DAVID Y. IGE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

DAMIEN A. ELEFANTE
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 Jill N. Tokuda, Chair
and Members of the Senate Committee on Ways and Means

Date: Monday, February 27, 2017
Time: 9:30 A.M.
Place: Conference Room 211, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: S.B. 1086, S.D. 1, Relating to the Motion Picture, Digital Media, and Film Production Income Tax Credit

The Department of Taxation (Department) defers to the Department of Business Economic Development and Tourism (DBEDT) on the merits of S.B. 1086, S.D. 1, and provides the following comments for your consideration.

S.B. 1086, S.D. 1, extends the sunset date of the motion picture, digital media, and film production income tax credit (film credit) from January 1, 2019 to January 1, 2024; limits the film credit to production costs incurred and expended within the state; adds requirements to qualify for the film credit; requires a financial audit of each film production; and requires an annual report to the Legislature. The measure is effective on July 1, 2017.

First, the Department suggests clarifying the term “expended within the State” in Section 2 of S.B. 1086, S.D. 1, which amends sections 235-17(a)(1) and (2), Hawaii Revised Statutes (HRS). If this provision is intended to only allow purchases from local vendors, it may violate the Commerce Clause of the United States Constitution. The Department defers to the Department of the Attorney General on this issue.

Second, the Department notes that the amendment to subsection (f) of section 235-17, HRS, on page 7, starting with line 14 is not necessary because these requirements already exist in subsections (h) and (i) of section 235-17, HRS. Section 235-17 (h), HRS, requires all taxpayers claiming the film credit, no later than 90 days following the end of each taxable year in which the qualified production costs were expended, to submit statement to DBEDT identifying all qualified production costs; section 235-17 (i), HRS, requires DBEDT to certify the amount of qualified production costs, and requires all taxpayers claiming the film credit to attach the certificate from DBEDT to the taxpayers' tax return to claim the film credit.

To ensure compliance with section 235-17 (h), HRS, the Department suggests amending section 235-17 (h), HRS, to include the following statement, "Failure to comply with this provision may constitute a waiver of the right to claim the credit."

Third, the Department defers to the Film Office within DBEDT on the administration of the additional requirements to qualify for the film credit set forth in section 235-17(d) (6), (7), (8), (9), and (10), HRS.

Fourth, Section 7 of the measure requires the Department to collaborate with DBEDT and report to the Legislature annually, beginning January 1, 2018, on the number of jobs created in the State and the fiscal impact to the State of every film production in the State. The Department is willing to collaborate with DBEDT, but notes that it has no expertise in determining the number of jobs created in the State and the fiscal impact to the State of every film production in the State other than to provide a revenue estimate of the film credit amount.

In order to assist DBEDT in obtaining necessary information from the production companies, the Department suggests that the Committee consider requiring the production companies to file online surveys with DBEDT similar to section 235-110.91 (i), (j), (k), and (l), HRS.

Finally, the Department suggests making Section 2 of this measure apply to taxable years beginning after December 31, 2017 to prevent any ambiguity as to which productions the new requirements apply to.

The estimated revenue impact of S.B. 1086, S.D. 1, to the general fund is a loss of:

FY 2020 $36.5 milion
FY 2021 $37.6 million
FY 2022 $38.7 million
FY 2023 $39.9 million

Thank you for the opportunity to provide comments.

DAVID Y. IGE
GOVERNOR

LUIS P. SALAVERIA
DIRECTOR

MARY ALICE EVANS
DEPUTY DIRECTOR

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
Web site: dbedt.hawaii.gov

Telephone: (808) 586-2355
Fax: (808) 586-2377

Statement of
Luis P. Salaveria
Director
Department of Business, Economic Development, and Tourism
SENATE COMMITTEE ON WAYS AND MEANS
Monday, February 27, 2017
9:30 AM
State Capitol, Conference Room 211

In consideration of
SB 1086, SD1
RELATING TO FILM AND DIGITAL MEDIA INDUSTRY DEVELOPMENT.

Chair Tokuda, Vice Chair Dela Cruz, and Members of the Senate Committee on Ways and Means.

