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Item G  
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**Subject:** Request to authorize the Kekaha Agriculture Association to pursue a declaratory order to designate a portion of Agribusiness Development Corporation's Kekaha lands as Important Agricultural Lands in accordance with Chapter 205, Hawaii Revised Statutes, and to certify ADC's authorization as landowner

**Authority:** Section 163D – 4 (a) (18), Hawaii Revised Statutes

**Location:** Kekaha, Island of Kauai, Hawaii

**Land Area:** Portions of the Mana plain lands, acreage to be determined in the Land Use Commission process

**Tax Map Key:** (4)1-2-02-01 (por) under ADC control

**Land Status:** Encumbered by Governor's Executive Order Nos. 4007 to the Agribusiness Development Corporation ("ADC") for agricultural purposes.

**Trust Land Status:** DHHL 30% entitlement lands pursuant to the Hawaii State Constitution.

**BACKGROUND:** In 2005, the Hawaii State Legislature enacted Part III of the Land Use Commission act, entitled, "Important Agricultural Lands" for the stated purposes of conserving and protecting agricultural lands, promoting diversified agriculture, increasing agricultural self-sufficiency, and assuring the availability of agriculturally suitable lands. There are essentially 2 state routes to achieving important agricultural land ("IAL") status – via identification of public lands by the State and via declaration by the Land Use Commission ("LUC"). Because the ADC lands are, by definition, excepted from the inventory of State public lands, a petition for declaratory order is the only state route available to achieve IAL status for the ADC lands. Once designated as IAL, landowners can develop farm dwellings and employee housing on up to 5% or 50 acres of agricultural

housing, whichever is less, and farmers or owners of IAL lands can qualify for income tax credits for agricultural expenditures on infrastructure-type expenses such as roads or utilities, processing facilities, irrigation facilities as well as the farm dwellings. In fact, the tax credit appears to be broad enough to include expenditures that confer a majority of benefit upon IALs, even if incurred by farmers or agricultural businesses that are not direct owners, lessees or licensees of the IALs. We don't know, however, whether this interpretation has been challenged. There are several other incentives as well. Although the current tax incentives expired on December 31, 2107, there is currently an effort before the legislature to revive and extend those tax credits for another ten years.

The ADC manages approximately 5,000 acres of land on the Mana plain pursuant to Executive order 4007. The Kekaha Agriculture Association ("KAA") currently holds a 20-year license for most of the infrastructure improvements available for the use and benefit of all ADC Kekaha land tenants. Included in the KAA-licensed infrastructure are the Kekaha Ditch and the intakes, screens, tunnels, siphons, culverts, overpasses, flumes, recorders, control gates, ladders, gratings, access roadways, measuring weirs, motors, and controls, attached reservoirs, settling basins, wells, shafts, motors, and pumps, drainage canals and ravines, roads, bridges, culverts, railway tracks, security gates, the Waimea and Waiawa hydroelectric power plants, transmission and distribution components, transformers, switches, meters, etc. The KAA has historically expended millions of dollars for infrastructure operational, maintenance and repair costs, subsidized by third-party vendor income from the Kekaha agricultural operations, capital improvement project funds from the ADC, and KAA membership fees. These are precisely the types of activities and expenditures that the IAL tax credits are intended to incentivize.

The KAA has proposed to voluntarily petition the LUC for a declaratory order designating portions of the ADC Mana plain lands as IAL. If successful, and assuming the tax credits are extended, such designation could result in tremendous benefits to the KAA, and to qualified agricultural costs incurred by individual tenants. The petition will only seek IAL designation; there will be no request to reclassify any ADC lands. Attached is a brief description of the benefits to be derived by the KAA.

Although the ADC manages these lands, the fee simple interest in and to the lands remain with the State of Hawaii, through its Board of Land and Natural Resources. Therefore, simultaneous with this request, the ADC has requested that the Land Board also approve the KAA's proposed action.

**CONCLUSION:** The ADC is tasked with assisting, promoting and developing agriculture within the State. Ownership of these lands by the ADC ensures the use of these lands in agriculture, in perpetuity. However, the ADC can do more to help agriculture, starting with taking advantage of tax incentive programs such as the IAL designation incentives. ADC is also fortunate to have the KAA willing to voluntarily seek IAL designation on its own.

