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GOVERNOR

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LT. GOVERNOR



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HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS CONCERNS

TESTIMONY REGARDING HB 2778 RELATING TO TAX CREDITS

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: FEBRUARY 5, 2008

TIME: 8:30AM

ROOM: 325

This bill expands the current responsibilities for the Department of Business, Economic Development and Tourism to conduct a comprehensive study of the social and economic benefits of Hawaii's income tax credits. The bill takes effect on July 1, 2008.

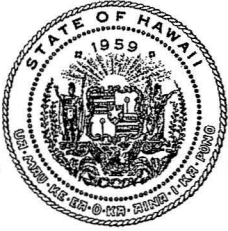
The Department of Taxation **strongly opposes** this measure, on grounds that the Department of Taxation is in the best position to serve as the lead agency for economic studies on the effects of Hawaii's income tax credits. There are several reasons for this.

- **CURRENT RESPONSIBILITY OF DOTAX**—The Department is already charged with performing an economic study on the effectiveness of the largest of these credits, the high technology business investment tax credit. A new study of the credit by another agency would involve unnecessary duplication of effort.
- **ACCESS TO INFORMATION**—The Department of Taxation is the only agency with access to the detailed tax data needed to properly study income tax credits. For a competent study of these credits, state tax returns must be matched with federal income tax returns to obtain a comprehensive picture of a company's income or of an individual's income. The State is unable to provide access to federal income tax returns to any of its other agencies.
- **UNDERSTANDING OF TAX LAW**—The Department of Taxation is the only agency with in-depth knowledge of how the State's income tax credits actually operate. It has people that know the legal tax issues and that know how to perform solid economic analysis. As evidence of these abilities, you may refer to the Report of the 2005-2007 Tax Review Commission. Department of Taxation staff performed four of the six economic studies contained in the report.

- **CONFIDENTIALITY**—The Department operates under strict confidentiality laws that preclude it from sharing confidential tax information. Tax information is very personal and the fewer people that have access to it the better. After aggregating the data, however, the Department will work with others to fully study the impact of Act 221 and other income tax credits.

In summary, the Department of Taxation is in the best position to lead studies of income tax credits. This would allow the studies to benefit from the most detailed tax information available and, at the same time, prevent exposure of taxpayer information.

Based on the foregoing, the Department urges the Committee to reject this bill and to adopt the substitute offered by H.B. 2961.



**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT & TOURISM**

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THEODORE E. LIU
DIRECTOR
MARK K. ANDERSON
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Statement of
THEODORE E. LIU
Director
Department of Business, Economic Development, and Tourism
before the
COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS CONCERNS

Tuesday, February 5, 2008
8:30 AM
State Capitol, Conference Room 325

In consideration of

HB 2778
RELATING TO TAX CREDITS

Chair Yamashita, Vice Chair Wakai, and members of the Committee on Economic Development & Business Concerns.

The department supports the intent of HB 2778, which requires the Department of Business, Economic Development and Tourism (DBEDT) to conduct or commission a comprehensive study of the benefits of state tax credits. DBEDT support efforts to increase accountability for the use of tax credits and efforts to determine their beneficial impact on the State's economy. Act 206 (SLH 2007) directed the Department of Taxation to measure the effectiveness of one tax credit provision; that being the high technology business investment tax credit. There have been many good ideas introduced this legislative session that support the State's economic development goals. We note, however, that an appropriation for such a study as called for in HB 2778, was not included in the Executive's Supplemental Budget, and request that any appropriation not displace the priorities contained in that budget.

There are apparently more than 50 tax credits or tax exemptions contained in the Hawaii Revised Statutes. These range from research and investment tax credits relating to qualified high technology businesses, to credits for the purchase of child passenger restraint systems.

While DBEDT would be an appropriate agency to conduct such a study, the effort would face challenges. First, to determine the benefit of tax credits, such a study would need to review a considerable amount of detailed tax data, much of which would likely be confidential data related to individual tax returns. However, DBEDT does not have access to the confidential tax data that would be needed by a consultant to pursue the study. Only the department of taxation has that access.

