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To: The Honorable Angus L.K. McKelvey, Chair
and Members of the House Committee on Consumer Protection and Commerce

Date: Monday, February 11, 2013
Time: 3:30 p.m.
Place: Conference Room 312, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. No. 329 Relating to General Excise Tax Exemption for Certain Scientific Contracts with the United States

The Department of Taxation (Department) strongly supports H.B. 329, a measure which amends the general excise tax (GET) exemption for certain scientific contracts with the United States, and offers the following comments for the Committee's consideration.

Currently, the scientific contracts exemption allows the gross receipts arising from the performance of any "scientific work," derived by a contractor or subcontractor under a contract with the United States, an exemption from general excise tax. Gross receipts received from the sale of tangible personal property are also exempt if the tangible personal property is affixed or becomes a physical or integral part of the scientific facility. For the purpose of this exemption, "scientific work" is work primarily involving the research and development for, or the design, manufacture, instrumentation, installation, maintenance or operation of the scientific facility.

Many issues arise as to which contracts qualify as a scientific contract and which gross receipts may be applicable for purposes of the exemption. The Department believes that the exemption is currently being claimed by taxpayers in a manner that is beyond its original intent and therefore, requires an amendment.

H.B. 329 amends the scientific contracts exemption from the GET so that the gross receipts exempted would be calculated based on the research expenses allowable under Internal Revenue Code Section 41. This will ease the administrative burden placed on the Department by the current version of the scientific contracts exemption. The Department estimates that at least 10% of the Department's audit staff hours are being used to evaluate claims for this exemption.

If approved, the Department could simply verify the allowable general excise tax exemption amount by looking at the gross receipts claimed and allowed for the research credit under Internal Revenue Code section 41. This type of conformity or parallel alignment generally promotes administrative efficiency for the Department and provides certainty for the taxpayer.

Thank you for the opportunity to provide comments.

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SUBJECT: GENERAL EXCISE, Exemption for scientific contracts

BILL NUMBER: HB 329

INTRODUCED BY: Choy

BRIEF SUMMARY: Amends HRS section 237-26 to provide that the gross proceeds received under a contract or subcontract entered into with the United States (including any agency or instrumentality thereof but not including national banks) equal to qualified research expenses for the taxable year over the base amount, basic research payments determined under IRC section 41(e)(1)(A), and amounts paid or incurred by the taxpayer in carrying on any trade or business of the taxpayer during the taxable year (including as contributions) to an energy research consortium for energy research, shall not be subject to the general excise tax. The gross proceeds exempted under this section shall not exceed the amount claimed and allowable under section 41 of the Internal Revenue Code (IRC) for the same taxable period.

Defines “qualified research expenses for the taxable year of the base amount” for purposes of the measure.

EFFECTIVE DATE: January 1, 2014

STAFF COMMENTS: It appears when this exemption was initially enacted it was to allow local businesses to compete with out-of-state companies in bidding for scientific contracts with the U.S. since the out-of-state companies were not subject to the general excise tax.

This measure is similar to the department of taxation administration measure. The purpose clause of this measure states that 98% of all federal contracts are held by out-of-state companies who pay no tax due to the exemption and the tax loss is estimated to be between \$20 to \$40 million. The department of taxation has also indicated that to verify the existing exemption creates an administrative burden to their audit staff. By amending the exemption to that of the parameters set under IRC section 41 it would allow a more efficient administration of the exemption. While it appears that by updating the exemption to the federal IRC provisions, the revenue loss would not be as large, it is questionable how much the overall economic impact to the state will be due to the tightening up of the exemption - in other words - what is the end result to the state financially under the existing exemption as compared to the proposed exemption.

