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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.

TESTIMONY BY GEORGINA K. KAWAMURA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE SENATE COMMITTEE ON ENERGY AND ENVIRONMENT
ON
SENATE BILL NO. 2945

January 31, 2008

RELATING TO RENEWABLE ENERGY.

Senate Bill No. 2945 authorizes the formation of cooperatives for the purpose of generating electricity from renewable energy resources to be sold to its membership, and the issuance of revenue bonds to finance costs related to constructing, upgrading, and acquiring transmission facilities.

The Department has concerns with this bill.

The Director of Finance cannot issue revenue bonds to finance projects for a private, nonprofit cooperative. Article VII, Section 12 of the State Constitution defines revenue bonds as "all bonds payable from the revenues, or user taxes, or any combination of both, of a public undertaking, improvement, system or loan program and any loan made thereunder and secured as may be provided by law." The private, non-profit cooperative organized under this bill is not a *public* undertaking, improvement, system or loan program.

It would appear that the proposed financing could be more appropriately handled under Parts III, IV or V of Chapter 39A, Hawaii Revised Statutes, which authorize the issuance of special purpose revenue bonds to assist manufacturing, processing and industrial enterprises.



**DEPARTMENT OF BUSINESS,
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Statement of
THEODORE E. LIU
Director

Department of Business, Economic Development, and Tourism
before the

COMMITTEE ON ENERGY AND ENVIRONMENT

Thursday, January 31, 2008

2:15 p.m.

State Capitol, Conference Room 414

in consideration of
SB 2945
RELATING TO RENEWABLE ENERGY.

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

The Department of Business, Economic Development, and Tourism (DBEDT) supports the intent of SB 2945 which proposes to allow for the organization of renewable energy cooperatives to generate, transmit, and sell electricity to their members. The bill also proposes to authorize the issuance of revenue bonds to finance costs related to constructing, upgrading, and acquiring transmission facilities. It also proposes to exempt the cooperatives from PUC regulation except for interconnection agreements.

DBEDT believes that this bill which allows and facilitates the formation and organization of renewable energy cooperatives is another step towards accelerating the

increased use and development of renewable energy, and will help transform Hawaii's energy sector from one that is heavily dependent on imported fossil fuel, to one that is based primarily on Hawaii's abundant renewable energy provided by nature.

This bill builds on the many State's energy initiatives designed to decrease Hawaii's dependence on imported fossil fuels which is an essential step towards achieving energy security and independence, economic diversification and sustainability with the attendant creation of new jobs from the development of a renewable energy sector or industry. More importantly, this bill provides customers choice for their electricity energy provider or supplier, and would allow them to participate in transforming Hawaii's electricity sector.

DBEDT supports the intent of this bill. DBEDT however, suggests that the renewable cooperatives should be completely renewable-based and must derive one hundred per cent of the electricity produced from renewable energy, rather than allowing twenty-five per cent to be derived from fossil fuels as proposed in the bill's Section 421C-B, pages 2-6.

DBEDT defers to the Department of Budget and Finance on matters relating to the issuance of revenue bonds and other related financing matters.

Thank you for the opportunity to testify.



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TO THE SENATE COMMITTEE ON ENERGY AND ENVIRONMENT

THE TWENTY-FOURTH LEGISLATURE
REGULAR SESSION OF 2008

Thursday, January 31, 2008
2:15 p.m.

TESTIMONY OF CATHERINE P. AWAKUNI, EXECUTIVE DIRECTOR,
DIVISION OF CONSUMER ADVOCACY, DEPARTMENT OF COMMERCE AND
CONSUMER AFFAIRS TO THE HONORABLE SENATOR MENOR, CHAIR
AND MEMBERS OF THE COMMITTEE

SENATE BILL NO. 2945 – RELATING TO RENEWABLE ENERGY.

DESCRIPTION:

This measure: (1) provides for the organization of renewable energy cooperatives to generate, transmit, and sell electricity to their membership; (2) authorizes the issuance of revenue bonds to finance costs related to constructing, upgrading, and acquiring transmission facilities; and (3) exempts cooperatives from Hawaii Public Utilities Commission ("Commission") regulation, except for interconnection agreements.

POSITION:

The Division of Consumer Advocacy ("Consumer Advocate") takes no position on this bill, and provides the following comments for this Committee's consideration.

S.B. No. 2945
Senate Committee on Energy and Environment
Thursday, January 31, 2008, 2:15 p.m.

COMMENTS:

The portions of the measure that establish the creation of renewable energy cooperatives, exempt such cooperatives from Commission regulation, and require agreements for interconnection with a public utility are unnecessary. By state law, cooperatives that provide electrical power to themselves may be formed, and if formed, are not subject to Commission jurisdiction. In addition, interconnection agreements between customers and public utilities have already been filed with the Commission and approved.

Thank you for this opportunity to testify.