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SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING SB 2273
RELATING TO DIGITAL MEDIA

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 7, 2008
TIME: 1:15PM
ROOM: 224

This legislation modifies the existing motion picture tax credit provided under HRS § 235-17, to include an additional component comprised of a credit equal to 50% of costs incurred in wages associated with training below-the-line crew.

The Department of Taxation takes **no position** on this measure.

I. STRONG SUPPORT FOR THE MOTION PICTURE INDUSTRY

The Department strongly supports the existing tax incentives for the motion picture industry and the economic activity this incentive has brought to Hawaii. Likewise, the Department also recognizes that additional incentives could help even further with continuing to build up Hawaii's talent and labor forces that provide services to this industry. However, the Legislature must ensure that the Hawaii Film Office, which implements a majority of this credit, is sufficiently staffed to carry out any extension of the existing credit.

II. NEED TO COMPETE WITH OTHER JURISDICTIONS

The Department recognizes that in order for Hawaii to remain competitive in the worldwide marketplace of filming locations, its tax incentives must remain attractive. Labor costs associated with filmmaking can be a large production cost, including the labor costs in Hawaii. The Department understands that other states, such as New Mexico, have created labor incentive programs similar to this measure. The Department suggests that the Committee consider the spirit of this proposal by providing additional incentives targeted at the labor side of motion picture production.

III. CLARIFICATION ON CREDIT REDUCTION.

The bill currently requires a reduction of credit for costs associated with claiming the credit for below-the-line local hires. The Department finds the following language awkward:

> (a) Any law to the contrary notwithstanding, there shall be allowed to each taxpayer subject to the taxes imposed by this chapter, an income tax credit which shall be deductible from the taxpayer's net income tax liability, if any, imposed by this chapter for the taxable year in which the credit is properly claimed. The amount of the credit shall be:
>
> (1) Fifteen per cent of the qualified production costs incurred by a qualified production in any county of the State with a population of over seven hundred thousand; or
>
> (2) Twenty per cent of the qualified production costs incurred by a qualified production in any county of the State with a population of seven hundred thousand or less[~~.~~]<u>; and</u>
>
> <u>(3) Fifty per cent of the wages or salaries paid to below-the-line crew members; provided that the below-the-line crew member:</u>
>
> <u>(A) Is a Hawaii resident;</u>
>
> <u>(B) Has participated in below-the-line crew on-the job-training or attended a below-the-line crew training course established under section 394-8 or approved by the film industry branch of the department of business, economic development, and tourism; and</u>
>
> <u>(C) Has been certified as a film and multimedia trainee by the film industry branch of the department of business, economic development, and tourism;</u>
>
> <u>***provided further that any [credit??] claimed under this paragraph shall first be applied to a qualified production's qualified production costs prior to calculating any credit under paragraph (1) or (2).***</u>

What is the purpose of applying any credit claimed under the local hire program toward the qualifying costs? The Department reads the intent to reduce the qualified costs from the overall production expenditures by the amount of any wages or salaries paid under the local hire credit.

A clearer provision could read:

> **provided further than any wages or salaries claimed under this paragraph shall be disqualified as a qualified production cost for purposes of calculating any credit under paragraph (1) or (2).**

IV. <u>REVENUE ESTIMATE</u>

This legislation will result in a revenue loss of approximately $5.75 million for FY 2009 (1/2 yr impact), and $11.5 million for FY 2010 to FY 2016.

According to the Hawaii Data Book 2006, motion picture and TV production expenditures amounted to $164.0 million in 2004. We assumed 40% of the expenditures was the total wages paid to below-the-line crew. We further assumed 50% of the total wages paid to below-the-line crew qualified for the new 50% credit. Currently, the wages qualify for the 15% (or 20% for neighbor islands) credit. Thus, based on the proposal, the wages would qualify for an additional 35% credit (50% - 15%). We assumed all the film and TV production occurred on Oahu.

LINDA LINGL
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THEODORE E. LI
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DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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Statement of
THEODORE E. LIU
Director
Department of Business, Economic Development, and Tourism
before the
SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
Thursday, February 7, 2008
1:15 p.m.
State Capitol, Conference Room 229

in consideration of
SB 2273
RELATING TO DIGITAL MEDIA.

Chair Fukunaga, Vice-Chair Espero, and members of the Committee.

The Department of Business, Economic Development & Tourism (DBEDT) supports the concept behind SB 2273 but we must oppose the bill, as we have concerns that it would create significant problems to implement, that it may impact the limited resources of the Film Industry Branch and have significant cost implications.

SB 2273 seeks to stimulate film and digital media production in the state by amending §235-17, HRS, motion picture, digital media, and film production income tax credit to include a 50% credit on wages paid to below-the-line crew who are residents of Hawaii and to grow the experience level and size of our local crew base by authorizing the Department of Labor and Industrial Relations to implement and operate a media production training programs.

