

SB 781

Measure Title: RELATING TO PUBLIC UTILITIES.

Report Title: Public Utilities; Tax Credits; Undergrounding

Description: Creates a tax credit for electric utilities for undergrounding utility lines.

Companion:

Package: None

Current Referral: CPN, WAM

Testimony before the Senate Committee on Commerce and Consumer Protection

**By Rouen Liu
Permit Engineer, Engineering Department
Hawaiian Electric Company, Inc.**

**February 4, 2011
9:00 am**

**Senate Bill 781
Relating to Public Utilities**

Chair Baker, Vice Chair Taniguchi and Members of the Committee:

My name is Rouen Liu and I am testifying on behalf of the Hawaiian Electric Company and its subsidiaries, Hawaii Electric Light Company and Maui Electric Company.

Position:

We are in favor of undergrounding utility lines but oppose SB781 which proposes a tax credit for the electric utilities for the undergrounding of new facilities or the conversion of existing overhead lines to underground.

Comments:

- We question why this bill targets only electric utility lines. When installing new lines or converting existing overhead lines to underground, all utilities should be considered including telecommunications, cable television and street light utility lines.
- We appreciate the intent of providing a "financial incentive" to underground utility lines by creating a tax credit to do so. However, there are problems with the proposed tax credit. First, it does not appear to be good tax policy. The entire burden is placed on the current generation of tax payers versus spreading the burden over several generations who would also benefit from the undergrounding. Secondly, it requires the Public Utilities Commission to "verify" all qualified costs. The process of how this will be accomplished is not clear and

would place an additional burden on the PUC. Finally, it would not incentivize HECO because a tax credit is not the reason HECO would decide to underground. There are several reasons when HECO would consider undergrounding per Rule 13 of our tariffs.

- Because of the high costs, we believe that undergrounding utility lines should be cost-shared and funded by multiple sources, such as the federal government, state, counties, utilities, and those neighborhoods who benefit. The 2003 report by the American Institute of Architects Honolulu Chapter on "Oahu Utilities Under-grounding and Visual Mitigation Studies" provides overall estimated costs for undergrounding and funding mechanisms.

Thank you for the opportunity to testify on this matter.

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126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Underground electric facility tax credit

BILL NUMBER: SB 781; HB 54 (Identical)

INTRODUCED BY: SB by Ige; HB by Takai, Awana, Belatti, Brower, Hanohano, Ito, Keith-Agaran, Manahan, Marumoto, McKelvey, Mizuno, Nishimoto, B. Oshiro, Pine, 3 Democrats and 1 Republican

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers subject to HRS chapters 235, 237, 237D, 238, 239, 241, or 431 to claim a tax credit for qualified costs in the planning, design, and construction of new electric facilities to be placed underground; or the costs necessary to convert existing electric utilities for placement underground. The tax credit may be claimed for tax years beginning after 12/31/13 and be deductible from the taxpayer's net income tax liability and, at the election of the taxpayer, from the tax liability imposed by HRS chapters 237, 237D, 238, 239, 241, or 431.

Stipulates that the tax credit earned shall be equal to the qualified costs incurred from 6/1/12 through 5/31/17, up to a maximum of \$75 million of credits in the aggregate for all qualified taxpayers for all years. The amount of tax credits earned and used in any year shall be limited to a maximum of \$15 million in the aggregate for all qualified taxpayers provided that the credits in excess of a taxpayer's tax liability for any year for which the credit is taken may be applied to subsequent years until exhausted; provided that the taxpayer may continue to claim the credit provided in this section if the qualified costs are incurred before 6/1/17.

Requires the director of taxation to prepare the necessary forms to claim the credit, requires the taxpayer to furnish information to validate a claim for the credit, and adopts rules pursuant to HRS chapter 91. Claims, including any amended claims, are to be filed on or before the end of the twelfth month following the taxable year for which the credit may be claimed.

Provides for the recapture of the credit if the tax credit no longer meets the definition of qualified costs during the five-year period in which the credits are earned. Requires the taxpayer to submit a statement by March 31 to the public utilities commission (PUC), identifying: (1) qualified costs made in the previous taxable year; (2) the amount of tax credits claimed in the previous taxable year; and (3) the tax liability under HRS chapters 235, 237, 237D, 238, 239, 241, and 431 against which the tax credits are claimed. Requires the PUC to maintain records of the taxpayers eligible for the credits and the total amount of qualified costs incurred from 6/1/12 to 5/31/17. Requires the PUC to verify all qualified costs and issue a certificate to the taxpayer that shall be filed with the department of taxation and shall not certify more than \$15 million in tax credits in the aggregate for all taxpayers for each taxable year provided the department shall not verify more than \$75 million in costs from 6/1/12 to 5/31/17.

Defines "electric utility facility," "qualified costs" and "qualified taxpayer" for purposes of the measure.

Makes a conforming amendment to HRS section 235-2.45.

EFFECTIVE DATE: Upon approval; applicable to qualified costs incurred after May 31, 2012

STAFF COMMENTS: This measure proposes a tax credit of up to \$75 million for qualified costs in the planning, design, construction: (1) of new electric facilities to be placed underground; or (2) necessary to convert existing electric utilities for placement underground. The credit would be equal to the costs incurred provided no more than \$15 million a year in qualified costs may be claimed. Thus, the maximum amount of the credit would have to be claimed over a period of five years. Apparently the sponsor of the proposal believes that the credit would entice taxpayers to undertake the undergrounding of utility lines. More than likely the taxpayer would be any of the utilities - telephone or electric - which currently string lines overhead. This proposal, no doubt, is driven by the continual downing of utility lines along the Leeward Coast although the proposal is not geographic specific as to the qualified costs eligible for the proposed credits.

