

DAVID Y. IGE  
GOVERNOR

JOSH GREEN M.D.  
LT. GOVERNOR



ISAAC W. CHOY  
DIRECTOR OF TAXATION

STATE OF HAWAII  
**DEPARTMENT OF TAXATION**  
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To: The Honorable Sean Quinlan, Chair;  
The Honorable Daniel Holt, Vice Chair;  
and Members of the House Committee on Economic Development

From: Isaac W. Choy, Director  
Department of Taxation

Date: Wednesday, February 9, 2022  
Time: 10:00 A.M.  
Place: Via Video Conference, State Capitol

**Re: H.B. 2226, Relating to the Tax Credit for Research Activities**

The Department of Taxation (Department) offers the following comments regarding H.B. 2226 for your consideration.

H.B. 2226 adds a cap of \$2,500,000 that an eligible taxpayer and the taxpayer's related entities may receive per taxable year; consolidates the survey and certification requirements; increases the annual aggregate cap from \$5 million to \$15 million; and requires certification on a first-come, first-served basis to be based on the date a complete application is received. The measure is effective upon approval and applies to taxable years beginning after December 31, 2021

First, the Department notes that the measure limits a taxpayer, together with all of its related entities including subsidiaries or business entities with common ownership structures, to no more than \$2,500,000 in credit per taxable year but fails to define what a "related entity" is or what constitutes "common ownership." Although there are several different definitions that could apply, the Department suggests defining against a known reference as follows:

Each taxpayer, together with all of its related entities (as determined under Internal Revenue Code section 267(b)) and all business entities under common control (as determined under Internal Revenue Code sections 414(b), 414(c), and 1563(a)), shall not be eligible for more than \$2,500,000 in tax credits provided by this section per taxable year.

The Department also notes that the measure changes the time for certification from before March 31 after the end of the calendar year in which research was conducted, to before the last day of the third month following the close of the taxable year in which research was conducted. Because some taxpayers are on fiscal year filers, with the end of the tax year varying, this change could result in some taxpayers having a substantial advantage or disadvantage in obtaining the credit, depending on when their fiscal year ends. The Department suggests deleting this amendment.

Finally, the Department suggests clarification of the certification provision contained on page 7, lines 17-21. This provision requires proration if the \$15 million aggregate cap is not reached in the first 24 hours from when applications are accepted. The Department interprets this to mean that all applicants from day 2 to the last day would be receiving a prorate share. In lieu of this, the Department suggests simplifying the certification provision as follows:

To comply with this restriction, the department of business, economic development, and tourism shall certify credits on a [~~first come, first served~~] first-come, first-served basis[.], which is determined based on the date that a complete application is received by the department of business, economic development, and tourism. Complete applications received on the same date shall be certified on a pro rata basis.

This certification provision will result in a fair and predictable application and certification process.

Thank you for the opportunity to provide testimony on this measure.

DAVID Y. IGE  
GOVERNOR



CRAIG K. HIRAI  
DIRECTOR

GLORIA CHANG  
DEPUTY DIRECTOR

STATE OF HAWAII  
DEPARTMENT OF BUDGET AND FINANCE  
P.O. BOX 150  
HONOLULU, HAWAII 96810-0150

EMPLOYEES' RETIREMENT SYSTEM  
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND  
OFFICE OF THE PUBLIC DEFENDER

ADMINISTRATIVE AND RESEARCH OFFICE  
BUDGET, PROGRAM PLANNING AND  
MANAGEMENT DIVISION  
FINANCIAL ADMINISTRATION DIVISION  
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

**LATE**

**WRITTEN ONLY**  
TESTIMONY BY CRAIG K. HIRAI  
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE  
TO THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT  
ON  
HOUSE BILL NO. 2226

**February 9, 2022**  
**10:00 a.m.**  
**Room 312 and Videoconference**

RELATING TO THE TAX CREDIT FOR RESEARCH ACTIVITIES

The Department of Budget and Finance (B&F) offers comments on this bill.

House Bill No. 2226 amends Section 235-110.91, HRS, to: cap the amount each eligible taxpayer and the taxpayer's related entities may receive for the Tax Credit for Research Activities at \$2,500,000 per taxable year; consolidate the survey and certification requirements necessary to receive the tax credit into one section; increase the annual aggregate cap from \$5,000,000 to \$15,000,000; and require the Department of Business, Economic Development and Tourism to certify credits on a first-come, first-served basis, which would be determined based on the date and time a complete application is received by the department.

B&F notes that the federal American Rescue Plan (ARP) Act restricts states from using ARP Coronavirus State Fiscal Recovery Funds (CSFRF) to directly or indirectly offset a reduction in net tax revenue resulting from a change in law, regulation, or administrative interpretation beginning on March 3, 2021, through the last day of the fiscal year in which the CSFRF have been spent. If a state cuts taxes during this

period, it must demonstrate how it paid for the tax cuts from sources other than the CSFRF, such as:

- By enacting policies to raise other sources of revenue;
- By cutting spending; or
- Through higher revenue due to economic growth.

