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GOVERNOR

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JOSHUA WISCH
DEPUTY DIRECTOR

To: The Honorable Donovan Dela Cruz, Chair
and Members of the Senate Committee on Economic Development, Government
Operations and Housing

The Honorable David Y. Ige, Chair
And Members of the Senate Committee on Ways and Means

Date: Thursday, March 28, 2013
Time: 9:00 a.m.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. No. 964 H.D.1 Relating to General Excise Tax Exemption for Certain Scientific
Contracts with the United States

The Department of Taxation (Department) **strongly supports** H.B. 964 H.D.1, an administration measure which amends the general excise tax exemption for certain scientific contracts with the United States.

Currently, the scientific contracts exemption applies to gross receipts arising from the performance of any "scientific work" derived by a contractor or subcontractor under a contract with the United States. 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 relating to what contracts qualify as a scientific contract, and whether the exemption of gross receipts, is applicable. The Department believes that the exemption is currently being claimed by taxpayers in a manner that is well beyond its original intent, and therefore, requires an amendment.

This bill amends the scientific contracts exemption so that the gross receipts exempted would be calculated based on the research expenses allowed under Internal Revenue Code Section 41. This will ease the administrative burden placed on the Department by the current language of the

scientific contracts exemption. The Department estimates that at least 10% of 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 determining the amount of research credit claimed and allowed, pursuant to Internal Revenue Code section 41. In cases where a taxpayer has made expenditures that qualify for the federal tax credit outside Hawaii, the taxpayer simply needs to apportion the expenditures properly allocable to Hawaii to determine the exemption amount. This type of conformity or parallel alignment generally promotes administratively efficiency for the Department.

In order to clarify that only qualified expenditures properly allocable to Hawaii may be used to calculate the general excise tax exemption amount, the Department suggests adding the following provision to page 3, line 3, after "energy research":

; provided that all expenditures used to calculate the exemption under this section shall be properly treated as expenditures made in the State. Expenditures made in any jurisdiction outside of the State shall not be considered for the purpose of calculating the exemption provided under this section.

The Department estimates that this measure will result in a revenue gain of \$7.5 million in FY 2014, and \$18 million per year in FY 2015 and later.

Thank you for the opportunity to provide comments.

From: [Dane Wicker](#)
To: [WAM Testimony](#)
Subject: FW: Submitted testimony for HB964 on Mar 28, 2013 09:00AM
Date: Wednesday, March 27, 2013 8:10:29 AM

From: mailinglist@capitol.hawaii.gov [mailto:mailinglist@capitol.hawaii.gov]
Sent: Tuesday, March 26, 2013 5:47 PM
To: EGHTestimony
Cc: achung@navatekltd.com
Subject: Submitted testimony for HB964 on Mar 28, 2013 09:00AM

HB964

Submitted on: 3/26/2013

Testimony for EGH/WAM on Mar 28, 2013 09:00AM in Conference Room 211

Submitted By	Organization	Testifier Position	Present at Hearing
Ann Chung	Navatek Ltd.	Oppose	No

Comments: Aloha Chair Dela Cruz, Chair Ige, Vice Chairs Slom and Kidani, and members of the EGH and WAM Committees: We respectfully request that this measure be deferred as the proposed change to the GET will have the unintended consequence of hurting local R&D companies by increasing the cost of conducting R&D by local companies and thus, putting us at a major disadvantage as compared to mainland companies that do not pay the tax for R&D contracts outside the state. Mahalo for your consideration and leadership.

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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Written Recommendation for Amendment

James P Karins, PhD
President, Pukoa Scientific
before the

**SENATE COMMITTEE ON ECONOMIC DEVELOPMENT, GOVERNMENT
OPERATIONS AND HOUSING and
SENATE COMMITTEE ON WAYS AND MEANS**

March 28, 2013

9:00 AM

State Capitol, Conference Room 211

In consideration of

**HB 964 HD 1 RELATING TO THE GENERAL EXCISE TAX EXEMPTION FOR
CERTAIN SCIENTIFIC CONTRACTS WITH THE UNITED STATES**

Chairs Dela Cruz and Ige, Vice Chairs Slom and Kidani, and Members of the Committees:

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.

