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To: The Honorable Jill N. Tokuda, Chair  
and Members of the Senate Committee on Ways and Means

Date: Friday, February 27, 2015  
Time: 1:00 P.M.  
Place: Conference Room 211, State Capitol

From: Maria E. Zielinski, Director  
Department of Taxation

Re: S.B.1150, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of S.B. 1150 and offers the following comments.

S.B. 1150 deletes the sunset provisions applicable to the special fuel tax rate for naphtha fuels sold to a power generating facility, making the special rate imposed on naphtha fuel permanent. The Department notes that, if the special rate for naphtha fuel is allowed to sunset, the rate of tax on naphtha fuel may revert to the default fuel tax rate for liquid fuel of 17 cents per gallon. This measure is effective upon approval.

The repeal of the sunset provision in Act 103, Session Laws of Hawaii 2007 (Act 103) is somewhat confusing. Act 103 was subsequently amended by Act 198, Session Laws of Hawaii 2009, and Act 188, Session Laws of Hawaii 2012. Each of the subsequent amendments to Act 103 extended the sunset provision. Act 103 initially set the rate of tax on naphtha fuel at one cent per gallon. The Department is uncertain whether the rate increase to two cents per gallon enacted in Section 2 of Act 198, Session Laws of Hawaii 2009, actually has a sunset date since the rate was not increased through an Amendment of Act 103.

The Department suggests that to permanently codify the special rate for naphtha fuel, as a simpler method of making the amendments suggested in S.B. 1150, that the following language take effect upon the sunset of Act 103, Session Laws of Hawaii 2007:

1. By adding a new definition in HRS section 243-1 to read:

"Power-generating facility" means any electricity-generating facility that requires a permit issued under the Federal Clean Air Act (42 U.S.C. 7401-7671q), the Hawaii air pollution control law (chapter 342B), or both.

2. By amending HRS section 243-4(a) to read:

(a) Every distributor, in addition to any other taxes provided by law, shall pay a license tax to the department of taxation for each gallon of liquid fuel refined, manufactured, produced, or compounded by the distributor and sold or used by the distributor in the State or imported by the distributor, or acquired by the distributor from persons who are not licensed distributors, and sold or used by the distributor in the State. Any person who sells or uses any liquid fuel, knowing that the distributor from whom it was originally purchased has not paid and is not paying the tax thereon, shall pay such tax as would have applied to such sale or use by the distributor. The rates of tax imposed are as follows:

(1) For each gallon of diesel oil, 2 cents;

(2) For each gallon of gasoline or other aviation fuel sold for use in or used for airplanes, 2 cents;

(3) For each gallon of naphtha sold for use in a power-generating facility, 2 cents;

~~[(3)]~~ (4) For each gallon of liquid fuel, other than fuel mentioned in paragraphs (1), (2), and (3), and other than an alternative fuel, sold or used in the city and county of Honolulu, or sold in any county for ultimate use in the city and county of Honolulu, 17 cents state tax, and in addition thereto an amount, to be known as the "city and county of Honolulu fuel tax", as shall be levied pursuant to section 243-5;

~~[(4)]~~ (5) For each gallon of liquid fuel, other than fuel mentioned in paragraphs (1), (2), and (3), and other than an alternative fuel, sold or used in the county of Hawaii, or sold in any county for ultimate use in the county of Hawaii, 17 cents state tax, and in addition thereto an amount, to be known as the

"county of Hawaii fuel tax", as shall be levied pursuant to section 243-5;

~~[(5)]~~ (6) For each gallon of liquid fuel, other than fuel mentioned in paragraphs (1), (2), and (3), and other than an alternative fuel, sold or used in the county of Maui, or sold in any county for ultimate use in the county of Maui, 17 cents state tax, and in addition thereto an amount, to be known as the "county of Maui fuel tax", as shall be levied pursuant to section 243-5; and

~~[(6)]~~ (7) For each gallon of liquid fuel, other than fuel mentioned in paragraphs (1), (2), and (3), and other than an alternative fuel, sold or used in the county of Kauai, or sold in any county for ultimate use in the county of Kauai, 17 cents state tax, and in addition thereto an amount, to be known as the "county of Kauai fuel tax", as shall be levied pursuant to section 243-5.

If it is shown to the satisfaction of the department, based upon proper records and from any other evidence as the department may require, that liquid fuel, other than fuel mentioned in paragraphs (1), (2), and (3), is used for agricultural equipment that does not operate upon the public highways of the State, the user thereof may obtain a refund of all taxes thereon imposed by this section in excess of 1 cent per gallon. The department shall adopt rules to administer such refunds.

