment of tax required to be shown on a return if the portion of underpayment is due to a substantial valuation misstatement.

(b) There is a substantial valuation misstatement if the value of any property (or the adjusted basis of any property) claimed on any return of tax is one hundred and fifty per cent or more of the amount determined to be the correct amount of such valuation or adjusted basis, as the case may be.

(c) No penalty shall be imposed by a person under this section unless that portion of the underpayment for the taxable year attributable to the substantial valuation misstatement exceeds $1,000.

§231-B Substantial valuation misstatements attributable to incorrect appraisals. (a) There shall be assessed a penalty upon any person:

(1) Who prepares an appraisal of the value of property and such person knows, or reasonably should have known, that the appraisal would be used in connection with a return or a claim for refund; and

(2) The claimed value on a return or claim for refund which is based on such appraisal results in a substantial valuation misstatement under section 231-A.

(b) The penalty assessable under subsection (a) shall be equal to the lesser of:

(1) The greater of:

(i) Ten per cent of the amount of the underpayment attributable to the misstatement under subsection (a); or

(ii) $1,000; or

(2) One hundred and twenty-five per cent of the gross

```
        income received by the person described in
        subsection (a) from the preparation of the
        appraisal.
        (c)  No penalty shall be imposed under this
    section if the person establishes that the value
    established in the appraisal was more likely than not
    the proper value."
```

PROPERTY CLASS STANDARDS—The Department is concerned about certain of the definitions used with the credit. For example, "conservation and preservation purpose" and "cultural property" are both very broad terms and the express definitions only increase the expanse of these definitions. The Department recognizes the rulemaking authority; however settling the issue in statute is the preferred method.

PUBLIC OR PRIVATE CONSERVATION AGENCY—There is concern over who will be running any conservation program. In order to ensure continuity and consistency, the Department suggests amending the bill to ensure some specific government agency be charged with implementing the conservation program before any tax credit is available.

PASS-THROUGH ENTITY PROVISION—Subsection (g) is unnecessary and confusing. Well-settled principles of partnership (pass-through) entity law typically do not allow any tax consequences for the "entity." All tax attributes of a partnership flow through to the partners that realize the tax consequences on individual tax returns. When an election is made by a partnership or limited liability company to be taxed at the entity level as a corporation, the entity is then considered a corporation for tax purposes and no longer a pass-through. The Department strongly suggests that subsection (g) be eliminated entirely. The Department submits that existing conformity to partnership and corporate tax principles is sufficient.

All that is needed is the following language:

```
        "(g)  In the case of a partnership, S corporation,
    estate, or trust, the tax credit allowable shall be
    determined at the entity level.  Distribution and share
    of credit shall be determined in accordance with section
    235-2.45(d)."
```

POSSIBLE LOSS OF FEDERAL AND STATE CHARITABLE CONTRIBUTION DEDUCTION—In its prior testimony, the Department had concerns with a potential double benefit by receiving the credit under this bill and a state charitable deduction. After further analysis, the loss of a generous federal benefit as a result of this credit is of greater concern. Generally, the taxpayer would receive a charitable contribution deduction for the donation of the property to a government entity or a nonprofit entity. The Internal Revenue Service has indicated that an issue exists as to whether providing a state tax credit in exchange for a donation of a conservation easement qualifies as a deductible charitable contribution and recommended public guidance be published on this issue. *See CCA 200238041, attached.* The IRS has yet to publish any guidance on this issue. Therefore, it is unclear whether donors would lose their federal and state charitable contribution deduction if the donor utilizes the credit. In addition, any requirement that conditions the credit on qualifying for the

Section 170 charitable contribution deduction may be unworkable.

RULEMAKING—The Department already has broad rulemaking authority. Subsection (i) is unnecessary. There is also a conflict between subsection (i) and (j). Do both agencies get to make concurrent rules? Will one agency's rules trump the other?

CERTIFICATION PROCESS—In light of the Department's concerns, the Department also suggests a certification process whereby, rather than the Board of Land & Natural Resources being authorized to make rules for this credit, the DLNR could be authorized to certify credits, maintain information, and simply send a certificate to the Department to process the credit. Other similar certification processes are currently administered with the Department of Business, Economic Development & Tourism and the Hawaii Film Office. *See e.g.*, HRS § 235-17.

TRANSACTIONS SUBJECT TO POTENTIAL ABUSE—The Department mentions that the IRS has highlighted possible abusive transactions relating to donations of conservation easements. In certain cases, the IRS has disallowed deductions and assessed penalties on transactions it has found to be shams. The Committee should be aware that conservation easements have been used in the past in allegedly abusive tax transactions.

II. REVENUE IMPACT

This legislation will result in a revenue loss of approximately $3.2 million for FY 2009.

The Legacy Land Conservation program under DLNR provides matching funds for non-profits to engage in land purchases for conservation. In many of these cases, a part of the land interest is gifted to the non-profit. It is assumed that most conservation land donation transactions goes through this mechanism.

Gifts through the Legacy Lands project for 2008 are projected to be $3,238,500. The Department assumed that this covers half of all eligible transactions under the credit (including investments covered in section (c) paragraph (2)). Thus the Department projects the value of eligible transactions to be $6.5 million, of which a 50% tax credit would cause of revenue loss of $3.2 million.

Impact for future years is indeterminate, due to the large volatility in gift amounts from year-to-year.

CCA 200238041

UIL No. 170.14-00; 170.12-07; 164.03-00; 162.05-15; 1001.00-00

Headnote:

IRS has supplemented its earlier chief counsel advice concerning transferee of Colorado conservation easement credit being entitled to federal tax deduction when using credit to reduce state taxes.

Reference(s): IRC Sec(s). 170 ; IRC Sec(s). 164 ; IRC Sec(s). 162 ; IRC Sec(s). 1001

FULL TEXT:

Release Date: 9/20/2002

Reply to: CC:ITA:B1

INTERNAL REVENUE SERVICE NATIONAL OFFICE LEGAL ADVICE

MEMORANDUM FOR AREA COUNSEL,

SMALL BUSINESS/SELF-EMPLOYED, AREA 5

FROM: Associate Chief Counsel

(Income Tax and Accounting)

SUBJECT: Colorado Conservation Easement Credit

PRESP-152782-01

This memorandum responds to your request for advice. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

Previously, by a memorandum dated May 31, 2001, we provided Chief Counsel Advice to your office on a related matter. At that time, we concluded that the transferee of a Colorado conservation easement credit is entitled to a federal tax deduction when using the credit to reduce state taxes. We also stated that we would provide a supplemental response on issues affecting the original recipient of the credit.

After consideration, we have determined that these issues, along with certain other issues raised in connection with the federal tax treatment of state tax credits, would be best addressed in official published guidance. This will allow full consideration of concerns we have identified with respect to the tax treatment of these and other refundable and transferable state tax credits, and help ensure uniform treatment of taxpayers. In addition, we will be able to take into account the interplay of the issues you raised with certain legislation concerning the tax treatment of conservation easements now pending in Congress. Accordingly, our office will recommend that the treatment of state tax credits, including credits such as the Colorado conservation easement credit, be addressed in published guidance. Please be aware that the decision to issue published guidance must be approved at higher levels.

Pending resolution of these issues, we cannot furnish definitive advice on the questions you raised. However, we are providing an updated summary of the facts and a brief discussion of the two key questions concerning the tax treatment of the original recipient of the conservation easement credit, and some of the concerns and considerations that will need to be taken into account in answering those questions.

FACTS

For tax years beginning on or after January 1, 2000, a Colorado state income tax credit is available for the donation of all or part of the value of a perpetual conservation easement in gross by resident individuals, C corporations, partnerships, S corporations, other similar pass-through entities, estates, and trusts. Colo. Rev. Stat. § 39-22-522 (2001); see generally Colorado Department of Revenue, FYI — Income 39 - Gross Conservation Easement Credit (December 2001) ("State Explanation"). If a charitable deduction is claimed on the federal income tax return for any donation subject to the credit, the amount deducted from federal taxable income must be added back to determine the taxpayer's Colorado taxable income. Colo. Rev. Stat. §§ 39-22-104(3)(g) and 39-22-304(2)(f) (2001). However, if the federal deduction exceeds the amount of the credit created by the donation, then the "addback" is only the amount equal to the credit, including any credit carried forward to future tax years. See State Explanation p. 2.

Amount: For tax years beginning on or after January 1, 2000, but before January 1, 2003, the credit is equal to the fair market value of the donated portion of a perpetual conservation easement in gross created upon real property located in Colorado, but the credit cannot exceed $100,000 for any donation. For tax years beginning on or after January 1, 2003, the credit is equal to 100% of the first $100,000 of the fair market value of the donated portion of such conservation easement when created, and 40% of all amounts of the donation in excess of $100,000, except that the credit cannot exceed $260,000 per donation. Colo. Rev. Stat. § 39-22-522(4)(a). To the extent of a taxpayer's net income tax liability, a taxpayer can always use the credit in full. If the credit exceeds the tax liability, there are three possibilities: carryover, refund, or transfer.

Carryover: Any unused portion of the credit may be carried forward by the taxpayer for up to 20 years. Colo. Rev. Stat. § 39-22-522(5)(a). Only one credit may be claimed each year. Section 39-22-522(6). Additional credits may not be earned by the taxpayer during any year to which a prior conservation easement credit is being carried forward, either by the taxpayer or by another taxpayer who has received a transferred credit from that taxpayer. Id. (A taxpayer is not permitted to carry back the credit to years prior to the donation of the easement.)

Refund: Refundability of the credit will depend on whether there are excess state revenues in the prior year that must be refunded to Colorado taxpayers under the state constitution. [1] If there is no surplus, the credit is not refundable. If there is a surplus, at the election of the taxpayer the credit can exceed the amount of the net tax liability, with the balance being refunded to the taxpayer. However, in such a case for donations made during tax years beginning on or after January 1, 2000, but before January 1, 2003, the total credit for the year, including the nonrefundable and refundable portions, cannot exceed $20,000. For donations made during tax years beginning on or after January 1, 2003, the amount is $50,000. Colo. Rev. Stat. § 39-22-522(5)(b)(III).

Transfer: A taxpayer may transfer all or a part of the unused portion of the credit to a transferee who meets the definition of a taxpayer who can claim the credit. [2] Colo. Rev. Stat. § 39-22-522(7). The credit may be transferred to more than one transferee. For donations made during tax years beginning on or after January 1, 2000, but before January 1, 2003, the minimum amount of unclaimed credit that can be transferred to any one transferee is $20,000. For donations made during tax years beginning on or after January 1, 2003, there is no minimum amount. Transferred credits are always nonrefundable for the transferee, although they may be carried over. A transferee may not transfer the credit to another.

DISCUSSION

I. Major issues

The key feature that raises the two primary issues in this fact pattern is the fact that the transfer of the conservation easement-which is generally appreciated property-entities the taxpayer to a substantial financial benefit for up to the full fair market value of the easement.

The first major issue this raises is whether, to the extent a taxpayer is effectively reimbursed for the transfer of the easement through the use, refund, or transfer of the credit, that benefit is a quid pro quo that reduces or eliminates a charitable contribution deduction under § 170. (A subsidiary issue is whether, when the benefit takes the form of a reduction in state tax liability, disallowing a deduction under § 170 entitles the taxpayer to an equivalent deduction for a deemed payment of state tax under § 164 or § 162.)

The other major question is whether the benefit of the state conservation easement credit is, in substance, an amount realized from the transfer of the easement under § 1001, generally resulting in taxable capital gain. Although there may be authority to defer recognition of that gain until the benefit is actually realized through use, refund, or transfer of the credit, failure to tax that gain altogether is arguably unfair to taxpayers who sell conservation easements or other appreciated property and receive cash.

To take a simplified example, assume a taxpayer in State A and a taxpayer in State B each transfer a conservation easement with a tax basis of $4,000 and a fair market value of $10,000 to a state agency. The taxpayer in State A sells the easement to a state agency for a cash payment of $10,000. The taxpayer in State B donates the easement to a state agency and receives a cash payment of $10,000 as a refundable tax credit. For federal income tax purposes, the taxpayer in State A would not have a § 170 deduction and would pay tax on the $6,000 of capital gain. If the taxpayer in State B is able to deduct $10,000 as a charitable contribution and avoid paying tax on the capital gain-a "double benefit" that is generally allowed under § 170 when taxpayers donate appreciated property-it is difficult to explain why the two taxpayers should be treated differently, since both received $10,000 in cash. Even if the $10,000 § 170 deduction for the taxpayer in State B is offset by treating the $10,000 refundable credit payment as ordinary income, the resulting offset cancels out the benefit of the charitable deduction but still allows the taxpayer in State B to exclude 100% of the $6,000 capital gain -a benefit not available to the similarly-situated taxpayer in State A, even under the proposed legislation discussed below. Similar concerns are raised when the benefit of the state conservation easement credit is realized in the form of a reduction in state tax, or through sale of an excess credit to a third party. Finally, there is the question of whether taxpayers should be treated differently because they donated an easement to a charitable organization rather than a state agency.

II. Charitable deduction under § 170

The first issue that will need to be considered under the §170 analysis is whether the receipt of a state tax credit is a substantial return benefit. The external features of a transaction should be examined to determine whether a taxpayer transferred money or property to a charity with the expectation of a quid pro quo. Hernandez v. Commissioner, 490 U.S. 680, 690-691 (1989). Here, a taxpayer receives the state credit for transferring an easement to a governmental entity or § 501(c)(3) organization. As demonstrated by Singer Co. v. United States, 449 F.2d 413 (Ct. Cl. 1971), the benefit does not need to come from the donee and the benefit does not need to be specifically quantifiable at the time of the transfer. See also § 1.170A-14(h)(3)(i).

Under the return benefit analysis, we will need to consider the fact that the tax benefit of a federal or state charitable contribution deduction is not viewed as a return benefit that reduces or eliminates a deduction under § 170, or vitiates charitable intent. [3] The question is whether a program such as Colorado's is distinguishable.

If there is a return benefit, we need to determine whether a taxpayer, at least in some circumstances, can satisfy the requirements under United States v. American Bar Endowment, 477 U.S. 105 (1986), to show that the taxpayer knowingly contributed an easement in excess of the value of the state credit received in return. See § 1.170A-14(h)(3)(i). For example, do the external features of a transaction demonstrate donative intent to the extent a taxpayer arranges to sell the credit to a third party for a discounted amount before transferring the easement to a charity? See generally § 1.170A-1(h)(1); Rev. Rul. 67-246, 1967-2 C.B. 104.

III. Disposition under § 1001

The second primary issue to consider is whether, because the original recipient of the conservation easement credit has essentially transferred property, usually appreciated property, in return for a payment or other financial benefit measured by the value of the transferred property, the transaction should be treated as a disposition of property generally resulting in capital gain.

A. Refunds

This issue is most clearly presented in the case of a refundable credit that is paid to a taxpayer in return for an easement transferred to the state. As discussed in the example above, it is difficult to distinguish this situation from other situations in which state agencies purchase conservation easements for cash.

B. Credits

If the benefit received by a particular taxpayer is a reduction in state tax liability resulting from the application of the credit, we need to consider whether the general treatment of a "nonrefundable" state tax credit as a reduction in tax liability should apply. A reduction in liability generally confers a benefit in the same manner as an outright payment, and is often taxed as such. But when the liability that is reduced is one that, like the liability for state tax, would be deductible if paid, it is often unnecessary and overly complex to recharacterize the transaction as a deemed payment to the taxpayer, followed by a deemed payment by the taxpayer, since the resulting income and deduction would simply offset each other. See, e.g., § 108(e)(2) ("Income not realized to extent of lost deductions"); Rev. Rul. 79-315, 1979-2 C.B. 27, Holding (3) (Iowa income tax rebate used to reduce state tax liability is neither gross income nor deductible under § 164 as state income tax paid).

However, one situation in which a transaction is generally recharacterized is one in which a liability is reduced or satisfied by the transfer of property. In order to reflect accurately the substance of the transaction, such a transaction is generally treated as a deemed disposition of the property, resulting in the realization of gain or loss, followed by a deemed payment of the sales proceeds in satisfaction of the liability. For example, in our previous Chief Counsel Advice on the tax treatment of a purchaser of a Colorado conservation easement credit, we advised that rather than treating the purchaser's use of the credit as a reduction in state tax liability, which would deprive the purchaser of a deduction for the payment of state tax, we viewed the situation as analogous to one in which the state permitted the taxpayer to pay the state tax liability with property. In such a case, the taxpayer would be treated as having first disposed of the credit, with the "face amount" of the credit as an amount realized, and then paid the proceeds to the state, resulting in a deduction for the full face amount under § 164. We need to consider whether a similar approach is appropriate for the original recipient of the conservation credit as well, who would be treated as having disposed of the easement and then made a deemed payment of state tax with the proceeds. [4]

C. Transfers

If the benefit received by the transferor of a conservation easement takes the form of cash received on the sale of the credit to another taxpayer, the question is whether that benefit should be treated as an amount realized from the disposition of the easement, from the disposition of the credit itself, or in some other manner. This would affect the character of any gain as well as the basis to be used in the calculation.

D. Bargain sale

Another question is whether a taxpayer could be treated as making a bargain sale of an easement in certain circumstances-for example, as discussed above, to the extent that the amount received on the transfer of a credit is less than the value of the easement, and the requirements of American Bar Endowment are satisfied.

E. Timing

If or to the extent that it is determined that the benefit of the credit is an amount realized from the transfer of the easement, an additional issue to consider is whether the transaction should be considered as "closed," resulting in an amount realized in the year the easement is transferred. Alternatively, since the credit can be carried forward, can the taxation of gain be deferred until the benefit of the credit is "realized" through sale, refund, or use, in a manner similar to an installment sale, perhaps under the principles of Arrowsmith v. Commissioner, 344 U.S. 6 (1952)? Such treatment would also raise the issue of how the basis of the easement should be handled.

F. Transfers to charity

Another question is whether, for § 1001 purposes, the benefit of the tax credit should be viewed as an amount realized from the transfer of an easement even though the easement is transferred to a charitable organization rather than the state. [5]

IV. Effect of pending legislation

Finally, we note that a bill pending in the Senate contains a provision that, if enacted, would affect the analysis of the state conservation easement credit for easements transferred after December 31, 2003. Specifically, section 107 of H.R. 7 would add a new Code section 121A to provide for the exclusion of 25% of the long-term capital gain for certain sales of land interests to eligible entities for conservation purposes. In the case of a bargain sale, a taxpayer will not fail to qualify for a charitable contribution deduction solely because the taxpayer derives a tax benefit from the partial exclusion of long-term capital gain from the sale. The version of H.R. 7 passed by the House does not contain a provision similar to section 107.

Associate Chief Counsel

(Income Tax and Accounting)

By

PAUL M. RITENOUR

Chief, Branch 1

1

Under section 20(7) of Article X of the Colorado constitution, this surplus is based on spending limits determined by factors such as inflation, population growth, voter authorization, etc. The determination of whether there is a surplus is announced in October or November of the following year. It is our understanding that the State of Colorado had surpluses for the past few years and does not expect to have surpluses for the next several years.

2

A state non-profit organization will act as a clearinghouse for the transfer of these credits. Donors will register with this organization to sell their credits for a specified percentage of "face value" (e.g., 80%), buyers will sign a letter of intent to pay a specified percentage of face value (e.g., 90%), and the difference will go to the organization to cover its costs.

3

See McLennan v. United States, 23 Cl. Ct. 99 (1991), subsequent proceedings, 24 Cl. Ct. 102, 106 n.8 (1991), aff 'd, 994 F.2d 839 (Fed. Cir. 1993); Skripak v. Commissioner, 84 T.C. 285, 319 (1985); Allen v. Commissioner, 92 T.C. 1, 7 (1989), aff'd, 925 F.2d 348 (9th Cir. 1991); see also Browning v. Commissioner, 109 T.C. 303 (1997) (addressing the question of tax benefits as an amount realized in a charitable bargain sale, rather than as a quid pro quo issue).

4

Note that recharacterizing the transaction in this way has the advantage of providing a rationale for allowing a deduction under § 162 or § 164 that would compensate for the denial of a § 170 deduction. This is appropriate, since, unlike the refund or transfer scenarios, the taxpayer does not end up with cash when the state tax credit is used to reduce state tax liability.

5

Cf. Rev. Rul. 88-95, 1988-2 C.B. 28; Notice 87-26, 1987-1 C.B. 470; Standley v. Commissioner, 99 T.C. 259 (1992), aff'd without published opinion, 24 F.3d 249 (9th Cir. 1994).

END OF DOCUMENT -

Notice 2004-41, 2004-28 IRB 31, 06/30/2004, IRC Sec (s). 170

Charitable contributions—conservation easements—disallowed deductions.

Headnote:

In light of possible improper charitable deductions, IRS is advising those who participate in transferring real property easement to charitable org or making payments to such org. in connection with real estate purchase from org. or who promote these type of transactions that it will disallow deductions as necessary and may impose penalties and excise taxes. IRS also reviewed requirements for donation of conservation easement under Code Sec. 170(h); , and noted that in situations involving purchase of real property from charitable org, it would apply substance-over-form doctrine to find that payment to charity for property and "donation" is in reality purchase price for property. IRS might also challenge exempt status of org., based on operation for substantial nonexempt purpose or impermissible private benefit.

Reference(s): ¶ 1704.45; Code Sec. 170;

Full Text:

The Internal Revenue Service is aware that taxpayers who (1) transfer an easement on real property to a charitable organization, or (2) make payments to a charitable organization in connection with a purchase of real property from the charitable organization, may be improperly claiming charitable contribution deductions under § 170 of the Internal Revenue Code. The purpose of this notice is to advise participants in these transactions that, in appropriate cases, the Service intends to disallow such deductions and may impose penalties and excise taxes. Furthermore, the Service may, in appropriate cases, challenge the tax-exempt status of a charitable organization that participates in these transactions. In addition, this notice advises promoters and appraisers that the Service intends to review promotions of transactions involving these improper deductions, and that the promoters and appraisers may be subject to penalties.

Contributions of Conservation Easements

Section 170(a)(1) allows as a deduction, subject to certain limitations and restrictions, any charitable contribution (as defined in § 170(c)) that is made within the taxable year. Generally, to be deductible as a charitable contribution under § 170, a transfer to a charitable organization must be a gift of money or property without receipt or expectation of receipt of adequate consideration, made with charitable intent. *See U.S. v. American Bar Endowment* , 477 U.S. 105, 117-18 [58 AFTR 2d 86-5190](1986); *Hernandez v. Commissioner* , 490 U.S. 680, 690 [63 AFTR 2d 89-1395](1989); *see also* § 1.170A-1(h)(1) and (2) of the Income Tax Regulations.

Section 170(f)(3) provides generally that no charitable contribution deduction is allowed for a transfer to a charitable organization of less than the taxpayer's entire interest in property. Section 170(f)(3)(B)(iii) provides an exception to this rule in the case of a qualified conservation contribution.

A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for certain conservation purposes. Section 170(h)(1), (2), (3), and (4); § 1.170A-14(a). A qualified real property interest includes a restriction (granted in perpetuity) on the use that may be made of the real property. Section 170(h)(2)(C); *see also* § 1.170A-14(b)(2). For purposes of this notice, qualified real property interests described in § 170(h)(2)(C) are referred to as conservation easements.

One of the permitted conservation purposes listed in § 170(h)(4) is the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem. Section 170(h)(4)(A)(ii); *see also* § 1.170A-14(d)(1)(ii) and (3). Another of the permitted conservation purposes is the preservation of open space ("open space easement"), including farmland and forest land, for the scenic enjoyment of the general public or pursuant to a clearly delineated governmental conservation policy. However, if the public benefit of an open space easement is not significant, the charitable contribution deduction will be disallowed. *See* § 170(h)(4)(A)(iii); *see also* § 1.170A-14(d)(1)(iii) and (4)(iv), (v), and (vi). Section 170(h) and § 1.170A-14 contain many other requirements that must be satisfied for a contribution of a conservation easement to be allowed as a deduction.

A charitable contribution is allowed as a deduction only if substantiated in accordance with regulations prescribed by the Secretary. Section 170(a)(1) and (f)(8). Under § 170(f)(8), a taxpayer must substantiate its contributions of $250 or more by obtaining from the charitable organization a statement that includes (1) a description of any return benefit provided by the charitable organization, and (2) a good faith estimate of the benefit's fair market value. *See* § 1.170A-13 for additional substantiation requirements. In appropriate cases, the Service will disallow deductions for conservation easement transfers if the taxpayer fails to comply with the substantiation requirements. The Service is considering changes to forms to facilitate compliance with and enforcement of the substantiation requirements.

If all requirements of § 170 are satisfied and a deduction is allowed, the amount of the deduction may not exceed the fair market value of the contributed property (in this case, the contributed easement) on the date of the contribution (reduced by the fair market value of any consideration received by the taxpayer). *See* § 1.170A-1(c)(1), (h)(1) and (2). Fair market value is the price at which the contributed property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and each having reasonable knowledge of relevant facts. Section 1.170A-1(c)(2). *See* § 1.170A-14(h)(3) and (4) for a discussion of valuation.