Additionally, businesses that have signed long-term fixed-price or time and material contracts to conduct scientific efforts will unfairly have a significant cost added to the work without the potential of recouping that cost from the federal government.

Therefore, we urge the committee to **hold this measure until it can be further studied**. Thank you for the opportunity to express our views.

Sincerely,

James P. Karins, PhD
Karins@pukoa.com
(407)694-4485

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

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

From: [Dane Wicker](#)
To: [WAM Testimony](#)
Subject: FW: Submitted testimony for HB964 on Mar 28, 2013 09:00AM
Date: Wednesday, March 27, 2013 8:10:14 AM

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To: EGHTestimony
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HB964

Submitted on: 3/26/2013

Testimony for EGH/WAM on Mar 28, 2013 09:00AM in Conference Room 211

Submitted By	Organization	Testifier Position	Present at Hearing
Martin Kao	Navatek Ltd.	Oppose	No

Comments: Aloha Chair Dela Cruz, Chair Ige, Vice Chairs Slom and Kidani, and members of the EGH and WAM Committees: We respectfully request that this measure be deferred as the proposed change to the GET will have the unintended consequence of hurting local R&D companies by increasing the cost of conducting R&D by local companies and thus, putting us at a major disadvantage as compared to mainland companies that do not pay the tax for R&D contracts outside the state. Mahalo for your consideration and leadership.

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**THE SENATE
THE TWENTY-SEVENTH LEGISLATURE
Regular Session of 2013**

**COMMITTEE ON ECONOMIC DEVELOPMENT, GOVERNMENT OPERATIONS AND
HOUSING**

Chair Dela Cruz, Vice Chair Slom, Members of the Committee:

COMMITTEE ON WAYS AND MEANS

Chair Ige, Vice Chair Kidani, Members of the Committee

**Hearing date: Thursday, March 28, 2013
Testimony on HB964 HD1
GET for Scientific Contracts**

Chair Dela Cruz, Chair Ige, Vice Chair Slom, Vice Chair Kidani, Members of the Committee:

I testify in opposition to this bill which would gut the current general excise tax ("GET") exemption for scientific contracts with the United States. The bill would replace the current exemption with the test for the research and experimentation tax credit under Internal Revenue Code section 41, which in the Department of Taxation's view is limited to expenditures for research and experimentation in the laboratory sense.

The GET exemption has been in the law since 1965 to foster economic development in connection with federal scientific contracts in Hawaii. "Scientific work" is broadly defined to include many types of services (R&D, design, manufacture, instrumentation, installation, maintenance, operation) of aerospace, agriculture, astronomical, biomedical, electronic, geophysical, oceanographic and test range facilities. Before severely limiting this long-standing exemption, the Department of Taxation should work with industry (including labor and construction) and the Department of Business, Economic Development and Tourism, to determine the impact of this bill on the economy.

Respectfully submitted,
CHUN, KERR, DODD, BEAMAN & WONG,
a Limited Liability Law Partnership

Ray Kamikawa



**Testimony to the Senate Committees on Economic Development, Government
Operations and Housing, and Ways and Means
Thursday, March 28, 2013 at 9:00 A.M.
Conference Room 211, State Capitol**

**RE: HOUSE BILL 964 HD 1 RELATING TO GENERAL EXCISE TAX
EXEMPTION FOR CERTAIN SCIENTIFIC CONTRACTS WITH THE
UNITED STATES**

Chairs Dela Cruz and Ige, Vice Chairs Slom and Kidani, and Members of the Committees:

The Chamber of Commerce of Hawaii ("The Chamber") **opposes** HB 964 Relating to General Excise Tax Exemption for Certain Scientific Contracts with the United States.

The Chamber is the largest business organization in Hawaii, representing over 1000 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 members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

This bill will hurt our high technology industries in Hawaii. This bill provides some incentives for our local companies and provides a level playing field against out of state companies who do business with the U.S. government but are not located in the state.

Please defer this bill.

Thank you for the opportunity to testify.