

OFFICE OF THE CLERK OF THE HOUSE OF REPRESENTATIVES
HONOLULU, HAWAII

ACT 106

H.B. NO. 3163

A Bill for an Act Relating to the Taxation of Financial Institutions.

Be It Enacted by the Legislature of the State of Hawaii:

PART I

SECTION 1. The legislature finds that the financial institutions of today are dramatically different from the way they were thirty years ago when the franchise tax on financial institutions was adopted.

In Hawaii, banks and other financial institutions are subject to the franchise tax in lieu of the general excise and corporate income tax. This unique method of taxation evolved during the period when the federal government imposed strict limitations on the ability of states to tax national banks. Since

1976, however, federal controls have been lifted and states have had the freedom to tax banks in any nondiscriminatory manner.

The Hawaii franchise tax was adopted in 1957, during the period of federal control, and has remained virtually unchanged, although the basic assumptions underlying its structure have changed.

The legislature finds that financial institutions have been treated differently from other taxpayers with respect to the general excise tax under chapter 237, Hawaii Revised Statutes, and the franchise tax under chapter 241, Hawaii Revised Statutes, as dictated by prior federal law.

The legislature also finds that the second tax review commission, in its 1989 report to the legislature, made several recommendations to correct the inefficiencies in the general excise tax and to streamline the franchise tax imposed upon financial institutions.

During the 1990 and 1991 legislative interim, the department of taxation met with representatives of the Tax Foundation of Hawaii, the Hawaii League of Savings Institutions, the Hawaii Bankers Association, the Hawaii Financial Services Association, and interested individuals from trust companies to consider the recommendations of the second tax review commission and to draft this Act relating to the taxation of financial institutions.

The purpose of this Act is to revise the manner in which financial institutions are taxed to provide for a more equitable method of taxation.

PART II

SECTION 2. Section 235-9, Hawaii Revised Statutes, is amended to read as follows:

“§235-9 Exemptions; generally. Except as provided in sections 235-61 to 235-67 relating to withholding and collection of tax at source, and section 235-2.4 relating to “unrelated business taxable income”, the following persons and organizations shall not be taxable under this chapter: Banks, building and loan associations, financial services loan companies, financial corporations, small business investment companies, trust companies, mortgage loan companies, financial holding companies, subsidiaries of financial holding companies as defined in chapter 241, and development companies taxable under chapter 241; and insurance companies, agricultural cooperative associations, and fish marketing associations exclusively taxable under other laws.”

SECTION 3. This Part, upon its approval, shall apply to taxable years beginning after December 31, 1992.

PART III

SECTION 4. Chapter 237, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

“§237- Amounts not taxable for financial institutions. (a) In addition to the amounts not taxable under section 237-24, this chapter shall not apply to amounts received by:

(1) Financial institutions from:

(A) Interest, discount, points, commitment fees, loan fees, loan origination charges, and finance charges which are part of the computed annual percentage rate of interest and which are

- contracted and received for the use of money;
- (B) Leasing of personal property;
- (C) Fees or charges relating to the administration of deposits;
- (D) Gains resulting from changes in foreign currency exchange rates but not including commissions or compensation derived from the purchase or sale of foreign currency or numismatic currency whether legal tender or not;
- (E) The servicing and sale of loans contracted for and received by the financial institution; and
- (F) Interest received from the investment of deposits received by the financial institution from financial or debt instruments;
- (2) Trust companies or trust departments of financial institutions from:
 - (A) Trust agreements and retirement plans where the trust companies or trust departments are acting as fiduciaries;
 - (B) Custodial agreements; and
 - (C) Activities relating to the general servicing of fiduciary/custodial accounts held by the trust companies or trust departments; and
- (3) Financial corporations acting as interbank brokers as defined by chapter 241 from brokerage services.

(b) As used in this section:

“Activities relating to the general servicing of fiduciary/custodial accounts” means those activities performed by trust companies which are directly or indirectly performed within the fiduciary/custodial relationship between the trust company or trust department of a financial institution and its client and which are not offered to any person outside of the fiduciary/custodial relationship.

“Annual percentage rate” and “finance charge” have the same meaning as defined in the federal Truth in Lending Act (15 U.S.C. sections 1605(a) to (c) and 1606).

“Deposit” means:

- (1) Money or its equivalent received or held by a financial institution in the usual course of business and for which it has given or is obligated to give credit to:
 - (A) A commercial (including public deposits), checking, savings, time, or thrift account;
 - (B) A check or draft drawn against a deposit account and certified by the financial institution;
 - (C) A letter of credit; or
 - (D) A traveler’s check, on which the financial institution is primarily liable;
- (2) Trust funds received or held by a financial institution, whether held in the trust department or held or deposited in any other department of the financial institution;
- (3) Money received or held by a financial institution, or the credit given for money or its equivalent received or held by a financial institution in the usual course of business for a special or specific purpose, regardless of the legal relationship thereby established, including, without being limited to, escrow funds, funds held as security for an obligation due the financial institution or others (including funds held as dealers’ reserves) or for securities loaned by the financial institution, funds deposited by a debtor to meet maturing obligations, funds deposited as advance payment on subscriptions to

United States Government securities, funds held for distribution or purchase of securities, funds held to meet the financial institution's acceptances or letters of credit, and withheld taxes;

- (4) Outstanding drafts, cashier's checks, money orders, or other officer's checks issued in the usual course of business for any purpose; or
- (5) Money or its equivalent held as a credit balance by a financial institution on behalf of its customer if the financial institution is engaged in soliciting and holding the balances in the regular course of its business.

