HAWAII STRATEGIC DEVELOPMENT CORPORATION

HTDC Cultivating Hawaii's tech sector
HIGH TECHNOLOGY DEVELOPMENT CORPORATION

Written Statement of

KARL FOOKS
President
Hawaii Strategic Development Corporation
and
Yuka Nagashima
Executive Director and CEO
High Technology Development Corporation

before the
SENATE COMMITTEE ON WAYS AND MEANS
February 24, 2012
9:00 AM
State Capitol, Conference Room 221

In consideration of
SB 2941 SD1 RELATING TO HIGH TECHNOLOGY.

Chair Ige, Vice Chair Kidani, and Members of the Committee on Ways and Means:

The Hawaii Strategic Development Corporation (HSDC) and the High Technology Development Corporation (HTDC) respectfully submit comments on SB 2941 SD1. We strongly recommend SB2941 SD1 be amended to restrict the credit to only qualified R&D activities that are conducted in-state. SB2941 SD1 appears to provide a tax credit for R&D activities conducted out-of-state in addition to in-state expenditures. If 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.

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.

HSDC and HTDC support efforts to reinstate this tax credit and support the addition of requirements to collect metrics from companies claiming the credit as this will provide the data needed to measure the effectiveness of the credit.

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

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L E G I S L A T I V E

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: SB 2941, SD-1

INTRODUCED BY: Senate Committee on Economic Development and Technology

BRIEF SUMMARY: Amends HRS section 235-110.91 to amend the definition of "qualified high technology business" as a business employing or owning capital or property, or maintaining an office in this state provided that more than 50% of its total business activities are qualified research and more than 50% of its qualified research is in this state.

Also requires a qualified high technology business that claims the credit under this section to complete and file with the director of taxation, through the department website, an annual survey on electronic forms prepared and prescribed by the department. Requires the survey to be filed before June 30 of each year following the calendar year in which the credit may be claimed under this section. Failure to file the survey shall be subject to a fine of up to $1,000 for each month of a delay to file.

The survey shall include: (1) identification of the industry sector in which the qualified high technology business conducts business; (2) qualified expenditures; (3) revenue and expense data; (4) Hawaii employment and wage data including the number of full and part-time employees retained, new jobs, temporary positions, external services procured by the business, and payroll taxes; (5) filed intellectual property, including invention disclosures, provisional patents, and patents issued or granted; and (6) federal and state income tax returns and documents related to deductions for tax credits for research activities.

The department of taxation shall request information necessary to measure the effectiveness of the tax credit, such as information related to patents. In preparing the survey and requesting any additional information, the department shall ensure that qualified high technology businesses are not subject to duplicative reporting requirements. The department shall use information collected to prepare summary descriptive statistics by category and reported at the aggregate level to prevent compromising identities of qualified high technology business investors or other confidential information. The department shall also identify each qualified high technology business that is the beneficiary of tax credits claimed under this section. The department shall report the information required under this subsection to the legislature by September 1 of each year.

The department shall also use the information collected to study the effectiveness of the tax credit and shall report on the amount of tax credits claimed and total taxes paid by qualified high technology businesses, the number of qualified high technology businesses in each industry sector, jobs created, external services and materials procured by the businesses, compensation levels, qualified research activities, and other factors as the department determines. The department shall report the results of its study to the legislature by December 1 of each year.

Extends the expiration of the tax credit for research activities from 12/31/10 to 12/31/16.

EFFECTIVE DATE: Tax years beginning after December 31, 2011

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 and tax incentives, to encourage high tech businesses and individuals associated with high tech businesses to locate in the state. This measure adds extensive information reporting requirements and extends the expiration of the tax credit from December 31, 2010 to December 31, 2016. While the adoption of this measure would allow the department of taxation to ascertain the effectiveness of the tax credit for research activities, such a review should have been performed a few years after the credit had been adopted.

While the proposed measure would also extend the credit for research activities until December 31, 2016, it would perpetuate the drain on state funds. 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 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.

While it is gratifying to know that lawmakers have finally realized that they need to evaluate the effectiveness of some of these tax incentives, it comes a tad late, but better later than never. What is appalling is that lawmakers wish to continue the credit before the evaluation is made. So no matter what the evaluation finds, the credit will go on without further review. Rather than extending it for an irrelevant period of time, the extension should be made co-terminus with the submission of the study so that policymakers can have the evaluation and recommendations before them before they decide the fate 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 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 2/23/12