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HOUSE COMMITTEE ON FINANCE

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING SB 753, SD 2, HD 1 PROPOSED HD 2 RELATING TO HIGH TECHNOLOGY

TESTIFIER: FREDERICK D. PABLO, DIRECTOR OF TAXATION (OR
DESIGNEE)
COMMITTEE: FIN
DATE: APRIL 6, 2011
TIME: 4:00PM
POSITION: SUPPORT INTENT; REQUEST AMENDMENT

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 repeals the certification requirements, and includes extensive reporting requirements, including an annual survey which the Department of Taxation (Department) is required to use in preparing annual data and effectiveness reports for the Legislature.

The Department **supports the intent** of this measure.

SUPPORT FOR RESEARCH & DEVELOPMENT INCENTIVES, GENERALLY—As a principal matter, 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. These activities directly relate the development of a taxpayer's "business component," which is a product, process, formula, or other idea having marketable value and that which allows the Company to exploit the idea for economic gain, thus expanding Hawaii's economy.

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 FOR DOUBLE INCENTIVE—However, the Department points out a general tax policy concern, which is the propriety of providing a "double incentive" for a program already being spearheaded by the federal government. With state revenues scarce and social service priorities growing, the Department questions whether already limited state general fund revenues should go toward programs already being funded by the federal government.

AMEND DEFINITION OF "QHTB" – The Department recommends amending the definition of "qualified high technology business" in this section. Currently it references section 235-110.9, the high technology business investment tax credit, which has expired.

ELIMINATION OF CERTIFICATION REQUIREMENT – The Department supports the previous committee's amendment, eliminating the certification requirement. This measure's addition of a survey requirement provides a better information-gathering tool than the certification process, and does not require the Department to use audit resources. The Department also supports the inclusion of a penalty for failure to file the survey in order to ensure compliance.

REVENUE IMPACT— Assuming 50% research activity to be a QHTB, the measure will result in an estimated revenue loss of \$10.9 million per year from FY 2012 to FY 2016.

According to the survey filed by QHTBs for calendar year 2009, a total of 64 QHTBs claimed \$10.9 million in research activities tax credit. These companies have a total of (1) 871 full-time employees in 2009, a decline of 8% from 2008, (2) 114 part-time employees in 2009, an increase of 34% from 2008, and (3) 50 temporary employees in 2009. Total full-time, part-time, and temporary employees for these companies in 2009 are 1,035. The average wage for these companies is \$77,756.

For the committee's reference, here is the historical data on claims for the Research Tax Credit: TY 2008: \$13.0 m; TY 2007: \$10.4 m; TY 2006: \$14.4 m; TY 2005: \$13.2 m; TY 2004: \$12.2 m.

Written Statement of

YUKA NAGASHIMA
Executive Director & CEO
High Technology Development Corporation
before the
HOUSE COMMITTEE ON FINANCE
April 6, 2011
4:00 PM
State Capitol, Conference Room 308

In consideration of
SB 753 SD2 HD1 RELATING TO HIGH TECHNOLOGY.

Chair Oshiro, Vice Chair Lee, and Members of the Committee on Finance.

The High Technology Development Corporation (HTDC) supports SB 753 SD2 HD1, which reinstates the Research and Development Tax Credit. Further, HTDC strongly supports the language of the Proposed House Draft 2 being considered, and offers suggestions to further improve the bill.

This initiative is fiscally conservative with measurable results and a predictable budget impact. Over the past nine years, the tax credit claims under this program averaged approximately \$11 million a year. 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 offset by taxes paid on expenditures, payroll, and the resulting economic activities.

HTDC is appreciative of the wisdom of the legislature to consider the addition of Part III in the Proposed HD2 which factors in innovation infrastructure capacity as part of the key ingredients for Hawaii's commercialization success, an overall vision which start with this R&D tax credit. While we move forward to discuss the possibility of establishing a technology park and a new incubation center, it is prudent to also consider an extension of the existing land lease at the Manoa Innovation Center (MIC) because of the current fiscal constraints. Extension of the land lease, unlike establishment of a tech park or an incubation center, does not cost the State. Further, it provides a safety net for the State to be able to conduct technology-based economy development (TBED) activities through HTDC. HTDC, therefore, will be assured that current net revenues generated at MIC can go towards underwriting its operational expenses as well as other program costs of the agency, as all the stakeholders consider various scenarios for the future of the State.