Secondly, we do not believe that such a study could be completed and presented to the legislature by the end of 2008 as required. A comprehensive study of this nature could take six to twelve months to conduct. This would be time needed beyond the preliminary stages, such as release of funds, requests for proposal, contract negotiation and contract award.

It is difficult to estimate the cost of such a study, but some additional resources would be needed.

Thank you for the opportunity to provide comments on this bill.

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, Tax Credits

BILL NUMBER: HB 2778

INTRODUCED BY: Yamashita, Awana, Brower, Caldwell, Carroll, Chang, Chong, Green, Hanohano, Har, Herkes, Ito, Karamatsu, Magaoay, Manahan, McKelvey, Mizuno, Morita, Nakasone, M. Oshiro, Say, Tokioka, Tsuji, Wakai, Waters, Yamane and 5 Democrats

BRIEF SUMMARY: Requires the department of business, economic development and tourism (DBEDT) to conduct a comprehensive study to determine the social and economic benefits derived from state tax credits provided by the legislature provided the department may contract for a private entity to carry out the study.

Requires the DBEDT to submit a report containing the results of the study to the legislature prior to the convening of the 2009 legislature.

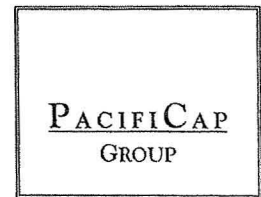
Appropriates \$ _____ in general funds for fiscal 2009 for a comprehensive study by DBEDT to determine the social and economic benefits of state tax credits provided by the legislature.

EFFECTIVE DATE: July 1, 2008

STAFF COMMENTS: This measure requires DBEDT to conduct a comprehensive study to determine the social and economic benefits derived from state tax credits provided by the legislature. This measure is, no doubt, proposed to address concerns about the plethora of targeted business tax credits adopted in recent years. With everything from investments in high technology to ethanol producing plants to tax credits for hotel construction and home renovation and construction, taxpayers have been asked to pay for projects for which there are just promises that jobs will be created or new businesses will be attracted to provide those jobs. At the end of the day, while the beneficiaries laugh all the way to the bank with their profits, the taxpayer is left empty-handed. It should be remembered that giving tax breaks to one select group of taxpayers comes at the expense of all other taxpayers. As such, it is an insult to all other taxpayers that they are not deserving of such tax preferences. Rather than singling out a particular area for tax relief, concurrent efforts must be made to improve Hawaii's business climate to enhance the economic prospects for all businesses.

It should be noted that even the trade association of state legislatures known as the National Conference of State Legislatures points out that such gimmicks, like targeted tax credits, damage the integrity of a good tax system, shift the burden among taxpayers, and create the illusion that the economy is being stimulated.

Digested 2/04/08



PACIFICAP GROUP, LLC
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Honolulu, HI 96813
Direct: 808.237.5388 Fax: 808.537.2188

February 3, 2008

To: EDBtestimony@capitol.hawaii.gov
*Testimony for Hearing before the
House Committee on Economic Development and Business Concerns
Tuesday, February 5, 2008, 8:30 am*

*State Capitol, Conference Room 325
415 South Beretania Street
Honolulu, Hawaii 96813*

Re: Testimony in Strong Opposition to HB 2778—Relating to Tax Credits

Chair Yamashita, Vice Chair Wakai, and Committee Members:

Thank you for the opportunity to submit testimony in STRONG OPPOSITION to HB 2778, which requires the Department of Business Economic Development and Tourism ("DBEDT") "to report on the social and economic benefits of tax credits."

I am Jeff Au, Managing Director and General Counsel of PacifiCap, Hawaii's largest locally based venture capital firm. Since 2000, PacifiCap affiliates have invested in more than two dozen Hawaii companies, and we have led or co-invested in financing rounds totaling more than \$400 million. Our investor base of more than 100 institutional, corporate and high net worth individual investors from Hawaii demonstrates the widespread support that innovation, capital formation and economic diversification have across our community.

