

H.B. NO. 1156

A BILL FOR AN ACT

RELATING TO HIGH TECHNOLOGY BUSINESS INVESTMENT TAX CREDIT.

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

1 SECTION 1. Section 235-2.45, Hawaii Revised Statutes, is
2 amended by amending subsection (d) to read as follows:

3 "(d) Section 704 of the Internal Revenue Code (with
4 respect to a partner's distributive share) shall be operative
5 for purposes of this chapter; except that section 704(b)(2)
6 shall not apply to:

7 ~~[(1) Allocations of the high technology business investment~~
8 ~~tax credit allowed by section 235-110.9;~~

9 ~~[(2) Allocations of net operating loss pursuant to section~~
10 ~~235-111.5;~~

11 ~~[(3)]~~ (1) Allocations of the attractions and educational
12 facilities tax credit allowed by section 235-110.46;

13 or

14 ~~[(4)]~~ (2) Allocations of low-income housing tax credits
15 among partners under section 235-110.8."

16 SECTION 2. Section 235-110.9, Hawaii Revised Statutes, is
17 amended to read as follows:

1 "§235-110.9 High technology business investment tax
2 credit. (a) There shall be allowed to each taxpayer subject to
3 the taxes imposed by this chapter a high technology business
4 investment tax credit that shall be deductible from the
5 taxpayer's net income tax liability, if any, imposed by this
6 chapter for the taxable year in which the investment was made
7 and the following four years provided the credit is properly
8 claimed. The tax credit shall be as follows:

9 (1) In the year the investment was made, thirty-five per
10 cent;

11 (2) In the first year following the year in which the
12 investment was made, twenty-five per cent;

13 (3) In the second year following the investment, twenty
14 per cent;

15 (4) In the third year following the investment, ten per
16 cent; and

17 (5) In the fourth year following the investment, ten per
18 cent;

19 of the investment made by the taxpayer in each qualified high
20 technology business, up to a maximum allowed credit in the year
21 the investment was made, \$700,000; in the first year following
22 the year in which the investment was made, \$500,000; in the

1 second year following the year in which the investment was made,
2 \$400,000; in the third year following the year in which the
3 investment was made, \$200,000; and in the fourth year following
4 the year in which the investment was made, \$200,000.

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

14 (c) If the tax credit under this section exceeds the
15 taxpayer's income tax liability for any of the five years that
16 the credit is taken, the excess of the tax credit over liability
17 may be used as a credit against the taxpayer's income tax
18 liability in subsequent years until exhausted. Every claim,
19 including amended claims, for a tax credit under this section
20 shall be filed on or before the end of the twelfth month
21 following the close of the taxable year for which the credit may

1 be claimed. Failure to comply with the foregoing provision
2 shall constitute a waiver of the right to claim the credit.

3 (d) If at the close of any taxable year in the five-year
4 period in subsection (a):

5 (1) The business no longer qualifies as a qualified high
6 technology business;

7 (2) The business or an interest in the business has been
8 sold by the taxpayer investing in the qualified high
9 technology business; or

10 (3) The taxpayer has withdrawn the taxpayer's investment
11 wholly or partially from the qualified high technology
12 business;

13 the credit claimed under this section shall be recaptured. The
14 recapture shall be equal to [~~ten~~] fifty per cent of the amount
15 of the total tax credit claimed under this section in the
16 preceding two taxable years. The amount of the credit
17 recaptured shall apply only to the investment in the particular
18 qualified high technology business that meets the requirements
19 of paragraph (1), (2), or (3). The recapture provisions of this
20 subsection shall not apply to a tax credit claimed for a
21 qualified high technology business that does not fall within the
22 provisions of paragraph (1), (2), or (3). The amount of the

1 recaptured tax credit determined under this subsection shall be
2 added to the taxpayer's tax liability for the taxable year in
3 which the recapture occurs under this subsection.

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

- 8 (1) Qualified investments, if any, expended in the
9 previous taxable year; and
- 10 (2) The amount of tax credits claimed pursuant to this
11 section, if any, in the previous taxable year.
- 12 (f) The department shall:
 - 13 (1) Maintain records of the names and addresses of the
14 taxpayers claiming the credits under this section and
15 the total amount of the qualified investment costs
16 upon which the tax credit is based;
 - 17 (2) Verify the nature and amount of the qualifying
18 investments;
 - 19 (3) Total all qualifying and cumulative investments that
20 the department certifies; and
 - 21 (4) Certify the amount of the tax credit for each taxable
22 year and cumulative amount of the tax credit.