"Financial institution" means banks, building and loan associations, development companies, financial corporations, financial services loan companies, small business investment companies, financial holding companies, mortgage loan companies, and trust companies all as defined in chapter 241.

"Leasing of personal property" occurs if:

- (1) The lease is to serve as the functional equivalent of an extension of credit to the lessee of the property;
- (2) The property to be leased is acquired specifically for the leasing transaction under consideration, or was acquired specifically for an earlier leasing transaction;
- (3) The lease is on a nonoperating basis, i.e., the financial institution may not, directly or indirectly:
 - (A) Provide for the maintenance, repair, replacement, or servicing of the leased property during the lease term;
 - (B) Purchase parts and accessories in bulk or for an individual property after the lessee has taken delivery of the property; or
 - (C) Purchase insurance for the lessee;
- (4) At the inception of the lease the effect of the transaction will yield a return that will compensate the lessor financial institution for not less than the lessor's full investment in the property plus the estimated total cost of financing the property over the term of the lease, from:
 - (A) Rentals;
 - (B) Estimated tax benefits (capital goods excise tax credit, net economic gain from tax deferral from accelerated depreciation, and other tax benefits with a substantially similar effect); and
 - (C) The estimated residual value of the property at the expiration of the initial term of the lease;
- (5) The maximum lease term during which the lessor financial institution must recover the lessor's full investment in the property, plus the estimated total cost of financing the property, shall be forty years; and
- (6) At the expiration of the lease (including any renewals or extensions with the same lessee), all interest in the property shall be either liquidated or leased again on a nonoperating basis as soon as practicable (in no event later than two years from the expiration of the lease), but in no case shall the lessor retain any interest in the property beyond fifty years after the lessor's acquisition of the property."

SECTION 5. Section 237-4, Hawaii Revised Statutes, is amended to read as follows:

"§237-4 "Wholesaler", "jobber", defined. "Wholesaler" or "jobber"

applies only to a person making sales at wholesale. Only the following are sales at wholesale:

- (1) Sales to a licensed retail merchant, jobber, or other licensed seller for purposes of resale;
- (2) Sales to a licensed manufacturer of material or commodities which are to be incorporated by the manufacturer into a finished or saleable product (including the container or package in which the product is contained) during the course of its preservation, manufacture, or processing, including preparation for market, and which will remain in such finished or saleable product in such form as to be perceptible to the senses, which finished or saleable product is to be sold and not otherwise used by the manufacturer;
- (3) Sales to a licensed producer or cooperative association of materials or commodities which are to be incorporated by the producer or by the cooperative association into a finished or saleable product which is to be sold and not otherwise used by the producer or cooperative association, including specifically materials or commodities expended as essential to the planting, growth, nurturing, and production of commodities which are sold by the producer or by the cooperative association;
- (4) Sales to a licensed contractor, of material or commodities which are to be incorporated by the contractor into the finished work or project required by the contract and which will remain in such finished work or project in such form as to be perceptible to the senses;
- (5) Sales to a licensed producer, or to a cooperative association described in section [237-23(a)(8)] 237-23(a)(7) for sale to such producer, or to a licensed person operating a feed lot, of poultry or animal feed, hatching eggs, semen, replacement stock, breeding services for the purpose of raising or producing animal or poultry products for disposition as described in section 237-5 or to be incorporated in a manufactured product as described in paragraph (2) or for the purpose of breeding, hatching, milking, or egg laying other than for the customer's own consumption of the meat, poultry, eggs, or milk so produced; provided that in the case of a feed lot operator, only the segregated cost of the feed furnished by the feed lot operator as part of the feed lot operator's service to a licensed producer of poultry or animals to be butchered or to a cooperative association described in section [237-23(a)(8)] 237-23(a)(7) of such licensed producers shall be deemed to be a sale at wholesale; and provided further that any amount derived from the furnishing of feed lot services, other than the segregated cost of feed, shall be deemed taxable at the service business rate. This paragraph shall not apply to the sale of feed for poultry or animals to be used for hauling, transportation, or sports purposes;
- (6) Sales to a licensed producer, or to a cooperative association described in section [237-23(a)(8)] 237-23(a)(7) for sale to the producer, of seed for producing agricultural products, or bait for catching fish (including the catching of bait for catching fish), which agricultural products or fish are to be disposed of as described in section 237-5 or to be incorporated in a manufactured product as described in paragraph (2);
- (7) Sales to a licensed producer, or to a cooperative association described in section [237-23(a)(8)] 237-23(a)(7) for sale to such

producer; of polypropylene shade cloth; of polyfilm; of polyethylene film; of cartons and such other containers, wrappers, and sacks, and binders to be used for packaging eggs, vegetables, fruits, and other agricultural products; of seedlings and cuttings for producing nursery plants; or of chick containers; which cartons and such other containers, wrappers, and sacks, binders, seedlings, cuttings, and containers are to be used as described in section 237-5, or to be incorporated in a manufactured product as described in paragraph (2);

