

# HB2540

# HD1

**Measure Title:  
RELATING TO TAXATION.**

**Report Title:  
Income Tax; General Excise Tax; Potable Water**

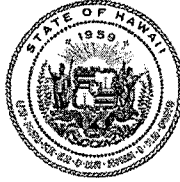
**Description:  
Provides an income tax and general excise tax exemption for companies that provide potable water and are exempt under section 501(c)(12) of the IRC. Effective January 1, 2020. (HB2540 HD1)**

**Introducer(s):  
EVANS**

**Current Referral:  
HTH, EDT, WAM**

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 HEALTH  
TESTIMONY REGARDING HB 2540 HD 1  
RELATING TO TAXATION**

**TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)**

**DATE: MARCH 12, 2008**

**TIME: 1:15PM**

**ROOM: 225**

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This legislation provides an income and general excise tax exemption for nonprofit organizations organized under § 501(c)(12) of the Internal Revenue Code (relating to community irrigation or ditch organizations); provided the company receives 85% of its income from members for the sole purpose of meeting losses or expenses.

The Department of Taxation (Department) takes **no position** on this measure; however offers comments.

Currently, a nonprofit organization recognized under § 501(c)(12) of the IRC is subject to both Hawaii income and general excise tax because § 501(c)(12) is not operative for Hawaii income tax purposes and the general excise tax also does not recognize this entity for purposes of the existing exemptions. Under § 501(c)(12), certain tax benefits are available under federal law where the company receives 85% of its income for the sole purpose of meeting losses and expenses in pursuit of its exempt purpose, which can include obtaining water for communities.

**NOT FACTORED INTO EXECUTIVE BUDGET**—The Department points out that this legislation has not been factored into the Executive Budget and is outside the executive priorities for tax relief this legislation session.

**REVENUE IMPACT**—Given the lack of information on entities that could qualify under this bill, this bill will result in an indeterminate revenue loss.

# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, GENERAL EXCISE, Exempt potable water

BILL NUMBER: HB 2540, HD-1

INTRODUCED BY: House Committee on Finance

STAFF COMMENTS: Amends HRS section 235-2.3 (b) to provide that companies that provide potable water under IRC section 501(c) (12) shall not be subject to state income taxation.

Amends HRS section 237-23 (a) to provide that companies that provide potable water under IRC section 501(c) (12) shall not be subject to the general excise tax.

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

STAFF COMMENTS: Under current law, IRC 501(c) (12) organizations, while exempt from federal income taxation, are taxable under the state income tax provisions.

It is unclear who this particular measure would benefit and how the operation is structured. If, in fact, a separate nonprofit has been set up to provide potable water, it is not what the federal law originally addressed in (c)(12) which applies to benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone or electric companies. Ditch and irrigation companies do not provide potable water and, therefore, it is curious to whom this proposal would apply. If, in fact, the (c)(12) company is being used to pass through income to a profit making company which in turn is covering the losses and expenses of the nonprofit, the expansion of the defined activity should be questioned.

While this measure would exempt from state income and general excise taxation an IRC 501(c)(12) organization that provides potable water, it would provide preferential tax treatment to a very select group of taxpayers. From the standpoint of equity, such preferential treatment should be granted to all IRC 501(c)(12) organizations with a sunset date of one year to allow the legislature to determine the effects and outcome of the exemption and whether it should be continued or repealed. At the very least, the department of taxation should be tasked with explaining whether or not such organizations should or should not be recognized as being exempt for state tax purposes.

Digested 3/12/08

## **Napu'u Water Inc.**

P.O. Box 4525  
Kailua-Kona, Hawaii 96745

Senator David Ige  
Chair, Health committee  
Hawaii State Capitol, Room 215  
415 South Beretania St.  
Honolulu HI 96813

### **Written testimony for Health committee, March 13th<sup>th</sup>, 1.15pm**

12 March 2008

Dear Senator Ige:

**Re: Support of HB2540** , Relating to income tax and general excise tax exemption for companies that provide potable water and are exempt under section 501(c) 12 of the IRC

We, the members of Napu'u Water, Inc., a Hawaii nonprofit-member corporation formed pursuant to Hawaii Revised Statutes Section 414D for the sole purpose of ensuring the availability of water to the rural communities known as *Pu'uwa'awa'a*, *Puuanahulu* and *Puu Lani Ranch* on the Island of Hawaii, and exempt under Internal Revenue Code Section 501(c) (12), urge you and the members of the Senate Health Committee to support HB 2540 HD1.

HB 2540 HD1, if adopted, would exempt nonprofit organizations providing potable water from Hawaii income tax and general excise tax if they are exempt for federal income tax purposes under Internal Revenue Code Section 501(c) (12).

Internal Revenue Code Section 501(c) (12) provides federal income tax exemption for benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, electric companies, or "like organizations". The purpose of an Internal Revenue Code Section 501(c) (12) organization is to provide certain services to its members at the lowest possible cost. To qualify for and maintain exemption under the Code Section, a cooperative must receive 85 percent or more of its income each year from members. The income must be collected solely to meet the cooperative's losses and expenses.