1 Upon each determination made under this subsection, the
2 department shall issue a certificate to the taxpayer verifying
3 information submitted to the department, including qualifying
4 investment amounts, the credit amount certified for each taxable
5 year, and the cumulative amount of the tax credit during the
6 credit period. The taxpayer shall file the certificate with the
7 taxpayer's tax return with the department.

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

13 (g) As used in this section:

14 ~~["Investment tax credit allocation ratio" means, with~~
15 ~~respect to a taxpayer that has made an investment in a qualified~~
16 ~~high technology business, the ratio of:~~

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

21 ~~(2) The amount of the investment in the qualified high~~
22 ~~technology business.]~~

1 "Qualified high technology business" means a business,
2 employing or owning capital or property, or maintaining an
3 office, in this State; provided that:

4 (1) More than [~~fifty~~] seventy-five per cent of its total
5 business activities are qualified research[~~;~~ and
6 ~~provided further that the business conducts more than~~
7 ~~seventy five per cent of its qualified research]~~
8 activities conducted in this State; and

9 (2) More than seventy-five per cent of its [~~gross income~~
10 ~~is derived from qualified research; and provided~~
11 ~~further that this income is received from:~~

12 ~~(A) Products sold from, manufactured in, or produced~~
13 ~~in this State; or~~

14 ~~(B) Services performed in this State.]~~ workforce
15 conducting the qualified research activities is
16 comprised of employees or independent contractors
17 physically performing services in this State.

18 "Qualified research" means [~~the same as defined in section~~
19 ~~235-7.3.]~~ the same as in section 41(d) of the Internal Revenue
20 Code.

21 [~~(h) Common law principles, including the doctrine of~~
22 ~~economic substance and business purpose, shall apply to any~~

1 ~~investment. There exists a presumption that a transaction~~
2 ~~satisfies the doctrine of economic substance and business~~
3 ~~purpose to the extent that the special allocation of the high~~
4 ~~technology business tax credit has an investment tax credit~~
5 ~~ratio of 1.5 or less of credit for every dollar invested.~~

6 ~~Transactions for which an investment tax credit allocation~~
7 ~~ratio greater than 1.5 but not more than 2.0 of credit for every~~
8 ~~dollar invested and claimed may be reviewed by the department~~
9 ~~for applicable doctrines of economic substance and business~~
10 ~~purpose.~~

11 ~~Businesses claiming a tax credit for transactions with~~
12 ~~investment tax credit allocation ratios greater than 2.0 of~~
13 ~~credit for every dollar invested shall substantiate economic~~
14 ~~merit and business purpose consistent with this section.]~~

15 ~~[(i)]~~ (h) This section shall not apply to taxable years
16 beginning after December 31, 2010."

17 SECTION 3. Statutory material to be repealed is bracketed
18 and stricken. New statutory material is underscored.

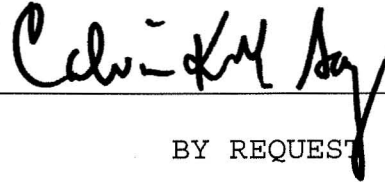
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1 SECTION 4. This Act shall take effect upon approval and
2 shall apply to investments made on or after July 1, 2009.

3

4

INTRODUCED BY:



BY REQUEST

5

JAN 26 2009

Report Title:

Income Tax; High Technology Business Investment Tax Credit
Amendments

Description:

Amends the High Technology Investment credit, also known as Act 221, to align the statute to its original intent to encourage investment in innovative, research-oriented high technology companies that create jobs and promote economic diversification in Hawaii.

JUSTIFICATION SHEET

DEPARTMENT: Taxation

TITLE: A BILL FOR AN ACT RELATING TO HIGH TECHNOLOGY BUSINESS INVESTMENT TAX CREDIT.

PURPOSE: Makes various amendments to the high technology business investment tax credit, including clarifying the definitions of qualified high technology business and qualified research, and conforms to Internal Revenue Code (IRC) section 704(b).

MEANS: Amend sections 235-2.45(d) and 235-110.9, Hawaii Revised Statutes (HRS).

