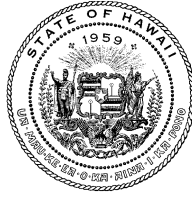


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TAX INFORMATION RELEASE NO. 2000-2

RE: Hotel Construction and Remodeling Tax Credit

This Tax Information Release (TIR) provides guidance regarding the types of expenditures that are eligible for the refundable four percent income tax credit under section 235-110.4, Hawaii Revised Statutes (HRS), for tax years 1999 through 2002.¹

I. Applicable Law

The credit is applicable to the “construction or renovation costs” for a “qualified hotel facility”² of a taxpayer subject to the net income tax under chapter 235, HRS, and the transient accommodations tax under chapter 237D, HRS, including an association of apartment owners or timeshare association. The credit must be claimed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. A taxpayer claiming the credit may reduce the basis of property by the amount of the credit allowable and claimed or treat the credit as taxable income.

II. Construction and Renovation Activities

“Construction or renovation costs” are defined as “any costs incurred after December 31, 1998, for plans, design, construction, and equipment related to new construction, alterations, or modifications to a qualified hotel facility, including upgrading the infrastructure with wiring to provide guests with Internet access.” (emphasis added) The plain meaning of the terms “alter” and “modify” require actions which change a facility by renewing its condition. The legislative history supports this plain reading of the statute as the “Legislature recognized the need to rejuvenate the infrastructure of Hawaii’s primary economic engine by producing a tax credit on the construction and renovation of resort facilities and other capital improvements to resort

¹ The credit was enacted in Act 195 (Act 195, SLH 2000).

² A hotel/hotel-condo as defined in section 486K-1, HRS, including a time share facility or project.

areas.”³ (emphasis added) Expenditures to change or remodel a facility by renewing its condition are often characterized as capital expenses and will generally qualify for the credit.⁴

Maintenance is the act of making repairs to prevent a decline, lapse in the existing state or condition. Routine maintenance, therefore, would not qualify for the credit because routine maintenance does not change a facility by renewing its condition. However, to the extent that incidental maintenance repairs are incurred as part of a general plan of renovation, these expenses will qualify for the credit since they are incurred as part of a capital expenditure to improve a facility.

III. Examples

Examples of expenditures that qualify for the credit:

1. Replacing or recovering a floor
2. Reconditioning elevators
3. Replacing or recovering a roof
4. Installing a new air conditioner
5. Reconditioning a fully depreciated machine and extending its useful life.
6. Replacing a phone system with a new phone system capable of connecting to the Internet.

Examples of expenditures that do not qualify for the credit

1. Patching and repairing floors
2. Piece meal repair to floors
3. Reinforcing sagging floors.
4. Piecemeal repair to floor boards.
5. Replacement of small parts.

³ Floor Speech by Representative Ahu Isa on May 2, 2000. Twentieth Legislature, House Journal Page 60.

⁴ While income tax principles provide guidelines to determine whether a cost is capitalized or expensed, these principles are not controlling.

IV. Application of the Hotel and Remodeling Tax Credit to a Bed and Breakfast Home

A bed and breakfast home, generally, is a single-family dwelling, including a single guest house, which provides transient accommodations and meals. The credit is applicable to a bed and breakfast home if the operator of the home is subject to the net income tax under chapter 235, HRS, and the transient accommodations tax under chapter 237D, HRS; and the home is a “qualified hotel facility.”

While the income received by the operator of the bed and breakfast home is subject to the net income tax under chapter 235, HRS, and the transient accommodations tax under chapter 237D, HRS, the home must be a “qualified hotel facility” to qualify for the hotel and remodeling tax credit. This means that the home must be a “hotel/hotel-condo,” which is defined in section 486K-1, HRS, as an “establishment consisting of any building or structure used primarily for the business of providing for consideration transient accommodation lodging facilities.” (emphasis added).

The application of the hotel and remodeling tax credit to a bed and breakfast home is illustrated in the following examples:

Example 1: Taxpayer, a bed and business proprietor, rents two bedrooms in a three-bedroom house and provides meals. Taxpayer replaces the flooring and installs new air conditioners in these two rooms. These expenditures will qualify for the credit because the house was used “primarily” as a transient accommodation lodging facility at the time the expenditures were made.

Example 2: A home owner converts a house to a bed and breakfast home. These expenditures will not be eligible for the credit. The house was not used “primarily” as a transient accommodation lodging facility at the time the expenditures were made.

Forms and other tax information may be downloaded from the Department’s website at www.state.hi.us/tax. On Oahu, forms may be ordered by calling the Department’s Forms Request Line at 808-587-7572. Persons who are not calling from Oahu may call 1-800-222-7572 to receive forms by mail or 808-678-0522 from a fax machine to receive forms by fax.

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HRS Section Explained: §235-110.4