- (8) Sales of tangible personal property to a licensed person engaged in the service business; provided that (A) the property is not consumed or incidental to the performance of the services; (B) there is a resale of the article at the retail rate of four per cent; and (C) the resale of the article is separately charged or billed by the person rendering the services;
- (9) Sales to a licensed leasing company of capital goods which are thereafter leased as a service to others. Capital goods means goods which have a depreciable life and which are purchased by the leasing company for lease to its customers.

If the use tax law is finally held by a court of competent jurisdiction to be unconstitutional or invalid insofar as it purports to tax the use or consumption of tangible personal property imported into the State in interstate or foreign commerce or both, wholesalers and jobbers shall be taxed thereafter under this chapter in accordance with the following definition (which shall supersede the preceding paragraph otherwise defining "wholesaler" or "jobber"): "Wholesaler" or "jobber" means a person, or a definitely organized division thereof, definitely organized to render and rendering a general distribution service which buys and maintains at the person's place of business a stock or lines of merchandise which the person distributes; and which, through salesmen, advertising, or sales promotion devices, sells to licensed retailers, to institutional or licensed commercial or industrial users, in wholesale quantities and at wholesale rates. A corporation deemed not to be carrying on a trade or business in this State under section 235-6 shall nevertheless be deemed to be a wholesaler and shall be subject to the tax imposed by this chapter."

SECTION 6. Section 237-13, Hawaii Revised Statutes, is amended to read as follows:

"§237-13 Imposition of tax. There is hereby levied and shall be assessed and collected annually privilege taxes against persons on account of their business and other activities in the State measured by the application of rates against values of products, gross proceeds of sales, or gross income, whichever is specified, as follows:

- (1) Tax on manufacturers.
 - (A) Upon every person engaging or continuing within the State in the business of manufacturing, including compounding, canning, preserving, packing, printing, publishing, milling, processing, refining, or preparing for sale, profit, or commercial use, either directly or through the activity of others, in whole or in part, any article or articles, substance or substances, commodity or commodities, the amount of the tax to be equal to the value of the articles, substances, or commodities, manufactured, compounded, canned, preserved, packed, printed, milled,

processed, refined, or prepared, for sale, as shown by the gross proceeds derived from the sale thereof by the manufacturer or person compounding, preparing, or printing them, multiplied by one-half of one per cent.

- (B) The measure of the tax on manufacturers is the value of the entire product for sale, regardless of the place of sale or the fact that deliveries may be made to points outside the State.
- (C) If any person liable for the tax on manufacturers [shall ship] ships or [transport] transports the person's product, or any part thereof, out of the State, whether in a finished or unfinished condition, or [shall sell] sells the same for delivery outside of the State (for example, consigned to a mainland purchaser via common carrier f.o.b. Honolulu), the value of the products in the condition or form in which they exist immediately before entering interstate or foreign commerce, determined as hereinafter provided, shall be the basis for the assessment of the tax imposed by this paragraph [(1)]. This tax shall be due and payable as of the date of entry of the products into interstate or foreign commerce, whether the products are then sold or not. The department of taxation shall determine the basis for assessment, as provided by this paragraph, as follows:
 - (i) If the products at the time of their entry into interstate or foreign commerce already have been sold, the gross proceeds of sale, less the transportation expenses, if any, incurred in realizing the gross proceeds for transportation from the time of entry of the products into interstate or foreign commerce, including insurance and storage in transit, [are] shall be the measure of the value of the products.
 - (ii) If the products have not been sold at the time of their entry into interstate or foreign commerce, and in cases governed by clause (i) in which the products are sold under circumstances such that the gross proceeds of sale are not indicative of the true value of the products, the value of the products constituting the basis for assessment shall correspond as nearly as possible to the gross proceeds of sales for delivery outside the State, adjusted as provided in clause (i), or if sufficient data are not available, sales in the State, of similar products of like quality and character and in similar quantities, made by the taxpayer (unless not indicative of the true value) or by others. Sales outside the State, adjusted as provided in clause (i), may be considered when they constitute the best available data. The department shall prescribe uniform and equitable rules for ascertaining such values.
 - (iii) At the election of the taxpayer and with the approval of the department, the taxpayer may make the taxpayer's returns under clause (i) even though the products have not been sold at the time of their entry into interstate or foreign commerce.
 - (iv) In all cases in which products leave the State in an unfinished condition the basis for assessment shall be adjusted so as to deduct such portion of the value as is attributable

to the finishing of the goods outside the State.

