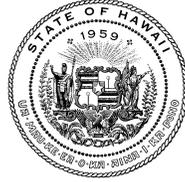


LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

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DIRECTOR OF TAXATION

STANLEY SHIRAKI
DEPUTY DIRECTOR

PHONE NO: (808) 587-1530
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November 30, 2009

LETTER RULING NO. 2009-09

[REDACTED TEXT]
[REDACTED TEXT]
[REDACTED TEXT]
[REDACTED TEXT]

Re: Application of certain tax incentives regarding [REDACTED TEXT]

Dear [REDACTED TEXT]:

This letter responds to your request of [REDACTED TEXT], for a comfort ruling confirming that certain tax incentives are available if [REDACTED TEXT] (the "Company"), meets the definition of a qualified high technology business ("QHTB").

In general, Hawaii offers the following tax incentives to qualifying businesses:

1. The high technology business investment tax credit under § 235-110.9, Hawaii Revised Statutes ("HRS");
2. The income tax exclusion for royalties and other income derived from patents and copyrights received by an individual or a QHTB and developed and arising out of a QHTB under § 235-7.3, HRS; and
3. The income tax exclusion for stock options, dividends from stock, the receipt of the options, the exercise of the options, and income from the sale of the options under § 235-9.5, HRS.

In addition, other tax provisions may provide tax incentives to a QHTB that do not depend on whether the business meets the definition of a qualified high technology business.

SHORT ANSWER

Based on the information in your request for a high tech comfort ruling, the questionnaire, "Does a Company Qualify for Hawaii Tax Incentives?" ("Questionnaire"), and the representations made by the Company as stated below in this letter (the "Representations"), the Company will meet the definition of a qualified high technology business as defined in both § 235-7.3, HRS and § 235-110.9, HRS; provided the amount of cash invested in the Company does

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not exceed \$10,000,000.

Based solely on the Representations, the Company qualifies as a QHTB for purposes of the tax benefits identified above in Paragraph 1.

Based solely on the Representations, the patents, copyrights, or trade secrets developed and arising out of the Company will qualify for the tax benefits identified above in Paragraph 2.

Based solely on the Representations, the Company's members will qualify for the tax benefits identified above in Paragraph 3, as further discussed in Part III of this letter.

FACTS REPRESENTED BY THE COMPANY

The Company makes the following representations:

The Company is a Hawaii limited liability company organized on [REDACTED TEXT]. The Company represents that it will be engaged in the film production business, and will conduct the majority of its qualified research activities, consisting of film production activities, in Hawaii. The Company is in the process of identifying and selecting a potential film project and currently expects to raise total investment monies of up to [REDACTED TEXT] to fund production. The Company represents that high technology business investment tax credits allocated to investors in the Company will not exceed the amount each investor's qualified investment in the Company, and that with respect to any investor in the Company, the "Investment Tax Credit Allocation Ratio," as defined under HRS §235-110.9(h), will not be more than 1:1. The Company further represents that to accomplish the appropriate investment tax credit allocation ratio, a portion of the equity of the Company may be owned by a Hawaii limited liability company special purpose entity called [REDACTED TEXT].

Although not required as a pre-condition to investing in the Company, in addition to their own funds, investors may obtain loan proceeds on a fully recourse basis from an unrelated, third-party lender to invest in the Company. The Company may assist in arranging for loans from such a lender or lenders, but will not receive any compensation with respect to these loan transactions, which will be strictly on an arm's-length basis, on commercially reasonable terms, between the investors and the lenders. Each such investment, regardless of the source of investor funds (the "Investment"), shall be a nonrefundable investment within the meaning of §465 of the Internal Revenue Code of 1986, as amended (the "Code").

The Company will fully expend the investments it receives from the investors, directly or through the SPE, in the ordinary course of business, and at least 75% of such expenditures will be expended directly for qualified research activities, *i.e.*, film production activities, in Hawaii. Assuming a sufficient production budget is secured, the Company expects to hire between [REDACTED TEXT] workers to carryout the Company's performing arts products activities, either directly as employees or as independent contractors. Such production personnel will include [REDACTED TEXT]. Based upon a typical production budget, which the Company

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[REDACTED TEXT]

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intends to spend in Hawaii, approximately [REDACTED TEXT] of the total production budget will be spent on salaries and personnel costs. Further, a substantial portion of the balance of the budget will be spent on [REDACTED TEXT].