Amending the relevant statutes in this way will eliminate any confusion as to the applicable rates and expiration dates. If these suggested amendments are adopted, the measure should be made effective January 1, 2016, to avoid a lapse in the special naphtha fuel tax rate.

Thank you for the opportunity to provide comments.

# TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

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**SUBJECT:** FUEL, Rate on naphtha used for power generation

**BILL NUMBER:** SB 402; SB 1150; HB 1243 (Identical)

**INTRODUCED BY:** SB 402/SB 1150 by Kouchi; HB by Kawakami, Morikawa & Tokioka

**BRIEF SUMMARY:** Makes permanent the 2 cents per gallon fuel tax on naphtha sold for use in a power-generating facility.

**EFFECTIVE DATE:** Upon approval

**STAFF COMMENTS:** The legislature by Act 103, SLH 2007, provided that naphtha used in a power generating facility shall be taxed at the rate of one cent per gallon until December 31, 2009. The legislature by Act 198, SLH 2009, increased the tax on naphtha fuel used in a power generating facility from 1 cent to 2 cents per gallon effective 7/1/09 and extended the sunset date of Act 103, SLH 2007, from 12/31/09 to 12/31/12. Act 188, SLH 2012, extended the sunset from 12/31/12 to 12/31/15. This measure would make this provision permanent by repealing the sunset provision of Act 188, SLH 2012.

It should be remembered that receipts of the fuel tax are realizations of the state's transportation funds, largely the state highway fund. Naphtha used to generate electricity does not utilize the highway infrastructure, so it makes sense for such fuel to be exempt from the state fuel tax, which it was before 2007. The tax was supposed to be temporary (where have we heard this before?). Instead, the cost of the additional tax on naphtha fuel used to generate electricity has contributed to rising energy costs for all taxpayers including government. Passage of this bill would make this anomaly permanent.

Digested 2/2/15



Testimony Before the Senate Committee on  
Ways and Means

By Michael Yamane, P.E.  
Chief of Operations  
Kauai Island Utility Cooperative  
4463 Pahee Street, Suite 1, Lihue, Hawaii, 96766-2000

Friday, February 27, 2015, 1:00 p.m.  
Conference Room #211

**Senate Bill No. 1150 – Relating to Taxation**

To the Honorable Jill N. Tokuda, Chair; Ronald D. Kouchi, Vice-Chair, and Members of the Committee:

Thank you for the opportunity to testify on this measure. I am Michael Yamane, Chief of Operations at Kauai Island Utility Cooperative (“KIUC”). KIUC stands in strong support of Senate Bill No. 1150, that removes the sunset date initially established in Act 103, Session Laws of Hawaii 2007, as further extended until December 31, 2012 by Act 198, Session Laws of Hawaii 2009, and most recently extended until December 31, 2015 in Act 188, Session Laws of Hawaii 2012.

Act 103 was the result of a question raised regarding interpretation of language contained in HRS §243 pertaining to which types of liquid fuels are subject to which types of taxes.

Specifically at issue is how naphtha should, or should not, be taxed.

KIUC continues to believe that the primary purpose of the fuel tax is to provide funds for highway construction and maintenance (or in the case of aviation fuels, funds for airport construction and maintenance). This has been accomplished over the years by imposing the tax on fuel sold for on-highway use. KIUC believes that the intent of the law is to exclude naphtha sold and used for power generation purposes from the State vehicle transportation and respective County fuel taxes.

Act 103 clarified this interpretation.

KIUC annually uses approximately 15 million gallons of naphtha annually in the generation of electricity, which represents approximately 50% of KIUC’s yearly electrical energy production.

This would result in an additional \$4.4 million tax expense would have increased KIUC's cost of purchased fuel and raised KIUC member s' energy bills by approximately 7%.

As you know, KIUC is a member-owned electric cooperative. Unlike for-profit corporations (i.e. investor owned utilities), cooperatives are not-for-profit and member-run. Without the need for profits and shareholder dividends, cooperatives are free to invest what would normally be profits (cooperatives call them "margins") in the business by allocating margins to the cooperative's members as capital credit contributions, or, eventually, by making patronage capital refunds to its members; and otherwise generally using the monies collected for the general welfare of the cooperative members. Any additional expenses would be passed through to our members and reduce KIUC margins that would impact patronage capital refunds back to our members.

KIUC is also committed to reducing its dependency on imported fossil fuels as KIUC's Strategic Plan calls for 50% renewable generation by 2023.

For these reasons, KIUC supports Senate Bill No. 1150 and, therefore asks that this bill be passed.

Thank you again for the opportunity to inform you of KIUC's position on this matter.