



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 WAYS AND MEANS

Wednesday, March 30, 2016
9:00 a.m.
State Capitol, Conference Room 211

in consideration of
HB 1689, HD2, SD1
RELATING TO TAXATION.

Chair Tokuda, Vice Chair Dela Cruz, and Members of the Committee.

The Department of Business, Economic Development & Tourism (DBEDT) offers comments on HB 1689, HD2, SD1, which establishes a renewable fuels facility tax credit and repeals the ethanol facility tax credit. SD1 amends the production qualification date to January 1, 2020, clarifies that one gallon will equate to 76,330 British thermal units, and amends the qualifying renewable (RE) fuel definition.

While we appreciate the clarifying amendment to the definition of qualifying renewable fuel under SD1, we defer to the Department of the Attorney General on the updated definition's effectiveness in addressing the interstate commerce clause. We do not take a position on the other SD1 amendments.

With regards to the State's policy (reference: <http://energy.hawaii.gov/energypolicy>) of diversifying Hawaii's energy portfolio, we remain 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 in order to qualify for the full tax credit; thus negating potential diversification of our energy portfolio with indigenous resources and leading to subsidization of non-indigenous resources. For example, a renewable fuel producer may use one percent Hawaii-grown renewable feedstock and blend it with another 99 percent non-Hawaii sourced

renewable feedstock and still qualify for the full tax credit under the present language of 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 indigenous and non-indigenous renewable feedstock is allowed.

While the bill caps the available tax credit at an aggregate total of forty million gallons per year, there is nothing to prohibit a single taxpayer of a renewable fuels facility to capture the full allocation of the credit, which may detract from establishing a competitive clean fuels market.

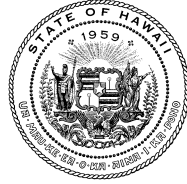
DBEDT also remains concerned about its responsibilities under this bill as DBEDT lacks, and would require, funding and human resources beyond our current budget to execute our responsibilities under the bill. Responsibilities of concern to DBEDT under this bill include: the verification of actual production of the renewable fuel facilities, which would be required to revise the facilities' capacity (lines 6-16, page 9) and the annual report to the Governor and Legislature.

DBEDT defers to the Department of Taxation on the administration of the renewable fuels production tax credit; and to the Department of Budget and Finance on the fiscal impacts of this measure.

Thank you for the opportunity to offer these comments regarding HB 1689, HD2, SD1.

DAVID Y. IGE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



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MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

JOSEPH K. KIM
DEPUTY DIRECTOR

To: The Honorable Jill N. Tokuda, Chair
and Members of the Senate Committee on Ways and Means

Date: March 30, 2016
Time: 9:00 A.M.
Place: Conference Room 211, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 1689, H.D. 2, S.D. 1, Relating to Taxation.

The Department of Taxation (Department) appreciates the intent of H.B. 1689, H.D. 2, S.D. 1, and provides the following comments for your consideration.

H.B. 1689, H.D. 2, S.D. 1, amends the ethanol facility tax credit at section 235-110.3, Hawaii Revised Statutes (HRS), to apply to facilities that produce renewable fuels. The definition of renewable fuels include a variety of fuel products produced from "renewable feedstocks," which are defined. The measure has a defective effective date of July 1, 2030 and the amendments apply to taxable years beginning after December 31, 2015.

First, the Department notes that the suggested amendment to Paragraph (a)(4) is not clear. The paragraph reads "No taxpayer that claims the credit under this section shall use the investment upon which the claim under this section is made to claim any other tax credit under this chapter for the taxable year." The Department suggests clarification of this provision as the credit is limited by the "investment" amount, but the credit is not calculated on it.

Second, the Department notes that this tax credit is certified by the Department of Business, Economic Development, and Tourism (DBEDT). The certification requirements are contained in subsection (d) of section 235-110.3, HRS, and is not edited by this measure. The Department defers to DBEDT regarding its ability to make the necessary certifications, but requests that the certification provisions in this tax credit remain, as the Department is unable to administer the \$12 million aggregate cap and unable make the technical judgments necessary to administer this tax credit.

Finally, the Department notes that this tax credit is refundable. As a general matter, the Department recommends that tax credits be non-refundable because refundable credits are more prone to wrongful claims and abuse.

Due to the defective effective date, there is no revenue impact. However, if the proposal

takes effect upon its approval, annual revenue loss will be \$12 million in FY 2017 and thereafter.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: INCOME, Renewable Fuels Facility Tax Credit

BILL NUMBER: HB 1689, SD-1

INTRODUCED BY: Senate Committee on Transportation and Energy

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. Meaning, we as taxpayers know what we're getting and we know how much we're paying for it.

