

JOSH GREEN M.D.
GOVERNOR

SYLVIA LUKE
LT. GOVERNOR



GARY S. SUGANUMA
DIRECTOR

KRISTEN M.R. SAKAMOTO
DEPUTY DIRECTOR

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

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

TESTIMONY ON THE FOLLOWING MEASURE:

H.B. No. 1193, Relating to the 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") offers the following comments regarding H.B. 1193 for your consideration.

H.B. 1193 seeks to amend section 235-110.91 Hawaii Revised Statutes (HRS), relating to the tax credit for research activities, by: (1) imposing an unspecified cap 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) expanding the required data that qualified high technology businesses must submit to DBEDT; (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 occupy a business location and address within the State where at least 75 percent of the business's employees are located; and (7) extending the repeal date from December 31, 2024 to December 31, 2029.

The measure is effective upon approval and applies to taxable years beginning

after December 31, 2023.

First, 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.

Second, the Department notes that 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 15, be replaced with “calendar year.”

Third, 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.

Finally, the Department recommends amending the effective date of the bill to apply to qualified expenses incurred after December 31, 2023.

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



Statement of
Hermann Kugeler
Vice President of Business Development
Makai Ocean Engineering, Inc.
before the
House Committee on Economic Development
Wednesday, February 8, 2023
10:15 am
Videoconference
State Capitol, Conference Room 423
In consideration of
HB1193
RELATING TO THE TAX CREDIT FOR RESEARCH ACTIVITIES.

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

Makai Ocean Engineering, Inc. **SUPPORTS HB1193.**

Makai is a locally-owned and operated technology company based in Hawai'i for 50 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 several software and hardware development projects supporting our Navy and other federal customers.

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 **SUPPORT HB1193**, 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 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 Support of

HB1193 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 Support of HB1193

Honorable Chair, Vice-Chair and Committee Members:

Thank you for the opportunity to submit testimony in **Support of HB1193**.

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 will narrow the qualifying criteria to encourage Hawaii-based R&D and will extend the sunset date from December 31, 2024 to December 31, 2029.

Therefore, Oceanit is in strong support of HB1193



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 & Videoconference

In consideration of
HB1193
RELATING TO THE TAX CREDIT FOR RESEARCH ACTIVITIES.

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

The Hawai'i Technology Development Corporation (HTDC) **supports** HB1193 that 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; applies to taxable years beginning after 12/31/2023.

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.

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: HB 1193

INTRODUCED BY: HOLT, GATES, HASHIMOTO, KILA, KITAGAWA, LAMOSAO, LOWEN, MATAYOSHI, MIZUNO, TODD

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 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 provided by this section 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 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. 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: Taxable years beginning after December 31, 2023.

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: 2/6/2023

HB-1193

Submitted on: 2/6/2023 11:19:23 AM

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

Submitted By	Organization	Testifier Position	Testify
Audra White	Individual	Support	Written Testimony Only

Comments:

I am in full support of HB1193.

LATE

HB-1193

Submitted on: 2/7/2023 4:36:18 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 strongly support HB 1193 and respectfully request the threshold to be changed to 50% employees in Hawaii. The Research Tax Credit is a critical initiative that allows Hawaii companies to effectively compete 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.

Mahalo for your consideration.