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To: The Honorable Chris Lee, Chair
and Members of the House Committee on Energy and Environmental Protection

The Honorable Della Au Belatti, Chair
and Members of the House Committee on Health

Date: Tuesday, February 16, 2016
Time: 8:35 A.M.
Place: Conference Room 325, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 1983, Relating to Cesspools.

The Department of Taxation (Department) appreciates the intent of H.B. 1983, defers to the Department of Health (DOH) on the merits of this bill, and provides the following comments regarding this measure for your consideration.

H.B. 1983 authorizes that DOH to establish a cesspool upgrade, conversion, or connection rebate program of up to \$10,000 per cesspool, provided that the family's income is an unstated percentage of the federal poverty level, disallows the tax credit for cesspool upgrade, conversion, or connection for taxpayers whose adjusted gross income exceeds certain amounts and applies the rebate program and the tax credit program to all cesspools, regardless of location. It also provides that cesspools found to be illegal, as a result of an inspection conducted due to a person applying for a rebate or taxpayer claiming a credit, shall not be subject to any penalty that under chapters 321, 322, 342D, or 342E, Hawaii Revised Statutes (HRS). The measure is effective upon approval and applies to taxable years ending after December 31, 2015.

First, the Department notes that it firmly believes that a rebate system is far preferable than a tax credit for assisting low income taxpayers because it enables a low income household to obtain funds sooner than waiting for the end of a tax year before filing a claim for tax refund.

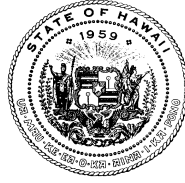
Second, in regards to the Rebate program being considered under this measure, the Department recommends that a definition of "wastewater" be added and which is the same definition used in the tax credit provision defining "wastewater" since both the rebate program and the tax credit program cover the same subject matter.

Third, it is not clear whether the “adjusted gross income” (AGI) to be used in determining the income qualification is the federal AGI or the State AGI. Because the State does not tax various income sources, including Social Security benefits, certain military pay, and pension payments where the taxpayer did not contribute to the retirement fund, the Department believes that the federal AGI more accurately reflects the ability of a taxpayer to afford a cesspool upgrade, conversion, or connection without the need for a tax credit, and requests that it be so clarified.

Fourth, the Department notes that this measure deletes the requirement that the DOH certify the cesspool upgrade, conversion, or connection as being eligible for the tax credit. The Department has no expertise in cesspools, septic systems, or aerobic treatment unit systems, and would not know if a conversion or connection met the requirements as set forth in the section 235-16.5, HRS. The Department strongly requests that the requirement that DOH certify all taxpayer claims for the credit be retained, and that the credit continue to be available only after the DOH and such county agency in charge of issuing the requisite permits has approved the installation. Without this certification requirement the aggregate cap on the tax credit cannot be administered.

Finally, the Department notes that both the rebate and the tax credit are available for the same cesspool. As such, the taxpayer would be eligible for a double benefit for the same upgrade, conversion or connection.

Thank you for the opportunity to provide comments.



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**Testimony COMMENTING on HB1983
RELATING TO CESSPOOLS**

REPRESENTATIVE CHRIS LEE, CHAIR
HOUSE COMMITTEE ON ENERGY & ENVIRONMENTAL PROTECTION

REPRESENTATIVE DELLA AU BELATTI, CHAIR
HOUSE COMMITTEE ON HEALTH

Hearing Date: February 16, 2016
Time: 8:35 AM

Room Number: 325

- 1 **Fiscal Implications:** This measure does not provide the resources necessary to implement the
- 2 rebate program.

- 3 **Department Testimony:** The Department appreciates the intent of this bill to establish a rebate
- 4 program to offset qualified expenses incurred by low-income households that perform a cesspool
- 5 upgrade, conversion, or connection to a sewer system. However, the Department does not have
- 6 the resources or expertise to implement a rebate program as defined in the bill.

- 7 Also, the Department opposes to the striking of the definition of “qualified cesspools” under
- 8 Section 235-16.5, Hawaii Revised Statutes (HRS). Cesspools that are located near surface
- 9 waters and drinking water sources pose a greater risk to human health and the environment than
- 10 cesspools that are not located near any of these water sources.

- 11 The Department defers to the Department of Taxation and the Governor’s Executive Budget to
- 12 address the fiscal implications that would be involved with the implementation of the rebate
- 13 program.

- 14 Thank you for the opportunity to testify on this measure.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: INCOME, Disallow Cesspool Tax Credit for High Income Taxpayers

BILL NUMBER: HB 1983

INTRODUCED BY: EVANS, HASHEM, ICHIYAMA

EXECUTIVE SUMMARY: Disallows the tax credit for cesspool upgrade, conversion, or connection for taxpayers whose adjusted gross income exceeds certain amounts. Applies tax credit to all cesspools, regardless of location. Amendments should be considered to address various issues with the bill as written, including retroactivity.