- (2) Tax on business of selling tangible personal property; producing.
 - (A) Upon every person engaging or continuing in the business of selling any tangible personal property whatsoever (not including, however, bonds or other evidence of indebtedness, or stocks), there is likewise hereby levied, and shall be assessed and collected, a tax equivalent to four per cent of the gross proceeds of sales of the business; provided that insofar as certain retailing is taxed by section 237-16, the tax shall be that levied by section 237-16, and in the case of a wholesaler, the tax shall be equal to one-half of one per cent of the gross proceeds of sales of the business. Upon every person engaging or continuing within this State in the business of a producer the tax shall be equal to one-half of one per cent of the gross proceeds of sales of the business, or the value of the products, for sale, if sold for delivery outside the State or shipped or transported out of the State, and the value of the products shall be determined in the same manner as the value of manufactured products covered in the cases under paragraph (1)(C).
 - (B) Gross proceeds of sales of tangible property in interstate and foreign commerce shall constitute a part of the measure of the tax imposed on persons in the business of selling tangible personal property, to the extent, under the conditions, and in accordance with the provisions of the Constitution of the United States and the acts of the Congress of the United States which may be now in force or may be hereafter adopted, and whenever there occurs in the State an activity to which, under the Constitution and acts of Congress, there may be attributed gross proceeds of sales, such gross proceeds shall be so attributed.
 - (C) No manufacturer or producer, engaged in such business in the State and selling the manufacturer's or producer's products for delivery outside of the State (for example, consigned to a mainland purchaser via common carrier f.o.b. Honolulu), shall be required to pay the tax imposed in this chapter for the privilege of so selling the products, and the value or gross proceeds of sales of the products shall be included only in determining the measure of the tax imposed upon the manufacturer or producer as such.
 - (D) When a manufacturer or producer, engaged in such business in the State, also is engaged in selling the manufacturer's or producer's products in the State at wholesale, retail, or in any other manner, the tax for the privilege of engaging in the business of selling the products in the State shall apply to the manufacturer or producer as well as the tax for the privilege of manufacturing or producing in the State, and the manufacturer or producer shall make the returns of the gross proceeds of the wholesale, retail, or other sales required for the privilege of selling in the State, as well as making the returns of the value or gross proceeds of sales of the products required for the privilege of manufacturing or producing in the State. The manufacturer or producer shall pay the tax imposed in this chapter at the highest rate applicable for any of the privileges

exercised by the manufacturer or producer in respect of the particular products, and the value or gross proceeds of sales of the products, thus subjected to tax at the highest rate, may be deducted insofar as duplicated as to the same products by the measure of the tax upon the manufacturer or producer for the other privileges enumerated in this paragraph, paragraph (1), and section 237-16.

- (E) A taxpayer selling to a federal cost-plus contractor may make the election provided for by paragraph (3)(C), and in any such case the tax shall be computed pursuant to the election, notwithstanding this paragraph or paragraph (1) to the contrary.
- (F) The department, by rule, may provide that a seller may take from the purchaser of tangible personal property a certificate, in such form as the department shall prescribe, certifying that the sale is a sale at wholesale. If the certificate is so provided for by rule of the department:
 - (i) Any purchaser who [shall furnish] furnishes such a certificate shall be obligated to pay to the seller, upon demand, if the sale in fact is not at wholesale, the amount of the additional tax which by reason thereof is imposed upon the seller; and
 - (ii) The absence of such a certificate, unless the sales of the business are exclusively at wholesale, in itself shall give rise to the presumption that the sale is not at wholesale.
- (3) Tax upon contractors.
 - (A) Upon every person engaging or continuing within the State in the business of contracting, the tax shall be equal to four per cent of the gross income of the business; provided that insofar as the business of contracting is taxed by section 237-16, which relates to certain retailing, the tax shall be that levied by section 237-16.
 - (B) In computing the tax levied under this paragraph or section 237-16, there shall be deducted from the gross income of the taxpayer so much thereof as has been included in the measure of the tax levied under subparagraph (A) or section 237-16, on:
 - (i) Another taxpayer who is a contractor, as defined in section 237-6;
 - (ii) A specialty contractor, duly licensed by the department of commerce and consumer affairs pursuant to section 444-9, in respect of the specialty contractor's business as such; or
 - (iii) A specialty contractor who is not licensed by the department of commerce and consumer affairs pursuant to section 444-9, but who performs contracting activities on federal military installations and nowhere else in this State,
 if the tax on the amount so deducted has been paid by the other person, or has been withheld by the taxpayer and shall be paid over by the taxpayer to the assessor at the time of filing the return, such withholding being authorized by this paragraph; but any person claiming a deduction under this

paragraph shall be required to show in the person's return the name of the person paying the tax on the amount deducted by the person or from whom the tax was withheld, and shall issue a receipt for any amount of tax withheld, which upon filing by the other taxpayer with the taxpayer's return, shall relieve the other taxpayer of liability for the amount of tax withheld.

