

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT AND
TOURISM

Rules Amending Title 15
Hawaii Administrative Rules

1. Chapter 15-6, Hawaii Administrative Rules, entitled "Enterprise Zones", is amended and compiled to read as follows:

"HAWAII ADMINISTRATIVE RULES

TITLE 15

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT AND
TOURISM

CHAPTER 6

ENTERPRISE ZONES

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SUBCHAPTER 1

GENERAL PROVISIONS

§15-6-1 Purpose. The purpose of this chapter is to provide rules for administration of the state

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enterprise zones program authorized by chapter 209E, Hawaii Revised Statutes ("HRS"). [Eff 11/3/90; comp] (Auth: HRS §209E-8) (Imp: HRS §209E-1)

§15-6-2 Definitions. As used in this chapter, unless a different meaning clearly appears in the context:

"Average number of full-time employees" means the sum of the number of full-time employees employed at the end of each payroll period during a qualified business' taxable year divided by the number of payroll periods in the taxable year.

"Base taxable year" means the taxable year preceding the taxable year during which the business is first qualified under this program.

"County" or "counties" means the city and county of Honolulu and the counties of Hawaii, Kauai, and Maui.

"Department" means the department of business, economic development and tourism.

"Developed" means the improvements made to land through the construction, repair, or remodeling of structures to accommodate the principal use to which the land is or will be put. Improvements to land where parking is the principal use shall not constitute development except where the business purchasing or leasing the land can demonstrate to the satisfaction of the county and department that such use is necessary in order to further the purpose of the program and the local development objectives.

"Director" means the director of business, economic development and tourism.

"Enterprise zone" means an area selected by a county and approved by the governor to be eligible for this program.

"Establishment" means a single physical location where business is conducted. A qualified business may

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include one or more establishments, at least one of which must be in an enterprise zone.

"Extended three-year cycle" means the thirty-six consecutive months during which qualified businesses engaged in the manufacturing of tangible personal property or the producing or processing of agricultural products may receive enterprise zone benefits in addition to the business' seven-year cycle.

"Full-time employee" means an employee, including a leased employee and an employee under a joint employment arrangement as defined in section 209E-2, HRS, for whom the employer is legally required to provide employee fringe benefits.

"Governing body" means the mayor or county council, or both, as provided by county ordinance.

"Gross receipts" means gross income, wherever derived, as reported on a qualified business' general excise tax return or similar computation for those businesses exempt from chapter 237, HRS.

"Person" means the same as defined in section 235-1, HRS.

"Program" means the state enterprise zones program authorized by chapter 209E, HRS.

"Qualification period" means the seven-year cycle, plus, if applicable, the extended three-year cycle.

"Qualified business" means the same as defined in section 209E-2, HRS.

"Service business" means is not owned by the service business or calling. a qualified business that repairs ships, aircraft, or assisted technology equipment, provides telecommunication services, medical and health care services, or education and training services as defined in chapter-209E, HRS. Where the service business, in the same transaction, engages in both the sale of tangible property and services, the service business shall segregate the sale of services that are

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exempt under chapter 209E, HRS, from the sale of tangible personal property. The service business shall sustain the burden of proving the segregation was properly made. If the service business fails to sustain the burden, the entire transaction shall be subject to the general excise tax.

"Seven-year cycle" means the eighty-four consecutive months during which a qualified business may receive enterprise zone benefits. The cycle begins on the first of the month following the date the department determines that a business is eligible to participate in the enterprise zones program. The cycle ends after eighty-four consecutive months.

"State" means the State of Hawaii.

"Taxable year" or "tax year" means the calendar year (or the fiscal year ending during such calendar year) on the basis of which taxes due the State are computed under the applicable tax law.

"Taxes due the State" means income taxes due under chapter 235, HRS.

"Wholesale" means those activities defined in section 237-4(8), HRS. [Eff 11/3/90; am and comp] (Auth: HRS §209E-8) (Imp: HRS §209E-2)

SUBCHAPTER 2

APPLICATION FOR, SELECTION CRITERIA, AND TERMINATION OF ENTERPRISE ZONE STATUS

§15-6-3 Eligibility criteria for zone nomination.

(a) To be designated as an enterprise zone, a proposed area shall be located within one United States census tract or two or more contiguous United States census tracts in accordance with the most recent decennial United States Census. The census tract or tracts within which each enterprise zone is

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located also shall meet at least one of the following requirements:

- (1) At least twenty-five per cent of the population of each census tract shall have a median family income below eighty per cent of the median family income of the county in which the census tract is located; or
- (2) The unemployment rate in each census tract shall be at least 1.5 times the state average unemployment rate. [Eff 11/3/90; am and comp] (Auth: HRS §209E-8) (Imp: HRS §209E-4)

§15-6-4 Procedure for zone nomination by counties. (a) Nominations for enterprise zone designation shall be made by the governing body of each county.

