ACT 221 H.B. NO. 175

A Bill for an Act Relating to Taxation.

Be It Enacted by the Legislature of the State of Hawaii:

SECTION 1. Through Act 178, Session Laws of Hawaii (SLH) 1999, and Act 297, SLH 2000, the legislature provided a platform to encourage the continued growth and development of high technology businesses and associated industries in Hawaii. These legislative efforts have resulted in growing interest in Hawaii as a ''New Economy'' marketplace. Additional incentives must now be put in place to set Hawaii apart as a tech-friendly place to do business for both technical and non-technical businesses.

SECTION 2. Chapter 235, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

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

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

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

(d) If a deduction is taken under section 179 (with respect to election to expense depreciable business assets) of the Internal Revenue Code, no tax credit shall be allowed for that portion of the renovation cost for which the deduction is taken.

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

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

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

(h) The tax credit allowed under this section shall be available for taxable years beginning after December 31, 2000, and shall not be available for taxable years beginning after December 31, 2005.

(i) As used in this section:

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

"Renovation costs" means costs incurred after December 31, 2000, to plan, design, install, construct, and purchase technology-enabled infrastructure equipment to provide a commercial building with technology-enabled infrastructure.

"Technology-enabled infrastructure" means:

(1) High speed telecommunications systems that provide Internet access, direct satellite communications access, and videoconferencing facilities;
(2) Physical security systems that identify and verify valid entry to secure spaces, detect invalid entry or entry attempts, and monitor activity in these spaces;
(3) Environmental systems to include heating, ventilation, air conditioning, fire detection and suppression, and other life safety systems; and
(4) Backup and emergency electric power systems.

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

SECTION 3. Chapter 237, Hawaii Revised Statutes, is amended by adding two new sections to be appropriately designated and to read as follows:

"§237- **Exemption for public Internet data centers.** (a) This chapter shall not apply to the gross income or gross proceeds received by a public Internet data center.

(b) As used in this section:

"Compensated use by the public" means use of equipment, maintenance of equipment, and rental of space in a public Internet data center.

"Public Internet data center" means a facility available for compensated use by the public and designed to:

(1) House data servers;
(2) Operate on a twenty-four-hour, seven-day-a-week basis;
(3) Have redundant systems for electricity, air conditioning, fire suppression, and security; and
(4) Provide services such as bandwidth, co-location, data backup, complex web hosting, and aggregation for application service providers.

(c) This section shall apply to gross income or gross proceeds received after June 30, 2001, but not after December 31, 2005.

§237- Exemption for sale of net operating loss by qualified high technology business. Effective January 1, 2001, there shall be exempted from the measure of taxes imposed by this chapter all of the value or gross income derived from the sale of a net operating loss by a qualified high technology business defined in section 235-7.3 or by any partner, member, or shareholder of a qualified high technology business in the case of partnerships, limited liability partnerships, limited liability companies classified as partnerships, and S corporations.

This section shall be repealed on December 31, 2005."

SECTION 4. Chapter 239, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

"**§239- Exemption for public Internet data centers.** (a) This chapter shall not apply to the gross income or gross proceeds received by a public Internet data center.

(b) As used in this section:

"Compensated use by the public" means use of equipment, maintenance of equipment, and rental of space in a public Internet data center.

"Public Internet data center" means a facility available for compensated use by the public and designed to:

(1) House data servers;
(2) Operate on a twenty-four-hour, seven-day-a-week basis;
(3) Have redundant systems for electricity, air conditioning, fire suppression, and security; and
(4) Provide services such as bandwidth, co-location, data backup, complex web hosting, and aggregation for application service providers.

(c) This section shall apply to gross income received after June 30, 2001, but not after December 31, 2005."

SECTION 5. Section 235-2.4, Hawaii Revised Statutes, is amended to read as follows:

"**§235-2.4 Operation of certain Internal Revenue Code provisions; sections 63 to 530.** (a) Section 63 (with respect to taxable income defined) of the Internal Revenue Code shall be operative for the purposes of this chapter, except that the standard deduction amount in section 63(c) of the Internal Revenue Code shall instead mean:

(1) $1,900 in the case of:
    (A) A joint return as provided by section 235-93; or

(B) A surviving spouse (as defined in section 2(a) of the Internal Revenue Code);

(2) $1,650 in the case of a head of household (as defined in section 2(b) of the Internal Revenue Code);

(3) $1,500 in the case of an individual who is not married and who is not a surviving spouse or head of household; or

(4) $950 in the case of a married individual filing a separate return.