The Company has represented that it may agree with its investors that it will not begin substantial production activities in connection with the film or video projects or incur material expenses in connection therewith unless and until it enters into a distribution or "negative pickup agreement." A negative pickup agreement is a distribution agreement wherein a distribution company or companies agrees to pay the Company a pre-sale royalty for the use of, or right to use the copyright in and to the Company's performing arts products. These contractual arrangements are customary in the industry because the distribution companies need to begin marketing the film or video well in advance of production thereof, but would want to have contractual rights to the film or video before incurring any time or expense in marketing the same. See Part I.E., *infra*, for additional discussion on these issues.

The Company represents that it will comply with the terms and requirements of Tax Information Release No. 2003-1 generally and, without limiting the foregoing, specifically with respect to the requirements that the investments in the Company made by the investors, directly or through the SPE, shall not be repaid in part or in whole before one year from the date of investment.

The Company represents that more than 50% of its total business activities will be qualified research and more than 75% of its qualified research will be conducted in Hawaii. The Company's qualified research activities (*i.e.*, its film production) will constitute more than 50% of its total activities (the first step of the "Activity Test" defined under HRS §235-110.9, based on the cost of the qualified research activities (the "Cost Method")). Under the Cost Method, compliance with the Activity Test is based on the ratio of the costs associated with the Company's qualified research activities to the total cost associated with all activities of the Company.

The Company represents that it will receive more than 75% of its income from royalties from the sale or license of the film or video it produces pursuant to a commercially reasonable, arm's-length agreement to be negotiated with an unrelated distribution company, and that therefore more than 75% of its gross income will be derived from qualified research and from either (i) products sold from, manufactured in, or produced in Hawaii, or (ii) services performed in Hawaii.

The Company has made additional representations, in Exhibit A, regarding jobs to be created by the Company, Hawaii costs and Investments in the Company. The Company has agreed that the redacted version of this ruling attached as Exhibit B will be available for public inspection and copying.

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LAW AND ANALYSIS

The requirements for these tax incentives and their application to the Company are discussed below.

I. High technology business investment tax credit

For investments made in taxable years beginning after December 31, 2000, but before taxable years beginning after December 31, 2010, a nonrefundable high technology business investment tax credit of up to \$2,000,000 per taxpayer is available. The credit is graduated over five years (35% to 10%) from the date of the “investment”¹ in a QHTB. The credit is capped at varying amounts (\$700,000 in the year the investment is made to \$200,000 in the last year). Some of the credit claimed will be recaptured in certain circumstances. *See* Part I.D., below. If the tax credit exceeds the taxpayer's income tax liability for any of the five years that the credit is taken, the excess of the tax credit over liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted; provided, however, that no carryover of any unused credits is allowed with respect to investments made on or after May 1, 2009 for tax years ending on or before December 31, 2010.

Additional restrictions are placed upon investments received on or after May 1, 2009 and on or before December 31, 2010, pursuant to Act 199 (Session Laws of Hawaii, 2009). These restrictions include the following:

- 1) Not more than 80% of a taxpayer's tax liability may be offset by utilizing such credits for tax years ending on or before December 31, 2010;
- 2) The credit must be taken ratably over the five year period in accordance with HRS § 235-110.9(a) and may not exceed an Investment Tax Credit Allocation Ratio of 1:1; and

¹ “Investment” is defined as “a nonrefundable investment, at risk, as that term is used in section 465 (with respect to deductions limited to amount at risk) of the Internal Revenue Code, in a qualified high technology business, of cash that is transferred to the qualified high technology business, the transfer of which is in connection with a transaction in exchange for stock, interests in partnerships, joint ventures, or other entities, licenses (exclusive or nonexclusive), rights to use technology, marketing rights, warrants, options, or any items similar to those included in this definition, including but not limited to options or rights to acquire any of the items included in this definition. The nonrefundable investment is entirely at risk of loss where repayment depends upon the success of the qualified high technology business. If the money invested is to be repaid to the taxpayer, no repayment except for dividends or interest shall be made for at least one year from the date the investment is made. The annual amount of any dividend and interest payment to the taxpayer shall not exceed twelve per cent of the amount of the investment.” *See* § 235-1, HRS.

