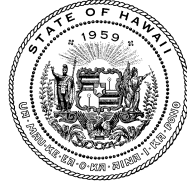


HB 2042,
HD2

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To: The Honorable Mike Gabbard, Chair
and Members of the Senate Committee on Water, Land, and Agriculture

Date: March 14, 2016
Time: 2:45p.M.
Place: Conference Room 224, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 2042, Relating to Water Conservation.

The Department of Taxation (Department) appreciates the intent of H.B. 2042 and provides the following comments for your consideration.

H.B. 2042 provides a refundable income tax credit for fifty percent of the cost of a residential water conservation system, up to a maximum of \$1,000, with an aggregate cap of \$2 million per year. The bill is effective upon approval and applies to taxable years beginning after December 31, 2016.

First, the Department recommends non-refundable tax credits because refundable tax credits create the potential for wrongful claims and abuse.

Second, the Department notes that aggregate caps are difficult for the Department to administer and often result in uncertainty for taxpayers. Accordingly, the Department requests that the credits be certified by another State agency if the Legislature intends to impose an aggregate cap on the total amount of claims.

Third, the Department notes that the definition of "residential water conservation system" in subsection (f)(1) is broad, as it includes any system to capture, infiltrate, *or* utilize rainfall from roofs or other hard surfaces on residential property. This may be interpreted to include any device to capture water even if the purpose is not to store and use the water, such as rain gutters without a storage tank. If the intent of this bill is to provide a credit for systems that capture rainfall for reuse, the Department suggests amending the definition to: "The equipment and supplies used to construct a system for the capturing, infiltrating, [ø] and utilizing of rainfall from roofs"

Fourth, assuming the definition of a "residential water conservation system" is intended to include either a system that captures and reuses rainwater as described in subsection (f)(1) *or* a system that collect and reuses grey water as described in (f)(2), the Department suggest replacing the word "and" in subsection (f)(1) on line 2, page 4, with an "or".

Finally, the Department notes that this bill will require a new form and computer system programming; therefore, the Department requests that this bill apply to taxable years beginning after December 31, 2017.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

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SUBJECT: INCOME, Credit for Residential Water Conservation System

BILL NUMBER: HB 2042, HD-2

INTRODUCED BY: House Committee on Finance

EXECUTIVE SUMMARY: Proposes an income tax credit for a residential water conservation system. The proposed credit would result in a subsidy of such devices as it would merely grant a tax credit for such purchase irrespective of a taxpayer's need for tax relief. If it is considered desirable to have this subsidy, we ask the committee to consider a rebate program instead of burdening the tax system.

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers to claim a tax credit for a residential water conservation system where the cost is incurred and paid during a tax year. The amount of the credit shall be ___% of the cost of the system incurred and paid during the taxable year up to a maximum of \$_____.

Defines "residential water conservation system" as (1) the equipment and supplies used to construct a system for the capturing, infiltrating, or utilizing of rainfall from roofs, constructed catchment surfaces, or other hard surfaces on a residential property; or (2) the equipment and supplies used to construct a system for the collection and reuse of gray water, as defined in HRS section 342D-1, on a residential property.

If a deduction is taken for the system under Internal Revenue Code section 179, no tax credit shall be allowed for that portion of the system costs for which the deduction was taken. The basis of the system for depreciation purposes will be reduced by the amount of credit allowable and claimed, and no deduction for state income tax purposes shall be allowed for the costs for which the credit is claimed.

Credits in excess of a taxpayer's income tax liability may be applied to subsequent income tax liability until exhausted. Requires all claims for the credit to be filed on or before the end of the twelfth month following the close of the taxable year. The director of taxation may prepare the necessary forms to claim the credit and may require the taxpayer to furnish information to ascertain the validity of the claim for the credit. The director may adopt rules under chapter 91.

EFFECTIVE DATE: Effective 7/1/2030, applies to taxable years beginning after 12/31/16.

STAFF COMMENTS: It appears that this measure is proposed to encourage taxpayers to purchase residential water conservation systems by allowing taxpayers to claim a tax credit for the costs of a system, up to an unspecified maximum (presumably per year).

Lawmakers need to remember two things. First, the tax system is the device that raises the money that they, lawmakers, like to spend. Using the tax system to shape social policy merely throws the revenue raising system out of whack, making the system less than reliable as there is

no way to determine how many taxpayers will avail themselves of the credit and in what amount. The second point to remember about tax credits is that they are nothing more than the expenditure of public dollars, but out the back door. If, in fact, these dollars were subject to the appropriation process, would taxpayers be as kind about the expenditure of these funds when students are roasting in our schools, or when there isn't enough money for social service programs?

Utilizing tax credits other than to alleviate an excessive tax burden cannot be justified and is of a questionable benefit relative to the cost for all taxpayers. If lawmakers want to encourage the use of water conservation systems by reducing the cost of such systems, then a direct appropriation to subsidize that cost, such as through a rebate program, would be more accountable and transparent.

Furthermore, the additional credit would require changes to tax forms and instructions, reprogramming, staff training, and other costs that could be massive in amount compared to the loss in revenue from the credit. A direct appropriation, or even a program similar to the way we currently subsidize energy efficient appliances, may be a far less costly method to accomplish the same thing.

Digested 3/11/2016