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To: The Honorable Donovan M. Dela Cruz, Chair
and Members of the Senate Committee on Ways and Means

Date: Thursday, April 4, 2019
Time: 1:40 P.M.
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 624, H.D. 1, Proposed S.D. 2, Relating to the Structure of Government

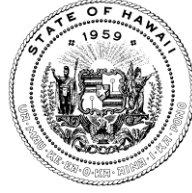
The Department of Taxation provides the following comments regarding H.B. 624, H.D. 1, Proposed S.D. 2, for the Committee's consideration.

As originally written, H.B. 624 transfers the rights, powers, functions, and duties of the Hawaii Technology Development Corporation and the Hawaii Strategic Development Corporation to the University of Hawaii. Proposed S.D. 2 instead transfer these functions to a to-be-created Hawaii Innovation and Technology Corporation (HITC). The measure is effective on July 1, 2021, except that part V (related to unencumbered balances remaining in the technology special fund) and part VI (related to the to-be-created Hawaii Broadband Office) takes effect on July 1, 2019.

As it relates to tax, proposed section 206M-AA, Hawaii Revised Statutes, provides that HITC may establish a Regulated Investment Company (RIC) for the purpose of allowing individual investors to contribute to the program and invest venture capital in businesses in Hawaii. The measure implies that any dividends paid to such investors are free from taxation.

While a RIC can be any of the different types of investment entities, it must meet all of the requirements contained in Internal Revenue Code (IRC) sections 851 through 855, IRC section 860 (relating to deficiency dividends), and IRC section 4982 (relating to tax on undistributed earnings). If the Internal Revenue Service approves a structure as a RIC and the requirements are otherwise met, the RIC itself is not subject to tax. However, the dividends it pays to its investors are subject to both federal and State income taxes. A RIC avoids the tax at the corporate level, but not at the investor level.

Thank you for the opportunity to provide comments.



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Testimony of the Department of Commerce and Consumer Affairs

**Before the
Senate Committee on Ways and Means
Thursday, April 4, 2019
1:40 p.m.
State Capitol, Conference Room 211**

**On the following measure:
H.B. 624, Proposed S.D. 2, RELATING TO THE STRUCTURE OF GOVERNMENT**

Chair Dela Cruz and Members of the Committee:

My name is Ji Sook “Lisa” Kim, and I am the Cable Administrator of the Department of Commerce and Consumer Affairs’ (Department) Cable Television Division. The Department supports part VI of proposed S.D. 2 and defers to the Department of Business, Economic Development, and Tourism on all other provisions of this proposed bill.

The purpose of proposed S.D. 2 is to amend the powers, duties, and programs of the Hawaii Technology Development Corporation and Hawaii Strategic Development Corporation and consolidate their functions in a new entity known as the Hawaii Innovation and Technology Corporation (HITC). Additionally, part VI of this proposed measure: (1) establishes the Hawaii Broadband Office within the newly formed HITC, including the creation of a state broadband strategy officer position to head the office; (2) renames the Broadband Assistance Advisory Council to the Broadband Advisory Council and amends the council’s membership and duties; and (3) transfers the amended duties of the council to the HITC.

With respect to part VI of the proposed S.D. 2, the Department recognizes the strong relationship between broadband access and economic development, as well as broadband's importance in fostering education, health, community building, and civic engagement throughout the State. Accordingly, the Department supports part IV's approach to create a central office solely focused on facilitating the availability of affordable broadband access services through the development of state strategy and policies, coordination of efforts among public and private broadband stakeholders, and securing of funding and investment for broadband infrastructure, services, and programs.

Thank you for the opportunity to testify on this proposed draft.



DAVID Y. IGE
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MIKE MCCARTNEY
DIRECTOR

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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Statement of
MIKE MCCARTNEY
Director

Department of Business, Economic Development, and Tourism
before the
SENATE COMMITTEE ON WAYS AND MEANS

Thursday, April 4, 2019
1:40 PM
State Capitol, Conference Room 211

In consideration of
HB 624, HD1, Proposed SD2
RELATING TO THE STRUCTURE OF GOVERNMENT.

