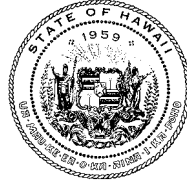


LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION

P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

May 11, 2006

TAX INFORMATION RELEASE 2006-01

**RE: The Attraction and Educational Facilities Tax Credit Established by Act 100,
Session Laws of Hawaii 2003**

I. GENERAL DESCRIPTION OF THE CREDIT

Act 100, Session Laws of Hawaii 2003, established a tax credit for certain "qualified costs" for development of attractions and educational facilities on the Ko Olina Resort and Marina property. The credit is codified in section 235-110.46, Hawaii Revised Statutes (HRS). The credit "earned" is equal to 100% of "qualified costs" as defined under the statute, provided that claims for the credit shall not exceed \$75,000,000 in the aggregate for all taxpayers over the life of the credit. However, notwithstanding the amount of the tax credits earned in any year, a maximum of \$7,500,000¹ of tax credits in the aggregate for all taxpayers may be used in any one "taxable year".² Taxpayers have a six-year period in which to "earn" credits by incurring "qualified costs", beginning on June 1, 2003 and before June 1, 2009. Taxpayers may claim the credits beginning with the taxable year starting after December 31, 2004.

The Ko Olina credit may be used to offset several Hawaii tax types:

- Net income;
- General excise (GET);
- Use;
- Transient Accommodations (TAT);
- Public Service Company (PSC);
- Banks and Other Financial Corporations (Franchise); and
- Insurance premium taxes.

For each qualified taxpayer subject to the taxes imposed by Chapter 235, HRS³, or HRS Chapters 237, 237D, 238, 239, 241, or 431⁴, a tax credit may be claimed for taxable years

¹ This includes credits earned for the expenditure of qualified costs and credits carried over.

² The DOTAX and DBEDT interpret the intent of the legislature to be that a maximum of \$7,500,000 in credits shall be allowed in any calendar year.

³ Net Income Tax

⁴ GET Tax, TAT Tax, Use Tax, PSC Tax, Banks and Financial Corporations Tax, and Insurance Company Premiums Tax, respectively.

beginning after December 31, 2004, for qualified costs in the development of facilities for attractions and educational purposes at Ko Olina Resort and Marina. The tax credit shall be deductible from the taxpayer's net income tax liability, if any, and, at the election of the taxpayer, from the tax liability imposed by HRS Chapters 237, 237D, 238, 239, 241, and 431. Act 100, among other things, allows partnership investors the flexibility of allocating the credit among the partners without regard to the substantial economic effect tax rule of Section 704(b)(2) of the Internal Revenue Code (IRC) of 1986, as amended (26 U.S.C. 704).

II. WHO IS A "QUALIFIED TAXPAYER"?

To qualify for this credit as a "qualified taxpayer", a taxpayer shall be the expending entity and shall:

1. Have expended qualified costs on and be developing a world-class aquarium and marine science and mammal research facility at Ko Olina Resort and Marina⁵; and
2. Dedicate one-half of the net operating income of the world-class aquarium to the State, beginning on the first day of the seventeenth year following the year in which the attractions and educational facilities credit was first taken.

The Department of Taxation (DOTAX) recognizes that the entity actually incurring expenses may be different from the taxpayer that actually claims the credit, such as in the case of certain "pass-through entities". Therefore, in the case of a partnership, limited liability company (treated as a partnership for net income tax purposes), S corporation, estate, trust, or association of apartment owners, the cost upon which the credit is computed shall be determined at the expending entity's level.

If credits are allocated to a taxpayer that is a pass-through entity, the pass-through entity itself may claim the tax credits and the balance of the credits may be allocated to the partners or members.

Example 1: In 2004, Expending Entity (EE) incurs \$7,500,000 of qualified costs. The Department of Business, Economic Development and Tourism (DBEDT) certifies the qualified costs of \$7,500,000, generating \$7,500,000 of tax credits. EE, which is treated as a pass-through entity for net income tax purposes, has two members: A, a pass-through limited liability company (LLC) that has elected to be taxed as a partnership and has no GET, Use, TAT or PSC tax liability and B, a pass-through LLC which has a GET liability of \$3,000,000. EE allocates \$3,750,000 of credits to A and B, respectively. The credits allocated by EE to A can be allocated to the members of A since it is a pass-through entity that has no GET, Use, TAT or PSC tax liability. B can allocate any credits to itself to offset

⁵ Including an international sports training complex, a travel industry management intern campus, infrastructure for the transfer of ocean waters to the aquarium or marine mammal facilities, or both, seawater air conditioning, and other educational facilities developed or operated in cooperation with the University of Hawaii or other educational institutions.

any part of B's GET liability. Any credits remaining after B allocates the desired part of its credits to offset its GET liability may be allocated to B's members.