If the donor (or a related person) reasonably can expect to receive financial or economic benefits greater than those that will inure to the general public as a result of the donation of a conservation easement, no deduction is allowable. Section 1.170A-14(h)(3)(i). If the donation of a conservation easement has no material effect on the value of real property, or enhances rather than reduces the value of real property, no deduction is allowable. Section 1.170A-14(h)(3)(ii).

Purchases of Real Property from Charitable Organizations

Some taxpayers are claiming inappropriate charitable contribution deductions under § 170 for cash payments or easement transfers to charitable organizations in connection with the taxpayers' purchases of real property.

In some of these questionable cases, the charitable organization purchases the property and places a conservation easement on the property. Then, the charitable organization sells the property subject to the easement to a buyer for a price that is substantially less than the price paid by the charitable organization for the property. As part of the sale, the buyer makes a second payment, designated as a "charitable contribution," to the charitable organization. The total of the payments from the buyer to the charitable organization fully reimburses the charitable organization for the cost of the property.

In appropriate cases, the Service will treat these transactions in accordance with their substance, rather than their form. Thus, the Service may treat the total of the buyer's payments to the charitable organization as the purchase price paid by the buyer for the property.

Penalties, Excise Taxes, and Tax-Exempt Status

Taxpayers are advised that the Service intends to disallow all or part of any improper deductions and may impose penalties under § 6662.

The Service intends to assess excise taxes under § 4958 against any disqualified person who receives an excess benefit from a conservation easement transaction, and against any organization manager who knowingly participates in the transaction. In appropriate cases, the Service may challenge the tax-exempt status of the organization, based on the organization's operation for a substantial nonexempt purpose or impermissible private benefit.

In addition, the Service intends to review promotions of transactions involving improper deductions for conservation easements. Promoters, appraisers, and other persons involved in these transactions may be subject to penalties under §§ 6700, 6701, and 6694.

Drafting Information

The principal author of this notice is Patricia M. Zweibel of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Ms. Zweibel at (202) 622-5020 (not a toll-free call).

LINDA LINGLE
GOVERNOR OF HAWAII

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
POST OFFICE BOX 621
HONOLULU, HAWAII 96809

LAURA H. THIELEN
CHAIRPERSON
BOARD OF LAND AND NATURAL RESOURCES
COMMISSION ON WATER RESOURCE MANAGEMENT

RUSSELL Y. TSUJI
FIRST DEPUTY

KEN C. KAWAHARA
DEPUTY DIRECTOR - WATER

AQUATIC RESOURCES
BOATING AND OCEAN RECREATION
BUREAU OF CONVEYANCES
COMMISSION ON WATER RESOURCE MANAGEMENT
CONSERVATION AND COASTAL LANDS
CONSERVATION AND RESOURCES ENFORCEMENT
ENGINEERING
FORESTRY AND WILDLIFE
HISTORIC PRESERVATION
KAHOOLAWE ISLAND RESERVE COMMISSION
LAND
STATE PARKS

TESTIMONY OF THE CHAIRPERSON OF THE BOARD OF LAND AND NATURAL RESOURCES

on House Bill 2518, House Draft 1, Senate Draft 1 – RELATING TO LAND CONSERVATION

BEFORE THE SENATE COMMITTEE ON
ECONOMIC DEVELOPMENT AND TAXATION

March 18, 2008

House Bill 2518, House Draft 1, Senate Draft 1 provides a land conservation incentive tax credit to encourage the preservation and protection of land in the State. The Department of Land and Natural Resources (Department) supports the intent of this measure to provide incentives for landowners to preserve and protect their important mauka lands, but defers to the Department of Taxation on tax implications and effects the bill would have on their operations.

Over half of the lands in Hawai‘i are privately owned and *mauka* lands, including intact forests, open woodlands, and pasture lands, and provide a significant amount of "ecosystem services," that support all of Hawaii's residents and visitors. These services include the delivery of clean drinking water, carbon sequestration that stabilizes the climate, cultural practices, opportunities for recreation, and many others. These lands also play a critical role in supporting Hawaii's unique native plants and animals. It is essential to provide solid stewardship incentives for private landowners to care for *mauka* lands that are critical in ecosystem service production.

The Department participated in a working group formed in response to House Concurrent Resolution 200, 2006 Legislative Session, to conduct an analysis of local, national, and international incentive programs that promote landowner protection of important *mauka* lands and recognize the public benefits of the ecosystem services provided by those lands. The establishment of state tax credits for donated conservation easements and landowner-funded activities that promote conservation on private lands was one of the key recommendations in the working group report (http://hawaii.gov/dlnr/reports/2008/division-of-forestry-wildlife/FW08-Important-Mauka-Lands-Report.pdf).

Promoting conservation easements is a valuable conservation tool. Conservation easements are restrictions placed on land to enhance conservation values. They are either voluntarily sold or donated by a landowner. The Legacy Land Conservation Program, Chapter 173A, Hawaii Revised Statutes, provides State funding for the acquisition of conservation easements on lands having value as a resource to the State. This measure would provide tax credits for landowners that donate or make a bargain sale of land or conservation easements or voluntarily invest in conservation management. These credits would be added to federal tax benefits for these actions. The combination of existing federal tax benefits and proposed state tax credits will likely provide an immediate stimulation to expanded conservation actions and promote delivery of ecosystem services on *mauka* lands throughout the State with its public benefits.

The Department is aware of the Department of Taxation's concerns with certifying what donations of land or investments in management of land qualify for the tax credit. The Department is the appropriate agency to certify donations or management actions for natural and cultural resources and the Department of Agriculture (DOA) would be the appropriate agency for agricultural easements or management. The Department is willing to work with the Department of Taxation on how best to implement such a process and identify ways to streamline the process and book-keeping and reporting requirements. The Department was given the authority to adopt rules for this process. DOA should be given this authority as well.

The Department notes that the Senate Water and Land Committee amended the House version of this measure by replacing its content in its entirety with the content of Senate Bill 2198, Senate Draft 2, which requires that the appropriate state agency work with the taxpayer to identify opportunities for public access if appropriate and reasonable. The Department supports this approach because it allows flexibility in dealing with public access to the lands qualifying for the tax credit. Requiring public access to all potential lands will be a disincentive for some landowners to participate. While appropriate for some lands such as beach or recreational access, open public access may not be appropriate for other lands such as cultural and historic properties, and working farms or ranches that have legitimate concerns about vandalism, resource theft, and liability. The taxpayer should be required to provide access to the public or private conservation agency holding the conservation easement to monitoring the status of the conservation easement or to verify that conservation management actions have been implemented on the property. Public access should be encouraged and required where appropriate to fulfill the purpose of the easement, but not be required in cases where it would jeopardize or degrade resources intended for protection or create an undue hardship or liability for the landowner.

LINDA LINGLE
Governor

SANDRA LEE KUNIMOTO
Chairperson, Board of Agriculture

DUANE K. OKAMOTO
Deputy to the Chairperson

State of Hawaii
DEPARTMENT OF AGRICULTURE
1428 South King Street
Honolulu, Hawaii 96814-2512

MAR 17 2008

TESTIMONY OF SANDRA LEE KUNIMOTO
CHAIRPERSON, BOARD OF AGRICULTURE

BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
TUESDAY, MARCH 18, 2008
1:15 p.m.
Room 224

HOUSE BILL 2518, HOUSE DRAFT 1, SENATE DRAFT 1
RELATING TO LAND CONSERVATION

Chair Fukunaga, Vice-Chair Espero and Members of the Committee:

Thank you for the opportunity to testify on House Bill No. 2518, House Draft 1, Senate Draft 1 that seeks to establish a tax credit to encourage the preservation and protection of certain donated or "bargain sale" lands in the State at less than fair market value, and in perpetuity. The Department of Agriculture supports the intent of this bill and offers an amendment. We defer to the Department of Taxation regarding the tax credit and its implications on the State budget.

The amendment is to Section 2 (page 1, lines 4-13) to clarify that only agricultural lands qualifying for the land conservation tax credit that are designated as IAL may access incentives for IAL that will be developed and enacted by the Legislature. The amendment is in bold and double-underlined.

SECTION 2. Section 205-45, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) A farmer or landowner with lands qualifying under section 205-44 may file a petition for declaratory ruling with the commission at any time in the designation process. <u>The holder of an interest in agricultural lands that qualifies for the land conservation incentives tax credit under section 235-</u>

may petition the commission for designation of the agricultural lands as important agricultural lands, and**, upon designation,** enjoy the incentives for important agricultural lands provided under section 205-46.."

Emailed to: testimony@Capitol.hawaii.gov

Mar. 16, 2008
Denise Antolini 59-463 Alapi`o Road Pūpūkea, O`ahu 96712
(808) 638-5594

Senate Economic Development and Taxation Committee
Hearing March 18, 2008
1:15 p.m. Conf. Room 224

Dear Chair Fukunaga, Vice Chair Espero, and Members of the Committee:

I write in **strong support of HB2518 HD1 SD1**, providing tax credits for land conservation.

The State of Hawaii needs -- **NOW, this session** -- a broader range of land conservation tools to protect the "crown jewels" of our coastal, agricultural, and rural landscape.

For proposed public-private acquisitions, such as the **Galbraith** agricultural lands in Central O`ahu, the **Turtle Bay** property on the North Shore, and the **many other high priority needs around the state**, this new tool of tax credits for willing landowners is critical to add to the toolbox.

The cost to the state is "pennies on the dollar" compared to the benefits, particularly now when the real estate market has slowed down considerably. With appropriate safeguards to ensure proper valuation, this tool can result in considerable long-term savings to taxpayers through avoided costs of development.

Twelve other states in the country have this kind of tax credit for conservation program -- Hawaii should proudly become the 13th state to join this effort that brilliantly leverages state and private resources for permanent land conservation.

Mahalo for your support.

Sincerely,

Denise Antolini

HARC

Hawaii Agriculture Research Center
99-193 Aiea Heights Drive, Suite 300
Aiea, Hawaii 96701
Ph: 808-487-5561/Fax: 808-486-5020

TESTIMONY BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

HB 2518 HD1 SD1

RELATING TO LAND CONSERVATION

March 18, 2008

Chair Fukunaga and Members of the Committee:

My name is Stephanie Whalen. I am President and Research Director of the Hawaii Agriculture Research Center (HARC). I am testifying today on behalf of the center, our research and support staff, and our members and clients.

HARC **strongly supports HB 2518 HD1 SD1 Relating to Land Conservation**.

In order to preserve some of the lands of Hawaii incentives are important. Because of the unique land holding situation in Hawaii many land owners do not qualify for the federal tax credits provided to those helping to preserve lands for the purposes proposed in this measure. Although there have been efforts to make an exception specifically for Hawaii to allow our land owners to receive these federal tax credits, those efforts have not been successful.

It is in the public interest of this state to provide those tax credits to ensure some lands for unique or special use are preserved in perpetuity.

Thank you for this opportunity to provide **SUPPORT** for **HB 2518 HD1 SD1**, preserving land in Hawaii for the public interest.

The Nature Conservancy
Protecting nature. Preserving life.

The Nature Conservancy of Hawai'i
923 Nu'uanu Avenue
Honolulu, Hawai'i 96817

Tel (808) 537-4508
Fax (808) 545-2019

nature.org/hawaii

Testimony of The Nature Conservancy of Hawai'i
Supporting H.B. 2518, SD1 Relating to Land Conservation
Senate Committee on Economic Development and Taxation
Tuesday, March 18, 2008, 1:15PM, Room 224

The Nature Conservancy of Hawai'i supports H.B. 2518, SD1 Relating to Land Conservation. **We also suggest a few amendments noted below and attached.**

Undeveloped private lands often provide significant benefits and services to the general public such as watersheds, erosion control, carbon sequestration, green space, recreational opportunities, and cultural preservation. However, landowners do not presently receive any remuneration for the ecosystem services their lands provide. While the public depends upon the provision of these services, society often treats them as essentially free.

For many private landowners, there is significant pressure to convert forests, ranch and agricultural lands, open spaces, and lands with historical or cultural features to uses that generate greater income to the landowner. A mix of existing government and private funding for conservation land purchases, as well tax incentives like those in this bill can enable landowners a variety of options to avoid conversion and help government achieve a public benefit. Indeed, tax incentives that allow landowners to retain ownership while committing to protection can help achieve public conservation priorities without requiring the government to expend many millions more to buy and manage the land itself.

We ask that you consider lengthening or, preferably, eliminating the 2012 sunset date in Section 5 in favor of a reporting requirement by the relevant state agencies.

In other states, it took at least three years before even a nominal number of land owners completed the land donation tax credit process. In many cases, landowners will want to test the water with a small donation and follow up a few years later with a more meaningful donation. California adopted a 10-year sunset, prior to which they could assess the effectiveness of their legislation. For many other states, rather than adopting a sunset provision, they implemented a reporting requirement to gather data about the use of the tax credits. States have found that the tax credits were useful money savers in their quest to protect scarce resources. The trend has actually been to amend statutes to provide more generous incentives to inspire more donations.

Finally, we suggest an amendment to give rule making authority to both DLNR and Deptartment of Agriculture to assist the Department of Taxation with certifying donations. And, we suggest an amendment to give penalty authority to the Department of Taxation to prevent appraisal misstatements.

Attachment

Suggested amendments by The Nature Conservancy of Hawai‘i to H.B. 2518 SD1 [addition to (j), new (k) and (l), delete sunset]

(j) The chairperson of the board of land and natural resources and the chairperson of the board of agriculture may adopt rules pursuant to chapter 91 to effectuate this section and to certify that donations or investments claimed for a tax credit under this section fulfill a conservation or preservation purpose pursuant to subsection (c).

(k) The director of taxation, the chairperson of the board of land and natural resources and the chairperson of the board of agriculture shall together prepare and submit an annual report to the Legislature not later than twenty days prior to the convening of the regular session of the use and effectiveness of the tax credit provided in this section, including the relevant details of the value of tax credits claimed and the types of donations made by taxpayers. The director of taxation my include this report in that department's annual report to the legislature."

(l) Any appraisal prepared pursuant to the requirements of subsection (e)(1) shall be subject to all requirements, including the same level of penalties for valuation misstatements, for appraisals and appraisers under applicable federal law and regulations governing charitable contributions."

SECTION 4. New statutory material is underscored.

SECTION 5. This Act shall take effect on July 1, 2050, and shall apply to taxable years beginning after December 31, 2007~~;~~ ~~provided that this Act shall be repealed on December 31, 2012~~.

OFFICE OF HAWAIIAN AFFAIRS

Legislative Testimony

HB 2518, HD 1, SD 1, RELATING TO LAND CONSERVATION

Senate Committee on Economic Development and Taxation

March 18, 2008 | 1:15 p.m. | Room: 224

The Office of Hawaiian Affairs supports the intent of H.B. 2518, H.D. 1, S.D. 1, which would provide an incentive tax credit for conservation and preservation lands.

OHA has substantive obligations to protect the cultural and natural resources of Hawai'i for its beneficiaries, the people of this land. The Hawaii Revised Statutes (HRS) mandate that OHA "[s]erve as the principal public agency in the State of Hawaii responsible for the performance, development, and coordination of programs and activities relating to native Hawaiians and Hawaiians; . . . and [t]o assess the policies and practices of other agencies impacting on native Hawaiians and Hawaiians, and conducting advocacy efforts for native Hawaiians and Hawaiians." (HRS § 10-3)

Because of these mandates, we must examine all proposals with a view toward the best possible preservation and perpetuation of constitutionally and judicially protected Native Hawaiian rights and practices. On its face, this bill appears to provide for such interests by promoting preservation and conservation through providing tax incentives for private land donations.

While OHA appreciates that language was added to this bill that attempts to address the issue of access, we do not believe that the new language goes far enough to protect Native Hawaiian access. OHA notes that Native Hawaiians are guaranteed a separate and additional layer of access from what is afforded to the public at large. Moreover, the state has a responsibility to preserve Native Hawaiian's constitutionally and statutorily protected right to access.

Therefore, we would prefer if the bill included specific language that assured preservation of Native Hawaiian access, gathering and religious rights and practices within the donated lands that would qualify for the proposed tax exemption. Arguably, these rights run with undeveloped land, but for clarity purposes OHA would prefer language included in the statutory amendment.

Furthermore, OHA requests that the language relating to public access that was added to the bill be clarified. In the statement, "[…] the state agency work with the taxpayer to identify opportunities for public access if appropriate and reasonable," the phrase "if appropriate and reasonable" maybe too vague and discretionary.

We also have questions about the proposed Section 235 - ___ (c)(2), which states that the tax credit would apply to an eligible State taxpayer who "voluntarily invests in the management of land to protect or enhance a conservation or preservation purpose under a land protection agreement, conservation management agreement, or other legal instrument that is consistent with a conservation or preservation purpose." This subsection needs to be clarified so that people do not profit or get subsidized for fulfilling management responsibilities that they already have and should be completing. What qualifies as investment and appropriate land management? Also, must this management investment be toward a conservation or preservation purpose that will run with the land in perpetuity, as in the case of a conservation easement, or could the management investment be a temporary one that may lead to development of the same parcel?

Thank you for the opportunity to testify and for considering our concerns.

THE TRUST *for* PUBLIC LAND

Hawai'i Office
212 Merchant St.
Suite 320
Honolulu, HI
96813
T 808-524-8560
F 808-524-8565
www.tpl.org

THE TRUST FOR PUBLIC LAND'S TESTIMONY IN SUPPORT
HB 2518
Senate Committee on Economic Development and Taxation
Tuesday, March 18, 2008, 1:15 p.m., Room 224
testimony@capitol.hawaii.gov

Dear Chairperson Fukunaga and Vice Chair Espero:

The Trust for Public Land (TPL) supports HB 2518 Relating to Land Conservation.

As development and urban sprawl increase, concern about the future of land use and its relation to Hawai'i's natural resources, economy and heritage have come to the forefront of community concern. Some of these concerns are protected and embodied in recent laws providing funding for the acquisition of private lands for public conservation purposes. The recent State Legacy Lands Act is but one example.

Funding from programs such as the Legacy Lands Conservation Program yield great benefits to the people of Hawai'i, but further incentives are necessary to provide alternatives to the tremendous financial pressures to convert needed agricultural or conservation land to other uses that generate greater revenue. It is also impossible for the government to acquire and take care of all of these lands.

H.B. 2518 provides a voluntary incentive for private landowners to protect our precious lands and offers an alternative to acquisition and government management. It advances conservation by creating a competitive class of land use in an economy where conversion by private landowners to other uses are an attractive or economic necessity.

We urge you to support HB 2518.

Mahalo for this opportunity to testify,

Lea Hong

Lea Hong

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Land conservation incentives tax credit

BILL NUMBER: HB 2518, SD-1

INTRODUCED BY: Senate Committee on Water and Land

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow an eligible taxpayer who is the owner of land to claim a land conservation incentives tax credit if the taxpayer: (1) donates the land in perpetuity or completes a bargain sale in perpetuity to the state or public or private conservation agency that fulfills a conservation or preservation purpose provided that any donation or sale that represents a less-than-fee interest qualifies as a charitable contribution deduction under IRC section 170(h); or (2) voluntarily invests in the management of land to protect or enhance a conservation or preservation purpose under a land protection, conservation, or management agreement. Requires the taxpayer to provide reasonable public access to lands under this section. Donations of land for open space to fulfill density requirements to obtain subdivision or building permits do not qualify for the credit.

Permits a holder of an interest in agricultural lands to petition the land use commission for designation of the agricultural lands as important agricultural lands so as to be able to claim the credits proposed in this measure.

The amount of the tax credit shall be 50% of the fair market value of the land that the eligible taxpayer donates in perpetuity on or after January 1, 2008 for a conservation or preservation purpose to the state or public or private conservation agency; or 50% of the amount invested in the management of land. Limits the credit to $2.5 million per donation regardless of the value or interest in the land. The credit may be claimed only once per tax year. Delineates procedures for the claiming of the credit by a pass-through entity. This credit shall be repealed on December 31, 2012.

Credits in excess of a taxpayer's income tax liability may be applied to subsequent income tax liability. Claims for the credit, including any amended claims, must be filed on or before the end of the twelfth month following the close of the taxable year. The director of taxation may adopt rules pursuant to HRS chapter 91 and prepare the necessary forms to claim the credit and may require proof to claim the credit.

Defines "bargain sale," "conservation or preservation purpose," "cultural property," "eligible taxpayer," "interest in land or real property," "land" and "public or private conservation agency" for purposes of the measure.

Amends HRS section 205-45 to allow a holder of interest in agricultural land that qualifies for the land conservation initiative tax credit to petition the commission for the designation of agricultural lands as important agricultural lands.

EFFECTIVE DATE: July 1, 2050, applicable to tax years beginning after December 31, 2007

STAFF COMMENTS: This measure proposes an incentive in the form of an income tax credit to encourage a landowner to donate, complete a bargain sale to the state or a conservation agency, or voluntarily invest in the management of land to protect or enhance a conservation or preservation purpose.

While the credit may be intended as an incentive, it lacks accountability. In considering this measure, lawmakers should ask themselves just how much will this program cost the state treasury? If this program required an appropriation, how much would lawmakers be willing to appropriate for this program? The financial impact of the proposed credit is no different from the expenditure of public dollars albeit out the back door and hidden from public scrutiny.

Tax credits generally are designed to mitigate the tax burden of those individuals or businesses that do not have the ability to pay their share of the tax burden. These credits are justified on the basis that low-income taxpayers should be relieved of the burden imposed by taxes that are not based on the income of the taxpayer, such as the general excise tax. The proposed credit contained in this measure bears no relationship to the tax burden of the landowner. Thus, the credit amounts to nothing more than a subsidy by state government. Such subsidies are more accountable if funded with a direct appropriation of state funds.

It has been noted that the federal law has incentives for such donations, it should be noted that Hawaii already conforms to this provision of the federal law by allowing for the deduction of contributions made to government or nonprofit agencies. The federal government does not have a credit for such donation to government or charities as this measure proposes. While there may also be other states that have such credits, they are not as generous as the one proposed in this bill. States where such credits are available are those states which have relatively vast acreage of land which has very little value anyway. That is not the case in Hawaii. Thus, comparing Hawaii to those states is like comparing fruit with vegetables.

Given the economic outlook for the state and the financial picture for state government this is a credit that the state simply cannot afford, for though this is a tax credit, it is nothing more than an expenditure of tax dollars that would otherwise have paid for a general fund program or service.

Digested 3/17/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2739 HD 1 SD 1
RELATING TO STATE ENTERPRISE ZONES

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This bill would provide farmers with an alternative means of obtaining and maintaining enterprise zone (EZ) benefits.

The Joint House Committee on Economic Development & Taxation and Agriculture amended the measure by defining a "force majure" event, among other nonsubstantive changes.

The House Committee on Finance passed this measure unamended.

The House of Representatives passed this measure on third reading.

The Senate Committee on Agriculture & Hawaiian Affairs amended the agriculture general excise tax provision of this measure to provide that entities not conducting genetically-engineered agricultural production shall not be exempt from the payment of general excise taxes.

The Department of Taxation ("Department") **supports the intent** of this bill. The Department defers to the Department of Business, Economic Development and Tourism ("DBEDT") and the Department of Agriculture regarding this bill's merits.

The State currently provides tax breaks for qualifying businesses in an Enterprise Zone. Under section 209E-11, Hawaii Revised Statutes (HRS), certain types of businesses in the enterprise zone that satisfy hiring requirements are exempt from the state general excise and use tax for up to seven years. Qualified businesses can also claim two partial state income tax credits under section 209E-10, HRS:

1. **An income tax credit based on taxes due the State.** The tax credit is equal to 80 percent of the taxes due for the first tax year, which decreases by 10 percent for each year thereafter,

over the next six years;

2. **An income tax credit based on unemployment taxes paid.** The tax credit is equal to 80 percent of the unemployment taxes paid during the first year, which decreases by 10 percent for each year thereafter, over the next six years.

The Department notes that pursuant to HRS 209E-10, DBEDT has been tasked with certifying to the Department the applicability of the tax credit for a qualified business against any taxes due to the State.

This bill amends the requirements of the state enterprise zone program by:

1. Allowing the Department of Business, Economic Development, and Tourism to extend tax incentives to qualifying agricultural businesses for the duration of the effects of a *force majeure*;

2. Enabling agricultural businesses to remain eligible for the tax incentives under the Program during any period of interruption caused by a *force majeure* event;

3. Adds a definition of "force majure event," "leased employee," and "joint employment" to HRS § 209E-2, and amends HRS § 209E-2 to include "leased employees" and "joint employees" in the definition of "full-time employees";

4. Amends HRS § 209E-10 to allow agricultural business as the only businesses that could use retail sales of value-added products from crops grown within an EZ to count toward certification for the tax credit.

5. Adds clarifying language to HRS § 209E-11 that an agricultural business is not exempt from general excise tax on certain gross proceeds of non-genetically engineered agricultural retail sales.

