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

ON THE FOLLOWING MEASURE:
H.B. NO. 2661, H.D. 1, RELATING TO SPECIAL PURPOSE REVENUE BONDS TO ASSIST INDUSTRIAL ENTERPRISES.

BEFORE THE:
HOUSE COMMITTEE ON FINANCE

DATE: Thursday, February 21, 2008 **TIME:** 10:00 AM
LOCATION: State Capitol, Room 308
Deliver to: Committee Clerk, Room 306, 2 Copies

TESTIFIER(S): Mark J. Bennett, Attorney General
or Brian Aburano, Deputy Attorney General

Chair Oshiro and Members of the Committee:

The Attorney General has comments regarding whether the special purpose revenue bonds proposed by this bill would be tax-exempt under current federal tax laws.

This bill is to authorize the issuance of special purpose revenue bonds under part V, chapter 39A, Hawaii Revised Statutes (HRS), in a total amount not to exceed $38,000,000, for the purpose of assisting Hui Mana'Oma'o or an enterprise or commercial entity in which Hui Mana'Oma'o possesses a vested equity interest, for establishment of facilities to convert renewable energy resources into electrical energy [page 2, lines 5-13].

Generally, the purpose of issuing special purpose revenue bonds is to issue tax-exempt bonds, i.e., bonds that will pay interest that is exempt from federal income taxes. Tax-exempt bonds have lower interest rates than taxable bonds or commercial loans since they produce interest that is exempt from federal taxation. As outlined below, current federal tax laws will make it difficult for the special purpose revenue bonds proposed by this bill to be tax-exempt bonds.

Tax-exempt bonds may be issued under 26 U.S.C. § 142(a)(8) so long as 95 percent or more of the net proceeds of the bonds are used to provide "facilities for the local furnishing of electrical energy or gas." However, this provision is limited to entities that were engaged in the furnishing of electrical energy or gas on January 1, 1997, and the proposed facility must serve the area served by that entity on January 1, 1997. See 26 U.S.C. § 142(f)(3). Hui Mana'Oma'o would not qualify to issue tax-exempt bonds under this provision, because it was not furnishing electrical energy in Hawaii on January 1, 1997.

Tax-exempt bonds may be issued under 26 U.S.C. § 144(a) if they are "qualified small issue bonds." Bonds issued after December 31, 1986, do not qualify as "qualified small issue bonds" unless 95 percent of the net proceeds of those bonds are used to provide a "manufacturing facility" or farm property. See 26 U.S.C. § 144(a)(12)(A) and (B). A "manufacturing facility" is defined as a facility used "in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property)." See 26 U.S.C. § 144(a)(12)(C). Hui Mana'Oma'o's proposed facility for the production of electrical energy from renewable resources would not qualify as a "manufacturing facility" as the production of electrical energy is not the production or manufacture of tangible personal property. Further, the amount of the proposed bonds exceeds the amount that is allowed for small issue bonds. See 26 U.S.C. § 144(a)(1) and (4) ($1,000,000 and optional $10,000,000 limit).

Tax-exempt bonds may be issued under 26 U.S.C. § 145(a) if all property to be provided by the net proceeds of the bonds is to be owned by a 501(c)(3) organization, i.e., a nonprofit organization under 26 U.S.C. § 501(c)(3). The records of the Department of Commerce and Consumer Affairs do not indicate that Hui Mana'Oma'o is a nonprofit organization. Rather, they indicate that it is a domestic limited liability company. Also, IRS Publication 78, Cumulative List of Organizations described in section 103 of the Internal Revenue Code of 1986 does not list Hui Mana'Oma'o as an organization described in 26 U.S.C. § 501(c)(3). As such, the bonds to be issued under this bill would not qualify as tax-exempt bonds under 26 U.S.C. § 145(a).

While not tax-exempt, the proposed bonds could receive favorable tax treatment if they qualify as "clean renewable energy bonds" (CREB) under 26 U.S.C. § 54. However, the borrower who uses the proceeds of CREB special purpose revenue bonds must be a mutual or cooperative electric company, i.e., a nonprofit organization organized under 26 U.S.C. § 501(c)(12) or 1381(a)(2)(C). See 26 U.S.C. § 54(d)(1)(B) and (j)(5). Hui Mana'Oma'o does not appear to be such a company. The bonds proposed by this bill also may not meet other requirements for CREB bonds set out in 26 U.S.C. § 54, including a current requirement that the bonds be issued before December 31, 2008. See 26 U.S.C. § 54(m).