SB 2546

Measure Title: RELATING TO TAXATION.

Report Title: High Technology Business Investment Tax Credit; Maximum Claimable

Description: Establishes a maximum aggregate dollar amount of the certified high technology business investment tax credits that may be claimed in a taxable year. Requires a taxpayer claiming the credit to provide certain information and consent to allow the information to be made public. Applies to taxable years beginning after 12/31/2017.

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To: The Honorable Glenn Wakai, Chair
and Members of the Senate Committee on Economic Development, Environment, and Technology

Date: February 5, 2016
Time: 1:15 P.M.
Place: Conference Room 414, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 2546, Relating to Taxation.

The Department of Taxation (Department) appreciates the intent, but has serious concerns regarding S.B. 2546, and offers the following comments for your consideration.

S.B. 2546 creates a new section in chapter 235, Hawaii Revised Statute (HRS), to establish an aggregate cap of $40 million during a taxable year for all unclaimed high technology business investment tax credit pursuant to section 235-110.9, HRS (high tech credit). Any claim of the high tech credit exceeding the aggregate cap for the taxable year must be disallowed; however, the Department may waive any penalty or interest attributable to the disallowed claim. S.B. 2456 applies to taxable years beginning after December 31, 2017.

S.B. 2546 also requires a taxpayer claiming the high tech credit in any taxable year to file with the Department of Business Economic Development, and Tourism (DBEDT) a written certified statement that includes the following information: (1) the qualified high technology business (QHTB) that the taxpayer invested in; (2) the investment amount and investment tax credit allocation ratio; and (3) the number of employees employed by the QHTB, including a list of the employees and the salary of each employee. Taxpayers must also submit a written consent stating that the information provided to DBEDT is available for public inspection and dissemination under chapter 92F, HRS.

The data received by DBEDT must be reported to the legislature in an aggregate format no later than twenty days prior to the convening of each regular session. DBEDT is not required to monitor or require a taxpayer to comply with the certification process, but is required to notify the Department of any non-compliance that it's aware of. The Department then must deny the taxpayer's claim for the credit and impose applicable penalty and interest upon receiving notification from DBEDT. The Department defers to DBEDT on the implementation of this new reporting requirement.

First, the Department is uncertain about the legal effect of this measure in its entirety because it adds an additional requirement to use a carryforward of a credit that has already been properly claimed. The Department defers to the Department of the Attorney General for a full analysis on this issue.

Second, the Department cannot administer the aggregate cap as set forth in S.B.2546. The Department does not have a way to track the returns, as they are being processed, in order to determine the aggregate dollar amount of any credit or credit carryforward being claimed on a return. Thus, Department would not be able to stop processing on a return if the proposed cap is reached as contemplated in this measure. The Department would only be able to determine the aggregate amount claimed after the close of the filing period.

If the Department denies the credit carryforward after the return is filed, the Department must assess the taxpayer for the additional money owed or the taxpayer must file an amended return. Both of these processes are time consuming for the Department and taxpayers. Further, the authority to waive penalties and interest provided under subsection (c) do not alleviate these administrative issues, as a waiver would only be granted after the additional tax is ultimately paid.

Third, if the Legislature wishes to implement an aggregate cap, the Department suggests that DBEDT certify the amount of credit carryforward that each taxpayer can claim as the taxpayers file the required statement. This certification process would alleviate the administrative difficulties discussed above. A similar certification process is in place for the Motion picture, digital media, and film production income tax credit provided under section 235-17, HRS.

Finally, the Department notes that the high tech credit is not only claimed by individuals and corporations. Banks and other financial corporations and insurance companies are eligible to claim the high tech credit; in the past, these entities have claimed, on average, over 30% of the total high tech credit claims. For consistency, the Department suggests that the aggregate cap is also applied to section 241-4.8, HRS (high tech credit for *banks and other financial corporations*), and section 431:7-209, HRS (high tech credit for *insurance*).

Thank you for the opportunity to provide comments.

Chamber of Commerce HAWAII
The Voice of Business

Testimony to the Senate Committee on Economic Development, Environment and Technology
Friday, February 5, 2016 at 1:15 P.M.
Conference Room 414, State Capitol

RE: SENATE BILL 2546 RELATING TO TAXATION

Chair Wakai, Vice Chair Slom, and Members of the Committee:

The Chamber of Commerce Hawaii ("The Chamber") **opposes** SB 2546, which establishes a maximum aggregate dollar amount of the certified high technology business investment tax credits that may be claimed in a taxable year. Also requires a taxpayer claiming the credit to provide certain information and consent to allow the information to be made public and applies to taxable years beginning after 12/31/2017.