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- 3) No carryover of any unused credits from investments made on or after May 1, 2009 for tax years ending on or before December 31, 2010.

If a QHTB accepts any investments after June 30, 2007, the QHTB is required to file an annual survey as described in Act 206 (Session Laws of Hawaii, 2007). Failure to file the survey when due may result in a penalty of \$1,000 per month for each month the annual survey is not filed, not to exceed a total of \$6,000 for any annual survey not filed. Furthermore, by accepting an investment for which an investment credit allowed under section 235-110.9, HRS may be claimed, the QHTB is deemed by statute to have consented to the public disclosure of the Company's name and status as a beneficiary of the investment credit.

To be considered a QHTB for purposes of this tax credit, in each of the years for which the credit will be claimed, the Company must employ or own capital or property, or maintain an office, in Hawaii and:

- (1) More than 50% of its total business activities must be qualified research and more than 75% of its qualified research must be conducted in Hawaii (the "Activity Test"); or
- (2) More than 75% of its gross income must be derived from qualified research and the income from this qualified research must be received from:
 - (a) Products sold from, manufactured in, or produced in Hawaii; or
 - (b) Services performed in Hawaii (the "Gross Income Test").²

If the Company contracts with another person to perform qualified research, the research will qualify as research performed by the Company for the purpose of determining the Company's status as a QHTB only if the contract meets the following requirements:

- (1) The contract must be entered into before the performance of the qualified research activity;
- (2) The contract requires the Company to bear the expense of the research even if the project is unsuccessful; and
- (3) The contract provides that the research is to be performed on behalf of the Company and the Company will have substantial rights to the research results.³

² This definition of a QHTB for purposes of § 235-110.9 differs from the definition of a QHTB in § 235-7.3, HRS, which is discussed in Part II of this letter.

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If another person contracts with the Company to have the Company perform qualified research, the research will not qualify as research performed by the Company for the purpose of determining the Company's status as a QHTB if the above requirements have been met in favor of the other person, even if the other person is not a QHTB.

A. The Company's presence in Hawaii

The Company, a limited liability company organized under the laws of Hawaii, represents that it maintains its office at [REDACTED TEXT]. The Company also represents that it will maintain an office, have employees, and own property in Hawaii. Therefore, for purposes of HRS § 235-110.9, the Company meets the requirement that it employ or own capital or property or maintain an office in Hawaii.

B. The Company's qualified research activities

The term "qualified research" means:⁴

- (1) The same as in § 41(d), Internal Revenue Code ("IRC");
- (2) The development and design of certain computer software;
- (3) Biotechnology;
- (4) Performing arts products;
- (5) Sensor and optic technologies;
- (6) Ocean sciences;
- (7) Astronomy; or
- (8) Nonfossil fuel energy-related technology.

Item (4) Performing arts products

Item (4) of the definition of "qualified research" includes performing arts products. Performing arts products is defined as:

- (1) Audiofiles, video files, audiovideo files, computer animation, and other entertainment products perceived by or through the operation of a computer; and
- (2) Commercial television and film products for sale or license, and reuse or residual fee payments from these products.

³ If the Company receives a license, the term of the license must be for the useful life of product(s) or research.

⁴ Section 235-110.9, HRS, incorporates the definition of "qualified research" in § 235-7.3, HRS.