HTDC recommends the following amendments to further improve SB753 SD2 HD2:

- 1. The length of the lease term within this document should be consistent.** The length of the lease term "thirty-five years" on in the last paragraph of Part I. The number of years quoted in Part III, Section 3 (a) cites "not less than twenty years". HTDC recommends that the

language in the bill specify the **additional number of years to be added to the existing lease which expires on April 30, 2015.**

2. Part II, Section 2 (d) should define “Qualified high technology business” as in “Section 235-7.3 (c)”, and not 235-110.9, as the later forces an additional qualification rule which is unnecessary, and may undermine the intent of this measure. This change will also make the referent consistent with the reporting section of this bill in Part II Section 2 (h) (1).

3. Technical/amendments for clarity: Part II Section 2 (h) (5), eliminate the second comma (between the word “patents” and “submitted” to clarify the reporting requirement. I believe the intent is to have the companies disclose both filed and issued patents, because the patent application process is quite lengthy and we will not be able to track sufficient economic activities from this initiative if the reporting only lists patents already issued.

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 FINANCE

April 6, 2011

4:00 PM

State Capitol, Conference Room 308

In consideration of

SB 753 SD2 HD2 RELATING TO HIGH TECHNOLOGY

Chair Oshiro, Vice Chair Lee and Members of the Committee on Finance:

The Hawaii Strategic Development Corporation (HSDC) strongly supports SB 753 SD2 HD2. Part II of this bill reinstates the state tax credit for research activities that 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. Part III of this bill addresses the long-term lease issues of the High Technology Development Corporation (HTDC).

Over the past nine years, the R&D tax credit claims under this program averaged approximately \$11 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 in large part offset by taxes paid on expenditures and payroll, not only on the qualified research activities, but also the broader scope of technology related economic activity supported by the research expenditures.

Part III in the Proposed HD2 recognizes that innovation infrastructure capacity is a key ingredient of a Hawaii innovation ecosystem that is supported by the R&D tax credit. Extension of the existing land lease at the Manoa Innovation Center will not cost the State any additional funds and will provide a safety net for the State to be able to conduct technology-based economy development (TBED) activities through HTDC, since HTDC can be assured that on-going operational expenses can be covered by its rent revenues.

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

Testimony to the House Committee on Finance

April 6, 2011

4:00 PM

State Capitol, Conference Room 308

RE: SB 753 SD2 HD1 RELATING TO HIGH TECHNOLOGY

Chair Oshiro, Vice Chair Lee, and Members of the Committee on Finance.

As the Chair of the High Technology Development Corporation (HTDC) and a resident of the State of Hawaii, I support SB 753 SD2 HD1, which reinstates the Research and Development Tax Credit, and recommend minor changes to improve the likelihood of the bill achieving the intended results. Further, I strongly support the language of the Proposed House Draft 2 being considered.

Having served on the Board of Directors and the HTDC representative to Hawaii Strategic Development Corporation (HSDC) for the past years, I have witnessed how tax credit had enabled many brilliant innovative ideas became viable businesses. These businesses have been phenomenal in demonstrating that Hawaii is a great place for high tech development, and, we do have the talents within the State or those who would like to come home to Hawaii if opportunities are available. The bill proposes a solution that is fiscally conservative but with measurable results and predictable budget. Over the past nine years, the tax credit claims under this program averaged approximately \$11 million a year. Since the credit can only be claimed for 20% of the qualified expenditures that are made in Hawaii, a good part of the cost of the program is directly offset by taxes paid on expenditures and payroll. The expenditures made by the credit recipients for other people, and other resources will create indirect tax income for the State. This will help propel the velocity of the needed economic and high technology development energy, which we know we badly need.

Innovation infrastructure is a critical component which has been included as the addition of Part III in HD2 to include innovation infrastructure capacity. The upcoming expiration of the HTDC land lease with the University of Hawaii would have left a gaping hole in the formula to enable innovation to march toward successful businesses. Given the fiscal position of the State, the viability of new construction is not appearing positive. The continuous of the lease will enable many young growing but not yet mature high tech related businesses a chance to outgrow the growing pain. This can be a win-win solution to help complete the UH education life cycle – to enable great ideas and knowledge to come to fruition as viable businesses. HTDC has the leadership, knowledge and experience to make it happen. The HTDC model will also enable the ability to incubate or nurture new high-tech businesses sustainable and self-sufficient.

I support the suggestions offered by the Executive Director of HTDC to further improve the language of the proposed SB753 SD2 HD2.