The Department of Business, Economic Development and Tourism (DBEDT) **supports** SB1086, SD1, which 1) extends the Motion Picture, Digital Media, and Film Production Income Tax Credit sunset date to January 1, 2024; 2) requires productions claiming the credit to provide evidence of consideration of cultural, community and environmental sensitivities; 3) requires productions claiming a tax credit of more than $8M provide an advanced screening on the island where the majority of the production took place; and 4) adds clarifying language that only production costs expended within the state are claimable for the credit.

Extending the sunset date to January 1, 2024, provides the business certainty necessary to attract television and feature film productions to our shores. The extension is also needed to expand Hawaii's infrastructure for the film and media industries by attracting a private sector partner to develop, manage and operate a new facility which will support our creative media and film industries development.

DBEDT appreciates the Legislature's consideration of protecting our natural and cultural resources while recognizing the economic value the film and media industries bring to our State. In line with this recommendation is a new resource being developed as a result of the Hawaiian Media Makers Conference. The Hawaiian Handbook will be a cultural and environmental protocol guide for film and media makers. Patterned after a similar guide established by the New Zealand Film Commission, this tool will help producer's, cast and crew better understand what makes Hawaii unique and how to navigate our natural and cultural environment, along with being aware of certain sensitivities.

DBEDT agrees with the necessity to engage a third party auditor to conduct and report on the annual employment, fiscal impacts and also conduct a financial audit of each film production claiming the tax credit. In order to accomplish this, the department will require additional funding to carry out this mandate.

Thank you for the opportunity to testify on this measure.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Extension and Tightening of Motion Picture, Digital Media, and Film Production Credit

BILL NUMBER: SB 1086, SD-1

INTRODUCED BY: Senate Committee on Economic Development, Tourism, and Technology

EXECUTIVE SUMMARY: Limits the aggregate motion picture, digital media, and film production income tax credit to $50,000,000 per taxable year. Clarifies that qualified expenditures are required to be expended within this State. Amends Act 88, Session Laws of Hawaii 2006, to extend the sunset date from January 1, 2019, to January 1, 2024. Requires DBEDT to submit an annual report to the legislature regarding the activities and expenditures of the tax credit. Clarifies that no rule shall be adopted to expand the scope of the tax credit where the rule conflicts with legislative intent. Requires DBEDT to conduct a financial audit of every film production in the State.

SYNOPSIS: Amends HRS section 235-17(a) to require the creditable production costs be incurred and expended within the State.

Amends HRS section 235-17(d) to require a production to provide evidence of ability to understand and navigate cultural and environmental sensitivities unique to Hawaii; employ or contract for the services of cultural resources or historical, cultural, or language experts to advise the production; and, for a production claiming a credit of more than $8 million, to agree to provide a community screening of the finished production in advance of its world premiere within the county in which the majority of the production took place.

Extends the sunset date of the credit to January 1, 2024.

Provides that no rule shall be adopted to expand the scope of the tax credit where the rule conflicts with legislative intent.

Requires DBEDT, in collaboration with Department of Taxation (DOTAX), to submit to the governor and the legislature a report on the number of jobs created in the State and the fiscal impact of every film production in the State; provided that each report shall be independently verified and audited for accuracy.

EFFECTIVE DATE: July 1, 2017.

STAFF COMMENTS: Several the changes proposed in the bill appear to be reactions to the State Auditor’s Report No. 16-08, “Audit of Hawai’i's Motion Picture, Digital Media, and Film Production Income Tax Credit.”

The auditor’s report, for example, accused DOTAX of broadening the scope of the film tax credit by including out-of-state expenses as qualified production costs. The auditor charged that this action is inconsistent with the plain language of the statute and the legislative intent of the initiative. Similarly, DOTAX allowed insurance premium costs to qualify as production costs because they were explicitly mentioned in the statute. The auditor took DOTAX to task on that one as well, citing a requirement in the statute that all qualified production costs be subject either to the net income or general excise tax, and noting that insurance premiums were subject to insurance premium tax.

