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STATE OF HAWAII
DEPARTMENT OF TAXATION

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**TESTIMONY OF
GARY S. SUGANUMA, DIRECTOR OF TAXATION**

TESTIMONY ON THE FOLLOWING MEASURE:

H.B. No. 990, Relating to Tax Credit for Research Activities

BEFORE THE:

House Committee on Economic Development

DATE: Wednesday, February 8, 2023

TIME: 10:15 a.m.

LOCATION: State Capitol, Room 423

Chair Holt, Vice-Chair Lamosao, and Members of the Committee:

The Department of Taxation ("Department") supports H.B. 990, an Administration measure, and offers the following comments for your consideration.

H.B. 990 amends section 235-110.91, Hawaii Revised Statutes (HRS), relating to the tax credit for research activities, by: (1) imposing a cap of \$1,000,000 that an eligible taxpayer and the taxpayer's related entities may receive per taxable year; (2) changing the deadline that the taxpayer must provide a certified statement to the Department of Business, Economic Development, and Tourism (DBEDT) from March 31 of each year to the last day of the third month following the end of the taxable year; (3) consolidating the requirements of the annual survey into the certification statement; (4) clarifying that the certification is determined based on the date a complete application is received; and (5) amending the aggregate cap from a "taxable" year to a "calendar" year for administration of the credit.

The measure is effective upon approval and applies to taxable years beginning after December 31, 2022.

First, the Department suggests adding a definition for the term “related entity” to avoid ambiguity as to how the \$1,000,000 cap will apply.

Second, the Department notes that the measure changes the certification deadline from March 31 after the end of the calendar year in which research was conducted to the last day of the third month following the close of the taxable year in which research was conducted. Some taxpayers are fiscal year filers, with the end of the tax year varying. Because of the aggregate cap, 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.

Third, 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 9, be replaced with “calendar year.”

Fourth, 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.

Finally, the Department recommends amending the effective date of the bill to apply to qualified expenses incurred after December 31, 2022.

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



**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT & TOURISM**
KA 'OIHANA HO'OMOHALA PĀ'OIHANA, 'IMI WAIWAI
A HO'OMĀKA'IKA'I

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CHRIS J. SADAYASU
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Statement of
CHRIS J. SADAYASU
Director
Department of Business, Economic Development, and Tourism
before the
HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT
Wednesday, February 8, 2023
10:15 AM
State Capitol, Conference Room #423 & Videoconference
In consideration of
HB990
RELATING TO TAX CREDIT FOR RESEARCH ACTIVITIES.

Chair Holt, Vice Chair Lamosao and members of the Committee. The Department of Business Economic Development, and Tourism (DBEDT) **supports** HB990 that consolidates the survey and the certification requirements for the research activities tax credit, requires the certification on a first-come, first-served basis by date subject, to certain conditions, and adds a cap for the taxpayer and related entities.

A total of thirty-five qualified high technology businesses (QHTB) applied for the Hawaii tax credit for research activities for the tax year 2021. Thirty-four completed the application by submitting the required DBEDT survey. DBEDT issued certificates to nine 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 2021 can be found on our website at:
https://files.hawaii.gov/dbedt/economic/data_reports/HawaiiResearchTaxCredit_TaxYear2021.pdf

This bill adds language to make the program easier for DBEDT to administer and aims to add some consistency with other DBEDT tax credit programs. 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. In addition, the bill will allow the Department of Taxation to issue guidance addressing the allocation of credits in the event that the cap is reached, including the ability to carry the credits forward.

Thank you for the opportunity to testify.

HB-990

Submitted on: 2/7/2023 7:39:19 AM

Testimony for ECD on 2/8/2023 10:15:00 AM

Submitted By	Organization	Testifier Position	Testify
Hermann Kugeler	Makai Ocean Engineering, Inc.	Oppose	Written Testimony Only

Comments:

Makai Ocean Engineering prefers the language in SB951 & HB1193, over the language in this bill (HB990)



Written Statement of
Len Higashi
Executive Director
Hawaii Technology Development Corporation
before the
House Committee on Economic Development
Wednesday, February 8, 2023
10:15 a.m.
Conference Room 423

In consideration of
HB990
RELATING TO TAX CREDIT FOR RESEARCH ACTIVITIES.

