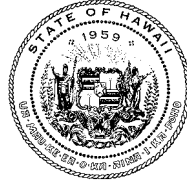


NEIL ABERCROMBIE
GOVERNOR

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 Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Tuesday, March 28, 2013
Time: 3:15 p.m.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. No. 1349, S.D. 2, H.D. 1 Relating to Economic Development

The Department of Taxation (Department) **appreciates the intent** of S.B. 1349, S.D. 2 H.D. 1 and offers the following information and comments for your consideration.

S.B. 1349 S.D. 2 HD1 re-enacts the tax credit for qualified research activities to apply to taxable years from 2013 to 2017; amends the definitions of "qualified high technology business" and "qualified research"; establishes new reporting requirements; and requires that in order to claim the credit, taxpayers must also claim the federal tax credit under section 41 of the Internal Revenue Code (IRC).

The main difference between this H.D.1 version of S.B. 1349 and previous drafts is how the credit is calculated. Previous drafts expressly made inoperative any references to the base amount. Simply put, the base amount refers to an amount of qualified expenditures more than which a taxpayer needs to expend in order to claim the credit under IRC section 41. The Department supports this amendment because IRC conformity generally simplifies tax administration and compliance enforcement for the Department.

The Department recognizes the importance of encouraging research and development, which in turn creates new jobs and greater prosperity for the State. However, as the Legislature is aware, administration and proper enforcement of this tax credit created numerous difficulties for the Department in the past.

The Department also supports the requirement that a taxpayer be required to claim the federal tax credit, under IRC section 41, as a prerequisite to claim the State tax credit. Because the Internal Revenue Service (IRS) has far greater expertise in the subject matter and the resources to determine and resolve which expenses qualify for this tax

credit, the prerequisite of claiming the federal tax credit will assist the State in determining whether the State tax credit claims are meritorious. However, this prerequisite of claiming the federal credit will not be effective where the taxpayer's federal credit amount does not match the qualified expenses attributable to Hawaii if the taxpayer has expenses incurred in other jurisdictions.

The Department notes that page 3, line 13, states that the purpose of the act is to provide support for scientific experimentation at twenty per cent of qualified research expenditures; however, IRC section 41 also provides for alternate methods of calculating the credit, to simplify the calculation, but at a lower percentage rate of tax credit. The Department requests clarification regarding the method which taxpayers will be allowed to calculate and claim the tax credit.

The Department suggests clarifying page 4, line 19-21, by amending it to read: "shall apply only to expenses incurred for qualified research activities after December 31, 2013" if the intent of the bill is to apply these provisions to taxable years beginning after December 31, 2013, as stated in subsection (n) of the statute being amended.

Additionally, the Department recommends that subsection (g) be amended to reflect a nonrefundable tax credit, as follows:

The credit allowed under this section shall be claimed against net income tax liability for the taxable year. A tax credit under this section which exceeds the taxpayer's income tax liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted.

In the past, the research credit has been prone to abuse and generated very intensive litigation for the Department over the tax credit requirements. For example, although the federal research credit was first allowed for internal use software in 1986, and despite numerous attempts by the IRS to define what internal use software is, it has yet to issue final regulations on the issue. The result was extremely protracted litigation as to whether software is internal use or not. It is not uncommon for IRS litigation to exceed ten years before a final court decision on the matter can be made. For these reasons, the Department supports conformity to the federal provisions in determining whether the certain expenses qualify for the tax credit.

If made effective immediately and applied to taxable years beginning after December 31, 2013, the estimated revenue loss would be \$3.25 million per year for fiscal years 2015 through 2018. Since some taxpayers may have fiscal years beginning very late in the calendar year, small revenue losses may occur in fiscal year 2019. This estimate presumes that only qualified research expenses incurred after December 31, 2013 qualify for the tax credit, and that the Hawaii tax credit will mirror the federal tax credit in allowing the alternative calculation.

Thank you for the opportunity to provide comments.

