

DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR



ISAAC W. CHOY
DIRECTOR OF TAXATION

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 Glen Wakai, Chair;
The Honorable Bennette E. Misalucha, Vice Chair;
and Members of the Senate Committee on Energy, Economic Development, and
Tourism

From: Isaac W. Choy, Director
Department of Taxation

Date: Friday, January 28, 2022
Time: 3:00 P.M.
Place: Via Video Conference, State Capitol

Re: S.B. 2079, Relating to Taxes

The Department of Taxation (Department) offers the following comments regarding SB. 2079 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, S.B. 2079 does the following:

- Establishes an 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 (HRS);
- 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 ten per cent;
- 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 motion picture, digital media, and film production income tax credit to withhold a certain amount to the credit of the general excise tax (GET) account of the loan-out company; and
- Amends the Tax Administration Special Fund to allow for the deposit of Film Credit application fees.

First, the Department notes that the income tax provision is confusing. This provision applies to every person claiming a tax credit pursuant to section 235-17, HRS. Thus, individual

investors in a partnership or LLC that is producing a motion picture in conjunction with a loan-out company would be required to withhold, even though they themselves are not making any payments to the loan-out company. In addition, the measure requires that the withholding amount be at the rate applicable to the employee of the loan-out company. The applicable rate to the employee cannot be determined only from the amount paid to the loan-out company. The Department suggests the rate be set at a flat rate such as 10%. This provision also does not contain any deadlines for remitting payment or penalty for non-compliance. The Department suggests that the proposed section be rewritten as follows:

§235-_____ Withholding of tax on loan-out companies.

(a) Every person making payment to a loan-out company and claiming a tax credit pursuant to section 235-17 shall deduct and withhold ten per cent of all payments made to the loan-out company for services performed in Hawaii. The amounts withheld shall be remitted as specified in subsection (b). The amounts so withheld under to this section shall be deemed to be a tax withholding for the benefit of the loan-out company's employee actually performing the service.

(b) Every person required to withhold and remit taxes under this section shall make a return of the amount withheld and file the return with the department no later than thirty calendar days from date on which the payment was made to the loan-out company. The taxes withheld shall be remitted with the return. The department shall prescribe the forms and procedures to administer this section.

All taxes withheld pursuant to this section shall be held in trust by the person withholding for the State. If any person required to withhold and remit taxes under this section fails to withhold or remit such taxes, the person shall be liable for the failure as provided in section 235-64.

(c) For the purposes of this chapter, "loan-out company" means a wholly-owned entity formed on behalf of a person or persons, which serves as a separate entity that constitutes the person's or persons' means of entering a contact with a third party for the purpose of providing services to the third party.

Second, 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 twenty to ten percent.

Third, the Department has concerns about exempting productions with \$1 million or less from the requirement to obtain a verification review of the qualified productions costs from an independent CPA. It is the Department's understanding that smaller productions have a similar number of costs that need to be reviewed as a larger production. The CPA verification review serves as a preliminary review before the production report is submitted to DBEDT.

Fourth, the GET withholding provision requires clarification. Similar to the Department's comments regarding the income tax withholding provision, the Department suggests limiting the withholding obligation to the person who makes the payment to the loan-out company.

In addition, it appears as though this provision is intended to change the rate of GET imposition from 4% to the manufacturing rate of 0.5%. The Department notes that this provision is merely a withholding obligation and does not change the rate of GET imposition. Thus, if this provision were adopted as currently written, the withholding amount would be 0.5%, but the GET imposition including the county surcharge is 4.5%, leaving the loan-out company underpaid by 4%. The loan-out companies will be subject to penalties and interest if the correct y are underpaid

Fifth, the Department appreciates the inclusion of application/processing fees into its Tax Administration Special fund under section 235-20.5, HRS. However, the Department was unable to find the statutory authority to impose such fees.

Finally, the Department has discovered significant noncompliance with income tax credit claims and related GET nonpayment/underpayment. As such, the Department respectfully requests 4 FTE field auditors who will focus on the examination of these issues. In order to provide the 4 FTEs, the Department requests the following be inserted into this measure as a new section:

SECTION X. The department of taxation may establish four new full-time equivalent (4.0 FTE) tax auditor positions to examine claims for the motion picture, digital media, and film production income tax credit provided under section 235-17, Hawaii Revised Statutes, and other tax expenditures.

Thank you for the opportunity to provide comments.



DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

DAVID Y. IGE
GOVERNOR

MIKE MCCARTNEY
DIRECTOR

CHUNG I. CHANG
DEPUTY DIRECTOR

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
MIKE MCCARTNEY
Director

Department of Business, Economic Development, and Tourism
before the

SENATE COMMITTEE ON ENERGY, ECONOMIC DEVELOPMENT, AND TOURISM

Friday, January 28, 2022

3:00 PM

State Capitol, Conference Room 224

In consideration of

SB 2079

RELATING TO TAXES.