- (C) In computing the tax levied under this paragraph against any federal cost-plus contractor, there shall be excluded from the gross income of the contractor so much thereof as fulfills the following requirements:

- (i) The gross income exempted shall constitute reimbursement of costs incurred for materials, plant, or equipment purchased from a taxpayer licensed under this chapter, not exceeding the gross proceeds of sale of the taxpayer on account of the transaction.
- (ii) The taxpayer making the sale shall have certified to the department that the taxpayer is taxable with respect to the gross proceeds of the sale, and that the taxpayer elects to have the tax on such gross income computed the same as upon a sale to the state government.

- (D) A person who, as a business or as a part of a business in which the person is engaged, erects, constructs, or improves any building or structure, of any kind or description, or makes, constructs, or improves any road, street, sidewalk, sewer, or water system, or other improvements on land held by the person (whether held as a leasehold, fee simple, or otherwise), upon the sale or other disposition of the land or improvements, even if the work was not done pursuant to a contract, shall be liable to the same tax as if engaged in the business of contracting, unless the person [shall show] shows that at the time the person was engaged in making the improvements it was, and for the period of at least one year after completion of the building, structure, or other improvements, it continued to be the person's purpose to hold and not sell or otherwise dispose of the land or improvements. The tax in respect of the improvements shall be measured by the amount of the proceeds of the sale or other disposition that is attributable to the erection, construction, or improvement of such building or structure, or the making, constructing, or improving of the road, street, sidewalk, sewer, or water system, or other improvements. The measure of tax in respect of the improvements shall not exceed the amount which would have been taxable had the work been performed by another, subject as in other cases to the deductions allowed by subparagraph (B). Upon the election of the taxpayer this paragraph may be applied notwithstanding the improvements were not made by the taxpayer, or were not made as or as a part of a business, or were made with the intention of holding the same. However, this paragraph shall not apply in respect of any proceeds that constitute or are in the nature of rent; all such gross income shall be taxable under paragraph (10).

- (4) Tax upon theaters, amusements, radio broadcasting stations, etc. Upon every person engaging or continuing within the State in the

business of operating a theater, opera house, moving picture show, vaudeville, amusement park, dance hall, skating rink, radio broadcasting station, or any other place at which amusements are offered to the public, the tax shall be equal to four per cent of the gross income of the business.

- (5) Tax upon sales representatives, etc. Upon every person classified as a representative or purchasing agent under section 237-1, engaging or continuing within the State in the business of performing services for another, other than as an employee, there is likewise hereby levied and shall be assessed and collected a tax equal to four per cent of the commissions and other compensation attributable to the services so rendered by the person.
- (6) Tax on service business. Upon every person engaging or continuing within the State in any service business or calling not otherwise specifically taxed under this chapter, there is likewise hereby levied and shall be assessed and collected a tax equal to four per cent of the gross income of any such business; provided that where any person engaging or continuing within the State in any service business or calling renders such services upon the order of or at the request of another taxpayer who is engaged in the service business and who, in fact, acts as or acts in the nature of an intermediary between the person rendering such services and the ultimate recipient of the benefits of such services, so much of the gross income as is received by the person rendering the services shall be subjected to the tax at the rate of one-half of one per cent and all of the gross income received by the intermediary from the principal shall be subjected to a tax at the rate of four per cent; and provided that where any person is engaged in the business of selling interstate or foreign common carrier telecommunication services within and without the State, the tax shall be imposed on that portion of gross income received by any such person from service which is originated or terminated in this State and is charged to a telephone number, customer, or account in this State notwithstanding any other state law (except for the exemption under section [237-23(a)(2))] 237-23(a)(1)) to the contrary. If, under the Constitution and laws of the United States, the entire gross income as determined under this paragraph of a business selling interstate or foreign common carrier telecommunication services cannot be included in the measure of the tax, such gross income shall be apportioned as provided in section 237-21; provided that the apportionment factor and formula shall be the same for all persons providing such services in the State.
- (7) Tax on insurance solicitors and agents. Upon every person engaged as a licensed solicitor, general agent, or subagent pursuant to chapter 431, there is hereby levied and shall be assessed and collected a tax equal to .15 per cent of the commissions due to such activity.
- (8) Professions. Upon every person engaging or continuing within the State in the practice of a profession, including those expounding the religious doctrines of any church, there is likewise hereby levied and shall be assessed and collected a tax equal to four per cent of the gross income on the practice or exposition.
- (9) Tax on receipts of sugar benefit payments. Upon the amounts received from the United States government by any producer of sugar (or the producer's legal representative or heirs), as defined

under and by virtue of the Sugar Act of 1948, as amended, or other acts of the Congress of the United States relating thereto, there is hereby levied a tax of one-half of one per cent of the gross amount received, provided that the tax levied hereunder on any amount so received and actually disbursed to another by such producer in the form of a benefit payment shall be paid by the person or persons to whom such amount is actually disbursed, and the producer actually making any such benefit payment to another shall be entitled to claim on the producer's return a deduction from the gross amount taxable hereunder in the sum of the amount so disbursed. The amounts taxed under this paragraph shall not be taxable under any other paragraph, subsection, or section of this chapter.

