
From: Tina Desuacido [tina500@juno.com]
Sent: Monday, February 07, 2011 9:22 AM
To: ERBtestimony
Subject: Tax Foundation Testimony
Attachments: h0370-11.pdf; h0831-11.pdf; h0983-11.pdf; h1159-11.pdf; h0475-11.pdf

TRANSMISSION OF TESTIMONY

DATE: Monday, February 7, 2011

TO: House Committee on Economic Revitalization & Business

FROM: Tax Foundation of Hawaii

Total Pages 7

FOR: Rep. Angus McKelvey, Chair

Testifier: Lowell L. Kalapa, President - Tax Foundation of Hawaii

(Mr. Kalapa will not appear in person at the hearing.)

Date of Hearing - Tuesday, February 8, 2011

Position: Comments

Time of Hearing - 8:00 am

HB 370 - Relating to the Enterprise Zones (2 pages)

HB 831 - Relating to the General Excise Tax (1 page)

HB 983 - Relating to the Hawaii Strategic Development Corporation (1 page)

HB 475 - Relating to Taxation (1 page)

HB 1159 - Relating to Taxation (2 pages)

Number of copies - 4

Thank you.

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, Hawaii strategic development corporation tax credits

BILL NUMBER: HB 983

INTRODUCED BY: McKelvey, Chong, Yamashita

BRIEF SUMMARY: Adds a new section to HRS chapter 211F to allow the state to issue \$100 million in tax credits to the Hawaii strategic development corporation (HSDC) that may be transferred or used to reduce the tax liability of any taxpayer subject to HRS chapters 235, 241, or 431:7-202; provided that the tax credits transferred by the corporation shall not be exercisable in a taxable year beginning before January 1, 2013 or ending after December 31, 2025.

The amount of tax credits transferred by the HSDC shall not exceed an aggregate total of \$20 million per fiscal year. Tax credits which exceed a taxpayer's income tax liability under HRS chapters 235 or 241 or section 431:7-202 shall be used in subsequent taxable years until exhausted. The HSDC shall not transfer or sell any tax credit at more than a thirty percent discount.

Amends HRS section 211F-1 to add the definition of "tax credits" and "taxpayer."

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: This measure proposes to authorize the transfer of \$100 million in tax credits to the HSDC that may be transferred or used to reduce the tax liabilities of any taxpayer subject to HRS chapter 235 (income), chapter 241 (banks and financial institutions) and section 431:7:202 (insurers other than insurers of life insurance contracts, ocean marine insurance contracts, and real property title insurance contracts).

It should be noted that the state has not tracked the cost-benefit of any of the tax credit programs as recommended by the most recent Tax Review Commission. The state has not ascertained if taxpayer dollars that have been spent have gotten any economic returns that these investments may have had. There is sparse data on how these credits affect the equity of the overall tax system. At best, the portion of the technology business that this measure impacts remains a small part of the employment pie while commanding a comparatively large share of state resources. The bottom line is that this measure represents an outflow of real dollars from the state treasury. At the very least, one of the conditions of the credit should be a filing by companies wanting to claim the credit to insure that they produce expected outcomes and the amount that was invested in Hawaii.

Finally, one has to ask what is the rationale behind handing over \$100 million of tax credits to the HSDC? Will taxpayers and lawmakers be abdicating their oversight as to how these credits will benefit the state, the community and the economy? Where is the accountability and transparency in handing out these credits? This measure contains some serious flaws of fiduciary responsibility.

Digested 2/7/11

Written Statement of

KARL FOOKS

President

Hawaii Strategic Development Corporation

before the

HOUSE COMMITTEE ON ECONOMIC REVITALIZATION AND BUSINESS

February 8, 2011

8:00 AM

State Capitol, Conference Room 312

In consideration of

HB 983 RELATING TO HAWAII STRATEGIC DEVELOPMENT CORPORATION

Chair McKelvey, Vice Chair Choy, and Members of the Committee on Economic Revitalization and Business:

HB 983 provides a financing mechanism that will support a multi-year investment program that can be implemented this year and support Hawaii economic recovery and growth. This financing mechanism is structured to not have a budget impact during this biennium and to have a maximum budget impact of no more than \$20 million in any one fiscal year in future years.

It took a conscious effort by government to establish tourism in Hawaii, and it will require that same discipline to establish digital media, information technology, nanotechnology, ocean sciences, biotechnology, aerospace, astronomy and other innovation fields. These industries bring dollars into Hawaii, with minimal impact on our environment, enhance the quality of education, lead our drive toward self-sufficiency, and create high paying jobs for our local families.

However, for Hawaii to successfully foster innovation-led economic growth, an infrastructure and an ecosystem that supports entrepreneurialism, commercialization, and business formation must be established and maintained. Capital formation is a key ingredient on an innovation ecosystem and many states, including Hawaii, have used state sponsored investment programs to support capital formation in their regions. Hawaii Strategic Development Corporation (HSDC) was established in 1991 specifically for this purpose.

HSDC provides venture capital funding to emerging and high growth companies by investing in limited partnerships managed by venture capital professionals. Since 1995, HSDC has committed over \$16 million to twelve investment partnerships and a merchant bank, which to date have invested in 83 firms, 44 of these Hawaii based business, ranging from basic service industry providers to high technology start-up companies. HSDC's limited partner investments have been leveraged over three times by private sector co-investments in the

partnerships. In turn, these investments have been leveraged with company-level co-investments and follow-on investments by private sector investors.