The Chamber is Hawaii's leading statewide business advocacy organization, representing about 1,000 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.

The QHTB program ended several years ago. There are, however, still numerous taxpayers who have unused QHTB credits that are allowed to be carried forward under the statute. See HRS 235-110.9 ("the excess of the tax credit over liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted").

As an initial matter, the statute limits the ability to claim "unclaimed" tax credits. It is unclear, however, whether there are any "unclaimed" credits being held by any taxpayer. The QHTB statute requires any tax credit to be "claimed" within twelve months of the end of the tax year in which the credit may be claimed. Accordingly, the vocabulary being used in the statute may render it inoperative because under the statute any "unclaimed" credits are deemed waived.

From a policy standpoint the bill would dramatically alter the economics of the investors' investments and tax credits. Investors made these investments with the understanding and expectation that the credits would be allowed to be claimed. Indeed, the State of Hawaii encouraged this investment, using the QHTB tax credit (and its carry-forward qualities) as an incentive. Changing the terms of this incentive to disallow certain carry-forwards, five or ten years after the investment was made, is both unfair and potentially actionable. Significantly, such a move would also destroy investor confidence in any tax incentives that the State offers in the future.

Thank you for the opportunity to testify.

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LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Limit High Technology Tax Credit Carryover

BILL NUMBER: SB 2546

INTRODUCED BY: TOKUDA, BAKER, DELA CRUZ, ENGLISH, GALUTERIA, INOUYE, KEITH-AGARAN, KIDANI, NISHIHARA, SHIMABUKURO

EXECUTIVE SUMMARY: Imposes an aggregate cap of $40 million a year on high technology investment credits awarded under now-defunct HRS section 235-110.9 but that have not yet been claimed. The bill addresses a problem that exists to a far less degree than suspected and on balance might not be needed. If it is decided to advance the bill, the terminology in this bill has significant problems and needs to be reworked.

BRIEF SUMMARY: Adds a new section to HRS chapter 235 that provides that the Department of Taxation may allow taxpayers to claim "unclaimed certified high technology business investment tax credits" in the aggregate amount of $40 million in a taxable year. Once the aggregate amount is reached, the Department is not to allow any taxpayer to claim such credits for the balance of the year. The credits could file a claim for the credits in subsequent taxable years, and the Department may waive any penalty or interest attributable to the increase in tax because of the disallowance.

Defines "unclaimed certified high technology business investment tax credits" as credits under HRS section 235-110.9 that were certified before the credit expired but that were unclaimed as of January 1, 2016.

Requires a taxpayer to file certain information with DBEDT in order to claim an unclaimed certified high technology business investment tax credit in any taxable year. DBEDT is then to collect the information and submit a report to the legislature. DBEDT is not required to monitor or compel a taxpayer to comply with the reporting requirements, but it may notify the Department of Taxation.

EFFECTIVE DATE: Applies to taxable years beginning after December 31, 2017.

STAFF COMMENTS: This bill responds to a comment in the Legislative Auditor's Report No. 15-11, entitled "Credits Continue to Tax the State: Follow-Up on Recommendations Made in Report No. 12-05, Audit of the Department of Taxation's Administrative Oversight of High-Technology Business Investment and Research Activities Tax Credits." There, the state auditor notes that "nearly $1 billion" in high technology business investment tax credits remained unclaimed in 2012. This, of course, is a terrifying number, and prudent legislators do need to get to the bottom of it.

Page 3 of Report No. 15-11 reveals the basis for the Auditor's assertion:

According to the DoTAX 2010 report, the cumulative cost of high-technology investment tax credits from 1999 through 2010 was $857.6 million. However, from 2000 to 2009, qualified high technology businesses made $1.7 billion in cash investments. Because the high-technology tax credit is for 100 percent of taxpayers' investments, $1.7 billion represents both the total cash investments and tax credits earned by the taxpayers from 2000 to 2009. Therefore, nearly $1 billion more in DoTAX-approved tax credits had not been claimed at the time of the 2010 report's publication. The State remains obligated to honor these tax credit claims.

Under HRS section 235-110.9, when a taxpayer invests in a qualified high technology business and wants to claim the investment credit, the taxpayer needs to apply to the department for certification of the investment by March 30 of the year following the investment. A claim for the credit needs this certification. If a proper claim is not made within 12 months of the last day of the taxable year in which the investment is made, the taxpayer waives any right to claim the credit. (This is a common but unfortunate feature of almost all credits in the Hawaii income tax system.) The statute does not apply to taxable years beginning after December 31, 2010, so any claims for the credit needed to have been certified by March 30, 2011, and claimed by December 31, 2011; if not, the credits are waived and can no longer be claimed. The Department of Taxation has been relentless and efficient in disallowing late claims, and the court system has backed up the Department in some high-profile cases such as *In re Cosmo World of Hawaii, Inc.*, 97 Haw. 270, 36 P.3d 814 (Ct. App.), *cert. denied,* No. 23649 (Haw. Nov. 19, 2001). Investors who made investments but haven't claimed credits for them, which is what the auditor seems to be worried about, are, quite simply, out of luck; as such, they are no threat to the treasury.

