LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

STANLEY SHIRAKI
DEPUTY DIRECTOR

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

PHONE NO: (808) 587-1510
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HOUSE COMMITTEE ON FINANCE
TESTIMONY REGARDING HB 2962
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 18, 2010
TIME: 5PM
ROOM: 308

This measure amends the current Technology Infrastructure Renovation Tax Credit and the High Technology Business Investment Tax Credit by deferring claims of the credit until July 1, 2013.

The Department of Taxation has the following **comments** on this measure—

CLARIFY THE OPERATIVE LANGUAGE TO REFLECT CREDITS—The Department has initial concerns with the language used in this measure to describe the deferral of the tax credits. The bill refers to the reduction as a "deduction." The proper reference should be to a "credit."

"Beginning on July 1, 2010, [~~deductions~~] credits against a taxpayer's net income tax liability for claims under this section shall be deferred until July 1, 2013."

Or

"Beginning on July 1, 2010, no tax liability under this chapter shall be reduced by a credit under this section until July 1, 2013."

REVENUE IMPACT—This measure results in the following revenue gains:

- FY 2011, $93.3m
- FY 2012, $47.5m
- FY 2013, $27.5m

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, Deferral of high technology tax credits

BILL NUMBER: HB 2962

INTRODUCED BY: M. Oshiro

BRIEF SUMMARY: Amends HRS sections 235-110.51, 235-110.9, 241-4.8 and 431:7-209 to provide that beginning July 1, 2010, any tax credits to be deducted against a taxpayer's net income tax liability shall be deferred until July 1, 2013.

EFFECTIVE DATE: July 1, 2010

STAFF COMMENTS: This measure proposes that any tax credits that may be claimed under the high technology infrastructure renovation tax credit or high technology business investment tax credit shall be deferred until July 1, 2013. It would appear that while these credits are scheduled to sunset on 12/31/10, this measure would suspend the actual claiming of any of these tax credits earned up to this year until 2013. This means the deferral of credits by this measure will result in a payout of state funds hopefully after the current financial crisis. Given that the high technology tax credit costs the state $130 million in 2007 and is expected to grow in revenue impact, this measure would improve the cash flow for the state during the next three years.

While the focus on high technology in the last few years is commendable, it fails to recognize that investments are made with the prospect that the venture will yield a profit. If the prospects for making a profit are absent, no amount of tax credits will attract investment from outside Hawaii's capital short environment. People do not invest to lose money. It should be remembered that until Hawaii's high cost of living can be addressed, all the tax incentives in the world will not make a difference in attracting new investments to Hawaii. The only attractive aspect for resident investors to plough money into such activities is the fact that the credit provides a way to avoid paying state taxes.

Again, lawmakers must ask themselves whether or not these incentives are appropriate in these dire financial times. Given that there are many other proposals in the legislature to hike tax rates for either the general excise or net income taxes, taxpayers will find the continuance of these targeted business tax credits frightening.

In order to reassure that the investments made will still be qualified for the tax credit, language should be inserted to indicate deferral and not the abolition. Suggested language might include:

"235-A <u>Credits against income; certain claims deferred. (a) Notwithstanding any law to the contrary providing for a tax credit that may be claimed against a taxpayer's tax liability under section 235-110.51, 235-110.9, 241-4.8, or 431:7-209 for taxable years beginning on or after July 1, 2010, and ending before January 1, 2014, claims for these tax credits shall be deferred until tax years beginning after July 1, 2013</u>."

Digested 2/17/10

HVCA SINCE 1988 HAWAII VENTURE CAPITAL ASSOCIATION

805 Kainui Drive
Kailua, Hawaii 96734

DATE: February 18, 2009
TIME: 2:00pm
PLACE: Conference Room 308

TO: House Committee on Finance
Representative Marcus Oshiro, Chair
Representative Lee, Vice Chair

FROM: Bill Spencer, President, Hawaii Venture Capital Association

RE: Testimony In Strong Opposition to **HB 2984 HD1**

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

On behalf of the 2,000 members and friends of the Hawaii Venture Capital Association, let me express our strong opposition for HB2962 HD1 due to changes indicated in HD1 of this otherwise good bill that would end Act 221/215 before its scheduled sunset date.

HVCA supports the intent of the original draft of HB2984 to extend the research and development tax refund. However, prematurely ending Act 221/215 would not only change the rules after they have been applied, but could hurt many companies that are depending upon raising investments from local investors in 2010.

The Hawaii Venture Capital Association is one of Hawaii's oldest economic development trade associations devoted to diversifying Hawaii's economy, capital formation and Hawaii's entrepreneurs for last 22 years.

Thank you for your kind consideration of this testimony.

