DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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

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
WAYS AND MEANS
Thursday, February 21, 2008
9:30 a.m.
State Capitol, Conference Room 211

in consideration of
SB2764,SD2
RELATING TO ETHANOL FACILITY TAX CREDIT.

Chair Baker, Vice Chair Tsutsui, and Members of the Committee.

The Department of Business, Economic Development, and Tourism (DBEDT) appreciates the over-all concept of this bill as it includes initiatives supportive of our goals and objectives, but we are concerned about the cost implications generated by this proposal. We defer to the Department of Taxation on tax implications and administration.

SB2764,SD2 would repeal the cap on the annual amount of tax credits and the statewide capacity limit.

We agree that more flexibility in the size of a facility is desirable, but are concerned about completely repealing the cap on maximum aggregate annual credits payable; we concur with the change proposed on pages 7 and 8.

However, we do not support the change proposed on Page 6. We recommend that, beginning on page 6, line 5, the bill be revised to read:

> If in any year, the annual amount of certified credits reaches $12,000,000 in the aggregate, the department of business, economic development, and tourism shall immediately discontinue certifying credits and notify the department of taxation. In no instance shall the total amount of certified credits exceed $12,000,000 per year.

This bill, if passed with our recommended changes, would allow both large and small facilities to receive the same tax credit for their first 15 million gallons per year of production capacity, without exposing the State treasury to an unknown level of liability.

Encouraging the local production of renewable fuels is consistent with Hawaii's energy objectives and supportive of Hawaii's renewable energy future.

Thank you for the opportunity to offer these comments.

ALEXANDER & BALDWIN, INC.

822 Bishop Street
Honolulu, Hawaii 96813
P.O. Box 3440
Honolulu, HI 96801-3440
www.alexanderbaldwin.com
Tel (808) 525-6611
Fax (808) 525-6652

SB 2764 SD2
RELATING TO ETHANOL FACILITY TAX CREDIT

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

FEBRUARY 21, 2008

Chair Baker and Members of the Senate Committee on Ways & Means

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 2764 SD2, "A BILL FOR AN ACT RELATING TO ETHANOL FACILITY TAX CREDIT." We support this bill.

As one of two remaining sugar companies operating in the State, Hawaiian Commercial & Sugar Company (HC&S) celebrated its 125th 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, is 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 would serve to support the potential of an ethanol industry in Hawaii and at HC&S by modifying the qualifying capacity limits of ethanol production facilities and repealing the sunset provision with respect to the total annual nameplate capacity for qualifying ethanol production facilities. This is particularly important for HC&S, and likely for other prospective producers, because economies of scale can improve significantly on a facility above 15 million gallons.

Based on the aforementioned, we respectfully request your favorable consideration on this bill.

Thank you for the opportunity to testify.

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, Ethanol facility tax credit

BILL NUMBER: SB 2764, SD-2

INTRODUCED BY: Senate Committee on Economic Development and Taxation

BRIEF SUMMARY: Amends HRS section 235-110.3 to provide that the ethanol facility tax credit shall be applicable to the first 15 million gallons produced by the facility. Deletes the amount of the credit limitations to provide that if the annual amount of certified credits reaches $_____, the department of business, economic development and tourism (DBEDT) shall discontinue certifying credits and notify the department of taxation. Further stipulates that in no instance shall the total amount of certified credits exceed $______ per year. Repeals the provisions prohibiting the issuance of the credits when ethanol production reaches 40 million gallons per year.

EFFECTIVE DATE: July 1, 2025

STAFF COMMENTS: The legislature by Act 289, SLH 2000, established an investment tax credit to encourage the construction of an ethanol production facility in the state. The legislature by Act 140, SLH 2004, changed the credit from an investment tax credit to a facility tax credit.

While the proposed measure would make the ethanol facility tax credit applicable to the first 15 million gallons produced by the facility over the eight-year period, it is questionable whether the limitation proposed in this measure is fair to those businesses who are committed to and are currently constructing an ethanol production facility in the state.

While this measure would perpetuate the tax incentives for the construction and development of an ethanol production facility in the state, it should be remembered that a direct appropriation would be preferable. This would provide some accountability for the taxpayers' funds being utilized to support this effort. However, the more important point to note here is the arduous path to success with this proposal with the initial tax incentive adopted in 2000 and here some eight years later, the interested parties have yet to put the first spade in the ground. Meanwhile the administration, in its great wisdom, has mandated the use of 10% ethanol in motor vehicles, resulting in the importing of ethanol to meet the needs of the state.

