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TAX INFORMATION RELEASE NO. 97-5

RE: Application of State Tax Exemption to Business Development Corporations

This TIR is in response to recent publicity about certain persons who have incorporated business development corporations ("BDCs"). The Department of Taxation ("Department") explains in this TIR the proper interpretation of the law regarding BDCs and associated tax benefits.

Chapter 420, Hawaii Revised Statutes ("HRS") (Act 288, Session Laws of Hawaii 1957) was enacted to permit the establishment of privately financed credit corporations which would make available medium and long-term capital in the form of loans and investments. The BDCs were given powers to accomplish the purpose of making capital available to small and medium size business entities.

The loans made by a BDC to business entities may only be made after the business entity has applied for a loan through ordinary banking channels and the loan applied for was refused by at least one bank or other financial institution.

Substantial tax benefits are offered to BDCs because of the significant business risk they undertake by providing loans to struggling businesses or financing industrial businesses (businesses engaging in manufacturing, processing, fabricating, or assembling operations) which will provide many jobs.

BDCs may not be formed for the purpose of conducting active business enterprises, such as movie theaters, management consulting services, and retailing. The Department will challenge any tax benefits claimed for BDCs formed or operated for these and any other purposes not within the design and intent of the law.

RAY K. KAMIKAWA
Director of Taxation

HRS Sections Explained: HRS Sections 420-2 and 420-16.

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