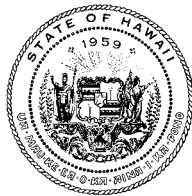


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September 17, 2009

## **TAX INFORMATION RELEASE NO. 2009-05**

**RE:** Advanced Notice of Proposed Administrative Rules Relating to the Taxation of the Motion Picture and Television Film Production Industry

On August 8, 2008, the Department of Taxation (Department), issued Tax Information Release (TIR) No. 2008-02, which set forth an informal notice of proposed administrative rules relating to the taxation of the motion picture and television film production industry.

On October 31, 2008, the Department issued Announcement No. 2008-08, advising taxpayers that the Department would be closing the informal comment period on the proposed administrative rules contained in TIR 2008-02 on December 1, 2008.

### **RESTATEMENT OF PROPOSED ADMINISTRATIVE RULES**

This Tax Information Release includes revisions to the original proposed administrative rules set forth in TIR No. 2008-02, after having considered the informal comments offered by the public. The revised proposed administrative rules include a Ramseyer format, which sets forth the deletions (bracketed and stricken-through) from and additions (underlined) to the proposed rules issued on August 8, 2008. A non-Ramseyer format of the revised proposed administrative rules is also attached, which begins on page 53.

As was the case with TIR 2008-02, the revised proposed administrative rules serve as the Department's positions on the income and general excise taxation of this industry. Taxpayers may rely upon this TIR and the accompanying revised proposed administrative rules to the extent taxpayers are authorized to rely upon TIRs generally as the Department's administrative interpretation.

### **VOLUNTARY PROVISIONS**

Provisions relating to the requirement to obtain an independent certification of qualified production costs (Prop. Admin. Rule § 18-235-17-18) and the requirement to provide access to set and locations for courtesy visits (Prop. Admin. Rule § 18-235-17-23) create affirmative requirements for taxpayers. The Department will not enforce these provisions until an administrative rule has been

formally adopted. Taxpayers are free to voluntarily comply with these provisions.

### **SAMPLE DOCUMENTS**

Proposed administrative rule § 18-235-17-22 sets forth a safe harbor for production companies utilizing loan-out companies. In short, the Department will not challenge a qualified production cost on the basis that the income or general excise tax went unpaid if the provisions of this section are satisfied. A sample Tax Advisory that must be provided to nonresident personnel, as well as a form loan-out company report that must be submitted to the Department, as discussed in the safe harbor requirements, are attached at the end of this TIR.

### **PROSPECTIVE RELIEF ONLY**

This TIR may be relied upon for prospective relief only, except where otherwise expressly allowed by the Director through subsequent official pronouncement.

### **FORMAL ADMINISTRATIVE RULES PROCESS**

The revised proposed administrative rules in this TIR are also intended to be the substance of the version that will be submitted to the Governor for approval and formal adoption in accordance with Chapter 91, Hawaii Revised Statutes. The Department reserves the right to make any amendments to the formal proposed administrative rules and will modify this TIR accordingly.



KURT KAWAFUCHI  
Director of Taxation

**Sections affected: HRS §§ 235-7.3; 235-9; 235-17; 237-2; 237-9; 237-13; 237-18**

RAMSEYER FORMAT

DEPARTMENT OF TAXATION

Proposed Hawaii Administrative Rules

SUMMARY

**Proposed Administrative Rules Applying HRS § 235-7.3**

§18-235-7.3-01	Royalties and other income tax exclusion; generally.
§18-235-7.3-02	Ownership of intellectual property; loan-outs, individuals, and qualified high technology businesses.
§18-235-7.3-03	Performing arts products; analysis of the work-for-hire doctrine.
§18-235-7.3-04	Performing arts products; extension of exclusion to authors, assignors, licensors, or licensees.
§18-235-7.3-05	Qualified high technology businesses and royalties or other income determination; nexus with Hawaii not required.
§18-235-7.3-06	Royalties and other income; defined.
§18-235-7.3-07	Patents, copyrights, and trade secrets; definitions.
<u>§18-235-7.3-08</u>	<u>Royalties exclusion; impact of half-per cent general excise tax rate.</u>

**Proposed Administrative Rule Applying HRS § 235-9**

§18-235-9-01	Exemption from income tax; motion picture and television film production.
<u>§18-235-9-02</u>	<u>No deduction for expenses associated with tax exempt activity; conformity to section 265 of the Internal Revenue Code.</u>

**Proposed Administrative Rules Applying HRS § 235-17**

§18-235-17-01	Motion picture, digital media, and film production income tax credit;
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	allowed.
§18-235-17-02	Claim for credit; procedures; multiple entities involved.
§18-235-17-03	Qualified productions; \$200,000 threshold determination.
§18-235-17-04	Claiming the credit; timing; twelve-month rule.
§18-235-17-05	Distribution of credit.
§18-235-17-06	Prorating qualified production costs between counties in Hawaii; airfare and shipping costs.
§18-235-17-07	Qualified production costs; generally.
§18-235-17-08	Qualified production costs; production services fees.
§18-235-17-09	Qualified production costs; wages for nonresidents; prorating.
§18-235-17-10	Qualified production costs; loan-outs.
§18-235-17-11	Qualified production costs; per diem allowances and fringe benefits.
§18-235-17-12	Qualified production costs; "kit" or "box" rentals.
§18-235-17-13	Qualified production costs; rental of local facilities or locations owned by nonprofit organizations.
§18-235-17-14	Qualified production costs; insurance.
§18-235-17-15	Qualified production costs; credit calculation for fixed equipment costs.
§18-235-17-16	Qualified production costs; <u>imported goods or services subject to the use tax.</u>
§18-235-17- <del>16</del> <u>17</u>	Utilizing the motion picture, digital media, and film production income tax credit and the high technology business investment tax credit simultaneously; same production; safe harbor for segregating funds.
§18-235-17- <del>17</del> <u>18</u>	Independent certification [ <del>opinion</del> ] of motion picture, digital media, and film production income tax credit claims.
§18-235-17- <del>18</del> <u>19</u>	Evidence of reasonable efforts to hire local talent and crew.
§18-235-17- <del>19</del> <u>20</u>	Evidence of financial or in-kind contributions to educational or workforce development for the local

	film, television, and digital media industry.
§18-235-17- <del>20</del> <u>21</u>	Disallowance of credit for unpaid expenditures.
<u>§18-235-17-22</u>	<u>Production company personnel and contractors; required Hawaii tax notice; safe harbor.</u>
<u>§18-235-17-23</u>	<u>Access to production company set and locations; required courtesy visit and press conference.</u>

**Proposed Administrative Rule Applying HRS § 237-2**

§18-237-2-01	"Business", "engaging in business"; motion picture industry loan-out entities; defined and distinguished.
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**Proposed Administrative Rule Applying HRS § 237-9**

§18-237-9-01	General excise tax licenses; motion picture industry.
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**Proposed Administrative Rules Applying HRS § 237-13**

§18-237-13-01.01	Imposition of tax on manufacturers; motion picture industry.
§18-237-13(6)-10	Imposition of tax on service business; motion picture industry; loan-outs.
§18-237-13(6)-11	Imposition of tax on the rental or leasing of tangible personal property; rental of personal property out-of-state; taxable.

**Proposed Administrative Rule Applying HRS § 237-18**

§18-237-18-01	General excise tax rate for services provided to a motion picture production; half per cent rate.
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DEPARTMENT OF TAXATION  
PROPOSED HAWAII ADMINISTRATIVE RULES

TITLE 18

DEPARTMENT OF TAXATION

Chapter 235

Income Tax Law

**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 235-7.3.**

**§18-235-7.3-01 Royalties and other income tax exclusion; generally.** Section 235-7.3, HRS, provides an exclusion from Hawaii income tax under chapter 235, HRS, for royalties and other income derived from any patents, copyrights, and trade secrets received by an individual taxpayer or qualified high technology business. In order to qualify for the exclusion, the royalties or other income must be directly derived from the patents, copyrights, or trade secrets that are owned by the individual taxpayer or qualified high technology business and also be developed and arise out of a qualified high technology business. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-02 Ownership of intellectual property; loan-outs, individuals, and qualified high technology businesses.** (a) In order to qualify for the income tax exclusion allowed under section 235-7.3, HRS, the patents, copyrights, and trade secrets giving rise to the royalties or other income must be:

- (1) Owned by an individual or qualified high technology business; and
- (2) Developed and arising out of a qualified high technology business.

(b) Loan-outs. For purposes of this section, "loan-out" has the same meaning as provided under section 18-235-17-10, HAR. An individual is not disqualified from qualifying for the exclusion under section 235-7.3, HRS, by reason of organizing their performing arts business affairs through use of a loan-out entity.

(c) Qualified high technology businesses. Section 235-7.3(c), HRS, defines qualified high technology business as a business that conducts more than fifty percent of its activities in qualified research. For purposes of the income tax exclusion provided under section 235-7.3, HRS, a qualified high technology business can be an individual that carries out business as a sole proprietorship or any other business entity. For purposes of calculating the fifty per cent activities test required under section 235-7.3, HRS, an individual that carries on qualified research in the capacity of a sole proprietor may qualify as a qualified high technology business

under this section only if the individual calculates the percentage of activities by comparing his or her qualified research activities to all of his or her business activities, including activities conducted as an employee.

(d) To make the determination of whether a qualified high technology business, including an individual as provided under subsection (b), satisfies the activities test under section 235-7.3(c), the qualified high technology business must use a numerator that contains a measurement of activities in direct support of qualified research and a denominator that includes a measurement for all business activities. Business activities may be measured by the cost of these activities, the time spent on these activities, or another consistently applied reasonable basis.

(e) Section 18-235-7.3-02, HAR, is illustrated as follows:

**EXAMPLE:** Ian Invention is an inventor of novel devices that constitute patentable subject matter. Ian carries out his invention business activities, which constitutes qualified research, as a sole proprietor. In order to make enough money to pay his bills while he is inventing, Ian also is a part-time bartender in the evenings. Assume for purposes of this example that Ian spends 30 hours per week in his garage working on his inventions and spends 20 hours per week in the evening bartending. For purposes of the income tax exclusion under section 235-7.3, HRS, Ian Invention is a qualified high technology business as a sole proprietor because at least fifty per cent of Ian's activities as a sole proprietor are in qualified research when he compares all of his business time—including time as an employee—to the time he spends conducting qualified research.

(Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-03 Performing arts products; analysis of the work-for-hire doctrine.**

(a) The income tax exclusion allowed under section 235-7.3, HRS, may be attributed to an individual or qualified high technology business that receives royalties or other income from performing arts products determined with or without regard to the work-for-hire doctrine under United States copyright law. An analysis of the work-for-hire doctrine may be relevant to and determinative of a taxpayer's claim for an exclusion under section 235-7.3., HRS, where the taxpayer claiming the exclusion is not the owner of the copyrights that gave rise to the income sought to be excluded.

(b) For purposes of analyzing whether royalties received from performing arts products are property excluded, an analysis of copyright laws and the ownership of copyrights in the performing arts products industry is relevant. Copyright protection subsists in any original work of authorship fixed in a tangible medium of

expression, now known or later developed, from which the expression can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. Copyright in a work vests initially in the author or authors of a work. The authors of a joint work are coowners of copyright in the work. A joint work is a work prepared by two or more authors with the intention that their contributions be merged into inseparable or interdependent parts of a unitary whole. For purposes of performing arts products, sufficient copyrightable expression may arise from the artistic expression of authors as defined under United States copyright law, including actors, directors, screen writers, cinematographers, or other similar performing arts roles that provide identifiable expressive components within a performing arts product that may give rise to copyright protection. Whether a participant in the production of a performing arts product qualifies as an author depends upon the facts and circumstances of each case.

(c) The work-for-hire doctrine for purposes of section 235-7.3., HRS, means:

- (1) A work, as discussed in subsection (b), prepared by an employee within the scope of his or her employment; or
- (2) A work, as discussed in subsection (b), specially ordered or commissioned for use as a contribution to a collective work, as part of a motion picture or other audiovisual work, if the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire; or
- (3) A work, as discussed in subsection (b), otherwise qualified under federal court interpretations of the work-for-hire doctrine. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-04 Performing arts products; extension of exclusion to authors, assignors, licensors, or licensees.** (a)

The income tax exclusion provided under section 235-7.3, HRS, for performing arts products purposes, extends to authors, assignors, licensors, and licensees of any copyright rights in performing arts products, or any parts thereof, that are:

- (1) Owned by the individual taxpayer or qualified high technology business; and
- (2) Are developed and arise out of a qualified high technology business.

(b) As provided in section 18-235-7.3-02, HAR, an individual who organizes their performing arts products affairs through the use of a loan-out entity is not disqualified from the income tax exclusion under section 235-7.3, HRS.

(c) An author is any person who contributes expression capable of copyright protection, as is defined under United



states copyright law. Authors may include writers, recording artists, actors, directors, animators, among other persons.

(d) Section 18-235-7.3-04, HAR, is illustrated as follows:

**EXAMPLE 1:** Ann Actress, an actor, formed a loan-out entity that contracts with third parties for her acting services. Ann's loan-out enters into a contract with XYZ Productions. XYZ Productions is a qualified high technology business. Pursuant to Ann's acting contract with XYZ Production Company, which will own the film, Ann is paid royalty and other income for her services of acting. Specifically, her contract calls for the arrangement to constitute a work-for-hire under United States copyright law. Also, the contract terms require a concurrent assignment of all of her copyright interests, worldwide and whatever the rights may constitute, to XYZ Production, which as a practical matter is industry necessity in order for XYZ Production to exploit the film. For purposes of section 235-7.3, HRS, Ann is entitled to exclude from her Hawaii income the amount received that is considered royalties or other income from copyrights because she is an author without regard to the work-for-hire doctrine pursuant to section 18-235-7.3-03, HAR, and further is an assignee of copyrights pursuant to this section, both of which entitle Ann to the income tax exclusion under section 235-7.3, HRS.

**EXAMPLE 2:** Assume the same facts as Example 1, except that Ann is paid for her acting services associated with a television commercial for a new pair of jeans. XYZ Production Company films the commercial but is not the owner of the copyrightable expression, i.e., the commercial. Assume the clothing line manufacturer owns the copyright in the television commercial and all rights to the commercial. The clothing line manufacturing is not a QHTB. Ann's income from her acting in the clothing line manufacturer's television commercial is not entitled to the exclusion under section 235-7.3, HRS, because the copyright for the television commercial is not owned by Ann or a qualified high technology business. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-05 Qualified high technology business and royalties or other income determination; nexus with Hawaii not required.** (a) There is no requirement that the qualified high technology business or the royalties or other income derived from patents, copyrights, and trade secrets be:

- (1) Sourced to Hawaii in any way;
- (2) Developed and arising out of a Hawaii business;
- (3) Owned by a Hawaii resident;
- (4) Owned by a qualified high technology business

organized under the laws of Hawaii; or

(5) Owned in Hawaii.

(b) The activities giving rise to the development of the patents, copyrights, or trade secrets subject to the income tax exclusion provided under section 235-7.3, HRS, may be sourced anywhere worldwide.

(c) A qualified high technology business for purposes of section 235-7.3, HRS, is a business that conducts more than fifty per cent of its activities in qualified research. As provided in subsection (b), the qualified research is not required to be performed in Hawaii. A qualified high technology business for purposes of section 235-7.3, HRS, is different from the definition of qualified high technology business for purposes of sections 235-110.9 and 235-110.91, HRS.

(d) Royalties or other income derived from the exploitation of any patents, copyrights, or trade secrets may be derived from any source worldwide. There is no requirement that the income excluded under section 235-7.3 must be earned from a Hawaii source. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-06 Royalties and other income; defined.** (a) Section 235-7.3, HRS, provides an exclusion from Hawaii income tax law under chapter 235, HRS, for royalties and other income derived from any patents, copyrights, and trade secrets received by an individual taxpayer or qualified high technology business.

(b) For purposes of section 235-7.3, HRS, "royalties" means compensation, however designated, paid to the owner of a patent, copyright (with and without regard to the work-for-hire doctrine analysis provided under section 18-235-7.3-03, HAR), or trade secret, for the use of, or the right to use, the patent, copyright, or trade secret, or any interests in any of the same. The payment is typically a percentage of profit or a specified sum per item sold; however that in itself is not determinative. The purpose for which the payment is made and not the manner of payment is the determining factor.

(c) For purposes of section 235-7.3, HRS, "other income" means accumulation of wealth from sources other than royalties. Other income includes compensation for services; gross income derived from business activities; gains from the sale of property interests; dividends; pension income; distributive shares of partnership interests; and other non-royalty income items that would fall within the definition of "income" for purposes of section 61(a) of the Internal Revenue Code; provided that the "other income" is derived directly from patents, copyrights, and trade secrets.

(d) "Royalties and other income" may be derived in any form. For example, income received in the form of a royalty or other income payment may be received and reported on Form W-2 or Form HW-2 (wage income) or on Form 1099 (non-wage income), or other source of receipt and reporting. The means by which income

is received or reported is not dispositive for the analysis as to whether income constitutes royalties or other income within the meaning of section 235-7.3, HRS.

(e) "Royalties and other income" excludes income not directly derived from the exploitation of patents, copyrights, and trade secrets. For example, income that is [~~disqualified~~] taxable and not excluded from the income tax [~~exclusion~~] under section 235-7.3, HRS, includes income from:

- (1) Appearance fees;
  - (2) Ticket revenue;
  - (3) Autograph income; or
  - (4) Sponsorship fees.
- (f) Section 18-235-7.3-06, HAR, is illustrated as follows:

**EXAMPLE:** Roy Rockstar performs a live concert at the Waikiki Shell. In an advanced arrangement with concert promoters and Roy's record label, the concert at the Shell is to be recorded. Roy owns the copyright to the music he performs, as well as the copyright to any recording of his performance at the Shell. Roy has arranged through his contract with concert promoters that he will be paid a percentage of ticket sales for the live performance; a set fee for appearing one hour before the show to sign autographs backstage by a local sponsor of the concert; and a percentage of record sales from the live concert recording. For his performance at the Shell, Roy earns \$50,000 in his share of ticket sales; \$10,000 from the sponsor for appearing before the show for autographs; and \$100,000 in payments from the record label as his share of record sales from his live performance at the concert during the taxable year. For purposes of the income tax exclusion under section 235-7.3, HRS, Roy Rockstar will be entitled to exclude only the \$100,000 from the record sales that represents royalties or other income from the exploitation of his copyrightable subject matter. Roy will not be entitled to exclude the ticket fees or appearance revenues because this income is [~~unrelated to~~] not directly derived from any copyrightable expression under the facts of this example. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-07 Patents, copyrights, and trade secrets; definitions.** (a) Only royalties or other income derived from patents, copyrights, and trade secrets are entitled to the exclusion under section 235-7.3, HRS.

