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Ways & Means Committee
Tuesday, April 1, 2008, 10:15 AM
Conference Room 211
Support for HB 2540
Relating to Income Tax, General Excise Tax and Portable Water

WAMtestimony@capitol.hawaii.gov

Chair Baker, Tsutsui and Committee Membes:

We urge you support HB 2540 that "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 Internal Revenue Code".

More specifically, HB 2540, if adopted, would amend subsection (b) of section 235-2.3, Hawaii Revised Statutes, to read as follows: "(b) The following Internal Revenue Code subchapters, parts of subchapters, sections, subsections, and parts of subsections shall not be operative for the purposes of this chapter, unless otherwise provided... (20) Section 501 (c) (12), (15), and (16) (with respect to exempt organizations); except for companies that provide potable water under section 501(c) (12)..."

The Bill would also amend subsection (a) of section 237-23, Hawaii Revised Statutes, to read as follows: "(a) This chapter shall not apply to the following persons... and (11) Companies that provide potable water and are exempt under section 501(c) (12) of the Internal Revenue Code of 1986, as amended."

We support HB 2540 as the State of Hawaii should exempt from taxation a federally recognized Section 501(c)(12) tax exempt cooperative established for the sole purpose of providing potable water to members within a rural community that is unable to obtain similar services from the State, County or other service provider. Adoption of HB 2540 is fair, equitable and good public policy as such cooperatives relieve the burden of the State and Counties to provide similar services.

Section 501(c)(12) organizations are designed to provide certain services to its members at the lowest possible cost. The strict federal requirements for tax exemption under Section 501(c)(12) of the Internal Revenue Code are: (1) The organization must be formed as mutual ditch or irrigation companies, mutual or cooperative telephone companies and like organizations; (2) The organization must operate, be democratically governed, and account under the cooperative principles; and (3) 85% or more of their income of the organization must consist of amounts collected from members for the sole purpose of meeting losses and expenses.

Furthermore, we recommend that HB 2540 be revised to not only exempt companies that provide potable water and are exempt under section 501(c)(12) of the Internal Revenue Code but all organizations that are exempt under section IRC 501(c)(12).

For these reasons, we strongly urge you to join us in supporting the passage of HB 2540, and the proposed revision, if possible. We appreciate this opportunity to submit our written testimony and the enclose Fact Sheet regarding an intended beneficiary of the Bill. If you or any member of the Committee has any questions, please feel free to contact us.

Respectfully submitted,
Horwath Kam & Company, An Accountancy Corporation



Howard K. Kam, Jr., CPA
Its Managing Director

Encl: Napu'u Water Fact Sheet

PROPOSED BENEFICIARY FACT SHEET

Napu'u Water, Inc. (A Hawaii Nonprofit Membership Corporation and Federally Tax Exempt IRC 501(c)(12))

Background of Napu'u Water, Inc.

Napu'u Water, Inc. ("Napuu") was formed as a Hawaii nonprofit-member corporation pursuant to HRS 414D on February 4, 2005 for the sole purpose of ensuring the availability of water to the rural communities known as Puuwaawaa, Puuanahulu and Puu Lani Ranch on the Island of Hawaii through the acquisition, management and operation of the Puuwaawaa Water System for the benefit of its rural community members in accordance with IRC 501(c)(12). Napu'u is the sole source of potable water for the rural community.

Napu'u evolved through necessity since Puuwaawaa Waterworks, Inc. (the PUC regulated for profit owner and operator of the potable water system serving the community since the early 1970's) had filed for Chapter 11 under the Federal Bankruptcy laws and the Board of Water Supply for the Hawaii County refused to take over the system due to its internal limitations. The potable water system consists of two wells, a gas chlorine injection system, three separate tank storage system and surface transmission lines. Napu'u obtained the initial funding to the purchase of the Water System through a loan from the federal Rural Community Assistance Corporation, and currently owns and operates the system for its members.

Estimated Rural Community Population

The estimated population that Napu'u serves is 330, which is based upon an average of 2.5 people per residential connection or (2.5 x 132).

Demographics of the Rural Community

Apart from residential connections, there are 3 cattle ranchers with 5 connections on leased State land (for which the State does not provide any assistance with water), and 3 Department of Forestry and Wildlife State connections. Napu'u also provides water for the volunteer fire station which has just been adopted by the County.

The median income for the rural community served by Napu'u is approximately \$47,000 based upon the 2000 Census. The residences consist of blue collar, white collar, farmers and ranchers, and retirees. Most of the families in Puuanahulu homesteads have lived there for several generations.

