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**STATE OF HAWAII  
DEPARTMENT OF TAXATION**

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To: The Honorable Donovan M. Dela Cruz, Chair  
and Members of the Senate Committee on Ways and Means

Date: Wednesday, February 6, 2019  
Time: 10:00 A.M.  
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director  
Department of Taxation

Re: S.B. 972, Relating to Ship Repair Industry

The Department provides the following comments regarding S.B. 972 for your consideration.

S.B. 972 repeals the capital infrastructure tax credit and in its place establishes the ship repair industry income tax credit, utilizing a non-profit entity, to construct and place into service purpose-built floating drydocks at Pearl Harbor for use by the United States Navy. The measure is effective upon approval and applies to taxable years beginning after December 31, 2018.

First, the Department notes that the measure repeals the capital infrastructure tax credit and enacts the ship repair industry tax credit by amending section 235-17.5, Hawaii Revised Statutes (HRS). To prevent any confusion the Department suggests repealing section 235-17.5, HRS, and creating a new section in chapter 235, HRS, for the ship repair industry tax credit.

Second, to prevent any unexpected revenue loss, the Department suggests that language in section (c)(2) of the credit read as follows:

The qualified entity, together with all of its special purpose entities, including all partners and members of the qualified entity and its special purpose entities, shall not claim any credit in any one taxable year that exceeds of \$ \_\_\_\_\_; and

This provision will ensure that the revenue loss does not exceed what the Legislature intended.

Third, the Department notes that Hawaii income tax law adopts or conforms to Internal Revenue Code sections 704 and 706. These sections generally require distribution of a credit in proportion to the ownership in the partnership or other pass-through entity and provide guidance as to the taxable year of partner in relation to the partnership. As currently written, distribution

of the ship repair industry credit does not need to be consistent with these provisions.

Finally, the Department respectfully requests that this new credit be made available for taxable years beginning after December 31, 2019 to allow sufficient time to make the necessary form, instruction and computer system changes.

Thank you for the opportunity to provide comments.

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Ship Repair Industry Tax Credit

BILL NUMBER: HB 534; SB 972 (Identical)

INTRODUCED BY: HB by NAKASHIMA; SB by KIDANI, S. CHANG, Shimabukuro

EXECUTIVE SUMMARY: Establishes the ship repair industry income tax credit for non-profit entities to offset costs incurred to construct and put into service purpose-built floating drydocks at Pearl Harbor for use by the United States Navy. Claims for the ship repair industry income tax credit can be made annually after the drydock is put into service and until the credit is exhausted. Repeals the capital infrastructure tax credit (which was scheduled to sunset on Dec. 31, 2019 anyway).

SYNOPSIS: Amends HRS section 235-17.5 (which now defines the capital infrastructure credit that is set to sunset on Dec. 31, 2019) to become the ship repair industry tax credit.

Allows a credit of \_\_\_% of the total costs paid or incurred by a qualified entity to design and construct the purpose-built floating dry dock to be used by the United States Navy in Pearl Harbor. A qualified entity shall become eligible for the maximum credit of \$\_\_\_\_\_ per qualified entity after construction of the floating drydock has been completed and the floating drydock has been placed into service.

Defines "ship repair industry costs" as capital expenditures, as used in section 263 and 1012 of the Internal Revenue Code and the regulations promulgated thereunder, or capital expenditures for real property, fixtures, structures, machinery, equipment, or capital assets that are paid or incurred in connection with the construction of a purpose-built floating drydock; provided that the ship repair industry costs shall not include amounts for which another credit is claimed or any amounts received in any form from the State.

Defines "qualified entity" as a not-for-profit entity with the principal purpose of facilitating and enhancing the ship repair business in Hawaii and that is involved in the design and construction of a purpose-built floating drydock to be used by the United States Navy in Pearl Harbor.

Provides that a qualified entity may form a special purpose entity for the purposes of raising investor capital and claiming the credit on behalf of the qualified entity; but the qualified entity, together with all of its special purpose entities, including all partners and members of the qualified entity and its special purpose entities, shall not claim any credit in excess of \$\_\_\_\_\_.

The credit allowed under this section shall be claimed against the net income tax liability for the taxable year. Credits in excess of a taxpayer's income tax liability may be used as a credit against the taxpayer's net income tax liability in subsequent years until exhausted. All claims, including amended claims, for a tax credit shall be filed on or before the end of the twelfth month

following the close of the taxable year. Failure to comply with the foregoing provision shall constitute a waiver of the right to claim the credit.

In the case of an entity taxed as a partnership, credit shall be determined at the entity level, but distribution and share of the credit may be determined notwithstanding section 704 or section 706 of the Internal Revenue Code.

Sunsets on December 31, \_\_\_\_.

