

HAWAII ADMINISTRATIVE RULES

TITLE 15

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

CHAPTER 6

ENTERPRISE ZONES

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§15-6-1 Purpose. The purpose of this chapter is to provide rules for administration of the state enterprise zones program authorized by chapter 209E, Hawaii Revised Statutes ("HRS"). [Eff November 03 1990] (Auth: HRS §209E-8) (Imp: HRS S209E-8)

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

"Authorized to do business in the State" means a corporation incorporated under chapter 416, HRS, a foreign corporation admitted under chapter 418, HRS, a corporation incorporated under chapter 415, HRS, or a foreign corporation admitted under chapter 415, HRS; a partnership registered under chapter 425, HRS, or 425D, HRS; or a sole proprietorship.

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

"Full-time employee" means an individual employed by a qualified business who works more than twenty hours a week during the business' payroll period.

"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.

"Low-income person" means an individual whose income is less than eighty percent of the median individual income of the last county in which the person lived during the twelve months immediately preceding the month in which the person was hired.

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

"Qualified business" means any corporation, partnership, or sole proprietorship authorized to do business in the State which is:

- (1) Subject to the state corporate or individual income tax under chapter 235, HRS, the public service company tax under chapter 239, HRS, or the bank and financial corporation tax under chapter 241, HRS;
- (2) Engaged in manufacturing, the wholesale sale of tangible personal property, or a service business or calling; and
- (3) Qualified under section 15-6-9. A qualified business may include one or more establishments, at least one of which must be in an enterprise zone.

"Service business or calling" means any corporation, partnership, or sole proprietorship that acts upon or processes tangible personal property that is not owned by the service business or calling. This includes cleaning, repair, and maintenance businesses. By way of example, this does not include businesses such as brokerage, legal, accounting, architectural, engineering, consulting, contracting, real estate firms, and travel agencies. Where the service business or calling, in the same transaction, engages in both the sale of tangible property and services, the service business or calling shall segregate the sale of services that are exempt under chapter 209E, HRS, from the sale of tangible personal property. The service business or calling shall sustain the burden of proving the segregation was properly made. If the service business or calling 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 or the end of the twenty-year designation for the zone in which the qualified business is located, whichever comes first.

"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:

- (1) In the case of a corporation, partnership, or sole proprietorship, income tax due under chapter 235, HRS;
- (2) In the case of a public service company, tax due under chapter 239, HRS; and
- (3) In the case of a financial institution, tax due under chapter 241, HRS.

"Trade or business" means all business activity by a qualified business within an enterprise zone, whereby (1) tangible personal property is sold at wholesale and the sale takes place within the zone; (2) a qualified business engages in a service business or calling within the zone; or (3) value is added to materials or products that are manufactured within the zone.

"Wholesale" means those activities defined in section 237-4, HRS. [Eff NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS 5209E-8)

## 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 1980 United States census tract or two or more contiguous 1980 United States census tracts. Any area designated as an enterprise zone after 1990 census data becomes available shall be located within one 1990 United States census tract or two or more contiguous 1990 United States census tracts. The census tract or tracts within which each enterprise zone is located also shall meet at least one of the following requirements, which are based upon the most current census data:

- (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.

Based on the 1980 state average unemployment rate, the unemployment rate in each census tract within a zone must be at least 7.05 per cent. [Eff NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)

§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 NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)

§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 NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)

§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 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 NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)

§15-6-7 Procedure for amendment of zone status by counties.

(a) A county may request amendment (or termination--see following section) of approved 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 NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)

§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 department of taxation that the zone has been terminated.

(b) If the department determines that a business is eligible to participate in the program prior to the termination of the zone under this section, the business may be eligible for business tax

credits and the general excise tax exemption for the remainder of the business' seven-year cycle.

(c) In the case of a business that is located in a zone which is not terminated by the State or counties under this section, the business shall not be eligible for the business tax credits and the general excise tax exemption, regardless of the time remaining in the business' seven-year cycle, from the date that a zones terminates at the end of its twenty-year life. [Eff NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)

### 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 corporation, partnership, or sole proprietorship authorized to do business in the State shall satisfy the following requirements:

- (1) Be subject to the state corporate or individual income tax under chapter 235, HRS, the public service company tax under chapter 239, HRS, or the bank and financial corporation tax under chapter 241, HRS;
  - (2) Be engaged in a trade or business, as defined in section 15-6-2; and
  - (3) Be qualified under either section 15-6-9(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 establishment's gross receipts be attributable to the active conduct of a trade or business and the requirement that a sufficient number of low income persons be hired shall be determined by the actual number of months that it does business within the zone during the taxable year.

