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SUBJECT: GENERAL EXCISE, Exemption for scientific contracts

BILL NUMBER: HB 964, HD-1

INTRODUCED BY: House Committee on Economic Development & Business

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: Tax years beginning after December 31, 2013

STAFF COMMENTS: This is an administration measure submitted by the department of taxation TAX-14 (13). 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.

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.

Digested 2/12/13



Written Recommendation for Amendment

James P Karins, PhD
President, Pukoa Scientific
before the

HOUSE COMMITTEE ON FINANCE

February 14, 2013

3:30 PM

State Capitol, Conference Room 325

In consideration of

HB 964 HD 1 RELATING TO THE GENERAL EXCISE TAX

Chair Luke, Vice Chairs Nishimoto and Johanson, and Members of the Committee on Finance:

Pukoa Scientific strongly opposes HB 964 HD 1.

Pukoa like most of the other DoD research and development contractors, has suffered over the past couple of years through significant reductions in available funding while withstanding increased costs due to lost R&D tax credits, increased unemployment insurance and other taxes. This proposed change to the GET will increase the cost of conducting R&D by local small businesses by adding GET to R&D contracts. This puts the Hawaii based companies at a significant disadvantage to mainland companies that do not pay the tax for R&D contracts outside the state.

Therefore, we urge the committee to **hold this measure**. As an alternative, we urge the committee to amend the bill to exempt scientific contracts conducted within the state that are exported to federal agencies outside the state. Thank you for the opportunity to express our views.

James P. Karins, PhD

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