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LETTER RULING NO. 2010-18

[REDACTED TEXT]
[REDACTED TEXT]
[REDACTED TEXT]
[REDACTED TEXT]

[REDACTED TEXT]
[REDACTED TEXT]
[REDACTED TEXT]
[REDACTED TEXT]

August 26, 2010

**RE: APPLICATION OF TIR 2010-04 TO [REDACTED TEXT] AND
[REDACTED TEXT]**

Dear [REDACTED TEXT]:

This letter responds to your [REDACTED TEXT] request for a joint letter ruling concerning the application of Tax Information Release (“TIR”) No. 2010-04 to [REDACTED TEXT] and [REDACTED TEXT]. ([REDACTED TEXT] and [REDACTED TEXT] are sometimes collectively referred to herein as the “Taxpayers.”)

Based upon the analysis below, the Department of Taxation (Department) concludes that the contribution of content by each of [REDACTED TEXT] and [REDACTED TEXT] to the motion picture [REDACTED TEXT] (hereinafter “Motion Picture”), each qualify [REDACTED TEXT] and [REDACTED TEXT] respectively as a separate “Qualified Production” for purposes of the Motion Picture, Digital Media, and Film Production Income Tax Credit available under Section 235-17, Hawaii Revised Statutes (“HRS”) (hereinafter “Film Credit”).

STATEMENT OF FACTS

[REDACTED TEXT] and [REDACTED TEXT] represent the following—

The Motion Picture is [REDACTED TEXT]. Physical production of the Motion Picture will be generally divided into three distinct production units that will each contribute specific content to the completed Motion Picture. Each production unit will be involved in the partial production of the Motion Picture. [REDACTED TEXT] will primarily handle the [REDACTED TEXT] based location work. [REDACTED TEXT] is also the production unit with primary oversight amongst all of the production units involved in the Motion Picture. More specifically, [REDACTED TEXT] is the entity that was engaged by [REDACTED TEXT] to produce the Motion Picture.

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[REDACTED TEXT], which is based in [REDACTED TEXT], has engaged both [REDACTED TEXT] and [REDACTED TEXT] separately and independently through means of Production Services Agreements to produce, in part, the production companies' respective partial content for final contribution to the Motion Picture. [REDACTED TEXT] will handle and/or be involved in a significant portion of the work and activities of and/or relating to water based location work (the "Water Work"), and [REDACTED TEXT] will handle and/or be involved in a significant portion of the work and activities of and/or relating to beach/jungle location work (the "Jungle Work"). The relationship by and among [REDACTED TEXT], [REDACTED TEXT], and [REDACTED TEXT] is substantially as set forth in the diagram attached hereto as Exhibit A.

[REDACTED TEXT] and [REDACTED TEXT] are and shall remain, at all times relevant herein, separate entities with separate Federal Tax Identification numbers and separate Hawai'i State GET licenses. [REDACTED TEXT] and [REDACTED TEXT] have each registered with the Business Registration Division of the Department of Commerce and Consumer Affairs to do business in the State of Hawai'i. [REDACTED TEXT] and [REDACTED TEXT] report for net income and general excise tax purposes on a fiscal year, accrual basis. [REDACTED TEXT] and [REDACTED TEXT] also file separate net income and general excise tax returns.

Notwithstanding the functional independence of each production company, [REDACTED TEXT] and [REDACTED TEXT] have entered into an Accounting and Administrative Services Agreement, whereby, among other things, expense items will be posted to, and paid by or on behalf of, the appropriate entity (Water Work by [REDACTED TEXT] and Jungle Work by [REDACTED TEXT]) by way of intercompany charges. Under the terms of the agreement, [REDACTED TEXT] serves as [REDACTED TEXT]'s agent in contracting, administering, and paying certain production costs for and on behalf of [REDACTED TEXT]. Both [REDACTED TEXT] and [REDACTED TEXT] remain separately liable for the respective charges posted to each. [REDACTED TEXT] and [REDACTED TEXT] also represent that the necessary approvals have been obtained from [REDACTED TEXT] to allow delegation of certain responsibilities, as required by the terms of the Production Services Agreements. A copy of the Accounting and Administrative Services Agreement is attached hereto as Exhibit B.

Pursuant to its Production Services Agreement with [REDACTED TEXT], [REDACTED TEXT]'s activities and operations will primarily involve the preparation, pre-production, production and principal photography work for the Hawai'i based Water Work and certain set work and [REDACTED TEXT] will operate the marine department, ship rigging, and boat construction production activities associated therewith. [REDACTED TEXT]'s activities and operations will be based primarily on the Island of [REDACTED TEXT]. Moreover, [REDACTED TEXT]'s production activities and payment duties will operate simultaneously with, but generally independent from, [REDACTED TEXT]'s activities.

