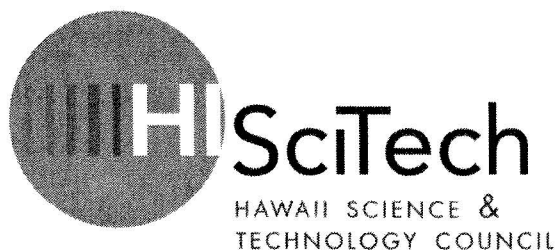


LATE TESTIMONY



Bill **HB2984**
Date **February 9, 2010**
Time **8:30am**
Place **Conference Room 312**
Committee **Economic Revitalization, Business, & Military Affairs**
Chair **EBM: The honorable Representative Angus McKelvey**
Vice Chair **EBM: The honorable Issac W. Choy**

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

Hawaii Science and Technology Council (HSTC) would like to add comments to HB2984.

On behalf of HSTC, we would like to comment that we support the intent of HB2984, however we understand the economic circumstances that the State faces this year. Therefore, we would strongly support a revenue neutral amendment to HB2984.

Thank you for your time and consideration.

Respectfully yours,

Jamie Ayaka Moody
Government Relations
Hawaii Science & Technology Council
733 Bishop Street. #1800
Honolulu, HI 96813



Bill HB2984
Date February 9, 2010
Time 8:30am
Place Conference Room 312
Committee EBM: Economic Revitalization, Business, & Military Affairs Committee
Chair EBM: The Honorable Representative Angus L.K. McKelvey
Vice Chair EBM: The Honorable Representative Isaac W. Choy

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

I would like to thank the introducer and signatures of this bill, Representative Yamashita, and others (Representatives Chong, Har, Ito, McKelvey, Tokioka and Speaker Say) for their support to the Science and Technology Industry.

Hawaii Science & Technology Council (HSTC) supports the intent of HB2984, with comments.

The Science & Technology community of Hawaii is acutely aware of our State's current crisis; the State is facing a general fund deficit of at least \$1.2 billion (could possibly increase to \$1.5 billion), social services are being jeopardized due to the lack of funding, and our keiki, our future, are paying the price right now for the teacher furloughs. Therefore it is difficult, at this time, to ask for any tax credit without commenting.

As an industry, we believe that the revenue generated to the State by R&D companies exceed the expenses of the R&D tax credit. We welcome the opportunity to share this analysis with you.

We also understand that the goal for this session is to present a balanced budget. If and only if this goal is achieved and the State has the sufficient resources, we humbly ask that the extension for the tax credit for research activities be considered. We will continue to work with you to determine the most responsible way to achieve this extension.

Mahalo,

Keiki-Pua S. Dancil, Ph.D.
President and CEO
Hawaii Science & Technology Council
733 Bishop St. #1800
Honolulu, HI 96813



LATE TESTIMONY

700 Bishop Street, Suite 2000 Honolulu, HI 96813

HB 2984 - Relating to Tax Credits
DATE: February 9, 2010
TIME: 8:30am
PLACE: Conference Room 312

TO: House Committee on Economic Revitalization, Business, & Military Affairs
Representative Angus L.K. McKelvey, Chair
Representative Issac W. Choy, Vice Chair

FROM: Traci H. Downs, Ph.D.
President & COO
Archinoetics, LLC

RE: Testimony in **Strong Support** of HB 2984

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

Thank you for the opportunity to testify on this bill. Archinoetics strongly supports HB 2984 and its proposed extension of the research tax credit. This credit allows companies, like Archinoetics, to take the risks needed to grow its research and grow its business in Hawaii.

Archinoetics, LLC is a woman owned world class technology company located in downtown Honolulu. It is focused on the research and development of human-centered technologies. Our current projects include functional brain imaging systems, human fatigue and performance monitoring devices, intelligent algorithms based on genetic programming and biometric sensors, remote sensing, and specialized computing platforms. We were created in 2005 with the help of Act 221 and the research tax credits which allowed my husband and I to make the leap of investing in our own company. Today we employ 32 software and hardware engineers and scientists from varying backgrounds at Archinoetics and have spun off a subsidiary company, Fatigue Science, which now employs 4 employees and is growing. Over ½ of our employees are kamaaina who left Hawaii and never dreamed that they would be able to work in their profession and raise their children back here at home. The Research Tax credit has made a profound impact on life for all of us here on the islands and I commend your efforts to extend it.

