

**HB 1642,  
HD2**

**EDT**

NEIL ABERCROMBIE  
GOVERNOR

BRIAN SCHATZ  
LT. GOVERNOR



STATE OF HAWAII  
**DEPARTMENT OF TAXATION**  
P.O. BOX 259  
HONOLULU, HAWAII 96809  
PHONE NO: (808) 587-1530  
FAX NO: (808) 587-1584

FREDERICK D. PABLO  
DIRECTOR OF TAXATION

RANDOLF L. M. BALDEMOR  
DEPUTY DIRECTOR

## SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY

### TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING HB 1642 HD 2 RELATING TO HIGH TECHNOLOGY

**TESTIFIER:** FREDERICK D. PABLO, DIRECTOR OF TAXATION (OR  
DESIGNEE)  
**COMMITTEE:** EDT  
**DATE:** MARCH 23, 2011  
**TIME:** 1:15PM  
**POSITION:** SUPPORT INTENT; CONCERNED WITH CAP

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This measure extends the Tax Credit for Research Activities (Research Credit) allowed under Section 235-110.91, Hawaii Revised Statutes (HRS), prior to December 31, 2010, by five years to 2015. This measure also caps the aggregate amount of credit available to all taxpayers per year.

The Department of Taxation (Department) **supports the intent** of this measure; however raises **concerns over the aggregate cap** anticipated by this measure.

**SUPPORT FOR RESEARCH & DEVELOPMENT INCENTIVES, GENERALLY**—In general, the Department supports the Legislature's efforts to expand the research and development industries in Hawaii through means of the Research Credit. The Research Credit was in effect for several years until its expiration on December 31, 2010. The Department supports the concept of the Research Credit because it is a credit that rewards scientific and technical innovation in a laboratory sense.

**STATISTICS SHOW RESEARCH & DEVELOPMENT INCENTIVES HELP THE LOCAL TECH INDUSTRY**—In a 2007 study released by Grant Thornton, LLP, statistics show that the Research Credit provides effective incentives through tax policy to expand Hawaii's tech industry. These statistics include:

- 81% of respondents indicated the Research Credit will increase high tech jobs in Hawaii; and
- 74% of respondents indicated that the Research Credit is more effective in attracting high tech jobs than other incentives.

Based upon this study, among other data regarding the credit from throughout the country, extending

the Research Credit is worth exploring.

**CONCERN OVER AGGREGATE CAP**—The Department generally opposes aggregate caps, especially in this measure's form. There is no legislative guidance on how the cap is to be administered. Is the cap based on who files first? Do taxpayers need to apply for the credit? Should the credit be spread evenly amongst all taxpayers? All of these issues arise when an aggregate cap is instituted. These issues become even more concerning when there are a substantial number of taxpayer claiming the credit, such as with the Research Credit.

**DEFINITION OF QHTB**—The Department recommends defining the phrase "qualified high technology business" within HRS § 235-110.91 because the current definition cross-references HRS § 235-110.9, which while still an operative law, deals with a credit which has sunsetted.

**REVENUE IMPACT**—This measure will result in an estimated revenue loss of \$10.9 million per year from FY 2012 to FY 2016. Based on historical data, the credit claims in the past were:

- Tax Year 2008: \$13.0 million
- Tax Year 2007: \$10.4 million
- Tax Year 2006: \$14.4 million
- Tax Year 2005: \$13.2 million
- Tax Year 2004: \$12.2 million

Written Statement of

**KARL FOOKS**

**President**

Hawaii Strategic Development Corporation

before the

**SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY**

March 23, 2011

1:15 PM

State Capitol, Conference Room 016

In consideration of

**HB 1642 HD2 RELATING TO HIGH TECHNOLOGY.**

Chair Fukunaga, Vice Chair Wakai, and Members of the Committee on Economic Development and Technology:

The Hawaii Strategic Development Corporation (HSDC) respectfully submits comments in support of HB 1642 HD2. 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 past nine years, the tax credit claims under this program averaged approximately \$12 million a year. As the credit can only be claimed for qualified research conducted in Hawaii and only for 20% of the qualified expenditures, the cost of the program is largely offset by taxes paid on expenditures and payroll.

