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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.

General Excise Tax Exemption

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.

Revenue Impact

This bill will result in an indeterminate revenue loss.

X. SB 2455, RELATING TO RENEWABLE ENERGY TECHNOLOGIES

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

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

XI. SB 2932, RELATING TO ENVIRONMENTAL RESPONSE TAX

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.

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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 2932
RELATING TO ENVIRONMENTAL RESPONSE TAX.

Chair Menor, Vice Chair Hooser, and Members of the Senate Committee on Energy and Environment.

Senate Bill No. 2932, Relating to Environmental Response Tax, addresses the funding stream for State Energy programs by increasing the state environmental response tax from 5 cents a barrel to 25 cents a barrel. The purpose of the ERRF remains unchanged and includes funding for energy conservation and alternative energy development.

Over the last five years, the annual budgeted General Fund appropriation to the State's energy program has averaged about $1.2 million. I would say this amount of funding is disproportionate compared to the broad role and responsibilities of the energy program. As you know, over the past several years, legislative measures have increased the scope and breadth of activity in Hawaii's energy sector. Federal funding has supported the state's energy program at a level twice of the annual state general fund funding, via the federal State Energy Program and competitive grant funding. As the result, two-thirds of the state energy program's staff is federally funded. Federal funding sources are diminishing, and are expected to be practically exhausted within the next 3 to 4 years.

The newly created federal partnership with the State of Hawaii, the Clean Energy Initiative, will bring new sources of funding to energy initiatives in Hawaii, but these will be program focused, and not designed to replace the PVE funding that is expiring. Moreover, the partnership will require state matching funds to conduct important work in support of the state's goals for energy security. These opportunities will make staff support an imperative and will increase the requirements of the staff beyond the already strained workload.

While the structure of the State's energy program is fairly stable and resilient, the resources that the program has existed on to date are coming to an end, and new sources of funding do need to be identified and aligned in a transition for the successful implementation of the Hawaii Clean Energy Initiative.

There have been many good ideas introduced this legislative session that support the State's economic development goals. We note, however, that this increase in the Environmental Response Tax was not included in the Executive's Supplemental Budget, and request that this tax not displace the priorities contained in that budget.

Thank you for the opportunity to testify.

LINDA LINGLE
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CHIYOME LEINAALA FUKINO, M.D.
DIRECTOR OF HEALTH

In reply, please refer to:
File:

COMMITTEE ON ENERGY AND ENVIRONMENT

S.B. 2932, RELATING TO ENVIRONMENTAL RESPONSE TAX

Testimony of Chiyome Leinaala Fukino, M.D.
Director of Health

January 31, 2008
2:15p.m.

(REVISED TESTIMONY)

Department's Position: The Department of Health appreciates the intent of this bill to provide financial support for energy conservation, alternative energy development, and global warming initiatives. However, the Department respectfully opposes the bill.

Fiscal Implications: Amending HRS Section 243-3.5 to raise the per barrel oil tax from the present 5-cents to 25-cents to fund energy conservation, alternative energy development, and global warming efforts, will increase tax revenues from approximately $1,700,000 in FY 2007 to approximately $8,500,000 annually in the Environmental Response Revolving Fund (ERRF) (about $1,7000,000 per 5 cents).

Purpose and Justification: The bill is designed to have the Environmental Response Revolving Fund (ERRF) collect monies for alternative energy, energy conservation, global warming initiatives, and other efforts.

In general, the Department strongly supports the development of clean energy, independent from fossil fuels, and the reduction of greenhouse gas emissions. We support adequate funding to advance those goals, consistent with administration budget priorities. However, we do not support a fee increase.

GUY TOYAMA
H2 Technologies, Inc
73-4347 Malie Pl, Kailua-Kona, Hawaii 96740
Phone (808) 938-6325

Wednesday, January 30, 2008

Ladies and gentlemen:

*I hereby submit the following testimony regarding **SB2455, SB 2744 and SB2932**. The SENATE Energy and Environment Committee is set to hear this bill on Thursday, January 31, 2008 at 2:15 pm in Senate Conference Room 414.*

I would appreciate if you would make and deliver appropriate number of copies of my testimony to Room 414 for this hearing. Thank you.

TO: THE SENATE ENERGY and ENVIRONMENT COMMITTEE, Senator Ron Menor, Chair, Senator Gary L Hooser, Vice-Chair

FROM: GUY TOYAMA, H2 TECHNOLOGIES, INC

SUBJECT: Testimony relating to RENEWABLE ENERGY TECHNOLOGIES and ENVIRONMENTAL RESPONSE TAX (***SB2455, SB 2744 and SB2932***) - set to be heard on 1/31/2008 at 2:15 pm in Conference Room 414

I support each of these three bills, which support incentives for clean energy technology growth in Hawaii. A support for moving Hawaii into a more energy secure and environmentally responsible State.

I encourage this committee to approve ***SB2455, SB 2744 and SB2932*** and hasten their passage.

Thank you very much for your consideration of my views and my testimony on this bill.