If, in fact, as the department points out that most of the scientific contracts are being successfully bid by out-of-state firms, then validity of perpetuating the exemption no longer exists as there few, if any, locally based bidders of these contracts. And what few there are do not seem disadvantaged as a result of the general excise impost.

kawakami2 - Rise

From: mailinglist@capitol.hawaii.gov
Sent: Saturday, February 09, 2013 1:54 PM
To: CPCtestimony
Cc: alan.hayashi@baesystems.com
Subject: Submitted testimony for HB329 on Feb 11, 2013 15:30PM

HB329

Submitted on: 2/9/2013

Testimony for CPC on Feb 11, 2013 15:30PM in Conference Room 325

Submitted By	Organization	Testifier Position	Present at Hearing
Alan Hayashi	Individual	Oppose	Yes

Comments: ALAN S. HAYASHI 207-4 Kawaihae Street Honolulu, Hawaii 96825 TESTIMONY TO THE HOUSE COMMITTEE ON CONSUMER PROTECTION AND COMMERCE Monday, February 11, 2013 @ 3:30 pm Conference Room #325 RE: HB 329 "RELATING TO THE GENERAL EXCISE TAX" Chair Tsuji, Vice Chair Ward, and members of the House EDB Committee: My name is Alan Hayashi and I am testifying as an individual employed by a large defense contractor involved in research and development, and as the representative of the ED&I Committee of the Chamber of Commerce. My testimony is in OPPOSITION to the intent of HB 329.. The High Technology industry's research and development (R&D) function is one that could employ Hawaii's brightest and best STEM graduates and could grow to be a substantial contributor to the kind of green "clean" economy we are striving to develop in Hawaii. Unfortunately, the 2008 economic downturn and corresponding lack of funding for research and development dealt a severe blow to the High Technology industry and the local technology community. The suspension in 2011 of the R&D Tax credit was crippling to many small R&D firms. Some were sold to "off island" interests, and some severely cut back on employees, or closed. Because the industry is based on invention, and innovation of intellectual property (IP), firms are transportable beyond geographic boundaries....large factories are not necessary. Many sections of the country offer incentives to attract high technology industry to their cities. As such the competition for high technology companies is always present. Many stay in Hawaii, because they grew up here and enjoy the life style and closeness of family. However, in these competitive times, that is not enough. Senator Inouye provided some much need R&D funding, but that is no longer available. Unless Hawaii offers a competitive economic environment many will leave and the dream of a society of smart young folks solving problems and innovating will forever disappear from Hawaii. The window of opportunity is closing for a viable technology community to survive. The brightest and best of our technology folks will leave Hawaii for opportunities elsewhere. The intent of HB 329 will make federal government scientific contract costs escalate at a time when all are attempting to decrease costs...the threat of sequestration, and draconian budget cuts have already had impacts on the economy. Scientific contracts have always been exempted under past Hawaii law under Section 237-26. To have as a reason that the Department of Taxation testifies it takes too much personnel and time to administer is unacceptable and not believable. Government's role should be assisting the private sector to grow the Hawaii economy, rather than blame their process as a way to impose a tax and hinder good industry. Why is the department not more streamlined to do this work? Could it be that the qualification of scientific work performed is too broad? Surely, a small working group of industry and DoTax personnel can identify the problem, and streamline this process in a short meeting.... Current DoTax attitude and reason for denying the exemption for scientific (R&D) work in Hawaii is unacceptable! The defense company I work for does

not currently include the cost of GET in our scientific contracts with the Federal government. To include this GET cost will decrease the scientific work product that can be performed under a contract...in these times of reduced budgets this directly reduces the scientific product to help our war fighters in the war against terrorism. I'm sure the federal government would not be in favor of this transfer of costs from State to Federal governments, and could easily transfer scientific contract work to other states that have kept the scientific exemption. Imposing this burden on the scientific research sector, will surely be a negative to any federal contract administrator and contractor. If you value the technology sector and innovation to move our economy forward...this is not a good conceptual to tax scientific contracts. Thank you for the opportunity to testify on this measure. I will be glad to answer any questions.

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

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