LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

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

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING SB 3236 SD1
RELATING TO LIFE SCIENCES

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 12, 2008
TIME: 1:15 PM
ROOM: 224

This bill would establish an income tax credit amounting to fifteen per cent of costs incurred for qualified clinical trials conducted in any county of Hawaii with a population over 700,000, and twenty per cent in any county with a population under 700,000. This bill caps the credit at $8,000,000 per clinical trial. The bill would apply to taxable years beginning after December 31, 2007.

The Committee on Health made only technical, nonsubstantive changes.

The Department of Taxation ("Department") takes **no position** on this legislation; however provides the following comments.

I. DEFERRAL OF PRE-QUALIFICATION

In order to receive the tax credit, a taxpayer must first pre-qualify the clinical trial for the credit by registering with the Department of Taxation. The Department believes that such a determination of clinical trial is outside of the scope of the Department's focus. The Department therefore suggests that pre-qualification registration be deferred to the Department of Business, Economic Development, and Tourism or the Department of Health.

II. REASONABLE EFFORTS TO HIRE LOCAL RESEARCHERS AND STAFF

As a pre-qualification requirement, this legislation provides that a clinical trial provide "reasonable efforts to hire local researchers and staff." Section 2 – (d)(3). The bill further requires the submission of "the number of total hires versus the number of local hires by category (*i.e.*, department) and by county." Section 2 – (h)(3). This bill does not provide further guidance into what constitutes a "local hire."

Furthermore, the favoring of local researchers and staff might raise possible concerns dealing with the privileges and immunities clause of the United States Constitution. This, however, would be an issue that the Department of the Attorney General would be better suited to address.

III. SHOULD REQUIRE WAIVER OF THE RESEARCH & DEVELOPMENT CREDIT.

The Department points out that Hawaii income tax law already provides one of the most generous research and development credits in the nation, which provides a 20% refundable credit for qualified costs. A taxpayer that claims the proposed credit should be required to waive the R & D credit.

IV. ADMINSITRATIVE DIFFICULTY

The Department requests that subsection (h) be eliminated in its entirety because it is unnecessary. If this subsection remains, however, the Department respectfully requests an appropriation.

V. REVENUE IMPACT

This bill results in an indeterminate revenue impact. Due to no hard data on the number of qualified clinical trials and the amount of qualified clinical trial costs, revenue impact is indeterminate. However, if the qualified clinical trial cost were $100 million, then annual revenue loss would be $15 million annually. According to industry, close to 300 clinical trials are currently underway in Hawaii.

ALSTON HUNT FLOYD & ING LAWYERS
Attorneys at Law • A Law Corporation

BEFORE THE

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice Chair

Testimony of
WILLIAM M. KANEKO

SB3236, SD1 RELATING TO LIFE SCIENCES

Tuesday, February 12, 2008, 1:15 p.m.
State Capitol, Conference Room 224

Chair Fukunaga and members of the Committee:

This law firm represents Pfizer, Inc., a national pharmaceutical and biotechnology company which conducts clinical trials throughout the U.S. Pfizer SUPPORTS SB3236, SD1 which provides tax credits for qualified clinical trials conducted in Hawaii.

According to the U.S. National Institute for Health, there are about 790 clinical trials registered in Hawaii. Having tax credits available in SB3236, SD1 would provide incentives for Pfizer and possibly other national biotechnology and pharmaceutical firms to increase the level of clinical research trials in Hawaii. With an ethnically diverse population, and a brand new medical school facility which is promoting biotechnology research, SB3236, SD1 provides the kinds of incentives that enable both local and national biotechnology firms to conduct more research within the state.

In review of SB3236, SD1, however, we offer the following recommendations:

1) In Section 1 of the SB3236, HD1, the bill states that the clinical trials must be in phases 3 or 4 in order to qualify for the credit. We suggest that the credit be available to include all phases of clinical trial testing in order to better attract the wide range of clinical trials being conducted.

2) We recommend that the 20% tax credit be applied statewide, particularly since most of the clinical research facilities are located on Oahu.

American Savings
BankTower
18th Floor
1001 Bishop Street
Honolulu, Hawai`i
96813
Phone: (808) 524-1800
Fax: (808) 524-4591

Palani Court, Suite 104
74-5620 Palani Road
Kailua-Kona, Hawai`i
96740
Phone: (808) 326-7979
Fax: (808) 326-4779

E-mail: info@ahfi.com
www.ahfi.com

3) SB3236, SD1 states that each taxpayer must "pre-qualify" with the Department of Taxation in order to take the tax credit. In lieu of pre-qualifying with the Tax Department which may not have the technical expertise to evaluate the applicability of clinical trials, we recommend that the tax payer merely attach documentation received from the U.S. Food & Drug Administration as a FDA approved clinical trial.

4) SB3236, SD1 states that the threshold level for qualifying for the tax credit is $200,000 for each year. We believe that this amount as a start of this incentive may be too high. A qualifying rate of $50,000 may be more appropriate, particularly for smaller local biotechnology companies in Hawaii.

We SUPPORT SB3236, SD1 with the above-referenced suggestions. Thank you for the opportunity to testify on this matter.

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: INCOME, Clinical trial income tax credit

BILL NUMBER: SB 3236, SD-1

INTRODUCED BY: Senate Committee on Health

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers to claim an income tax credit of: (1) 15% of the qualified clinical trial costs incurred by a qualified clinical trial in a county with a population of over 700,000; or (2) 20% of the qualified clinical trial costs incurred by a qualified clinical trial in a county with a population of under 700,000. A qualified clinical trial occurring in more than one county may prorate its expenditures based on the amounts spent in each county.

In the case of a partnership, S corporation, estate, or trust, the tax credit allowable is for costs incurred by the entity for the taxable year with the cost on which the credit is computed determined at the entity level. Distribution and share of the credit shall be determined by rule. If a deduction is taken under IRC section 179 (with respect to election to expense depreciable business assets), no credit shall be allowed for that portion for which the deduction is taken. The basis of eligible property for depreciation or accelerated cost recovery system purposes for state income tax purposes shall be reduced by the amount of credit allowable and claimed.

Credits in excess of a taxpayer's income tax liability will be refunded provided the amounts are over $1. Claims for the credit, including any amended claims, must be filed on or before the end of the 12th month following the close of the taxable year. The director of taxation may adopt rules pursuant to HRS chapter 91 and prepare the necessary forms to claim the credit and may require proof of claim for the credit.

To qualify for the tax credit a clinical trial shall: (1) meet the definition of a qualified clinical trial, (2) have qualified clinical trial costs of at least $200,000; (3) provide evidence of reasonable efforts to hire local researchers and staff; and (4) provide evidence of financial aid or in-kind contributions of educational or workforce development efforts toward the furtherance of the local science, technology and health industry.

On or after July 1, 2008, this credit shall not be available if the high technology business investment tax credit was claimed for any qualified clinical trial cost.

Requires a taxpayer to pre-qualify for the clinical trial for the credit by registering with the department of taxation. Failure to pre-qualify may constitute a waiver of the right to claim the credit. Further delineates information that must be filed by the taxpayer to validate the claim for the credit.

Requires the department of taxation to: (1) maintain records of taxpayers claiming the credit; (2) obtain and total the aggregate amounts of all qualified clinical trial costs per qualified clinical trial and per qualified clinical trial per year; and (3) provide a letter to the director of taxation specifying the amount of