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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
January 31, 2008
2:15 PM
State Capitol, Conference Room 414

in consideration of

SB 2946
RELATING TO RENEWABLE ENERGY OPPORTUNITY ZONES.

Chair Menor, Vice Chair Hooser, 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 cost and other implications generated by this proposal. SB 2946 provides for the establishment of renewable energy opportunity zones by the director of the Department of Business, Economic Development and Tourism (DBEDT) to facilitate the development of Hawaii's renewable energy resources. SB 2946 additionally provides tax incentives to qualifying businesses, however, we defer to the Department of Taxation with regard to tax implications.

As stated in the measure, the legislature's intent is to "have the groundwork prepared in anticipation of the entry of qualified businesses ... by having certain areas in the respective counties designated ..., approved for certain types of renewable energy generation, with all the necessary environment impact statements performed and in place, and by expediting the issuance of necessary county permits, in consultation with the respective counties through their active participation in an advisory committee."

While we appreciate the measure's intent, we are concerned that the designation of the zones and the preparation of the EIS and performance of other permit functions are difficult and complex tasks that require considerable expertise and resources. We suggest an approach successfully employed for the orderly development of geothermal energy in Hawaii which required the establishment of geothermal resource sub zones by the Board of Land and Natural Resources pursuant to Sections 205-5.1 and 205-5.2, HRS. Act 296, Session Laws of Hawaii 1983, the enabling legislation, provides for sub zone designation and requires a geothermal assessment and impact analysis.

Similarly, as an initial step toward designation of zones for renewable energy development, we suggest that assessments should be funded and conducted to identify appropriate areas. Such assessments would utilize existing renewable resource maps for wind, bioenergy, solar, ocean, and geothermal energy, and further consider electrical transmission and distribution infrastructure, land ownership, zoning, roads, and other parameters that may impact siting decisions. Further, an impact analysis may be more achievable then the envisioned environmental impact statement (EIS). Without specific project information, the scope for an EIS will include all potential project conditions resulting in considerable complexity and examination of concerns that may not be appropriate for specific projects.

The combination of siting assessments, impact analyses, and the support of the renewable energy facilitator position, as provided in the Executive Supplemental Budget, will assist developers as intended by this measure.

DBEDT recommends strongly that any effort at improving Hawaii's permitting processes be provided with the appropriate authority and commensurate resources to undertake this difficult task.

Thank you for the opportunity to offer these comments.

DEPARTMENT OF PLANNING AND PERMITTING
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January 31, 2008

The Honorable Ron Menor, Chair
and Members of the Committee on Energy
and Environment
Senate
State Capital
Honolulu, Hawaii 96813

Dear Chair Menor and Members:

**Subject: Senate Bill 2946
Relating to Renewable
Energy Opportunity Zones**

The Department of Planning and Permitting **opposes** Senate Bill 2946, which among other measures would expedite the issuance of county permits by essentially usurping established county land use planning and zoning policies and permit procedures, local decision-making and community input.

The purpose and intent of this bill, i.e., to decrease Hawaii's dependence on imported oil, is supportable; as are many of the measures and provisions contained within the bill. However, the renewable energy facilities that this bill seeks to facilitate will be located in separate counties for the production of energy which will serve those individual communities. As such, there is no overriding state-wide imperative which justifies superseding local control over the site selection of a proposed renewable energy facility. The site selections are and should remain local decisions subject to established county planning, land use, engineering and building requirements.

On Oahu, just within the last year, we have approved a new biodiesel fuel production facility at Barbers Point and a new wind machine farm in Kahuku. In both cases, the land use approvals were expeditiously and successfully processed in a matter of a few months. Furthermore, we understand that a proposed photo-voltaic energy farm is proposed for the Kapolei area. Such a facility will require at most a minor conditional use permit, which could takes up to 45 days to process, but, in this case, may not even require a permit if the proposed utility installation is not found to involve any particularly adverse potential impacts for surrounding permitted uses.