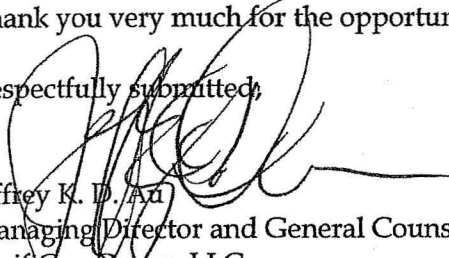
While I support the Legislature's intent to study and evaluate the socio-economic benefits of tax credits, I strongly oppose this bill for the following reasons:

- The Legislature has already determined that the Department of Taxation ("DoTax"), and NOT DBEDT, is the appropriate agency to review and evaluate tax credits. DBEDT lacks sufficient professional staff and training in tax law to sufficiently understand and evaluate tax credits. After extensive discussions last year among State officials from both the Administration and the Legislature, as well as representatives from the business community, broad consensus was reached in 2007 that DoTax and not DBEDT should review and evaluate tax credits. The Legislature endorsed this conclusion with the passage of Act 206, SLH 2007 last year, which required DoTax, and not DBEDT, to study the effectiveness of Act 221/215 investment tax credits. A copy of Tax Director Kurt Kawafuchi's October 19, 2007 letter to the Governor summarizing the 2007 DoTax study required by Act 206, SLH 2007 is attached for your reference. You will see from this letter that completing an accurate study of Act 221/215 tax credits, as mandated by Act 206, required the participation of at least **TEN** DoTax staff members. To have DBEDT create a redundant study of Act 221/215 and/or any other tax credits would be a waste of taxpayer money.

- The Legislature should not appropriate more taxpayer dollars to DBEDT to analyze social and economic benefits of anything until DBEDT has completed an effective evaluation of the social and economic benefits of high technology initiatives that the Legislature mandated last year pursuant to Act 148, SLH 2007, which required DBEDT to "collect, analyze and disseminate appropriate data to measure the growth industries that have the potential to transform Hawaii's economy and to accelerate their development into more robust pillars of Hawaii's society," and for which the Legislature appropriated to DBEDT \$400,000 and two new full time staff positions.
- Allowing DBEDT to "contract for a private entity to carry out the study" of tax credits, as this bill provides, would be inappropriate and irresponsible while on going investigations of procurement law noncompliance and violations by DBEDT are being conducted by the Office of Procurement and the Hawaii State Senate (pursuant to SR 2). DBEDT's noncompliance with State procurement laws in awarding of the State Hydrogen Fund contract, which the State Procurement Office ordered DBEDT to rescind, as well as other procurement matters being investigated by the Senate, would seriously undermine public confidence in the objectivity and credibility of any study on tax credits conducted by DBEDT and/or any "private entity" to whom DBEDT might choose to award this contract. A January 23, 2008 Honolulu Advertiser report on this matter is attached for your reference.
- HB 2778 is excessively vague in defining the metrics by which "social and economic benefits" of tax credits would be measured, as well as the qualifications that would be required of the "private entity to carry out the study" that DBEDT would select. Such vagueness in legislation greatly increases the risks for future procurement law violations and does not hold DBEDT sufficiently accountable for the results of its study. We must also ask how any "private entity" could be more qualified to evaluate Act 221/215 tax credits than TEN DoTax staff members?
- HB 2778 is too narrow in scope in only evaluating tax credits. In order to get a full picture of the social and economic benefits of State programs intended to promote economic development, as well as a comparative basis to compare the effectiveness of tax credits with other State programs, any study of tax credits must be expanded to also determine the social and economic benefits, USING THE SAME METRICS, of all programs managed by DBEDT, which spend more than \$200 million of taxpayer money each year.

Thank you very much for the opportunity to submit this testimony.

