



GOV. MSG. NO. 648

EXECUTIVE CHAMBERS
HONOLULU

LINDA LINGLE
GOVERNOR

July 1, 2010

The Honorable Colleen Hanabusa, President
and Members of the Senate
Twenty-Fifth State Legislature
State Capitol, Room 409
Honolulu, Hawaii 96813

Dear Madam President and Members of the Senate:

I am transmitting herewith SB2001 SD1 HD1, without my approval, and with the statement of objections relating to the measure.

SB2001 SD1 HD1

A BILL FOR AN ACT
RELATING TO TAXATION.

Sincerely,

LINDA LINGLE

EXECUTIVE CHAMBERS

HONOLULU

July 1, 2010

STATEMENT OF OBJECTIONS TO SENATE BILL NO. 2001

Honorable Members
Twenty-Fifth Legislature
State of Hawaii

Pursuant to Section 16 of Article III of the Constitution of the State of Hawaii, I am returning herewith, without my approval, Senate Bill No. 2001, entitled "A Bill for an Act Relating to Taxation."

The purpose of this bill is to repeal the High Technology Business Investment Tax Credit and the Technology Infrastructure Renovation Tax Credit retroactively on May 1, 2010, rather than December 31, 2010. This bill also extends the Tax Credit for Research Activities by one year, from December 31, 2010 to December 31, 2011.

This measure is objectionable because it raises fundamental doubts about the reliability and veracity of the State and adversely impacts the technology industry by extending support to specific parts of the technology sector at the expense of others.

Investors, entrepreneurs, and businesses make decisions to hire staff, expand operations, or start a new enterprise based on assessments of the risks and rewards they face. When government policies and commitments change with little notice or rationale, investors and firms understandably decide to pull back and invest their capital elsewhere.

This bill's retroactive elimination of a fundamental tax credit that numerous firms and individuals have depended upon since 1999, implies that people who invest in Hawaii can no longer trust State Government to keep its word. This is poor public policy and will have long-term adverse implications for

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SENATE BILL NO. 2001
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the State's ability to attract and retain new jobs and new investment.

Hawaii's technology industry is diverse in its makeup, including computer software, renewable energy, digital media, bioengineering, and defense-related companies. Depending on the field, function and maturity of these firms, research and development may or may not be a part of their ongoing functions. According to the Department of Taxation, there were a total of 203 qualified high technology companies using the business investment tax credit to attract investors in 2008, of which 76 companies also claimed the research tax credit. Many of these 76 research-oriented companies are in the fields of biotechnology and defense.

While these two sectors have contributed significantly to Hawaii's technology industry, it is vital for Hawaii to develop a diverse and vibrant industry that includes all sectors of innovation and technological development. This bill unfairly divides the industry and sacrifices companies with less research-oriented functions for the sake of companies oriented toward research and development. The State should not be in the business of picking winners and losers in the technology industry when the goal is to ensure the whole industry thrives in all its diversity.

For the foregoing reason, I am returning Senate Bill No. 2001 without my approval.

Respectfully,


LINDA LINGLE
Governor of Hawaii

A BILL FOR AN ACT

RELATING TO TAXATION.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 PART I

2 SECTION 1. The legislature finds that due to the dismal
3 state budget situation, there is a compelling public interest
4 for the early termination of tax credits that result in
5 significant tax expenditures. Therefore, the purpose of this
6 Act is to address taxation by extending the research activity
7 tax credit and terminating early the technology infrastructure
8 renovation and high technology business investment tax credits.

9 PART II

10 SECTION 2. The purpose of this part is to extend the
11 research activity tax credit.

12 SECTION 3. Section 235-110.91, Hawaii Revised Statutes, is
13 amended by amending subsection (j) to read as follows:

14 "(j) This section shall not apply to taxable years
15 beginning after December 31, [~~2010-~~] 2011."