The Honorable Ron Menor, Chair
and Members of the Committee on Energy
and Environment
Senate
Re: Senate Bill 2946
January 31, 2008
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There does not appear to be any particular permit issuance problems which warrant the extraordinary measures that this bill proposes. However, if this measure is intended to address problems occurring in another county, with respect to land use and permitting for renewable energy facilities, then we respectfully object to any provision which unfairly paints with a broad brush all of the counties. We believe our existing land use and planning requirements adequately and successfully accommodate important new technologies while appropriately ensuring compatibility with local long-range plans and land use policies, necessary input from affected host communities, and local decision-making authority.

We note that there are numerous alternative bills introduced this legislative session which appear to adequately address renewable energy opportunity zones without trespassing on county prerogatives, and are worthy of further consideration.

Please file Senate Bill 2946.

Very truly yours,

Henry Eng

Henry Eng, FAICP, Director
Department of Planning and Permitting

HE:jmf
sb2946-jh.doc

Testimony on

S.B. NO. 2946 – RELATING TO RENEWABLE ENERGY OPPORTUNITY ZONES

Before the

Senate Committee on Energy and Environment
Thursday, January 31, 2008, 2:15 p.m., Conference Room 414

by

David Rezachek, Honolulu Seawater Air Conditioning LLC

Honolulu Seawater Air Conditioning LLC (HSWAC) **supports the intent** of S.B. 2946, Relating to Renewable Energy Opportunity Zones, which requires the Director of the Department of Business, Economic Development, and Tourism, in consultation with advisory committee, to designate renewable energy opportunity zones, and determine types of energy generation for a zone, number of zones, and period of zones, and to perform the required EIS for these zones and expedite issuance of county permits.

However, HSWAC cannot support this bill because it generally includes only those renewable energy technologies that produce electricity. The bill does include one important displacement technology – solar water heating, but excludes another, that is just as important – seawater air conditioning. This makes no sense.

- **Displacement of electricity use by thermal applications of renewable energy technologies is just as important and beneficial as electricity generation from renewable resources.** While these technologies do not generate electricity, they provide electricity savings by displacement of the electricity used to perform the same tasks. And, they definitely use renewable energy resources.

- **Displacement technologies may actually be more beneficial than using renewable energy generated electricity to provide energy for the same end use.** Using renewable energy generated electricity for water heating or space cooling, makes no more sense than using fossil fuel generated electricity for the same purpose. Solar thermal allows direct use of solar energy. SWAC allows direct use of cold, deep seawater.

- **Displacement technologies are generally sited at, or near, the end user and reduce or eliminate transmission and distribution (T&D) losses.** In addition to the benefits of direct use of thermal energy, displacement technologies reduce the T&D losses of electricity by more than 11%. More of the electricity produced goes to end users.

- **Solar water heating and SWAC have the potential to provide more than 30% of the renewables needed to meet the 20% requirement for Oahu in 2020.** If these displacement technologies are not included in RPS requirements, other renewable energy technologies will have to make up the difference. An additional 340 megawatts of PV would be required, in addition to that already needed by 2020. <u>This is 10 times the goal of the State's recently announced Department of Transportation initiative.</u> This is also equivalent to nearly 126,000 residential PV systems at 2.5 kW each. Or, an additional 223 megawatts of wind would be required.

- **Solar water heating and SWAC are cost effective and available today and can be developed in a rapid manner.** More than 56,000 solar water heating systems have already been installed on Oahu, to-date. A reasonable goal is 100,000 systems by 2020. A 25,000-ton SWAC system is currently under development for Downtown Honolulu. Three to five more SWAC systems of this size are possible on Oahu.

- **It is critical that we accelerate renewable energy development to address greenhouse gas and global climate change problems, immediately – we cannot afford to wait – or to eliminate any renewable energy technologies from being included in Renewable Energy Opportunity Zones.** Hawaii needs to use and support all renewables, in any form (i.e., electricity, thermal, mechanical) to reduce the use of fossil fuels.

Therefore, if this committee decides to move this bill forward, HSWAC respectfully requests that the definition of "renewable energy," in this bill, be amended as follows:

> **" 'Renewable energy' also means electrical energy savings brought about by the use of renewable displacement or off-set technologies, including solar water heating, seawater air-conditioning district cooling systems, solar air-conditioning."**

Thank you for this opportunity to testify.