

JOSH GREEN M.D.
GOVERNOR

SYLVIA LUKE
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STATE OF HAWAII
DEPARTMENT OF TAXATION

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GARY S. SUGANUMA
DIRECTOR

KRISTEN M.R. SAKAMOTO
DEPUTY DIRECTOR

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

TESTIMONY ON THE FOLLOWING MEASURE:

H.B. No. 1193, H.D.1, S.D.1, Relating to the Tax Credit for Research Activities

BEFORE THE:

Senate Committee on Ways and Means

DATE: Thursday, March 30, 2023

TIME: 10:05 a.m.

LOCATION: State Capitol, Room 211

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

The Department of Taxation ("Department") offers the following comments regarding H.B. 1193, H.D.1, S.D.1, for your consideration.

H.B. 1193, H.D.1, S.D.1, seeks to amend section 235-110.91 Hawaii Revised Statutes (HRS), relating to the tax credit for research activities, by: (1) specifying that research funded by grant, forgivable loan, or other amounts not included in gross income are not considered "eligible research"; (2) imposing an unspecified cap that an eligible taxpayer and the taxpayer's related entities may receive per taxable year; (3) expanding the required data that qualified high technology businesses must submit to the Department of Business, Economic Development, and Tourism (DBEDT) to be eligible to claim the credit; (4) clarifying that the certification is determined on a first-come, first-served basis and is based on the date that the complete application is received; (5) amending the aggregate cap from \$5,000,000 per taxable year to an unspecified amount per calendar year; (6) amending the definition of "qualified high technology business" to include provisions that the business must be registered to do business within the State; and (7) extending the repeal date from December 31, 2024 to December 31, 2029.

The measure has a defective effective date of June 30, 3000.

Department of Taxation Testimony
H.B. 1193, H.D.1, S.D.1
March 30, 2023
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The Department appreciates the amendments made by the Senate Committee on Energy, Economic Development, and Tourism relating to the certification deadline and the scope of eligible research and requests that these amendments be maintained.

The expected revenue loss is indeterminate, as the credit and cap amounts are unspecified.

Finally, the Department notes that it will require resources and time to implement the new credit. Accordingly, the Department requests that when the effective date of the measure is updated, it be amended to apply to qualified expenses incurred after December 31, 2023.

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



Written Statement of
Len Higashi
Executive Director
Hawaii Technology Development Corporation
before the
Senate Committee On Ways and Means
Thursday, March 30, 2023
10:05 p.m.
Conference Room 211 & Videoconference

In consideration of
HB1193, HD1, SD1
RELATING TO THE 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** HB1193, HD1, SD1 that extends the repeal date of the tax credits for research activities for an additional five years; adds a cap amount on the tax credit for research activities that may be claimed by a taxpayer and all its business entities; consolidates the survey and certification requirements for the tax credit for research activities; changes to an unspecified amount the annual aggregate cap amount on the tax credit for research activities; requires certification of the tax credit for research activities on a first-come, first-served basis to be based on the date that a complete application is received, subject to certain conditions; and requires a qualified high technology business be registered to do business in the State.

HTDC supports initiatives aimed at growing tech and innovation jobs. Last year, HTDC assisted 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. HTDC suggests this bill be coordinated with the Admin bill HB990. HB1193 includes language from HB990 and extends the sunset date, changes to an unspecified cap and adds restrictions to eligibility based on percentage of employees in the state.

HTDC supports this measure provided it does not supplant the priorities in the Administration's budget and respectfully requests correction of the defective effective date. Thank you for the opportunity to offer these comments



Written Statement of
MR. MATTHEW SULLIVAN
HEAD OF PRODUCT OCEANIT

Before the
SENATE COMMITTEE ON WAYS AND MEANS

Thursday, March 30, 2023
10:05 a.m.
State Capitol, Conference Room 211& Videoconference

In Support and Requested Changes to
HB1193 HD1 SD1, RELATING TO TAX CREDIT FOR RESEARCH ACTIVITIES

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

From: Mr. Matthew Sullivan, Director of Product

Re: Testimony in Support and Requested Changes to HB1193 HD1 SD1.

Honorable Chair, Vice-Chair and Committee Members: Thank you for the opportunity to submit testimony in **Support and Requested Changes to HB1193 HD1 SD1**.

Oceanit is one of the largest local science and engineering companies in the State of Hawaii and has been around for over 35 years. We employ over 100 local scientists and engineers in specialized fields such as artificial intelligence and nanomaterials, addressing global problems such as climate change and energy transformation.

