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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.

<u>General Excise Tax Exemption</u>

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.

<u>Revenue Impact</u>

This bill will result in an indeterminate revenue loss.

X. <u>SB 2455, RELATING TO RENEWABLE ENERGY TECHNOLOGIES</u>

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

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

XI. <u>SB 2932, RELATING TO ENVIRONMENTAL RESPONSE TAX</u>

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 p.m.
State Capitol, Conference Room 414

in consideration of
SB 2986
RELATING TO REFUNDABLE RENEWABLE ENERGY TAX CREDIT.

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

The Department of Business, Economic Development and Tourism (DBEDT) supports SB2986, which is an Administration measure to allow for the present renewable energy tax credits to be refundable for those taxpayers with an adjusted gross income of up to $20,000. Joint filings by a husband and wife would be capped at $40,000.

At present the statutes governing the renewable energy tax credits are only offered to those with tax liabilities. Therefore, home owners who have no tax liability, such as retired persons on fixed incomes or certain low income families, cannot take advantage of the sizeable tax credits offered. This proposed bill would allow residential taxpayers to claim a refund for their investment in renewable energy technologies. At present the tax credit is for 35%, with various dollar caps, for the cost to purchase and install solar water heating systems, photovoltaic systems, and wind systems. Home owners with limited or fixed incomes would benefit from the use of solar water heating or other renewable energy system to reduce their utility costs. Under the present statute, residential taxpayers who do not have a tax liability do not benefit from the renewable energy tax credits. This bill will allow the tax credits to be refundable to offset the cost of the renewable system.

During our many community outreach and exhibit efforts, we have often received comments from senior citizen home owners who are not able to claim the present tax credit. These home owners have felt shut out from the tax credit and the benefits of installing renewable energy devices.

Thank you for the opportunity to offer these comments.

COMMITTEE ON ENERGY AND ENVIRONMENT

Senator Ron Menor, Chair
Senator Gary L. Hooser, Vice Chair
Senator Les Ihara
Senator Russell S. Kokubun
Senator Gordon Trimble

SB 2986 - RELATING TO REFUNDABLE

RENEWABLE ENERGY TAX CREDIT

January 31, 2008 2:15PM
State Capitol
Conference Room 414
415 South Beretania Street
Honolulu, HI 96813

TESTIMONY SUBMITTED BY

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Support for SB 2986 – RELATING TO REFUNDABLE RENEWABLE ENERGY TAX CREDIT

My name is Joseph Saturnia and I am President of Island Pacific Energy, a local renewable energy finance company. I am testifying in support of SB 2986, RELATING TO REFUNDABLE RENEWABLE ENERGY TAX CREDIT. I support the passage of this bill however I urge the committee to consider removing the $20,000 income ceiling and open the tax refund up to all eligible renewable energy technology customers.

All renewable energy projects rely on government incentives to achieve a positive financial payback. Without government incentives, renewable energy systems do not come close to achieving parity with power from the electric utility. Changing from a tax credit to a tax refund is an excellent idea and will have an immediate impact on the installation of new renewable energy systems. The biggest stumbling block to the widespread installation of renewable energy systems in Hawaii has been the ability to monetize the State of Hawaii solar energy tax credits. In Hawaii there are many citizens and organizations that have the desire for renewable energy but lack the tax credit appetite. Without the ability to monetize the State of Hawaii tax credits, the payback on a renewable project is not sufficient.

Currently, the ability to fully utilize the State of Hawaii tax credits is hampered by the relatively low state income tax rate. At the current State of Hawaii income tax rate of 6.4% and State of Hawaii tax credit of 35%, customers must have a taxable income in excess of $500,000 to fully utilize the tax credits on a $100,000 photovoltaic solar energy system. At this income level, the number of qualified customers is small. Furthermore, many customers who have sufficient income have already exhausted their tax credit appetite because they are already invested in other tax credit oriented investments such as ACT 221. With a tax refund, consumers no longer need to have tax credit appetite to monetize the savings. The refunds are available to all customers regardless of income.

In order to lessen the financial impact on the State government, the tax refunds could be funded through a surcharge on electric rates. This would be modeled off of the current rebate offered to solar hot water customers. The benefits would be twofold. First, any increase in utility rates rewards renewable energy users because they use less utility power. It encourages the installation of renewable energy by others to avoid the higher utility rates. Second, funding the tax refunds with a surcharge on electric rates lessens the negative effects that additional renewable energy systems would have on reducing the State of Hawaii income tax receipts.