(b) For each proposed enterprise zone, the governing body of the county shall submit an application which includes:

- (1) A written description of the boundaries of the proposed zone;

- (2) A map identifying the proposed enterprise zone boundaries relative to the boundaries of the census tracts that will be fully or partially included in the zone; and relative to the state land use district classifications, publicly held lands, and county general plan and/or development plan classifications; and
- (3) A statement indicating the local incentives proposed by the county. Each county may propose incentives which it will make generally available throughout the zone or available only to certain types of businesses for limited periods of time. [Eff 11/3/90; comp] (Auth: HRS §209E-8) (Imp: HRS §§209E-4, 209E-12)

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§15-6-5 Procedure for state review of zone nominations. (a) The application shall be reviewed by the department within sixty days of receipt of the completed application. Within ninety days of receipt, the director shall recommend for approval by the governor those applications which meet the requirements set forth by statute and these rules.

(b) The governor shall approve, upon recommendation of the director, enterprise zone status for a twenty-year period beginning on the date of approval. The amendment of the zone status under section 15-6-7 shall not extend the twenty-year period.

(c) A county whose application for zone designation is denied shall be notified and provided with the reasons for denial. [Eff 11/3/90; comp] (Auth: HRS §209E-8) (Imp: HRS §209E-5)

§15-6-6 Zone selection criteria and other requirements. (a) In its recommendations to the governor, the department shall consider the economic condition of the area, the potential benefits which may accrue to the State and counties from business and industrial development in the area, and the need and potential for job creation in the area.

(b) A maximum of six areas in each county may be designated as enterprise zones.

(c) If any portion of an area designated as a state enterprise zone is subsequently included in an area designated as an enterprise zone by an agency of the federal government, the state enterprise zone shall be enlarged to include the area designated by the federal government.

(d) Upon designation of an area as an enterprise zone, the State and any agency of a political subdivision that owns any land within the enterprise zone may make available for sale or lease, under

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appropriate law, all land within the zone not designated or targeted for public use with the condition that it be developed as defined in this chapter. No public land shall be sold or leased if the intended purpose of the sale or lease is real estate speculation. [Eff 11/3/90; comp] (Auth: HRS §209E-8) (Imp: HRS §209E-4)

§15-6-7 Procedure for amendment of zone status by counties. (a) A county may request amendment (or termination--see following section) of zone applications by submitting a written notification in accordance with the procedures contained in sections 15-6-4, 15-6-5, and 15-6-6. Requests for amendments will be considered if the amendments relate to:

- (1) Changes in local program incentives;
- (2) Changes of zone boundaries; or
- (3) Termination of the zone.

(b) If the request is for expansion of a zone boundary, the expanded zone area shall meet the eligibility requirements of section 15-6-3.

(c) The request for amendment shall be reviewed by the department and forwarded to the governor. If approved by the governor, the amendment shall take effect on the date of approval. A county whose application for amendment is denied by the governor shall be notified and provided with the reasons for denial. [Eff 11/3/90; am and comp] (Auth: HRS §209E-8) (Imp: HRS §209E-13)

§15-6-8 Procedure for termination of zone designation by State or counties. (a) A county shall notify the department of any inability or unwillingness to continue any approved local incentives for any zone

or zones within the county's jurisdiction. This shall result in termination of any affected zone on the date notification is received by the department. The department shall advise the

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department of taxation that the zone has been terminated.

(b) If the department determines that a business is qualified to participate in the program prior to the termination of the zone by a county or prior to the zone's expiration at the end of its twenty-year life, the business may be eligible for state tax credits and the state general excise tax exemption for the remainder of the business' qualification period.

[Eff 11/3/90; am and comp] (Auth: HRS §209E-8) (Imp: HRS §209E-13)

SUBCHAPTER 3

DESIGNATION OF A BUSINESS AS A QUALIFIED BUSINESS;

CERTIFICATION BY THE DEPARTMENT

§15-6-9 State criteria used to determine business qualification. (a) To qualify for enterprise zone benefits, a qualified business authorized to do business in the State shall satisfy the following requirements:

- (1) Be subject to chapter 235, HRS
- (2) Be engaged in an eligible business activity, as defined in section [] 209E-2, HRS; and
- (3) [] Meet the requirements under either [] subsection (c) or (d).

(b) Where the department finds that a business becomes eligible to participate under the program during a business' taxable year, rather than at the start of the taxable year, the requirement that at least fifty per cent of the business' enterprise zone [] establishments' gross receipts be attributable to the active conduct of a trade or business within

enterprise zones located within the same county, and the requirement that the business increase its average annual number of full-time employees by at least ten per cent by the end of its first tax year of participation, and the requirement that a business increase its gross sales of agricultural crops or agricultural products by two per cent annually, shall be determined by the actual number of months that it does business within enterprise zones located within the same county during the taxable year.

(c) [] A business which begins operation of a trade or business in an eligible business activity within a zone after the date of zone designation shall meet the following requirements:

- (1) During each taxable year, at least fifty per cent of the business' enterprise zone [] establishments' gross receipts are attributable to the active conduct of a trade or business[] within enterprise zones located within the same county; and
- (2) Increases its average annual number of full-time employees employed at the business' establishment or establishments within enterprise zones located within the same county by at least ten per cent by the end of its first tax year of participation, and during each subsequent taxable year at least maintains that higher level of employment; or
- (3) Increases its gross sales of agricultural crops produced, or agricultural products processed within enterprise zones located within the same county by two per cent annually.
- (4) If the calculation used to determine compliance with paragraph (2) results in a fractional percentage, the result should be

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rounded up or down to the next whole percentage.

