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SENATE COMMITTEE ON ENERGY & ENVIRONMENT

TESTIMONY REGARDING THE JANUARY 31, 2008 AGENDA

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

DATE: JANUARY 31, 2008

TIME: 2:15PM

ROOM: 414

Contained in this testimony are the Department of Taxation (Department) comments on the Senate Committee on Energy & Environment's agenda for January 31, 2008. Because each measure relates to taxation, the Department's comments are in summary fashion for your convenience—

This legislation provides various tax incentives aimed at renewable energy and other alternative fuel related legislation.

I. THE DEPARTMENT SUPPORTS ENERGY REFORM POLICY.

The Department recognizes the importance of this legislation because these bills serve as another step in the right direction for minimizing Hawaii's dependence on fossil fuels. The Department and the administration both recognize the importance of Hawaii's energy independence and are in strong support of policies to that effect. The administration is committed to energy conservation and promoting alternative energy production, including reducing Hawaii's fuel dependency.

This legislation also compliments current federal incentives on the same subject matter.

II. DEFERRAL TO DBEDT ON THE MERITS.

The Department also defers to the Department of Business, Economic Development, & Tourism on the merits of this legislation. Though the Department is highly involved in the administration of these tax measures, the Department is not the subject matter expert on the viability of these policies and incentives.

III. SB 3215, RELATING TO BIODIESEL

This legislation, among other things, provides a real property exemption and an income tax exemption for biodiesel feedstock crop facilities.

Real Property Exemption

The Department has **no additional comments** on the real property exemption provided in this legislation, other than it will impact the county revenues.

Income Tax Exemption

The Department has **no additional comments** on this component.

Revenue Impact

This bill will result in an indeterminate revenue loss.

IV. SB 2766, RELATING TO ETHANOL

This legislation provides an income tax credit for installation of E-85 fueling facilities.

The Department **opposes** this legislation because it is underdeveloped and requires additional common requirements associated with other tax credits. Examples of this language can be provided upon request. Other similar bills in this agenda include the necessary language.

This legislation will result in the following revenue loss:

FY2010 (loss): \$198,000
FY2011 (loss): \$204,000

V. SB 2764, RELATING TO ETHANOL FACILITY TAX CREDIT

The Department has **no additional comments** on this legislation. However, the Department requests that the Committee be cognizant of its revenue impact because the 40 million gallon cap is eliminated.

This legislation will currently result in an indeterminate revenue estimate because the credit caps are blank.

VI. SB 2468, RELATING TO ETHANOL FACILITY TAX CREDIT

The Department has **no additional comments** on this legislation.

This legislation will result in a \$4 million gain.

VII. SB 2632 RELATING TO RENEWABLE ENERGY TECHNOLOGIES

This legislation amends the current Renewable Energy Technologies Income Tax Credit, by adding a new definition for "concentrating solar power energy 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.

Based upon the Department's estimates, this legislation will not have an impact on the general fund.

VIII. SB 2623, RELATING TO RENEWABLE ENERGY TECHNOLOGIES

This legislation amends the current Renewable Energy Technologies Income Tax Credit, by adding a new definition for "solar electric energy 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.

Based upon the Department's estimates, this legislation will not have an impact on the general fund.

IX. SB2744, RELATING TO HYDROGEN FUEL

The Department **opposes** this bill because of the numerous technical flaws outlined below.

Income Tax Credit

COMPLIANCE WITH RULES & STATUTES—The Department objects to this provision. The Department does not have the expertise or resources to ensure that any taxpayer claiming the credit is in compliance with all rules and regulations of whatever sort. For example, if a taxpayer obtains a speeding ticket or other citation, the taxpayer would be precluded from obtaining the credit as the bill is written. This section should be removed.

AMBIGUOUS CREDIT ACTIVITY—Currently the credit applies to "capital, operation, maintenance, or leasing costs related to the investments in hydrogen-powered vehicles and hydrogen fueling stations." The Department points out that it would be better to allow a credit for "costs" generally. Also, the Department suggests that the credit be narrowed to apply only to investments in the "development" of hydrogen fuel vehicles or fueling stations. This bill presupposes that such vehicles and stations exist, which they do not. The Department's comments should be taken into account to spur the activity that will result in the foregoing products.

ELIMINATE CAPS—This credit has caps in the aggregate. The Department strongly opposes caps because they are difficult to administer. There is no guidance. Should the caps be on a first-come-first-served basis? The caps should be eliminated in favor of a cap per taxpayer, which is

administrable.

DEFINITION OF "CORPORATION"—It would be unwise to define a corporation to include what are clearly partnership or pass through entities. Under well settled tax principles, a corporation is not a partnership and a partnership is not a corporation. However, a taxpayer may ELECT under current law to be taxed as a corporation. Better policy would be to defer to taxpayer desires and allow the taxpayer to control its own taxing status, rather than mandate it by statute.

TRANSFER OF CREDIT—The Department strongly opposes transferring any state tax credit. Transferring of credits turns otherwise good tax policy into tax shelters subject to abuse and fraud. Moreover, transferring credits makes administration difficult when it comes time to audit. One taxpayer claims the credit, when all of the facts relate to an unrelated taxpayer. The Department will be required to chase two different entities—one with the facts, the other with the money. The transfer of credits should be eliminated.

