

DAVID Y. IGE
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To: The Honorable Sylvia Luke, Chair;
The Honorable Kyle T. Yamashita, Vice Chair;
and Members of the House Committee on Finance

From: Isaac W. Choy, Director
Department of Taxation

Date: Monday, February 28, 2022
Time: 11:00 A.M.
Place: Via Video Conference, State Capitol

Re: H.B. 1982, H.D. 1, Relating to Taxes

The Department of Taxation (Department) offers the following comments regarding H.B. 1982, H.D. 1, for your consideration. The measure is effective on July 1, 2022, and applicable to payments made to a taxpayer or loan-out company after June 30, 2022. With respect to tax administration. H.B. 1982, H.D. 1, does the following:

- Establishes a 10 percent income tax withholding requirement for all payments to loan-out companies for services performed in Hawaii for persons claiming the motion picture, digital media, and film production income tax credit (Film Credit) under section 235-17, Hawaii Revised Statutes;
- Prohibits the defense against the penalty erroneous claim for refund or credit if the claim for refund was generated by a tax credit and lowers the penalty for the erroneous claim for refund or credit generated by a tax credit to 10 percent;
- Authorizes the Department to impose fees for the processing of Film Credit Applications with the fees collected going into the Tax Administration Special Fund (TASF);
- Exempts qualified production with costs of \$1 million or less from being required to obtain a verification review from an independent certified public accountant (CPA) before submitting the production report to the Department of Business, Economic Development and Tourism (DBEDT);
- Requires that taxpayers claiming the Film Credit to withhold and remit to the Department within 30 calendar days 4.5 percent of payments made to loan-out companies to the credit of the general excise tax (GET) account of the loan-out company;
- Amends the TASF to allow for the deposit of Film Credit application fees; and
- Authorizes the Department to establish 4 FTE auditor positions to examine the Film Credit claims and other tax expenditures.

The Department notes that the House Committee on Economic Development adopted many of its suggested amendments. The Department appreciates the consideration of its suggestions.

The Department supports the amendment to the erroneous claim for refund penalty. Although the amendment disallows the reasonable basis defense, the penalty imposed is lowered from 20 to 10 percent.

Finally, the Department notes that it is able to administer the measure as currently written. Thank you for the opportunity to testify on this measure.



UNIVERSITY OF HAWAII SYSTEM

Legislative Testimony

Testimony Presented to the
House Committee on Finance
Monday, February 28, 2022 at 11:00 a.m.

by

Christopher P. Lee, Founder/Director, Academy for Creative Media System
on behalf of

Vassilis L. Syrmos, Vice President for Research and Innovation
University of Hawai'i System

HB 1982 HD1 – RELATING TO TAXES

Chair Luke, Vice Chair Yamashita, and Members of the Committee:

The University of Hawai'i (UH) supports the intent of HB 1982 HD1 to enhance Hawai'i's successful motion picture/television/streaming production industry with changes to the current film production tax credit. In particular, UH strongly supports the extension of the sunset date of the credit from December 31, 2025 to December 31, 2032.

A stable, reliable credit is essential to continuing the growth of this vital diversification of Hawai'i's economy. While numbers are not finalized, 2021 is likely to be another record year of positive impact for the local economy, with a direct spend of over \$400 million.

Thank you for the opportunity to offer testimony on this measure.



DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

DAVID Y. IGE
GOVERNOR

MIKE MCCARTNEY
DIRECTOR

CHUNG I. CHANG
DEPUTY DIRECTOR

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Statement of
MIKE MCCARTNEY
Director

Department of Business, Economic Development, and Tourism
before the

HOUSE COMMITTEE ON FINANCE

Monday, February 28, 2022
11:00 AM
State Capitol, Conference Room 308

In consideration of
HB1982, HD1
RELATING TO TAXES.

Chair Luke, Vice Chair Yamashita and members of the Committee.