(c) A business is qualified under section 209E-9, HRS, if the business satisfies the criteria in either this subsection or subsection (d). A business which begins operation 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 establishment's gross receipts are attributable to the active conduct of a trade or business, as defined in section 15-6-2;
- (2) At least forty per cent of the average number of full-time employees of its zone establishments shall be

low-income persons; and

- (3) if the calculation 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.

(d) A business may also qualify under section 209E-9, HRS, if the business is engaged in the conduct of a trade or business in a zone prior to the time of zone designation and the business meets the following requirements:

- (1) During each taxable year, at least fifty per cent of the business' enterprise zone establishment's gross receipts are attributable to the active conduct of a trade or business;
- (2) The average number of full-time employees of its zone establishment, during the taxable year the zone establishment first qualifies, shall be at least five per cent greater than the average for the establishment's base taxable year;
- (3) The average annual number of full-time employees of its zone establishment shall remain at or above the increased level required in paragraph (2) during the remainder of the cycle;
- (4) At least forty per cent of the increase in full-time zone employees, as stipulated in paragraph (2), shall be attributable to low-income persons;
- (5) The number of low-income persons employed by a zone establishment shall increase by five per cent annually until at least forty per cent of a zone establishment's full-time employees are low-income persons; and
- (6) If the calculations used to determine compliance with either paragraph (2), (3), (4), or (5) result 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 the seven-year cycle, a business must meet the requirements of this section in each year remaining in its seven-year cycle to receive certification for the tax credits or the exemption from the general excise tax for that year.

[Eff NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS 5209E-8)

§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. 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 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 seven-year cycle, 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 together with the forms verifying the status of low income employees. The form from the department shall be reviewed by an independent accountant.

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 year of the seven-year cycle, 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, 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 a trade or business, as defined in this chapter; (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 trade or business 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 section 15-6-10(c), and in subsequent years of the seven-year cycle 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 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 a trade or business, as defined in this chapter; (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 trade or business 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 NOV 03 1990] (Auth: §HRS 209E-8) (Imp: 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 the State according to the following formula:

First year	80% of tax due
Second year	70% of tax due
Third year	60% of tax due
Fourth year	50% of tax due
Fifth year	40% of tax due
Sixth year	30% of tax due
Seventh year	20% of tax due

The business shall be eligible for a credit against any taxes due the State when the tax return required under chapters 235, 239, and 241, HRS, is filed with the department of taxation, together with the certification by the department. No unusable tax credit shall carry over or carry back.

(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 the State in an amount equal to a percentage of unemployment insurance premiums paid on the payroll of all the business' employees employed in the enterprise zone, including employees who do not qualify under the definition of a low-income person, according to the following formula:

First year	80% of premiums paid
Second year	70% of premiums paid
Third year	60% of premiums paid
Fourth year	50% of premiums paid
Fifth year	40% of premiums paid
Sixth year	30% of premiums paid
Seventh year	20% of premiums paid

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 the State when the annual tax return required under chapters 235, 239, and 241, HRS, 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 a zone. All of ABC's income is derived from trade or business within the zone. During the initial year of the seven-year cycle, ABC pays \$500 in unemployment insurance premiums for all employees, including employees who do not qualify under the definition of a low-income person. ABC's seven-year cycle begins on January 1. After the 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 of 80 per cent of the income taxes due, or \$800. ABC is also eligible for a credit of 50 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 of \$1,000 at the end of the initial year if ABC is certified by the department. 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.  
[Eff NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)

§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 fifty per cent of the business' enterprise zone establishment's gross receipts must be attributable to the active conduct of a trade or business within the zone.

(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 within the zone.

(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 the zone.

(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 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 trade or business within the zone. The business shall multiply the income by a fraction. The numerator of the fraction is the total gross receipts of a qualified business within the zone during the taxable year whereby tangible personal property is sold at wholesale to business firms, a qualified business engages in a service business or calling, or value is added to materials or products that are manufactured by a qualified business. 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 is taxable without the enterprise zone if the business has:

(i) Income from business activity within the zone which does not fall within the definition of trade or business; or

(ii) Income 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 in an amount equal to a percentage of unemployment insurance premiums paid on the payroll of all the business' employees employed in the enterprise zone, including employees who do not qualify under the definition of a low income person. 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 the zone 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 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 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 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 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 divided by \$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. 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 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 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, 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 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 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) 66.7 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 \$466.90. Third, 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 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 NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)

§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. Both the transfer of title and delivery to the buyer of the tangible personal property must take place in the same enterprise zone in which the tangible personal property is sold.

