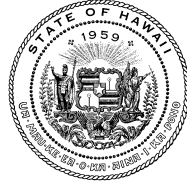


DAVID Y. IGE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
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MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

JOSEPH K. KIM
DEPUTY DIRECTOR

To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: February 26, 2016

Time: 1:00 P.M.

Place: Conference Room 308, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 2028, H.D. 1, Relating to Taxation.

The Department of Taxation (Department) appreciates the intent of H.B. 2028, H.D. 1, and offers the following comments regarding Sections 1 and 3 of the bill for your consideration.

H.B. 2028, H.D. 1, creates a general excise tax exemption for income received from certain public-private partnership contracts entered into with the Employee Retirement System (ERS), capped at an unspecified percentage of direct costs of construction and operation, which will be certified by ERS. The measure creates a similar exemption for income tax purposes. The measure has a defective effective date of July 1, 2050 and applies to taxable years beginning after December 31, 2015.

The Department appreciates the amendments made by the Committee on Water and Land and Committee on Energy and Environmental Protection, which had been suggested by the Department at the prior hearing. The Department proposes the following additional amendments.

First, the Department notes that as written, Section 3 confers a double benefit, as qualifying taxpayers will be able to exclude from income their costs from income under paragraph (15), and also take business deductions for those same costs. If it is not the intent to confer a double benefit, the Department suggests adding the following language to paragraph (15): "No taxpayer who excludes income under this paragraph shall claim any other credit or deduction for the same expenses or costs."

Second, the Department notes that this bill will require form modifications and computer system programming. Therefore, the Department requests that this bill apply to taxable years beginning after December 31, 2016.

Thank you for the opportunity to provide comments.

DAVID Y. IGE
GOVERNOR



THOMAS WILLIAMS
EXECUTIVE DIRECTOR

KANOE MARGOL
DEPUTY EXECUTIVE DIRECTOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

TESTIMONY BY THOMAS WILLIAMS
EXECUTIVE DIRECTOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII

TO THE HOUSE COMMITTEE FINANCE
ON

HOUSE BILL NO. 2028, H.D. 1

FEBRUARY 26, 2016, 1:00 P.M.

RELATING TO TAXATION

Chair Luke, Vice Chair Nishimoto and Members of the Committee,

H.B. 2028, H.D. 1 would permit the Employees' Retirement System (ERS) to invest in public-private partnerships to develop construction projects to implement clean energy technology or construction projects to improve the State's water supply with respect to this proposal.

As of the submittal of this testimony, the ERS Board of Trustees has not had the opportunity to review H.B. 2028, H.D. 1 and therefore has not taken a formal position on this proposal; however, the ERS staff has the following comments and concerns:

- H.B. 2028, H.D. 1 proposes to amend Section 88-119, Hawaii Revised Statutes, regarding ERS investments, by allowing the ERS to invest in a set of defined public-private partnerships. The amendment may not be necessary as ERS' investment policy already allows for these types of investments; and, in fact, the ERS staff and Board of Trustees encourages investment managers to seek out direct investments in Hawaii infrastructure (particularly "green" infrastructure) projects for inclusion in their portfolio or for the Board's consideration.



Employees' Retirement System
of the State of Hawaii

- ERS does not typically invest directly with partners in the construction or management of projects but does so through investment managers with the necessary skills and experience to evaluate, price and monitor such opportunities. In addition, the types of projects listed in the bill are under the authority of specific governmental agencies or departments. Therefore, the language in Sections 1 and 3 regarding certification by the ERS of the non-taxable costs should be amended to allow for certifications to be made by the ERS, its agent or another appropriate government entity. These types of investments, as with all investments, would be subject to our disciplined investment process and have to be evaluated according to the ERS' usual fiduciary standards.
- Though not mandated by this proposal, possible reporting requirements for these construction project partnerships to the Legislature or the Department of Taxation will further burden the ERS investment staff and its managers through added expense or diverting time that could otherwise be spent on supporting the funding of the ERS and reducing the ERS' \$8.8 billion unfunded liability.

On behalf of the Board of Trustees and staff of ERS we wish to thank you for the opportunity to testify.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, INCOME, USE, Exemptions/Credits for Clean Energy

BILL NUMBER: HB 2028, HD-1

INTRODUCED BY: House Committees on Water & Land and Energy & Environmental Protection

EXECUTIVE SUMMARY: Exempts personal income tax income and general excise tax income in an amount up to an unspecified percentage of the costs of construction and operation of projects entered into under a public-private partnership with the ERS to improve water infrastructure or water supply, or to promote clean energy. Authorizes ERS investments in such public-private partnerships. This strategy dodges procurement laws and budgeting, increases risk to ERS assets, and may even be prohibited by ERISA.

