

PACIFICAP
GROUP

PACIFICAP GROUP, LLC
820 Mililani Street, Suite 600
Honolulu, HI 96813

Direct: 808.237.5388 Fax: 808.537.2188

LATE TESTIMONY

February 4, 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 Support of HB 2961 – Relating to Taxation

Chair Yamashita, Vice Chair Wakai, and Committee Members:

Thank you for the opportunity to submit testimony in support of HB 2961, which provides the Department of Taxation with the powers necessary to evaluate and study the economic impact of Hawaii tax incentives.

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.

As a supporter of Hawaii's Act 221/215 tax credits, I support this bill because I believe that if more study and analysis of these incentives can be done, more evidence can and will be revealed to the Legislature, and to the general public, of how tremendously successful these tax incentives have been.

The 2007 study conducted by the Department of Taxation, as the Legislature required last year under Act 206, found that between 2002 and 2006, as a result of Act 221/215 tax credits, more than \$820 million was invested in more than 287 Hawaii companies, which have already spent more than \$1 billion in Hawaii and paid more than \$500 million in salaries, at a cost to the State over this five year period of less than \$200 million. These data clearly suggest that the benefits have already far exceeded the costs.

Any further study of these tax incentives must be done by a State agency that has the requisite professional training, legal access to relevant data, institutional integrity and integrity of leadership that will engender the confidence and trust of both the public and the Legislature.

I strongly believe that at the present time, the Department of Taxation is the most appropriate State agency that fulfills these requirements.

You can see from the attached October 19, 2007 letter to Governor Lingle from Tax Director Kurt Kawafuchi 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. How any other State agency, that has ZERO professionally trained tax experts currently on staff, can even start to imagine how it could do an accurate analysis of tax incentives, without a sufficient understanding of the specific tax laws that it is supposed to be analyzing, and without legal access to the relevant data, is beyond my comprehension.

As a practicing corporate attorney for almost twenty years, now, I can tell you first hand that taxation is a highly specialized area. I would estimate that at least 85% of the lawyers, and even many of the CPA's whom I know, have a very limited understanding, if any, of tax law. Although I have worked on quite a few tax related transactions over the years, when it comes to tax law, I still consider myself to only know enough to be dangerous. I repeatedly remind people that I am a corporate lawyer, and not a tax lawyer, and anyone who has done business with our firm will tell you that for all of our investment transactions, I always insist that all tax related issues be independently analyzed, reviewed and approved by our outside tax lawyers or CPA's, who are the real tax experts.

I therefore find it pretty amazing that any State agency that may have ZERO professionally trained tax lawyers or CPA's on staff would find itself to be more qualified than the Department of Taxation to evaluate the costs and benefits of tax incentives that are based upon quite complicated tax laws. When we, as members of the public see this happening, we have to ask ourselves, what is motivating these state officials? Is it arrogance? Is it ignorance of not knowing what they don't know, or worse, is there another motive or political agenda?

In addition, no other State agency can get full access to all relevant taxpayer data without violating State and federal laws and regulations protecting taxpayer confidentiality.

While I strongly believe that a professional understanding of tax law is required to conduct any legitimate study of tax incentives, I also believe that it is not sufficient. Also essential are experience and expertise in the areas of economic development, business, and in this case, high technology.

HB 2961 meets these needs by providing that the Department of Taxation may contract with experts with national and international knowledge and credentials, in addition to collaborating with other industry, tax and economic development experts, as well as with other State agencies.

All of this expertise, however, still would have little value without public trust and confidence in the institutional integrity and leadership of the Department of Taxation.

While many of us in this room may have honest disagreements over tax credits and other policy issues, one thing that all of us should be able to agree upon is that Tax Director Kurt Kawafuchi would make a lousy politician. His primary problem is that he is too honest. I think those of you who know Kurt well would agree that it is very difficult for him to tell a lie, be hypocritical or to take a disingenuous policy position for political reasons.

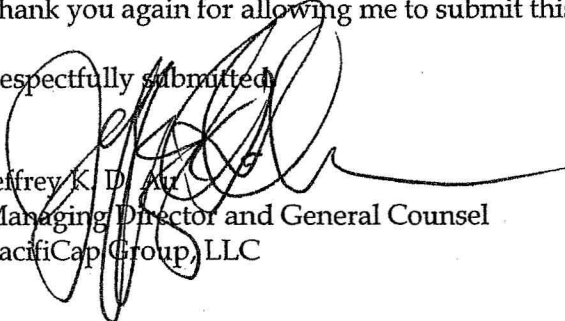
Kurt Kawafuchi is not very good at creating slick sound bites, or "putting lipstick on a pig" to tell you what you want to hear, in spite of the facts, and he is not always right (particularly when he disagrees with me), but if there is a disagreement, with Kurt, at least we all know that it is an honest disagreement, and not one motivated by political or other ulterior motives.

Again, I fully support your Committee's desire to have further study and analysis done of Hawaii's high technology tax incentives, as I firmly believe that such further study will further validate the tremendous benefits and success of these incentives.

However, it is essential that any such study be conducted with the professional, institutional and personal integrity, free of political bias, that will be essential to earn public trust and confidence in its findings.

Thank you again for allowing me to submit this testimony.

Respectfully submitted,



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

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1440
FAX NO: (808) 587-4145

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.

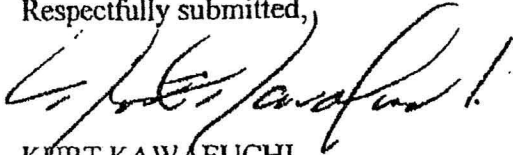
Some highlights:

- 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



LATE TESTIMONY

HOUSE BILL 2961: RELATING TO TAXATION

DATE: February 5, 2008
8:30 a.m., Conference Room 325

TO: House Committee on Economic Development & Business Concerns
The Honorable Kyle Yamashita, Chair
The Honorable Glen Wakai, Vice Chair

House Committee on Agriculture
The Honorable Clift Tsuji, Chair
The Honorable Tom Brower, Vice Chair

FROM: Lisa H. Gibson
President
Hawaii Science & Technology Council

RE: Testimony In Support of HB2961 with Amendments

Aloha Chair, Vice Chair, and Members of the Committee:

For the reasons set forth in our testimony on HB 2778 regarding the enactment of Act 206, and Act 148, we support this bill with amendments.

Again, it is the position of HiSciTech that the collection of data and analysis of 221/215 stay in the jurisdiction of DoTax. We do recognize that the research and development tax credit was not included in Act 206 and we support the purpose and intent of the bill to conduct a review of the R & D credit. Therefore, we would support a narrowly drawn amendment to Act 206, namely to require DoTax to also conduct a review and analysis of the "R&D" credits as it is required to do for the investor credit. We would also support an appropriation to DoTax to discharge its duties under Act 206. With respect to section 2, we note that tax incentive analysis can be done by DoTax without the authority of this bill.

The Hawaii Science & Technology Council is a 501(c)6 industry association with a 28-member board. The council serves Hawaii companies engaged in ocean sciences, agricultural biotechnology, astronomy, defense aerospace, biotech/life sciences, information & communication technology, energy, environmental technologies, and creative media.

Thank you for the opportunity to testify on this bill.

Lisa H. Gibson
President