- (d) A business which is actively engaged in the conduct of a trade or business in an eligible business activity in a zone prior to the time of zone designation shall meet the following requirements:
 - (1) During each taxable year, at least fifty per cent of the business' enterprise zone establishments' gross receipts are attributable to the active conduct of a trade or business within enterprise zones located within the same county; and Either:
 - (i) Increases its average annual number of full-time employees employed at the business' establishment or establishments within enterprise zones located within the same county by at least ten per cent by the end of the first year of operation, and by at least fifteen per cent by the end of each of the fourth, fifth, sixth, and seventh years of operation, and for businesses eligible for tax credits extending past the seventh year, at least maintains that higher level of employment during each subsequent taxable year; or
 - (ii) Increases its gross sales of agricultural crops produced, or agricultural products processed within enterprise zones located within the same county by two per cent annually.
 - (3) The percentage increase in paragraph (2) shall be based on the employee count at the beginning of the initial year of operation within the enterprise zone or zones.

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(4) If the calculations used to determine compliance with paragraph (2) results in a fractional percentage, the result should be rounded up or down to the next whole percentage.

(e) Even after the certification of a business at the end of the initial year of qualification, a

business must meet the requirements of this section in each year remaining in its qualification period to receive certification for the tax credits or the exemption from the general excise tax for that year. [Eff 11/3/90; am and comp] (Auth: HRS §209E-8) (Imp: HRS §209E-9)

§15-6-10 Business application procedure. (a) A business interested in participating in the enterprise zones program should obtain an application form from the department. The form should be completed by the business, reviewed by an independent accountant who shall be responsible for verifying the accuracy of the information in the application, and submitted to the department.

(b) The business shall submit separate applications for each zone in which it conducts trade or business.

(c) A business may participate in the program for a seven-year cycle. A business engaged in manufacturing tangible personal property or producing or processing of agricultural products may participate in the program for an additional three-year cycle. During the initial year of the seven-year cycle, the department shall determine if the applying business is eligible to participate in the enterprise zones program. The business shall be advised of the department's decision. The seven-year cycle will commence on the first of the month following the date that the department determines that the business is eligible to participate in the program. The business may claim the exemption from the general excise tax

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from the first of the month following the date the department determines that the business is eligible to participate in the program. If the business is not certified at the end of the year, however, the business shall pay all taxes, penalties, and interest normally levied by law to the department of taxation.

(d) A qualified business shall not be entitled to a credit against taxes due the State, until certified by the department. The department of taxation shall reject any claim for exemption in a return filed without the certification. At the end of each taxable year of the business' qualification period, including

the initial year, the department shall determine if the business should be certified to receive the state income tax credits and general excise tax exemption available under this program. For the department to make this determination, the business must submit to the department a form designated by the department.

Following its review of the forms, the department shall return the certified form to the business and notify the department of taxation if the business is certified.

(e) A business that has been certified shall:

- (1) File the applicable state tax returns;
- (2) Attach copies of the appropriate department form and department of taxation enterprise zone tax credit form to the tax return; and
- (3) Forward a copy of the certified department form to the governing body of the county in which the qualified business is located.

(f) The business tax credits may be claimed at the end of each tax year of the business' qualification period, including the initial year, if the appropriate tax returns are filed and a credit is claimed against any taxes due the State on the tax returns. These returns need not be prepared by an accountant. The department of taxation enterprise zone tax credit form shall be attached to the tax returns filed with the department of taxation. All taxes,
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penalties, and interest normally levied by law shall be paid to the department of taxation for the period that the business is not certified to receive enterprise zone tax benefits. Additionally, the department of taxation, during the statutory limitations period, may audit a business to determine whether:

- (1) The business is engaged in an eligible business activity, as defined in chapter 209E, HRS;
- (2) The business has properly allocated and apportioned income from trade or business in a zone, which is eligible for the income tax credits and the general excise tax exemption, from other income that is not eligible for the credits and exemption, including income from business activity within the zone which does not fall

within the definition of an eligible business activity or income from business activity conducted outside the zone; and

- (3) The business has properly allocated the business tax credits based upon the number of months it is qualified during the taxable year.

(g) The exemption from the general excise tax may be claimed at the time of the filing of the returns during the initial year, as provided in subsection (c), and in subsequent years of the business' qualification period at the time of the filing of the returns if the tax returns are filed as required by law. A business shall submit standard periodic tax returns (monthly, quarterly, or semiannually) as required under chapter 237, HRS, and claim an exemption from the general excise tax for trade or business in the zone. The periodic returns and the annual return need not be prepared by an accountant. These returns shall be filed, claiming the

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exemption, even when no tax is due. The appropriate department form shall also be attached to the annual tax return. All taxes, penalties, and interest normally levied by law shall be paid to the department of taxation for the period that the business is not certified to receive enterprise zone tax benefits. Additionally, the department of taxation, during the statutory limitations period, may audit a business to determine whether (1) the business is engaged in an eligible business activity, as defined in chapter 209E, HRS; (2) the business has properly allocated and apportioned income from trade or business in a zone which is eligible for the business tax credits and the general excise tax exemption, from other income that is not eligible for the credits and exemption, including income from business activity within the zone that does not fall within the definition of eligible business activity or income from business activity conducted outside the zone; and (3) the business has properly allocated the general excise exemption based upon the number of months it is qualified during the taxable year. [Eff

