

DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR



ISAAC W. CHOY
DIRECTOR OF TAXATION

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

To: The Honorable Sylvia Luke, Chair;
The Honorable Kyle T. Yamashita, Vice Chair;
and Members of the House Committee on Finance

From: Isaac W. Choy, Director
Department of Taxation

Date: Monday, April 4, 2022
Time: 1:30 P.M.
Place: Via Video Conference, State Capitol

Re: S.B. 2599, S.D.1, H.D. 1, Relating to the Tax Credit for Research Activities

The Department of Taxation (Department) offers the following comments regarding SB. 2599, S.D. 1, H.D. 1 for your consideration.

S.B. 2599, S.D.1, H.D. 1, amends the income tax credit for research activities by: adding a \$2.5 million cap that an eligible taxpayer and the taxpayer's related entities may receive per taxable year; consolidates the survey and certification requirements; increasing the annual aggregate cap from \$5 million to \$15 million; and requiring certification on a first-come, first-served basis to be based on the date a complete application is received. The measure has a defective effective date of October 18, 2050 but is otherwise applicable to taxable years beginning after December 31, 2021.

The Department notes that the taxpayer submission deadline in subsection (d) may be read to conflict with subsection (f). Subsection (f) refers to the aggregate cap and certifications in terms of a calendar year. As such, subsection (d) should also be set in terms of a calendar year so that no taxpayer has an advantage based on their specific tax year end date. The Department strongly suggests that the term "taxable year" on page 3, line 12, be replaced with "calendar year." Furthermore, in the event that the total applications exceed the aggregate cap, by requiring all taxpayers to submit applications at the same time, all taxpayers who submit applications on the same day will receive a prorated share of the credit.

In addition, to prevent the credit from being claimed on research that has been funded by tax-exempt receipts such as a grant, the Department suggests that subsection (b) be amended to read as follows:

(b) All references to Internal Revenue Code sections within sections 41 and 280C(c) of the Internal Revenue Code

shall be operative for purposes of 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. In determining the allowable credit, research funded by any grant, forgivable loan, or other amounts not included in gross income for purposes of this chapter shall not be eligible research.

Thank you for the opportunity to testify on this measure.



DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

DAVID Y. IGE
GOVERNOR

MIKE MCCARTNEY
DIRECTOR

CHUNG I. CHANG
DEPUTY DIRECTOR

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Web site: dbedt.hawaii.gov

Telephone: (808) 586-2355
Fax: (808) 586-2377

Statement of
MIKE MCCARTNEY
Director

Department of Business, Economic Development, and Tourism
before the
HOUSE COMMITTEE ON FINANCE

Monday, April 4, 2022
1:30 PM

State Capitol Conference Room 308 and Videoconference

In consideration of
SB2599, SD1, HD1
RELATING TO TAX CREDIT FOR RESEARCH ACTIVITIES.

Chair Luke, Vice Chair Yamashita and Members of the Committee.

The Department of Business Economic Development and Tourism (DBEDT) **supports** SB2599, SD1, HD1 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.

SB2599, SD1, HD1, requires distribution credits on a first-come, first-served basis which shall be determined based on the date that a complete application is received, and complete applications received on the same date shall be certified on a pro rata basis. DBEDT believes this change is an improvement over the current statute.

We support this measure provided that its passage does not replace or adversely impact priorities indicated in our Executive Budget.

Thank you for the opportunity to testify.



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

Monday April 4, 2022
1:30 p.m.
Conference Room 308 and Videoconference

In consideration of
SB2599, SD1, HD1
RELATING TO TAX CREDIT FOR RESEARCH ACTIVITIES

Chair Luke, Vice Chair Yamashita and Members of the Committee

The Hawai'i Technology Development Corporation (HTDC) **supports** SB2599, SD1, HD1 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

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 defers to the department regarding the fiscal and administrative impacts of this measure.

HTDC supports this bill as it improves our primary concern that the uncertainty involved with claiming the credit currently negates the incentive to growing the industry. We support this request provided it does not supplant the Governor's priorities in the Administrative budget. Thank you for the opportunity to offer these comments.

DAVID Y. IGE
GOVERNOR



CRAIG K. HIRAI
DIRECTOR

GLORIA CHANG
DEPUTY DIRECTOR

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

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

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

WRITTEN ONLY
TESTIMONY BY CRAIG K. HIRAI
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE HOUSE COMMITTEE ON FINANCE
ON
SENATE BILL NO. 2599, S.D. 1, H.D. 1

April 4, 2022
1:30 p.m.
Room 308 and Videoconference

RELATING TO THE TAX CREDIT FOR RESEARCH ACTIVITIES

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

Senate Bill No. 2599, S.D. 1, H.D. 1, 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 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.