If the defective date were removed (and assuming approval before June 30, 2008) the revenue losses are estimated to be $200,000 for fiscal year 2009, $400,000 for fiscal year 2010, $600,000 for fiscal year 2011 and $550,000 per year thereafter.

It is estimated that the construction of facilities for the agricultural and processing facilities would cost $25 million over three years, with $5 million being incurred in the first and third years and $15 million being incurred in the second year. (The figure for construction was revised downward after consulting with DBEDT. Apparently much of the construction is already in place). In the fourth year and thereafter, the facilities are assumed to generate $50 million in gross receipts and to increase the enterprise zone tax credit by 20%. GET is foregone at the rate of 4% on the construction costs and at ½% on the gross receipts from the new agricultural and processing facilities.

LINDA LINGLE
GOVERNOR
THEODORE E. LIU
DIRECTOR
MARK K. ANDERSON
DEPUTY DIRECTOR

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

No. 1 Capitol District Bldg., 250 South Hotel St., 5th Flr., Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Web site: www.hawaii.gov/dbedt

Tel.: (808) 586-2355
Fax: (808) 586-2377

Statement of
THEODORE E. LIU
Director
Department of Business, Economic Development, and Tourism
before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

Tuesday, March 18, 2008
1:15 P.M.
State Capitol, Conference Room 224

in consideration of
HB 2739 HD1 SD1
RELATING TO STATE ENTERPRISE ZONES

Chair Fukunaga, Vice-Chair Espero, and Committee members:

The department supports the concept of HB 2739 HD 1 SD1, which allows agricultural businesses to continue to qualify for zone benefits in case of f*orce majeure* events; includes leased and jointly employed workers in hiring formulas; changes the timing of employee increases; counts value-added agricultural product retail sales towards qualification for tax credits, and allows ag producers to qualify for certification based upon an increase in gross sales rather than employee increases.

There have been many good ideas introduced this legislative session that support the State's economic development goals, and we note that no appropriation is associated with this bill.

Agriculture is a vital component of Hawaii's economy, preserving open space essential to tourism and helping to protect our environment. Currently, there are more than 5500 farms, but as of January 2007, only 32 participated in the Enterprise Zone (EZ)

Program. In 2006, only 12 of the 32 firms qualified for benefits, 4 companies did not qualify and the remaining 16 farmers did not file their annual reports. Common reasons for not filing included closing the business or knowing that certification criteria had not been met.

This bill also helps farmers cope with natural disasters by allowing them to retain EZ eligibility when their operation has been negatively affected and then resume production, with the time added to their full participation period. This change would have benefited many farmers affected by the Spring 2006 floods on Oahu and Kauai and a few on the Big Island whose water systems were damaged by the Kiholo earthquake.

The department, however, identifies two areas that need to be addressed. The first is on page 5, Section 4 subsection (a). This describes the requirement for qualification for a "new" business. For new ag businesses, they can include their retail value-added receipts for certification. but do not have the option to increase their gross sales instead of hiring more workers. Whereas page 6 subsection (b) states the criteria for "existing" ag businesses as allowing the gross sales option, but not the ability to include value-added retail receipts. The changes on the attachment will sync the two new proposals.

The second change contained on page 6, lines 14-16, establishes the base employee count from the time the business opened for operation and not when they applied into the EZ program as is currently practiced. The implication is that a business that has been around for 30, 40, or 50 years, can apply and use their base employee count from 30, 40, or 50 years ago, and if they increased their staff by 10% in the first year, and 15% in years two to seven, they would *automatically fulfill this requirement* for benefits that would apply 23, 33, or 43 years later. It will be difficult to obtain credible data from companies that have been for over 10 years. It would be difficult to verify and difficult to enforce. Furthermore, this would conflict with the purpose of the EZ program which is to encourage economic growth in our communities *today*. We would recommend omitting the changes stated on lines 14 to 16.

Thank you for the opportunity to offer these comments.

<u>**ATTACHMENT TO DBEDT TESTIMONY ON HB 2739 H.D. 1 S.D.1 3/14/08**</u>

SECTION 4. Section 209E-9, Hawaii Revised Statutes, is amended by amending subsections (a) and (b) to read as follows:

(a) Any business firm may be eligible to be designated a qualified business for purposes of this chapter if the business:

(1) Begins the operation of a trade or business within an enterprise zone;

(2) During each taxable year has at least fifty per cent of its enterprise zone establishment's gross receipts attributable to the active conduct of trade or business within the enterprise zone;

(3) Increases its average annual number of full-time employees by at least ten per cent by the end of its first tax year of participation; and

[(4)] <u>**(A)**</u> During each subsequent taxable year at least maintains that higher level of employment[~~.~~]<u>**; or**</u>

<u>**(B) Increases its gross sales of agricultural crops or agricultural products produced within the enterprise zone by two per cent annually.**</u>"

<u>provided that receipts from value-added products made from crops grown within an enterprise zone and sold at retail pursuant to the limits of subsection (e) shall count towards the gross receipts required under paragraph (2) for business firms engaged in producing or processing agricultural products.</u>

(b) A business firm also may be eligible to be designated a qualified business for purposes of this chapter if the business:

(1) Is actively engaged in the conduct of a trade or business in an area immediately prior to an area being designated an enterprise zone;

(2) Meets the requirements of subsection (a)(2); and

(3) <u>(A)</u> Increases its average annual number of full-time employees employed at the business' establishment or establishments located within the enterprise zone by at least ten per cent annually[~~.~~]<u>;</u> **[<u>provided that the percentage increase shall be based upon the employee count at the beginning of the initial year of operation;</u>]**<u>or</u>

Remove text in brackets

(B) Increases its gross sales of agricultural crops or **agricultural** products produced within the enterprise zone by two per cent annually."

provided that receipts from value-added products made from crops grown within an enterprise zone and sold at retail pursuant to the limits of subsection (e) shall count towards the gross receipts required under paragraph (2) for business firms engaged in producing or processing agricultural products.

Hawaii Aquaculture Association

To:

THE SENATE
THE TWENTY-FOURTH LEGISLATURE
REGULAR SESSION OF 2008

COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION
Sen. Carol Fukunaga, Chair
Sen. Will Espero, Vice Chair

<u>HEARING</u>

DATE: Tuesday, March 18, 2008
TIME: 1:15p.m.
PLACE: Conference Room 224, State Capitol
415 South Beretania Street

From: Ronald P. Weidenbach, President, Hawaii Aquaculture Association
Cell: 429-3147, Email: hawaiifish@gmail.com

Re: **HB2739 H.D.1 S.D.1** - RELATING TO STATE ENTERPRISE ZONES

Chair Fukunaga, Vice-Chair Espero, and Members of the Committee:

The Hawaii Aquaculture Association (HAA) **strongly supports the intent of HB2739 H.D.1 S.D.1** to qualify agricultural businesses for enterprise zones, to allow them to receive benefits in case of force majeure, to add a second qualification option based in a 2% annual increase in gross revenues, to count leased employees and joint employment workers in hiring formulas, and to qualify certain value-added agricultural sales towards certification for income tax credit purposes.

However, the HAA has noted one apparent oversight in the current wording of HB2739 H.D.1 S.D.1 that we would like to bring to the attention of the Committee and request appropriate amendment. On page 1, lines 11-16, the bill was amended to state: "The business shall remain eligible for all tax incentives under this chapter for any period of time while experiencing conditions under paragraph (1) or (2) caused by a force majeure event, and the seven-year eligibility time shall be extended by an equivalent period of time." Yet on page 7, lines 13-18, the original and seemingly inconsistent wording states: "The gross proceeds received by a contractor licensed under chapter 444 shall be exempt from the general excise tax for construction within an enterprise zone performed for a qualified business within the enterprise zone. The exemption shall extend for a period not to exceed seven years."

The HAA requests that the wording on line 18 be amended to say approximately "The exemption shall extend for a period not to exceed seven years except as noted on page 1, lines 11-16 above." Such an amendment would enable agriculture operations recovering from force majeure events to still be able to attract contractors with this incentive during the duration of their recovery period and their subsequent extended period of eligibility, thereby better supporting the goals of the EZ Program and the spirit of force majeure language on page 1.

The HAA strongly supports the EZ program and HB2739 H.D.1 S.D.1 with the requested amendment. This legislation is urgently needed by the EZ farms recovering from the numerous force majeure events of the last two years. The HAA urges the Committee to pass of this important bill and respectfully requests this Committee to indicate to WAM that this is a priority bill urgently needed by the agricultural community.

Thank you for the opportunity to testify.

HARC

Hawaii Agriculture Research Center

99-193 Aiea Heights Drive, Suite 300
Aiea, Hawaii 96701
Ph: 808-487-5561/Fax: 808-486-5020

TESTIMONY BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

HB 2739 HD1 SD1

RELATING TO STATE ENTERPRISE ZONES

March 18, 2008

Chair Fukunaga and Members of the Committee:

My name is Stephanie Whalen. I am President and Research Director of the Hawaii Agriculture Research Center (HARC). I am testifying today on behalf of the center, our research and support staff, and our members and clients.

HARC **strongly supports HB 2739 HD1 SD1 Relating to State Enterprise Zones.**

It recognized the uniqueness of agricultural businesses and would be very helpful in maintaining the viability of agriculture. In the transition from large scale farming to smaller and more diverse farms it is imperative that the statutes also change and adapt to the needs of this situation. There is a demonstrated employment crunch in Hawaii and finding employees is often very difficult, especially for agriculture. While we recognize the original intent of this statute was to increase employment, times have changed, all sectors are scrambling to find and keep employees in a very financially difficult environment. Increasing revenues is an equally important contribution to the economic viability of our state. Agriculture has been faced with labor shortages from its beginnings and is forced to be entrepreneurial in maintaining and increasing output while faced with a dwindling workforce. Providing for either employment or revenue increases will allow for more agricultural businesses to support in the business tax incentives.

The employee sharing concept is very progressive. Many of the newer crops do not require year-round labor but with the diversity developing, shared or leased employees just makes sense. Whereas diversity existed under one employer in the past which allowed year-round employment by one company, that diversity is now manifested in many independent farms where peak and shorter employment periods are the norm.

It is exciting to see this proposed measure combining ideas to support the diversification of agriculture that has been the goal for over three decades.

Thank you for the opportunity to testify.

SUBJECT: MISCELLANEOUS, Enterprise zone agricultural businesses

BILL NUMBER: HB 2739, SD-1

INTRODUCED BY: Senate Committee on Agriculture and Hawaiian Affairs

BRIEF SUMMARY: Adds a new section to HRS chapter 209E to provide that if an agricultural business is: (1) prevented from maintaining enterprise zone eligibility requirements; or (2) interrupted due to a force majeure event, the business located in an enterprise zone shall not be disqualified as an eligible business. The seven-year eligibility period for such business shall be extended by the duration of the force majeure event.

Amends HRS section 209E-2 to add the definition of "force majeure," "joint employment," and "leased employee" for purposes of the measure. Amends the definition of "full-time" employee to include leased employees and employees under a joint employment relationship and the definition of "qualified business" to include a business engaged in processing agricultural products. Defines "force majeure" as an event including, but not limited to, damaging weather or natural disasters such as epidemic disease, pest outbreak, high wind, thunderstorm, hail storm, tornado, fire, flood, earthquake, lava flow or other volcanic activity, drought, tidal wave, hurricane, or any situation beyond the control of the agricultural business.

Amends HRS section 209E-9 to stipulate that receipts from value-added products made from crops grown within an enterprise zone and sold at retail pursuant to the enterprise zone requirements, shall count toward the gross receipts requirement for business firms engaged in producing or processing agricultural products. Also provides that a business shall be eligible as a "qualified business" if the business increases its average annual number of full-time employees employed at the business located within the enterprise zone by at least 10% by the end of the first year of operation; provided the increase shall be based on the employee count at the beginning of the initial year of operation; or increases its gross sales of agricultural crops or products within the enterprise zone by 2% annually.

Amends HRS section 209E-11 to provide that agricultural businesses not engaged in genetically engineered agricultural production shall not be exempt from the payment of general excise taxes on the gross proceeds of agricultural retail sales.

EFFECTIVE DATE: July 1, 2034

STAFF COMMENTS: In an enterprise zone, businesses are attracted and encouraged to relocate to the zone through tax incentives, bonds, and other appropriate measures. Businesses located in an enterprise zone may claim a credit against taxes paid for a period of seven years and also allows the sale of items sold by such businesses to be exempt from the general excise tax. This measure proposes to allow an agricultural business located in an enterprise zone to maintain its eligibility requirements in the event of a force majeure and also to extend its enterprise zone benefits by the duration of the event.

While it is understandable that agricultural operations are perhaps more prone to suffer economic dislocation as a result of a natural disaster or severe weather conditions, one has to pose the question whether or not other businesses that suffer from a force majeure should also be granted the same leniency this measure proposes? What this measure does emphasize is the inequity created by enterprise zones by handing out more favorable treatment for those located in the zone, usually at the expense of those who are not.

The proposed measure also amends the eligibility requirements of an enterprise zone to include the processing of agricultural products. It should be remembered that in recent years, the type of businesses that have been included to receive enterprise zone benefits include call centers of disease management services, sale of wind farm generated electricity sold to a public utility, research, development and sale of genetically engineered medical, agricultural, or maritime biotechnology, etc. The proposed measure would singling out another business for preferential treatment merely conferring preferences for those businesses at the expense of all other taxpayers

It should be remembered that enterprise zones merely exacerbate what is already considered a poor climate in which to do business. Singling out specific areas of the state merely confers preferences for those businesses located within those geographic areas at the expense of all other taxpayers who are not so favored. It should be remembered that those taxpayers who live and work in the zone will demand the same public services as those who are not as fortunate to be located in the zone. Who then will pay for these services?

Concurrent efforts must be made to improve Hawaii's business climate to enhance the economic prospects for all businesses. Enterprise zones are merely an abdication of government's responsibility to create a nurturing and supportive business climate so that all businesses can thrive in Hawaii and provide the jobs the people of Hawaii need.

Finally, while Hawaii has had the enterprise zone concept on the books for years, no evaluation of how effective these zones have been in improving the well-being of those communities on which this status has been conferred. Before further corrupting the economic marketplace with added versions of the enterprise zone concept, an evaluation of the current zones should be undertaken. Instead of expanding the enterprise zone program, the program should be repealed in favor of across-the-board tax relief for all businesses in Hawaii. Indeed, has there been a comprehensive evaluation of the program and do lawmakers know exactly how much enterprise zone businesses have benefitted and whether or not they have created the jobs promised when the program was first established? If the legislature is adamant about the designation of enterprise zones in the state, then the whole state should be designated an enterprise zone and the tax treatment will be equitable for all businesses

Digested 3/17/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2860 HD 2 SD 1
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This bill proposes to exempt aviation fuel purchased from a foreign trade zone from the state general excise and use taxes for fuel used in inter-island air travel.

The House Committee on Economic Development & Business Concerns amended this bill's effective date for purposes of further discussion.

The House Committee on Transportation amended the bill by including the comments of the Department's prior testimony.

The House Committee on Finance passed the bill unamended.

The House of Representatives passed this measure on third reading.

The Senate Committee on Transportation & International Affairs amended this measure to give it a current effective date.

The Department of Taxation (Department) **supports** this legislation.

This bill amends the general excise and use tax law regarding the exemptions from taxation that are currently allowed. Presently, aviation fuel purchased in a foreign trade zone is exempt from state taxation for those flights that are bound for an out-of-state or foreign destination. Because these flights are considered within interstate or foreign commerce, taxation is exempt pursuant to federal law. There is no corresponding exemption for inter-island flights because these flights are not considered to be in foreign or interstate commerce for tax purposes.

I. SUBSTANTIVE COMMENTS.

The Department appreciates the amendments made by the prior committees that included a workable definition of inter-island flight, which defines the appropriate commerce to carry out the intent of the measure as "two points between the State." This definition, coupled with the appropriate tax exemptions in the relevant tax chapters, makes this legislation technically accurate.

The Department points out that the two exemptions are not identical and should be reconciled as follows:

Chapter 237—

"**§237- Aviation fuel for air transportation.** This chapter shall not apply to amounts received from the sale of aviation fuel, as defined in section 243-1, categorized as privileged foreign merchandise, non-privileged foreign merchandise, domestic merchandise, or zone-restricted merchandise that is admitted into a foreign-trade zone and purchased **[~~in a foreign-trade zone and is made directly to or is used~~]** by a common carrier for consumption or use in air transportation between two points in the State."

Chapter 238—

"(12) The use of aviation fuel, as defined in section 243-1, categorized as privileged foreign merchandise, non-privileged foreign merchandise, domestic merchandise, or zone-restricted merchandise that is admitted into a foreign-trade zone and is used by a common carrier **[~~by air~~]** for consumption **or use** in air transportation between two points in the State."

II. REVENUE IMPACT.

After considering recent additional information regarding aviation fuel sale data, it is the Department's position that this legislation will result in a revenue loss of approximately:

- $5.1 million loss, FY2009.
- $5.3 million loss, FY2010.
- $5.5 million loss, FY2011.

110 million gallons of fuel was sold on Oahu in FY2007. From previous estimates, it was found that approximately 55% of this was of non-exempt fuel. From this, the GE revenues derived from aviation fuel were calculated to be $4.8 million. This was inflated by CPI_U for the relevant fiscal years.

LINDA LINGLE
GOVERNOR
MARSHA WIENERT
TOURISM LIAISON

TOURISM LIAISON

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Telephone: (808) 586-2362
Fax: (808) 586-2370

Written statement of
MARSHA WIENERT
Tourism Liaison
Department of Business, Economic Development & Tourism
before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION
Tuesday, March 18, 2008
1:15 p.m.
State Capitol, Conference Room 224

in consideration of
HB 2860 HD2 SD1
RELATING TO TAXATION.

Chair Fukunaga and Members of the Senate Committee on Economic Development & Taxation.

The Department of Business, Economic Development and Tourism supports the intent of HB 2860 HD2 SD1, which exempts from general excise and use taxes the fuel sold from a foreign trade zone for interisland air transportation by common carriers.

In as much as we support the intent of HB 2860 HD2 SD1 and believe that the interisland carriers should have the same exemptions in general excise and use taxes as airlines traveling out-of-state, we are concerned about the cost implications generated by this proposal.

Thank you for the opportunity to comment on HB 2860 HD2 SD1.

Aloha

AIRLINES

Stephanie C. Ackerman
Senior Vice President
Public Relations and
Government Affairs
P.O. Box 30028
Honolulu Hawaii 96820
Facsimile 808 836-0303
Telephone 808 539-5972

March 14, 2008

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice-chair

RE: HB 2860, HD2 Relating to Taxation

Chair Fukunaga, Vice-Chair Espero and Members of the Committee:

My name is Stephanie Ackerman and I am Senior Vice President, Public Relations and Government Affairs, for Aloha Airlines. Thank you for this opportunity to testify in strong support of HB 2860, HD2, SD1.

In the past we have urged lawmakers to act on this matter to remedy an inequity in current state law that places an undue tax burden on Hawaii-based interisland carriers.

The existing statute (Section 212-8) grants a General Excise and Use tax exemption to airlines when they purchase jet fuel from the Hawaii Foreign Trade Zone for flying in interstate or foreign commerce. This is consistent with Federal law governing foreign trade zones and interstate commerce. However, the law is not being applied consistently and as a result, there is discrimination against Hawaii-based air carriers. Legislation is required to ensure that the Hawaii Department of Taxation applies the GET and use tax exemption when airlines purchase fuel from a foreign trade zone for use in interisland flying, which is regulated by Federal law as interstate commerce.

The Commerce Clause of the U.S. Constitution gives Congress sole power to regulate interstate commerce. Contrary to the testimony submitted by the Tax Department that "*...court cases conclude that transportation from one point in a state through international territory and back to another point in the same state is not interstate commerce,*" the U.S. Court of Appeals, Ninth Circuit, in *Island Airlines, Inc. v. C.A.B., (352 F.2d 735),* held that:

> "The high seas over which interisland flights flew while traveling among the various islands of Hawaii, were a "place" within statute defining jurisdiction of the Civil Aeronautics Board over interstate commerce as transportation between points in the same state over a foreign country or high seas as well as over another state."

The Court also cited that the Congress in Senate Committee Report 86-80 on the Hawaii Statehood Act on aviation matters, said:

> "Hawaii presents a unique situation with respect to the impact of statehood on the federal regulation of air transportation between the main islands. ...most, if not all, of the interisland air transportation passes through airspace not a part of the territory. ...interstate air transportation, which is defined to include not only transportation between a place in a state and a place in any other state, but also transportation between places in the same state through the airspace over any place outside thereof.. ***...with the admission of Hawaii as a state, interisland air transportation will remain subject to the economic controls provided by the Federal Aviation Act including other applicable federal legislation, because that transportation, or most of it, while between places in the same state, will pass through airspace outside the state***. In the other states, air transportation of this kind passing through airspace outside the state of slight volume in comparison with air transportation merely between places in the same state. ***...the Committee wishes to make it clear that ...the provisions of the Federal Aviation Act and other applicable federal legislation to the State of Hawaii should continue in accordance with the definition of interstate air transportation as contained in that Act.***"

Title 49 U.S. Code, section 40102 (Federal Aviation Act) specific defines "interstate air transportation" as "the transportation of passengers or property by aircraft as a common carrier for compensation, or the transportation of mail by aircraft ...between a ***place*** in ***Hawaii and another place in Hawaii through the airspace over a place outside Hawaii.***"

As we understand it, Federal law preempts the State from imposing GET on the sale of fuel from a foreign trade zone when the fuel is used in interstate commerce, which includes points within the State of Hawaii.

With that in mind, we return to the equity issue. We believe that ALL flights operated by common carriers must be considered interstate transportation; therefore the GET exemption on fuel must apply to ALL of them.

Passage of this bill will do what is fair, by clarifying and expanding the scope of the current GET exemption to include locally based airlines. In this way, you will also be recognizing the vital role that interisland airlines play in the economy of our state by bridging our communities, and employing more than 6,500 Hawaii residents.

March 14, 2008

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice-chair

RE: HB 2860, HD2 Relating to Taxation

Chair Fukunaga, Vice-Chair Espero and Members of the Committee:

Bill summary

Currently aviation fuel purchased in Hawaii's Foreign Trade Zone ("FTZ") for use on flights originating in Hawaii and terminating outside of Hawaii is exempt from state excise tax under Hawaii Revised Statutes section 212-8. This exemption is consistent with the purpose of the FTZ to facilitate international and interstate commerce. This bill proposes to extend that exemption to any aviation fuel sold in the FTZ for use on interisland flights. Hawaii's foreign trade zone was established under the provisions of 19 U.S.C. 81a-81u, 15 CFR 400, and 19 CFR part 146. While Hawaii's interisland airlines do not depart the state, they nonetheless are engaged in 'interstate commerce' for the purpose of federal regulations and federal law.

Testimony in Support

There are three strong reasons why this bill should be enacted into law:

First: Legally, the exemption from excise tax on airline fuel to airlines leaving the state is based on their operation within 'interstate commerce' as it is applied to federally regulated airlines. Airlines that complete domestic flights within the state of Hawaii are also engaged in 'interstate commerce' as it is defined under federal law.

Second: As a matter of equity, the state department of taxation is in a situation where it must discriminate among Federally Regulated airlines based on whether their flights will terminate within the state or not. This results in some airlines receiving preferential treatment over others, without any legal or policy basis.

Third: As a matter of policy, it is good policy to reduce taxes on the interisland airlines, as the airlines provide a vital lifeline for our island state, and because higher costs resulting from the taxes have a dramatically negative impact on Airline employees and on charities supported by the local airlines. This policy argument is especially true where the taxes being applied go in to the general fund and are not earmarked for aviation infrastructure.

I. Interisland airlines operate within 'interstate commerce' and therefore this bill is mandated by federal law:

The state department of taxation currently grants a G.E.T. exemption for fuel purchased within the Foreign Trade Zone for use on flights that leave the state. This exemption is provided in accordance with federal law mandates that State G.E.T. shall not interfere with the flow of interstate commerce.

This very issue has been litigated before the U.S. Supreme Court. In the 1983 case of *Aloha Airlines v. Director of Taxation*, citation 464 U.S. 7 (1983), appellants Aloha Airlines and Hawaiian Airlines prevailed in their argument that Hawaii's G.E.T. on interisland airline tickets was in violation of Federal Law. Hawaii's GET on interisland tickets was found to be preempted by Federal Law and was therefore determined to be invalid in the U.S. Supreme Court.

It is abundantly clear that even though a flight may originate and terminate within the state of Hawaii, it is nonetheless within the economic umbrella of interstate commerce, and must be treated as such in every way. Indeed the only reason the federal government has the authority to regulate the airlines is because of the limited powers granted to the federal government by the U.S. Constitution's Interstate Commerce Clause. Conceptually one can easily see how air freight originating on the neighbor islands and then changing planes in Honolulu for out of state destinations does not suddenly become 'interstate commerce' the minute it changes planes in Honolulu. Passengers as well often change planes. Federal law does not discriminate between the part of the flight that happens within Hawaii and the part that leaves the state. We ask the legislature to provide guidance to the state department of taxation by enacting this law.

