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**STATE OF HAWAII
DEPARTMENT OF TAXATION**

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To: The Honorable Angus L.K. McKelvey, Chair
and Members of the House Committee on Economic Development & Business

Date: Wednesday, February 6, 2019
Time: 11:00 A.M.
Place: Conference Room 309, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 339, Relating to Taxation

The Department of Taxation (Department) provides the following comments regarding H.B. 339 for your consideration.

HB 339 extends the Tax Credit for Research Activities, 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.

The Department notes that the calculation of the base of the credit conforms to the Internal Revenue Code. This method allows the Department to rely on determinations or adjustments made to the federal credit by the Internal Revenue Service.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Increase Tax Credit for Research Activities

BILL NUMBER: HB 339; SB 965 (Identical)

INTRODUCED BY: HB by MCKELVEY, BELATTI, NISHIMOTO, YAMASHITA; SB by KIDANI, S. Chang, K. Kahele, Kanuha, Shimabukuro, Wakai

EXECUTIVE SUMMARY: Amends HRS section 235-110.91 to reinsert 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.”

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: Taxable years beginning after December 31, 2018.

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.

Under current law, the state credit is 100% of the federal credit, but the qualified research expenses on which the credit is based are not to include research expenses incurred outside of Hawaii. In addition, the credit must be claimed by a qualified high technology business as defined in HRS section 235-7.3(c).

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.

Re: HB 339
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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 2/1/2019



Statement of
Hermann Kugeler
Business Development Manager
Makai Ocean Engineering, Inc.
before the
House Committee on Economic Development & Business
Wednesday, February 6, 2019
11:00am
State Capitol, Conference Room 309
In consideration of
HB339
RELATING TO TAXATION.

Chair McKelvey, Vice Chair Kitagawa, and Members of the Committee

Makai Ocean Engineering, Inc. **STRONGLY SUPPORTS HB339**. The original bill was passed in 2013 as Act 270 to support research and development in Hawaii. The main purpose of this bill is to extend the sunset of Act 270 and de-couple the credit from the federal base requirement. The existing law currently only allows for the credit on the incremental increase in qualified research expenses from the previous year – significantly reducing the amount of credit local Hawaii companies can qualify for.

Makai is a locally-owned and operated technology company based in Hawai'i for over 45 years. We are currently performing R&D on a variety of exciting ocean technology projects, including autonomous underwater vehicles, ocean thermal energy conversion (OTEC) and seawater air conditioning (SWAC) systems, submarine and subsea cable systems, and a Department of Energy project to grow and harvest macroalgae offshore in Hawaiian waters to produce a renewable biofuel alternative for transportation.

Makai has been successful in bringing in tens of millions of dollars in R&D funds from federal and international sponsors to Hawai'i, helping to stem the tide of "brain drain" of talented kama'aina kids going to the mainland. Makai is not unique among Hawaii technology companies in this. There is a tech community here that has made a strong economic impact in terms of high paying jobs, and demonstrated success in commercializing federal R&D, which has increased taxable revenue for the state, and brought home kama'aina scientists and engineers.

This bill would enhance the ability of Hawaii companies like Makai to outshine mainland peers in competitive federal R&D projects, bring home R&D dollars that greatly exceed the initial investment, and create a critical mass and a truly vibrant industry of innovative R&D companies in Hawaii. It would expand and diversify Hawaii's economy, and enable our tech industry to support high-paying, highly-skilled professional jobs for our keiki here at home.



Supporting this bill supports Hawaii's R&D companies enabling them to continue spending monies on wages, materials and subcontractors IN THE STATE OF HAWAII and recognizes the importance of Hawaii's innovation industries to our economy.

Makai requests amending the bill to add 1 FTE permanent compliance specialist position in the department of taxation to assist with the certification and administration of the credit.

AMENDMENT LANGUAGE

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. Section 235-110.91, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

By amending subsection (a) to read:

"(a) Section 41 (with respect to the credit for increasing research activities) and section 280C(c) (with respect to certain expenses for which the credit for increasing research activities are allowable) of the Internal Revenue Code shall be operative for the purposes of this chapter as provided in this section; provided that the federal tax provisions in section 41 of the Internal Revenue Code, as that section was enacted on December 31, 2011, irrespective of any subsequent changes to section 41 of the Internal Revenue Code, shall remain in effect for purposes of determining the state income tax credit under this section; provided further that the federal tax provisions in section 41 of the Internal Revenue Code, as enacted on December 31, 2011, irrespective of any subsequent amendments to section 41 of the Internal Revenue Code, shall apply only to

expenses incurred for qualified research activities after December 31, 2012 [--]; provided further that, for tax years beginning after December 31, 2018, there shall be allowed a Hawaii state income tax credit of one and one-quarter times any credit as calculated under the federal tax provisions in section 41 of the Internal Revenue Code as enacted on December 31, 2011."

(n) This section shall not apply to taxable years beginning after December 31, 2022."

SECTION 2. There is appropriated out of the general revenues of the State of Hawaii the sum of \$ _____ or so much thereof as may be necessary for fiscal year 2019-2020 and the same sum or so much thereof as may be necessary for fiscal year 2020-2021 for the establishment of one full-time equivalent (1.00 FTE) permanent compliance specialist position in the department of taxation to assist with the certification and administration requirements of the tax credit for research activities under section 235-110.91, Hawaii Revised Statutes.

The sums appropriated shall be expended by the department of taxation for the purposes of this Act.