Any taxpayer claiming a tax credit under this section shall, within ninety days of the end of the calendar year, submit the following information to the department of taxation: (1) the amount of the eligible costs [for that year] for which the tax credit may be claimed; and (2) the qualified entity which incurred the costs. Failure to timely submit the information shall be subject to a penalty of \$5,000 per month or a fraction thereof, not to exceed \$25,000.

EFFECTIVE DATE: This Act, upon its approval, shall apply to taxable years beginning after December 31, 2018.

STAFF COMMENTS: Tax credits generally are designed to reduce the tax burdens of certain groups by refunding a portion of taxes paid on purchases of essential items and services. The credit proposed by this measure amounts to nothing more than a subsidy of state funds as there is no obvious undue burden of taxes. And as with any subsidy, this one needs to be paid for. Either government needs to shrink, or the cost of government must be borne by all other taxpayers who do not qualify for the subsidy.

Here, the idea apparently is that public money is going to be used to pay for a substantial part of a floating drydock that is going to be used to make money and in which the State will have no ownership or other rights.

Technical problems abound within this bill. Here are some of them:

1. Who would be eligible to claim the credit, the qualified entity (a nonprofit), its investors, its special purpose entities, or some combination of the above? The bill as now drafted does not clearly answer this question.
2. What is the tax credit based on? Total costs to design and construct as provided in subsection (c), or ship repair industry costs as defined in subsection (b)? If the former, why define ship repair industry costs?
3. When the construction of the drydock has been completed and placed into service, does the qualified entity then become entitled to claim the maximum allowable credit regardless of how much (or how little) costs were expended? That appears to be what the last sentence of (c) implies.

Until these technical issues are addressed, it is difficult to understand exactly what is being proposed and how much the budgetary impact would be.

Digested 2/2/2019

## TESTIMONY

FOR SB 972 - RELATING TO THE ISSUANCE OF SPECIAL PURPOSE REVENUE BONDS TO ASSIST PEARL HARBOR FLOATING DRYDOCK, LLC.

COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS

Rep. Angus L.K. McKelvey, Chair

Rep. Lisa Kitagawa, Vice Chair

DATE: Wednesday, February 6, 2019

TIME: 10:00 a.m.

PLACE: Conference Room 211

As a former Commanding Officer of the Pearl Harbor Shore Intermediate Maintenance Activity (SIMA) and the Intermediate Maintenance Officer for the COMMANDER, PACIFIC FLEET, I gained significant expertise and experience in the criticality of the private sector ship repair industrial base in Hawaii. Additionally, I was an Executive Manager at Honolulu Shipyard and Pacific Shipyards at a critical period in the Industry's history. Ultimately, I was the President of BAE Systems Ship Repair until retirement in 2015 and the BAE Hawaii Shipyards located at DD# 4, and the prime contractor on the current multiyear surface ship contract, was one of my key Business Units in my AOR (Area of Responsibility).

Therefore, I have had direct and personal involvement in the local ship repair Industry for over 20 years and keenly aware of the vital role it plays in supporting Pearl Harbor home ported surface ships and those transiting ships in the Pacific. There is a critical balance of public/private workload that is required to maintain a trained and vibrant Industry. Without a stable and predictable non-nuclear surface ship workload, the Industry will decline and erode to the point where it is unrecoverable.

Pearl Harbor Naval Shipyard, one of four Naval shipyards in the U.S., is a significant part of federal military value-added comprising 6 percent of Hawaii GDP. While the submarine footprint and associated workload in Pearl Harbor will continue to grow, the home ported surface ship workload is forecasted to be significantly reduced, based on the current Navy Workload Schedules which reflect surface ships being relocated to San Diego for dry-docking related maintenance, and some at risk for not returning.

Surface vessel repairs are typically outsourced to private-sector ship repair companies, a major part of the estimated \$180-200 million in civilian ship repair activities in Hawaii during 2018. The impact of losing surface vessel repair work would be far-reaching, well beyond the loss of direct military jobs associated with surface ships leaving the area. The Navy's documented drydock capacity shortfalls will refocus almost all of the current PH drydock capacity on critical submarine maintenance and displace nearly all surface ship drydock maintenance and modernization to the west coast. The loss of Navy surface ship drydock maintenance to the Pearl Harbor private-sector ship repair community would cause irrecoverable damage to this critical Industry, which is a national asset.