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In Part I of the Questionnaire, the Company checked the box indicating that it is involved in performing arts products. The Company represents that 100% of its activities are the creation of performing arts products. The Company will produce films and videos for sale or licensing to third parties. The films and videos created by the Company and resulting from its research activities will be owned or substantially owned by the Company. By checking this box, the Company represents that it meets the requirements of Item (4) of qualified research, creating performing arts products. In addition, the Company acknowledges that existing content or existing performing arts products do not constitute qualified research activities for purposes of § 235-7.3, HRS and § 235-110.9, HRS. To the extent the Company produces original performing arts products, the Company's activities constitute qualified research under § 235-7.3, HRS and § 235-110.9, HRS. Based solely on the Representations, the Company performs qualified research pursuant to the requirements of Item (4).

C. Activity Test and Gross Income Test

Under § 235-110.9, HRS, in order for a company performing qualified research to meet the definition of a QHTB, it must be a business employing or owning capital or property, or maintaining an office, in the State of Hawaii. In addition, the company must meet the requirements of either the Activity Test or the Gross Income Test. Under the Activity Test, a company is a QHTB if more than 50% of its total business activities are qualified research and more than 75% of such qualified research is conducted in Hawaii. Under the Gross Income Test, a company is a QHTB if more than 75% of its gross income is derived from qualified research in the form of either (i) products sold from, manufactured in, or produced in Hawaii, or (ii) services performed in Hawaii.

Due to the highly fact intensive nature of qualifying as a QHTB under the Gross Income Test, including the uncertainty and ambiguity of: 1) revenue streams associated with qualified research; 2) determining the source of product sales; 3) manufacturing or production quantification; as well as 4) the extent services are performed in the State within the meaning of HRS § 235-110.9(g), the Department will not issue rulings determining whether a business satisfies the Gross Income Test for purposes of qualifying as a QHTB.

The Company represents that it is maintaining an office in Hawaii or is employing capital or property in Hawaii.

The Company represents that it will meet the Activity Test because more than 50% of its activities will be in qualified research and more than 75% of those qualified research activities will be conducted in Hawaii. In making this determination, the Company used a numerator that contained the costs of activities in direct support of qualified research and a denominator that included all costs for all activities.⁵ Furthermore, as to the requirement that 75% of the qualified

⁵ "Business activities" may be measured by the cost of these activities, the time spent on these activities, or another consistently applied reasonable basis. This statement is based upon general principles in the income tax and general excise tax law. Whatever the measure adopted by the taxpayer, the measure must reasonably reflect business realities.

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research activities be conducted in Hawaii, the Company used a numerator that contained all costs incurred in direct support of qualified research activities conducted in Hawaii and a denominator that contained all costs incurred for all qualified research activities. In making these representations about the Activity Test, the Company understands that the following activities do not count as qualified research activities for purposes of this test:

- Activities associated with research that is funded by grants and in which the Company has no substantial risks and rights;
- Activities associated with research being performed by the Company pursuant to a contract in which the contract requirements discussed in Part I, above, have been met in favor of another party to the contract; and
- Activities performed by another business on behalf of the Company where the contract requirements discussed in Part I, above, have not been met in favor of the Company.

Specifically, the Company represents it will satisfy the Activities Test by employing a Cost Method based upon the numerator and denominator determinations discussed above. Employee salaries, supplies and materials, and contract services directly and substantially related to film and video production are examples of expenditures that would be considered qualified research expenses for purposes of employing the Company's Cost Method. Out-of-state expenses are not counted toward the cost of qualified research activities conducted in Hawaii for purposes of satisfying the second requirement of the Activities Test that 75% of a QHTB's qualified research activities be conducted in Hawaii.

Though the Department will not rule on whether the Company satisfies the Gross Income Test, the Company nonetheless represents that it will meet the Gross Income Test because more than 75% of the gross income for the Company will be derived from qualified research, and the income from such qualified research will be received either from products sold from, manufactured in, or produced in Hawaii, or services performed in Hawaii.

Based on the Representations, the Company is a QHTB for purposes of the high technology business investment tax credit because it meets the requirements of Item 4, creating performing arts products, in the definition of "qualified research," the Company will maintain an office in Hawaii, and employ capital or property in Hawaii, and, based upon the representations above, the Company satisfies the Activity Test. Solely based on the Representations, investments (as defined in HRS § 235-1) in the Company will qualify for the high technology business investment tax credit.

