

# TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

**SUBJECT:** INCOME, Automatic fire sprinkler system

**BILL NUMBER:** SB 2722; HB 2720 (Identical)

**INTRODUCED BY:** SB by Hanabusa by request; HB by Say by request

**BRIEF SUMMARY:** Adds a new section to HRS chapter 235 to allow taxpayers to claim an income tax deduction for the installation of an automatic fire sprinkler system provided the system is placed in service after 12/31/08. For taxpayers who are owner-occupants of a single-family residence, the deduction shall be equal to the qualifying cost to install the system not to exceed \$7,000. For taxpayers who are owner-occupants residing in a residential, mixed-use condominium or cooperative housing corporation, the deduction shall be a portion of the maintenance fees allocable to the qualifying costs to install the system.

Defines "automatic fire sprinkler system" and "qualifying costs" for purposes of the measure.

Requires the director of taxation to require the taxpayer to furnish reasonable information to validate a claim for the credit [sic] and adopt rules pursuant to chapter 91.

**EFFECTIVE DATE:** Tax years beginning after December 31, 2008

**STAFF COMMENTS:** This measure proposes an income tax deduction for every automatic fire sprinkler system installed and placed in service in a residential or commercial property after 12/31/08. The proposed measure would grant preferential tax treatment to a very select group of taxpayers and do so without the taxpayer's need for tax relief.

Inasmuch as there is absolutely no relationship between the cost of the automatic fire sprinkler system and the taxpayer's tax burden, there is little justification for granting this tax preference which is merely a subsidy of the cost of an automatic fire sprinkler system by state government.

Undoubtedly this measure is being submitted in response to fires in multi-family dwelling units or condominiums. While it is true that older condominiums in Honolulu were not required to install fire sprinkler systems, that is not true of newer condominiums or those that will be built in the future. Newer buildings are now required to install such systems and, as such, the developers of those buildings that will be built in the future should have accommodated the cost. If consideration is to be given to this proposal, it should be applicable only to those buildings that were not required by law to install such systems.

Finally, this is one more divergence from the legislature's stated intent to maintain conformity with the federal Code to minimize differences between the state and federal law as a way to ease administration and compliance with the law. By creating a deduction not found in the Code, this measure adds yet one more digression from the Code and adds to the complexity of filing the annual income tax return. Further, it sets a bad precedent for other deductions that may be considered health and safety expenditures. What about sewer connections in older subdivisions where cesspools were the norm when

the subdivisions were built? One might argue that residents in these older homes are now retired and on fixed incomes and therefore cannot afford the tremendous cost of hooking up to the city's sewer system. Should these residents be allowed a special deduction because undertaking the hookup is crucial to the sanitary condition of that home?

If the legislature believes public assistance is needed to encourage the installation of fire sprinkler systems, then a program of low-interest, no-interest loans might be more efficient and appropriate. It should be remembered that in order to claim the deduction, the owner must have the capital to make the improvement first. Should the taxpayer not be capable of putting up the initial cost, then the deduction would not be available. What is curious is that the special deduction would be allowed only to owner occupants. What about landlords or tenants in the same building?

It should be noted that the drafting of this measure leaves much to be desired. While the measure proposes an income tax deduction for the qualifying costs of an automatic sprinkler system, there are references to a tax credit in section 2 of the measure as it directs the director of taxation to require taxpayers to furnish reasonable information to validate a claim for the credit.

Digested 1/29/08

HAWAII COUNCIL OF ASSOCIATIONS  
OF APARTMENT OWNERS

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January 28, 2008

Sen. Russell Kokubun, Chair  
Sen. David Ige, Vice-Chair  
Senate Committee on Commerce,  
Consumer Protection & Affordable Housing  
State Capitol  
Honolulu, Hawaii 96813

Sen. Suzanne Chun-Oakland, Chair  
Sen. Les Ihara, Jr., Vice-Chair  
Senate Committee on Human Services  
and Public Housing  
State Capitol  
Honolulu, Hawaii 96813

RE: SB 2722, Re Fire Sprinkler Tax Deduction  
Hearing: Wed., Jan.30, 2008, 9 a.m., Conf. Rm. #229

Chairs Kokubun and Chun-Oakland and Members of the Joint-Committee:

I am Jane Sugimura, President of the Hawaii Council of Associations of Apartment Owners (HCAAO).

