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TAX INFORMATION RELEASE NO. 2006-02

RE: Refundable Income Tax Credit for Persons Engaged in the Motion Picture, Television, and Digital Media Production Business

HRS § 235-17, AS AMENDED BY ACT 88, SESSION LAWS OF HAWAII 2006.

Section 235-17, Hawaii Revised Statutes, provides an income tax credit for motion picture and other film productions. Act 88 substantially amends HRS § 235-17. For more information, *see* Tax Announcement 2006-05, discussing Act 88, Relating to Digital Media.

A. This TIR Supercedes All References to HRS § 235-17 Contained In TIR 98-1.

Effective July 1, 2006 until December 31, 2015, this Tax Information Release will supercede the guidance contained in Tax Information Release 98-1 relating to HRS § 235-17. On January 1, 2016, HRS § 235-17 will be reenacted in the form in which it read on June 30, 2006. Likewise, the guidance provided in Tax Information Release 98-1 relating to HRS § 235-17 will be resurrected.

The prior version of HRS § 235-17 allowed the Director of Taxation to define several terms for purposes of the motion picture credit. In order to provide taxpayers guidance on the prior motion picture credit, the Department of Taxation issued Tax Information Release 98-1, which defined various terms. The defined terms included: "benefits", "costs incurred in Hawaii", "motion picture or television film", "production costs", and "transient accommodation costs".

The amendments to HRS § 235-17 made by Act 88 make all of these definitions obsolete; either because Act 88 provides express definitions or the terms are no longer relevant. In order to clarify and update the tax laws and guidance provided in the past, Tax Information Release 98-1 will no longer serve as the position of the Department of Taxation regarding HRS § 235-17 and can no longer be relied upon by taxpayers from July 1, 2006 to December 31, 2015.

B. Qualified Productions Costs Under Act 88.

Act 88 amended HRS § 235-17 by defining "qualified production costs" for purposes of the production tax credit. A taxpayer is entitled to a credit equal to a percentage of qualified production costs. In order to qualify as a production cost, Act 88 requires, among other things, that the costs be:

"incurred by a qualified production within the state that are subject to the general excise tax under chapter 237 or income tax under this chapter...."

1) Costs Subject to Hawaii Tax

Prior to Act 88, the Department of Taxation defined costs for which the motion picture credit could be taken as those where the person delivering the goods or performing the services was subject to the Hawaii general excise or transient accommodations tax. In order to maintain consistency in the application of Hawaii tax laws, the Department of Taxation will consider a cost as a qualifying cost under Act 88 if the person delivering the goods or performing the services is subject to Hawaii general excise or income tax.

It is the taxpayer's responsibility to determine whether a vendor, employee, contractor, or other business or person is subject to Hawaii general excise or income tax within the meaning of Act 88 and as further explained in this Tax Information Release. In instances where a production may be uncertain as to whether an individual or company is subject to Hawaii general excise or income tax, it may be preferable for the production company to obtain a letter from the provider of the goods or services stating that the individual or company is subject to those taxes.

2) Qualified Expenditures, Generally

The list of qualified production costs identified in HRS § 235-17(l) is a non-exhaustive list of expenditures commonly associated with motion picture, commercial, and television productions. Other production costs may qualify for the production tax credit; provided the cost is subject to the Hawaii general excise or income tax within the meaning of HRS § 235-17 and this Tax Information Release, and has not been financed by any investments for which a credit has been or will be claimed pursuant to HRS § 235-110.9.

3) Examples

***EXAMPLE A*—**A, a resident of California, is hired by XYZ Productions to perform for the filming of a movie in Hawaii. Under Hawaii law, the personal services of A performed in Hawaii are subject to Hawaii income tax. *See generally*, HRS § 235-4(b); HAR § 18-235-4.03(b)(3). A's personal services—acting for the movie—if performed in Hawaii, is a qualified production cost for purposes of the production tax credit because A's Hawaii performed services subject A to Hawaii income tax.