(b) For purposes of section 235-7.3, HRS, only patents that are active patents issued by the United States Patent and Trademark Office are entitled to the exclusion. Abandoned, inactive, or expired patents do not qualify for the exclusion under section 235-7.3, HRS. Patentable subject matter may qualify as a trade secret;

however loses its characterization as a trade secret when efforts to maintain its secrecy under the circumstances are no longer maintained.

(c) For purposes of section 235-7.3, HRS, it is not necessary that the expression giving rise to royalties or other income is derived from an active and issued registered copyright by the United States Copyright Office; provided the expression giving rise to the royalties or other income is sufficiently [reative] original such that the expression constitutes copyrightable subject matter.

(d) For purposes of section 235-7.3, "trade secret" means information, including a formula, pattern, compilation, program, device, method, technique, or process, that:

- (1) Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by, other persons who can obtain economic value from its disclosure or use; and
- (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-08 Royalties exclusion; impact of half-per cent general excise tax rate.** A taxpayer that is entitled to utilize the income tax exclusion under section 235-7.3, HRS, is not precluded from being taxed at the half-per cent general excise tax rate assessable on gross income or gross proceeds from the performance of services to a production company pursuant to section 18-237-18-01, HAR. Likewise, a taxpayer that is entitled to be taxed at the half-per cent general excise tax rate pursuant to section 18-237-18-01, HAR, is not precluded from the income tax exclusion under section 235-7.3, HRS.

**PROPOSED ADMINISTRATIVE RULE APPLYING HRS § 235-9.**

**§18-235-9-01 Exemption from income tax; motion picture and television film production.** (a) Section 235-9, HRS, provides an exemption from Hawaii income tax for persons engaged in various business industries. Included as persons exempt from Hawaii income tax law are those engaged in the business of motion picture and television film production.

(b) To qualify for the income tax exemption allowed by section 235-9, HRS, a person engaged in the business of motion picture and television film production must satisfy all of the following:

- (1) The person must be engaged in the motion picture or television film production business in Hawaii; and
- (2) The person must produce the motion picture or television film products in Hawaii.

(c) A person will only be entitled to an exemption from Hawaii income tax law under section 235-9, HRS, to the extent the person's activities satisfy all of the requirements of subsection (b).

(d) Multi-jurisdiction productions; safe harbor. A person will qualify for the income tax exemption only for income received from the production of the motion picture and television film products produced in Hawaii. Income received from production of motion picture and television film products produced outside Hawaii will not qualify for the income tax exclusion. For businesses engaged in the business of motion picture and television film production occurring both within and without Hawaii, income may be apportioned amongst the production activities creating the performing arts products occurring within and without the State based upon any reasonable method, including separate accounting, costs, and time. The department of taxation will not challenge apportionment of income based upon costs incurred in the production of the multi-jurisdictional performing arts products.

(e) For purposes of this section, "motion picture or television film":

- (1) Means a feature-length motion picture, short film, made-for-television movie, commercial, music video, television series pilot or any number of television series episodes, television special, national magazine show, national talk show, or other production approved by the director; and
- (2) Does not include: daily news; public affairs programs; non-national magazine or talk shows; televised sporting events or activities; productions that solicit funds; productions produced primarily for industrial, corporate, institutional, or other private purposes; and productions that include any material or performance prohibited by chapter 712.

(d) Section 18-235-9-01, HAR, is illustrated as follows:

**EXAMPLE 1:** XYZ Production Co. is a motion picture and television film production company. During the taxable year, XYZ Production Co. produces three films in Hawaii and receives gross taxable income in the amount of \$10,000 from the sale, lease, or license of its film products. Also in the same taxable year, XYZ Production Co. receives gross taxable income in the amount of \$20,000 in lease payments for use of its parking lot from an unrelated third party for use with the third party's business, which is unrelated to motion picture production. Under this example, XYZ Production Co. is considered a motion picture and television film production business; however XYZ Production Co. will only be exempt from income tax under section 235-9, HRS, to the extent of the gross taxable income of \$10,000, from its motion picture or television film production activity. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS §235-9)

**§18-235-9-02 No deduction for expenses associated with tax exempt activity; conformity to section 265 of the Internal Revenue Code.** No deduction shall be allowed for any amount otherwise allowable as a deduction for expenses incurred with the production of income wholly exempt from tax under chapter 235, HRS. Persons exempt from income under section 235-9, HRS, shall not be entitled a deduction for expenses incurred with respect to the production of income exempt under that section. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS §235-9)

**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 235-17.**

**§18-235-17-01 Motion picture, digital media, and film production income tax credit; allowed.** (a) Beginning July 1, 2007, until December 31, 2015, section 235-17, HRS, allows qualified taxpayers to claim a refundable income tax credit equal to the following percentages of qualified costs incurred for qualified productions being produced in Hawaii:

- (1) Fifteen per cent of qualified production costs incurred in any county in the State with a population of over seven hundred thousand (i.e., the city and county of Honolulu); and
- (2) Twenty per cent of qualified production costs incurred in any county in the State with a population of seven hundred thousand or less (i.e., Kauai, Maui, and Hawaii counties).

(b) Any qualified production that conducts business activities in Hawaii such that the qualified production is considered a taxpayer for purposes of chapter 235, HRS, is eligible to claim the credit under section 235-17, HRS. There is no requirement that the qualified production be organized under the laws of Hawaii. A qualified production may be organized under the laws of any jurisdiction. In order to qualify for the credit under section 235-17, HRS, a qualified production must be considered a taxpayer for purposes of chapter 235, HRS, Hawaii income tax law. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-02 Claim for credit; procedures; multiple entities involved.** (a) Every taxpayer claiming the credit under section 235-17, HRS, is required to prequalify for the credit by registering with the department of business, economic development, and tourism. The Hawaii film office is the branch within the department of business, economic development, and tourism responsible for the prequalification determination. A qualified production must submit its prequalification registration to the Hawaii film office not later than one week before principal photography begins. Failure to timely obtain prequalification registration may result in waiver of the credit. The determination of whether an untimely prequalification registration results in waiver of the credit is within the discretion of the Hawaii film office.

(b) Not later than ninety days following the end of the taxable year in which the qualified production costs were expended, all taxpayers must submit a sworn report to the Hawaii film office identifying the information required by the Hawaii film office. Required information includes data on the production and a detailed expenditure report in order for the Hawaii film office to make its credit claim certification determination. After determination of the amount of qualified

production costs expended by a taxpayer, the Hawaii film office will issue a certificate to the taxpayer. In order to properly claim the credit, the taxpayer must attach a copy of the certificate to the taxpayer's income tax return claiming the credit, along with any other required forms.

(c) It is not uncommon in the motion picture and film production industry for multiple production companies to participate in the production of one performing arts product. For purposes of claiming the credit under section 235-17, HRS, only one taxpayer may file a claim for credit with the Hawaii film office per production. The Hawaii film office will process tax credit applications and claims for credit in the order in which the applications and claims are received. Any subsequent qualified production(s) claiming credit for a production that has already claimed the credit will be denied the credit.

(d) Where multiple qualified productions participate in the creation of a final performing arts product, it is important for the relevant production entities to negotiate which taxpayer will claim the credit under section 235-17, HRS. Particularly in advertising agency relationships, confusion can arise as to which entity can claim the credit. In an advertising agency relationship where a television commercial is the performing arts product, a client company hires an advertising agency, which in turn hires a production company to film the performing arts product. Under the statutory provisions of section 235-17, HRS, any one of the three entities may qualify as a qualified production incurring qualified production costs to the extent of the respective party's qualified expenditures. Productions should negotiate which of the entities will be claiming the credit. The production company filming the commercial, for example, could claim as qualified production costs the cost to create the commercial itself. The advertising agency, however, could claim as qualified production costs the amount it was billed by the production company to create the commercial, which is likely the actual cost of production plus the production company's markup or profit. The client company, lastly, could claim as qualified production costs the amount it pays to the advertising agency and/or the production company, which would include the actual costs incurred by the advertising agency and the production company plus both the production company's and advertising agency's markups or profits. As discussed in this subsection, any one of the three entities could be a qualified production; however only one of the three may claim the credit. In addition, the amount of the credit will be different for each entity that could claim the credit. In general, the client company's credit claim would be the highest and the production company's credit claim would be the lowest. The distinction between the differing credit claim entitlements is due to the fact that the credit is calculated based upon qualified costs and the client company would incur the most costs between the entities discussed.



(e) If a production company produces more than one production in a taxable year, qualified production costs must be aggregated for purposes of claims for credit, which must also be aggregated on a single tax return for the taxable year. The credit allowed under section 235-17, HRS, is used first to credit any tax liability owed, with any excess being refunded to the taxpayer. The requirement that qualified production costs must be aggregated for purposes of claiming the credit on one tax return does not impact the \$8,000,000 cap provided under section 235-17(j). The \$8,000,000 cap is determined on a per production basis, not per taxpayer. Therefore, where a taxpayer produces multiple qualified productions in one taxable year, it is possible for a single taxpayer to receive total credit at the end of the taxable year in excess of \$8,000,000.

(f) Where a taxpayer produces multiple qualified productions in a taxable year, each of the separate certificates received from the Hawaii film office certifying the qualified production costs must be attached to the taxpayer's return. The aggregating of qualified production costs, as discussed under subsection (e), may be reported on a single Form N-340 and a single Schedule CR.

(g) Claims for credit under section 235-17, HRS, must correspond with the taxpayer's accounting method. In general, a cash method taxpayer must claim all qualified production costs in the year in which the cost was paid as provided in section 461, Internal Revenue Code. An accrual method taxpayer must claim all qualified production costs in the year in which the cost was properly accrued under section 461, Internal Revenue Code.

(h) If qualified production costs are incurred in two separate tax years for the same production, the credit under section 235-17, HRS, will only be allowed based upon the costs paid or incurred in the respective tax year. For example, if \$400,000 in qualified production costs were incurred in 2007 and \$500,000 in qualified production costs were incurred in 2008, the credit must be claimed in the two separate tax years based upon the qualified production costs incurred in each respective taxable year. Therefore, a taxpayer in this situation will file for the credit once in each 2007 and 2008 claiming credit for the qualified production costs incurred in the respective taxable years. A taxpayer with qualified productions costs for one production that spans two taxable years should take care to ensure a timely application for credit certificates with the Hawaii film office in each of the successive tax years. The report required under section 235-17(h) must be filed within ninety days following the end of the taxable year in which qualified production costs may be claimed as the basis of the tax credit. The report submitted to the Hawaii film office must include a statement and report of qualified production costs incurred within the taxable year sufficient for the Hawaii film office to certify credits allowed in that taxable year. Another statement and report must be submitted in the succeeding taxable

year to account for qualified production costs incurred in the subsequent taxable year.

(i) Application of subsection (g) relating to the claiming of qualified production costs in the year the costs are properly accounted for based upon a taxpayer's accounting method are not intended to conflict with the definitional requirement of a qualified production contained in section 18-235-17-03, HAR. A taxpayer must independently satisfy the \$200,000 qualified production cost definitional requirement in order to qualify for a claim for credit under section 235-17, HRS. For additional discussion on the definition requirement of a qualified production, see section 18-235-17-03, HAR. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-03 Qualified productions; \$200,000 threshold determination.** (a) Section 235-17(d)(2), HRS, requires as a condition precedent to qualifying for the credit that the production shall have qualified production costs associated with the production of at least \$200,000.

(b) For purposes of section 235-17(d), HRS, and qualifying for the credit, section 235-17(1), HRS, defines a qualified production by category and considers each production as a separate, individual qualified production. In order to be a qualified production such that qualified production costs may be paid or incurred as the basis for a claim for credit, each production of a taxpayer must independently qualify for the \$200,000 production cost threshold, regardless of the number of productions one taxpayer may have in a tax year.

(c) Section 18-235-17-03, HAR, is illustrated as follows:

**EXAMPLE 1:** 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 qualified production costs. XYZ Productions does not qualify as a qualified production 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 qualified production costs of \$250,000 on the same production. XYZ Production's total qualified production costs for the entire production is now more than \$200,000. XYZ Productions can file an amended return for 2007 taking into account the \$75,000 in qualifying expenditures during 2007 because the production is now a qualified production; provided a timely amended return is filed within twelve months following the close of the taxable year in which the costs were paid or incurred.

**EXAMPLE 2:** XYZ Productions produces four productions throughout the taxable year, with each production incurring

qualified production costs of \$75,000. For the entire taxable year, XYZ Productions has incurred qualified production costs in excess of \$200,000 for all productions. XYZ Productions will not be entitled to the income tax credit under section 235-17, HRS, because each production is treated as a separate, individual production for purposes of section 235-17(d), HRS, which requires that each production have qualified production costs of at least \$200,000 in order to qualify. Even though XYZ Productions incurred qualified production costs in excess of \$200,000 in the aggregate during the taxable year (\$300,000), each of the four productions on an individual basis, which is the test required under section 235-17(d) and (1), HRS, incurred qualified production costs of less than \$200,000. (\$75,000 each). (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-04 Claiming the credit; timing; twelve-month rule.** (a) Section 235-17(c), HRS, requires all claims for the credit, including amended claims, be filed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. Failure to comply with the twelve-month filing requirement constitutes waiver of the right to claim the credit.

(b) Taxpayers should take care to ensure that claims for the credit under section 235-17, HRS, are timely made. The incumbent waiver of the credit due to an untimely claim is final. There are no appeal rights or other discretionary authority vested with the department of taxation to suspend or waive this provision.

(c) Taxpayers should take particular care in the following factual situations:

- (1) Partnerships. Taxpayers that are partners in partnerships constituting qualified productions should ensure timely claims of the production credit. A partnership's tax return is considered informational in nature and does not constitute a claim for credit. A claim for credit is timely made by a partner on or before the end of the twelfth month following the close of the taxable year in which the partner receives his or her distributive share of the partnership's credit allocation. Because of the length of time some partnerships take in order to calculate the partnership's information return, as well as all partners' distributive shares, time is of the essence to ensure timely claims by the partners.
- (2) Productions with straddling tax years. Productions that incur costs insufficient to claim the credit in Year One of the production; however incur sufficient costs in Year Two of the production should take care to ensure timely claims of the credit on original or

amended returns. Example 1 under section 18-235-17-03(c), HAR, elaborates on the factual situation where a timely amended return is at issue. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-05 Distribution of credit.** Section 235-17(a), HRS, provides that the tax credit allowed shall be determined at the entity level for partnerships, S corporations, estates, or trusts. Claim for credit may not be made at the entity level for a partnership, S corporation, estate, or trust unless such entity has elected to be taxed as a corporation under relevant federal tax law. Distributions of credit under section 235-17, HRS, shall be made in accordance with Internal Revenue Code Subchapter K, Subchapter J, Subchapter S, or other relevant pass-through entity allocation laws of the Internal Revenue Code to which Hawaii conforms. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-06 Prorating qualified production costs between counties in Hawaii; airfare and shipping costs.** (a) Section 235-17(a), HRS, provides that a taxpayer claiming credit for qualified production costs in Hawaii may prorate its expenditures based upon the amount spent in each county if the population base differs such that an expenditure in one county may entitle that taxpayer to a higher or lower credit, whichever the case may be. Prorating of qualified production costs only applies for costs incurred between two counties. This section does not apply to costs incurred between other states or countries and Hawaii.

(b) Qualified production costs may be prorated amongst the counties by any reasonable method, taking into account the specific facts and circumstances in any particular case.

(c) Safe harbor for airfare, shipping, and other similar costs.

- (1) The department will not challenge the prorating of qualified production costs for airfare, shipping costs, or qualified production costs of a similar nature where two locations equally impact upon a single expenditure; provided a taxpayer accounts for the expenditure as provided in paragraph (2). Airfare and shipping costs are one example of qualified production costs where neither the origination nor the destination should control disposition of the credit amount, but rather both the origination and destination impact the qualified production cost equally.
- (2) A taxpayer will be considered to have properly accounted for a prorated cost for purposes of airfare, shipping cost, or similar qualified production cost where two locations equally impact a single expenditure if the taxpayer takes the total expenditure and divides

the sum in half. Next, the taxpayer must apply the fifteen per cent tax credit rate to one-half of the cost and the twenty per cent tax credit rate to the other half of the cost. The total credit allocable for that one prorated qualified production cost will be comprised of the sum of the fifteen per cent rate product and the twenty per cent rate product.

- (3) Airfare and shipping costs between the counties of Kauai, Maui, and Hawaii are eligible for the twenty per cent credit rate and are not required to be prorated under the safe harbor.
- (d) Section 18-235-17-06, HAR, is illustrated as follows:

**EXAMPLE 1.** 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 safe harbor provided by section 18-235-17-05, HAR, XYZ Productions must divide the total fare (\$1,000) in half (\$500 and \$500). Then, XYZ Productions must take the tax credit at the fifteen per cent rate for half of the cost ( $\$500 \times .15 = \$75$ ), and take the credit at the twenty per cent rate for the other half of the cost ( $\$500 \times .20 = \$100$ ). XYZ Production's total credit properly allocable as provided under section 18-235-17-05, HAR, for the airfare is \$175.

**EXAMPLE 2.** Assume the same facts in Example 1, except that the cost to transport talent and crew is from Los Angeles to Kailua-Kona for production only on the Big Island of Hawaii. The prorating safe harbor and this section do not apply to this example. The amount of credit for costs incurred in airfare or shipping costs to Hawaii will be determined by the destination county. Based upon the facts in this example, airfare purchased to transport talent and crew to Kailua-Kona will be entitled to the twenty per cent credit rate on the entire purchase.

**EXAMPLE [2]3.** 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 fifteen per cent rate. Three-fourths of the cost (the use on Kauai) is entitled to the credit at the twenty per cent rate. Time spent in transit while transporting or shipping the camera will not be taken into account in calculating use for purposes of this example.

**EXAMPLE [3]4.** Assume the same facts in Example 2, 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 twenty per cent rate. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-07 Qualified production costs; generally.** (a) Section 235-17, HRS, provides a refundable income tax credit for a qualified production's expenditure of qualified production costs. Qualified production costs are those costs incurred by a qualified production in Hawaii that are subject to either:

- (1) Hawaii income tax under chapter 235, HRS; or
- (2) Hawaii general excise tax under chapter 237, HRS.

A cost is "subject to tax" within the meaning of section 235-17(1), HRS, if the State has jurisdiction to subject the taxpayer to a net income tax or general excise tax regardless of whether, in fact, the State does or does not tax such person.

(b) A qualified production cost will lose its character as a cost that qualifies for purposes of the credit if the cost was financed or paid for with funds that represent an investment for which a credit was or will be claimed under section 235-110.9, HRS. For additional information on ensuring that the source of production company funds do not jeopardize the qualifying nature of a production cost, see section 18-235-17-17, HAR.

(c) Section 235-17(1), HRS, provides a list of common expenditures that constitute qualified production costs. This is a list of costs that are ordinary and necessary in the motion picture or film production industry. The list contained under this section is illustrative and not exhaustive.