16 PART III

17 SECTION 4. The purpose of this part is to terminate early
18 the technology infrastructure renovation tax credit and high



1 technology business investment tax credit prior to their
2 statutory repeal date of December 31, 2010.

3 SECTION 5. Section 235-110.51, Hawaii Revised Statutes, is
4 repealed.

5 [~~§235-110.51 Technology infrastructure renovation tax~~
6 ~~credit.~~ (a) ~~There shall be allowed to each taxpayer subject to~~
7 ~~the taxes imposed by this chapter, an income tax credit which~~
8 ~~shall be deductible from the taxpayer's net income tax~~
9 ~~liability, if any, imposed by this chapter for the taxable year~~
10 ~~in which the credit is properly claimed.~~

11 (b) ~~The amount of the credit shall be four per cent of the~~
12 ~~renovation costs incurred during the taxable year for each~~
13 ~~commercial building located in Hawaii.~~

14 (c) ~~In the case of a partnership, S corporation, estate,~~
15 ~~trust, or any developer of a commercial building, the tax credit~~
16 ~~allowable is for renovation costs incurred by the entity for the~~
17 ~~taxable year. The cost upon which the tax credit is computed~~
18 ~~shall be determined at the entity level. Distribution and share~~
19 ~~of credit shall be determined pursuant to section 235-110.7(a).~~

20 (d) ~~If a deduction is taken under section 179 (with~~
21 ~~respect to election to expense depreciable business assets) of~~
22 ~~the Internal Revenue Code, no tax credit shall be allowed for~~



1 ~~that portion of the renovation cost for which the deduction is~~
2 ~~taken.~~

3 ~~(e) The basis of eligible property for depreciation or~~
4 ~~accelerated cost recovery system purposes for state income taxes~~
5 ~~shall be reduced by the amount of credit allowable and claimed.~~
6 ~~In the alternative, the taxpayer shall treat the amount of the~~
7 ~~credit allowable and claimed as a taxable income item for the~~
8 ~~taxable year in which it is properly recognized under the method~~
9 ~~of accounting used to compute taxable income.~~

10 ~~(f) The credit allowed under this section shall be claimed~~
11 ~~against the net income tax liability for the taxable year.~~

12 ~~(g) If the tax credit under this section exceeds the~~
13 ~~taxpayer's income tax liability, the excess of credit over~~
14 ~~liability may be carried forward until exhausted.~~

15 ~~(h) The tax credit allowed under this section shall not be~~
16 ~~available for taxable years beginning after December 31, 2010.~~

17 ~~(i) As used in this section:~~

18 ~~"Net income tax liability" means income tax liability~~
19 ~~reduced by all other credits allowed under this chapter.~~

20 ~~"Renovation costs" means costs incurred after December 31,~~
21 ~~2000, to plan, design, install, construct, and purchase~~



1 ~~technology-enabled infrastructure equipment to provide a~~
2 ~~commercial building with technology-enabled infrastructure.~~

3 ~~"Technology-enabled infrastructure" means:~~

4 ~~(1) High speed telecommunications systems that provide~~
5 ~~Internet access, direct satellite communications~~
6 ~~access, and videoconferencing facilities;~~

7 ~~(2) Physical security systems that identify and verify~~
8 ~~valid entry to secure spaces, detect invalid entry or~~
9 ~~entry attempts, and monitor activity in these spaces;~~

10 ~~(3) Environmental systems to include heating, ventilation,~~
11 ~~air conditioning, fire detection and suppression, and~~
12 ~~other life safety systems; and~~

13 ~~(4) Backup and emergency electric power systems.~~

14 ~~(j) No taxpayer that claims a credit under this section~~
15 ~~shall claim any other credit under this chapter."]~~

16 SECTION 6. Section 235-110.9, Hawaii Revised Statutes, is
17 repealed.

18 [~~§235-110.9 High technology business investment tax~~
19 ~~credit. (a) There shall be allowed to each taxpayer subject to~~
20 ~~the taxes imposed by this chapter a high technology business~~
21 ~~investment tax credit that shall be deductible from the~~
22 ~~taxpayer's net income tax liability, if any, imposed by this~~