III. WHAT ARE "QUALIFIED COSTS"?

"Qualified Costs" means any costs for:

- Plans, design, and construction;
- Equipment that is permanently affixed to a building or structure;
- Acquisition of facilities for educational purposes;
- The development of facilities for attractions and educational purposes;
- Infrastructure within the Ko Olina Resort and Marina that is directly related to those facilities; and
- Those administrative and overhead costs under Section 263A of the IRC, that are related to the costs itemized above.

The cost of land acquisition is excluded.

In the case of a partnership, limited liability company, S corporation, estate, trust, or association of apartment owners, the tax credit allowable is for qualified costs incurred by the entity. The costs upon which the credit is computed shall be determined at the entity level. However, for ease of administration, the use of subsidiary entities that are pass-through entities may be treated for certification purposes as expended by the parent entity (see Section V. below).

IV. RESPONSIBILITIES OF DEPARTMENTS

DBEDT will certify the costs eligible for the credit, issue certificates, up to the annual limits, of credits to be offset against the allowed and elected tax types, handle carryovers, and act as the primary "gatekeeper" of this credit, and will have the responsibility to ensure the credits correspond to qualified costs and that the yearly and aggregate caps are not exceeded. DOTAX and the Department of Commerce and Consumer Affairs (DCCA) will be responsible for ascertaining the validity of actual credit claims, as certified by DBEDT.

V. CERTIFICATION

Every qualified taxpayer, should, as soon as possible, but no later than March 31 of each year, submit a written, certified statement to DBEDT, in the form specified by DBEDT, identifying:

1. Qualified costs, if any, expended in the previous calendar year⁶;
2. The amount of credits used, if any, in the previous calendar year;

⁶ The certification of the amount of qualified costs for the first taxable year beginning after December 31, 2004 will include qualified costs incurred from June 1, 2003 through December 31, 2004.

3. The net income tax liability and tax liabilities HRS Chapters 237, 237D, 238, 239, 241, and 431, against which the tax credits are claimed during the previous calendar year; and
4. The estimated amount of credits to be claimed, by tax type, in the current calendar year.

Items 1 through 3, above, in aggregate form, without the identification of individual taxpayers, will be public records. Item 4, above, will be a non-public, confidential record.

DBEDT shall maintain records of the names of taxpayers eligible for the credits and the total amount of qualified costs incurred from June 1, 2003, through May 31, 2009. DBEDT shall verify all qualified costs and, upon each determination, shall issue a certificate to the taxpayer certifying:

- The amount of the qualified costs; and
- The amount of credits that the taxpayer is allowed to use for the taxable year.

DBEDT shall certify no more than \$7,500,000 in credits in the aggregate for all taxpayers for each taxable year; provided that DBEDT may certify no more than \$75,000,000 in total aggregate credits.⁷

Example 2: Expending Entity (EE) an LLC, which is treated as a pass-through entity for net income tax purposes, incurred \$4,000,000 of qualified costs in 2003 and 2004 and \$20,000,000 of qualified costs in 2005. In 2006, EE files with DBEDT and DBEDT verifies a total of \$24,000,000 of qualified costs and certifies that \$7,500,000 may be used for the purpose of claiming the credit for 2005.⁸ Because the aggregate amount of tax credits for all taxpayers is limited to \$7,500,000 in any tax year, EE will have to file a certification with DBEDT, on or before March 31, 2007, certifying the amount of the remaining \$16,500,000 up to \$7,500,000 in each of the following years, that can be used as a credit.⁹

⁷ As noted previously, DOTAX and DBEDT interpret the intent of the legislature to be that a maximum of \$7,500,000 in credits shall be allowed in any calendar year.

⁸ DBEDT interprets HRS § 235-110.46 to mean that it may only allocate the \$7,500,000 annual credit cap. Expenditures beyond that level, even if certified, are carried over to the succeeding year, wherein a maximum of \$7,500,000 may be allocated in the subsequent year.

⁹ Under Section VIII below, claims for the credits must be filed within twelve months after the close of the calendar year for which the certified credits are issued. Under this example, the claims for the \$7,500,000 in certified credits, which credits were issued in a certificate by DBEDT in April 2006 for use in the calendar year 2006, are taken against the 2006 periodic returns due in 2006 which periodic returns and amended periodic returns must be filed by December 31, 2007; and the certified credits taken against the 2005 annual return filed in 2006 must be filed by December 31, 2006.

The taxpayer shall file the Form N-335, Statement of Ko Olina Resort and Marina Attractions and Educational Facilities Tax Credit, which includes the DBEDT certificate¹⁰, with the taxpayer's tax return to the Department of Taxation, Attention: Ko Olina Credit, P.O. Box 259, Honolulu, HI 96809. To facilitate identification and processing of the returns claiming the Ko Olina Credit, taxpayers must label all documents claiming a credit with bold letters indicating "Ko Olina Credit", in the open space at the top of the Form.