Statement of
Hermann Kugeler
Vice President of Business Development
Makai Ocean Engineering, Inc.

before the
House Committee on Finance
Monday, April 4, 2022
1:30 pm
Videoconference
State Capitol, Conference Room 308
In consideration of
SB2599

RELATING TO THE TAX CREDIT FOR RESEARCH ACTIVITIES.

Chair Luke, Vice Chair Yamashita, and Members of the Committee

Makai Ocean Engineering, Inc. **STRONGLY SUPPORTS SB2599**. We respectfully request your consideration to extend the sunset date to 2029. The credit currently sunsets in 2024.

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 R&D, which has increased taxable revenue for the state, and brought home kama'aina scientists and engineers.

This bill allows 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 helps 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.

This is why we **STRONGLY SUPPORT SB2599**, with the request to extend the sunset date of this bill by 5 years, which 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.



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

Before the
HOUSE COMMITTEE FINANCE

Monday, April 4, 2022
1:30 p.m.
State Capitol, Conference Room 308 & Videoconference

In Support of
SB2599 RELATING TO TAX CREDIT FOR RESEARCH ACTIVITIES

To: Chair Representative Sylvia Luke and Vice Chair Representative Kyle Yamashita and Members of the Committee

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

Re: Testimony in Support of SB2599

Honorable Chair, Vice-Chair and Committee Members:

Thank you for the opportunity to submit testimony in **Support of SB2599.**

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 SB2599.

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 HD 1

INTRODUCED BY: House Committee on Economic Development

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.

SYNOPSIS: Amends section 235-110.91(c), HRS, to provide that each taxpayer, together with all of the taxpayer's related entities, as determined under section 267(b) of the Internal Revenue Code, and all business entities under common control, as determined under sections 414(b), 414(c), and 1563(a) of the Internal Revenue Code, shall not be eligible for more than \$2,500,000 in tax credits provided by this section 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 by DBEDT. Complete applications received on the same date shall be certified 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: October 18, 2050; provided that this Act, upon its approval, shall apply to taxable years beginning after December 31, 2021.

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.”

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: 4/1/2022



LATE *Testimony submitted late may not be considered by the Committee for decision making purposes.

NALU SCIENTIFIC
ENABLING INNOVATION

2800 Woodlawn Drive Suite 240
Honolulu, HI 96822 USA
info@naluscientific.com
(808) 913 - 1599

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

Monday, February 4, 2022
1:30 PM
State Capitol, Conference Room 308 & Videoconference

In consideration of
SB2599
RELATING TO THE TAX CREDIT FOR RESEARCH PURPOSES

Dear Rep. Sylvia Luke, Chair; Rep. Kyle T. Yamashita, Vice Chair; and members of the House Committee on Finance:

Nalu Scientific, LLC **supports** SB2599, which increases the aggregate cap for the research tax credit from \$5 million to \$15 million, plus implements other measures to ensure the tax credit is available to a wider variety of companies.

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

Nalu Scientific designs and builds high-end, high-performance sensors and systems. 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.

SB-2599-HD-1

Submitted on: 4/1/2022 2:46:03 PM

Testimony for FIN on 4/4/2022 1:30:00 PM

Submitted By	Organization	Testifier Position	Testify
Ann Chung	Individual	Support	Written Testimony Only

Comments:

Aloha Chair and Committee members:

I support SB2599 and humbly request your consideration of an amendment to extend the sunset of the R&D Tax Credit for another 5 years as the current sunset date is 2024.

Mahalo for your consideration.

RYAN KAWAILANI OZAWA

P.O. Box 892727

Mililani, HI 96789-8332

Main: (808) 707-3027

Fax: (808) 427-9227



@hawaii 

Email: hawaii@hey.com

April 1, 2022

Aloha, Rep. Sylvia Luke, Chair Rep. Kyle T. Yamashita, Vice Chair; and members of the Committee on Finance:

I am writing to express my **support** of SB2599, SD1, HD1, relating to the tax credit for research activities. The proposed changes will vastly expand the breadth and depth of research projects that can be based in Hawaii and support a more diversified island economy.

Mahalo for your consideration.



Ryan Kawailani Ozawa