Hawaii's R&D tax credit is one of the few state policies to support the local tech industry. We ask that you conform HB1193 HD1 SD1 to be consistent with the language found in SB951 SD2 HD1:

- HRS Sec. 235-110.91 (m) – Add qualifying criteria to limit the tax credit to small businesses in the State of Hawaii.
 - Add to the end of the last sentence to the qualifying requirements as follows - “...and shall be a “Small Business”.”
 - Add the definition of a small business - “Small business” means a company with no more than five hundred employees, including affiliates.”
- HRS Sec. 235-110.91 (c) - Fill in the blank of this section with “\$1.5 million” to cap the amount of tax credits a taxpayer is eligible for per year.
- HRS Sec. 235-110.91 (f) – Delete the last sentence of the first paragraph of this section which reads as follows – “Complete applications received on the same date shall be certified on a pro rata basis.”
 - We believe that the addition of “pro rata” language will make it impractical to calculate and issue tax credits to companies in a timely manner and furthermore will penalize companies that prioritize the preparation and timely

submission of their application. The industry already spends a significant amount of time and money to qualify, categorize, and substantiate expenses for the R&D tax credit. For various reasons, DOTAX has been slow to review tax returns including the R&D tax credit to companies that qualify. It is not uncommon for companies to wait a significant amount of time to receive the tax credit. Further, returns remain open to audit beyond the date after which the tax return is processed. Adding “pro rata” will add confusion and slow this process which will make it difficult for small businesses to use the tax credit to hire employees and purchase equipment – the intent of the bill.

The Hawaii R&D tax credit is a good investment for the State.

According to a 2021 UHERO report titled *The Hawaii Research Activity Tax Credit: Is It Effective and How Can It Be Improved?*, every \$1 in tax credits claimed generates an additional \$1-2 in additional spending in the State by private firms.

The tech industry supports a living wage for locals, empowering locals to compete for housing in Hawaii and remain in the State vs move to the mainland.

According to the *Report on Hawaii Tax Credit for Research Activities for Tax Year 2021* prepared by DBEDT, the average annual wage was \$93,634 for the 34 Qualified High Technology Businesses that applied for the Hawaii tax credit for research activities for the tax year 2021.

The R&D tax credit enables Hawaii companies to compete with other states for talent.

37 of the 50 states in the U.S. offer an R&D tax credit. Hawaii’s R&D tax credit enables Hawaii companies to compete with other states to recruit and retain more local talent and stem Hawaii’s “Brain Drain”.

To grow our local tech industry, the annual \$5 million cap should be increased.

In 2021, 34 companies applied for the Hawaii tax credit but only 9 received it due to the \$5 million annual cap. In aggregate, the 34 QHTBs generated a total of \$223 million revenue from all goods and services produced in Hawaii, \$195 million as operating cost, and paid a total of \$80 million as payroll.

Mahalo for your consideration,

Matthew Sullivan

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: HB 1193 SD 1

INTRODUCED BY: Senate Committee on Energy, Economic Development and Tourism

EXECUTIVE SUMMARY: Extends the repeal date of the tax credits for research activities for an additional 5 years. Adds a cap amount on the tax credit for research activities. Consolidates the survey and certification requirements for the tax credit for research activities. Changes to an unspecified amount the annual aggregate cap amount on the tax credit for research activities. Requires certification of the tax credit for research activities on a first-come, first-served basis to be based on the date that a complete application is received, subject to certain conditions. Requires a qualified high technology business and at least 75% of its employees to be physically located in the State.

SYNOPSIS: Amends section 235-110.91(c), HRS, to provide that 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.

Provides 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 \$ _____ in tax credits for research activities per taxable year.

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 on or before March 31: (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) 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 in the State that separated from, or were established by, the qualified high technology business 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. Failure to meet the requirements of this subsection shall constitute a waiver of the right to claim the credit.

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 \$_____ million per calendar year (used to be \$5 million). 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.

Amends section 5 of Act 261, SLH 2019, to extend the sunset date of this credit to December 31, 2029.

EFFECTIVE DATE: June 30, 3000.

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: 3/28/2023

HB-1193-SD-1

Submitted on: 3/28/2023 8:30:49 PM

Testimony for WAM on 3/30/2023 10:05:00 AM

Submitted By	Organization	Testifier Position	Testify
Yvonne Alvarado	Individual	Oppose	Written Testimony Only

Comments:

IYvonne Alvarado oppose to bill HB1193

HB-1193-SD-1

Submitted on: 3/29/2023 9:14:11 AM

Testimony for WAM on 3/30/2023 10:05:00 AM

Submitted By	Organization	Testifier Position	Testify
Ginelle Rivera	Individual	Oppose	Written Testimony Only

Comments:

I solely oppose bill HB1193 regarding limiting the types of monetary access that contributes to my Family income therefore jepordizing my families food security, Housing security and a way of living and ornsaving for my childrens future and my lineage to follow!

Mahalo,

Ginelle Rivera