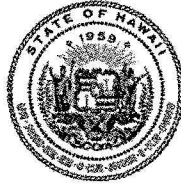


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HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS CONCERNS

TESTIMONY REGARDING HB 2961 RELATING TO TAXATION

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 Taxation to assess the operations of qualified high technology businesses and to examine the effects of Hawaii's income tax credits. The bill takes effect on July 1, 2008 and automatically repeals on January 1, 2012.

The Department of Taxation **strongly supports** this measure and urges the Committee to pass it.

I. IT IS IMPORTANT TO HAVE GOOD INFORMATION ON THE EFFECTS OF ACT 221.

The Legislature has enacted path-breaking tax credits to promote growth in technology and innovation, with the goal of encouraging knowledge-based, higher-wage industries in Hawaii. The Legislature has also recognized, however, that it is important to evaluate the effectiveness of its efforts in this area. To this end, the Department of Taxation was asked to improve the data it collects on the operations of the high technology businesses, to issue reports that give statistics on these operations, and to evaluate the effectiveness of the high technology business investment tax credit provided by section 235-110.9 of the Hawaii Revised Statutes (HRS). The present bill expands the State's evaluation of its tax credits in several important ways.

- First, it asks the Department of Taxation to evaluate the economic effects of the research credit provided by section 235-110.91, HRS. The research credit is an important tax incentive for high technology industries, so it should be included in the State's evaluation of its tax incentives for high technology industries.
- Second, the bill asks the Department of Taxation to evaluate other income tax credits. Specifically, it asks the Department to
 - Contract with knowledgeable experts in the fields of technology and research

investment to evaluate existing and proposed tax incentives in Hawaii. (The 2005-2007 Tax Review Commission strongly recommended that an outside party conduct research on the high technology business investment tax credit.)

- Establish a working group of government, tax, and industry experts to identify the standards and data necessary to measure and quantify Act 221 accomplishments.
 - Coordinate with other departments to obtain further information, including the Department of Labor and Industrial Relations and the Department of Business, Economic Development and Tourism.
 - Review the necessary tax returns to accomplish the Department of Taxation's objectives.
- Third, the bill asks the Department of Taxation to update its analysis of tax incentives to assist the Tax Review Commission and the Council on Revenues to better perform their duties.
 - Finally, the bill provides the necessary funding to accomplish these tasks.

II. THE DEPARTMENT OF TAXATION IS IN THE BEST POSITION TO LEAD OR CONDUCT THESE STUDIES

The Department of Taxation is in the best position to be the lead agency for an economic study on the effects of Hawaii income tax credits. There are several reasons for this.

ACCESS TO TAX INFORMATION - The Department of Taxation is the only agency with access to detailed tax data. Moreover, to properly study tax credits, state tax returns must be matched with federal income tax returns to obtain a complete picture on a company's operations. A competent study of Act 221, or any other income tax credit, cannot be accomplished without such access and the State is unable to provide such access to any of its other agencies.

THE NECESSARY EXPERTISE IN THE AREA - The Department of Taxation is the only agency with in-depth knowledge of how Act 221 and other 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.

FEWER THE BETTER - 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.

Although it has considerable expertise in the area, the Department of Taxation recognizes that it will need assistance to produce a competent study of the tax credits provided sections 235-110.9 and 235-110.91, HRS. To this end, it plans to enlist the help of industry experts, academic economists, and other governmental agencies. Grants to study tax credits are best administered by the Department of Taxation, as the Department can work with the outside researcher to explain the details of the tax law and to compile and process the tax confidential data without revealing tax-

confidential information. In this way, the outside researcher can effectively take advantage of detailed data. It is also important to give affected industries the chance to provide input to the studies, as they often have valuable information on the practical operations of the credits. The final study, however, must give priority to the interests of the public.

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 strongly urges the Committee to pass this measure as the only vehicle for a thorough study of Act 221 and of Hawaii's other income tax credits.

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: ADMINISTRATION, High technology business tax credits evaluation

BILL NUMBER: HB 2961

INTRODUCED BY: Yamashita, Awana, Brower, Caldwell, Chang, Chong, Hanohano, Herkes, Lee, Manahan, McKelvey, Morita, B. Oshiro, M. Oshiro, Tokioka, Tsuji, Wakai, Yamane and 1 Democrat

BRIEF SUMMARY: Adds a new section to HRS chapter 231 to provide that the department of taxation shall determine the economic impact and evaluate existing and proposed tax incentives of HRS Title 14. Authorizes the department to: (1) contract with technical experts knowledgeable in the field of technology and research investment to evaluate existing and proposed tax incentives; (2) establish a working group of industry, tax, and economic development experts to identify and develop a set of standards, benchmarks, and data elements for evaluation and quantification of the economic impact of tax incentives in Hawaii; (3) coordinate and receive relevant information from other state agencies; (4) review taxpayer returns to collect and analyze aggregate data on the impact of tax incentives; and (5) update its analysis of tax incentives to assist the Tax Review Commission and the Council on Revenues to better perform their responsibilities.

Amends HRS section 235-20.5 to provide that the tax administration special fund shall also be used to administer the tax credit under HRS section 235-110.91. Repeals this section on January 1, 2012.

Amends Act 206, SLH 2007, to provide that the required annual survey filed by a qualified high technology business may include information from and after January 1, 2002. Repeals this section on January 1, 2012.

Extends the repeal date of Act 206, SLH 2007, from January 1, 2011 to January 1, 2012 and provides that HRS sections 235-20.5 and 235-110.9(b) shall be reenacted in the form in which they read on the day before June 20, 2007.

The department of taxation shall study the economic impact of the tax credits of HRS sections 235-110.9 and 235-110.91 on Hawaii's economy and evaluate their effectiveness. Requires the department to report its findings to the legislature prior to each regular session. Directs the department of taxation to collect and evaluate information from January 1, 2002 and: (1) exercise its powers under HRS section 231; (2) use the information collected and analyses conducted under Act 206, SLH 2007; and (3) review returns of companies whose investors receive credits pursuant to HRS sections 235-110.9 and 235-110.91. Permits such data to be sub-aggregated into industry sectors to delineate and differentiate economic impacts. Repeals this section on January 1, 2012.

Appropriates \$250,000 in general funds in fiscal 2009 to the department of taxation for the purposes of this act.

BILL SPENCER
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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