HB 1642 HD 2 renews the research and development tax credit contained in Section 235-110.91 HRS, but proposes adding an annual aggregate cap. HSDC does not believe a cap is necessary given the relative stability of claims over the years. However, if an annual aggregate cap is deemed to be necessary for budgetary reasons, an appropriate mechanism needs to be established to administer the cap in a manner that benefits the largest number of potential claimants.

HB 1642 HD2 contains references to definitions in HRS 235-110.9. This section sunset as of December 2010 and it may be prudent to incorporate the definitions directly in HB 1642 HD 2 to avoid confusion in implementation at a later date. In addition, the reporting requirements previously required by companies utilizing the credit should be directly incorporated into the new legislation.

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

Written Statement of

**YUKA NAGASHIMA**  
**Executive Director & CEO**

High Technology Development Corporation  
before the

**SEATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY**

March 23, 2011

1:15 PM

State Capitol, Conference Room 016

In consideration of

**HB 1642 HD2 RELATING TO HIGH TECHNOLOGY**

Chair Fukunaga, Vice Chair Wakai, and Members of the Committee on Economic Development and Technology.

The High Technology Development Corporation (HTDC) respectfully submits comments in support of HB 1642 HD2. The state tax credit for research activities has 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 past nine years, the tax credit claims under this program averaged approximately \$11-\$12 million a year. As the credit can only be claimed for qualified research conducted 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. Such initiative is especially prudent now for Hawaii to hang onto the high-wage jobs we have already created, due to the suspension of earmarks as well as the sunset of Act 221. Just in properties managed by HTDC, the impact of our tenants with respect to the moratorium of earmark is estimated to be \$50M, already forcing those companies to lay off their workers.

HTDC's recommendations for further improvement of this bill, is as follows:

**1. Eliminate the proposed cap for the tax credit.**

HB 1642 HD2 renews the research and development tax credit contained in Section 235-110.91 HRS, but proposes adding an annual aggregate cap. HTDC agrees with the Dept. of Taxation that the cap is unnecessary, and possibly damaging. Setting a cap on a stable trend of claims only adds logistic complications to the measure, as well as added burden for monitoring the aggregate cap. Setting a cap too low would diminish the value of the very activities which the State is trying to incentivize because it is no longer certain that the businesses will be guaranteed these taxes before the expenditure is planned. If the cap is set too high, it means that the businesses are not going to reach that cap, so it wasn't necessary to begin with. Further, should an aggregate cap be set, DoTAX has stated that the cap number will be used as the revenue impact to the state rather than their current estimate they derived by examining the past credit levels.

HTDC appreciates the legislature's concern regarding the State's exposure given the present economic conditions. However, HTDC feels that given the steady past track record of the R&D tax credit claims, and the fact that a great increase of the claims is highly unlikely, the cap is not needed. The credit claims is more controlled with this type of tax credit where the businesses must expend the monies first to receive the tax credit. It means that the businesses have already paid their payroll taxes, GET, income tax, etc. and the activities the State wanted to incentivize already taken place.

**2. Add reporting requirements** that is in line with the R&D activities (vs. items optimized for the purpose of the investment tax credit portion of Act 221). HTDC suggests starting with the list the Senate version of this bill required, and add "patents filed" (in addition to patents granted), and remove "invention disclosures" (as it is an internal process to R&D companies not consistently practiced, and will not function well as a measure of economic activity). Further, add a stricter reporting requirement: same deadline, same penalty (\$1000/mo.) AND the survey **MUST** be filed to receive the tax credit.

**3. DoTAX reported data to go to DBEDT for economic impact reports.**

HTDC also recommends that after the sets of information are collected by DoTAX that DBEDT be given the aggregated, anonymized data for analysis so that DBEDT may provide an appropriate economic impact report to the legislature. Because this is an economic stimulus measure, it is not sufficient for the legislature to know the immediate liabilities to the State. We must also take into account the income, payroll and other taxes these companies must have already paid in order to receive the R&D tax credits. The DBEDT staff is better suited to such analyses, given proper resources, to factor in the economic multipliers and produce impact reports. Doing so will bring further synergy to other reports that DBEDT is already mandated to provide (e.g., emerging industries report, etc.).