BRIEF SUMMARY: Adds a new section to HRS chapter 237 to establish a GET exemption for amounts received by a contractor not more than ___% of the direct costs of construction and operation incurred by a contractor under a public-private partnership with the employees' retirement system to develop a construction project to implement clean energy technology, as that term is defined in section 269-121(b), or a construction project to improve the State's water supply, including projects defined as a water facility under section 167-2 or section 174-2, a wastewater treatment plant under section 340B-1, or a public water system under section 340E-1; provided that the income shall be excluded from gross income for each year of the anticipated useful life of the construction project. Provides for certification by ERS of the creditable amount. Defines "direct costs of construction and operation" as the costs of materials, labor, equipment, and directly involved efforts or expenses for the completion and operation of a construction project, excluding all general overhead costs.

Adds a new paragraph to HRS section 235-7 to establish an income tax exemption for not more than ___% of the direct costs of construction and operation, as described above. Note that unlike the new section in HRS chapter 237, "direct costs of construction and operation" are not defined.

Amends HRS section 88-119 to allow ERS to invest in the public-private partnerships described above.

EFFECTIVE DATE: July 1, 2050; applies to taxable years beginning after December 31, 2015.

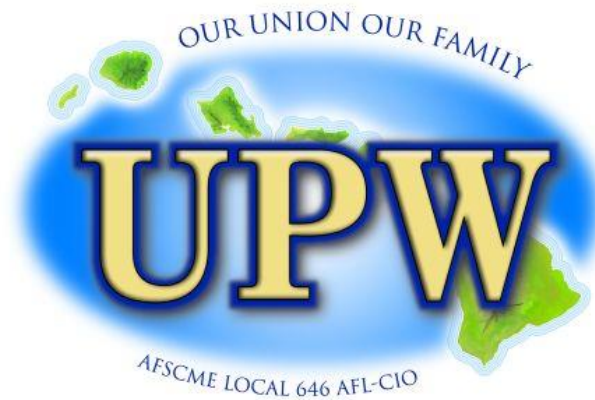
STAFF COMMENTS: Apparently the proponent of this bill is interested in construction projects that are intended to implement clean energy or improve the State's water supply, such as building water facilities or wastewater treatment plants. Apparently realizing the difficulty of having a state agency procure the projects, the bill proposes throwing tax exclusions at those who would build such projects, and would allow them to enter into a public-private partnership with the Employees' Retirement System and the sizable nest egg it is holding.

Doing that, however, is a perversion of the tax system, the procurement process, and the retirement system. The tax system is supposed to collect revenue for government, not build public works projects. And the money in ERS is to satisfy the obligations the State owes to its retired workers now and in the future. That system is actuarially underfunded right now by billions of dollars. Increasing risk to those assets is not prudent. Indeed, we may even be prohibited by ERISA from gambling with those funds, which is what this bill seems to be doing.

Some technical changes to consider if the Committee still wants to move the bill:

- As written, the exclusions apply independently of each other. Thus, allowing an exclusion “up to 2%,” for example, of a \$1 million investment in all three places would mean the taxpayer concerned could take a \$20,000 net income tax exclusion on top of a \$20,000 GET exclusion, for each year of the anticipated useful life of the construction project.
- Income exclusions do not themselves represent revenue loss, but only have value to the extent of other income and tax rate. For example, to a taxpayer making \$1 million in net income, a \$20,000 exclusion would be worth 8.25% of the excluded amount, or \$1,650. To a taxpayer sustaining a large amount of operating losses without other offsetting income, the same exclusion would be worth nothing. If the intent is to apply a fixed dollar incentive, a credit should be considered instead.

Digested 2/24/2016



THE HAWAII STATE HOUSE OF REPRESENTATIVES
The Twenty-Eighth Legislature
Regular Session of 2016

COMMITTEE ON FINANCE

The Honorable Sylvia J. Luke, Chair
The Honorable Scott Y. Nishimoto, Vice Chair

DATE OF HEARING: Friday, February 26, 2016
TIME OF HEARING: 1:00 p.m.
PLACE OF HEARING: State Capitol, 415 South Beretania Street
Conference Room 308

TESTIMONY IN OPPOSITION TO HB2028, HD1 RELATING TO TAXATION

By DAYTON M. NAKANELUA,
State Director of the United Public Workers (UPW),
AFSCME Local 646, AFL-CIO

My name is Dayton M. Nakanelua, State Director of the United Public Workers, AFSCME, Local 646, and AFL-CIO. The UPW is the exclusive bargaining representative for approximately 12,000 public employees, which include blue collar, non-supervisory employees in Bargaining Unit 01 and institutional, health and correctional employees in Bargaining Unit 10, in the State of Hawaii and various counties. The UPW also represents about 1,500 members of the private sector.

HB2028, HD1 authorizes the Employees' Retirement System (ERS) to invest in a public-private partnership entity to improve the water supply, a waste water treatment plant and to implement clean energy technology. The bill also creates a general excise tax and personal income tax exemption related to the construction of these projects.