VI. ANNUAL CLAIM OF CREDITS

The taxpayer's credits, not to exceed the annual credit limit, will be issued by DBEDT on a calendar-year basis. This will require taxpayers to use the issued credits and annual cap within the calendar year of issue, i.e., from January, to offset taxes due under the net income tax chapter and other elected tax chapters. The tax types to be offset are determined by the taxpayer. The credits can be used in the sequence of accrual of the taxes under the elected chapters.

A. Sequence of Accrual for Hawaii Taxes

Since taxes under the different chapters accrue at different times, the credits can be used according to the dates of accrual of the different taxes. For example, the taxes due under Chapter 239, the Public Service Company Tax, and Chapter 241, the Taxation of Banks and Other Financial Corporations, accrue on the first day of the taxable year and, if the tax liability exceeds \$100,000, is payable on the tenth day of each month in the taxable year. If a taxpayer uses a calendar taxable year, the taxes under these tax chapters would be the first-in-time to accrue and, if elected, may be the first to be offset. If elected, the entire year's taxes due is available for an offset at the time that the first installment of the tax is due, i.e., on the tenth of the first month if the liability exceeds \$100,000, and on the twentieth day of the fourth month, if the liability is \$100,000, or less.

Generally, the GET, Use, and TAT taxes accrue on a monthly basis and are payable by the end of the month following the month of accrual. If these tax types are elected for offset, these taxes would be the next-in-time taxes available for offset. Any balance of taxes reported on the annual returns should be offset or the credit reestablished (situations of overpayment) when the annual return is filed.

As to Insurance Premium Taxes, insurers are required to file quarterly tax statements with the Commissioner, on or before the last day of the calendar month following the quarter's end. Insurers are also required to file an annual tax statement by March 1 of each year. If the Insurance Premium Tax is elected to be offset, they would be the next-in-time taxes available for offset. Any balance of taxes reported on the annual returns should be offset or the credit reestablished (situations of overpayment) when the annual return is filed.

¹⁰ This includes the amount of the credit being claimed, as well as the allocation of the claimed Credit among the applicable tax types.

Beginning with the taxable year starting after December 31, 2004, taxpayers may claim this credit on their periodic tax returns, for liabilities arising in the year in which the certificates are issued.

Net Income Taxes accrue at the close of the taxable year and are payable by the twentieth day of the fourth month following the close of the taxable year. The liability for this tax type may be offset at the time of filing the net income tax return or through reduced quarterly estimated tax payments.

Taxpayers that filed PSC, Franchise, GET, Use, TAT or Insurance Premium tax returns for the reporting periods after December 31, 2004, which are due before the issuance of the certificate by DBEDT may file amended returns to claim the appropriate credits. The appropriate amended returns must be filed within 12 months following the close of the taxable year for which the credit may be claimed. A failure to comply with the twelve-month provision shall constitute a waiver of the right to claim the credit.

Procedures for determining the credit earned for qualified costs incurred in 2003 and 2004 and claiming the credit for these costs on periodic tax returns and amended tax returns filed in 2005 will be coordinated by procedures determined by DOTAX and DBEDT.

B. Taxpayers Using a Fiscal Year End

For taxpayers using a fiscal year end, certified credits can be used only against taxes that are accrued within the calendar months falling within the taxpayer's fiscal year. Therefore, the certified credits and annual cap are used against taxes accruing from the month of January through the month of December. Consequently, the issued credits will be used over two fiscal years. For example, a taxpayer using a fiscal year ending on June 30, 2005, would use the certified credits within the annual cap issued by DBEDT for the period January 1, 2005 through June 30, 2005, for the fiscal year ending on June 30, 2005, and continue using the certified credits within the annual cap through the month ending on December 31, 2005, the first six months of the fiscal year ending on June 30, 2006. Upon issuance of the certified credits within the annual cap for the calendar year 2006, the taxes accruing from January 1, 2006 through the end of the fiscal year ending June 30, 2006, would be subject to offset. This sequence of usage will continue throughout the period for which the statute allows the certified credit within the annual cap to be utilized. For net income tax returns using a fiscal year ending, taxpayers may offset the entire tax liability for the taxable year within the calendar year within which the fiscal year ends, notwithstanding the fact that a part of the fiscal year occurs within the preceding calendar year.

C. Schedule of Certified Credits and Annual Cap Use

Each taxpayer is required to submit to the Department of Taxation and DBEDT on a quarterly basis the schedule attached to this TIR, showing the amount of certified credits and the annual cap amount issued by DBEDT and the monthly usage of the certified credits, including

information on the investor's year-to-date use of the credits. This schedule is based on a calendar year and is submitted independently of any tax returns filed. The schedule should be filed no later than the close of the calendar month following the close of each quarterly period for which the schedule is submitted. Schedules must be mailed to the Department of Taxation, Attention: Ko Olina Credit, P.O. Box 259, Honolulu, Hawaii 96809. Schedules submitted to DBEDT should be sent to the Department of Business, Economic Development and Tourism, Attention: Ko Olina Credit, P.O. Box 2359, Honolulu, Hawaii 96804.

