

**Report on
Senate Concurrent Resolution
No. 115 H.D. 1.**



**Department of Taxation
State of Hawaii
December 2007**

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Web Site: <http://www.hawaii.gov/tax>

STATE OF HAWAII
Linda Lingle, Governor

DEPARTMENT OF TAXATION
Kurt Kawafuchi, Director
Sandra Yahiro, Deputy Director

RULES OFFICE
Johnnel Nakamura, Rules Officer

Report Title:

Capital Goods Excise Tax Credit; Recodification

Description:

Eliminates and reintroduces the capital goods excise tax credit in order to reflect the definitions and other references to the Internal Revenue Code of 1954, as amended.

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A BILL FOR AN ACT

RELATING TO THE CAPITAL GOODS EXCISE TAX CREDIT.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The legislature finds that Section 235-110.7,
2 relating to the capital goods excise tax credit, has been
3 difficult to administer for both taxpayers and the department of
4 taxation because the section references Internal Revenue Code
5 provisions as of December 31, 1984. Since 1984, many of these
6 Internal Revenue Code sections have been repealed or
7 substantially amended. To assist the administration of this
8 frequently used income tax credit, this Act amends section 235-
9 110.7, Hawaii Revised Statutes, to eliminate, to the extent
10 possible, references to outdated Internal Revenue Code
11 provisions. This bill is not intended to change the application
12 of section 235-110.7, Hawaii Revised Statutes.

13 SECTION 2. Section 235-110.7, Hawaii Revised Statutes is
14 amended to read as follows:

15 "§235-110.7 Capital goods excise tax credit. [~~(a)~~—There
16 shall be allowed to each taxpayer subject to the tax imposed by
17 this chapter a capital goods excise tax credit which shall be

1 ~~deductible from the taxpayer's net income tax liability, if any,~~
2 ~~imposed by this chapter for the taxable year in which the credit~~
3 ~~is properly claimed.~~

4 ~~The amount of the tax credit shall be determined by the~~
5 ~~application of the following rates against the cost of the~~
6 ~~eligible depreciable tangible personal property used by the~~
7 ~~taxpayer in a trade or business and placed in service within~~
8 ~~Hawaii after December 31, 1987. For calendar years beginning~~
9 ~~after: December 31, 1987, the applicable rate shall be three~~
10 ~~per cent; December 31, 1988, and thereafter, the applicable rate~~
11 ~~shall be four per cent. For taxpayers with fiscal taxable~~
12 ~~years, the applicable rate shall be the rate for the calendar~~
13 ~~year in which the eligible depreciable tangible personal~~
14 ~~property used in the trade or business is placed in service~~
15 ~~within Hawaii.~~

16 ~~In the case of a partnership, S corporation, estate, or~~
17 ~~trust, the tax credit allowable is for eligible depreciable~~
18 ~~tangible personal property which is placed in service by the~~
19 ~~entity. The cost upon which the tax credit is computed shall be~~
20 ~~determined at the entity level. Distribution and share of~~
21 ~~credit shall be determined by rules.~~

22 ~~In the case of eligible depreciable tangible personal~~
23 ~~property for which a credit for sales or use taxes paid to~~
24 ~~another state is allowable under section 238-3(i), the amount of~~

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1 ~~the tax credit allowed under this section shall not exceed the~~
2 ~~amount of use tax actually paid under chapter 238 relating to~~
3 ~~such tangible personal property.~~

4 ~~If a deduction is taken under section 179 (with respect to~~
5 ~~election to expense certain depreciable business assets) of the~~
6 ~~Internal Revenue Code of 1954, as amended, no tax credit shall~~
7 ~~be allowed for that portion of the cost of property for which~~
8 ~~the deduction was taken.~~

9 ~~(b) If the capital goods excise tax credit allowed under~~
10 ~~subsection (a) exceeds the taxpayer's net income tax liability,~~
11 ~~the excess of credit over liability shall be refunded to the~~
12 ~~taxpayer; provided that no refunds or payment on account of the~~
13 ~~tax credit allowed by this section shall be made for amounts~~
14 ~~less than \$1.~~

15 ~~All claims for tax credits under this section, including~~
16 ~~any amended claims, must be filed on or before the end of the~~
17 ~~twelfth month following the close of the taxable year for which~~
18 ~~the credits may be claimed. Failure to comply with the~~
19 ~~foregoing provision shall constitute a waiver of the right to~~
20 ~~claim the credit.~~

21 ~~(c) Application for the capital goods excise tax credit~~
22 ~~shall be upon forms provided by the department of taxation.~~

1 ~~(d) Sections 47 (with respect to dispositions of section~~
2 ~~38 property and the recapture percentages) of the Internal~~
3 ~~Revenue Code of 1954, as amended, as of December 31, 1984, and~~
4 ~~280F as operative for this chapter (with respect to limitation~~
5 ~~on investment tax credit and depreciation for luxury~~
6 ~~automobiles; limitation where certain property used for personal~~
7 ~~purposes) of the Internal Revenue Code of 1954, as amended,~~
8 ~~shall be operative for purposes of this section.~~

9 ~~(e) As used in this section, the definition of section 38~~
10 ~~property (with respect to investment in depreciable tangible~~
11 ~~personal property) as defined by section 48(a)(1)(A), (a)(1)(B),~~
12 ~~(a)(3), (a)(4), (a)(7), (a)(8), (a)(10)(A), (b), (c), (f), (l),~~
13 ~~(m), and (s) of the Internal Revenue Code of 1954, as amended as~~
14 ~~of December 31, 1984, is operative for the purposes of this~~
15 ~~section only.~~

