



## ***Hawaiian* STATE TAX INCENTIVES FOR FILM PRODUCTION**

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After years of observing the effects of successful foreign film and television production tax incentives, the United States is finally amending its views and tax policy to counteract the effects of runaway production (i.e. US film production in Canada attracted by Canadian tax incentives and the benefits of Canada's many bi-lateral co-production treaties, among other runaway destinations). This US change of position is evidenced by a number of states' recently amended production tax incentive programs such as New Mexico's Film Production Tax Credit and its Filmmaker Gross Receipts Tax Reduction, Missouri's Film Production Tax Credit, Louisiana's Non-transferable Labor Tax Credit, and Investor Tax Credit, and Hawaii's Investment Tax Credit (Act 221, Session Laws of Hawaii 2001). In total, over 35 states now offer different forms of soft money, while Hawaii is one of only two state that provide investment tax credits patterned after renown foreign investment credits previously found in Germany, Luxembourg and the United Kingdom. This article shall focus on the audiovisual investment incentives arising from the state of Hawaii.

### **Implemented State Tax Incentive Acts**

Changes have occurred in various states in terms of incentivizing US productions from running across the border. States such as Connecticut, Rhode Island, Louisiana, New Mexico and Hawaii have all implemented various laws allowing the states to grant tax credits to local investors in movie production and/or local production via labor tax credits.

The most notable of these state tax incentives (and most strikingly derivative of Germany's highly utilized income tax incentives) hails from Hawaii. There are actually two different tax incentives that may be applied to television and film production in Hawaii. The more progressive of which is an investment tax credit (Act 221), which is geared toward high technology and is applicable to a television and film production company wanting to establish a presence in Hawaii. It was originally introduced in 2001 and allows the state of Hawaii to grant 100% tax credits to local investors in qualifying movie productions. The other tax incentive is the Motion Picture and Film Production Income Tax Credit, which is a refundable tax credit for television and film productions being produced in Hawaii.

### **Hawaii's Motion Picture and Film Production Income Tax Credit**

To obtain the refundable production tax credits, the Hawaii Film Office must send a letter to the Department of Taxation certifying that the production occurred. The production must then file an Income Tax Return and





Form N-316 (Motion Picture and Film Production Income Tax Credit Request) with the State Department of Taxation.

The motion picture tax credit is equivalent to 15% of qualified production costs incurred on Oahu, and 20% on the neighbor islands (Big Island, Kauai, Lanai, Maui, Molokai). The credit was established on July 1, 2006 and remains effective **through December 31, 2015**. There is an **\$8 million cap per "qualified production"** in receipt of the credit, and minimum of \$200,000 must be spent in production costs for feature films,

television programming (not including news programs), commercials and interactive games. No distribution agreements need be in place to qualify for this tax credit.

The credit must be claimed on a State income tax return filed within one year following the close of the taxable year during which principle photography began in Hawaii.

### **Hawaii's Investment Tax Credit (Act 221)**

To obtain the investment tax credit (Act 221, Session Laws of Hawaii 2001) *FOR HIGH TECHNOLOGY BUSINESS INVESTMENT*, the business must qualify as a high technology business ("**QHTB**"), which is defined as:

- A business employing or owning capital or property or maintaining an office in Hawaii, provided that:
- more than 50% of its total business activities constitute "**qualified research**" and that the business conducts more than 75% of its qualified research in Hawaii (thus, passing the "**Activity Test**"), or
- more than 75% of its gross income is derived from qualified research and said income is received from products sold from services performed in Hawaii, products sold, manufactured, or produced in Hawaii (thus, passing the "**Gross Income Test**").

"Qualified Research" is defined as:

- Development and design of computer software
- Biotechnology
- Performing arts products
- Sensor and optic technologies
- Ocean sciences





- Astronomy
- Non-fossil fuel energy-related technology

“Performing arts products” is defined as:

- Audio files, video files, audio-video files, computer animation, and other entertainment products perceived by or through the operation of a computer; and
- commercial television and film products for sale or license, and reuse or residual fee payments from these products.