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



Written Statement of  
**John Kuriyama**  
**General Manager**  
Oceanit  
before the  
**SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY**  
March 23, 2011  
1:15 PM  
State Capitol, Conference Room 016  
In Support of  
**HB 1642 HD2 RELATING TO HIGH TECHNOLOGY.**

TO: Chair Fukunaga, Vice Chair Wakai, and Members of the Committee

From: John Kuriyama, General Manager, Oceanit

Re: Testimony in Support of HB1642

Honorable Chair, Vice-Chair and Committee Members:

Thank you for the opportunity to submit testimony in **support of HB1642 HD2.**

Oceanit currently employs about 160 scientists, engineers and support staff. We regularly host interns, school classes, and conduct numerous outreach activities for elementary thru college level kids to introduce them to science and engineering careers. We let kids know that there are exciting, decent paying jobs for them in Hawaii if they pursue these careers. Many of them have returned to us, equipped with college degrees, wanting to work in science and engineering.

It is our hope that we can continue to offer an alternative to kids that want to work in an industry that is growing nationally as well as internationally - and to show them that world class technical work can thrive in Hawaii.

Oceanit supports this measure with the following amendments:

- Eliminate the annual aggregate cap on the tax credit.
  - The Chamber agrees with the Department of Taxation that the cap is unnecessary given the relative stability of claims over the past nine years, which averaged at about \$11-\$12 million a year. Also, placing a cap may inhibit growth in this flourishing sector and will be expensive and difficult to administer fairly.
- Add reporting requirements.
  - The Chamber supports the requirements as stated in SB 753 SD2 with the following clarifications:

- **Remove “invention disclosures”** (lines 3-4)
    - Justification: This would be harder to track consistently when the industry as a whole does not follow this practice, only some companies claim to track this.
  - **Change “Filed intellectual property..., provisional patents, and patents issued or granted”** to read: **(5) Patents filed: (a) provisional, (b) full; and patents issued and granted.**
    - Justification: Patents issued/granted happens after the start of the filing process, so if we just track the filed IP metric, we may not be capturing all the near term activities and results.
  - **Add a stricter reporting requirement: same deadline, same penalty and the survey must be filed to receive the tax credit.**
- Require DOTAX reported data to go to DBEDT for economic analysis reports.
    - This will take into account the income, payroll and other taxes these companies have paid in order to receive the credit. The tax credit can only be claimed for qualified research conducted in Hawaii and for 20% of the qualified expenditures. This refund occurs after the company files its tax return. So, R&D tax credits for 2011 would not be paid until 2012 and most of the payments will be in the latter half of the year. Therefore, the state receives the benefits of a business base now and doesn't pay for on average 18 months later.
    - Also, DBEDT is probably the more appropriate agency to evaluate the economic impacts.

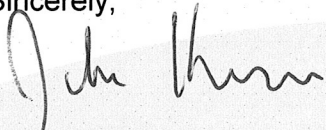
Without Hawaii's R&D tax credit, we would not have been able to make as many investments, and in the future, we will be forced to severely curtail R&D infrastructure investments across the board.

Because of the forward-looking nature of research, few R&D investments have short term rewards. This bill would provide longer term continuity for an industry that is still in its infancy, and is struggling to grow.

We urge you to maintain the momentum that has started and to keep this new sector of the economy growing at this critical juncture.

Thank you for your continued support of the R&D tax credit and for your support of the industry.

Sincerely,



John Kuriyama

General Manager







**Testimony to the Senate Committee on Economic Development and Technology  
Wednesday, March 23, 2011 at 1:15 p.m.  
Conference Room 016, State Capitol**

**RE: HOUSE BILL NO. 1642 HD1 RELATING TO HIGH TECHNOLOGY**

Chair Fukunaga, Vice Chair Wakai, and Members of the Committee:

Cardax Pharmaceuticals, Inc. (“Cardax”) **supports HB 1642 HD2** relating to High Technology with amendments.

