SB 1550

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, Expand motion picture, digital media and film production credit

BILL NUMBER: SB 1550, SD-1

INTRODUCED BY: Senate Committees on Economic Development and Technology and Tourism

BRIEF SUMMARY: Amends HRS section 235-17 to increase the motion picture, digital media, and film production tax credit from 15% to ___% for the costs incurred in a county with a population over 700,000 for qualified production costs incurred by a qualified production company and from ___% to 40% for costs incurred in a county with a population of 700,000 or less.

Allow taxpayers to claim a credit of ___% of the qualified special or visual effect and animation production costs incurred by a qualified production in the state, in addition to the motion picture income tax credit.

Allows taxpayers, between July1, 2011 and December 31, 2015, to claim a credit of ___% of the qualified costs incurred for qualified media infrastructure projects in any county with a population over 700,000; or ___% of the qualified costs incurred for qualified media infrastructure projects in any county with a population of 700,000 or less. To qualify for the credit: (1) the base investment for a qualified media infrastructure project shall be in excess of $________; (2) the qualified media infrastructure project tax credit shall be non-refundable with any tax credit that exceeds the tax liability of the taxpayer for the tax year carried forward to offset net income tax liability in subsequent tax years for up to 10 years or until exhausted, whichever occurs first. The director of taxation may require the tax credits to be taken or assigned in the tax period in which the credit is earned or may structure the tax credit in the initial certification of the project to provide that only a portion of the tax credit be taken over the course of two or more years; (3) the total qualified media infrastructure project tax credit allowed for any state-certified infrastructure project shall not exceed $___________; (4) if any portion of an infrastructure project is a facility that may be used for other purposes unrelated to production or post production activities, then the project shall be approved only if a determination is made that the multiple use facility will support and will be necessary to secure production or post production activity for the production and post production facility; provided that no tax credits shall be earned on such multiple use facilities until the production or post production facility is complete; (5) tax credits for infrastructure projects shall be earned only if: (a) construction of the infrastructure project begins within six months of the initial certification and shall be completed within a five-year time frame; (b) expenditures shall be certified by the director of taxation and credits shall not be earned until that certification; (c) the tax credits shall be deemed earned at the time the expenditures are made, provided that all requirements of this subsection have been met and the tax credits have been certified; (6) for state-certified infrastructure projects, the application for a qualified media infrastructure project tax credit shall include: (a) a detailed description of the infrastructure project; (b) a preliminary budget; (c) a complete detailed business plan and market analysis; (d) estimated start and completion dates; and (e) if the application is incomplete, additional information may be requested prior to further action by the director of taxation; (7) an application fee shall be submitted with the application for a qualified media infrastructure project tax credit; (8) prior to any final certification of a tax credit for a state-certified infrastructure project, the applicant for the infrastructure project tax credit shall submit to the director of taxation an audit of the expenditures audited and certified by an independent certified public accountant as determined by rule. Upon approval of the audit, the director of taxation shall issue a final tax credit certification letter indicating the amount of tax credits certified for the state-certified infrastructure project to the investors. Bank loan finance fees applicable to the qualified media infrastructure project expenditures, as certified by the director of taxation, and any general excise taxes that have been paid on the bank loan finance fees and remitted to the state may be included as part of the tax credit.

There shall be a qualified local crew training program rebate equal to ___% of the hourly wages of each resident participant in a qualified local crew training program up to the first ______ physically worked by the qualifying crew member in a specialized craft position.

Deletes the $______ million limit of the total production tax credits that may be claimed under this section per qualified production and provides that the qualified media infrastructure project income tax credits shall be capped at $__________ in the aggregate.

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. A tax credit assignment under this section shall be irrevocable and shall be made on a form prescribed by the director of taxation. A taxpayer claiming a tax credit under this section shall send a copy of the completed assignment form to the department of taxation 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.

Adds definitions of "base investment," "director," "qualified local crew training programs," "qualified media infrastructure project"and "qualified special or visual effects and animation production" for purposes of the measure.

Amends the definition of "qualified production costs" to include: (1) rentals of any transient accommodations for cast and crew; (2) costs for equipment or items not readily obtainable in the state which are passed through a qualified resident vendor and upon which a mark-up and general excise tax are paid; (3) bank loan finance fees applicable to the qualified production expenditures as finally certified by the director of taxation to the extent that a general excise tax is paid and remitted to the state. For the purposes of this section, banks providing loans to qualified productions shall be considered service vendors that are providing services to a production company where the motion picture film product consists in part of the value of services provided and shall be subject to the one-half of one per cent tax rate under HRS section 237-18(c); and (4) other direct production costs specified by the department in consultation with the department of business, economic development, and tourism.

EFFECTIVE DATE: July 1, 2050; Tax years beginning after December 31, 2010

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.

