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

The Honorable Glenn Wakai, Chair
and Members of the Senate Committee on Economic Development, Tourism, and
Technology

Date: Friday, February 3, 2017
Time: 2:45 P.M.
Place: Conference Room 414, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 1056, Relating to Income Tax Benefits for Seawater Air Conditioning

The Department of Taxation (Department) appreciates the intent of the measure which reduces Hawaii's dependence on fossil fuels for energy, but has serious concerns regarding the structure of this measure. The Department provides the following comments regarding S.B. 1056 for your consideration.

S.B. 1056 creates a tax credit to encourage private businesses to purchase chilled seawater for use in seawater air conditioning systems and also to encourage private investment in a seawater air conditioning business. The measure is effective upon approval and effective for tax years beginning after an unspecified date.

First, this measure will provide an income tax credit, not to exceed 20%, of the cost to purchase chilled water for an air conditioning system that utilizes seawater for cooling purposes. This is notwithstanding the stated claim that seawater air condition provides a service that is price-competitive. The fact that a tax credit must be offered in order to persuade a consumer to use seawater is indicative of the opposite. In essence, the State will be subsidizing the costs for consumers by twenty percent. It also should be noted that the credit is available for each year the consumer purchases cooled seawater for use in a seawater air conditioning system.

Second, the Department is especially concerned with Section 3 of the measure, which creates a new refundable income tax credit for investments made by a taxpayer into a seawater air conditioning business. As a general matter, the Department prefers nonrefundable credits because refundable credits create the potential for wrongful claims and abuse. The measure, as currently drafted, seems to allow a tax credit of 20% of the investment made for each year for

five years, thus, enabling the investor to recoup 100% of the investment made. The State essentially becomes the guarantor of the investment, with the investor having no risk of having the business fail. Thus, the State will be the one to bear all of the risks, while the investor will reap all of the business if the business flourishes and is successful.

Third, there is no requirement that the seawater air conditioning business use the funds invested to build or operate the business here in Hawaii, or even that such use be connected to sea water air conditioning. Such limitless use may encourage use of the funds that are not consistent with the purpose of this measure. For example, the sea water air conditioning business can use the funds to pay management highly inflated salaries, purchase other business opportunities, build sea water air conditioning plants outside of the State, or for any other purpose else, since the monies have no limitations on its use. In addition, there is no sunset date for the credit, which may lead to large amounts of tax revenue lost.

Fourth, the recapture provisions are ambiguous and may not be effective. Although the measure purports to create a recapture if the seawater business fails in any of the five-year credit period, or if the investors sells its interest in the business, the recapture is far from certain or clear. The measure provides that recapture “shall apply only to the investment in the particular qualified seawater air conditioning system business that meets the requirements of paragraphs (1) or (2).” It is not clear what this statement means, as paragraphs (1) and (2) are the events which trigger a recapture, and states no requirements that a seawater air condition business must meet.

Fifth, the credit for investments found in Section 3 seems very similar to the High-Technology Business Investment and Research Activities Tax Credit enacted by Act 221, Session Laws of Hawaii 2000. The Department expended considerable compliance resources to determine whether taxpayer claims for the credits were justified. This credit is likely to bring very similar compliance issues. Validation of tax credit claims requires review of extremely detailed and technical information, and disputes concerning the credit are not easily resolved. It is not uncommon, for example, that audits and the related appeals to span several years of extensive and costly litigation.

Finally, if the Committee wishes to advance this measure, the Department requests that effective date be made no earlier than taxable years beginning after December 31, 2017. This will allow the Department sufficient time to make the necessary form, instruction and computer system modifications.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

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SUBJECT: INCOME, Credit for Seawater Air Conditioning

BILL NUMBER: SB 1056

INTRODUCED BY: GALUTERIA, Dela Cruz, Espero, Gabbard, Harimoto, Keith-Agaran

EXECUTIVE SUMMARY: Enacts a new income tax credit to encourage seawater air conditioning. A direct appropriation would be preferable as it would provide some accountability for the taxpayer funds being utilized to support this effort. Meaning, we as taxpayers know what we're getting and we know how much we're paying for it.

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow a credit for 20% of the actual cost of purchasing chilled water that is to be used by an air conditioning system. If there are multiple tenants in a building in which the owner of the building or other entity purchases the chilled water, the owner of the building may claim a tax credit up to \$_____. If there are multiple tenants in a building and each tenant purchases the chilled water, then each tenant may claim a tax credit up to \$_____.

Tax credits shall apply only to the actual cost of the purchase of chilled water that is to be used in an air conditioning system, and shall not include the cost of consumer incentive premiums unrelated to the operation of the air conditioning system or offered with the sale of electricity produced therefrom.

Adds a second new section to HRS chapter 235 to allow a credit for 20% of the investment made by the taxpayer in a seawater air conditioning system business in the year of investment and the four subsequent years (totaling 100% of the investment) up to a maximum amount of \$_____ per investment.

If at the close of any taxable year in the five-year investment period the qualified seawater air conditioning system business no longer qualifies, or if the business or an interest in it has been sold or withdrawn by the taxpayer, then all of the credit claimed shall be recaptured.

Each taxpayer claiming an investment credit is to apply to the department of taxation for certification of the credit. The department may assess and collect a fee to do this.

If the amount of either the purchase credit or the investment credit exceeds the taxpayer's income tax liability, the excess of credit over liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted.

EFFECTIVE DATE: Upon approval, takes effect on an unspecified date.

STAFF COMMENTS: 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 the use of or investment in emerging technologies, 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 an 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 technologies to a deliberate timetable on pain of losing 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.

Notable about this tax credit legislation is that it does not contain the familiar and hated provision requiring a taxpayer to claim it within a year or forever lose it. Thus, taxpayers could claim this credit a bit more than three years after the close of the taxable year. Because of this, lawmakers could not know the full impact of these credits until several years down the road.

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From: mailinglist@capitol.hawaii.gov
Sent: Monday, January 30, 2017 4:24 PM
To: TRE Testimony
Cc: mendezj@hawaii.edu
Subject: *Submitted testimony for SB1056 on Feb 3, 2017 14:45PM*

SB1056

Submitted on: 1/30/2017

Testimony for TRE/ETT on Feb 3, 2017 14:45PM in Conference Room 414

Submitted By	Organization	Testifier Position	Present at Hearing
Javier Mendez-Alvarez	Individual	Support	No

Comments:

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