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

The Department of Business, Economic Development and Tourism supports HB624, HD1, Proposed SD2, which consolidates powers, duties, and programs of the Hawaii Technology Development Corporation and Hawaii Strategic Development Corporation into a single entity and appropriates funds for staffing. This bill also establishes the Hawaii Broadband Office and appropriates funds.

DBEDT recommends keeping the name of Hawaii Technology Development Corporation instead of the Hawaii Innovation and Technology Corporation in order to ensure a smooth transfer and continuity of the execution of ongoing technology initiatives.

Broadband is important to business and is essential to maintain Hawaii's global competitiveness. Therefore, DBEDT supports the creation of the broadband office and the restructuring of the Broadband Advisory Council to meet the duties set forth in the measure.

DBEDT defers to HTDC and HSDC on any proposed amendments to the specific operations of the combined HTDC.

DBEDT requests that appropriations and position counts be included since it was not included in HB2, HD1, SD1, CD1. Below is what is required for each component.

BED143 – HAWAII TECHNOLOGY DEVELOPMENT CORPORATION

FY 19-20	MOF	FY 20-21	MOF
3.00*		3.00*	
10.00#		10.00#	
2,601,808	A	2,601,808	A
2,422,384	B	2,422,384	B
9.00#		9.00#	
964,713	P	964,713	P
1,500,000	W	1,500,000	W

BED145 – HAWAII STRATEGIC DEVELOPMENT CORPORATION

FY 19-20	MOF	FY 20-21	MOF
2,608,516	B	2,608,516	B
1.00#		1.00#	
4,211,451	W	4,211,451	W

HAWAII BROADBAND OFFICE

FY 19-20	MOF	FY 20-21	MOF
2.00#		2.00#	
200,000	A	200,000	A

Thank you for the opportunity to testify.



Written Statement of
Len Higashi
Acting Executive Director
Hawaii Technology Development Corporation
before the
Senate Committee on Ways and Means
Thursday, April 4, 2019
1:40 p.m.
State Capitol, Conference Room 211

In consideration of
HB624, HD1, SD2 PROPOSED
RELATING TO THE STRUCTURE OF GOVERNMENT.

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

The Hawaii Technology Development Corporation (HTDC) **supports with comments** HB624, HD1, SD2 PROPOSED that merges the HSDC into the HTDC; establishes the Hawaii Broadband Office within HTDC; establishes the position of State Broadband Strategy Officer; renames the Broadband Assistance Advisory Council as the Broadband Advisory Council and amends its purpose and membership; requires the CEO of HTDC to convene and chair the Broadband Advisory Council; and appropriates funds.

As part of HTDC's vision to create 80,000 new innovation jobs in Hawaii earning \$80,000 or more by 2030, HTDC works closely with DBEDT and HSDC on initiatives aimed at promoting technology and innovation jobs. In the 2017 HTDC economic impact survey, 149 companies participating in HTDC programs reported 3,736 jobs in Hawaii, \$589 million in total revenue generating \$1 billion in total economic impact.

HTDC offers the following comments :

- updates in Sections 3-7 are consistent with HTDC's current activities
- prefer not to change its name since it was just changed in 2017
- **oppose repealing its special fund** in section 20. The special fund is required to collect revenue from the MRTC facility, Entrepreneurs Sandbox facility, sponsorships, and for the federally funded INNOVATE Hawaii program. The revenue collected is used to offset current expenses for each of these facilities and programs. HTDC cannot operate without its special fund.
- the appropriation and positions for HTDC and HSDC are not included in HB2, CD1 general appropriation bill. HTDC requests that the program appropriations be included in this bill or the agencies will lose all staff in the new fiscal year. If additional general funds are added for positions and operations, HTDC supports decreasing the special fund ceiling by the same amount.
- support the establishment of the Hawaii Broadband Office in HTDC.
- defer to HSDC on the merging of HSDC statute into HTDC.

HTDC looks forward to working with all stakeholders to meet the intent of this measure. Thank you for the opportunity to offer these comments.



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Statement of
Karl Fooks
President

Hawaii Strategic Development Corporation
before the
SENATE COMMITTEE ON WAYS AND MEANS

Thursday, April 4, 2019
1:40 PM
State Capitol, Conference Room 211

In consideration of
HB 624 HD1 SD2 Proposed
RELATING TO THE STRUCTURE OF GOVERNMENT

Chair Dela Cruz, Vice Chair Keith-Agaran and members of the Committee, the Hawaii Strategic Development Corporation (HSDC) provides comments on the proposed HB 624 HD1 SD2 a bill that merges the Hawaii Strategic Development Corporation into the Hawaii Technology Development Corporation (HTDC) and creates the Hawaii Broadband Office within HTDC.