Pursuant to Department of Taxation Announcement No. 2008-07, the Department makes no determination as to whether the Company qualifies under the Gross Income Test.

D. Credit Recapture

Section 235-110.9(d), HRS, provides for recapture of credits that have been claimed by a taxpayer where one of the following three events occurs (recapture event):

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- (1) The business no longer qualifies as a QHTB;
- (2) The business or an interest in the business has been sold by the taxpayer investing in the QHTB;
- (3) The taxpayer has withdrawn the taxpayer's investment wholly or partially from the QHTB.

Where recapture is triggered, 10% of the amount of the total tax credit claimed by the selling or withdrawing investor in each of the two taxable years prior to the year in which recapture occurs must be added to such investors' tax liability for the taxable year in which the recapture occurs.

The credit cannot be claimed in the year of a recapture event because investors do not have an investment in a QHTB. If a recapture event occurs, the Company should notify the investors that they are not eligible to claim the credit and that some of the credit claimed in prior years shall be recaptured.

E. Miscellaneous Issues Relative to Ruling Determination

In its correspondence and discussions with the Department, the Company raised several issues unique to its circumstances. The conclusions drawn in this letter, including the Company's qualification as a QHTB, are further subject to the limitations discussed in this section.

(1) Utilizing Loan Proceeds for Investments

The Company has represented that, although not required as a pre-condition to investing in the Company, in addition to their own funds, investors in the Company may obtain loan proceeds on a fully recourse basis from an unrelated, third-party lender to invest in the Company. The Company may assist in arranging for loans from such a lender or lenders, but will not receive any compensation with respect to these loan transactions. These loan transactions have been represented to be strictly on an arm's-length basis, on commercially reasonable terms, including recourse liability of the borrower, between the investors and the lenders. Based upon the representations that investors will utilize commercially reasonable, fully recourse loan proceeds, which are considered at-risk within the meaning of Internal Revenue Code §465, an investor may utilize such proceeds to make an "investment" in the Company under HRS § 235-1; provided all other requirements of HRS § 235-1 are satisfied (*i.e.*, no repayment except for limited dividends and interest for the first year following investment, *etc.*).

(2) Repayment of Investment Dependent Upon the Success of the Business

The Company has raised the issue regarding whether an investment, as personal funds or loan proceeds, "is entirely at risk of loss where repayment depends upon the success of the qualified high technology business." HRS § 235-1. The Department acknowledges that the law expressly provides that a nonrefundable investment is entirely at risk of loss where repayment depends upon the success of the QHTB. However, the Department has not been provided

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company documents, agreements, contracts, or other evidence to suggest whether or not any repayment agreement, in fact, is actually dependent upon the Company's success. Furthermore, given the highly fact intensive nature of what is considered a QHTB's "success," which is subjective and could be interpreted in any number of reasonable ways, the Department will not rule on any repayment or risk of loss scenarios that are purportedly dependent upon the Company's "success."

(3) Impact of Investment's Risk Based upon Entering into a Distribution or Negative Pickup Agreement

The Company has also represented that it will seek to enter into arm's-length, commercially reasonable distribution or "negative pick up" agreements with one or more unrelated, established film distribution companies, pursuant to which the distribution company or companies each agrees to pay the Company a pre-sale royalty. The Company represents that these contractual arrangements are customary in the industry because the distribution companies need to begin marketing the film or video well in advance of production thereof, but would want to have contractual rights to the film or video before incurring any time or expense in marketing the same. Regardless of the customary or arm's length nature of distribution agreements, including negative pickup agreements, the Department has not been provided with company documents, agreements, contracts, or other evidence of the terms of any such distribution or negative pickup agreement. Because the Department has not been apprised of any terms of any distribution agreements, the Department will not rule on the effects of a distribution agreement or negative pickup agreement on the Company's circumstances, including the effect on an investor's riskiness, in this letter.