11/3/90; am and comp
(Imp: HRS §209E-9)

] (Auth: HRS §209E-8)

§15-6-11 State income tax credits and general excise tax exemption available to a business that has been certified. (a) A business that has been certified is entitled, subject to the apportionment provisions discussed in these rules, to tax credits against any taxes due under chapter 235, HRS to the State according to the following formula:

First year of the seven-year cycle 80 per cent of tax due

Second year of the seven-year cycle 70 per cent of tax due

Third year of the seven-year cycle 60 per cent of tax due

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Fourth year of the seven-year cycle 50 per cent of tax due

Fifth year of the seven-year cycle 40 per cent of tax due

Sixth year of the seven-year cycle 30 per cent of tax due

Seventh year of the seven-year cycle 20 per cent of tax due

Eighth, ninth, and tenth years (extended three-year cycle) 20 per cent of tax due for qualified businesses engaged in the manufacturing of tangible personal property or the producing or processing of agricultural products.

The business shall be eligible for a credit against any taxes due the State under chapter 235, HRS when the tax return required is filed with the department of taxation, together with the certification by the department. No unusable tax credit shall carry over or carry back or be refunded.

(b) A business that has been certified is entitled, subject to the apportionment provisions discussed in these rules, to tax credits against any taxes due to the State under chapter 235, HRS in an amount equal to a percentage of unemployment insurance premiums paid on the payroll of all the business'

employees employed within enterprise zones located within the same county, according to the following formula:

First year of the seven-year cycle 80 per cent of premiums paid
Second year of the seven-year cycle 70 per cent of premiums paid
Third year of the seven-year cycle 60 per cent of premiums paid
Fourth year of the seven-year cycle 50 per cent of premiums paid

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Fifth year of the seven-year cycle 40 per cent of premiums paid
Sixth year of the seven-year cycle 30 per cent of premiums paid
Seventh year of the seven-year cycle 20 per cent of premiums paid
Eighth, ninth, and tenth years (extended three-year cycle) 20 per cent of premiums paid for qualified businesses engaged in the manufacturing of tangible personal property or the producing or processing of agricultural products.

Tax credits provided for in this subsection apply only to the amount of unemployment insurance premiums paid. Those premiums shall be paid by the business and the business shall be eligible for a credit against any taxes due to the State under chapter 235, HRS when the annual tax return required is filed with the department of taxation, together with the certification by the department.

No unusable tax credit may be carried over or carried back to another tax period.

(c) The tax credits allowed under subsections (a) and (b) may be combined by the business. The department of taxation, however, shall not refund any unusable credit. The application of this provision is illustrated in the following example.

Example 1:

ABC Company's application to participate in the enterprise zones program is approved by the department shortly after ABC commences a trade or

business in an eligible business activity in a zone. All of ABC's income is derived from trade or business in an eligible business activity within the zone. During the initial year of the seven-year cycle, ABC pays \$500 in unemployment insurance premiums for all employees. ABC's seven-year cycle begins on January 1. After the

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initial year of the seven-year cycle, it is determined that ABC owes \$1,000 in net income taxes to the State under chapter 235, HRS. When ABC files its tax returns at the end of the initial year, it is eligible for a tax credit equaling 80 per cent of the income taxes due, or \$800. ABC is also eligible for a credit of ~~[Se]~~ 80 per cent of unemployment insurance premiums paid, or \$400. Thus, ABC's total credits under the program against income taxes are \$1,200. As ABC's income tax liability is \$1,000, ABC tax credit is limited to \$1,000 at the end of the initial year if ABC is certified by the department even though the calculated maximum credit is \$1,200. The \$200 of unusable credit, however, shall not be refunded to ABC nor shall it be carried over or carried back to another tax period.

(d) A business may claim the exemption from the general excise tax on the gross receipts from all transactions eligible under this chapter from the first of the month following the date the department determines that the business is eligible to participate in the program. The business, however, shall file the tax returns required under chapter 237, HRS. The business shall submit standard periodic tax returns as required under chapter 237, HRS, report the gross income from the business, and [-] claim an exemption from the general excise tax for trade or business in the zone. These returns shall be filed even if no tax is due.

(e) Businesses engaged in the manufacturing of tangible personal property or the producing or processing of agricultural products are eligible to receive enterprise zone benefits for an extended three-year cycle in addition to their seven-year cycle. [Eff

11/3/90; am and comp] (Auth: HRS §209E-8)
8) (Imp: HRS §§209E-10, 209E-11)

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§15-6-12 Calculation of eligibility for tax credits and exemption; apportionment. (a) This section sets forth the calculations that a business may have to complete to determine its eligibility for business tax credits and the general excise exemption and the apportionment of the credits and the exemption.

(b) During each taxable year, at least 50 per cent of the business' enterprise zone establishments' gross receipts must be attributable to the active conduct of a trade or business in an eligible business activity within enterprise zones located within the same county.

(c) A business which has income taxable both within and without the State shall apportion and allocate the business' net income under sections 235-21 to 235-38, HRS, prior to calculating the enterprise zone tax credits.

(d) The general excise tax exemption and the enterprise zone tax credits shall apply only to the extent that a qualified business conducts trade or business in an eligible business activity within enterprise zones located within the same county.