Although the proposed credit may be viewed as a means of encouraging the utilities to begin undergrounding utility lines, there are many other considerations to undertaking this kind of project, not the least of which is the cost of and availability of the capital. Further, the proposal does not in any way take into account just how much either the annual or aggregate credit represents as a percentage of the total cost of undertaking the project. While one might not think that \$75 million would be enough to underground say all of the overhead wiring on the Leeward Coast, the taxpayer could pace the work such that only \$15 million in work or qualified costs is accomplished each year for the next five years. On the other hand, if \$75 million represents a fraction of the total cost of the project, it may be insufficient to be enough of an incentive to attract taxpayers to engage in such a project when capital may not be available in the current capital markets.

However, what is important to note here is that the \$75 million tax credit proposed in this bill represents an expenditure of taxpayer dollars and, as such, should be subject to the scrutiny of the appropriation process. By expending these funds out the back door, so to speak, once the credit is approved, there will be no oversight as to the amount of qualified costs incurred in any one year and the pace at which the work is completed. Furthermore, there will be no evaluation as to the efficiency and effectiveness of the funds expended which will qualify for the credit. Perhaps the most onerous aspect is that it will place the entire burden of the \$75 million in tax credits on this generation of taxpayers when the object of the qualified expenditure is the undergrounding of utility lines that will not only serve the current generation of taxpayers but several more generations down the line. This is because it is a large capital improvement that hopefully will serve utility customers and motorists for years well beyond the five years of the credit.

It is for this reason that large capital improvements of public infrastructure are usually financed with the use of debt, the issuance of state bonds for which the term of repayment will span 20 to 30 years. Thus, the beneficiaries of the capital improvement will share in the payment for the capital improvement over the life of the infrastructure. The tax credit proposed in this measure is merely another means of paying cash for capital improvements. There are a variety of debt instruments that could be employed. Because the undergrounding improvements would technically be property of a private company serving a public purpose, special purpose revenue bonds might be the appropriate instrument. If, on the other hand, public policymakers believe all taxpayers should participate in the payment as the convenience and safety of having those utility lines underground would benefit the population as a whole, consideration

might be given to general obligation bonds or if lawmakers see the undergrounding of the utility lines as benefitting motorists, consideration might be given to utilizing highway reimbursable general obligation bonds. In any case, the cost of the project could then be spread over a number of generations of beneficiaries.

No doubt the proposed credit would be welcomed by the utilities who share those overhead power lines as the cost of undergrounding the lines would have to be borne by their customers, but in the larger sense after experiencing the downing of the power lines on the Leeward Coast, the benefit of undergrounding the power lines goes far beyond the customers of the utilities. The benefit also extends far beyond the residents of the Leeward Coast when one thinks of the workers that must commute from that area of the island and their employers who depend on that population for their labor force. Thus, it is recommended that instead of a tax credit, other means of public participation be considered that would spread the cost out over not only the current rate payers but all taxpayers, both current and future, who will benefit from this capital improvement.

Consideration might also be given to issuing public debt that would be guaranteed by the utilities who sign on to guarantee the repayment of the debt or a portion thereof. Should any other private company wish to utilize the convenience of the underground system such as cable companies or fiber optic transmitters who are not original guarantors of the debt, a pricing differential could be imposed for the use of the underground facility.

Note well that there are some technical difficulties, if not oversights. For example, in order to qualify, costs incurred include equipment that is permanently affixed to a building or structure. It is unknown if this requirement would be met in the undergrounding of utility lines. The requirement, no doubt, is a carryover from the requirements of the capital goods excise tax credit which has its genesis in the federal investment tax credit. This also raises the question of the interaction of the proposed credit and the capital goods excise tax credit. Under the proposal, if the credit is claimed under this section of the law, no other credit under the income tax law may be claimed. Thus, if the claimant applies for the proposed credit, the application for the capital goods excise tax credit which is designed to offset the 4% (4.5%) general excise/use tax imposed on the purchase of capital equipment could not be claimed.

Finally, unlike other credits for equipment or goods, such as the renewable energy credits, there is no provision in the proposal calling for the equipment to be placed in service before the credit can be claimed. There is no specification in the definition of qualified costs that the construction or equipment must be placed in service in order to qualify for the credit nor is there any such provision in the recapture provisions of the credit. Not that it is an alternative, but one must raise the question what are the consequences if the construction commences and the equipment is built and perhaps installed but for some reason never placed in service?

While not readily apparent, these comments have focused on the Leeward Coast as being the impetus for this proposal. However, because the credit does not specify a geographic location, the taxpayer may choose to undertake such a project on another part of Oahu or for that matter on the Neighbor Islands.

With the appropriation of funds, be it cash or debt, lawmakers and utilities can outline the scope of the project, put an estimated cost on the table and inform taxpayers what kind of public participation is being offered to undertake the project. Utilizing the tax system for the proposed purpose is an inefficient means of accomplishing the proposed goals of this measure.

Note well that a study conducted several years ago found that the cost to underground utility lines was substantially more than the \$75 million proposed in this bill. By comparison to the estimate of that study, the \$75 million is a mere drop in the proverbial bucket. Further, it should also be noted that undergrounding utility lines along the Leeward Coast would not be feasible as any effort would hit the shallow water table along that coast.

Digested 2/3/11