Extending the exemption to interstate airlines will allow the tax department to treat all airlines equally

It is inappropriate for a state government to provide benefits to one class of individuals and not to another without a policy basis for doing so. The law as it is being applied forces the tax department to make an artificial distinction between airlines, thus conferring benefits on some, while burdening others. Without a legitimate purpose for doing so, the law is both improper and unfair.

This tax exemption will assist in stabilizing the airlines, will benefit Hawaii's airlines' 7000 employees, and will benefit the communities that these airlines serve

Most airline costs are fixed costs and are difficult or impossible to reduce. These fixed costs include:

1. Fuel
2. Taxes and fees
3. Aircraft and equipment leases
4. Facility leases
5. Maintenance costs
6. Other miscellaneous expenses, such as food concessions, technical and I.T. services, etc.

The other major airline expense is labor. Because airlines have little 'wiggle room' with regards to these costs, they routinely turn to labor for cost concessions. Over the past few years Aloha's employees have endured a 20% pay cut. Hawaiian Airlines' employees have endured similar cuts. Hawaii Island Air had substantial layoffs. The tax exemption provided by this bill will help the airlines remain viable and will reduce the pressure on the airlines to ask for wage and benefit cuts of their employees by reducing the interisland airlines' fixed costs. It will also allow the airlines to continue to make generous charitible donations, both financial and in-kind.

The reduction in interisland airlines' fixed costs that will result from this bill's tax exemption will benefit Hawaii's airline employees

In the words of Southwest Airlines' former CEO Herb Kelleher, "an airline is made up of people, not airplanes." Any reduction in taxes, whether State or Federal will directly benefit the over 7,000 people who work for Hawaii's interisland airlines, as well as their families and dependents. It is the peculiar nature of the our industry that rising costs are seldom passed on to consumers, and as a result, the high cost of fuel and the heavy tax burden that air carriers shoulder are impacting the bottom line of our local airlines. As airline employees who have sacrificed so much, we urge you to act on this measure to help reduce fixed costs and ensure the stability and viability of Hawaii's interisland airlines.

Public policy favors passage of this bill

Hawaii's interisland airlines are a vital part of Hawaii's economy. They provide a vital service to our communities. The well-being of Hawaii's airline employees is vital to our airlines. The tax exemption provided by this bill will be good for these employees, it will be good for the interisland carriers, and it will be good for Hawaii. This is really about treating all airlines that serve our state fairly, and taking care of the employees who work for Hawaii's interisland airlines, which ultimately provides economic benefits for all of Hawaii. This is good public policy.

march of dimes

Hawaii Chapter
1451South King Street, PH-504
Honolulu, Hawaii 96814
Tel: 808-973-2155
Interisland: 1-800-272-5240
Fax: 808-973-2160
Email: chernandez@marchofdimes.com

March 14, 2008

Senator Carol Fukunaga
Chair
Committee on Economic Development and Taxation
State Capitol

RE: HB 2860 HD2 Relating to Taxation

Chair Fukunaga, Vice Chair Espero and Members of the Committee:

My name is Carmella Hernandez and I am State Director of the Hawaii Chapter of the March of Dimes. I am testifying in support of HB 2860.

In 2006, the March of Dimes honored Aloha Airlines with the Franklin Delano Roosevelt Award for Distinguished Community Service. Aloha Airlines has long supported the March of Dimes and many other not-for-profit organizations in Hawaii in numerous ways. For example, when expectant mothers on the Neighbor Islands are in danger, and specialized medical treatment is not available where they live, Aloha provides air transportation to Oahu so they can get the care they need. There are many times when a baby is born premature on a Neighbor Island and needs to be flown to Honolulu to be cared for at Kapi'olani Medical Center's neonatal intensive care unit. Aloha provides tickets so that the parents can come to Honolulu and stay with their baby. Sadly, there are times for a variety of reasons that the mother cannot come to be with her baby. Aloha Airlines helps these babies by flying the mother's breast milk to Oahu for them. This may sound like a small thing, but to the health of these tiny babies, there is nothing better for them than having their mother's breast milk. Aloha has also donated tickets for Neighbor Island families that have children with cancer to bring them here to specialists at Kapi'olani for life saving treatment.

Aloha continues to provide free tickets to the March of Dimes staff and volunteers when we need to travel to the neighbor islands to set up our biggest fundraising event – March for Babies. A practice they have done for more than 15 years. And as an incentive for our walkers to raise money, Aloha Airlines donates tickets for us to give as prizes for each of our five walk sites top fundraisers. They also help us raise money by putting an Aloha Airlines team of employees who come out to support the walk and by donating tickets to our annual ball that we include in our auction. They do not often take credit for their community giving, but they keep on giving, in good times and bad. Their name says it all, they always have and will continue to show much Aloha for the people of Hawaii.

As I understand it, Aloha and other Hawaii-based carriers are asking Hawaii's lawmakers to remedy an inequity, by clarifying state law to extend a tax exemption that other airlines already have. If federal law does indeed regard them as interstate carriers, and if interstate carriers are exempt from GET on fuel purchases from the free trade zone at Honolulu Airport, then you should act swiftly to unburden Hawaii's airlines and secure those benefits for them.

Our inter-island airlines have been dedicated to serving Hawaii for decades. Without the reliable passenger and cargo service they provide, and the helping hand they offer to Hawaii's people, we would all be lost. Charities depend on our local businesses to support and fund our important work in the community. When business profits decline due to a slowing economy and increased costs, so does a company's ability to contribute to the organizations that help our community in time of need. Aloha Airlines is always ready to help when the need arises, as noted earlier – in good times and in bad - now its time for the Aloha State to help all our local airline companies by passing HB 2860.HD2. To help them is to help the communities we live in. I urge you to think of who we are and what we care about, and pass House Bill 2860 to give our local airlines the same benefits already enjoyed by other airlines.

Thank you,

Carmella H

Carmella Hernandez
State Director
March of Dimes Hawaii Chapter

March 14, 2008

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice-chair

RE: HB 2860, HD2 Relating to Taxation

Chair Fukunaga, Vice-Chair Espero and Members of the Committee:

My name is Randy Kauhane and I am Assistant General Chairman of the International Association of Machinists and Aerospace Workers (IAM) District 141 for Aloha Airlines, Hawaiian Airlines, United Airlines and Philippine Airlines, testifying in strong support of HB 2860.

Our members are concerned that current tax law is not being applied fairly, depriving our local Hawaii-based airlines of tax advantages enjoyed by all other airlines flying from Hawaii.

It is not fair that airlines are granted General Excise and Use tax exemption when they purchase jet fuel from the Hawaii Foreign Trade Zone for flying out-of-state but airlines that fly within the State of Hawaii are denied this exemption. Under federal law, all common use carriers in the United States, including Hawaii's locally based airlines, are regulated by the same laws that govern interstate commerce.

Hawaii's airlines operate under the same federal regulations. It does not seem right that the state Taxation Department has chosen to treat some airlines one way and others another way, when we are all engaged in interstate commerce under federal law.

We urge you to amend House Bill 2860 HD2.

Thank you.

March 14, 2008

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice-chair

RE: HB 2860, HD2 Relating to Taxation

Chair Fukunaga, Vice-Chair Espero and Members of the Committee:

I am Kamuela Clemente, testifying on behalf of the Transport Workers Union, representing Dispatchers, Assistant Dispatchers and Crew Schedulers of Aloha Airlines.

We strongly support passage of HB2860, which exempts interisland carriers from the general excise tax and use tax on sales of aviation fuel from a foreign trade zone for use in interstate air transportation.

For one thing, the current law is unfair to our interisland carriers because they are common carriers in interstate commerce just like the overseas carriers that already take advantage of this exemption.

For another thing, we believe that interisland air transportation is interstate commerce under federal law and should be treated equally under the law.

Finally I urge you to act in support of the working people of Hawaii, including our Aloha Airlines employees, who are so committed to serving the communities of our State.

We support passage of HB 2860, HD2.

Mahalo Nui Loa,

Kamuela Clemente

testimony

From: Sampson, Eric, HALMEC [Eric.Sampson@alpa.org]
Sent: Friday, March 14, 2008 11:01 PM
To: testimony
Cc: Bumgarner, Janis; Drake, Mark, HALMEC; Taeu, Samuel, HALMEC; Wohlhueter, Kim, HALMEC
Subject: HB 2860

14 March 2008

Hawaii State Capitol
Senator Daniel K. Akaka
Honolulu, HI 96813

Dear Senator Daniel K. Akaka,

I am the Master Executive Chairman for the Alpa Int'l Pilots and represent the interests of 342 Pilots employed at Hawaiian Airlines. I am asking for your support in the passage of HB 2860.

Our Company employs over 3000 workers in Hawaii and provides revenue for many related businesses in Hawaii. We face many economic challenges especially the rising fuel costs. The exemption from the general excise tax and the use tax for fuel would be of enormous help to us.

My members and I would gratefully appreciate your support of **HB 2860.**

Thank you,

Captain Eric H. Sampson
HAL Master Executive Chairman
HAL Council-SB-1 Representative
808-836-2572 office
808-836-1449 facsimile

March 16, 2008

Senator Carol Fukunaga
Hawaii State Capitol
Honolulu, Hawaii 96813

Dear Senator Fukunaga:

I am writing on behalf of the nearly 1,000 Flight Attendants that are members of the Association of Flight Attendants – CWA and employees of Hawaiian Airlines. We are asking for your support in the passage of HB 2860.

Our Company employs over 3,000 people in Hawaii and provides revenue for many related businesses in Hawaii. We face many economic challenges especially with the rising fuel costs. The exemption for the general excise tax and the use tax for fuel would be of enormous help for us.

My members and I would gratefully appreciate your support of HB 2860.

Thank you,

Sharon Soper
President
Hawaiian Airlines Master Executive Council
Association of Flight Attendants – CWA
AFL-CIO

The Chamber of Commerce of Hawaii

Since 1850

Testimony to the Senate Committee on Economic Development and Taxation
Hawaii State Capitol
Conference Room 224
415 South Beretania Street
Tuesday, March 18, 2008 at 1:15 p.m.

SUBJECT: HOUSE BILL 2860, HD2, SD1 – RELATING TO TAXATION

Chair Fukunaga, Vice Chair Espero, and Members of the Committee:

My name is Jim Tollefson and I am the President and CEO of The Chamber of Commerce of Hawaii ("The Chamber"). I appreciate the opportunity to state The Chamber's strong support of House Bill No. 2860 HD2, SD1, relating to Taxation.

The Chamber is the largest business organization in Hawaii, representing 1100 businesses. Approximately 80% of our members are small businesses with less than 20 employees. The organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

The measure, as received by your Committee, exempts from general excise and use taxes the fuel sold from a foreign-trade zone for intrastate air transportation by common carriers.

The Chamber, through its Tourism Committee, encourages a broad base of understanding, support and appreciation for the Tourism and Travel Industries within the business community, Legislature and the general public. The committee also supports visitor industry growth and improvement while working to enhance the visitor experience.

The Chamber understands the value and significance of the airline industry, especially our local carriers, who in addition to serving the travel needs for the people of Hawaii and beyond, have contributed significantly to the community. Any decline in the travel industry harms all businesses and the local economy. As a result, the Chamber wants to embrace and strengthen the commercial aviation sector.

This bill proposes to give fuel tax relief for intrastate air transportation by common carriers. The Chamber believes this is a relevant step in the right direction of giving aid to the industry. Airlines are facing serious challenges today, and exempting them from the general excise and use tax on aviation fuel will help to alleviate some financial burdens. Additionally, this measure provides a fair and balanced relief to the local carriers as well as is consistent with the federal law relating to interstate commerce.

In light of this, The Chamber of Commerce of Hawaii urges your support of House Bill 2860 HD2, SD1 relating to Taxation.

Thank you for the opportunity to express our views on this matter.

1132 Bishop Street, Suite 402 • Honolulu, Hawaii 96813 • Phone: (808) 545-4300 • Facsimile: (808) 545-4369

International Association of Machinist and Aerospace Workers
David Figueira Local Committee Chairman Hawaiian Airlines Mechanics & Related
1934 Hau Street Honolulu, Hi 96819 (808)833-2613

March 17, 2008

Honorable Senator Carol Fukunaga
Chair EDT Committee

Re: House Bill 2860

Dear Senator,

The International Association of Machinist & Aerospace Workers, Local Lodge 1979 is asking for your full support in passing HB2860 out of committee, as this bill would greatly offer support to the local airlines. With the constant ever rising cost of fuel, any financial relief the local airlines can get would greatly decrease the need for these company's to further seek cost cutting measures from their loyal employees, which ultimately affect their families.

Thank you in advance for your support.

David Figueira

David Figueira
Committee Chairman &
Local Lodge Executive Board Member
IAMAW & LL1979

TESTIMONY OF KEONI WAGNER ON BEHALF OF HAWAIIAN AIRLINES IN SUPPORT OF H.B. NO. 2860, HD 2, SD 1, RELATING TO TAXATION

March 18, 2008

To: Chairperson Carol Fukunaga and Members of the Senate Committee on Economic Development and Taxation:

My name is Keoni Wagner and I am the Vice President for Public Affairs for Hawaiian Airlines presenting this testimony on behalf of Hawaiian Airlines in strong support of H.B. No. 2860, HD 2, SD 1.

This bill provides an exemption from state general excise and use taxes on fuel purchased from a foreign trade zone (FTZ) and used for interisland air transportation within the State of Hawaii. The state currently exempts from these taxes all fuel sold from an FTZ that is used for flights between Hawaii and the mainland or international destinations. We continue to believe that this same exemption should apply to interisland flights and respectfully request that legislation be passed to make this exemption more explicit.

Thank you for the opportunity to testify on this measure.

SUBJECT: GENERAL EXCISE, USE, Exempt Foreign Trade Zone aviation fuel

BILL NUMBER: HB 2860, SD-1

INTRODUCED BY: Senate Committee on Transportation and International Affairs

BRIEF SUMMARY: Adds a new section to HRS chapter 237 and a new paragraph to the definition of "use" under HRS section 238-1 to provide that the sales of aviation fuel categorized as privileged foreign merchandise, non-privileged foreign merchandise, domestic merchandise, or zone-restricted merchandise that is admitted into a foreign trade zone and purchased in a foreign trade zone and is made directly to or used by any common carrier for consumption or use in air transportation between two points in the state, shall be exempt from the state's general excise and use tax laws.

EFFECTIVE DATE: July 1, 2008

STAFF COMMENTS: Currently aviation fuel is imported and stored in Hawaii Fueling Facilities Corporation (HFFC) storage tanks. HFFC was established in 1969 to provide fuel storage and distribution to its member airlines. On September 1, 1997, the HFFC began operating under the Foreign Trade Zone (FTZ) at the Honolulu International Airport. Fuel purchased from HFFC for use in aircraft of HFFC members is exempt from the imposition of the general excise, use, and fuel taxes since they are operating in the FTZ. When the fuel is then pumped through the HFFC's bonded fuel lines and provided to the aircraft, the fuel remains in interstate commerce and technically is outside the jurisdiction of the state and the imposition of state taxes. The current exemption from taxes for product within the FTZ but sold for consumption outside the state applies only when the consumption of such product occurs out of state where sales are made to any common carrier in interstate or foreign commerce.

The purpose clause notes that the rising cost of fuel has added to the challenges of the local airlines and that the cost of the general excise and use tax exacerbates these challenges. Exempting the fuel used for intrastate air transportation would help level the playing field and create a fairer market for all airlines.

While it is the federal law that confers exempt status on products in the FTZ, recognizing that the products have not entered the country, it is understood that the states can further define that recognition with respect to use of products that have FTZ exempt status. This is what this measure proposes with respect to tax laws imposed by the state.

Digested 3/17/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2985 HD 1
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This legislation provides for an income tax credit equal to 15% of the costs of hotel renovations between 2014 and 2019.

Previously, the law allowed for a credit for the renovation costs incurred by a qualified hotel facility through December 31, 2005. This credit was allowed at rates of 10% and 4%, depending upon the taxable year. At that time, "qualified hotel facility" included a hotel-condo and time-share facility or project.

The House Committee on Tourism & Culture amended the measure by defecting the effective date.

The House Committee on Finance passed this measure unamended.

The House of Representatives passed this measure on third reading.

The Senate Committee on Tourism & Government Operations passed this bill unamended.

The Department of Taxation has **strong concerns** with this measure; offers comments, and provides the revenue estimate.

I. SUPPORT FOR THE TOURISM INDUSTRY, GENERALLY

The Department supports the tourism industry and the importance of the economic activity this important industry brings to Hawaii. The Department acknowledges that having modern and newly renovated rooms are an important factor in maintaining the flow of tourists to this State.

II. FISCAL PRIORITY OF SUBSIDIZING THIS INDUSTRY QUESTIONABLE

The Department's primary concern relates to the fiscal priority of subsidizing the hotel industry at this time. The hotel industry is comprised of highly capable entities that have capitalized on a booming tourism industry over the past few years to improve several facilities throughout the State. Though there is evidence suggesting tourism is stabilizing, the Department requests that the Committee strictly evaluate the fiscal priority of subsidizing this industry.

III. THE MEASURE MAY CAUSE HOTEL FACILITIES TO DEFER RENOVATIONS

Because the credit as set forth in this measure applies only to costs incurred beginning in calendar year 2014 through calendar year 2019, hotels may opt to defer needed renovations until such time the costs become eligible for the credit. This would be counter-productive to insuring modern and updated hotel rooms being available for the tourism industry. The Department also raises other timing issues with the bill since "renovation" is defined to include costs incurred after December 31, 2007 and subsection (h) seems to prohibit double-dipping with Chapter 235D, which expired on December 31, 2005.

IV. THE LEGISLATION IS PREMATURE AT THIS TIME

The Department believes that the current legislation is premature at this time. The state of the economy in 2013 and beyond can only be the subject of conjecture and educated guesses. Whether a hotel renovation tax credit is appropriate at that time is better suited for later Legislatures, with more current information as to the status of the construction industry, the tourism industry, and the economic health of the State as a whole.

V. ANY TAX INCENTIVE SHOULD BE NONREFUNDABLE

The Department points out that this legislation provides for a refundable income tax credit. The Department suggests that the Committee consider amending the measure to make the credit nonrefundable. In order for a company to enjoy a nonrefundable credit, the company must be generating income. With a refundable credit, on the other hand, there is no incentive or encouragement to be profitable. Having a nonrefundable credit would encourage the hotel industry to both invest in their operations, as well as generate sufficient revenues to ensure that a nonrefundable credit was worthwhile. At the same time, revenue growth from the hotels will translate into commensurate growth within the tourism industry, generally.

VI. RECONCILE TECHNICAL AMBIGUITY

This legislation currently contains an ambiguity over which costs may be utilized for the credit. "Renovation" for purposes of the credit is defined as follows:

> <u>"Renovation" means any **costs incurred after December 31, 2007**, for plans, design, construction, and equipment related to renovations, alterations, or modifications to a hotel facility.</u>

However, the credit is available for taxable years beginning several years after this date:

> **(i) The tax credit allowed under this section shall be available for taxable years beginning after December 31, 2013,** for building permits submitted to the appropriate county agency before December 31, 2014, and shall not be available for taxable years beginning after December 31, 2019."

Because of this ambiguity, taxpayers could read the bill to allow expenditures incurred after 2007 for "renovations" that are the basis of the credit during the time beginning after December 31, 2013. The Department suggests clarifying whether costs incurred after December 31, 2007 are allowed to be claimed during 2014; or if for all practicable purposes, the credit is allows for renovation costs incurred after December 31, 2013.

VII. REVENUE ESTIMATE

Assuming this legislation takes effect prior to 2014 two possible scenarios can happen. Scenario 2 is much more probable.

Scenario 1: Construction continues as normal from now until 2015:

- **FY2015 (loss): $9.1 million.**
- **FY2016 (loss): $9.4 million.**
- **FY2017 (loss): $9.7 million.**

Scenario 2: Hotels delay construction to take advantage of the credit:

- **FY2012 (loss): $2.2 million**
- **FY2013 (loss): $2.2 million**
- **FY2014 (loss): $2.3 million**
- **FY2015 (loss): $11.7 million**
- **FY2016 (loss): $12.0 million**
- **FY2017 (loss): $12.4 million**
- **FY2018 (loss): $12.7 million**

Scenario 1:

The amount of eligible existing hotel stock was taken, and assuming annual depreciation of 2.0%, it is estimated that 2% of eligible units will be renovated in any given year. Assuming a renovation cost of $63,000 (based on inflation-adjusted renovation costs in 2002), it is estimated that the estimated renovation costs will total $60.9 million in 2014. With a 15% tax credit, the tax credit will result in a revenue loss of $9.1 million in FY2015.

Scenario 2:

It is assumed that any renovation after 2010 will be postponed until after 2014 to take advantage of the credit. Thus, the loss in revenue from FY2011-2014 will be the forgone GE revenue from the construction that otherwise would have happened. The loss in revenue from FY2015 onwards will be the credit cost of the now-increased construction, less the additional GE that was displaced from FY2011-FY2014.

LINDA LINGLE
Governor

Hawai'i Tourism Authority

REX D. JOHNSON
President and Chief Executive Officer

Hawai'i Convention Center, 1801 Kalākaua Avenue, Honolulu, Hawai'i 96815
Website: www.hawaiitourismauthority.org

Telephone: (808) 973-2255
Fax: (808) 973-2253

Testimony of
Rex Johnson
President and Chief Executive Officer
Hawai'i Tourism Authority
on
H.B. 2985, H.D. 1
Relating to Taxation

Senate Committee on Economic Development and Taxation
Tuesday, March 18, 2008
1:15 p.m.
Conference Room 224

The Hawai'i Tourism Authority (HTA) supports H.B. 2985, H.D, 1, which proposes a tax credit for the renovation of hotel facilities, equal to fifteen percent of the renovation costs beginning in the taxable years after December 31, 2013 and ending before January 1, 2020.

The HTA is tasked with marketing and promoting Hawai'i as a visitor destination, with the goal of increasing visitor spending. One of the keys to branding the Hawai'i visitor industry product and increasing visitor spending is the improvement and enhancement of the tourism product, which includes the physical infrastructure. As such, the HTA supports H.B. 2985, H.D. 1, which provides a tax credit of 15 percent of the costs of renovation of a hotel facility. The credit will be an incentive for the private sector to improve hotel facilities for visitors.

Thank you for the opportunity to provide these comments.

LINDA LINGLE
GOVERNOR
MARSHA WIENERT
TOURISM LIAISON

TOURISM LIAISON

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804

Telephone: (808) 586-2362
Fax: (808) 586-2370

Written statement of
MARSHA WIENERT
Tourism Liaison
Department of Business, Economic Development & Tourism
before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION
Tuesday, March 18, 2008
1:15 p.m.
State Capitol, Conference Room 224

in consideration of
HB 2985 HD1
RELATING TO TAXATION.

Chair Fukunaga and Members of the Senate Committee on Economic Development & Taxation.

The Department of Business, Economic Development and Tourism appreciates the overall concept of HB 2985 HD1, which provides a tax credit for hotel renovations. However, we have strong concerns about the cost implications that may be generated by this proposal.

Reinvestment in our tourism product and hotel inventory is vital to maintaining a successful visitor industry, but due to the advanced date of the tax credit within this measure, hotel companies may choose to postpone needed renovations in order for the credit to apply. Furthermore, we believe that it would be more appropriate to discuss the necessity of a hotel renovations tax credit in 2014 at a later date, as we can only guess at the budgetary effects that such a credit may have at that time.

Therefore, we respectfully request that this measure be deferred.

Thank you for the opportunity to comment on HB 2985 HD1.

UNITE HERE!
LOCAL 5 HAWAII

Eric Gill, Financial Secretary-Treasurer *Hernando Ramos Tan, President* *Godfrey Maeshiro, Senior Vice-President*

Friday, March 14, 2008

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice Chair
Senate Committee on Economic Development & Taxation

Testimony regarding HB 2985 HD 1; *relating to taxation.*

Chair Fukunaga, members of the Senate Committee on Economic Development & Taxation, I submit this testimony on behalf of UNITE HERE! Local 5 – a local labor organization representing nearly 12,000 hotel and health care workers throughout our State.

House Bill 2985 HD 1 would provide for an income tax credit equal to 15% of the costs of hotel renovations between 2014 and 2019.

UNITE HERE! Local 5 would like to offer comments on this measure.

While we believe it is worthy to support measures that speak to the importance of the economic activity generated by Hawaii's tourism industry, we wish to echo the concerns already articulated by the Department of Taxation before the House Committee on Tourism & Culture regarding the "fiscal priority of subsidizing this industry."

Nonetheless and as we engage ourselves in these discussions surrounding the economic viability and future of our hotel industry, we humbly suggest that we first remind ourselves of the important role our unionized hotel workers have and continue to play in securing a future for middle-class families in Hawaii. Consequently, the sacrifices made by our members and other hotel workers whose properties have and continue to undergo hotel renovations must not be overlooked in these discussions. In other words, if we are to provide financial incentives for the improving of hotel facilities for our visitors then we must also be confident that such initiatives are mutually beneficial for the workers and taxpayers of our State. As such, we must pay close attention to and advocate for strict qualification guidelines that protect workers' rights that can in return be applied to the process those seeking the tax credit must eventually abide by.

