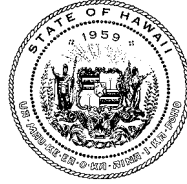


LATE TESTIMONY

NEIL ABERCROMBIE
GOVERNOR

BRIAN SCHATZ
LT. GOVERNOR



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INTERIM DIRECTOR OF TAXATION

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DEPUTY DIRECTOR

LATE

SENATE COMMITTEES ON ECONOMIC DEVELOPMENT & TECHNOLOGY AND EDUCATION

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING SB 1132 RELATING TO DIGITAL MEDIA

TESTIFIER: FREDERICK D. PABLO, INTERIM DIRECTOR OF
TAXATION (OR DESIGNEE)

COMMITTEE: EDT-EDU

DATE: FEBRUARY 11, 2011

TIME: 2:45PM

POSITION: OPPOSED TO TRANSFERABLE CREDITS;
CONCERNED WITH COSTS

This measure establishes digital media enterprise subzones surrounding the University of Hawaii campus, which includes certain tax benefits.

The Department of Taxation (Department) **opposes the provision allowing transferability of credits**, and raises **concerns regarding its revenue loss**.

DEFERRAL TO DBEDT—The Department defers to the Department of Business, Economic Development & Tourism on whether the enterprise zone incentives should be expanded to include this program.

NOT FACTORED INTO BUDGET—The Department must be cognizant of the biennium budget and financial plan. This measure has not been factored into either.

REVENUE IMPACT—This measure will result in an indeterminate revenue loss because its provisions are blank.

TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Digital media enterprise subzone workforce development tax credit within an enterprise zone

LATE

BILL NUMBER: SB 1132; HB 1309 (Identical)

INTRODUCED BY: SB by Gabbard, Baker, Chun Oakland, Fukunaga, Shimabukuro and 1 Democrat; HB by Har, Aquino, Awana, Chang, Cullen, Hashem, Ichiyama, Ito, Manahan, McKelvey, Mizuno, B. Oshiro, Tokioka, Tsuji, Yamane and 1 Democrat

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow a taxpayer that operates a qualified animation or visual effects business located within a digital media enterprise subzone to claim an income tax credit of _____ % of the wages paid to animation or visual effects personnel who are Hawaii residents. To qualify for this tax credit, a business shall: (1) operate in a digital media enterprise subzone; (2) have qualified labor costs totaling at least \$200,000; (3) provide evidence of reasonable efforts to hire Hawaii residents as animation or visual effects personnel; (4) keep accurate records of all animation or visual effects personnel who are Hawaii residents whose wages may qualify for the tax credit; and (5) require any wages attributable to minimum cost thresholds for which the wage reimbursement tax credit does not apply to have Hawaii income tax withheld; provided that the wage and tax information is subject to verification by the department of taxation.

Any credit in excess of a taxpayer's income tax liability shall be refunded to the taxpayer; provided such amounts are over \$1. Requires all claims, including any amended claims, for tax credits to be filed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. Failure to comply with the foregoing provision shall constitute a waiver of the right to claim the credit.

In the case of a partnership, S corporation, estate, or trust, the tax credit allowable is for qualified labor costs incurred by the entity for the taxable year. The cost upon which the tax credit is computed shall be determined at the entity level. The credit allowed under this section shall be claimed against the net income tax liability for the taxable year. For the purposes of this section, "net income tax liability" means net income tax liability reduced by all other credits allowed under this chapter and chapter 209E.

Requires the director of taxation to prepare forms as may be necessary to claim a tax credit, may require the taxpayer to furnish information to ascertain the validity of the claim for credit, and may adopt rules necessary to effectuate the purposes of this section pursuant to HRS chapter 91.

Directs a taxpayer claiming a tax credit to submit, no later than 90 days following the end of each taxable year in which qualified labor costs were expended, a written, sworn statement to the department of business, economic development, and tourism (DBEDT), identifying: (1) all qualified labor costs incurred in the previous taxable year; (2) the amount of tax credits claimed pursuant to this section in the previous taxable year; and (3) the number of resident personnel working in Hawaii by category (i.e., department) and by county. Requires DBEDT to: (1) maintain records of the names of the taxpayers and

qualified animation or visual effects businesses thereof claiming the tax credits; (2) obtain and total the aggregate amounts of all qualified labor costs per qualified animation or visual effects business per taxable year; and (3) provide a letter to the director of taxation specifying the amount of the tax credit per qualified animation or visual effects business for each taxable year that a tax credit is claimed and the cumulative amount of the tax credit for all years claimed. DBEDT shall issue a letter to the taxpayer regarding the qualified animation or visual effects business, specifying the qualified labor costs and the tax credit amount qualified for in each taxable year a tax credit is claimed. Allows DBEDT to establish a fee to process the taxpayer letter. Requires the taxpayer to file the letter with the taxpayer's tax return for the qualified animation or visual effects business to the department of taxation. Allows the director of taxation to audit and adjust the tax credit amount to conform to the information filed by the taxpayer.