Chair Holt, Vice Chair Lamosao, and Members of the Committee.

The Hawai'i Technology Development Corporation (HTDC) **supports** HB990 that consolidates the survey and the certification requirements for the research activities tax credit, requires the certification based on the date a complete application is received subject to certain conditions, and adds a cap for an eligible taxpayer and related entities.

HTDC supports initiatives aimed at growing tech and innovation jobs. Last year, HTDC assisted the Department of Business, Economic Development, and Tourism (DBEDT) with the online applications for the certification. Last year the entire \$5 million cap was claimed in the first **23 seconds** after the applications opened. This bill adds language to process applications according to a date stamp instead of timestamp to prevent applicants from competing to submit electronically at the exact second the application opens and over burdening the system. Adding a cap per taxpaying entity ensures that the credit is available for multiple companies. The bill allows the Department of Tax to issue guidance addressing the allocation of credits in the event that the cap is reached, including the ability to carry the credits forward. The changes will make the program easier for DBEDT to administer and aims to add some consistency with other DBEDT tax credit programs. 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.

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 TAX, Tax Credit for Research Activities

BILL NUMBER: HB 990, SB 1288 [BED-05]

INTRODUCED BY: HB by SAIKI; SB by KOUCHI (Governor's Package)

EXECUTIVE SUMMARY: Consolidates the survey and certification requirements for the research activities tax credit. Requires the certification based on the date a complete application is received subject to certain conditions. Adds a cap for an eligible taxpayer and the taxpayer's related entities.

SYNOPSIS: Amends section 235-110.91, HRS, to impose a cap of \$1 million per taxable year on an eligible taxpayer together with its related entities.

Amends the application requirement so that the application may be submitted on or before March 31 of the year following the year the R&D activity was conducted.

Amends section 235-110.91(d), HRS, to require, as a condition of claiming the credit, a credit applicant to submit the following to DBEDT: (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; and (7) The number of new companies spun out or established in Hawaii to commercialize the intellectual property owned by the qualified high technology business.

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

Clarifies that an applicant who is denied certification because the annual statewide cap on the credit has been reached "shall receive certification priority" in the following calendar year, but does not excuse the taxpayer from submitting a timely credit claim (with the tax return) in that year.

Deletes the requirement that the taxpayer submit an annual survey to DBEDT.

EFFECTIVE DATE: Taxable years beginning after December 31, 2022.

STAFF COMMENTS: This bill is an Administration measure sponsored by the Department of Business, Economic Development and Tourism and designated BED-05 (23).

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: 2/6/2023



Written Statement of
DR. PATRICK SULLIVAN
PRESIDENT/CEO OCEANIT

Before the
HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT

Wednesday, February 8, 2023
10:15 a.m.
State Capitol, Conference Room 423 & Videoconference

In Opposition of

HB990 RELATING TO TAX CREDIT FOR RESEARCH ACTIVITIES

To: Chair Representative Daniel Holt and Vice Chair Representative Rachele F. Lamosao and Members of the Committee

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

Re: Testimony in Opposition of HB990

Honorable Chair, Vice-Chair and Committee Members:

Thank you for the opportunity to submit testimony in **Opposition of HB990**.

Oceanit respectfully requests that the House Committee on Economic Development move forward with **HB1193** so that more local companies will benefit from Hawaii's R&D Tax Credit resulting in greater economic diversification and job creation for the state.

Therefore, Oceanit is in OPPOSITION to HB990.

LATE

HB-990

Submitted on: 2/7/2023 4:32:35 PM

Testimony for ECD on 2/8/2023 10:15:00 AM

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

Comments:

I support HB990 but prefer the language in HB1193.

The Research Tax Credit is a critical initiative that allows Hawaii companies to effectively competitive for 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 highpaying, highly-skilled professional jobs for our keiki here at home.