There will be drastic adverse economic and industrial impacts to the State of Hawaii as a result of the U.S. Navy's current plan to move surface fleet maintenance from Pearl Harbor to the West Coast. A mitigation strategy is needed that avoids the adverse economic impacts of displaced ship repair activities over the next seven years: loss of nearly \$1.31 billion in Hawaii GDP, \$351 million in labor earnings, and an annual average of nearly 1000 jobs each year. **Current workload schedules are**

**forecasted through 2025 and if this drydock shortfall is not remedied, this economic impact will continue.**

**The immediate and most cost-effective solution for the State of Hawaii** is the construction of a purpose-built floating drydock capable of accommodating any of the submarines and surface ships currently in and planned for at Pearl Harbor. This floating drydock will not only protect private-sector maritime jobs that are expected to be lost, but will stimulate overall job growth of this sector, prevent the erosion of Hawaii's private ship repair capability and provide greater strength and stability to the Navy's Mid-Pacific Surface Force. This offers a shared solution for the Industry, State of Hawaii, and Navy that results in a fifth drydock; a new, mobile, floating asset that can be in place by 2022. Given its 50+ year life cycle, this additional Pearl Harbor drydocking capacity will provide economic gains well into the future.

**SB-972**

Submitted on: 2/2/2019 11:58:48 AM

Testimony for WAM on 2/6/2019 10:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Ann Chung	Testifying for Pacific Marine	Support	Yes

Comments:

We STRONGLY SUPPORT SB972. Pearl Harbor Naval Shipyard, one of four Naval shipyards in the U.S., is a significant part of federal military value-added comprising 6 percent of Hawaii GDP. While the submarine footprint in Pearl Harbor will continue to grow slightly by 2025, the surface combatant fleet currently homeported in Pearl Harbor is planned to be significantly reduced and surface ships will be relocated to San Diego for deep maintenance, and most are at risk for not returning.

Surface vessel repairs are typically outsourced to private-sector ship repair companies, a major part of the estimated \$180-200 million in civilian ship repair activities in Hawaii during 2018.

The impact of losing surface vessel repair work would be far-reaching, well beyond the loss of direct military jobs associated with surface ships leaving the area. The Navy's drydock capacity shortfalls will refocus nearly 100% of the current PH drydock capacity on submarine maintenance and displace nearly all surface ship drydock maintenance and modernization to the west coast. **THE LOSS OF NAVY SURFACE SHIP DRYDOCK MAINTENANCE TO THE PH PRIVATE-SECTOR SHIP REPAIR COMMUNITY WOULD SIGNIFICANTLY SHRINK THE LOCAL INDUSTRY AND BE UNRECOVERABLE.**

There will be drastic adverse economic and industrial impacts to the State of Hawaii as a result of the U.S. Navy's current plan to move surface fleet maintenance from Pearl Harbor to the West Coast. A mitigation strategy is needed that avoids the adverse economic impacts of displaced ship repair activities over the next seven years: **LOSS OF NEARLY 1.31 BILLION IN HAWAII GDP, \$351 MILLION IN LABOR EARNINGS, AND AN ANNUAL AVERAGE OF NEARLY 1000 JOBS EACH YEAR.**

The construction of a purpose-built floating drydock capable of accommodating any of the submarines and surface ships currently in and planned for at Pearl Harbor represents the best mitigating solution for the State of Hawaii. This floating drydock will not only protect private-sector maritime jobs that are expected to be lost, but will stimulate overall job growth of this sector, prevent the erosion of Hawaii's private ship repair capability and provide greater strength and stability to the Navy's Mid-Pacific Surface Force. This offers a shared solution for the industry, State of Hawaii, and Navy

that results in a fifth drydock; a new, mobile, floating asset in place by 2022. Given its 50+ year life cycle, this additional Pearl Harbor drydocking capacity will provide economic gains well into the future.

We urge you to pass this bill.



**SB-972**

Submitted on: 2/2/2019 2:53:36 PM

Testimony for WAM on 2/6/2019 10:00:00 AM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
cheryl	Individual	Comments	No

Comments:

PLEASE JUST stop putting profit, the US military and govt., Foreign governments and corporations before those of us who live here. Do you know how many bills right now, similar to this one are attacks on our land and resources? Try look and JUST STOP.

I understand many local people work at Pearl Harbor and are affected by this dock etc. BUT when did the Federal Govt.'s kuleana become ours?? Oh, that's right, they often don't take care of the lands and areas they take.. ie Red Hill, Kahoolawe, Pohakuloa.

**SB-972**

Submitted on: 2/2/2019 9:03:29 PM

Testimony for WAM on 2/6/2019 10:00:00 AM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Alan S. Hayashi	Individual	Support	Yes

Comments:

Committee on Ways and Means

Chair Dela Cruz, Vice Chair Keith-Agaran

Thank you for the opportunity to testify. My name is Alan S. Hayashi, testifying as a concerned citizen, in STRONG SUPPORT of passage of this bill, SB972.

Unless legislative assistance is provided by the Hawaii State Legislature in this 2019 session, the Ship Repair industry, as a critical part of Hawaii's heavy industrial base, will start to disappear in 2023, with resulting loss of \$1.3B in revenue and about 900-1,000 jobs, per recent report submitted to DBEDT and the Hawaii State Legislature by the Ship Repair Association of Hawaii.

