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HOUSE COMMITTEE ON ECONOMIC REVITALIZATION, BUSINESS & MILITARY AFFAIRS
TESTIMONY REGARDING HB 2984
RELATING TO TAX CREDITS

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 9, 2010
TIME: 8:30AM
ROOM: 312

This measure extends the tax credit for research activities until 2011.

The Department of Taxation (Department) **opposes extending the tax credit due to unbudgeted revenue loss.**

I. STRONG SUPPORT FOR HIGH TECH BUSINESSES

The Department and the Administration support the use of tax incentives to assist with the development of Hawaii's high tech industry. Act 221 has been effective in encouraging local and out-of-state investment in Hawaii's high tech businesses, as well as investing in research activities, which makes Hawaii a high-tech community.

The importance of promoting innovation and research-based activities was recognized with the enactment of several ground-breaking tax credits and programs intended to promote growth in technology and other innovation-related sectors. Beginning with Act 178, Session Laws of Hawaii 1999, the State vigorously encouraged the development of high technology businesses in order to further diversify its economy, attract former residents to return home, and develop business sectors with better paying jobs.

Act 178 was followed by Act 221, Session Laws of Hawaii 2001, which provided for what is believed to be the only one hundred percent tax credit available for investments into businesses conducting high technology research-related activities. Act 221 provided financial backing for these companies by attracting capital from both local and out-of-state sources through government incentives. Recognizing the amount the State has invested in these companies through tax incentives to date, coupled with the viability these companies demonstrate as promising profitable ventures, it is important that the State maintain its commitment to making Hawaii a high technology hub of the future for the sake of its overall economy, which is overly tourism- and real estate-based. Along with the 100% investment tax credit, Hawaii also provides a very generous tax credit for research activities, which is much more competitive than its counterpart federally and in other states. For example, Hawaii's research credit is 20% of costs without any requirement to "increase" research activities. Also, Hawaii's credit is refundable, which means the excess is paid to the taxpayer. As a general matter, Hawaii's research credit has been successful. Though in the eyes of the Department there was initial abuse by taxpayers, the Department and taxpayers have developed an efficiently administered tax credit program that helps Hawaii R & D companies.

II. ANTICIPATED REVENUE LOSS

This measure will result in a revenue loss of approximately $20 million in FY 2012 for the additional extension. This cost has not been factored into the Executive Budget and is not a priority this session when the Executive and Legislative branches are both struggling to balance the budget. Quite simply, extending this credit this year is not a priority when education cuts and loss of other services are competing for the same revenues.

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, Extend tax credit for research activities

BILL NUMBER: HB 2984

INTRODUCED BY: Yamashita, Chong, Har, Ito, McKelvey, Say, Tokioka

BRIEF SUMMARY: Amends HRS section 235-110.91 to extend the expiration of the tax credit for research activities from December 31, 2010 to December 31, 2011.

EFFECTIVE DATE: Tax years beginning after December 31, 2009

STAFF COMMENTS: The legislature by Act 178, SLH 1999, and Act 221, SLH 2001, enacted various tax incentives to encourage the development of high technology businesses in the state. The acts provided investment and research credits, as well as income exclusions, providing tax relief to high tech businesses and individuals associated with high tech businesses. While this measure proposes to extend the expiration of the tax credit for research activities from December 31, 2010 to December 31, 2011, it perpetuates the financial drain on the state's revenues. It should also be remembered that the research credit is a refundable tax credit. Thus, should the amount of the credit exceed the taxpayer's income tax liability, any excess credit is a cash payment out of the state treasury to the claimant.

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 investment 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.

A former Hawaii resident who has been a success in the field of high technology pointed out recently what will make Hawaii conducive to high tech businesses and they are: (1) entrepreneurs, not capital, that comes first; (2) entrepreneurs coming from engineering schools and technology companies; (3) building a world class engineering school in Hawaii; (4) supporting internships at technology companies; (5) allowing our best children to go away to get a worldwide perspective; (6) not broadband passing through Hawaii that is a selling point; (7) that people fly direct and therefore is Hawaii's location in the middle of the Pacific an advantage?; (8) learning the rules of the game; (9) looking at Israel and learn from them; and (10) doing your own thing, being a copy cat does not work. At the heart of his remarks was the fact that in order to produce a high technology industry in Hawaii, those companies need to have access to institutions of higher education which are producing the people needed by the high technology industry. Without the academic synergy, Hawaii will never become a center for high technology activity. Thus, all of the tax incentives, like this measure embodies, will fall short of luring high technology firms to Hawaii.

Further, the tremendous tax burden, the draconian regulatory environment, and the dramatic increase in fees that go with the permitting process make Hawaii an unattractive place to do business. It should be remembered that while the high technology credits may look like a good incentive or enticement to undertake research activities in Hawaii, those who would conduct this research must live in the same high cost-of-living environment with which other taxpayers continue to struggle. Thus, the cost of maintaining those researchers will be higher than to do so where the cost of living is much lower. Let's not bet the farm on high technology without really understanding what makes this industry tick.