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



UNIVERSITY OF HAWAII SYSTEM

Legislative Testimony

Testimony Presented Before the
Committee on Finance
Wednesday, April 6, 2011, 4:00 p.m.

by
James R. Gaines
Vice President for Research, University of Hawaii'i

SB 753 SD2 Proposed HD2 - RELATING TO HIGH TECHNOLOGY

Chair Oshiro, Vice Chair Lee and members of the committee:

The University strongly OPPOSES Section 3 of this bill.

In 1990 the University of Hawaii'i (UH) entered into an agreement under which the new Mānoa Innovation Center (MIC) was to be leased to the High Technology Development Corporation (HTDC) for a 25-year term, after which the facility was to revert to UH. All parties agreed to this arrangement.

In planning ahead for when the current lease expires in 2015, it is important to emphasize the commitment of UH to the development of a robust research and technology industry in Hawaii'i. Last year UH President Greenwood convened a blue ribbon task force to recommend key changes in how the University develops this research industry. Participants at our recently completed *E Kamakani Noi'i* conference further focused our ideas on what it will take to build a 21st century economy in Hawaii'i.

We are still in the formative stages of defining exactly what form and structure will best support this needed innovation agenda. However, we expect that these activities will be based at the Mānoa Innovation Center, which is already a significant site for the University's research enterprise. In fact, UH and our related programs are already the single largest set of tenants in the facility and we are paying the largest portion of the rent, which goes to support HTDC operations.

President Greenwood and UH leadership has held preliminary discussions with the HTDC Executive Director and some of the HTDC board members. UH emphasized our willingness to let HTDC remain in the MIC facility after 2015 if they so choose. Our discussions further explored a range of possibilities, including HTDC playing a role in implementing the University's innovation agenda. These discussions are continuing and we will be happy to keep the Legislature informed of our progress.

The University does support the development of a technology park on O'ahu, the only island without such a capability. The Mānoa Innovation Center is not large enough to house the activities normally found within a technology park, so another venue must be

found to provide full support for emerging technology businesses. HTDC would be the natural organization to lead such an initiative, and UH supports such an initiative.

We believe this is an opportune time for the State to invest in the development of high technology to diversify and strengthen our economy. But this should not be done at the expense of the new innovation agenda being developed by UH.

We urge you to delete Section 3 from this bill and preserve the agreement made with UH at the time MIC was constructed.

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: SB 753, Proposed HD-2

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Amends HRS section 235-110.91 to require 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 annual survey shall result in a fine of \$1,000 per month. Stipulates that a qualified high technology business may not claim a tax credit under this section until an annual survey has been filed with the department of taxation.

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; and (5) filed intellectual property, including invention disclosures, provisional patents, and patents issued or granted.

The department of taxation shall use information collected under this section and prepare summary descriptive statistics by category. The information shall be 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 December 21 of each year.

Directs the department of business, economic development, and tourism (DBEDT) to use the information collected to study the effectiveness of the tax credit under this section. The department 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 21 of each year.

The director of taxation may adopt any rules under HRS chapter 91 and forms necessary to carry out this section.

Extends the expiration date of the tax credit for research activities from December 31, 2010 to December 31, 2015.

Repeals the existing provisions requiring a qualified high technology business to file a written certified statement in order to claim the tax credit for research activities.

Makes non tax amendments requiring the Manoa Innovation Center to be leased to the High Technology Development Center for 20 years.

EFFECTIVE DATE: July 1, 2112; applicable to 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. This measure adds extensive information reporting requirements and extends the expiration of the tax credit from December 31, 2010 to December 31, 2015. While the adoption of this measure would allow the department of taxation and DBEDT to ascertain the effectiveness of the tax credits for research activities, such a review should have been performed a few years after the credit had been adopted.

The proposed measure would also extend the credit for research activities until December 31, 2015, perpetuating 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.

Adoption of the many targeted business tax credits over the last ten years represents nothing more than a frittering away of state tax revenues albeit out the back door. Because this "spending" of public dollars did not require an appropriation, the public and many lawmakers did not recognize these credits as expenditures. However, because these credits reduce the amount that accrues to the state's coffers, they are indeed the expenditures of state tax dollars, state tax dollars that nonetheless must be made up by other taxpayers in order to keep state government running. To a large degree, these tax credits are a major factor that contributed to the current financial challenges the state now faces and will continue to contribute to the financial woes in the future as many of these credits will be collected for the next several years.

