SB736

Extends the tax credit for qualified research activities for an additional five years. Clarifies the method of calculating the tax credit. Amends the definition of "qualified high technology business". Repeals existing certification requirements and establishes new reporting requirements. Requires the department of business, economic development, and tourism to conduct studies to measure the effectiveness of the tax credit and submit reports to the legislature.

HAWAII STRATEGIC DEVELOPMENT CORPORATION

HTDC Cultivating Hawaii's tech sector
HIGH TECHNOLOGY DEVELOPMENT CORPORATION

Written Statement of

KARL FOOKS
President
Hawaii Strategic Development Corporation
And
Yuka Nagashima
Executive Director and CEO
High Technology Development Corporation

Before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT, GOVERNMENT OPERATIONS and HOUSING
And the
SENATE COMMITTEE ON TECHNOLOGY AND THE ARTS

February 8, 2013
2:50 PM
State Capitol, Conference Room 016

In consideration of
SB 736 RELATING TO ECONOMIC DEVELOPMENT.

Chair Dela Cruz, Chair Wakai, and Members of the Committee on Economic Development & Business and the Committee on Technology and the Arts:

The Hawaii Strategic Development Corporation (HSDC) and the High Technology Development Corporation (HTDC) respectfully **submit comments on SB 736**. The state tax credit for research activities sunset at the end of calendar year 2010. This tax credit program was an effective measure to support research and development activities, which in turn, foster and encourage the innovation essential to create high-wage job opportunities in our economy.

SB 736 would align the calculation of the State research tax credit with the approach used by the Federal research tax credit provisions by allowing a tax credit only for qualified research above an annual base amount. This will reduce the dollar amount of credits claimed, but also reduce the effectiveness of the credit as a tool for promoting economic development.

SB 736 includes important requirements to collect data and provide metrics on the effectiveness of the proposed research tax credit. We recommend that resources be appropriated to the Department of Taxation and Department of Business, Economic Development and Tourism in order that they are able to collect the data, analyze the impacts and report their findings.

Finally, the objective of SB 736 is to promote economic development in the State. Supporting research activities alone will not accomplish this objective. We recommend the Committees also consider a comprehensive policy that supports the continuum of entrepreneurialism, commercialization and business formation capabilities needed to foster high growth businesses. As part of an entrepreneurial ecosystem, a research tax credit program can be effective in creating sustainable high wage jobs.

Thank you for the opportunity to submit testimony on this bill.

L E G I S L A T I V E

TAXBILLSERVICE

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SUBJECT: INCOME, Tax credit for research activities

BILL NUMBER: SB 736; HB 559 (Identical)

INTRODUCED BY: SB by Dela Cruz, Chun Oakland and 5 Democrats; HB by Har, Cullen, Fale, Oshiro, Say, Tsuji, Yamashita

BRIEF SUMMARY: Amends HRS section 235-110.91 to provide that the federal tax provisions in section 41 as that section was enacted on December 31, 2011, shall remain in effect for purposes of determining the state income tax credit under this section. Provided further that the federal tax provisions in section 41, as enacted on December 31, 2011, shall apply only to expenses incurred for qualified research activities after December 31, 2012.

Also requires a qualified high technology business that claims the credit under this section to complete and file with the director of taxation, through the department website, an annual survey on electronic forms prepared and prescribed by the department. Requires the survey to be filed before June 30 of each year following the calendar year in which the credit is claimed under this section. Permits the department to adjust the due date of the annual survey by rule. Companies that fail to file the survey shall be subject to a fine of up to $2,000 for each month of a delay to file. Requires a qualified high tech business to file an annual survey before claiming the tax credit for qualified research.

The survey shall include: (1) identification of the industry sector in which the qualified high technology business conducts business; (2) qualified expenditures; (3) revenue and expense data; (4) Hawaii employment and wage data including the number of full and part-time employees retained, new jobs, temporary positions, external services procured by the business, and payroll taxes; (5) filed intellectual property, including invention disclosures, provisional patents, and patents issued or granted; and (6) federal and state income tax returns and documents related to deductions for tax credits for research activities.

The department of taxation may request any additional information necessary to measure the effectiveness of the tax credit, such as information related to patents. Also directs the department of taxation to allow the department of business, economic development, and tourism (DBEDT) to access data collected under this section to conduct economic impact analyses and produce legislative reports.

Requires DBEDT to prepare summary descriptive statistics by category and ensure that the information be reported at the aggregate level to prevent compromising identities of qualified high technology business investors or other confidential information. DBEDT shall also identify each qualified high technology business that is the beneficiary of tax credits claimed under this section. Requires DBEDT to report the information to the legislature by December 21 of each year.

Further requires DBEDT to use the information collected to study the effectiveness of the tax credit and shall report on the amount of tax credits claimed and total taxes paid by qualified high technology businesses, the number of qualified high technology businesses in each industry sector, jobs created, external services and materials procured by the businesses, compensation levels, qualified research activities, and other factors as the department determines. The department shall report the results of its study to the legislature by December 21 of each year.

Changes the expiration of the tax credit for research activities from 12/31/10 to 12/31/17.

