NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

LATE

FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

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

Date: Thursday, February 21, 2013
Time: 9:00 a.m.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. 463, S.D. 1, Relating to Digital Media Industry Development

The Department of Taxation (Department) appreciates the intent of S.B. 463, S.D. 1. However, as written, the Department is concerned that it will not be able to implement the provisions of the S.D. 1 due to the anticipated difficulty in administering this bill, as well as the potential for a substantial increase in revenue loss resulting from the increase in the credit amounts and the additional media infrastructure project tax credit.

Motion Picture, Digital Media, and Film Production Income Tax Credit

Part II of S.B. 463, S.D. 1, increases in the motion picture, digital media, and film production tax credit amount from 15% to 20% of the qualified production costs incurred in a county with a population over 700,000, and from 20% to 25% of the qualified production costs incurred in a county with a population of 700,000 or less, repeals the credit ceiling of $8 million per qualified production, and extends the sunset date of Act 88, Session Laws of Hawaii 2006, from January 1, 2016 to January 1, 2023. It is applicable to taxable years beginning January 1, 2013.

The Department defers to the Department of Business Economic (DBEDT) on the merits of amendments made in Part II of S.B. 463, S.D. 1., but notes that due to the provision that allows a partnership to claim the tax credit at the entity level, modification to the tax form and computer system is required. The Department will need additional time and resources to implement the bill.

The Department also notes that the amendments in Part II could result in an estimated revenue loss of $11.8 million for fiscal year (FY) 2014; $25.6 million for FY 2015; $37.8 million for FY 2016; and $50.0 million per year for FY 2017 to FY 2023.

Media Infrastructure Project Tax Credit

Part III of S.B. 463, S.D. 1, adds a new section to Chapter 235, Hawaii Revised Statutes, to create a media infrastructure project tax credit. The credit is a nonrefundable tax credit equal to 25% of the qualified infrastructure costs, beginning July 1, 2013 and ending December 31, 2015.

The Department is concerned about the broad range of costs (the development, construction, renovation, or operation of a film, video, television, or media production or postproduction facility, or any other facility that supports the project, including a movie theater or other commercial exhibition facility) that would qualify for the tax credit. Such broad wording will create administration and enforcement difficulties for the Department.

The measure requires the Department approve an audit of the infrastructure tax credit and certify the expenditures for the project, including: a detailed description of the project, a preliminary budget, a complete detailed business plan and market analysis, an estimated start and completion dates, and a letter from the mayor and council of the county. Thereafter the Department is required to issue a final tax credit certification letter indicating the amount of tax credits certified for the infrastructure project to the investors. The Department is unable to comply with these requirements as Department staff does not have the technical background on. Currently, the DBEDT certifies all creative media type expenditures; the Department notes that they may be better suited to continue doing these certifications.

The amendments in Part III could result in estimated revenue loss of $14.4 million for FY 2014, $28.8 million for FY 2015, and $14.4 million for FY 2016.

Thank you for the opportunity to provide comments.

LATE

SUBJECT: INCOME, Extend and increase motion picture, digital media and film production credit; media infrastructure project tax credit

BILL NUMBER: SB 463, SD-1

INTRODUCED BY: Senate Committees on Economic Development, Government Operations & Housing & Technology & the Arts

BRIEF SUMMARY: Amends HRS section 235-17 to increase the motion picture, digital media, and film production tax credit from 15% to 20% 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 20% to 25% for costs incurred in a county with a population of 700,000 or less.

Repeals the provision limiting the total tax credits that may be claimed per qualified production to $8 million.

Amends Act 88, SLH 2006, to extend the motion picture, digital media and film production credit from December 31, 2015 to December 1, 2022.

Adds a new section to HRS chapter 235 to allow taxpayers, between July1, 2013 and December 31, 2015, to claim a credit of 25% of the qualified costs incurred for qualified media infrastructure projects situated in West Oahu or on the most populous island in a county with a population between 100,000 and 175,000.

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 so any tax credit that exceeds the tax liability of the taxpayer may be carried forward to offset net income tax liability in subsequent tax years for up to ten 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 ___ year time frame; (b) expenditures shall be certified by the director of taxation and credits shall not be earned until certification is received; (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 of ___% times the estimated total incentive tax credits 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 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.

Further requires the taxpayer claiming the credit to file a progress report of a qualified media project with DBEDT, deliver a performance bond in a form prescribed by DBEDT in an amount equal to 100% of total projected expenditures determined upon initial certification; and either: (1) pledge of a lien on the qualified media infrastructure project in favor of the state; or (2) collateral security.

Also requires any taxpayer eligible to claim a qualified media infrastructure project tax credit to file with DBEDT an annual report by March 1 following each taxable year for which the credit is claimed delineating: (1) the amount of general excise tax paid; (2) the amount of transient accommodations tax paid; (3) the amount of tax credits claimed under this section; (4) gross proceeds of each project; (5) number of full-time employees, part-time employees employed on each qualified media infrastructure project; (6) number of independent contractors contracted to work on each qualified media infrastructure project; (7) amount disbursed as payroll on each qualified media infrastructure project; and (8) list of job classifications with average wage level.