16 ~~As used in this section:~~

17 ~~"Cost" means (1) the actual invoice price of the tangible~~
18 ~~personal property, or (2) the basis from which depreciation is~~
19 ~~taken under section 167 (with respect to depreciation) or from~~
20 ~~which a deduction may be taken under section 168 (with respect~~
21 ~~to accelerated cost recovery system) of the Internal Revenue~~
22 ~~Code of 1954, as amended, whichever is less.~~

23 ~~"Eligible depreciable tangible personal property" is~~
24 ~~section 38 property as defined by the operative provisions of~~

1 ~~section 48 and having a depreciable life under section 167 or~~
2 ~~for which a deduction may be taken under section 168 of the~~
3 ~~federal Internal Revenue Code of 1954, as amended.~~

4 ~~"Placed in service" means the earliest of the following~~
5 ~~taxable years:~~

6 ~~(1) The taxable year in which, under the:~~

7 ~~(A) Taxpayer's depreciation practice, the period for~~
8 ~~depreciation; or~~

9 ~~(B) Accelerated cost recovery system, a claim for~~
10 ~~recovery allowances; with respect to such property~~
11 ~~begins; or~~

12 ~~(2) The taxable year in which the property is placed in a~~
13 ~~condition or state of readiness and availability for a~~
14 ~~specifically assigned function.~~

15 ~~"Purchase" means an acquisition of property.~~

16 ~~"Tangible personal property" means tangible personal~~
17 ~~property which is placed in service within Hawaii after~~
18 ~~December 31, 1987, and the purchase or importation of which~~
19 ~~resulted in a transaction which was subject to the imposition~~
20 ~~and payment of tax at the rate of four per cent under chapter~~
21 ~~237 or 238. "Tangible personal property" does not include~~
22 ~~tangible personal property which is an integral part of a~~

1 ~~building or structure or tangible personal property used in a~~
2 ~~foreign trade zone, as defined under chapter 212.]~~ (a) Capital
3 Goods Excise Tax Credit Allowed. There shall be allowed to each
4 taxpayer subject to the tax imposed by this chapter a capital
5 goods excise tax credit which shall be deductible from the
6 taxpayer's net income tax liability, if any, imposed by this
7 chapter for the taxable year in which the credit is properly
8 claimed, if the following conditions are met:

- 9 (1) The taxpayer purchases or imports eligible property;
10 (2) The purchase or import of eligible property results in
11 a transaction which is subject to the imposition and
12 payment of tax at the rate of four per cent under
13 chapters 237 or 238, HRS;
14 (3) The eligible property is used by the taxpayer in a
15 trade or business; and
16 (4) The eligible property is placed in service within
17 Hawaii.

18 (b) Amount of Credit. The amount of the tax credit shall
19 be four per cent of the basis, as defined in subsection (q), of
20 eligible property used by the taxpayer in a trade or business
21 and placed in service within Hawaii. Any credit claimed under
22 this section shall be subject to the following limitations:

- 23 (1) In the case of eligible property for which a credit
24 for sales or use taxes paid to another state is

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1 allowable under section 238-3(i), HRS, the amount of
2 the tax credit allowed under this section shall not
3 exceed the amount of use tax actually paid under
4 chapter 238 relating to such tangible personal
5 property.

6 (2) If a deduction is taken under section 179 of the
7 Internal Revenue Code of 1986, as amended, no tax
8 credit shall be allowed for that portion of the basis
9 of property for which the deduction was taken.

10 (3) Solar and wind energy property. If a taxpayer is
11 eligible for both the income tax credit under section
12 235-12.5, HRS, and the capital goods excise tax credit
13 for a particular solar or wind energy property, the
14 credit under section 235-12.5, HRS, shall be deducted
15 from the taxpayer's net income tax liability before
16 the capital goods excise tax credit.

17 (c) Credit allowed to a partnership, S corporation, estate
18 or trust. In the case of a partnership, S corporation, estate,
19 or trust, the tax credit allowable is for eligible property
20 which is placed in service by the entity. The basis upon which
21 the tax credit is computed shall be determined at the entity
22 level.

1 (d) Credit is refundable. If the capital goods excise tax
2 credit allowed under subsection (a) exceeds the taxpayer's net
3 income tax liability, the excess of credit over liability shall
4 be refunded to the taxpayer; provided that no refunds or payment
5 on account of the tax credit allowed by this section shall be
6 made for amounts less than \$ 1.

7 (e) Time for claiming credit. All claims for tax credits
8 under this section, including any amended claims, must be filed
9 on or before the end of the twelfth month following the close of
10 the taxable year for which the credits may be claimed. Failure
11 to comply with the foregoing provision shall constitute a waiver
12 of the right to claim the credit.

13 (f) Taxable year in which credit is allowable. The credit
14 shall be allowed only for the first taxable year in which the
15 property is placed in service by the taxpayer. If in the first
16 taxable year in which a taxpayer places property in service no
17 portion of the property qualifies as eligible property, no credit
18 shall be allowed to the taxpayer with respect to the property.
19 If a portion of the property qualifies as eligible property in
20 the first year in which the property is placed in service, then a
21 credit only as to the portion which qualifies shall be allowed to
22 the taxpayer.