It is the purview of the Legislature and the Administration to determine policy and the appropriate structure of government to implement that policy. HSDC's role is to execute on the mission established in its authorizing statute, §211F-2 HRS: to **provide incentives** and **reduce the risks** of private investment in order to encourage economic development and stimulate private capital investments. HSDC's mission is to co-invest with the private sector to **strategically** to develop new growth sectors of the economy.

Without funding to execute on HSDC's mission, the proposed organizational structure will not be able to achieve the economic development objectives set out in the bill.

It is imperative that the State commit to a long-term, comprehensive, technology-based economic development (TBED) strategy to support sustainable economic growth. TBED is the only development effort that can create high wage opportunities for our citizens. Most of the jobs in our economy are relatively lower paying service sector jobs. With the emphasis on STEM education in our educational system, if we do not undertake a sustained effort to create jobs that use these skills, the trend of rising domestic outmigration will continue.

HSDC defers to HTDC on the funding requirements for HTDC and the Hawaii Broadband Office, and the proposed amendments to HTDC's statute.

Thank you for the opportunity to testify.

What is Technology-based Economic Development?*

Over the last several years, the U.S. economy has been undergoing a dramatic transformation as the nation moves to an economy driven by technology and innovation—through the creation of new industries and the application of technology in traditional industries. Competing in a global economy, regions must have an economic base composed of firms that constantly innovate and maximize the use of technology in the workplace. ¹Technology-based economic development, or TBED, is the approach used to help create a climate where this economic base can thrive.

What is Required for a Technology-based Economy?

Based on the experience of tech-based economies like Silicon Valley, Research Triangle, and Route 128, the following elements are required for a tech-based economy:

- A research base that generates new knowledge;
- Mechanisms for transferring knowledge to the marketplace;
- An entrepreneurial culture;
- Sources of risk capital; and,
- A technically skilled workforce.

What Approaches Can Be Employed to Develop These Elements?

Research Capacity. Initiatives that strengthen the capacity to conduct research in universities, federal labs, or the private sector include: centers of excellence, university-industry partnerships, and initiatives to expand research facilities, recruit eminent scholars, or increase research funding through R&D tax credits.

Commercializing Research. Initiatives that promote the conversion of research into technologies and products with high commercial potential include proof-of-concept funds and centers, entrepreneurs-in-residence to assess commercial potential and develop commercialization strategies, and pilot-scale production and scalability testing.

Promoting Entrepreneurship. Enriching the skills and ability of entrepreneurs, increasing capacity of entrepreneurs to successfully grow and start companies, and improving the environment for entrepreneurial development can be delivered through many forms, including: venture development organizations, mentorship programs, and accelerators and incubators.

Increasing Access to Capital. The availability of capital to support startup and emerging companies is critical. Regions can address needs for capital through angel investor tax credits, investing in technology companies, using public funds to leverage private investment funds, and help companies access capital sources.

Technically Skilled Workforce. Approaches that regions can take to ensure the availability of a technically skilled workforce include encouraging more students to enter STEM fields, STEM internship programs and providing technical training for workers in existing companies.

* Recommendations from the State Science and Technology Institute

State of Hawaii Efforts to Promote TBED

Area of TBED Focus	Responsible State Entity
Research Capacity	University of Hawaii
Commercializing Research	<ul style="list-style-type: none"> • University of Hawaii for university research (grants) • Hawaii Technology Development Corporation for private research (grants) • Hawaii Strategic Development Corporation (investments)
Promoting Entrepreneurship	Hawaii Technology Development Corporation
Increasing Access to Capital	Hawaii Strategic Development Corporation
Technically Skilled Workforce	University of Hawaii

The state's economic development strategy has emphasized organizational self-sufficiency and as a result entities have pursued programs that generate revenue to support their operations, like incubator rent revenue and licensing income from research, and not collaborative ecosystem and capacity building efforts.

