# SB 147

NEIL ABERCROMBIE
GOVERNOR

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LT. GOVERNOR

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## SENATE COMMITTEES ON ECONOMIC DEVELOPMENT & TECHNOLOGY AND ENERGY & ENVIRONMENT

## TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING SB 147 RELATING TO BIOFUELS

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| **TESTIFIER:** | **FREDERICK D. PABLO, INTERIM DIRECTOR OF TAXATION (OR DESIGNEE)** |
| **COMMITTEE:** | **EDT-ENE** |
| **DATE:** | **FEBRUARY 2, 2011** |
| **TIME:** | **1:15PM** |
| **POSITION:** | **NO POSITION; CONCERNED WITH COSTS** |

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This measure creates a new biofuel production facilities tax credit.

The Department of Taxation (Department) defers to the Department of Business, Economic Development & Tourism on the technical and policy aspects of this measure; however **prefers the approach of SB 772**, which modifies the existing ethanol fuel facility tax credit.

This measure is anticipated to result in a revenue loss of about $200,000 in 2010; $2.7 million in 2011, 2012, and 2013; and $2.5 million in 2014. There is a potential loss of similar amounts for 2015 and 2016 due to construction of new facilities between then and now. The Department assumes construction costs per year are: $1.25 million in 2010; $17.75 million in 2011, 2012, and 2013; and $16.5 million in 2014.

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, Biofuel production facility tax credit

BILL NUMBER: SB 147; HB 791 (Identical)

INTRODUCED BY: SB by Dela Cruz, Fukunaga, Galuteria, Kouchi, Nishihara, Tsutsui, Wakai and 1 Democrat; HB by Say

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow a taxpayer to claim a biofuel production facility income tax credit of 15% of the qualified development and construction costs of the facility. To qualify for the credit, a facility shall: (1) be located in the state and use locally grown feedstock for at least 75% of its production output; (2) meet the definition of a qualified biofuel production facility; (3) have a production capacity of at least 10 million gallons; (4) have qualified development and construction costs totaling at least $10 million; and (5) be in production on or before January 1, 2017. The total credits claimed per qualified biofuel facility shall not exceed $60 million.

Requires the taxpayer to first prequalify for the credit by registering with the department of business, economic development, and tourism (DBEDT) during the development or construction stage. Failure to comply with this provision may constitute a waiver of the right to claim the credit. Requires every taxpayer claiming the credit to submit a written, sworn statement to DBEDT no later than 90 days following the end of a tax year.

Every taxpayer claiming the credit must submit a written statement to DBEDT within 90 days of the close of the tax year, of the qualified costs, amount of tax credits claimed and the number of hires related to the development or construction of the facility in a taxable year. Requires DBEDT to maintain records of the taxpayers claiming the credit, obtain and total the aggregate amount of the construction costs for each facility and provide a letter to the director of taxation delineating the amount of tax credit for each facility and the cumulative amount claimed for all years.

In the case of a partnership, S corporation, estate, or trust, the tax credit allowable shall be for qualified production costs incurred by the entity with the cost upon which the tax credit is computed shall be at the entity level. Distribution and share of the tax credit shall be determined by rule adopted by the director of taxation. If a deduction is taken under section 179 (with respect to election to expense depreciable business assets) of the Internal Revenue Code, no tax credit shall be allowed for those costs for which the deduction is taken. The basis for eligible property for depreciation of accelerated cost recovery system purposes for state income taxes shall be reduced by the amount of credit allowable and claimed.

Credits in excess of tax liability shall be refunded provided such amounts are in excess of $1. Requires all claims for the credit to be filed before the end of the twelfth month following the tax year. The director of taxation shall prepare forms as may be necessary to claim the credit and may adopt rules pursuant to chapter 91.

Defines "qualified biofuel production facility" and "qualified development and construction cost" for purposes of the measure.

The credit shall be applicable to qualified development and construction costs incurred on or after July 1, 2010 and before January 1, 2017. Repeals this credit on January 1, 2017 provided that any qualified cost incurred before January 1, 2017 shall be eligible for the credit in the immediately following tax year if not claimed in a prior taxable year or before the repeal date of this act.