DOTAX replied by saying that it had obtained an opinion from the Office of the Attorney General that the general excise tax and use tax are complementary taxes, concluding that the

> inclusion of the use tax as a qualified production cost in spite of its exclusion from the plain language of the statute and the inclusion of insurance premiums in the plain language of the statute appear to be proper. The Director's treatment of both costs are grounded in well-established case law… To avoid subjecting the Film Credit to constitutional challenge, the Director has correctly recommended the inclusion of the use tax as a qualified production cost. The Director appears to be appropriately reading the plain language of the Film Credit in including insurance premiums.

Often, DOTAX will be asked to enforce tax statutes that may not have been perfectly drafted. The film credit statute is one of these. In such cases, the enforcing agency needs to resolve the ambiguities. The Attorney General concluded that DOTAX did so here, and we cannot find fault with that conclusion.

On the broader policy question of whether the credit is justified, we call attention to the findings of California's Legislative Analyst's Office (LAO) regarding California's production credit.

Perhaps the most startling is the LAO's conclusion that $1 out of every $3 in credits went to productions that would have shot in California anyway. It turns out that California's credit was limited, the production companies applied for more credits than were available, and the state had to conduct a lottery to determine which of the productions would be awarded credit. But several productions began shooting even before lottery results were announced.

This result supports what Hawaii credit opponents have been saying over the years, namely, "They'll come anyway, so why do we need to pay them to come? We have great weather, blue sky, pristine beaches, and more."

The hard reality, however, is that productions are businesses and most do take a hard look at the bottom line, evidenced by the companies accounting for the other two-thirds of credits. Indeed, although the LAO lamented that industry-specific tax credits were "inappropriate public policy because they (1) give some businesses an unequal advantage at the expense of others and (2) promote unhealthy competition among states in a way that does not benefit the nation as a whole," LAO concluded that California shouldn't be giving up its production credit program while other states (including Hawaii) are actively competing with it for the production dollars. LAO recommended that California should consider scaling its program back when other states do.

At the same time, we in Hawaii need to remember that this interstate competition does affect us. We don't have a monopoly on beaches, sand, sunshine, forested hills, overgrown jungle, or other natural wonders. Productions can and do find comparable locations in Puerto Rico, New Zealand, and elsewhere.

Next, the LAO concluded that the tax credit program boosted California's economy only minimally, if at all. Because of the way California credits work, that state saw revenue benefits in the early years of the credit but found that the program cost more as time went on. We in Hawaii have had our production credit since 1997, so it's been almost twenty years. Have there been any studies about what the program has done for Hawaii's economy or Hawaii's tax revenue? None were cited to the Legislature when the Hawaii production tax credit was increased in 2013. Maybe we don't care as much about the hard dollars as we do about other intangible effects like local jobs, the development of a skilled workforce, or robust media education programs that simply weren't around at the turn of the century. Even if so, lawmakers should have data on these intangibles, and other cost-benefit information, so they can make intelligent decisions on this matter.

Digested 2/25/2017

The Twenty-Ninth Legislature, State of Hawaii
Hawaii State Senate
Committee on Ways and Means

Testimony by
Hawaii State AFL-CIO
February 27, 2017

S.B. 1086, S.D.1 – RELATING TO THE MOTION PICTURE, DIGITAL MEDIA, AND FILM PRODUCTION INCOME TAX CREDIT

The Hawaii State AFL-CIO supports S.B. 1086, S.D.1 which requires that to qualify for the tax credit a production must provide evidence of recognition, ability to understand, and efforts to respect and comply with cultural and environmental sensitivities in sensitive locations; including employing or contracting for the services of cultural resources or historical, cultural, or language experts to advise the production, requires that to qualify for the tax credit a production must agree that if the production claims a credit of more than $8,000,000, the production will provide an advanced screening of the finished product in the county of the island in which the majority of the production took place, clarifies that qualified expenditures are required to be expended within this State and amends Act 88, Session Laws of Hawaii 2006, to extend the sunset date from January 1, 2019, to January 1, 2024.