BRIEF SUMMARY: Adds a new section to HRS chapter 342D providing that the department of health may establish a cesspool upgrade, conversion, or connection rebate program to offset qualified expenses incurred by low-income households. Eligibility will be restricted to persons whose family income is no more than ___% of the federal poverty level. The dollar amount of a rebate is not to exceed \$10,000 per cesspool.

Amends HRS section 235-16.5(e) to provide that if the taxpayer has received a rebate from the rebate program described above, 50% of the rebate received will be deducted from the amount of credit the taxpayer may claim.

Amends HRS section 235-16.5 to add a new subsection (i) providing that the tax credit shall not be available to a single taxpayer or a married taxpayer filing separately with AGI of \$300,000 or more; head of household with AGI of \$450,000 or more; or married filing jointly or surviving spouse with AGI of \$600,000 or more.

Amends HRS section 235-16.5 to add a new subsection (j) providing that any cesspool found to be in noncompliance with chapter 321, 322, 342D, or 342E, or rules adopted thereunder, as a result of any inspection or other action conducted by state or county personnel pursuant to a taxpayer claiming a credit under this section, shall not be subject to any penalty imposed by those chapters or rules. The same provision appears in subsection (e) of the new section in chapter 342D.

Amends HRS section 235-16.5 to delete the definition of “qualified cesspool,” which is currently defined as one within 200 feet of a shoreline, perennial stream, or wetland; a source water assessment program area; or a residential large capacity cesspool. Makes conforming amendments to the text of the tax credit provisions.

EFFECTIVE DATE: Upon approval, except that the rebate program is repealed on December 31, 2020, and the income tax credit changes apply to taxable years beginning after to December 31, 2015.

STAFF COMMENTS: Act 120, SLH 2015, enacted a temporary income tax credit, expiring on December 31, 2020, for 100% of the qualified costs of a cesspool upgrade, conversion, or connection, up to \$10,000. The recitals in the Act explain the problem addressed:

The legislature finds that the State's streams, groundwater, and ocean are being harmed by water pollution from nonpoint contamination sources that flow off the land directly, rather than through pipes or ditches. Cesspools constitute a nonpoint contamination source of grave concern. These substandard systems are essentially holes in the ground that discharge raw, untreated sewage. Groundwater, drinking water sources, streams, and the ocean are contaminated by cesspool pollution from systems that do not treat wastewater, but merely dispose of it.

The legislature further finds that cesspools in Hawaii release approximately 55,000,000 gallons of untreated sewage into the ground each day. There are approximately 90,000 cesspools in the State, with nearly 50,000 located on Hawaii island, approximately 14,000 on Kauai, over 12,000 on Maui, over 11,000 on Oahu, and over 1,400 on Molokai. Reducing the number of cesspools in the State is a matter of great importance. The legislature additionally finds that cesspools near drinking water wells or within two hundred feet of surface waters and cesspools that are connected to multiple residential dwellings present a higher risk of harm to public health and the environment and should be prioritized by the department of health for upgrade. The department of health indicates that there are approximately 6,860 cesspools in those priority locations.

Priority should be given to cesspool owners who request financial assistance to upgrade, convert, or connect cesspools that: affect public drinking water wells; are within two hundred feet of the shoreline, streams, or wetlands; or are connected to multiple residential dwellings.

As we noted at the time, this credit was given without any consideration of the taxpayer's need for tax relief. This bill now seeks to correct this, but does so in somewhat ham-fisted fashion with an all-or-nothing approach.

The legislature may want to consider the following if it is now concerned about the cost of the credit:

- Phasing in the disallowance, so the "tax cliff" effect upon taxpayers is mitigated.
- Changing the trigger to federal AGI rather than Hawaii AGI, as is used for other income level disallowance provisions. The reason for this is that there is no requirement for the taxpayer to be a resident, and a nonresident may have substantial income from sources outside Hawaii.
- Allowing for prospective application. A retroactive disallowance, which is possible under the bill as it is now written, would unfairly penalize taxpayers who have already contracted and paid for the work in reliance on the credit.

This bill also gives the department of health the ability to establish a rebate program. The way it is set up, however, allows users of the program to make a profit off the government. Here's how it works: The taxpayer incurs qualified expenses, let's say \$1,000. The taxpayer then applies for the rebate, which appears to be limited to the maximum of qualified expenses or \$10,000, so the taxpayer gets \$1,000. Then the taxpayer applies for the credit, which is 100% of qualified expenses minus half of the rebate, or \$500. So the taxpayer has paid \$1,000 and got \$1,500 back. What a deal! Rather, the amount of any rebate should be deducted in full from the credit, as is presently done under HRS section 235-12.5 (renewable energy tax credit) and similar provisions.

Finally, two different clauses in the bill say that any noncompliance with the public health provisions (chapter 321 relating to the department of health, 322 relating to nuisances and sanitary regulations, 342D relating to water pollution, and 342E relating to nonpoint source pollution management and control) shall not be subject to penalties. Which means a taxpayer wanting a credit for converting a cesspool can endanger public health and pollute our environment with impunity? At a minimum, the intent behind this provision needs to be ascertained to see if a more surgical approach is possible.

Digested 2/3/16