



Written Statement of
Len Higashi
Executive Director
Hawaii Technology Development Corporation
before the
Senate Committee On Ways and Means
Wednesday, February 22, 2023
10:00 a.m.
Conference Room 211 & Videoconference

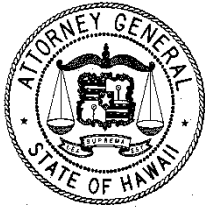
In consideration of
SB951, SD1
RELATING TO THE TAX CREDIT FOR RESEARCH ACTIVITIES.

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

The Hawai'i Technology Development Corporation (HTDC) **supports** SB951, SD1 that adds a cap for the amount of tax credits for research activities that an eligible taxpayer and the taxpayer's related entities may receive per taxable year; consolidates the survey and certification requirements for tax credits for research activities; amends the annual aggregate cap on tax credits for research activities that the Department of Business, Economic Development, and Tourism (DBEDT) may certify; and requires certification of the tax credits 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; extends the sunset date for tax credits for research activities from December 31, 2024 to December 31, 2029.

HTDC supports initiatives aimed at growing tech and innovation jobs. Last year, HTDC assisted 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 will resolve the issue by allowing same-day applicants to split a pro-rata share of the credit and increases the total amount available for all filers.

HTDC supports this bill provided it does not supplant the priorities of the administration. Thank you for the opportunity to offer these comments



**WRITTEN TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
KA 'OIHANA O KA LOIO KUHINA
THIRTY-SECOND LEGISLATURE, 2023**

ON THE FOLLOWING MEASURE:

S.B. NO. 951, S.D. 1, RELATING TO THE TAX CREDIT FOR RESEARCH ACTIVITIES.

BEFORE THE:

SENATE COMMITTEE ON WAYS AND MEANS

DATE: Wednesday, February 22, 2023 **TIME:** 10:00 a.m.

LOCATION: State Capitol, Room 211

TESTIFIER(S): **WRITTEN TESTIMONY ONLY.**

(For more information, contact Cynthia M. Johiro,
Deputy Attorney General, at (808) 586-1472)

Chair Dela Cruz and Members of the Committee:

The Department of the Attorney General provides the following comments.

The purpose of this bill is to add requirements as to who may take, and how they may take, the research activities tax credit, and to increase the credit's annual cap from \$5,000,000 to \$15,000,000. See page 7, lines 17-18. The bill would also require qualified high technology businesses to "[m]aintain and operate a physical place of business in the State where at least seventy-five per cent of the business' employees are located." Page 3, lines 12-14.

This bill could be subject to challenge under the Privileges and Immunities Clause of the United States Constitution. "The Privileges and Immunities Clause, U.S. Const., Art. IV, § 2, provides that the Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several states." *Lunding v. New York Tax Appeals Tribunal*, 522 U.S. 287, 290 (1998) (internal brackets and quotation marks omitted). "One right thereby secured is the right of a citizen of any State to 'remove to and carry on business in another without being subjected in property or person to taxes more onerous than the citizens of the latter State are subjected to.'" *Id.* at 296 (quoting *Shaffer v. Carter*, 252 U.S. 37, 56 (1920)). The Clause requires "substantial equality of treatment" for resident and nonresident taxpayers; "[w]here nonresidents are subject to different treatment, there must be 'reasonable grounds for . . . diversity of treatment.'"

Id. at 297-98 (quoting *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60, 79 (1920)). Thus, "the Privileges and Immunities Clause bars 'discrimination against citizens of other States where there is no substantial reason for the discrimination beyond the mere fact that they are citizens of other states.'" *Id.* at 298 (quoting *Toomer v. Witsell*, 334 U.S. 385, 396 (1948)).

Here, it is not clear whether there is a "substantial reason" for restricting tax credit recipients to operate a "physical place of business in the State where at least seventy-five per cent of business' employees are located" or whether there is a substantial relationship between operation of a "physical place of business in the State where at least seventy-five per cent of the business' employees are located" and the proposed tax credit. Accordingly, we recommend deleting the word "and" on page 3, line 11, and the requirement of "a physical place of business in the State where at least seventy-five per cent of the business' employees are located" on page 3, lines 12-14. These amendments should sufficiently address a possible Privileges and Immunities challenge.

