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**DEPARTMENT OF TAXATION**

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**LATE**

To: The Honorable Carol Fukunaga, Chair  
and Members of the Senate Committee on Economic Development and Technology

Date: Wednesday, March 21, 2012

Time: 1:15 p.m.

Place: Conference Room 016, State Capitol

From: Frederick D. Pablo, Director  
Department of Taxation

**Re: H.B. 1551, H.D. 2, Proposed S.D. 1 Relating to Tax Credits**

The Department of Taxation (Department) appreciates the intent of H.B. 1551 HD2, Proposed SD1. However, the Department has concerns about its ability to administer the provisions of the bill due to the lack of controls over the tax credit.

H.B 1551, H.D. 2, Proposed S.D. 1, defines "qualified high technology business" to mean a business employing or owning capital or property, or maintaining an office, in this State; provided that more than fifty per cent of its total business activities are qualified research and more than fifty per cent of its qualified research is in this State. This bill also adds reporting requirements to measure the effectiveness of the tax credit for research activities, establishes a fine for failure to file the survey information in the reporting requirements, includes federal and state income tax returns and documents related to deductions for tax credits for research activities to be filed as part of the survey, and extends the tax credit through 2016. If passed the measure applies to tax years beginning after December 31, 2011.

The Department would first note that due to the elimination of the requirement that qualified research be performed in Hawaii (provided that at least 50% of the total qualified research was done in Hawaii), Hawaii taxpayers could end up paying for the cost of research done throughout the United States without any direct benefit to the State of Hawaii. For example, a company that had offices both in California and Hawaii would be able to claim the credit on all qualified research costs, provided only that the Hawaii office performed more than 50 percent of the qualified research.

The Department also is concerned about the potential revenue impact this measure will have on the State's financial plan with the tax credit being offered as a refundable credit. On the federal level, the tax credit is non-refundable. Furthermore, there is no upper limit on the amount a company may claim. The vagueness of what constitutes qualified research also will result in many more companies claiming the credit.

The Department notes that the broad definitions for "research" have historically made it difficult for the Department to administer research tax credits. This has directly resulted in the Department being involved in protracted and complex litigation, which indirectly increases the cost to the State's taxpayers.

The broadness of the term "business activities" also creates a significant challenge for the Department and its ability to administer the tax credit. Likewise, the Department would note that a company whose activities are only 25% conducted in Hawaii could be a qualified company, since the measure only requires that a company do 50% of its business activities in Hawaii in qualified research. Thus a company that does 50% of its activities in non-qualified matters outside of Hawaii but does at least 50% of its activities in research would qualify, so long as 50% of that qualified activity was done in Hawaii.

Finally, the Department notes that it does not have the expertise to evaluate the effectiveness of the credit as required under this bill. For all of these reasons, the Department expresses its concerns about the adoption of this measure.

Thank you for the opportunity to provide comments.

## fukunaga2 - Ashley-Jane

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**From:** mailinglist@capitol.hawaii.gov  
**Sent:** Tuesday, March 20, 2012 9:56 PM  
**To:** EDTTestimony  
**Cc:** ikitajima@oceanit.com  
**Subject:** Testimony for HB1551 on 3/21/2012 1:15:00 PM

Testimony for EDT 3/21/2012 1:15:00 PM HB1551

Conference room: 016  
Testifier position: Support  
Testifier will be present: No  
Submitted by: Ian Kitajima  
Organization: Dual Use Hawaii  
E-mail: [ikitajima@oceanit.com](mailto:ikitajima@oceanit.com)  
Submitted on: 3/20/2012

### Comments:

Aloha Chair Fukunaga, Vice Chair Wakai, and EDT members. Thank you for the opportunity to SUPPORT the R&D tax credit. Having just returned from Houston, Texas, I want to share with you that the Oil & Gas industry in Texas is very successful like our tourism, and growing film industry. However, in Texas, they are BUILDING upon the success of their core industries (oil & gas) to create a more resilient, innovative, and sustainable economy. Tourism and film are fantastic industries upon which to build a high tech industry upon which we can build synergies and create exports. Another way to think about why should we build a tech industry is to ask a question like "what do we export in Hawaii?" "What is the impact on our economy, our workforce, and our peoples' ability to prosper in Hawaii? Should we be concerned? Mahalo for the opportunity to support this critical and timely measure. Aloha, Ian Kitajima



March 21, 2012

**TESTIMONY TO THE COMMITTEE ON ECONOMIC  
DEVELOPMENT AND TOURISM**

**March 21, 2012**

**1:15 PM**

**ROOM 016**

**HAWAII STATE CAPITOL**

**RE: HB 1551, RELATING TO TAX CREDITS**

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Dear Chair Fukunaga, Vice Chair Wakai and members of the committee:

I am writing to you to express my strong support for HB 1551 which seeks to extend for five years the research and development (R&D) tax credit that has proven so successful in the past. This bill is extremely important and affects a large number of individuals and organizations in the State of Hawaii that perform R&D work.

