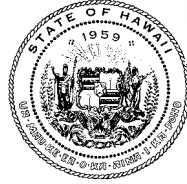


NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



LATE

FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

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

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

Date: Tuesday, February 26, 2013
Time: 10:05 a.m.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

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

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

S.B. 1349, S.D. 1 retroactively re-enacts the tax credit for qualified research activities to apply to taxable years from 2010 to 2015, amends the definitions of "qualified high technology business" and "qualified research", and establishes new reporting requirements. The measure is effective upon its approval and applicable to tax years beginning after December 31, 2010.

The Department recognizes the importance of encouraging research and development, which in turn creates new jobs and greater prosperity for the State. However, the Department has serious concerns due the anticipated administrative and enforcement issues, including expensive and protracted litigation.

Although this measure would adopt the federal requirements set forth under Internal Revenue Code (IRC) section 41, there is no requirement that the taxpayer actually claim the federal tax credit in order to qualify for the State tax credit for research activities. The Department believes that a taxpayer should be required to claim the federal credit under IRC section 41 in order to claim the State credit; requiring the taxpayer to make the federal tax claim will help validate that the taxpayer's tax credit claim sufficiently meets the federal standards.

In addition, because this measure retroactively re-enacts the research credit, the Department would be faced with the additional tasks of reviewing amended tax returns and issuing refunds where appropriate. The retroactive application may have a direct impact on the state's current fiscal year budget.

Past experience has been that the research credit is prone to abuse, is very costly to the State, and has generated costly and intensive litigation over the tax credit requirements. These issues are particularly pronounced where the state tax law is inconsistent with the federal tax law. The Department is able to better ensure compliance when the state tax law conforms with the federal law; conformity to the federal law allows the Department to rely on the Internal Revenue Service's greater expertise and resources.

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 end result is extremely protracted litigation as to whether software is for 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.

The Department estimates this measure would result in a revenue loss of \$39 million for fiscal year 2014 and \$13 million per year for fiscal years 2015 through 2018. Because some taxpayers may have fiscal years beginning very late in the calendar year, small revenue losses may occur in fiscal year 2019.

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: INCOME, Tax credit for research activities

BILL NUMBER: SB 1349, SD-1

INTRODUCED BY: Senate Committees on Economic Development, Government Operations & Housing & Technology & the Arts

BRIEF SUMMARY: Amends HRS section 235-110.91 to provide that the federal tax provisions in section 41 of the Internal Revenue Code (IRC) as that section was enacted on December 31, 2011, shall remain in effect for purposes of determining the state income tax credit under this section. The federal tax provisions in IRC section 41, as enacted on December 31, 2011, shall apply only to expenses incurred for qualified research activities after December 31, 2010.

Adds a definition of qualified research expenses to provide that it shall have the same meaning as in IRC section 41(b) provided it shall not include research expenses incurred outside of the state.

Requires a qualified high technology business that claims the credit under this section to complete and file with the director of business, economic development and tourism (DBEDT), through the department's website, an annual survey on electronic forms prepared and prescribed by the department. Requires the survey to be filed before June 30 of each year following the calendar year in which the credit is claimed under this section. Permits the department to adjust the due date of the annual survey by rule.

The survey shall include: (1) identification of the industry sector in which the qualified high technology business conducts business; (2) total and qualified expenditures; (3) revenue and expense data; (4) Hawaii employment and wage data including the number of full and part-time employees retained, new jobs, temporary positions, external services procured by the business, and payroll taxes; (5) filed intellectual property, including invention disclosures, provisional patents, and patents issued or granted; and (6) the number of new companies spun out or established to commercialize the intellectual property owned by the qualified high technology business.

DBEDT may request any additional information necessary to measure the effectiveness of the tax credit, such as information related to patents. DBEDT shall use information collected under this section and through its other reporting requirements to prepare summary descriptive statistics by category. The information shall be reported at the aggregate level to prevent compromising identities of qualified high technology business investors or other confidential information. DBEDT shall also identify each qualified high technology business that is the beneficiary of tax credits claimed under this section. DBEDT shall report the information required under this subsection to the legislature by September 1 of each year.