(d) A production cost will be considered subject to chapter 235, HRS, (Hawaii income tax law) or chapter 237, HRS, (Hawaii general excise tax law), where the person delivering the goods or performing the services ~~was~~ is subject to either tax. It is a taxpayer's responsibility to determine whether a vendor, employee, contractor, or other business or person is subject to chapter 235 or chapter 237, HRS, within the meaning of section 235-17(1), HRS.

(e) Section 18-235-17-07, HAR, is illustrated as follows:

**EXAMPLE 1.** 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~~] on an apportioned basis. 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 roundtrip airfare on ABC Airlines is a qualified production cost for purposes of the credit under section 235-17, HRS, because ABC Airlines, which is delivering the service, is subject to Hawaii income tax.

**EXAMPLE 2.** 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 income tax and 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 credit under section 235-17, HRS, because 123 Catering, which is delivering the goods, is subject to Hawaii income tax and general excise tax.

**EXAMPLE 3.** Steve Screenwriter, 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. Steve Screenwriter offers to sell XYZ Productions his screenplay. Steve Screenwriter's screenplay is not a qualifying production cost because Steve Screenwriter is not subject to Hawaii income or general excise tax.

**EXAMPLE 4.** Assume the same facts as Example 3, except that Steve Screenwriter is a resident of Hawaii and subject to Hawaii income tax. Steve Screenwriter's screenplay, though not listed in section 235-17(1), HRS, is a qualified production cost because Steve Screenwriter is subject to Hawaii income tax.

**EXAMPLE 5.** 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 with nexus to Hawaii~~] an apportioned basis. 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. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-08 Qualified production costs; production service fees.** (a) Section 235-17(1), HRS, defines qualified production costs to include a number of costs customarily included in the production of motion pictures, including the cost of office supplies, equipment, salaries, and other similar costs; provided that the cost is incurred in Hawaii and subject to either chapter 235 (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law). Included as a cost that may qualify as a qualified production cost for purposes of the credit is production services fees; except as otherwise provided in this section.

(b) "Production services fees" for purposes of the credit under section 235-17, HRS, generally means a line item fee assessed by a production company to a third party for whom the production is being produced (i.e., advertising agency or other person ordering the production) for ordinary and necessary production expenditures incurred in the ordinary course of producing a motion picture on an incidental or attendant basis, and may be calculated as a percentage of the production's billed cost. Components [~~that comprise~~] of a production services fee may include:

- (1) Office overhead;
- (2) Miscellaneous labor;
- (3) Rent;
- (4) Insurance;
- (5) Lighting, heating, cooling, or similar costs;
- (6) Accounting services or fees;
- (7) Telephone and other communication costs;
- (8) Depreciation, amortization, and other like costs; and
- (9) Mark-up or profit potential realized by a production company to the extent the production services fee is greater than actual expenditures that otherwise constitute the fee charged.

(c) A production services fee constitutes a qualified production cost for purposes of the credit under section 235-17, HRS, only to the extent the production service fee is paid by the taxpayer claiming the credit.

(d) No credit is allowed for a production services fee charged by the entity claiming the credit, unless the entity



claiming the credit for the production services fee can produce documentary evidence of expenditures that the claiming entity actually paid for qualified production costs to third parties.

(e) Section 18-235-17-08, HAR, is illustrated as follows:

**EXAMPLE 1:** XYZ Production Company charges 123 Advertising, its client company, a production services fee of \$5,000, which represents 1% of the total cost of producing a commercial. 123 Advertising is the entity claiming the credit under section 235-17, HRS, for the qualified production costs incurred in creating the commercial. The \$5,000 production services fee charged by XYZ Production Company and paid by 123 Advertising is a qualified production cost within the meaning of section 235-17, HRS, because the production services fee is paid by 123 Advertising, the taxpayer claiming the credit.

**EXAMPLE 2:** Assume the same facts as Example 1, except that XYZ Production Company will be the claiming entity and charges the same \$5,000 production services fee to 123 Advertising. The production services fee does not qualify as a qualified production cost for purposes of the credit under section 235-17, HRS, because XYZ Production Company did not pay the production services fee. The production services fee was a line item on the invoice for 123 Advertising and, except as discussed in Example 3, is profit or mark-up that XYZ Production Company was able to enjoy because the fee was greater than costs actually incurred.

**EXAMPLE 3:** Assume the same facts as in Example 1 and 2, except that XYZ Production Company can prove to the department of taxation's satisfaction that the \$5,000 production services fee included \$100 for coffee; \$200 for tape from a local hardware store; \$700 for telephone services; as well as \$500 in other incidental supplies used in the back-office. Under this example, XYZ Production Company may claim as a qualified production cost the \$1,500 of the production services fee that it can prove constitutes qualified production costs paid by the claiming entity that comprised the production services fee. The remaining \$3,500 of the production services fee does not qualify as a qualified production cost because XYZ Production Company paid nothing for this amount and is XYZ Production Company's profit mark-up. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-09 Qualified production costs; wages for nonresidents; prorating.** (a) Wages or salary paid to nonresident employees or contractors that perform services for a qualified production in Hawaii are considered qualified

production costs for purposes of the credit under section 235-17, HRS. For Hawaii income tax purposes, income earned while performing services or carrying on a trade or business in Hawaii is taxable under section 235-4(b), HRS. Because the wages earned from services performed in Hawaii by a nonresident are taxable regardless of residency under chapter 235, HRS, wages paid to nonresidents qualify as a qualified production cost. Wages earned from services performed in Hawaii by a nonresident constitute a qualified production cost even if such wages are exempt from withholding while in Hawaii under the 60-day rule provided under section 18-235-61-04(b)(1)(E), HAR.

(b) In certain circumstances, production companies employ full-time employees that work out of the production company's out-of-state headquarters. When such a qualified production company is producing a production in Hawaii, the qualified production company will utilize the same full-time employee for the time spent in Hawaii working on-location. If a full-time salaried employee is temporarily located to Hawaii for the purposes of performing services on behalf of the qualified production company/employer, the annual salary of the employee may be prorated for the amount of wages earned while performing services in Hawaii. As provided in subsection (a), the services performed in Hawaii by an employee, even if a nonresident, will be subject to income tax under chapter 235, HRS.

(c) Section 18-235-17-09, HAR, is illustrated as follows:

**EXAMPLE.** Gus Grip, 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 Gus Grip performed in Hawaii are subject to Hawaii income tax under section 235-4(b), HRS, and section 18-235-4.03(b)(3), HAR. Gus Grip's personal services of serving as a key grip for the movie, if performed in Hawaii, is a qualified production cost for purposes of the credit under section 235-17, HRS, because Gus Grip's Hawaii performed services subject Gus Grip to Hawaii income tax. Gus Grip's personal services qualify as a qualified production cost even if the wages are not subject to withholding pursuant to administrative rule. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-10 Qualified production costs; loan-outs.** (a) Section 235-17(1), HRS, defines qualified production costs to include wages or salary paid to cast, crew, or musicians; provided that the cost is incurred in Hawaii and subject to either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law).

(b) For purposes of this section, a "loan-out company" or "loan-out" means a wholly-owned entity formed on behalf of an actor, performer, director, producer, or other "above the line"

cast or crewmember of a motion picture production, which serves as a separate entity that constitutes the individual's means of contracting with a motion picture production for services rendered by the "above-the-line" individual. In general, a loan-out is the entity that agrees to provide services to the motion picture production, which in turn requires [~~the sole~~] an employee of the loan-out (i.e., the actor/owner of the loan-out) to perform the services contracted with the loan-out to the motion picture production pursuant to the terms of a contract. It is acceptable for loan-out companies to employ more than one person.

(c) Fees paid to a loan-out for services performed in Hawaii for a qualified production that represents wages or salary for cast or crew are qualified production costs for purposes of the credit under section 235-17, HRS; provided that the fees paid are subject to either chapter 235 or 237, HRS.

(d) In most instances, the fees paid to a loan-out for the services performed in Hawaii for a qualified production will qualify as qualified production costs because the loan-out entity doing business in Hawaii is subject to both Hawaii income and general excise taxes. A loan-out will be subject to general excise tax under chapter 237, HRS, for the privilege of doing business in Hawaii. For more information on this requirement, see section 18-237-13(06)-10, HAR. Also, the loan-out, whether a disregarded entity for income tax purposes or separately recognized as a taxable entity, will be subject to Hawaii income tax under chapter 235, HRS, for the income earned from services performed in Hawaii. For more information on this requirement, see sections 18-235-17-07 and 18-235-17-09, HAR.

(e) Expenditures for loan-out services are not disqualified under section 235-17, HRS, because some portion of the loan-out's income earned may be excluded from income tax under section 235-7.3, HRS. Depending upon the facts and circumstances, the loan-out may be entitled to other payments not considered excluded from income tax. The loan-out is considered subject to chapter 235, HRS, within the meaning of section 235-17(1), HRS. The loan-out will also be subject to general excise tax under section 237-13(6), HRS, as discussed under section 18-237-13(06)-10, HAR. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-11 Qualified production costs; per diem allowances and fringe benefits.** (a) Section 235-17(1), HRS, defines qualified production costs to include wages or salary paid to cast, crew, or musicians; provided that the cost is incurred in Hawaii and subject to either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law).

(b) Wages or salary for cast or crew are qualified production costs for purposes of the credit under section 235-17, HRS; provided that the fees paid are subject to either chapter 235 or 237, HRS and incurred in Hawaii. Section 235-17(1), HRS, also provides the director with the discretion to approve any

additional production costs in consultation with the department of business, economic development, and tourism.

(c) Per diem allowances provided to employees or contractors by a qualified production company are qualified production costs for purposes of the credit under section 235-17, HRS. For purposes of this section, "per diem" means an allowance to an employee or contractor provided by a qualified production as reimbursement for lodging, meals, and incidental expenses of the employee or contractor while the individual is away from home during work-related travel. Per diems will constitute qualified production costs to the extent that the per diem is for time spent in Hawaii. Per diems are considered wages or salary, or other production costs that qualify as determined by the director of taxation within the meaning of section 235-17(1), HRS.

(d) The following per diem allowances qualify within the meaning of this section:

- (1) Per diem allowances provided under an "accountable plan;" and
- (2) Per diem allowances provided under a "nonaccountable plan;"

as determined under section 62(c) of the Internal Revenue Code, accompanying federal regulations, and conforming Hawaii income tax law.

(e) In addition to per diem allowances as qualified production costs, fringe benefits considered ordinary and necessary business expenses under section 162 of the Internal Revenue Code qualify as qualified production costs for purposes of the credit under section 235-17, HRS; provided that such costs are subject to chapter 235 or 237, HRS, and incurred in Hawaii.

(f) The following fringe benefits commonly associated with the motion picture and film production industry qualify as a qualified production cost within the meaning of this section:

- (1) Unemployment insurance premium costs;
- (2) Employment taxes assessed under federal and state law;
- (3) Workers compensation insurance premium costs;
- (4) Union pension and welfare benefits to the extent required by contract between the union and the qualified production; and
- (5) Health insurance premiums;

to the extent incurred in Hawaii.

(g) Amounts considered per diem allowances under subsection (d), whether or not pursuant to an accountable plan, and fringe benefits identified in subsection (f) are considered subject to chapter 235, HRS, within the meaning of section 235-17(1), HRS. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**18-235-17-12 Qualified production costs; "kit" or "box" rentals.** (a) Section 235-17(1), HRS, defines qualified production costs to include wages, costs of set construction, wardrobe expenses, accessories, rentals, and any additional

production cost determined by the director in consultation with the department of business, economic development, and tourism; provided that the cost is incurred in Hawaii and subject to either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law).

(b) The costs incurred by a qualified production for the rental of an employee's or contractor's kit or box use constitutes a qualified production cost; provided that the fees paid are subject to either chapter 235 or 237, HRS.

(c) For employees, the rental paid for use of the employee's personal kit or box can be considered wages or income from renting personal property that is subject to Hawaii income tax law under chapter 235, HRS. If the rental is considered a reimbursement for ordinary and necessary business expenses, the cost is considered subject to Hawaii income tax law.

(d) For independent contractors, the rental paid for use of the contractor's personal kit or box can be considered wages or income from services provided to the qualified production company that is subject to Hawaii income tax law under chapter 235, HRS. Moreover, an independent contractor is subject to Hawaii general excise tax under chapter 237, HRS, on all gross proceeds earned as a privilege of doing business in Hawaii. To the extent that the kit or box rental is paid to an independent contractor, the proceeds received for the rental can be subject to both Hawaii income and general excise tax laws under chapter 235 and 237, HRS.

(e) For purposes of this section, "kit or box" means the personal tools, accessories, or other equipment of a specialist or tradesperson that utilizes the instruments to complete their specialized tasks in the motion picture and television film industry. Examples of items that would constitute a kit or box include a makeup artist's equipment or the construction tools of a ~~contractor~~ set designer. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-13 Qualified production costs; rental of local facilities or locations owned by nonprofit organizations.** (a)

Section 235-17(1), HRS, defines qualified production costs to include the costs associated with the rental and fees for use of local facilities and locations; provided that the cost is incurred in Hawaii and subject to either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law).

(b) For certain scenes filmed on-location in Hawaii, a production company may choose to utilize the property or location owned by a nonprofit organization. In exchange for use of its facilities, it is common for a nonprofit organization to charge the production company rent or other fee. It is possible that the nonprofit organization is exempt, to some extent, from Hawaii taxes under both the income tax law and general excise tax law assessed under chapters 235 and 237, HRS.

(c) For purposes of Hawaii's general excise tax law under chapter 237, HRS, a tax-exempt organization is only exempt from general excise tax to the extent the proceeds are a direct result of the exempt organization's exempt activity. The general excise tax exemption does not extend to any activity the primary purpose of which is to produce income even though the income is to be used for, or in furtherance of, the exempt activities of such organization. In general, rent received by a nonprofit organization is considered directly related to the production of income and not in pursuit of an exempt purpose and is therefore taxable under chapter 237, HRS, notwithstanding the fact that the income may be used to further an exempt organization's exempt purpose. Because rent received by an exempt organization is generally taxable under chapter 237, HRS, the rent paid by a production company to a nonprofit organization will generally be subject to chapter 237, HRS, and will constitute a qualified production cost. Furthermore, for purposes of Hawaii's income tax law under chapter 235, HRS, a tax-exempt organization is taxable on unrelated business taxable income.

(d) Section 18-235-17-13, HAR, is demonstrated as follows:

**EXAMPLE.** XYZ Productions is filming on location at a church, owned by an Internal Revenue Code section 501(c)(3) tax-exempt religious organization, the exempt purpose of which is to advance religious practices of its congregation. XYZ pays the church \$1,000 in rent for the use of the church facility for one day of shooting. The \$1,000 rent payment qualifies as a qualified production cost under section 235-17, HRS, because the church's business activities of receiving rent are taxable under chapter 237, HRS, because the rent's primary purpose is the production of income, even if the rental income is later used for the church's exempt purposes. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-14 Qualified production costs; insurance.** (a) Section 235-17(1), HRS, defines qualified production costs to include the cost of insurance; provided that the cost is incurred in Hawaii and subject to either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law). However, under title 14, HRS, insurance is not subject to either chapter 235 or 237, HRS.

(b) Insurance premiums under Hawaii law are subject to the insurance premiums tax under chapter 431, article 7, HRS. Effectively, chapter 431, article 7, HRS, serves as a substitute for Hawaii's income and general excise taxes under chapters 235 and 237, HRS, respectively.

(c) Because chapter 431, article 7, HRS, is a substitute for Hawaii net income tax and general excise tax, insurance subject to the insurance premiums tax under chapter 431, article

7, HRS, will constitute a qualified production cost.

(d) Section 235-17(1), HRS, expressly provides that insurance is a qualified production cost, thus intending insurance to qualify as a production cost notwithstanding any proviso to the contrary. Insurance that is written on a Hawaii risk, which is incurred in Hawaii, and that is subject to Hawaii's insurance premiums tax under chapter 431, article 7, HRS, will constitute a qualified production cost. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-15 Qualified production costs; credit calculation for fixed equipment costs.** (a) Section 235-17(1), HRS, defines qualified production costs to include costs of equipment and any additional production cost determined by the director in consultation with the department of business, economic development, and tourism; provided that the cost is incurred in Hawaii and subject to either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law). However, section 235-17(a), HRS, precludes any production cost from qualifying where a deduction for the cost is taken under section 179 (with respect to election to expense depreciable business assets) of the Internal Revenue Code.

(b) In many instances, motion picture production companies own fixed equipment that is used for filming various productions. Examples of fixed equipment include cameras, lights, computers, and trucks. These items are usually purchased as a matter of business necessity and are not necessarily associated with any specific production. The fixed equipment; however, is utilized by the production companies various film ventures on an as-needed basis. A qualified production company that utilizes fixed equipment in a Hawaii film production may claim as a qualified production cost the amount of the depreciation allowance, if any, for the equipment for the qualified production company's taxable year[+], prorated for the amount of equipment actually used in Hawaii; provided that a deduction has not been taken under section 179 of the Internal Revenue Code with respect to the equipment . The depreciation allowance allowable under state law shall be utilized to calculate the credit amount under this section.

(c) Section 18-235-17-15, HAR, is illustrated as follows:

**EXAMPLE.** XYZ Production Company has cameras that it ships to Hawaii to film a production for six months. All of these items were purchased by the production company prior to production in Hawaii and have been utilized as equipment for the past few years on other film projects. These cameras are available on a checkout basis for all productions being created by XYZ Production Company. Assume that the cameras are all "5 year" property under Internal Revenue Code depreciation conventions and assume further

that a deduction under section 179 of the Internal Revenue Code was not taken with respect to the cameras. Depreciation amounts have been taken over the prior years. Assume further that XYZ Production Company is entitled to take a depreciation allowance for the cameras for the taxable year of the production in Hawaii equal to \$1,000. XYZ Production Company can claim as a qualified production cost an amount equal to the depreciation allowance for the taxable year in which the production activities occurred prorated for the amount of use in Hawaii. In this case, because the cameras are used in Hawaii for six months, a \$500 qualified production cost is incurred for purposes of the credit under section 235-17, HRS. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-16 Qualified production costs; imported goods, services, or contracting subject to the use tax.** (a) Section 235-17(1), HRS, defines qualified production costs to include costs incurred by a qualified production within the state that are subject to chapter 237, HRS (Hawaii general excise tax law). Not all business transactions occurring in the state are subject to chapter 237, HRS. In order to ensure a level playing field amongst business transacted both within and without Hawaii, to avoid constitutionally infringing upon out-of-state taxpayers, and to complement the general excise tax as an overall excise tax regime, there is imposed in Hawaii a complementary tax on the use in this state of tangible personal property, services, or contracting imported into Hawaii under chapter 238, HRS (Hawaii use tax law).