- (1) The business may claim an exemption from the general excise tax at the time of the filing of the periodic returns required under chapter 237, HRS, only for trade or business within enterprise zones located within the same county.
- (2) A business may claim an enterprise zone credit against any taxes due the State. Subject to the allocation and apportionment, if any, under subsection (c), a business with income from business activity which is taxable both within and without an enterprise zone, shall allocate and

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apportion the income, pursuant to this section, and apply for an enterprise zone tax credit at the end of each taxable year only for the income derived from the qualified business activities of the trade or business within enterprise zones located within the same county. The business shall multiply the income by a fraction. The numerator of the fraction is the total gross receipts of the qualified business activity conducted by the qualified business in an eligible business activity within enterprise zones located within the same county during the taxable year. The denominator is the total gross receipts of the qualified business within the State during the taxable year, including sales within and without the enterprise zone.

- (A) For purposes of allocation and apportionment of income under this section, a business' income is earned outside of an enterprise zone if the:
 - (i) Income is from business activity within the zone which does not fall within the definition of eligible business activity; or
 - (ii) Income is from business activity conducted outside the zone. This term includes work that a business located within a zone subcontracts to a business located outside the zone and the work is delivered outside the zone.
- (3) A business may claim an enterprise zone credit against any taxes due the State under chapter 235, HRS, in an amount equal to a percentage of unemployment insurance premiums paid on the payroll of all the

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business' employees employed within enterprise zones located within the same county. Where the business has employees both within and without the enterprise zone,

the business shall allocate and apportion the unemployment insurance premiums by multiplying the unemployment insurance premiums paid by a fraction. The numerator of the fraction is the payroll for employees employed within enterprise zones located within the same county during the taxable year, and the denominator is the payroll for all employees within the State.

- (A) An employee is employed within the zone if:
 - (i) The individual's service is performed entirely within the zone; or
 - (ii) The individual's service is performed both within and without the zone, but the service performed without the zone is incidental to the individual's service within the zone.

(e) The credits, which are reduced in every year of the seven-year cycle, are apportioned over a twelve-month period. Accordingly, the credits may have to be apportioned over two taxable years if the department finds that a business is eligible to participate under the program during a taxable year, rather than at the start of a taxable year.

(f) Each partner or S corporation shareholder of a business that has been certified shall separately determine for the partner's or shareholder's taxable year within which the business' taxable year ends, the partner's or shareholder's share of the credit. The partner's or shareholder's share of the entity's net

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income or loss and unemployment insurance credit shall be determined in accordance with the ratio in which the partners and shareholders divide the profits and losses of the partnership or the S corporation, respectively.

(g) The application of this section is illustrated in the following examples:

Example 1:

ABC Corporation is located in an area designated as an enterprise zone. ABC submits an application to the department. The department determines that ABC is eligible to participate in the program commencing on December 27. Under section 15-6-10, ABC's seven-year cycle will commence on January 1. ABC claims the general excise tax exemption from January 1 for income from trade or business in the zone. ABC, however, pays the general excise tax for income from business activity without the zone. ABC's total income at the end of the taxable year is \$100,000. ABC pays \$500 in unemployment insurance premiums during the taxable year. ABC's net profit before taxes is \$10,000. ABC determines that seventy per cent of its income was attributable to the conduct of a trade or business in an eligible business activity in the zone. During the taxable year, ABC properly claimed the general excise exemption for \$70,000 of its income. ABC is also eligible for a tax credit against the \$440 in taxes ABC owes the State, calculated as follows: (1) 70 per cent of ABC's income is derived from sales within the zone (\$70,000 divided by \$100,000); and (2) 70 per cent multiplied by 80 per cent (the amount of the credit in the first year) multiplied by \$440 (ABC's tax liability for the taxable year before the application of the enterprise zone credit) is \$246.40. ABC is also eligible for a

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credit of \$400, which is 80 per cent of the \$500 unemployment insurance premiums paid. Thus, ABC's enterprise zone credits against taxes due the State are \$646.40. As ABC's tax liability is \$440, ABC may claim a tax credit of \$440. The \$206.40 of unusable credit, however, shall not be refunded to ABC nor shall it be carried over or carried back to another tax period.

Example 2:

Assume the same facts as in Example 1, except that ABC is a sole proprietorship owned by individual X who files a joint return with Y; Y has a salary of \$20,000; X and Y jointly receive dividends and interest of \$2,000; and X and Y

claim personal exemptions of \$2,080 and itemized deductions of \$9,920. X and Y's adjusted gross income is \$32,000, which is calculated by adding the \$10,000 profit of ABC, Y's salary of \$20,000, and \$2,000 in dividends and interest. After subtracting the itemized deductions and personal exemptions, their taxable income is \$20,000. By applying the apportionment factor of 70 per cent to the \$10,000 of income earned by X through ABC, \$7,000 of ABC's net profit is apportioned to trade or business in an eligible business activity in the zone. X and Y are subject to a tax of \$2,000, which is calculated by multiplying X and Y's taxable income of \$20,000 by a tax rate of 10 per cent, before the application of the enterprise zone credit. The tax of \$2,000 is multiplied by 21.875 per cent ($\$7,000 \div \$32,000$). This amount is \$437.50, which is then multiplied by 80 per cent to arrive at \$350, the enterprise zone income tax credit which X and Y may claim on their joint return. X and Y may also claim a credit of \$400, which is 80 per cent of the \$500 in unemployment insurance premiums paid.

