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SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION AND ENERGY & ENVIRONMENT

TESTIMONY REGARDING SB 2519 RELATING TO FUEL TAX

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 7, 2008
TIME: 10:10AM
ROOM: 224

This bill would exempt power-generating facilities utilizing diesel fuel from the license tax on liquid fuel.

The Department of Taxation ("Department") **provides comments.**

I. SAVINGS PASSED ON TO CONSUMERS.

As has been noted by other legislative committees considering fuel tax relief for energy producers in the past, the tax on fuel used by power-generating facilities is passed on to consumers.

This Committee, then, should be cognizant of the fact that this bill does not provide any mechanism to assure the tax exemption is passed on to consumers. It is the Department's position that only market forces will dictate whether the tax savings is passed on to consumers. The Department would be very disappointed if the tax exemption provided in this legislation were not likewise passed on to consumers.

II. DEFINITIONAL ERROR

The Department points out that the definition of "power-generating facilities" contained at HRS § 243-1 repeals on December 31, 2009. There would be no definition thereafter. Based upon this bill, these amendments will not repeal with the other tax incentives provided to other power-generating facilities (*e.g.*, naptha tax rate). A permanent definition should be provided.

III. EFFECTIVE DATE

To allow the Department to administer the exemption in an orderly fashion, the effective date should be delayed until October 1, 2008.

IV. FISCAL IMPACT.

This legislation will result in no impact to general fund. However, the bill would reduce the State Highway Fund by $600,000 in fiscal year 2008, and about $1.2 million in fiscal year 2009. It would reduce the State Highway Fund by about by about $600,000 in fiscal year 2010. After fiscal year 2010, there would be no revenue effect.

The State's non-highway use of diesel oil was about 120 million gallons in fiscal year 2007. The counties did not tax this fuel. It is assumed that virtually all of this fuel was used for power generation. The tax rate on this fuel was set to decrease from 2 cents per gallon to 1 cent per gallon automatically on December 31, 2009 (see Act 193, SLH 2007). Act 103 was approved on May 29, 2007.

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Testimony Before the Senate

Committee on Economic Development & Taxation

and

Committee on Energy & Environment

By: Randall J. Hee, P.E.
President and Chief Executive Officer
Kauai Island Utility Cooperative
4463 Pahee Street, Suite 1, Lihue, Hawaii, 96766-2000

Thursday, February 7, 2008, 10:10 a.m.
Conference Room # 224

Senate Bill No. 2519 – Relating to Taxation

To the Honorable Carol Fukunaga, Chair; Will Espero, Vice-Chair,
and members of the Committee on Economic Development & Taxation:

To the Honorable Ron Menor, Chair; Gary Hooser, Vice Chair,
and members of the Committee on Energy & Environment:

Thank you for the opportunity to testify before you. I am Randy Hee, President and CEO of the Kaua`i Island Utility Cooperative (KIUC). I am here today to testify on SB 2519 that would clarify the intent of Act 209 of the 2007 regular session that the additional one-cent added to the license tax of diesel fuel was not intended for diesel oil sold or used for power generation purposes.

KIUC believes that the intent of Act 209 was to promote the use of transportation fuels containing alcohol through an exemption of the excise tax on retail sale of fuels containing at least 10% alcohol. Tax revenues would be balanced by an increase in tax of other non-alcohol fuels by an additional one-cent. KIUC believes that the intent was to tax other transportation related non-alcohol fuels by the additional one-cent and believes that the intent was not to increase the tax on fuels used for the generation of electricity by utility power-generating facilities.

KIUC is a member-owned not-for-profit electric cooperative. Margins or what would be considered "profits" by an investor owned company, are invested back into the business by allocating margins to the cooperative's members as capital credit contributions. KIUC has also made annual patronage capital refunds to its members in the amount of 25% of net margins each year since it was founded.

KIUC currently generates about one-half of its annual production of electricity by burning No. 2 diesel fuel. This amounts to an annual usage of about 15 million gallons of diesel. KIUC is a regulated utility and fuel costs are passed on to its customers. The additional one-cent tax adds about $150,000 annual burden to KIUC's ratepayers.

As previously stated, KIUC believes the intent of Act 209 was to increase transportation related fuels by one-cent to off set the exemption of fuel containing alcohol used for transportation.

KIUC therefore requests and seeks passage of SB 2519 that could place the tax on diesel used by power generation facilities to produce electricity at one-cent.

For these reasons, KIUC supports SB 2519 and, therefore asks that this bill be passed.

Thank you again for the opportunity to inform you of KIUC's position on this matter.

37

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: FUEL, Diesel oil for power generation

BILL NUMBER: SB 2519; HB 2922 (Similar)
2/7 ELD 1/30 TRN

INTRODUCED BY: SB by Hooser; HB by Tokioka and Morita

BRIEF SUMMARY: Amends HRS section 243-4 to provide that diesel oil sold for use in electric power generation shall be taxed at 1 cent per gallon.

HB 2922 further stipulates that the amendments made by this act shall not be repealed when this section is repealed and reenacted on December 31, 2009 by Act 103, SLH 2007.

EFFECTIVE DATE: SB - Tax years beginning after December 31, 2007; HB - Upon approval

STAFF COMMENTS: The legislature by Act 209, SLH 2007, reenacted a general excise tax exemption for the sale of alcohol fuels which expired December 31, 2006. While Act 209, SLH 2007, took effect on July 1, 2007, the Act also increased the state fuel tax by one cent per gallon, including each gallon of diesel oil. This measure proposes that the fuel tax imposed on diesel oil used to generate electricity shall be taxed at 1 cent per gallon. It should be noted that Act 103, SLH 2007, provided that naphtha used to in a power generating facility shall be taxed at the rate of one cent per gallon.

While the proposed measure proposes to restore the one cent per gallon rate on diesel oil used to generate electricity, there is no logical reason for that tax to be paid as the receipts of the fuel tax are realizations of the state's transportation funds, largely the state highway fund. Since fuel used to generate electricity does not utilize the highway infrastructure, such fuel should be exempt from the state fuel tax.

Setting out that fuel used to generate electricity is subject to the state fuel tax to fund the transportation infrastructure further underscores the inappropriateness of imposing the tax on non-highway use. Thanks to our legislators, the cost of the additional tax on diesel fuel used to generate electricity has contributed to rising energy costs for all taxpayers including government.

Digested 1/29/08