Section 63(c)(4) shall not be operative in this State. Section 63(c)(5) shall be operative, except that the limitation on basic standard deduction in the case of certain dependents shall be the greater of $500 or such individual's earned income. Section 63(f) shall not be operative in this State.

The standard deduction amount for nonresidents shall be calculated pursuant to section 235-5.

(b) Section 72 (with respect to annuities; certain proceeds of endowment and life insurance contracts) of the Internal Revenue Code shall be operative for purposes of this chapter and be interpreted with due regard to section 235-7(a), except that the ten per cent additional tax on early distributions from retirement plans in section 72(t) shall not be operative for purposes of this chapter.

(c) Section 121 (with respect to exclusion of gain from sale of principal residence) of the Internal Revenue Code shall be operative for purposes of this chapter, except that for the election under section 121(f), a reference to section 1034 treatment means a reference to section 235-2.4(n) in effect for taxable year 1997.

(d) Section 165 (with respect to losses) of the Internal Revenue Code shall be operative for purposes of this chapter. Section 165 as operative for this chapter shall also apply to losses sustained from the sale of stocks or other interests issued through the exercise of the stock options or warrants granted by a qualified high technology business as defined in section 235-7.3.

[~~(d)~~] (e) Section 219 (with respect to retirement savings) of the Internal Revenue Code shall be operative for the purpose of this chapter. For the purpose of computing the limitation on the deduction for active participants in certain pension plans for state income tax purposes, adjusted gross income as used in section 219 as operative for this chapter means federal adjusted gross income.

[~~(e)~~] (f) Section 220 (with respect to medical savings accounts) of the Internal Revenue Code shall be operative for the purpose of this chapter, but only with respect to medical services accounts that have been approved by the Secretary of the Treasury of the United States.

(g) Section 265 (with respect to expenses and interest relating to tax-exempt income) of the Internal Revenue Code shall be operative for purposes of this chapter; except that it shall not apply to expenses for royalties and other income derived from any patents, copyrights, and trade secrets by an individual or a qualified high technology business as defined in section 235-7.3. Such expenses shall be deductible.

[~~(f)~~] (h) Section 408A (with respect to Roth Individual Retirement Accounts) of the Internal Revenue Code shall be operative for the purposes of this chapter. For the purposes of determining the aggregate amount of contributions to a Roth Individual Retirement Account or qualified rollover contribution to a Roth Individual Retirement Account from an individual retirement plan other than a Roth Individual Retirement Account, adjusted gross income as used in section 408A as operative for this chapter means federal adjusted gross income.

[~~(g)~~] (i) In administering the provisions of sections 410 to 417 (with respect to special rules relating to pensions, profit sharing, stock bonus plans, etc.), sections 418 to 418E (with respect to special rules for multiemployer plans), and sections 419 and 419A (with respect to treatment of welfare benefit funds) of the Internal Revenue Code, the department of taxation shall adopt rules under chapter 91 relating

to the specific requirements under such sections and to such other administrative requirements under those sections as may be necessary for the efficient administration of sections 410 to 419A.

In administering sections 401 to 419A (with respect to deferred compensation) of the Internal Revenue Code, Public Law 93-406, section 1017(i), shall be operative for the purposes of this chapter.

In administering section 402 (with respect to the taxability of beneficiary of employees' trust) of the Internal Revenue Code, the tax imposed on lump sum distributions by section 402(e) of the Internal Revenue Code shall be operative for the purposes of this chapter and the tax imposed therein is hereby imposed by this chapter at the rate determined under this chapter.

[~~(h)~~] (j) Section 468B (with respect to special rules for designated settlement funds) of the Internal Revenue Code shall be operative for the purposes of this chapter and the tax imposed therein is hereby imposed by this chapter at a rate equal to the maximum rate in effect for the taxable year imposed on estates and trusts under section 235-51.

