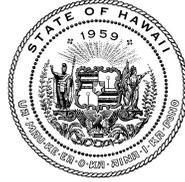


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DEPUTY DIRECTOR

To: The Honorable Gilbert S.C. Keith-Agaran, Chair
and Members of the Senate Committee on Judiciary and Labor

Date: March 22, 2016
Time: 9:00 A.M.
Place: Conference Room 016, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 2028, H.D. 1, Relating to Taxation.

The Department of Taxation (Department) appreciates the intent of H.B. 2028, H.D. 1, and offers the following comments regarding Sections 1 and 3 of the bill for your consideration.

H.B. 2028, H.D. 1, creates a general excise tax exemption for income received from certain public-private partnership contracts entered into with the Employee Retirement System (ERS), capped at an unspecified percentage of direct costs of construction and operation, which will be certified by ERS. The measure creates a similar exemption for income tax purposes. The measure has a defective effective date of July 1, 2050 and applies to taxable years beginning after December 31, 2015.

The Department appreciates the amendments made by the House Committee on Water and Land and House Committee on Energy and Environmental Protection, which were suggested by the Department. In addition, the Department proposes the following additional amendments.

First, the Department notes that as written, Section 3 confers a double benefit, as qualifying taxpayers will be able to exclude from income their costs under paragraph (15), and also take business deductions for those same costs. If it is not the intent to confer a double benefit, the Department suggests adding the following language to paragraph (15): "No taxpayer who excludes income under this paragraph shall claim any other credit or deduction for the same expenses or costs."

Second, the Department notes that this bill will require form modifications and computer system programming. Therefore, the Department requests that this bill apply to taxable years beginning after December 31, 2016.

Thank you for the opportunity to provide comments.

DAVID Y. IGE
GOVERNOR



THOMAS WILLIAMS
EXECUTIVE DIRECTOR

KANOE MARGOL
DEPUTY EXECUTIVE DIRECTOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

TESTIMONY BY THOMAS WILLIAMS
EXECUTIVE DIRECTOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII

TO THE SENATE COMMITTEE JUDICIARY AND LABOR
ON

HOUSE BILL NO. 2028, H.D. 1

MARCH 22, 2016, 9:00 A.M.

RELATING TO TAXATION

Chair Keith-Agaran, Vice Chair Shimabukuro and Members of the Committee,

H.B. 2028, H.D. 1 would permit the Employees' Retirement System (ERS) to invest in public-private partnerships to develop construction projects to implement clean energy technology or construction projects to improve the State's water supply with respect to this proposal.

The ERS Board of Trustees has not taken a formal position on this proposal; however, the ERS staff has the following comments and concerns:

- H.B. 2028, H.D. 1 proposes to amend Section 88-119, Hawaii Revised Statutes, regarding ERS investments, by allowing the ERS to invest in a set of defined public-private partnerships. The amendment may not be necessary as ERS' investment policy already allows for these types of investments; and, in fact, the ERS staff and Board of Trustees encourages investment managers to seek out direct investments in Hawaii infrastructure (particularly "green" infrastructure) projects for inclusion in their portfolio or for the Board's consideration.



Employees' Retirement System
of the State of Hawaii

- ERS does not typically invest directly with partners in the construction or management of projects but does so through investment managers with the necessary skills and experience to evaluate, price and monitor such opportunities. In addition, the types of projects listed in the bill are under the authority of specific governmental agencies or departments. Therefore, the language in Sections 1 and 3 regarding certification by the ERS of the non-taxable costs should be amended to allow for certifications to be made by “the ERS, its agent or another appropriate government entity.” These types of investments, as with all investments, would be subject to our disciplined investment process and have to be evaluated according to the ERS’ usual fiduciary standards.
- Though not mandated by this proposal, possible reporting requirements for these construction project partnerships to the Legislature or the Department of Taxation will further burden the ERS investment staff and its managers through added expense or diverting time that could otherwise be spent on supporting the funding of the ERS and reducing the ERS’ \$8.8 billion unfunded liability.

On behalf of the Board of Trustees and staff of ERS we thank you for the opportunity to testify.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, INCOME, USE, Exemptions/Credits for Clean Energy

BILL NUMBER: HB 2028, HD-1

INTRODUCED BY: House Committees on Water & Land and Energy & Environmental Protection

EXECUTIVE SUMMARY: Exempts personal income tax income and general excise tax income in an amount up to an unspecified percentage of the costs of construction and operation of projects entered into under a public-private partnership with the ERS to improve water infrastructure or water supply, or to promote clean energy. Authorizes ERS investments in such public-private partnerships. This strategy dodges procurement laws and budgeting, increases risk to ERS assets, and may even be prohibited by ERISA.

BRIEF SUMMARY: Adds a new section to HRS chapter 237 to establish a GET exemption for amounts received by a contractor not more than ___% of the direct costs of construction and operation incurred by a contractor under a public-private partnership with the employees' retirement system to develop a construction project to implement clean energy technology, as that term is defined in section 269-121(b), or a construction project to improve the State's water supply, including projects defined as a water facility under section 167-2 or section 174-2, a wastewater treatment plant under section 340B-1, or a public water system under section 340E-1; provided that the income shall be excluded from gross income for each year of the anticipated useful life of the construction project. Provides for certification by ERS of the creditable amount. Defines "direct costs of construction and operation" as the costs of materials, labor, equipment, and directly involved efforts or expenses for the completion and operation of a construction project, excluding all general overhead costs.

Adds a new paragraph to HRS section 235-7 to establish an income tax exemption for not more than ___% of the direct costs of construction and operation, as described above. Note that unlike the new section in HRS chapter 237, "direct costs of construction and operation" are not defined.

Amends HRS section 88-119 to allow ERS to invest in the public-private partnerships described above.

EFFECTIVE DATE: July 1, 2050; applies to taxable years beginning after December 31, 2015.

STAFF COMMENTS: Apparently the proponent of this bill is interested in construction projects that are intended to implement clean energy or improve the State's water supply, such as building water facilities or wastewater treatment plants. Apparently realizing the difficulty of having a state agency procure the projects, the bill proposes throwing tax exclusions at those who would build such projects, and would allow them to enter into a public-private partnership with the Employees' Retirement System and the sizable nest egg it is holding.

Doing that, however, is a perversion of the tax system, the procurement process, and the retirement system. The tax system is supposed to collect revenue for government, not build public works projects. And the money in ERS is to satisfy the obligations the State owes to its retired workers now and in the future. That system is actuarially underfunded right now by billions of dollars. Increasing risk to those assets is not prudent. Indeed, we may even be prohibited by ERISA from gambling with those funds, which is what this bill seems to be doing.

Some technical changes to consider if the Committee still wants to move the bill:

- As written, the exclusions apply independently of each other. Thus, allowing an exclusion “up to 2%,” for example, of a \$1 million investment in all three places would mean the taxpayer concerned could take a \$20,000 net income tax exclusion on top of a \$20,000 GET exclusion, for each year of the anticipated useful life of the construction project.
- Income exclusions do not themselves represent revenue loss, but only have value to the extent of other income and tax rate. For example, to a taxpayer making \$1 million in net income, a \$20,000 exclusion would be worth 8.25% of the excluded amount, or \$1,650. To a taxpayer sustaining a large amount of operating losses without other offsetting income, the same exclusion would be worth nothing. If the intent is to apply a fixed dollar incentive, a credit should be considered instead.

Digested 2/24/2016