The film industry is a significant economic driver for the state of Hawaii. Many popular television shows such as Hawaii Five-0 and Lost have been produced in Hawaii including a number of box office hits such as Jurassic Park, Pirates of the Caribbean, and 50 First Dates. These movies and television shows help promote Hawaii's tourism industry and provide high-quality jobs to a number of Hawaii residents. By extending the film tax credit it will continue to encourage production companies to film and produce movies and shows in the state of Hawaii and allow Hawaii to remain competitive with other states and countries that have enacted a similar film tax credit.

Thank you for the opportunity to testify.

Respectfully submitted,

Jason Bradshaw
COPE Director

SAG·AFTRA.

Musicians' Association of Hawai'i 677

The Senate
The Twenty-Ninth Legislature
Regular Session of 2017

Committee on Ways and Means
Senator Jill Tokuda, Chair
Senator Donovan M. Dela Cruz, Vice Chair

RE: SB 1086, SD1 RELATING TO THE MOTION PICTURE, DIGITAL MEDIA, AND FILM PRODUCTION INCOME TAX CREDIT

Date: Monday, February 27, 2017
Time: 9:30 a.m.
Place: Conference Room 211
State Capitol
415 South Beretania Street, Honolulu, HI

Aloha Chair Tokuda, Vice Chair Dela Cruz and Members of the Committee,

We are the representatives of the film and entertainment industry unions, Brenda Ching, SAG-AFTRA Hawaii Local, Irish Barber, I.A.T.S.E. Local 665, Steve Pearson, American Federation of Musicians' Local 677 and Wayne Kaululaau, Hawaii Teamsters & Allied Workers Local 996. Collectively, we represent over 1700 members who work in film, television and new media productions as performers, crew, musicians and drivers in Hawaii.

We ***strongly support*** the extension of the sunset date to January 1, 2024 with no other changes. Today we are competing in a global market and without the production film tax credit, we risk losing jobs, current productions and potential productions that are vital to the industry.

The film industry is a *vibrant* and *creative* industry. At its core, it promotes the State, provides numerous jobs and business opportunities for a broad spectrum of local companies. The industry has proven to be a good business and economic driver for our State.

We appreciate the legislature's strong support of the industry. Thank you for giving us the opportunity to offer testimony on this measure.

Brenda Ching	Irish Barber	Steve Pearson	Wayne Kaululaau
SAG-AFTRA Hawaii	I.A.T.S.E. Local 665	A.F.M. Local 677	Teamsters Local 996

MOTION PICTURE ASSOCIATION OF AMERICA

TESTIMONY

ON HAWAII SENATE BILL 1086

BEFORE THE SENATE COMMITTEE ON WAYS AND MEANS

Monday, February 27, 2017

State Capitol

Honolulu

The Motion Picture Association of America, Inc. (MPAA) submits this written testimony regarding Hawaii Senate Bill 1086. MPAA members include the leading producers and distributors of television programs and motion pictures worldwide. In addition to CBS, which as you are well aware produces the locally based Hawaii 5-0 television series, MPAA members include Disney, Fox, Paramount, NBC Universal, Sony Pictures and Warner Bros.

MPAA and its member companies supports the extension of the production tax credit for five additional years in the legislation. However, the bill makes additional changes to the program that may discourage television and motion picture producers from choosing Hawaii as a production location.

SB 1086 bill would also limit qualified expenditures to only those purchases made in Hawaii. This is a significant change that may adversely affect the production tax credit program. Production companies will always prefer to buy or rent goods and services for production locally. However, there may items that may not be available in Hawaii, or may be in use by other productions and unavailable. Producers will make best efforts to source goods and services locally but limiting qualified expenditures to only those goods and services purchased/rented locally will unduly burden productions and may make the

Hawaii's production tax credit program less appealing to some productions. MPAA also opposes this provision in SB 1086.

In addition, SB 1086 requires an advance screening of any production that claim tax credits in excess of $8 million. We would recommend that an advance screening be among a menu of options for a production to select to promote and market Hawaii as well as provide a give-back to the community. Contractual agreements may prohibit an advance screening of certain productions, particularly of feature length motion pictures. Extending the production tax incentive program for five more years provides enhanced stability and predictability for motion picture and television producers who want to bring projects to Hawaii. This, in turn, extends Hawaii's economic reach into the world. Both the state and the industry will benefit.

