

JAN 26 2009

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 235-110.9, Hawaii Revised Statutes, is
2 amended to read as follows:

3 "§235-110.9 High technology business investment tax credit.

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

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

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

15 (3) In the second year following the investment, twenty
16 per cent;

17 (4) In the third year following the investment, ten per
18 cent; and

1 (5) In the fourth year following the investment, ten per
2 cent;
3 of the investment made by the taxpayer in each eligible
4 qualified high technology business, up to a maximum allowed
5 credit in the year the investment was made, \$700,000; in the
6 first year following the year in which the investment was made,
7 \$500,000; in the second year following the year in which the
8 investment was made, \$400,000; in the third year following the
9 year in which the investment was made, \$200,000; and in the
10 fourth year following the year in which the investment was made,
11 \$200,000.

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

21 (c) If the tax credit under this section exceeds the
22 taxpayer's income tax liability for any of the five years that

1 the credit is taken, the excess of the tax credit over liability
2 may be used as a credit against the taxpayer's income tax
3 liability in subsequent years until exhausted. Every claim,
4 including amended claims, for a tax credit under this section
5 shall be filed on or before the end of the twelfth month
6 following the close of the taxable year for which the credit may
7 be claimed. Failure to comply with the foregoing provision
8 shall constitute a waiver of the right to claim the credit.

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

11 (1) The business no longer qualifies as a qualified high
12 technology business;

13 (2) The business or an interest in the business has been
14 sold by the taxpayer investing in the qualified high
15 technology business; or

16 (3) The taxpayer has withdrawn the taxpayer's investment
17 wholly or partially from the qualified high technology
18 business;

19 the credit claimed under this section shall be recaptured. The
20 recapture shall be equal to ten per cent of the amount of the
21 total tax credit claimed under this section in the preceding two
22 taxable years. The amount of the credit recaptured shall apply

1 only to the investment in the particular qualified high
2 technology business that meets the requirements of paragraph
3 (1), (2), or (3). The recapture provisions of this subsection
4 shall not apply to a tax credit claimed for a qualified high
5 technology business that does not fall within the provisions of
6 paragraph (1), (2), or (3). The amount of the recaptured tax
7 credit determined under this subsection shall be added to the
8 taxpayer's tax liability for the taxable year in which the
9 recapture occurs under this subsection.

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

- 14 (1) Qualified investments, if any, expended in the
15 previous taxable year; and
16 (2) The amount of tax credits claimed pursuant to this
17 section, if any, in the previous taxable year.

18 (f) The department shall:

- 19 (1) Maintain records of the names and addresses of the
20 taxpayers claiming the credits under this section and
21 the total amount of the qualified investment costs
22 upon which the tax credit is based;

- 1 (2) Verify the nature and amount of the qualifying
2 investments;
- 3 (3) Total all qualifying and cumulative investments that
4 the department certifies; and
- 5 (4) Certify the amount of the tax credit for each taxable
6 year and cumulative amount of the tax credit.

7 Upon each determination made under this subsection, the
8 department shall issue a certificate to the taxpayer verifying
9 information submitted to the department, including qualifying
10 investment amounts, the credit amount certified for each taxable
11 year, and the cumulative amount of the tax credit during the
12 credit period. The taxpayer shall file the certificate with the
13 taxpayer's tax return with the department.

14 The director of taxation may assess and collect a fee to
15 offset the costs of certifying tax credits claims under this
16 section. All fees collected under this section shall be
17 deposited into the tax administration special fund established
18 under section 235-20.5.

19 (g) All tax credit claims under this section shall be made
20 pursuant to the following credit allotment procedures:

21 (1) Aggregate and periodic credit caps. The maximum
22 amount of tax credits available under this section

1 shall not exceed the following amounts for the
2 following periods:

3 (A) \$80,000,000 for investments made beginning July
4 1, 2009 and ending December 31, 2009;

5 (B) \$40,000,000 for investments made beginning
6 January 1, 2010 and ending June 30, 2010, plus
7 any carryover credits available from unused
8 allotments in subparagraph (A);

9 (C) \$40,000,000 for investments made beginning July
10 1, 2010 and ending December 31, 2010, plus any
11 carryover credit available from unused allotments
12 in subparagraph (B);

13 provided that the maximum amount of tax credits
14 available under this section shall not exceed
15 \$160,000,000 for all periods beginning after June 30,
16 2009 and before January 1, 2011.

17 (2) Credit allotment application. Beginning July 1, 2009,
18 the department shall allot up to the maximum amount of
19 tax credits as provided in paragraph (1). A qualified
20 high technology business may apply to the department
21 for an allotment of tax credits. A qualified high
22 technology business may apply for an allotment of tax

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1 credits in any amount not to exceed \$10,000,000 per
2 qualified high technology business per calendar year.
3 A qualified high technology business may apply for an
4 allotment of tax credits, on the form prescribed by
5 the department, no earlier than thirty days before the
6 beginning of the allotment period for which it seeks
7 allotment. All allotments issued by the department
8 shall be made on a first to file basis only.

