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HOUSE COMMITTEE ON FINANCE
TESTIMONY REGARDING HB 2945 HD 1
RELATING TO ECONOMIC DEVELOPMENT

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 18, 2010
TIME: 2PM
ROOM: 308

This measure, among other things, funds the State private investment fund to allow transferability of tax credits.

The Department of Taxation ("Department") **opposes the credit transfer amendments; as well as any anticipated revenue loss** anticipated by this measure.

I. THE DEPARTMENT OPPOSES TRANSFERS OF CREDIT.

The Department is strongly opposed to any provision that allows Hawaii tax credits to be sold, assigned, or transferred. Allowing taxpayers to market or sell their tax credits is fundamentally poor tax policy. Selling tax credits can be subject to abuse and suspect motivation by parties involved.

The Department's fundamental and primary concerns regarding credit transfers are the following:

- The transferability rewards a separate taxpayer unrelated to the taxpayer that generated the credit, which is fundamentally poor tax policy for encouraging behavior and directly rewarding that behavior;

- The Department is not setup to regulate credit transfers. Will the Department be required to establish a "Bureau of Credit Conveyances" in order to track transfers? If this is the case, resources will have to be dedicated to this;

- And, abuse relating tax credit transfer prices will be problematic. The State will be out a $1 when taxpayers will be transferring this $1 for pennies.

II. ANTICIPATED REVENUE LOSS

This measure also provides for the funding of the investment fund's allocable credits. Currently, this program is not funded. Funding this program will result in a revenue loss to the general fund equal to whatever is appropriated.

The Department points out that the measure, as amended, defers the initial payout of credits until a date unspecified. By deferring the payout of potential credits, impacts to the general fund are effectively delayed.

TESTIMONY BY DAVID SHIMABUKURO
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON FINANCE
ON
HOUSE BILL NO. 2945, H.D. 1

RELATING TO ECONOMIC DEVELOPMENT

FEBRUARY 18, 2010

Chair Oshiro and Members of the Committee:

The ERS Board of Trustees opposes a provision in H.B. 2945, H.D. 1 which requires the ERS' Chief Investment Officer (CIO) to serve on the State Private Investment Fund Board of Directors.

The ERS Board of Trustees recognizes the importance and value of the proposed State Private Investment Fund to increase the availability of venture capital for the State's emerging industries. However, the CIO's participation as a State Private Investment Fund Board Director could present a potential misalignment of interests and a conflict of responsibilities already assigned to the ERS' CIO.

Thank you for the opportunity to testify on this measure.

HSDC HAWAII STRATEGIC DEVELOPMENT CORPORATION

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Written Statement of
Karl Fooks
President
Hawaii Strategic Development Corporation

Before the
HOUSE COMMITTEE ON FINANCE

February 18, 2010
2:00 PM
State Capitol, Conference Room 308

In consideration of

HB 2945 HD1 RELATING TO ECONOMIC DEVELOPMENT

Chair Oshiro, Vice Chair Lee and Members of the Committee:

Hawaii Strategic Development Corporation (HSDC) supports HB 2945 HD1 if the amendments HSDC have suggested are incorporated.

Many states have adopted a fund of funds model to support venture capital investment in their state, indeed HSDC has been managing Hawaii's venture capital fund of funds program for many years. The focus of this bill is to create a financing mechanism that will not use scarce State fiscal resources, but still allow investment capital to be mobilized by HSDC for Hawaii's high technology companies.

Four objectives are important for financing a venture capital investment program in the current economic conditions:

- Cost to the State should be deferred for a minimum of two fiscal years.
- Potential for investment returns to offset costs should be preserved.
- Any costs incurred should be known and spread over a number of years.
- Capital should be pooled into investment funds and managed by private sector fund managers

Utilizing contingent tax credit financing mechanisms created by this bill appears to be an efficient means to meet these four objectives. The ability to defer cost from a state budgeting perspective will be determined by the earliest date the tax credits can be cashed. If that date is set for two years out, there will be no cost allocated in the budget for the first two years; if that date is set for four years out, there will be no cost allocated in the budget for the first four years, etc. However, a longer period of deferral may increase the cost of financing depending on the financing mechanism pursued.

From an economic perspective, the investments of the fund will be used to repay the capital raised from the market and therefore there is the potential for tax credits to never be cashed. In the unfortunate event where investment returns are insufficient to repay all the capital raised from the market, the State's cost from the exercise of tax credits will be capped by the annual limits and overall program limit imposed by this legislation. The Department of Taxation has expressed concern over the credit transfer provisions of this bill, but these provisions are necessary for HSDC to sell, transfer, or assign the tax credits and thus, efficiently monetize the value of the tax credits.

Other states that are operating similar investment programs as contemplated by HB2945 HD1 have stressed the need to provide flexibility in the enabling legislation to ensure that the cheapest means of financing can be arranged. Many of these programs are around $100 million in total size for a ten or twelve-year program as this amount seems to support the cost of raising financing and create a meaningful presence in the venture capital industry.

HB 2945 HD1 appears to establish the SPIF independent of HSDC. This creates implementation problems as there is no State entity providing administrative or fiscal support to the SPIF. The amendments HSDC suggests would correct this problem.

Thank you for the opportunity to submit testimony.