Today, cost is the single most important factor for a producer in determining where a project will be located. Hawaii competes, successfully against other states, as well as nations worldwide, in attracting its share of motion picture and television productions.

The vision of the Hawaii legislature to create jobs and stimulate the economy is being realized by attracting Hawaii 5-0 and sustaining the production, which is now in its seventh season. The series currently employs 300 cast and crew members and about 250 local background performers per episode. In addition, Hawaii has been the location recently for *Jurassic World*, *Aloha*, *Godzilla* and *The Hunger Games*. NBCUniversal will soon begin production of a sequel to *Jurassic World*. The major motion picture production will employ scores of Hawaii residents and spend millions of dollars into the state economy with small businesses that provide goods and services.

Hawaii Senate Bill 1086 enhances that stability and paves the way for 5-0 in future years upon renewal, as well as, potentially, new television series and motion picture productions.

In addition to stimulating the economy, which is estimated to be $400 million total spend over the past five years, and this year will be an additional $87 million dollars, Hawaii 5-0 has been a Hawaiian showcase that has also stimulated tourism to the islands from visitors around the world. 5-0 is not only popular in the US, it has found enormous audiences worldwide.

Mister Chairman and members of the committee, we urge you to approve Senate Bill 1086. On behalf of MPAA and our member company studios and television companies, we look forward to the continuation of a long and successful partnership with Hawaii, and being part of your welcoming and dynamic community for years to come.

The Twenty-Ninth Legislature
Regular Session of 2017

THE SENATE
Committee on Ways and Means
Senator Jill N. Tokuda, Chair
Senator Donovan M. Dela Cruz, Vice Chair
State Capitol, Conference Room 211
Monday, February 27, 2017; 9:30 a.m.

STATEMENT OF THE ILWU LOCAL 142 ON S.B. 1086 SD 1
RELATING TO THE MOTION PICTURE, DIGITAL MEDIA,
AND FILM PRODUCTION INCOME TAX CREDIT

The ILWU Local 142 supports S.B. 1086 SD 1, which originally limited the aggregate motion picture, digital media, and film production income tax credit to $50,000,000 per taxable year and required that qualified expenditures be expended within this State. The original bill further extended the sunset date from January 1, 2019 to January 1, 2024, and required DBEDT to submit an annual report to the legislature regarding the activities and expenditures of the tax credit. The original S.B. 1086 also clarified that no rule would be adopted to expand the scope of the tax credit where the rule conflicted with legislative intent, and required DBEDT to conduct a financial audit of every film production in the State.

It is well recognized that the film industry not only is a significant component of Hawaii's economy, but also plays a crucial role in promoting Hawaii as a visitor destination. Moreover, at times film development and production may take much longer than anticipated, and delay the time for when a decision of where to film is made. Because of the strong competition with other jurisdictions, the film tax credit is a significant economic factor in making this decision.

H.B. 1086 SD 1 would extend the film tax credit for another five years, and to that degree would provide stability and predictable economic incentives for the film industry. This will allow Hawaii to remain competitive with other jurisdictions in attracting qualified productions that will generate additional revenue, jobs, and tourism marketing exposure.

S.B. 1086 HD 1 also attempts to increase accountability in processing the film tax credit by providing (1) that no rule shall be adopted to expand the scope of the tax credit where the rule conflicts with legislative intent, and (2) that DBEDT shall submit an annual report to the legislature reporting on the activities and expenditures of the film tax credit to the legislature. S.B. 1086 HD 1 also requires that DBEDT, working with the Department of Taxation, submit an annual report to the Governor and Legislature on the number of jobs created in the State and the fiscal impact of every film production.

S.B. 1086 SD 1 further eliminates the aggregate limit on the film tax credit of $50,000,000 per taxable year. In light of these changes, made through the SD 1 version of the bill, in conjunction with the benefits reflected in the use of the tax credit, and the positive goals reflected in this legislation, the ILWU would support an even longer extension, which would send a clear message to the industry.

The ILWU urges passage of S.B. 1086 SD 1. Thank you for the opportunity to share our views on this matter.