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HOUSE COMMITTEE ON FINANCE

TESTIMONY REGARDING HB 2961, HD 1 RELATING TO TAXATION

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

DATE: FEBRUARY 26, 2008

TIME: 11:00AM

ROOM: 308

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 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 by 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 by explaining the details of the tax law and by compiling and processing the detailed tax 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 confidential 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

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SUBJECT: ADMINISTRATION, High technology business tax credits evaluation

BILL NUMBER: HB 2961, HD-1

2/26 FIN

INTRODUCED BY: House Committee on Economic Development and Business Concerns

BRIEF SUMMARY: Adds a new section to HRS chapter 231 to provide that the department of taxation shall determine the economic impact of 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 shall include information from and after January 1, 2002. The department of taxation shall submit information on the high technology business tax credit 20 days prior to the convening of the legislature instead of September 1. 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.

The sections repealed shall be reenacted in the form in which they read on June 20, 2007.

HB 2961, HD-1 - Continued

EFFECTIVE DATE: July 1, 2008

STAFF COMMENTS: In their examination of the high technology business investment tax credit, the Tax Review Commission reiterated the findings of the previous Tax Review Commission that stated that, "A tax incentive program is a potential 'black hole' because it is a future benefit of unknown proportions, which is determined by the favored taxpayer's interpretation of what the tax credit should be, and is claimed on a tax return which is confidential."

The most recent Tax Review Commission brought in outside consultants to assess the costs and benefits of the high technology tax credits, but the results were not definitive because they could not obtain current data on the cost of the credit or on the operations of the qualified high tech businesses. They also found data to be incomplete due to confusion about filing requirements when the certification for the credits were changed. In its final recommendations with respect to the high technology tax credit and tax credits in general, the Commission recommended increased transparency and timely disclosure and suggested a confidentiality waiver should be required of those taxpayers claiming tax credits so that pertinent data can be released to the public, and that all beneficiaries of tax credits be required to file truth-in-disclosure reports in addition to income tax returns.

This measure directs the department of taxation to determine the economic impact of existing and proposed tax incentives with emphasis on the high technology investment tax credit (HRS section 235-110.9) and the tax credit for research activities (HRS section 235-110.91). However, this may be just as daunting a task for the department as it was for the Commission's consultants as the beneficiaries hide behind the confidentiality screen. The legislature should consider the recommendation of the Commission to require a waiver of confidentiality so that successes or failures of individual taxpayers can be tracked and evaluated. The legislature has already adopted a similar waiver of confidentiality when it required American Hawaii Cruises to open its books by Act 228, SLH 1991, in order to secure its exemption from the public service company tax.

Given that these tax credits are a back door expenditure of public dollars, the granting of the credits should be subjected to the same scrutiny that appropriation and expenditure of tax dollars are subjected to under the rubric of the procurement code. How can policymakers justify the establishment of such tax incentives when there is no means by which to measure whether or not the promise of jobs, economic stimulation, or growth in the industry has resulted if this information is not available?

Conversely, if these beneficiaries want to feed on public dollars through these tax incentives, then they should be more than willing to reveal how those dollars were used and how those dollars benefitted the taxpaying public. The analogy is something akin to having to put the quarter in the juke box if one wants to dance.

Digested 2/25/08



HOUSE BILL 2961 HD1: RELATING TO TAXATION

DATE: February 26, 2008
11:00a.m., Conference Room 308

LATE

TO: House Committee on Finance
The Honorable Marcus Oshiro, Chair
The Honorable Marilyn Lee, Vice Chair

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

RE: Testimony In Support of HB2961 HD1 with Amendments

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

We support this bill with amendments.

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