23 (g) Must use department's forms. Application for the
24 capital goods excise tax credit shall be upon forms provided by
25 the department of taxation.

1 (h) Credit is a taxable income item. The taxpayer shall
2 treat the amount of credit allowable and claimed as a taxable
3 income item for the taxable year in which it is properly
4 recognized under the method of accounting used to compute
5 taxable income. Alternatively, the basis of eligible property
6 for depreciation or ACRS purposes for state income taxes shall
7 be reduced by the amount of credit allowable and claimed.

8 (i) Recapture of credit. Recapture of the previously
9 claimed credit applies where a recapture event occurs under
10 paragraph (2) and the percentage of credit provided in paragraph
11 (1) shall be included as income under chapter 235 or 241 in the
12 year a recapture event occurs.

13 (1) Recapture percentage. Where the recovery property or
14 depreciable property ceases to be eligible property
15 within the following period, which constitutes a full
16 year after being placed in service, the accompanying
17 percentage shall be the recapture percentage:

18	<u>Recapture period</u>	<u>Recapture percentage</u>
19	One full year	100
20	<u>Two full years</u>	<u>66</u>
21	<u>Three full years</u>	<u>33</u>
22	<u>Four full years</u>	<u>0</u>

23 (2) Recapture event. A recapture event occurs when:

1 (A) Property ceases to be eligible property with
2 respect to a taxpayer. Property ceases to be
3 eligible property with respect to a taxpayer
4 when:

5 (i) The property ceases to be owned by taxpayer.

6 Recapture would be triggered upon disposition of
7 the property.

8 (ii) The property ceases to be eligible property.

9 The cessation shall be treated as having occurred on
10 the first day of the taxable year.

11 (B) There is a decrease in the business use of listed
12 property to less than fifty per cent. During the
13 recapture period, all or a portion of the credit
14 taken in an earlier year for listed property may
15 be subject to recapture if: (i) the percentage of
16 business use falls below the percentage of
17 business use for the year the listed property was
18 placed in service; or (ii) the listed property is
19 converted from business to personal use and does
20 not satisfy the more-than-fifty per cent business
21 use test. The terms "listed property" and "the
22 more-than-fifty per cent business use test" are
23 defined in subsection (q).

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1 (C) There is a decrease in basis of eligible property.
2 During the recapture period, all or a portion of
3 previously taken credit as determined in subsection
4 (i)(1) may be subject to recapture if the basis of
5 eligible property used to calculate the credit
6 decreases, either through a refund in the purchase
7 price or usage of the property for personal
8 purposes.

9 (j) Application of recapture rules to partnerships, S
10 corporations, estates, or trusts shall be as follows:

11 (1) In general. In the case of a partnership, S
12 corporation, estate, or trust, the recapture rule
13 applies to a partner, shareholder, or beneficiary who
14 originally received the benefit of a credit if within
15 the recapture period: the S corporation, partnership,
16 estate, or trust disposes of eligible property, or if
17 eligible property otherwise ceases to be eligible
18 property in the hands of the entity; or the partner's,
19 shareholder's, or beneficiary's interest in the entity
20 is reduced, for example, by sale of interest in the
21 entity, below a "specified percentage" as defined in
22 subsection (q).

1 (2) Prior recapture determination. In making a recapture
2 determination, there may be taken into account any
3 prior recapture determination made with respect to the
4 partner, shareholder, or beneficiary in connection with
5 the same property.

6 (k) Application of recapture rules to valid S corporation
7 election shall be as follows:

8 (1) In general. If a C corporation makes a valid election
9 under section 235-2.4, HRS, to be an S corporation,
10 then on the last day of the taxable year immediately
11 preceding the first taxable year for which the
12 election is effective, any eligible property the basis
13 of which was taken into account to compute the C
14 corporation's credit allowable in taxable years before
15 the first taxable year for which the election is
16 effective and which has not been disposed of or
17 otherwise ceased to be eligible property with respect
18 to the C corporation before such last day shall be
19 considered as having ceased to be eligible property
20 with respect to the C corporation and the recapture
21 rule shall apply. However, the recapture rule shall
22 not apply if the S corporation and each of its
23 shareholders on the first day of the first taxable
24 year for which the election under section 235-2.4,

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1 HRS, is to be effective, or on the date of the
2 election, whichever is later, execute an agreement as
3 is described in paragraph (2).
4 (2) The agreement shall (A) be signed by the shareholders;
5 and on behalf of the S corporation by a person who is
6 duly authorized; (B) state that if eligible property
7 for which the credit was taken is later disposed of
8 by, or ceases to be eligible property with respect to
9 the S corporation during the recapture period and
10 during a taxable year for which the S election is
11 effective, each signer agrees to notify the director
12 of a disposition or cessation; and to be jointly and
13 severally liable to pay the director an amount equal
14 to the increase in tax provided by the recapture rule;
15 (C) state the name, address, and taxpayer
16 identification number of each party to the agreement;
17 (D) be filed with the department for the taxable year
18 immediately preceding the first taxable year for which
19 the S election is effective; and (E) be filed with the
20 department on or before the due date, including
21 extensions of time, of the return, unless the director

1 permits, upon a showing of good cause, that the
2 agreement may be filed on a later date.

3 (3) Shareholder's share of the amount of credit recapture.