- (10) Tax on other business. Upon every person engaging or continuing within the State in any business, trade, activity, occupation, or calling not included in the preceding paragraphs or any other provisions of this chapter, there is likewise hereby levied and shall be assessed and collected, a tax equal to four per cent of the gross income thereof. In addition, the rate prescribed by this paragraph shall apply to a business taxable under one or more of the preceding paragraphs or other provisions of this chapter, as to any gross income thereof not taxed thereunder as gross income or gross proceeds of sales or by taxing an equivalent value of products, unless specifically exempted."

SECTION 7. Section 237-23, Hawaii Revised Statutes, is amended by amending subsections (a) and (b) to read as follows:

"(a) This chapter shall not apply to the following persons:

- [(1)] Banks taxable under chapter 241;
- [(2)] (1) Public service companies (as that term is defined in section 239-2), with respect to the gross income, either actual gross income or gross income estimated and adjusted, which is included in the measure of the tax imposed by chapter 239;
- [(3)] (2) Public utilities owned and operated by the State or any county or other political subdivision thereof;
- [(4)] (3) Fraternal benefit societies, orders, or associations, operating under the lodge system, or for the exclusive benefit of the members of the fraternity itself, operating under the lodge system, and providing for the payment of death, sick, accident, prepaid legal services, or other benefits to the members of such societies, orders, or associations, and to their dependents;
- [(5)] (4) Corporations, associations, trusts, or societies organized and operated exclusively for religious, charitable, scientific, or educational purposes, as well as that of operating senior citizens housing facilities qualifying for a loan under the laws of the United States as authorized by section 202 of the Housing Act of 1959, as amended, as well as that of operating a prepaid legal services plan, as well as that of operating or managing a homeless facility, or any other program for the homeless authorized under chapter 358D;
- [(6)] (5) Business leagues, chambers of commerce, boards of trade, civic leagues, and organizations operated exclusively for the benefit of the community and for the promotion of social welfare which shall include the operation of a prepaid legal service plan, and from which no profit inures to the benefit of any private stockholder or

- individual;
- [(7)] (6) Hospitals, infirmaries, and sanitarium;
- [(8)] (7) Cooperative associations incorporated under chapter 421 or 422 or Code section 521 cooperatives which fully meet the requirements of section 421-23 or 422-33, except Code section 521 cooperatives need not be organized in Hawaii; provided that:
 - (A) The exemption shall apply only to the gross income derived from activities which are pursuant to purposes and powers authorized by chapter 421 or 422, except those provisions pertaining to or requiring corporate organization in Hawaii do not apply to Code section 521 cooperatives;
 - (B) The exemption shall not relieve any person who receives any proceeds of sale from the association of the duty of returning and paying the tax on the total gross proceeds of the sales on account of which the payment was made, in the same amount and at the same rate as would apply thereto had the sales been made directly by the person, and all such persons shall be so taxable; and
 - (C) As used in this paragraph, "section 521 cooperatives" mean associations which qualify as a cooperative under section 521 (with respect to exemption of farmers' cooperatives from tax) of the Internal Revenue Code of 1986, as amended;
- [(9)] Building and loan associations taxable under chapter 241;
- [(10)] (8) Persons affected with Hansen's disease and kokuas, with respect to business within the county of Kalawao;
- [(11)] (9) Corporations, companies, associations, or trusts organized for the establishment and conduct of cemeteries no part of the net earnings of which inures to the financial benefit of any private stockholder or individual (provided that the exemption shall apply only to the activities of such persons in the conduct of cemeteries and not to any activity the primary purpose of which is to produce income, even though the income is to be used for or in the furtherance of the exempt activities of such persons); and
- [(12)] Financial services loan companies taxable under chapter 241; provided that the exemption shall apply only to the gross income derived from the "engaging in the business of a financial services loan company" as defined in section 408-2;
- (13) Development companies taxable under chapter 241; provided that the exemption shall apply only to gross income derived from interest on loans made to borrowers as provided by Title V of the federal Small Business Investment Act of 1958, Public Law 699, as amended;
- [(14)] (10) Nonprofit shippers associations operating under part 296 of the Civil Aeronautics Board Economic Regulations[;]
- (15) Small business investment companies taxable under chapter 241; provided that the exemption shall apply only to the gross income derived from activities engaged in as provided by the federal Small Business Investment Act of 1958, Public Law 699, as amended; provided further that the exemption shall not apply to gross income derived from consulting and advisory services engaged in under the first sentence of section 308(b) of Public Law 699; and