Cardax is one of Hawaii’s leading biopharmaceutical companies. We have raised more than \$22 million, most of which has been spent in Hawaii, for the development of a new class of anti-inflammatory compounds for treatment of chronic unmet medical needs such as rheumatoid arthritis, cardiovascular disease, liver disease, macular degeneration, and prostate disease. It has been awarded 12 U.S. patents on its technology and has received more than \$1 million in NIH funding. Ongoing licensing discussions with more than a dozen large and/or mid-size pharmaceutical companies speak to the interest the pharmaceutical industry has in our products.

HB 1642 HD2 extends the income tax credit for qualified research activities for five years and places an annual aggregate cap on the tax credit.

Cardax supports this measure with the following amendments:

- Eliminate the annual aggregate cap on the tax credit.
  - The Chamber agrees with the Department of Taxation that the cap is unnecessary given the relative stability of claims over the past nine years, which averaged at about \$11-\$12 million a year. Also, placing a cap may inhibit growth in this flourishing sector and will be expensive and difficult to administer fairly
- Add reporting requirements.
  - The Chamber supports the requirements as stated in SB 753 SD2 with the following clarifications:
    - Remove **“invention disclosures”** (lines 3-4)
      - Justification: This would be harder to track consistently when the industry as a whole does not follow this practice, only some companies claim to track this.

- Change **“Filed intellectual property..., provisional patents, and patents issued or granted”** to read: **(5) Patents filed: (a) provisional, (b) full; and patents issued and granted.**
    - Justification: Patents issued/granted happens after the start of the filing process, so if we just track the filed IP metric, we may not be capturing all the near term activities and results.
  - Add a stricter reporting requirement: same deadline, same penalty and the survey must be filed to receive the tax credit.
- Require DOTAX reported data to go to DBEDT for economic analysis reports.
    - This will take into account the income, payroll and other taxes these companies have paid in order to receive the credit. The tax credit can only be claimed for qualified research conducted in Hawaii and for 20% of the qualified expenditures. This refund occurs after the company files its tax return. So, R&D tax credits for 2011 would not be paid until 2012 and most of the payments will be in the latter half of the year. Therefore, the state receives the benefits of a business base now and doesn't pay for on average 18 months later.
    - Also, DBEDT is probably the more appropriate agency to evaluate the economic impacts.

Almost all potential investors from the Mainland question our decision to locate in Hawaii and while we can talk at length about Hawaii's culture and quality of life, the 20% refundable R&D credit in HB 1642 brings immediate credibility to our location.

Helping insure the success of small, hi-tech companies such as Cardax helps grow our tax base in a time when the necessity of such diversification is perhaps never more apparent.

Thank you for the opportunity to provide testimony. We respectfully ask that the committee pass this measure with the proposed amendments.

Sincerely,

David G. Watumull  
President and CEO  
Cardax Pharmaceuticals, Inc.

## Jody Nakanelua

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**From:** mailinglist@capitol.hawaii.gov  
**Sent:** Friday, March 18, 2011 2:13 PM  
**To:** EDTTestimony  
**Cc:** guy@h2-techs.com  
**Subject:** Testimony for HB1642 on 3/23/2011 1:15:00 PM

Testimony for EDT 3/23/2011 1:15:00 PM HB1642

Conference room: 016  
Testifier position: support  
Testifier will be present: No  
Submitted by: Guy Toyama  
Organization: H2 Technologies, Inc.  
Address:  
Phone:  
E-mail: [guy@h2-techs.com](mailto:guy@h2-techs.com)  
Submitted on: 3/18/2011

Comments:



Written Testimony of

James P Karins,  
President, Pukoa Scientific

before the

Senate Committee on Economic Development and Technology  
Wednesday, March 23, 2011 at 1:15 p.m.  
Conference Room 016, State Capitol

**RE: HOUSE BILL NO. 1642 HD2 RELATING TO HIGH TECHNOLOGY**

Chair Fukunaga, Vice Chair Wakai, and Members of the Committee:

Pukoa Scientific strongly supports this bill with minor amendments described below. Pukoa Scientific is a small dual-use company located in the Manoa Innovation Center. It has 7 full-time employees working on image processing technologies. Since it was founded in 2004 Pukoa has utilized the R&D tax credit to pursue and win very competitive contracts that otherwise would have been nearly impossible to obtain, to write and file patents for its novel algorithms, and to fund part-time students.