EFFECTIVE DATE: July 1, 2011; applicable to tax year beginning after December 31, 2010

STAFF COMMENTS: The legislature by Act 289, SLH 2000, established an investment tax credit to encourage the construction of an ethanol production facility in the state. The legislature by Act 140, SLH 2004, changed the credit from an investment tax credit to a facility tax credit. This measure proposes a similar credit for the production of biofuels.

While it has been almost ten years since the credit for the construction of an ethanol plant in Hawaii was enacted and ground has not broken yet, it appears that there are other far more efficient biofuels that could be developed and, therefore, the existing credit, which is specific to ethanol, might not be available to assist in the development of these other types of fuels.

While the idea of providing a tax credit to encourage such activities may have been acceptable a few years ago when the economy was on a roll and advocates could point to credits like those to encourage construction and renovation activities, what lawmakers and administrators have learned in these past few months is that unbridled tax incentives, where there is no accountability or limits on how much in credits can be claimed, are indeed irresponsible as the cost of these credits go far beyond what was ever contemplated.

As an alternative, lawmakers should consider repealing the existing ethanol facility tax credit and utilize other strategies to encourage the development and use of alternate energy resources such as a loan program or the issuance of special revenue bonds for this purpose or perhaps even a specific appropriation of taxpayer dollars. At least lawmakers would have a better idea of what is being funded and hold the developers of these alternate forms of energy to a deliberate timetable or else lose the funds altogether. A direct appropriation would be preferable to a tax credit as it would provide some accountability for the taxpayers' funds being utilized to support this effort.

Finally, this proposal verifies what has been said all along about legislators latching onto the fad of the month without doing very serious research. While ethanol was the panacea of yesterday, lawmakers have learned that there are more down sides to the use of ethanol than there are pluses. Ethanol production demands more energy to produce than using a traditional petroleum product to produce the same amount of energy and the feedstock that is used to produce ethanol basically redirects demand for that feedstock away from traditional uses, causing those other products to substantially increase in price. Even algae, which was once thought of as a great alternative fuel, has been reported to consume more energy and resources than the energy that is produced from the substance. Lawmakers have a wealth of resource information at their finger tips through the Hawaii Natural Energy Institute upon which to draw and learn more about cutting edge research in this area.

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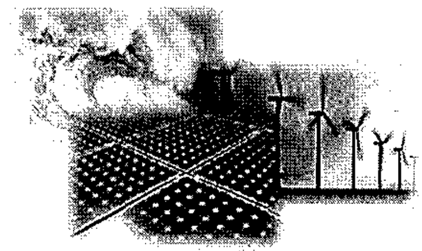
blue planet FOUNDATION



**SENATE COMMITTEE ON ENERGY AND ENVIRONMENT**
**SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY**
February 2, 2011, 1:30 P.M.
Room 016
**(Testimony is 1 page long)**

**TESTIMONY IN SUPPORT OF SB 147**

Chairs Gabbard and Fukunaga and members of the Committees:

The Blue Planet Foundation supports SB 147, a measure that creates an income tax credit for development and construction costs for qualifying biofuel production facilities. This policy will provide greater support for Hawaii's diverse biofuel production infrastructure.

Biofuels will likely play a major role in Hawaii's clean energy future—particularly as a substitute for petroleum-based transportation fuels. Transportation fuels in Hawai`i can be made from renewable resources, such as biomass in various forms, algae, and waste products. These materials are neither as scarce nor as expensive as crude oil. Even more importantly, these materials are available here. Hawai'i should set a clear course for a steady, incremental transition to renewable fuels including local and sustainable biofuels.

Thank you for the opportunity to testify.

**Jeff Mikulina, executive director • jeff@blueplanetfoundation.org**
55 Merchant Street 17th Floor • Honolulu, Hawai'i 96813 • 808-954-6142 • blueplanetfoundation.org

AINA KOA PONO
Topa Financial Center, 745 Fort Street Mall, Suite 1603, Honolulu, HI 96813

BEFORE THE SENATE COMMITTEES ON
ECONOMIC DEVELOPMENT & TECHNOLOGY
AND
ENERGY & ENVIROMENT

**SENATE BILL 147 RELATING TO BIOFUELS**

Testimony of
CHRIS ELDRIDGE
Partner
Aina Koa Pono, LLC

February 2, 2011
1:30 pm, State Capitol Room 016

Chair Fukunaga, Chair Gabbard, and members of the Joint Committee:

Thank you for the opportunity to testify on SB 147, the Biofuel Production Facility Tax Credit which provides for a 15% tax credit for agriculturally based biofuel production facilities built in Hawaii. Aina Koa Pono **STRONGLY SUPPORTS** this legislation.