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

Sincerely,

Traci H. Downs

Traci H. Downs, Ph.D.
President & COO (co-founder)
Archinoetics, LLC

382-0314 (direct)
traci@archinoetics.com

(T) 808.585.7439, (F) 888.279.0289
www.archinoetics.com



LATE TESTIMONY

HB2984 - Relating to Tax Credits

DATE: February 9, 2010

TIME: 8:30 A.M.

PLACE: Room 312

TO: Economic Revitalization, Business and Military Affairs Committee

Rep. McKelvey, Chair

Rep. Choy, Vice Chair

FROM: James P. Karins

President and CEO

Pukoa Scientific

Re: Testimony in Strong Support to HB2984

Chair, Vice-Chair and Committee Members:

Thank you for the opportunity to submit testimony in strong support to HB2984. My name is Jim Karins and I am the President of Pukoa Scientific. Pukoa Scientific is a 17 person company started in 2004 specializing in the interpretation of image and signal data to identify objects, threats or targets for military, security, medical and industrial applications. Pukoa Scientific is in the dual use sector which has proven to be one of the fastest growing technology sectors. Even during the trying year of 2009 we were able to grow to 17 employees; 13 of our 17 employees are full time and 16 of those 17 reside in Hawaii. Of the 12 full time staff in Hawaii, 8 graduated from high schools in Hawaii, 11 graduated from the University of Hawaii or Hawaii Pacific University and at least 4 worked on the mainland prior to finding work in Hawaii. We currently generate more than \$2.5M in revenue and pay over \$1.5M in compensation.

All of us understand the difficult financial condition of the state and industry wants to help. One of the best ways for industry to help is to maintain and grow the workforce. Without job creation, all the cost cutting and all the tax increases will only create a downward spiral, requiring more costs and more tax increases. The state must maximize its return by spending money that generates multiples of increased spending, garnering the most jobs and job income from the least amount of tax dollars. Research and development is one of those areas.

Research and development is a highly critical component to a sustainable economy. R&D provides high-paying jobs to highly educated employees. These employees pay significant taxes back to the state and spend significant amounts of their income within the state for goods and

services. Additionally as the R&D matures it creates product companies that increase the number of jobs and tax base significantly.

Some important facts related to R&D tax credits are:

- (1) The cost of the R&D tax credit is between \$13 and \$14 million per year, but R&D employees are highly paid and pay income taxes at high rates and generate significant other economic activity within the state (see Appendix A for analysis),
- (2) R&D is so important to the economy of the United States that the federal government is considering making the federal R&D tax credit permanent,
- (3) R&D is so important to the economy of states, that approximately 33 states provide R&D tax credits of various kinds and of the 17 that don't, 4 have no corporate income taxes (see Appendix B),
- (4) R&D is becoming more competitive world-wide. Some countries are offering vastly larger tax credits to lure R&D companies, for example small companies in Quebec are eligible for a 37.5% tax credit in addition to the Canadian tax credits. Additionally, for the first time, China has increased its R&D at a rate higher than the United States (see Appendix C),
- (5) A tax credit of 20% on wages and supplies amounts to about 10% of the cost of doing R&D,
- (6) The tax credits for R&D are comparable or less than those given to other critical industries to economic diversity such as Act 88 (15% credit on costs not just salaries and supplies) for the movie industry or 35% tax credits on renewable energy,
- (7) R&D funds are highly leveraged by imported monies, thus generating more economic activity than economic activities that just move money from one in-state entity to another,
- (8) R&D tax credits are only received after the company has expended the funding, generating tax revenues to the state first,
- (9) R&D tax credits typically go back into additional R&D through additional salaries,
- (10) Studies have shown that for every \$1 in tax credits or lower costs of operation, R&D increases by approximately \$2-\$3.