Pukoa strongly supports this measure with the following amendments:

- Eliminate the annual aggregate cap on the tax credit.
  - Pukoa agrees with the Department of Taxation that the cap is unnecessary given the relative stability of claims over the past nine years, which averaged at about \$11-\$12 million a year. Also, placing a cap may inhibit growth in this flourishing sector.
- Add reporting requirements.
  - Pukoa supports the requirements as stated in SB 753 SD2 with the following clarifications:
    - Remove **“invention disclosures”** (lines 3-4)
      - Justification: This would be harder to track consistently when the industry as a whole does not follow this practice, only some companies claim to track this.



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

- (1) 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.

### Summary

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 administration and 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 **pass this measure**. Thank you for the opportunity to express our views.

## Jody Nakanelua

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**From:** mailinglist@capitol.hawaii.gov  
**Sent:** Monday, March 21, 2011 2:20 PM  
**To:** EDTTestimony  
**Cc:** kmiyashiro@terasystechnologies.com  
**Subject:** Testimony for HB1642 on 3/23/2011 1:15:00 PM

Testimony for EDT 3/23/2011 1:15:00 PM HB1642

Conference room: 016  
Testifier position: support  
Testifier will be present: Yes  
Submitted by: Kevin Miyashiro  
Organization: TeraSys Technologies  
Address:  
Phone:  
E-mail: [kmiyashiro@terasystechnologies.com](mailto:kmiyashiro@terasystechnologies.com)  
Submitted on: 3/21/2011

Comments:

# Testimony in Support of HB1642

Navatek is a Hawaii based company that specializes in the most advanced and cutting edge maritime technologies for the US Military. Our technologies are world class and compete with and beat the largest defense contractors in the world.

Hiring the “best and brightest” almost sounds cliché, but for us it is a simple fact. We are the best because we hire the best...doctorate level engineers from schools like MIT, Michigan, Stanford, UH, etc. The majority of our scientists and engineers are all from Hawaii...Punahou and Iolani grads that went off to MIT and now back home.

We take great pride in being able to boast of our Hawaii pedigree that has been off to the best Universities on the mainland and now back home in the islands. This is not an easy thing to achieve. To attract this talent is very expensive.

At this point, to say the R&E credit creates jobs in Hawaii sounds trite. But the reality is that it does. Again, the unfortunate reality is that the best engineers in our field come from schools like MIT and Stanford. We have been fortunate enough to bring these kinds of people to Hawaii because of the Hawaii R&E Credits. Simply stated, we must pay them more...MUCH MORE...to come to Hawaii.

The Hawaii R&E credit does not make up all the difference...but it ABSOLUTELY helps.

Bottom line...the credits help and I guarantee will yield returns to Hawaii.

-Martin Kao, CFO



**TESTIMONY TO THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT &  
TECHNOLOGY**

MARCH 23, 2011

1:15 PM

ROOM 016

HAWAII STATE CAPITOL

**RE: HOUSE BILL NO. 1642 RELATING TO HIGH TECHNOLOGY**

Dear Chair Fukunaga, Vice Chair Wakai, and Members of the Committee:

Thank you for the opportunity to submit testimony in **support** of HB 1642 HD2 relating to high technology with amendments.

Referentia is a Hawaii-based software innovation company committed to building a sustainable high technology company in Hawaii and providing interesting science and technology jobs today and in the future. HB 1642 HD2 extends the income tax credit for qualified research activities for five years and places an annual aggregate cap on the tax credit. This bill supports companies like Referentia that bring outside capital to our State's economy and create innovative technologies here in Hawaii.

