

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 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: Isaac W. Choy, Director
Department of Taxation

Date: Wednesday, February 2, 2022
Time: 10:00 A.M.
Place: Via Video Conference, State Capitol

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

The Department of Taxation (Department) offers the following comments regarding SB. 2599 for your consideration.

S.B. 2599 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 comments.



Written Statement of
Len Higashi
Acting Executive Director
Hawaii Technology Development Corporation
before the
SENATE COMMITTEE ON WAYS AND MEANS

Wednesday, February 2, 2022
10:00 a.m.
Videoconference

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

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

The Hawai'i Technology Development Corporation (HTDC) **supports with comments** SB2599 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. However, HTDC **prefers the Administration's bill SB 3051** as it allows **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.

Thank you for the opportunity to offer these comments.



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
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Statement of
MIKE MCCARTNEY
Director

Department of Business, Economic Development, and Tourism
before the
SENATE COMMITTEE ON WAYS AND MEANS

Wednesday, February 2, 2022
10:00 a.m.
Videoconference

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

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

The Department of Business Economic Development and Tourism (DBEDT) offers **comments** on SB2599 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 requires distributing credits on a first-come first-served timestamp basis and then on a pro-rata basis. This would be administratively burdensome as it could be interpreted to allow applicants to submit beyond the application period.

DBEDT prefers the Administration's bill SB 3051 as it allows 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. Pro-rata on the first day and then first-come first-served would be more equitable and intuitive.

Thank you for the opportunity to testify.

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)

WRITTEN ONLY
TESTIMONY BY CRAIG K. HIRAI
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON
SENATE BILL NO. 2599

February 2, 2022
10:00 a.m.
Room 211 & 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 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.

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

INTRODUCED BY: KEOHOKALOLE, CHANG, KEITH-AGARAN, MISALUCHA, Baker, Fevella, Ihara, San Buenaventura, Shimabukuro, Wakai

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

THE SENATE
THE THIRTY-FIRST LEGISLATURE SESSION OF 2022

**TESTIMONY ON SENATE BILL NO. 2599, RELATING TO THE HAWAII TECHNOLOGY
DEVELOPMENT CORPORATION**

Position: **Support**

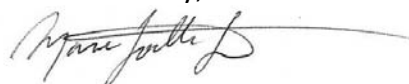
To the Honorable Senator Donovan M. Dela Cruz, Chair, and the Honorable Senator Gilbert S.C. Keith-Agaran, Vice Chair; and Members of the Committee:

Our company is an Oahu-based small business developing new ways to recycle waste generated in Hawaii into sustainable aviation fuel, green hydrogen, and other beneficial products such as new building materials. In order to be able to convert solid waste into fuel intermediates and liquid fuels compatible with commercial fuel refining catalysts such as those use at the petroleum refinery in Hawaii, we had to invent, and are starting to test, a new process. Our new process is now patent pending. To execute this research we have hired several new employees, all local Hawaii residents, to include paid technical internships for several University of Hawaii undergraduate students. We are working on developing and installing our new manufacturing process in a demonstration plant here in Hawaii. However, because the state R&D tax credit program has been oversubscribed, we have not yet been able to receive the tax credit and use those funds to accelerate and advance our research and increase the hours of our employees.

We offer this testimony in **support** of this bill, and add the following comments:

1. Extend the sunset date for the R&D tax credit beyond 2 years, i.e. amend subsection n: “[~~(n)~~] (l) This section shall not apply to taxable years beginning after December 31, 202430.”
2. Consider adding a mechanism for independent validation that the taxpayer did indeed engage in bona fide research, such as a requirement that to be a “qualified high technology business,” the taxpayer must have won at least one federal research contract or grant within the past three tax years,” i.e. add to the list in subsection (d):
(8) A federal research and development contract number for at least one U.S. federal grant or contract for research and development issued within the past three tax years.
(89) 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; provided that the certification shall be subject to the penalties provided in section 231-36, including monetary fines or imprisonment.

Sincerely,



Marie-Joelle Simonpietri
President



LATE

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

Wednesday, February 2, 2022
10:00 AM
State Capitol, Conference Room 211 & Videoconference

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

Chair Senator Donovan M. Dela Cruz, Vice Chair Senator Gilbert S.C. Keith-Agaran, and members of the Committee on Ways and Means:

Nalu Scientific, LLC **supports** SB2599 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.

I founded Nalu Scientific in 2016. Nalu Scientific has 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.

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.



LATE

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

Before the
SENATE COMMITTEE ON WAYS AND MEANS

Wednesday, February 2, 2022
10:00 a.m.
State Capitol, Conference Room 211 & Videoconference

In Support of
SB2599 RELATING TO TAX CREDIT FOR RESEARCH ACTIVITIES

To: Chair Senator Donovan M. Dela Cruz and Vice Chair Senator Gilbert S.C. Keith-Agaran 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.

RYAN KAWAILANI OZAWA

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January 27, 2022

Aloha e Senator Donovan M. Dela Cruz, Chair; Senator Gilbert S.C. Keith-
Agaran, Vice Chair; and members of the Committee on Ways and Means:

I am writing to express my **support** of SB2599, relating to the tax credit for
research activities. Increasing the aggregate credit cap from \$5 million to \$15
million 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 Kawaiiani Ozawa