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Thus, X and Y's credits from the program total \$750 against a tax liability of \$2,000. If no other credits are taken by X and Y, they will owe a balance of \$1,250 to the State.

Example 3:

ABC Corporation, which is engaged in business within the State but located outside an area designated as an enterprise zone, opens XYZ, an establishment, in an area designated as an enterprise zone. XYZ is a subsidiary of ABC. The department determines that XYZ is eligible to participate in the program commencing on December 27. Under section 15-6-2, XYZ's seven-year cycle commences on January 1. XYZ may claim the general excise tax exemption from January 1 for receipts that XYZ receives for trade or business in an eligible business activity in the zone. XYZ pays \$2,000 in unemployment insurance premiums during the year for all employees employed in the enterprise zone. ABC's total receipts during the

taxable year are \$100,000, including XYZ's receipts of \$10,000. \$5,000 of XYZ's receipts are derived from trade or business in an eligible business activity in the zone. Accordingly, the requirement in section 209E-9(a)(2), HRS, that at least 50 per cent of the establishment's receipts, rather than the business' receipts, be attributable to the active conduct of a trade or business in an eligible business activity, is satisfied. ABC's net profit before taxes is \$10,000. During the taxable year, ABC incorrectly claimed the general excise tax exemption on all of XYZ's receipts. At the end of the year when XYZ is certified to receive tax benefits, ABC must file the annual general excise tax return and pay the taxes and interest on the \$5,000 that

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was erroneously exempted from the general excise tax. ABC is entitled to a tax credit of \$17.60 against the \$440 in taxes owed the State, calculated as follows: (1) 5 per cent of its income is derived from sales within the zone (\$5,000 divided by \$100,000); and (2) 5 per cent multiplied by 80 per cent multiplied by \$440 (which is the tax liability before the enterprise zone credit) is \$17.60. ABC is also eligible for a credit for unemployment insurance premiums paid of \$1,600, calculated by multiplying the \$2,000 in unemployment insurance premiums paid (for employees located in the zone) by 80 per cent. Thus, ABC's credits under the program are \$1,617.60. As ABC's tax liability is \$440, ABC may claim a tax credit of \$440. The \$1,177.60 of unusable credit, however, shall not be refunded to ABC nor shall it carry over or carry back.

Example 4:

ABC Corporation is located in an area designated as an enterprise zone. ABC is engaged in the conduct of a trade or business in an eligible business activity for several years before ABC submits an application to the department. Under section 15-6-2, ABC's seven-year cycle commences on May 1, 1993. ABC may claim the general excise

tax exemption from May 1. ABC pays \$500 in unemployment insurance premiums during 1993. At the end of 1993, ABC is certified to receive tax benefits. ABC determines that it owes \$1,000 in net income taxes to the State under chapter 235, HRS. When ABC files its income tax returns for the taxable year ending December 31, 1993, it is eligible for a tax credit of \$533.60, calculated as follows: (1) ABC is eligible for the credit for 8 months of the year, from May to

December. Eight months divided by 12 months is 66.7 per cent; (2) in the first year of the seven-year cycle, ABC is eligible for a credit of 80 per cent against any taxes due the State; (3) 67 per cent multiplied by 80 per cent is 53.36 per cent; and (4) 53.36 per cent of the \$1,000 tax liability is \$533.60. ABC is also eligible for a credit of \$266.80, which is 53.36 per cent of the \$500 unemployment insurance premiums paid. Thus ABC may claim total credits of \$800.40 after the first year of the seven-year cycle. ABC, however, will owe a balance of \$199.60 for state income taxes.

Example 5:

Assume the same facts as in Example 4, except that at the end of 1994, year 2 of the cycle, ABC determines that it owes \$1,000 in net income taxes. ABC pays \$1,000 in unemployment insurance premiums during 1994. ABC is certified to receive tax benefits. When ABC files its income tax returns for the taxable year ending December 31, 1994, ABC is eligible for a tax credit of \$266.40, calculated as follows: (1) ABC is eligible for four more months of credit for the first year of the seven-year cycle. Four months divided by 12 months is 33 per cent; (2) 33 per cent multiplied by 80 per cent is 26.64 per cent; and (3) 26.64 per cent of \$1,000 is \$266.40. The second portion of the tax credit amounts to \$466.90, calculated as follows: (1) ABC is eligible for 8 months of credit in the second year. Eight months divided by 12 months is 66.7 per cent; (2) ABC is eligible for a credit of 70

per cent against any taxes due the State in the second year of the cycle; (3) 66.7 per cent multiplied by 70 per cent is 46.69 per cent; and (4) 46.69 per cent of \$1,000 is \$446.90. Third,
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ABC is eligible for a credit of \$266.40, which is 26.64 per cent of the unemployment insurance premiums paid. Fourth, ABC is eligible for a credit of \$466.90, which is 46.69 per cent of unemployment insurance premiums paid. Thus, ABC's total enterprise zone credits against income taxes are \$1,466.60 in year 2. As ABC's income tax liability is \$1,000, ABC may claim a tax credit of \$1,000 at the end of the second year. The \$466.60 of unusable credit, however, shall not be refunded to ABC nor shall it carry over or carry back.