**Proposed amendments to HB 1642 HD 2**

In order to maximize and sustain the outcome of this credit to benefit Hawaii's economy, Referentia respectfully requests that the committee amends the bill to:

- Eliminate the annual aggregate cap on the tax credit.
  - Referentia agrees with the Department of Taxation (DOTax) that the cap is unnecessary given the relative stability of claims over the past nine years, which averaged about \$11-\$12 million a year.
- Add reporting requirements. Referentia supports the requirements as stated in SB 753 SD2 with the following clarifications:
  - *Remove* **“invention disclosures”** (lines 3-4)
    - Justification: This would be harder to track consistently when the industry as a whole does not follow this practice.
  - *Change* **“Filed intellectual property..., provisional patents, and patents issued or granted”** to read: **(5) Patents filed: (a) provisional, (b) full; and patents issued and granted.**
    - Justification: Patents issued/granted happens after the start of the filing process. So, if we track only the filed IP metric, we may not capture all the near-term activities and results.
  - *Add* a stricter reporting requirement: same deadline, same penalty and the survey must be filed to receive the tax credit.
- Require DOTax reported data go to DBEDT for economic analysis reports.
  - Justification: DBEDT is the more appropriate agency to evaluate the economic impacts.
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in Hawaii and 20% of the qualified expenditures. This refund occurs after the company files its tax return. So, R&D tax credits for 2011 would not be paid until 2012 and most payments will be made in the latter half of 2012, enabling the State to receive benefits of a business base in the current year, but not pay out until on average 18 months later.

### **Role of the Defense and Dual Use Technology Industry in Hawaii**

The large presence of the military in Hawaii has spurred the development of the dual use technology industry in Hawaii and has helped to establish the critical role Hawaii plays in national defense. The Defense industry is a key economic driver in the State's economy and has helped provide R&D funding for small local companies, like Referentia, to grow and develop technology solutions for critical and complex DoD needs. These solutions are readily transitionable to other key areas of national and international importance.

The R&D tax credit is an effective way to help drive innovation, boost the economic development of our industry and create high value STEM careers for the next generation.

Without the R&D credit, small businesses like Referentia may be forced to curtail our investment in R&D. Because of the forward-looking nature of research, few R&D investments have a payoff horizon shorter than one year. The R&D tax credit is critical to encourage R&D, foster high-wage job growth, and enable Hawaii to compete as an economic stronghold of innovation nationally and internationally.

By supporting the R&D tax credit, you will enable dual-use technology firms such as Referentia to keep investing in the future of our companies, our employees, and our State.

We urge you to support the R&D tax credit through HB 1642 HD 2 with the proposed amendments.

Sincerely,



Nelson Kanemoto  
President and CEO

**TESTIMONY TO THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT &  
TECHNOLOGY**  
MARCH 23, 2011  
1:15 PM  
ROOM 016  
HAWAII STATE CAPITOL

**RE: HOUSE BILL NO. 1642 RELATING TO HIGH TECHNOLOGY**

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  - *Add* a stricter reporting requirement: same deadline, same penalty and the survey must be filed to receive the tax credit.
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in Hawaii and 20% of the qualified expenditures. This refund occurs after the company files its tax return. So, R&D tax credits for 2011 would not be paid until 2012 and most payments will be made in the latter half of 2012, enabling the State to receive benefits of a business base in the current year, but not pay out until on average 18 months later.

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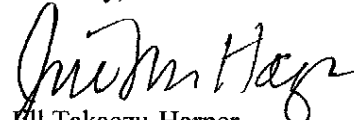
The R&D tax credit is an effective way to help drive innovation, boost the economic development of our industry and create high value STEM careers for the next generation.

Without the R&D credit, small businesses like Referentia may be forced to curtail our investment in R&D. Because of the forward-looking nature of research, few R&D investments have a payoff horizon shorter than one year. The R&D tax credit is critical to encourage R&D, foster high-wage job growth, and enable Hawaii to compete as an economic stronghold of innovation nationally and internationally.