I urge your consideration and passage of this measure to save this critical sector of Hawaii's Ship Repair industry. Thank you for your consideration.

I will stand on my testimony, however, if any questions, I will be glad to address your concerns. ALOHA, Alan Hayashi

**SB-972**

Submitted on: 2/4/2019 9:25:18 AM

Testimony for WAM on 2/6/2019 10:00:00 AM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Michael Buelsing	Testifying for Pacific Marine & Supply, Co.	Support	No

Comments:

Through its subsidiary, Pacific Shipyards, LLC., Pacific Marine has been involved with the Ship Repair Association of Hawaii (SRAH) since its founding in 2002. Without the addition of new drydocking capacity at Pearl Harbor Naval Shipyard (PHNSY), SRAH anticipates that all or nearly-all of the private-sector supported surface-ship maintenance activities at PHNSY could be forced to relocate to San Diego - an estimated loss of nearly 1,000 jobs and a GDP impact to the State of Hawaii of up to \$1.31 billion over the next seven years alone.

To avoid this outcome, Pacific Marine supports the initiative to deploy a purpose-built mobile floating drydock at Pearl Harbor, and specifically supports S.B. 972.

# *A & B Electric Co., Inc.*

February 4, 2019

To: Senate Committee on Ways and Means

From: Malcolm Barcarse, Jr.  
Vice President of A & B Electric Co., Inc.

RE: **OPPOSITION** to SB 972 Relating to Ship Repair Industry

Chair Dela Cruz, Vice Chair Keith-Agaran and members of the Committee,

A & B Electric Co., Inc. is an electrical contractor who has been in business since 1986, servicing commercial, industrial, and marine customers. One of the industries that we service is the ship year industry as an electrical subcontractor to the ship repair industry in Hawaii. We stand in **OPPOSITION** to this bill as this bill and SB 985 which was heard on February 5, 2019 seem to solely benefit a company that does not current currently exist and would give them a competitive edge in the marketplace with state assistance.

Currently there are 3 private drydocks in the State that provide docking repairs to for Private, State, and military vessels. With the upcoming expiration of the Multi Ship Multiple Option (MSMO) contract, which is currently being held by BAE Hawaii Shipyards. It will give the various companies in the ship repair industry in Hawaii an opportunity to compete for the various repairs to the nine homeported destroyers at Pearl Harbor. Some of these availabilities will require drydock services some of them will not. The availabilities that require drydock services will require the existing ship repair companies to upgrade their drydocks for these future availabilities

We **OPPOSE** this bill as it appears that the legislature is appearing to favor one entity in a competitive local marketplace. We feel that it is an inappropriate use of tax payer dollars in the form of tax credits to benefit one company in a competitive marketplace. We further note, that this bill is to benefit a company that does not even exist. (See attachment of DCCA business entity search showing no company named Pearl Harbor Floating Drydock LLC dated 2/4/2019.)

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## Search for Business Entity & Documents

Search for a business by name. You can obtain file number and business information and then proceed to purchase a certificate of good standing or other documents.

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You may also **authenticate** a certified document or Certificate of Good Standing (COGS).

Please note: The results of this search should not be used as a definitive method to determine name availability. The purpose of this search is simply to determine whether a company/entity exists and to provide basic information on the company/entity. Contact the Department of Commerce and Consumer Affairs - Business Registration Division at (808) 586-2727 for assistance with business registrations. If you are registering a business entity name, **NEVER** assume the name is available until you have received a response from the Business Registration Division. You may also read the **Business Naming Rules**.

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# Ship Repair Association of Hawaii

P.O. Box 29001, Honolulu HI 96820  
Ph# (808) 848-6211 Fax# (808) 848-6279

4 February 2019

COMMITTEE ON WAYS AND MEANS

Senator Donovan M. Dela Cruz, Chair

Senator Gilbert S.C. Keith-Agaran, Vice Chair

Testimony for SB972

DATE: Wednesday, February 6, 2019

TIME: 10:00 a.m.

PLACE: Conference Room 211

State Capitol, 415 South Beretania Street

Dear Senator Donovan M. Dela Cruz, Chair; Senator Gilbert S.C. Keith-Agaran, Vice Chair; and members of the Ways and Means Committee:

The Ship Repair Association of Hawaii (SRAH) Strongly Supports the establishment of the ship repair industry income tax credit for non-profit entities to offset costs incurred to construct and put into service purpose-built floating drydocks at Pearl Harbor for use by the United States Navy.

Respectfully yours,

A handwritten signature in black ink, appearing to read "Iain S. Wood".

Iain S. Wood, President

Ship Repair Association of Hawaii

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