Example 6:

ABC Company is engaged in a trade or business in an eligible business activity in an enterprise zone. Due to the difficulty of a particular job, however, ABC subcontracts a portion of the job to XYZ, which is not located in the enterprise zone. XYZ's services are not provided in the zone. ABC will have to apportion the income received from this job which is attributable to the services performed by XYZ and claim tax credits and the general excise tax exemption only for the services delivered in the zone. [Eff 11/3/90; am and comp] (Auth: HRS §209E-8) (Imp: HRS §209E-9)

§15-6-13 Wholesale sale of tangible personal property. (a) Tangible personal property must be sold at wholesale by an establishment or qualified business located within an enterprise zone. The transfer of title to the buyer of the tangible personal property must take place in an enterprise zone located within the same county in which the tangible personal property is sold.

(b) When title passes is dependent upon the factual circumstances of the transaction gathered from
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the contract of sale and invoice. Among the circumstances that are considered in making this determination are when the risk of loss transferred from the seller to the purchaser, where delivery occurs, and when title to the property sold passed from the seller to the purchaser under the provisions of the uniform commercial code, chapter 490, HRS. A statement in a contract that title passes at a certain time or event will not in itself create a presumption of passing of title for purposes of this section, unless title has in fact passed considering all of the facts and circumstances.

(c) The application of this section is illustrated in the following examples:

Example 1:

ABC Company is located in an area designated as an enterprise zone. ABC is a wholesaler of electronic parts and equipment. The purchasers take title and receive delivery of the parts and equipment in the zone. Accordingly, ABC will qualify for tax credits against any taxes due the State and the general excise tax exemption.

Example 2:

ABC Seafood Company is located in an area designated as an enterprise zone. ABC sells the seafood at wholesale to purchasers who take title to the seafood within the zone and receive delivery of the seafood within the zone. ABC also sells the seafood at retail to customers who come to ABC's place of business. The wholesale sales will qualify for the income tax credits and general excise tax exemption. The retail sales to customers, however, will not qualify. Accordingly, ABC will have to allocate the income

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received from each type of sale and claim income tax credits and the general excise tax exemption only for wholesale sales.

Example 3:

ABC Ranch is located in an area designated as an enterprise zone. ABC raises cattle and various food crops. ABC sells the cattle and crops at wholesale to purchasers who receive title and delivery within the zone. ABC will qualify for the tax credits and general excise exemption.

Example 4:

Assume the same facts as in Example 3, except that ABC also sells cattle and crops to purchasers who receive possession of the cattle and crops in an enterprise zone outside of the county that ABC is located in. The contract provides that title passes to the purchaser upon execution of the contract but also provides that ABC must bear the cost of delivery and any risk of loss. Under applicable law, title is deemed not to pass to the purchaser and ABC will have to apportion the income received from the sales outside the county that ABC is located in and claim income tax credits and the general excise tax exemption only for sales where the purchasers receive title within an enterprise zone located within the same county in which the cattle and crops are sold.
[Eff 11/3/90; am and comp] (Auth:
HRS §209E-8) (Imp: HRS §209E-9)

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§15-6-14 Sale of services. (a) Services must be sold [by] and delivered at an establishment of a qualified business engaged in a service business as defined in this chapter, within an enterprise zone within the same county. Where the service business, in the same transaction, engages in both the sale of tangible property and services, the service business shall segregate the sale of services that are exempt under chapter 209E, HRS, from all non-exempt transactions, including the sale of services or of tangible personal property. The service business shall sustain the burden of proving the segregation was

properly made. If the service business fails to sustain the burden, the entire transaction shall be subject to the general excise tax.

(b) The application of this section is illustrated in the following examples:

Example 1:

ABC Ship Repair is located in an area designated as an enterprise zone. ABC provides servicing and repair work on ships. ABC provides these services for customers who bring their ships to ABC's place of business. All of ABC's gross receipts are derived from services that are sold and delivered within the zone. Accordingly, ABC will qualify for the income tax credits and general excise tax exemption.

Example 2:

Assume the same facts as in Example 1, except that ABC Ship Repair also repairs ships in an area that is not in an enterprise zone in the county in which ABC is registered in. ABC will have to apportion income received from each type of sale and claim income tax credits and the general excise tax exemption only for services

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performed within the zones within the same county it is registered in.

Example 3:

Assume the same facts as in Example 2, except that ABC Ship Repair also rents tools that it owns, or alternatively sells specialized tools at retail to customers. ABC Ship Repair will not qualify for the income tax credits and general exercise exemption on these sales as the rental of tools or the sale of tools at retail is not an eligible activity of ABC Ship Repair.

[Eff 11/3/90; am and comp] [Auth:
HRS §209E-8) (Imp: HRS §209E-9)

§15-6-15 Manufacturing. To be eligible for enterprise zone benefits, value must be added to

materials or products that are manufactured within the enterprise zone. [Eff 11/3/90; comp]
(Auth: HRS §209E-8) (Imp: HRS §209E-8)

§15-6-16 Terms and conditions under which the tax credits and the general excise exemption may be claimed by a certified business. (a) A qualified business which has received certification from the department may receive state tax credits and the general excise tax exemption for seven consecutive taxable years. A qualified business engaged in the manufacturing of tangible personal property or the producing or processing of agricultural products may receive state tax credits and the general excise tax exemption for an additional three consecutive taxable years.