Obviously the authors of this proposal would like to ignore the evaluation of these tax incentives done by UHERO last year which basically condemned the credits as a waste of state resources as there is little evidence that the current program of tax credits has created substantial new employment or on-going enterprises. It is truly amazing that given the dire condition of the state's financial condition, that lawmakers would continue to support unbridled drains of resources while at the same time proposing that the tax burden be increased on all other taxpayers. With declining revenues, every program from education to corrections to health services will be severely curtailed. If the state doesn't have the money to put textbooks in the schools why then do we need the highly touted, high-paying jobs the advocates for the industry promise? The next generation may not even know how to read given the cuts to the education budget.

Again, lawmakers must ask themselves whether or not this incentive is 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. Frightening because these very lawmakers are supposed to represent the best interest of their constituents. Raising taxes on constituents while still handing out money to favored groups will engender the ire of constituents. The finger of blame for these potential increases in tax burden should not stop at lawmakers but be placed squarely on those in the community who continue to push for these targeted tax credits. Perhaps those proponents should be asked to pick up the tab for this reckless expenditure of precious tax dollars.

Digested 2/8/10

THE CHAMBER OF COMMERCE OF HAWAII
1132 Bishop Street, Suite 402
Honolulu, HI 96813

Testimony to the House Committee on Economic Revitalization, Business, and Military Affairs

Tuesday, February 9, 2010
8:30 AM
Conference Room 312
RE: HOUSE BILL NO. 2984, RELATING TO TAX CREDITS

Chair McKelvey, Vice Chair Choy, and members of the committee.

My name is Charles Ota and I am the Vice President for Military Affairs at The Chamber of Commerce of Hawaii (The Chamber). I am here to state The Chamber's strong support of House Bill 2984, Relating To Tax Credits.

The Chamber's Military Affairs Council (MAC) serves as the liaison for the state in matters relating to the US military and its civilian workforce and families, and has provided oversight for the state's multi-billion dollar defense industry since 1985.

The measure proposes to extend the tax credit for research activities for one year.

This measure will allow sufficient time to complete a more in-depth study of the research and development (R&D) sector and develop recommendations that would ensure long term growth and expansion of technology companies.

The large presence of all of the Nation's military services in Hawaii has attracted the top defense prime contractors to establish operations in the state. This has served as a source of funding and contracting opportunities for Hawaii's growing R&D sector, and there is considerable opportunity for even greater growth.

This bill will extend tax credits for one more year and provide a means for the legislature to become better informed on the impediments hindering growth in this important high technology sector. There are literally millions of dollars that could be directed to Hawaii R&D businesses via military channels and through the prime defense contractors.

For these reasons, we respectfully request that the proposed measure be passed for further review and adoption.

Thank you for the opportunity to testify.

Statement of
YUKA NAGASHIMA
Executive Director & CEO
High Technology Development Corporation
before the
HOUSE COMMITTEE ON ECONOMIC REVITALIZATION, BUSINESS & MILITARY AFFAIRS
Tuesday, February 9, 2010
8:30 AM
State Capitol, Conference Room 312

In consideration of
HB 2984 RELATING TO TAX CREDITS.

Chair McKelvey, Vice Chair Choy, and Members of the House Committee on Economic Revitalization, Business and Military Affairs.

The High Technology Development Corporation (HTDC) supports HB 2984, which extends the tax credit for research activities for an additional year. This tax credit, which was provided through Act 221/215 legislation, is uncontroversial and benefits the innovation companies directly.

This bill, unlike HB 2828 (and its companion bill SB 2293), advocates the extension of the tax credit without establishing a high technology research and development task force. HTDC prefers HB 2984, not because we feel further discussion is unnecessary, but because discussions need not be led under legislation. Exemplified by the preparation and work involved with the tech caucus bills introduced this year, the tech community and its related industries (e.g., accounting, angel investing) have shown that they can come together and hold discussions without any legislative mandate. Another advantage of NOT forming a task force formally under legislation is that such a format will be more exclusive than inclusive: 1) current sunshine laws demand that these meetings take place in a traditional manner (physical location, discussion in real time), 2) many entrepreneurs on the neighbor island or on travel will be excluded, 3) discussions outside the "publicly noticed" meetings will be prohibited, and 4) difficulties in establishing quorum which would lead to fewer meetings. Those constraints will negatively affect the tech entrepreneurs who better contribute their ideas openly via mailing lists, blogs, Twitter, and other online communities, which are more open and inclusive than what our current sunshine laws would allow for a legislated task force.

In summary: we can still accomplish the intent of HB 2828 and SB 2293 through HB 2984 without a formal task force being established.

Thank you for the opportunity to submit testimony on this bill.