The Department of Business, Economic Development and Tourism (DBEDT) offers the following comments on HB1982, HD1 which requires all filers to provide agreed upon procedures reports (AUPR), extends the sunset date to December 31, 2032, Requires the report by DBEDT to include the dollar amount claimed, name of the company, and name of the qualified production of the taxpayer, requires every person making payment to a loan-out company and claiming the film tax credit to withhold payments to loan-out companies. Prohibits the defense of erroneous claim for a refund or credit if the claim for refund was generated by a tax credit and sets the penalty for such case to ten per cent. Requires qualified taxpayers to withhold a certain amount and remit that amount. Amends the use of the tax administration special fund. Authorizes the department of taxation to establish four full-time equivalent tax auditor positions. (HD1)

DBEDT strongly supports the extension of the sunset date to December 31, 2032, noted in this measure. We defer to the Department of Taxation on the sections related to changes in the financial requirements for obtaining the credit, including loan out amendments, as well as any fiscal impacts to the state budget in this measure.

The Motion Picture, Digital Media, and Film Production Income Tax Credit, §235-17, Hawaii Revised Statutes, is an essential tool to the state's economic recovery efforts amidst this global pandemic. 2021 was another record year for production for the state with \$423M in direct expenditures and nearly 4,500 jobs.

The department agrees that we must maintain the momentum of sustained annual jobs, small business support, and infusion of tax dollars which stimulates the economy prior to any certification of credits that are issued, as per statute.

The positive impacts of this core facet of Hawaii's creative economy also fuel the potential to attract private investment to advance development of a new multi-stage facility, as well as regional centers for local production use.

The department will continue to work with the Legislature and industry to ensure extension of the sunset date which supports strengthening of our film and entertainment industry job creation and development.

Thank you for the opportunity to testify.

Testimony of Walea Constantinou,
Film Commissioner, Honolulu Film Office
City and County of Honolulu

COMMITTEE ON FINANCE

February 28, 2022

11:00 AM

State Capitol, via Videoconference; Conference Room 308

RE: HB1982, HD1 RELATING TO TAXES

Dear Chair Luke, Vice-chair Yamashita, and members of the committees:

I **strongly support the extension of the Sunset Date to 2032** which is crucial to the continued growth and development of the film industry as a key sector to diversify the economy.

The Hawaii Production Tax Credit is the fuel that drives the engine that powers the current and future development of Hawaii's film industry.

Business certainty is vital to the industry to be able to make physical production and infrastructure commitments. The extension provides that business assurance, and allows the industry the necessary time needed for planning and implementation.

It can take several years for a movie or television series to be conceived of and brought to the point of physical production. For a television series, usually a 5-year minimum run for physical production is projected. The currently requested extension to 2032 allows for a 5-year planning, development and funding phase, and a 5-year implementation and operational phase.

I also strongly encourage the committee to work closely with the industry and DBEDT to craft language acceptable to the long-standing industry practices pertaining to the loan-out section.

Thank you for your kind attention and the opportunity to provide these comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, GENERAL EXCISE, ADMINISTRATION, Withholding of Tax by Persons Claiming Film Credit, Elimination of Reasonable Basis Defense for Overclaiming Credits

BILL NUMBER: HB 1982 HD 1

INTRODUCED BY: House Committee on Economic Development

EXECUTIVE SUMMARY: Requires every person making payment to a loan-out company and claiming the film tax credit to withhold payments to loan-out companies. Prohibits the defense of erroneous claim for a refund or credit if the claim for refund was generated by a tax credit and sets the penalty for such case to ten per cent. Requires the report by DBEDT to include the dollar amount claimed, name of the company, and name of the qualified production of the taxpayer. Requires qualified taxpayers to withhold a certain amount and remit that amount. Amends the use of the tax administration special fund. Authorizes the department of taxation to establish four full-time equivalent tax auditor positions. We do not recommend passage of the penalty enhancements, which would apply to other credits as well. We also have suggested technical amendments.

SYNOPSIS: Adds a new section to chapter 235, HRS, requiring every person claiming a credit under section 235-17, HRS, to withhold 10% of all payments to loan-out companies for services performed in Hawaii and to remit the withholding to the Department of Taxation within 30 days from the date of payment.

Amends section 231-36.8, HRS, to impose a penalty at a reduced rate of 10% for erroneous claims for refund or credit that are generated by a tax credit, and to provide that the penalty is applied whether or not the taxpayer had a reasonable basis in law for making the claim.

Amends section 235-1, HRS, by adding a new definition of “loan-out company” as a wholly-owned entity formed on behalf of a person that serves as a separate entity that constitutes the person's means of entering a contact with a third party for the purpose of providing services to the third party.

