

September 26, 2019

Hawaii Department of Taxation

Hawaii Department of Business, Economic Development & Tourism -- Film Office

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

Verification Review - Agreed Upon Procedures

I. Introduction

Section 235-17, Hawaii Revised Statute (HRS), provides a refundable motion picture, digital media, and film production income tax credit (film credit) to qualified productions for qualified production costs incurred in the State of Hawaii (Hawaii). The film credit is 20% of qualified production costs incurred in the City and County of Honolulu and 25% of qualified production costs incurred in any other county.

Section 6 of Act 143, Session Laws of Hawaii 2017, and section 235-17(h), HRS, require every taxpayer claiming the film credit to submit to the Hawaii Film Office a production report and a verification review. The verification review and the production report must be submitted no later than 90 days following the end of the calendar year in which the qualified production costs were incurred.

Under section 18-235-17-14, Hawaii Administrative Rules (HAR), a verification review is an agreed upon procedures report (AUPR) prepared by a qualified certified public accountant (CPA). The main purpose of the verification review is to ensure that claims for the film credit are proper under section 235-17, HRS, and its administrative rules. The purpose of this document is to set forth the requirements of the AUPR.

II. General Requirements

- a. The AUPR shall:
 - i. Be prepared by a CPA who:
 1. Is licensed in the State of Hawaii;
 2. Is in good standing to provide accounting services; and
 3. Does not have an ownership or pecuniary interest in the taxpayer or the production;
 - ii. Contain the following:
 1. CPA's name, address, and telephone number;
 2. CPA's license number issued by the Professional & Vocational Licensing Division of the Hawaii Department of Commerce and Consumer Affairs, license status, and expiration date;

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3. A statement signed under the penalty of perjury by the CPA stating that he or she does not have an ownership or other pecuniary interest in the taxpayer or the production and that he or she is qualified to produce the AUPR under section 235-17, HRS, and its administrative rules;
4. Name of the Production Company (taxpayer) and project name; and
5. Date that the AUPR was completed;
- iii. Be presented in United States dollars (USD). If production costs were paid in foreign currency, the conversion rate to USD on the date that the cost was incurred must be used to convert the cost from the foreign currency to USD;
- iv. Be prepared for all taxpayers on a calendar year basis;
 1. For calendar year taxpayer, the first AUPR shall cover the production costs incurred from January 1 to December 31 of 2019.
 2. For fiscal year taxpayers, the first AUPR shall cover the first day of the tax year to December 31, 2019. Subsequent AUPRs shall cover January 1 to December 31 of the appropriate year, as if the fiscal year taxpayer was calendar year taxpayer.
- v. Be signed by the taxpayer under the penalty of perjury and contain the following statement:
 1. "I declare, under the penalties set forth in section 231-36, HRS, that the information furnished for the purpose of producing this Verification Review has been examined by me and, to the best of my knowledge and belief, it is true and correct for the calendar year stated, pursuant to the Hawaii Income Tax Law, Chapter 235, HRS."
- vi. Separately state the amount of:
 1. Qualified production costs incurred in the City and County of Honolulu;
 2. Qualified production costs incurred in any other county besides the City and County of Honolulu;
 3. Credit based on qualified production costs incurred in the City and County of Honolulu;
 4. Credit based on qualified production costs incurred in any other county besides the City and County of Honolulu; and
 5. Costs that do not qualify for the film credit.
- vii. State the method of sampling if sampling was used; and
- viii. Be submitted together with all workpapers that support the AUPR's results.

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III. Procedures

- a. Required documentation. The CPA will obtain all information and documents required to be submitted as part of the production report as specified in section 18-235-17-03(b), HAR.
- b. Ordinary and necessary. The CPA will verify that the claimed production costs are costs that are ordinary and necessary in the motion picture or film production industry through one of the following methods:
 - i. The claimed costs are among those specifically listed under the definition of "qualified production costs" in section 235-17(m), HRS, paragraphs (1) to (10); or
 - ii. For a claimed cost other than a direct production cost specified in the definition of "qualified production costs" in section 235-17(m), HRS, verify that the cost is otherwise allowable under the administrative rules.
- c. Minimum expenditure threshold. The CPA will review the Hawaii expenditure report to ensure the qualified production costs are \$200,000 or greater. If this threshold is not met, the taxpayer does not qualify for the Hawaii film credit.
- d. Verification of certain items to be included in the production report. The CPA will verify that the information that is required to be submitted under sections 18-235-17-03(b)(3), (5), (6), (7), (8), and (13), HAR, meets the requirements of the applicable paragraph.
 - i. If general excise tax numbers are required and not provided, the costs should be disqualified.
 - ii. If substantiation of use tax payments are not provided, the costs should be disqualified.
- e. Verification of Expenditures. The CPA will evaluate the taxpayer's assertion of amounts proposed as qualified production costs within the meaning of the definition of "qualified production costs" in section 235-17, HRS, and the requirements of sections 18-235-17-09 to 13, HAR, as applicable, for the calendar year.
 - i. Sampling. The CPA may perform the verification of expenditures on a test basis with a sample selected according to applicable professional standards for transaction with a value of less than \$10,000. Sample testing shall not be used for transactions with a value of \$10,000 or more.
 - ii. Tracing. The CPA will trace the amount of the payments for claimed production costs to checks, bank statements, or other third-party documentary evidence.
 - iii. Wages. For wage payments to resident and nonresident cast and crew, the CPA will:
 - 1. Verify that federal Form W-2 or paystubs show Hawaii income tax was withheld, and
 - 2. Verify that payroll handling fees include the general excise tax license number of the payroll provider/administrator.

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3. Separately state the amount for wages and the amount for payroll handling fees.
- iv. Other Payments made-through payroll companies. For payments made to loan-out companies, through a payroll company or the like, the CPA will verify that the:
 1. Amounts that were ultimately paid to loan-out companies and the amounts paid for handling/service fees to the payroll company are stated separately,
 2. General excise tax license number of each loan-out company is included in the "Loan Out List", and
 3. General excise tax license number of the payroll company or other company handling the payment is included in the "Vendor List".
- v. Small purchases of goods. The CPA may allow, as a qualified production costs, the purchase of goods (tangible personal property), without the general excise tax license number of the seller/vendor, if the:
 1. Seller is physically located in Hawaii;
 2. Purchase (transaction) is less than \$100;
 3. Following information is contained in the "Small Purchases" section of the Expenditure Report (spreadsheet):
 - a. Name of the seller/vendor;
 - b. Description of the purchase; and
 - i. Please note: "Petty cash" or other generic descriptions are not sufficient.
 - c. Amount of purchase.
- vi. Imported goods and services. For products or services obtained from vendors that are not engaged in business in Hawaii, the CPA will obtain from the production company a sworn statement, under the penalties set forth in section 231-36, HRS, that reasonable efforts to secure and use comparable products or services within Hawaii were unsuccessful.
- vii. Direct costs. The CPA will verify that the claimed costs are directly related to the qualified production for which the AUPR is being produced as required under section 18-235-17-10(d), HAR.
- viii. Capital assets. Verify that the amount of capital fixed assets that were not sold or destroyed are limited to the amount of the depreciation allowance for the time period and prorated for the amount that the equipment was used in Hawaii.
- ix. Financial or in-kind contributions. The CPA will verify that contributions required under section 18-235-17-17, HAR, are not claimed as a qualified production cost.