In addition, too much policy emphasis has been placed on supporting research related activities while ignoring the need to promote entrepreneurship, access to capital and a tech workforce, the drivers of real economic activity and job creation. A successful TBED policy must be comprehensive and support all the elements required for a thriving tech-based economy.

Rather than simply create a new state entity that does not have a well-defined policy mandate it may be prudent to step back and assess:

1. Where does Hawaii stand in comparison to other states that are leading in this field?
2. What opportunities and challenges exist in Hawaii for growth in technology-based industries?
3. How does Hawaii become a leading center of technology-based industries?
4. What policy and organizational recommendations can we provide the Administration and Legislature to improve the capacity of the state to successfully execute a TBED Strategy?

The best way to develop a consensus on the appropriate path forward is to engage a consulting firm with domain expertise in TBED policy and programs. The consulting firm will work with the stakeholders in the state representing the areas of research capacity, research commercialization, entrepreneurship, access to capital and tech workforce development to produce a report that:

1. Sets out the objectives and benchmarks for the next 3-5-10 years that would put Hawaii on a trajectory to become a leading center of technology based industries;
2. Identify specific programs and policies to implement that will drive economic growth in technology-based industries to achieve those objectives and benchmarks; and
3. Recommend organizational changes in the state to facilitate the successful implementation of those programs and policies.

HSDC ACCOMPLISHMENTS 2012-2018

Accelerators Establish Startup Ecosystem in Key Industry Sectors: Deploying the \$2 million Launch Akamai Venture Accelerator funding, HSDC helped establish accelerator programs in four key industry sectors: software, film and media, clean tech, and food innovation. UHERO's 2016 report, "Evolution of the HI Growth Initiative", concluded that HSDC leveraged state resources 11x and that HSDC's investment resulted in "the rapid growth in Hawaii based accelerators [that] may finally provide the necessary impetus to draw attention to entrepreneurship in the state, leading to further growth in venture capital, one of the necessary ingredients in a vibrant innovation ecosystem". HSDC supported accelerators achieved national recognition and are catalysts for their industry sectors through their mentor and investor networks, and the frequent community events they host to facilitate collaboration.

Continuum of Financing Creates Access to Startup Capital: HSDC used the \$13 million US Treasury State Small Business Credit Initiative (SSBCI) grant and the \$6 million HI Growth Initiative to capitalize 6 funds spanning the pre-seed, seed and Series A stage of startup development. Startup Capital Ventures documented the growth in venture capital in Hawaii in their report, "Hawaii Venture Capital 2010 to 2018". The analysis showed that HSDC's investment program significantly increased deal flow from 2012 onward through its establishment of various accelerator programs and investment funds. Annual venture capital investment in the State is now averaging \$20 million a year. The US Treasury reported that Hawaii achieved 33x private capital leverage on its SSBCI allocation, the highest in the nation.

Aquaculture Initiative to Jumpstart New Industry Sector: HSDC organized the first Statewide Aquaculture Summit, bringing together companies, researchers, investors, entrepreneurs and government agencies involved in Hawaii's aquaculture industry. The summit allowed the industry to articulate areas of strength, areas needing support, and recommendations on how to further develop the industry. This effort led to the successful funding for an aquaculture accelerator to be located at NELHA. HSDC was awarded a \$275,000 grant under the EDA's competitive Seed Fund Grant program. HSDC will partner with the University of Hawaii and NELHA and use this grant to build deal pipeline for the NELHA accelerator and support the capital raising activities of the investment fund affiliated with that accelerator.

Ecosystem Success Stories: Volta Charging, a Blue Startups graduate, has raised \$60 million to build its national network of EV charging stations. GVS released the film, "Running for Grace", in an 11 city national theatrical release and now available on the leading streaming services. The movie was completely filmed and produced on the Big Island utilizing GVS' Honua Studio. Kineticor, commercialized UH and Queens technology to develop an image correction system for MRI machines. Siemens has incorporated the technology in its MRI machines. Kineticor raised over \$12 million to grow and scale the business. IBIS Networks, a graduate of the Elemental Excelsior, has raised over \$4 million, and is now deploying its energy management system across California's community college system. OHi Superfood Bars, a graduate of the Maui Food Innovation Center, raised growth capital and is now selling its products in natural food retailers on the Mainland.