If the CSFRF provided have been used to offset tax cuts, the amount used for this purpose must be repaid to the U.S. Treasury.

The U.S. Department of Treasury has issued rules governing how this restriction is to be administered. B&F will be working with the money committees of the Legislature to ensure that the State of Hawai'i complies with this ARP restriction.

Thank you for your consideration of our comments.



Written Statement of  
**DR. PATRICK K. SULLIVAN**  
**PRESIDENT/CEO OCEANIT**

Before the  
**HOUSE ON ECONOMIC DEVELOPMENT**

Wednesday, February 9, 2022  
10:00 a.m.  
State Capitol, Conference Room 312 & Videoconference

In Support of  
**HB2226 RELATING TO TAX CREDIT FOR RESEARCH ACTIVITIES**

To: Chair Representative Sean Quinlan and Vice Chair Representative Daniel Holt and Members of the Committee

From: Dr. Patrick K. Sullivan, President/CEO

Re: Testimony in Support of HB2226

Honorable Chair, Vice-Chair and Committee Members:

Thank you for the opportunity to submit testimony in **Support of HB2226**

Oceanit is a local diversified science and engineering company with capabilities/facilities in advanced technology, artificial intelligence, quantum, life sciences, information systems, aerospace, energy, oil and gas, and consulting engineering services.

Through various federal funding sources we have demonstrated the ability to develop “disruptive technologies” that are changing the way we live and work in the world. However, the ability to take disruptive technologies to the next level or to commercialize has been a challenge. Federal R&D funding is restricted to research and development activities, i.e., no marketing or commercialization activities allowed. And only a small percentage of tech businesses are venture-fundable. To diversify Hawaii’s economy and the help Hawaii’s economic recovery, the State needs to support Hawaii technology companies who are stuck in the “ditch” between research and product realization.

Previous support of Hawaii’s Dual Use technologies, has created several new high tech startups in Hawaii, as well as product development efforts which have brought funding and people to Hawaii. This bill will create a task force to explore potential dual use technology research and development efforts to create high income jobs opportunities for Hawaii’s residents and graduates of Hawaii’s educational institutions. In return, the State will benefit from tax revenues, job creation and economic growth.

This bill will increase the aggregate cap so that more technology companies will be able to apply for the tax credit. In addition, it gives the state some added protections by requiring a written declaration signed by an Officer of the company certifying that the information is true and correct that they are qualified high technology business and will be subject to monetary and imprisonment if the information in the application is false.

**Therefore, Oceanit is in strong support of HB2226.**



Statement of  
Isar Mostafanezhad, Ph.D.  
Founder and CEO  
**Nalu Scientific, LLC**  
before the  
**House Committee on Economic Development**

Wednesday, February 9, 2022 at 10:00 AM

In consideration of  
**HB2226 — RELATING TO THE TAX CREDIT FOR RESEARCH PURPOSES**

Chair Rep. Sean Quinlan; Vice Chair Rep. Daniel Holt; and members of the Committee on Economic Development:

Nalu Scientific, LLC **supports** HB2226 that (1.) increases the aggregate cap from \$5M to \$15M, (2.) provides that taxpayers and related entities may not be eligible for more than \$2.5M in tax credits per taxable year, (3.) provides a pro-rata share for certified companies who complete the application within the first 24 hours, and (4.) requires a written declaration certifying that submitted information is true and correct.

Hawaii is fortunate to be in a position where demand for a program like this is very high, with past opportunities being snapped up within seconds. The increased aggregate cap and the 24 hour window will ensure a greater diversity of companies will be able to participate.

I founded Nalu Scientific in 2016, and since then, we have earned multiple large-scale federal grants totalling more than \$10 million. Nalu Scientific was named Hawaii's Most Innovative Company in 2019 by both the U.S. Small Business Administration (SBA) and Hawaii Business Magazine.

Our company employs many UH graduates and former Hawaii residents who were able to return home to the islands and apply their specialized skills. Research tax credits have been a key reason why we have been able to provide these opportunities and to support Hawaii's innovation community.

Thank you for the opportunity to offer these comments.



Written Statement of  
**Len Higashi**  
Acting Executive Director  
Hawaii Technology Development Corporation  
before the  
**HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT**

Wednesday, February 9, 2022  
10:00 a.m.  
Videoconference

In consideration of  
**HB2226**  
**RELATING TO TAX CREDIT FOR RESEARCH ACTIVITIES**

Chair Quinlan, Vice Chair Holt and Members of the Committee

The Hawai'i Technology Development Corporation (HTDC) **supports with requested amendment** HB2226 that adds a cap for an eligible taxpayer and the taxpayer's related entities per taxable year; consolidates the survey and certification requirements; amends the annual aggregate cap; and requires certification on a first-come, first-served basis to be based on the date a complete application is received, subject to certain conditions, for the tax credit for research activities.

