LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: FUEL, Rate on Naphtha Used for Power Generation

BILL NUMBER: SB 2131, SD-2

INTRODUCED BY: Senate Committee on Ways and Means

EXECUTIVE SUMMARY: This bill retroactively reinstates the 2 cent per gallon tax on naphtha sold for use in a power-generating facility. The measure highlights a much larger problem: why are we applying a fuel tax to uses of fuel that have no relation to highway use?

BRIEF SUMMARY: Amends HRS section 243-4 to add a 2 cent per gallon tax on naphtha sold for use in a power-generating facility. Amends HRS section 243-1 to add a definition for "power-generating facility" as any electricity-generating facility that requires a permit issued under the Federal Clean Air Act (42 U.S.C. 7401 through 7671q), the Hawaii air pollution control law (HRS chapter 342B), or both.

EFFECTIVE DATE: Retroactive to January 1, 2016.

STAFF COMMENTS: 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. Act 198, SLH 2009, increased the tax to 2 cents per gallon effective and extended the sunset date of Act 103, SLH 2007, to 12/31/12. Act 188, SLH 2012, further extended the sunset date to 12/31/15. Because the sunset date has passed, naphtha used in a power-generating facility is now subject to fuel tax at the much higher rate for fuels other than diesel oil or aviation fuel. This measure would reinstate the lower rate and would make the lower rate permanent.

It should be remembered that receipts of the fuel tax are realizations of the state's transportation funds, largely the state highway fund. Because this naphtha is used to generate electricity and does not power a vehicle utilizing the highway infrastructure, such fuel should not be subject to the state fuel tax.

If instead we are considering the fuel tax as a "sin tax" on the use of fossil fuels to discourage use of such fuels, similar to how we tax the use of tobacco products or liquor, then we need to realize that naphtha is a petroleum distillate, and is therefore a fossil fuel. If we as a policy matter are going to tax coal, fuel oil, or LNG that is used to generate electricity, then why are we sparing naphtha? If we are going to spare naphtha, then can we also have relief for the tax on other fuels used in a power-generating facility?

Thanks to our legislators, the cost of the additional tax on fuel used to generate electricity has contributed to rising energy costs for all taxpayers including the government. Indeed, because energy costs are a necessity for most, the burden of this tax is highly regressive, meaning that it falls disproportionately on those who are least able to afford it.

Digested 3/15/2016

Kaua`i Island Utility Cooperative
Your Touchstone Energy® Cooperative

Testimony Before the House Committee on
Energy & Environmental Protection

By Jim Kelly
Member Services & Communications Manager
Kauai Island Utility Cooperative
4463 Pahee Street, Suite 1, Lihue, Hawaii, 96766-2000

Thursday, March 17, 2016, 8:30 a.m.
Conference Room # 325

Senate Bill No. 2131, SD2– Relating to Energy

To the Honorable Chris Lee, Chair; Nicole E. Lowen, Vice-Chair, and Members of the Committee:

Thank you for the opportunity to testify on this measure. I am Jim Kelly, Member Service and Communications Manager at Kauai Island Utility Cooperative ("KIUC"). KIUC stands in strong support of Senate Bill No. 2131, SD2.

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.

Senate Bill No. 2131, SD2 clarifies this interpretation.

KIUC 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 that would increase KIUC's cost of purchased fuel and raise the average residential electric bill by 7% or about $10 a month.

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.

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

DAVID Y. IGE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

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

Date: March 17, 2016
Time: 8:30 A.M.
Place: Conference Room 325, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 2131, S.D. 2, Relating to Energy.

The Department of Taxation (Department) appreciates the intent of S.B. 2131, S.D. 2, and offers the following comments for your consideration.

S.B. 2131, S.D. 2, restores amendments previously made to sections 243-1 and 243-4(a), Hawaii Revised Statutes (HRS), which were repealed on December 31, 2015. The measure is effective upon approval and Section 2 of S.B. 2131, S.D. 2, has a retroactive effective date of January 1, 2016.

Section 1 of this measure adds a definition of "power generating facility" to section 243-1, HRS. Section 2 amends section 243-4, HRS, to establish the rate for naphtha fuel used for a power generating facility at 2 cents per gallon.

The Department notes that it is able to administer the changes set forth in S.B. 2131, S.D. 2. However, the retroactive effective date applicable to Section 2 of the bill creates administrative difficulties, as taxpayers will be required to file amended returns for the period between January 1, 2016 and the date this measure is approved. To ease administration of this measure and avoid confusion for taxpayers, the Department requests that the effective date be changed to July 1, 2016.

Thank you for the opportunity to provide comments.

DAVID Y. IGE
GOVERNOR

Testimony by:
FORD N. FUCHIGAMI
DIRECTOR

Deputy Directors
JADE T. BUTAY
ROSS M. HIGASHI
EDWIN H. SNIFFEN
DARRELL T. YOUNG

IN REPLY REFER TO:

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION
869 PUNCHBOWL STREET
HONOLULU, HAWAII 96813-5097

March 17, 2016
8:30 a.m.
State Capitol, Room 325
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S.B. 2131, S.D. 2
RELATING TO ENERGY

House Committee on Energy and Environmental Protection

The Department of Transportation **supports the intent** of S.B. 2131, S.D. 2 to restore the amendments made to sections 243-1 and 243-4(a), HRS, which sunsetted on December 31, 2015. The bill clarifies that naphtha fuel, used in a power-generating facility, is subject to the fuel tax at a rate of 2 cents per gallon, retroactive to January 1, 2016.