[~~(i)~~] (k) Section 469 (with respect to passive activities and credits limited) of the Internal Revenue Code shall be operative for the purposes of this chapter. For the purpose of computing the offset for rental real estate activities for state income tax purposes, adjusted gross income as used in section 469 as operative for this chapter means federal adjusted gross income.

[~~(j)~~] (l) Sections 512 to 514 (with respect to taxation of business income of certain exempt organizations) of the Internal Revenue Code shall be operative for the purposes of this chapter as provided in this subsection.

"Unrelated business taxable income" means the same as in the Internal Revenue Code, except that in the computation thereof sections 235-3 to 235-5, and 235-7 (except subsection (c)), shall apply, and in the determination of the net operating loss deduction there shall not be taken into account any amount of income or deduction that is excluded in computing the unrelated business taxable income. Unrelated business taxable income shall not include any income from a prepaid legal service plan.

For a person described in section 401 or 501 of the Internal Revenue Code, as modified by section 235-2.3, the tax imposed by section 235-51 or 235-71 shall be imposed upon the person's unrelated business taxable income.

[~~(k)~~] (m) Section 521 (with respect to cooperatives) and subchapter T (sections 1381 to 1388, with respect to cooperatives and their patrons) of the Internal Revenue Code shall be operative for the purposes of this chapter as to any cooperative fully meeting the requirements of section 421-23, except that Internal Revenue Code section 521 cooperatives need not be organized in Hawaii.

[~~(l)~~] (n) Sections 527 (with respect to political organizations) and 528 (with respect to certain homeowners associations) of the Internal Revenue Code shall be operative for the purposes of this chapter and the taxes imposed in each such section are hereby imposed by this chapter at the rates determined under section 235-71.

[~~(m)~~] (o) Section 530 (with respect to education individual retirement accounts) of the Internal Revenue Code shall be operative for the purposes of this chapter. For the purpose of determining the maximum amount that a contributor could make to an education individual retirement account for state income tax purposes, modified adjusted gross income as used in section 530 as operative for this chapter means federal modified adjusted gross income as defined in section 530."

SECTION 6. Section 235-2.45, Hawaii Revised Statutes, is amended by amending subsection (e) to read as follows:

"(e) Section 704 of the Internal Revenue Code (with respect to a partner's distributive share) shall be operative for purposes of this chapter; except that [~~[~~]section 704(b)(2)[~~]~~] shall not apply to [~~allocations~~]:

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

(2) Allocations of net operating loss pursuant to section 235-111.5."

SECTION 7. Section 235-7.3, Hawaii Revised Statutes, is amended to read as follows:

"§235-7.3 Royalties derived from patents, copyrights, or trade secrets excluded from gross income. (a) In addition to the exclusions in section 235-7, there shall be excluded from gross income, adjusted gross income, and taxable income, amounts received by an individual or a qualified high technology business as royalties and other income derived from any patents, copyrights, and trade secrets:

(1) Owned by the individual or qualified high technology business; and

(2) Developed and arising out of a qualified high technology business.

(b) With respect to performing arts products, this exclusion shall extend to:

(1) The authors of performing arts products, or any parts thereof, without regard to the application of the work-for-hire doctrine under United States copyright law;

(2) The authors of performing arts products, or any parts thereof, under the work-for-hire doctrine under United States copyright law; and

(3) The assignors, licensors, and licensees of any copyright rights in performing arts products, or any parts thereof.

[~~(b)~~] (c) For the purposes of this section:

"Performing arts products" means:

(1) Audio files, video files, audiovideo files, computer animation, and other entertainment products perceived by or through the operation of a computer; and

(2) Commercial television and film products for sale or license, and reuse or residual fee payments from these products.

"Qualified high technology business" means a business [~~conducting~~] that conducts more than fifty per cent of its activities in qualified research[~~. The term "qualified high technology business" does not include:~~

~~(1) Any trade or business involving the performance of services in the field of law, architecture, accounting, actuarial science, consulting, athletics, financial services, or brokerage services;~~

~~(2) Any banking, insurance, financing, leasing, rental, investing, or similar business; any farming business, including the business of raising or harvesting trees; any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 611 (with respect to allowance of deduction for depletion), 613 (with respect to basis for percentage depletion), or 613A (with respect to limitation on percentage depleting in cases of oil and gas wells) of the Internal Revenue Code;~~

~~(3) Any business operating a hotel, motel, restaurant, or similar business; and~~

~~(4) Any trade or business involving a hospital, a private office of a licensed health care professional, a group practice of licensed health care professionals, or a nursing home~~].