SECTION 3. New statutory material is underscored.

SECTION 4. This Act shall take effect on July 1, 2019, and shall apply to taxable years beginning after December 31, 2019.



LATE

Written Statement of
Len Higashi
Acting Executive Director
Hawaii Technology Development Corporation
before the
House Committee on Economic Development and Business
Friday, February 6, 2019
11:00 a.m.
State Capitol, Conference Room 309

In consideration of
HB339
RELATING TO TAXATION.

Chair McKelvey, Vice Chair Kitagawa, and Members of the Committee.

The Hawaii Technology Development Corporation (HTDC) submits **comments** on HB339 that Increases the state tax credit for research activities to one and one-quarter times the allowable federal tax credit and amends qualifying tax years.

HTDC does not take a position on the bill. In discussions with representatives from DOTAX and DBEDT – READ, it was pointed out that although the current statute requires the company to complete the DBEDT survey, it does not have a mechanism to ensure the survey is completed. Thus, not all companies are completing the survey. Also, the DBEDT survey deadline is currently set at June 30, while companies that file extensions submit their returns on October 20. We suggest that the deadline for filing DBEDT survey be removed so companies can file the DBEDT survey year-round. We suggest that these gaps be addressed if the credits are continued.

From HRS 235-11.91

“(i) A qualified high technology 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.”

Thank you for the opportunity to offer these comments.

HB-339

Submitted on: 2/4/2019 10:12:57 AM

Testimony for EDB on 2/6/2019 11:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Ann Chung	Individual	Support	Yes

Comments:

I strongly SUPPORT HB339. The original bill was passed in 2013 as Act 270 to support research and development in Hawaii. The main purpose of this bill is to extend the sunset of Act 270 and de-couple the credit from the federal base requirement. The existing law currently only allows for the credit on the incremental increase in qualified research expenses from the previous year – significantly reducing the amount of credit local Hawaii companies can qualify for. Supporting this bill supports Hawaii’s R&D companies enabling them to continue spending monies on wages, materials and subcontractors IN THE STATE OF HAWAII and recognizes the importance of Hawaii’s innovation industries to our economy.

I request amending the bill to add 1 FTE permanent compliance specialist position in the department of taxation to assist with the certification and administration of the credit.

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SECTION 1. Section 235-110.91, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) Section 41 (with respect to the credit for increasing research activities) and section 280C(c) (with respect to certain expenses for which the credit for increasing research activities are allowable) of the Internal Revenue Code shall be operative for the purposes of this chapter as provided in this section; provided that references to the base amount in section 41 of the Internal Revenue Code shall not apply and credit for all qualified research expenses may be taken without regard to the amount of expenses for previous years; provided further that the federal tax provisions in section 41 of the Internal Revenue Code, as that section was enacted on December 31, 2011, irrespective of any subsequent changes to section 41 of the Internal Revenue Code,

shall remain in effect for purposes of determining the state income tax credit under this section; provided further that the federal tax provisions in section 41 of the Internal Revenue Code, as enacted on December 31, 2011, irrespective of any subsequent amendments to section 41 of the Internal Revenue Code, shall apply only to expenses incurred for qualified research activities after December 31, 2019.

(n) This section shall not apply to taxable years beginning after December 31, 2022."

SECTION 2. There is appropriated out of the general revenues of the State of Hawaii the sum of \$ or so much thereof as may be necessary for fiscal year 2019-2020 and the same sum or so much thereof as may be necessary for fiscal year 2020-2021 for the establishment of one full-time equivalent (1.00 FTE) permanent compliance specialist position in the department of taxation to assist with the certification and administration requirements of the tax credit for research activities under section 235-110.91, Hawaii Revised Statutes.

The sums appropriated shall be expended by the department of taxation for the purposes of this Act.

SECTION 3. New statutory material is underscored.

SECTION 4. This Act shall take effect on July 1, 2019, and shall apply to taxable years beginning after December 31, 2019.



MAUI
CHAMBER OF COMMERCE
VOICE OF BUSINESS

LATE

**HEARING BEFORE THE HOUSE COMMITTEE ON
ECONOMIC DEVELOPMENT & BUSINESS
HAWAII STATE CAPITOL, HOUSE CONFERENCE ROOM 309
WEDNESDAY, FEBRUARY 6, 2019 AT 11:00 A.M.**

To The Honorable Angus L.K. McKelvey, Chair;
The Honorable Lisa Kitagawa, Vice Chair; and
Members of the Committee on Economic Development & Business,

TESTIMONY IN SUPPORT OF HB 339 RELATING TO TAXATION

Aloha, my name is Pamela Tumpap and I am the President of the Maui Chamber of Commerce with approximately 650 members. I am writing share our support of HB 339.

The Maui Chamber of Commerce supports tax credits to spur industry growth and supports economic diversity and industry development, so we support this bill to increase the state tax credit for research activities.

While we support this bill, we also understand that with any benefits offered to attract an industry to Hawaii, the goal is to have those organizations remain and continue to build and create jobs in Hawaii, not just use the incentive and leave. Therefore, we would also encourage revisions to this bill to have these organizations remain in the state for a certain time period in order to use these credits. This would increase the likelihood that we will increase the return on our investment.

Mahalo for your consideration of our testimony and we hope you will move this bill forward.

Sincerely,

Pamela Tumpap

Pamela Tumpap
President

To advance and promote a healthy economic environment for business, advocating for a responsive government and quality education, while preserving Maui's unique community characteristics.