These credits have been morphing and expanding into full-blown tax credits since they "got their foot in the door" in 1997. This measure proposes to increase the motion picture, digital media, and film production tax credit from 15% to 35% in a county with a population of 700,000 or over and from 20% to 40% in a county with a population of under 700,000. While the initial 4% credit for production costs and 7.25% for transient accommodations may have been justified as alleviating this additional cost for film producers because such imposts may not be levied in other jurisdictions, increasing the amount of the credit to 35% or 40% amounts to nothing more than a generous subsidy of these productions by the state. That being the case, then an appropriation of state funds would be more accountable and transparent than a wide-open, back door tax credit.

The proposed measure also expands the existing motion picture, digital media and film production income tax credits to special or visual effects and animation, and media infrastructure projects. As proposed in this measure there are new tax credits for: (1) ___% of the qualified special or visual effects and animation production costs; (2) qualified media infrastructure projects which may include rentals of any transient accommodations for cast and crew, certain equipment costs, bank loan finance fees attributable to a qualified production, other direct production costs. This measure would also eliminate the $8 million cap of the tax credits which may be claimed by a qualified production.

It should be remembered that the perpetuation and expansion of the 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.

There is absolutely no rational basis for this proposal that the credit be increased and expanded to include media infrastructure projects, 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.

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. While the sponsors try to make an argument that Hawaii needs to enact such an incentive 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.

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.

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 cannot afford what looks like a promising opportunity.

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.
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> 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 e 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."

Digested 2/23/11

Wai'anae Business Center
Pacific Growth Associates

February 22, 2011

Honorable David Y. Ige, Chair
WAYS and MEANS COMMITTEE
Hawaii State Capitol
415 South Beretania Street, Room 215
Honolulu, HI 96813

Honorable Michelle Kidani, Vice Chair
WAYS and MEANS COMMITTEE
Hawaii State Capitol
415 South Beretania Street, Room 228
Honolulu, HI 96813

RE: SB1550 SD1 – RELATING TO TAX CREDITS. Motion Picture, Digital Media, and Film Production Tax Credits.

Dear Chair Ige and Vice Chair Kidani,

Over the past eighteen (18) months, community leaders have been meeting regularly as a planning committee and with the Leeward Coast community to implement a model business incubator that combines education and business in the digital media and interactive entertainment industry. The Waianae Coast Coalition and the City & County of Honolulu Leeward Coast Community Benefits Program have supported our efforts by providing technical support and funding.

The business incubator for emerging digital media businesses will feature classrooms equipped with smart technology and production facilitates that will also serve as a home to primary, secondary, and higher educational institutions. The design will accommodate 15 to 20 start-up companies, while providing them with networking opportunities to expand their company.

The primary target population of the business incubator will be low- to moderate-income Leeward Coast residents, by allowing residents the opportunity to enter into the media and technology fields through the development of a start-up company in the digital media and interactive entertainment industry, being employed by a company in such an industry, or through educational opportunities provided on-site in the fields of media and technology.

The incubator will be a significant strategy towards poverty alleviation. Each incubator tenant will be provided with competitive lease rates and services ranging from basic business consulting to marketing and advertising, human resources, accounting, web and promotional design and access to capital. Additional services are developed as the needs of the tenant business are identified. The primary point to be made is that the incubating business and students have support on site and are assisted as needed.

The space will provide a much-needed location to situate emerging entrepreneurial companies to start and grow. Trainings, seminars, conferences, symposiums, job fairs, trade shows, and networking events will be planned and implemented on an on-going basis. The incubator will be a vibrant and cutting edge working space of world-class companies, professionals, and students that are afforded opportunities to learn, collaborate, and partner in creative and financial ways to grow, flourish, and compete globally.

The planning committee kindly submits the following amendments to SB1550 SD1, as we firmly believe the intent of the legislation is not to exclude any community efforts, but to include our community, businesses, and residents who have been working diligently towards securing a future for our children in this industry:

- Page 4, line 5 and 6 to read: (a) beginning on July 1, 2011, and ending on December 31, 2016, the following credits shall apply:

- Page 6, line 9 through 12 to read: (A) Construction of the infrastructure project can begin anytime between July 1, 2011 and December 31, 2016 once certified and shall be one hundred per cent completed within a five year time frame from the start of the infrastructure project;

- Page 8 and 9, line 18 through 2 to read: There shall be a qualified local crew training program rebate that shall be equal to ____ per cent of the hourly wages of each resident participant in a qualified local crew training program that works in conjunction with an existing non-profit organization that currently provide industry training and technical assistance, and if incurred by a qualified production in any county of the State, shall be reimbursed up to the first physically worked by the qualifying crew member in a specialized craft position.