"Qualified research" means:

(1) The same as in section 41(d) of the Internal Revenue Code;

(2) The development and design of computer software using fourth generation or higher software development tools or native programming languages to design and construct unique and specific code to create applications and design databases [~~of~~] for sale or license;
(3) Biotechnology; [~~or~~]
(4) Performing arts products[~~.~~];
(5) Sensor and optic technologies;
(6) Ocean sciences;
(7) Astronomy; or
(8) Nonfossil fuel energy-related technology.''

SECTION 8. Section 235-9.5, Hawaii Revised Statutes, is amended to read as follows:

''§235-9.5 Stock options from qualified high technology businesses [~~exempt~~] excluded from taxation. (a) Notwithstanding any law to the contrary, all income [~~received from stock options~~] earned and proceeds derived from stock options or stock, including stock issued through the exercise of stock options or warrants, from a qualified high technology business or from a holding company of a qualified high technology business by an employee, officer, or director[~~,~~] of the qualified high technology business, or investor who qualifies for the credit under section 235-110.9, that would otherwise be taxed as ordinary income or as capital gains to those persons [~~is exempt~~] shall be excluded from taxation under this chapter.

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

(b) For the purposes of this section:

''Holding company of a qualified high technology business'' means any business entity that possesses:

(1) At least eighty per cent of the total voting power of the stock or other interest; and
(2) At least eighty per cent of the total value of the stock or other interest; in the qualified high technology business.

''Income earned and proceeds derived from stock options or stock'' includes income from:

(1) Dividends from stock or stock received through the exercise of stock options or warrants;
(2) The receipt or the exercise of stock options or warrants; or
(3) The sale of stock options or stock, including stock issued through the exercise of stock options or warrants.

''Qualified high technology business'' means [~~a business conducting more than fifty per cent of its activities in qualified research. The term ''qualified high technology business'' does not include:~~

~~(1) Any trade or business involving the performance of services in the field of law, architecture, accounting, actuarial science, consulting, athletics, financial services, or brokerage services;~~
~~(2) Any banking, insurance, financing, leasing, rental, investing, or similar business; any farming business, including the business of raising or harvesting trees; any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 611 (with respect to allowance of deduction for depletion), 613 (with respect to basis for percentage depletion), or 613A (with respect to limitation on percentage depleting in cases of oil and gas wells) of the Internal Revenue Code;~~

~~(3) Any business operating a hotel, motel, restaurant, or similar business; and~~

~~(4) Any trade or business involving a hospital, a private office of a licensed health care professional, a group practice of licensed health care professionals, or a nursing home.~~

~~"Qualified research" means:~~

~~(1) The same as in section 41(d) of the Internal Revenue Code; or~~

~~(2) The development and design of computer software using fourth generation or higher software development tools or native programming languages to design and construct unique and specific code to create applications and design databases for sale or license; or~~

~~(3) Biotechnology~~[1] the same as defined in section 235-7.3."

SECTION 9. Section 235-110.9, Hawaii Revised Statutes, is amended to read as follows:

"**§235-110.9 High technology business investment tax credit.** (a) There shall be allowed to each taxpayer[~~,~~] subject to the taxes imposed by this chapter[~~,~~] a high technology business investment tax credit that shall be deductible from the taxpayer's net income tax liability, if any, imposed by this chapter for the taxable year in which the investment was made and the following four years provided the credit is properly claimed. The tax credit shall be [~~an amount equal to ten per cent~~] as follows:

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

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

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

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

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

of the investment made by the taxpayer in each qualified high technology business, up to a maximum allowed credit [~~of $500,000 for the taxable year for the investment made by the taxpayer in a qualified high technology business.~~] in the year the investment was made, $700,000; in the first year following the year in which the investment was made, $500,000; in the second year following the year in which the investment was made, $400,000; in the third year following the year in which the investment was made, $200,000; and in the fourth year following the year in which the investment was made, $200,000.

