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To: The Honorable David Y. Ige, Chair
And Members of the Senate Committee on Ways and Means

Date: Thursday, March 29, 2012
Time: 9:00 a.m.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. 2869 H.D. 2, S.D. 1 Relating to the Economy

The Department of Taxation (Department) defers to the Department of Business Economic Development and Tourism (DBEDT) on the merits of H.B. 2869, H.D. 2, S.D. 1. As written, the Department is unable to support this bill due to our concerns about our ability to implement its provisions, as well as the potential substantial increase in the tax revenue loss.

The S.D. 1 version of H.B. 2869 HD2 SD1 reinstates the motion picture, digital media, and film production tax credit amount to 15% or 20% of the qualified "production costs". The measure adds an unspecified percentage of the qualified production costs paid to legal residents of Hawaii and to Hawaii vendors and suppliers.

A legal resident is demonstrated by: (1) having filed Hawaii income tax return for the previous year, **or** (2) having a valid Hawaii driver's license or other state-issued identification confirming residency. The measure defines Hawaii vendors and Hawaii suppliers as vendors and suppliers that are registered with the State, have a physical location in the State, and employ one or more legal residents of this State. If the intent of these provisions is to provide employment to state residents, the Department believes that stricter language should be adopted. As written, the test for Hawaii residency can be easily met by someone who has just relocated from another state, as there is no residency requirement to obtain either of those forms of identification.

This measure adds a new threshold of $50,000 for a qualified digital media project whereby keeping the threshold of $200,000 for a qualified expenditures. This bill changes the cap per qualified production from $8 million to an unspecified amount.

This measure also adds a new section to Chapter 235 of the Hawaii Revised Statutes, to create a motion picture, digital media, and film production infrastructure tax credit. The credit is a refundable tax credit equal to an unspecified amount of the qualified infrastructure costs, provided that the credit claimed per qualified infrastructure project shall not exceed an unspecified amount, and provided further that the minimum project cost is $10 million and is able to provide proof of reasonable effort to hire Hawaii residents. The measure also requires a prequalification of the project by registering with DBEDT during the development stage, and allows for all or a portion of the infrastructure project to be used for other purposes unrelated to production or post-production activities.

S.D. 1 requires the infrastructure credit claimed by paid through an annual payment equal to 15% of the qualified infrastructure project's taxable income until such time as the tax credit has been repaid. The Department would like to point out that the repayment may not work. The taxpayers may not have any taxable income or may have negative taxable income for an extended period of time. The State may never recover the tax credit if the credit pay back is based on “taxable income” rather the tax credit amount.

This measure also provides for a recapture of the infrastructure credit. However, it is not clear how the recapture provision works. Additional clarifying language is required to address a situation where the credit is transferred or sold to another entity.

S.D. 1 requires the Department of Taxation to make quarterly payments, in an amount equal to 2% of the total aggregate wages and salaries paid to legal residents of this State, as calculated by DBEDT, beginning July 1, 2013. The Department defers to the Department of Budget and Finance regarding this provision; however, the Department is concerned about policy implications of making such payments.

The Department notes that the provision that allows a partnership to claim the tax credit at the entity level, will require modification to the tax forms, instructions and computer system. Due to the lack of resources and staffing, the Department may not be able to implement these changes within the implementation schedule in the bill.

Thank you for the opportunity to provide comments.

From: mailinglist@capitol.hawaii.gov
To: WAM Testimony
Cc: mendezj@hawaii.edu
Subject: Testimony for HB2869 on 3/29/2012 9:00:00 AM
Date: Wednesday, March 28, 2012 1:35:06 PM

Testimony for WAM 3/29/2012 9:00:00 AM HB2869

Conference room: 211
Testifier position: Comments Only
Testifier will be present: No
Submitted by: Javier Mendez-Alvarez
Organization: Individual
E-mail: mendezj@hawaii.edu
Submitted on: 3/28/2012

Comments:
I oppose any tax breaks for the big networks that pay $65 for sometimes 14-hour working days for local extras and ignore the local talent to bring mainland actors for small parts. Hawai'i doesn't need another low-wage industry making big profits while enjoying tax breaks from the state and unfair labor treatment for its residents.

