

SB 2652

**RELATING TO
TAXATION**

DAVID Y. IGE
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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. 2652, Relating to Taxation.

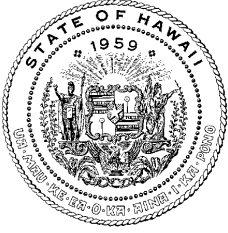
The Department of Taxation (Department) appreciates the intent of S.B. 2652, and offers the following comments for your consideration.

S.B. 2652 repeals the ethanol facility tax credit and establishes a refundable renewable fuels production tax credit. The new tax credit is available at the rate of 20 cents per 76,000 British thermal units of fuel produced and has a per-taxpayer and aggregate cap of \$3,000,000 per taxable year. The credit is certified by the Department of Business, Economic Development and Tourism. The measure is effective on July 1, 2016 and applies to taxable years beginning after December 31, 2016. Section 2 is repealed on December 31, 2021.

The Department notes that the following provisions may be impermissible under the Commerce Clause of the United States Constitution: the requirement that renewable fuels be produced from feedstocks having their point of origin within the State; and that the renewable fuels be sold for distribution in Hawaii. The Department defers to the Department of the Attorney General regarding the constitutionality of these provisions.

Finally, as a general matter, the Department recommends non-refundable credits over refundable credits, because refundable credits are more prone to wrongful claims and abuse.

Thank you for the opportunity to provide comments.



DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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Statement of
LUIS P. SALAVERIA
Director
Department of Business, Economic Development, and Tourism
before the
SENATE COMMITTEE ON TRANSPORTATION AND ENERGY

Tuesday, February 2, 2016
2:50 p.m.
State Capitol, Conference Room 229

in consideration of
SB 2652
RELATING TO TAXATION

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

The Department of Business, Economic Development & Tourism (DBEDT) offers comments on SB 2652, which establishes a renewable fuels production tax credit (TC) and repeals the ethanol facility tax credit.

DBEDT recognizes the value of the State of Hawaii in becoming more self-sufficient in its energy supply. We respectfully refer the Legislature to our state energy policy directives (<http://energy.hawaii.gov/energypolicy>) of diversifying our energy portfolio (Policy #2) and balancing technical, economic, environmental, and cultural considerations (Policy #4).

With regards to the State's Policy #2, we are concerned that this bill does not provide a clear definition of how much renewable feedstock must originate from Hawaii and be used for renewable fuel production and qualify for the full tax credit, thus negating potential diversification of our energy portfolio with indigenous resources. For example, a renewable fuel producer may use only 1% Hawaii grown renewable feedstock and blend it with another 99% non-Hawaii sourced renewable feedstock and still qualify for the full tax credit under the present

language under the Bill. Therefore, this bill will require more clarity on the administration of the tax credit and how it will be computed, especially if a blend of renewable feedstock is allowed.

DBEDT is also concerned about several issues regarding its responsibilities under this bill. First, DBEDT lacks the expertise and staffing to execute the required verification and certification requirement and would also require further clarity on the implementation of the verification and certification process. Second, DBEDT lacks and will require the necessary funding and budget allocation to execute the responsibilities under the Bill. Finally, DBEDT would require further clarity on the prioritization of the aggregate tax credit should, for example, all renewable fuel producers turn in the tax credit applications at once.

Finally, regarding DBEDT's role in verifying and certifying the tax credits, DBEDT suggests that the Legislature consider having the renewable fuel producer(s) self-certify by providing required confirmation via an independent third party and impose upon participating renewable producers a performance penalty that is material enough to hold them accountable for meeting their stated self-certified renewable fuels production (i.e., a 200% recapture of all tax credit allocated and lifetime band of any future tax credit participation in the State).

DBEDT defers to the Department of Taxation on the administration of the renewable fuels production tax credit.

Thank you for the opportunity to offer these comments regarding SB 2652.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: INCOME, Renewable fuels production tax credit

BILL NUMBER: SB 2652

INTRODUCED BY: GABBARD, CHUN OAKLAND, KIDANI, NISHIHARA, Harimoto, Riviere, Shimabukuro, Slom

EXECUTIVE SUMMARY: Replaces the ethanol fuels income tax credit with a renewable fuels production income tax credit to encourage the production of such fuels. A direct appropriation would be preferable as it would provide some accountability for the taxpayer funds being utilized to support this effort.

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to establish a renewable fuels production tax credit. The credit shall be allowed to taxpayers producing qualifying renewable fuels provided the credit shall not be claimed for more than five years.

The annual dollar amount of the credit shall be 20 cents per 76,000 British thermal units (BTU) of renewable fuels using the lower heating value produced for distribution in Hawaii; provided that the production by the facility is not less than 15 billion BTUs of renewable fuels per year. Limits the amount of tax credit that may be claimed by a taxpayer to \$3 million per taxable year.

Defines “credit period” and “net income tax liability.” Defines “qualifying renewable fuels” as fuels produced in the state from renewable feedstocks at the production facility located in the state and the fuels produced will be sold in the state, and meet the relevant ASTM International specifications for the particular fuel or other industry specifications for liquid or gaseous fuels, including but not limited to: (1) methanol, ethanol, or other alcohols; (2) hydrogen; (3) biodiesel or renewable diesel; (4) biogas; (5) other biofuels; or (6) renewable jet fuel or renewable gasoline. Defines “renewable feedstocks” as biomass crops; agricultural residues; oil crops, including but not limited to algae, canola, jatropha, palm, soybean and sunflower; sugar and starch crops, including but not limited to sugar cane and cassava, other agricultural crops; grease and waste cooking oil; food wastes; municipal solid wastes and industrial wastes; water and animal residues and wastes, that can be used to generate energy.