Sincerely,

/s/
Bill Spencer
President
Hawaii Venture Capital Association

Bill: HB 2962
Date: February 18, 2010
Time: 5pm
Place: House conference room 308

Committee: FIN
Chair: Representative Marcus R. Oshiro
Vice Chair: Representative Marilyn B. Lee

I oppose this bill

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

My name is Mike Curtis and I run a small local software development company called SDC Hawaii, LLC. We employ seven people, five of whom are software designers and developers. We are a start-up company owned and funded by local investors and members of our own employee team.

This bill deferring deduction of the Act 221 investment tax credit will result in irreparable harm to my company's investors, the company itself, and my employee partners. It will also result in further damage to our state's reputation as a place to do business.

While I understand and appreciate the fiscal crisis we face as a state, I strongly oppose this proposed bill. It upsets existing law and is certain to damage those companies that have relied on the investor tax credit to develop their financing plans for the remainder of this year.

Making further changes to Act 221 prior to its established sunset date continues a dangerous precedent set last year wherein the Legislature upset what investors and local tech companies considered to be stable law. The sunset date was put into effect four years ago. Major provisions within the law were then changed last session, critically impacting companies (and costing jobs) throughout the state. Please do not repeat this mistake.

Thank you for the opportunity to testify on this important bill.

Sincerely,

Name: Mike Curtis
Title: Chief Operating Officer
Company: SDC HAWAII, LLC
Phone: 808-292-6862
Email: mcurtis@hawaii.rr.com

PACIFICAP
GROUP

PACIFICAP GROUP, LLC
820 Mililani Street, Suite 600
Honolulu, HI 96813
Direct: 808.237.5388 Fax: 808.537.2188

February 18, 2010

Testimony for Hearing before the
House Committee on Finance
Wednesday, February 18, 2010, 5:00 pm

State Capitol, Conference Room 308
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in OPPOSITION to HB 2962
Relating to Taxation

Chair Oshiro, Vice-Chair Lee, and Committee Members:

Thank you for the opportunity to submit testimony in OPPOSITION to HB 2962.

This bill appears to attempt to defer to July 1, 2013 claims of the High Technology Business Investment Tax Credit, commonly known as the "Act 221 Investment Credit" under Section 235-110.9, Hawaii Revised Statutes ("HRS") that could otherwise be claimed beginning on July 1, 2010.

This bill appears to have serious mechanical and legal flaws and is potentially unconstitutional to the extent that it defers the ability to claim Act 221 Investment Credits in current and future years for investments that have already been made prior to the bill's enactment.

While somewhat unclear, it appears that Section 4 of this bill may be attempting to address some retroactivity concerns in the language that reads:

> This Act does not affect rights and duties that matured, penalties that were incurred, and proceedings that were begun before its effective date.

However, this language still does not address the retroactivity problems of Investment Credits that continue to mature over the five year period after an investment was made, if some of this five year period occurs after this bill's effective date.

Other technical and mechanical flaws in this bill, which to be honest, I have not been able to completely figure out, include what appears to be a direct conflict with Act 178, SLH 2009, which the Legislature passed last year.

Act 178 PROHIBITED the carry forward of credits for investments made after April 30, 2009, but this bill appears to REQUIRE that credit claims be "deferred" until July 1, 2013. It is completely unclear to me what the difference is between a credit that is "carried forward" and a credit that is "deferred" and how this can be both prohibited and required at the same time.

If 2010 credits that are deferred to 2013 exceed a taxpayer's 2013 tax liability, can these credits be carried forward to 2014 and after?

Act 178 also limited credit claims in 2009 and 2010 to 80% of a taxpayer's 2009 and 2010 tax liability. If credit claims for 2010 are to be deferred until 2013, how does one apply this 80% cap from 2010 to credits claimed in 2013?

Requiring investors to defer credit claims to 2013 for investments already made could have a substantial adverse impact on their tax and cash flow situations and therefore raise significant constitutional problems of retroactivity.

For example, our firm has some very elderly investors who are in their 90's. The deferral of their 2010 credits to 2013 imposed by this bill could have the effect of completely confiscating their credits from them if they should pass away prior to 2013.

Other investors may not be able to use their credits in 2013 and later due to substantially lower tax liability in those later years, whether due to retirement or investment returns earned prior to 2013.

Some corporate investors may have invested funds from their 2010-2012 state tax budgets into Act 221 companies in reliance on the reasonable expectation that Act 221 Investment Credits would be available to cover their 2010-2012 state tax liabilities. Requiring them now to pay their 2010-2012 taxes after they have already invested the cash from their state tax budgets for these years could create serious cash flow problems for these investors.

Thank you for the opportunity to testify.

Respectfully submitted,

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

Bill: HB 2962
Date: February 18, 2010
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Place: House conference room 308

Committee: FIN
Chair: Representative Marcus R. Oshiro
Vice Chair: Representative Marilyn B. Lee

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