Testimony to the House Committee on Economic Development and Business
Thursday, March 28, 2013 at 3:15 P.M.
Conference Room 308, State Capitol

LATE

RE: SENATE BILL 1349 SD2 HD 1 RELATING TO ECONOMIC DEVELOPMENT

Chair Tsuji, Vice Chair Ward, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") **supports SB 1349, SD 2 HD 1 Relating to Economic Development.**

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 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. 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.

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.

We do prefer the language in the senate draft as it did make it easier for Hawaii companies to utilize the credit.

Thank you for this opportunity to express our views.

LATE

Written Statement of
Dr. Elliot Parks, Hawaii Biotech Inc.
before the
HOUSE COMMITTEE ON FINANCE
MARCH 28, 2013, 3:15 PM
State Capitol, Conference Room 308
In Support of
SB1349 SD2 Relating to Economic Development

To: Chair Luke, Vice Chairs Nishimoto & Johanson, and Members of the Committee
From: Dr. Elliot Parks, President & CEO, Hawaii Biotech Inc.
Re: **Testimony in SUPPORT of SB1349 SD2 Relating to Economic Development**

Honorable Chair, Vice-Chairs and Committee Members:

Thank you for the opportunity to submit comments in **strong support** of **SB1349 SD2**.

As a key member of management of one of Hawai'i's premier knowledge-based companies, I am writing in strongly support of the Hawaii Growth Initiative, SB1349 SD2.

I can speak firsthand to what is required in Hawaii to create and fund innovative companies, to build and nurture a skilled workforce, and to spawn well-paying jobs.

The R&D tax credit has been essential in supporting knowledge-based industry in Hawai'i. It has been responsible for job creation, as well as many long-term investments in high-tech and biotech companies. These investments in time, talent, and treasure have set the stage for our State's economic growth into the future.

R&D investment not only provides longer-term continuity for an important industry, but very importantly, yields short-term rewards as well. In the past, the refundable R&D income tax credit for qualified research activities in the State of Hawai'i has led to the creation and maintenance of quality jobs for skilled Hawaii residents. Direct spending by these employees has spread across the State, supporting additional local jobs and small business, and leading to a stronger State economy and increased income tax revenues.

I urge you to maintain the momentum that you started and thank you for your **support** of **SB1349 SD2** as the stimulus to an innovative Hawai'i STEM economy that our keiki can be a part of.

Sincerely,

Dr. Elliot Parks
President & CEO
Hawaii Biotech Inc.
99-193 Aiea Heights Drive, # 200
Aiea, HI, 96701-3900
Email: eparks@hibiotech.com
808-792-1399 O
808-342-7281 M

LATE

Written Statement of
Lisa Palminteri
before the
HOUSE COMMITTEE ON FINANCE
MARCH 28, 2013, 3:15 PM
State Capitol, Conference Room 308
In Support of
SB1349 SD2 Relating to Economic Development

To: Chair Luke, Vice Chairs Nishimoto & Johanson, and Members of the Committee
From: Lisa Palminteri, Levin & Hu, LLP
Re: **Testimony in SUPPORT of SB1349 SD2 Relating to Economic Development**

Honorable Chair, Vice-Chairs and Committee Members:

Thank you for the opportunity to submit comments in **strong support** of **SB1349 SD2**.

The R&D tax credit has been essential in jump starting the tech industry in Hawai'i. It has been responsible for job creation, as well as many long-term investments tech companies have made that will set the stage for growth into the future.

Because of the forward-looking nature of research, few R&D investments have short-term rewards. This bill would re-establish a temporary refundable R&D income tax credit for qualified research activities in the State of Hawai'i, to help provide longer-term continuity for an industry that is struggling to grow. We urge you to maintain the momentum that you started.

Thank you for your continued support of R&D as the stimulant to an innovative Hawai'i STEM economy that our keiki can be a part of.

Sincerely,



Lisa Palminteri
Staff Accountant
Levin & Hu, LLP