We strongly feel that there will be significant problems in implementing a 50% local wage credit that is applicable only to Hawaii residents. The exclusion of this credit for any above-the-line positions for Hawaii residents is counter to the goal of growing all aspects of a robust local industry.

While we defer to the Department of the Attorney General (AG) to comment on the technical merits of the constitutional implications of such a wage credit, it is our understanding from prior communication with the AG that a wage credit linked to a local hiring requirement may pose legal issues with regard to our state constitution. And if such a wage credit could pass constitutional muster with our state AG, such a wage credit would not apply to any of the high paying, more senior above-the-line positions that carry more responsibility, thereby discouraging out of state productions from using Hawaii hires to fill these important positions.

We believe that the current provisions of the motion picture, digital media and film production income tax credit are generous at this point and bring Hawaii to a competitive level with other jurisdictions. If such a wage credit were to be implemented, and since the existing 15-20% credit applies to all wages and salaries, above- and below-the-line, it would provide productions a total of 57.5% to 60% for local wages below the line. There's no doubt that would provide additional incentive to productions to shoot in Hawaii and hire locally but we have serious concerns that the state may not be able to sustain such a generous credit, especially since we have not had a chance to fully assess the overall economic impact of Act 88 on the state.

We defer to the Department of Labor and Industrial Relations to respond to the substantive merits of the amendments to §383-128, HRS. However, we strongly believe that a media production training program is so highly specialized that it would pose a challenge for the department to develop such a program, despite the development and administration guidance of an industry advisory group. Assembling such an advisory group to carry out this mandate poses a challenge in itself because of the broad cross section of industry that would have to be represented and the time and effort involved. If such a program were to be implemented, having the option to contract these training program services out to qualified industry organizations would be critical.

Additionally, the Film Industry Branch currently has neither the expertise nor sufficient staff to approve film training programs or certify production crew as film and multimedia trainees. Currently DBEDT's Film Industry Branch is responsible for certifying the tax credits applied for through §235-17, HRS and for handling all film permitting and other production support. The branch does not have sufficient staff to handle these current responsibilities. Hawaii cannot risk losing its reputation as a film friendly location, which is a likely outcome if an increased number of productions may not be able to efficiently access our tax credit program and securing film permits in a timely manner for filming on public property poses a challenge. We believe that it is more appropriate to have the private sector create a certification system, thereby preventing conflicts or duplication with the unions that oversee the film industry.

Thank you for this opportunity to comment on this bill.

LINDA LINGLE
GOVERNOR

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February 6, 2008

To: The Honorable Carol Fukunaga, Chair
and Members of the Senate Committee on Economic Development and Taxation

Date: February 7, 2008
Time: 1:15 p.m.
Place: Conference Room 229, State Capitol

From: Darwin L.D. Ching, Director
Department of Labor and Industrial Relations

Testimony in Opposition to S.B. 2273 – Relating to Digital Media

I. OVERVIEW OF CURRENT PROPOSED LEGISLATION

Senate Bill 2273 authorizes the Department of Labor and Industrial Relations ("Department") to implement and operate media production training programs through the Department's New Industry Training Program.

Further, S.B. 2273 amends the "Motion Picture, Digital Media, and Film Production Income Tax Credit" to allow a tax credit on fifty percent of wages paid to below-the-line crew who are Hawaii residents that meet certain training and certification requirements.

II. CURRENT LAW

New Industry Training Program

Section 394-8, Hawaii Revised Statutes ("HRS"), was established in 1987. The program was intended to be a "rapid response" program to provide training programs to local residents hired by businesses relocating to Hawaii or local businesses expanding their operations. The legislature appropriated $250,000 in General Funds to the Department to support the program.

The New Industry Training Program presently exists in statute only. There is no current staff or funding allocated to this program.

Employment Training Fund

The Department also administers the employer funded Employment Training Fund ("ETF") to assist in upgrading employee skills.

In 1991, the legislature added an additional .05 percent assessment on wages subject to unemployment taxes to fund an employment and training fund. This law was to sunset at the end of 1996. It was assumed that the fund would be allowed to sunset because the training programs had provided employment training to only a small percentage of the workforce. However, instead of allowing the fund to sunset, the legislature made it permanent and expanded the purposes for which the funds could be used to include grants and subsidies to agencies which provide services for the school-to-work program.

Additionally, because the ETF fund was established on a temporary basis the tax on employers was designed to be phased out incrementally. As such, the tax on employers had been reduced from .05 percent to a .01 percent assessment on wages. Once the program and fund was made permanent, the assessment was never restored to the original funding level. This has caused the ETF to require that employers pay for fifty (50) percent of the training or any excess beyond the tuition cap. Today, less then five (5) percent of Hawaii businesses are utilizing the fund although they entirely fund the program.