(b) Importation of goods, services, or contracting into this state from out of state for use in this state is subject to chapter 238, HRS, capturing the general excise tax equivalent. Effectively, chapter 238, HRS, serves as a substitute for Hawaii's general excise tax under chapter 237.

(c) Because chapter 238, HRS, is a substitute for Hawaii general excise tax, production costs incurred by a qualified production in Hawaii, which would otherwise qualify as a qualified production cost, are considered subject to tax within the meaning of section 235-17(1), HRS, where the production cost (as either an item of tangible personal property, service, or contracting) is imported into Hawaii and is subject to the use tax under chapter 238, HRS, and the use tax is actually paid. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-17 Utilizing the motion picture, digital media, and film production income tax credit and the high technology business investment tax credit simultaneously; same production; safe harbor for segregating funds.** (a) Section 235-17(e), HRS,



contains a restriction on the source of funds used to purchase or acquire qualified production costs. On or after July 1, 2006, a qualified production cost that has been financed by an investment for which a credit was claimed under section 235-110.9, HRS, is ineligible for the section 235-17, HRS, tax credit. Furthermore, section 235-17(1), HRS, defines qualified production cost to include only those costs incurred by a qualified production that have not been financed by any investments for which a credit was or will be claimed pursuant to section 235-110.9, HRS.

(b) The statutory framework of section 235-17, HRS, including its limitation on the use of investments for which a credit was or will be claimed under section 235-110.9, HRS, does not preclude a qualified production from utilizing the section 235-17, HRS, refundable income tax credit in conjunction with financing portions of the qualified production with the utilization of the nonrefundable income tax credit provided by section 235-110.9, HRS.

(c) A taxpayer may take advantage of both the refundable credit available under section 235-17, HRS, for qualified production costs, as well as the nonrefundable credit available under section 235-110.9 for other related costs for the same production, and will not be challenged by the department for utilizing both tax credits; provided that the taxpayer complies with the requirements under this section.

(d) Safe harbor, generally. To the extent a dollar representing an investment in a qualified high technology business, as defined under section 235-110.9, HRS, will not be used to claim a credit under section 235-110.9, HRS, that dollar may be utilized to purchase qualified production costs that qualify for the refundable credit under section 235-17, HRS. Any invested dollar in a qualified high technology business, as defined under section 235-110.9, HRS, for which any credit is claimed under section 235-110.9, HRS, by any taxpayer disqualifies any costs paid for with the dollar invested, from qualifying for the refundable tax credit under section 235-17, HRS.

(e) Safe harbor; segregation requirement. To take advantage of both the nonrefundable income tax credit under section 235-110.9, HRS, and the refundable income tax credit under section 235-17, HRS, the production must clearly segregate funds based on source and use so as to maintain adequate tracing of the funds. A taxpayer will be considered to have adequately segregated the source and use of funds if the production maintains an entirely separate bank account, ledger, and tracing method for the money that represents an investment in the production company for which a credit is or will be claimed under section 235-110.9, HRS; and another separate bank account, ledger, and tracing method for contributions, investments, loans, profits, earnings, or other funds that will not be used to obtain a credit under section 235-110.9, HRS.

(f) Safe harbor; commingled funds. Where funds that

represent an investment for which a credit was or will be claimed under section 235-110.9, HRS, are commingled with other funds otherwise eligible for the credit under section 235-17, HRS, a taxpayer will be eligible for the refundable credit under section 235-17, HRS, as allowed under this subsection. The department will consider payment of qualified production costs of the production to have been first paid by any funds that represent an investment for which a credit was or will be claimed under section 235-110.9, HRS, and therefore disqualified for the refundable income tax credit under section 235-17, HRS. After all funds representing an amount equal to the amount of credit that was or will be claimed by any taxpayer under section 235-110.9, HRS, pursuant to an arrangement at the time the investment was made have been expended on qualified production costs; all remaining funds of the production may then be utilized to purchase qualified production costs that will be eligible for the refundable tax credit under section 235-17, HRS.

(g) Waiver requirement for commingled funds or other arrangement. A taxpayer that seeks to utilize funds that represent an investment under section 235-110.9, HRS, to be eligible for costs that qualify for the refundable tax credit under section 235-17, HRS, and further utilizes the safe harbor provided in subsection (f), or any other arrangement not provided by this section, is required to comply with this subsection. In order to qualify production costs for the credit available under section 235-17, HRS, for qualified production costs that will be paid for with funds that represent an investment under section 235-110.9, HRS, a taxpayer or investor must forever relinquish their right to claim the credit under section 235-110.9, HRS. Allocating credits under section 235-110.9, HRS, to partners or investors does not constitute relinquishing a right to claim the credit. The attribution of an investment dollar that qualifies for credit under section 235-110.9, HRS, to a dollar incurred for a qualified production cost will occur only once for each investment dollar that qualifies for credit under section 235-110.9, HRS. An investment dollar that qualifies under section 235-110.9, HRS, will lose its character as an investment eligible for the credit under section 235-110.9, HRS, only if the person ultimately eligible to claim the credit under section 235-110.9, HRS, provides the production with a signed waiver that is enforceable by the department against the investor/taxpayer. The extent to which an investor/taxpayer will be considered eligible to make a claim, and therefore the amount of credit the investor/taxpayer may waive, will be determined after any allocations of credit have been made by intervening pass-through entities, as allowed under sections 235-2.45 and 235-110.9, HRS. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-18 Independent certification [opinion] of motion picture, digital media, and film production income tax credit**

**claims.** (a) In order to ascertain the validity of a credit claim made under section 235-17, HRS, all production report statements submitted to the department of business, economic development, and tourism Hawaii film office pursuant to section 235-17(h), HRS, shall first be verified by an independent tax practitioner [~~as provided in this section~~]. No determination letter setting forth the qualified production costs incurred and the credit amount claimable under 235-17, HRS, shall be issued by the department of business, economic development, and tourism until the department of business, economic development, and tourism has received [~~an unqualified~~] a tax opinion or agreed upon procedures report as to the validity of a taxpayer's credit claim pursuant to this section. The independent verification of qualified production costs as required by this section will be satisfied as follows:

- (1) Issuance of a tax opinion. A tax opinion issued pursuant to this section shall reach a conclusion substantially similar to the following: "It is more likely than not that at least \$\_\_\_\_(insert appropriate amount) expended by the taxpayer during\_\_\_\_(insert taxable year) would qualify as eligible production costs within the meaning of section 235-17, HRS, that would be eligible for credits under that section." To qualify as a tax opinion acceptable under this section, such an opinion shall meet the requirements for covered opinions as set forth in Treasury Circular 230, 31 Code of Federal Regulations subtitle A, part 10, section 10.35(c), which by this reference is incorporated herein, with conforming changes in nomenclature and other language as authorized by chapter 235, HRS.
- (2) Issuance of an agreed upon procedures report. An agreed upon procedures report issued pursuant to this section shall evaluate the taxpayer's assertion of the amount qualifying as eligible production costs within the meaning of section 235-17, HRS, that would be eligible for credits under that section. The report shall test compliance with the elements set forth in section 235-17, HRS, and any relevant administrative rules or administrative guidance issued by the department, and shall separately state the total of eligible production costs for which no exceptions were noted. This report shall comply with the Standards for Consulting Services established by the American Institute of Certified Public Accountants, also known as AICPA.

It is not necessary that the opinion as described in paragraph (1) or the agreed upon procedures report described in paragraph (2) be addressed to, or be relied upon by, any person other than the taxpayer.

~~[(b) The procedures contained in this section are considered the minimum standards for acceptability of the~~

~~verification and certification opinion required before a determination letter will be issued for a credit claim under section 235-17, HRS. An unqualified certification opinion as to a taxpayer's credit claim shall be accepted, provided:~~

- ~~(1) The person or firm providing the certification opinion is an independent tax practitioner;~~
- ~~(2) The independent tax practitioner's certification opinion must be addressed to the taxpayer;~~
- ~~(3) The independent tax practitioner's name, address, and telephone number must be evident on the certification opinion and production report statement;~~
- ~~(4) The certification opinion must be dated as of the completion of the verification of the credit claim;~~
- ~~(5) The verification must be conducted at the item level. Verification pursuant to sampling methods will be considered insufficient verification without the permission of the department of business, economic development, and tourism and the department of taxation;~~
- ~~(6) The title of the production, the production tax credit number (as assigned by the Hawaii film office), and when applicable, the episode number(s), must be disclosed;~~
- ~~(7) The period during which the costs were incurred must be disclosed;~~
- ~~(8) A certification opinion shall only be issued for production report statements calculated using United States dollars.;~~
- ~~(9) The certification opinion shall certify to the department of business, economic development, and tourism, that the taxpayer's credit claim has been examined by the independent tax practitioner and that all eligible costs incurred with respect to the credit claim qualify and that the production expenditure report contains only qualified production costs within the meaning of section 235-17, HRS to the best of the independent tax practitioner's belief and that the claims "would more likely than not be sustained on its merits" if challenged by the department as that phrase is defined and applied by section 6694 of the Internal Revenue Code and relevant treasury and Internal Revenue Service practice regulations.~~
- ~~(10) The certification opinion shall include supporting documentation and records to substantiate the basis for the independent tax practitioner's conclusion that the costs claimed meet the standard of paragraph (9).~~
- ~~(11) The certification opinion shall contain refund and credit adjustments that are received for discounts, rebates, invoicing errors, and purchase returns, which must be credited to the production costs. Proceeds from the sale of props and other production assets~~

~~must be deducted from the costs presented in the production report statement. In cases where props and other production assets are kept in inventory for future productions, these items must be separately accounted for, identifying the amount of qualified production cost claimed as set forth under section 18-235 17 15, HAR;~~

- ~~(12) Amortization of series costs must be allocated to specific cost categories; and~~
- ~~(13) All sources of funds that were used to finance the production must be disclosed in supporting documents, including any non monetary transactions that were included in the cost of the production. Sources of funds that must be segregated for purposes of the verification include a segregation of funds that include funds for which a credit was or will be claimed under section 235 110.9, HRS. If there were no non-cash transactions for the production, the certification opinion must contain a disclosure to that effect. Any waivers of credits under section 235 110.9, HRS, pursuant to section 18-235 17 16, HAR, must also be disclosed.~~

~~(c) The certification opinion and verification supporting documents must accompany the taxpayer's production report statement.~~

~~(d)] (b) The certification opinion must be submitted to the department of business, economic development, and tourism not later than 90 days following the end of the taxable year in which qualified production costs were expended or incurred.~~

~~(e)] (c) It is the taxpayer's responsibility to ensure that all information relevant to ascertain the validity of the credit claim is provided to the taxpayer's independent tax practitioner.~~

~~(f)] (d) The cost of [conducting] the [verification and issuing the certification opinion] tax opinion or agreed upon procedures report shall be the responsibility of the taxpayer. The cost [incurred in conducting the verification and the issuance of the certification opinion] of the tax opinion or agreed upon procedures report required by this section shall be considered a qualified production cost; provided the services are subject to taxation under chapter 235 or chapter 237, HRS.~~

~~(g)] (e) This section is only required for taxpayers with qualified production costs in excess of \$1,000,000.~~

~~(h)] (f) Notwithstanding the requirement that a taxpayer provide a [certification opinion] tax opinion or agreed upon procedures report to the department of business, economic development, and tourism, the director of taxation may audit and adjust the tax credit amount to conform to the information obtained by the department or provided by the taxpayer.~~

~~(i)] (g) As used in this section:~~

~~["Financial interest" means:~~

- ~~(1) An ownership interest in the taxpayer;~~

- ~~(2) A creditor interest in the taxpayer;~~
- ~~(3) An employment or prospective employment for which negotiations have begun with the taxpayer;~~
- ~~(4) A loan or debtor interest with the taxpayer; or~~
- ~~(5) A directorship or officership in the taxpayer.]~~

"Independent tax practitioner" means a tax practitioner engaged in writing by the taxpayer to provide a [~~certification opinion~~] tax opinion or agreed upon procedures report under this section whose [~~self, spouse, dependent child, or employing firm does not~~;

- ~~(1) Have a financial interest in the taxpayer; and~~
- ~~(2) Is not engaged in any prohibited activities with or on behalf of the taxpayer;~~

~~for one year before and one year after the engagement to provide a certification opinion under this section.]~~ engagement relating to the issuance of the tax opinion or agreed upon procedures report is in compliance with, and does not contravene, any statute, regulation, ethical code or rule of professional conduct regulating the tax practitioner's professional conduct; and the tax practitioner does not have an ownership or pecuniary interest in the taxpayer.

~~["Prohibited activities" means the following activities performed by a tax practitioner with or on behalf of the taxpayer in any matter not related to a certification opinion performed under this section,~~

- ~~(1) Bookkeeping or other services related to the accounting records or financial statements of the taxpayer;~~
- ~~(2) Appraisal or valuation services, fairness opinions, or contribution in kind reports;~~
- ~~(3) Actuarial services;~~
- ~~(4) Internal audit outsourcing services;~~
- ~~(5) Tax services;~~
- ~~(6) Internal management outsourcing services;~~
- ~~(7) Management functions or human resources;~~
- ~~(8) Broker or dealer, investment adviser, or investment banking services;~~
- ~~(9) Legal services and expert services;~~
- ~~(10) Any other services determined by the Director of Taxation and issued by Tax Information Release.]~~

"Tax practitioner" means an individual, wherever located, who is authorized or permitted to practice or appear before the Internal Revenue Service or the department of taxation on behalf of a taxpayer; provided that if such individual practices under this section at any time while physically in Hawaii, such person shall be in compliance with relevant professional regulatory affiliations. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-19 Evidence of reasonable efforts to hire local talent and crew.** (a) Section 235-17(d)(4), HRS, requires as a

condition precedent to qualifying for the credit that a production provide to the department of business, economic development, and tourism, evidence of reasonable efforts to hire local talent and crew. A production must provide this evidence prior to submitting the production report for credit certification.

(b) Evidence of reasonable efforts to hire local talent and crew ~~may~~ shall be demonstrated as follows:

- (1) The production must provide documentary evidence of having contacted Hawaii chapters of industry unions or guilds, including the date and time of any telephone calls, emails or other contact; the name of the union or guild representative contacted; the name of the production representative initiating contact; and the name of the union or guild contacted~~[-];~~ or
- (2) The production must ~~also~~ provide documentary evidence of the specific means of notifying the public of the production's desire to hire local talent and crew, including copies of any press releases; solicitations; requests for proposals; bids; local newspaper ads; trade journal ads; flyers posted; open casting calls; radio spots; Hawaii film office website or other internet posting; or engagement of local production professionals as references for local talent and crew hires.

~~[(3) The production may also provide other evidence of the production's efforts to hire local talent and crew with the Hawaii film office's advanced permission.] (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)~~

**§18-235-17-20 Evidence of financial or in-kind contributions to educational or workforce development for the local film, television, and digital media industry.** (a) Section 235-17(d)(5), HRS, requires as a condition precedent to qualifying for the credit that a production provide to the department of business, economic development, and tourism, evidence of financial or in-kind contributions or educational or workforce development efforts, in partnership with related local industry labor organizations, educational institutions, or both, toward the furtherance of the local film, television, and digital media industries. A production must provide this evidence prior to submitting the production report for credit certification.

(b) Only one contribution is necessary to fulfill the requirement under this section. However, a production may make multiple contributions.

(c) Contributions required under section 235-17(d) are not refundable, even if a production does not qualify to claim the income tax credit. Contributions are also not considered charitable contributions.

(d) The following contributions will qualify for purposes of the evidence of educational or workforce development contribution required under section 235-17(d)(5), HRS:

- (1) Financial contributions to Hawaii public or charter schools. Financial contributions to Hawaii public or charter schools, at a minimum, equal to the lesser or 0.1 per cent of a production's qualified production costs or \$1,000. Financial contributions must be made specifically to an arts program at a Hawaii public or charter elementary school, middle school, high school, or post-secondary school. It is preferred that the contribution be made to a school in the same neighborhood in which the production takes place. Arts programs may include film/video, radio, performing arts, theater, music, and visual and fine arts.
- (2) In-kind donations to Hawaii public or charter schools. In-kind contributions to Hawaii public or charter schools that have the equivalent monetary value equal to, at a minimum, the lesser of 0.1 per cent of a production's qualified production costs or \$1,000. Contributions of in-kind property or services must be made specifically to an arts program at a Hawaii public or charter school, preferably in the same community in which production takes place. The in-kind contribution must include production-related property or services, including cameras and sound equipment; editing/post-production equipment; grip/electric equipment; computer hardware/software; props/set dressing; costumes; or other property or services previously agreed to by school administrators.
- (3) Educational program with Hawaii public or charter schools. At least one on-set or post-production internship arrangement with a Hawaii public or charter high school or post-secondary school, preferably in the same community in which the production takes place. The internship must include a cumulative of five hours, at a minimum, of arts or digital media education-related volunteer services, such as teaching acting classes, directing a school play, participating in animated student projects, or giving craft seminars. The internship may be arranged with any cast or crew. The minimum time requirement, at the discretion of the Hawaii Film Office, may be reduced based upon the value of services.
- (4) Educational program with local labor union chapters. At least one on-set craft apprenticeship arranged with one of the local labor union chapters. The apprenticeship must include a cumulative of five hours, at a minimum, of education-related volunteer services, such as giving a craft-related seminar. The apprenticeship may be arranged with any cast or crew.



The minimum time requirement, at the discretion of the Hawaii Film Office, may be reduced based upon the value of services.

- (5) FilmHawaii seminar participation with the Hawaii film office. Participation as a speaker in two or more FilmHawaii seminars. Such participation may also be used to offset the minimum five hours of volunteer services required in paragraph (3) or (4), above. Participation in one seminar shall be equal to 2.5 hours of volunteer services.
- (6) Any other evidence of financial or in-kind contributions or educational or workforce development approved by the Hawaii film office. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-21 Disallowance of credit for unpaid expenditures.** Section 235-17(1), HRS, defines qualified production cost to mean, among other requirements, costs incurred by a qualified production. For purposes of qualifying as a qualified production cost as defined, no income tax credit will be allowed for costs that remain unpaid at the time the production report is filed with the Hawaii film office. Any unpaid production expenditures at the time the production report is filed will not be considered paid or incurred within the meaning of section 235-17(1), HRS. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-22 Production company personnel and contractors; required Hawaii tax notice; safe harbor.** (a) Any taxpayer filing for prequalification for the income tax credit allowed under section 235-17, HRS, shall provide every nonresident employee, contractor, vendor, loan-out company, or other agent providing goods or performing services in Hawaii with a tax advisory informing such persons of Hawaii tax obligations. The tax advisory under this section shall be provided to all such persons not later than thirty business days after the engagement of the nonresident employee, contractor, vendor, loan-out company, or other agent is consummated.

(b) The tax advisory to be provided shall be any tax advisory made available to the motion picture and television film industry by the department through official pronouncement; or in a form that includes substantially the following:

"The purpose of this Tax Advisory is to provide notice to persons engaged in the motion picture and television film production industry of the potential tax obligations of working in Hawaii.