DBEDT may establish a fee of \$_____ to cover the costs of administering the tax credit certification program established under this subsection. The proceeds of the fee shall be deposited into the Hawaii film office special fund.

Total tax credits claimed per qualified production shall not exceed \$_____ in any given tax year.

Defines "animation or visual effects" to mean animation and visual effects created primarily with digital technologies for designing, modeling, rendering, lighting, painting, animating, and composing for qualified productions, but does not include: (1) audio effects; (2) in-camera effects; (3) credit rolls; (4) subtitles; (5) animation or visual effects all or substantially all of which are created by editing activities; (6) animation or visual effects for use in promotional material for a production eligible for the motion picture, digital media and film production tax credit; or (7) activities that are of a scientific or experimental nature.

Defines "digital media," "Hawaii resident," "qualified animation or visual effects business" and "qualified labor costs" for purposes of the measure.

This credit shall be repealed on June 30, 2021.

Adds a new part to HRS chapter 209E to define a digital media enterprise subzone as a geographic area located within a _____ mile radius of a University of Hawaii campus, on or off campus, that is within an enterprise zone; or other delineated geographic area designated as a digital media enterprise subzone by the legislature; provided that effective July 1, 2011 to June 30, 2113, the establishment of a subzone shall be limited to an area located within a _____ mile radius, on or off campus, of the University of Hawaii-West Oahu. This part shall be repealed on June 30, 2021.

Makes other nontax amendments to redesignate the Hawaii television and film development board as the Hawaii film office board and the Hawaii television and film development special fund as the Hawaii film office special fund, delineate moneys that shall be deposited into the fund and that the monies in the fund shall be used for operations of the Hawaii film office including personnel costs of staff positions existing on November 1, 2010, limited to employees performing specialized duties and assigned solely to the Hawaii film office operations.

EFFECTIVE DATE: July 1, 2011

STAFF COMMENTS: This measure proposes an income tax credit of _____ % of the wages paid to animation or visual effects personnel who are Hawaii residents, by a qualified animation or visual effects business that is located within a digital media enterprise subzone. As proposed by this measure, a digital media enterprise subzone is an area within an enterprise zone located near a University of Hawaii campus. While this measure proposes an income tax credit that would result in a payout of state funds, it should also be remembered that this would be in addition to any other tax incentives afforded to businesses in an enterprise zone, so it is incredulous that a proposal such as this would be submitted given the financial crisis in state finances.

It should be remembered that in an enterprise zone, businesses are attracted and encouraged to relocate to the zone through tax incentives, bonds, and other appropriate measures. Businesses located in an enterprise zone may claim a credit against taxes paid for a period of seven years and also allows the sale of items sold by such businesses to be exempt from the general excise tax.

Inasmuch as this proposal seems to benefit the University of Hawaii as the subzones would be located within an unspecified mile radius of a University campus, consideration should be given to offsetting the revenues losses with a reduction in general fund appropriations to the University. At least that trade off would insure revenue neutrality for the state general fund.

This, along with proposals from film producers, seems to have caught the eye and excitement of lawmakers. Certainly the promise of the land of milk and honey seems all too good to be true especially amidst the doom and gloom of an \$850 million budget shortfall. However the harsh reality is that on the other end taxpayers are looking at proposals to raise taxes, tax pensions, raise alcohol taxes, slap new taxes on sugary drinks and yet another round of fee and user charge increases. With the loss of millions of dollars in tax breaks and tax credits, how can local taxpayers buy into proposals like these, especially in light of the fact that lawmakers are unwilling to make cuts in other programs? Before lawmakers go off on the deep end entranced by all of these wonderful offers to bring the state to the land of milk and honey, they need to address the fiscal realities on the road before them. On top of this all, lawmakers have yet to address the unfunded liability of the state's retirement and health system.

Digested 2/11/11