Thank you for the opportunity to provide these comments.

Sincerely,

Cade M. Watanabe

Cade M. Watanabe
Community/Political Organizer

1050 Queen Street, Suite 100 • Honolulu, Hawaii • 96814-4130 • Phone (808) 941-2141 • Fax (808) 941-2166 • www.unitehere5.org

HAWAI`I HOTEL & LODGING
ASSOCIATION
2270 Kalakaua Ave., Suite 1506
Honolulu, HI 96815
Phone: (808) 923-0407
Fax: (808) 924-3843
E-Mail: hhla@hawaiihotels.org
Website: www.hawaiihotels.org

VISITOR INDUSTRY CHARITY WALK
30th Anniversary
Are You Walking???
May 17, 2008
(Always the 3rd Saturday in May)
www.charitywalkhawaii.org

TESTIMONY OF MURRAY TOWILL
PRESIDENT
HAWAI`I HOTEL & LODGING ASSOCIATION

March 18, 2008

RE: HB 2985 HD 1 Relating to Taxation

Good afternoon Chairperson Fukunaga and members of the Senate Committee on Economic Development & Taxation. I am Murray Towill, President of the Hawai`i Hotel & Lodging Association.

The Hawai`i Hotel & Lodging Association is a statewide association of hotels, condominiums, timeshare companies, management firms, suppliers, and other related firms and individuals. Our membership includes over 170 hotels representing over 47,300 rooms. Our hotel members range from the 2,523 rooms of the Hilton Hawaiian Village to the 4 rooms of the Bougainvillea Bed & Breakfast on the Big Island.

The Hawai`i Hotel & Lodging Association supports HB 2785 HD 1 Relating to Taxation. This bill would provide a future tax credit for the renovations of hotels.

This measure is timely in that it would help encourage renovations at a time when the economy is slowing and the industry is expecting fewer customers. Stimulating construction activity will not only assist construction jobs but will help to position the visitor industry to be competitive in the future.

An additional advantage of a hotel renovation tax credit is that it would help to offset the financial incentive of converting hotels to timeshares or condominium developments. In recent years conversions of this type have made great economic sense due to consumer demand and the ability to obtain a more immediate return for developers and investors. The net effect of this incentive would be to help maintain the hotel room inventory.

One of the limitations of this bill is that the tax credit does not take effect until 2014. We would be concerned that this measure might encourage owners to delay investment to a time closer to the availability of the tax credit.

Again, mahalo for this opportunity to testify.

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Hotel renovation tax credit

BILL NUMBER: HB 2985, HD-1

INTRODUCED BY: House Committee on Tourism and Culture

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers subject to HRS chapter 235 and 237D to claim a hotel renovation tax credit of 15% of the renovation costs incurred after December 31, 2007. Stipulates that it shall not include the construction or renovations cost for which another income tax credit was claimed for the taxable year.

In the case of a partnership, S corporation, estate or trust, the credit shall be determined at the entity level. If a deduction is taken under IRC section 179 (with respect to election to expense depreciable business assets), no tax credit shall be allowed for that portion of the renovation cost for which the deduction was taken. The basis of eligible property for depreciation or accelerated cost recovery system shall be reduced by the amount of credit allowable and claimed.

The credit shall be deductible from the taxpayer's income tax liability with any excess credit in an amount greater than $1 refunded to the taxpayer. Claims for the credit, including any amended claims, must be filed on or before the end of the twelfth month following the close of the taxable year. The credit shall be applied for on forms provided by the tax department.

The tax credit shall be available for tax years beginning after December 31, 2013 for building permits submitted to the appropriate county agency before December 31, 2014, and shall not be available for tax years beginning after December 31, 2019.

Defines "hotel facility," "net income tax liability," "renovation" and "taxpayer" for purposes of the measure. "Hotel facility" shall not include any building that is used or contains any room that is used as a condominium or timeshare unit.

EFFECTIVE DATE: July 1, 2025

STAFF COMMENTS: The legislature by Act 195, SLH 2000, enacted a hotel construction and renovation tax credit of 4% for hotel renovations effective for tax years beginning after December 31, 1998 but before December 31, 2002. Act 10 of the Third Special Session of 2001 increased the hotel renovation tax credit to 10% for construction costs incurred before July 1, 2003. Act 10 also provided that the credit shall revert back to 4% on July 1, 2003 and sunset on December 31, 2005. This measure proposes a similar credit for a five-year period between December 31, 2014 and December 31, 2019.

The original tax credit was promoted on the argument that the tax credit would be an incentive for hotels to refurbish their properties in order to remain competitive with other destinations around the world. The credit amount was set at 4% to seemingly offset the 4% general excise tax. When 9/11 hit, the momentum of the crisis fostered support for an increase in the credit to 10% to supposedly keep projects which were already in progress going. However, the governor objected and threatened to veto the sweetened credit. The legislature compromised and provided that the 10% credit would be nonrefundable.

While this measure proposes to reestablish a hotel renovation tax credit, it should be noted that no evaluation has been done to validate the effectiveness of this credit in spurring substantial renovations of hotel resort properties. While some may argue that this credit is necessary to make their upcoming renovations pencil out, one must ask whether or not it is the role of government to subsidize private investments. While the credit might be viewed as critical to a taxpayer's project or to the continued renovation of the resort plant, one must ask how long must all other taxpayers suffer the heavy burden of taxation so that this subsidy can be extended to a few?

It would be a very different picture if those who are asking for the subsidy would be willing to forgo other public services or make recommendations on how government can rein in spending, but that is not the case.

Now more than ever lawmakers need to recognize that they need to set priorities for what precious few dollars taxpayers can part with to run state and local government. One must ask how lawmakers can provide subsidies like this proposal when they raised the general excise tax on all other taxpayers to pay for a transit system in Honolulu? Taking care of a few taxpayers at the expense of all other taxpayers is certainly a cavalier attitude for which taxpayers have long suspected comes with the legislature.

Instead of perpetuating these targeted tax incentives and subsidies, lawmakers should look at the broader picture and enact tax relief that will benefit all taxpayers. Perpetuating targeted tax credits, like this, merely perpetuates the high burden of taxes in Hawaii which, in turn, places a barrier on any recovery. From a global perspective, what effect will these credits have on the cost of construction in Hawaii?

In retrospect, lawmakers should examine what their past actions accomplished in this area. Told that tax credits to stimulate construction would encourage renovation of hotel facilities prior to 9/11 and then after that tragedy to get construction workers off the bench and help the economy in the aftermath, the credit for hotel construction and renovation tax credit was boosted on a temporary basis and a 4% residential renovation and construction tax credit was adopted. But what drove the construction activity after 9/11 was really the fall in interest rates creating new homeowners and homeowners who traded up. On the hotel renovation side, with cheaper financing, projects began to pencil out as feasible. Thus, the tax credits became nothing more than additional savings and profit as homeowners renovated in preparation for sale and for the hotel side, the cost of renovation brought the potential rental income into a reasonable territory.

It is interesting to note that in the committee report attached to HD-1 there is growing concern about the conversion of hotels to timeshares and condominiums, especially for non-beachfront properties which can't command the same room rates as beachfront properties. The committee report notes that as a result, beachfront properties can pay for needed renovation costs where as non-beachfront properties may not be able to afford to upgrade their facilities. If that is the case, then the tax may just be a windfall for beachfront properties while the non-beachfront properties will still have to struggle with amassing the capital to undertake the renovation. It should be remembered that the credit can only be claimed if the activity is undertaken. Thus, the credit is of no use if a property cannot pull the financing together.

What should be learned is that while well-intended, government intervention into the economic cycle merely skews the economy out of kilter and into artificial growth patterns. The outcome of the tax credit subsidy is that construction costs will become even more costly in the future and again skew the economic marketplace. This fooling around with the economic marketplace came at a dear price as state tax resources were stretched thin. Raising taxes while providing such subsidies to specific taxpayers should be unacceptable. Lawmakers should not allow this to happen.

Digested 2/25/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 3064 HD 2 SD 1
RELATING TO REFUNDABLE RENEWABLE ENERGY TAX CREDITS

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This measure amends the Renewable Energy Technologies Income Tax Credit by allowing the credit to be refundable for those that have little Hawaii taxable income.

The Senate Committee on Energy & Environment amended this measure by unspecifying the adjusted gross income amounts for purposes of determine credit qualification.

The Department of Taxation (Department) **strongly supports** this Lingle-Aiona Administration measure as a policy to encourage additional investment in renewable energy technologies.

PURPOSE OF REFUNDABLE CREDIT

Under current Hawaii law, pension income, including social security is not taxable. This population includes retirees that may have little Hawaii taxable income (investment income) due to the exclusion, but would otherwise have the resources to invest in these technologies. This legislation will allow those with the resources to obtain a refundable incentive for installations of renewable energy technologies. This legislation also extends to any taxpayer with less than $_________ of adjusted gross income. This would provide incentives for the lower- and middle-class to invest in these technologies, depending upon what this amount ultimately is.

ADJUSTED GROSS INCOME AMOUNT

The Department is open to the unspecifying of the adjusted gross income limits for discussion purposes, to the extent that the income amounts are reasonable. The intent of the measure is to provide a refundable credit for those that have low Hawaii taxable income. This adjusted gross income amount should reflect this intent.

As a guide for selecting the proper adjusted gross income, the Department provides the following chart from US Department of Health & Human Services. The Department submits that $20,000 adjusted gross income in the prior bill represented the income of a family at or near poverty in Hawaii.

2008 HHS Poverty Guidelines

Persons in Family or Household	48 Contiguous States and D.C.	Alaska	Hawaii
1	$10,400	$13,000	$11,960
2	14,000	17,500	16,100
3	17,600	22,000	20,240
4	21,200	26,500	24,380
5	24,800	31,000	28,520
6	28,400	35,500	32,660
7	32,000	40,000	36,800
8	35,600	44,500	40,940
For each additional person, add	3,600	4,500	4,140

REVENUE IMPACT

This legislation will result in an indeterminate amount due to the unspecified adjusted gross income level.

Assuming the $20,000 adjusted gross figure was utilized, the revenue estimate is estimated to be $41,000, starting in fiscal year 2009.

The estimate for making the renewable energy tax credit refundable for taxpayers with adjusted gross income of $20,000 or less (or $40,000 or less for joint filers) is based on 2005 renewable energy tax credit data. Total number of returns that claimed the renewable energy credit for Single/Married Filing Separate and Head of Households with AGI <$20,000 is 316, with total amount claimed of $117,304. Total number of returns that claimed the renewable energy credit for Single/Married Filing Separate and Head of Households with AGI <$20,000 is 76 returns, with total amount claimed of $16,861. Total number of returns that claimed the renewable energy credit for Joint filers with AGI <$40,000 is 240, with total amount claimed of $100,443. Total credit claimed was $117,304. Assuming that because the credit is now refundable, there will be an increase of 35%. Therefore, the estimated lost in income tax is $41,000 annually.

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

LINDA LINGLE
GOVERNOR
THEODORE E. LIU
DIRECTOR
MARK K. ANDERSON
DEPUTY DIRECTOR

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Web site: www.hawaii.gov/dbedt

Telephone: (808) 586-2355
Fax: (808) 586-2377

Statement of
THEODORE E. LIU
Director
Department of Business, Economic Development, and Tourism
before the
SENATE COMMITTEE
ON
ECONOMIC DEVELOPMENT AND TAXATION
Tuesday, March 18, 2008
1:15 p.m.
State Capitol, Conference Room 224

in consideration of
HB3064 HD2 SD1
RELATING TO REFUNDABLE RENEWABLE ENERGY TAX CREDIT.

Chair Fukunaga, Vice Chair Espero, and Members of the Committee.

The Department of Business, Economic Development, and Tourism (DBEDT) supports the intent of HB3064, HD2, SD1, but strongly recommends adoption of HB3064, HD1, which reflects the original intent of this Administration measure. The Administration measure allows for the present renewable energy tax credits to be refundable for those taxpayers with an adjusted gross income of up to $20,000. Joint filings by a husband and wife would be capped at $40,000.

HB3064, HD2, SD1, makes changes to the Administrative measure by:

(1) Changing the taxpayer's qualifying adjusted gross income limit to an unspecified amount;

(2) Changing the measure's effective date to July 1, 2050 to facilitate continued discussion; and

(3) Making technical, nonsubstantive amendments for the purpose of style and clarity.

At present, the statutes governing the renewable energy tax credits are only offered to those with tax liabilities. Therefore, home owners who have no tax liability, such as retired persons on fixed incomes or certain low-income families, cannot take advantage of the sizeable tax credits offered. HB3064, HD1, would allow residential taxpayers to claim a refund for their investment in renewable energy technologies. Currently, the tax credit is 35%, with various dollar caps, for the cost to purchase and install solar water heating systems, photovoltaic systems, and wind systems. Home owners with limited or fixed incomes would benefit from the use of solar water heating or other renewable energy system to reduce their utility costs. Under the present statute, residential taxpayers who do not have a tax liability do not benefit from the renewable energy tax credits. HB3064, HD1, will allow the tax credits to be refundable to offset the cost of the renewable system.

During our many community outreach and exhibit efforts, we have often received comments from senior citizen home owners who are not able to claim the present tax credit. These home owners have felt shut out from the tax credit and the benefits of installing renewable energy devices.

Thank you for the opportunity to offer these comments.

COLLEGE OF SOCIAL SCIENCES

HAWAII ENERGY POLICY FORUM

UNIVERSITY OF HAWAI'I AT MĀNOA

Testimony of
Warren Bollmeier
Co-Chair – Renewable Energy Working Group
Hawai'i Energy Policy Forum

Senate Committee on Economic Development and Taxation
Tuesday, March 18, 2008
1:15 p.m.
Conference Room 224

IN SUPPORT OF HB 3064, SD 1 - Relating to Refundable Renewable Energy Tax Credit

I am Warren Bollmeier, Co-Chair of the Renewable Energy Working Group of the Hawaii Energy Policy Forum ("Forum"). The Forum is comprised of 45 representatives from the electric utilities, oil and natural gas suppliers, environmental and community groups, renewable energy industry, and federal, state and local government, including representatives from the neighbor islands. We have been meeting since 2002 and have adopted a common vision and mission, and a comprehensive "10 Point Action Plan," which serves as a framework and guide for meeting our preferred energy vision and goals.

The Forum supports the passage of HB 3064, SD 1 as it helps achieve the goal of Point One - expand renewable energy opportunities. The purpose of HB 3064, SD 1 is to allow a taxpayer, whose income consists solely of pension benefits or has an unspecified adjusted gross income to qualify for a refundable tax credit for the purchase and installation of a renewable energy technology, including solar water heating, photovoltaic systems, and wind systems.

Thank you for this opportunity to testify.

This testimony reflects the position of the Forum as a whole and not necessarily of the individual Forum members or their companies or organization

2424 Maile Way • Saunders Hall 723 • Honolulu, HI 96822 • Telephone (808) 956-4237 • Fax (808) 956-6870

Sierra Club
Hawai'i Chapter
PO Box 2577, Honolulu, HI 96803
808.537.9019 hawaii.chapter@sierraclub.org

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
March 18th, 2008, 1:15 P.M.

(Testimony is 1 page long)

TESTIMONY IN SUPPORT OF HB 3064 HD2 SD1

Chair Fukunaga and members of the Committee:

The Sierra Club, Hawai`i Chapter, with 5500 dues paying members statewide, supports HB 3064 HD2 SD1, providing a direct refund to retired or low income individuals for the purchase and installation of a renewable energy system.

Hawaii's renewable energy tax credits have proven incredibly successful in helping to promote the use of solar and other renewable energies in the state. Hawai'i currently leads the nation in the number of solar water heaters installed per capita (although 80% of homes still lack this basic renewable energy device).

House Bill 3064 HD2 SD1 would enable those who lack a taxable income over a certain amount to access the renewable energy incentive. It particularly makes sense to extend this tax credit in the form of a refund to those low-income homeowners who would most benefit from reduced energy costs provided by a solar water heater. Additionally, retired homeowners on a fixed income should be encouraged to invest in this smart technology as well.

Thank you for the opportunity to testify.

Jeff Mikulina, Director

HAWAII RENEWABLE ENERGY ALLIANCE

46-040 Konane Place #3816, Kaneohe, HI 96744 – Telephone/FAX: 247-7753 – Email: wsb@lava.net

TESTIMONY OF WARREN BOLLMEIER ON BEHALF OF THE HAWAII RENEWABLE ENERGY ALLIANCE BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

HB 3064 HD2 SD1, RELATING TO REFUNDABLE RENEWABLE ENERGY TAX CREDIT

March 18, 2008

Chair Fukunaga, Vice-Chair Espero and members of the Committee I am Warren Bollmeier, testifying on behalf of the Hawaii Renewable Energy Alliance (HREA). HREA is a nonprofit corporation in Hawaii, established in 1995 by a group of individuals and organizations concerned about the energy future of Hawaii. HREA's mission is to support, through education and advocacy, the use of renewables for a sustainable, energy-efficient, environmentally-friendly, economically-sound future for Hawaii. One of HREA's goals is to support appropriate policy changes in state and local government, the Public Utilities Commission and the electric utilities to encourage increased use of renewables in Hawaii.

The purpose of HB 3064 HD2 SD1 is to allow a taxpayer whose sole source of income is derived from pension benefits or with an adjusted gross income of $ or less to qualify for a refundable tax credit for the purchase and installation of a renewable energy technology, which includes solar water heating, photovoltaic, and wind systems

HREA **strongly supports** this bill, which will provide an option to those consumers (seeking to invest in wind or solar systems) that don't have a "tax credit" appetitive.

Thank you for this opportunity to testify.

Testimony before the
Senate Committee on
Economic Development and Taxation

H. B. 3064 HD2, SD1 - Relating to Refundable Renewable Energy Tax Credit

Tuesday, March 18, 2008
1:15 p.m., Conference Room 224

by Keith Block
Director, Customer Efficiency Programs
Hawaiian Electric Company, Inc.

Chair Fukunaga, Vice Chair Espero and Members of the Committee:

My name is Keith Block and I am testifying on behalf of Hawaiian Electric Company, Inc., and its subsidiaries, Maui Electric Company (MECO) and Hawaii Electric Light Company, Inc. (HELCO).

Hawaiian Electric supports the use and development of renewable energy and supports HB 3064 HD2, SD1.

Hawaiian Electric has been encouraging the use of renewable energy through its residential solar water heating program for over 11 years. In that time the companies have provided rebates to over 39,000 customers for the installation of solar water heating systems on their homes.

Tax credits are a vehicle which the legislature has used successfully for many years. Making the renewable energy technology tax credit refundable for Hawaii residents who are exempt from taxation or who have low adjusted gross incomes should make these systems more affordable and accelerate Hawaii's transition to increased use of renewable energy. Increasing the penetration of renewable energy systems is consistent with State's energy policy and support achieving established Renewable Energy Portfolio Standards.

Thank you for this opportunity to testify

Hawaii Solar Energy Association
Serving Hawaii Since 1977

TESTIMONY OF THE HAWAII SOLAR ENERGY ASSOCIATON
IN REGARD TO H.B. 3064, H.D. 2, S.D. 1
RELATING TO REFUNDABLE RENEWABLE ENERGY TAX CREDIT
BEFORE THE
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION
ON
TUESDAY, MARCH 18, 2008

Chair Fukunaga, Vice-Chair Espero and members of the committee, my name is Rick Reed and I represent the Hawaii Solar Energy Assn (HSEA) The HSEA is a professional trade association established in 1977, and affiliated with the Solar Energy Industries Association (SEIA) in Washington, D.C. HSEA represents manufacturers, distributors, contractors, financiers, and utility companies active in the solar energy industry in Hawaii. We strongly support the passage of H.B. 3064, H.D. 2, S.D. 1.

This bill amends HRS 235-12.5 to allow resident taxpayers whose taxable income is either exempt from taxation, or falls below an unspecified – but assumed to be relatively low - AGI for singles and couples, to receive a cash refund rather than a standard income tax credit against taxable income for installing a solar water heating system, PV system, or wind generator.

This simple amendment will broaden the effectiveness and equity of this statute by making solar technologies more affordable to low income taxpayers, retired families and those whose retirement income is exempt in Hawaii from taxation.

Thank you for the opportunity to testify.

P.O. Box 37070 Honolulu, Hawaii 96837
SOLAR HOTLINE (808)521-9085

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Renewable energy technology systems

BILL NUMBER: HB 3064, SD-1

INTRODUCED BY: Senate Committee on Energy and Environment

BRIEF SUMMARY: Amends HRS section 235-12.5 to provide that the renewable energy technologies income tax credit claimed by taxpayers with no taxable income or with adjusted gross income of under $_________ shall be refundable.

EFFECTIVE DATE: July 1, 2050; applicable to tax years beginning after December 31, 2007

STAFF COMMENTS: This is an administration measure submitted by the department of business, economic development and tourism BED-12(08). While the administration's justification sheet states that the adoption of this measure will allow residential taxpayers with no tax liability or those with low incomes to purchase a renewable energy system to help offset the upfront cost, it underscores the fact that such renewable energy systems are still not affordable to everyone.

If it is the intent of the legislature to encourage a greater use of renewable energy systems by all taxpayers, as an alternative, consideration should be given to a program of low-interest loans available to all income levels.

The combination of a low-interest loan which can be repaid with energy savings would have a much more broad-base application than a credit which amounts to nothing more than a "free monetary handout" or subsidy by state government for those taxpayers who more than likely can afford to make the conversion. A program of low or no-interest loans such as those proposed in HB 2101 would do much more to increase the acquisition of these devices. Persons of all income levels could borrow the funds, make the acquisition, and repay the state program in an amount equal to the avoided cost that their utility bills would now reflect.

To reiterate, if lawmakers truly want to provide a financial incentive for taxpayers to make the switch to using these alternative energy devices while taking advantage of the credit, then a program of no-interest, or low-interest loans would be far more effective. The state could provide the capital to acquire these devices, and the taxpayer could receive a discount of 30% provided by the federal tax credit. The amount of the state loan could then be amortized by the energy savings realized by the taxpayer.

Finally, it appears that there are some taxpayers for whom there is no state tax liability and therefore a nonrefundable tax credit such as the renewable energy tax credit provides no incentive. Again, this is one of the inherent flaws of using tax credits to entice certain behaviors. To change the credit now for some people and not for others from a nonrefundable to a refundable credit sets poor tax policy as it lacks consistency.

Digested 3/17/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 3444 HD 2 SD 1
RELATING TO ENERGY

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 4:00PM
ROOM: 308

As amended, this bill amends the environmental response tax to include an energy security tax component. This legislation also increases the environmental response and security tax to an unspecified amount. The legislation provides allocation of revenues to various sources.

The Department of Taxation **opposes** this legislation.

First, this legislation represents a tax increase that will eventually impact the gasoline prices all Hawaii drivers pay. Last legislative session, tempering high gasoline prices was a top priority that led to passage of an alcohol fuel general excise tax exemption. This legislation runs counter to accomplishments in reducing Hawaii's gas prices. In order to effectively minimize the high price of gasoline at the pump, such efforts must be done in ways other than tax increases such as this legislation.

Second, this bill creates an unnecessary special fund. The Department opposes the creation of a special fund that does not meet the mandatory requirements by law.

This legislation will result in no loss to the general fund. However, the tax is expected to generate an unspecified amount of revenue for the various special funds. This amount is indeterminate because of the unspecified tax rate.

The tax is expected to generate approximately $5.2 million annually, with $4.4 million deposited into the energy security special fund and $0.9 million deposited into the energy systems development special fund (due to rounding, the appropriations do not add up to $5.2 million). Note: $1.7 million or approximately 5 cents per barrel is already being deposited into the environmental response revolving fund.

General Fund expenditures will increase by an amount yet to be specified.

Based on the Liquid Fuel Tax Base and Collections Report for FY2007, $1.7 million was collected in the environmental response tax, which is a 5-cent per barrel tax on petroleum products sold by a distributor to any retail dealer or end user other than a refiner. To approximate the number of barrels sold, the Department divided the total collections by $0.05 (34.8 million barrels). The Department then imposed the 15 (additional) cent per barrel tax to estimate total revenues generated on top of the existing 5-cent environmental response tax.

WRITTEN ONLY

TESTIMONY BY GEORGINA K. KAWAMURA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT
AND TAXATION
ON
HOUSE BILL NO. 3444, H.D. 2

March 18, 2008

RELATING TO ENERGY

House Bill No. 3444, H.D. 2, would provide additional financing for the energy program of the Department of Business, Economic Development and Tourism by establishing the Energy Security Special Fund. The Energy Security Special Fund would be used to promote energy self-sufficiency and energy security for the State. The special fund would be funded through legislative appropriations, interest earnings, a portion of the revenues from the environmental response tax that is imposed on each barrel of petroleum product sold by a distributor, and other moneys made available from other sources. The bill appropriates an unspecified amount in general funds in FY 09 to be deposited into the special fund.