4 A shareholder's share of the amount of credit
5 recapture shall be determined as if the property had
6 ceased to be eligible property as of the last day of
7 the taxable year immediately preceding the first
8 taxable year for which the S election is effective;
9 however, the recapture percentage shall be determined
10 as if the property ceased to be eligible property on
11 the date the property actually ceased to be eligible
12 property.

13 (1) Transfer of eligible property out of Hawaii. During
14 the recapture period, all or a portion of previously taken credit
15 as determined in subsection (i)(1) will be subject to recapture
16 if the eligible property is transferred out of the State of
17 Hawaii.

18 (m) Exceptions to the recapture rule shall be as follows:

19 (1) Transfer by reason of death. A transfer by reason of
20 death is not considered to be a disposition of
21 eligible property subject to the recapture rule. This
22 exception to the recapture rule applies to transfers
23 by reason of death of a sole proprietor, partner, S
24 corporation shareholder, or beneficiary of an estate
25 or trust.

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1 (2) Transaction to which section 381(a) of the Internal
2 Revenue Code applies. A disposition of eligible
3 property in a transaction to which section 381(a) of
4 the Internal Revenue Code of 1986, as amended, applies
5 is not considered to be a disposition of eligible
6 property, subject to the recapture rule. However, if
7 the acquiring corporation disposes of the eligible
8 property before the close of the recapture period,
9 there will be an early disposition and the recapture
10 rule will be triggered.

11 (3) Mere change in form of conducting a trade or business.
12 Recapture is not required as a result of a mere change
13 in the form of conducting a trade or business if:

14 (A) The property is retained as eligible property in
15 the same trade or business;

16 (B) The transferor, or in a case where the transferor
17 is a partnership, estate or trust, or S
18 corporation, the partner, beneficiary, or
19 shareholder, of eligible property retains a
20 substantial interest in the trade or business;

21 (C) Substantially all the property, whether or not
22 eligible property, necessary to the trade or

1 business is transferred in the change of form;

2 and

3 (D) The basis of eligible property in the hands of
4 the transferee is determined in whole or in part
5 by reference to the basis of eligible property in
6 the hands of the transferor.

7 (4) Paragraph (3) shall not apply to the transfer of
8 eligible property if section 381 of the Internal
9 Revenue Code of 1986, as amended, applies to the
10 transfer.

11 (5) S corporation. Neither an election to be treated as
12 an S corporation, nor a termination or loss of S
13 corporation status automatically triggers recapture.
14 However, recapture may result if one or more of the
15 recapture events discussed in paragraph (6) occurs.
16 In determining whether a reduction in a shareholder's
17 interest will result in recapture, the 66 2/3 per cent
18 and 33 1/3 per cent rules apply even if the
19 corporation is no longer an S corporation.

20 (6) Disposition or cessation. Property ceases to be
21 eligible property with respect to a transferor, or in
22 a case where the transferor is a partnership, estate
23 or trust, or S corporation, the partner, beneficiary
24 or shareholder, and the transferor must make a

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1 recapture determination if during the recapture
2 period:

3 (A) The transferee disposes of eligible property;

4 (B) Eligible property otherwise ceases to be eligible
5 property in the hands of the transferee; or

6 (C) The transferor, or in a case where the transferor
7 is a partnership, estate or trust, or S
8 corporation, the partner, beneficiary, or
9 shareholder, does not retain a substantial
10 interest in the trade or business directly or
11 indirectly through ownership in other entities
12 provided that the other entities' bases in the
13 interests are determined in whole or in part by
14 reference to the bases of the interest in the
15 hands of the transferor.

16 (n) Transfer between spouses incident to divorce. A
17 transfer between spouses incident to divorce is not considered
18 to be a disposition, subject to the recapture rule. Subsequent
19 to a transfer between spouses or incident to divorce, a
20 disposition by the transferee during the recapture period may
21 result in recapture to the same extent as if the disposition had
22 been made by the transferor at that later date.

1 (o) Property destroyed by casualty. The recapture rule
2 shall not apply to eligible property which is disposed of or
3 otherwise ceases to be eligible property with respect to the
4 taxpayer as a result of its destruction or damage by fire,
5 storm, shipwreck, or other casualty, or theft.

6 (p) Downward basis adjustment pursuant to section 754 of
7 the Internal Revenue Code. In the case of a partnership, a
8 downward basis adjustment pursuant to section 754 of the
9 Internal Revenue Code of 1986, as amended, is not subject to
10 recapture because use of the property is not considered to be
11 terminated for purposes of the credit.

12 (q) Definitions. For purposes of this section:

13 "33 1/3 per cent rule" means that once there has been a
14 recapture by reason of the 66 2/3 per cent rule, there is no
15 further recapture until the partner's, shareholder's, or
16 beneficiary's interest is reduced to less than 33 1/3 per cent
17 of its interest at the time the credit was taken. Thereafter,
18 any reduction in interest, however small, will again subject the
19 partner, shareholder, or beneficiary to the recapture
20 provisions.

21 "66 2/3 per cent rule" means that if a partner's,
22 shareholder's, or beneficiary's interest in the entity is
23 reduced below 66 2/3 per cent of its interest at the time the
24 credit was taken, a pro rata share of the partner's,

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1 shareholder's, or beneficiary's interest in the entity's
2 eligible property will cease to be eligible property with
3 respect to the partner, shareholder, or beneficiary, and credit
4 recapture will be required.

5 "ACRS" means the accelerated cost recovery system.