This bill will enable broad sectors of R&D activities in the State to continue by incentivizing this type of work. R&D activities in the State produce the very kinds of jobs that are desired here, high paying technology sector jobs. The type of personnel that perform this kind of activity are also the same entrepreneurs that start additional new companies that ultimately yield even more revenues, jobs and provide tremendous upside potential in Hawaii.

R&D work is critical to the future growth in Hawaii industry and education and should be supported as this bill would do. A few points to consider;

- The tech industry lost most of its Federal and State support in a single year in 2011 leading to several companies closing or significantly downsizing, so the R&D support has never been more critical to retain and grow high tech jobs in Hawaii. Large numbers of these highly trained and highly paid individuals have left the State and it takes years to regain that human resource capability.
- Local tech companies provide opportunities for young tech workers coming out of school who are otherwise forced to move to mainland locations to find gainful employment in tech fields.
- Tech workers are the kind of high paying innovation jobs Hawaii should most want, both for their high wage positions and also for the type of people tech workers tend to be, entrepreneurial individuals that often start up additional companies and significantly expand the economy. The latest issue of Hawaii Business magazine talks about the wealthiest people in Hawaii and 4 out of the top 5 of those individuals made their fortune in the technology industry.

- Tech workers make up ~5% of the workforce in the State but produce >10% of the revenue.
- Tech companies inspire STEM education opportunities through internships, relationships with local universities and schools, science fairs, robotic competitions, etc. STEM education in Hawaii is weak and will become weaker still without a technology industry to provide opportunities, mentorships, teaching, etc. We need to provide work opportunities for STEM educated students to interact and go to upon completion of school.

Please feel free to contact me at any time if you have other questions or comments.

Sincerely,

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**LATE**

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TESTIMONY TO THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY

Wednesday, March 21, 2012 @ 1:15 pm

Conference Room #016

RE: HB1551 HD2 / Proposed SD1 "RELATING TO HIGH TECHNOLOGY"

Chair Fukunaga, Vice Chair Wakai, and members of the Senate EDT Committee:

My name is Alan Hayashi and I am testifying as an individual employed by a large defense contractor involved in research and development. My testimony is in support of the intent of HB1551 HD2 / Proposed SD1.

The High Technology industry's research and development (R&D) function is one that could employ Hawaii's brightest and best STEM graduates and could grow to be a substantial contributor to the kind of green "clean" economy we are striving to develop. Unfortunately, the 2008 economic downturn and corresponding lack of funding for research and development dealt a severe blow to the High Technology industry and the local technology community. The suspension last year of the R&D Tax credit was crippling to many small R&D firms. Some were sold to "off island" interests, and some severely cut back on employees, or closed. Because the industry is based on invention, and the innovation of intellectual property....firms are transportable, large factories are not necessary. Many sections of the country offer incentives to attract high technology industry to their cities. As such the competition for high technology companies is always present. Many stay in Hawaii, because they grew up here and enjoy the life style and closeness of family. However, in these competitive times, that is not enough. Unless Hawaii offers a competitive economic environment many will leave and the dream of a society of smart young folks solving problems and innovating will forever disappear.

Unlike some industries, high technology is an industry that requires the gathering of varied talent, molded into a team that that can solve complex and intricate problems. You cannot start and stop this industry without hurting its effectiveness and capability. Hawaii has to decide whether we want an industry of smart young people to help us solve the problems of the future....otherwise they will go elsewhere. What are we training our young folks, with our many STEM programs, if not to employ them here in Hawaii to help us with our economy?

If the Legislature values the High Technology capability, I urge you to support the industry with re-instatement of a tax credit.

Thank you for consideration of my position on the issue and for the opportunity to present testimony. I will be glad to answer any questions you might have.