As a matter of general policy, this department does not support the creation of any special or revolving fund which does not meet the requirements of Sections 37-52.3 or 37-52.4 of the Hawaii Revised Statutes. Special or revolving funds should: 1) reflect a clear nexus between the benefits sought and charges made upon the users or beneficiaries of the program; 2) provide an appropriate means of financing for the program or activity; and 3) demonstrate the capacity to be financially self-sustaining. It is difficult to determine whether the fund will be self-sustaining.

LINDA LINGLE
GOVERNOR OF HAWAII

CHIYOME LEINAALA FUKINO, M.D.
DIRECTOR OF HEALTH

STATE OF HAWAII
DEPARTMENT OF HEALTH
P.O. Box 3378
HONOLULU, HAWAII 96801-3378

In reply, please refer to:
File:

SENATE COMMITTEE ON

ECONOMIC DEVELOPMENT AND TAXATION

H.B. 3444, HD2, SD1, RELATING TO ENERGY

Testimony of Chiyome Leinaala Fukino, M.D.
Director of Health

March 18, 2008
1:15 P.M.

Department's Position: The Department of Health appreciates the intent of this bill to provide financial support for energy conservation, alternative energy development, and global warming initiatives. The Department has reservations about the bill but asks that it be kept alive as a vehicle for further discussion.

Fiscal Implications: The bill proposes 20 cents of taxes per barrel of petroleum, compared to 5 cents per barrel now. We defer to the Departments of Budget and Finance and Taxation as to the fiscal impacts of this legislation. Last fiscal year, the 5 cent tax per barrel generated about $1.6 M for the Environmental Response Revolving Fund (ERRF).

Purpose and Justification: The bill intends to provide monies for alternative energy, energy conservation, global warming initiatives, and other efforts. The bill amends HRS Section 243-3.5 to rename the tax the "Environmental Response and Energy Security Tax" and alters the per barrel petroleum product tax from the present 5-cents to an undetermined amount that will be distributed among the three funds: 5 cents per barrel to the ERRF, as now occurs; 12.5 cents per barrel to a new energy security special fund; and 2.5 cents per barrel to the energy systems development special fund.

In general, the Department strongly supports the development of clean energy, produced in Hawaii, and independent from fossil fuels, and the reduction of greenhouse gas emissions. We support adequate funding to advance those goals, consistent with administration budget priorities. .

Given the cost of living in Hawaii, we are very concerned with the effect of any fee or tax increases on our citizens. The administration does have a proposal in the Executive Supplemental Budget that funds some energy operations from the ERRF. We urge continued discussion about the most appropriate funding mechanism to meet the State's critical goal of producing clean, alternative energy in Hawaii.

The Department has a specific concern that at least a 5-cents per barrel tax maintained for the ERRF to fund our statutorily mandated functions to be ready to respond to oil spills and hazardous substance releases, and to continue support our 38 departmental positions.

We ask that any legislation avoid an adverse impact on the priorities in the Executive Supplemental Budget.

Thank you for the opportunity to testify on this important measure.

UNIVERSITY OF HAWAIʻI SYSTEM
Legislative Testimony

Testimony Presented Before the
Senate Committee on Economic Development and Taxation
March 18, 2008 at 1:15 p.m.
Conference Room 224

Presented by
Dr. Richard Rocheleau
Director of the Hawaii Natural Energy Institute
University of Hawaiʻi at Mānoa

HB 3444, HD2, SD1 – RELATING TO ENERGY

Chair Fukunaga, Vice Chair Espero, and Members of the Committee:

Thank you for the opportunity to testify today on HB 3444, HD2, SD1. I am Dr. Richard Rocheleau, Director of the Hawaii Natural Energy Institute (HNEI) of the University of Hawaiʻi at Mānoa. The University can only support the intent of the bill at this time because of our pressing priorities, such as our tremendous need for repairs and maintenance and health and safety issues, which are critical to our ability to perform our core mission for the State of Hawaiʻi. We are grateful for the Legislature's attention to these needs.

We recognize that you have many priorities and issues to weigh for the state, so the following substantive information on this program is provided to assist you in your decision-making process.

While I support the intent of all aspects of HB 3444, my comments below are specific to the portion of the fund intended for the Energy Systems Development Special Fund.

In 2007, this legislature passed ACT 253 (HB 1003) which established HNEI in statute and directed HNEI to work in coordination with state and federal agencies and private entities to undertake a number of activities including:

- Develop renewable sources of energy for power generation;
- Conduct research and development of renewable sources of energy;
- Demonstrate and deploy efficient energy end-use technologies including those that address peak electric demand issues;
- Aggressively seek matching funding from federal agencies and private entities for research and development and demonstration issues; and,
- Report annually to the legislature.

Act 253 also established the Energy Systems Special Fund to be administered by HNEI for the purpose of developing an integrated approach and portfolio management of renewable energy and energy efficiency technologies. The portfolio approach and oversight provided for in Act 253 was designed to ensure that technologies selected for funding were those most likely to reduce Hawai'i 's dependence on fossil fuels and move Hawai'i quickly toward energy self-sufficiency.

HB 3444, HD2, SD1 includes the assignment of a portion of the Energy Security Special Fund that will be used to fund the energy systems development special fund managed by the Hawaii Natural Energy Institute. As demonstrated in similar programs in other states, funding of the Energy Systems Special Fund can be expected to leverage federal and private investments to accelerate acceptance and deployment of critically needed emerging technologies in both renewable energy generation and energy efficiency benefiting all stakeholders. Used in support of the recently announced Hawaii Clean Energy Initiative, a partnership between the state of Hawai'i and the US Department of Energy, it is reasonable to expect significant leveraging of federal and state investment in Hawai'i.

Thank you for the opportunity to testify in support of the intent of HB 3444, HD2, SD1. We appreciate all interest in the University, and want to emphasize that we will be able to perform better in all arenas and best serve the state with support of the current campus priorities approved by the Board of Regents.

COLLEGE OF SOCIAL SCIENCES
HAWAII ENERGY POLICY FORUM
UNIVERSITY OF HAWAI'I AT MĀNOA

Testimony of
Warren Bollmeier
Co-Chair – Renewable Energy Working Group
Hawai'i Energy Policy Forum

Senate Committee on Economic Development and Taxation
Tuesday, March 18, 2008
1:15 pm
Conference Room 224

IN GENERAL SUPPORT OF HB 3444, SD 1 – Relating to Energy

I am Warren Bollmeier, Co-Chair of the Renewable Energy Working Group of the Hawaii Energy Policy Forum ("Forum"). The Forum is comprised of 46 representatives from the electric utilities, oil and natural gas suppliers, environmental and community groups, renewable energy industry, and federal, state and local government, including representatives from the neighbor islands. We have been meeting since 2002 and have adopted a common vision and mission, and a comprehensive "10 Point Action Plan," which serves as a framework and guide for meeting our preferred energy vision and goals. The Forum generally supports the passage of HB 3444, SD 1 as it helps achieve many goals of the Forum.

HB 3444, SD 1 establishes the Energy Security Special Fund into which the renamed Environmental Response and Energy Security tax will be deposited. This bill would provide a dedicated source of funding for DBEDT's energy program.

The number of energy related programs under DBEDT's purview has dramatically increased in recent years due to the Legislature's passage of numerous measures that will enable Hawaii to have a secure energy future. Currently, two-thirds of DBEDT's energy staff is funded by federal funding, which, at the current rate of expenditure will disappear in approximately 3-4 years. The Forum strongly supports funding for DBEDT's energy staff and while the Forum is reluctant to support an increase in taxes, we believe that if state general funds or federal funds are not available, then an increase in the environmental response tax is needed to ensure continuity of the state's energy programs. The proposed tax increase will have enormous benefits that will save money in the long run and ensure that Hawaii's future remains energy secure.

While the Forum supports this increase to provide a dedicated source of funding for DBEDT's energy programs, we strongly urge that no funds be diverted or diminished from the current allocation of the environmental response tax towards oil spill planning, prevention, preparedness, education, research, training, removal, and remediation, and to support environmental protection and natural resource protection programs.

Thank you for this opportunity to testify.

This testimony reflects the position of the Forum as a whole and not necessarily of the individual Forum members or their companies or organization

2424 Maile Way • Saunders Hall 723 • Honolulu, HI 96822 • Telephone (808) 956-4237 • Fax (808) 956-6870

Testimony Before the Senate

Committee on Economic Development and Taxation

By Michael V. Yamane P.E.
Senior Electrical Engineer
Kauai Island Utility Cooperative
4463 Pahee Street, Suite 1, Lihue, Hawaii, 96766-2000

Tuesday, March 18, 2008, 1:15 p.m.
Conference Room # 224

House Bill No. 3444, HD2, SD1 – Relating to Energy

To the Honorable Carol Fukunaga, Chair; Will Espero, Vice-Chair, and members of the Committee on Economic Development and Taxation:

Thank you for the opportunity to testify on this measure. My name is Mike Yamane, representing Kauai Island Utility Cooperative. I am here today to testify on H.B. 3444 H.D. 2, S.D. 1, which *"Establishes the Energy Security Special Fund. Renames the Environmental Response Tax the 'Environmental Response and Energy Security Tax' and increases the tax."*

KIUC supports the intent of H.B. 3444 H.D. 2, S.D. 1 and commends the Legislature on their commitment to develop a long-term energy strategy to secure a sustainable energy future for Hawaii. However, KIUC has some reservation about this bill and would like to offer comments for your consideration.

- Any additional tax placed on the fuel KIUC purchased for Power Generation will be directly borne by our members.
- As you are aware KIUC is a member-owned electric cooperative. Unlike for profit corporations, cooperatives are non-profit and member run. Without the need for profits and shareholder dividends, cooperatives are free to invest what would normally be profits (cooperatives call them "margins") in the business by allocating margins to the cooperative's members as capital credit contributions, or, eventually, by making patronage capital refunds to its members.
- KIUC believes monies could be more effectively utilized by the cooperative to help us achieve KIUC goals in our Strategic Plan, which calls for reduced carbon emissions to 1990 levels and 50% renewable generation by 2023.

Thank you for the opportunity to testify today representing KIUC.

Sierra Club
Hawai'i Chapter
PO Box 2577, Honolulu, HI 96803
808.537.9019 hawaii.chapter@sierraclub.org

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
March 18th, 2008, 1:15 P.M.

(Testimony is 2 pages long)

TESTIMONY IN STRONG SUPPORT OF HB 3444 HD2 SD1

Chair Fukunaga and members of the Committee:

The Sierra Club, Hawai`i Chapter, with 5500 dues paying members statewide, strongly supports HB 3444 HD2 SD1, providing needed funding for clean energy and global warming initiatives through an increase in the oil barrel surcharge. The bill is smart tax-shifting policy to foster greater energy independence by tapping into the source of our problem to fund our preferred future. We appreciate the amendments that the previous committee made to this measure which allocate the carbon fund to various critical clean energy development and environmental programs. **We ask that the measure be further amended to contain a fee of $0.20 per barrel (assumed with the allocation specified in the SD1) and an appropriate start date.**

The concept behind HB 3444 is to help "internalize" the external costs of certain activities; in this case, charge a fee for products that are damaging to the environment and use that money to help mitigate the damage. The link is quite clear between the use of petroleum products and corresponding impacts on our fragile island environments—not only in oil spills, which was the original impetus for the environmental response tax, but also in runoff from the roads our cars drive on, in degraded air quality, and in greenhouse gas emissions and climate change. Currently, the Department of Health is desperately under-funded and lacks the resources to adequately deal with these environmental impacts. Most critically, the newly established Greenhouse Gas Emissions Reduction Task Force—the group charged with developing the roadmap to achieve dramatic reductions in statewide greenhouse gas emissions—needs resources and staffing to complete their work. This measure would provide additional funds for their efforts.

The Senate Draft 1 of this measure creatively allocates the funds to various needs:

1. The original intent of the Environmental Response Fund, such as environmental programs and responding to emergency oil spills (25%);
2. Energy security projects and development to increase Hawaii's energy self-sufficiency (62.5%); and
3. Energy systems development for renewable energy and energy efficiency technology projects that will reduce Hawaii's dependence on fossil fuel, managed by the Hawai'i natural energy institute (12.5%).

Such a "clean energy" surcharge on a barrel of oil of $0.20 is approximately the same as a carbon tax of $0.41 per ton of CO_2 (23 lbs CO_2 produced per gallon oil, 42 gallons per barrel).

It would have a marginal impact on petroleum users, yet significantly increase the Department's ability to protect Hawaii's environment that is adversely impacted by petroleum use. A $0.41 "carbon fee" is nominal. Many European countries have carbon taxes that exceed $10.00 per ton. ***Last month, the Canadian province of British Columbia enacted a carbon fee that starts at approximately $8.00 per ton (English) in July, 2008, and increases to $24 per ton by 2012.***

The impact of CO_2 emissions alone from one barrel oil is much greater than the proposed tax. The Gas Company, in their Integrated Resource Plan, attempted to quantify the externalities (impacts not reflected in the market costs of an activity) per ton of pollutant. They examined environmental, energy security, macroeconomic and employment, and social and cultural externalities. Their results are shoking: the low estimate was $10/ton CO_2, the mid-range was $27/ton CO_2, and the high was $77/ton CO_2 (The Gas Company, 1999. *The Gas Company Integrated Resource Plan Report*, Jan 28, 1999 Draft, Honolulu.). Again, the approximate carbon tax equivalent of this measure is $0.41.

While we all likely agree that we need to aggressively increase our clean energy use in Hawai'i and decrease our reliance on imported crude, we cannot do it with funding for research, development, and policy implementation. House Bill 3444 HD2 SD1 wisely taps the source of our problem—imported oil—to fund clean energy programs.

House Bill 3444 HD2 SD1 is smart tax-shifting policy that encourages resource conservation and increases our ability to protect Hawaii's environment by making the "polluter pay." As we dramatically expand our clean energy capacity in Hawai'i, the real economic benefits of this carbon surcharge will far outweigh the additional burden it may present. This common sense policy will foster greater energy independence by tapping into the source of our problem to fund our preferred future.

We note that this measure has received support from the Department of Business, Economic Development and Tourism, the Energy Policy Forum, renewable energy organizations, and environmental organizations. In addition, the *Honolulu Advertiser* editorial board supports the measure, writing in their Sunday, March 16 edition:

> *Raising a tax is never a popular move, but the proposal to do so for the creation of a (sic) Energy Security Special Fund is warranted. HB 3444 would raise the Environmental Response and Energy Security Tax from 5 cents per barrel of petroleum to 20 cents, with about 15 cents going into the energy fund. It's sure to be passed on to consumers at the pump, but analysts argue that the per-person cost would amount to $3.85 per year.*
>
> *That's a worthwhile investment if the result is a fund for research and development of multiple modes of renewable energy for Hawai'i. Now the state needs to see that the money is used wisely to tap the Islands' reservoir of power — from the wind, waves, geothermal and, of course, the sun.*

Please amend this measure to contain a $0.20 (or greater) fee per barrel.

Thank you for the opportunity to testify.

HAWAII RENEWABLE ENERGY ALLIANCE
46-040 Konane Place #3816, Kaneohe, HI 96744 – Telephone/FAX: 247-7753 – Email: wsb@lava.net

TESTIMONY OF WARREN BOLLMEIER ON BEHALF OF THE HAWAII RENEWABLE ENERGY ALLIANCE BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

HB 3444 HD2 SD1, RELATING TO ENERGY

March 18, 2008

Chair Fukunaga, Vice-Chair Espero and members of the Committee I am Warren Bollmeier, testifying on behalf of the Hawaii Renewable Energy Alliance (HREA). HREA is a nonprofit corporation in Hawaii, established in 1995 by a group of individuals and organizations concerned about the energy future of Hawaii. HREA's mission is to support, through education and advocacy, the use of renewables for a sustainable, energy-efficient, environmentally-friendly, economically-sound future for Hawaii. One of HREA's goals is to support appropriate policy changes in state and local government, the Public Utilities Commission and the electric utilities to encourage increased use of renewables in Hawaii.

The purposes of HB 3444 HD2 SD1 are to: (1) establish the energy security special fund, (2) rename the environmental response tax the "environmental response and energy security tax" and increases the tax, (3) amend the uses of tax revenue to include deposits to the energy security special fund and the energy systems development special fund, (4) amend uses of the environmental response revolving fund by deleting energy conservation and alternative energy development uses, and (5) appropriates moneys to the Energy Security Special Fund. HREA **strongly supports** this bill with the following comments:

1. Support of DBEDT-Energy Office. A long-term source of funding for DBEDT's Energy Office is needed. The proposed energy security special fund could provide certainty for funding of the Energy Office, assuming that the fund matched or exceeded the requirements of the Energy Office;
2. Source of Funding. While HREA generally is not in favor of tax increases, we believe it is appropriate to place a tax on imported fossil energy to fund the proposed energy security special fund. We recommend that the tax be placed now only on importation of crude oil, but also refined petroleum products and coal; and
3. Energy Security Special Fund Security. HREA highly recommends that language be added to the bill to ensure that the energy security special fund can only be used for the stated purposes, i.e., it cannot be raided for other purposes.

Thank you for this opportunity to testify.

Hawaii Solar Energy Association
Serving Hawaii Since 1977

TESTIMONY OF THE HAWAII SOLAR ENERGY ASSOCIATON
IN REGARD TO H.B. 3444, H.D. 2, S.D. 1
RELATING TO ENERGY
BEFORE THE
SENATE COMMITTEE ECONOMIC DEVELOPMENT & TAXATION
ON
TUESDAY, MARCH 18, 2008

Chair Fukunaga, Vice-Chair Espero and members of the committee, my name is Rick Reed and I represent the Hawaii Solar Energy Assn (HSEA) The HSEA is a professional trade association established in 1977, and affiliated with the Solar Energy Industries Association (SEIA) in Washington, D.C. HSEA represents manufacturers, distributors, contractors, financiers, and utility companies active in the solar energy industry in Hawaii. We strongly support the passage of H.B. 3444, H.D. 2, S.D. 1.

Leading U.S. economists, including Greg Mankiw former Bush Administration Chairman of the Council of Economic Advisors and Nobel laureate Gary S. Becker, believe that a tax levied to correct the negative externalities of a market activity, in this case the profligate purchase and combustion of oil, is warranted. Both, in fact, would argue that a .50 cent - $1 per gallon tax is long overdue on the federal level and that we are missing a golden opportunity to protect the environment, reduce road congestion, produce a lasting reduction in miles driven, help balance the budget, ultimately make the federal tax code more favorable to growth, and enhance our national security.

H.B. 3444, H.D. 2, S.D. 1 proposes a modest 15 cent increase in taxes now levied on a barrel of oil in Hawaii. Among other things, this tax increase could provide much needed funding to staff DBEDT's Energy Division. Most of Debt's staff are now on federal funds that will be depleted over the next four years. Much more will be expected of the Energy Division going forward and adequate staffing is the prerequisite to enhanced capability and performance.

Pursuant to Act 253, Session Laws of Hawaii 2007, this measure also will fund the Hawaii Natural Energy Institute's task of developing an integrated approach to managing renewable energy and energy efficiency projects in Hawaii. This is also necessary and important work that deserves to be funded.

Two other quick points. HSEA also believes that a similar levy on imported and highly polluting coal is also appropriate. Language that requires that the monies in this fund be used exclusively for the stated purposes would be welcome.

Thank you for the opportunity to testify.

P.O. Box 37070 Honolulu, Hawaii 96837
SOLAR HOTLINE (808)521-9085

SUBJECT: FUEL, Environmental response and energy security tax

BILL NUMBER: HB 3444, SD-1

INTRODUCED BY: Senate Committee on Energy and Environment

BRIEF SUMMARY: Amends HRS section 243-3.5 to rename the environmental response tax the environmental response and energy security tax. Increases the tax from 5 cents to ___ cents with: (1) 5 cents collected on each barrel to be deposited into the environmental response revolving fund provided that _____ cents of the tax on each barrel shall be used to address concerns related to drinking water; (2) 12.5 cents shall be deposited into the proposed energy security special fund; and 2.5 cents be deposited into the energy systems development special fund.

Amends HRS section 128D-2 to repeal the provision discontinuing the imposition of the environmental response tax when the balance in the fund exceeds $20 million with a provision that provides that any amount that causes the balance in the fund to exceed $20 million shall be deposited into the general fund. No deposits shall be made to the fund until the balance drops below $3 million.

Adds a new section to the HRS to create an energy security special fund. When moneys in the fund exceed $10 million from all sources delineated, the energy security tax shall cease to be imposed until the balance in the fund declines to less than $5 million, at which time the tax will be reinstated. The fund shall be used by the department of business, economic development and tourism for its energy programs as enumerated.

Appropriates an unspecified amount of general funds for fiscal 2009 for deposit into the energy security special fund.

Appropriates an unspecified amount out of the energy security special fund for fiscal 2009 for the purposes of this act.

EFFECTIVE DATE: July 1, 2050

STAFF COMMENTS: This measure proposes to increase the environment response tax from 5 cents to ___ cents and provide that 12.5 cents shall be deposited into the energy security special fund; and 2.5 cents be deposited into the energy systems development special fund.

Section 1 of this measure states that the energy program within the strategic industries division of the department of business, economic development and tourism (DBEDT) requires additional funding due to its expansion and declining federal funding, and declining oil overcharge fund sources which has resulted in diminished program budgets and reduced staff positions. The measure further states that increased state funding is necessary to support core energy program funding.

It should be noted that the establishment of the funding mechanisms proposed in this measure to provide additional revenue to allow the energy program of the strategic industries division of DBEDT to operate, sets this program area apart from other state agencies or programs which are funded through the budget and appropriation process. By establishing a specific tax to fund this program area allows this program to bypass the normal budgetary process. If such a program is deemed a priority, then a direct appropriation for this program of work should be directly funded rather than through the back door method as proposed by this measure.

While proponents of the measure may argue that the proposed energy security tax parallels the environmental response tax which also taps each barrel of petroleum product sold, it should be noted that the State Auditor has singled out the environmental response fund as not meeting the criteria established and the Auditor recommended that it be repealed. The Auditor criticized the use of such funds as they hide various sums of money from policymakers as they are not available for any other use and tend to be tacitly acknowledged in the budget process.

It should also be noted that funds deposited into a special fund are not subject to close scrutiny as an assumption is made that such funds are self-sustaining. It should be remembered that earmarking of funds for a specific program represents poor public finance policy as it is difficult to determine the adequacy of the revenue source for the purposes of the program. To the extent that earmarking carves out revenues before policymakers can evaluate the appropriateness of the amount earmarked and spent, it removes the accountability for those funds. There is no reason why such a program should not compete for general funds like all other programs which benefit the community as a whole.

To a large extent this proposal represents the arrogance of lawmakers to merely pass on tax increases to their constituents without the courage to be held accountable for the tax increase by hiding it deep within the product chain so that it is not apparent to the ultimate consumer. Instead the "blame" for the price increase is aimed at the business selling to the final consumer. The hypocrisy of lawmakers decrying the "highest gasoline prices in the nation" while proposing a tax increase on the front end of what eventually will be sold at the gas pump is pitiful.

Rather than perpetuating the problems of the barrel tax, the existing environmental response tax should be repealed and all programs that are funded out of the environmental response fund should be funded through the general fund. At least program managers would then have to justify their need for these funds. By continuing to special fund these programs, it makes a statement that such environmental programs are not a high priority for state government. This sort of proliferation of public programs needs to be checked as it appears to be growing out of hand and at the expense of the taxpayer.

While lawmakers may be concerned about clean water or energy security, what this proposal does say is that they do not care about their taxpaying constituents, for this measure amounts to nothing more than lawmakers saying "let them eat cake!" by not only raising taxes, in this case a fee, but because it is on the "front" end of all goods and services consumed being that everything relies on energy, it also increases the cost of living and doing business in Hawaii. Lawmakers better consider the economic impact this will have especially in view of the slowing economy that is forecast for the next few years. Lawmakers will find themselves in the same pickle that they did in 1998, trying to jumpstart the economy with no resources to do so.

Digested 3/17/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2961 HD 1 PROPOSED SD 1
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

The intent of this bill is to conform Hawaii law to the requirements of the Streamlined Sales and Use Tax Agreement ("SSUTA"). The Streamlined Sales and Use Tax Agreement is a method developed by the states and businesses primarily to have internet and catalogue sellers voluntarily collect the sales and use tax from consumers on behalf of the States for those sellers who did not have nexus with the state. Currently, people who buy from catalogues and the internet are supposed to pay use tax on their purchases, however in practice, few do.[1] This bill would provide a ***voluntary*** mechanism for internet and catalog sellers to collect this tax from the consumers and pass it on to the Department, thereby resulting in a net revenue gain to the State.

The Department of Taxation takes **no position on the content** of this measure; however respectfully **requests that the original HD 1 and other technical corrections requested by the Department in HB 3192/SB 3114 be inserted in its place**.