Chair Wakai, Vice Chair Misalucha, and members of the Committee.

The Department of Business, Economic Development and Tourism (DBEDT) offers the following comments on SB2079 that establishes new criteria for qualifying claims, and other amendments, in particular the necessary sunset date extension to January 1, 2033. We defer to the Department of Taxation on the sections related to 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. We are pleased to report that 2021 was another record year for production for the state with \$423M in direct expenditures and nearly 4,500 jobs.

As this increased production trend continues into 2022, we strongly support the extension of the sunset date to January 1, 2033, noted in this measure. This provides business certainty for all production, but particularly television and streaming series where longer planning lead times and projected multi-year runs are part of the budgeting process by studios.

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 industry to our creative economy and building a workforce continues to be a pipeline of opportunity for our local labor force and the college students who are interested in pursuing careers in film and creative media. An important aspect of building a pipeline of talent to work in

production is the need to attract private investment to advance the Legislature's and Administration's intent to build a new multi-stage facility.

We would like to note that the universal mandatory Agreed Upon Procedures Review (AUPR) was a requirement established by the Legislature specifically to streamline the certification process and provide third-party review for all productions claiming the credit. The Department of Taxation developed these Agreed Upon Procedures which are now well understood by the qualified CPAs doing the AUPRs and all the filers who are claiming the credit. DBEDT feels it would be prudent to maintain this universal requirement.

The department looks forward to working with the Legislature on this and other measures which support the strengthening of our film credit program.

Thank you for the opportunity to testify.



UNIVERSITY OF HAWAII SYSTEM

Legislative Testimony

Written Testimony Presented to the
Senate Committee on Energy, Economic Development, and Tourism
Friday, January 28, 2022 at 3:00 p.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

SB 2079 – RELATING TO TAXES

Chair Wakai, Vice Chair Misalucha, and Members of the Committee:

The University of Hawai'i (UH) supports the intent of SB 2079 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, 3032. 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.

Hawai'i's Motion Picture, Digital Media and Film Production Tax Credit has been a success, as noted by economists Sumner La Croix and James Mak in their March 2021 UHERO report, *Understanding the Role of the Hawaii Film/TV/Digital Production Tax Credit In Diversifying the Hawaii Economy*: "Since the passage of the film credit in 2006, spending in Hawai'i on TV/film productions has soared, with inflation-adjusted spending increasing by 116 percent between 2007 (\$164.5 million) and 2019 (\$355.6 million). This is much larger than the overall increase in Hawai'i real gross domestic product over the same period, a modest 17 percent."

Thanks to the foundational and continuing support of the Legislature, UH's Academy for Creative Media has graduated hundreds of students contributing to the state's creative economy with locally based living wage jobs. Most recently, UH Mānoa ACM graduate Alike Maikau debuted his first feature film, *Every Day in Kaimuki* at the Sundance Film Festival -- the most competitive film festival in the world. This is the second year in a row that an ACM graduate premiered a Hawai'i-made feature at Sundance following Christopher Makoto Yogi's *I Was A Simple Man* -- a film which *The New Yorker's* film critic Richard Brody declared the fourth best film of the year. ACM graduates are garnering global recognition while making a difference at home both creatively and in terms of the economy.

Thank you for the opportunity to testify today.



The Senate
The Thirty-First Legislature
Regular Session of 2022

COMMITTEE ON ENERGY, ECONOMIC DEVELOPMENT AND TOURISM
Sen. Glenn Wakai, Chair
Sen. Bennette E. Misalucha, Vice Chair

RE: SB 2079 RELATING TO TAXES

Date: Friday, January 28, 2022
Time: 3:00 p.m.
Conference Room 224
State Capitol
415 South Beretania Street

January 27, 2022

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

Aloha Chair Wakai and Vice Chair Misalucha, 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 of the Bill.

(b) The proposed language in Section 3 of the Bill 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.

(c) The proposed language in Section 3 of the Bill that would extend the year in which excess tax credits may be claimed.

(d) The intent of the proposed language in Section 3 of the Bill that would define the qualified activity of film and television production as “Manufacturing” for general excise tax purposes.

We STRONGLY OPPOSE

(a) The proposed deletion of the good faith defense as set forth in Section 2 of the Bill. 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.

(b) The proposed language in Section 3 of the Bill, 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.

(c) The proposed language in Section 3 of the bill 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.

(d) The proposed language in Section 4 of the Bill to use the Tax Administration Special Fund to process qualified production applications for the motion picture, digital media, and film production income tax credit. 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.