Hawaii depends on over 90% of its energy needs on imported fuel. The impact on Hawaii with rising oil prices as well as the availability of fuel would be more severe here than on other states in the Union. Recent pronouncements by John Hofmeister, past president of Shell Oil company, that gasoline prices will be $5 per gallon in 2012 if true would have devastating impact on our state. Maui already has $4 gasoline. Hofmeister's prediction was based on mainland pricing of gasoline which is currently about $3 per gallon. This projects to greater than $6 per gallon on Maui. What will this do to Hawaii's economy? BP has recently projected that the world demand for oil will increase by 40% by 2030 because of the increasing demand for oil by India and China. This also portends for higher prices as well a potential shortages of liquid fuel.

Hawaii cannot stand by waiting for the impact of either higher pricing or shortages. We need to do something now. If we have the will and determination, we can protect our State from these impacts. Because of the demise of the pineapple and sugar industries in Hawaii, we have large agricultural lands which have been laying fallow for many years. We need to get these lands back into productive use for both food and energy. But we must have the will and the foresight to provide the incentives needed for this to occur.

Building agriculturally based biofuel refineries in Hawaii has the potential to reinvigorate Hawaii's struggling agriculture industry while also helping to meet the renewable energy goals of Hawaii's Clean Energy Initiative. This initiative aims to reduce Hawaii's reliance on petroleum fuels by 40% by 2030. We cannot get this accomplished unless we provide incentives for the private sector to invest in these projects.

For a relatively modest 15% incentive, the private sector will invest an additional85% of private capital to build these plants. This will potentially help the Hawaiian economy in the following ways. The construction of biofuel production facilities is an investment in Hawaii's workforce that will pay dividends with the training, employment and development of skilled local workers. It has been projected that eleven jobs will be created for every $1,000,000 spent on construction in the State. Economic projections also indicate that for every $1 spent on the project at least 2 to 3 times that expenditure will be created in ancillary jobs created by the activity. In addition, because the incentive is for agriculturally related biofuel plants, numerous jobs will be created in the agricultural sector for growing the biofuel in addition to the jobs to run the biofuel plant. Our projection for the plant that we will build in Ka'u will create at least 300 construction related jobs for a period of two years plus an additional 150 to 200 jobs for the 20 to 30 years that the plant will be operational. If this were replicated 10 times, 3000 jobs would be created in the construction industry and 1500 to 2000 permanent jobs would be created in running the biofuel plant. Our belief is that if we want Hawaii to have an economic renaissance in the short term, these type projects are the only ones that have the potential of doing this in the short term. All other major potential development projects will not have an impact for at least 5 to 10 years from now.

In that regard, because of the job creation, tax revenues will increase. Also we understand the economic circumstances of Hawaii including the budget shortfalls. In order to mitigate that we would suggest that the bill be amended to say that the payments would be paid 60 days after the plant becomes operational. This will do two things: (1) assure that the payments will occur after the next two year budget cycle, i.e, 2014 or beyond; (2) will assure that payments will not be made unless the plant becomes operational.

We cannot emphasize enough the need for these incentives to attract private capital to invest in these projects for Hawaii. We have found that because of the lack of commercial biofuel projects already constructed, that private capital is reluctant to invest in these type plants. This legislation will assist greatly in attracting private capital to Hawaii so we can become energy self sufficient.

Thank you very much for allowing me to provide you my views of this Legislation.

Wednesday, Feb. 2, 2011
1:30 PM, Conference Room 016

COMMITTEES ON Economic Dev. & Technology and Energy and Environment
Senator Carol Fukunaga, Chair
Senator Mike Gabbard, Chair

**In support of SB 147, Relating to Biofuels**

Testimony of Pacific Biodiesel

Pacific Biodiesel, Inc. is the oldest biodiesel production company in the U.S., in continuous operation since its first plant was constructed on Maui in 1996. Having opened America's very first retail biodiesel pump and developed proprietary technology, we have built a solid reputation as a leading pioneer in the biodiesel industry. Pacific Biodiesel owns and operates two biodiesel plants in Hawaii, employs at least 30 residents and is currently developing a new, state-of-the-art, zero-waste biodiesel facility on the Big Island.