I. ORIGINAL CONTENTS—THE IMPORTANCE OF STUDYING TAX INCENTIVES

The Legislature has enacted path-breaking tax credits to promote growth in technology and innovation, with the goal of encouraging knowledge-based, higher-wage industries in Hawaii. The Legislature has also recognized, however, that it is important to evaluate the effectiveness of its efforts in this area as well as other areas of tax incentive policy. The Department of Taxation respectfully requests the authority and resources to conduct an economic study on the effects of Hawaii income tax credits.

---

[1] However, businesses generally comply with the use tax more than individuals.

II. SUGGESTED AMENDMENTS FOR EFFICIENT TAX ADMINISTRATION

The Department respectfully requests that the Committee consider inserting the following technical considerations into this measure for streamlined tax administration. These amendments can be found in HB 3192/SB 3114:

ERRONEOUS REFUND CLAIMS—Congress recently amended the Internal Revenue Code to allow for a twenty percent penalty on any excessive refund claims. This new erroneous refund claim penalty is found at 26 USC § 6676. This penalty was included in recent congressional legislation as a revenue raiser for the federal government. With certain of the tax incentives provided in Title 14, HRS, providing the Department of Taxation with the ability to assess a penalty for refund or credit claims where a taxpayer's claim lacks a reasonable basis will assist with the administration of Hawaii's taxes by providing a deterrent mechanism, which presently does not exist. As was the intent on the federal level, this legislation would also be a potential revenue raiser for the general fund.

During this provision's prior consideration in the Senate, the industry had problems with this penalty's lack of definitions. The Department does not object to the Committee inserting a specific definition of "reasonable basis" to include, among other things inadvertence, mistake, or innocence. Also, the Department does not object to thresholds where this penalty takes effect; nor does the Department object to applying this penalty only where tax professionals are involved. The Department is willing to work with the Committee on draft language for this provision.

Because this legislative session has many fiscal constraints given the current economic conditions, this amendment will provide revenue gains for the budget.

PUBLIC BOARD OF REVIEW INFORMATION—Current law is ambiguous as to whether certain information discussed at a Taxation Board of Review hearing is public and able to be disseminated.

Chapter 232, HRS, is clear that a Board of Review hearing is a public meeting. However, other conflicting confidentiality laws preclude the Department from discussing the taxpayer's identity or the specific legal arguments presented to the Board of Review. A dilemma arises if a person who was not present at the hearing requests information regarding the hearing, the Department cannot disclose appeal briefs or taxpayer identity. However, if the same person were at the hearing, the person would know the taxpayer's identity and other material information. This bill clarifies what information is public when discussed at a Board of Review hearing.

SOCIAL SECURITY NUMBERS ON APPEAL DOCUMENTS—With the onset of identity theft, administration of tax appeals should likewise conform to protection of such sensitive data.

Currently, tax appeals require taxpayers to submit a copy of the tax return(s) in dispute during the appeal. Tax returns routinely contain sensitive data, including social security numbers of individuals. This bill authorizes individuals and the Department to redact all but the last four digits of the social security number on any tax returns filed with the Tax Appeal Court.

"KIDDIE TAX" AMENDMENTS—In its conformity provisions, Hawaii does not expressly conform to the "Kiddie Tax" assessed by the Internal Revenue Code.

However, Hawaii has adopted its own "Kiddie Tax" at section 235-7.5, HRS. In 2006, Congress made various amendments to the "Kiddie Tax" contained in the Internal Revenue Code. This bill makes similar conforming amendments to the changes made by Congress to ensure consistency in the application and assessment of these similar taxes.

Because this legislative session has many fiscal constraints given the current economic conditions, this amendment will provide revenue gains for the budget.

TAX ADMINISTRATION SPECIAL FUND—Act 206, Session Laws of Hawaii 2007, amended the Tax Administration Special Fund to allow use of the funds for the administration of credits under section 235-110.9, HRS.

The Department of Taxation understood the intent of this amendment was to allow use of the funds for administration of other high tech credits, including the refundable credit for research activities under section 235-110.91, HRS. This bill clarifies that the tax administration special fund may be used for administering both high technology tax credits.

CANNED COMPUTER SOFTWARE ELIGIBILITY FOR THE CAPITAL GOODS EXCISE TAX CREDIT—Hawaii's capital goods excise tax credit allows a credit equal to the general excise tax paid on depreciable tangible personal property.

The credit defines depreciable tangible personal property as of the Internal Revenue Code of 1954, as amended in 1984. Canned computer software was considered depreciable tangible personal property in the Internal Revenue Code of 1986. This bill amends the definition of depreciable tangible personal property to allow for canned computer software to qualify for the capital goods excise tax credit. The bill also deletes from the definition of cost "the actual invoice price," so that cost will be defined as basis, which is simpler to administer. The bill also eliminates the phase-in language since the credit has been completely phased-in since 1989.

This amendment will clarify erroneous positions taken by taxpayers and tax practitioners that argue computer software currently qualifies under this credit.

SOCIAL SECURITY NUMBER USE IN TAX ADMINSITRATION—Chapter 487J, HRS, was enacted in 2006 to limit the use of social security numbers by businesses and government.

The Department's tax administration processes and procedures rely heavily on the use of the social security number to ensure identification of a taxpayer. This bill makes clarifying amendments to chapter 487J, HRS, that allow the Department of Taxation to utilize social security numbers in the administration of Hawaii taxes.

III. THE STREAMLINED SALES & USE TAX PROJECT

A. Concerns over this legislation in a slowing economy.

Initially, the Department points out that it is a well-settled principle of economics that when an economy is slowing, increasing taxes is strongly discouraged because people are already struggling to make ends meet financially. During economic slowing, economics suggests that money should remain with the people and in the economy in order to boost economic performance. The Department cautions further consideration of this legislation during a slowing economy based upon these economic concepts.

B. Benefits of Streamlined Sales Tax.

The Streamlined Sales & Use Tax Project may provide benefits to Hawaii, including:

1. **Increased Revenue to the General Fund.** It is undetermined at this time exactly how much additional revenue Hawaii may stand to gain from this bill. The Department concedes that a revenue gain is likely, however the Department is concerned that past projections have significantly overestimated this potential gain.

2. **Level the Playing Field.** Adopting this legislation will effectively bring equity to local retailers that lose business to internet or mail-order commerce. By purchasing goods on the internet, for example, local purchasers can realize a minor tax benefit by purchasing out-of-state. Each sale out-of-state is a lost sale in Hawaii, thus impacting local businesses.

C. Concerns about Streamlined Sales Tax implementation in Hawaii.

1. **Adds Complexity.** Because Hawaii has a general excise tax imposed on the seller rather than a sales tax, which is imposed on the buyer, the provisions of the SSUTA do not fit neatly into Hawaii's general excise tax regime. Therefore, the SSUTA provisions need to be modified to take Hawaii's different tax structure into account.

   In addition, to comply with the SSUTA's requirement that the State and each local taxing jurisdiction have only one rate, except in certain circumstances not applicable in Hawaii, the different tax rates applicable under Hawaii general excise tax law need to be removed from the general excise tax chapter and shifted into another taxing chapter. The creation of three new chapters also adds complexity to Hawaii's tax law and may prove to be another source of confusion to taxpayers.

   In addition, whether the approach taken in the bill would be considered a "replacement tax" is an issue. It is also unclear at this time whether replacement taxes are permitted under the SSUTA.

2. **Provides Amnesty.** The SSUTA requires the State to provide amnesty to out-of-state sellers that may or may not have nexus with the State. The State will be giving up its

right to pursue these sellers for general excise tax on their operations in the State.

3. **Vendor Compensation.** The SSUTA requires the State to compensate out-of-state vendors who voluntarily participate in the SSUTA for collecting the Hawaii tax. However, in-state businesses that are obligated to pay the Hawaii tax are not compensated for collecting and paying the tax.

4. **Voluntary.** Currently, participation by sellers pursuant to the SSUTA is voluntary. While hundreds of companies have agreed to participate, Amazon.com and eBay have indicated that they will not participate at this time. Therefore, it is unclear how much potential revenue will be generated for Hawaii by participating in SSUTA.

5. **"Home Rule" Concerns.** Participation in SSUTA requires the State to annually certify to the national governing board that the state's laws are in compliance with SSUTA. Therefore, **any tax law changes in the future must meet the requirements of SSUTA** in order for the State to continue to comply with SSUTA. Therefore, **the State is limiting its ability to adopt legislation in favor of decisions made by a national governing board regarding a state's tax law.**

   In addition, now that the City and County of Honolulu has enacted the county surcharge, the City and County of Honolulu must be bound to follow the SSUTA with respect to the surcharge.

6. **Appropriations.** The Department will need an appropriation to implement the SSUTA compliance, which, among other things, requires the development of a database of zip codes and tax rates. The Department is currently working on developing an accurate and comprehensive cost estimate for implementing this legislation. The complexity associated with updating the Department's current tax collection systems and the required labor and incidental costs require further analysis.

7. **Further Study.** The Department believes that further study is warranted on this issue. The general excise tax is a major revenue source for the State and any substantial revisions, such as those contained in this bill, should only be enacted after a thorough and thoughtful analysis can be done. In addition, time would also enable the Department to learn from other states' experiences with the SSUTA. Other states did not actually begin implementing SSUTA until late 2005. On April 1, 2008, eighteen states[2] will have become full members of SSUTA and begun implementing SSUTA. (Three new state recently became full member states: Arkansas, Wyoming, and Nevada; but these states were already participating as Associate Member states. In fact, since the agreement became effective in 2005, only Washington, Vermont and Rhode Island have been added to the list of original associate and full members.) If the State waits, it could learn from the problems the other states' experience. Some states remain cautiously guarded about

[2] The full member states are Arkansas, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, West Virginia, Wyoming. Nevada becomes a full member state on April 1, 2008. Washington will become a full member on July 1, 2008.

implementing the SSUTA. For example, New York issued a report that cautioned joining the project because it was unclear whether the project would yield net benefits to taxpayers and local businesses. Again, further study of these paramount issues is advised.

C. General comments.

Delayed Effective Date—The delayed effective date of the bill is appreciated, but the delay may not be long enough to allow these changes to be fully integrated into the computer systems of the Department. A longer delayed effective date would give time for practitioners and businesses to adjust to these changes. When the corporate statutes were substantially revised, the effective date was delayed one year to allow professional associations, businesses, and practitioners sufficient time to analyze the changes in the law, prepare conferences, or other industry analysis. Given the challenges the Department would face integrating such large, wholesale changes into its operations, longer than two years may be more realistic of a time frame. The delayed effective date would also provide time to obtain approval from the National SSTP Governing Board to assure that Hawaii's amendments conform to the SSUTA. This is very important since Hawaii's general excise tax is not a sales tax.

Frequent Changes to the SSUTA Will Require Legislative Action. The legislature needs to be aware that the SSUTA is not a static document. It has undergone substantial and frequent changes since it was adopted on November 12, 2002. It has been amended 11 times.[3] It has been amended 7 times since the SSUTA became effective on October 3, 2005. Each change requires member States to amend its law in order to remain in conformity with the SSUTA. The debate at the Governing Board meetings currently includes allowing intra-state origin based taxes, the extension of associate member status beyond the original deadline, and very relevant to this bill, the issue of using "replacement taxes" by States to circumvent the provisions of the SSUTA, such as New Jersey's fur tax.

D. Revenue diversion.

The Department cannot support GET revenue diversions. The Department is always cautious about policy that redirects general excise tax revenue away from the general fund and into specific special funds. The Department routinely opposes funding mechanisms such as this because the general excise tax represents over one-half of the State's overall operating revenue stream. The Department strongly prefers that a direct appropriation be the means for funding the programs of the Department of Education and the University of Hawaii so that the amount may be budgeted and prioritized just as any other program.

---

[3] November 19, 2003, November 16, 2004, April 16, 2005, October 1, 2005, January 13, 2006, April 18, 2006, August 30, 2006, December 14, 2006, June 23, 2007, September 20, 2007, and December 12, 2007

IV. REVENUE IMPACT

The bill would increase revenues by about $10 million annually.

The expansion of the GET exemption for blind, deaf, and disabled taxpayers would cost about $500,000 annually.

In a study produced for the State's Auditor in April 2006, Dr. William Fox estimated that joining the SSUTA would provide Hawaii with about $10 million in additional GET revenues annually. He reaffirmed his estimate in 2007.

The Chair was provided the start-up and ongoing cost estimates under separate cover.

Hawaii Association of REALTORS®
www.hawaiirealtors.com

The REALTOR® Building
1136 12th Avenue, Suite 220
Honolulu, Hawaii 96816

Phone: (808) 733-7060
Fax: (808) 737-4977
Neighbor Islands: (888) 737-9070
Email: har@hawaiirealtors.com

March 18, 2008

The Honorable Carol Fukunaga, Chair
Senate Committee on Economic Development and Taxation
State Capitol, Room 224
Honolulu, Hawaii 96813

RE: H.B. 2961, H.D. 2, Proposed S.D.1, Relating to Taxation
Hearing Date: March 18, 2008 @ 1:15 p.m., Room 224

On behalf of our 10,000 members in Hawaii, the Hawaii Association of REALTORS® (HAR) **supports H.B.2961, H.D.2, Proposed S.D.1, Relating to Taxation** - adopting amendments to Hawaii tax laws to implement the streamlined sales and use tax agreement.

The Report of the 2001-2003 Tax Review Commission states at page 6 that Hawaii would potentially achieve not only the benefit of better definitions, uniformity, and certainty, but also increase tax compliance by interstate vendors (primarily mail order and e-commerce merchants) who agree to pay state taxes under the Streamlined Sales Tax Project. The Report goes on to state that because of Hawaii's uniquely broad based General Excise and Use Tax system, by joining the Streamlined Sales Tax Project, Hawaii may be able to better maintain the viability of its broad revenue base.

The Report of the 2005-2007 Tax Review Commission states at page 9 that while the Commission believes that the goal of coordinating the collection of taxes on interstate sales, such as via the internet, is desirable, and that Hawaii should remain involved in discussions on the Streamlined Sales Tax Project, the Commission did not think that Hawaii should make a formal commitment yet.

The Hawaii Association of REALTORS® believes that the delayed effective date of January 1, 2010 should help alleviate the concerns of the 2005-2007 Tax Review Commission, and that H.B.2961, H.D.2, Proposed S.D.1, should eventually level the playing field for local merchants who must deal with the high cost of doing business in Hawaii and still compete with mail order and e-commerce merchants from outside of the State.

Mahalo for the opportunity to testify.

Sincerely,

Craig K. Hirai, Member
Subcommittee on Taxation and Finance
HAR Legislative Committee

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice Chair
Committee on Economic Development & Taxation
State Capitol, Honolulu, Hawaii 96813

HEARING Tuesday, March 18, 2008
1:15 pm
Conference Room 224

RE: HB2961, HD2, SD1 (proposed), Relating to Taxation

Chair Fukunaga, Vice Chair Espero, and Members of the Committee:

Retail Merchants of Hawaii (RMH) is a not-for-profit trade organization representing about 200 members and over 2,000 storefronts, and is committed to support the retail industry and business in general in Hawaii.

RMH supports HB2961, HD2, SD1 as proposed, which adopts amendments to Hawaii's tax laws to implement Streamlined Sales and Use Tax Agreement.

Through our affiliation with the National Retail Federation, the world's largest retail trade association, and a major participant in the Streamlined Sales Tax Project, RMH has watched the development and progress of this program over the past seven years and has supported Hawaii's initiatives to participate in the multi-state discussions. As commerce over the Internet increased, traditional brick and mortar retailers, which are required by law to collect taxes for government, have experienced an erosion of their sales base to remote sellers, which, under most circumstances, are not subject to tax mandates. The Streamlined Sales Tax Project will level the playing field.

Additionally, we are encouraged that an initiative in congress holds even greater promise to ameliorate this unfair situation.

The members of the Retail Merchants of Hawaii respectfully request that you pass HB2961, HD2, SD1 as proposed. Thank you for your consideration and for the opportunity to comment on this measure.

Carol Pregill
President

RETAIL MERCHANTS OF HAWAII
1240 Ala Moana Boulevard, Suite 215
Honolulu, HI 96814
ph: 808-592-4200 / fax: 808-592-4202

888 Mililani Street, Suite 601
Honolulu, Hawaii 96813-2991
www.hgea.org

Telephone: 808.536.2351
Facsimile: 808.528.4059

Hawaii Government Employees Association
AFSCME Local 152, AFL-CIO

Working Together for Hawaii

The Twenty-Fourth Legislature, State of Hawaii
Hawaii State Senate
Committee on Economic Development and Tourism

Testimony by
HGEA/AFSCME, Local 152, AFL-CIO
March 18, 2008

H.B. 2961, H.D. 2, S.D. 1 (Proposed)
– RELATING TO TAXATION

The Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO strongly supports the purpose and intent of H.B. 2961, H.D 2, S.D. 1 (Proposed) – Relating to Taxation. The purpose of this legislation is to make specific changes to Hawaii's tax law that will allow the state to participate in the Streamlined Sales and Use Tax Agreement that will permit the taxation of Internet-based transactions. There are several reasons for taxing Internet-based transactions.

The Internet has transformed retail trade. As the popularity of "e-commerce" grows, fairness dictates that Internet-based transactions should be treated in the same manner as other retail transactions. Retail transactions that are taxable by "bricks and mortar" retailers should also be taxable when sold through the Internet.

Hawaii has already lost millions of dollars in Internet-based sales, and the losses will likely increase as the importance of the Internet continues to grow. Therefore, we support H.B. 2961, H.D. 2, S.D. 1, which makes necessary changes to the tax code to comply with the Streamlined Sales and Use Tax Agreement. The ongoing loss of millions in tax revenue from e-commerce is a problem that will get worse over time unless we take appropriate action. The revenues gained through the Streamlined Sales and Use Tax Agreement may fund public education and other important public policy priorities. Thank you for the opportunity to testify in support of this important measure.

Respectfully submitted,

Nora A. Nomura
Deputy Executive Director

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, High technology business tax credits evaluation

BILL NUMBER: HB 2961, HD-2

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Adds a new section to HRS chapter 231 to provide that the department of taxation shall determine the economic impact of and evaluate existing and proposed tax incentives of HRS Title 14. Authorizes the department to: (1) contract with technical experts knowledgeable in the field of technology and research investment to evaluate existing and proposed tax incentives; (2) establish a working group of industry, tax, and economic development experts to identify and develop a set of standards, benchmarks, and data elements for evaluation and quantification of the economic impact of tax incentives in Hawaii; (3) coordinate and receive relevant information from other state agencies; (4) review taxpayer returns to collect and analyze aggregate data on the impact of tax incentives; and (5) update its analysis of tax incentives to assist the Tax Review Commission and the Council on Revenues to better perform their responsibilities.

Amends HRS section 235-20.5 to provide that the tax administration special fund shall also be used to administer the tax credit under HRS section 235-110.91. Repeals this section on January 1, 2012.

Amends Act 206, SLH 2007, to provide that the required annual survey filed by a qualified high technology business shall include information from and after January 1, 2002. The department of taxation shall submit information on the high technology business tax credit 20 days prior to the convening of the legislature instead of September 1. Repeals this section on January 1, 2012.

Extends the repeal date of Act 206, SLH 2007, from January 1, 2011 to January 1, 2012 and provides that HRS sections 235-20.5 and 235-110.9(b) shall be reenacted in the form in which they read on the day before June 20, 2007.

The department of taxation shall study the economic impact of the tax credits of HRS sections 235-9.5, 235-110.51, 235-110.9 and 235-110.91 on Hawaii's economy and evaluate their effectiveness. Requires the department to report its findings to the legislature prior to each regular session. Directs the department of taxation to collect and evaluate information from January 1, 2002, and: (1) exercise its powers under HRS section 231; (2) use the information collected and analyses conducted under Act 206, SLH 2007; and (3) review returns of companies whose investors receive credits pursuant to HRS sections 235-110.51, 235-110.9 and 235-110.91 or benefit from stock options whose capital gains are excluded from taxation under HRS section 235.9.5. Permits such data to be sub-aggregated into industry sectors to delineate and differentiate economic impacts. Repeals this section on January 1, 2012.

Appropriates $_________ in general funds in fiscal 2009 to the department of taxation for the purposes of this act.

The sections repealed shall be reenacted in the form in which they read on June 20, 2007.

EFFECTIVE DATE: July 1, 2020

STAFF COMMENTS: In their examination of the high technology business investment tax credit, the Tax Review Commission reiterated the findings of the previous Tax Review Commission that stated that, "A tax incentive program is a potential 'black hole' because it is a future benefit of unknown proportions, which is determined by the favored taxpayer's interpretation of what the tax credit should be, and is claimed on a tax return which is confidential."

The most recent Tax Review Commission brought in outside consultants to assess the costs and benefits of the high technology tax credits, but the results were not definitive because they could not obtain current data on the cost of the credit or on the operations of the qualified high tech businesses. They also found data to be incomplete due to confusion about filing requirements when the certification for the credits was changed. In its final recommendations with respect to the high technology tax credit and tax credits in general, the Commission recommended increased transparency and timely disclosure and suggested a confidentiality waiver should be required of those taxpayers claiming tax credits so that pertinent data can be released to the public, and that all beneficiaries of tax credits be required to file truth-in-disclosure reports in addition to income tax returns.

This measure directs the department of taxation to determine the economic impact of existing and proposed tax incentives with emphasis on: (1) the income tax exclusion of stock options from qualified high technology businesses (HRS section 235-9.5); (2) technology infrastructure tax credit (HRS section 235-110.51); (3) high technology investment tax credit (HRS section 235-110.9); and (4) the tax credit for research activities (HRS section 235-110.91). However, this may be just as daunting a task for the department as it was for the Commission's consultants as the beneficiaries hide behind the confidentiality screen. The legislature should consider the recommendation of the Commission to require a waiver of confidentiality so that successes or failures of individual taxpayers can be tracked and evaluated. The legislature has already adopted a similar waiver of confidentiality when it required American Hawaii Cruises to open its books by Act 228, SLH 1991, in order to secure its exemption from the public service company tax.

Given that these tax credits are a back door expenditure of public dollars, the granting of the credits should be subjected to the same scrutiny that appropriation and expenditure of tax dollars are subjected to under the rubric of the procurement code. How can policymakers justify the establishment of such tax incentives when there is no means by which to measure whether or not the promise of jobs, economic stimulation, or growth in the industry has resulted if this information is not available?

Conversely, if these beneficiaries want to feed on public dollars through these tax incentives, then they should be more than willing to reveal how those dollars were used and how those dollars benefitted the taxpaying public. The analogy is something akin to having to put the quarter in the juke box if one wants to dance.

Digested 3/14/08

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2005 HD 1 SD 1
RELATING TO RENEWABLE ENERGY TECHNOLOGIES

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This bill would replace the photovoltaic energy system category of § 235-12.5, HRS with a newly defined category of solar electric energy systems.

The House Committee on Finance amended this measure to allow for the transfer or sale of the tax credit.

The House of Representatives passed this measure on third reading.

The Senate Committee on Energy & Environment defected the measure's effective date.

The Department of Taxation **opposes the current draft** of this legislation; however **supports redefining the renewable energy systems** provided by this section of Chapter 235, HRS.

I. NEW PROPOSED DEFINITION OF SOLAR ELECTRIC SYSTEMS.

The Department **does not like this additional definition** and prefers that a definition in this credit focus on what is put into a machine rather than an approach based upon what the machine creates. **In short, the Department prefers defining the technology based upon inputs; not outputs.** As the law is currently drafted, renewable energy technologies are defined based upon the type of renewable resource that enters a system (*e.g.*, wind, sun, light). This legislation would amend the law to add an additional credit component for what is created (*e.g.*, solar water heating, solar air conditioning, solar space heating, solar drying, and solar process heat system).

II. THE DEPARTMENT OPPOSES THE AMENDMENT TO ALLOW TRANSFER OF CREDIT.

The Department is strongly opposed to any provision that allows Hawaii tax credits to be sold, assigned, or transferred. Allowing taxpayers to market or sell their tax credits is fundamentally poor tax policy. Selling tax credits can be subject to abuse and suspect motivation by parties involved.

The Department's fundamental and primary concerns regarding credit transfers are the following:

- The transferability rewards a separate taxpayer unrelated to the taxpayer that generated the credit, which is fundamentally poor tax policy for encouraging behavior and directly rewarding that behavior;
- Transferability will create great hardships for those that claim the credit when another taxpayer's activity generates the credit when the latter taxpayer is audited. For example, if taxpayer A's activity generates the credit and transfers the credit to taxpayer B, and subsequently taxpayer A's activities are audited; the Department will be forced to track down B, advise them that the credit is being rejected, and taxpayer B will now have a deficiency with the Department due to A's actions. This will cause contract and warranty disputes between taxpayers.
- The Department is not setup to regulate credit transfers. Will the Department be required to establish a "Bureau of Credit Conveyances" in order to track transfers? If this is the case, resources will have to be dedicated to this.
- And, abuse relating tax credit transfer prices will be problematic. The State will be out a $1 when taxpayers will be transferring this $1 for pennies.