Amends section 235-17, HRS, to add a provision requiring each qualified production to withhold an amount equal to 4.5% of qualified production costs; provided that the amount withheld shall be remitted to the department of taxation to the credit of the general excise tax account of the loan-out company to whom the qualified production costs were paid or will be paid. The amount withheld shall be remitted no later than thirty calendar days after the qualified production costs are paid or incurred. Taxpayers who fail to comply with this subsection shall be subject to the applicable interest and penalties pursuant to chapter 231 and section 235-104.

Makes additional technical and conforming amendments.

EFFECTIVE DATE: July 1, 2022

STAFF COMMENTS:

Withholding Income Tax for Payments to Loan-Out Companies: Apparently, this provision is meant to collect tax at the source because employees of loan-out companies have not been following the requirement to file an income tax return.

Elimination of Reasonable Basis Defense to Penalty for Erroneous Credit Claim: Because the tax laws are complex and often subject to interpretation, we do not believe a “strict liability” penalty of this type is appropriate. Such a penalty would penalize “innocent mistakes where the excessive amount is the result of inadvertence, mathematical error, or where otherwise defined as innocent.” It also should be kept in mind that this penalty enhancement applies to all tax credits, not just the motion picture, digital media, and film production income tax credit pursuant to section 235-17, HRS,

General Excise Tax Withholding: We do not recommend that withholding of general excise tax be contained in an income tax section; it would be difficult or impossible for practitioners to find. Instead, we recommend amendment of section 237-44, HRS, which now requires withholding of general excise tax in the “entertainment business,” and which contains the necessary trust fund and derivative liability language. For example:

SECTION __. Section 237-44, Hawaii Revised Statutes, is amended to read as follows:

“**§237-44 Entertainment business; loan-out companies.** (a) As used in this section:

"Admission" means the amount paid for admission to any place, including admission by season ticket or subscription, and also includes the amount paid for seats and tables, reserved or otherwise, and other similar accommodations.

"Cabaret" means any roof garden, cabaret, or other similar place furnishing a public performance, by or for any patron or guest who is entitled to be present during any portion of the performance, including any room in any hotel, restaurant, hall, or other public place where music and dancing privileges or any other entertainment are afforded the patrons in connection with the serving or selling of food, refreshment, or merchandise.

“Loan-out company” means the same as in section 235-1.

"Transient taxpayer" refers to any person subject to the tax imposed by this chapter who has no permanent place of business in the State.

(b) Every person receiving admissions for any circus, carnival, or any other place whatsoever at which a transient taxpayer is engaged in business (whether or not further admissions are charged inside the place, such further admissions, if any, being also subject to this section), shall set aside from the admissions and hold in trust for the State five per cent of the admissions, or such lesser amount as the department of taxation shall approve as sufficient, to guarantee payment of the tax levied by this chapter on the transient taxpayer. The amount so required to be

set aside from the admissions shall be deposited with the department promptly upon collection thereof, from time to time, for deposit by it in a special trust fund in the treasury of the State, there to remain until refunded upon voucher of the department, or until applied to the payment of the taxes guaranteed thereby with the consent of the person making the deposit, or until deposited in court pursuant to chapter 655 or the rules of court. The department may bring an action to obtain an adjudication of its right to apply the guarantee fund in payment of taxes and may deposit the fund in court to await the results of the adjudication, or may be sued by an interested person seeking to obtain the adjudication and may be ordered to make such deposit in court, notwithstanding that the department asserts a claim against the fund.

(c) If any person fails to deposit promptly the guarantee fund required by this section, the department may distrain upon the admissions or any bank account or other asset in which the same can be found, for the purpose of obtaining and depositing in the treasury the required guarantee fund.

(d) Whenever a transient taxpayer is engaged in business at any place for which admissions are charged, or at any cabaret whether or not admissions are charged, [or whenever a loan-out company is engaged for services performed or to be performed within the State](#), the person engaging the transient taxpayer [or loan-out company](#) shall collect from the transient taxpayer, by withholding or otherwise, the tax levied by this chapter on the transient taxpayer, shall hold the tax in trust for the State, and shall return and pay over the tax to the proper collecting officer of the State in the manner and at the time required by this chapter, for the account of the transient taxpayer. If the person fails to do so, the person shall be liable to pay to the State the amount of the tax levied by this chapter on the transient taxpayer, together with penalties and interest as provided by law. The amount of the liability may be collected from the guarantee fund, if any, or may be assessed against and collected from the person so becoming liable in the same manner as if the tax had been levied upon the person.