Pacific Biodiesel strongly supports SB 147, with the following change in the interest of sustainability.

**We respectfully propose the following amendments to improve this bill:**

1. The specification for feedstock be changed to "locally <u>sourced</u> feedstock", on page 4
2. Eliminate or lower (by at least half) the minimum gallons per year, page 6

The included language limiting qualifying facilities to production capacities of at least 10 million gallons per year discourages the construction of multiple sustainably-scaled facilities, providing a diverse and flexible biofuel production network within the state. Also, referring to "minimum gallons per year" seems to pose a difficulty with the inclusion of gaseous fuels.

3. Clarification on page 6: did the author mean to say "if the project <u>is</u> capitalized and not expensed"? If so, you need to eliminate the word "not" before "capitalized".

Pacific Biodiesel urges the passage of SB 147, with changes which will allow more sustainable biofuel businesses to develop, propelling the state forward towards energy independence and encouraging jobs and economic growth through locally owned businesses. Companies such as Pacific Biodiesel can lead the State of Hawaii forward towards energy independence, new job creation and economic growth through locally owned businesses.

Thank you for the opportunity to testify,

Kelly King, Vice President
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**SB 147**

**RELATING TO BIOFUELS**

**JOEL K. MATSUNAGA**
**CHIEF OPERATING OFFICER & EXECUTIVE VP**
**HAWAII BIOENERGY**

**FEBRUARY 2, 2011**

Chairs Gabbard and Fukunaga and Members of the Senate Committees on Energy and Environment and Economic Development and Technology:

I am Joel Matsunaga, testifying on behalf of Hawaii BioEnergy on SB 147, "Relating to Biofuels."

## SUMMARY

Hawaii BioEnergy ("HBE") supports SB147, which creates an income tax credit for development and construction costs for qualifying biofuel production facilities.

## HAWAII BENEFITS FROM LOCAL BIOFUELS PRODUCTION

Hawaii BioEnergy is a local company dedicated to strengthening the state's energy future through sustainable biofuel production from locally grown feedstocks. Among its partners are three of the larger land owners in Hawaii. HBE and its partners would like to use significant portions of their land to address Hawaii's existing and growing energy needs.

One of the biofuel alternatives that HBE is pursuing is the production of jet fuel and other oil derivatives from micro-algae, and is already engaged in Phase II of a Hawaii-based, DARPA-funded algae project. Along with providing a local, renewable, and lower-carbon fuel source, expanded algae-based biofuel production will benefit the agriculture industry by providing a local source of protein for animal feed, fertilizers and other products. In addition to HBE's on-going algae-based biofuel projects, the company is moving forward with plans to develop locally produced high density fuels from sweet sorghum, eucalyptus and/or other dedicated energy crops. The feedstocks and conversion production pathways under consideration hold tremendous potential to displace fossil fuel imports given their relatively low input requirements, exceptionally high yields, and capacity to produce a portfolio of products including liquid fuels for transport and power generation while contributing feed, and other bio-based co-products to the local market.

In addition to the clear environmental and energy security benefits that local production would bring to bear, fostering Hawaii's biofuel industry would also provide needed economic stimulus to the state through direct investment, job creation, and demand for goods and services. Based on an independent analysis commissioned by HBE, it's projected that a large-scale agricultural operation coupled with biofuels facility could provide up to 1,400 new direct, indirect and induced jobs, over $115 million in value added or new wealth, and over $17 million in annual tax revenue from combined indirect business and personal income taxes. Such benefits could be multiplied through additional investments in large-scale biofuels facilities supported through an income tax credit for development and construction costs.

While the environmental, energy security and economic benefits are clear, the state's ability to secure the substantial capital required for large-scale commercial facilities requires providing a degree of assurance to private investors that they will be able to recover their investment within a reasonable time horizon. Providing an income tax credit for the development and construction costs of biofuels facilities would help to offset the upfront capital costs that have, among other factors, inhibited the state's biofuels industry from getting off of the ground. The credit would also be partially offset from the additional business and income tax revenue generated by the industry.

## CONCLUDING REMARKS

HBE is moving forward with projects that will help to address Hawaii's energy future and believes that SB 147 will help to accelerate investment in Hawaii's bio-based economy. Based on the aforementioned, Hawaii BioEnergy respectfully requests your support for SB 147.

Thank you for the opportunity to testify.