Requires the department of business, economic development and tourism (DBEDT) to verify and certify each claim for the credit including the total amount of credit for each taxable year and the cumulative amount of tax credit during the credit period. The department shall issue a certificate to qualifying taxpayers who shall file the certificate with the department of taxation (DOTAX).

If in any year the annual amount of certified credits reaches \$3 million in the aggregate, DBEDT shall discontinue certifying credits and notify the department of taxation.

If the amount of credits exceeds the taxpayer’s income tax liability, the excess of credit over liability shall be refunded to the taxpayer.

Prior to production of any qualifying renewable fuels for the year, the taxpayer is to provide written notice of the taxpayer's intention to begin production of qualifying renewable fuels to DOTAX and DBEDT with information on the taxpayer, facility location, facility production capacity, anticipated production start date, and the taxpayer's contact information. The taxpayer shall also provide written notice to the director of taxation and the director of DBEDT within 30 days following the start of production and include the production start date and expected renewable fuel production for the next year.

In each calendar year during the credit period, the taxpayer shall provide information to the director of DBEDT on the number of BTUs of renewable fuels produced and sold during the previous calendar year, the type of fuels, feedstocks used for renewable fuels production, the number of employees of the facility and each employee's state of residency, and the projected number of BTUs of renewable fuels production for the succeeding year.

Directs the director of DBEDT, following each year in which a credit under this section has been claimed, to submit a written report to the governor and legislature regarding the production and sale of renewable fuels.

Requires DOTAX to prepare the necessary forms to claim the credit, and DOTAX may require the taxpayer to furnish information to validate a claim for the credit.

Repeals the ethanol facility tax credit under HRS section 235-110.3.

EFFECTIVE DATE: Applies to taxable years beginning after December 31, 2016. The credit is to sunset on December 31, 2021.

STAFF COMMENTS: Act 289, SLH 2000, established an investment tax credit to encourage the construction of an ethanol production facility in the state. Act 140, SLH 2004, changed the credit from an investment tax credit to a facility tax credit. This measure proposes to replace the ethanol facility tax credit with a renewable fuels production tax credit.

While the idea of providing a tax credit to encourage such activities may have been acceptable a few years ago when the economy was on a roll and advocates could point to credits like those to encourage construction and renovation activities, what lawmakers and administrators have learned in these past few years is that unbridled tax incentives, where there is no accountability or limits on how much in credits can be claimed, are irresponsible as the cost of these credits goes far beyond what was ever intended. Instead, lawmakers should consider repealing the ethanol facility credit and look for other types of alternate energy to encourage through the appropriation of a specific number of taxpayer dollars. At least lawmakers would have a better idea of what is being funded and hold the developers of these alternate forms of energy to a deliberate timetable or else lose the funds altogether. A direct appropriation would be preferable to the tax credit as it would: (1) provide some accountability for the taxpayers' funds being utilized to support this effort; and (2) not be a blank check.

Ethanol was the panacea of yesterday; lawmakers have since learned that there are more minuses to the use of ethanol than there are pluses. Ethanol production demands more energy to produce than using a traditional petroleum product to produce the same amount of energy, and the

demand for feedstock that is used to produce ethanol basically redirects that feedstock away from traditional uses, causing products derived from the feedstock to substantially increase in price. It may make sense to encourage development of other alternative fuels that will not have these issues, but doing it in open-ended fashion by way of a tax credit is an invitation to abuse.

An appropriation of taxpayer dollars for such untried and unproven technologies would be far more accountable than the tax credit as such technologies would have undergone the scrutiny of lawmakers. Providing a tax incentive is an indicator that lawmakers are unwilling to do the hard research and unwilling to impose strict discipline in the expenditure of hard-earned tax dollars. The tax incentive approach represents nothing more than a hope and a wish that some breakthrough will be made, no matter how inefficient it may be, that some alternative to fossil fuel will be found. In the meantime, those tax dollars will be wasted on some unproven folly. If this were an appropriation, taxpayers would then know who to hold accountable for the waste of those tax dollars.

This, along with numerous other proposals targeted at certain types of business activity, is truly an indictment of what everyone has known and acknowledged since before Hawaii became a state, that is, the climate imposed by government regulations and taxation makes it difficult to survive without some kind of subsidy such as tax credits from government. Once those subsidies disappear, so will the businesses. Instead of throwing out such breaks for special interests, lawmakers must endeavor to make Hawaii's business climate more welcoming and conducive to nurturing entrepreneurs.

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**Testimony to the Senate Committee on Transportation and Energy
Tuesday, February 2, 2016 2:50 pm
Conference Room 229, State Capitol
RE: SENATE BILL 2652**

Chair Inouye, Vice Chair Gabbard and Members of the Transportation and Energy Committee:

Hawaii Gas **supports** SB 2652, which establishes a renewable fuels production tax credit to achieve greater energy security for Hawaii.

Hawaii Gas is the only franchised Gas Utility in the State of Hawaii. We have been providing cleaner, lower cost alternative fuel for residential, commercial and industrial customers for over 110 years. Gas is the most efficient source of heat energy and a cleaner burning fuel making it the perfect bridge to Hawaii's clean energy future. Hawaii Gas is supportive of the production of renewable fuels as a diversified fuel mix to achieve the state's renewable energy goals.

SB 2652 supports the production of biogas, which will provide a valuable source renewable energy to the state.

Thank you for the opportunity to testify.