DOT recommends that Section 243-3, Hawaii Revised Statutes subsection (a), also restore the 17 cents per gallon fuel tax, retroactive to January 1, 2016 to maintain its current fuel tax collections from the previous fiscal years.

Act 188, 2012 Session Laws of Hawaii repealed the 17 cents per gallon liquid fuel tax that was enacted in Act 209, 2007 Session Laws of Hawaii on December 31, 2015 to the current 16 cents per gallon liquid fuel tax. Therefore, the Highways Division is requesting to restore the 17 cents per gallon fuel tax to maintain its current fuel tax collections from the previous fiscal years. The one cent per gallon restoration in the state tax on liquid fuel is estimated to cost an average driver an additional $5.50 annually per one cent increase while generating approximately $5.1 million in revenues for the State Highway Fund.

The DOT recommends that Section 243-3(a) should be amended as follows:

"(a) Every distributor shall, in addition to any other taxes provided by law, 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 hereby imposed are as follows:

(1) For each gallon of diesel oil, [~~1 cent;~~] 2 cents;

(2) For each gallon of gasoline or other aviation fuel sold for use in or used for airplanes, [~~1 cent;~~] 2 cents;

(3) For each gallon of liquid fuel other than fuel mentioned in paragraphs (1) and (2), 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, [~~16~~] 17 cents state tax, and in addition thereto such amount, to be known as the "city and county of Honolulu fuel tax", as shall be levied pursuant to section 243-5;

(4) For each gallon of liquid fuel other than fuel mentioned in paragraphs (1) and (2), 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, [~~16~~] 17 cents state tax, and in addition thereto such amount, to be known as the "county of Hawaii fuel tax", as shall be levied pursuant to section 243-5;

(5) For each gallon of liquid fuel other than fuel mentioned in paragraphs (1) and (2), 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, [~~16~~] 17 cents state tax, and in addition thereto such amount, to be known as the "county of Maui fuel tax", as shall be levied pursuant to section 243-5; and

(6) For each gallon of liquid fuel, other than fuel mentioned in paragraphs (1) and (2), 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, [~~16~~] 17

cents state tax, and in addition thereto such 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 [~~such~~] other evidence as the department may require, that liquid fuel other than fuel mentioned in paragraphs (1) and (2), 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."

The state fuel tax revenue for fiscal year 2015 was $86.58 million or 32 per cent of the total State Highway Fund revenue. The state fuel tax is the major revenue source for the State Highway Fund and is a main source of pledged revenues for the Highway Revenue Bonds. This revenue source contributes positively to the Highways Revenue Bond ratings of AA, Aa2, and AA+ from Fitch, Moody's, and Standard & Poor's respectively. The high bond ratings decrease our cost of borrowing.

The highways financial plan relies on the state fuel tax to support the continued operations and maintenance of the State Highway System. Appropriations from the State Highway Fund are used for the construction, operations, and maintenance of the State Highway System.

Any increase in this primary source of revenues for the State Highway Fund will enhance the Department's ability to construct, operate and maintain the State Highway System. This would enable an increase in the highways capital improvement program and special maintenance programs. The failure of the State to properly maintain the State Highway System may result in sanctions by the Federal Highway Administration including the loss of federal funds.

The DOT is seeking additional revenue increases in SB 2938 which proposes to restore the 17 cents per gallon State fuel tax and increases it to 19 cents per gallon. The bill also proposes to restore the diesel oil and other aviation fuel taxes to two cents per gallon. In addition, the bill will increase the State vehicle registration fees and the motor vehicle weight tax..

The increase in revenues will provide safer infrastructure enhancements for all users including pedestrians, bicyclists, transit users and motorists and would positively impact the department's ability to qualify state matching funds for the highways federal-aid program. The availability of state matching funds will result in attracting its share for federal funds. The normal federal share for eligible projects on the interstate system is 90 per cent and for other eligible roadways it is 80 per cent.

To meet the economic needs of the State and preserve the unique quality of life of its residents and visitors to these precious islands, the Department of Transportation must provide a safe, efficient, and effective land transportation system for the movement of people and goods. The state land transportation system, however, has not kept pace with our growing economy, land use development patterns, and increased demand for travel. Programmatic and project needs far exceed the available resources. The land transportation system will continue to deteriorate as demand for travel continues to increase; and costs to manage, construct, and administer the system increases.

As the average fuel economy of motor vehicles improves in accordance with the Corporate Average Fuel Economy standards and the increase in electric, plug-in hybrid electric vehicles and alternative fuel vehicles, it is clear that the current gas fuel tax is not sustainable for future highway funding. The fate of the State's ability to provide safe and efficient roadways to the public relies upon its ability to acquire the needed funding for all highway programs and projects. With the funding needs of the State Highway Program severely outweighing the revenues being generated through the state fuel tax, more innovative revenue generating programs need to be studied to support the State Highway Fund revenues.

The increase in revenues will provide safer infrastructure enhancements for all users including pedestrians, bicyclists, transit users, and motorists and would positively impact the department's ability to qualify state matching funds for the highways federal-aid program.

Thank you for the opportunity to testify on this bill.