HCAAO supports the intent and purpose of this bill, especially since it may motivate apartment owners to install a fire sprinkler system in their buildings and units. Accordingly, we ask that you pass this bill out of the joint-committee to allow further discussion on this issue.

The cost to retrofit a high-rise building is extremely high. See attached study prepared by the City and County's Fire Dept. contractor during the 2005 Fire Safety Task Force indicating the per unit cost to retrofit a fire sprinkler system. (Note that for Pearl One, a 300-unit building in Aiea, the per unit cost is over \$8,500 and for the 112-unit Royal Court on Ward Ave., the per unit cost is over \$13,000.) Please also note that the cost is reflected in 2005 dollars and that the actual cost today is likely to be higher. Since the apartment owners will have to bear their pro-rata share of these additional costs as well as the cost to install the system in their units, unless the deduction amount is substantial, it will not motivate apartment owners to install this system.

For apartment owners, included in their "actual cost" is their pro-rata share of the cost for the installation of a sprinkler system in the common elements, e.g., hallways, as will be reflected in the payment of increased maintenance fees to the association of apartment owners, since the cost of installing the infrastructure makes up most of the cost.

Without this bill, retrofitting of high-rise buildings [to install sprinklers] is not likely happen since many owners do not have the "extra funds" to pay for that cost and it takes an affirmative vote of a majority of apartment owners to agree to pay for retrofitting. Assuming owner approval happens, in accordance with the budget and reserves law in HRS 514A, retrofitting will be added to the condo's reserve study and the association will have a consultant estimate how long it would take for the association to raise the requisite funds, which could run between 10-20 years.

Let's take the numbers for Royal Court (112 units). Total amount to retrofit (in 2005 dollars) = \$1,509,000. Per unit cost = \$13,500. Assume that 80% of that cost (\$10,800) is for the infrastructure and common element retrofitting, which all owners have to pay in the form of maintenance fees over time since HRS 514A does not permit special assessments except in very limited circumstances and mandatory retrofitting is not one of those circumstances. Under a 10-year program, an owner would be charged \$90/month in increased maintenance fees (this is a big increase) times 12 month (\$1,080) time 10 years (\$10,800).<sup>1</sup> \$90/month may not seem like a large amount but given that maintenance fees run typically run between \$350 and \$600 on the average, this is more than a 10% annual increase and this does not include the regular 3% to 4% increase most condos have to do to take care of ordinary repair and maintenance.

Under this bill, an owner occupant would be able to deduct \$1,080 from his or her adjusted income annually for 10 years. Investor owners are already able to deduct 100% of their maintenance from any rental income they receive from the apartment.

Allowing tax deductions should not have a negative impact on the State. Whatever reduction in income taxes paid by residents would be offset by the 4% GET on the work done and income taxes paid by the contractors who do the works. The Royal Court is a small job at \$996,000. The cost to most buildings will be over \$1 million and the City claims there are over 300 high-

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<sup>1</sup> In a 15-year allocation, the monthly maintenance fee would increase by \$60 per month.

rise buildings on Oahu that are higher than 75 ' and would be subject to retrofiting. That's a lot of tax revenue that would be generated for the State. Also please note that the seniors who do not file tax returns will not be getting this credit. The Task Group is considering other means to assist that group of apartment owners.

