

NEIL ABERCROMBIE  
GOVERNOR

SHAN TSUTSUI  
LT. GOVERNOR



STATE OF HAWAII  
**DEPARTMENT OF TAXATION**  
P.O. BOX 259  
HONOLULU, HAWAII 96809  
PHONE NO: (808) 587-1530  
FAX NO: (808) 587-1584

FREDERICK D. PABLO  
DIRECTOR OF TAXATION

JOSHUA WISCH  
DEPUTY DIRECTOR

To: The Honorable Clift Tsuji, Chair  
and Members of the House Committee on Economic Development and Business

Date: Friday, February 1, 2013  
Time: 9:00 a.m.  
Place: Conference Room 312, State Capitol

From: Frederick D. Pablo, Director  
Department of Taxation

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

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

Currently, the scientific contracts exemptions allows for the 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 as to which contracts qualify as a scientific contract and whether the exemption of gross receipts are allowable. 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.

This bill amends the scientific contracts exemption 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 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 claimed and allowed for the research credit under Internal Revenue

Department of Taxation Testimony

HB 964

February 1, 2013

Page 2 of 2

Code section 41. This type of conformity or parallel alignment generally promotes administratively efficiency for the Department.

Thank you for the opportunity to provide comments.

# 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: SB 1195; HB 964 (Identical)

INTRODUCED BY: SB by Kim by request; HB by Souki by request

**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 1/31/13