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 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.

<u>General Excise Tax Exemption</u>

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.

<u>Revenue Impact</u>

This bill will result in an indeterminate revenue loss.

X. <u>SB 2455, RELATING TO RENEWABLE ENERGY TECHNOLOGIES</u>

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 **<u>Department requests that a definition be added</u>** so that the Department can effectively administer this credit's extension.

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

XI. <u>SB 2932, RELATING TO ENVIRONMENTAL RESPONSE TAX</u>

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.

LINDA LINGLE
GOVERNOR
THEODORE E. LIU
DIRECTOR
MARK K. ANDERSON
DEPUTY DIRECTOR

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Web site: www.hawaii.gov/dbedt

Telephone: (808) 586-2355
Fax: (808) 586-2377

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
SB 2623
RELATING TO RENEWABLE ENERGY TECHNOLOGIES.

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

The Department of Business, Economic Development, and Tourism (DBEDT) supports SB 2623. We defer to the Department of Taxation on tax implications.

SB 2623 replaces the term "photovoltaic system" with "solar electric energy system" so that solar thermal systems which produce electricity (as opposed to simply heating water) would be eligible for the same income tax credit as photovoltaic systems.

Solar thermal electric systems are in the same general cost range as photovoltaic systems, and the end product is also electricity. The proposed change would allow a solar thermal electric system to displace a similar sized photovoltaic system, so the estimated revenue impact is zero.

We also do not anticipate any revenue impact from the proposed change in the definition of "Solar Thermal Energy System" to "include solar water heating, solar air conditioning, solar space heating, solar drying, and solar process heat systems." The proposed change is adding detail but not changing what is commonly understood to be included under the meaning of "solar thermal."

The use of solar energy to meet our energy needs is consistent with State energy objectives.

Thank you for the opportunity to offer these comments.

SOPOGY™
Solar Power Technology

To: Senator Ron Menor, Chair
Committee on Energy & Environment

From: Sopogy Inc.

Date: January 30, 2008

Subject: Support for SB 2623 Relating to Renewable Energy Technologies

Chair Menor, Vice-Chair Hooser and Members of the Committees:

Sopogy, Inc. is a renewable technology company based in Hawaii. We are a spin-off of Hawaii's own Energy Industries and its clean technology incubator "Energy Laboratories." Our purpose is to bring renewable solar energy technologies to Hawaii and its people for the betterment of our environment, independence from volatile imported fossil fuels, and energy stability.

Sopogy has developed a concentrating solar panel that enables the production of electricity, air conditioning, and/or process heat using the sun's power. Our technology is not categorized as Photovoltaic but as Solar Thermal and/or Concentrating Solar Power (CSP). Understanding, therefore, that solar generated electricity can come from a broader range of technologies than just photovoltaic (PV), Sopogy supports this bill's language that would broaden the investment tax credit to all solar electric technologies.

In general, Sopogy, Inc. supports the adoption of renewable energy and energy efficiency measures that lessen the state's dependence on oil, reduce greenhouse gas emissions, and provide energy price stability to Hawaii's consumers.

Thank you for this opportunity to testify.

2660 Waiwai Loop Suite 201 Honolulu, HI 96819

L E G I S L A T I V E

TAXBILLSERVICE

1-2

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

SUBJECT: INCOME, Renewable energy technology systems

BILL NUMBER: SB 2623; HB 2005 (Identical)

1/24 EEP

INTRODUCED BY: SB by Menor, Inouye, Sakamoto, Trimble, 7 Democrats & 1 Republican; HB by Morita and Carroll

BRIEF SUMMARY: Amends HRS section 235-12.5 to replace the term "photovoltaic" with "solar electric." Adds a definition of "solar electric energy systems" to include solar thermal electric and photovoltaic systems. Also adds a definition of "solar thermal energy systems" to include solar water heating, solar air conditioning, solar space heating, solar drying, and solar process heat systems.

EFFECTIVE DATE: Tax years beginning after December 31, 2007

STAFF COMMENTS: Hawaii's income tax credit for alternate energy devices was established by the 1976 legislature originally for solar energy systems and was later expanded to include wind energy devices, heat pumps, ice storage systems, and photovoltaic systems. This measure proposes to further expand the state energy tax credits to include solar air conditioning, solar space heating, solar drying, and solar process heat systems.

While some may consider an incentive necessary to encourage the use of energy conservation devices, it should be noted that the high cost of these energy systems limits the benefit to those who have the initial capital to make the purchase. If the combined incentives of federal and state income tax credits during the early 1980's equal to 50% were not able to encourage more than those who did install alternate energy devices during the period when the federal credits were in effect, it is questionable whether the state tax credits along with the federal energy tax credits (30%) will encourage many more taxpayers to install such devices.

If it is the intent of the legislature to encourage a greater use of renewable energy systems by extending the existing energy tax credits to include solar thermal energy systems, as an alternative, consideration should be given to a program of low-interest loans available to all income levels as is being proposed in HB 2101. However, if the taxpayer avails himself of the loan program, the renewable energy credit should not be granted for projects utilizing the loan program as the projects would be granted a double subsidy by the taxpayers of the state.

Low-interest loans, which can be repaid with energy savings, would have a much more broad-based application than a credit which amounts to nothing more than a "free monetary handout" or subsidy by state government for those taxpayers who more than likely can afford to make the conversion. A program of low or no-interest loans would do much more to increase the acquisition of these devices. Persons of all income levels could borrow the funds, make the acquisition, and repay the state program in an amount equal to the avoided costs that their utility bills would now reflect. While this recommendation has fallen on deaf ears in the past; the above-mentioned proposal would help put such devices within the reach of more people. The credit, on the other hand, merely becomes a windfall for those who are able to come up with the up-front costs for such devices. This leaves the poor and lower-middle income families still dependent on fossil fuel energy.

While this proposal focuses on newer alternate energy technologies which are far more expensive to acquire, it underscores the above point that the credit benefits only those who have the means to install such devices. If lawmakers truly want to provide a financial incentive for taxpayers to make the switch to using these alternative energy devices while taking advantage of the credit, then a program of no-interest, or low-interest loans would be far more effective. The state could provide the capital to acquire these devices, and the taxpayer could receive a discount of 30% provided by the federal tax credit. The amount of the state loan could then be amortized by the energy savings realized by the taxpayer.

Merely providing federal and state tax credits ignores the reality of living in Hawaii, that is, most families don't have the resources to make such a large capital outlay while struggling to put food on the table.

Digested 1/22/08