- (16) Financial corporations taxable under chapter 241; provided that the exemption shall apply only to interest, discount, points, loan fees, loan origination charges, and finance charges which are part of the computed annual percentage rate of interest and which are contracted and received for the use of money; provided further that in the case of financial corporations acting as interbank brokers taxable under chapter 241, the exemption shall apply only to gross income derived from brokerage services. As used in this paragraph, "finance charge" and "annual percentage rate" have the same meaning as defined in the federal Truth in Lending Act (15 U.S.C. 1601 et seq.).
- (b) The exemptions enumerated in subsection [(a)(4) to (7)] (a)(3) to (6) shall apply only:
 - (1) To those persons who shall have registered with the department of taxation by filing a written application for registration in such form as the department shall prescribe, shall have paid the registration fee of \$20, and shall have had the exemption allowed by the department or by a court or tribunal of competent jurisdiction upon appeal from any assessment resulting from disallowance of the exemption by the department; and
 - (2) To activities from which no profit inures to the benefit of any private stockholder or individual, except for death or other benefits to the members of fraternal societies; and
 - (3) To the fraternal, religious, charitable, scientific, educational, communal, or social welfare activities of such persons, or to the activities of such hospitals, infirmaries, and sanitariums as such, and not to any activity the primary purpose of which is to produce income even though the income is to be used for or in furtherance of the exempt activities of such persons."

SECTION 8. This Part shall take effect on January 1, 1993.

PART IV

SECTION 9. Chapter 241, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

"§241- Alternative tax. Section 1201 (with respect to alternative tax for corporations) of the Internal Revenue Code shall be operative for the purposes of this chapter and shall be applied as set forth in this section. If for any taxable year a bank, building and loan association, development company, financial corporation, financial services loan company, small business investment company, mortgage loan company, financial holding company, or trust company has a net capital gain, then, in lieu of the tax imposed by section 241-4, there is hereby imposed a tax (if such tax is less than the tax imposed under section 241-4) which shall consist of the sum of:

- (1) A tax computed on the taxable income reduced by the amount of the net capital gain, at the rates and in the manner as if this section had not been enacted; plus
- (2) Four per cent of the net capital gain for the taxable year."

SECTION 10. Section 241-1, Hawaii Revised Statutes, is amended as follows:

1. By adding four new definitions to be appropriately inserted and to read as follows:

“Financial holding company” means any corporation registered under the Federal Bank Holding Company Act of 1956, as amended, or registered as a savings and loan holding company under the Home Owners’ Loan Act of 1933, as amended.

“Mortgage loan company” means any company licensed under chapter 454.

“Subsidiary” means any corporation doing business in Hawaii engaged in activities set forth in Title 12 of the Code of Federal Regulations, sections 225.22 and 225.25 (1990) (Regulation Y) and sections 584.2-1 and 584.2-2 (1990) (Office of Thrift Supervision) and whose voting stock is more than eighty per cent owned, directly or indirectly, by a financial holding company, bank, building and loan association, financial services loan company, financial corporation, or trust company.

“Trust company” means a corporation or joint stock company authorized to conduct business as a trust company under chapter 406.”

2. By amending the definition of “financial corporation” to read as follows:

““Financial corporation” means (1) any corporation, domestic or foreign, other than a bank or building and loan association, which is a financial corporation within the meaning of section 5219 of the Revised Statutes of the United States, as amended (12 U.S.C. 548), or other similar law, doing business in the State and not subject to the taxes imposed by [chapters] chapter 235 [and 237, or not subject to one of such taxes], but shall not include an insurance company which pays the tax on premiums imposed by chapter 431, and (2) an interbank broker doing business in the State and not subject to the taxes imposed by chapter 235 [and 237, or not subject to one of such taxes].”

SECTION 11. Section 241-1.5, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

“(a) The tax imposed by this chapter applies to every bank, building and loan association, development company, financial corporation, financial services loan company, [or] trust company, mortgage loan company, financial holding company, small business investment company, or subsidiary as defined in section 241-1:

- (1) Which is in business at the commencement of a calendar year, as of January 1 of that year;
- (2) Which begins business after the commencement of a calendar year, as of the commencement of business.”

SECTION 12. Section 241-2, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

“(a) Every national banking association located or doing business in the State shall annually[, as of January 1,] pay a franchise tax according to, or

measured by, its net income, to be computed as provided in section 241-4, at the rate there prescribed. The State is hereby [adopting method numbered (4), authorized by] adhering to the prescriptions of section 5219, Revised Statutes of the United States, as amended (12 U.S.C. 548), or other similar law.”

SECTION 13. Section 241-3, Hawaii Revised Statutes, is amended to read as follows:

“§241-3 Imposition of tax on other banks, building and loan associations, financial services loan companies, financial corporations, small business investment companies, [and] trust companies, mortgage loan companies, financial holding companies, development companies[.], and subsidiaries. Every bank, other than a national banking association, every building and loan association, every financial services loan company, financial corporation, small business investment company, [and] trust company, mortgage loan company, financial holding company, development company, and subsidiary located or doing business in the State, shall annually[, as of January 1,] pay a franchise tax measured as, and at the rate, provided in section 241-4.”

