



STATE OF HAWAII
DEPARTMENT OF HEALTH
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**Testimony COMMENTING on HB1983 H. D. 1
RELATING TO CESSPOOLS**

SENATOR GLENN WAKAI, CHAIR
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT, ENVIRONMENT, AND
TECHNOLOGY

SENATOR ROSALYN H. BAKER, CHAIR
SENATE COMMITTEE ON COMMERCE, CONSUMER PROTECTION, AND HEALTH

Hearing Date: March 21, 2016
Time: 10:15 AM

Room Number: 229

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.

DAVID Y. IGE
GOVERNOR

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To: The Honorable Glenn Wakai, Chair
and Members of the Senate Committee on Economic Development, Environment,
and Technology

The Honorable Rosalyn H. Baker, Chair
and Members of the Senate Committee on Commerce, Consumer Protection, and
Health

Date: Monday, March 21, 2016
Time: 10:15 A.M.
Place: Conference Room 229, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 1983 H.D. 1, Relating to Cesspools.

The Department of Taxation (Department) appreciates the intent of H.B. 1983, H.D. 1, but has concerns regarding the provision that allows the Department of Health (DOH) to establish a tax credit program in addition to a rebate program and the provision that deletes the requirement that the DOH certify the tax credit claims. The Department defers to DOH on the merits of the balance of this bill, and provides the following comments regarding this measure, for your consideration.

H.B. 1983, H.D. 1, authorized 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 under chapters 321, 322, 342D, or 342E, Hawaii Revised Statutes (HRS). The House Committee on Energy and Environmental Protection and the House Committee on Health made various amendments to the measure, including:

- 1) Clarifying that the DOH is authorized to establish a cesspool upgrade, conversion, or connection tax credit or rebate program;

- 2) Deleting the provision that the DOH must evaluate the costs and benefits of a rebate program and determine that a rebate program serves the public interest before instituting a rebate program;
- 3) Establishing an unspecified date as the date before which a non-compliant cesspool will not be subject to penalty because the cesspool's owner applied for a rebate;
- 4) Specifying that a person cannot qualify for any other similar credit other than what is provided under the rebate program; and
- 5) Deleting the specific amounts of adjusted gross income above which taxpayers are ineligible to claim the tax credit.

The measure is effective upon approval and applies to taxable years ending after December 31, 2015, and the rebate program is repealed on December 31, 2020, which is the same date that the tax credit is set to be repealed.

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, rather than having to wait till the end of a tax year before filing a claim for tax refund.

Second, Section 1 of the measure provides in pertinent part that DOH "may establish a cesspool upgrade, conversion, or connection tax credit or rebate program". It is not clear whether the intent is to add a second tax credit program, since one already exists and is set forth in section 235-16.5, HRS. If there is no intent to create a second tax credit, the Department suggests that the phrase "tax credit or" be deleted from line 6 of page 1.

Third, with reference to the rebate program being considered under this measure, the Department recommends that a definition of "wastewater" be added; the definition should mirror the definition as used in the tax credit provision, since both the rebate program and the tax credit program cover the same subject matter.

Fourth, it is not clear whether the "adjusted gross income" (AGI) to be used in determining the income qualification for the tax credit is the federal AGI or the Hawaii AGI. In the absence of a specific mandate, the Hawaii AGI would normally control. However, 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, as well as income sources outside the State for non-residents, 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.

Fifth, 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 concerns with this deletion as it has no expertise in cesspools, septic systems, or aerobic treatment unit systems; therefore, the Department would not know if an upgrade, conversion, or connection meets 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 the county agency in charge of issuing the requisite permits has approved the installation. In addition, this certification requirement is necessary because the aggregate amount of the tax credit remains capped at \$5 million per year. The only way that the aggregate cap can be administered is through the implementation of the certification process managed by the DOH.

Sixth, while the rebate program sets an unspecified date for a homeowner to apply for a rebate for any cesspool which has been installed illegally and without proper approvals, the tax credit program has no such date. The Department suggests that the date by which a homeowner can obtain a tax credit without fear of the imposition of a penalty be the same as that used for the rebate program.

Finally, the Department notes that while it appears that the intent is that a taxpayer not receive both the benefit of a rebate and a tax credit for the same cesspool upgrade, conversion, or connection, the measure does not prevent it. While subsection (f) of the rebate program provides that a taxpayer may not qualify for any "similar" tax credit, the proposed section 235-16.5(e)(2), HRS, provides only that the tax credit is reduced by 50% of the amount received under the rebate program. Since the rebate program authorizes a rebate of up to \$10,000, up to \$5,000 of the same costs allowed for the rebate program would qualify as costs under the tax credit. As such, the taxpayer would be eligible for a double benefit for the same upgrade, conversion or connection. If this is not the intent of the measure, the Department recommends that the language be clarified by stating that if a rebate has been claimed, no tax credit can be claimed. This would make the tax credit consistent with subsection (f) of the rebate program.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

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

BILL NUMBER: HB 1983, HD-1

INTRODUCED BY: House Committees on Energy & Environmental Protection and Health

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.

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 \$_____ or more; head of household with AGI of \$_____ or more; or married filing jointly or surviving spouse with AGI of \$_____ 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 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? Apparently, the intent is to have people with cesspools come forward to have them fixed, even if they may now be noncompliant. A more surgical approach is possible, such as by giving the department of health the authority to waive penalties for those choosing to come forward to fix their problems. The following is offered as an alternative to proposed HRS section 235-16.5(j):

(j) The department of health shall, unless exceptional circumstances are present, waive penalties that otherwise would be imposed under chapter 321, 322, 342D, or 342E with regard to a cesspool being upgraded, converted, or connected and upon which a claim for credit under this section is based.

Digested 3/17/16