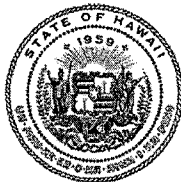


LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



KURT KAWAFUCHI
DIRECTOR OF TAXATION

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DEPARTMENT OF TAXATION
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SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING SB 2722 SD 1 RELATING TO FIRE SPRINKLER TAX DEDUCTION

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

DATE: FEBRUARY 12, 2008

TIME: 1:15PM

ROOM: 224

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 Committee on Commerce, Consumer Protection, & Affordable Housing amended the measure to allow non-occupant owners to claim the deduction; provided permission was given by the occupant.

The Department of Taxation (Department) 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 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 loss of approximately \$7.4 million in FY2009, since it applies to systems installed after December 31, 2008 and \$14.8 million annually thereafter.

According to the 2006 Hawaii Data Book, there were 501,956 housing units in Hawaii in 2006. According to the 2000 Census, approximately 12% of all housing units were vacant. We apply this to the number of housing units in 2006 and estimate approximately 441,721 units were occupied in 2006. We assume 8% of the occupied units install fire sprinkler systems and use the full \$7,000 limit. There is an estimated \$247.4 million reduction in tax liability. Applying an income tax rate of 6%, we estimate an overall revenue loss of \$14.8 million annually.



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

February 8, 2008

The Honorable Carol Fukunaga, Chair
Committee on Economic Development and Taxation
The State Senate
State Capitol, Room 216
Honolulu, Hawaii 96813

Dear Chair Fukunaga:

Subject: S.B. 2722, S.D. 1 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, S.D. 1, 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.

According to the Home Fire Sprinkler Coalition, fires kill more people in the United States every year than all natural disasters combined. Eighty percent of fire deaths occur in a home. Sprinklers typically reduce the loss of life and property in a fire by one-half to two-thirds, as compared to when sprinklers are not present. Ninety percent of home fires are contained with a single sprinkler head. On an average, fire hoses use eight and one-half times more water than sprinklers to contain a fire.

During 2000-2004, fires in single-family homes within the City and County of Honolulu accounted for 43% of the structure fires, 59% of the property damage, and 95% of the fatalities. Fire damage estimates in high-rise buildings with sprinklers were \$175,410 or 1% of the total property damage. Fire damage estimates in high-rise buildings without sprinklers were \$2,770,420 or 5% of the total property damages.

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

The Honorable Carol Fukunaga, Chair
Page 2
February 8, 2008

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, S.D. 1.

Should you have any questions, please call SFC Legislative Liaison Lloyd Rogers at 723-7171.

Sincerely,

A handwritten signature in black ink, appearing to read "Kenneth G. Silva". The signature is fluid and cursive, with a prominent initial "K" and a long, sweeping underline.

KENNETH G. SILVA
Chair

KGS/LR:cn

Bryan J. Baptiste
Mayor

Robert F. Westerman
Fire Chief

John T. Blalock
Deputy Fire Chief



COUNTY OF KAUAI
Fire Department
Mo'ikeha Building
4444 Rice Street, Suite 295
Lihu'e, Kaua'i, Hawaii 96766

February 11, 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 Robert F. Westerman, Fire Chief of the Kauai Fire Department (KFD) and member of the State Fire Council (SFC). The KFD and the SFC 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 KFD and the SFC request your committee's support on the passage of S.B. 2722.

Should you have any questions, please call me at 241-6500.

Sincerely,



Robert F. Westerman
Fire Chief

RFW/cz

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: INCOME, Automatic fire sprinkler system

BILL NUMBER: SB 2722, SD-1

INTRODUCED BY: Senate Committee on Commerce, Consumer Protection, and Affordable Housing

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers to claim an income tax deduction for: (1) the installation of an automatic fire sprinkler system in a single-family residence; or (2) a portion of maintenance fees allocable to the qualifying costs to install a system in a residential or mixed-use condominium or cooperative housing corporation. Specifies that the credit shall be applicable to a system placed in service after 12/31/08.

For taxpayers who are owner-occupants or owners other than owner-occupants of a single-family residence or a residential unit in a condominium or cooperative housing project, the deduction shall be the lesser of the qualifying cost to install the system, or \$7,000. If the qualifying cost is for the installation in a residential unit in a condominium or cooperative housing project, the agreement and consent of all owner-occupants or owners other than the owner-occupants of units in the condominium or cooperative housing project shall be obtained prior to the installation of 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 single family residence, mixed-use condominium or cooperative housing corporation 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.

SB 2722, SD-1 - Continued

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.

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 2/11/08