On the other hand, I support tax breaks for local computer imagery small businesses that, like any other small business in Hawai'i, face a hostile, tough environment as star-ups. These businesses will provide high paying jobs and bring money into the state by supplying services to the TV and movie companies that otherwise will get such services from Californian firms. Such businesses will return Hawai'i's tax breaks investments handsomely.

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Increase motion picture, digital media and film production credit; infrastructure tax credit

BILL NUMBER: HB 2869, SD-1

INTRODUCED BY: Senate Committee on Economic Development and Technology

BRIEF SUMMARY: **Motion picture, digital media, and file production income tax credit.** Amends HRS section 235-17 to provide that an additional credit of ___% of the qualified production costs paid to residents of the state and to Hawaii vendors and Hawaii suppliers may be claimed by the eligible taxpayer. The credit may be recovered directly by the entity that incurred the qualified expenditures. The credit allowed under this section shall be claimed after all other tax credits available to the taxpayer have been claimed.

Allows a taxpayer eligible to claim a tax credit under this section to assign all or a portion of a tax credit under this section to any assignee who may subsequently assign a tax credit or any portion of a tax credit assigned under this subsection to one or more assignees. A taxpayer may claim a portion of a tax credit and assign the remaining tax credit amounts. A tax credit assignment under this subsection shall be irrevocable. Requires a taxpayer claiming a tax credit under this section to submit a copy of the completed assignment form to the department in the tax year in which the assignment is made and shall attach a copy of the form to the tax return on which the tax credit is claimed.

In order to qualify for the tax credit: (1) a qualified production shall have qualified expenditures totaling at least $200,000 for a qualified production, or $50,000 for a qualified digital media project or qualified independent and emerging media project; (2) provide marketing materials promoting the state as a tourist destination or film and digital media production destination, when appropriate, at no cost to the state, which shall include placement of a "Filmed in Hawaii" or "Produced in Hawaii" logo in the end credits; and (3) provide evidence of efforts to hire local talent and crew; provided that: (A) for a digital media project or an independent and emerging media project, at least 50% of the positions that make up the production cast and below-the-line production crew are filled by residents of this state or students enrolled full-time in a film-and-entertainment-related course of study at an institution of higher education in the state; or (B) for a production beginning January 1, 2016 the percentage of positions in the production cast and below-the-line production crew to be filled by residents of this state shall be set at levels certified by the state as reflecting an appropriate workforce requirement, based on the prior three years' level of aggregate wages and salaries paid for positions created by productions and projects that received tax credits under this section.

Permits the department of business, economic development, and tourism (DBEDT) to establish a fee of $_____ to process the taxpayer letter and provide that the fee revenues shall be deposited into the Hawaii film and digital media special fund.

Increases the total tax credits that may be claimed per qualified production from $8 million to $___ million.

Delineate provisions allowing the director of taxation to revoke or modify any written decision qualifying, certifying, or otherwise granting eligibility for tax credits under this section if it is discovered that the taxpayer submitted any false statement, representation, or certification in any application, record, report, plan, or other document filed in an attempt to receive tax credits under this section.

Requires DBEDT, by December 31 of each year, to submit a report to the governor and the legislature that outlines the return on investment and economic benefits of the tax credits to the state, for the previous calendar year. The report shall also include an estimate of the full-time equivalent positions for residents of this state and aggregate wages and salaries paid for positions created by each production or project that received tax credits under this section and information relating to the distribution of productions receiving credits, by county and by type of production.

Defines “legal resident,” “qualified digital media project,” “qualified independent and emerging media project” for purposes of the measure.

This section shall be applicable to qualified production costs incurred on or after July 1, 2012 and before July 1, 2027.

Motion picture, digital media, and film production infrastructure income tax credit. Adds a new section to HRS chapter 235 to allow taxpayers to claim an income tax credit of ___% of the “qualified infrastructure costs” incurred by a qualified taxpayer in the state; provided that the tax credit claimed per project shall not exceed $______. To qualify for this tax credit, a qualified infrastructure project shall: (1) meet the definition of a qualified infrastructure project; (2) have qualified infrastructure costs totaling at least $10 million; and (3) provide evidence that for the first two years of the infrastructure project credit, at least 60%, and thereafter, at least 70% of the positions are filled by legal residents of this state or students enrolled in a construction or related course of study at an educational institution in the state.