Number of Current Napu'u Members

Napu'u has 154 connections, each meter being one member for voting purposes as required by the organization's bylaws. There are very few multi-meter holders (e.g. cattle ranchers and the State).

Current Napu'u Water Costs for the Rural Community Members

Fixed Service Fee	\$75.75 per Month
First 5,000 Gallons	\$11.00 per 1,000
5001-15,000 Gallons	\$16.75 per 1,000
15,001-25,000 Gallons for Residential	\$17.75 per 1,000

25,001 or More Gallons for Residential	\$19.75 per 1,000
15,001-30,000 Gallons for Cattle Ranchers	\$17.75 per 1,000
30,001 or More Gallons for Cattle Ranchers	\$11.00 per 1,000

Note: This rate structure was agreed after several community discussions and a vote. The cattle provide some measure of fire protection around the area. According to a Public Utilities Commission report to the Legislature in December 2007, entitled Senate Concurrent Resolution No 3 S.D.1 "Requesting the PUC to study the rate structures of private entities that furnish water used for agricultural purposes", Napu'u water rates was shown in the highest bracket.

Current Hawaii County Water Rates (Residential)

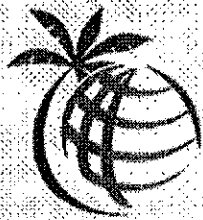
Meter Charge	\$12 per Month
Power Charge	\$1.60 per 1,000
First 5,000 Gallons	\$0.75 per 1,000
5001-15,000 Gallons	\$1.55 per 1,000
15001-40,000 Gallons	\$2.75 per 1,000
40,000 or More Gallons	\$3.65 per 1,000

Remarks

1. Napu'u average residential member uses approximately 300 gallons per day. The monthly cost to a residential member is approximately \$198 (exclusive of taxes), whereas a Hawaii County user cost would be approximately \$36.
2. The County has separate rates for agricultural users which include the monthly meter charge and the same power charge of \$1.60 per 1,000 gallons. All agricultural water is charged at \$0.85 regardless of volume.
3. The Community does not have access to a local sewer system. The residences utilize either separate septic or cesspool systems.
4. Hawaii Electric Company and HawaiianTelcom serves the entire rural community.
5. See map of Puuanahulu, Hawaii on the following page (approximately center of the map) to obtain an understanding of the rural community's remote water service location.

testimony

From: Jessica Su [jsu@horwathkam.com]
Sent: Friday, March 28, 2008 6:29 PM
To: testimony
Subject: Testimony HB 2540
Attachments: image001.png



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Before the Ways and Means Committee

Tuesday, April 1, 2008 at 10:15 AM
Conference Room 211

Support of House Bill No. 2540
Relating to Income Tax; General Excise Tax; Potable Water

VIA Email: testimony@capitol.hawaii.gov

Chair Baker, Vice-Chair Tsutsui and Committee Members:

On behalf of the Tax Committee of the Hawaii Society of Certified Public Accountants, you support HB 2540 that "provides an income tax and general excise tax exemption to provide potable water and are exempt under Section 501(c)(12) of the Internal Revenue

Code. HB 2540 should be adopted to allow Hawaii residence in outlying communities that are public utility services due to the constraints of their municipality to establish and operate community based cooperative services without taxation. We believe that exempting such organizations from taxation which have met the stringent federal tax exemption requirements is also appropriate since these nonprofit organizations assist in relieving the burden of the State and counties.

The Department of Taxation understands the political value of such nonprofit organizations accordingly, is not opposing HB 2540 that would bring the total number of State recognized organizations to 26 out of the 28 federally recognized tax exempt organizations under Section 501(c)(12) of the Internal Revenue Code.

The purpose of a Section 501(c)(12) organization is to provide certain services to its members at the lowest possible cost. To qualify for and maintain the federal tax exemption, a cooperative must (1) be organized as a mutual ditch or irrigation company, mutual or cooperative telephone company, or other cooperative as further defined under the Code; (2) The organization must operate, be governed, and act on a cooperative basis; and (3) 85 percent or more of the organization's income must be collected from members for the sole purpose of meeting losses and expenses.

Furthermore, we recommend that HB 2540 not only exempt companies that provide potable water that are exempt under Section 501(c)(12) of the Internal Revenue Code but all organizations that are exempt under that Section.

We appreciate this opportunity to submit our written testimony.