Defines “qualified media infrastructure project” as the development, construction, renovation, or operation of a film, video, television, or media production or post-production facility and the immovable property and equipment related thereto, or any other facility that supports and is a necessary component of the proposed infrastructure project, that is located in the state. The facility may include a movie theater or other commercial exhibition facility to assist in offsetting operating costs of the production or post-production facility, but shall not include a facility used to produce pornographic matter or a pornographic performance.

A taxpayer may claim the media infrastructure project tax credit for investments made on a qualified media infrastructure project prior to January 1, 2016 if construction of the media infrastructure project commenced prior to January 1, 2016. Delineates recapture provisions if the qualified media infrastructure project no longer qualifies for the tax credit and the recapture shall be equal to 90% of the amount of the tax credit claimed in the preceding five years.

EFFECTIVE DATE: Tax years beginning after December 31, 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 to increase the credit from15% to 20% in a county with a population over 700,000 and from 20% to 25% in a county with a population of 700,000 or less. The measure also repeals the $8 million limit of tax credits that may be claimed per qualified production and extends the motion picture, digital media and film production credits from December 31, 2015 to December 31, 2022. The proposed measure would allow taxpayers to claim a media infrastructure project tax credit in West Oahu or on the island of Maui.

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.

There is absolutely no rational basis for increasing 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, spam musubi, and plate lunches with two scoops rice. 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. 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.

Instead of creating sustainable economic development incentives, the film tax credits waste money 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.

Instead of handing out a tax credit to build the film infrastructure, be it a studio or a sound stage, lawmakers should appropriate a specific sum of money and put a request for proposals to build such a project and see which bidder would come forward with the best proposal and offer to match the state's share. This way, each bidder could be evaluated as to what they have to offer and what benefit the state would get. Inasmuch as the state would probably be able to offer the land for such a facility, it could also offer a streamlined permitting process which would also be an in-kind contribution. Based on the responses to the request, a careful review done by experts in the field could be made and the best proposal selected. The persons responsible for making the final selection would then be held accountable for their selection and provide the justification for the selection. Another alternative would be the use of special purpose revenue bonds. These alternatives would be far more efficient and transparent than by the tax credit proposed by this measure. Lawmakers need to exert a little creativity if indeed they believe that such infrastructure is necessary to the development of this industry in the islands. Consideration should be given to the many assets the state brings to the table including land availability, streamlined permitting, tax free interest debt financing and the like. Instead of just handing out a tax credit, lawmakers need to take a more active role in the development of this infrastructure and should be held accountable for the success or failure of such an initiative.

Digested 2/20/13

LATE

ALAN M. ARAKAWA
MAYOR

200 South High Street
Wailuku, Hawai'i 96793-2155
Telephone (808) 270-7855
Fax (808) 270-7870
e-mail: mayors.office@mauicounty.gov

OFFICE OF THE MAYOR
Ke'ena O Ka Meia
COUNTY OF MAUI – Kalana O Maui

TESTIMONY OF ALAN ARAKAWA, MAYOR
COUNTY OF MAUI

BEFORE THE SENATE
COMMITTEE ON WAYS & MEANS

Thursday, February 21, 2013, 9:00 a.m., Conference Rm. 211

SENATE BILL 750
RELATING TO DIGITAL MEDIA INFRASTRUCTURE

SB 463
RELATING TO FILM AND DIGITAL MEDIA INDUSTRY DEVELOPMENT

The Honorable Senator David Y. Ige, Chair
Honorable Senator Michelle N. Kidani, Vice Chair
And Members of the Committee on Ways and Means

SUBJECT: **TESTIMONY OF MAUI COUNTY MAYOR ALAN ARAKAWA ON SB750 AND SB463 RELATING TO MOTION PICTURE, DIGITAL MEDIA, AND FILM PRODUCTION**

Thank you for this opportunity to offer our testimony in **support on SB750 and SB463** relating to Motion Picture, Digital Media and Film Production tax credits. We believe that it is vital that the existing film and digital media production on Oahu be expanded and modernized; and, that the counties of Maui, Kauai, and Hawaii are able to create a new industry for its residents.

As Mayor of the County of Maui, I **strongly support** **SB750 and SB463** for the following reasons:

A. The creation and development of a new industry relating to motion picture, digital media, and film production, will:

- Create new, higher-paying jobs, as well as training, advancement and new educational opportunities for our residents.
- Provide incentives for the construction of **new** infrastructure including new sound stages; and, lead to the renovation and modernization of existing infrastructure on Oahu.

- Benefit the entire State of Hawaii by diversifying and stimulating our economy. Research has shown that each sound stage built in the state would inject nearly $140 million into our economy via the hiring of local labor and the purchasing of materials locally over a two-year period; and that each movie filmed here would create approximately 193 local jobs immediately (based on a movie with a $90 million budget).

Thank you for your consideration of our testimony supporting SB750 and SB463.