**RECOMMENDATION:** Accordingly, it is recommended that this Board:

- 1) Authorize the Kekaha Agriculture Association to pursue a declaratory order to designate a portion of Agribusiness Development Corporation's Kekaha lands as Important Agricultural Lands in accordance with Chapter 205, Hawaii Revised Statutes,
- 2) If appropriate, certify or otherwise consent, as the landowner or land manager, to KAA's forthcoming petition as the landowner, and
- 3) Authorize the ADC staff to assist and cooperate with the KAA as necessary to secure the designation of the Mana plain lands as important agricultural lands.

Respectfully submitted,



James J. Nakatani  
Executive Director

Designation of the ADC lands in Kekaha as Important Agricultural Lands, and extension of the IAL refundable tax credit, may offer several benefits to ADC and the Kekaha Agriculture Association. Pursuant to Executive Orders, ADC controls certain lands in Kekaha, Kauai that ADC has licensed to the KAA and KAA members.

It may be possible for ADC and/or KAA to secure designation of the ADC lands by the Land Use Commission as Important Agricultural Lands pursuant to Part III of Chapter 205, "Important Agricultural Lands." Under this statute, IAL include lands that are capable of producing "sustained high agricultural yields" and that "[c]ontribute to the State's economic base[.]" IAL also produce agricultural commodities for "export or local consumption" and promote "expansion of agricultural activities and income for the future[.]" In addition, IAL designation is intended to promote the maintenance of "essential agricultural infrastructure systems, including irrigation systems" such as the Kekaha ditch irrigation system. Current farming of the ADC lands appears to be aligned with these basic objectives and suggests IAL designation may be possible.

Upon designation as IAL, ADC and KAA may be eligible for the IAL refundable tax credit, under section 235-110.93, Hawaii Revised Statutes, "Important agricultural land qualified agricultural cost tax credit," if the credit is extended by the Legislature during the 2018 legislative session (the credit has expired). Under the incentives section of the IAL statute, State tax policies shall promote the "economic sustainability" of agriculture and, accordingly, IAL shall be eligible for incentives. Thus, through designation of the ADC lands as IAL, and extension of the refundable tax credit, ADC and KAA may realize certain direct and indirect benefits, including but not limited to the following.

First, the refundable tax credit may reduce the overall cost of farming on the ADC lands. Upon designation of the ADC lands as IAL, under the IAL tax credit statute "each taxpayer" (i.e., presumably KAA and/or KAA members, depending on petitioner for IAL designation) may be eligible to receive a refundable income tax credit amounting to fifty percent of "qualified agricultural costs" up to a total of \$1 million. The Department of Agriculture is charged with verifying and certifying that costs claimed under the credit are "qualified agricultural costs" within the meaning of the statute.

Second, a wide range of agricultural expenditures costs can qualify for the IAL tax credit, thereby aiding and benefiting ADC and KAA. Importantly, the IAL statute authorizes tax credits to "offset operational costs" of farming. The IAL tax credit statute broadly defines "qualified agricultural costs" to include expenditures for a wide range of agriculture-related costs, including planning, construction, repair and maintenance of roads and utilities; agricultural processing facilities; water wells, dams, reservoirs, pipelines, ditches and irrigation systems; agricultural housing; farming equipment; and consulting services.

Third, IAL designation of the ADC lands and extension of the IAL tax credit may aid and support ADC and KAA with regard to irrigation infrastructure, including efforts to upgrade the Kekaha ditch system with pressurized pipelines. The IAL statute authorizes tax incentives to support "agricultural irrigation systems," and under the IAL tax credit statute, "qualified agricultural costs" include water pipelines, ditches and irrigation systems.

Fourth, IAL designation of the ADC lands and extension of the IAL tax credit may aid and support ADC and KAA with regard to electric power needs, including efforts to replace the Waiawa hydropower facility. Utilities for agricultural purposes are among the qualified costs under the IAL tax credit statute.

Fifth, IAL designation and the tax credit may aid ADC and KAA in ongoing efforts to implement the mediated resolution of the recent Water Commission proceeding involving the irrigation system serving the ADC lands, as reflected in the Waimea Watershed Agreement. Under the IAL tax statute, qualifying costs include expenditures for “regulatory processing, studies, and legal and other consulting services related to obtaining or retaining sufficient water for agricultural activities[.]”

Finally, agricultural housing may be similarly advanced insofar as the IAL statute authorizes the construction of farm dwellings and employee housing on IAL, and agricultural housing is specifically identified as a qualifying cost under the tax credit statute.

The foregoing suggests support for IAL designation of the ADC lands, and extension of the IAL tax credit, may result in several potential benefits to ADC, KAA and/or KAA members. Such important benefits appear to be entirely consistent with broader State goals concerning the continued growth, protection and development of agriculture in Hawaii.