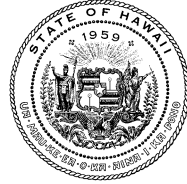


DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR



RONA M. SUZUKI
DIRECTOR OF TAXATION

DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
Phone: (808) 587-1540 / Fax: (808) 587-1560
Email: Tax.Directors.Office@hawaii.gov

To: The Honorable Donovan M. Dela Cruz, Chair;
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair;
and Members of the Senate Committee on Ways and Means

From: Rona M. Suzuki, Director
Department of Taxation

Re: S.B. 2059, Relating to Well Abandonment

Date: Wednesday, January 29, 2020

Time: 10:10 A.M.

Place: Conference Room 211, State Capitol

The Department of Taxation (Department) appreciates the intent of this measure. The measure establishes an income tax credit for taxpayers who are required to fill and seal abandoned wells on their real property. The credit is of an unspecified percentage of qualified compliance costs incurred by the taxpayer, up to an unstated maximum. The Commission on Water Resource Management (Commission) must verify the costs and certify the amount of the credit that the taxpayer is entitled. The measure is effective upon approval, and the credit is applicable to taxable years beginning after December 31, 2019 and is repealed on an unspecified date.

This measure contains an aggregate cap. As with other income tax credits that require a certification, the Department will work with the certifying agency on procedures and any required forms.

The Department respectfully requests that this new tax credit be made available for taxable years beginning after December 31, 2020. This will allow sufficient time for the Department and the Commission to prepare the necessary forms, instructions, procedures, and computer system changes to properly administer the credit.

Thank you for the opportunity to provide comments.

DAVID Y. IGE
GOVERNOR OF
HAWAII

LATE

SUZANNE D. CASE
CHAIRPERSON
BOARD OF LAND AND NATURAL RESOURCES
COMMISSION ON WATER RESOURCE MANAGEMENT

ROBERT K. MASUDA
FIRST DEPUTY

M. KALEO MANUEL
DEPUTY DIRECTOR - WATER

AQUATIC RESOURCES
BOATING AND OCEAN RECREATION
BUREAU OF CONVEYANCES
COMMISSION ON WATER RESOURCE MANAGEMENT
CONSERVATION AND COASTAL LANDS
CONSERVATION AND RESOURCES ENFORCEMENT
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FORESTRY AND WILDLIFE
HISTORIC PRESERVATION
KAHOOLAWE ISLAND RESERVE COMMISSION
LAND
STATE PARKS



**STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES**

POST OFFICE BOX 621
HONOLULU, HAWAII 96809

**Testimony of
SUZANNE D. CASE
Chairperson**

**Before the Senate Committee on
WAYS AND MEANS**

**January 29, 2020
10:10 AM
State Capitol, Conference Room 211**

**In consideration of
SENATE BILL 2059
RELATING TO WELL ABANDONMENT**

Senate Bill 2059 proposes to amend Chapters 235- and 508D, Hawai'i Revised Statutes (HRS), to establish a compliance income tax credit to seal abandoned wells and require sellers to disclose the existence of an abandoned well on their property. This measure is to be effective upon approval with credit applicable to taxable years beginning December 31, 2019. **The Department of Land and Natural Resources (Department) supports the intent of this measure and offers the following comments and suggested amendments.**

First, this measure refers to the definitions of abandoned wells and qualified compliance costs that are slightly incomplete. In addition to Section 174C-81, HRS, Section 13-168-2 Hawai'i Administrative Rules (HAR), the Department's Commission on Water Resources' (Commission) 2019 Water Resource Protection Plan (WRPP) Section I.3.2, and the 2004 Hawai'i Well Construction and Pump Installation Standards (HWCPIS) Section 3.1 further clarify the definition for abandoned wells and are slightly different. To be comprehensive and consistent, the Department suggests adding a new SECTION that amends the definition of abandoned well under Section 174C-81, HRS as follows:

"[+]§174C-81[+] **Definitions.** As used in this part, unless the context otherwise requires, the terms:

"Abandoned well" means any well whose purpose or use [that] has been permanently discontinued. Any well shall be deemed abandoned and sealed whenever the well [which] has served its purpose, the well use has been permanently discontinued, the

well is not properly maintained, the physical condition of the well is causing a waste of ground water or is impairing or threatens to impair the quality of the ground-water resources, or [it]the well is in such a state of disrepair that its continued use [for the purpose of obtaining ground water] is impractical or it is a hazard to public health or safety.