BRIEF SUMMARY: Amends to HRS section 235-110.3, which now defines the ethanol facility tax credit, to be retitled the renewable fuels facility tax credit. The credit shall be allowed to taxpayers producing qualifying renewable fuels for an eight-year period beginning on the date of first production.

The annual dollar amount of the credit shall be 30% of the annual nameplate capacity if it is greater than 500,000 but less than 15,000,000 gallons. Defines one gallon as equal to 76,330 BTUs, which is the energy content per gallon of ethanol. The credit amount is not to exceed 100% of the total of all investments made by the taxpayer in the facility during the credit period; the facility must operate at 75% or more of its nameplate capacity on an annualized basis; and the facility must be in production on or before January 1, 2017.

No taxpayer that claims the credit shall use the investment upon which the claim for credit is made to claim any other Hawaii income tax credit for the same taxable year.

Defines "qualifying renewable fuel" as fuel created from renewable feedstocks.

Defines "qualifying renewable fuels production" as fuel produced or generated from renewable feedstocks. All qualifying production shall be fermented, distilled, transesterified, gasified, pyrolyzed, combusted, or produced by physical, chemical, biochemical, or thermochemical conversion methods at the facility.

Defines "qualifying renewable fuels production facility" as one located in Hawaii that produces or generates, directly from renewable feedstocks, fuel grade renewable fuels meeting 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 (1) biomass crops; (2) agricultural residues; (3) oil crops, including but not limited to algae, canola, jatropha, palm, soybean, and sunflower; (4) sugar and starch crops, including but not limited to sugar cane and cassava; (5) other agricultural crops;

(6) grease and waste cooking oil; (7) food wastes; (8) municipal solid wastes and industrial wastes; (9) water; and (10) animal residues and wastes, that can be used to generate energy.

EFFECTIVE DATE: July 1, 2030; applies to taxable years beginning after December 31, 2015.

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 amend the ethanol facility tax credit to encompass facilities that produce other renewable fuels.

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.

One technical suggestion to make the credit legislation easier to understand and administer: Because the credit was originally awarded based on gallons of ethanol produced and the credit is now tied to BTU produced, the credit could be awarded as a dollar amount per BTU produced rather than defining "gallons" in artificial fashion. This is similar to the approach taken with the barrel tax in HRS section 243-3.5 when it was expanded to other fossil fuels by Act 185, SLH 2015. We suggest:

§235-110.3 Renewable fuels facility tax credit. (a) Each year during the credit period, there shall be allowed to each taxpayer subject to the taxes imposed by this chapter, a renewable fuels facility tax credit that shall be applied to the taxpayer's net income tax liability, if any, imposed by this chapter for the taxable year in which the credit is properly claimed.

For each qualifying renewable fuels production facility, the annual dollar amount of the renewable fuels facility tax credit during the eight-year period shall be equal to *\$1.00 per 255,000 British thermal units produced; provided that the facility's nameplate capacity is greater than 38.165 billion but less than 1.145 trillion British thermal units*. A taxpayer may claim this credit for each qualifying renewable fuels facility; provided that:...

(b) ... "Nameplate capacity" means the qualifying renewable fuels production facility's net production design capacity, *in British thermal units per year*.

...

(g) Once the total nameplate capacities of qualifying renewable fuels production facilities built within the State reaches or exceeds a level of *three trillion British thermal units per year*, credits under this section shall not be allowed for new renewable fuels production facilities. If a new facility's production capacity would cause the statewide renewable fuels production capacity to exceed *three trillion British thermal units per year*, only the renewable fuels production capacity that does not exceed the statewide *three trillion British thermal units per year* level shall be eligible for the credit.

In addition, "gallons" would be replaced with "British thermal units" in subsections (k) and (m).



SENATE COMMITTEE ON WAYS AND MEANS

March 30, 2016, 9 A.M.

Room 211

(Testimony is 3 page long)

TESTIMONY IN SUPPORT OF HB 1689 HD2 SD1

Suggested Amendment

Aloha Chair Tokuda, Vice Chair Dela Cruz, and Committee Members:

Blue Planet Foundation supports HB 1689 HD2 SD1, which will help Hawai'i's biofuels industry move beyond ethanol. This policy—providing a biofuel facility tax credit to incentivize the needed development, construction, and operation of local renewable fuel facilities—will provide greater support for Hawai'i's diverse biofuel production infrastructure. We suggest an amendment to ensure that the bill addresses the need for local renewable feedstocks rather than imported feedstocks, and to ensure that the bill is constitutional under the U.S. constitution's commerce clause.