- Page 11, line 5 and 6 to read: (4) Provide evidence of reasonable efforts to hire local talent and crew including and not limited to non-profit organizations that currently provide industry training and technical assistance; and

- Page 11, line 7 through 12 to read: Provide evidence of financial or in-kind contributions of educational or workforce development efforts, in partnership with related local industry labor organizations, educational institutions, non-profit organizations that currently provide industry training and technical assistance, or any combination of, toward the furtherance of the local film and television and digital media industries.

We look forward to working with you on all legislation pertaining to the motion picture, digital media, and film production industry to demonstrate our commitment to providing opportunities for residents and our children of Hawaii in this industry. Please feel free to contact us anytime at (808) 696-1217.

Sincerely,

Tamar R. P. deFries S.

Tamar deFries
Project Director

cc: Honorable Calvin Say, Speaker of the Hawaii State House of Representatives
Honorable Marcus Oshiro, Finance Chair
Honorable Marilyn B. Lee, Finance Vice Chair
Honorable Angus McKelvey, Economic Revitalization & Business Chair
Honorable Isaac Choy, Economic Revitalization & Business Vice Chair
Honorable Carol Fukunaga, Economic Development & Technology Chair
Honorable Glenn Wakai, Economic Development & Technology Vice Chair
Honorable Donna Mercado Kim, Tourism Chair
Honorable Ronald D. Kouchi, Tourism Vice Chair
Mr. Richard Lim, DBEDT Director

Testimony of Clyde T. Hayashi
Director
Hawaii LECET
1617 Palama Street
Honolulu, HI 96817

SENATE COMMITTEE ON WAYS AND MEANS
Thursday, February 24, 2011
9:00 a.m., Conference Room 211

SB1550 SD1 - RELATING TO TAX CREDITS

Aloha Chair Ige, Vice-Chair Kidani, and Members of the Committee:

My name is Clyde Hayashi and I am the director of Hawaii LECET (Laborers-Employers Cooperation and Education Trust). Hawaii LECET is a partnership between the Hawaii Laborers' Union, Local 368 and our union contractors.

I am submitting this testimony in **strong support** of the intent and purpose of SB 1550 SD1.

SB 1550 SD1 will provide the needed incentives that will allow for an expansion and development of our important film industry, an industry with tremendous potential.

SB 1550 SD1 will allow for expansion of the film industry to a point that it will have the infrastructure and facilities which will provide a much more attractive package to producers and film companies. This package added to the lure of our beautiful state will attract many more to film here.

As the film industry is built & expanded, construction opportunities and jobs will be created. This comes at a time when our industry is struggling. Our benches are filled with unemployed construction workers and our contractors are struggling to survive the awful construction downturn. We also expect a stable and growing film industry to continue to provide construction opportunities and jobs over the coming years.

SB 1550 SD1 will to help establish training programs so that Hawaii can provide the film industry with the trained, skilled workforce that it needs.

SB 1550 SD1 will help to provide a needed boost to our economy and create a stable film industry to which will benefit Hawaii over the coming years.

Thank you for the opportunity to submit this testimony.

Perry O. Artates
782 Lau'ie Drive
Waiohuli, Kula, Hawaii 96790

Wednesday, February 23, 2011

Amended Notice of Decision
Thursday, February 24, 2011
9:00 am
Conference Room 211, State Capitol, 415 South Beretania Street

Committee on Ways and Means

Senator David Y. Ige – Chair
Senator Michelle Kidani – Vice Chair
Senator Suzanne Chun Oakland
Senator Donovan M. Dela Cruz
Senator J. Kalani English
Senator Carol Fukunaga
Senator Gilbert Kahele
Senator Donna Mercado Kim
Senator Ronald D. Kouchi
Senator Pohai Ryan
Senator Jill N. Tokuda
Senator Glen Wakai
Senator Sam Slom

SB 1550
Support

Aloha Chair Ige, Vice Chair Kidani & Committee Members,
For the record, my name is Perry Artates, a member of 27 years of the Hawaii Operating Engineers Local Union #3. I testify today in support of Senate Bill 1550. We have over 65% of our membership through-out the State of Hawaii whom are unemployed and approximate 18% whom ran out of unemployment benefits. The Operating Engineers Local Union #3 are the first to break ground, so that other Construction Union Trades are able to put their membership back to work whom are going to wait a lot longer. In these horrific economical times, we embrace investors such as Relativity Media whom commits to use Union Labor whether it's in the Construction Industry or Filming Industry. The Economic multiplying factor will also benefit big, small, and even mom & pop stores in Hawaii. The social livelihood of our membership has grown enormously from domestic violence, divorces, substance abuse, fore-closers and even suicide. I've witnessed these crisis day in and day out at our Union Administration, yet all we can do is tell our membership we are sorry, we will try to help turn this economy around. Supporting this bill will give hope to the greater good of Hawaii, for it will create jobs, jobs, and jobs for our Union Families. Mahalo for allowing me to testify and speak in behalf of the unemployed in our construction industry. Let us put money back into the pockets of our working people.

I am,

Perry O. Artates