The Department of Taxation (Department) has asked

that this Tax Advisory be provided to persons involved in the motion picture industry while in Hawaii, including crew, actors, directors, writers, producers, or others who conduct activities in Hawaii in the capacity of an employee, vendor, independent contractor, or loan-out companies for income or profit.

#### INCOME TAX OBLIGATIONS

W-2 Employees--As a general matter, wages earned while working in Hawaii as an employee are subject to Hawaii income tax for the amount of income earned while in Hawaii.

1099 Independent Contractors and Loan-Out Companies--Also as a general matter, income earned in Hawaii while performing services in Hawaii or otherwise conducting business activities as an independent contractor or loan-out company is likewise subject to Hawaii income tax.

Residency--Income earned from performing services in Hawaii is taxable regardless of residency.

Royalties Exclusion--In certain circumstances, persons, whether W-2 employees or 1099 independent contractors or loan-out companies, may be entitled to an income tax exclusion for income earned as royalties from the exploitation of copyrights.

Relevant Forms--Income tax is reported and remitted by using the proper income tax form. For individual income tax purposes, residents file Form N-11 (Individual Resident Income Tax Return) or Form N-13 (Individual Resident Income Tax Return--Resident Short Form). Nonresidents file Form N-15 (Individual Income Tax Return For Nonresidents and Part-Year Residents). S-Corporations file Form N-35 (S Corporation Income Tax Return). Other Corporations file Form N-30 (Corporation Income Tax Return). Other forms may be necessary depending up the circumstances.

#### GENERAL EXCISE TAX OBLIGATIONS

W-2 Employees--Persons working or conducting business activities in Hawaii as a W-2 employee are generally not subject to the general excise tax.

1099 Independent Contractors and Loan-Out Companies--Generally, independent contractors and loan-out companies that provide services or other business activities to a production company are considered to be

conducting business in Hawaii and are subject to the general excise tax. Because independent contractors or loan-out companies are subject to the general excise tax, these persons must apply for and obtain a general excise tax license. Also, these persons must file a return and pay over general excise tax on the gross proceeds earned in Hawaii.

Relevant Forms--A general excise tax license is obtained from the Department by filing Form BB-1 (State of Hawaii Basic Business Application, Instructions, and Payment Voucher). General excise tax is reported and remitted by filing periodic returns on Form G-45 (General Excise/Use Tax Return), followed by filing Form G-49 (Annual Return & Reconciliation of General Excise/Use Tax Return) at the end of the tax year. Other forms may be necessary depending upon the circumstances.

CONTACT A TAX PROFESSIONAL

The Department suggests that any person affected by this Tax Advisory contact a tax professional familiar with Hawaii tax laws to assist them with any Hawaii tax issues.

ADDITIONAL INFORMATION

For additional information--

-Website: [www.hawaii.gov/tax](http://www.hawaii.gov/tax)

-Telephone: (808) 587-1569

-Fax: (808) 587-1584

-Tax Information Release Nos. 2006-02; 2008-02; 2009-05"

(c) "Subject to tax" safe harbor. (a) A taxpayer claiming the tax credit under section 235-17, HRS, that has complied with the terms of this section shall not have a production cost challenged as being disqualified because the tax upon the transaction was unpaid by the person providing the goods or rendering the services that were the basis of the production cost claimed.

(d) A taxpayer that satisfies the following shall be entitled the safe harbor provided in this section:

- (1) The taxpayer must provide the tax advisory required by this section to the vendor or service provider rendering the services that are the basis of the production cost claimed;
- (2) The taxpayer must obtain the acknowledgement of the vendor or service provider that they have received the tax advisory required by this section; and
- (3) The taxpayer must submit to the department of taxation

compliance division a report, signed by the taxpayer under the penalties set forth under section 231-36, HRS, setting forth the name, address, identifying number, amounts of gross income or gross proceeds paid to the vendor or service provider for Hawaii-based activity, and any other relevant information requested by the department, prior to filing a tax return claiming the credit under section 235-17.

(e) Section 18-235-17-22(c) is demonstrated as follows:

**EXAMPLE:** XYZ Production Company pays \$1,000,000 for the use of Donna Dancer's loan-out services in filming a qualified production. Under the facts of this example, Donna Dancer's income and gross proceeds are taxable under Hawaii income tax and general excise tax law. Assume further that the invoices billed to XYZ Production Company for Donna Dancer's loan-out services have no line item for taxes being passed on because it is not uncommon for certain service contracts to not include a pass-on of the general excise tax. Assume that Donna Dancer fails to file and pay the income tax and general excise tax. XYZ has no notice or knowledge of Donna Dancer's failure to comply with her tax obligations. At the time XYZ Production Company and Donna Dancer executed the contract for Donna Dancer's loan-out services, XYZ Production Company included with her contract a copy of a tax advisory discussed in this section. XYZ Production Company obtained Donna Dancer's signature as proof of receiving a copy of the tax advisory. XYZ Production Company also provided the department of taxation with a spreadsheet providing all information required by this rule. Because XYZ Production Company timely complied with the tax advisory and other requirements discussed in this section, XYZ Production Company's claim for Donna Dancer's loan-out costs as a qualified production cost will not be challenged by the department on the basis that the cost was not subject to tax because the tax went unpaid. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-23 Access to production company set and locations; required courtesy visit and press coverage.** (a) All taxpayers filing a production report with the Hawaii Film Office shall allow access to the taxpayer's production set or location at least once during production for a courtesy visit by government officials. Taxpayers are entitled to at least seven days notice of the government's intent to visit the taxpayer's set or locations. The taxpayer is entitled to escort the government officials on the visit and restrict access to any part

of the set or location deemed proprietary and that which would result in competitive harm if government officials were allowed to visit. Government officials allowed to participate in the courtesy visit include Hawaii Film Office personnel; department of taxation personnel; state and county film commissioners; legislators; and other governmental officials.

(b) All taxpayers filing a production report with the Hawaii Film Office shall submit to a press conference or agree to at least one press story, broadcast, or print, as agreed by both the production and the Hawaii Film Office, where the taxpayer and any of its representatives shall allow themselves to be interviewed by government officials and the media regarding the qualified production. The press conference or other press story shall be held at a location mutually-agreed upon between the production and the Hawaii Film Office, including the production's set or other location.

(c) The courtesy visit and press requirements of this section shall be satisfied before the Hawaii Film Office accepts a taxpayer's production report as being complete.

(d) Nothing in this section shall be interpreted as limiting or restricting the department's authority to access premises or documents, including subpoena power, otherwise allowed.

DEPARTMENT OF TAXATION

PROPOSED HAWAII ADMINISTRATIVE RULES

TITLE 18

DEPARTMENT OF TAXATION

Chapter 237

General Excise Tax Law

**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 237-2.**

**§18-237-2-01 "Business", "engaging in business"; motion picture industry loan-out entities; defined and distinguished.**

(a) Section 237-2, HRS, defines conducting or carrying on business or engaging in business to include all activities (personal, professional, or corporate), engaged in or caused to be engaged in with the object of gain or economic benefit either direct or indirect, excluding casual transactions. Businesses that constitute loan-out entities in the motion picture or television film industry are considered to be doing business in Hawaii, provided sufficient nexus is otherwise present as defined under chapter 237, HRS, and relevant Hawaii case law, such that the loan-out must register to do business in Hawaii and remit and pay over general excise tax owed on gross proceeds earned or received in Hawaii. For purposes of this section, "loan-out" has the same meaning as in section 18-235-17-10, HAR. This section and the requirement that a loan-out register to do business and remit and pay over general excise tax owed on gross proceeds earned from Hawaii applies regardless of where the loan-out entity is organized or domiciled.

(b) Section 18-237-2-01, HAR, is illustrated as follows:

**EXAMPLE 1:** Holly Wood is a high paid, above-the-line actress who is a resident of California. Because of the high-dollar value of her contracts to perform in various motion picture projects, her ability to organize her business affairs distinct from her personal affairs, the ability to exploit her intellectual property, and for pension purposes, she has organized her acting services through the use of a loan-out corporation. She has formed a qualified subchapter S corporation. Through Holly Wood's loan-out corporation, the corporation executes an immediate contract with the production company, which in turn obligates Holly Wood, as an employee of the loan-out S corporation, to perform the acting services on the loan-out corporation's behalf for the production company pursuant to the contract. For purposes of Holly Wood's loan-out relationship with the production company and for tax

purposes, the loan-out is considered an independent contractor or vendor of services. Because Holly Wood has elected to organize her acting affairs through the use of a loan-out entity that is separate and distinct for general excise tax purposes the loan-out is considered doing business or engaging in business in Hawaii for the filming in which she participates while in Hawaii. Holly's loan-out will have to register to do business in Hawaii with the department of taxation and remit and pay over the general excise tax on proceeds earned in Hawaii for the privilege of doing business in Hawaii.

**EXAMPLE 2.** Assume the same facts as in Example 1, except that Holly Wood has elected to be an independent contractor for her loan-out entity rather than an employee of the loan-out entity. Because Holly has elected to be considered doing business directly with her loan-out, which in turn is doing business for the production company, Holly has added an additional layer of general excise tax and Holly herself—as well as the loan-out entity—are required to register to do business in Hawaii with the department of taxation and remit and pay over the general excise tax on proceeds earned in Hawaii for the privilege of doing business in Hawaii.

**EXAMPLE 3.** Mike Rophone is a boom mic operator for a production company. Mike Rophone is a below-the-line staffer for the production company who is paid wages that are reported on a Form W-2 for federal and state tax purposes. Because Mike Rophone is an employee and is not considered engaging in business for purposes of chapter 237, HRS, and is otherwise exempt from the general excise tax under section 237-24(6), HRS, Mike Rophone is not subject to Hawaii general excise tax law. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-2)

**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 237-9.**

**§18-237-9-01 General excise tax licenses; motion picture industry.** Any person who has gross income or gross proceeds of sales that are subject to general excise tax under chapter 237, HRS, must apply for and receive a license as a condition precedent to engaging or continuing to engage in business in Hawaii. Application is made on the department Form BB-1 or BB-1X for an amended form. A \$20 fee must also be provided. The requirement to register for a general excise tax license includes production companies or vendors seeking to do business with production companies that will have gross proceeds in Hawaii. The requirement to obtain the general excise tax license and submit the fee applies to any production company in Hawaii that will receive gross proceeds or gross income taxable under chapter 237, HRS, and loan-out companies, as defined under section 18-235-17-10, providing goods or services to production companies in Hawaii. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-9)



**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 237-13.**

**§18-237-13-01.01 Imposition of tax on manufacturers; motion picture industry.**

(a) Section 237-13(1), HRS, levies and assesses a privilege tax on account of business and other activities in the State measured by gross income or gross proceeds from business on every person engaging or continuing within the State in the business of manufacturing, including the compounding, canning, preserving, packing, printing, publishing, milling, processing, refining, or preparing for sale, profit, or commercial use, any article, substance, or commodity.

(b) A motion picture or television film production company is considered to be in the business of manufacturing for Hawaii general excise tax purposes under chapter 237, HRS; provided the production company will be selling, licensing, leasing, profiting, or otherwise exploiting the motion picture or television film product for profit. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-13(1))

**§18-237-13(6)-10 Imposition of tax on service business; motion picture industry; loan-outs.**

(a) Section 237-13(6), HRS, levies and assess a privilege tax on account of business and other activities in the State measured by gross income or gross proceeds from business on every person engaging or continuing within the State in a service business or calling.

(b) A loan-out entity, as defined under section 18-235-17-10, HAR, providing services to a motion picture or television film production company in the capacity as an independent contractor or vendor is considered a service business or calling for Hawaii general excise tax purposes under chapter 237, HRS. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-13(6))

**§18-237-13(6)-11 Imposition of tax on the rental or leasing of tangible personal property; rental of personal property out-of-state; taxable.**

(a) Section 237-13(6), HRS, levies and assesses a privilege tax on account of business and other activities in the State measured by gross income or gross proceeds from business on every person engaging or continuing within the State in a service business or calling.

(b) The business of renting or leasing tangible personal property for use in Hawaii is taxable under chapter 237, HRS. To the extent there is sufficient nexus under United States and Hawaii law, which includes a taxpayer's property within the taxing jurisdiction, the out-of-state rental or leasing of tangible personal property bound for Hawaii for use in Hawaii is subject to chapter 237, HRS.

(c) If the property is used in more than one state, the taxpayer may allocate the gross income from the lease or rental of personal property by using any reasonable method of allocation

that clearly, fairly, and properly reflects the gross income to the various states; provided that the allocation method is documented. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-13(6))

**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 237-18.**

**§18-237-18-01 General excise tax rate for services provided to a motion picture production; half per cent rate.** (a) Section 237-18(c), HRS, provides that the tax rate of one-half of one per cent shall apply to the gross income or gross proceeds earned through the activity of a person engaged in a service business or calling; provided the services contribute to the manufacture of a product that consists in part of the value of the services provided.

(b) A loan-out, as defined under section 18-235-17-10, HAR, that provides services to a motion picture or television film production company considered a manufacturer under section 18-237-13-01.01, HAR, shall be entitled to the one-half of one per cent tax rate for the assessment of the loan-out's general excise tax on gross income or gross proceeds under chapter 237, HRS, earned from services provided to a motion picture or television film production.

(c) The one-half of one per cent tax rate under section 237-18(c), HRS, shall only apply to service vendors that are providing services to a production company where the motion picture film product consists in part of the services provided.

(d) Notwithstanding the provisions of this section, all requirements of section 235-18(c), HRS, must be satisfied by all participants in order for the one-half of one per cent tax rate to apply.

(d) Section 18-237-18-01, HAR, is illustrated as follows:

**EXAMPLE 1:** Assume the same facts as provided in Example 1 contained at section 18-237-2-01(b), HAR. Holly Wood's acting services provided to the production company are distinct and identifiable components of the film because her personal contributions can be discerned in the final product produced. Because Holly Wood's contribution to the film product (her distinct acting) consists in part of the value she provided to the production company, which is a manufacturer under these facts because the film product will be exploited for profit, Holly Wood's loan-out subchapter S corporation will qualify for the lower one-half of one per cent tax rate on its gross income or gross proceeds from doing business in Hawaii for the production company.

**EXAMPLE 2:** XYZ Food Services is a catering company that provides food and catering services to Hawaii production companies. XYZ Food Services prepares its own food, as well as sells pre-made foods to the productions. XYZ Food Services is not entitled to calculate its Hawaii general excise tax liability at the one-half per cent rate because it is not a service business or calling taxable under section 235-13(6), HRS. XYZ Food Service is conducting business as a manufacturer or seller of tangible

personal property and is not entitled to the lesser one-half per cent general excise tax rate allowed under section 237-18(c), HRS. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-18)

NON RAMSEYER FORMAT

DEPARTMENT OF TAXATION

Proposed Hawaii Administrative Rules

SUMMARY

**Proposed Administrative Rules Applying HRS § 235-7.3**

- |                |   |
|----------------|---|
| §18-235-7.3-01 | Royalties and other income tax exclusion; generally.  |
| §18-235-7.3-02 | Ownership of intellectual property; loan-outs, individuals, and qualified high technology businesses.             |
| §18-235-7.3-03 | Performing arts products; analysis of the work-for-hire doctrine.   |
| §18-235-7.3-04 | Performing arts products; extension of exclusion to authors, assignors, licensors, or licensees.                  |
| §18-235-7.3-05 | Qualified high technology businesses and royalties or other income determination; nexus with Hawaii not required. |
| §18-235-7.3-06 | Royalties and other income; defined.  |
| §18-235-7.3-07 | Patents, copyrights, and trade secrets; definitions.  |
| §18-235-7.3-08 | Royalties exclusion; impact of half-per cent general excise tax rate.   |

**Proposed Administrative Rule Applying HRS § 235-9**

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**Proposed Administrative Rules Applying HRS § 235-17**

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§18-235-17-11	Qualified production costs; per diem allowances and fringe benefits.
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§18-235-17-17	Utilizing the motion picture, digital media, and film production income tax credit and the high technology business investment tax credit simultaneously; same production; safe harbor for segregating funds.
§18-235-17-18	Independent certification [ <del>opinion</del> ] of motion picture, digital media, and film production income tax credit claims.
§18-235-17-19	Evidence of reasonable efforts to hire local talent and crew.
§18-235-17-20	Evidence of financial or in-kind contributions to educational or workforce development for the local film, television, and digital media

	industry.
§18-235-17-21	Disallowance of credit for unpaid expenditures.
§18-235-17-22	Production company personnel and contractors; required Hawaii tax notice; safe harbor.
§18-235-17-23	Access to production company set and locations; required courtesy visit and press conference.

**Proposed Administrative Rule Applying HRS § 237-2**

§18-237-2-01	"Business", "engaging in business"; motion picture industry loan-out entities; defined and distinguished.
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**Proposed Administrative Rule Applying HRS § 237-9**

§18-237-9-01	General excise tax licenses; motion picture industry.
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**Proposed Administrative Rules Applying HRS § 237-13**

§18-237-13-01.01	Imposition of tax on manufacturers; motion picture industry.
§18-237-13(6)-10	Imposition of tax on service business; motion picture industry; loan-outs.
§18-237-13(6)-11	Imposition of tax on the rental or leasing of tangible personal property; rental of personal property out-of-state; taxable.

**Proposed Administrative Rule Applying HRS § 237-18**

§18-237-18-01	General excise tax rate for services provided to a motion picture production; half per cent rate.
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DEPARTMENT OF TAXATION  
PROPOSED HAWAII ADMINISTRATIVE RULES

TITLE 18

DEPARTMENT OF TAXATION

Chapter 235

Income Tax Law

**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 235-7.3.**

**§18-235-7.3-01 Royalties and other income tax exclusion; generally.** Section 235-7.3, HRS, provides an exclusion from Hawaii income tax under chapter 235, HRS, for royalties and other income derived from any patents, copyrights, and trade secrets received by an individual taxpayer or qualified high technology business. In order to qualify for the exclusion, the royalties or other income must be directly derived from the patents, copyrights, or trade secrets that are owned by the individual taxpayer or qualified high technology business and also be developed and arise out of a qualified high technology business. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-02 Ownership of intellectual property; loan-outs, individuals, and qualified high technology businesses.** (a) In order to qualify for the income tax exclusion allowed under section 235-7.3, HRS, the patents, copyrights, and trade secrets giving rise to the royalties or other income must be:

- (3) Owned by an individual or qualified high technology business; and
- (4) Developed and arising out of a qualified high technology business.

(b) Loan-outs. For purposes of this section, "loan-out" has the same meaning as provided under section 18-235-17-10, HAR. An individual is not disqualified from qualifying for the exclusion under section 235-7.3, HRS, by reason of organizing their performing arts business affairs through use of a loan-out entity.