A number of incentives are already in place to encourage renewable energy in Hawaii. However the existing incentives are not enough to sufficiently encourage renewable energy systems. In order to achieve broad support and enhance the use of clean energy technologies, we must make the ability to monetize the State of Hawaii tax credits available to all customers. I urge the committee as part of SB 2986 to remove the $20,000 income ceiling and open the tax refund up to all renewable energy technology customers. Thank you for this opportunity to testify.

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Testimony before the
Senate Committee on
Energy & Environment

S. B. 2986 - Relating to Refundable Renewable Energy Tax Credit

Thursday, January 31, 2008
2:15 p.m., Conference Room 414

by Keith Block
Director, Customer Efficiency Programs
Hawaiian Electric Company, Inc.

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

My name is Keith Block and I am testifying on behalf of Hawaiian Electric Company, Inc., and its subsidiaries, Maui Electric Company (MECO) and Hawaii Electric Light Company, Inc. (HELCO).

Hawaiian Electric supports the use and development of renewable energy and supports SB 2986.

Hawaiian Electric has been encouraging the use of renewable energy through its residential solar water heating program for over 11 years. In that time the companies have provided rebates to over 39,000 customers for the installation of solar water heating systems on their homes.

Tax credits are a vehicle which the legislature has used successfully for many years. Making the renewable energy technology tax credit refundable for Hawaii residents who are exempt from taxation or who have low adjusted gross incomes should make these systems more affordable and accelerate Hawaii's transition to increased use of renewable energy. Increasing the penetration of renewable energy systems is consistent with State energy policy and support achieving established Renewable Energy Portfolio Standards.

Thank you for this opportunity to testify

Testimony before the
Senate Committee on
Energy and Environment

S. B. 2943 - Relating to Energy

Thursday, January 31, 2008
2:15 p.m., Conference Room 414

by Keith Block
Director, Customer Efficiency Programs
Hawaiian Electric Company, Inc.

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

My name is Keith Block and I am testifying on behalf of Hawaiian Electric Company, Inc., and its subsidiaries, Maui Electric Company (MECO) and Hawaii Electric Light Company, Inc. (HELCO).

Hawaiian Electric supports the use and development of renewable energy and strongly supports SB 2943.

Hawaiian Electric has been encouraging the use of renewable energy through its residential solar water heating program for over 11 years. In that time the companies have provided rebates to over 39,000 customers for the installation of solar water heating systems on their homes.

Tax credits are a vehicle which the legislature has used successfully for many years. Increasing tax credits for solar water heaters, wind and photovoltaics will make these systems more affordable to taxpayers and accelerate Hawaii's transition to increased use of renewable energy. In addition, increasing the tax credits is consistent with State energy policy and support achieving established Renewable Energy Portfolio Standards.

Thank you for this 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, Renewable energy technology systems

BILL NUMBER: SB 2986; HB 3064 (Identical)

INTRODUCED BY: SB by Hanabusa by request; HB by Say by request

BRIEF SUMMARY: Amends HRS section 235-12.5 to provide that the renewable energy technologies income tax credit claimed by taxpayers with no taxable income or with adjusted gross income of under $20,000 shall be refundable.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: This is an administration measure submitted by the department of business, economic development and tourism BED-12(08). While the administration's justification sheet states that the adoption of this measure will allow residential taxpayers with no tax liability or those with low incomes to purchase a renewable energy system to help offset the upfront cost, it underscores the fact that such renewable energy systems are still not affordable to everyone.

If it is the intent of the legislature to encourage a greater use of renewable energy systems by all taxpayers, as an alternative, consideration should be given to a program of low-interest loans available to all income levels.

The combination of a low-interest loan which can be repaid with energy savings would have a much more broad-base application than a credit which amounts to nothing more than a "free monetary handout" or subsidy by state government for those taxpayers who more than likely can afford to make the conversion. A program of low or no-interest loans such as those proposed in HB 2101 would do much more to increase the acquisition of these devices. Persons of all income levels could borrow the funds, make the acquisition, and repay the state program in an amount equal to the avoided cost that their utility bills would now reflect.

To reiterate, if lawmakers truly want to provide a financial incentive for taxpayers to make the switch to using these alternative energy devices while taking advantage of the credit, then a program of no-interest, or low-interest loans would be far more effective. The state could provide the capital to acquire these devices, and the taxpayer could receive a discount of 30% provided by the federal tax credit. The amount of the state loan could then be amortized by the energy savings realized by the taxpayer.

Finally, it appears that there are some taxpayers for whom there is no state tax liability and therefore a nonrefundable tax credit such as the renewable energy tax credit provides no incentive. Again, this is one of the inherent flaws of using tax credits to entice certain behaviors. To change the credit now for some people and not for others from a nonrefundable to a refundable credit sets poor tax policy as it lacks consistency.

Digested 1/30/08