Perhaps had lawmakers mandated strict reporting standards and periodic evaluation of the effectiveness of the credits, they might have suspended the credits sooner. This measure, at least, requires the reporting of information about the research tax credit and an evaluation, something that should have been done from the very beginning.

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 including the general excise rate, taxpayers will find the continuance of these targeted business tax credits distasteful. Distasteful 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.

So instead of creating jobs, the financial dilemma created by all these tax credits now will necessitate a tax increase that, in turn, will destroy jobs. This is certainly poor tax policy.

Digested 4/5/11



Testimony from
Dr. Patrick Sullivan
Founder and Chairman

Oceanit
to the
REPRESENTATIVE COMMITTEE ON FINANCE

April 6, 2011

4:00 PM

State Capitol, Conference Room 308

In **Support** of

SB753 SD2 HD1 RELATING TO HIGH TECHNOLOGY

TO: Chair Oshiro, Vice Chair Lee, and Members of the Committee

From: Dr. Patrick Sullivan, Oceanit

Re: Testimony in Support of SB753 SD2 HD1

Honorable Chair, Vice-Chair and Committee Members:

Thank you for the opportunity to submit testimony in support of SB753.

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.

The R&D credit has helped to jump start an industry that is in its infancy in Hawaii. The R&D credit has been responsible for job creation, as well as long term investments that will set the stage for growth into the future. At Oceanit, the R&D credit has allowed us to:

- Establish and launch the Oceanit Innovation Fund, providing early stage R&D funding through a process that is open to all staff at Oceanit. We have established a bi-annual proposal process where anyone can submit innovative, early stage ideas for internal funding. This has allowed us to nurture a culture of innovation, risk taking and entrepreneurial spirit that are essential to creating a long term growth industry. These funds have been used to provide the initial early stage research that allows scientists and engineers to make a strong case to obtain follow on funding from traditional sources. As a result, a relatively modest capital investment has allowed us to leverage this into large funding sources that have led to new jobs and opportunities.
- Internally fund prototype developments that would normally flounder in what the dual use community calls the "valley of death". This is the stage

in which federal funding runs out but technology development is perhaps 70% complete. Customers will not fund that final last stretch of technology development so the majority of R&D dies at this stage. We have internally invested in pushing technologies through this stage and are nearing marketable products.

- Invest in equipment and laboratory space that is required to conduct cutting edge research. This investment has allowed us to build world class materials and life science labs that allow us to successfully compete at a national level for R&D funding.

We view all of the above as investments that will act as a catalyst for continued job growth. The reality is that without Hawaii's R&D tax credit, we would not have been able to make all of these 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,

Dr. Patrick Sullivan

Oceanit

Testimony to the House Committee on Finance
Wednesday, April 6, 2011
4:00 p.m.
State Capitol - Conference Room 308
Agenda #3

RE: SENATE BILL NO. 753 SD2, HD1 (PROPOSED HD2) RELATING TO HIGH TECHNOLOGY

Chair Oshiro, Vice Chair Lee, and members of the committee:

The Chamber of Commerce of Hawaii ("The Chamber") **strongly supports** SB 753 SD2, HD1 (Proposed HD2), relating to High Technology.

The Chamber is the largest business organization in Hawaii, representing more than 1,100 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of its members, which employ more than 200,000 individuals, to improve the state's economic climate and to foster positive action on issues of common concern.

This bill repeals existing certification requirements and establishes reporting requirements to measure the effectiveness of the tax credit for research activities. The measure also extends this tax credit for an additional five years and requires the Manoa Innovation Center to be leased to the High Technology Development Center for twenty years.

While technically referred to as a "tax credit", this credit could be viewed as a sound state "investment" that has the proven potential to diversify the economy exponentially and create meaningful careers in skilled, technical and manufacturing jobs.

This is a prime opportunity to promote the R&D sector in our state and support our small local companies in the R&D industry so that it can continue to flourish. This will allow them to provide jobs for our talented citizens and ensure that our keiki has a viable option to move back or stay in Hawaii and obtain quality jobs. Furthermore, this measure will strengthen the industry's effort to compete with other players in the national and international arena.

Finally, supporting the R&D industry will help broaden and diversify Hawaii's economic base by spurring spin-off activities resulting from successful innovations. This would include production and manufacturing businesses that would further expand business activity and create skilled jobs outside the service and retail sectors.