RECAPTURE—This credit lacks recapture provisions. The Committee should consider adding recapture provisions in order to ensure that if property is sold or disposed of the state is made whole by including in income the previously taken credit.

General Excise Tax Exemption

ELIMINATE CAPS—The Department does not support caps on credits or exemptions throughout the tax code. Caps on exemptions specifically are the most difficult to administer because there is no guidance provided in the statute for how to administer them. For example, is the exemption to be claimed on a first-come-first-served basis? Also, tax returns are filed periodically, which could likely result in going over the cap during a given period.

Revenue Impact

This bill will result in an indeterminate revenue loss.

X. SB 2455, RELATING TO RENEWABLE ENERGY TECHNOLOGIES

This legislation extends the current Renewable Energy Technologies Income Tax Credit to include hydrogen energy systems. There is no definition of the term "hydrogen energy system." The **Department requests that a definition be added** so that the Department can effectively administer this credit's extension.

This bill's revenue estimate is estimated to be minimal.

XI. SB 2932, RELATING TO ENVIRONMENTAL RESPONSE TAX

This bill increases the State Environmental Response Tax to \$0.25 per barrel of petroleum product. The bill also provides that an unspecified amount be used for concerns relating to drinking

water. The Department has no comments on this legislation.

The increased environmental response tax will increase the annual revenue of the Environmental Response Revolving Fund by approximately \$7.0 million dollars.

XII. SB 2032, RELATING TO INCOME TAX

This legislation increases the wind-powered Renewable Energy Technologies Income Tax Credit by various amounts. The Department has no comments on this legislation.

This legislation would resulting a revenue loss of \$10,600 annually.

XIII. SB 2986, RELATING TO REFUNDABLE RENEWABLE ENERGY TAX CREDIT

This Lingle-Aiona Administration 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 Department strongly supports this measure as a policy to encourage additional investment in renewable energy technologies.

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 \$20,000 of adjusted gross income. This would provide incentives for the lower- and middle-class to invest in these technologies.

Annual revenue loss is estimated to be \$41,000, starting in fiscal year 2009.

XIV. SB 3230, RELATING TO ENERGY

This legislation creates a Energy Security Tax assessed on a per-barrel of petroleum product basis, as well as a special fund to administer the revenue.

The Department of Taxation has no additional comments on this legislation other than it is a tax increase that will eventually impact the gasoline prices all Hawaii drivers pay and creates an unnecessary special fund.

XV. SB 2943, RELATING TO ENERGY

This legislation increases the Renewable Energy Technology Income Tax Credit amounts to various amounts. This legislation also includes wave energy as a qualifying energy technology. The Department has no additional comments on this legislation.

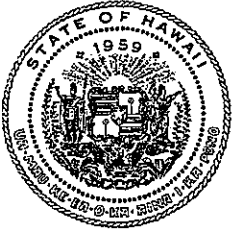
This legislation will result in a revenue loss of approximately \$400,000 for FY 2009 and \$1.2 million for FY 2010.

XVI. SB 2946, RELATING TO RENEWABLE ENERGY OPPORTUNITY ZONES

This legislation creates Renewable Energy Opportunity Zones that, among other things, provide taxpayers within the zones with tax incentives similar to that of current Enterprise Zones.

The Department of Taxation **supports the intent** of this measure because it is an intuitive, logical, and bold step in the right direction for supporting Hawaii energy independence. The Department, as a co-participant of the Enterprise Zone system, agrees that these systems have worked to attract businesses to high-risk areas that need economic stimulus. This legislation will provide businesses with the opportunity to join other similar businesses geographically in order to consolidate the talent and resources of alternative energy research and development into one opportunity zone. The Department also points out that similar "opportunity zone" legislation has been very successful on the federal level with the Liberty Zone in New York and the Gulf Opportunity Zones in the south.

This legislation will result in a revenue loss of approximately \$1 million per year.



**DEPARTMENT OF BUSINESS,
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Statement of
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Department of Business, Economic Development, and Tourism
before the

**SENATE COMMITTEE ON
ENERGY AND ENVIRONMENT**

Thursday, January 31, 2008
2:15 PM

State Capitol, Conference Room 414

in consideration of
SB 2032
RELATING TO INCOME TAXATION.

Chair Menor, Vice Chair Hooser, and Members of the Committee.

The Department of Business, Economic Development, and Tourism (DBEDT) supports the concept behind SB2032. We defer to the Department of Taxation on tax implications. There have been many good ideas introduced this legislative session that support the State's energy goals. We hope the Legislature will see it fit to support, pass and fund these ideas, together with the priorities of the Executive Supplemental Budget.

SB2032 would increase the tax credit for wind energy systems, for both commercial and residential property, from 20% to 35%. Credit caps would not change.

We have not evaluated the necessity or impact of this change, nor the revenue impacts. However, having the same percentage apply to solar and wind systems would simplify communication with the public about the availability of these tax credits.

Thank you for the opportunity to offer these comments.