HB 2984, HD2, SD1

Testimony

The Chamber of Commerce of Hawaii
The Voice of Business in Hawaii

Testimony to the Senate Committee on Ways and Means
Monday, March 29, 2010
9:30 a.m.
Conference Room 211

SUBJECT: HOUSE BILL 2984 HD2 SD1 Relating to Tax Credits

Chair Mercado Kim, Vice Chair Tsutsui, and Members of the Committee:

My name is Jim Tollefson and I am the President and CEO of The Chamber of Commerce of Hawaii ("The Chamber"). I am here to state the Chamber's support for passage of Section 2 of House Bill 2984 HD2 SD1, which is the language from the HD2 version that the Chamber supported. While the Chamber supports the extension, we leave the methodology to the Legislature.

The Chamber is the largest business organization in Hawaii, representing more than 1,000 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of its members, which employ more than 200,000 individuals, to improve the state's economic climate and to foster positive action on issues of common concern.

The Chamber also has a role in the military industry in Hawaii. 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 large presence of all of the Nation's military services in Hawaii has attracted the top defense prime contractors, small and large, to establish operations in the state. It has also spurred local companies to form and emerge into this industry. 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. There are literally millions of dollars that could be directed to Hawaii R&D businesses via military channels and through the prime defense contractors.

Recognizing the strong ties between the military and dual-use companies, and the tremendous opportunities they provide to our economy, the Chamber recently formed the Defense and Dual-Use Technology Committee. The mission is to create and build business opportunities in Hawaii by linking together the technology capabilities of Hawaii's entire business community; showcase technology-related products and services ready and nearly ready for the market; leverage these technologies to promote stronger partnerships with the military, state and county governments and to create business opportunities with state, federal, and international institutions; and provide advocacy for a healthy and nurturing environment for Research and Development in Hawaii.

We understand the difficult financial condition of the State of Hawaii. With that said, the Defense and Dual Use industry can and will play a vital role in stabilizing the state's economic climate. One of the best ways for the industry to help is to maintain and grow the workforce. Without job creation, cost cutting and 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 return from the least amount of tax dollars.

Research and development is one of those areas. In comparing the R&D tax credit to other credits, we observe that the R&D tax credit is one of the most effective in generating and maintaining jobs per tax dollar, generating higher tax revenues for dollar spent, and stimulating measurably more economic activity in the state per dollar of tax credit. Additionally, companies leveraging the R&D tax credits tend to be more mature companies; many on the cusp of significant expansion, which will accelerate the hiring of new employees and concomitant tax revenue.

Additionally, research and development is a highly critical component to a sustainable economy. R&D provides well-paying jobs to highly-educated employees. These employees pay significant taxes back to the state and spend considerable amounts of 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. For example, the average salary for technology jobs is $66,000.
(2) 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,
(3) R&D tax credits are only received after the company has expended the funding, generating tax revenues to the state first,
(4) R&D tax credits typically go back into additional R&D through additional salaries,

While these positive aspects are fairly defined, some have expressed concerns about the competitiveness of Hawaii's R&D tax credit levels and their refundability. However, 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 a economic driver worldwide and Hawaii companies compete worldwide,
(2) 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
(3) 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, creating new companies and employing a number of residents. Therefore, it is important that a gap does not exist 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 commensurate high paying jobs, job growth, and its direct impact on the sustainability of the state's economy.

Therefore, we urge the committee to extend the end date for the tax credit for research activities from December 31, 2010 to December 31, 2011. Thank you for the opportunity to express our views.

HI SciTech
HAWAII SCIENCE & TECHNOLOGY COUNCIL

Bill	**HB2984 HD2 SD1**
Date	**March 29, 2010**
Time	**9:30am**
Place	**Conference Room 211**
Committee	**WAM**
Chair	**The honorable Senator Donna Mercado Kim**
Vice Chair	**The honorable Senator Shan Tsutsui**

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

Hawaii Science and Technology Council (HSTC) would like to provide comments for HB2984 HD2 SD1.

We believe that tax credits represent a tool that governments can use to effectively stimulate economic growth and support the creation of sustainable, high-paying jobs. The Qualified High-Tech Business investment and research credits have been key contributors to making Hawaii's high-tech sector one of the fastest-growing in the state.

However, we also recognize the fiscal realities currently facing the state, and the critical, near-term need to balance the state's budget and provide essential social services. Regrettably, in order to meet immediate economic needs, not all initiatives that build long-term economic growth and prosperity may survive without modification or curtailment. The people of Hawaii look to our elected officials to make these difficult, no doubt unpleasant tradeoff decisions.

Curtailment of such long-term growth initiatives is regrettable, but some changes cause more damage than others. Cancellation of tax credit initiatives means investor money will be left on the table going forward, and fewer high-tech jobs will be brought to the state. More damaging than this by far, however, is changing how tax credits for previously made investments will be treated. Investors place money into Hawaii companies and hire local engineers and scientists with the understanding that the State will continue to issue credits as promised. Once their money is in, they cannot retrieve it, and are reliant on the State to keep its end of the bargain. If tax credits for previously made investments are curtailed, delayed, or capped, Hawaii will earn an unwelcome reputation as a place with uncertain investment and political risk. This will make it more difficult to raise funds for all sectors of Hawaii's economy, not just the high-tech sector, and may increase the costs for the State to raise bond monies.

We agree with the extension of the research tax credit contained in this bill, and are confident that this provision would directly translate to additional high-tech jobs continuing to come to Hawaii.

Thank you for your time and consideration.

Respectfully yours,

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L E G I S L A T I V E

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SUBJECT: INCOME, Tax credit for research activities

BILL NUMBER: HB 2984, SD-1

INTRODUCED BY: Senate Committee on Economic Development and Technology

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.

Provides that this act shall take effect on July 1, 2010; provided that final senate drafts of either HB 2877 or HB 2962, or both pass final reading by both houses of the legislature.

EFFECTIVE DATE: July 1, 2010

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.

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 out side 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 especially if the return of the credit is 100% of money invested as the current tax credit is designed to do.

As one 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.

It should be noted that the Senate gutted HB 2962, HD-1 which would have suspended the ability to claim the Act 221 tax credits for a three-year period as a way to close the budget shortfall. Thus, if the suspension is not adopted, lawmakers will have to make up the funds in other ways. As the prior committee has proposed, they intend to make up that budget shortfall by raising the general excise tax on all taxpayers. Thus, that approach sends a message that all taxpayers, both rich and poor, that they will be asked to pay for the tax breaks enjoyed by a privileged few as they continue to collect their windfall of Act 221 tax credits. By deleting the earlier repeal of the Act 221 credits and allowing those investors to continue to reap their windfall, the burden will be shifted to those who have no choice but to pay the increased general excise tax and the added costs it will impose on all goods and services. Delaying the sunset of these credits will cause the state to hemorrhage even more in lost tax revenues.

Digested 3/25/10