Delineate provisions requiring the taxpayer to prequalify for the credit by registering with DBEDT. Permits DBEDT to establish a fee of $_____ to process the taxpayer letter and provide that the fee revenues shall be deposited into the Hawaii film and digital media special fund.

Defines “qualified infrastructure costs” as total costs incurred by a qualified infrastructure project including the costs of purchasing or leasing real property which are subject to HRS chapters 237 or 235 that have not been financed by any investments for which a credit was or will be claimed pursuant to HRS section 235-110.9. Defines “qualified infrastructure project” as a construction project in the state, for the development, construction, or renovation of a film, video, television, or media production or post-production facility and the immovable property and related equipment or any other facility that supports and is a necessary component of such infrastructure project.

The tax credit claimed under this section shall be repaid through an annual payment from the taxpayer equal to 15% percent of the qualified infrastructure project’s taxable income until such time as the tax credit has been repaid; provided that if the ownership of a qualified infrastructure project is transferred, the transferee shall be obligated to the terms of the recapture.

If the infrastructure project ceases to be a qualified infrastructure project, the credit claimed under this section shall be recaptured with the amount of the recaptured tax credit added to the taxpayer's tax liability for the taxable year in which the recapture occurs.

Credits in excess of a taxpayer's income tax liability shall be refunded provided such amount is over $1. Requires all claims for a tax credit, including amended claims, to be filed on or before the end of the twelfth month following the close of the taxable year for which the tax credit may be claimed. Failure to comply with the foregoing provision shall constitute a waiver of the right to claim the tax credit. Directs the director of taxation to prepare the necessary forms to claim a credit, may require the taxpayer to furnish information to validate a claim for the credit, and adopt rules pursuant to HRS chapter 91. In the case of a partnership, S corporation, estate, or trust, the tax credit allowable is for qualified infrastructure 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. Distribution and share of the credit shall be determined by rule.

Requires DBEDT to submit an annual report by December 31 for the previous fiscal year to the governor and the legislature that outlines the return on investment and economic benefits of the tax credits to the state, including an estimate of the full-time equivalent positions for legal residents of this state and aggregate wages and salaries paid for positions created by each qualified infrastructure project that received tax credits under this section along with information relating to the distribution of qualified infrastructure projects receiving credits, by county and by type of project.

The tax credit for qualified infrastructure costs shall be applicable to tax years beginning after June 30, 2012 and before January 1, 2027.

Amends Act 88, SLH 2006, to provide that the motion picture, digital media and film production income tax credit shall be applicable to qualified expenditures incurred on or after July 1, 2006.

Appropriates $__________ in general funds for fiscal year 2013 to DBEDT for additional resources and staffing support to assist state agencies in collecting and reporting annually on estimates of the full-time equivalent positions for Hawaii residents by each production receiving tax credits, aggregate wages and salaries paid to Hawaii residents in prior years, as well as distribution of productions receiving credits, by county and type of production.

Appropriates $__________ in general funds for fiscal 2013 to the department of accounting and general services for additional resources and staffing support for the office of information management and technology to assist state agencies in collecting and reporting annually on estimates of the full-time equivalent positions for Hawaii residents by each production receiving tax credits, aggregate wages and salaries paid to Hawaii residents in prior years, as well as distribution of productions receiving credits, by county and type of production.

Establishes a Hawaii film and digital media special fund into which shall be deposited: (1) legislative appropriations; (2) donations and contributions made by private individuals or organizations; (3) grants provided by governmental agencies; (4) fees collected pursuant to HRS section 235-17; and (5) quarterly payments equal to 2% of the total aggregate wages and salaries paid to legal residents of this state beginning on July 1, 2013.

Repeals HRS chapter 201, part IX, which establishes the Hawaii television and film development board and special fund.

Repeals this act on January 1, 2027 and provides that HRS section 235-17 shall be reenacted in the form in which it read on the day before the effective date of Act 88, SLH 2006.

EFFECTIVE DATE: July 1, 2012

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 exclusion of income received from royalties was initially established by Act 178, SLH 1999, as an incentive to attract high technology businesses to Hawaii. The original proposal would have applied to royalties and other income received from high technology businesses. This section of the law was later amended in 2000 by Act 297 which added the inclusion of royalties from "performing arts products" and again amended by Act 221, SLH 2001, to include authors of "performing arts products."