EFFECTIVE DATE: Upon approval; applicable to tax years beginning after December 31, 2012

STAFF COMMENTS: The legislature by Act 178, SLH 1999, and Act 221, SLH 2001, enacted various tax incentives to encourage the development of high technology businesses in the state. These acts provided investment and research credits, as well as income exclusions and tax incentives, to encourage high tech businesses and individuals associated with high tech businesses to locate in the state. It should be noted that while the credit for research activities enacted by Act 178, SLH 1999, expired on 12/31/10 and this measure would reenact the credit, it is questionable whether the methodology proposed by this measure is appropriate. Since the credit expired on 12/31/10, the method proposed by this measure merely changes the expiration date of the existing statutory language, and it would appear to be more appropriate to restate the provisions as language in a new section under the income tax law.

While the re-adoption of the credit for research activities would require the department of taxation to ascertain the effectiveness of the tax credit for research activities, such a review should have been performed a few years after the credit had been adopted. While the proposed measure would re-enact the credit for research activities for a five-year period, it would add another drain on state funds. It should also be remembered that the research credit is a refundable tax credit. Thus, should the amount of the credit exceed the taxpayer's income tax liability, any excess credit is a cash payment out of the state treasury to the claimant.

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 plough money into such activities is the fact that the credit provides a way to avoid paying state taxes.

A former Hawaii resident who has been a success in the field of high technology pointed out recently what will make Hawaii conducive to high tech businesses and they are: (1) entrepreneurs, not capital, that comes first; (2) entrepreneurs coming from engineering schools and technology companies; (3) building a world class engineering school in Hawaii; (4) supporting internships at technology companies; (5) allowing our best children to go away to get a worldwide perspective; (6) despite the drive by the current administration to enhance broadband communications in Hawaii, broadband passing through Hawaii is already everywhere and is not a selling point; (7) that people can fly direct and therefore Hawaii's mid-Pacific location is not an advantage; (8) learning the rules of the game; (9) looking at Israel and learning from them; and (10) doing your own thing, being a copy cat does not work. At the heart of his remarks was the fact that in order to produce a high technology industry in Hawaii, those companies need to have access to institutions of higher education that are producing the people needed by the high technology industry. Without the academic synergy, Hawaii will never become a center for high technology activity. Thus, all of the tax incentives, like this measure embodies, will fall short of luring high technology firms to Hawaii.

Further, the tremendous tax burden, the draconian regulatory environment, and the dramatic increase in fees that go with the permitting process make Hawaii an unattractive place to do business. It should be remembered that while the high technology credits may look like a good incentive or enticement to undertake research activities in Hawaii, those who would conduct this research must live in the same high cost-of-living environment with which other taxpayers continue to struggle. Thus, the cost of maintaining those researchers will be higher than to do so where the cost of living is much lower. Let's not bet the farm on high technology without really understanding what makes this industry tick.

Obviously the authors of this proposal would like to ignore the evaluation of these tax incentives done by UHERO a few years ago which basically condemned the credits as a waste of state resources as there is little evidence that the current program of tax credits has created substantial new employment or on-going enterprises. It is truly amazing that given the dire condition of the state's financial condition that lawmakers would continue to support unbridled drains of resources while at the same time proposing that the tax burden be increased on all other taxpayers. With declining revenues, every program from education to corrections to health services will be severely curtailed. If the state doesn't have the money to put textbooks in the schools, why then do we need the highly touted, high-paying jobs the advocates for the industry promise? The next generation may not even know how to read given the cuts to the education budget.

Again, lawmakers must ask themselves whether or not this incentive is appropriate given an economy that is still trying to recover from the recent economic downturn. Given that there are many other proposals in the legislature to hike tax rates, taxpayers will find the continuance of these targeted business tax credits distasteful. Reprehensible probably is more appropriate given that these are the lawmakers who are supposed to represent the best interest of their constituents. Raising taxes on constituents while still handing out money to favored groups will engender the ire of constituents. The finger of blame for these potential increases in tax burden should not stop at lawmakers, but be placed squarely on those in the community who continue to push for these targeted tax credits. Perhaps those proponents should be asked to pick up the tab for this reckless expenditure of precious tax dollars.

Digested 2/1/13

Dane Wicker

From: mailinglist@capitol.hawaii.gov
Sent: Sunday, February 03, 2013 11:08 PM
To: EGHTestimony
Cc: econnell1@hawaii.rr.com
Subject: Submitted testimony for SB736 on Feb 8, 2013 14:50PM

SB736
Submitted on: 2/3/2013
Testimony for EGH/TEC on Feb 8, 2013 14:50PM in Conference Room 016

Submitted By	Organization	Testifier Position	Present at Hearing
Emmons Connell	Individual	Oppose	No

Comments: High Tech Tax Credits irritate me. The State gives away revinue (via tax credits)and tells us all the good the High Tech industry is going to do. Before we provide $11,000,000 per year, to the Tech Industry, for the next five years, show us,with numbers, how the State benifitted during the last ten years. In the mean time please vote no on this bill.

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

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