(4) Idle Funds—Agreement with Investors not to Spend Funds Until Entering into a Distribution Agreement

The Company has also raised a potential issue whereby it may consider an agreement with its investors that the Company will not begin substantial production activities in connection with the film or video or incur material expenses in connection therewith unless and until it enters into an acceptable distribution or negative pick up agreement. However, the Company further represented that it will fully expend the investments it receives from the investors, directly or through the SPE, in the ordinary course of business, and at least seventy-five percent (75%) of such expenditures will be expended, for qualified research activities, *i.e.*, film production activities, in Hawaii. Funds not immediately required to be expended by the Company will be held in interest-bearing accounts to be utilized when and as needed to defray production costs.

The Department cautions the Company in its business decision to include a condition precedent to expending investment funds for which a credit may be claimed under HRS § 235-110.9 of the type discussed in this section. For all practical purposes, a company can only qualify as a QHTB if it has sufficient qualified expenditures. Idled funds or funds that are subject to a restriction or condition before they may be expended are considered disqualified expenditures until the restriction or condition lapses, which will reduce the Company's

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satisfaction of the Activities Test using the Cost Method.⁶ The Company's qualification as a QHTB will be placed in jeopardy if the Company includes in its investment solicitation materials, its representation to prospective investors, or otherwise adopts a company policy or protocol whereby investment funds will not be spent until the occurrence of an event. Placing the Company's QHTB status in jeopardy could result in recapture of credits if the Company is found not to be a QHTB because it failed to have sufficient qualified research activities. Therefore, based upon the Company's identification of the condition precedent relative to obtaining an acceptable distribution or negative pickup agreement, the conclusions in this letter that the Company qualifies as a QHTB are contingent upon the elimination or the lapse of the condition from the Company's business plan. In short, investment funds must be expended in the ordinary course of business relative to the creation of performing arts products free of restrictions on the use of funds in order to qualify as a QHTB as the Department understands the facts of this case. If the Company decides to utilize a method other than the Cost Method (*i.e.*, time spent on qualified activities), the same analysis would apply. Any condition precedent to starting research activities will preclude the Company from qualifying as a QHTB until that condition is met. Once the condition is met, the QHTB must then carry out the required activities for QHTB status.

II. Income tax exclusion for royalties and other income from QHTB

Pursuant to § 235-7.3, HRS, an income tax exclusion is available for income received by an individual or a QHTB⁷ as royalties and other income derived from any patents, copyrights, and trade secrets developed and arising out of a QHTB.⁸ The exclusion may be claimed by the individual or QHTB that owns the patents, copyrights, or trade secrets. For purposes of the royalty income exclusion, a QHTB is defined as “a business conducting more than 50% of its activities in qualified research.”⁹

⁶ For example, if the Company receives \$1,000 in investments and spends \$100 on salary, start up costs, and script procurement; however idles \$900 in an account subject to an understanding that substantial sums will not be spent until a satisfactory distribution agreement is executed, the Company will not be a QHTB at any time prior to the lapse of the restriction because the idled \$900 will be considered disqualified costs. The Company will fail the Activities Test using the Cost Method because the qualified costs (\$100) are only 10% of the Company's qualified activities and the remaining 90% of activities are based upon the disqualified idled funds costs (\$900). Thus, the Company cannot satisfy the 50% requirement of the Activities Test.

⁷ If the QHTB receiving the income is treated as a partnership for income tax purposes, then the partners or members of the QHTB may exclude the allocated portion of such income, even if the partner or member excluding the income is not an individual or QHTB.

⁸ Expenses for royalties and other income derived from any patents, copyrights, and trade secrets by an individual or a QHTB as defined in § 235-7.3, HRS, are deductible. *See* § 235-2.4(g), HRS.

⁹ This definition differs from the definition of a QHTB in § 235-110.9, HRS, which is discussed in Part I of this letter.