Biofuels will likely play a major role in Hawai'i's clean energy future—particularly as a substitute for petroleum-based transportation fuels. While much of our work has been focused on renewable energy and reducing electricity use, transportation in Hawai'i (cars, trucks, ships, and planes) accounts for approximately two-thirds of the oil consumed. **In 2015, Hawai'i cars and trucks burned more than 500 million gallons of gasoline and diesel fuel (an increase over 2014).** For a typical car, that's enough fuel to cover the distance equivalent to over 21,000 round trips to the moon.

As an alternative to these imported fossil fuels, transportation fuels in Hawai'i can be made from renewable feedstocks, such as biomass in various forms, algae, and waste products. Just as importantly, these materials are available here. Hawai'i should set a clear course for a steady transition to renewable fuels and energy security, including local and sustainable biofuels.

Tax incentives have proven to be an extraordinarily effective mechanism to develop a local renewable energy industry; the rooftop solar industry has grown to become an important part of the state's construction industry and is serving as a backstop in the electricity industry to ensure that consumers have options for clean energy. Tax incentive policies for renewable transportation fuels can serve the same purpose for transportation energy.

Blue Planet also asks legislators to also consider requiring that a certain percentage (5% - 10%) of diesel fuel sold in Hawai'i be biodiesel. One of Hawai'i's current entrepreneurial success stories is biodiesel, a fuel that is being locally created from recycled cooking grease and oils, and which can be substituted in place of fossil fuel-based diesel for transportation. Already, this local industry is creating enough fuel to displace 5% of transportation diesel fuel sold in the state. Blue Planet supports a mandate to blend biodiesel with all locally sold diesel fuel. This smart step will help to continue the momentum for a local industry to supply local clean energy for our transportation energy needs.

Suggested Amendment

Blue Planet is concerned that it is not clear in HB 1689 HD2 SD1 whether a renewable fuel could qualify for the tax credit using unsustainable imported feedstocks. Under many scenarios, this practice would undermine the purpose of the bill to promote Hawai'i's energy security with sustainable fuels.

We propose a clarifying definition, requiring that a qualifying fuel must be in Hawai'i's public interest. We also suggest inserting a new Section 1 purpose clause to expressly explain that the purpose of the bill is to support Hawai'i's energy security and sustainability through the promotion of local renewable fuel infrastructure.

"Qualifying renewable fuel" means a fuel created from renewable feedstocks; provided that for the purpose of the renewable fuels facility tax credit, any renewable feedstock transported more than five hundred miles using a fossil fuel can become a qualifying renewable feedstock only upon a showing to the state energy office of the department of business, economic development, and tourism that the renewable feedstock serves a legitimate local purpose for Hawaii. For the purpose of this showing, the state energy office of the department of business, economic development, and tourism shall consider the impact of such fossil fuel transportation on the State's energy security and contribution to greenhouse gas emissions.

This definition is consistent with the commerce clause. Evaluating the commerce clause, the U.S. Supreme Court has stated: "As long as a State does not needlessly obstruct interstate trade or attempt to 'place itself in a position of economic isolation,' it retains broad regulatory authority to protect the health and safety of its citizens and the integrity of its natural resources."¹

Requiring that renewable feedstocks must serve a legitimate local purpose if they are transported using unsustainable fossil fuels is not economic isolation. Instead, this concept is borrowed directly from the U.S. Supreme Court test; a tax credit is valid if it "serves a legitimate

¹ *Maine v. Taylor*, 477 U.S. 131, 151 (1986) (quoting *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935)).

local purpose” and this purpose could not be served as well by other available means, even if it the tax credit favors Hawai‘i taxpayers over other taxpayers in interstate commerce.²

This Supreme Court jurisprudence is the reason that it makes sense to add a purpose clause explaining that the bill is intended to support energy security and sustainability. Hawai‘i’s unique situation and context makes this a *bona fide* and legitimate local purpose. With the nearest out-of-state energy infrastructure thousands of miles away, local energy production is a direct solution for greater energy security. Hawai‘i has no indigenous fossil fuels; indigenous biofuels are presently the *only available source* of secure and sustainable transportation fuels for internal combustion engines in Hawai‘i. Establishing a local industry to produce feedstocks and process those feedstocks into fuels is sound policy. Local sustainable energy resources serve the purpose of energy security and sustainability better than any other means, irrespective of the impact on Hawai‘i taxpayers in comparison to other taxpayers.³

Thank you for the opportunity to testify.

² *Id.* at 138 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979)).