By supporting the R&D tax credit, you will enable dual-use technology firms such as Referentia to keep investing in the future of our companies, our employees, and our State.

We urge you to support the R&D tax credit through HB 1642 HD 2 with the proposed amendments.

Sincerely,



Jill Takaezu-Harper  
Vice President  
Business Operations

**TESTIMONY TO THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT &  
TECHNOLOGY**

MARCH 23, 2011

1:15 PM

ROOM 016

HAWAII STATE CAPITOL

**RE: HOUSE BILL NO. 1642 RELATING TO HIGH TECHNOLOGY**

Dear Chair Fukunaga, Vice Chair Wakai, and Members of the Committee:

Thank you for the opportunity to submit testimony in **support of HB 1642 HD2** relating to high technology with amendments.

Referentia is a Hawaii-based software innovation company committed to building a sustainable high technology company in Hawaii and providing interesting science and technology jobs today and in the future. HB 1642 HD2 extends the income tax credit for qualified research activities for five years and places an annual aggregate cap on the tax credit. This bill supports companies like Referentia that bring outside capital to our State's economy and create innovative technologies here in Hawaii.

**Proposed amendments to HB 1642 HD 2**

In order to maximize and sustain the outcome of this credit to benefit Hawaii's economy, Referentia respectfully requests that the committee amends the bill to:

- Eliminate the annual aggregate cap on the tax credit.
  - Referentia agrees with the Department of Taxation (DOTax) that the cap is unnecessary given the relative stability of claims over the past nine years, which averaged about \$11-\$12 million a year.
- Add reporting requirements. Referentia supports the requirements as stated in SB 753 SD2 with the following clarifications:
  - *Remove* “**invention disclosures**” (lines 3-4)
    - Justification: This would be harder to track consistently when the industry as a whole does not follow this practice.
  - *Change* “**Filed intellectual property..., provisional patents, and patents issued or granted**” to read: **(5) Patents filed: (a) provisional, (b) full; and patents issued and granted.**
    - Justification: Patents issued/granted happens after the start of the filing process. So, if we track only the filed IP metric, we may not capture all the near-term activities and results.
  - *Add* a stricter reporting requirement: same deadline, same penalty and the survey must be filed to receive the tax credit.
- Require DOTax reported data go to DBEDT for economic analysis reports.
  - Justification: DBEDT is the more appropriate agency to evaluate the economic impacts.
  - This takes into account the income, payroll and other taxes that companies have paid in order to receive the credit. The tax credit can only be claimed for qualified research

conducted in Hawaii and 20% of the qualified expenditures. This refund occurs after the company files its tax return. So, R&D tax credits for 2011 would not be paid until 2012 and most payments will be made in the latter half of 2012, enabling the State to receive benefits of a business base in the current year, but not refund the tax credits until on average 18 months later.

### **Role of the Defense and Dual Use Technology Industry in Hawaii**

The large presence of the military in Hawaii has spurred the development of the dual use technology industry in Hawaii and has helped to establish the critical role Hawaii plays in national defense. The Defense industry is a key economic driver in the State's economy and has helped provide R&D funding for small local companies, like Referentia, to grow and develop technology solutions for critical and complex DoD needs. These solutions are readily transitionable to other key areas of national and international importance.


The R&D tax credit is an effective way to help drive innovation, boost the economic development of our industry and create high value STEM careers for the next generation.

Without the R&D credit, small businesses like Referentia may be forced to curtail our investment in R&D. Because of the forward-looking nature of research, few R&D investments have a payoff horizon shorter than one year. The R&D tax credit is critical to encourage R&D, foster high-wage job growth, and enable Hawaii to compete as an economic stronghold of innovation nationally and internationally.

By supporting the R&D tax credit, you will enable dual-use technology firms such as Referentia to keep investing in the future of our companies, our employees, and our State.

We urge you to support the R&D tax credit through HB 1642 HD 2 with the proposed amendments.

