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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 1642

INTRODUCED BY: Yamashita, Aquino, Awana, Brower, Carroll, Chang, Chong, Cullen, Evans, Hashem, Ichiyama, Ito, Manahan, McKelvey, Mizuno, Nakashima, B. Oshiro, Say, Souki, Tokioka, Tsuji, Yamane

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.

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, 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.

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.

Digested 2/4/11

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 1642 RELATING TO HIGH TECHNOLOGY

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

The High Technology Development Corporation (HTDC) respectfully submits comments in support of HB 1642. 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 \$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.

HB 1642 renews the research and development tax credit contained in Section 235-110.91 HRS, but proposes adding an annual aggregate cap. HTDC does not believe a cap is necessary given the relative stability of claims over the years and because the tax credit is limited to claims by qualified high technology businesses. However, if an annual aggregate cap is deemed to be necessary for budgetary reasons, HTDC suggests an aggregate cap of \$15 million for this tax credit as this is in line with industry claims over the past years and will accommodate some growth in activity over the five year life of the proposed credit. With a cap however, some mechanism must be put into place to allocate tax credits if the cap limits the ability of all tax credit claims to be met. HTDC suggests that all claims submitted by March 31, as stipulated in Section 235-110.91 HRS, will be receive a prorated amount of their claim if all claims received by that date exceed the aggregate cap. Thereafter claims will be on a first come, first served basis.

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

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 1642 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 in support of HB 1642. 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 \$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.

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

From: Tina Desuacido [tina500@juno.com]
Sent: Friday, February 04, 2011 11:46 AM
To: ERBtestimony
Subject: Tax Foundation Testimony
Attachments: h0848-11.pdf, h1642-11.pdf, h0364-11.pdf

TRANSMISSION OF TESTIMONY

DATE: Friday, February 4, 2011

TO: House Committee on Economic Revitalization & Business

FROM: Tax Foundation of Hawaii

Total Pages 6

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 848 - Relating to the General Excise Tax (2 pages)

HB 364 - Relating to Economic Development (2 pages)

HB 1642 - Relating to High Technology (2 pages)

Number of copies - 4

Thank you.