(b) The credit allowed under this section shall be claimed against the net income tax liability for the taxable year. For the purpose of this section, "net income tax liability" means net income tax liability reduced by all other credits allowed under this chapter.

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

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

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

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

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

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

[~~(d)~~] (e) As used in this section:

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

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

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

(A) Products sold from, manufactured in, or produced in [~~the~~] this State; or

(B) Services performed in this State.

[2]~~The term "qualified high technology business" does not include:~~

~~(1) Any trade or business involving the performance of services in the field of law, architecture, accounting, actuarial science, consulting, athletics, financial services, or brokerage services;~~

~~(2) Any banking, insurance, financing, leasing, rental, investing, or similar business; any farming business, including the business of raising or harvesting trees; any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 611 (with respect to allowance of deduction for depletion), 613 (with respect to basis for percentage depletion), or 613A (with respect to limitation on percentage depleting in cases of oil and gas wells) of the Internal Revenue Code;~~

~~(3) Any business operating a hotel, motel, restaurant, or similar business; and~~

~~(4) Any trade or business involving a hospital, a private office of a licensed health care professional, a group practice of licensed health care professionals, or a nursing home.~~]

"Qualified research" means[~~:~~

~~(1) The same as in section 41(d) of the Internal Revenue Code;~~

~~(2) The development and design of computer software using fourth generation or higher software development tools or native programming languages to design and construct unique and specific code to create applications and design databases for sale or license; or~~

~~(3) Biotechnology.~~] the same as defined in section 235-7.3.

(e) [2]This section shall not apply to taxable years beginning after December 31, 2005."

SECTION 10. Section 235-110.91, Hawaii Revised Statutes, is amended as follows:

1. By amending the title and subsection (a) to read:

"**§235-110.91 Tax credit for [~~increasing~~] research activities.** (a) Section 41 (with respect to the credit for increasing research activities) and section 280C(c) (with respect to certain expenses for which the credit for increasing research activities are allowable) of the Internal Revenue Code shall be operative for the purposes of this chapter as provided in this section[~~.~~]; except 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. If section 41 of the Internal Revenue Code is repealed or terminated prior to January 1, 2006, its provisions shall remain in effect for purposes of the income tax law of the State as modified by this section, as provided for in subsection (h)."

2. By amending subsections (c), (d), and (e) to read:

"(c) There shall be allowed to each taxpayer, subject to the tax imposed by this chapter, an income tax credit for [~~increased~~] qualified research activities equal to the credit for research activities provided by section 41 of the Internal Revenue Code[~~.~~] and as modified by this section. The credit shall be deductible from the taxpayer's net income tax liability, if any, imposed by this chapter for the taxable year in which the credit is properly claimed.

(d) As used in this section:

[~~"Qualified research" under section 41(d)(1) of the Internal Revenue Code shall not include research conducted outside of the State.~~]

"Basic research" under section 41(e) of the Internal Revenue Code shall not include research conducted outside of the State.

"Qualified research" under section 41(d)(1) of the Internal Revenue Code shall not include research conducted outside of the State.

(e) If the tax credit for [~~increased~~] qualified research activities claimed by a taxpayer exceeds the amount of income tax payment due from the taxpayer, the excess of the tax credit over payments due shall be refunded to the taxpayer; provided that no refund on account of the tax credit allowed by this section shall be made for amounts less than $1."

3. By amending subsection (h) to read:

"(h) This section shall [~~not~~] apply to taxable years beginning after December 31, [~~2005.~~] 2000, but not to taxable years beginning after December 31, 2005."

SECTION 11. Section 235-111.5, Hawaii Revised Statutes, is amended by amending subsections (a), (b), and (c) to read as follows:

"(a) A qualified high technology business as defined in section 235-7.3 may apply to the department [~~of taxation~~] to sell its unused net operating loss carryover to another taxpayer. If approved by the department [~~of taxation~~], a qualified high technology business may sell its unused net operating loss carryover to another taxpayer in an amount equal to at least seventy-five per cent of the amount of the surrendered tax benefit[~~;~~], computed at the corporate rate pursuant to section 235-71; provided that the qualified high technology business may sell no more than $500,000 of its unused net operating loss carryover to another taxpayer per year. In the case of partnerships, limited liability partnerships, limited liability companies classified as partnerships, and S corporations, each partner, member, or shareholder may sell its share of the entity's total net operating loss. The tax benefit purchased by the buyer shall be claimed in the year for which the sale is approved by the department. Any use of the purchased net operating loss carryover for tax carryback or carryforward purposes shall comply with applicable law. The income from the sale of the net operating loss carryover received by the seller shall be reported on its tax return in the taxable year received but shall not be considered taxable income.