While these positive aspects are fairly defined, there have been some people who have expressed concerns about the competitiveness of Hawaii's R&D tax credit levels and their refundability. But several factors that are not considered in those concerns include:

- (1) Comparisons are only made to other states and not to other countries. R&D is becoming an economic driver worldwide and Hawaii companies compete worldwide,
- (2) Hawaii's tax credits have been defined to a very small but high payoff group of high technology companies defined as QHTBs while most states provide their tax credits to any company that can qualify under federal tax credit laws,
- (3) The entire cost of doing R&D is the most important factor. Hawaii has a number of competitive disadvantages such as high income tax rates, high cost of living, high unemployment insurance costs, and high transportation costs, and
- (4) R&D returns are highest after several years when R&D turns into products, resulting in significant growth in job opportunities, increased intellectual property owned by Hawaii residents, and increased travel to the state by customers and technology related conferences

In summary the Hawaii R&D tax credit has been effective in generating new taxes, generating new companies and employing approximately 1100 residents. It is important that there not be a gap in the R&D tax credit while the 2011 legislature addresses the longer term impact of R&D on the state. Companies need to make long term plans when doing R&D. It is critical to the industry that the tax credit be in place long enough to encourage R&D and its commiserate high paying jobs, potential job growth, and its impact on the sustainability of the states economy.

I therefore strongly encourage the committee to pass this bill.

Thank you for the opportunity to testify.

/s/James P Karins

James P. Karins
President and CEO
Pukoa Scientific
karins@pukoa.com

APPENDICES

A. Revenue generated to the state by R&D companies compares favorably to the expenses of the R&D tax credit. The table below demonstrates a fairly simple model of the tax revenue generated by the R&D efforts and supporting structure of the companies. In 2008 \$13.4M in tax credits was claimed. Since the credit is 20% of qualified expenses, the qualified expenses are 5 times the credit (\$67M). Typically about half of an R&D companies expenses are qualified, yielding expenses of about \$134M by companies relating to qualified R&D. Wages are about 60% of those expenses and 40% goes to a variety of expenses including rent. I used a 6% income tax rate and a 4.5% GET rate to estimate the taxes directly paid by these companies. An economic multiplier of 2 was used since most of the wages and most the other expenses are recycled in the economy. Total revenue of about \$14.4M is calculated to be attributable to the R&D efforts of the companies receiving \$13.4M in R&D tax credits.

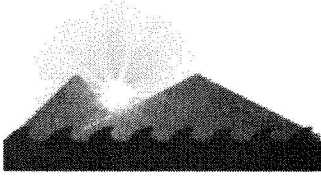
2008		Income Tax	GET
R&D Tax Credit	\$13.4 M		
Qualified Expenses	\$67 M		
Total R&D Related Expenses	\$134 M		
Wages	\$80.4 M	\$4.8 M	
Other Expenses	\$53.6 M		\$2.4 M
Economic Multiplier Effect		\$9.6 M	\$4.8 M
TOTAL REVENUE	\$14.4 M		

B. State R&D tax credits vary greatly from state to state. In some respects Hawaii's tax credit is very good. In a couple it lags other states. For example the credit rate is the best in Hawaii, however only a few states such as Hawaii restrict it to certain companies or R&D areas.

R&D Credit Topic		Notes
R&D Tax Credits	33 States	Of the 17 that do not 4 have no income taxes
Non-incremental	3 States	HI, CT, WV
Credit Refundable	8 States	
Limited Availability	2 States	HI, AR
Taxes the Credit Received	1	HI
Tax Credit	2.5-20%	Average rate is 6.5%

C. International tax credits vary even more and are particularly favorable in some countries. The table below is a summary of some of the tax credits offered by competing nations. A direct comparison is difficult since the incentives are in various forms such as tax abatements or enhanced deductions. One noteworthy example is Quebec Province in Canada where overall tax credits can reach 72.5%.

Country	R&D Tax Incentive
Australia	• Allows a 125% deduction for R&D expenses • <i>Plus</i> a 175% deduction for R&D expenditures exceeding a base amount of prior-year spending.
Canada	• Offers a permanent 20% flat (i.e., first-dollar) R&D tax credit for large companies Small companies receive 35% flat R&D tax credit Quebec province offers an additional 37.5% for small companies Other provinces offer other incentives
China	• Offers foreign investment enterprises a 150% deduction for R&D expenditures, provided that R&D spending has increased by 10% from the prior year.
France	• Allows a 50% R&D credit, includes a 10% flat credit and a 40% credit for R&D expenditures in excess of average R&D spending over the two previous years.
India	• Companies carrying on scientific research and development are entitled to a 100% deduction of profits for 10 years. • Automobile industry also is entitled to a 150% deduction for expenditures on in-house R&D facilities.
Ireland	• Offers a 20% R&D tax credit, plus a full deduction, as well as a low generally applicable 12.5% corporate income tax rate. • Capital expenditures may also qualify for a separate flat credit.
Japan	• Offers a flat 10% R&D tax credit (a 15% flat credit is provided for small companies), in addition to other incentives.
Korea	• Tax holidays, up to 7 years, are provided for high-technology businesses. • In addition, a variety of tax credits are provided for R&D type expenditures.
Singapore	• "R&D and Intellectual Property Management Hub Scheme" offers U.S. companies a 5-year tax holiday for foreign income earned with respect to Singapore-based R&D.
United Kingdom	• Allows a 125% deduction for R&D expenses Plus a 175% deduction for R&D expenditures exceeding a base amount of prior-year R&D spending.