Except as provided in the force majeure provisions in this chapter, if a business fails to be certified for any taxable year during these qualification periods, the business shall not be entitled to the income tax credits or general excise
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tax exemption offered by this program. The business, however, is eligible to qualify and be certified for any remaining taxable years of its qualification period.

(b) Except as provided in the force majeure provisions in this chapter, any business which fails to be certified for one or more taxable years during the cycle shall not be allowed to compensate by requesting certification after completion of the original seven consecutive year cycle or the additional three consecutive year cycle for businesses engaged in the manufacturing of tangible personal property or the producing or processing of agricultural products. The application of this provision is illustrated in the following example:

Example 1:

ABC Company is certified to receive enterprise zone tax benefits by the department in the initial year of the seven-year cycle. ABC applies for and receives certification from the department in the next two years. The department, however, denies ABC certification in year four. ABC applies for

and receives certification in years five, six, and seven. ABC applies for certification in year eight. ABC will not receive certification from the department in year eight as the term of the seven-year cycle has expired.

(c) When a taxpayer conducts business within two or more zones, only one return shall be filed by the taxpayer with attached schedules supporting the amount of the business tax credit or the exemption from the general excise tax.

(d) The department shall not provide certification to a business which enters into a transaction where the principal purpose of the

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transaction is evasion or avoidance of any taxes or unemployment insurance premiums owed the State by securing the benefit of a credit or exemption which the business would not otherwise enjoy.

(1) Where a business sells or delivers any tangible personal property or service to or for an affiliated business or person and the consideration paid by the affiliate to the business is not indicative of economic substance or the true value of the property or services delivered, this shall be prima facie evidence that the transaction was for the principal purpose of evasion or avoidance of any taxes or unemployment insurance premiums owed the State.

(e) Where a business commences and completes its qualification period, such business or any successor business shall not be eligible to participate in the enterprise zones program. Where a business commences and does not complete its qualification period, the successor business, if any, shall continue the qualification period of the predecessor business. "Successor business" means a business which either continues the historic business of the predecessor business or uses significant portion of the predecessor business' assets.

(1) The continuity of business requirement is satisfied if the successor business continues the predecessor business' historic business. The historic business is the

business it has conducted most recently. The fact that the successor business is in the same line of business as the predecessor business may establish the requisite continuity, but is not alone sufficient. If the predecessor business has more than one line of business, the successor business must only continue a significant line of business.

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- (2) The continuity of business requirement is also satisfied if the successor business uses a significant portion of the predecessor business' historic business assets, including stock and securities and intangible operating assets such as good will, patents, and trademarks, whether or not they have a tax basis, in a business. The determination of the portion of a business' assets considered "significant" is based, generally, on the relative importance of the assets to the operation of the business. All facts and circumstances, including the net fair market value of those assets will be considered. [Eff 11/3/90; am and comp] (Auth: HRS §209E-8)(Imp: HRS §§209E-10, 209E-11)

§15-6-16.5 Force majeure event. a) A force majeure event may be accepted by the department by:

- (1) An official announcement or declaration by a federal official or agency; or
- (2) An official announcement or declaration by a state official or agency.

(b) A business engaged in agricultural production or processing may apply annually to the department for allowable benefits under chapter 209E, HRS, during a force majeure event by completing and submitting the application form authorized by the department. The business shall also complete and submit annually to the department a department approved end-of-the-year report.

(c) If the department approves a business' annual force majeure application, the business is eligible to receive annual certification for allowable benefits under chapter 209E, HRS, without meeting the

eligibility requirements under section 209E-9, HRS, for the period during which the business is prevented from maintaining these requirements or the business is

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interrupted by reason of the force majeure event. For the purposes of this section, a business' gross receipts, and either number of employees or gross sales, as applicable under section 209E-9, HRS, shall be compared against that which the business reported in the year prior to the first year the business' force majeure application was approved.

[Eff _____] (Auth: HRS §209E-8) (Imp: HRS 209E-14)

SUBCHAPTER 4

ADMINISTRATION

§15-6-17 Administration. (a) The department is authorized to implement and enforce the rules of this chapter.

(b) The department shall conduct a continuing evaluation of the enterprise zones program and submit an annual report to the governor and each county within the first quarter of each subsequent year.

(c) The department shall advise each county in regard to accumulation of data, the zone nomination process, business eligibility criteria, and possible local incentives.

(d) The department shall monitor the program to assure adherence to these rules, the effectiveness of local incentives, and that the purpose of the program is upheld. [Eff 11/3/90; comp _____] (Auth: HRS §209E-8) (Imp: HRS §209E-3)

§15-6-18 Waiver. The director may waive particular provisions of this chapter to conform to applicable federal requirements. [Eff 11/3/90; comp _____] (Auth: HRS §209E-8) (Imp: HRS §209E-3)

§15-6-19

§15-6-19 Severability. If any part, section, sentence, clause, or phrase of this chapter, or its application to any person, transaction, or other circumstance, is for any reason held to be unconstitutional or invalid, the remaining parts, sections, sentences, clauses, and phrases of this chapter, or its application to other persons, transactions, or circumstances shall not be affected."
[Eff 11/3/90; comp] (Auth: HRS §209E-8)
(Imp: HRS §209E-8)