Respectfully submitted,



Jeffrey K. D. An
Managing Director and General Counsel
PacifiCap Group, LLC

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KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA YAHIRO
DEPUTY DIRECTOR

October 19, 2007

The Honorable Linda Lingle
Governor
State of Hawaii

Dear Governor Lingle:

I am pleased to present you with this **Report on the Operations of Qualified High Technology Businesses From 2002 Through 2006** as required by Act 206, SLH 2007.

On June 21, 2007, House Bill 1631 HD2, SD2, CD 1, was signed into law as Act 206. The purpose of Act 206 is to measure the effectiveness of the Act 178/221/215 business investment tax credit. The act requires any qualified high technology business (QHTB) that accepts an investment for which a credit may be claimed under Section 235-110.9, Hawaii Revised Statutes (HRS), to complete a survey that must be provided to the Department of Taxation by June 30 of each year for each of the five years following the year of investment.

The survey is to be filed electronically through the Department's website. The Department is required to report the information by providing summary statistical information. The report is due by September 1 of each year. The Department is currently finalizing the survey form, which should be ready for implementation early in 2008. This on-line survey will be used to gather information for the 2007 and later calendar years.

Act 206, SLH 2007 also requires that the Department prepare a report by October 31, 2007 summarizing the data submitted by QHTBs on Form N-317 prior to Act 206, SLH 2007. The report is to include summary statistics of the information provided, to date. The present report was compiled in order to satisfy this requirement.

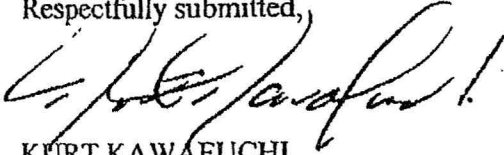
Some highlights:

- A total of 287 separate QHTBs filed Form N-317 at one time or another over the period from 2002 through 2006.
- Total expenses incurred in Hawaii by the QHTBs totaled \$1.043 billion over the period from 2002 through 2006.
- Investments received by the QHTBs totaled \$821.6 million over the same period.
- QHTBs that reported operations solely in the Performing Arts sector received about 35 percent of the investments received by all QHTBs (\$284.7 million) over the same period.
- Computer Software is the most frequently listed activity of the QHTBs.

- In 2006, the 157 QHTBs that filed Form N-317 reported paying 2,322 employees that year; the average of the employee salaries was \$56,262.
- In 2006, the 157 QHTBs that filed Form N-317 reported that they created 5,383 jobs since their inceptions.
- Total High Technology Business Investment Tax Credit claimed by Hawaii residents totaled \$195.6 million over the period from 1999 through 2005.

This report was prepared under the direction of Dr. Tu Duc Pham, Tax Research and Planning Officer, with the assistance of the Tax Research and Planning Office's staff: Glenn Ifuku, High Technology Study Technical Coordinator; Yvonne Chow, Economist; Lynn Ma, Research Statistician; the Rules Office's staff: Johnnel Nakamura, Rules Officer; Jason Healey, Rules Specialist – who compiled the summary and history of the High Technology Business Investment Tax Credit and Tax Credit for Research Activities; Betty Lam, Rules Specialist; Donald Rousslang, Tax Specialist – who compiled the tables and drafted the initial report; and Titin Sakata, Special Assistant to the Director.

Respectfully submitted,



KURT KAWAFUCHI
Director of Taxation

Posted on: Wednesday, January 23, 2008

\$8.7M hydrogen technology contract held up by dispute

By Sean Hao
Advertiser Staff Writer

The state has until the end of this month to decide whether to award a contract to manage an \$8.7 million hydrogen technology investment fund.

The fund was authorized by lawmakers in 2006 to help finance companies working to develop clean-burning hydrogen fuel from renewable resources such as wind and water. However, the fund's launch has been held up by a dispute over who should manage the project.

The state Procurement Office ruled in September that a contract to manage the fund should have been awarded to the highest-ranking bidder, which was Kolohala Holdings LLP. Earlier this month the Department of Business, Economic Development and Tourism requested more time to decide whether to award the contract to Kolohala or cancel the contract outright.