1 ~~chapter for the taxable year in which the investment was made~~
2 ~~and the following four years provided the credit is properly~~
3 ~~claimed. The tax credit shall be as follows:~~

4 ~~(1) In the year the investment was made, thirty five per~~
5 ~~cent,~~

6 ~~(2) In the first year following the year in which the~~
7 ~~investment was made, twenty five per cent,~~

8 ~~(3) In the second year following the investment, twenty~~
9 ~~per cent,~~

10 ~~(4) In the third year following the investment, ten per~~
11 ~~cent, and~~

12 ~~(5) In the fourth year following the investment, ten per~~
13 ~~cent,~~

14 ~~of the investment made by the taxpayer in each qualified high~~
15 ~~technology business, up to a maximum allowed credit in the year~~
16 ~~the investment was made, \$700,000; in the first year following~~
17 ~~the year in which the investment was made, \$500,000; in the~~
18 ~~second year following the year in which the investment was made,~~
19 ~~\$400,000; in the third year following the year in which the~~
20 ~~investment was made, \$200,000; and in the fourth year following~~
21 ~~the year in which the investment was made, \$200,000.~~



1 ~~(b) The credit allowed under this section shall be claimed~~
2 ~~against the net income tax liability for the taxable year. For~~
3 ~~the purpose of this section, "net income tax liability" means~~
4 ~~net income tax liability reduced by all other credits allowed~~
5 ~~under this chapter. By accepting an investment for which the~~
6 ~~credit allowed under this section may be claimed, a qualified~~
7 ~~high technology business consents to the public disclosure of~~
8 ~~the qualified high technology business' name and status as a~~
9 ~~beneficiary of the credit under this section.~~

10 ~~(c) If the tax credit under this section exceeds the~~
11 ~~taxpayer's income tax liability for any of the five years that~~
12 ~~the credit is taken, the excess of the tax credit over liability~~
13 ~~may be used as a credit against the taxpayer's income tax~~
14 ~~liability in subsequent years until exhausted. Every claim,~~
15 ~~including amended claims, for a tax credit under this section~~
16 ~~shall be filed on or before the end of the twelfth month~~
17 ~~following the close of the taxable year for which the credit may~~
18 ~~be claimed. Failure to comply with the foregoing provision~~
19 ~~shall constitute a waiver of the right to claim the credit.~~

20 ~~(d) If at the close of any taxable year in the five year~~
21 ~~period in subsection (a):~~



1 ~~(1) The business no longer qualifies as a qualified high~~
2 ~~technology business;~~

3 ~~(2) The business or an interest in the business has been~~
4 ~~sold by the taxpayer investing in the qualified high~~
5 ~~technology business; or~~

6 ~~(3) The taxpayer has withdrawn the taxpayer's investment~~
7 ~~wholly or partially from the qualified high technology~~
8 ~~business;~~

9 ~~the credit claimed under this section shall be recaptured. The~~
10 ~~recapture shall be equal to ten per cent of the amount of the~~
11 ~~total tax credit claimed under this section in the preceding two~~
12 ~~taxable years. The amount of the credit recaptured shall apply~~
13 ~~only to the investment in the particular qualified high~~
14 ~~technology business that meets the requirements of paragraph~~
15 ~~(1), (2), or (3). The recapture provisions of this subsection~~
16 ~~shall not apply to a tax credit claimed for a qualified high~~
17 ~~technology business that does not fall within the provisions of~~
18 ~~paragraph (1), (2), or (3). The amount of the recaptured tax~~
19 ~~credit determined under this subsection shall be added to the~~
20 ~~taxpayer's tax liability for the taxable year in which the~~
21 ~~recapture occurs under this subsection.~~