Other testimony has suggested that Act 221 credits are "sellable." This is an inaccurate statement. Act 221 credits are not sellable. What are considered sellable are partnership interests in a qualified high technology business that generates a credit. A person buys an interest in a business and not a tax credit. A suggestion that credits are sellable is incorrect and transactions characterized as sales of credits only are potentially subject to audit by the Department.

III. SUGGESTED AMENDMENTS TO CLARIFY THE CREDIT BASED UPON TECHNOLOGY DEVELOPMENTS.

The Department understands that this legislation is based primarily upon technological developments in renewable energy systems that produce electricity from sunlight and an attempt to reconcile the different credit caps and amounts for the varying technologies. **The Department supports redefining the technologies for purposes of this credit**. The Department suggests the Committee consider making the following amendments to the measure as an SD 1 to clarify the application of the renewable energy technologies tax credit to conform to current and future uses of sunlight and other renewable sources.

IV. REVENUE IMPACT

H.B. 2005 H.D. 1 as drafted results in the following revenue loss:

- FY2009 (loss): $315,000
- FY2010 (loss): $2.3 million
- FY2011 (loss): $1.3 million
- FY2012 and annually thereafter (loss): $2.3 million

The Department's proposed SD 1 results in the following revenue loss:

- Annual loss of $500,000 beginning in FY2010.

Due to change in solar qualifications (both drafts):

The change in solar qualifications would allow certain types of solar devices to qualify for the $500,000 credit where originally they would only qualify for the $250,000 solar thermal credit. It is estimated that at most, 2 of these (commercial) systems will be built per year.

For transferability of credit (HD.1 as drafted only):

The transferability of the credit is functionally equivalent to making the credit refundable. Average tax liabilities for different AGI brackets were estimated, and using the 2005 participation rates for the renewable energy credit, the amount of "carry-over" credit was estimated. From this, it was assumed that all of the carry-over credit would become sold/repurchased, and thus be applied to someone else's tax liability and result in revenue loss.

The impact due to future commercial projects was calculated from a list of planned and/or proposed projects, with estimated or known completion dates. It was assumed that these projects would be eligible for the maximum credit of $500,000. It is also assumed that these projects will have little to no tax liability (as any income will most likely be offset by depreciation), thus the transferability of the credit will result in a cost equal to the full eligible credit amount. Thus the revenue loss from commercial properties in a year is equal to $500,000 multiplied by the number of new facilities built.

PROPOSED SD 2 AMENDMENTS

SECTION 1. Section 235-12.5, Hawaii Revised Statutes, is amended as follows:

"§235-12.5 Renewable energy technologies; income tax credit. (a) When the requirements of subsection (c) are met, each individual or corporate taxpayer that files an individual or corporate net income tax return for a taxable year may claim a tax credit under this section against the Hawaii state individual or corporate net income tax. The tax credit may be claimed for every eligible renewable energy technology system that is installed and placed in service in the [~~State~~] state by a taxpayer during the taxable year. This credit shall be available for systems installed and placed in service in the [~~State~~] state after June 30, 2003. The tax credit may be claimed as follows:

(1) [~~Solar thermal~~] For each solar energy system[~~s~~], thirty-five percent of the actual cost or the cap amount determined in subsection (b), whichever is less; and ~~for:~~

~~(A)~~ ~~Single-family residential property: thirty-five per cent of the actual cost or~~

~~$2,250, whichever is less;~~

~~(B)~~ ~~Multi-family residential property: thirty-five per cent of the actual cost or $350 per unit, whichever is less; and~~

(C) ~~Commercial property: thirty-five per cent of the actual cost or $250,000, whichever is less;~~

(2) [~~Wind-powered~~] For each wind-powered energy system[~~s~~], twenty percent of the actual cost or the cap amount determine in subsection (b), whichever is less. ~~for:~~

~~(A)~~ ~~Single-family residential property: twenty per cent of the actual cost or [$1,500] the cap amount determined in subsection (g), whichever is less;~~

~~(B)~~ ~~Multi-family residential property: twenty per cent of the actual cost or $200 per unit, whichever is less; and~~

~~(C)~~ ~~Commercial property: twenty per cent of the actual cost or $500,000, whichever is less; and~~

~~(3) [Photovoltaic]~~ ~~**Solar electric**~~ ~~energy systems for:~~

~~(A)~~ ~~Single-family residential property: thirty-five per cent of the actual cost or $5,000, whichever is less;~~

~~(B)~~ ~~Multi-family residential property: thirty-five per cent of the actual cost or $350 per unit, whichever is less; and~~

(C) ~~Commercial property: thirty-five per cent of the actual cost or $500,000, whichever is less;]~~

~~provided that multiple owners of a single system shall be entitled to a single tax credit; and provided further that the tax credit shall be apportioned between the owners in proportion to their contribution to the cost of the system.~~

~~In the case of a partnership, S corporation, estate, or trust, the tax credit allowable is for every eligible renewable energy technology system that is installed and placed in service in the [State] state by the entity. The cost upon which the tax credit is computed shall be determined at the entity level. Distribution and share of credit shall be determined pursuant to section 235-110.7(a).~~

(b) The amount of credit allowed for each eligible renewable energy technology system shall not exceed the applicable cap amount, which is determined as follows:

(1) If the primary purpose of the solar energy system is to use energy from the sun to heat water for household use, then the cap amounts shall be:

(A) $2,250 per system for single-family residential property;

(B) $350 per unit per system for multi-family residential property; and

(C) $250,000 per system for commercial property.

(2) For all other solar energy systems, the cap amounts shall be:

(A) $5,000 per system for single-family residential property;

(B) $350 per unit per system for multi-family residential property; and

(C) $500,000 per system for commercial property.

(3) For all wind-power energy systems, the cap amounts that apply shall be:

(A) $1,500 per system for single-family residential property;

(B) $200 per unit per system for multi-family residential property; and

(C) $500,000 per system for commercial property.

For purposes of this section, "household use" means any use that heated water is commonly put to in a residential setting, and includes any commercial application of those uses.

(c) Multiple owners of a single system shall be entitled to a single tax credit and the tax credit shall be apportioned between the owners in proportion to their contribution to the cost of the system.

In the case of a partnership, S corporation, estate, or trust, the tax credit allowable is for every eligible renewable energy technology system that is installed and placed in service in the state by the entity. The cost upon which the tax credit is computed shall be determined at the entity level. Distribution and share of credit shall be determined pursuant to section 235-110.7(a).

[~~(b)~~] (d) For the purposes of this section:

"Actual cost" means costs related to the renewable energy technology systems under subsection (a), including accessories and installation, but not including the cost of consumer incentive premiums unrelated to the operation of the system or offered with the sale of the system and costs for which another credit is claimed under this chapter.

"Renewable energy technology system" means a new system that captures and converts a renewable source of energy, such as wind [~~, heat (solar thermal), or light (photovoltaic) from the sun~~] or energy from the sun, into:

(1) A usable source of thermal or mechanical energy;
(2) Electricity; or
(3) Fuel.

~~**"Solar electric energy systems" include solar thermal electric and photovoltaic systems.**~~

"Solar or wind energy system" means any identifiable facility, equipment, apparatus, or the like that converts [~~insolation~~] energy from the sun or wind energy to useful thermal or electrical energy for heating, cooling, or reducing the use of other types of energy that are dependent upon fossil fuel for their generation.

~~**"Solar thermal energy systems" include solar water heating, solar air conditioning, solar space heating, solar drying, and solar process heat systems.**~~

[~~(c)~~] (e) For taxable years beginning after December 31, 2005, the dollar amount of any utility rebate shall be deducted from the cost of the qualifying system and its installation before applying the state tax credit.

[~~(d)~~] (f) The director of taxation shall prepare any forms that may be necessary to claim a tax credit under this section, including forms identifying the technology type of each tax credit claimed under this section, whether for solar thermal, photovoltaic from the sun, or wind. The director may also require the taxpayer to furnish reasonable information to ascertain the validity of the claim for credit made under this section and may adopt rules necessary to effectuate the purposes of this section pursuant to chapter 91.

[~~(e)~~] (g) If the tax credit under this section exceeds the taxpayer's income tax liability, the excess of the credit over liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted. All claims for the 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 may be claimed. Failure to comply with this subsection shall constitute a waiver of the right to claim the credit.

[~~(f)~~] (h) By or before December, 2005, to the extent feasible, using existing resources to assist the energy-efficiency policy review and evaluation, the department shall assist with data collection on the following:

(1) The number of renewable energy technology systems that have qualified for a tax credit during the past year by:
   (A) Technology type (~~solar thermal,~~ ~~**solar thermal electric**~~, ~~photovoltaic from the sun,~~ sun and wind); and
   (B) Taxpayer type (corporate and individual); and
(2) The total cost of the tax credit to the [~~State~~] state during the past year by:
   (A) Technology type; and
   (B) Taxpayer type.

~~**(g) A taxpayer who installs and places in service an eligible renewable energy technology**~~

~~system in the state for which a tax credit under this section may be claimed may transfer the tax credit in exchange for a cash payment equal to the present value of the tax credit~~."

LINDA LINGLE
GOVERNOR
THEODORE E. LIU
DIRECTOR
MARK K. ANDERSON
DEPUTY DIRECTOR

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Web site: www.hawaii.gov/dbedt

Telephone: (808) 586-2355
Fax: (808) 586-2377

Statement of
THEODORE E. LIU
Director
Department of Business, Economic Development, and Tourism
before the
SENATE COMMITTEE ON
ECONOMIC DEVELOPMENT AND TAXATION
Tuesday, March 18, 2008
1:15 p.m.
State Capitol, Conference Room 224

in consideration of
HB2005 SD1
RELATING TO RENEWABLE ENERGY TECHNOLOGIES.

Chair Fukunaga, Vice Chair Espero, and Members of the Committee.

The Department of Business, Economic Development, and Tourism (DBEDT) supports of HB2005, HD2, which revises the current definitions of solar systems to include new technologies being developed.

We defer to the Department of Taxation on tax implications, and concur with their recommended revisions.

Thank you for the opportunity to offer these comments.

SOPOGY™

To: Senator Carol Fukunaga, Chair

Economic Development and Taxation Committee

From: Sopogy Inc.

Date: March 17, 2008

Subject: Support for HB 2005 – Relating to Renewable Energy Technologies

Chair Fukunaga, Vice-Chair Espero, and Members of the Committees:

Sopogy, Inc. (Sopogy) is a solar power technology company based in Hawaii. Our purpose is to bring renewable solar energy technologies to Hawaii and its people for the betterment of our environment, independence from volatile imported fossil fuels, and energy stability.

Sopogy has developed a concentrating solar panel that enables the production of electricity, air conditioning, and/or process heat using the sun's power. Our technology is not categorized as Photovoltaic but as Solar Thermal and/or Concentrating Solar Power (CSP). Understanding, therefore, that solar generated electricity can come from a broader range of technologies than just photovoltaic (PV), Sopogy supports this bill's original language that would broaden the investment tax credit to all solar electric technologies.

With respect to the Department of Taxation's request to eliminate Section G, **Sopogy strongly rejects the proposed elimination** since this would adversely affect efforts to develop all renewable energy projects within the State of Hawaii. Transferability of tax credits enables projects to more fully utilize the benefit afforded by the State to incentivize renewable energy initiatives. Moreover, transferability simplifies investment structuring, and thus attractiveness, by allowing the tax credits to be shared between both Hawaii and mainland investors with Federal and State tax liability. Similar to the transferability of tax credits under QHTB (Act 221), Section G will allow mainland investment in Hawaii's renewable energy projects and spur growth in Hawaii's renewable industry.

With the ITC equally applied to solar thermal electric and photovoltaics, and with the inclusion of Section G, Sopogy supports the adoption of renewable energy and energy efficiency measures to reduce the state's dependence on oil, reduce greenhouse gas emissions, and provide energy price stability to Hawaii's consumers.

Thank you for this opportunity to testify.

Power | Process Heat | Air Conditioning

P: (808) 833 4747 | F: (808) 356 0565 | 2660 Waiwai Loop | Honolulu, HI 96819 | www.sopogy.com

SunEdison
simplifying solar

TESTIMONY OF SUNEDISON, LLC IN REGARD TO HB2005 HD1 SD1, RENEWABLE ENERGY TECHNOLOGIES TAX CREDIT BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
TUESDAY, MARCH 18, 2008

Chair Fukunaga, Vice-Chair Espero and Members of the Committee.

SunEdison is a developer of large solar photovoltaic (PV) systems with seven offices in five states and an international presence. We simplify the installation of solar electric resources so that the benefits of solar energy, particularly the reduction in oil-fired grid-supplied electricity, can be realized in Hawaii. SunEdison develops PV systems at the lowest possible cost and, as a result, has been the fastest growing solar developer in the nation. We believe that Hawaii's dependence on oil and the resultant high electricity prices create an excellent opportunity for solar resources. Our commitment to Hawaii includes involvement in PUC proceedings, the legislative process and the acquisition of a local solar company. Our projects employ many people, create economic benefits for the host customer and local community, and save all utility ratepayers money.

SunEdison supports HB2005 HD1 SD1. Broadening access to the tax credit will enhance its usability and help diversify Hawaii's energy markets reducing our dependence on imported oil.

Oil imports in 2006 totaled $3.4 billion at a time when oil prices were in the $60-$70/bbl range. Recent prices have exceeded $110/bbl. Over $2 million is spent <u>daily</u> on Oahu for imported fossil fuels to generate electricity. We have to begin to turn this around – oil prices are not coming down.

Hawaii originally passed its renewable energy technologies tax credit in 2003 (SB855) providing an incentive to install renewables such as solar to reduce dependency on imported oil, which was running about $30/bbl at the time. Indeed, Brian T. Taniguchi, Chair, Committee on Ways and Means, noted in his committee's report:

> *Your Committee finds that supporting alternate energy systems is critical to reducing the State's dependency on imported oil. This dependency not only sends capital resources out-of-state, but also creates a tenuous reliance on an unsustainable and unstable resource.*

Since then however, the tax credit has been little used by solar developers. For 2005, the most current year for which data is available, the average credit amount per taxpayer was about $1,000. While 185 residential installations are helpful, the impact on reducing dependency on foreign oil would be much greater with larger systems. Yet, despite

SunEdison
simplifying solar

increasing the commercial tax credit cap from $250,000 to $500,000 in 2006, there are precious few commercial systems being installed.

There are a number of reasons for this (including net metering limitations and utility-unique interconnection standards), however tax credit usability is a major problem. Structuring effective projects for tax credit allocation within a partnership is a complex and cumbersome process resulting in higher costs. Transferability will reduce these complications allowing more competition within the industry, reducing installation costs, and allowing local businesses and non-profits to reduce their power load.

Hawaii tax equity investors have many other investment options that are not tied to project performance risk. For example, the QHTB (Act 221) tax credit is fully transferable, offers a typical market return of 2 for 1 (i.e. $2 in tax credits for a $1 dollar investment), and does not have project risk. We can most efficiently match investors with projects if we can transfer the Renewable Energy Tax Credit. Moreover, transferability will allow solar developers to compete for investors with projects that use the much more versatile QHTB (Act 221).

Transferability will enable the solar industry to achieve efficiencies and truly enable Hawaii to become a market where solar development can occur on a significant scale.

The Department of Taxation has legitimate concerns about the administration of such transferability. To address DOT's concerns more directly, we would be amenable to additions to the bill which would (1) require a certificate to follow the owner of the tax credit, (2) indemnify the certificate holder if the property was sold within the first 5 years such that the owner would be responsible for paying any HI REITC recapture penalty, and (3) limiting the transfer of the credit to a single transfer.

HB2005 HD1 SD1 provides the necessary transferability in paragraph (g) of Section 1, and we urge the committee to retain this sentence in its current form, or modify it consistent with the above discussion.

In 2006, Hawaii exported only $16.3 billion in goods and services, including visitor spending, while importing approximately $24 billion. Let's keep Hawaii dollars in Hawaii and spend fewer dollars on oil. We would like to thank the Committee for the opportunity to submit testimony and for the Committee's consideration.

Keith Cronin,
President, SunEdison Hawaii

Rick Gilliam
Managing Director, Western States Policy

Hawaii Solar Energy Association
Serving Hawaii Since 1977

TESTIMONY OF THE HAWAII SOLAR ENERGY ASSOCIATON
IN REGARD TO H.B. 2005, H.D. 1, S.D. 1
RELATING TO RENEWABLE ENERGY TECHNOLOGIES
BEFORE THE
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION
ON
TUESDAY, MARCH 18, 2008

Chair Fukunaga, Vice-Chair Espero and members of the committee, my name is Rick Reed and I represent the Hawaii Solar Energy Assn (HSEA) The HSEA is a professional trade association established in 1977, and affiliated with the Solar Energy Industries Association (SEIA) in Washington, D.C. HSEA represents manufacturers, distributors, contractors, financiers, and utility companies active in the solar energy industry in Hawaii. We strongly support the passage of H.B. 2005, H.D. 1, S.D. 1.

The realm of solar energy includes both heat (solar thermal) and light (solar electricity). Solar thermal energy is particularly versatile in that it can be used to provide air conditioning, to heat water and air, or to generate electricity. High temperature solar thermal steam generators, often referred to generically as concentrating solar power (CSP) technologies, are capable of generating enormous amount of electricity.

H.B. 2005 provides a definitional change (line 15) that acknowledges that both PV and solar thermal systems are capable of generating electricity. The bill deletes the reference to "photovoltaic energy systems" and replaces it with "solar electric energy systems", which is more accurate and clarifies the range of solar technologies capable of generating power.

H.B. 2005 also provides a definition for qualifying "solar thermal energy systems" – that Do Not generate electricity – to include solar water heating, solar air conditioning, solar space heating, solar drying, and solar process heat systems.

These changes provide clarity to the law and make this statute more consistent with the real world technical applications for solar energy.

Thank you for the opportunity to testify.

P.O. Box 37070 Honolulu, Hawaii 96837
SOLAR HOTLINE (808)521-9085

TESTIMONY OF THE HAWAII PV COALITION AND THE SOLAR ALLIANCE
IN REGARD
HB 2005 HD 1 SD 1 RELATING TO RENEWABLE ENERGY TECHNOLOGIES
BEFORE THE
BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
ON
TUESDAY, MARCH 18, 2008 AT 1:15PM

Chair Fukunaga, Vice-Chair Espero and Members of the Committee.

The Hawaii PV Coalition is a non-profit organization that represents installers, suppliers, manufacturers and customers of solar electric systems in the state of Hawaii.[1] The Solar Alliance is a state-focused alliance of solar manufacturers, integrators and financiers dedicated to accelerating the promise of photovoltaic (PV) energy in the United States.[2]

The Hawaii PV Coalition and the Solar Alliance supports HB 2005 HD 1 SD 1. We believe broadening the access to the tax credit by both expanding the definition and providing for transferring of the tax credit will help diversify Hawaii's energy markets and reduce Hawaii's dependence on imported energy.

The State of Oregon has a simple pass-through/transfer provision (similar to the one requested above) that has been helpful in expanding their solar program. In this system a project owner may transfer a tax credit to a partner in return for a lump-sum cash payment (the net present value of the tax credit) upon completion of the project. This system allows non-profit organizations, schools, governmental agencies, tribes, other public entities and businesses with and without tax liability to use the tax credit by transferring their tax credit for an eligible project to a partner with a tax liability.[3] The language currently in this legislation was copied from the Oregon legislation.

We strongly support Hawaii putting in place a similar provision that will likely increase the rate Hawaii uses renewable energy instead of importing fuels. We understand the Department of Taxation (DOT) is concerned that "[s]elling the tax credits can be subject

---

[1] The Hawaii PV Coalition, http://www.hawaiipvcoalition.org/
[2] The Solar Alliance, http://solaralliance.org/
[3]DSIRE Incentives by State Incentives in Oregon, http://www.dsireusa.org/library/includes/incentive2.cfm?Incentive_Code=OR03F&state=OR&CurrentPageID=1

to abuse and suspect motivation by parties involves." (Dept. of Taxation testimony on March 11 before Senate Committee on Energy and Environment). Currently one can allocate the tax credit within partnership deals. These partnerships can be created in several layers and can create a complex structure. These partnerships can be even less transparent than a straight transfer and subject to an even greater level of abuse and suspect motivation by parties involves.

The goal of the solar community, as well as that of the DOT we believe, is for Renewable Energy Tax Credit (RETC) investors to be vested in the long-term success of HI solar installations.

The solar community understands that DOT would like to be able to track the transactions with minimum administrative costs so that they can assure that the use of the tax credit is legitimate. We support DOT's goal here as well. We believe that we can address these concerns with fairly simple solutions. Limiting the transfer to the credit to a single transfer, providing for indemnification, and requiring the taxpayer claiming the credit to attach a project certificate to their tax return would provide a significant level of traceability and tractability. With this system there would be no need to follow the allocations through multiple tiers of partnerships in certain cases, which the DOT has remarked about in the Act 221 context. This can be accomplished by inserting the following language "(1) require owner of the tax credit to file a certificate letter with their tax returns stating the details of the project, (2) indemnify the certificate holder if the property was sold within the first 5 years such that the owner would be responsible for paying any HI REITC recapture penalty, and (3) limiting the transfer of the credit to a single transfer."

Currently, the banks in Hawaii are limiting going forward on solar projects,[4] which is going to significantly slow the growth of renewable energy in Hawaii. Increased financing of renewable energy projects is greatly needed now. This provision would facilitate the expansion of renewable energy financing, which would in turn reduce fuel imports and promote job growth in Hawaii. We look to your leadership to help accomplish this.

We would like to thank the Committee for the opportunity to submit testimony and for the Committee's consideration.

[4] Under Hawaiian bank charter law, a Hawaiian bank is prohibited from selling power. In Hawaii, Bank of Hawaii ("BOH") and First Hawaiian Bank ("FHB") have historically been active in tax-oriented financing transactions. As of the beginning of 2008, BOH and FHB have shifted to a position of not being willing to finance Solar PPA deals at all with any company for the foreseeable future.

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Renewable energy technology systems

BILL NUMBER: HB 2005, SD-1

INTRODUCED BY: Senate Committee on Energy and Environment

BRIEF SUMMARY: Amends HRS section 235-12.5 to replace the term "photovoltaic" with "solar electric." Adds a definition of "solar electric energy systems" to include solar thermal electric and photovoltaic systems. Also adds a definition of "solar thermal energy systems" to include solar water heating, solar air conditioning, solar space heating, solar drying, and solar process heat systems.

The taxpayer eligible for the credit may transfer the credit in exchange for a cash payment equal to the present value of the tax credit.

EFFECTIVE DATE: July 1, 2050

STAFF COMMENTS: Hawaii's income tax credit for alternate energy devices was established by the 1976 legislature originally for solar energy systems and was later expanded to include wind energy devices, heat pumps, ice storage systems, and photovoltaic systems. This measure proposes to further expand the state energy tax credits to include solar air conditioning, solar space heating, solar drying, and solar process heat systems.

While some may consider an incentive necessary to encourage the use of energy conservation devices, it should be noted that the high cost of these energy systems limits the benefit to those who have the initial capital to make the purchase. If the combined incentives of federal and state income tax credits during the early 1980's equal to 50% were not able to encourage more than those who did install alternate energy devices during the period when the federal credits were in effect, it is questionable whether the state tax credits along with the federal energy tax credits (30%), will encourage many more taxpayers to install such devices.

If it is the intent of the legislature to encourage a greater use of renewable energy systems by extending the existing energy tax credits to include solar thermal energy systems, as an alternative, consideration should be given to a program of low-interest loans available to all income levels as is being proposed in HB 2101. However, if the taxpayer avails himself of the loan program, the renewable energy credit should not be granted for projects utilizing the loan program as the projects would be granted a double subsidy by the taxpayers of the state.

Low-interest loans, which can be repaid with energy savings, would have a much more broad-based application than a credit which amounts to nothing more than a "free monetary handout" or subsidy by state government for those taxpayers who more than likely can afford to make the conversion. A program of low or no-interest loans would do much more to increase the acquisition of these devices. Persons of all income levels could borrow the funds, make the acquisition, and repay the state program in an amount equal to the avoided costs that their utility bills would now reflect. While this recommendation has fallen on deaf ears in the past, the above-mentioned proposal would help put such devices within the reach of more people. The credit, on the other hand, merely becomes a windfall for those who are able to come up with the up-front costs for such devices. This leaves the poor and lower-middle income families still dependent on fossil fuel energy.

While this proposal focuses on newer alternate energy technologies which are far more expensive to acquire, it underscores the above point that the credit benefits only those who have the means to install such devices. If lawmakers truly want to provide a financial incentive for taxpayers to make the switch to using these alternative energy devices while taking advantage of the credit, then a program of no-interest, or low-interest loans would be far more effective. The state could provide the capital to acquire these devices, and the taxpayer could receive a discount of 30% provided by the federal tax credit. The amount of the state loan could then be amortized by the energy savings realized by the taxpayer.

Merely providing federal and state tax credits ignores the reality of living in Hawaii, that is, most families don't have the resources to make such a large capital outlay while struggling to put food on the table.

Digested 3/17/08