

# TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

**SUBJECT:** INCOME, Extend tax credit for research activities

**BILL NUMBER:** HB 1511

**INTRODUCED BY:** McKelvey and 1 Democrat

**BRIEF SUMMARY:** Amends HRS section 235-110.91 to expand the tax credit for research activities to include 10% of the qualified labor costs. Defines "qualified labor costs" for purposes of the measure.

Extends the expiration of the tax credit for research activities from 12/31/10 to 12/31/15.

**EFFECTIVE DATE:** Tax years beginning after December 31, 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. These acts provided investment and research credits, as well as income exclusions, to attract high tech businesses to the state. This measure expands the tax credit for research activities to include qualified labor costs and extends the expiration of the tax credit from December 31, 2010 to December 31, 2015, which will perpetuate 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 learning 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 that 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 research credit 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 a few years ago 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 taxes or fees or adopt new fees to supplement and support new or existing programs, continuance of the research credit flies in the face of these tax increase proposals. Again, as noted above, when and until Hawaii has a topnotch academic community producing those who can contribute to the tome of research available, such a credit will be a waste of taxpayer money. The resources needed to fund this credit would be better spent improving and enhancing the state's academic and intellectual community.

Finally, it should be noted that this state credit basically tracks the federal tax credit for research activities, including the disqualification for the credit should any part of the cost of the research be supported by federal grants. It would be interesting to learn how many of the claims for this state research credit were disqualified because all or a part of the research activities were paid for with funds from federal grants.

Digested 1/25/12

Written Statement of  
**YUKA NAGASHIMA**  
**Executive Director & CEO**  
High Technology Development Corporation  
before the  
**HOUSE COMMITTEE ON ECONOMIC REVITALIZATION AND BUSINESS**  
Thursday, January 26, 2012  
8:30 AM  
State Capitol, Conference Room 312

In consideration of  
**HB 1511 RELATING TO HIGH TECHNOLOGY.**

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

The High Technology Development Corporation (HTDC) supports the intent of HB1511 to extend the tax credit for qualified research activities for five years and establish a tax credit for ten percent of qualified labor costs.

HTDC supports the effort to reinstate this tax credit, but has concerns about complications that may arise by adding an additional credit for “qualified labor costs”. Furthermore, HTDC respectfully suggests that tracking and reporting metrics similar to those agreed to by industry under last session SB753 HD2 Section 2 be considered for inclusion in this bill. Finally, with the elimination of federal earmark dollars, the tax credits granted by this bill are critically needed to support research and development activities in the state.

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



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Written Statement of

**KARL FOOKS**  
**President**

Hawaii Strategic Development Corporation  
before the

**HOUSE COMMITTEE ON ECONOMIC REVITALIZATION AND BUSINESS**

January 26, 2012

8:30 AM

State Capitol, Conference Room 312

In consideration of

**HB 1511 RELATING TO HIGH TECHNOLOGY.**

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

The Hawaii Strategic Development Corporation (HSDC) respectfully submits comments on HB 1511. The state tax credit for research activities sunset at the end of calendar year 2010. This tax credit program was an effective measure to support research and development activities, which in turn, foster and encourage the innovation essential to create high-wage job opportunities in our economy. Over the life of the previous tax credit, the tax credit claims under this program averaged approximately \$11 million a year. It is anticipated that use of this credit may fall below this average as Federal spending on research activities has been reduced due to the elimination of earmarks. As the credit can only be claimed for actual expenditures made in Hawaii and only for 20% of the qualified expenditures, the cost of the program is partially offset by taxes paid on expenditures and payroll.

HSDC supports efforts to reinstate this tax credit, but has concerns about the addition of "qualified labor costs" that will become eligible for an additional 10% credit. The added complications and cost to document and monitor this new category of eligible expenditures may not offset the benefit it provides and adds complexity to a credit that both industry and DoTax have already established a working system to administer.

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



700 Bishop Street, Suite 2000 Honolulu, HI 96813

HB 1511 - Relating to High Technology

DATE: January 26, 2012

TIME: 8:30am

PLACE: Conference Room 312

TO: House Committee on Economic Revitalization & Business

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 1511

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

Thank you for the opportunity to testify on this bill. Archinoetics strongly supports HB 1511 to establish a Research & Development (R&D) 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 25 software and hardware engineers and scientists from varying backgrounds at Archinoetics and have spun off two subsidiary companies, Fatigue Science and Vivonoetics. Over ½ of our employees are kama'āina 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 re-establish it.

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

Sincerely,

A handwritten signature in black ink that reads "Traci H. Downs". The signature is written in a cursive, flowing style.

Traci H. Downs, Ph.D.

President & COO (co-founder)

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