(c) Qualified high technology businesses. Section 235-7.3(c), HRS, defines qualified high technology business as a business that conducts more than fifty percent of its activities in qualified research. For purposes of the income tax exclusion provided under section 235-7.3, HRS, a qualified high technology business can be an individual that carries out business as a sole proprietorship or any other business entity. For purposes of calculating the fifty per cent activities test required under section 235-7.3, HRS, an individual that carries on qualified research in the capacity of a sole proprietor may qualify as a qualified high technology business



under this section only if the individual calculates the percentage of activities by comparing his or her qualified research activities to all of his or her business activities, including activities conducted as an employee.

(d) To make the determination of whether a qualified high technology business, including an individual as provided under subsection (b), satisfies the activities test under section 235-7.3(c), the qualified high technology business must use a numerator that contains a measurement of activities in direct support of qualified research and a denominator that includes a measurement for all business activities. Business activities may be measured by the cost of these activities, the time spent on these activities, or another consistently applied reasonable basis.

(e) Section 18-235-7.3-02, HAR, is illustrated as follows:

**EXAMPLE:** Ian Invention is an inventor of novel devices that constitute patentable subject matter. Ian carries out his invention business activities, which constitutes qualified research, as a sole proprietor. In order to make enough money to pay his bills while he is inventing, Ian also is a part-time bartender in the evenings. Assume for purposes of this example that Ian spends 30 hours per week in his garage working on his inventions and spends 20 hours per week in the evening bartending. For purposes of the income tax exclusion under section 235-7.3, HRS, Ian Invention is a qualified high technology business as a sole proprietor because at least fifty per cent of Ian's activities as a sole proprietor are in qualified research when he compares all of his business time—including time as an employee—to the time he spends conducting qualified research.

(Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-03 Performing arts products; analysis of the work-for-hire doctrine.**

(a) The income tax exclusion allowed under section 235-7.3, HRS, may be attributed to an individual or qualified high technology business that receives royalties or other income from performing arts products determined with or without regard to the work-for-hire doctrine under United States copyright law. An analysis of the work-for-hire doctrine may be relevant to and determinative of a taxpayer's claim for an exclusion under section 235-7.3., HRS, where the taxpayer claiming the exclusion is not the owner of the copyrights that gave rise to the income sought to be excluded.

(b) For purposes of analyzing whether royalties received from performing arts products are property excluded, an analysis of copyright laws and the ownership of copyrights in the performing arts products industry is relevant. Copyright protection subsists in any original work of authorship fixed in a tangible medium of

expression, now known or later developed, from which the expression can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. Copyright in a work vests initially in the author or authors of a work. The authors of a joint work are coowners of copyright in the work. A joint work is a work prepared by two or more authors with the intention that their contributions be merged into inseparable or interdependent parts of a unitary whole. For purposes of performing arts products, sufficient copyrightable expression may arise from the artistic expression of authors as defined under United States copyright law, including actors, directors, screen writers, cinematographers, or other similar performing arts roles that provide identifiable expressive components within a performing arts product that may give rise to copyright protection. Whether a participant in the production of a performing arts product qualifies as an author depends upon the facts and circumstances of each case.

(d) The work-for-hire doctrine for purposes of section 235-7.3., HRS, means:

- (1) A work, as discussed in subsection (b), prepared by an employee within the scope of his or her employment; or
- (2) A work, as discussed in subsection (b), specially ordered or commissioned for use as a contribution to a collective work, as part of a motion picture or other audiovisual work, if the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire; or
- (3) A work, as discussed in subsection (b), otherwise qualified under federal court interpretations of the work-for-hire doctrine. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-04 Performing arts products; extension of exclusion to authors, assignors, licensors, or licensees.** (a)

The income tax exclusion provided under section 235-7.3, HRS, for performing arts products purposes, extends to authors, assignors, licensors, and licensees of any copyright rights in performing arts products, or any parts thereof, that are:

- (1) Owned by the individual taxpayer or qualified high technology business; and
- (2) Are developed and arise out of a qualified high technology business.

(b) As provided in section 18-235-7.3-02, HAR, an individual who organizes their performing arts products affairs through the use of a loan-out entity is not disqualified from the income tax exclusion under section 235-7.3, HRS.

(c) An author is any person who contributes expression capable of copyright protection, as is defined under United

states copyright law. Authors may include writers, recording artists, actors, directors, animators, among other persons.

(d) Section 18-235-7.3-04, HAR, is illustrated as follows:

**EXAMPLE 1:** Ann Actress, an actor, formed a loan-out entity that contracts with third parties for her acting services. Ann's loan-out enters into a contract with XYZ Productions. XYZ Productions is a qualified high technology business. Pursuant to Ann's acting contract with XYZ Production Company, which will own the film, Ann is paid royalty and other income for her services of acting. Specifically, her contract calls for the arrangement to constitute a work-for-hire under United States copyright law. Also, the contract terms require a concurrent assignment of all of her copyright interests, worldwide and whatever the rights may constitute, to XYZ Production, which as a practical matter is industry necessity in order for XYZ Production to exploit the film. For purposes of section 235-7.3, HRS, Ann is entitled to exclude from her Hawaii income the amount received that is considered royalties or other income from copyrights because she is an author without regard to the work-for-hire doctrine pursuant to section 18-235-7.3-03, HAR, and further is an assignee of copyrights pursuant to this section, both of which entitle Ann to the income tax exclusion under section 235-7.3, HRS.

**EXAMPLE 2:** Assume the same facts as Example 1, except that Ann is paid for her acting services associated with a television commercial for a new pair of jeans. XYZ Production Company films the commercial but is not the owner of the copyrightable expression, i.e., the commercial. Assume the clothing line manufacturer owns the copyright in the television commercial and all rights to the commercial. The clothing line manufacturing is not a QHTB. Ann's income from her acting in the clothing line manufacturer's television commercial is not entitled to the exclusion under section 235-7.3, HRS, because the copyright for the television commercial is not owned by Ann or a qualified high technology business. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-05 Qualified high technology business and royalties or other income determination; nexus with Hawaii not required.** (a) There is no requirement that the qualified high technology business or the royalties or other income derived from patents, copyrights, and trade secrets be:

- (6) Sourced to Hawaii in any way;
- (7) Developed and arising out of a Hawaii business;
- (8) Owned by a Hawaii resident;
- (9) Owned by a qualified high technology business

organized under the laws of Hawaii; or

(10) Owned in Hawaii.

(b) The activities giving rise to the development of the patents, copyrights, or trade secrets subject to the income tax exclusion provided under section 235-7.3, HRS, may be sourced anywhere worldwide.

(c) A qualified high technology business for purposes of section 235-7.3, HRS, is a business that conducts more than fifty per cent of its activities in qualified research. As provided in subsection (b), the qualified research is not required to be performed in Hawaii. A qualified high technology business for purposes of section 235-7.3, HRS, is different from the definition of qualified high technology business for purposes of sections 235-110.9 and 235-110.91, HRS.

(d) Royalties or other income derived from the exploitation of any patents, copyrights, or trade secrets may be derived from any source worldwide. There is no requirement that the income excluded under section 235-7.3 must be earned from a Hawaii source. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-06 Royalties and other income; defined.** (a) Section 235-7.3, HRS, provides an exclusion from Hawaii income tax law under chapter 235, HRS, for royalties and other income derived from any patents, copyrights, and trade secrets received by an individual taxpayer or qualified high technology business.

(b) For purposes of section 235-7.3, HRS, "royalties" means compensation, however designated, paid to the owner of a patent, copyright (with and without regard to the work-for-hire doctrine analysis provided under section 18-235-7.3-03, HAR), or trade secret, for the use of, or the right to use, the patent, copyright, or trade secret, or any interests in any of the same. The payment is typically a percentage of profit or a specified sum per item sold; however that in itself is not determinative. The purpose for which the payment is made and not the manner of payment is the determining factor.

(c) For purposes of section 235-7.3, HRS, "other income" means accumulation of wealth from sources other than royalties. Other income includes compensation for services; gross income derived from business activities; gains from the sale of property interests; dividends; pension income; distributive shares of partnership interests; and other non-royalty income items that would fall within the definition of "income" for purposes of section 61(a) of the Internal Revenue Code; provided that the "other income" is derived directly from patents, copyrights, and trade secrets.

(d) "Royalties and other income" may be derived in any form. For example, income received in the form of a royalty or other income payment may be received and reported on Form W-2 or Form HW-2 (wage income) or on Form 1099 (non-wage income), or other source of receipt and reporting. The means by which income

is received or reported is not dispositive for the analysis as to whether income constitutes royalties or other income within the meaning of section 235-7.3, HRS.

(e) "Royalties and other income" excludes income not directly derived from the exploitation of patents, copyrights, and trade secrets. For example, income that is taxable and not excluded from the income tax under section 235-7.3, HRS, includes income from:

- (5) Appearance fees;
  - (6) Ticket revenue;
  - (7) Autograph income; or
  - (8) Sponsorship fees.
- (f) Section 18-235-7.3-06, HAR, is illustrated as follows:

**EXAMPLE:** Roy Rockstar performs a live concert at the Waikiki Shell. In an advanced arrangement with concert promoters and Roy's record label, the concert at the Shell is to be recorded. Roy owns the copyright to the music he performs, as well as the copyright to any recording of his performance at the Shell. Roy has arranged through his contract with concert promoters that he will be paid a percentage of ticket sales for the live performance; a set fee for appearing one hour before the show to sign autographs backstage by a local sponsor of the concert; and a percentage of record sales from the live concert recording. For his performance at the Shell, Roy earns \$50,000 in his share of ticket sales; \$10,000 from the sponsor for appearing before the show for autographs; and \$100,000 in payments from the record label as his share of record sales from his live performance at the concert during the taxable year. For purposes of the income tax exclusion under section 235-7.3, HRS, Roy Rockstar will be entitled to exclude only the \$100,000 from the record sales that represents royalties or other income from the exploitation of his copyrightable subject matter. Roy will not be entitled to exclude the ticket fees or appearance revenues because this income is not directly derived from any copyrightable expression under the facts of this example. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-07 Patents, copyrights, and trade secrets; definitions.** (a) Only royalties or other income derived from patents, copyrights, and trade secrets are entitled to the exclusion under section 235-7.3, HRS.

(b) For purposes of section 235-7.3, HRS, only patents that are active patents issued by the United States Patent and Trademark Office are entitled to the exclusion. Abandoned, inactive, or expired patents do not qualify for the exclusion under section 235-7.3, HRS. Patentable subject matter may qualify as a trade secret; however loses its characterization as a trade secret when efforts

to maintain its secrecy under the circumstances are no longer maintained.

(c) For purposes of section 235-7.3, HRS, it is not necessary that the expression giving rise to royalties or other income is derived from an active and issued registered copyright by the United States Copyright Office; provided the expression giving rise to the royalties or other income is sufficiently original such that the expression constitutes copyrightable subject matter.

(d) For purposes of section 235-7.3, "trade secret" means information, including a formula, pattern, compilation, program, device, method, technique, or process, that:

- (1) Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by, other persons who can obtain economic value from its disclosure or use; and
- (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS § 235-7.3)

**§18-235-7.3-08 Royalties exclusion; impact of half-per cent general excise tax rate.** A taxpayer that is entitled to utilize the income tax exclusion under section 235-7.3, HRS, is not precluded from being taxed at the half-per cent general excise tax rate assessable on gross income or gross proceeds from the performance of services to a production company pursuant to section 18-237-18-01, HAR. Likewise, a taxpayer that is entitled to be taxed at the half-per cent general excise tax rate pursuant to section 18-237-18-01, HAR, is not precluded from the income tax exclusion under section 235-7.3, HRS.

**PROPOSED ADMINISTRATIVE RULE APPLYING HRS § 235-9.**

**§18-235-9-01 Exemption from income tax; motion picture and television film production.** (a) Section 235-9, HRS, provides an exemption from Hawaii income tax for persons engaged in various business industries. Included as persons exempt from Hawaii income tax law are those engaged in the business of motion picture and television film production.

(b) To qualify for the income tax exemption allowed by section 235-9, HRS, a person engaged in the business of motion picture and television film production must satisfy all of the following:

(3) The person must be engaged in the motion picture or television film production business in Hawaii; and

(4) The person must produce the motion picture or television film products in Hawaii.

(c) A person will only be entitled to an exemption from Hawaii income tax law under section 235-9, HRS, to the extent the person's activities satisfy all of the requirements of subsection (b).

(d) Multi-jurisdiction productions; safe harbor. A person will qualify for the income tax exemption only for income received from the production of the motion picture and television film products produced in Hawaii. Income received from production of motion picture and television film products produced outside Hawaii will not qualify for the income tax exclusion. For businesses engaged in the business of motion picture and television film production occurring both within and without Hawaii, income may be apportioned amongst the production activities creating the performing arts products occurring within and without the State based upon any reasonable method, including separate accounting, costs, and time. The department of taxation will not challenge apportionment of income based upon costs incurred in the production of the multi-jurisdictional performing arts products.

(e) For purposes of this section, "motion picture or television film":

(3) Means a feature-length motion picture, short film, made-for-television movie, commercial, music video, television series pilot or any number of television series episodes, television special, national magazine show, national talk show, or other production approved by the director; and

(4) Does not include: daily news; public affairs programs; non-national magazine or talk shows; televised sporting events or activities; productions that solicit funds; productions produced primarily for industrial, corporate, institutional, or other private purposes; and productions that include any material or performance prohibited by chapter 712.

(d) Section 18-235-9-01, HAR, is illustrated as follows:

**EXAMPLE 1:** XYZ Production Co. is a motion picture and television film production company. During the taxable year, XYZ Production Co. produces three films in Hawaii and receives gross taxable income in the amount of \$10,000 from the sale, lease, or license of its film products. Also in the same taxable year, XYZ Production Co. receives gross taxable income in the amount of \$20,000 in lease payments for use of its parking lot from an unrelated third party for use with the third party's business, which is unrelated to motion picture production. Under this example, XYZ Production Co. is considered a motion picture and television film production business; however XYZ Production Co. will only be exempt from income tax under section 235-9, HRS, to the extent of the gross taxable income of \$10,000, from its motion picture or television film production activity. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS §235-9)

**§18-235-9-02 No deduction for expenses associated with tax exempt activity; conformity to section 265 of the Internal Revenue Code.** No deduction shall be allowed for any amount otherwise allowable as a deduction for expenses incurred with the production of income wholly exempt from tax under chapter 235, HRS. Persons exempt from income under section 235-9, HRS, shall not be entitled a deduction for expenses incurred with respect to the production of income exempt under that section. (Auth: HRS §§ 231-3(9), 235-118) (Imp: HRS §235-9)



**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 235-17.**

**§18-235-17-01 Motion picture, digital media, and film production income tax credit; allowed.** (a) Beginning July 1, 2007, until December 31, 2015, section 235-17, HRS, allows qualified taxpayers to claim a refundable income tax credit equal to the following percentages of qualified costs incurred for qualified productions being produced in Hawaii:

- (3) Fifteen per cent of qualified production costs incurred in any county in the State with a population of over seven hundred thousand (i.e., the city and county of Honolulu); and
- (4) Twenty per cent of qualified production costs incurred in any county in the State with a population of seven hundred thousand or less (i.e., Kauai, Maui, and Hawaii counties).

(b) Any qualified production that conducts business activities in Hawaii such that the qualified production is considered a taxpayer for purposes of chapter 235, HRS, is eligible to claim the credit under section 235-17, HRS. There is no requirement that the qualified production be organized under the laws of Hawaii. A qualified production may be organized under the laws of any jurisdiction. In order to qualify for the credit under section 235-17, HRS, a qualified production must be considered a taxpayer for purposes of chapter 235, HRS, Hawaii income tax law. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-02 Claim for credit; procedures; multiple entities involved.** (a) Every taxpayer claiming the credit under section 235-17, HRS, is required to prequalify for the credit by registering with the department of business, economic development, and tourism. The Hawaii film office is the branch within the department of business, economic development, and tourism responsible for the prequalification determination. A qualified production must submit its prequalification registration to the Hawaii film office not later than one week before principal photography begins. Failure to timely obtain prequalification registration may result in waiver of the credit. The determination of whether an untimely prequalification registration results in waiver of the credit is within the discretion of the Hawaii film office.

(b) Not later than ninety days following the end of the taxable year in which the qualified production costs were expended, all taxpayers must submit a sworn report to the Hawaii film office identifying the information required by the Hawaii film office. Required information includes data on the production and a detailed expenditure report in order for the Hawaii film office to make its credit claim certification determination. After determination of the amount of qualified

production costs expended by a taxpayer, the Hawaii film office will issue a certificate to the taxpayer. In order to properly claim the credit, the taxpayer must attach a copy of the certificate to the taxpayer's income tax return claiming the credit, along with any other required forms.

(c) It is not uncommon in the motion picture and film production industry for multiple production companies to participate in the production of one performing arts product. For purposes of claiming the credit under section 235-17, HRS, only one taxpayer may file a claim for credit with the Hawaii film office per production. The Hawaii film office will process tax credit applications and claims for credit in the order in which the applications and claims are received. Any subsequent qualified production(s) claiming credit for a production that has already claimed the credit will be denied the credit.

(d) Where multiple qualified productions participate in the creation of a final performing arts product, it is important for the relevant production entities to negotiate which taxpayer will claim the credit under section 235-17, HRS. Particularly in advertising agency relationships, confusion can arise as to which entity can claim the credit. In an advertising agency relationship where a television commercial is the performing arts product, a client company hires an advertising agency, which in turn hires a production company to film the performing arts product. Under the statutory provisions of section 235-17, HRS, any one of the three entities may qualify as a qualified production incurring qualified production costs to the extent of the respective party's qualified expenditures. Productions should negotiate which of the entities will be claiming the credit. The production company filming the commercial, for example, could claim as qualified production costs the cost to create the commercial itself. The advertising agency, however, could claim as qualified production costs the amount it was billed by the production company to create the commercial, which is likely the actual cost of production plus the production company's markup or profit. The client company, lastly, could claim as qualified production costs the amount it pays to the advertising agency and/or the production company, which would include the actual costs incurred by the advertising agency and the production company plus both the production company's and advertising agency's markups or profits. As discussed in this subsection, any one of the three entities could be a qualified production; however only one of the three may claim the credit. In addition, the amount of the credit will be different for each entity that could claim the credit. In general, the client company's credit claim would be the highest and the production company's credit claim would be the lowest. The distinction between the differing credit claim entitlements is due to the fact that the credit is calculated based upon qualified costs and the client company would incur the most costs between the entities discussed.

(e) If a production company produces more than one production in a taxable year, qualified production costs must be aggregated for purposes of claims for credit, which must also be aggregated on a single tax return for the taxable year. The credit allowed under section 235-17, HRS, is used first to credit any tax liability owed, with any excess being refunded to the taxpayer. The requirement that qualified production costs must be aggregated for purposes of claiming the credit on one tax return does not impact the \$8,000,000 cap provided under section 235-17(j). The \$8,000,000 cap is determined on a per production basis, not per taxpayer. Therefore, where a taxpayer produces multiple qualified productions in one taxable year, it is possible for a single taxpayer to receive total credit at the end of the taxable year in excess of \$8,000,000.

