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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.

LINDA LINGLE
Governor

SANDRA LEE KUNIMOTO
Chairperson, Board of Agriculture

DUANE K. OKAMOTO
Deputy to the Chairperson

State of Hawaii
DEPARTMENT OF AGRICULTURE
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TESTIMONY OF SANDRA LEE KUNIMOTO
CHAIRPERSON, BOARD OF AGRICULTURE

BEFORE THE SENATE COMMITTEES ON ENERGY AND ENVIRONMENT
AND
AGRICULTURE AND HAWAIIAN AFFAIRS
THURSDAY, JANUARY 31, 2008
2:15 p.m.
Room 414

SENATE BILL 3215
RELATING TO BIODIESEL

Chairpersons Menor and Tokuda and Members of the Committees:

Thank you for the opportunity to testify on Senate Bill No. 3215. We offer the following comments and concerns. This bill has five incentives to be offered by State and county governments to stimulate the development of biodiesel feedstock production and processing of biodiesel fuels in Hawaii:

1. The Department of Land and Natural Resources is to offer the best State-owned agricultural lands to biofuel feedstock growers by direct negotiation rather than public auction;
2. The State is to give preference to locally-grown and processed biodiesel blends to fuel its diesel powered vehicles;
3. The Department of Agriculture, through its energy feedstock program (Section 141-9, HRS) is to purchase locally-grown biodiesel feedstock, biodiesel fuel, and blended diesel from producers and processors and determine what to do with it;
4. Excludes from taxable income the gains to owners of leasehold properties who sell for fee, and to processors for crushing oil seed; and
5. The counties are to exempt biofuel feedstock production from property taxes.

The Department of Agriculture believes these incentives are premature, and strongly recommends that they be reconsidered upon the completion of the comprehensive renewable biofuels planning framework presently being developed by the Department of Business, Economic Development, and Tourism (DBEDT), pursuant to Act 253 that was passed by the 2007 Legislature. In accordance with Act 253, DBEDT is undertaking a bioenergy master plan that will include a Hawaii renewable biofuels program to manage the State's transition to energy self-sufficiency based in part on biofuels for power generation and transportation. The components of the plan include establishing strategic partnerships for the research, development, testing, and deployment of renewable biofuels technologies and production of biomass crops; evaluation of Hawaii's potential to rely on biofuels as a significant renewable energy resource; supporting biofuels demonstration projects, including infrastructure for production, storage, and transportation of biofuels; promoting Hawaii's renewable biofuels resources to potential partners and investors for development in Hawaii as well as for export purposes; and developing a plan or roadmap to implement commercially viable biofuels development.

We also have concerns that the energy feedstock program wasn't funded and we cannot perform the tasks described in this bill without personnel.

Finally, we are concerned that this bill gives favorable treatment to biofuel production over food production on the best lands owned by the State. We believe they should be treated as equally important so the same consideration the board is authorized to give biofuels for nominal lease rents and by negotiation should also be afforded to food crops.

imperium renewables

Committee On Energy and Environment
Committee on Agriculture and Hawaiian Afairs

Hawaii State Senate
January 31, 2008

Senate Bill 3215 (in support with suggested amendment)

Chair Menor, Chair Tokuda and members of the Committees: my name is David Leonard and I am the chief operating officer of Imperium Renewables Hawaii LLC. Imperium Renewables is a leading producer of environmentally-friendly biodiesel fuel and operates the nation's largest biodiesel refinery in Washington State.

In Hawaii, Imperium has been making exciting progress in building a major biodiesel production facility at Kalaeloa Barbers Point Harbor. This facility will make a significant contribution to Hawaii's renewable, sustainable and independent energy future, and we are committed to utilizing local feedstock when and where it is feasible. To that end, we have already invested substantial time, effort and funds in research on algae and plants that may be suitable for production in Hawaii.

Imperium Renewables supports this bill but requests an amendment to the last paragraph of Section 4. The current language excludes oil seed crushing facilities that are integrated with a biodiesel production facility from a tax exemption provided to other functions associated with biodiesel production. This distinction is not consistent with current market models and may limit the progress of developing indigenous feedstock. We recommend that the last phrase in section 4 ("and may not be integrated with a biodiesel production facility") be deleted.

Biodiesel is a clean-burning alternative fuel made from oils derived from farm crops, and can be used in any conventional diesel engine. It can be used in pure form (100% biodiesel) or in a "blended" form, in which it replaces a percentage of petroleum diesel. A U.S. Department of Energy study determined that biodiesel reduces carbon dioxide emissions by more than 50%, compared to petroleum diesel. Imperium's high quality fuel meets or exceeds ASTM D-6751 specifications.

Thank you for the opportunity to testify.

Testimony before the Senate Committees on

Energy and Environment and Agriculture and Hawaiian Affairs

S.B.3215 – Relating to Biodiesel

Thursday, January 31, 2008
2:15 pm, Conference Room 414

By Arthur Seki
Director of Technology
Hawaiian Electric Company, Inc.