6 "Alternative energy property" consists of the following
7 types of property:

8 (1) A boiler, the primary fuel for which will be an
9 alternate substance. An alternate substance is
10 any substance other than oil, natural gas, or any
11 product of oil and natural gas;

12 (2) A burner, including necessary on-site equipment
13 to bring the alternate substance to the burner,
14 for a combustor other than a boiler if the
15 primary fuel for the burner will be an alternate
16 substance;

17 (3) Equipment for turning an alternate substance into
18 a synthetic liquid, gaseous, or solid fuel;

19 (4) Equipment designed to modify existing equipment
20 which uses oil or natural gas as fuel or as
21 feedstock so that the existing equipment will use
22 either a substance other than oil and natural gas

1 or oil mixed with a substance other than oil and
2 natural gas where the other substance will
3 provide not less than twenty-five per cent of the
4 fuel or feedstock;

5 (5) Equipment to convert coal, including lignite, or
6 any non-marketable substance derived therefrom,
7 into a substitute for a petroleum or natural gas
8 derived feedstock for the manufacture of
9 chemicals or other products, or coal, including
10 lignite, or any substance derived therefrom, into
11 methanol, ammonia, or a hydroprocessed coal
12 liquid or solid;

13 (6) Pollution control equipment required by federal,
14 state, or local regulations to be installed on or
15 in connection with equipment described in
16 paragraphs (1) to (5) of this definition;

17 (7) Equipment used for the unloading, transfer,
18 storage, reclaiming from storage, and
19 preparation, including, but not limited to,
20 washing, crushing, drying, and weighing, at the
21 point of use for an alternate substance for use
22 in equipment described in paragraphs (1) to (6)
23 of this definition. This includes equipment used
24 for the storage of fuel derived from garbage at

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1 the site at which fuel was produced from garbage;

2 and

3 (8) Equipment used to produce, distribute, or use
4 energy from a geothermal deposit, but only, in
5 the case of electricity generated by geothermal
6 power, up to, but not including, the electrical
7 transmission state.

8 "Basis" means the cost of property.

9 (1) In general. The basis of new eligible property
10 which has been constructed, reconstructed, or
11 erected for the taxpayer's use includes that
12 portion of the cost of the property which is
13 subject to the imposition and payment of tax at
14 the rate of four per cent under chapter 237 or
15 238, HRS.

16 (2) Whether the cost or other basis of the
17 construction, reconstruction, or erection is
18 attributable to all or part of a property placed
19 in service may be determined by engineering
20 estimates or by cost accounting records.

21 (3) In the case of reconstructed property, the cost
22 of property does not include the adjusted basis

1 of the reconstructed property at the time the
2 reconstruction commences. However, the
3 reconstructed property may qualify as used
4 eligible property, as discussed in this
5 subsection, and the cost of the property may
6 include the adjusted basis of the reconstructed
7 property at the time the reconstruction commences
8 if the adjusted basis of the property is subject
9 to the imposition and payment of tax at the rate
10 of four per cent under chapter 237 or 238, HRS.

11 (4) If constructed, reconstructed, or erected
12 property which is placed in service over a span
13 of more than one taxable year, the credit shall
14 be allowed to the taxpayer for a particular
15 taxable year with respect to so much of the
16 eligible property that is subject to the
17 imposition and payment of tax at the rate of four
18 per cent under chapter 237 or 238, HRS.

19 (5) Basis of used eligible property. The basis of
20 used eligible property is the cost of the
21 property which is subject to the imposition and
22 payment of tax at the rate of four per cent under
23 chapter 237 or 238, HRS.

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1 (6) Basis for eligible property of a partnership, S
2 corporation, estate or trust. In the case of a
3 partnership, S corporation, estate, or trust, the
4 credit allowable is for eligible property which
5 is placed in service by the entity. The basis
6 upon which the credit is computed is determined
7 at the entity level. Each partner, S corporation
8 shareholder, or beneficiary of an estate or trust
9 shall separately take into account for its
10 taxable year with or within which the entity's
11 taxable year ends, the partner's, shareholder's,
12 or beneficiary's share of the basis and resulting
13 credit. A partner's share of the basis shall be
14 determined in accordance with the ratio in effect
15 on the date on which the eligible property is
16 placed in service in which the partners divide
17 the general profits of the partnership. The
18 basis of partnership eligible property which is
19 subject to a special allocation that is
20 recognized under section 704(a) and 704(b) of the
21 Internal Revenue Code of 1986, as amended, shall
22 be recognized for purposes of the credit, and an

1 upward basis adjustment pursuant to section 754
2 of the Internal Revenue Code of 1986, as amended,
3 is not eligible for the credit. A basis
4 adjustment under section 754 of the Internal
5 Revenue Code of 1986, as amended, is not eligible
6 for the credit because the adjustment is not a
7 transaction which is subject to the imposition
8 and payment of tax at the rate of four per cent
9 under chapter 237 or 238, HRS. Each S
10 corporation shareholder's basis of eligible
11 property is the shareholder's allocated share of
12 the corporation's basis in the eligible property.
13 A beneficiary's share of the basis is apportioned
14 between the entity and the beneficiaries, based
15 on the income of the entity allocable to each on
16 the date the eligible property is placed in
17 service. The term "beneficiary" includes an
18 heir, legatee, or devisee.