9 (3) Allotment periods. Allotments of tax credits shall be
10 issued and valid for the following allotment periods:

11 (A) For credits available in paragraph (1) (A), the
12 allotments shall be issuable beginning July 1,
13 2009 and valid for placement of credits through
14 December 31, 2009;

15 (B) For credits available in paragraph (1) (B), the
16 allotments shall be issuable beginning January 1,
17 2010 and valid for placement of credits through
18 June 30, 2010; and

19 (C) For credits available in paragraph (1) (C), the
20 allotments shall be issuable beginning July 1,
21 2010 and valid for placement of credits through
22 December 31, 2010.

1 (4) Credits for completed investments; loss of future
2 allotments. A qualified high technology business that
3 receives an allotment of credits shall be entitled to
4 receive investments for which credits may be claimed
5 under this section; provided all other requirements of
6 this section have been satisfied, up to the maximum
7 amount of credits allotted to that qualified high
8 technology business. Where a qualified high
9 technology business obtains less investments than the
10 amount of credits allotted at the time the allotment
11 expires, the difference between the amount of allotted
12 credits and the amount of the investment received for
13 which a credit may be claimed shall revert back to the
14 department for distribution as carryover credits
15 available as provided in paragraph (1). A qualified
16 high technology business that receives investments
17 that are less than ninety per cent of the allotted
18 credits during the allotment period shall be precluded
19 from receiving a credit allotment for the allotment
20 period immediately following the allotment period in
21 which a credit allotment was received.

1 (5) Fees. The department is authorized to assess a fee
2 for requests for credit allotments. The fee shall be
3 \$1,000 for every \$1,000,000 of credit requested or
4 fraction thereof; provided that the fee shall be \$500
5 for credit requests of less than \$1,000,000. The fee
6 shall be refunded for any applications of credit
7 allotment denied due to the exhaustion of the tax
8 credits for the allotment period.

9 (6) Confirmation of allotted credits. Within fifteen days
10 after the end of the allotment period, every qualified
11 high technology business receiving a credit allotment
12 must prove to the department's satisfaction by the
13 last day of the allotment period that the investment
14 transaction was completed for the respective allotment
15 period. For purposes of this paragraph, an investment
16 transaction will be considered completed where the
17 following events have occurred:

18 (A) The cash representing the investment into the
19 qualified high technology business has been
20 deposited into a bank account of the qualified
21 high technology business; and

1 (B) The equity interest in the qualified high
2 technology business was issued in exchange for
3 the cash investment.

4 "Investment" as used in this paragraph is as defined
5 in section 235-1. Upon determining that the
6 investment transaction has been completed, the
7 department will issue a confirmation of the tax
8 credits claimable, which must be attached to the tax
9 return of any taxpayer claiming the allotted credits,
10 including the tax return of an entity claiming credits
11 for further allocation to its partners, members, or
12 other equity holders.

13 (7) Non-transferable nature of allotments. All credit
14 allotments issued by the department are non-
15 transferable, non-negotiable, and non-assignable;
16 provided that a statutory conversion in the form of
17 business entity shall not be considered a transfer or
18 assignment.

19 (8) Credit claims subject to audit. Notwithstanding a
20 credit allotment under this section, every claim for
21 credit shall be subject to audit or review by the
22 department.

1 [~~(g)~~] (h) As used in this section:

2 "Eligible qualified high technology business" means a
3 qualified high technology business that has received an
4 allotment of credits under subsection (g), limited to the amount
5 of such allotted credits and the period as to which such credits
6 were allotted.

7 "Investment tax credit allocation ratio" means, with
8 respect to a taxpayer that has made an investment in a qualified
9 high technology business, the ratio of:

10 (1) The amount of the credit under this section that is,
11 or is to be, received by or allocated to the taxpayer
12 over the life of the investment, as a result of the
13 investment; to

14 (2) The amount of the investment in the qualified high
15 technology business.

16 "Qualified high technology business" means a business,
17 employing or owning capital or property, or maintaining an
18 office, in this State; provided that:

19 (1) More than fifty per cent of its total business
20 activities are qualified research; and provided
21 further that the business conducts more than seventy-

1 five per cent of its qualified research in this State;

2 or

3 (2) More than seventy-five per cent of its gross income is
4 derived from qualified research; and provided further
5 that this income is received from:

6 (A) Products sold from, manufactured in, or produced
7 in this State; or

8 (B) Services performed in this State.