1 ~~(e) Every taxpayer, before March 31 of each year in which~~
2 ~~an investment in a qualified high technology business was made~~
3 ~~in the previous taxable year, shall submit a written, certified~~
4 ~~statement to the director of taxation identifying:~~

5 ~~(1) Qualified investments, if any, expended in the~~
6 ~~previous taxable year; and~~

7 ~~(2) The amount of tax credits claimed pursuant to this~~
8 ~~section, if any, in the previous taxable year.~~

9 ~~(f) The department shall:~~

10 ~~(1) Maintain records of the names and addresses of the~~
11 ~~taxpayers claiming the credits under this section and~~
12 ~~the total amount of the qualified investment costs~~
13 ~~upon which the tax credit is based;~~

14 ~~(2) Verify the nature and amount of the qualifying~~
15 ~~investments;~~

16 ~~(3) Total all qualifying and cumulative investments that~~
17 ~~the department certifies; and~~

18 ~~(4) Certify the amount of the tax credit for each taxable~~
19 ~~year and cumulative amount of the tax credit.~~

20 ~~Upon each determination made under this subsection, the~~
21 ~~department shall issue a certificate to the taxpayer verifying~~
22 ~~information submitted to the department, including qualifying~~



1 ~~investment amounts, the credit amount certified for each taxable~~
2 ~~year, and the cumulative amount of the tax credit during the~~
3 ~~credit period. The taxpayer shall file the certificate with the~~
4 ~~taxpayer's tax return with the department.~~

5 ~~The director of taxation may assess and collect a fee to~~
6 ~~offset the costs of certifying tax credits claims under this~~
7 ~~section. All fees collected under this section shall be~~
8 ~~deposited into the tax administration special fund established~~
9 ~~under section 235-20.5.~~

10 ~~(g) As used in this section:~~

11 ~~"Investment tax credit allocation ratio" means, with~~
12 ~~respect to a taxpayer that has made an investment in a qualified~~
13 ~~high technology business, the ratio of:~~

14 ~~(1) The amount of the credit under this section that is,~~
15 ~~or is to be, received by or allocated to the taxpayer~~
16 ~~over the life of the investment, as a result of the~~
17 ~~investment; to~~

18 ~~(2) The amount of the investment in the qualified high~~
19 ~~technology business.~~

20 ~~"Qualified high technology business" means a business,~~
21 ~~employing or owning capital or property, or maintaining an~~
22 ~~office, in this State; provided that:~~



1 ~~(1) More than fifty per cent of its total business~~
2 ~~activities are qualified research; and provided~~
3 ~~further that the business conducts more than seventy-~~
4 ~~five per cent of its qualified research in this State,~~
5 ~~or~~

6 ~~(2) More than seventy five per cent of its gross income is~~
7 ~~derived from qualified research; and provided further~~
8 ~~that this income is received from:~~

9 ~~(A) Products sold from, manufactured in, or produced~~
10 ~~in this State; or~~

11 ~~(B) Services performed in this State.~~

12 ~~"Qualified research" means the same as defined in section~~
13 ~~235-7.3.~~

14 ~~(h) Common law principles, including the doctrine of~~
15 ~~economic substance and business purpose, shall apply to any~~
16 ~~investment. There exists a presumption that a transaction~~
17 ~~satisfies the doctrine of economic substance and business~~
18 ~~purpose to the extent that the special allocation of the high~~
19 ~~technology business tax credit has an investment tax credit~~
20 ~~ratio of 1.5 or less of credit for every dollar invested.~~

21 ~~Transactions for which an investment tax credit allocation~~
22 ~~ratio greater than 1.5 but not more than 2.0 of credit for every~~



1 ~~dollar invested and claimed may be reviewed by the department~~
2 ~~for applicable doctrines of economic substance and business~~
3 ~~purpose.~~

4 ~~Businesses claiming a tax credit for transactions with~~
5 ~~investment tax credit allocation ratios greater than 2.0 of~~
6 ~~credit for every dollar invested shall substantiate economic~~
7 ~~merit and business purpose consistent with this section.~~

