

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Small Business Research Activities Credit

BILL NUMBER: HB 2599; SB 3005 (Identical)

INTRODUCED BY: HB by SAY, BROWER, CACHOLA, EVANS, FUKUMOTO, HAR, KONG, MCDERMOTT, MIZUNO, THIELEN, TUPOLA, WARD, LoPresti; SB by KIM, INOUYE, K. KAHELE, RUDERMAN, S. Chang, Harimoto, Ihara, Riviere, L. Thielen

EXECUTIVE SUMMARY: Allows a “small business” a tax credit for increasing research activities in an amount equal to the federal credit under IRC section 41.

SYNOPSIS: Adds a new section to Chapter 235, HRS, to establish the credit.

The credit is allowed for any small business subject to Hawaii income tax that is eligible for the research credit under section 41, IRC. The credit is equal to the federal tax credit under section 41, except that qualified research expenses incurred outside Hawaii are not counted and the maximum credit allowed per year is \$25,000.

Makes sections 41 and 280C, IRC, applicable to state law for this purpose.

To qualify, a taxpayer must also apply for the federal credit.

A small business that intends to claim the credit must apply before March 31 of the year following the research activity. The department of taxation will certify the credit and issue a certificate that then can be filed with the taxpayer’s tax return.

The department may charge a fee for certifying the credit. Any fee collected will go to the tax administration special fund under section 235-20.5, HRS.

The credit is nonrefundable but may be carried forward until used.

All claims for a credit shall be filed no later than 12 months after the end of the taxable year for which the credit may be claimed. Failure to do so constitutes a waiver of the credit.

Defines “small business” the same as in section 201M-1, HRS.

Adds non-duplication provisions in the new section and in section 235-110.91, HRS.

EFFECTIVE DATE: This Act, upon its approval, shall apply to taxable years beginning after December 31, 2017.

STAFF COMMENTS: The provisions in the proposed new credit largely duplicate those in the tax credit for research activities in section 235-110.91, HRS. Key differences between the two credits include:

- The new credit has a \$25,000 per taxpayer cap, while the existing credit has no cap.

- The new credit requires that the claimant be a “small business,” which is a legal entity (or a sole proprietorship) domiciled and authorized to do business in Hawaii, is independently owned and operated, and employs fewer than 100 full- or part-time employees in Hawaii. The existing credit requires that the claimant be a “qualified high technology business,” which conducts more than 50% of its activities in qualified research, including research defined in section 41(d), IRC.
- The existing credit requires reporting by the recipient in the form of an annual survey, and it requires DBEDT to compile that information and any other information needed to assess the effectiveness of the credit and make a report by September 1st of each year. The new credit contains no such requirements.
- The existing credit sunsets on December 31, 2019. The new one has no sunset date.

Overlapping credits with nearly identical provisions seems to be a recipe for taxpayer confusion. If the concern is that the existing credit is not doing its job, why not amend it?

Digested 2/3/2018

**HB-2599**

Submitted on: 2/5/2018 6:17:45 PM

Testimony for EDB on 2/7/2018 9:30:00 AM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Melodie Aduja	OCC Legislative Priorities	Support	No

Comments:

**PRESENTATION OF THE  
OAHU COUNTY COMMITTEE ON LEGISLATIVE PRIORITIES  
DEMOCRATIC PARTY OF HAWAII  
TO THE COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS  
HOUSE OF REPRESENTATIVES  
TWENTY-NINTH LEGISLATURE  
REGULAR SESSION OF 2018  
Wednesday, February 7, 2018  
9:30 a.m.  
Hawaii State Capitol, Conference Room 309**

**RE: Testimony in Support of HB 2599, RELATING TO TAXATION**

To the Honorable Cindy Evans, Chair; the Honorable Jarrett Keohokalole, Vice-Chair and Members of the Committee on Economic Development & Business:

Good morning. My name is Melodie Aduja. I serve as Chair of the Oahu County Committee ("OCC") Legislative Priorities Committee of the Democratic Party of Hawaii. Thank you for the opportunity to provide written testimony on House Bill No. 2599, regarding a nonrefundable income tax credit for small business research and development activities within the State.

The OCC Legislative Priorities Committee is in favor of House Bill No. 2599 and support its passage.

House Bill No. 2599 is in accord with the Platform of the Democratic Party of Hawai'i ("DPH"), 2016, as it establishes a nonrefundable income tax credit for small business research and development activities within the State.