Directs DBEDT to use the information collected to study the effectiveness of the tax credit under this section and report on the amount of tax credits claimed and total taxes paid by qualified high technology

businesses; the number of qualified high technology businesses in each industry sector; jobs created; external services and materials procured by the businesses; compensation levels; qualified research activities; and any other factor DBEDT deems relevant. DBEDT shall report the results of its study to the legislature by December 1 of each year.

This section shall not apply to taxable years beginning after December 31, 2017.

EFFECTIVE DATE: Tax years beginning after December 31, 2010

STAFF COMMENTS: The legislature by Act 178, SLH 1999, and Act 221, SLH 2001, enacted various tax incentives to encourage the development of high technology businesses in the state. These acts provided investment and research credits, as well as income exclusions and tax incentives, to encourage high tech businesses and individuals associated with high tech businesses to locate in the state. It should be noted that while the credit for research activities enacted by Act 178, SLH 1999, expired on 12/31/10, this measure attempts to reenact the credit. It is questionable whether the methodology proposed by this measure is appropriate. Since the credit expired on 12/31/10, the method proposed by this measure merely changes the expiration date of the existing statutory language and provides that the provision shall be effective for tax years beginning after December 31, 2010 in an attempt to make it an “extension” of the expired credit. It would appear to be more appropriate to restate the provisions as language in a new section under the income tax law.

While the focus on high technology in the last few years is commendable, it fails to recognize that investments are made with the prospect that the venture will yield a profit. If the prospects for making a profit are absent, no amount of tax credits will attract investment from outside Hawaii’s capital short environment. People do not invest to lose money. It should be remembered that until Hawaii’s high cost of living can be addressed, all the tax incentives in the world will not make a difference in attracting new investment to Hawaii. The only attractive aspect for resident investors to plough money into such activities is the fact that the credit provides a way to avoid paying state taxes.

Given the fiasco of Act 221 which amounted to nothing more than an outright give away of precious state tax dollars on a dollar-for-dollar basis, this proposal and all others proposing added business-targeted tax credits should give lawmakers reason for pause before heading down the same disastrous path again.

If, indeed, the goal is to attract more research activities, then the state should concentrate its resources on enhancing the academic synergy implicit in the pursuit of research activities. While investors are important for research activities, if there is no promise that the environment is fertile to foster and nurture the creativity and initiative vital to sound research, therefore, no amount of money is going to attract such activities. Thus, the tax credit just becomes another throw away of taxpayer dollars. If the federal credit is insufficient to attract research to Hawaii, then a state tax credit cannot surmount the hurdle.

Digested 2/25/13



From: mailinglist@capitol.hawaii.gov
To: [WAM Testimony](#)
Cc: dwatumull@cardaxpharma.com
Subject: Submitted testimony for SB1349 on Feb 26, 2013 10:05AM
Date: Monday, February 25, 2013 9:57:13 AM

SB1349

Submitted on: 2/25/2013

Testimony for WAM on Feb 26, 2013 10:05AM in Conference Room 211

Submitted By	Organization	Testifier Position	Present at Hearing
David G. Watumull	Cardax Pharmaceuticals, Inc.	Support	No

Comments: This is David Watumull, CEO of Cardax Pharmaceuticals, Inc. We strongly support SB1349. Many states across the country are supporting development of the tech and life science industries in their area with incentives such as this R&D credit. To be competitive, Hawaii must do the same. Sincerely, David

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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SENT VIA EMAIL

February 25, 2013

Senator David Y. Ige
Chair, Committee on Ways and Means
Senator Michelle N. Kidani
Vice Chair, Committee on Ways and Means
Hearing on Senate Bill 1349 SD1 - Relating to Economic Development
State Capitol, Conference Room 211

Aloha Chair Ige and Vice Chair Kidani!