Role and Economic Impact of the Research and Development Industry in Hawaii

The large presence of all of the Nation's military services in Hawaii has spurred local companies to form and emerge into this industry. This has served as a source of funding and contracting opportunities for Hawaii's growing R&D sector, and there is considerable opportunity for even greater growth. There are literally millions of dollars that could be directed to Hawaii R&D businesses via military channels and through the prime defense contractors. Furthermore, the presence of a strong R&D community is important and is what helps sustain larger defense contractors in Hawaii.

The Defense and Dual Use industry can and will play a vital role in stabilizing the state's economic climate. One of the best ways for the industry to help is to maintain and grow the workforce. Without job creation, cost cutting and tax increases will only create a downward spiral, requiring more costs and more tax increases. The state must maximize its return by spending money that generates multiples of increased spending, garnering the most return from the least amount of tax dollars.

Research and development is one of those areas. In comparing the R&D tax credit to other credits, we observe that the R&D tax credit is one of the most effective in generating and maintaining jobs per tax dollar, generating higher tax revenues for dollar spent, and stimulating measurably more economic activity in the state per dollar of tax credit.

Additionally, companies leveraging the R&D tax credits tend to be more mature companies; many on the cusp of significant expansion, which will accelerate the hiring of new employees and tax revenue. Research and development is a highly critical component to a sustainable economy. R&D provides well-paying jobs to highly-educated employees. These employees pay significant taxes back to the state and spend considerable amounts of income within the state for goods and services. Furthermore, as the R&D matures it creates product companies that increase the number of jobs and tax base significantly.

Also, the cost of the tax credit helps support qualified expenses in business expenditures in the state. Much of these expenditures come from imported dollars either from outside investors, the federal government or large mainland businesses. These expenditures result in income taxes and significant GET taxes.

R&D tax credit requires a company to expend its funds for which it receives a percentage (has been 20% of wages) of qualified work. 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. The tax is highly focused on wages for research activities. These jobs are typically high paying and result in significant income tax revenues and GET from the money spent by these employees.

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:

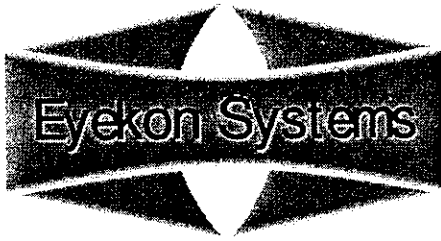
1. Comparisons are only made to other states and not to other countries. R&D is becoming a economic driver worldwide and Hawaii companies compete worldwide,
2. The entire cost of doing R&D is the most important factor. Hawaii has a number of competitive disadvantages such as high income tax rates, high cost of living, high unemployment insurance costs, and high transportation costs, and
3. R&D returns are highest 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.

With the loss of federal support that helped sustain R&D companies in a high-cost environment, the importance of a refundable R&D tax credit is even more prevalent and which will help keep existing businesses viable in Hawaii.

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 2011 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 respectfully ask that the committee to **pass this measure**. Thank you for the opportunity to provide testimony.



EYEKON SYSTEMS, LLC

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Written Statement of
Dr. Paul Konkola
Principal
Eyekon Systems LLC
before the
HOUSE COMMITTEE ON FINANCE

April 6, 2011
4:00 PM
State Capitol, Conference Room 308

RE: SB753 Proposed HD2 -- SUPPORT

Honorable Chair Oshiro, Vice-Chair Lee and Committee Members:

Thank you for the opportunity to submit testimony in support of SB753, Proposed HD2, which would extend the tax credit for research activities for five years.

Eyekon Systems is part of Hawaii's emerging defense and dual-use technology sector. Our company began operations in 2008, and since then we have won funding through the Department of Defense to develop innovative electrical-optical-mechanical technologies that have significant market potential.

Our company's R&D investment provides relatively high-paying jobs to highly educated and skilled employees, who pay taxes and spend significant amounts on local goods and services.

Sustained R&D investment is key to our state's and our company's ability to succeed in the competitive global marketplace. It is difficult to start a technology company anywhere, and in this economic climate, it is even harder in Hawaii. The good news is the payoff can be substantial and our state is an attractive place to work. Without the research tax credit, our company will have fewer funds to reinvest in R&D, which will severely hamper our ability to succeed and grow.

By extending the research tax credit, you will be investing in the future by giving critical support to fledgling dual-use technology companies like ours, which have the potential to remain a bright spot in our state economy. We urge you to extend the tax credit for research activities. Thank you for the opportunity to testify.