Further, the definition for qualified compliance costs also seems incomplete. It excludes costs incurred to seal or plug an incomplete and abandoned well permitted under Section 174C-84(e), HRS, which addresses changing the location of an approved and permitted well under Chapter 174C, HRS. However, this exclusion should also apply to: 1) incomplete wells permitted under the entire Section 174C-84, HRS, regardless of any location change and which are simply incomplete and should be abandoned, and 2) existing wells prior to Chapter 174C, HRS, whose owners have refused to allow well source certifications and verifications of a well or wells known to exist at one time on their property. These two additional situations include those who do not exhibit good faith in following conditions already included on their well construction permits or who do not allow verification of wells existing prior to the effective date of Chapter 174C, HRS (L 1987). The Department suggest amending (grey highlight) the definition of qualified compliance costs in subsection (i) of this measure as follows:

"Qualified compliance costs" means construction costs that are necessary and directly incurred by the taxpayer to fill and seal an abandoned well in compliance with section 174C-87.

"Qualified compliance costs" do not include costs incurred to seal or plug an incomplete, uncertified and abandoned well pursuant to [section] sections 174C-27 and 174C-84[~~(e)~~].

Second, this measure should clarify if the compliance income tax credit applies to or is excluded from sealing well activities under the jurisdiction and regulation of: 1) the State Department of Health's (DOH) Underground Injection Control Program (injection wells, Section 11-23 HAR); 2) the State Department of Health's Underground Storage Tank and the Office of Hazard Evaluation and Emergency Response Programs (environmental wells, Chapter 11-28.1, HAR and Chapter 128D, HRS, respectively); and 3) the State Department of Land and Natural Resources' Engineering Division (geothermal wells, Chapter 183, HAR). These agencies should be responsible for the requirements listed under the proposed Section 235- (f), HRS, of this measure under their respective programs rather the Commission including the issuance of certificates verifying qualifying compliance cost and credits each taxable year for similar sealing activities.

Third, this measure should clarify if there are differences in compliance income tax credit for voluntary or Commission-ordered abandonment. There are issues between voluntary abandonment, Commission action requiring abandonment, water use reporting of ground water data, and enforcement of these issues. The 2019 WRPP Section I.3.2 provides more detail but

generally explains the Commission's efforts and authority to determine when a source meets the definition of abandonment and requires sealing as authorized under Section 13-168-16, HAR. Commission efforts to determine abandonment is difficult and time consuming as many well owners are reluctant to voluntarily declare their well abandoned because wells are generally considered assets to the property and can be expensive to properly seal. If a well owner complies with monthly reporting requirements or allows Commission staff to gather data from a well not threatening the groundwater resource, then this is good for monitoring the health of the resource. However, if the owner does not report or allow the Commission to monitor its well, then significant Commission efforts can be expended on enforcement, fines, and orders to abandon. This measure should encourage voluntary abandonment and make a distinction between voluntary abandonment and well owners who require the Commission to take extra action to determine well abandonment and order their well source sealed.

Fourth, the proposed amendment to Chapter 508D, HRS, that require a seller to disclose the existence of an abandoned well on the seller's disclosure statement is a good provision, but the Commission recommends that the existence of any well on a seller's property be disclosed. The Commission presently issues source certifications to the landowners of permitted and verified pre-Chapter 174C, HRS, wells that notify them of their responsibilities in metering, reporting monthly pumpage, maintaining, and further appropriate regulatory permitting requirements, including the landowner's responsibility to seal an abandoned well, to protect the public trust resource. An additional requirement of these well source certificates is that, should an operator and/or landowner of a well source change, the Commission be notified such that the new parties are issued their own updated source certificates notification. This keeps the Commission informed of ownership changes that affect monthly reporting tracking purposes and notification for new owners of their responsibilities towards protecting the resource including the landowners' liability for sealing abandoned wells on their property. The Commission would strongly support requiring all wells to be part of a seller's disclosure and would help keep the Commission informed as well as protect prospective buyers from non-disclosure of wells and well owners' legal responsibilities to do their part to protect the public trust resource as well as address abandoned wells this measure seeks to address. As such, we suggest the measure be amended to require disclosure of any well as follows:

As such, the Department suggests amending (grey highlight) SECTION 2 of this measure to require disclosure of any well as follows:

"§508D- Abandoned wells; material fact; disclosure.

(a) The existence of [~~any abandoned~~] a well on real property subject to this chapter shall be considered a material fact and shall be included in a seller's disclosure statement.

(b) If a seller fails to disclose the existence of [~~any abandoned~~] a well, as required under subsection (a), the seller shall be liable to the buyer for costs incurred by the buyer to

fill and seal the well should the new owner be required by the commission on water resource management to abandon and seal the abandoned well in compliance with section 174C-87."