Specifically, the DPH Platform provides that "[w]e recognize that the responsible use and development of technology in all its manifestations offers immense potential for our community, government, including institutions of higher education and business sectors. We encourage synergistic research, development, commercialization and education programs to promote technological proficiency and innovation. In particular, we support Science, Technology, Engineering and Math (STEM) initiatives in our public, private and charter schools as these prepare the next generation to address the needs of our state. We also support programs that facilitate incubator, i.e., start-up, opportunities for new and promising technologies, and encourage the local retention of our intellectual resources." (Platform of the DPH, P. 3, Lines 149-156 (2016)).

Given that House Bill No. 2599 provides for a nonrefundable income tax credit for small business research and development activities within the State, it is the position of the OCC Legislative Priorities Committee to support this measure.

Thank you very much for your kind consideration.

Sincerely yours,

/s/ **Melodie Aduja**

Melodie Aduja, Chair, OCC Legislative Priorities Committee

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**STATE OF HAWAII  
DEPARTMENT OF TAXATION**

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To: The Honorable Cindy Evans, Chair  
and Members of the House Committee on Economic Development & Business

Date: Wednesday, February 7, 2018  
Time: 9:30 A.M.  
Place: Conference Room 309, State Capitol

From: Linda Chu Takayama, Director  
Department of Taxation

Re: H.B. 2599, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of H.B. 2599 and offers the following comments for your consideration. This measure establishes a nonrefundable income tax credit for small business research and development activities within the State. The measure is effective upon approval and applies to taxable years beginning after December 31, 2017.

First, the Department notes that the new credit proposed by H.B. 2599 is substantially similar to the Tax Credit for Research Activities under Hawaii Revised Statutes (HRS) section 235-110.91. The only difference appears to be that a taxpayer claiming this credit need not be a qualified high technology business as defined in HRS section 235-7.3(c). Rather than enacting an entirely new credit, the Department believes it is far more efficient to simply amend the definition of "qualified high technology business" in HRS section 235-110.91(f), as follows:

- (f) As used in this section:  
"Qualified high technology business" ~~shall have the same meaning~~ means:
- (1) The same as in section 235-7.3(c); or
  - (2) A small business as defined in section 201M-1, Hawaii Revised Statutes, provided that the amount of the credit shall not exceed \$25,000.

Second, if the intent of the measure is to eliminate the need for a small business to file a survey with the Department of Business, Economic Development, and Tourism, the Department suggests amending HRS section 235-110.91(i), as follows:

- (i) A qualified high technology business, other than a small business, that claims the credit under this section shall complete and file with the department of business,

economic development, and tourism, through that department's website, an annual survey on electronic forms prepared and prescribed by the department of business, economic development, and tourism. The annual survey shall be filed before June 30 of each calendar year following the calendar year in which the credit may be claimed under this section. The department of business, economic development, and tourism may adjust the due date of the annual survey by rules adopted pursuant to chapter 91.

Third, to prevent the credit from expiring for a small business, the Department suggests amending HRS section 235-110.91(n), as follows:

(n) For a qualified high technology business, this ~~this~~ section shall not apply to taxable years beginning after December 31, 2019.

Finally, if the Committee determines that two separate credits are preferable, the Department requests that it apply to taxable years beginning after December 31, 2018. The Department is in the process of implementing individual income tax into its new computer system and additional time will allow the Department to properly implement new tax features such as credits.

Thank you for the opportunity to testify.



Written Statement of  
**Robbie Melton**  
Executive Director & CEO  
Hawaii Technology Development Corporation  
before the  
**House Committee on Economic Development & Business**  
Wednesday, February 7, 2018  
9:30 a.m.  
State Capitol, Conference Room 309

In consideration of  
**HB2599**  
**RELATING TO TAXATION**

Chair Evans, Vice Chair Keohokalole, and Members of the Committee on Economic Development & Business.

The Hawaii Technology Development Corporation (HTDC) **offers comments on** HB2599 that establishes a nonrefundable income tax credit for small business research and development (R&D) activities within the State.

As part of HTDC's vision to create 80,000 new innovation jobs in Hawaii earning \$80,000 or more by 2030, HTDC supports initiatives aimed at growing the technology and innovation sector. HTDC is supportive of policies that extend benefits and incentives to R&D companies that are moving toward commercialization. The R&D tax credit, as one part of a comprehensive economic development policy supporting innovation, can be effective. This measure extends the R&D tax credit to companies beyond qualified high technology businesses. HTDC comments that the measure broadly incentivizes research activities in the State by small businesses. This may encourage more small businesses to participate in innovative activities, but the target audience and objectives of this program are a bit broad. HTDC also comments that HB2599 and HB2556 should be coordinated.

HTDC defers to the Department on implementation of this measure. Thank you for the opportunity to offer these comments.