Thank you for the opportunity to comment on this bill.

JOSH GREEN M.D.
GOVERNOR

SYLVIA LUKE
LT. GOVERNOR



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:

S.B. No. 951, S.D. 1, Relating to the Tax Credit for Research Activities

BEFORE THE:

Senate Committee on Ways and Means

DATE: Wednesday, February 22, 2023

TIME: 10:00 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 S.B. 951, S.D. 1, for your consideration.

S.B. 951, S.D. 1, seeks to amend section 235-110.91, Hawaii Revised Statutes (HRS) relating to the tax credit for research activities, by: (1) imposing a cap of \$1,500,000 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) expanding the required data that a qualified high technology business 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 \$15,000,000 per calendar year; and (6) requiring every qualified high technology business be registered to do business in the State and maintaining and operating a business location in the State where at least 75% of the business' employees are located. The measure further extends the sunset date for the credit from December 31, 2024 to December 31, 2029.

The measure is effective on July 1, 2023, and applies to taxable years beginning after December 31, 2022.

First, the Department notes that the measure changes the time for certification 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 (e) may be read to conflict with subsection (g). Subsection (g) refers to the aggregate cap and certifications in terms of a calendar year. As such, subsection (e) 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 18, 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.

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

Finally, the Department notes that this measure is estimated to result in a revenue loss of \$10 million for fiscal year 2024 and for each year thereafter until the sunset date.

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

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Tax Credit for Research Activities; Requirements; Survey; Certification; Caps

BILL NUMBER: SB 951 SD 1

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

EXECUTIVE SUMMARY: Adds a cap for the amount of tax credits for research activities that an eligible taxpayer and the taxpayer's related entities may receive per taxable year. Consolidates the survey and certification requirements for tax credits for research activities. Amends the annual aggregate cap on tax credits for research activities that the Department of Business, Economic Development, and Tourism may certify. Requires certification of the tax credits 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.

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 \$1,500,000 in tax credits per taxable year.

Adds a new subsection (d) that requires that every qualified high technology business (1) be registered to do business in the State; and (2) maintain and operate a physical place of business in the State where at least seventy-five per cent of the business' employees are located.

Amends section 235-110.9(d), HRS, and redesignates it as subsection (e), 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.

Clarifies that failure to meet the requirements of subsection (e) shall constitute a waiver of the right to claim the credit.

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 by DBEDT. 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.

Extends the sunset date of the credit by five years, to December 31, 2029.

EFFECTIVE DATE: July 1, 2023, provided that section 1 is applicable to taxable years beginning after December 31, 2022.

STAFF COMMENTS: As a technical matter, the new subsection (d) imposing requirements to be a qualified high technology business appears to contradict the definition of the term in existing subsection (o) (subsection (n) as amended).

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.

Re: SB 951 SD1

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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: 2/17/2023



Written Statement of
MR. MATTHEW SULLIVAN
DIRECTOR OF PRODUCT, OCEANIT

Before the
SENATE COMMITTEE ON WAYS AND MEANS

Wednesday, February 22, 2023, 10:00 a.m.
State Capitol, Conference Room 211 & Videoconference

In Support and Requested Changes to
SB951 RELATING TO TAX CREDIT FOR RESEARCH ACTIVITIES

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

From: Mr. Matthew Sullivan, Director of Product, Oceanit

Re: Testimony in Support and Requested Changes to SB 951

Honorable Chair, Vice-Chair and Committee Members: Thank you for the opportunity to submit testimony in **Support and Requested Changes to SB 951**.

Oceanit is one of the largest local science and technology 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 transition.

Hawaii's R&D tax credit is one of the few state policies to support the local tech industry. **We support SB 951 and request the following change to SB 951, as amended by SD 1:**

- **HRS Sec. 235-110.91 (g) - 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."**

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".

Mahalo for your consideration,

Matthew Sullivan