Enterprise Honolulu is supportive with the re-establishment of an income tax credit for qualified research activities as outlined in Senate Bill 1349 SD1.

As Hawai'i continues to improve and build upon our current economic condition, this legislation provides a means to support an entrepreneurial ecosystem that helps Hawaii's businesses expand capacity and move toward long term health.

We ask for your legislative support with this important initiative.

Please feel free to contact me directly should you have any questions.

Sincerely,

Pono Shim
President & CEO
Enterprise Honolulu, Oahu Economic Development Board



735 Bishop Street, Suite 424, Honolulu, Hawaii 96813 • 808-521-3611
Fax: 808-536-2281 • www.enterprisehonolulu.com





February 25, 2013

**COMMENTS TO THE COMMITTEE ON WAYS AND MEANS
February 26, 2013
10:05 PM
ROOM 211
HAWAII STATE CAPITOL**

RE: SB 1349, RELATING TO ECONOMIC DEVELOPMENT

CORPORATE OFFICE

1001 Bishop Street
Suite 2950
Honolulu, Hawaii 96813
808.441.3600
808.441.3601 fax

CALIFORNIA OPERATIONS

12675 Danielson Court
Suite 406
Poway, California 92064
858.376.0185
858.376.0190 fax

FINANCE OFFICE

1001 Bishop Street
Suite 2950
Honolulu, Hawaii 96813
808.441.3600
808.441.3601 fax

Dear Chair Ige, Vice Chair Kidani and members of the committee:

I am writing to you to express my strong support for SB 1349 which seeks to reinstate the research and development (R&D) tax credit that has proven so successful in the past. This bill is extremely important and affects a large number of individuals and organizations in the State of Hawaii that perform R&D work.

This bill will enable broad sectors of R&D activities in the State to continue by incentivizing this type of work. R&D activities in the State produce the very kinds of jobs that are desired here, high paying technology sector jobs. The type of personnel that perform this kind of activity are also the same entrepreneurs that start additional new companies that ultimately yield even more revenues, jobs and provide tremendous upside potential in Hawaii.

R&D work is critical to the future growth in Hawaii industry and education and should be supported as this bill would do.

Please feel free to contact me at any time if you have other questions or comments.

Sincerely,

Rick E. Holasek, Ph.D.
President and CEO
NovaSol
1001 Bishop Street, Suite 2950
Honolulu, HI 96813
(808) 441-3666
rick@nova-sol.com



February 25, 2013

**COMMENTS TO THE COMMITTEE ON WAYS AND MEANS
February 26, 2013
10:05 PM
ROOM 211
HAWAII STATE CAPITOL**

RE: SB 1349, RELATING TO ECONOMIC DEVELOPMENT

CORPORATE OFFICE

1001 Bishop Street
Suite 2950
Honolulu, Hawaii 96813
808.441.3600
808.441.3601 fax

CALIFORNIA OPERATIONS

12675 Danielson Court
Suite 406
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858.376.0185
858.376.0190 fax

FINANCE OFFICE

1001 Bishop Street
Suite 2950
Honolulu, Hawaii 96813
808.441.3600
808.441.3601 fax

Dear Chair Ige, Vice Chair Kidani and members of the committee:

I am writing to you to express my strong support for SB 1349 which seeks to reinstate the research and development (R&D) tax credit that has proven so successful in the past. This bill is extremely important and affects a large number of individuals and organizations in the State of Hawaii that perform R&D work.

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R&D work is critical to the future growth in Hawaii industry and education and should be supported as this bill would do.

Please feel free to contact me at any time if you have other questions or comments.