8 ~~(i) For investments made on or after May 1, 2009,~~
9 ~~notwithstanding any other law to the contrary, no allocations,~~
10 ~~special or otherwise, of credits under this section may exceed~~
11 ~~the amount of the investment made by the taxpayer ultimately~~
12 ~~claiming this credit; and investment tax credit allocation~~
13 ~~ratios greater than 1.0 of credit for every dollar invested~~
14 ~~shall not be allowed. In addition, the credit shall be allowed~~
15 ~~only in accordance with subsection (a).~~

16 ~~(j) For investments made on or after May 1, 2009, this~~
17 ~~section shall be subject to section 235-109.5.~~

18 ~~(k) This section shall not apply to taxable years~~
19 ~~beginning after December 31, 2010."]~~

20 SECTION 7. Section 241-4.8, Hawaii Revised Statutes, is
21 repealed.



1 including stock issued through the exercise of stock options or
2 warrants, from a qualified high technology business or from a
3 holding company of a qualified high technology business by an
4 employee, officer, or director of the qualified high technology
5 business [~~, or investor who qualifies for the credit under~~
6 ~~section 235-110.9,~~] that would otherwise be taxed as ordinary
7 income or as capital gains to those persons shall be excluded
8 from taxation under this chapter.

9 Similar provisions shall apply to options to acquire equity
10 interests and to equity interests themselves with regard to
11 entities other than corporations."

12 SECTION 11. Section 235-20.5, Hawaii Revised Statutes, is
13 amended to read as follows:

14 "§235-20.5 Tax administration special fund; established.

15 (a) There is established a tax administration special fund,
16 into which shall be deposited:

17 (1) Fees collected under sections 235-20 [~~, 235-110.9,~~] and
18 235-110.91 [~~+~~] and the former section 235-110.9;

19 (2) Penalties collected under section 2 of Act 206,
20 Session Laws of Hawaii 2007; and

21 (3) Revenues collected by the special enforcement section
22 pursuant to section 231-85; provided that in each



1 fiscal year, of the total revenues collected by the
2 special enforcement section, all revenues in excess of
3 \$500,000 shall be deposited into the general fund.

4 (b) The moneys in the fund shall be used for the following
5 purposes:

- 6 (1) Issuing comfort letters, letter rulings, written
7 opinions, and other guidance to taxpayers;
- 8 (2) Administering the tax credits under [~~sections 235-~~
9 ~~110.9 and 235-110.91;~~] section 235-110.91 and the
10 former section 110.9; and
- 11 (3) Administering the operations of the special
12 enforcement section."

13 SECTION 12. Section 235-110.91, Hawaii Revised Statutes,
14 is amended by amending subsection (f) to read as follows:

15 "(f) As used in this section:

16 "Basic research" under [~~section~~] Section 41(e) of the
17 Internal Revenue Code shall not include research conducted
18 outside of the [~~State-~~] state.

19 "Qualified high technology business" means [~~the same as in~~
20 ~~section 235-110.9.~~] a business, employing or owning capital or
21 property, or maintaining an office, in this state; provided
22 that:



1 SECTION 15. This Act shall take effect on May 1, 2010, and
2 shall apply to investments made and renovation costs incurred on
3 or after May 1, 2010; provided that:

4 (1) If this Act is approved or otherwise becomes law after
5 May 1, 2010, this Act shall still take effect on and
6 shall apply retroactively to May 1, 2010; and

7 (2) Notwithstanding section 8 of Act 206, Session Laws of
8 Hawaii 2007, and section 13 of Act 134, Session Laws
9 of Hawaii 2009, section 235-20.5, Hawaii Revised
10 Statutes, shall not be repealed and reenacted as
11 specified in those Acts, but shall exist in the form
12 provided by this Act until subsequently amended by
13 another Act.