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As discussed in Part I, relating to the high technology business investment tax credit, the Company's representations meet the requirements of Item 4, creating performing arts products, in the definition of "qualified research." The Company also represents that more than 50% of the Company's activities are in qualified research, again using a numerator that contained the costs of qualified research activities and a denominator that included all costs for all activities. Based on the Representations, royalties and other income derived from any patents, copyrights, and trade secrets developed and arising out of the Company received by an individual¹⁰ or a QHTB may be excluded from income tax. Furthermore, as long as the Company is a QHTB for purposes of § 235-7.3, HRS and treated as a partnership for income tax purposes, each member's allocated portion of royalties and other income derived from patents, copyrights, and trade secrets owned by the Company and developed and arising out of a QHTB may be excluded from income tax by the members of the Company.

III. Income tax exclusion for stock options from qualified high technology business

Section 235-9.5, HRS, provides an exclusion for "all income earned and proceeds derived from stock options or stock," including stock issued through the exercise of stock options or warrants, from a QHTB or from a holding company of a QHTB¹¹ by an employee, officer, or director of the QHTB, or investor who qualifies for the high technology business investment tax credit in § 235-110.9, HRS, effective for taxable years beginning after December 31, 2000. This exclusion is applicable to dividends from stock or stock received through the exercise of stock options or warrants, the receipt or the exercise of stock options or warrants, and income from the sale of stock, including stock issued through the exercise of stock options or warrants.¹²

With respect to a partnership or a limited liability company treated as a partnership for income tax purposes, the exclusion is applicable only to the gain from the sale of membership interest units. For purposes of this income tax exclusion, a QHTB means the same as defined in §235-7.3, HRS, relating to the income tax exclusion for royalties.

As discussed in Part I, relating to the high technology business investment tax credit, the Company's representations meet the requirements of Item 4, creating performing arts products, in

¹⁰ The performing arts product exclusion in § 235-7.3, HRS, is applicable to the author and assignors, licensors, and licensees.

¹¹ A holding company of a QHTB means any business entity that possesses:

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

¹² Section 165, IRC, is operative for Hawaii income tax purposes and applies to losses sustained from the sale of stock issued through stock options or warrants granted by a QHTB. See § 235-2.4(d), HRS.

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the definition of "qualified research." The Company also represents that more than 50% of the Company's activities are in qualified research, again using a numerator that contained the costs of qualified research activities and a denominator that included all costs for all activities. Based on the Representations and assuming the Company is treated as a corporation for income tax purposes, the income earned and proceeds derived from stock options, stock, options to acquire an equity interest, or equity interests may be excluded from income tax. However, if the Company is treated as a partnership for income tax purposes, only the gain from the sale of membership interest units may be excluded from income tax. And if the Company is treated as a sole proprietorship because it is a single-member limited liability company, then § 235-9.5, HRS, is not applicable.

IV. Conclusion

Based solely on the Representations and subject to the discussion in Part I.E.4, the Company qualifies as a QHTB for purposes of the tax benefits identified on the first page hereof in Paragraphs 1, 2, and 3. The conclusions reached in this letter apply only to the extent the amount of cash investments received by the Company do not exceed \$10,000,000.

This ruling is applicable only to the Company and shall not be applied retroactively. It may not be used or cited as precedent by any other taxpayer. As discussed in Part I.E., no opinion is expressed as the facts presented relate to repayment of investments dependent upon the Company's success. The Department set forth its position relative to the idled funds discussed in Part I.E.4, and has expressly cautioned the Company from restricting the use of investment funds for which a credit may be claimed under HRS § 235-110.9.

The conclusions reached in this letter are based on our understanding of the facts that the Company has represented. If it is later determined that our understanding of these facts is not correct, the facts are incomplete, or the facts later change in any material respect, the conclusion in this letter will be modified accordingly. This ruling also may be subject to change due to future amendments to laws, rules, or official Department positions.

If you have any further questions regarding this matter, please call me at 808-587-1569. Additional information on Hawaii's taxes is available at the Department's website at <http://www.hawaii.gov/tax>.

Very truly yours,

Administrative Rules Specialist
JOSEPH B. TICHY

Exhibit A To Comfort Ruling for [REDACTED TEXT]

As Submitted By [REDACTED TEXT]

[REDACTED TEXT]