Pursuant to its Production Services Agreement with [REDACTED TEXT], [REDACTED TEXT]'s activities and operations will primarily involve the production and principal photography work for the Hawai'i based Jungle Work and certain other Hawai'i land based location work.

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[REDACTED TEXT]'s activities and operations will be based primarily on the Island of [REDACTED TEXT]. Moreover, [REDACTED TEXT]'s production activities and payment duties will operate simultaneously with, but generally independently from, [REDACTED TEXT]'s activities.

Copies of [REDACTED TEXT]'s and [REDACTED TEXT]'s Production Services Agreements are collectively set forth as Exhibit C, which is attached hereto and by this reference incorporated herein. [REDACTED TEXT] and [REDACTED TEXT] both represent that the form of Production Services Agreement executed by each is similar to other production services agreements utilized by [REDACTED TEXT].

In all other material and substantive respects, [REDACTED TEXT] and [REDACTED TEXT] will each maintain independent production offices and certain accounting functions and will each conduct their production activities pursuant to the separate Production Services Agreements with [REDACTED TEXT].

As noted above, [REDACTED TEXT]'s activities will focus on the Hawaii based Water Work and [REDACTED TEXT]'s activities will focus on the Hawaii based Jungle Work. In this regard, water based location work on motion pictures can entail greater and different types of risks than the risks associated with non-water based location work including potential increased costs due to delays and shooting complications occasioned by unpredictable weather and ocean conditions. In addition, a shooting location in the central Pacific Ocean (which may be subject to greater and unpredictable natural forces such as gusting tradewinds and large surf) rather than other shooting locations (which may be less likely to be affected by high winds and large surf) may increase the risks associated with the water based location work. Lastly, water based location work often requires certain types of special equipment and personnel with specialized training and experience than that required for non-water based location work.

In light of the foregoing risks associated with the Water Work, Taxpayers represent that the use of separate and distinct production companies is not solely tax motivated and is motivated by business considerations to mitigate risks thereby reducing potential jeopardy that may be caused to the final Motion Picture.

[REDACTED TEXT] and [REDACTED TEXT] represent that each will undergo and obtain separate independent Film Credit audit certifications for the production companies' respective production costs pursuant to Proposed Administrative Rule § 18-235-17-18. *See* TIR 2009-05.

STATEMENT OF THE LAW

Section 235-17, HRS, provides a refundable income tax credit for each taxpayer with qualified production costs, up to a certain amount, incurred by each qualified production in any taxable year. In this regard, a "Qualified production":

- (1) Means a production, with expenditures in the State, for the total or partial

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production of a feature-length motion picture, short film, made-for-television movie, commercial, music video, interactive game, television series pilot, single season (up to twenty-two episodes) of a television series regularly filmed in the State (if the number of episodes per single season exceeds twenty-two, additional episodes for the same season shall constitute a separate qualified production), television special, single television episode that is not part of a television series regularly filmed or based in the State, national magazine show, or national talk show. For the purposes of subsections (d) and (j), each of the aforementioned qualified production categories shall constitute separate, individual qualified productions....

See HRS § 235-17(1)(1), TIR No. 2010-04.

TIR No. 2010-04 provides, in relevant part, that each of the foregoing categories of production activities [enumerated in HRS § 235-17(1)] is considered separate and that each of such production activities “. . . constitutes separate qualified productions that can each independently qualify for separate claims of the Film Credit . . .” provided for in HRS § 235-17. *See* TIR No. 2010-04 at p. 1.

TIR No. 2010-04 expressly provides that two or more entities which contribute partially to a single final motion picture may qualify as separate qualified productions for purposes of calculating the amount of the Film Credit available pursuant to HRS § 235-17; provided that there is a business purpose for each production entity and the entities were not created solely for tax purposes. In this regard, TIR No. 2010-04 at Section IV provides that:

Section 235-17, HRS, provides a Film Credit for each qualified production. “Qualified production,” as discussed above, is defined to include the partial production of a feature-length motion picture. Two or more production entities, which each contribute partially to a single final motion picture, may qualify as separate productions entitled to separate Film Credit claims; provided that there is a business purpose for each separate production entity and the separate production entities are not solely tax motivated.

The Department will not challenge separate and independent production entities each claiming the Film Credit where more than one entity’s contribution comprise a single final motion picture, so long as the business arrangement has a business purpose and is not solely tax motivated. For example, if a studio simply sets up two production entities in Hawaii without regard to the independence of each entity, treating both entities in substance as a single entity, and fails to demonstrate a business reason for both entities, the Department will disregard such an arrangement and treat the production as being produced by a single entity. However, where it is established by the taxpayers that more than one production entity is materially contributing in part to a single final motion picture; business purposes exist for the entities;

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the entities are respected separate and apart from one another; and the entities were not created for solely tax purposes, a separate and independent claim for the Film Credit may be claimed by each production entity.