***EXAMPLE B*—**ABC Airlines is a commercial airline that flies from Los Angeles, California to Honolulu, Hawaii. ABC Airlines has business operations in Hawaii; however it also has business operations in other jurisdictions. ABC Airlines is subject to Hawaii income tax for that portion of income with sufficient nexus under Hawaii income tax laws. XYZ Productions contracts with ABC Airlines to transport its cast and crew from Los Angeles, California to Honolulu, Hawaii to shoot a motion picture. The cost of airfare on ABC Airlines is a qualified production cost for purposes of the production tax credit because ABC Airlines, which is delivering the service, is subject to Hawaii income tax.

EXAMPLE C—123 Catering, a Hawaii limited liability company, is a vendor to local productions for catering services. 123 Catering has business operations only in Hawaii and is therefore subject to Hawaii general excise tax for its gross proceeds as a privilege of conducting business in Hawaii. XYZ Productions contracts with 123 Catering to provide plate lunches to its cast and crew for a production taking place in Hawaii. The cost of catering services provided by 123 Catering to XYZ Productions is a qualified production cost for purposes of the production tax credit because 123 Catering, which is delivering the goods, is subject to Hawaii general excise tax.

EXAMPLE D—Z, a resident of California with no contacts with Hawaii and not subject to Hawaii income tax, is an author and screenplay writer. XYZ Productions, a Hawaii limited liability company, intends to shoot a movie in Hawaii. Z offers to sell XYZ Productions his screenplay. Z's screenplay is not a qualifying production cost because Z is not subject to Hawaii income or general excise tax.

EXAMPLE E—Assume the same facts as Example D, except that Z is a resident of Hawaii and subject to Hawaii income tax. Z's screenplay, though not listed in HRS § 235-17(l), is a qualified production cost because Z is subject to Hawaii income tax.

EXAMPLE F—XYZ Productions, a California-based production company doing business in Hawaii, ships various filming equipment from California to Hawaii in order to carry out its production of a commercial. XYZ Productions contracts with two shipping companies—FastShip, a same-day air travel parcel shipping company to ship copies of the scripts, contracts, and costumes; and BigShip, a freight forwarder, container vessel company that will ship cameras, set materials, rigging, and other large objects. Both shipping companies have a presence in Hawaii, as well as on the mainland, and are subject to Hawaii income tax on that portion of activities attributable to Hawaii. The shipping costs incurred for both FastShip and BigShip are qualified production costs because both companies are subject to Hawaii income and/or general excise taxes.

C. Prorating Qualified Production Costs Between the Islands.

Section 235-17, Hawaii Revised Statutes, allows for an increased income tax credit for qualified production costs spent in any county with a population of 700,000 or less. If a qualified production occurs in more than one county, the production may prorate its expenditures based upon the amounts spent in each county.

1) Prorating Expenditures, Generally

Qualified production costs may be prorated by any reasonable method, taking into account the specific facts and circumstances in any particular case. For purposes of Act 88, a qualified expenditure is spent where used or consumed.

2) Airfare & Shipping Costs

Airfare and shipping costs merit specific treatment to carry out the intent that costs be reasonably prorated in instances where two destinations are at issue with substantially different population bases.

Where production activities occur on more than one island, in order to properly account for the Act 88 tax credit for airfare and shipping costs between Oahu and Neighbor Islands, a taxpayer may take the total airfare or shipping expenditure and divide the sum in half. Then, apply the 15 % tax credit to one half and the 20 % tax credit to the other half. Dividing the credit equally between the destinations reasonably prorates the expenses between the counties within the meaning of Act 88. Airfare and shipping costs between the Neighbor Islands other than Oahu are eligible for the 20% rate.