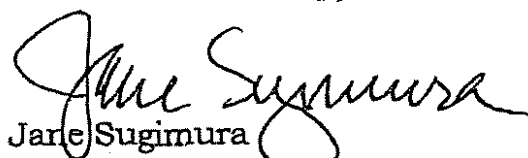
The tax breaks to apartment owners should be spread out over 15-20 years because there are not enough available contractors who can retrofit the 312 buildings in Oahu that would be subject to retrofiting. Given the construction boom and all of the new military and new housing projects, there may not be contractors who could do this work. If this task were to be completed in 20 years, that means 15 buildings a year. Retrofitting a high-rise building would take months - not weeks and in a building like the Marco Polo or Yacht Harbor Towers that have over 500 units - it would take over 1 year.

HCAAO believes that this type of incentive is necessary to encourage apartment owners to install fire sprinklers in their units and in their building.

Although this bill is not a "cure-all" that will guaranty that sprinkler systems will be installed in high-rise residential buildings, it is absolutely necessary to provide incentives like this to continue the discussion.

For these reasons, we ask that you pass this bill out of this committee.

Thank you for the opportunity to testify.

  
Jane Sugimura  
President

**COST ANALYSIS**  
High-Rise Fire Safety Task Force

DATE: 31-Mar-05

	<b>Marco Polo 2333 Kapiolani Blvd.</b>	<b>1001 Wilder Avenue</b>	<b>Pearl One 98-500 Koauka Loop</b>	<b>Royal Court 920 Ward Avenue</b>
Type of Building	<b>Residential Condo</b>	<b>Residential Condo</b>	<b>Residential Condo</b>	<b>Residential Condo</b>
Cost for sprinkler protection of dwelling	\$1,912,500	\$373,500	\$1,984,500	\$915,000
Cost of sprinkler system for common areas	\$162,750	\$124,500	\$205,500	\$315,000
Cost of fire pump system (electric motor drive)	\$75,000	\$78,000	\$55,500	\$55,500
Cost of BWS DC meter and connections	\$30,000	\$0	\$25,500	\$25,500
Cost for engine generator for emergency power	\$75,000	\$75,000	\$75,000	\$75,000
Cost for asbestos remediation	\$207,525	\$49,800	\$219,000	\$123,000
<b>Total cost of fire sprinkler system</b>	<b>\$2,462,775</b>	<b>\$700,800</b>	<b>\$2,565,000</b>	<b>\$1,509,000</b>
<b>Additional Items</b>				
Cost for upgrade of fire alarm system	\$432,344	\$103,750	\$456,250	\$256,250
Cost of fire pump system (diesel engine drive)	\$102,000	\$102,000	\$66,000	\$66,000
<b>Squarefoot Costs</b>				
Estimated Square Footage	642,985	75,316	625,985	233,701
Sprinkler System Cost/square foot	\$3.83	\$9.30	\$4.10	\$6.46
Fire Alarm System Cost/square foot	\$0.67	\$1.38	\$0.73	\$1.10
<b>Cost Per Dwelling Unit</b>				
Number of dwelling units	572	67	300	112
Sprinkler System Cost/dwelling unit	\$4,305.55	\$10,459.70	\$8,550.00	\$13,473.21
Fire Alarm System Cost/dwelling unit	\$755.85	\$1,548.51	\$1,520.83	\$2,287.95
Notes:	No sprinklers for parking garage included  Converting a standpipe riser to combination system.	no need for additional BWS fire service connection.  Converting a standpipe riser to combination system.  exact floor area not available figure show is an estimate	No sprinklers for parking garage included	
<b>Sprinkler Cost by:</b>	<b>Grinnell Fire Protection</b>	<b>Grinnell Fire Protection</b>	<b>Pacific Fire Protection</b>	<b>Pacific Fire Protection</b>
<b>Other Cost by:</b>	<b>SSD</b>	<b>SSD</b>	<b>SSD</b>	<b>SSD</b>