With respect to performing arts products, this exclusion extends to:

- The authors of performing arts products, or parts thereof, with or without regard to the application of the work for hire doctrine under United States copyright law; and
- the assignors, licensors, and licensees of any copyright rights in performing arts products, or any parts thereof.

For a business to be considered a QHTB, a comfort ruling must be obtained from the Hawaii State Department of Taxation. Moreover, there are actually two sections of Act 221 that apply to the film and television industry:

[Section 235-110.9](#), Hawaii Revised Statutes (HRS), provides a 100% investment income tax credit (over a five-year period) to Hawaiian investors in performing arts products.

[Section 235-7.3](#), HRS, states that royalties derived from performing arts products are excluded from income and, as such, are not subject to state income tax.

This credit is deductible from the Hawaiian investor’s net state income tax liability at a maximum amount of \$2 million annually, per investor, per QHTB. The tax credit is applied in percentages, spread out over five years, totaling 100% at the end of the five-year period.

- 35% The year in which the investment was made.
- 25% First year after which the investment was made.
- 20% Second year after which the investment was made.
- 10% Third year after which the investment was made.
- 10% Fourth year after which the investment was made.
- 100% Total of five years.

### **Use of Act 221 by US Film Industry**

Films having taken advantage of Act 221 include director John Stockwell’s “Blue Crush,” which was produced by Brian Grazer, “Fifty First Dates” produced by Sony Pictures and “The Big Bounce” produced by Warner Bros. The Act enabled Universal Studios to receive an alleged \$15 million-\$18 million investment credit for “Blue Crush’s” \$41 million budget (exact data is confidential). Qualification by the production of





“The Big Bounce” enabled Warner Bros. to receive an estimated \$13 million tax credit on an estimated budget of \$51 million. There are, however, examples of feature films that have failed to qualify for Act 221’s specialized tax treatment. Producer Arnold Rifkin’s “Tears of the Sun” is one such example, which was a one picture deal budgeted at \$40 million. Similar qualification uncertainty previously plagued Australian’s tax regime in early 2001 and negatively affected features such as Warner Bros.’ “The Red Planet” and 20<sup>th</sup> Century Fox’s “Moulin Rouge,” until a more erudite incentive scheme was introduced providing for a straight tax rebate, in September of 2001.

As written at present, Hawaii’s Act 221 encouraging qualifying production companies to commit to more than a one-picture deal, and thus ensuring long-term benefits to the state.

### **Abuse of Act 221 by US Film Industry**

There have also been crackdowns recently on ACT 221 abuses. Hawaii’s Department of Taxation has since Act 221’s implementation issued a [Tax Information Release](#) (TIR), because, although referred to as a 100 percent credit, the Act has actually enabled some investors to receive more tax credit than they invest in qualifying companies due to its liberal interpretation.

The Department will be developing and implementing an audit program to review single picture QHTB film funds to ascertain whether the production/financing entities meet the "Activity test" or the "Gross income test" and are a business within the meaning of Hawaii’s revised tax statutes.

To qualify under the "Activity test" the QHTB must actively produce the movie. To qualify under the "Gross income test" the QHTB must receive income from the sale of the products of the QHTB. Said qualified income will not include:

- Predetermined payments structured over the five-year period that are not received from the sale of the products or services of the QHTB;
- payments from amounts that were set aside for the specific purpose of being distributed to the QHTB as "income" in years two through five of the period during which the credit is claimed (i.e. escrow accounts); and
- any other insubstantial amount received by the QHTB in years two through five of the period during which the credit is claimed where the Department of Taxation determines the payment is made for the purpose of qualifying for the credit or not having a credit recaptured.

### **The Future of US Tax Incentives**





Even though Hawaii's state officials have publicized the continued need for strict interpretation of Hawaii's currently approved tax incentive laws, the state-side production and investment tax credit big picture remains hopeful for filmmakers. One need only look to the past (and at long standing and successful tax incentive offering territories such as Ireland and Australia) to predict that history has a fair chance of repeating itself and introducing a durable haven for tax motivated media investment in the US giving rise to long term sector benefit.