See TIR No. 2010-04 at p. 3. The TIR continues by providing various examples of instances where the Department anticipates motion picture productions may utilize the conclusions drawn in TIR 2010-04, including instances where intellectual property is intended to be exploited for future gain of one entity; material risks associated with production would dictate, for business reasons, mitigating hazards through separate production companies; government mandates; among other purposes to be determined on a case-by-case basis.

ANALYSIS

Based upon the representations in this letter, the contribution of content by each of [REDACTED TEXT] and [REDACTED TEXT] to the Motion Picture each qualify [REDACTED TEXT] and [REDACTED TEXT] respectively as a separate “Qualified Production” for purposes of the Film Credit.

Based upon the representations, each of [REDACTED TEXT] and [REDACTED TEXT] are materially contributing in part to a single final motion picture. [REDACTED TEXT] and [REDACTED TEXT] are separate and distinct legal entities with separate federal tax identification numbers and Hawaii State General Excise Tax Licenses. [REDACTED TEXT] and [REDACTED TEXT]’s production activities are markedly distinct and separate, with each focusing on separate principal photography needs. The use of separate production companies for water based production and land based production serve the purpose of minimizing risk to the entire production of the Motion Picture by isolating the more significant risk posed by the water based production with [REDACTED TEXT], a separate entity. [REDACTED TEXT] and [REDACTED TEXT] have demonstrated an adequate business purpose for its business relationship amongst the Motion Picture’s three production units—[REDACTED TEXT], [REDACTED TEXT], and [REDACTED TEXT]. [REDACTED TEXT] and [REDACTED TEXT] each maintain separate production offices and utilize separate production personnel in their respective locations. [REDACTED TEXT] and [REDACTED TEXT] have established that production of separate, though at times simultaneous, jungle and water production will, in fact, occur. [REDACTED TEXT] and [REDACTED TEXT] have demonstrated that the reason for the separate production entities is not solely tax motivated and that, for legitimate business reasons, including the aversion of risks incumbent with the water based and jungle based filming locations, the production activities of [REDACTED TEXT] and [REDACTED TEXT], as set forth hereinabove in the Statement of Facts and as carried on in furtherance of the production of the Motion Picture, each qualify as a “separate, individual qualified production” for purposes of HRS § 235-17(1)(1).

CONCLUSION

Based solely on the facts disclosed in this letter, [REDACTED TEXT] and [REDACTED TEXT] are considered separate “qualified productions” within the meaning of HRS § 235-17(1). As

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provided in TIR 2010-4, each will be entitled to separate and independent Film Credit claims with separate tax credit caps; provided that the requirements of HRS § 235-17(d) are met by each and that each Film Credit claim does not exceed \$8,000,000. Furthermore, HRS § 235-17(d) requires that both [REDACTED TEXT] and [REDACTED TEXT]:

- Have qualified production costs of at least \$200,000;
- Provide the State a required screen credit;
- Provide evidence of reasonable efforts to hire local talent and crew; and
- Provide evidence of financial or in-kind contributions or educational or workforce development efforts.

For more information on the requirements of HRS § 235-17(d), please contact the Hawaii Film Office.

Please note that the conclusions drawn in this ruling are limited to the conclusion as to whether [REDACTED TEXT] and [REDACTED TEXT] constitute separate “qualified productions” for purposes of the Film Credit. Film Credit is only allowable for “qualified production costs.” No opinion is being rendered on the qualifying nature of any production expenditure.

This ruling is applicable only to [REDACTED TEXT] and [REDACTED TEXT] as it relates to the Hawaii filming of the Motion Picture. It may not be used or cited as precedent by any other taxpayer. The conclusions reached in this letter are based on our understanding of the facts that the Company has represented. If it is later determined that our understanding of these facts is not correct, the facts are incomplete, or the facts later change in any material respect, the conclusion in this letter may be modified accordingly.

The Company has reviewed and agreed that the redacted version of this ruling attached as Exhibit D will be available for public inspection and copying.

If you have any further questions regarding this matter, please call me at 808-587-1553. Additional information on Hawaii’s taxes is available at the Department’s website at <http://www.hawaii.gov/tax>.

Very truly yours,

JOHNNEL NAKAMURA

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[REDACTED TEXT]

[REDACTED TEXT]

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Rules Officer

[REDACTED TEXT]