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May 23, 2011

LETTER RULING NO. 2011-04

[redacted text]

[redacted text]

[redacted text]

[redacted text]

Re: Exemption of Certain Scientific Contracts with the United States

Dear [redacted text]:

By letter dated January 11, 2011, [redacted text] ("Taxpayer"), a [redacted text] corporation, requested the State of Hawaii Department of Taxation (the "Department") rule on the proper treatment of gross proceeds derived from the performance of scientific work under subcontracts entered into with a contractor who entered into contracts with the United States under section 237-26 of the Hawaii Revised Statutes ("HRS").

SHORT ANSWER

Based on Taxpayer's representations, Taxpayer is performing scientific work under the contract and therefore Taxpayer's gross proceeds derived from the performance of that portion of the contract which constitutes scientific work are exempt from general excise tax under HRS § 237-26.

FACTS REPRESENTED BY TAXPAYER

Taxpayer, a company based in [redacted text], designs and manufactures an advanced-design energy-reducing modular building system called an "energy test platform."

Taxpayer is party to a subcontract with [redacted text] (Researcher). The prime contract is between Researcher and the Office of Naval Research (ONR). ONR made a grant to Researcher to install, test, and evaluate passive and active energy systems using the Taxpayer's energy test platforms at three different sites in Hawaii. The sites were selected to test how the energy test platforms respond in a range of climates. Taxpayer's subcontract with Researcher requires Taxpayer to manufacture and install the energy test platforms at the three sites.

Taxpayer represents that the energy test platforms it will install constitute scientific facilities. The Taxpayer's energy test platforms incorporate passive energy systems to optimize

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management of heat, airflow and lighting to minimize energy demand. The active energy systems use renewable energy to generate electrical energy for test platform use. Operational data from the energy systems installed at the project sites will be collected and analyzed during the data collection period of up to five years. As defined in the agreements among Taxpayer, Researcher and ONR, the overall purpose is to "study the integrated performance and effectiveness of the test platform and energy systems in relevant Pacific region environments for potential future applications by the Department of the Navy, United States."

Researcher proposes to provide structures and systems, including Taxpayer's energy test platforms, to study the effectiveness of energy neutral science and technology for the Pacific region. The objective is to achieve or exceed energy neutrality, defined as power equal to the demand to achieve complete operational effectiveness using clean alternative energy sources collected within the footprint of the test site.

Taxpayer's energy test platforms will provide the capability to record a range of energy and performance information and then compare this data within the individual site as well as across the distinct test sites. Information collected could include internal, external and differential data in the following areas: energy utilized (heat/cooling, lighting, user equipment), energy generation, net metering, load fluctuation, heat/cooling gain/loss, humidity, acoustic signature, thermal comfort, day lighting, and light signature.

In summary, Researcher, pursuant to a contract with ONR, will perform research and development at three test sites. Those three test sites will contain energy test platforms, which are scientific facilities. Taxpayer, pursuant to a subcontract with Researcher, will manufacture and install those scientific facilities.

LAW AND ANALYSIS

HRS § 237-26 states:

- (a) Any provision of law to the contrary notwithstanding, there shall be exempted from the measure of the taxes imposed by chapter 237, all of the gross proceeds derived by a contractor or subcontractor arising from the performance of any scientific work as defined in subsection (b), under a contract or subcontract entered into with the United States (including any agency or instrumentality thereof but not including national banks), and all of the gross proceeds derived from the sale of tangible personal property by a seller of such tangible personal property which is to be affixed to, or to become a physical, integral part of the scientific facility, or which is to be entirely consumed during the performance of the service required by the contract or subcontract.
- (b) For purposes of this section, "scientific work" is work involving primarily the research and development for, or the design, manufacture, instrumentation, installation, maintenance, or operation of aerospace, agricultural, astronomical, biomedical, electronic, geophysical, oceanographic, test range, or other scientific

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facilities. Maintenance or operation, for purposes of this section, shall include housekeeping functions in providing certain nonscientific logistic and support services.

Taxpayer's gross proceeds from the installation of energy test platforms at the test sites pursuant to its subcontract with Researcher are exempt from GE tax under HRS § 237-26.

First, the work is being performed under a contract with the United States. Based on Taxpayer's representations, Researcher entered into a prime contract to conduct research and development for ONR, an agency of the United States. As part of that prime contract, Researcher was required to install energy test platforms at the test sites in order to carry out its research. Researcher entered into a subcontract with Taxpayer to install those energy test platforms. Therefore, Taxpayer is a subcontractor performing work under a prime contract with the United States.

Second, Taxpayer is performing scientific work. HRS § 237-26(b) defines scientific work to include "installation...of...scientific facilities." The energy test platforms, where Researcher will be performing its research for ONR, are scientific facilities, and pursuant to its subcontract with Researcher, Taxpayer will install those scientific facilities.

Thus Taxpayer is performing scientific work, and doing so as a subcontractor under a prime contract with the United States. Any gross proceeds from the scientific work of installing the energy test platforms pursuant to the contract with Researcher are exempt from general excise tax.

Additionally, any subcontractors Taxpayer may enter into contract with in order to help it meet its contractual obligations to install the energy test platform may also potentially qualify for this exemption, so long as those subcontractors are also performing scientific work. However, the Department does not rule on the taxability of any of Taxpayer's specific subcontractors at this time.

The conclusion reached in this letter is based on our understanding of the facts that you have 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.

The Taxpayer has reviewed and agreed that the redacted version of this ruling will be available for public inspection and copying.

If you have any further questions regarding this matter, please call me at 808-587-5334.

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Sincerely,

/s/Jacob L. Herlitz

JACOB L. HERLITZ
Administrative Rules Specialist