

DEPARTMENT OF TAXATION

Amendments to section 18-235-38-03
Hawaii Administrative Rules

June 29, 1998

SUMMARY

1. § 18-235-38-03, Hawaii Administrative Rules, is amended by adding a new subsection (f).

§18-235-38-03 Special rules; sales factor. (a)

Where substantial amounts of gross receipts arise from an occasional sale of a fixed asset used in the regular course of the taxpayer's trade or business, those gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded.

(b) Insubstantial amounts of gross receipts arising from occasional transactions or activities may be excluded from the sales factor unless their exclusion would materially affect the amount of income apportioned to this State. For example, the taxpayer ordinarily may include in or exclude from the sales factor gross receipts from transactions such as the sale of office furniture or business motor vehicles.

(c) In subsections (a) and (b), a transaction qualifying as a casual sale as defined in section 237-1, HRS, and section 18-237-1 shall be considered an occasional transaction.

(d) Where the income producing activity in respect to business income from intangible personal property can be readily identified, the income is included in the denominator of the sales factor and, if the income producing activity occurs in this State, in the numerator of the sales factor as well. For example, usually the income producing activity can be readily identified in respect to interest income received on deferred payments on sales of tangible property (section 18-235-35-01(a)(1)) and income from the sale, licensing, or other use of intangible personal property (section 18-235-37-01(b)(4)).

(e) Where business income from intangible property cannot readily be attributed to any particular income producing activity of the taxpayer, the income cannot be assigned to the numerator of the sales factor for any state and shall be excluded from the denominator of the sales factor. For example, where business income in the form of dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures, or government

securities results from the mere holding of the intangible personal property by the taxpayer, the dividends and interest shall be excluded from the denominator of the sales factor. Income from a foreign affiliate as defined in section 18-235-38.5-02, including dividends from a foreign affiliate and interest paid on intercompany loans, shall be excluded from the denominator of the sales factor.

(f) Where gains and losses on the sale of liquid assets are not excluded from the sales factor by other provisions under this section, such gains or losses shall be treated as provided in this subsection. This subsection does not provide rules relating to the treatment of other receipts produced from holding or managing such assets. If a taxpayer holds liquid assets in connection with one or more treasury functions of the taxpayer, and the liquid assets produce business income when sold, exchanged or otherwise disposed, the overall net gain from those transactions for each treasury function for the tax period is included in the sales factor. For purposes of this subsection, each treasury function will be considered separately.

- (1) For purposes of subsection (f), a "liquid asset" is an asset (other than functional currency or funds held in bank accounts) held to provide a relatively immediate source of funds to satisfy the liquidity needs of the trade or business. "Liquid assets" include foreign currency (and trading positions therein) other than functional currency used in the regular course of the taxpayer's trade or business; marketable instruments (including stocks, bonds, debentures, options, warrants, futures contracts, etc.); and mutual funds which hold such liquid assets. An instrument is considered marketable if it is traded in an established stock or securities market and is regularly quoted by brokers or dealers in making a

- market. Stock in a corporation which is unitary with the taxpayer, or which has a substantial business relationship with the taxpayer is not considered marketable stock.
- (2) For purposes of subsection (f), a "treasury function" is the pooling and management of liquid assets for the purpose of satisfying the cash flow needs of the trade or business, such as providing liquidity for a taxpayer's business cycle, providing a reserve for business contingencies, business acquisitions, etc. A taxpayer principally engaged in the trade or business of purchasing and selling instruments or other items included in the definition of liquid assets set forth herein is not performing a treasury function with respect to income so produced.
- (3) For purposes of subsection (f), "overall net gain" refers to the total net gain from all transactions incurred at each treasury function for the entire tax period, not the net gain from a specific transaction.

Example 1: A taxpayer manufactures various gift items. Because of seasonal variations, the taxpayer must keep liquid assets available for later inventory acquisitions. Because the manufacturer wants to obtain a return on available funds, the manufacturer acquires liquid assets, which are held and managed in this State. The net gain resulting from all gains and losses on the sale of the liquid assets for the tax year will be reflected in the denominator of the sales factor and in the numerator of this State.

Example 2: A stockbroker acts as a dealer or

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trader for its own account in its ordinary course of business. Some of the instruments sold are liquid assets. This subsection does not operate to classify those sales as attributable to a treasury function."

[Eff 11/25/94; am **SEP 08, 1998**] (Auth: HRS §§231-3(9), 235-38, 235-118) (Imp: HRS §§235-35 to 235-38)

DEPARTMENT OF TAXATION

Amendments to section 18-235-38-03, Hawaii Administrative Rules, on the Summary page dated June 29, 1998, were adopted at a public hearing on June 29, 1998, after public notice was given in the Honolulu Advertiser, the Honolulu Star-Bulletin, the Hawaii Tribune-Herald, the Maui News, and the Garden Island News, on May 29, 1998.

These amendments shall take effect ten days after filing with the Office of the Lieutenant Governor.

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Director of Taxation

APPROVED:

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BENJAMIN J. CAYETANO
Governor
State of Hawaii

8/26/98

Dated: _____

APPROVED AS TO FORM:

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Deputy Attorney General

AUG 28, 1998

Filed