Aurora Research, LLC
73-4372 Hulilau St.
Kailua-Kona, HI 96740
+1 808-325-1631

LATE TESTIMONY

February 9, 2010

Testimony in support of HB 2984

COMMITTEE ON ECONOMIC REVITALIZATION, BUSINESS, & MILITARY
AFFAIRS

Rep. Angus L.K. McKelvey, Chair
Rep. Isaac W. Choy, Vice Chair

NOTICE OF HEARING

DATE: Tuesday, February 09, 2010

TIME: 8:30 a.m.

PLACE: Conference Room 312, State Capitol, 415 South Beretania Street

I, Roderick Hinman of Kailua-Kona, Hawai'i, support HB 2984. Our economy has historically been dependent on agriculture and tourism. While these industries are important and we should continue to support them, a more diversified economy can be resistant to changes in any one industry. Technology is an important part of the modern world, and research is its driver. Extending the tax credit for research activities will continue to encourage technology businesses to form or locate in Hawai'i, creating high-paying jobs that encourage our children to stay in the state or return home.

I respectfully urge you to pass this bill. While all of us in the State need to necessarily tighten our belts in these tough economic times, gutting one of Hawai'i's means of diversifying Hawai'i economy would be decidedly counterproductive.

Sincerely,

Roderick T. Hinman, Ph.D.
Principal Member

LATE TESTIMONY

Testimony of

John A. Chock

before the

HOUSE COMMITTEE ON ECONOMIC REVITALIZATION, BUSINESS, & MILITARY AFFAIRS

Rep. Angus L.K. McKelvey, Chair

Rep. Isaac W. Choy, Vice Chair

HB 2984 RELATING TO TAX CREDITS

DATE: Tuesday, February 9, 2010

TIME: 8:30 AM.

PLACE: Conference Room 312

State Capitol

415 South Beretania Street

Chair McKelvey, Vice Chair Choi, and Committee Members:

It has been said that if we're going to invest in educating our young people, we need to invest in good, high-paying jobs for them in the future as well.

HB 2984 Relating to Tax Credits will stimulate continued Research & Development, which is what drives innovation within the economy. R&D is the early stage of company growth that occurs after the "What if?" moment, when testing, proof of concepts, and prototypes are being developed out in garages and laboratories. This is the nucleus of future business growth.

Along with at least 32 other states and the federal government, Hawaii currently provides support for research by qualified research companies in the form of an R&D credit. This credit is utilized by tech companies across all sectors, from biotech, to software, to small and large defense/dual-use by companies, and by renewable energy firms, all contributing to innovation, high skilled jobs and growing our economy.

As important as R&D is, we also need to emphasize that as a state we must look at a long-term integrated capital formation policy which includes R&D, entrepreneurship,

venture capital, and expansion/follow-on financing, all of which are needed to grow successful businesses

With respect to R&D legislation, we are not asking for anything new. The legislature has established an R&D credit that parallels the Internal Revenue Code, providing support for scientific experimentation at 20% of the cost of the qualified research. That program cost to the state has averaged about \$11 million per year over the last 9 years, and in the last year for which data is available, 2006, provided funding to over 400 companies.

The state R&D credit has been a great source of support for local companies, and is seen as helping to level the playing field of our high cost state, as Hawaii companies compete with national and international competition. Further, the refundable element is helping to attract new technology companies to Hawaii.