III. HOUSE BILL

The Department <u>opposes</u> S.B. 2273 for the following reasons:

1. The New Industry Training Program is not operational. The Department has no staff, funding or expertise to implement and operate the media production job training programs envisioned by the bill.

2. Additionally, the bill is slightly confusing as it makes reference to the ETF and implies a relationship or interaction with the New Industry Training Program found in section 294-8, HRS. There is no relationship or interaction between these programs as the New Industry Training Programs does not exist.

3. The film industry already has the ability to apply for an ETF training (Macro) grant from the Department to effectuate the purpose of this bill. However, the ETF is not designed, nor does it have the resources, to fully fund the training program envisioned

by this bill.

The ETF training grant (Macro) program provides grants for education and training projects where there are critical skill shortages in high growth industries. However, it only acts as a catalyst, providing seed money for education, training curricula and program design. It is expected that the industry applying for and receiving the grant will also provide funding.

Additionally, S.B. 2273 creates an inequity in not allowing the Director to require employers utilizing the envisioned digital media training program to pay for fifty percent of the cost. The bill would single out one specific industry for preferential treatment while not giving the same consideration to other industries.

4. The Department defers to the Department of Taxation and the Department of Business, Economic Development and Tourism regarding the "Motion Picture, Digital Media, and Film Production Income Tax Credit".

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L E G I S L A T I V E

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SUBJECT: INCOME, Expand motion picture, digital media, and film production credit

BILL NUMBER: SB 2273; HB 2734 (Identical)

2/7 EDT 1/28 TAC

INTRODUCED BY: SB by Fukunaga, Espero, Ige, Baker, English and 1 Republican; HB by Rhoads

BRIEF SUMMARY: Amends HRS section 235-17 to provide that the motion picture, digital media, and film production tax credit shall be expanded to include 50% of the wages paid to below-the-line crew members who: (1) are Hawaii residents; (2) have participated in approved job-training courses; and (3)

and film production tax credit shall be expanded to include 50% of the wages paid to below-the-line crew members who: (1) are Hawaii residents; (2) have participated in approved job-training courses; and (3)

have been certified as a film and multimedia trainee by the film industry branch of the department of business, economic development and tourism provided further that the credit claimed under this section shall be first applied to a qualified production's qualified production costs prior to calculating any other tax credit under this section.

"Below-the-line crew" includes production, art construction, set dressing, props, camera, sound, stage and studio, electrical, grip, wardrobe, makeup, special effects, laboratory and film, food transportation, locations, editorial and other hires based upon industry standards.

This section shall be applicable to wages and salaries paid to Hawaii residents in below-the-line crew positions on or after July 1, 2008 and before January 1, 2016. Repeals this section on January 1, 2016 and provides that HRS section 235-17 shall be reenacted in the form in which it read before the effective date of this act.

EFFECTIVE DATE: July 1, 2008

STAFF COMMENTS: The legislature by Act 107, SLH 1997, enacted an income tax credit of 4% for costs incurred as a result of producing a motion picture or television film in the state and 7.25% for transient accommodations rented in connection with such activity. The credit was adopted largely to address the impost of the state's general excise tax on goods and services used by film producers. The proposed measure would provide a tax credit for 50% of the wages paid to below-the-line crew members who are Hawaii residents.

That earlier tax credit was replaced by the digital media and film production credit in 2006, Act 88 which provides for a credit of 15% of qualified production costs if the film is made on Oahu and 20% of qualified costs if filmed on a Neighbor Island. According to information disclosed by the Hawaii Film Office, that credit attracted more than $200 million in qualified production costs last year and that to date claims for more than $25 million for the digital media credit have been filed. For the advocates of the credit, this is proof that the credit is attracting productions to Hawaii. If that is so, one has to ask why this proposal is needed other than being an attempt to "give away the store" at the expense of all resident taxpayers.

It should be noted that income tax credits are designed to reduce the tax burden by providing relief for

SB 2273; HB 2734 - Continued

taxes paid. Tax credits are justified on the basis that taxpayers with a lesser ability to pay should be granted relief for state taxes imposed. As it was pointed out when the Act was originally enacted, this measure merely results in a subsidy by government at the expense of all taxpayers. This measure proposes to further expand the motion picture, digital media, and film production tax credit program. While the proponents of the measure may try to justify the argument that Hawaii needs to enact such an incentive to compete for this type of business, one has to ask "at what price?" Perhaps when wages are paid to these select workers, there should be a phrase at the bottom of the check that says: "Paid for by the working poor taxpayers of Hawaii."