According to the ERS, the agency has an investment policy allowing "...direct investments in Hawaii infrastructure (particularly "green" infrastructure) projects. The ERS has professional investment managers and does not "...typically invest directly with partners on projects..." The UPW has concerns about the soundness of this bill and what it proposes to do with the retirement funds of the thousands of active employees and retirees... The UPW **opposes** this measure.

Thank you for the opportunity to submit this testimony.



Wai Maoli

HAWAII FRESH WATER INITIATIVE

827 Fort Street Mall | Honolulu, HI 96813 | (808) 537-6333
HawaiiCommunityFoundation.org

Fresh Water Council Members

William Aila

Stephen Anthony*

Michael Buck

Suzanne Case

Reginald Castanares

Meredith Ching

Derek Chow

Ka'eo Duarte

Sumner Erdman

Mark Fox

Thomas Giambelluca

Timothy Johns

Howard Killian

Patrick Kobayashi

Ernest Lau

Keith Okamoto

Jerry Ornellas

Monty Richards

Kapua Sproat

David Taylor

Dennis Teranishi

Barry Usagawa

*US Geological Survey
Liaison/Scientific Advisor to HCF

**Testimony of the
Hawai'i Fresh Water Initiative
on
H.B. 2028
Relating to Taxation
House Committee on Finance
Friday, February 26, 2016. 1:00 P.M.
Conference Room 308**

The Hawaii Fresh Water Initiative was launched in 2013 to bring many diverse parties together to develop a forward-thinking and consensus-based strategy to increase water security for Hawaii. A blue ribbon panel of water stakeholders drawn from multiple perspectives came together to jointly and unanimously recommend key strategies and policies that will increase Hawaii's water security in the face of declining rainfall levels and climate change.

The Council identified a single goal for Hawaii: to create 100 million gallons per day (mgd) in additional, fresh water capacity for our islands by 2030. The key strategies to achieve this statewide goal is to increase water conservation, reuse, and recharge over the next 15 years.

H.B. 2028 exempts personal income tax income, general excise tax income, and use tax income in an amount up to an unspecified percentage of the costs of construction and operation of projects entered into under a public-private partnership with the ERS to improve water infrastructure or water supply, or to promote clean energy.

The Council believes that improving our water infrastructure to diversify capture, encourage reuse, and reduce system loss is an important step towards a more secure fresh water future. Innovative new methods and programs to finance this infrastructure improvement are increasingly required.

The Fresh Water Council supports the intent of H.B. 2028 in encouraging the investment of additional, innovative new funding sources to reach our state goal of 100 mgd in additional fresh water availability by 2030.

Hawai'i Green Growth is a public-private partnership that coordinates across government, non-governmental and cultural organizations, business, academia and philanthropy to achieve Hawai'i's Aloha+ Challenge 2030 sustainability goals.

**Testimony of Hawai'i Green Growth
In Support of HB2028 HD1 Relating to Taxation
House Committee on Finance**

26 February 2016, 1:00pm, Room 308

Steering Committee

Deanna Spooner

June Matsumoto

Matt Lynch

Mark Fox

Mike Hamnett

Piia Aarma

Pono Shim

Scott Enright

Scott Seu

Ulalia Woodside

William J. Aila Jr.

Aloha Chair Luke, Vice Chair Nishimoto, and Members of the Committee:

Hawai'i Green Growth (HGG) supports the intent of HB2028 HD1, which would authorize Employee Retirement System (ERS) investments in public-private partnership projects that improve water infrastructure, water supply, or promote clean energy.

Based on global climate disruption, increasingly severe weather and natural disasters, and projected long-term decline of rainfall, it is urgent we invest in water infrastructure to ensure increased fresh water availability and security. The ability to pump, divert, transport, store, treat, and deliver safe drinking water to the residents of Hawai'i is of the utmost importance. Innovative new methods and programs to finance water infrastructure improvements are increasingly required.

HGG public-private partners agree that innovative finance is critical to advancing the *Aloha+ Challenge*. The *Aloha+ Challenge* is a statewide commitment by the State Legislature (SCR 69), Governor, Mayors and Office of Hawaiian Affairs to achieve six sustainability goals for 2030 in the areas of clean energy, local food, natural resources, solid waste reduction, smart growth and climate resilience, and green jobs and education. Statewide HGG public-private partners are identifying shared measures to track progress and provide accountability with the online *Aloha+ Challenge* Dashboard, while developing an annual policy and action agenda to advance Hawai'i's shared 2030 sustainability goals.

The *Aloha+ Challenge* has been recognized nationally and internationally by the US State Department and Global Island Partnership as a model for locally appropriate implementation of UN Sustainable Development Goals. With the upcoming IUCN World Conservation Congress hosted by Hawai'i in September 2016, this legislative session is an important opportunity for Hawai'i to showcase leadership on sustainable development, conservation and resilience.

As a diverse public-private partnership, Hawai'i Green Growth supports the intent of HB2028 HD1 to increase innovative finance and investments in fresh water capacity and sustainable development.