Digested: 2/26/2022



The House of Representatives
The Thirty-First Legislature
Regular Session of 2022

COMMITTEE ON FINANCE
Rep. Sylvia Luke, Chair
Rep. Kyle T. Yamashita, Vice Chair

RE: HB 1982, HD1 RELATING TO TAXES

Date: Monday, February 28, 2022
Time: 11:00 a.m.
Conference Room 308
State Capitol
415 South Beretania Street

February 27, 2022

From: Roy Tjioe and Ricardo Galindez
Island Film Group
99-1245 Halawa Valley St.
Aiea, HI 96701
808-536-7955

Aloha Chair Luke and Vice Chair Yamashita, and Members of the Committee:

Our Background

Island Film Group is a locally owned and operated production company. We began working in Hawaii's film and television industry in 2001 as attorneys at Goodsill Anderson Quinn & Stifel, where we represented filmmakers and other production companies. Since our formation of Island Film Group in 2007, we have been working full-time as producers of feature films such as "Princess Ka'iulani" and "Soul Surfer", network and cable television movies and series, as well as a large number of commercial productions.

We SUPPORT

(a) The proposed withholding of income tax on payments to loan-out companies as set forth in Section 1, pages 1-2 of the Draft.

(b) The proposed language in Section 4, page 12 of the Draft that would extend the year in which excess tax credits may be claimed.

We STRONGLY OPPOSE

(a) The proposed language in Section 4, pages 12-13 of the Draft that would require the withholding of general excise tax and remittance of such amounts to the department of taxation no later than 30 calendar days after the qualified production costs are paid or incurred. Even without the proposed language, taxpayers are currently subject to statutory requirements in the reporting and payment of general excise tax, and they face penalties for failing to do so in a timely manner. The requirement that these obligations be transferred from the vendor to the production company would create an unfair strain and burden on the production.

(b) The proposed deletion of the good faith defense as set forth in Section 2, page 3. The proposed language is unnecessary given that the good faith defense requires a showing by the taxpayer that it has met its burden of proof regarding the reasonableness of the tax credit claim. The proposed language is a denial of Due Process in violation of the State and Federal Constitutions. The proposed language would also eliminate the good faith defense of innocent mistakes where the excessive amount is the result of inadvertence or mathematical error.

(c) The proposed language in Section 4, page 9 of the Draft that seeks to impose fees for processing qualified production applications for the motion picture, digital media and income tax credit (the Draft appears to inadvertently omit the word “credit”). The assessment of additional fees for processing the tax credit applications is in addition to the educational or workforce development contribution which is already required. Mandating both simply reduces the value of the tax credit further.

(d) The proposed language in Section 4, pages 9 and 18 of the Draft, to use the Tax Administration Special Fund to process qualified production applications for the motion picture, digital media, and film production income tax credit. To the extent this assumes that the Tax Department would be charged with processing qualified production applications, this function has been and should be handled by DBEDT/the Hawaii State Film Office which has a deep understanding of the film and television industry and which is responsible for the economic development of Hawaii.

(e) The proposed language in Section 4, pages 10-11 of the Draft, which seeks to require DBEDT to report to the legislature certain information reported by the taxpayer in unredacted form, in particular the dollar amount claimed, the name of the company and the name of the qualified production. While we have no objection to the information being provided to the legislature, we are deeply concerned that the media will obtain this information and use it to smear qualified production companies in the same manner that projects under Act 221 were unfairly targeted.

We **PROPOSE**:

- (a) Since the language regarding income tax withholding for payments to loan out companies is limited “for services performed in the State” under Section 1, page 1, then to be consistent, the same language should be included in Section 4, page 12 relating to general excise tax withholding for payments to loan out companies, so that it reads as follows: “(m). Every person making payment to a loan-out company shall withhold an amount equal to 4.5 per cent of qualified production costs for services performed in the State;...”
- (b) That in all other respects, film, television and commercial production shall be deemed “manufacturing” for general excise tax purposes, consistent with the Department of Taxation’s position until 2020. This clarification will help level the playing field between mainland production companies and local production companies.
- (c) That qualified productions with qualified production costs at or below \$1,000,000 need not submit its tax credit claim for verification review by a qualified certified public accountant.

Me ke aloha,



Roy Tjioe and Ricardo Galindez
Co-Founders
Island Film Group
Honolulu, Hawaii