Respectfully submitted,

testimony

From: Stephen and Cathleen Rickard [scrick@hawaiiintel.net]
Sent: Saturday, March 29, 2008 2:19 PM
To: testimony
Subject: HB 2540

Senator Rosalyn Baker
 Chair, Ways and Means Committee
 5th Senatorial District
 Hawaii State Capitol, Room 210
 415 South Beretania Street
 Honolulu, HI 96813

Written testimony for Senate Ways and Means Committee, April 1st 10.15am Conference Room 211

29 March 2008

Dear Senator Baker,

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 am writing to urge you and the members of the Senate Ways and Means Committee to support HB 2540.

I am 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*, *Puuana'hulu* and *Puu Lani Ranch* on the Island of Hawaii, and exempt under Internal Revenue Code Section 501(c) (12). 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.

I urge you and the members of the Senate Ways and Means 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 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 Ways and Means Committee has any questions, please feel free to contact me.

Respectfully submitted,

Stephen Rickard
 Cathleen Rickard
 71-1688 Puu Napoo Drive, #8
 Kailua Kona, HI 96740
 808 325-6957

Senator Rosalyn Baker
Chair, Ways and Means Committee
5th Senatorial District
Hawaii State Capitol, Room 210
415 South Beretania Street
Honolulu, HI 96813

**Written testimony for Senate Ways and Means Committee, April 1st 10.15am
Conference Room 211**

29 March 2008

Dear Senator Baker,

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 am writing on behalf of the members of Napu'u Water Inc. to urge you and the members of the Senate Ways and Means Committee to support HB 2540.

Napu'u Water Inc. is 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). 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.

In order to meet the requirements of federal tax exemption, the basis of our nonprofit organization is as follows:

- Each member has one vote;
- Members have the right to receive water substantially at cost, receive a return of any excess payments over losses and expenses, and to share in any assets upon dissolution;
- NWI's business is in control of its members who democratically elect its Board of Directors to operate the organization;
- NWI income is used solely for paying for losses and expenses, and derives from the members apart from a small amount of bank interest; and

- Any excess income not retained in reasonable reserves for future losses and expenses belongs to the members in proportion to their patronage of the organization.

We urge you and the members of the Senate Ways and Means 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 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 as the date of final approval. I appreciate this opportunity to submit written testimony. If you or any member of the Senate Ways and Means Committee has any questions, please feel free to contact me.

Respectfully submitted,

Anthony Craven
President, Napu'u Water Inc.

Senator Rosalyn Baker
Chair, Ways and Means Committee
5th Senatorial District
Hawaii State Capitol, Room 210
415 South Beretania Street
Honolulu, HI 96813

**Written testimony for Senate Ways and Means Committee, April 1st 10.15am
Conference Room 211**

29 March 2008

Dear Senator Baker,

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 am writing to urge you and the members of the Senate Ways and Means Committee to support HB 2540.

I am 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). 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).

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I urge you and the members of the Senate Ways and Means 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.
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- 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).
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- 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 Ways and Means Committee has any questions, please feel free to contact me.

Respectfully submitted,



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KAILUA-KONA HI 96740

SALLY H. RICE
71-1361 HAWAII BELT RD.
KAILUA-KONA, HI 96740-8308

Senator Rosalyn Baker
Chair, Ways and Means Committee
5th Senatorial District
Hawaii State Capitol, Room 210
415 South Beretania Street
Honolulu, HI 96813

**Written testimony for Senate Ways and Means Committee, April 1st 10.15am
Conference Room 211**

29 March 2008

Dear Senator Baker,

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

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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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- 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 Ways and Means Committee has any questions, please feel free to contact me.

Respectfully submitted,

Sally H. Rice

808-325-1470

Senator Rosalyn Baker
Chair, Ways and Means Committee
5th Senatorial District
Hawaii State Capitol, Room 210
415 South Beretania Street
Honolulu, HI 96813

**Written testimony for Senate Ways and Means Committee, April 1st 10.15am
Conference Room 211**

29 March 2008

Dear Senator Baker,

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

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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.

I urge you and the members of the Senate Ways and Means 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 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 Ways and Means Committee has any questions, please feel free to contact me.

Respectfully submitted,

Richard Toledo
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Kailua Kona
HI 96740-8315

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

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 WAYS & MEANS

TESTIMONY REGARDING HB 2540 HD 1 RELATING TO TAXATION

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

DATE: APRIL 1, 2008

TIME: 10:15PM

ROOM: 211

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).

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. It is difficult to determine which, if any, companies qualify under section 501 (c) (12) and also provide potable water. Public suppliers, who would not be affected by this bill, provide most of the state's drinking water. It is likely the impact of this bill will be minimal.