(f) Where a taxpayer produces multiple qualified productions in a taxable year, each of the separate certificates received from the Hawaii film office certifying the qualified production costs must be attached to the taxpayer's return. The aggregating of qualified production costs, as discussed under subsection (e), may be reported on a single Form N-340 and a single Schedule CR.

(g) Claims for credit under section 235-17, HRS, must correspond with the taxpayer's accounting method. In general, a cash method taxpayer must claim all qualified production costs in the year in which the cost was paid as provided in section 461, Internal Revenue Code. An accrual method taxpayer must claim all qualified production costs in the year in which the cost was properly accrued under section 461, Internal Revenue Code.

(h) If qualified production costs are incurred in two separate tax years for the same production, the credit under section 235-17, HRS, will only be allowed based upon the costs paid or incurred in the respective tax year. For example, if \$400,000 in qualified production costs were incurred in 2007 and \$500,000 in qualified production costs were incurred in 2008, the credit must be claimed in the two separate tax years based upon the qualified production costs incurred in each respective taxable year. Therefore, a taxpayer in this situation will file for the credit once in each 2007 and 2008 claiming credit for the qualified production costs incurred in the respective taxable years. A taxpayer with qualified productions costs for one production that spans two taxable years should take care to ensure a timely application for credit certificates with the Hawaii film office in each of the successive tax years. The report required under section 235-17(h) must be filed within ninety days following the end of the taxable year in which qualified production costs may be claimed as the basis of the tax credit. The report submitted to the Hawaii film office must include a statement and report of qualified production costs incurred within the taxable year sufficient for the Hawaii film office to certify credits allowed in that taxable year. Another statement and report must be submitted in the succeeding taxable

year to account for qualified production costs incurred in the subsequent taxable year.

(i) Application of subsection (g) relating to the claiming of qualified production costs in the year the costs are properly accounted for based upon a taxpayer's accounting method are not intended to conflict with the definitional requirement of a qualified production contained in section 18-235-17-03, HAR. A taxpayer must independently satisfy the \$200,000 qualified production cost definitional requirement in order to qualify for a claim for credit under section 235-17, HRS. For additional discussion on the definition requirement of a qualified production, see section 18-235-17-03, HAR. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-03 Qualified productions; \$200,000 threshold determination.** (a) Section 235-17(d)(2), HRS, requires as a condition precedent to qualifying for the credit that the production shall have qualified production costs associated with the production of at least \$200,000.

(b) For purposes of section 235-17(d), HRS, and qualifying for the credit, section 235-17(1), HRS, defines a qualified production by category and considers each production as a separate, individual qualified production. In order to be a qualified production such that qualified production costs may be paid or incurred as the basis for a claim for credit, each production of a taxpayer must independently qualify for the \$200,000 production cost threshold, regardless of the number of productions one taxpayer may have in a tax year.

(c) Section 18-235-17-03, HAR, is illustrated as follows:

**EXAMPLE 1:** 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 qualified production costs. XYZ Productions does not qualify as a qualified production 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 qualified production costs of \$250,000 on the same production. XYZ Production's total qualified production costs for the entire production is now more than \$200,000. XYZ Productions can file an amended return for 2007 taking into account the \$75,000 in qualifying expenditures during 2007 because the production is now a qualified production; provided a timely amended return is filed within twelve months following the close of the taxable year in which the costs were paid or incurred.

**EXAMPLE 2:** XYZ Productions produces four productions throughout the taxable year, with each production incurring

qualified production costs of \$75,000. For the entire taxable year, XYZ Productions has incurred qualified production costs in excess of \$200,000 for all productions. XYZ Productions will not be entitled to the income tax credit under section 235-17, HRS, because each production is treated as a separate, individual production for purposes of section 235-17(d), HRS, which requires that each production have qualified production costs of at least \$200,000 in order to qualify. Even though XYZ Productions incurred qualified production costs in excess of \$200,000 in the aggregate during the taxable year (\$300,000), each of the four productions on an individual basis, which is the test required under section 235-17(d) and (l), HRS, incurred qualified production costs of less than \$200,000. (\$75,000 each). (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-04 Claiming the credit; timing; twelve-month rule.** (a) Section 235-17(c), HRS, requires all claims for the credit, including amended claims, be filed on or before the end of the twelfth month following the close of the taxable year for which the credit may be claimed. Failure to comply with the twelve-month filing requirement constitutes waiver of the right to claim the credit.

(b) Taxpayers should take care to ensure that claims for the credit under section 235-17, HRS, are timely made. The incumbent waiver of the credit due to an untimely claim is final. There are no appeal rights or other discretionary authority vested with the department of taxation to suspend or waive this provision.

(c) Taxpayers should take particular care in the following factual situations:

- (1) Partnerships. Taxpayers that are partners in partnerships constituting qualified productions should ensure timely claims of the production credit. A partnership's tax return is considered informational in nature and does not constitute a claim for credit. A claim for credit is timely made by a partner on or before the end of the twelfth month following the close of the taxable year in which the partner receives his or her distributive share of the partnership's credit allocation. Because of the length of time some partnerships take in order to calculate the partnership's information return, as well as all partners' distributive shares, time is of the essence to ensure timely claims by the partners.
- (2) Productions with straddling tax years. Productions that incur costs insufficient to claim the credit in Year One of the production; however incur sufficient costs in Year Two of the production should take care to ensure timely claims of the credit on original or

amended returns. Example 1 under section 18-235-17-03(c), HAR, elaborates on the factual situation where a timely amended return is at issue. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-05 Distribution of credit.** Section 235-17(a), HRS, provides that the tax credit allowed shall be determined at the entity level for partnerships, S corporations, estates, or trusts. Claim for credit may not be made at the entity level for a partnership, S corporation, estate, or trust unless such entity has elected to be taxed as a corporation under relevant federal tax law. Distributions of credit under section 235-17, HRS, shall be made in accordance with Internal Revenue Code Subchapter K, Subchapter J, Subchapter S, or other relevant pass-through entity allocation laws of the Internal Revenue Code to which Hawaii conforms. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-06 Prorating qualified production costs between counties in Hawaii; airfare and shipping costs.** (a) Section 235-17(a), HRS, provides that a taxpayer claiming credit for qualified production costs in Hawaii may prorate its expenditures based upon the amount spent in each county if the population base differs such that an expenditure in one county may entitle that taxpayer to a higher or lower credit, whichever the case may be. Prorating of qualified production costs only applies for costs incurred between two counties. This section does not apply to costs incurred between other states or countries and Hawaii.

(b) Qualified production costs may be prorated amongst the counties by any reasonable method, taking into account the specific facts and circumstances in any particular case.

(c) Safe harbor for airfare, shipping, and other similar costs.

- (1) The department will not challenge the prorating of qualified production costs for airfare, shipping costs, or qualified production costs of a similar nature where two locations equally impact upon a single expenditure; provided a taxpayer accounts for the expenditure as provided in paragraph (2). Airfare and shipping costs are one example of qualified production costs where neither the origination nor the destination should control disposition of the credit amount, but rather both the origination and destination impact the qualified production cost equally.
- (2) A taxpayer will be considered to have properly accounted for a prorated cost for purposes of airfare, shipping cost, or similar qualified production cost where two locations equally impact a single expenditure if the taxpayer takes the total expenditure and divides

the sum in half. Next, the taxpayer must apply the fifteen per cent tax credit rate to one-half of the cost and the twenty per cent tax credit rate to the other half of the cost. The total credit allocable for that one prorated qualified production cost will be comprised of the sum of the fifteen per cent rate product and the twenty per cent rate product.

- (3) Airfare and shipping costs between the counties of Kauai, Maui, and Hawaii are eligible for the twenty per cent credit rate and are not required to be prorated under the safe harbor.
- (d) Section 18-235-17-06, HAR, is illustrated as follows:

**EXAMPLE 1.** 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 safe harbor provided by section 18-235-17-05, HAR, XYZ Productions must divide the total fare (\$1,000) in half (\$500 and \$500). Then, XYZ Productions must take the tax credit at the fifteen per cent rate for half of the cost ( $\$500 \times .15 = \$75$ ), and take the credit at the twenty per cent rate for the other half of the cost ( $\$500 \times .20 = \$100$ ). XYZ Production's total credit properly allocable as provided under section 18-235-17-05, HAR, for the airfare is \$175.

**EXAMPLE 2.** Assume the same facts in Example 1, except that the cost to transport talent and crew is from Los Angeles to Kailua-Kona for production only on the Big Island of Hawaii. The prorating safe harbor and this section do not apply to this example. The amount of credit for costs incurred in airfare or shipping costs to Hawaii will be determined by the destination county. Based upon the facts in this example, airfare purchased to transport talent and crew to Kailua-Kona will be entitled to the twenty per cent credit rate on the entire purchase.

**EXAMPLE 3.** 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 fifteen per cent rate. Three-fourths of the cost (the use on Kauai) is entitled to the credit at the twenty per cent rate. Time spent in transit while transporting or shipping the camera will not be taken into account in calculating use for purposes of this example.

**EXAMPLE 4.** Assume the same facts in Example 2, 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 twenty per cent rate. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-07 Qualified production costs; generally.** (a) Section 235-17, HRS, provides a refundable income tax credit for a qualified production's expenditure of qualified production costs. Qualified production costs are those costs incurred by a qualified production in Hawaii that are subject to either:

- (3) Hawaii income tax under chapter 235, HRS; or
- (4) Hawaii general excise tax under chapter 237, HRS.

A cost is "subject to tax" within the meaning of section 235-17(1), HRS, if the State has jurisdiction to subject the taxpayer to a net income tax or general excise tax regardless of whether, in fact, the State does or does not tax such person.

(b) A qualified production cost will lose its character as a cost that qualifies for purposes of the credit if the cost was financed or paid for with funds that represent an investment for which a credit was or will be claimed under section 235-110.9, HRS. For additional information on ensuring that the source of production company funds do not jeopardize the qualifying nature of a production cost, see section 18-235-17-17, HAR.

(c) Section 235-17(1), HRS, provides a list of common expenditures that constitute qualified production costs. This is a list of costs that are ordinary and necessary in the motion picture or film production industry. The list contained under this section is illustrative and not exhaustive.

(d) A production cost will be considered subject to chapter 235, HRS, (Hawaii income tax law) or chapter 237, HRS, (Hawaii general excise tax law), where the person delivering the goods or performing the services ~~was~~ is subject to either tax. It is a taxpayer's responsibility to determine whether a vendor, employee, contractor, or other business or person is subject to chapter 235 or chapter 237, HRS, within the meaning of section 235-17(1), HRS.

(e) Section 18-235-17-07, HAR, is illustrated as follows:

**EXAMPLE 1.** 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 on an apportioned basis. 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 roundtrip airfare on ABC Airlines is a qualified production cost for purposes of the credit under section 235-17, HRS, because ABC Airlines, which is delivering the service, is subject to Hawaii income tax.

**EXAMPLE 2.** 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 income tax and 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 credit under section 235-17, HRS, because 123 Catering, which is delivering the goods, is subject to Hawaii income tax and general excise tax.

**EXAMPLE 3.** Steve Screenwriter, 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. Steve Screenwriter offers to sell XYZ Productions his screenplay. Steve Screenwriter's screenplay is not a qualifying production cost because Steve Screenwriter is not subject to Hawaii income or general excise tax.

**EXAMPLE 4.** Assume the same facts as Example 3, except that Steve Screenwriter is a resident of Hawaii and subject to Hawaii income tax. Steve Screenwriter's screenplay, though not listed in section 235-17(1), HRS, is a qualified production cost because Steve Screenwriter is subject to Hawaii income tax.

**EXAMPLE 5.** 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 an apportioned basis. 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. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-08 Qualified production costs; production service fees.** (a) Section 235-17(1), HRS, defines qualified production costs to include a number of costs customarily included in the production of motion pictures, including the cost of office supplies, equipment, salaries, and other similar costs; provided that the cost is incurred in Hawaii and subject to either chapter 235 (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law). Included as a cost that may qualify as a qualified production cost for purposes of the credit is production services fees; except as otherwise provided in this section.

(b) "Production services fees" for purposes of the credit under section 235-17, HRS, generally means a line item fee assessed by a production company to a third party for whom the production is being produced (i.e., advertising agency or other person ordering the production) for ordinary and necessary production expenditures incurred in the ordinary course of producing a motion picture on an incidental or attendant basis, and may be calculated as a percentage of the production's billed cost. Components of a production services fee may include:

- (10) Office overhead;
- (11) Miscellaneous labor;
- (12) Rent;
- (13) Insurance;
- (14) Lighting, heating, cooling, or similar costs;
- (15) Accounting services or fees;
- (16) Telephone and other communication costs;
- (17) Depreciation, amortization, and other like costs; and
- (18) Mark-up or profit potential realized by a production company to the extent the production services fee is greater than actual expenditures that otherwise constitute the fee charged.

(c) A production services fee constitutes a qualified production cost for purposes of the credit under section 235-17, HRS, only to the extent the production service fee is paid by the taxpayer claiming the credit.

(d) No credit is allowed for a production services fee charged by the entity claiming the credit, unless the entity claiming the credit for the production services fee can produce documentary evidence of expenditures that the claiming entity actually paid for qualified production costs to third parties.

(e) Section 18-235-17-08, HAR, is illustrated as follows:

**EXAMPLE 1:** XYZ Production Company charges 123 Advertising, its client company, a production services fee of \$5,000, which represents 1% of the total cost of producing a commercial. 123 Advertising is the entity claiming the credit under section 235-17, HRS, for the qualified production costs incurred in creating the commercial. The \$5,000 production services fee charged by XYZ Production Company and paid by 123 Advertising is a qualified production cost within the meaning of section 235-17, HRS, because the production services fee is paid by 123 Advertising, the taxpayer claiming the credit.

**EXAMPLE 2:** Assume the same facts as Example 1, except that XYZ Production Company will be the claiming entity and charges the same \$5,000 production services fee to 123 Advertising. The production services fee does not qualify as a qualified production cost for purposes of the credit under section 235-17, HRS, because XYZ Production Company did not pay the production services fee. The production services fee was a line item on the invoice for 123 Advertising and, except as discussed in Example 3, is profit or mark-up that XYZ Production Company was able to enjoy because the fee was greater than costs actually incurred.

**EXAMPLE 3:** Assume the same facts as in Example 1 and 2, except that XYZ Production Company can prove to the department of taxation's satisfaction that the \$5,000 production services fee included \$100 for coffee; \$200 for tape from a local hardware store; \$700 for telephone services; as well as \$500 in other incidental supplies used in the back-office. Under this example, XYZ Production Company may claim as a qualified production cost the \$1,500 of the production services fee that it can prove constitutes qualified production costs paid by the claiming entity that comprised the production services fee. The remaining \$3,500 of the production services fee does not qualify as a qualified production cost because XYZ Production Company paid nothing for this amount and is XYZ Production Company's profit mark-up. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-09 Qualified production costs; wages for nonresidents; prorating.** (a) Wages or salary paid to nonresident employees or contractors that perform services for a qualified production in Hawaii are considered qualified production costs for purposes of the credit under section 235-17, HRS. For Hawaii income tax purposes, income earned while performing services or carrying on a trade or business in Hawaii

is taxable under section 235-4(b), HRS. Because the wages earned from services performed in Hawaii by a nonresident are taxable regardless of residency under chapter 235, HRS, wages paid to nonresidents qualify as a qualified production cost. Wages earned from services performed in Hawaii by a nonresident constitute a qualified production cost even if such wages are exempt from withholding while in Hawaii under the 60-day rule provided under section 18-235-61-04(b)(1)(E), HAR.

(b) In certain circumstances, production companies employ full-time employees that work out of the production company's out-of-state headquarters. When such a qualified production company is producing a production in Hawaii, the qualified production company will utilize the same full-time employee for the time spent in Hawaii working on-location. If a full-time salaried employee is temporarily located to Hawaii for the purposes of performing services on behalf of the qualified production company/employer, the annual salary of the employee may be prorated for the amount of wages earned while performing services in Hawaii. As provided in subsection (a), the services performed in Hawaii by an employee, even if a nonresident, will be subject to income tax under chapter 235, HRS.

(d) Section 18-235-17-09, HAR, is illustrated as follows:

**EXAMPLE.** Gus Grip, 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 Gus Grip performed in Hawaii are subject to Hawaii income tax under section 235-4(b), HRS, and section 18-235-4.03(b)(3), HAR. Gus Grip's personal services of serving as a key grip for the movie, if performed in Hawaii, is a qualified production cost for purposes of the credit under section 235-17, HRS, because Gus Grip's Hawaii performed services subject Gus Grip to Hawaii income tax. Gus Grip's personal services qualify as a qualified production cost even if the wages are not subject to withholding pursuant to administrative rule. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-10 Qualified production costs; loan-outs.** (a) Section 235-17(1), HRS, defines qualified production costs to include wages or salary paid to cast, crew, or musicians; provided that the cost is incurred in Hawaii and subject to either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law).

(b) For purposes of this section, a "loan-out company" or "loan-out" means a wholly-owned entity formed on behalf of an actor, performer, director, producer, or other "above the line" cast or crewmember of a motion picture production, which serves as a separate entity that constitutes the individual's means of contracting with a motion picture production for services

rendered by the "above-the-line" individual. In general, a loan-out is the entity that agrees to provide services to the motion picture production, which in turn requires an employee of the loan-out (i.e., the actor/owner of the loan-out) to perform the services contracted with the loan-out to the motion picture production pursuant to the terms of a contract. It is acceptable for loan-out companies to employ more than one person.

(c) Fees paid to a loan-out for services performed in Hawaii for a qualified production that represents wages or salary for cast or crew are qualified production costs for purposes of the credit under section 235-17, HRS; provided that the fees paid are subject to either chapter 235 or 237, HRS.

(d) In most instances, the fees paid to a loan-out for the services performed in Hawaii for a qualified production will qualify as qualified production costs because the loan-out entity doing business in Hawaii is subject to both Hawaii income and general excise taxes. A loan-out will be subject to general excise tax under chapter 237, HRS, for the privilege of doing business in Hawaii. For more information on this requirement, see section 18-237-13(06)-10, HAR. Also, the loan-out, whether a disregarded entity for income tax purposes or separately recognized as a taxable entity, will be subject to Hawaii income tax under chapter 235, HRS, for the income earned from services performed in Hawaii. For more information on this requirement, see sections 18-235-17-07 and 18-235-17-09, HAR.

