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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**

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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 result in 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  
**THEODORE E. LIU**  
**Director**  
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  
**SB2468**  
**RELATING TO ETHANOL FACILITY TAX CREDIT.**

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

The Department of Business, Economic Development, and Tourism (DBEDT) has concerns about SB 2468, which would reduce the ethanol facility incentive.

The statement in Section 1 of the bill, “this Act reduces the annual amount ... to meet the funding needs of other agricultural concerns in the State” implies that ethanol producers have been receiving money that could have been used to meet “other agricultural concerns.” This implication is incorrect. The amount stated is the upper limit that theoretically could be taken, if all 40 million gallons per year of capacity came on-line at the same time. The actual amount that has been used is \$0, and will continue to be \$0, until the facilities which have been planned have been built and are in production.

Since the ethanol production facilities are required to file notices in advance of facility construction, and again upon commencement of ethanol production, and the tax credit is not available until after the facility has produced at least 75% of its nameplate capacity (i.e. at least 9



months after start of production), there is significant advance notice before any funds are paid out for this incentive. These provisions provide lead time for the State to plan for anticipated expenditures under this program:

" (h) Prior to construction of any new qualifying ethanol production facility, the taxpayer shall provide written notice of the taxpayer's intention to begin construction of a qualifying ethanol production facility. The information shall be provided to the department of taxation and the department of business, economic development, and tourism on forms provided by the department of business, economic development, and tourism, and shall include information on the taxpayer, facility location, facility production capacity, anticipated production start date, and the taxpayer's contact information. Notwithstanding any other law to the contrary, this information shall be available for public inspection and dissemination under chapter 92F.

(i) The taxpayer shall provide written notice to the director of taxation and the director of business, economic development, and tourism within thirty days following the start of production. The notice shall include the production start date and expected ethanol fuel production for the next twenty-four months. Notwithstanding any other law to the contrary, this information shall be available for public inspection and dissemination under chapter 92F."

Also, implying that there is direct competition between this incentive and funds for "other agricultural concerns" is not accurate, since these funds are not set aside for agricultural purposes per se.

To reduce the stated incentive at this date would put the current projects in jeopardy; signal to those in the investment community a lack of our commitment to the goals of diversification of energy supplies and use of renewable fuels; and weaken our progress to meet the energy objectives of the State.

Thank you for the opportunity to offer these comments.

**SB 2468  
RELATING TO ETHANOL FACILITY TAX CREDIT**

**PAUL T. OSHIRO  
MANAGER – GOVERNMENT RELATIONS  
ALEXANDER & BALDWIN, INC.**

**JANUARY 31, 2008**

Chair Menor and Members of the Senate Committee on Energy & Environment:

I am Paul Oshiro, testifying on behalf of Alexander & Baldwin, Inc. (A&B) and Hawaiian Commercial & Sugar Company, one of its agricultural companies, on SB 2468, "A BILL FOR AN ACT RELATING TO ETHANOL FACILITY TAX CREDIT." We respectfully oppose this bill.

As one of two remaining sugar companies operating in the State, Hawaiian Commercial & Sugar Company (HC&S) celebrated its 125<sup>th</sup> anniversary in 2007. While Hawaii's many other sugar companies have shut down over the years, HC&S has been fortunate, through significant investments by our parent company, A&B, in our agricultural infrastructure and operations and the implementation of our diversified bio-production program, to have sustained our operations and continue as a major employer in the State of Hawaii. Today, as we face the prospect of lower margins from raw sugar production because of flat commodity prices along with increasing production costs, HC&S is in the process of transitioning from a primary producer of commodity sugar into the production of specialty sugar and bio-based products. In addition to being the sole supplier of Sugar In The Raw, the little brown packets of sugar seen at restaurants and coffee shops across the nation, HC&S is also expanding production of

our specialty Maui Brand Sugar. HC&S also produces several bio-based products, and provides Maui Electric with biomass produced electricity.

HC&S is also actively and seriously evaluating the feasibility of becoming a producer of ethanol. Our initial investigation into a production facility that would convert only our final molasses to ethanol found, after much research and analysis, that a plant of this scale would not be financially feasible. HC&S is now presently analyzing a larger ethanol production facility that would convert not only all of our molasses, but a significant portion of our cane juice as well. The fermentation process we are focused on is a proven, practical method, similar to how Brazil presently produces ethanol. The sugar cane plant provides many advantages over other crops with respect to energy output because of its efficiency in converting sunlight into biomass energy. However, the required investment in building an ethanol facility is significant and the risks, because of fluctuating energy prices, are also significant.

The ethanol facility tax credit is an important component in HC&S's determination of the financial feasibility of our ethanol production initiative that is presently under consideration. This bill proposes to reduce the annual amount of the ethanol facility tax credit from \$12 million to \$8 million from January 1, 2008 to December 31, 2012. Should this ethanol facility tax credit not be available to HC&S, it reduces the likelihood that our entry into the production of ethanol would prove to be an economically feasible endeavor.

Based on the aforementioned, we respectfully request that this bill be held in Committee.

Thank you for the opportunity to testify.