Testimony to the Representative Committee on Finance
Wednesday, April 6, 2011
4:00 p.m.
Conference Room 308

RE: SENATE BILL NO. 753 SD2 HD1 RELATING TO HIGH TECHNOLOGY

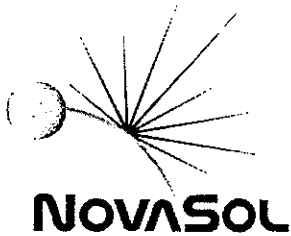
Chair Oshiro, Vice Chair Lee, and members of the committee:

My name is Ian Kitajima and I am the Convener of Hawaii Dual Use Network. I strongly support Senate Bill 753 SD2 HD1 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. SB753 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 loss our children and our culture if we don't create STEM career opportunities that match STEM education. SB753 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 wages and taxes paid by engineers and scientists are some of the highest.

For these reasons, I respectfully ask that you pass this measure.

Sincerely,
Ian Kitajima, Convener
Dual Use Network



April 5, 2011

TESTIMONY TO THE HOUSE COMMITTEE ON FINANCE
APRIL 6, 2011
4:00 PM
ROOM 308
HAWAII STATE CAPITOL

RE: SB 753, SD2 HD1 RELATING TO HIGH TECHNOLOGY

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808.441.3601 fax

Dear Chair Oshiro, Vice Chair Lee, and Members of the Committee on Finance:

I am writing to you to express my strong support for SB 753 SD2 HD1 which seeks to reinstate the Research and Development Tax Credit, and offers some suggestions to further improve the bill.

The research and development (R&D) tax credit that has proven so successful in the past 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.

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

Sincerely,

Rick E. Holasek, Ph.D.
President and CEO
NovaSol
1001 Bishop Street, Suite 2950
Honolulu, HI 96813
(808) 441-3666
rick@nova-sol.com



Written Testimony of

James P Karins,
President Pukoa Scientific
before the

HOUSE COMMITTEE ON FINANCE

April 6, 2011

4:00 PM

State Capitol, Conference Room 308

In consideration of

SB 753 SD2 HD1 RELATING TO HIGH TECHNOLOGY.

Chair Oshiro, Vice Chair Lee, and Members of the Committee on Finance.

Pukoa Scientific strongly supports this bill. 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.

This bill will create and retain jobs while increasing the state's revenues. We cannot afford to overlook the prime opportunity to promote this growing sector in our state. This is the opportune time to support our small local companies in the R&D industry so that it can continue to flourish and provide jobs for our talented citizens and ensure that our keiki have a viable option to move back or stay in Hawaii and obtain quality jobs. Furthermore, this measure will strengthen the industry's effort to compete with other players in the national and international arena. Finally, supporting the R&D industry will help broaden and diversify Hawaii's economic base.

This initiative is fiscally conservative with measurable results and predictable budget. Over the past nine years, the tax credit claims under this program averaged approximately \$11 million a year. 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 totally offset by taxes paid on expenditures and payroll over the lifetime of this proposed extension.

Further, Puko strongly supports the language of the Proposed House Draft 2 being considered. Pukoa is appreciative of the wisdom of the legislature to consider the addition of Part III in the Proposed HD2 which includes innovation infrastructure capacity as part of the key ingredients for Hawaii's commercialization success, which starts with this R&D tax credit. While we move forward to discuss the possibility of establishing a technology park and a new incubation center,

it is prudent to also consider an extension of the existing land lease at the Manoa Innovation Center because of the current fiscal constraints. Extension of the land lease, unlike establishment of a tech park or an incubation center, does not cost the State. Further, it provides a safety net for the State to be able to conduct technology-based economy development (TBED) activities through HTDC, since HTDC can be assured that on-going operational expenses can be covered by its rent revenues.

Pukoa recommends the following amendments to further improve SB753 SD2 HD2:

1. **The length of the lease term within this document should be consistent.** The length of the lease term “thirty-five years” on Page 4 line 6, and the number quoted on Page 11, line 13, “twenty” should be the same number.
2. **Page 7, line 9 should define “Qualified high technology business” as in “Section 235-7.3 (c)”**, and not 235-110.9, as the later forces an additional qualification rule which is unnecessary, and may undermine the intent of this measure. This change will also make the reference consistent with the reporting section of this bill on Page 9 line 2.
3. **Technical/amendments for clarity:** Page 9, line 11: eliminate the second comma (between the word “patents” and “submitted” to clarify the reporting requirement. I believe the intent is to have the companies disclose both filed and issued patents, because the patent application process is quite lengthy and we will not be able to track sufficient economic activities from this initiative if the reporting only lists patents already issued.