Digested 2/20/08

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 WAYS & MEANS

TESTIMONY REGARDING DECISION MAKING AGENDA FOR FEBRUARY 21, 2008

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 21, 2008
TIME: 9:30AM
ROOM: 211

Contained in this testimony are the Department of Taxation's (Department) comments on the Senate Committee on Ways & Means' decision-making agenda for February 21, 2008. Because each measure is before the Committee for decision-making only, the Department's comments are in summary fashion for your convenience—

I. SB 2829, SD 1, RELATING TO TAXATION (SSTP)

This bill provides implementing legislation for the Streamlined Sales & Use Tax Agreement (SSUTA).

The Department takes **no position on the merits of the SSUTA** and stands on its prior testimony submitted to the Committee on Economic Development & Taxation. However, the Department **opposes the redirection** of general excise tax receipts from the general fund to a special fund. The Department points out the following comments:

Delayed Effective Date—The delayed effective date of the bill is appreciated, but the delay may not be long enough to allow these changes to be fully integrated into the computer systems of the Department. A longer delayed effective date would give time for practitioners and businesses to adjust to these changes. Given the challenges the Department would face integrating such large, wholesale changes into its operations, longer than two years may be more realistic of a time frame. The delayed effective date would also provide time to obtain approval from the National SSTP Governing Board to assure that Hawaii's amendments conform to the SSUTA. This is very important since Hawaii's general excise tax is not a sales tax.

Frequent Changes to the SSUTA Will Require Legislative Action—The legislature needs to be aware that the SSUTA is not a static document. It has undergone substantial and frequent changes since it was adopted on November 12, 2002. It has been amended 11 times.[1] Each change requires member States to possibly amend its law in order to remain in conformity with the SSUTA.

Revenue Impact—The bill would increase revenues by about $10 million annually. However, joining the SSUTA would entail start-up costs and annual recurring costs. The Department is presently re-examining SSTP implementation costs. The expansion of the GET exemption for blind, deaf, and disabled taxpayers would cost about $500,000 annually.

II. SB 2838, SD 1, RELATING TO TAXATION (ELECTRONIC REFUND DEPOSIT)

This legislation requires the Department to implement necessary procedures to allow e-filing taxpayers to request a direct deposit of refunds to up to three accounts. The Department has **concerns** with this legislation and provides the following comments—

Bill Must Allow Deposit Only Into Certain Accounts—The Department requests that the bill be amended to allow an electronic deposit into only those bank accounts that receive an electronic refund request at the federal level. The amendments made to this measure based upon comments by the Department rely heavily upon federal electronic tax information. If a taxpayer is allowed to insert different accounts than those provided to the IRS, this legislation could have a much greater impact on Department resources and could cost much more to implement.

Appropriation—An appropriation to finance the computer and form costs associated with this measure is necessary. At this time, the Department requests an appropriation in the amount of $89,000 to carry out the purposes of this proposal.

III. SB 2819, SD 1, RELATING TO INTRA-COUNTY FERRY SERVICE (Fuel Tax Exemption)

This legislation exempts sales of fuel to an intra-county ferry service from the fuel tax. The Department takes **no position** on this legislation and offers the following comment for technical correctness

Inappropriate Statutory Placement— The current mechanics of this bill are counterintuitive and it does not make sense to include an exemption section within the assessment section of the license tax. The Department still believes that an exemption for an intra-county ferry service should be included within the current exemption section provided at HRS § 243-7.

Revenue Estimate—The Department's updated revenue estimate provided to the Committee on Economic Development & Taxation was not incorporated into its committee report, which was cited as $13,500. This legislation will result in no impact to general fund. Highway fund annual revenue will be decreased by $21,200, starting FY2009.

---

[1] November 19, 2003, November 16, 2004, April 16, 2005, October 1, 2005, January 13, 2006, April 18, 2006, August 30, 2006, December 14, 2006, June 23, 2007, September 20, 2007, and December 12, 2007

IV. **SB 2816, SD 1, RELATING TO TAXATION (Foreign Trade Zone Exemption)**

This legislation exempts fuel purchased from a Foreign Trade Zone by a common carrier that flies interisland from the general excise and use taxes.

The Department takes **no position** on this measure and offers one comment—

Definition of "Interstate Air Transportation"—For consistency throughout the proposal, this term should be defined as: **"Interstate air transportation" includes the transportation of passengers or property by aircraft between two points in the State."**

Revenue Impact— It is the Department's position that this legislation will result in a revenue loss of approximately:

- $5.1 million loss, FY2009.
- $5.3 million loss, FY2010.
- $5.5 million loss, FY2011.