Sincerely,

Rick E. Holasek, Ph.D.
President and CEO
NovaSol
1001 Bishop Street, Suite 2950
Honolulu, HI 96813
(808) 441-3666
rick@nova-sol.com

LATE

**Comments to the Senate Committee on Ways and Means
Tuesday, February 26, 2013 at 10:05 A.M.
Conference Room 211, State Capitol**

RE: SENATE BILL NO. 1349 SD 1 RELATING TO ECONOMIC DEVELOPMENT

Chair Ige, Vice Chair Kidani, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") **supports SB 1349, SD 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.

Thank you for this opportunity to express our views.



From: mailinglist@capitol.hawaii.gov
To: [WAM Testimony](#)
Cc: alan.hayashi@baesystems.com
Subject: Submitted testimony for SB1349 on Feb 26, 2013 10:05AM
Date: Saturday, February 23, 2013 9:42:30 AM

SB1349

Submitted on: 2/23/2013

Testimony for WAM on Feb 26, 2013 10:05AM in Conference Room 211

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

Comments: As you well realize, the federal funding for R&D work has been severely curtailed, making our small technology companies extremely vulnerable to closure. I ask that you please pass SB1349 in WAM, so the technology industry may have a chance to describe their condition and need for support of this measure to stimulate technology growth in Hawaii These are refundable dollars, since the companies must first pay the tax, then claim the percentage refund. Hawaii needs to diversify our economy... Defense budgets are now under siege with no short term solution. A technology sector could assist in a balanced future economy. I will be available to comment if you so desire. Thank you for the opportunity to comment on this matter. Mahalo, Alan Hayashi

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 Statement of
Dr. Patrick K. Sullivan
Founder & Chairman
Oceanit
before the
SENATE COMMITTEE ON WAYS AND MEANS
February 26, 2013, 10:05 AM
State Capitol, Conference Room 211
In Support of
SB1349 SD1 Relating to Economic Development

To: Chair Ige, Vice Chair Kidani, and Members of the Committee
From: Dr. Patrick K. Sullivan, Founder & Chairman, Oceanit
Re: **Testimony in Support of SB1349 SD1 Relating to Economic Development**

Honorable Chair, Vice-Chair and Committee Members:

Thank you for the opportunity to submit comments in **support** of **SB1349 SD1**.

Oceanit currently employs about 160 scientists, engineers and support staff. We regularly host interns, school classes, and conduct numerous outreach activities for elementary thru college level keiki to introduce them to science and engineering careers. We let keiki know that there are exciting, decent paying jobs for them in Hawai'i if they pursue these careers. Many of them have returned to us, equipped with college degrees, wanting to work in science and engineering. It is our hope that we can continue to offer an alternative to keiki who want to work in an industry that is growing nationally as well as internationally, and to show them that world class technical work can thrive in Hawai'i.

The R&D credit has helped to jump start an industry that is in its infancy in Hawai'i. It has been responsible for job creation, as well as many long-term investments Oceanit has made that will set the stage for growth into the future. The reality is that without Hawai'i's R&D tax credit, Oceanit would not have been able to make these investments.

Because of the forward-looking nature of research, few R&D investments have short-term rewards. These bills would re-establish a temporary 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,

Dr. Patrick K. Sullivan
Founder & Chairman



From: mailinglist@capitol.hawaii.gov
To: [WAM Testimony](#)
Cc: ranoguchi@gmail.com
Subject: Submitted testimony for SB1349 on Feb 26, 2013 10:05AM
Date: Monday, February 25, 2013 10:42:54 PM

SB1349

Submitted on: 2/25/2013

Testimony for WAM on Feb 26, 2013 10:05AM in Conference Room 211

Submitted By	Organization	Testifier Position	Present at Hearing
Reid Noguchi	Individual	Support	No

Comments: The intent of the bill is sound and is synergistic with the investment currently being made in STEM for Hawaii students. Without changes to the support of high tech companies in Hawaii, we are grooming our best and brightest students to excel in other communities on the mainland. If a State goal is to diversify Hawaii's economy through building and perpetuating its high tech industry, then passage of this bill would serve as a positive indicator that the State has prioritized this objective.

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