Sincerely,



Nancy Downes  
Program Manager

# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Extend tax credit for research activities

BILL NUMBER: HB 1642, HD-2

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Amends HRS section 235-110.91 to: (1) establish an annual maximum amount of credits that may be issued to all qualified taxpayers; and (2) extend the expiration of the tax credit for research activities from December 31, 2010 to December 31, 2015.

Requires the department of taxation to collect data on the income tax credit for qualified research activities including the amount of tax credits claimed and the financial impact of the credit.

EFFECTIVE DATE: July 1, 2030

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, providing tax incentives to encourage high tech businesses and individuals associated with high tech businesses to locate in the state. While this measure would establish an aggregate limit of the amount of tax credits that is paid out annually for all qualified taxpayers, it also extends the tax credit for another five years 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 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 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 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 the 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. Inasmuch as this proposal will require the department of taxation to collect information on this credit, one might say it is a day late and a dollar short. Such information should have been gathered from day one so that lawmakers could assess the efficacy of this credit and determine whether or not there is a suitable return on investment of public dollars in the form of the tax credit. Lawmakers should learn that if any similar incentive be enacted in the future, that data should be required to be filed and gathered so that they can assess the effectiveness of the credit.

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 know 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.



**Comments to the Senate Committee on Economic Development and Technology**  
**Wednesday, March 23, 2011**  
**1:15 p.m.**  
**Conference Room 016**

**RE: HOUSE BILL NO. 1642 HD2 RELATING TO HIGH TECHNOLOGY**

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

My name is Ian Kitajima and I am the Convener of Hawaii Dual Use Network. I strongly support House Bill 1642 HD2 relating to High Technology. Here are three simple reasons:

- **Business must lead the recovery** – businesses must lead the recovery if it is to be meaningful and sustainable. HB1642 HD2 supports companies who bring outside Federal research funding to Hawaii but there is no free lunch - the companies must first win the work, and do the work in Hawaii.
- **Create high value STEM careers** – that means supporting R&D companies, and the career opportunities they create by solving the world’s toughest problems. We will lose our children and our culture if we don’t create STEM career opportunities that match STEM education. HB1642 creates and keeps promising STEM jobs and careers here in Hawaii for the next generation.
- **Get an ROI today** - a company must spend \$5 in qualified R&D within Hawaii before they can claim a \$1. And the incomes taxes, property taxes, and GE taxes paid by engineers and scientists are some of the highest.

The Hawaii Dual Use Network supports this measure with the following amendments:

- Eliminate the annual aggregate cap on the tax credit.
  - The Chamber agrees with the Department of Taxation that the cap is unnecessary given the relative stability of claims over the past nine years, which averaged at about \$11-\$12 million a year. Also, placing a cap may inhibit growth in this flourishing sector and will be expensive and difficult to administer fairly

- Add reporting requirements.
  - The Chamber supports the requirements as stated in SB 753 SD2 with the following clarifications:
    - Remove **“invention disclosures”** (lines 3-4)
      - Justification: This would be harder to track consistently when the industry as a whole does not follow this practice, only some companies claim to track this.
    - Change **“Filed intellectual property..., provisional patents, and patents issued or granted”** to read: **(5) Patents filed: (a) provisional, (b) full; and patents issued and granted.**
      - Justification: Patents issued/granted happens after the start of the filing process, so if we just track the filed IP metric, we may not be capturing all the near term activities and results.
    - Add a stricter reporting requirement: same deadline, same penalty and the survey must be filed to receive the tax credit.
- Require DOTAX reported data to go to DBEDT for economic analysis reports.
  - This will take into account the income, payroll and other taxes these companies have paid in order to receive the credit. The tax credit can only be claimed for qualified research conducted in Hawaii and for 20% of the qualified expenditures. This refund occurs after the company files its tax return. So, R&D tax credits for 2011 would not be paid until 2012 and most of the payments will be in the latter half of the year. Therefore, the state receives the benefits of a business base now and doesn't pay for on average 18 months later.
  - Also, DBEDT is probably the more appropriate agency to evaluate the economic impacts.

For the reasons mentioned above, I respectfully ask that you pass this measure with the proposed amendments.

Sincerely,  
Ian Kitajima, Convener  
Dual Use Network