SB 2502

RELATING TO TAXATION

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To: The Honorable Lorraine R. Inouye, Chair
and Members of the Senate Committee on Transportation and Energy

Date: February 2, 2016
Time: 2:50 P.M.
Place: Conference Room 229, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 2502, Relating to Taxation.

The Department of Taxation (Department) appreciates the intent of S.B. 2502, and offers the following comments regarding Sections 1, 3, and 4 of the bill for your consideration.

S.B. 2502 creates a general excise tax exemption for income received from certain public-private partnership contracts entered into with the Employee Retirement System, capped at an unspecified percentage of direct costs of construction and operation. The measure creates similar incentives under the Income Tax Law and Use Tax Law. The measure is effective upon approval and applies to taxable years beginning after December 31, 2015.

First, the Department suggests clarifying what is meant by "direct costs of construction and operation." This term is vague and would make audit and enforcement of these tax benefits very difficult for the Department.

Second, the Department notes that in Sections 1 and 3 of S.B. 2502, the amount that may be excluded from income is confusing and unclear. Additionally, because the amount excluded from income is measured as a percentage of the taxpayer's costs, the Department suggests creating a certification mechanism whereby ERS or another appropriate government entity certify that a taxpayer has entered into a public-private partnership and certify the amount (based on the percentage of costs) that may be excluded from income. The taxpayer would then be required to attach the certification to its tax returns. This would aid in taxpayer compliance and enforcement of the tax benefits.

To clarify Section 1, the Department suggests amending the language as follows:

"(a) In addition to the amounts not taxable under section 237-24, this chapter shall not apply to an amount, as certified by the employees' retirement system, up to but not in excess of ___ per cent of the direct costs of construction and operation incurred by a contractor under a public-private partnership with the employees' retirement system to develop . . . ."

Similarly, the Department suggests amending paragraph (15) in Section 3 as follows:

"Income, in an amount certified by the employees' retirement system, up to but not in excess of ___ per cent of the direct costs of construction and operation incurred by a person under a public-private partnership with the employees' retirement system to develop . . . ."

Finally, the Department suggests amending the tax benefit prescribed in Section 4 of the bill. The Use Tax is typically applied to the landed value of property imported into the State. It is unclear what tax benefit under the Use Tax that Section 4 intends to provide to taxpayers.

Thank you for the opportunity to provide comments.

LEGISLATIVE TAX BILL SERVICE

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: SB 2502

INTRODUCED BY: WAKAI, INOUYE, Slom

EXECUTIVE SUMMARY: 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. 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.

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.

Adds a new subsection to HRS section 238-3 to establish a use tax exclusion for income in an amount not more than ___% of the direct costs of construction and operation, as described above.

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

EFFECTIVE DATE: 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 20%," for example, of a $1 million investment in all three places would mean the taxpayer concerned could take a $200,000 net income tax exclusion, a $200,000 GET exclusion, and a $200,000 Use Tax exclusion.
- Use Tax applies to value, not income, so an income exclusion in chapter 238 has little meaning.

Digested 1/30/2016

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

TO THE SENATE COMMITTEE ON TRANSPORTATION AND ENERGY
ON

SENATE BILL NO. 2502

FEBRUARY 2, 2016, 2:50 P.M.

RELATING TO TAXATION

Chair Inouye, Vice Chair Gabbard and Members of the Committee,

S.B. 2502 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.

The ERS Board of Trustees has not had the opportunity to review S.B. 2502 and therefore has not taken a formal position on this proposal; however, the ERS staff has the following comments and concerns:

- H.B. 2502 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. ERS does not typically invest directly with partners in projects but does so through investment managers with the necessary skills or experience to evaluate, price and monitor such opportunities. 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 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.