Chairs Menor and Tokuda, Vice Chairs Hooser and English, and Members of the Committees:

My name is Arthur Seki – I am the Director of Technology in the Energy Solutions & Technology Department at Hawaiian Electric Company. I am testifying on behalf of Hawaiian Electric Company (HECO) and its subsidiary utilities, Maui Electric Company (MECO) and Hawaii Electric Light Company (HELCO), hereby referred to collectively as the HECO Utilities.

We support S.B. 3215 that would provide incentives for biodiesel development in Hawaii.

As you may know, HECO Utilities are committed to exploring and using biofuels in its existing and planned generating units. The use of biofuels can reduce the State's dependence on imported oil and increase the amount of renewable energy from sustainable resources. This commitment by the HECO Utilities is demonstrated by the following initiatives:

- HECO's next power plant (100 MW) on Oahu (located at Campbell Industrial Park) will be 100% biofueled;

- MECO tested biodiesel in its diesel engines and combustion turbine at Maalaea power plant and will conduct further tests;
- HECO and MECO are partnering with BlueEarth Biofuels to build a 40 million gallon per year biodiesel production plant on Maui;
- HECO is developing test plans for a biofuel blend demonstration in a steam boiler generating unit on Oahu;
- HELCO will be testing biodiesel blends in a diesel engine on the Big Island;
- MECO will be testing glycerin (biodiesel by-product) in a Kahului steam boiler on Maui; and
- HECO is providing seed funding to the Hawaii Agriculture Research Center (HARC) and the agriculture departments at the University of Hawaii's Manoa and Hilo campuses to conduct biofuel crop research.

In conclusion, HECO Utilities support S.B. 3215 as a way to stimulate the development of locally produced biofuels.

Thank you for the opportunity to present this testimony.

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, Exclusion for oil seed crushing facility for biodiesel

BILL NUMBER: SB 3215; HB 3410 (Identical)

INTRODUCED BY: SB by Tsutsui and Hooser; HB by Carroll and Hanohano

STAFF COMMENTS: Amends HRS section 235-7 to exclude from state income taxation amounts derived from an oil seed crushing facility that processes oil seed produced or grown in the state for biodiesel production in the state.

Makes amendments to HRS section 141-9 that includes a provision that lands used for the production of biodiesel feedstock crops shall be exempted from the real property tax. This provision shall be applicable to tax years beginning on January 1, 2009 and repealed on December 31, 2018.

Makes other amendments relating to establishing incentives for the production of biodiesel in the state.

EFFECTIVE DATE: July 1, 2008

STAFF COMMENTS: This measure proposes various incentives to encourage the production of biodiesel in the state which include an income tax exclusion for an oil seed crushing facility which is used to produce the biomass necessary to produce biodiesel.

It should be noted that the use of the tax system to provide financial assistance in the form of an income tax exclusion is an inefficient use of the tax system. This exclusion amounts to nothing more than a subsidy as there is no obvious undue burden of taxes. If one project is blessed with a preferential tax treatment, why shouldn't the next proposal be just as serious a consideration? As such, project specific tax credit proposals violate the integrity of the tax system, setting a precedent with bad tax policy.

It should be remembered that giving tax breaks to one select group of taxpayers comes at the expense of all other taxpayers. As such, it is an insult to all other taxpayers that they are not deserving of such tax preferences. Rather than singling out a particular area for tax relief, concurrent efforts must be made to improve Hawaii's business climate to enhance the economic prospects for all businesses.

If lawmakers want to subsidize this specific project, then an appropriation of funds is far more accountable as taxpayers will then know who is to receive the subsidy, how much is being spent and then they can then judge whether or not this is an appropriate use of state taxpayer dollars.

While the measure also proposes that lands used for the production of biodiesel feedstock crops shall be exempted from the real property tax, this is a matter that has to be requested by the respective county governments as the real property taxation powers have been transferred to the respective counties.

Digested 1/30/08

ENE/AHW: In support of SB3215 - Relating to biodiesel

SB3215 - Relating to biodiesel
ENE/AHW hearing on January 31, 2008
2:15 p.m. in conference room 414

In support of SB3215 - Relating to biodiesel

Chair Menor, Vice Chair Hooser, Chair Tokuda, Vice Chair English and members of the committees:

I support SB3215. Hawaii needs to support local farmers and to give them the incentives to grow crops for biodiesel. This is not the biodiesel from palm oil in the tropics which destroy rainforests, leading to huge greenhouse gas emissions.

This is locally produced biodiesel which 1) provides a living for local farmers, 2) provides them with adequate incentives to grow crops that will become biodiesel, 3) keeps the money spent on this program in the state, and 4) decreases our dependence on imported oil.

Hawaii has many options to decrease the amount of oil we import. One of the smart options is growing locally produced biodiesel that does not destroy tropical rainforests. I believe we should avoid importing biodiesel, especially if it is produced from palm oil in tropical countries. That is a last resort.

Please pass SB3215. Support local farmers and local agriculture. Mahalo.

Randy Ching
Sierra Club, Oahu Group chair