Me ke aloha,



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

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Withholding of Tax by Persons Claiming Film Credit

BILL NUMBER: SB 2079

INTRODUCED BY: WAKAI, KEITH-AGARAN, MISALUCHA, Dela Cruz, Inouye, Taniguchi

EXECUTIVE SUMMARY: Establishes a 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. Prohibits the defense of erroneous claim for refund or credit if the claim for refund was generated by a tax credit. Sets the penalty for the erroneous claim for refund or credit generated by a tax credit at ten per cent. Requires taxpayers claiming the motion picture, digital media, and film production income tax credit to submit a sworn statement and verification review to the Department of Business, Economic Development, and Tourism only if qualified production costs exceed \$1,000,000. Requires reports by the Department of Business, Economic Development, and Tourism to the Legislature on the motion picture, digital media, and film production income tax credit to identify the dollar amount claimed, name of company, and name of program claiming the credit. Extends the period during which excess credits may be claimed to December 31, 2032. Requires qualified taxpayers claiming the motion picture, digital media, and film production income tax credit to withhold a certain amount and remit that amount within thirty calendar days to the Department of Taxation to the credit of the general excise tax account of the loan-out company. Amends the uses of the Tax Administration Special Fund.

SYNOPSIS: Adds a new section to chapter 235, HRS, requiring every person claiming a credit under section 235-17, HRS, to withhold all payments to loan-out companies for services performed in Hawaii.

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 235-17, HRS, to add a provision requiring each qualified production to withhold an amount equal to the general excise tax rate on manufacturing or producing, plus the applicable rate of county surcharge on general excise tax, from 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.”

General Excise Tax Withholding: We do not recommend that withholding of general excise tax be contained in an income tax section; we recommend amendment of section 237-44, HRS, which now requires withholding of general excise tax in the “entertainment business.” We also note that the withholding proposed would be at the 0.5% rate, while the Department of Taxation recently has taken the position, in Tax Information Release 2021-01, that the applicable tax rate would be the retail rate. We recommend that the conflicting positions be harmonized, either by legislation reversing the Department’s position in TIR 2021-01 or by increasing the proposed withholding rate.

Digested: 1/26/2022



MOTION PICTURE ASSOCIATION - AMERICA, INC.

1600 EYE STREET, NORTHWEST

WASHINGTON, D.C. 20006

(202) 293-1966

JANUARY 28, 2022

TO: SENATOR GLENN WAKAI
CHAIR, ENERGY, ECONOMIC DEVELOPMENT AND TOURISM
FROM: VANS STEVENSON
RE: SB2079 RELATING TO TAXES. - **SUPPORT**

Thank you, Chair Wakai, and members of the Senate Committee on Energy, Economic Development and Tourism. I am Vans Stevenson, Senior Vice President for State Government Affairs for the Motion Picture Association (MPA). I appreciate the opportunity to provide this written testimony in support of SB2079, which includes an extension of the state's successful production tax credit program to 2032.

MPA represents the major producers and distributors of motion pictures, television series and streaming productions: Netflix Studios, LLC; Paramount Pictures Corporation; Sony Pictures Entertainment Inc.; Universal City Studios LLC; Walt Disney Studios Motion Pictures; and Warner Bros. Entertainment Inc.

Chair Wakai, thank you for your vision to extend the state's incentive program, which will continue to advance additional opportunities for economic investment and enduring long-term job creation. The cornerstone of any production incentive program is that it is stable, predictable, and reliable. The extension of the program will ensure the state's commitment to creating jobs and investment that builds upon a growing sector of the Aloha State's economy. According to MPA research, in 2019, over 1,700 people were directly employed by the motion picture and television industry in Hawaii, and these industry workers earned over \$100 million in wages.

We are in a new age of television with streaming. There are over 500 scripted streaming productions being made right now, mostly in the United States, as a continuous surge in demand for streaming content. Many states are at production capacity due to this explosion of streaming production.

The economic impact of the production industry has touched many parts of the Hawaiian Islands. It is also felt across many business sectors. New and expanded businesses have followed because there are support services, which benefit from the industry but are not eligible to claim the tax credit. In addition to camera, lighting and audio equipment, production companies use a wide

range of support services during production including catering, construction, transportation, accounting/payroll and post-production. These ancillary business expansions have given rise to long-term capital investments, which ensure the state's investments in this industry are sound.

Now, more than ever, financial decisions drive the production location decision making process and as a result, tax credits are vital to producers. We look forward to working with the legislature to ensure the program's continued success.

Production incentive programs create jobs, expand revenue pools, and stimulate local economies. We support your vision to continue to build this vibrant industry to prosper in Hawaii by creating permanent jobs and long-term investment in the community.

I therefore urge the Committee's favorable approval of SB2079.

SB-2079

Submitted on: 1/27/2022 12:00:15 PM

Testimony for EET on 1/28/2022 3:00:00 PM

Submitted By	Organization	Testifier Position	Remote Testimony Requested
Sandie Wong	Individual	Comments	Yes

Comments:

I join the comments of Island Film Group which supports and opposes some of the proposed amendments. Thank you.