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 with minor amendments**. Thank you for the opportunity to express our views.



Indestructible Instant Networks™

Concentris Systems LLC
Manoa Innovation Center, Suite 238
2800 Woodlawn Drive
Honolulu, Hawaii 96822
phone: (808) 988-6100
FAX: (808) 589-3798

Re: Testimony in Support of SB753 SD2, HD1(HSCR1143)

Honorable Chair, Vice-Chair and Committee Members:

Thank you for the opportunity to submit testimony in support to SB753. Our company, Concentris Systems LLC, is part of Hawaii's emerging defense and dual-use technology sector, one of the fastest growing segments of Hawaii's economy. Based at the Manoa Innovation Center, Concentris focuses on advanced networking technologies for Federal government and commercial customers. We are a small, but truly high-tech business: eighty percent of our employees are engineers; over half hold advanced degrees.

Over the past five years, Concentris has won over \$5 million of Federal research and development (R&D) contracts from such agencies as the US Army Research Development and Engineering Command, the Defense Advanced Research Projects Agency (DARPA), and the U.S. Department of Energy, successfully competing for this funding against firms located across the United States and the world. It is important to note that our work not only creates jobs, but helps our government solve critical problems; in the last year we have worked on rapidly deployed communications systems for first responders as well as cyber-security for our nation's missile defense shield.

Hawaii's R&D tax credit program was a significant factor in our firm's ability to make the investments in R&D necessary to win these contracts. R&D investment is the key to our ability to innovate, attract customers and outside funding, compete in the global marketplace, and continue to grow our highly-educated, well-compensated team.

As a technology-based business, we must continue to invest in research and development (R&D) in order to survive. By extending the R&D tax credit, you will enable dual-use technology companies to keep investing in the future of our companies, our employees, and our State. You will also help keep one of the bright spots in our State economy intact and growing.

We urge you to support the extension of the R&D tax credit through SB753. Thank you for the opportunity to testify in support of this important bill.

Sincerely,

A handwritten signature in black ink, appearing to be "SB", followed by a horizontal line.

Steve Brennan
Vice President of Business Development



TESTIMONY TO THE HOUSE COMMITTEE ON FINANCE

April 6, 2011

4:00 p.m.

ROOM 308

HAWAII STATE CAPITOL

Agenda #3

RE: SB 753, SD2, HD1 (PROPOSED HD2) RELATING TO HIGH TECHNOLOGY

Dear Chair Oshiro, Vice Chair Lee, and members of the committee:

Thank you for the opportunity to submit testimony in support of SB 753, SD2, HD1.

Referentia Systems Incorporated is part of Hawaii's emerging defense and dual-use technology sector, one of the fastest growing segments of Hawaii's economy. 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.

SB 753 supports companies like Referentia who bring outside capital to our State's economy and create innovative technologies here in Hawaii that meet the critical needs of our Federal government. 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 here in Hawaii.

This fiscally conservative bill will provide measurable results and a predictable budget impact. The tax credit claims under this program have averaged approximately \$11 million annually over the past nine years. Since the credit can only be claimed for actual expenditures made in Hawaii and only for 20 percent of qualified expenditures, the cost of the program is offset by taxes paid on expenditures, payroll and the resulting economic activity.

Without Hawaii's R&D credit, small businesses like Referentia may be forced to curtail our investment in R&D. 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.

Proposed amendment to SB753 SD2 HD 1

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

- Page 7, line 9 should define "Qualified high technology business" as in "Section 235-7.3 (c)", and not 235-110.9, as the later forces an additional qualification rule which is unnecessary, and may undermine the intent of this measure. This change will also make the referent consistent with the reporting section of this bill on Page 9 line 2.

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 SB753 SD2 HD1.

Sincerely,

A handwritten signature in black ink, appearing to read "Nelson Kanemoto".

Nelson Kanemoto
President and CEO



TESTIMONY TO THE HOUSE COMMITTEE ON FINANCE

April 6, 2011

4:00 p.m.

ROOM 308

HAWAII STATE CAPITOL

Agenda #3

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Sincerely,

A handwritten signature in black ink that reads "Jill Takaezu-Harper".