The existing credit would stay in place for another year during which time we will have elections and opportunities for fresh ideas on R&D. This is a running in place strategy, not a growth initiative, and certainly is not requesting new tax dollars in this environment. What the bill asks is to keep the spark of R&D alive. This is the ember that will lead to future innovation, commercialization, and growth as the economy rebounds. It allows a thorough review of the best ways to provide R&D support at the state level, and it helps hundreds of tech firms get through the rough patch over the next year.

To conclude, I have been involved in economic diversification, technology development, and capital formation for a long time in both the public and private sectors and I early on learned that it's tough to convince people to invest in diversification when the economy's strong, and there is no need for diversification. It's equally tough to promote diversification when the economy's down and it's not affordable, so a long-term vision clearly is needed. Right now is no different, and HB 2984 provides that vision.

Thank you for the opportunity to provide testimony on HB 2984.

John A. Chock
1949 Kakela Drive
Honolulu, Hawaii 96822

LATE TESTIMONY

ALAN S. HAYASHI
207-4 Kawaihae Street
Honolulu, Hawaii 96825

February 08, 2010

Representative Angus L.K. McKelvey, Chair
Economic Revitalization, Business and Military Affairs Committee
Hawaii State Legislature
Isaac W. Choy, Vice Chair
Members of the Committee

SUBJECT: HB 2984 “Relating to Tax Credits”

Chair McKelvey, Vice Chair Choy, and Members of the Committee:

Thank you for the opportunity to provide comments on SB 2293. My name is Alan Hayashi and I am testifying in support, as an individual employed by a large local defense company.

The technology and defense Industry clearly understands the economic and fiscal challenges facing the state. For this reason industry has been working collaboratively with members of the legislature and stakeholders to craft workable proposals which address the state's budget needs while ensuring that we preserve jobs and companies in Hawaii's science and technology sectors. The result of this collaborative effort is **HB 2984 which industry supports.**

The impact of HB 2984 in its current form will be to extend the R&D credit and to allow study time for a more permanent proposal for the 2012 session. Some facts to consider:

- 1) R&D credits are calculated from funds already prepaid by the technology companies. The labor cost (on which the credits are based) are prepaid to employees (salaries), and to the state of Hawaii (labor / employment taxes).
- 2) These R&D credits are returned directly to these companies who pay the wages.... not to a second, or third party.

Is it worth the return on an annual investment of approximately \$14M (DoTax figures)? To have a high technology industry that can provide clean, high paying, expandable jobs where Hawaii's STEM graduates can be employed, I say the answer is yes! The STEM educational program that the legislature supports and has helped fund is definitely developing high quality graduates who can compete with the best on the mainland. Do we want them to move to the mainland with this valuable expertise when our economy is in need of their talent? Unless we create an environment where high technology can survive and thrive, we will educate our bright young folks for employment elsewhere. We must develop our technology sector for the benefit of future generations.

In this time of economic gloom, I ask you to be bold and to plant the seeds for the continued growth of an industry that can become a leader for Hawaii and the Pacific area. These are not the first yeas, but it does take time and the critical mass is now in place. There are success stories! Technology is the sector that can lead us into the future with capability to diversify and to expand our economy.

In my opinion, it is critical to keep the technology sector of Hawaii's economy alive during the current economic downturn. Most R&D projects cannot be turned off and restarted with out loss of critical time, and personnel with specific skill sets. As the local technology sector degrades, many will relocate to the mainland, or elsewhere to seek employment. It is true that all firms are suffering, not just research and development (R&D) firms. However, R&D has a higher risk and funding profile that companies alone have difficulty bearing with out supplemental support from government. After all they are developing products that have never been developed before! There are some failures in R&D...that is the price for exploring the unknown. Without this willingness, or capability to risk, there are no new inventions! The government must be a partner with the technology sector. The return will far outweigh the investment of \$14M.

How do you continue to fund this technology sector when many other sectors are also suffering? If you believe this is a sector that is, and can be, a large contributor to the future of this state..... the technology industry wants to work with you to explore acceptable solutions. We do understand the difficult situation the state is currently in. We believe we have some viable alternatives, and we want to be part of the solution thru working with you toward a future with a strong, growing, diversified economy.

Someday Hawaii will emerge from this recession...how long it lasts and what kinds of industry survive will depend on some of your decisions in this legislative session. All best wishes!

Thank you for the opportunity to provide this information. I would be glad to answer should you have any questions.

Sincerely,

Alan S. Hayashi