3) Examples

EXAMPLE A—XYZ Productions purchases airfare to transport talent and crew from Honolulu to Kailua-Kona on the Big Island of Hawaii. Production activities occurred on both islands. Honolulu and Hawaii counties have disparate county populations with the former having a population of greater than 700,000 and the latter having a population of less than 700,000. The cost of the total airfare is $1,000. To accurately account for the tax credit, XYZ Productions may divide the total fare ($1,000) in half ($500 and $500). Then, XYZ Productions may take the tax credit at the 15% rate for half of the cost ($500 X .15 = $75), and take the credit at the rate of 20% for the other half of the cost ($500 X .20 = $100). XYZ Production's total credit properly allocable as provided under this Tax Information Release is $175.

EXAMPLE B—XYZ Productions rents a camera from Oahu Camera Company located on Oahu, for use on its movie set located on both Oahu and the island of Kauai. Oahu Camera Company is headquartered on Oahu and has no business operations on Kauai. Use of the camera was divided among the islands accordingly: one-fourth of the use occurred on Oahu; three-fourths of the use occurred on Kauai. The cost of the camera rental is entitled to be prorated based upon the equipment's use between the islands because they are counties with disparate county populations. One-fourth of the cost (the use on Oahu) is entitled to the credit at the 15% rate. Three-fourths of the cost (the use on Kauai) is entitled to the credit at the 20% rate.

EXAMPLE C—Assume the same facts in Example B, except that the cost of the camera rental, which includes the shipping cost, is paid for on Oahu and all use of the camera occurs on Kauai. There is no prorating issue raised by this example because all use of the camera occurred on the island of Kauai. Therefore, the entire cost of the camera rental is entitled to the credit at the 20% rate.

D. $200,000 Minimum Expenditure Timeline.

In order to qualify for the Act 88 production tax credit, the production must be a "qualified production", as defined by law. The production is not a "qualified production" until at least $200,000 in qualifying expenditures has been incurred.

The $200,000 expenditure threshold is a definitional predicate that must be satisfied in order for a production to qualify for the tax credit. However, as provided in Act 88, a production has 12 months from the close of the production company's taxable year in order to claim the credit. If a production has less than $200,000 in qualifying expenditures in the taxable year, but satisfies the condition with sufficient expenditures within the following taxable year, an amended return may be filed to allow the production company to claim the credit now that the production has incurred $200,000 of costs.

EXAMPLE A—XYZ Productions is a calendar year taxpayer and has begun producing its film in Hawaii on January 1, 2007. At the end of XYZ Production's tax year (December 31, 2007), the production had $75,000 in qualifying expenditures. XYZ Productions does not qualify as a qualifying production under Act 88 and cannot claim the tax credit. XYZ Productions files its tax return for the 2007 tax year without the benefit of the production tax credit. In June of 2008, XYZ Productions has qualifying expenditures of $250,000. XYZ Production's total qualifying expenditures for the entire production is more than $200,000. XYZ Productions can file an amended return for 2007 taking into account the qualifying expenditures during 2008 because the production is now a qualified production.

EXAMPLE B—Assume the same facts as Example A, except that XYZ Productions began producing its film in Hawaii on January 1, 2006 and incurred $25,000 in qualifying expenditures in 2006. XYZ Productions cannot claim the credit for the 2006 expenditures because the production is not a qualified production until 2008 and a claim for the credit for the 2006 expenditures would have to have been filed by December 31, 2007 (12 months after the close of the production company's taxable year for which the expenditures can be claimed).

E. Effective Date of Guidance.

This Tax Information Release is effective for qualified production costs incurred on or after July 1, 2006 and before January 1, 2016.

For more information on this Tax Information Release or the income tax credit for those engaged in the motion picture and television film production business, please contact the Rules Office at (808)587-1577.

KURT KAWAFUCHI
Director of Taxation

HRS Section(s) Explained: HRS § 235-17
Tax Information Release(s) Superceded: Provisions of TIR 98-1 relating to HRS § 235-17