The legislature by Act 88, SLH 2006, increased the 4% credit to 15% in a county with a population over 700,000 and to 20% in a county with a population of 700,000 or less. Act 88 also repealed the income tax credit for transient accommodations and expanded the credit to include commercials and digital media productions, and limited the credit to $8 million per qualified production.

This measure proposes an additional tax credit of a percentage of the qualified production costs paid to residents of the state, Hawaii vendors and Hawaii suppliers. The measure also increases the limit of tax credits that may be claimed per qualified production from $8 million to $___ million and establishes a motion picture, digital media, and film production infrastructure tax credit. These credits have been morphing and expanding into full-blown tax credits since they "got their foot in the door" in 1997. It should be remembered that the perpetuation and expansion of motion picture credits are a drain on the state treasury. It is incredulous how lawmakers can bemoan the fact that there are insufficient resources to catch up on the backlog of school repairs and maintenance, to fund social programs and not being able to provide tax relief to residents and yet they are willing to throw additional public resources at a subsidy of film production and media infrastructure as proposed in this measure. Taxpayers should be insulted that lawmakers can provide breaks for film productions but refuse to provide tax relief for residents, many of whom work two or three jobs just to keep a roof over their head and food on the table.

Income tax credits are designed to reduce the tax burden by providing relief for 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. Sponsors try to make an argument that Hawaii needs to enact such incentives to compete for this type of business, one has to ask "at what price?" Promoters of the film industry obviously don't give much credit to Hawaii's natural beauty and more recently its relative security. Just ask the actors of "Lost" or "Hawaii 5-0" who have bought homes here if they would like to work elsewhere. While film producers may moan that they will lose money without the proposed tax credits, is there any offer to share the wealth when a film makes millions of dollars? 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. While lawmakers look like a ship of fools, movie producers and promoters are laughing all the way to the bank and the real losers in this scenario are the poor taxpayers who continue to struggle to make ends meet, a scenario akin to the bread and circus of ancient Rome.

So while there may be the promise of a new industry and increased career opportunities, lawmakers must return to the cold hard reality of solving the problems at hand. The long and short of it is that due in large part to the irresponsibility of handling state finances in the past, taxpayers cannot afford proposals like this. Thanks to the gushing generosity of those lawmakers who gave the state's bank away in all sorts of tax incentive schemes in recent years, taxpayers have had to bear increasing tax burdens.

Robert Tannenwald, a senior fellow at the Center for Budget and Policy Priorities, drew the following conclusions in a report entitled "State Film Subsidies Offer 'Little Bang for the Buck'," published in State Tax Notes Magazine, December 13, 2010:

> "State film subsidies are a wasteful, ineffective, and unfair instrument of economic development. While they appear to be a 'quick fix' that provides jobs and businesses to state residents with only a short lag, in reality they benefit mostly nonresidents, especially well-paid nonresident film and TV professionals. Some residents benefit from these subsidies, but most end up paying for them in the form of fewer services - such as education, healthcare and police and fire protection - or higher taxes elsewhere. The benefits to the few are highly visible; the costs to the majority are hidden because they are spread so widely and detached from the subsidies.
>
> State governments cannot afford to fritter away scarce public funds on film subsidies, or, for that matter, any other wasteful tax break. Instead, policymakers should broaden the base of their taxes to create a fairer and more neutral tax system. Economic development funds should be targeted on programs that are much more likely to be effective in the long run, such as support of education and training, enhancement of public safety, and maintenance and improvement of public infrastructure. Effective public support of economic development may not be glamorous, but at its best, it creates lasting benefits for residents from all walks of life."

There is absolutely no rational basis for expanding and continuing these tax credits other than that other states are offering similar tax credits. Then again, those states can't offer paradise, year-round good weather during which to film. Instead of utilizing back door subsidies through tax credits, film industry advocates need to promote the beauty that is synonymous with Hawaii. Instead of creating sustainable economic development incentives, the film tax credits waste moneys that could otherwise create an environment that is nurturing for all business activity, activity that lasts more than the six or eight months of a production. The overall tax burden could be lowered not only for families but for the businesses that provide long-term employment for Hawaii's people.

Digested 3/28/12