³ Notably, Hawai‘i’s isolated island geography also makes it uniquely susceptible to environmental risks and climate change caused by emissions from imported fossil fuels and transporting biofuel feedstocks long distances. Hawai‘i has a “legitimate interest in guarding against [even] imperfectly understood environmental risks.” *Id.* at 148. The “constitutional principles underlying the commerce clause cannot be read as requiring the State of [Hawai‘i] to sit idly by and wait until potentially irreversible environmental damage has occurred” *Id.*



Email: communications@uluPono.com

SENATE COMMITTEE ON WAYS & MEANS
Wednesday, March 30, 2016 — 9:00 a.m. — Room 211

UluPono Initiative Strongly Supports HB 1689 HD 2 SD 1, Relating to Taxation

Dear Chair Tokuda, Vice Chair Dela Cruz, and Members of the Committee:

My name is Murray Clay and I am Managing Partner of the UluPono Initiative, a Hawai'i-based impact investment firm that strives to improve the quality of life for the people of Hawai'i by working toward solutions that create more locally produced food; increase affordable, clean, renewable energy; and reduce waste. We believe that self-sufficiency is essential to our future prosperity and will help shape a future where economic progress and mission-focused impact can work hand in hand.

UluPono strongly supports HB 1689 HD 2 SD 1, which broadens the renewable fuels tax credit, because it aligns with our goal of increasing the production of clean, renewable energy in Hawai'i.

In recent years Hawai'i has seen significant growth in renewable energy adoption moving the State towards its renewable energy goals. However, while the state locally produces about 14% renewable electricity, renewable fuels are far less than 1% of fuel use. Electricity represents approximately 40% of energy use in the state while transportation fuels account for a larger share at 51%. This is disturbing as this means we are making the least amount of progress to date in renewable production for the largest share of the state's energy use.

We strongly believe that this bill has the potential to open the door for significant renewable energy investment in Hawai'i.

As Hawai'i's energy issues become more complex and challenging, we appreciate this committee's efforts to look at policies that support renewable energy production.

Thank you for this opportunity to testify.

Respectfully,

Murray Clay

Investing in a Sustainable Hawai'i

Managing Partner



Testimony to the Senate Committee on Ways and Means
Wednesday, March 30, 2016 at 9:00 am, Conference Room 211, State Capitol
RE: House Bill 1689 HD2 SD1

Chair Tokuda, Vice Chair Dela Cruz and Members of the Committee on Ways and Means:

Hawaii Gas strongly supports HB 1689. For the purpose of clarity, Hawaii Gas has provided the summary table below, which compares HB 1689 and SB 2652. Both Bills establish renewable fuel investment and production tax credits respectively for biogas, hydrogen and other non-ethanol fuels, which will help Hawaii achieve its renewable future by displacing the oil now used to produce synthetic natural gas, electricity and gasoline and diesel for ground and marine transportation.

Table 1: Comparison of HB 1689 and SB 2652.

Attribute	HB 1689 HD2 SD1	SB 2652 SD2 HD1
Type of Credit	Investment Tax Credit	Production Tax Credit
Requirement to Qualify for Credit	Construct facility to produce more than 500,000 but less than 15,000,000 gallons per year	Produce not less than 15 billion Btu per year (which equals 197,368 gallons based on a conversion factor of 76,000 Btu per gallon)
Qualifying Condition	Must produce fuel at 75% of nameplate capacity	Based on amount produced with no minimum
Offsets Taxpayer Net Income Tax Liability	Yes	Yes
Effective End Date in Statute	January 1, 2020	December 31, 2021
Years to Claim Credit	Eight (8) years	Five (5) years
Credit Defines	Dollar credit equals 30% of annual nameplate capacity in gallons	20 cents per 76,000 Btu produced
Normalization Factor so Credit can Apply to Different Types of Fuels	One gallon equals 76,333 Btu	Per 76,000 Btu produced
Normalized Incentive Amount (\$ per MMBtu)	\$3.93 per MMBtu	\$2.63 per MMBtu using the lower heating value
Can Claim Another Tax Credit for Renewable Fuel	No	No
Limit Credit per Tax Payer per Year	40 million gallons which equals \$12,000,000	\$3,000,000
Total Program Credit Limit per Year	40 million gallons which equals \$12,000,000	\$3,000,000

While there are differences in some key areas such as the length of time the credits are available, the dollar value of the credit and the production volume needed to qualify for the credit, both Bills establish appropriate incentives to support local biofuel production.

For the sake of normalizing the two Bills in one key area, we suggest the following changes to HB 1689 as shown in the double underlined wording:

- ...provided that one gallon shall be equal to ~~76,330~~ 76,000 British thermal units (using the lower heating value of renewable fuel produced), as defined by the United States Department of Energy Advanced Fuels Data Center, which is the energy content per gallon of ethanol

The rationale for the changes is that the amount of energy in one gallon of ethanol should be the same regardless of the Bill and 76,000 Btu per gallon is a generally accepted amount. Second, the lower heating value of the renewable fuel that is produced represents the real amount of energy available for use and is what ought to be incentivized.

Thank you for the opportunity to testify.