(b) When title passes is dependent upon the factual circumstances of the transaction gathered from 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 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.

(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 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 title and delivery in an enterprise zone other than the enterprise zone that ABC is located in. ABC will have to apportion the income received from the sales outside the zone that ABC is located in and claim income tax credits and the general excise tax exemption only for sales where the purchasers receive title and delivery within the same zone. [Eff NOV 03 1990]  
(Auth: HRS §209E-8) (Imp: HRS §209E-8)

§15-6-14 Sale of services. (a) Services must be sold by an establishment or qualified business engaged in a service business or calling, as defined in this chapter, within an enterprise zone and the services must be delivered in the same enterprise zone in which the services are sold. The business must act upon or process tangible personal property. This includes business activities such as cleaning, repair, and maintenance. By way of example, this term does not include business activities such as brokerage, legal, accounting, architectural, engineering, consulting, contracting, real estate, and travel agencies. Where the service business or calling, in the same transaction, engages in both the sale of tangible property and services, the service business or calling shall segregate the sale of services that are exempt under chapter

209E, HRS, from the sale of tangible personal property. The service business or calling shall sustain the burden of proving the segregation was properly made. If the service business or calling 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 Auto Dealer is located in an area designated as an enterprise zone. ABC provides servicing and repair work on automobiles. ABC provides these services for customers who bring their automobiles 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:

ABC Company is located in an area designated as an enterprise zone. ABC provides laundry services to the following persons: individual customers who bring their laundry to ABC's place of business and individual customers and hotels who offer laundry services to hotel guests where ABC collects the laundry outside the zone, cleans the laundry within the zone, and returns the laundry to the individual customers and hotels outside the zone. ABC will qualify for the income tax credits and general excise tax exemption for sales to customers who bring their laundry to ABC's business. ABC will also qualify for the income tax credits and general excise tax exemption for sales to both the individuals and the hotels where laundry is picked up.

Example 3:

Assume the same facts as in Example 2, except that ABC imposes a separate charge for goods that are picked up and delivered. As the pick up and delivery charges are not trade or business within the zone, 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 performed within the zone.

Example 4:

Assume the same facts as in Example 2, except that ABC also rents personal property that it owns, including table cloths, towels, and other linen, to customers located outside the zone. ABC Periodically collects soiled items from the customers, launders the items, and provides clean table cloths, towels, and linen to the customers. ABC will not qualify for the income tax credits and general excise exemption on these sales as the cleaning of property owned by the laundry is not an eligible activity.

Example 5:

ABC Company is located in an area designated as an enterprise zone. ABC leases automobiles and other equipment to customers who come to ABC's place of business. These services are sold and delivered within the zone. ABC, however, will not qualify for the income tax credits and general excise tax exemption as the lease of property is not an eligible activity. ABC does not act upon or process tangible personal property.

Example 6:

ABC is located in an area designated as an enterprise zone. ABC provides architectural and engineering advice to its customers who are located both within and outside the zone. ABC will not qualify for the income tax credits and general excise tax exemption as architectural and engineering activities are among the activities specifically excluded from the definition of a service business or calling.  
[Eff NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)

§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 NOV 03 1990] (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.

If a business fails to be certified for any taxable year during this seven-year period, the business shall not be entitled to the income tax credits or general excise tax exemption offered

by this program. The business, however, is eligible to qualify and be certified for any remaining taxable years of its seven-year cycle.

(b) 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. 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 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 acts upon or processes tangible personal property 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 of 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 seven-year cycle, 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 seven-year cycle, the successor business, if any, shall continue the seven-year cycle 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.
- (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 NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)

#### 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.

- (1) The department shall require from each county a survey of existing zone business conditions, to be submitted within sixty days of zone designation.
- (2) Within sixty days after the anniversary date of zone designation, each county shall submit a report evaluating this program's effectiveness.

(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 NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)

§15-6-18 Waiver. The director may waive particular provisions of this chapter to conform to applicable federal requirements. [Eff NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209-E)

§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 NOV 03 1990] (Auth: HRS §209E-8) (Imp: HRS §209E-8)