Fifth, amendments to Chapter 235-, HRS, allows the Director of Taxation and the Commission to ascertain the validity of a claim for credit, on an annual basis, and does not specify the limits of aggregate and total amounts of credits in both absolute dollar and percentage amounts. While the Commission will work with the Director of Taxation to address the procedures and forms required to implement this, -under this amendment the rules will reside under Chapter 235-, HRS, rather than Chapter 174C, HRS, which may be a more appropriate statute. The Commission has estimated the costs of sealing wells in the past that range between several thousand dollars for shallow small wells to millions of dollars for large plantation shaft and tunnel sources. The Commission does not have a recommendation at this time for aggregate or total credits but would prefer a simple percentage-based credit to treat all well owners equitably. Also, the Commission respectfully requests that this new tax credit be available beginning after December 31, 2020, to allow the Director of Taxation and the Commission sufficient time to prepare necessary procedures, forms, and computer system changes to properly administer this credit.

Lastly, existing staff resources may not be sufficient to take on the additional tasks outlined in this measure. To date, the Commission estimates there are about 1,619 former production wells that are candidates for sealing as abandoned wells (Ni'ihau (25), Kaua'i (135), O'ahu (784), Moloka'i (107), Lana'i (18), Maui (336), Kaho'olawe (2), and Hawai'i Island (212)). SB 2059 may help the Commission towards implementing its 2019 Water Resource Protection Plan Goal 2, Project 2.7, Tasks 2.7.1 and 2.7.2 that seek the timely decommissioning of these potential abandoned wells. Task 2.7.1 requires Commission staff to develop an abandoned well sealing program in coordination with DOH and the Counties, including staff and funding resources, towards eliminating these potential conduits for ground water contamination. Task 2.7.2 is prioritizing amongst the list of potential candidates for sealing (so far, Commission staff has only prioritized 77 candidate state owned sources for abandonment). Further, proposed amendments to Section 235- (f), HRS, requires the Commission to maintain records, verify, issue annual certifications of the total claimed amount of qualified compliance costs for each taxpayer claiming a credit for each taxable year subject to maximum annual credit amounts, and notify the Department of Taxation when credits are exceeded. These requirements would be in addition to the current workload for ground water hydrologic regulatory, monitoring, permitting, inspection, and enforcement related to wells.

Thank you for the opportunity to comment on this measure.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME TAX, Credit for Taxpayers for Filling and Sealing Abandoned Wells

BILL NUMBER: SB 2059

INTRODUCED BY: DELA CRUZ, KANUHA, KEITH-AGARAN, KIDANI, K. Kahele, Nishihara, Shimabukuro

EXECUTIVE SUMMARY: Establishes an income tax credit for taxpayers who are required to fill and seal abandoned wells on their real property. Requires sellers of real property to disclose the existence of abandoned wells. Tax credit sunsets on an unspecified date.

SYNOPSIS: Adds a new section to chapter 235 to establish a well abandonment compliance income tax credit. The nonrefundable credit is ___% of the qualified compliance costs incurred by the taxpayer, up to a ceiling of \$_____.

Defines “qualified compliance costs” as construction costs that are necessary and directly incurred by the taxpayer to fill and seal an abandoned well in compliance with section 174C-87. “Qualified compliance costs” do not include costs incurred to seal or plug an incomplete and abandoned well pursuant to section 174C-84(e).

The credit is to be precertified by the commission on water resource management. There is a statewide aggregate cap of \$_____.

The credit will sunset on December 31, _____.

EFFECTIVE DATE: Upon approval.

STAFF COMMENTS: This measure proposes a tax credit for sealing an abandoned well on the taxpayer’s property. The measure allows taxpayers to claim the credit regardless of a taxpayer’s need for tax relief, so the proposed credit is nothing more than a partial subsidy by the state to taxpayers for such conversion with absolutely no indication of the taxpayer’s need for that subsidy. This type of targeted tax incentive creates winners and losers, the winners being those who receive the incentives and the losers being the rest of us who have to pay for them.

When judging targeted tax incentives such as this one, we all should be mindful of these observations of the 2001-2003 Tax Review Commission: “Targeted tax incentives are generally only demonstrably good for those relatively few taxpayers that qualify for the benefits, and may not be demonstrably good for anyone else. They are not supported by rules of sound tax policy. In the first instance, they decrease State revenue and add complexity to the tax system. They may also be unfair to other businesses. Almost all of the present incentives lack accountability, and therefore create something of a “black hole” in State fiscal responsibility. A targeted tax incentive does not appropriate hard earned and increasingly scarce revenues. Rather, it creates a tax benefit of unknown proportions against future revenues, before the revenues are collected and subjected to the legislative appropriation process.”

Appropriations to favored businesses, or subsidies, are rarely enacted. Every public appropriation is publicly scrutinized. A tax incentive is a potential “black hole,” because it is a future benefit of unknown proportions which is determined by the favored taxpayer’s interpretation of what the tax credit should be and is claimed on a tax return which is confidential.

It also should be noted that a property owner who abandons a well is obligated under section 174C-87, HRS, to fill and seal it. The need for a tax incentive for someone to comply with an existing legal obligation is questionable as a policy matter.

Digested 1/27/2020