DBEDT requested more time because the agency has entered into discussions with the U.S. Department of Energy that could encumber some of the same hydrogen fund money sought by Kolohala. Further details surrounding that new renewable energy partnership will be announced next week, said DBEDT Director Ted Liu.

Yesterday, the Procurement Office said DBEDT cannot cancel its original request for proposals based on the new federal partnership. Procurement Office Administrator Aaron Fujioka also said DBEDT should award the hydrogen fund contract to Kolohala or provide justification for not awarding the contract by Jan. 31.

"While you have determined that a change in circumstance has delayed the award as required in my Sept. 25, 2007 memorandum, there does not appear to be sufficient justification to support this," Fujioka wrote in a letter to Liu dated yesterday. "If the DBEDT's determination that the federal partnership will result in no longer requiring the services of the RFP, then a request with sufficient justification should be submitted by the above date for my review and approval."

The hydrogen fund and the contents of the letter were discussed during a state Senate Tourism and Government Operations Committee hearing yesterday.

"This federal partnership I believe is in the best interest of the state," Liu told the committee. "If it happens, and it sounds like there's a very good chance it will happen, it's going to impact how the hydrogen fund is implemented."

Senate Vice President Donna Kim, D-14th (Halawa, Moanalua, Kamehameha Heights), said DBEDT has an obligation to follow through and award the contract to Kolohala. DBEDT mistakenly awarded the contract to third-ranked bidder H2 Energy LLC in August. In September the Procurement Office ordered DBEDT to rescind the award because H2 Energy was the lowest-ranking choice of an evaluation committee that reviewed three qualifying proposals. Kolohala was the top-ranked bidder.

"That (federal partnership) is great but that has no bearing on this RFP," Kim told Liu.

"You put out an RFP. We are bound by that RFP. In good faith people applied for it and went through the process of being evaluated.

"The only reason we are here, Mr. Liu, is because you wanted to give it to the No. 3 bidder."

Reach Sean Hao at shao@honoluluadvertiser.com.



The state has until the end of this month to decide whether to award a contract to manage an \$8.7 million hydrogen technology investment fund. Pictured, DBEDT Director Ted Liu.

[Back](#)

BILL SPENCER
Hawaii Venture Capital Association
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Phone (808) 262-7329 Fax (808) 263-4982

Monday, February 04, 2008

Ladies and gentlemen:

I hereby submit the following testimony regarding HB2778, 2961. The HOUSE Economic Development Committee is set to hear this bill on Tuesday, February 05, 2008 at 8:30 am in House Conference Room 325.

I would appreciate if you would make and deliver 25 copies of my testimony to Room 318 for this hearing. Thank you.

TO: THE HOUSE ECONOMIC DEVELOPMENT COMMITTEE, Representative Kyle T. Yamashita, Chair
(telefax - (808) 586-6501)

FROM: BILL SPENCER, HAWAII VENTURE CAPITAL ASSOCIATION

SUBJECT: Testimony relating to RELATING TO TAX CREDITS (HB2778, 2961) - Strong Opposition To HB 2778, Support Intent Of 2961, set to be heard on 2/5/2008 at 8:30 am in Conference Room 325

I strongly oppose HB2778 because it does not adequately define the criteria for measuring social and economic benefits of tax credits, the Department of Taxation is already empowered to analyze tax credit data as per Act 206, and there is no basis for comparative analysis with other states.

I support the intent of HB2961 which provides sufficient power to DoTAX to fulfill the intent of HB2728 and the legislatures need for effective analysis of tax incentives.

However the measure in HB2961 requiring DoTAX to collect additional data dating back to 1/1/2002 may be overly burdensome and yield little more information than what has already been collected.

Thank you very much for your consideration of my views and my testimony on this bill.

Respectfully submitted,

Bill Spencer
Hawaii Venture Capital Association
bspencer@hawaii.vc.com