JUSTIFICATION: The importance of promoting innovation and research-based activities was recognized with the enactment of several ground-breaking tax credits and programs intended to promote growth in technology and other innovation-related sectors. Beginning with Act 178, Session Laws of Hawaii 1999, the State vigorously encouraged the development of high technology businesses in order to further diversify its economy, attract former residents to return home, and develop business sectors with better paying jobs.

Act 178 was followed by Act 221, Session Laws of Hawaii 2001 (Act 221), which provided for what is believed to be the only one hundred percent tax credit available for investments into businesses conducting high technology research-related activities. Act 221 provided financial backing for these companies by attracting capital from both local and foreign sources through government incentives. While recognizing the effect that government incentives had in boosting Hawaii's technology industry, it is critical that the State review every incentive, including the incentive contained in this legislation, for effectiveness and to ensure that the intended benefits have come to

fruition. Essentially, two questions need to be answered: 1) whether the State should sustain the current level of commitment--a commitment unmatched by any other jurisdiction--to one industry; and 2) whether those who benefit from this legislative commitment have provided the State with the return on its investment in light of original intent.

As such, this measure ensures fairness and accountability by providing incentives to technology businesses involved in research and development as clearly defined in the Federal tax codes and extensive tax case law.

This measure continues to provide a one hundred percent nonrefundable income tax credit for investment in a qualified high technology business. This legislation limits the credit amount to one hundred percent of a taxpayer's investment rather than allowing for credit "multiples" received in addition to the amount invested. While Act 221 was not intended to be a windfall, investment practices have allowed investors to receive back well beyond what they actually risk.

Also, this measure clarifies the type of research that must be conducted in order for a business to qualify for investments. This measure expressly clarifies that a business' activities must be "qualified research" as defined under section 41(d) of the IRC. Section 41(d) of the IRC is the best definition for identifying the types of activities contemplated by the legislature through Act 221 and its predecessors. As a general matter, research that qualifies under this legislation are those research activities: (1) undertaken for the purpose of discovering information that is technological in nature; (2) intended to be useful as a business component of the company; and (3) which involves a process of

experimentation. This definition will greatly assist taxpayers and administrators with concrete guidelines on what the intended research means--actual research in the experimental sense.

Importantly, the definition in this legislation is not intended to be overly restrictive when compared to current law. It is likely that many current categories of research (including biotechnology, optic technology, ocean sciences, and nonfossil fuel energy related technologies) will continue to qualify under this new definition. Performing arts products would not qualify, unless the company is developing new technology meeting the definition of section 41(d) of the IRC while undertaking production. Movie productions would remain eligible for the refundable production credit available under section 235-17, HRS.

The bill also requires that seventy-five percent of the company's workforce be employed in Hawaii. The requirement is consistent with the original intent of Act 178 and Act 221 to foster a high technology workforce enabling young people to remain in Hawaii and reverse the brain drain by drawing Hawaii's young people working in high technology industries on the mainland, back home.

This measure also increases the recapture of credits in instances where the business fails to maintain its qualified status, the interest in the business is sold by a taxpayer, or a taxpayer withdraws an investment. The recapture provision is increased from ten per cent to fifty per cent of the amount of credit claimed in the two prior taxable years. Increasing the recapture amount ensures that taxpayers are investing long-term and also investing in businesses that are likely to maintain the five-year commitment to the State.

This measure takes effect upon approval and applies to investments made on or after July 1, 2009.

Impact on the public: Taxpayers that invest in qualified high technology businesses will be entitled to claim this credit. Investors investing after the effective date will be entitled to a 100 percent tax credit allowable under current law. There will no longer be credit allocations without regard to substantial economic effect. Recapture will be increased from ten per cent of credits claimed in the two prior taxable years to fifty per cent. A qualified high technology business will only qualify if it conducts at least seventy-five per cent of its business activities in qualified research as defined under section 41(d) of the IRC. To be a qualified high technology business, at least seventy-five per cent of its workforce conducting research must be with employees or independent contractors in Hawaii.

Impact on the department and other agencies: The Department of Taxation will be responsible for administering this credit.

GENERAL FUND: \$21,000,000 revenue gain for fiscal year 2009-2010; \$45,000,000 revenue gain for fiscal year 2010-2011.

OTHER FUNDS: None.

PPBS PROGRAM DESIGNATION: TAX-100.

OTHER AFFECTED AGENCIES: None.

EFFECTIVE DATE: Upon approval applying to investments received on or after July 1, 2009.