VII. CARRYOVER OF EXCESS CREDITS

If the credit claimed exceeds the taxpayer's net income tax liability or tax liability under HRS Chapters 237, 237D, 238, 239, 241, and 431 for any year for which the credit is taken, the excess of the credit may be carried forward and used as a credit against the taxpayer's tax liability for the listed taxes in subsequent years, until exhausted, in a manner to be determined by DBEDT.

VIII. CLAIM PERIOD

Every credit claim for a given taxable year, including amended claims, shall be filed on or before the end of the twelfth month following the close of the calendar year in which the credit certificate is issued by DBEDT. The claim shall be filed on Form N-335. Failure to comply with the foregoing provision shall constitute a waiver of the right to claim the credit. Form N-336 shall accompany the Form N-335, and a copy of both forms shall be filed with DBEDT.

The term taxable year means the taxpayer's calendar or fiscal year within which a credit may be claimed.

IX. RECAPTURE

If at any time DBEDT determines that the costs incurred did not or no longer meet the definition of qualified costs, the credits claimed shall be recaptured. The recapture shall be equal to one hundred per cent of the total credits claimed for the preceding taxable year, provided that the amount of the credits recaptured shall apply only to those costs that did not or no longer meet the definition of qualified costs. The amount of recaptured credits shall be added to the taxpayer's tax liability for the tax types against which the recaptured credits were claimed, in the taxable year in which the recapture occurs. DBEDT will notify the taxpayer and DOTAX as to any such determinations, and the amounts thereof.

The term *Apreceding taxable year@* means the taxable year immediately preceding the taxable year in which the recapture-triggering event occurs. DBEDT will identify the costs which did not or no longer meet the definition of qualified costs, and determine the date of the recapture-triggering event.

X. NO DUPLICATION OF CREDITS FOR THE SAME COSTS

A taxpayer may not claim any other credit for the same qualified costs for which this credit is claimed.¹¹ Once DBEDT has certified a qualified cost for the credit, the qualified cost may not be used to claim any other tax credit. Additionally, a qualified cost may only be used a single time to claim the credit.

Example 3: Taxpayer "A" makes a claim for the credit for qualified costs under HRS § 235-110.46, the Ko Olina Credit. Taxpayer "A" also claims the same costs as a tax credit under HRS § 235-110.4, the Hotel Construction and Remodeling Tax Credit.¹² DOTAX would properly disallow the hotel credit claimed pursuant to HRS § 235-110.4.

XI. IRREVOCABILITY OF ELECTION

Once an election has been made on Form N-335, the credit to be applied to each of the applicable tax types will be irrevocable for that tax year. If the taxpayer is unable to utilize the allocated credits against the tax types elected, the taxpayer will be allowed to "pool" all carry forwards (among tax types) and reallocate the sum, together with new credit amounts for the subsequent tax year, among tax types, in a manner to be determined by DBEDT.



for KURT KAWAFUCHI
Director of Taxation

HRS Section Explained: HRS Section 235-110.46

¹¹ Net Income Tax, Chapter 235, Hawaii Revised Statutes (HRS), or HRS Chapters 237, 237D, 238, 239, 241, or 431-- GET Tax, TAT Tax, Use Tax, PSC Tax, Banks and Financial Corporations Tax, and Insurance Company Premiums Tax, respectively.

¹² Qualified constructions costs pursuant to this section include the plans, designs, construction and equipment related to construction of a new hotel.

Schedule of Certified Ko Olina Tax Credits
ACT 100, SLH 2003

Name:
 Identification Number (FEIN/SSN):
 General Excise/Use/TAT/Insurance Premium Tax ID Number:
 Distributing Entity:

Available Credits

Taxable Year *	
Current Year's Allocated Credit/Qualifying Costs **	\$
Amount of Credits Used, Year-To-Date	\$
Balance Available	\$

Credits Applied Against Taxes, Per Quarter

Month and Year	(Month/Yr.)	(Month/Yr.)	(Month/Yr.)	This Quarter	Year-To-Date
Net Income Tax					
General Excise Tax					
Use Tax					
Transient Accommodations Tax					
Public Service Co. Tax					
Franchise Tax					
Insurance Premium Tax					
Total					**

* This schedule is used to reflect the use of the credits on a calendar year basis, which coincides with the calendar year for which the credits are certified by DBEDT.

** At no time should the total credits claimed, year-to-date, exceed the current year's allocated credit/qualifying costs, i.e., total credits available for use at the beginning of the year.