HTDC supports initiatives aimed at growing tech and innovation jobs. Last year, HTDC assisted DBEDT with the online applications for the certification. A total of forty-two QHTBs applied for the Hawaii tax credit for research activities for the tax year 2020 by submitting an executed Form N-346A. Forty completed the application by submitting the required DBEDT survey. DBEDT issued certificates to ten QHTBs, for the total of \$5 million credit certified, based on first-come first-served rule verifying the information submitted. The Report on Hawaii Tax Credit for Research Activities for Tax Year 2020 can be found at:

[https://files.hawaii.gov/dbedt/economic/data\\_reports/HawaiiResearchTaxCredit\\_TaxYear2020.pdf](https://files.hawaii.gov/dbedt/economic/data_reports/HawaiiResearchTaxCredit_TaxYear2020.pdf)

Last year the entire \$5 million cap was claimed in the first 3 minutes after the applications opened. Increasing the annual aggregate cap allows more companies to participate. Adding a cap per taxpaying entity further ensures that the credit is available for multiple companies. Collecting the survey information at the same time the certification is applied for ensures that all surveys will be completed and an accurate report can be generated.

HTDC supports this bill and requests the following amendment on page 7, line 14, which would allow **all** qualified applicants who claim the credit on the first day to participate on an equal basis regardless of whether the claims exceed the cap, and make subsequent awards on a first-come first-served basis:

first-come, first-served basis[.], which is determined based on the date ~~and time~~ a complete application is received by the department of business, economic development, and tourism. If all \$15,000,000 is not expended within the first twenty-four hours that the applications are made available, the department of business, economic development, and tourism shall certify any remaining credits after that date to companies on a pro rata first-come, first-served basis.

HTDC defers to the Department regarding the fiscal and administrative impacts of this measure. Thank you for the opportunity to offer these comments.



# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Additional Requirements for Tax Credit for Research Activities

BILL NUMBER: SB 2599, HB 2226

INTRODUCED BY: SB by KEOHOKALOOLE, CHANG, KEITH-AGARAN, MISALUCHA, Baker, Fevella, Ihara, San Buenaventura, Shimabukuro, Wakai; HB by QUINLAN, BRANCO, CLARK, GATES, HASHIMOTO, HOLT, ILAGAN, LUKE, MCKELVEY, OKIMOTO, TAKAYAMA, TODD

EXECUTIVE SUMMARY: Adds a cap for an eligible taxpayer and the taxpayer's related entities per taxable year; consolidates the survey and certification requirements; amends the annual aggregate cap; and requires certification on a first-come, first-served basis to be based on the date a complete application is received, subject to certain conditions, for the tax credit for research activities. We have technical comments.

SYNOPSIS: Amends section 235-110.91(c), HRS, to provide that each taxpayer, together with all of its related entities including subsidiaries or business entities with common ownership structures, shall not be eligible for more than \$2,500,000 in tax credits per taxable year.

Amends section 235-110.9(d), HRS, to require, as a condition of claiming the credit, a credit applicant to submit the following to DBEDT on or before the end of the third month following the end of the taxable year: (1) Qualified expenditures, if any, expended in the previous taxable year; (2) The amount of tax credits claimed pursuant to this section, if any, in the previous taxable year; (3) The industry sector or sectors in which the qualified high technology business conducts business, as set forth in paragraphs (2) to (8) of the definition of "qualified research" in section 235-7.3(c), HRS; (4) Revenue and expense data, including a breakdown of any licensing royalty or other forms of income generated from intellectual property; (5) Hawaii employment and wage data, including the numbers of full-time and part-time employees retained, new jobs, temporary positions, external services procured by the business, and payroll taxes; (6) The number of filed intellectual property, including invention disclosures, provisional patents, and patents issued or granted; (7) The number of new companies spun out or established in Hawaii to commercialize the intellectual property owned by the qualified high technology business; and (8) A written declaration signed by an officer of the qualified high technology business certifying that the information that is submitted is true and correct as to every material matter, which certification shall be subject to the penalties provided in section 231-36, HRS, including monetary fines or imprisonment.

DBEDT may request any additional information necessary to measure the effectiveness of the tax credit, such as additional information related to patents.

Amends section 235-110.91(f), HRS, to limit the amount of certified credits to \$15 million per calendar year. DBEDT shall certify credits on a first-come, first-served basis determined based

on the date and time a complete application is received. If all \$15,000,000 is not expended within the first twenty-four hours that the applications are made available, DBEDT shall certify any remaining credits after that date to companies on a pro rata basis.

Removes the requirement of an annual survey contained in current subsections (i) and (j) of section 235-110.91, HRS.

EFFECTIVE DATE: Applies to taxable years beginning after December 31, 2021.

STAFF COMMENTS: As a technical matter, we observe that the term “business entities with common ownership structures” is vague, and we recommend that it be specifically defined, perhaps by reference to sections 267, 1504, or 1563 of the Internal Revenue Code or section 237-23.5(a) of the General Excise Tax Law.

We also find confusing the provisions surrounding allocation of the \$15 million statewide credit cap. Perhaps DBEDT could comment on whether it finds those provisions administrable.

Digested: 1/29/2022