Jill Takaezu-Harper
Vice President – Business Operations



TESTIMONY TO THE HOUSE COMMITTEE ON FINANCE

April 6, 2011

4:00 p.m.

ROOM 308

HAWAII STATE CAPITOL

Agenda #3

RE: SB 753, SD2, HD1 (PROPOSED HD2) RELATING TO HIGH TECHNOLOGY

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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 SB753 SD2 HD1.

Sincerely,

A handwritten signature in black ink, appearing to read "Ellary Kim", written over a large, stylized flourish.

Ellary Kim
Director of Finance



TESTIMONY TO THE HOUSE COMMITTEE ON FINANCE

April 6, 2011

4:00 p.m.

ROOM 308

HAWAII STATE CAPITOL

Agenda #3

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Sincerely,

A handwritten signature in cursive script that reads "Nancy Downes".

Nancy Downes
Program Manager

HOUSE OF REPRESENTATIVES
THE TWENTY-SIXTH LEGISLATURE
REGULAR SESSION OF 2011

Testimony to the House Committee on Finance
Wednesday, April 6, 2011
4:00 P.M.
State Capitol, Conference Room 308

RE: SB 753, SD2, HD1: Relating to High Technology

The purpose of this bill is to extend the Hawaii Research and Development Tax Credit for an additional five years and to establish reporting requirements to measure the effectiveness of this tax credit for research activities in Hawaii.

I fully support the purpose and intent of this bill.

In recent years, there has been a great deal of time, effort and money spent on promoting the development of a high technology industry in Hawaii, creating exciting opportunities to stem the brain drain to the mainland to create a sustainable source of economic revenue for the State. Numerous tax incentives were developed through Act 221 and many R&D projects were funded via Congressional earmarks from Hawaii's Congressional delegation.

Things were moving well but we are now all faced with our own tsunami of economic disasters on both the national and state levels. We've seen the expiration of the economic incentives from Act 221, a decrease in investor investment in high tech, the rise of an incredible federal debt, elimination of over \$300 million per year from Congressional earmarks and a State deficit of \$1.3 billion.

There are no easy solutions but, you still need to spend money, to make money. Extending the State research and development tax credit for an additional five years is one way to help maintain existing jobs, hopefully create jobs, to maintain a source of reliable tax revenues and to emphasize the importance of high technology to Hawaii.

I would call your attention to a typo that has the effective date of July 1, 2112. It's unlikely this is the intent of your committee.

I strongly urge your favorable support of this measure.

Sincerely,

Reb Bellinger
Vice Present
Makai Ocean Engineering

FINTestimony

From: mailinglist@capitol.hawaii.gov
Sent: Tuesday, April 05, 2011 6:40 PM
To: FINTestimony
Cc: alan.hayashi@baesystems.com
Subject: Testimony for SB753 on 4/6/2011 4:00:00 PM

Testimony for FIN 4/6/2011 4:00:00 PM SB753

Conference room: 308
Testifier position: comments only
Testifier will be present: Yes
Submitted by: Alan Hayashi
Organization: Individual
Address:
Phone:
E-mail: alan.hayashi@baesystems.com
Submitted on: 4/5/2011

Comments:

Chair Oshiro, Vice Chair Lee, and members of the committee:

My name is Alan Hayashi and I am testifying as an individual employed by a large defense technology contractor. We were formally a small local technology contractor that was acquired by an international company.

Since the year 2000, I have observed the technology industry transition from one almost totally dependent on federal grants to one (in 2010) where there are hardly any new federal monies flowing to technology thru the federal sources due to national budget debate. The technology industry was starting to make strides toward sustainability about 2005, however, the economic meltdown hit all sectors of the industry in 2009 and 2010..

Most of the local technology companies are involved in Research and Development (R&D) activities with very little product generation for sustainability. It is very difficult to survive solely on R&D work. Until products can be manufactured either here in Hawaii, or elsewhere, I believe the R&D companies will need State and Federal assistance to stabilize the industry. The technology companies need the State's assistance to weather this major economic downturn.

The R&D credits are revenue positive per recent study by DBEDT and will help stabilize and eventually grow an industry that is environmentally clean and pays relatively high wages, which ripple thru our economy.. The technology industry pays its wages prior to claiming the credits...it is a refundable credit with a substantial lag time..

If this technology industry is not supported, what other industry can contribute positively to this state's economy?

Thank you for the opportunity to submit my remarks. Aloha.