Rather, the concern should lie in credits that have been claimed but have not been utilized. Because the credit is only usable to the extent of Hawaii tax liability (reduced by any other credits to which the taxpayer may be entitled), credits exceeding liability are generally carried over to the taxpayer's next taxable year. Under current law, which the auditor also pointed out in the report, credits that are carried over don't expire. The credits still can be used to offset tax liability until exhausted. These do constitute a drain on the treasury. In order to draw a box around the problem, then, we need to get a handle on the amount of credits that have been carried over under HRS section 235-110.9(c).

That being said, the bill as it is now drafted is technically flawed.

1. The bill defines "unclaimed certified high technology business investment tax credits" as credits under HRS section 235-110.9 that were certified before the credit expired but that were unclaimed as of January 1, 2016. There is no way for such credits to exist now. Instead, the terminology in the bill should be cleaned up so it targets credits being carried over.

2. The bill attempts to limit statewide utilization to $40 million per taxable year. However, taxpayers have different taxable years. Some end at the end of June; some end on December 31; some end on the same day of the week but on different days. In this case the calendar year probably should be used instead.

3. Finally, if the legislature is worried about the impact of these carryover credits it is probably permissible for the legislature to kill them on a date certain, maybe five years hence. Of course, legal counsel would need to be consulted, but it would seem that if the legislature giveth, it can taketh away after a reasonable time is given for investors who relied on the credits to use them.

Digested 1/31/2016

htdc
HIGH TECHNOLOGY DEVELOPMENT CORPORATION

Written Statement of
Robbie Melton
Executive Director & CEO
High Technology Development Corporation
before the
Senate Committee on Economic Development, Environment, and Technology
Friday, February 5, 2016
1:15 p.m.
State Capitol, Conference Room 414

In consideration of
SB2546
RELATING TO TAXATION.

Chair Wakai, Vice Chair Slom, and Members of the Committee on Economic Development, Environment, and Technology.

The High Technology Development Corporation (HTDC) offers **comments** on SB2546 which establishes a maximum aggregate dollar amount of the certified high technology business investment tax credits that may be claimed in a taxable year.

SB2546 requires a taxpayer claiming the credit to provide information, including a list of the employees and the salary of each employee, and consent to allow the information to be made public. HTDC suggests that the information may be collected as a list of employees by job title, whether the employee was in state or an out of state remote employee, and aggregate salary paid out to the list of employees during the taxable year to maintain some privacy for the individuals and competitiveness for the business.

Thank you for the opportunity to offer these comments.

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To: Senate Committee on Economic Development, Environment, and Technology

From: Cheryl Kakazu Park, Director

Date: February 5, 2016, 1:15 p.m.
State Capitol, Conference Room 414

Re: Testimony on S.B. No. 2546
Relating to Taxation

Thank you for the opportunity to submit testimony on this bill. The Office of Information Practices ("OIP") takes no position on the substance of this bill, which would establish a maximum aggregate yearly dollar amount for certified high technology business investment tax credits and require public disclosure of certain information about the taxpayer claiming the credit. OIP is testifying to draw the Committee's attention to the fact that the bill would require disclosure of the names **and salaries** of **all employees of a private sector business claiming the credit**.

A private sector employee's salary falls under the privacy exception and thus generally is not required to be disclosed under the Uniform Information Practices Act ("UIPA"). Even for government employees, where there is a higher public interest in knowing what public employees are paid, the UIPA requires disclosure only of salary ranges for rank-and-file employees and does not require the exact salary to be disclosed except for exempt employees. By contrast, this bill at proposed section 235-__(c)(1)(C) and (c)(2), bill page 5, lines 7-15, would require

disclosure of the salary of every employee of a business claiming the high technology business investment tax credit. The disclosure requirement is not limited to employees earning above a set threshold, or to a handful of senior employees, but instead would apply to every employee from top management to part-time workers. **If it is not this Committee's intent to require private sector businesses claiming the credit to identify and disclose the salary of every single employee, OIP would recommend that this committee amend proposed section 235-__(c)(1)(C) to limit its scope, such as restricting it to employees earning above a set amount or to a specified number of top responsible employees.**

Thank you for the opportunity to testify.