110 million gallons of fuel was sold on Oahu in FY2007. From previous estimates, it was found that approximately 55% of this was of non-exempt fuel. GE revenue from fuel was calculated to be (110 million gallons) * (55% non-exempt) * ($2.00 / gallon) * (4.00% excise tax rate) = $4.8 million. This was inflated for the relevant fiscal years.

V. **SB 3149, SD 2, RELATING TO HIGHWAYS (Requires GET Deposit)**

This legislation, among other things, requires a deposit of general excise tax revenues generated from the manufacture and sale of fuels to be deposited to the highway fund. The Department has **strong concerns** with this legislation.

GET Redirect—The Department is always cautious about policy that redirects general excise tax revenue away from the general fund and into specific special funds. The Department is concerned because the general excise tax represents over one-half of the State's overall operating revenue stream. The Department strongly prefers that a direct appropriation be the means for funding this program so that the amount may be budgeted and prioritized just as any other program.

Administrative Issues—The Department also points out that tracking the specific fuel revenues as contemplated by this measure is likely unworkable. The Department does not track the gross proceeds of sales of fuel to the extent requested in this measure. The Department would need an appropriation for computer and form enhancements, as well as additional time, in order to capture the data requested in this measure.

Revenue Estimate—This legislation will result in the following general fund losses:

- **FY2009 (loss): $36.8 million**
- **FY2010 (loss): $78.0 million**

- **FY2011 (loss): $79.1 million**

The taxable gallonage from fiscal year 2007 was used to derive the excise tax receipts derived from the selling of these fuels. Note that gasoline was mostly subject to the GE exemption for alcohol-based fuels, and that oil and gas refining has a special GE exemption for multiple refineries in multi-step refining processes. The revenue impact of each fuel was calculated by:

(Gallons sold in FY07) * [(Avg retail price) * (Retail GE {4% or 0%}) + (Avg wholesale price) * (Wholesale GE)]. The impacts of the individual fuels were summed to get the total revenue impact.

For FY 2010 / FY 2011, the repeal of the GE exemption for ethanol-blended fuels was added to the total.

VI. <u>SB 2455, SD 1, RELATING TO RENEWABLE ENERGY TECHNOLOGIES (Extends Credit to Hydrogen)</u>

This legislation extends the current Renewable Energy Technologies Income Tax Credit to include hydrogen energy systems. The Department has **<u>no additional comments</u>** on this measure.

This bill's revenue estimate is estimated to be minimal. There is no marketed product known that would provide power via hydrogen for residential or commercial use. This leaves commercial R&D as the only probable user of the credit. However previous department rulings regarding this credit dictate that "all additions adding to an existing system shall be treated as one installation" (TIR 07-02). This minimizes the impact due to the $35,000 limit. With the further consideration that the device must be powered by a renewable energy source, the number of adopters would probably be very low, if any.

VII. <u>SB 2623, RELATING TO RENEWABLE ENERGY TECHNOLOGIES (Extends Credit to Solar)</u>

This legislation amends the current Renewable Energy Technologies Income Tax Credit, by adding a new definition for "solar electric energy systems." The Department **<u>does not like this additional definition</u>** 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.

Based upon the Department's estimates, this legislation will not have an impact on the general fund.

VIII. <u>SB 2764, SD 2, RELATING TO ETHANOL FACILITY TAX CREDIT (Removes Caps)</u>

This legislation provides the Ethanol Facilities Tax Credit to large and small refineries for the first 15 million gallons of ethanol produced and eliminates certain caps. The Department of Taxation (Department) takes **<u>no position</u>** on this legislation.

This legislation will currently result in an indeterminate revenue estimate because the credit caps are blank. The amount of revenue loss is dependent upon the change in the annual credit limit. This is currently unspecified.

IX. SB 2986 SD 1, RELATING TO REFUNDABLE RENEWABLE ENERGY TAX CREDIT (Makes Renewable Energy Technologies Tax Credit Refundable)

This 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 of Taxation (Department) **strongly supports** this Lingle-Aiona Administration measure as a policy to encourage additional investment in renewable energy technologies.

Annual revenue loss is estimated to be $41,000, starting in fiscal year 2009.

X. SB 3215, SD 2, RELATING TO BIODIESEL (Biodiesel Production Incentives)

This legislation, among other things, provides tax incentives for biodiesel production facilities. The Department of Taxation (Department) provides **comments** on this legislation.

Income Tax Exemption—The Department notes that the income tax exemption is vague. It is unclear whether the tax exemption applies to 100% of income derived from the processing of oil seed produced in the State or to 100% of all income from any facility that processes any amount of oil seed produced in the State.

Revenue Impact—Due to the blanks, this bill will result in an indeterminate revenue loss.