Promoters of the film industry obviously don't give much credit to Hawaii's natural beauty and more recently its relative security. If promoters of the film industry would just do their job in outlining the advantages of doing this type of work in Hawaii and address some of the costly barriers by correcting them, such tax incentives would not be necessary. From permitting to skilled labor to facilitating transportation of equipment, there are ways that could reduce the cost of filming in Hawaii. Unless these intrinsic elements are addressed, movie makers will probably demand subsidies such as this incentive. Unfortunately, they come at the expense of all taxpayers and industries struggling to survive in Hawaii.

If lawmakers want to subsidize the film industry in Hawaii, then a direct appropriation of public funds is more accountable and would subject that expenditure to public scrutiny. If taxpayers do not agree with the subsidy or the amount of public funds being spent, they can hold their lawmakers accountable for that expense.

Finally, nothing has been done to insure that such productions only benefit once from the state trough. As lawmakers learned, investors in the Blue Crush movie will see $16 million in tax credits as a result of Act 221. One has only to ask just how much more will Hawaii taxpayers be asked to underwrite for the film industry that, at best, provides dubious economic gains for the state. If nothing else, lawmakers ought to demand a cost benefit analysis of this proposed credit as well as all the other handouts that have been provided with the various and sundry credits enacted in the last five years.

Finally, the bemoaning of lawmakers about the "brain-drain" of Hawaii's brightest and best is somewhat disingenuous given proposals like this when the burden of running state government shifts to all other taxpayers. Where do lawmakers believe the money to fund these tax credits comes from? And unlike the companies from the plantation that now have passed into history, how many of the beneficiaries of these tax credits truly give back to the community other than lending their presence at celebrity functions? In all truth, these beneficiaries have only taken and rarely have given back the way old time businesses did so willingly in the past.

Digested 1/25/08

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February 6, 2008

VIA FACSIMILE # 586-6899 AND HAND-DELIVERY

The Honorable Carol Fukunaga
Chair, Senate Committee on Economic Development and Taxation
Hawaii State Capitol, Room 216
415 South Beretania Street
Honolulu HI 96813

Dear Senator Fukunaga:

Re: S.B. No. 2273, Relating to Digital Media

Pursuant to your memorandum dated January 30, 2008 requesting our office to provide you with a purpose section for S.B. No. 2273 Relating to Digital Media, attached hereto is a new Section 1 that you may wish to consider including in the bill as this measure proceeds through the legislative process.

The purpose section explains that the bill increases the scope of qualified expenses under the film production tax credit, which will be available to resident and nonresident taxpayers alike, and is intended to ensure and provide for a highly skilled workforce for mainland and Hawaii film and digital media production companies.

Please contact me at (808) 586-1473 if you should have any questions.

Very truly yours,

Hugh R. Jones
Deputy Attorney General

APPROVED

Mark J. Bennett
Attorney General

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SECTION 1. The purpose of this bill is to stimulate the television, film, and cinematic production industry in Hawaii and to stimulate employment within this industry, by: (1) broadening the scope of the Hawaii's film production, digital media, and film production tax credit provided to all taxpayers who are subject to the taxes imposed by chapter 235, Hawaii Revised Statutes, and (2) providing media production training programs to ensure a highly skilled local workforce within this important industry segment that will be available for employment by Hawaii and mainland film and digital media production companies. The legislature expressly intends to enlarge the scope of expenses that qualify for this tax credit by including fifty per cent of wages paid to "below the line" crew members who have participated in "below the line" job training and who have been certified as a film and multimedia trainee by the department of business, economic development, and tourism. The existing tax credit is available to resident and nonresident Hawaii income taxpayers alike.

testimony

From: Shawn Christensen [shawnc@pdchawaii.com]
Sent: Wednesday, February 06, 2008 11:48 AM
To: testimony
Cc: Carol Fukunaga
Subject: SB 2273

Senator Carol Fukunaga, Chair
Senator Will Espero, Vice-Chair
Committee on Economic Development and Taxation February 07, 2008 Room 229 at 1:15pm

In support of SB 2273 relating to digital media:

The IATSE Local 665 is in strong support of SB 2273, with over 500 members we are Hawaii's film and stage technicians.
Due to the recent passing of other legislation which impacts our industry, we are on the cusp of seeing our industry grow and to be able to prepare for this expansion. We strongly urge the passing of this bill to help build the infrastructure of this industry and offer the next generation of technical people the opportunity for advancement and growth while at the same time retraining and retaining the knowledge of those technicians who have worked here in Hawaii.

SB 2273 provides an opportunity to teach and transfer knowledge from numerous sources and gather them into a cohesive training program that has never been accomplished in the history of this industry in the State of Hawaii. With this in mind we ask for your support of this measure and would be more than willing to discuss with you at length any questions or concerns you may have.

Shawn Christensen
Planning and Development
IATSE Local 665