19 (7) Basis limitation if a deduction is taken under
20 section 179 of the Internal Revenue Code. If a
21 deduction is taken under section 179 of the
22 Internal Revenue Code of 1986, as amended, the
23 portion of the basis of property for which the

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1 deduction is taken is not considered in
2 determining the amount of credit allowable.
3 (8) Basis limitation for vehicles subject to section
4 280F of the Internal Revenue Code. For purposes
5 of determining the amount of credit available,
6 the basis for vehicles subject to section 280F of
7 the Internal Revenue Code of 1986, as amended,
8 used predominantly for business purposes is
9 limited to an amount equal to the amount
10 necessary to obtain the maximum depreciation
11 deduction allowed in the first year for both
12 luxury passenger automobiles and trucks, vans and
13 SUVs under section 280F of the Internal Revenue
14 Code of 1986, as amended. Use is predominantly
15 for business purposes if over fifty percent of
16 the total use is for business purposes. This
17 limitation applies before any percentage
18 reduction for personal use, as discussed in
19 paragraph (9). If more than one taxpayer have an
20 interest in a vehicle subject to section 280F of
21 the Internal Revenue Code of 1986, as amended,
22 they are treated as one taxpayer for purposes of

1 the basis limitation. The limitation is to be
2 apportioned among the taxpayers according to
3 their interests in the passenger automobile.

4 (9) Basis limitation for listed property which does
5 not satisfy the more-than-fifty per cent business
6 use test. Listed property will not be treated as
7 eligible property, and the credit is denied if
8 the listed property does not satisfy the more-
9 than-fifty per cent business use test. If the
10 qualified business use satisfies the more-than-
11 fifty per cent business use test, but is not used
12 one hundred per cent for business, the amount of
13 credit is limited to the percentage of business
14 use. The amount of credit allowable in the
15 taxable year in which the listed property is
16 placed in service is unaffected by any increase
17 in the business use percentage in a subsequent
18 year. However, if there is a reduction in the
19 business use of property, then the credit taken
20 with respect to the listed property may be
21 subject to recapture as provided in subsection
22 (i).

23 "Biomass property" means property which is a boiler, the
24 primary fuel for which is an alternate substance, a burner,

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1 including necessary on-site equipment to bring the alternate
2 substance to the burner, for a combustor other than a boiler if
3 the primary fuel will be an alternate substance, or equipment
4 for converting an alternate substance into a qualified fuel,
5 including equipment used to store fuel derived from garbage at
6 the site at which such fuel was produced from garbage. For
7 purposes of defining biomass property, an alternate substance
8 means any substance other than an inorganic substance and coal,
9 including lignite, or any coal product. Biomass property also
10 includes pollution control equipment which is required to be
11 installed on or in connection with the above equipment, as well
12 as equipment used for the unloading, transfer, storage,
13 reclaiming from storage, and preparation at point of use of an
14 alternate substance for use in that equipment.

15 "Building" means any structure or edifice which encloses a
16 space within its walls, and is usually covered by a roof. The
17 term also includes any such structure which is constructed by or
18 for a lessee, even if the structure must be removed, or
19 ownership of the structure reverts to the lessor at the
20 termination of the lease.

21 "Bulk storage" means the storage of a commodity in a large
22 mass before its consumption or use.

1 "Cogeneration equipment" means property which is an
2 integral part of a system for using the same fuel to produce
3 both qualified energy and electricity at an industrial or
4 commercial facility. For purposes of this paragraph, the term
5 "industrial" means the purification of water and the
6 desalinization of water.

7 "Cost" means the lesser of either:

- 8 (1) The actual invoice price of eligible property; or
9 (2) The basis from which a deduction is taken under
10 section 167 or 168 of the Internal Revenue Code
11 of 1986, as amended.

12 "Credit" means the capital goods excise tax credit.

13 "Eligible property."

14 (1) Eligible property is defined as:

15 (A) Property which is tangible personal property or
16 other tangible property;

17 (B) Recovery property, within the meaning of section
18 168 of the Internal Revenue Code of 1986, as
19 amended, without regard to useful life, or any
20 other property with respect to which depreciation
21 is allowable to the taxpayer; and

22 (C) Property which has an estimated useful life or
23 recovery period, determined as of the time the
24 property is placed in service, of three years or

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1 more. A property shall have the same estimated
2 useful life or recovery period as that which is
3 used for depreciation or ACRS purposes.

4 (2) Property which is eligible for the credit is (A) new
5 eligible property or (B) used eligible property. The
6 terms "new eligible property" and "used eligible
7 property" are defined in this subsection.

8 (3) Tangible personal property, other than a central air
9 conditioning or heating unit, may qualify as eligible
10 property regardless of whether it is used as an
11 "integral part" of an activity, as defined in this
12 subsection, or constitutes a research or storage
13 facility used in connection with such activity, as
14 required for "other tangible property," as defined in
15 this subsection.

16 (4) Recovery or depreciable property requirement.
17 Eligible property must be either recovery property
18 within the meaning of section 168 of the Internal
19 Revenue Code of 1986, as amended, without regard to
20 useful life, or any other property with respect to
21 which depreciation is allowed by the taxpayer.

1 (A) If only part of a property is depreciable, only a
2 pro rata portion of the property may qualify as
3 eligible property.

4 (B) Property does not qualify as eligible property to
5 the extent that a deduction for depreciation
6 thereon is disallowed under section 274 of the
7 Internal Revenue Code of 1986, as amended.