SECTION 14. Section 241-4, Hawaii Revised Statutes, is amended to read as follows:

“§241-4 Measure and rate of tax. (a) The measure of the tax imposed by this chapter is the entire net income from all sources for the preceding calendar year, or in the case of a taxpayer operating on a fiscal year basis, for the preceding fiscal year. The tax [imposed by this chapter is hereby fixed at eleven and seven-tenths per cent thereof.] shall be at the rate of seven and ninety-two one hundredths per cent of the entire net income from all sources.

(b) The “entire net income from all sources” shall be determined in the same manner as the “taxable income” of a corporation, as provided by chapter 235, with the following changes and adjustments:

- (1) There is included in gross income interest received upon the obligations of the United States or its possessions, or upon securities issued under the authority of an act of Congress, or upon state, territorial, municipal, county, or other bonds or securities whether or not the income from such obligations, bonds, or securities, is tax free. Section 235-7(a)(1), (5), and (6) does not apply.
- [(2)] Section 235-3(c), (d), and (e) does not apply.
- [(3)] (2) In lieu of section 235-4, it is provided that there shall be excluded the gross income from property owned, trade or business carried on, and other sources outside the State.
- [(4)] Section] (3) Sections 235-5 [does] and 235-21 to 235-39 do not apply. The income excluded pursuant to paragraph [(3)] (2) shall be determined by an allocation and separate accounting. Losses from property owned outside the State and from other sources outside the State shall not be deducted. Reserves shall be allocated to the State by an application of a fraction, the numerator of which consists of the gross income included in determining the “entire net income from all sources” pursuant to this chapter and the denominator of which consists in the gross income similarly ascertained but without regard to whether from sources within or without the State.
- [(5)] (4) Deductions connected with income which by this chapter is required to be included in the computation of net income shall be

- allowed, but deductions connected with income which by this chapter is not to be included in the computation of net income shall not be allowed. Section 235-7(e)(1) does not apply.
- [(6)] One-half of such amount of capital gain as, under the Internal Revenue Code, is entitled to the alternative tax treatment, is deductible in the determination of net income.
 - (7) Section 166 of the Internal Revenue Code does not apply, except the provisions as to the basis for determining the amount of the deduction for a bad debt. Section 593 of the Internal Revenue Code does not apply. In lieu of the cited sections of the Internal Revenue Code, debts] (5) Debts ascertained to be worthless and charged off on the books of the taxpayer within the income year may be deducted, or in the discretion of the department of taxation may be treated as a reasonable addition to a reserve for bad debts; provided that when satisfied that a debt is recoverable only in part, the department may allow the debt to be charged off in part.
 - [(8)] Federal income taxes upon income derived or received from sources in the State may be deducted.
 - (9)] (6) In the case of any life insurance company (as defined by the Internal Revenue Code), which is determined to be a financial corporation as defined by this chapter, sections 801, 811, and 812 of the Internal Revenue Code do not apply. The total of the deductions allowed by sections 807 and 810 of the Internal Revenue Code shall not exceed the amount of the required interest, as defined by section 807 of the Internal Revenue Code.
 - [(10)] (7) Section 582[(c)] (with respect to bonds, etc., losses and gains of financial institutions) of the Internal Revenue Code shall be operative for the purposes of this chapter."

SECTION 15. Section 241-6, Hawaii Revised Statutes, is amended to read as follows:

"§241-6 Chapter 235 applicable. All of the provisions of chapter 235 not inconsistent with this chapter, and which may be appropriately applied to the taxes, persons, circumstances, and situations involved in this chapter, including without prejudice to the generality of the foregoing, sections 235-92, 235-98, 235-99, and 235-101 to 235-118, shall be applicable to the taxes imposed by this chapter; and to the assessment and collection thereof. Any tax refund payable under section 235-110, hereby made applicable to the taxes imposed by this chapter, shall be made in the manner provided in section 231-23(c).

The filing of a consolidated return under section 235-92 applies only to a bank, building and loan association, financial services loan company, financial corporation, small business investment company, development company, mortgage loan companies, trust company, or financial holding company, and their subsidiaries as defined in section 241-1."

SECTION 16. This Part shall take effect on January 1, 1994, so that the amendments made by this Part shall apply to the entire net income received for the calendar year preceding January 1, 1994, and for the calendar years thereafter. In the case of a taxpayer operating on a fiscal year basis, the amendments made by this Part shall apply to the entire net income received for the fiscal year in which January 1, 1994, occurs and for fiscal years thereafter.

PART V

SECTION 17. Statutory material to be repealed is bracketed. New statutory material is underscored.¹

SECTION 18. Subject to the foregoing effective dates, this Act shall take effect upon its approval.

(Approved May 27, 1992.)

Note

1. Edited pursuant to HRS §23G-16.5.