Respectfully submitted,

Guy Toyama
H2 Technologies, Inc
guy@h2-techs.com

Will Rolston
NELHA – Gateway Manager
Kailua-Kona, Hawaii 96740
Phone (808) 217-0201

Wednesday, January 30, 2008

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TO: THE SENATE ENERGY and ENVIRONMENT COMMITTEE, Senator Ron Menor, Chair, Senator Gary L Hooser, Vice-Chair

FROM: Will Rolston, Hawaii Gateway Manager

SUBJECT: Testimony relating to RENEWABLE ENERGY TECHNOLOGIES and ENVIRONMENTAL RESPONSE TAX (***SB2455, SB 2744 and SB2932***) - set to be heard on 1/31/2008 at 2:15 pm in Conference Room 414

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Thank you very much for your consideration of my views and my testimony on this bill.

Respectfully submitted,

Will Rolston

NELHA – Gateway Manager

willr@nelha.org

LEGISLATIVE

TAXBILLSERVICE

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

SUBJECT: FUEL, Increase state environmental response tax

BILL NUMBER: SB 2932

INTRODUCED BY: Ihara, Chun Oakland and 8 Democrats

BRIEF SUMMARY: Amends HRS section 243-3.5(a) to increase the state environmental response tax from 5 cents to 25 cents per barrel.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: The legislature by Act 300, SLH 1993, enacted an environmental response tax of 5 cents per barrel on petroleum products sold by a distributor to any retail dealer or end user. This measure proposes to increase the tax from by 5 cents to 25 cents per barrel to provide additional revenue for the expanded purposes of the fund.

It should be remembered that the environmental response tax was initially adopted for the purpose of setting up a reserve should an oil spill occur on the ocean waters that would affect Hawaii's shoreline. The nexus was between the oil importers and the possibility that a spill might occur as the oil product was being imported into the state. Now that the fund has become a cash cow, lawmakers have placed other responsibilities on the fund, including environmental protection and natural resource protection programs, such as energy conservation and alternative energy development, to address concerns related to air quality, global warming, clean water, polluted runoff, solid and hazardous waste, drinking water, and underground storage tanks, including support for the underground storage tank program of the department of health.

It should be noted that the enactment of the barrel tax for the environmental response revolving fund is the classical effort of getting one's foot in the door with a palatable and acceptable tax rate with the possibility of increasing the tax rate once it is enacted which is being proposed by this measure. Because the tax is imposed at the front end of the product chain, the final consumer does not know that the higher cost of the product is due to the tax. Thus, there is little, if any, accountability between the lawmakers who enacted the tax and the vast majority of the public that ends up paying the tax albeit indirectly.

It should be remembered that the State Auditor has singled out this particular fund as not meeting the criteria established and recommended that it be repealed. The Auditor criticized the use of such funds as they hide various sums of money from policymakers as they are not available for any other use and tend to be tacitly acknowledged in the budget process. More importantly, it should be recognized that it is not only the users of petroleum products who benefit from a cleaner environment, but it is the public who benefits. If this point can be accepted, then the public, as a whole, should be asked to pay for the clean up and preservation of the environment.

Funds deposited into a revolving fund are not subject to close scrutiny as an assumption is made that such

SB 2932 - Continued

funds are self-sustaining. It should be remembered that earmarking of funds for a specific program represents poor public finance policy as it is difficult to determine the adequacy of the revenue source for the purposes of the program. To the extent that earmarking carves out revenues before policymakers can evaluate the appropriateness of the amount earmarked and spent, it removes the accountability for those funds. There is no reason why such a program should not compete for general funds like all other programs which benefit the community as a whole.

Rather than perpetuating the problems of the barrel tax, it should be repealed and all programs that are funded out of the environmental response fund should be funded through the general fund. At least program managers would then have to justify their need for these funds. By continuing to special fund these programs, it makes a statement that such environmental programs are not a high priority for state government. This sort of proliferation of public programs needs to be checked as it appears to be growing out of hand and at the expense of the taxpayer.

If it is a matter that no funds in this fiscal environment have been set aside to address federal environmental mandates, then consideration should be given to first prioritizing how the money that is already in the fund is to be spent and then to set a sunset deadline by which these programs are to be general fund financed and the tax repealed.

Given that this proposal amounts to a tax increase of 500%, can its sponsors hold their heads high when they return to their constituents and tell them that while their colleagues rant and rave about the collusive petroleum industry ripping off motorists at the pump that they themselves contribute to not only the high cost of gasoline but also the high cost of electricity to light our homes to the pricey take-out lunch because the cost of that energy will increase even more with this proposal. While lawmakers would like to preen their feather that they are oh-so eco friendly and environmentally concerned, they do so at a cost to the taxpayer. While tax increases are unacceptable in these difficult times, this proposal is especially reprehensible as it hides behind the skirt of being environmentally concerned and it hides behind the shadow of businesses that will end up with the blame of ripping off the consumer yet again. Voters going to the polls this November should be reminded of these lawmakers who are digging their hands even deeper into the taxpayers' pocketbooks.

Digested 1/30/08