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

The Honorable Della Au Belatti, Chair
and Members of the House Committee on Health

Date: Tuesday, March 22, 2016
Time: 10:00 A.M.
Place: Conference Room 325, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 3084, S.D. 1, Relating to Cesspools.

The Department of Taxation (Department) provides the following comments for your consideration on S.B. 3084, S.D. 1.

S.B. 3084, S.D. 1, disallows the tax credit for cesspool upgrade, conversion, or connection for taxpayers whose adjusted gross income exceeds certain amounts. The measure has a defective effective date of January 1, 2050 and applies to taxable years beginning after December 31, 2015.

The Department notes that the measure would disallow the tax credit for:

- 1) A taxpayer filing a single return or a married person filing separately with a federal adjusted gross income of \$100,000 or more;
- 2) A taxpayer filing as a head of household with a federal adjusted gross income of \$150,000 or more; or
- 3) A taxpayer filing a joint return or as a surviving spouse with a federal adjusted gross income of \$200,000 or more.

The Department appreciates that the Senate Committee on Ways and Means adopted the Department's suggestion to clarify that the income thresholds apply to the taxpayers' federal adjusted gross income.

Thank you for the opportunity to provide comments.



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**Testimony COMMENTING on SB3084 S.D.1
RELATING TO CESSPOOLS**

REPRESENTATIVE CHRIS LEE, CHAIR
HOUSE COMMITTEE ON ENERGY & ENVIRONMENTAL PROTECTION

REPRESENTATIVE DELLA AU BELATTI, CHAIR
HOUSE COMMITTEE ON HEALTH

Hearing Date: March 22, 2016
Time: 10:00 AM

Room Number: 325

1 **Fiscal Implications:** This measure does not provide the resources necessary to implement the
2 tax credit program.

3 **Department Testimony:** The Department appreciates the intent of this bill to limit the tax
4 credit to lower income households that perform a cesspool upgrade, conversion, or connection to
5 a sewer system. The Department does not oppose the bill proposing income limitations in
6 Section 235-16.5 (i), Hawaii Revised Statutes (HRS). However, the Department does not have
7 the resources or expertise regarding income qualification to implement eligibility determinations
8 as defined in the bill, as those determinations are usually made by other agencies.

9 Furthermore, the Department defers to the Department of Taxation and the Governor's Executive
10 Budget to address the fiscal implications that would be involved with the implementation of this
11 bill.

12 Thank you for the opportunity to testify on this measure.

TAX FOUNDATION OF HAWAII

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SUBJECT: INCOME, Disallow Cesspool Credit Based on Income Level

BILL NUMBER: SB 3084, SD-1

INTRODUCED BY: Senate Committee on Ways and Means

EXECUTIVE SUMMARY: This bill would entirely disallow the credit for cesspool conversion for any taxpayer with adjusted gross income over certain levels. This measure would contribute to a “tax cliff” for couples reaching \$200,000 AGI, that could result in the next \$1 in income subjecting the couple to massive additional state tax.

BRIEF SUMMARY: Amends HRS section 235-16.5 to provide that the income tax credit for cesspool upgrade, conversion, or connection will be entirely disallowed for taxpayers at or above the following federal adjusted gross income (FAGI) levels:

- \$100,000 for a single taxpayer or married filing separately.
- \$150,000 head of household.
- \$200,000 married filing jointly, or as a surviving spouse.

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

STAFF COMMENTS: Act 120, SLH 2015, enacted a temporary income tax credit, expiring on December 31, 2020, for 100% of the qualified costs of a cesspool upgrade, conversion, or connection, up to \$10,000. The recitals in the Act explain the problem addressed:

The legislature finds that the State's streams, groundwater, and ocean are being harmed by water pollution from nonpoint contamination sources that flow off the land directly, rather than through pipes or ditches. Cesspools constitute a nonpoint contamination source of grave concern. These substandard systems are essentially holes in the ground that discharge raw, untreated sewage. Groundwater, drinking water sources, streams, and the ocean are contaminated by cesspool pollution from systems that do not treat wastewater, but merely dispose of it.

The legislature further finds that cesspools in Hawaii release approximately 55,000,000 gallons of untreated sewage into the ground each day. There are approximately 90,000 cesspools in the State, with nearly 50,000 located on Hawaii island, approximately 14,000 on Kauai, over 12,000 on Maui, over 11,000 on Oahu, and over 1,400 on Molokai. Reducing the number of cesspools in the State is a matter of great importance. The legislature additionally finds that cesspools near drinking water wells or within two hundred feet of surface waters and cesspools that are connected to multiple residential dwellings present a higher risk of harm to public health and the environment and should be prioritized by the department of health for upgrade. The department of health indicates that there are approximately 6,860 cesspools in those priority locations.

Priority should be given to cesspool owners who request financial assistance to upgrade, convert, or connect cesspools that: affect public drinking water wells; are within two hundred feet of the shoreline, streams, or wetlands; or are connected to multiple residential dwellings.

As we noted at the time, this credit was given without any consideration of the taxpayer's need for tax relief. This bill now seeks to correct this, but does so in somewhat ham-fisted fashion with an all-or-nothing approach.

The legislature may want to consider the following if it is now concerned about the cost of the credit:

- Phasing in the disallowance, so the "tax cliff" effect upon taxpayers is mitigated.
- Allowing for prospective application. A retroactive disallowance, which is possible under the bill as it is now written, would unfairly penalize taxpayers who have already contracted and paid for the work in reliance on the credit.
- Allowing for sunset of the disallowance when the credit sunsets on December 31, 2020.

Digested 3/19/16