High Technology Business Investment Tax Credit

Overview

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Senate Economic Development & Technology Committee

House Economic Revitalization, Business & Military Affairs Committee

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QHTB Investment Tax Credits

(Section 235.110.9, HRS)

- Key Provisions
  - 100% State Tax Credit Over 5 Years: 35%, 25%, 20%, 10% & 10% in Years 1-5, respectively;
  - * Credit Allocations may be disproportionately made among investors through LLC or Partnership investment entities;
  - 10% Recapture for Credits received in 2 years preceding Recapture Event.
  - $2 Million Credit Limit Over 5 Years per Investor per QHTB Investment per Year.

** 2004 Change: New Safe Harbors that can be exceeded with Economic Substance and Business Purpose*

QHTB Investment Tax Credits

- What is a Qualified High Technology Business ("QHTB")?
  - More than 50% of Total Business Activities from "Qualified Research"
    - At least 75% of which must be conducted in Hawaii; OR
  - More than 75% of Gross Income Derived from "Qualified Research"
    - Such income must be received from products or services sold from, manufactured, produced or performed in Hawaii

QHTB Investment Tax Credits

- What is "Qualified Research"?
  - As Defined in IRC Section 41(d);
  - * Computer Software Development or Design;
  - Biotechnology;
  - Performing Arts Products;
  - Sensor & Optic Technologies;
  - Ocean Sciences;
  - Astronomy; OR
  - Nonfossil Fuel Energy-Related Technologies

** 2004 Change: Software for ultimate sale/economic consideration; QHTB must retain substantial IP rights*

QHTB Investment Tax Credits

- What is a qualified "Investment"?
  - Defined in Section 235-1, HRS
  - Cash
  - Nonrefundable
  - "At Risk," as used in IRC Section 465

QHTB Credit "Multiples"

- Not "Multiples" of Credits
  - Simply a Disproportionate Allocation Among Investors (Who Can and Cannot Use the Credits) of the SAME Fixed Amount of Credits
  - Does NOT Cost the State More Money
  - Requires and Subject to Risk of 5 Years of QHTB Compliance to Fully Realize
  - Often Subject to Federal & State Effective Tax on Credits (Loss of Deduction for State Tax)
- Greatly Increases Market Validation of QHTB
  - Requires More Investors (e.g. from Mainland) to Invest More Money At The Same Time Without Receiving Credits
- Critical for Preventing Undercapitalization & Failure of QHTB's
  - "Equity Kickers" in Exchange for Credits Important for Attracting Outside Capital to Hawaii (which increases General Excise, Employment and Other Tax Revenues)
  - Important for Large Corporate Investors Who Do Not Have More Than 286% of Their State Tax Budgets to Invest in the First Year.
  - Important for Preventing Undercapitalization of "Angel Only" Deals

Act 221 Cost Benefit Analysis

(Data from Sept. 2008 Hawaii Department of Taxation Study)

- Cash Invested in 177 QHTB's 2002-2007: $1.2 Billion (Cov. Ltr. p. 2)
- Expenditures in HI by 177 2002-2007: $1.4 Billion (Cov. Ltr. p. 2)
- Credits Claimed'99-'06 for 333 QHTB's: $295.6 Million (Cov. Ltr. p. 2)
- 2007 QHTB Job Creation (from 177 QHTB's Funded in 2007): (Cov. Ltr. p. 2; Table 5.1a p. 42)
  - Employees: 1,450 Full Time; 154 Part Time; 641 Temp/Seasonal
  - Independent Contractors: 2,118
  - 2007 QHTB Salaries/Job Compensation Paid: $228 Million
- 2007 QHTB Revenues Earned Worldwide: $228.3 Million (Table 4.1a, p. 37)
- 2007 QHTB's Not Yet Profitable & In Need of Capital: 78.5% (Table 4.3a, p. 39)
- "Tax Gap" (Delinquent Taxes) > $1 Billion/Yr.; $7 Billion/7 Yrs.
- (1/7/09 DoTax WAM Testimony)