8 (5) Boilers fueled by oil or gas. Generally, any boiler,
9 used in Hawaii, which is primarily fueled by petroleum
10 or petroleum products, including natural gas,
11 qualifies as eligible property.

12 (6) Energy property. Energy property, as defined in this
13 subsection, qualifies as eligible property.

14 (7) Property which generally does not qualify as eligible
15 property. Certain classes of property which generally
16 do not qualify as eligible property and thereby are
17 not eligible for the credit include:

18 (A) A building or its structural components.

19 (B) Property purchased for use in a foreign trade
20 zone as defined in chapter 212, HRS.

21 (C) Property used by an organization which is exempt
22 from the tax imposed by chapter 235, HRS, unless
23 the property is used predominantly in an

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1 unrelated trade or business, the income from
2 which is subject to tax under chapter 235, HRS.

3 (D) Intangible property.

4 (E) Property used for lodging.

5 (8) Exceptions to paragraph (7):

6 (A) A nonlodging commercial facility which is available to
7 persons not using the lodging facility on the same
8 basis as it is available to tenants of the lodging
9 facility may qualify as eligible property.

10 (B) Property used by a hotel, motel, or other similar
11 establishment in connection with the trade or business
12 of furnishing lodging where more than one half of the
13 accommodation in the hotel, motel, or other similar
14 establishment is used by transients may qualify as
15 eligible property. An accommodation will be
16 considered to accommodate transients if the rental
17 period is normally less than thirty days.

18 (C) Coin-operated vending machines and coin-operated
19 washing machines and dryers may qualify as eligible
20 property.

21 "Energy property" means certain property intended to reduce
22 the amount of oil, natural gas, or other energy consumed in

1 heating or cooling a building or used in an industrial process.
2 Energy property is (1) alternative energy property, (2) solar or
3 wind energy property, (3) specially defined energy property, (4)
4 recycling equipment, (5) hydroelectric generating property, (6)
5 cogeneration equipment, and (7) biomass property.

6 "Hydroelectric generating property" means property
7 installed at a hydroelectric site which is:

- 8 (1) Equipment for increased capacity to generate
9 electricity by water up to, but not including, the
10 electrical transmission stage; and
11 (2) Structures for housing the generating equipment, fish
12 passageways, and dam rehabilitation property, required
13 by reason of the installation of equipment described
14 in paragraph (1) of this definition.

15 "Integral part" means property used directly in one of the
16 activities specified as a condition under which other tangible
17 property may be considered eligible property.

18 "Lease" is defined as it is for federal income tax
19 purposes.

20 "Listed property" means passenger automobiles and other
21 property used as a means of transportation; property generally
22 used for purposes of entertainment, recreation, or amusement;
23 computers and related peripheral equipment; and other property
24 as determined by the department.

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1 "Manufacturing, production, and extraction" means (1) the
2 construction, reconstruction, or making of property out of
3 scrap, salvage, junk, new, or raw material by processing,
4 manipulating, refining, or changing the form of an article, or
5 by combining or assembling two or more articles; (2) the
6 cultivation of the soil; (3) the raising of livestock; (4) the
7 mining of minerals.

8 "More-than-fifty per cent business use test" means that
9 certain business use of listed property, referred to as
10 "qualified business use," must exceed fifty per cent. For
11 purposes of determining the more-than-fifty per cent business
12 use test, use in a trade or business does not include use in an
13 investment or other activity conducted for the production of
14 income. However, if the more-than-fifty-per-cent-business-use
15 test has been met, the percentage of investment use may be added
16 in when figuring the total business use for purposes of
17 calculating the amount of credit allowable.

18 "New eligible property." Eligible property qualifies as
19 new eligible property if one of the following conditions is met:

20 (1) The property is eligible property, the original use of
21 which commences with the taxpayer after the date the
22 taxpayer acquires it.

1 (2) The property is eligible property which is (A) sold
2 and leased back by the same taxpayer within three
3 months of the date the property was originally placed
4 in service by the taxpayer or (B) leased to the same
5 taxpayer within three months of the date the property
6 was originally placed in service by that taxpayer.

7 (3) The property is eligible property, the construction,
8 reconstruction, or erection of which is placed in
9 service by the taxpayer, but only with respect to that
10 portion of the basis as is discussed in paragraphs (1)
11 through (5) of the definition of "basis" in this
12 subsection. It is not necessary that the materials
13 entering into the construction, reconstruction, or
14 erection be new in use. Construction, reconstruction,
15 or erection begins when physical work is started on
16 the construction, reconstruction or erection.

17 "Original use" means the first use to which the property is
18 put, whether or not it is the taxpayer's first use of the
19 property.

20 "Other tangible property" is tangible property, other than
21 tangible personal property, as defined in this subsection, which
22 qualifies as eligible property by meeting one of the following
23 three conditions:

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1 (1) The property is used as an integral part of
2 manufacturing, production, extraction or furnishing
3 transportation, communication, electrical energy, gas
4 water, or sewage disposal services;

5 (2) The property is used as a research or storage facility
6 used in connection with an activity referred to in
7 paragraph (1) of this definition; or

8 (3) The property is a facility used in connection with an
9 activity referred to in paragraph (1) of this
10 definition for the bulk storage of fungible
11 commodities, including commodities in a liquid or
12 gaseous state.