1. Fire sprinkler costs are based on Steel pipe system (schedule 40)

LINDA LINGLE  
GOVERNOR

JAMES R. AIONA, JR.  
LT. GOVERNOR



KURT KAWAFUCHI  
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**LATE**

**SENATE COMMITTEE ON COMMERCE, CONSUMER PROTECTION & HOUSING**

**TESTIMONY REGARDING SB 2722  
RELATING TO FIRE SPRINKLER TAX DEDUCTION**

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

**DATE: JANUARY 30, 2008**

**TIME: 9:00AM**

**ROOM: 229**

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The purpose of this bill is to provide an income tax deduction for owner-occupants for the installation of an automatic fire sprinkler system placed in service after December 31, 2008. This bill takes effect upon its approval and is applicable to tax years beginning after December 31, 2008.

The Department of Taxation (Department) is sympathetic with the intent and purpose of this bill and provides the following comments.

**I. COMMENTS REGARDING THE SPRINKLER DEDUCTION.**

Current law allows for the depreciation of the cost of a fire sprinkler system when used in rental facility. There is no corresponding tax benefit for the owner-occupants of a residential unit.

The Department notes the following concerns:

- The bill provides that owner-occupants of a residential unit may claim the deduction for the cost of the system, up to a maximum of \$7,000, which is claimed in its entirety in the year the system is placed in service. Because other owners of residential units must depreciate the sprinkler system over a number of years, other owners may find it advantageous to live in the residential unit for a short period, claim the deduction, and then rent the premises out, thereby essentially accelerating the cost recovery of the system. The measure provides for no minimum period of time that an owner-occupant must reside in the premises before qualifying for the deduction.
- The bill defines "qualifying costs" as "including but not limited to accessories and installation, professional fees for design and construction, and government permit and access fees". Because of the breadth of the language, the Department foresees litigation over

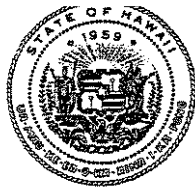
exactly what was intended to be included.

- The deduction would include the cost of labor required to install the system, which invites collusion between taxpayers and sellers of fire sprinkler systems to inflate the cost so that greater amounts of deduction can be claimed, especially since the deduction is for both new and existing construction. This will pose an allocation problem where the contractor/installer is doing work in addition to installing the sprinkler system such as general plumbing replacement or installation. The Department would need to conduct an audit to determine if labor for non-qualifying tasks is included. This will entail extensive and time-consuming effort to determine.

## II. REVENUE ESTIMATE.

There is an expected revenue loss of approximately \$5.2 million in FY2009, since it applies to systems installed after December 31, 2008 and \$10.3 million annually thereafter.





**STATE OF HAWAII**  
**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS**  
**State Fire Council**  
830 Punchbowl Street  
Honolulu, Hawaii 96813

January 29, 2008

The Honorable Russell S. Kokubun, Chair  
Committee on Commerce, Consumer Protection, and Affordable Housing  
The State Senate  
State Capitol, Room 407  
Honolulu, Hawaii 96813

Dear Chair Kokubun:

Subject: S.B. 2722 - Relating to a Fire Sprinkler Tax Deduction

I am Kenneth G. Silva, Chair of the State Fire Council (SFC) and Fire Chief of the Honolulu Fire Department (HFD). The SFC and the HFD support S.B. 2722, which would provide an income tax deduction to residential unit owner-occupants for qualifying costs of automatic fire sprinkler systems installed and placed into service after December 31, 2008.

Automatic fire sprinklers are proven fire protection devices that save lives, prevent injuries, reduce property losses, prevent fires from escalating, and do not rely on human factors to be effective. There have never been multiple lives lost due to fire or smoke in a fully sprinklered building. This bill would promote the installation of automatic fire sprinklers by creating a financial incentive for existing renovations, mandated retrofit ordinances, and new construction.

The SFC and the HFD request your committee's support on the passage of S.B. 2722.

Should you have any questions, please call Acting SFC Administrator William H. Melemai III at 723-7152.

Sincerely,

KENNETH G. SILVA  
Chair

KGS/WM:bh