We urge you and the members of the Senate Health Committee to support HB 2540 for the following reasons:

- Internal Revenue Code Section 501(c) (12) organizations, such as Napu'u Water, Inc., provide an invaluable service to their members, which are generally in rural communities, at cost.
- Internal Revenue Code Section 501(c) (12) organizations, such as Napu'u Water, Inc., relieve the government from the burden of providing such services to rural and outlying communities.
- The State of Hawaii has adopted all of the provisions of Internal Revenue Code Section 501, except for Code Sections 501(c) (12), (15), and (16).
- The adoption of HB 2540 would bring about a fair and equitable State tax result for all federally tax exempt nonprofit organizations, under Internal Revenue Code Section 501(c), situated in the State of Hawaii.
- The adoption of HB 2540 HD 1 would not significantly impact tax revenues to the State of Hawaii.

For these reasons, we strongly urge you to support the passage of HB 2540 with an effective date of the date of final approval. We appreciate this opportunity to submit our written testimony. If you or any member of the Senate Health Committee has any questions, please feel free to contact us.

Respectfully submitted,

Anthony B. Craven  
President, Napu'u Water Inc.

Senator David Ige  
Chair, Health committee  
State Capitol  
Honolulu

Honolulu HI 96813

**Written testimony for Health committee, March 13th, 1.15pm Conference Room  
225**

12 March 2008

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HB 2540, if adopted, would exempt **nonprofit** organizations from Hawaii income tax and general excise tax if they are exempt for federal income tax purposes under Internal Revenue Code Section 501(c) (12).

Internal Revenue Code Section 501(c) (12) provides federal income tax exemption for benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, electric companies, or "like organizations". The purpose of an Internal Revenue Code Section 501(c) (12) organization is to provide certain services to its members at the lowest possible cost. To qualify for and maintain exemption under the Code Section, a cooperative must receive 85 percent or more of its income each year from members. The income must be collected solely to meet the cooperative's losses and expenses.

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- Internal Revenue Code Section 501(c) (12) organizations, such as Napu'u Water, Inc., relieve the government from the burden of providing such services to rural and outlying communities.
- The State of Hawaii has adopted all of the provisions of Internal Revenue Code Section 501, except for Code Sections 501(c) (12), (15), and (16).
- The adoption of HB 2540 would bring about a fair and equitable State tax result for all federally tax exempt nonprofit organizations, under Internal Revenue Code Section 501(c), situated in the State of Hawaii.
- The adoption of HB 2540 would not significantly impact tax revenues to the State of Hawaii.

For these reasons, I strongly urge you to support the passage of HB 2540 with an effective date as the date of final approval. I appreciate this opportunity to submit written testimony. If you or any member of the Senate Health Committee has any questions, please feel free to contact me.

Respectfully submitted,

David and Michelle Johnson  
71-1676 Puu Lani Dr. C-44  
Kailua Kona, Hawaii 96740  
808-325-1567

## testimony

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**From:** Stephen and Cathleen Rickard [scrick@hawaiiantel.net]  
**Sent:** Wednesday, March 12, 2008 1:16 PM  
**To:** testimony  
**Subject:** Re: HB2540; for Health committee, March 13th, 1.15pm Conference Room 225

Seantor David Ige  
Chair, Health committee  
State Capitol  
Honolulu

Honolulu HI 96813

**Written testimony for Health committee, March 13th, 1.15pm Conference Room 225**

12 March 2008

Dear Senator Ige:

**Re: Support of HB2540**, Relating to income tax and general excise tax exemption for companies that provide potable water and are exempt under section 501(c) 12 of the IRC

I, as a member of Napu'u Water Inc., a Hawaii **nonprofit-member corporation** formed pursuant to Hawaii Revised Statutes Section 414D for the sole purpose of ensuring the availability of water to the rural communities known as *Pu'uwa'awa'a*, *Puuanahulu* and *Puu Lani Ranch* on the Island of Hawaii, and exempt under Internal Revenue Code Section 501(c) (12), urge you and the members of the Senate Health Committee to support HB 2540.

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I urge you and the members of the Senate Health Committee to support HB 2540 for the following reasons:

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For these reasons, I strongly urge you to support the passage of HB 2540 with an effective date as the date of final approval. I appreciate this opportunity to submit written testimony. If you or any member of the Senate Health Committee has any questions, please feel free to contact me.

Respectfully submitted,

Stephen Rickard  
Puu Lani Ranch, Hawaii



Senator David Ige  
Chair, Health committee  
State Capitol  
Honolulu

Honolulu HI 96813

**Written testimony for Health committee, March 13th, 1.15pm Conference Room  
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Dear Senator Ige:

**Re: Support of HB2540** , Relating to income tax and general excise tax exemption for companies that provide potable water and are exempt under section 501(c) 12 of the IRC

I, as a member of Napu'u Water Inc., a Hawaii **nonprofit-member corporation** formed pursuant to Hawaii Revised Statutes Section 414D for the sole purpose of ensuring the availability of water to the rural communities known as *Pu'uwa'awa'a*, *Puuanahulu* and *Puu Lani Ranch* on the Island of Hawaii, and exempt under Internal Revenue Code Section 501(c) (12), urge you and the members of the Senate Health Committee to support HB 2540.

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Respectfully submitted,

Richard Toledo and Wendy Light  
71-1776 Puu Lani Drive #55  
Kailua Kona  
HI 96740

Seantor David Ige  
Chair, Health committee  
State Capitol  
Honolulu

Honolulu HI 96813

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SCOTT W. NAIER

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Chair, Health committee  
State Capitol  
Honolulu

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*Dee M. Harwood*

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Chair, Health committee  
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Respectfully submitted,

*Sally H. Rice*

*sally@riceohana.com*



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Chair, Health committee  
State Capitol  
Honolulu

Honolulu HI 96813

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Respectfully submitted,

Thomas Scheetz