The investments in the earlier time periods helped to jump start the venture capital industry in Hawaii by providing capital to new, Hawaii-based funds. The investment activities of these pioneering funds helped to develop the investment, legal, accounting and management infrastructure necessary to support a venture capital industry. In later years, investment programs have been more targeted. For example, HSDC provided oversight to the Follow-on Funding Program, a \$5 million program to support commercialization of dual use technologies and the \$8.7 million Hydrogen Investment Capital Special Fund. HSDC's UPSIDE Fund supports commercialization of UH developed technologies. However, HSDC has not received a general fund capital infusion for its investment program since 2002 and requires additional resources to reinvigorate its investment program.

The financing mechanism provided by HB 983 will allow HSDC to implement a State capital formation program structured to mobilize and attract private capital to Hawaii's venture opportunities. To this end it will focus on perceived financing gaps and developing local fund management expertise. Two important objectives of the program are to

- 1) pool capital into professionally managed venture capital funds; and
- 2) network Hawaii's venture capital funds into the broader universe of mainland and international funds active in the sectors important to Hawaii.

In this way Hawaii companies will be able to leverage the domain expertise of experienced investors and gain access to follow-on capital for expansion.

A venture capital investment program structured along these guidelines would require approximately \$100mm of State supported financing over a 10 year period as this is the minimum scale required to attract additional investors and make an impact.

The investment program should also require that the funds and companies who receive investment capital from the State be required to provide timely reporting on key metrics and milestones that will allow the State to monitor the progress and effectiveness of the program. As these investments and investment programs are risky and may take many years before generating meaningful returns, a strong commitment to these programs is required to attract the participation of professional investors.

HSDC offers an amendment to this bill to allow the financing mechanism to operate efficiently. Currently, HSDC's investment programs are exempt from state procurement. However, the tax credit monetization mechanism proposed by HB 983 would be a financing arrangement and is not exempt from state procurement. As it is neither practicable nor advantageous to manage market driven investment and financing transactions under state procurement guidelines, HSDC proposes an amendment to exempt these activities.

"SECTION 3. Section 211F, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows: §211F-[] Exemption of corporation from Hawaii public procurement code. The corporation shall not be subject to chapter 103D and any and all other requirements of law for competitive bidding for investment and financing

agreements or other project contracts unless a project agreement with respect to a project otherwise shall require. “

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

RF



Hawaii Venture Capital
Association
805 Kainui Drive
Kailua, Hawaii 96734
808-262-7329
<http://www.hvca.org>

DATE: February 8, 2011
8:00AM, Conference Room 312

TO: COMMITTEE ON ECONOMIC REVITALIZATION & BUSINESS
Rep. Angus McKelvey, Chair
Rep. Isaac Choy, Vice Chair

FROM: Bill Spencer
President
Hawaii Venture Capital Association

RE: Testimony In SUPPORT of HB 983

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

As stated in Section 1. of this proposed bill, it is in the public interest to diversify Hawaii's economy by promoting the development of high technology ventures. Such ventures can generate export revenues, provide high quality jobs and balance Hawaii's dependence on tourism as the predominant industry.

In order to stimulate creation of businesses that can address global markets and grow the economy in meaningful ways, Hawaii needs more "return on investment" driven venture capital organizations with the expertise to find and grow successful high tech businesses.

This bill has the potential to stimulate the growth of venture capital firms. Hawaii has struggled for years to empower and grow the number of such firms, but significant capital is needed to assure that quality management and quality deals can be made.

HVCA has long supported capital formation in Hawaii, since being formed in 1988. The HSDC model began about that time and was able to leverage only \$3Million into almost \$500Million in investments between 1989 and 1991. The funding that this bill could stimulate would create even more investment at a time when Hawaii's economy is in dire need of stimulus.

I encourage this committee to carefully consider this bill as there are many companies that were seeded with Act 221 investments, that now need follow on capital in order to achieve their potential. This bill can serve as a viable means to support the expansion of Hawaii's economy.

Thank you for the opportunity to provide testimony in SUPPORT of HB 983.

Bill Spencer
President
Hawaii Venture Capital Association

Written Statement of
YUKA NAGASHIMA
Executive Director & CEO
High Technology Development Corporation
before the
HOUSE COMMITTEE ON ECONOMIC REVITALIZATION AND BUSINESS
February 8, 2011
8:00 AM
State Capitol, Conference Room 312

In consideration of
HB 983 RELATING TO HAWAII STRATEGIC DEVELOPMENT CORPORATION

Chair McKelvey, Vice Chair Choy, and Members of the Committee on Economic Revitalization and Business:

High Technology Development Corporation (HTDC) is in support of HB983, which issues tax credits to the Hawaii Strategic Development Corporation (HSDC) and allows HSDC to broker the tax credits to raise funds for investment.

While capital is not the only ingredient needed for a healthy innovation pipeline and the ecosystem we need to establish and nurture, there is currently no capital formation strategy or tool for the State of Hawaii with the sun setting of Act 221/215. Further, HSDC has not received any infusion to invest for almost 10 years.

There have been many discussions and concerns about the effectiveness of Act 221/215, and alleged abuse. This method of capital formation via providing funds to HSDC to invest per their statute, minimizes these concerns. Further, beyond having funds to invest in support of local companies, the funds will also command smart money, that is, expertise, mentorship, and networks our companies require to attract future follow-on funding from the mainland.

The State's investment to the innovation-based economy development will not require as nearly as much funds the State had to put on the books for Act 221/215. Further, by investing these monies via HSDC, the State is assured board oversight, the benefits of investing in fund-to-funds (where the winners are picked by experienced managers whose financial incentives are aligned with the State), and gain the attention of these fund managers who will be required to keep visiting Hawaii in search of new companies to invest in and providing valuable mentorship to them along the way.

Thank you for this opportunity to testify in support of this measure.