13 "Placed in service." Property shall be considered to be
14 placed in service in the earliest of the following taxable
15 years:

16 (1) The taxable year in which the period for depreciation
17 with respect to the property begins;

18 (2) The taxable year in which, under ACRS, a claim for
19 recovery allowances with respect to the property
20 begins; or

1 (3) The taxable year in which the property is placed in a
2 condition or state of readiness and available for a
3 specifically assigned function by the taxpayer.

4 In a sale-leaseback transaction, the property shall be
5 considered to be placed in service on the date the property was
6 first placed in service by the seller-lessee.

7 "Property used for lodging" means property which is used
8 predominantly to furnish lodging; or in connection with the
9 furnishing of lodging.

10 (1) Property used predominantly to furnish lodging
11 includes that which is used in the living quarters of
12 a lodging facility such as, for example, beds, other
13 furniture, refrigerators, ranges, and other equipment.

14 (2) A lodging facility includes an apartment house, hotel,
15 motel, dormitory or other facility, or part of a
16 facility, where sleeping accommodations are provided
17 and let; however the term does not include a facility
18 which is used primarily as a means of transportation
19 such as, for example, an aircraft or vessel, or to
20 provide medical or convalescent services, even though
21 sleeping accommodations are provided.

22 (3) Property used predominantly in connection with the
23 furnishing of lodging includes that which is used to
24 operate a lodging facility or to serve tenants,

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1 whether furnished by the owner of the lodging facility
2 or another person. However, property used in
3 furnishing, to the management of a lodging facility or
4 its tenants, electrical energy, water, sewage disposal
5 services, gas, telephone services or other similar
6 utility services shall not be treated as property used
7 in connection with the furnishing of lodging.

8 "Purchase" means an acquisition of property.

9 "Qualified business use" means use of listed property that
10 meets the more-than-fifty per cent business use test.

11 "Qualified energy" means steam, heat, or other forms of
12 useful energy, other than electric energy, to be used for
13 industrial, commercial, or space-heating purposes other than in
14 the production of electricity.

15 "Recapture period" means the period beginning on the first
16 day of the month the eligible property is placed in service, and
17 extending for a full three years.

18 "Recycling equipment." Recycling equipment includes any
19 equipment which is used exclusively to sort and prepare solid
20 waste for recycling or in the recycling of solid waste. The
21 term recycling equipment does not include any equipment used in
22 a process after the first marketable product is produced or in

1 the case of recycling iron or steel, any equipment used to
2 reduce the waste to a molten state and in any process
3 thereafter.

4 (1) Ten per cent virgin material allowed. Any equipment
5 used in the recycling of material which includes some
6 virgin materials shall not be treated as failing to
7 meet the exclusive requirements of this definition if
8 the amount of the virgin materials is ten per cent or
9 less.

10 (2) The term recycling equipment includes any equipment
11 which is used in the conversion of solid waste into a
12 fuel or into useful energy such as steam, electricity,
13 or hot water.

14 "Sale-leaseback" is defined as it is for federal income tax
15 purposes.

16 "Solar or wind energy property" means any equipment which
17 uses solar or wind energy to: generate electricity, heat or
18 cool, or provide hot water for use in, a structure, or provide
19 solar process heat.

20 "Specially defined energy property" means property which is
21 installed in an existing industrial or commercial facility to
22 reduce the amount of energy consumed in the existing industrial
23 or commercial process.

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1 "Specified percentage" means whichever of these two rules
2 applies: (1) 66 2/3 per cent rule; or (2) 33 1/3 per cent rule.

3 "Structural component" means parts of a building such as
4 walls, partitions, floors, ceilings, and permanent coverings;
5 all components of a central air conditioning or heating system;
6 plumbing and plumbing fixtures; electric wiring and lighting
7 fixtures, chimneys; stairs, escalators, and elevators. The term
8 structural component does not include property which is
9 contained in or attached to a building such as production
10 machinery, the sole justification for the installation of which
11 is to meet temperature or humidity requirements which are
12 essential for the operation of other machinery of the processing
13 of materials or foodstuffs. Machinery may also meet this sole
14 justification test even though it incidentally provides for the
15 comfort of employees, or serves, to an insubstantial degree,
16 areas where the temperature or humidity requirements are not
17 essential.

18 "Substantial interest." A transferor, or in a case where
19 the transferor is a partnership, estate or trust, or S
20 corporation, the partner, beneficiary, or shareholder, is
21 considered to have retained a substantial interest in the trade
22 or business if, after the change in form, the transferor's

1 interest in the trade or business is: (1) substantial in
2 relation to the total income interest of all the owners; or (2)
3 equal to or greater than the transferor's interest before the
4 change in form. A taxpayer will not be considered to have
5 retained a substantial interest where the only basis for
6 claiming substantial interest is that the values of the
7 interests exchanged are equal. The determination of whether a
8 taxpayer has retained a substantial interest in the trade or
9 business is to be made immediately after the change in the form
10 of conducting the trade or business, and after each time the
11 taxpayer disposes of a portion of the taxpayer's interest in the
12 new enterprise.

13 "Tangible personal property" means any tangible property
14 except land and improvements thereto, such as buildings or other
15 inherently permanent structures, including items which are
16 structural, components of the buildings, or structures.

17 "Transportation business" means airlines, bus companies,
18 shipping or trucking companies, and oil pipeline companies.

19 "Used eligible property." Property qualifies as used
20 eligible property if the property is eligible property as
21 defined in this subsection and the property is not new eligible
22 property as defined in this subsection."

23 SECTION 3. Repealed material is bracketed and stricken.
24 New material is underscored.

