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To: The Honorable Donovan M. Dela Cruz, Chair;
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair;
and Members of the Senate Committee on Ways and Means

From: Rona M. Suzuki, Director
Department of Taxation

Re: **H.B. 339, H.D. 1, Relating to Taxation**
Date: Tuesday, March 17, 2020
Time: 10:35 A.M.
Place: Conference Room 211, State Capitol

The Department of Taxation (Department) provides the following comments regarding H.B. 339, H.D. 1.

H.B. 339, H.D. 1, extends the Tax Credit for Research Activities (research credit) provided under section 235-110.91, Hawaii Revised Statutes, which was due to sunset after 2019, to an unspecified date, and increases this refundable credit from 100% of the allowed federal credit to 125% of the allowed federal credit for work done in Hawaii. H.B. 339, H.D. 1, has a defective effective date of December 31, 2112, but it would otherwise apply to taxable years beginning after December 31, 2018.

The Department notes that the research credit was amended by Act 261, Session Laws of Hawaii 2019. As such, any amendments made should be based on the current version of the research credit.

The Department defers to the Department of Business, Economic Development and Tourism regarding the economic development policy intent of this measure. However, given the recent Council on Revenues' economic projections, the Department cannot support increases to credits until the economy stabilizes.

Thank you for the opportunity to provide comments

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Written Statement of
Len Higashi
Acting Executive Director
Hawaii Technology Development Corporation
before the
Senate Committee on Ways and Means
Tuesday, March 17, 2020
10:35 a.m.
State Capitol, Conference Room 211

In consideration of
HB339, HD1
RELATING TO TAXATION.

Chair Dela Cruz, Vice Chair Keith-Agaran, and Members of the Committee.

The Hawaii Technology Development Corporation (HTDC) submits **comments** on HB339, HD1 that increases the state tax credit for research activities to one and one-quarter times the allowable federal tax credit. Repeals December 31, 2019 sunset.

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 tech and innovation jobs. A total of fourteen Qualified High Technology Businesses (QHTBs) completed the survey with the State Department of Business, Economic Development and Tourism (DBEDT) for the Hawaii research tax credit for the tax year 2018. About 75% of full-time employees in the QHTBs were paid $60,000 and more annually, of which about half were paid more than $100,000 annually. The R&D credit will bring more jobs to Hawaii as well as many long-term investments to Hawaii's economy. This bill amends Act 261 SLH2019 which re-established a refundable R&D income tax credit for qualified research activities in the State of Hawai'I beginning in 2020. HTDC believes tax credits are effective as one component of a comprehensive economic development policy.

Thank you for the opportunity to offer these comments.

SUBJECT: INCOME, Increase Tax Credit for Research Activities

BILL NUMBER: HB 339, HD-1

INTRODUCED BY: House Committee on Economic Development and Business

EXECUTIVE SUMMARY: Amends HRS section 235-110.91 to provide that the tax credit for research activities is increased to 125% of any credit calculated under section 41 of the Internal Revenue Code. At a minimum the bill needs to clarify the effect on Act 26, SLH 2019, which last year amended the same section of the HRS.

SYNOPSIS: Amends HRS section 235-110.91 to provide that the tax credit for research activities is increased to 125% of any credit calculated under section 41 of the Internal Revenue Code.

Amends the sunset date of the credit from Dec. 31, 2019 to Dec. 31, _____.

EFFECTIVE DATE: December 31, 2112.

STAFF COMMENTS: The legislature by Act 270, SLH 2013, reestablished the income tax credit for qualified research activities that expired on 12/31/10. The prior version of that law, under Act 221, SLH 2001, offered a credit for qualified research activities that was a flat percentage of qualified research expenses in Hawaii without regard to the federal base amount (the federal credit is supposed to be an incentive to increase research activities, so the federal credit is based on incremental research expenses). When Act 270 brought the credit back, it did so as an incremental credit, like the federal credit.

Act 261, SLH 2019, amended the credit by reinserting the phrase "provided that references to the base amount shall not apply and credit for all qualified research expenses may be taken without regard to the amount of expenses for previous years."

This bill is carried over from the 2019 session and does not yet reflect the amendment made by Act 261. Thus, the current bill is not in proper form and needs to be amended either to undo the changes made by Act 261 or clarify that the proposed changes in credit rate are to be made to the current version of section 235-110.91, HRS.

Substantively, over the last decade, Hawaii has adopted various tax incentives to encourage the development of high technology businesses in the state. The acts provided investment and research credits as well as income exclusions providing tax relief to high tech businesses and individuals associated with high tech businesses. 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 plow money into such activities is the fact that the credit provides a way to avoid paying state taxes.

At a minimum, lawmakers should carefully examine the results that have come out of this 20-year-old incentive to see if the State has gotten its money's worth. If it hasn't, how can an extension or increase in the credit be justified?

Digested 3/14/2020