9 "Qualified research" means the same as defined in section
10 235-7.3.

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

18 Transactions for which an investment tax credit allocation
19 ratio greater than 1.5 but not more than 2.0 of credit for every
20 dollar invested and claimed may be reviewed by the department
21 for applicable doctrines of economic substance and business
22 purpose.

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

5 ~~[(i)]~~ (j) This section shall not apply to taxable years
6 beginning after December 31, 2010."

7 SECTION 2. Statutory material to be repealed is bracketed
8 and stricken. New statutory material is underscored.

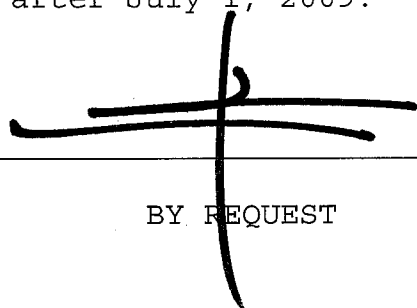
9 SECTION 3. This Act shall take effect upon approval and
10 shall apply to investments made on or after July 1, 2009.

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INTRODUCED BY: _____

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BY REQUEST

Report Title:

Income Tax; High Technology Business Investment Tax Credit

Description:

Amends the High Technology Investment credit, also known as Act 221, to provide an aggregate cap on the amount of high technology business investment tax credit issued per year.

JUSTIFICATION SHEET

DEPARTMENT: Taxation

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

PURPOSE: To provide an aggregate cap on the amount of High Technology Business Investment Tax Credits available and to institute a procedure for allotting credits to qualified high technology businesses.

MEANS: Amend section 235-110.9, Hawaii Revised Statutes (HRS).

JUSTIFICATION: The importance of promoting innovation and research-based activities was recognized with the enactment of several groundbreaking 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. Recognizing the amount the State has invested in these companies through tax incentives to date, coupled with the viability these companies demonstrate as promising profitable ventures, it is important that the State maintain its commitment to making Hawaii a high technology hub of the future for the sake of

its overall economy, which is overly tourism- and real estate-based.

While recognizing the effect that government incentives had in boosting Hawaii's technology industry, it is critical that the State keep a watchful eye on its most expensive tax incentive to ensure fiscal responsibility, especially during current times.

In the years after Act 221, Hawaii saw a boom in investment capital being injected into Hawaii's high technology sector. As a credit based upon investment (versus expenditures or jobs-created), nearly \$1,000,000,000 may be infused into these companies over Act 221's lifetime, which is set to expire at the end of 2010. However, as a one hundred per cent tax credit, for every dollar invested the State becomes liable for repayment of that dollar over time.

The purpose of this measure is to preserve the State's commitment to diversifying Hawaii's economy with a booming high technology industry by maintaining the current structure of the one hundred per cent investment tax credit, but capping the amount of credits that may be generated.

By implementing a cap, the State will be better able to insulate the general fund from unpredictable drains in revenue due to volatile credit claims. From a budgeting perspective, knowing the maximum amount of liability the State will need to fund allows for predictability, especially in such trying times.

This measure establishes a credit placement procedure that allows qualified high technology businesses to apply for credit allotment from the Department of Taxation. Allotments will be determined on a first-come, first-served basis, which eliminates

any subjectivity in choosing which companies are allotted the tax credits. The procedure also creates three allotment periods for investment. After applying for credits, eligible businesses will take the allotment to the investment community to raise money from investors who are assured that tax credits are available.

The maximum amount of credits will be approximately \$80,000,000 per year, divided amongst the periods, with an aggregate cap of \$160,000,000 for the remainder of the credit, which is set to expire at the end of 2010.

Eligible businesses will be entitled to apply for up to \$10,000,000 in credits per business per year. There is a sliding-scale fee, which increases with every \$1,000,000 in credits being sought.

In order to ensure an orderly allotment of credits, this legislation establishes checks to ensure that the allotment is not exhausted by companies seeking to maximize credits without the ability to subsequently raise sufficient investment dollars. An eligible business that fails to place ninety per cent of the allotted credits is precluded from receiving allotments in the next allotment period. In light of these parameters, it is expected that economics and free market principles will control credit requests. Also, in order to ensure all possible credits budgeted can be claimed, any unused credits from an allotment period can be carried forward to subsequent periods until the credit expires.

Within thirty days from the close of an allotment period, eligible businesses will be required to report to the Department the amount of funds invested and credit confirmation will be issued by the Department to taxpayers.

Lastly, to ensure that credits for investments are being given to legitimate high technology companies, all credit allotments remain subject to audit and review.

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 the existing one hundred per cent high technology business investment tax credit; subject to aggregate and periodic caps. Qualified high technology businesses must abide by new procedures to obtain credit allotments.

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.