(b) No application for the sale of unused net operating losses shall be approved if the seller is a qualified high technology business that:

(1) Has demonstrated positive net income in [~~any~~] either of the two previous full years of ongoing operations as determined on its financial statements;

(2) Has demonstrated a ratio [~~in excess~~] of one hundred ten per cent or greater of operating revenues divided by operating expenses in [~~any~~] either of the two previous full years of operations as determined on its financial statements; or

(3) Is directly or indirectly at least fifty per cent owned or controlled by another corporation that has demonstrated positive net income in [~~any~~] either of the two previous full years of ongoing operations as determined on its financial statements or is part of a consolidated group of affiliate corporations, as filed for federal income tax purposes, that in the aggregate has demonstrated positive net income in [~~any~~] either of the two previous full years of ongoing operations as determined on its combined financial statements[~~; as certified and documented by a licensed certified public accountant~~].

In the case of partnerships, limited liability partnerships, limited liability companies classified as partnerships, and S corporations, the application for the sale of unused net operating losses shall only be approved to the extent that all partners, members, or shareholders certify that they have not received a tax benefit from the losses.

(c) As used in this section[~~, "net~~]:

"Net operating loss" means a net operating loss for income tax purposes occurring in the two taxable years preceding the year in which the sale of net operating loss carryover occurs.

"Surrendered tax benefit" means the tax liability saved if the net operating loss carryforward could have been used by the qualified high technology business."

SECTION 12. Section 237-23.5, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) This chapter shall not apply to amounts received, charged, or attributable to services furnished by one related entity to another related entity or to imputed or stated interest attributable to loans, advances, or use of capital between related entities.

As used in this subsection:

"Related entities" means:

(1) An affiliated group of corporations within the meaning of section 1504 (with respect to affiliated group defined) of the federal Internal Revenue Code of 1986, as amended;

(2) A controlled group of corporations within the meaning of section 1563 (with respect to definitions and special rules) of the federal Internal Revenue Code of 1986, as amended;

(3) Those entities connected through ownership of at least eighty per cent of the total value and at least eighty per cent of the total voting power of each such entity (or combination thereof), including partnerships, associations, trusts, S corporations, nonprofit corporations, limited liability partnerships, or limited liability companies; and

(4) Any group or combination of the entities described in paragraph (3) constituting a unitary business for income tax purposes;

whether or not the entity is located within or without the State or licensed under this chapter.

"Services" means legal and accounting services, the use of computer software and hardware, information technology services, database management, and those managerial and administrative services performed by an employee, officer,

partner, trustee, sole proprietor, member, or manager in the person's capacity as an employee, officer, partner, trustee, sole proprietor, member, or manager of one of the related entities and shall include overhead costs attributable to those services."

SECTION 13. It is the intention of the legislature that the amendments in this Act be liberally construed. The department of taxation is further given latitude to interpret these amendments in light of industry developments. The legislature does not intend by the amendments in this Act to opine on the interpretation taken by any taxpayer or the department of taxation on any issue arising under prior law.

SECTION 14. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.[3]

SECTION 15. This Act shall take effect on July 1, 2001; provided that:

(1) Sections 5, 6, 7, 8, 10, and 11 shall apply to taxable years beginning after December 31, 2000;

(2) Section 9 shall apply to taxable years beginning after December 31, 2000, but shall not apply to taxable years after December 31, 2005; provided that a taxpayer may continue to claim the credits if the five-year period to claim the credits commences in taxable years beginning before January 1, 2006; and

(3) Section 12 shall apply to gross income or gross proceeds received after June 30, 2001.

(Approved June 8, 2001.)

Notes

1. Prior to amendment "." appeared here.
2. So in original.
3. Edited pursuant to HRS §23G-16.5.