(e) Expenditures for loan-out services are not disqualified under section 235-17, HRS, because some portion of the loan-out's income earned may be excluded from income tax under section 235-7.3, HRS. Depending upon the facts and circumstances, the loan-out may be entitled to other payments not considered excluded from income tax. The loan-out is considered subject to chapter 235, HRS, within the meaning of section 235-17(1), HRS. The loan-out will also be subject to general excise tax under section 237-13(6), HRS, as discussed under section 18-237-13(06)-10, HAR. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-11 Qualified production costs; per diem allowances and fringe benefits.** (a) Section 235-17(1), HRS, defines qualified production costs to include wages or salary paid to cast, crew, or musicians; provided that the cost is incurred in Hawaii and subject to either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law).

(b) Wages or salary for cast or crew are qualified production costs for purposes of the credit under section 235-17, HRS; provided that the fees paid are subject to either chapter 235 or 237, HRS and incurred in Hawaii. Section 235-17(1), HRS, also provides the director with the discretion to approve any additional production costs in consultation with the department of business, economic development, and tourism.

(c) Per diem allowances provided to employees or

contractors by a qualified production company are qualified production costs for purposes of the credit under section 235-17, HRS. For purposes of this section, "per diem" means an allowance to an employee or contractor provided by a qualified production as reimbursement for lodging, meals, and incidental expenses of the employee or contractor while the individual is away from home during work-related travel. Per diems will constitute qualified production costs to the extent that the per diem is for time spent in Hawaii. Per diems are considered wages or salary, or other production costs that qualify as determined by the director of taxation within the meaning of section 235-17(1), HRS.

(d) The following per diem allowances qualify within the meaning of this section:

- (3) Per diem allowances provided under an "accountable plan;" and
- (4) Per diem allowances provided under a "nonaccountable plan;"

as determined under section 62(c) of the Internal Revenue Code, accompanying federal regulations, and conforming Hawaii income tax law.

(e) In addition to per diem allowances as qualified production costs, fringe benefits considered ordinary and necessary business expenses under section 162 of the Internal Revenue Code qualify as qualified production costs for purposes of the credit under section 235-17, HRS; provided that such costs are subject to chapter 235 or 237, HRS, and incurred in Hawaii.

(f) The following fringe benefits commonly associated with the motion picture and film production industry qualify as a qualified production cost within the meaning of this section:

- (6) Unemployment insurance premium costs;
- (7) Employment taxes assessed under federal and state law;
- (8) Workers compensation insurance premium costs;
- (9) Union pension and welfare benefits to the extent required by contract between the union and the qualified production; and
- (10) Health insurance premiums;

to the extent incurred in Hawaii.

(g) Amounts considered per diem allowances under subsection (d), whether or not pursuant to an accountable plan, and fringe benefits identified in subsection (f) are considered subject to chapter 235, HRS, within the meaning of section 235-17(1), HRS. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**18-235-17-12 Qualified production costs; "kit" or "box" rentals.** (a) Section 235-17(1), HRS, defines qualified production costs to include wages, costs of set construction, wardrobe expenses, accessories, rentals, and any additional production cost determined by the director in consultation with the department of business, economic development, and tourism; provided that the cost is incurred in Hawaii and subject to

either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law).

(b) The costs incurred by a qualified production for the rental of an employee's or contactor's kit or box use constitutes a qualified production cost; provided that the fees paid are subject to either chapter 235 or 237, HRS.

(c) For employees, the rental paid for use of the employee's personal kit or box can be considered wages or income from renting personal property that is subject to Hawaii income tax law under chapter 235, HRS. If the rental is considered a reimbursement for ordinary and necessary business expenses, the cost is considered subject to Hawaii income tax law.

(d) For independent contractors, the rental paid for use of the contractor's personal kit or box can be considered wages or income from services provided to the qualified production company that is subject to Hawaii income tax law under chapter 235, HRS. Moreover, an independent contractor is subject to Hawaii general excise tax under chapter 237, HRS, on all gross proceeds earned as a privilege of doing business in Hawaii. To the extent that the kit or box rental is paid to an independent contractor, the proceeds received for the rental can be subject to both Hawaii income and general excise tax laws under chapter 235 and 237, HRS.

(e) For purposes of this section, "kit or box" means the personal tools, accessories, or other equipment of a specialist or tradesperson that utilizes the instruments to complete their specialized tasks in the motion picture and television film industry. Examples of items that would constitute a kit or box include a makeup artist's equipment or the construction tools of a set designer. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-13 Qualified production costs; rental of local facilities or locations owned by nonprofit organizations.**

(a) Section 235-17(1), HRS, defines qualified production costs to include the costs associated with the rental and fees for use of local facilities and locations; provided that the cost is incurred in Hawaii and subject to either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law).

(b) For certain scenes filmed on-location in Hawaii, a production company may choose to utilize the property or location owned by a nonprofit organization. In exchange for use of its facilities, it is common for a nonprofit organization to charge the production company rent or other fee. It is possible that the nonprofit organization is exempt, to some extent, from Hawaii taxes under both the income tax law and general excise tax law assessed under chapters 235 and 237, HRS.

(c) For purposes of Hawaii's general excise tax law under chapter 237, HRS, a tax-exempt organization is only exempt from general excise tax to the extent the proceeds are a direct result

of the exempt organization's exempt activity. The general excise tax exemption does not extend to any activity the primary purpose of which is to produce income even though the income is to be used for, or in furtherance of, the exempt activities of such organization. In general, rent received by a nonprofit organization is considered directly related to the production of income and not in pursuit of an exempt purpose and is therefore taxable under chapter 237, HRS, notwithstanding the fact that the income may be used to further an exempt organization's exempt purpose. Because rent received by an exempt organization is generally taxable under chapter 237, HRS, the rent paid by a production company to a nonprofit organization will generally be subject to chapter 237, HRS, and will constitute a qualified production cost. Furthermore, for purposes of Hawaii's income tax law under chapter 235, HRS, a tax-exempt organization is taxable on unrelated business taxable income.

(d) Section 18-235-17-13, HAR, is demonstrated as follows:

**EXAMPLE.** XYZ Productions is filming on location at a church, owned by an Internal Revenue Code section 501(c)(3) tax-exempt religious organization, the exempt purpose of which is to advance religious practices of its congregation. XYZ pays the church \$1,000 in rent for the use of the church facility for one day of shooting. The \$1,000 rent payment qualifies as a qualified production cost under section 235-17, HRS, because the church's business activities of receiving rent are taxable under chapter 237, HRS, because the rent's primary purpose is the production of income, even if the rental income is later used for the church's exempt purposes. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-14 Qualified production costs; insurance.** (a) Section 235-17(1), HRS, defines qualified production costs to include the cost of insurance; provided that the cost is incurred in Hawaii and subject to either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law). However, under title 14, HRS, insurance is not subject to either chapter 235 or 237, HRS.

(b) Insurance premiums under Hawaii law are subject to the insurance premiums tax under chapter 431, article 7, HRS. Effectively, chapter 431, article 7, HRS, serves as a substitute for Hawaii's income and general excise taxes under chapters 235 and 237, HRS, respectively.

(c) Because chapter 431, article 7, HRS, is a substitute for Hawaii net income tax and general excise tax, insurance subject to the insurance premiums tax under chapter 431, article 7, HRS, will constitute a qualified production cost.

(d) Section 235-17(1), HRS, expressly provides that insurance is a qualified production cost, thus intending



insurance to qualify as a production cost notwithstanding any proviso to the contrary. Insurance that is written on a Hawaii risk, which is incurred in Hawaii, and that is subject to Hawaii's insurance premiums tax under chapter 431, article 7, HRS, will constitute a qualified production cost. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-15 Qualified production costs; credit calculation for fixed equipment costs.** (a) Section 235-17(1), HRS, defines qualified production costs to include costs of equipment and any additional production cost determined by the director in consultation with the department of business, economic development, and tourism; provided that the cost is incurred in Hawaii and subject to either chapter 235, HRS (Hawaii income tax law) or 237, HRS (Hawaii general excise tax law). However, section 235-17(a), HRS, precludes any production cost from qualifying where a deduction for the cost is taken under section 179 (with respect to election to expense depreciable business assets) of the Internal Revenue Code.

(b) In many instances, motion picture production companies own fixed equipment that is used for filming various productions. Examples of fixed equipment include cameras, lights, computers, and trucks. These items are usually purchased as a matter of business necessity and are not necessarily associated with any specific production. The fixed equipment; however, is utilized by the production companies various film ventures on an as-needed basis. A qualified production company that utilizes fixed equipment in a Hawaii film production may claim as a qualified production cost the amount of the depreciation allowance, if any, for the equipment for the qualified production company's taxable year[+], prorated for the amount of equipment actually used in Hawaii; provided that a deduction has not been taken under section 179 of the Internal Revenue Code with respect to the equipment. The depreciation allowance allowable under state law shall be utilized to calculate the credit amount under this section.

(c) Section 18-235-17-15, HAR, is illustrated as follows:

**EXAMPLE.** XYZ Production Company has cameras that it ships to Hawaii to film a production for six months. All of these items were purchased by the production company prior to production in Hawaii and have been utilized as equipment for the past few years on other film projects. These cameras are available on a checkout basis for all productions being created by XYZ Production Company. Assume that the cameras are all "5 year" property under Internal Revenue Code depreciation conventions and assume further that a deduction under section 179 of the Internal Revenue Code was not taken with respect to the cameras. Depreciation amounts have been taken over the prior years.

Assume further that XYZ Production Company is entitled to take a depreciation allowance for the cameras for the taxable year of the production in Hawaii equal to \$1,000. XYZ Production Company can claim as a qualified production cost an amount equal to the depreciation allowance for the taxable year in which the production activities occurred prorated for the amount of use in Hawaii. In this case, because the cameras are used in Hawaii for six months, a \$500 qualified production cost is incurred for purposes of the credit under section 235-17, HRS. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-16 Qualified production costs; imported goods, services, or contracting subject to the use tax.** (a) Section 235-17(1), HRS, defines qualified production costs to include costs incurred by a qualified production within the state that are subject to chapter 237, HRS (Hawaii general excise tax law). Not all business transactions occurring in the state are subject to chapter 237, HRS. In order to ensure a level playing field amongst business transacted both within and without Hawaii, to avoid constitutionally infringing upon out-of-state taxpayers, and to complement the general excise tax as an overall excise tax regime, there is imposed in Hawaii a complementary tax on the use in this state of tangible personal property, services, or contracting imported into Hawaii under chapter 238, HRS (Hawaii use tax law).

(b) Importation of goods, services, or contracting into this state from out of state for use in this state is subject to chapter 238, HRS, capturing the general excise tax equivalent. Effectively, chapter 238, HRS, serves as a substitute for Hawaii's general excise tax under chapter 237.

(c) Because chapter 238, HRS, is a substitute for Hawaii general excise tax, production costs incurred by a qualified production in Hawaii, which would otherwise qualify as a qualified production cost, are considered subject to tax within the meaning of section 235-17(1), HRS, where the production cost (as either an item of tangible personal property, service, or contracting) is imported into Hawaii and is subject to the use tax under chapter 238, HRS, and the use tax is actually paid. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-17 Utilizing the motion picture, digital media, and film production income tax credit and the high technology business investment tax credit simultaneously; same production; safe harbor for segregating funds.** (a) Section 235-17(e), HRS, contains a restriction on the source of funds used to purchase or acquire qualified production costs. On or after July 1, 2006, a qualified production cost that has been financed by an investment

for which a credit was claimed under section 235-110.9, HRS, is ineligible for the section 235-17, HRS, tax credit. Furthermore, section 235-17(1), HRS, defines qualified production cost to include only those costs incurred by a qualified production that have not been financed by any investments for which a credit was or will be claimed pursuant to section 235-110.9, HRS.

(b) The statutory framework of section 235-17, HRS, including its limitation on the use of investments for which a credit was or will be claimed under section 235-110.9, HRS, does not preclude a qualified production from utilizing the section 235-17, HRS, refundable income tax credit in conjunction with financing portions of the qualified production with the utilization of the nonrefundable income tax credit provided by section 235-110.9, HRS.

(c) A taxpayer may take advantage of both the refundable credit available under section 235-17, HRS, for qualified production costs, as well as the nonrefundable credit available under section 235-110.9 for other related costs for the same production, and will not be challenged by the department for utilizing both tax credits; provided that the taxpayer complies with the requirements under this section.

(d) Safe harbor, generally. To the extent a dollar representing an investment in a qualified high technology business, as defined under section 235-110.9, HRS, will not be used to claim a credit under section 235-110.9, HRS, that dollar may be utilized to purchase qualified production costs that qualify for the refundable credit under section 235-17, HRS. Any invested dollar in a qualified high technology business, as defined under section 235-110.9, HRS, for which any credit is claimed under section 235-110.9, HRS, by any taxpayer disqualifies any costs paid for with the dollar invested, from qualifying for the refundable tax credit under section 235-17, HRS.

(e) Safe harbor; segregation requirement. To take advantage of both the nonrefundable income tax credit under section 235-110.9, HRS, and the refundable income tax credit under section 235-17, HRS, the production must clearly segregate funds based on source and use so as to maintain adequate tracing of the funds. A taxpayer will be considered to have adequately segregated the source and use of funds if the production maintains an entirely separate bank account, ledger, and tracing method for the money that represents an investment in the production company for which a credit is or will be claimed under section 235-110.9, HRS; and another separate bank account, ledger, and tracing method for contributions, investments, loans, profits, earnings, or other funds that will not be used to obtain a credit under section 235-110.9, HRS.

(f) Safe harbor; commingled funds. Where funds that represent an investment for which a credit was or will be claimed under section 235-110.9, HRS, are commingled with other funds otherwise eligible for the credit under section 235-17, HRS, a

taxpayer will be eligible for the refundable credit under section 235-17, HRS, as allowed under this subsection. The department will consider payment of qualified production costs of the production to have been first paid by any funds that represent an investment for which a credit was or will be claimed under section 235-110.9, HRS, and therefore disqualified for the refundable income tax credit under section 235-17, HRS. After all funds representing an amount equal to the amount of credit that was or will be claimed by any taxpayer under section 235-110.9, HRS, pursuant to an arrangement at the time the investment was made have been expended on qualified production costs; all remaining funds of the production may then be utilized to purchase qualified production costs that will be eligible for the refundable tax credit under section 235-17, HRS.

(g) Waiver requirement for commingled funds or other arrangement. A taxpayer that seeks to utilize funds that represent an investment under section 235-110.9, HRS, to be eligible for costs that qualify for the refundable tax credit under section 235-17, HRS, and further utilizes the safe harbor provided in subsection (f), or any other arrangement not provided by this section, is required to comply with this subsection. In order to qualify production costs for the credit available under section 235-17, HRS, for qualified production costs that will be paid for with funds that represent an investment under section 235-110.9, HRS, a taxpayer or investor must forever relinquish their right to claim the credit under section 235-110.9, HRS. Allocating credits under section 235-110.9, HRS, to partners or investors does not constitute relinquishing a right to claim the credit. The attribution of an investment dollar that qualifies for credit under section 235-110.9, HRS, to a dollar incurred for a qualified production cost will occur only once for each investment dollar that qualifies for credit under section 235-110.9, HRS. An investment dollar that qualifies under section 235-110.9, HRS, will lose its character as an investment eligible for the credit under section 235-110.9, HRS, only if the person ultimately eligible to claim the credit under section 235-110.9, HRS, provides the production with a signed waiver that is enforceable by the department against the investor/taxpayer. The extent to which an investor/taxpayer will be considered eligible to make a claim, and therefore the amount of credit the investor/taxpayer may waive, will be determined after any allocations of credit have been made by intervening pass-through entities, as allowed under sections 235-2.45 and 235-110.9, HRS. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-18 Independent certification of motion picture, digital media, and film production income tax credit claims.** (a)

In order to ascertain the validity of a credit claim made under section 235-17, HRS, all production report statements submitted to the department of business, economic development, and tourism

Hawaii film office pursuant to section 235-17(h), HRS, shall first be verified by an independent tax practitioner. No determination letter setting forth the qualified production costs incurred and the credit amount claimable under 235-17, HRS, shall be issued by the department of business, economic development, and tourism until the department of business, economic development, and tourism has received a tax opinion or agreed upon procedures report as to the validity of a taxpayer's credit claim pursuant to this section. The independent verification of qualified production costs as required by this section will be satisfied as follows:

- (1) Issuance of a tax opinion. A tax opinion issued pursuant to this section shall reach a conclusion substantially similar to the following: "It is more likely than not that at least \$\_\_\_\_(insert appropriate amount) expended by the taxpayer during \_\_\_\_ (insert taxable year) would qualify as eligible production costs within the meaning of section 235-17, HRS, that would be eligible for credits under that section." To qualify as a tax opinion acceptable under this section, such an opinion shall meet the requirements for covered opinions as set forth in Treasury Circular 230, 31 Code of Federal Regulations subtitle A, part 10, section 10.35(c), which by this reference is incorporated herein, with conforming changes in nomenclature and other language as authorized by chapter 235, HRS.
- (2) Issuance of an agreed upon procedures report. An agreed upon procedures report issued pursuant to this section shall evaluate the taxpayer's assertion of the amount qualifying as eligible production costs within the meaning of section 235-17, HRS, that would be eligible for credits under that section. The report shall test compliance with the elements set forth in section 235-17, HRS, and any relevant administrative rules or administrative guidance issued by the department, and shall separately state the total of eligible production costs for which no exceptions were noted. This report shall comply with the Standards for Consulting Services established by the American Institute of Certified Public Accountants, also known as AICPA.

It is not necessary that the opinion as described in paragraph (1) or the agreed upon procedures report described in paragraph (2) be addressed to, or be relied upon by, any person other than the taxpayer.

(b) The certification opinion must be submitted to the department of business, economic development, and tourism not later than 90 days following the end of the taxable year in which qualified production costs were expended or incurred.

(c) It is the taxpayer's responsibility to ensure that all information relevant to ascertain the validity of the credit

claim is provided to the taxpayer's independent tax practitioner.

(d) The cost of the tax opinion or agreed upon procedures report shall be the responsibility of the taxpayer. The cost of the tax opinion or agreed upon procedures report required by this section shall be considered a qualified production cost; provided the services are subject to taxation under chapter 235 or chapter 237, HRS.

(e) This section is only required for taxpayers with qualified production costs in excess of \$1,000,000.

(f) Notwithstanding the requirement that a taxpayer provide a tax opinion or agreed upon procedures report to the department of business, economic development, and tourism, the director of taxation may audit and adjust the tax credit amount to conform to the information obtained by the department or provided by the taxpayer.

(g) As used in this section:

"Independent tax practitioner" means a tax practitioner engaged in writing by the taxpayer to provide a tax opinion or agreed upon procedures report under this section whose engagement relating to the issuance of the tax opinion or agreed upon procedures report is in compliance with, and does not contravene, any statute, regulation, ethical code or rule of professional conduct regulating the tax practitioner's professional conduct; and the tax practitioner does not have an ownership or pecuniary interest in the taxpayer.

"Tax practitioner" means an individual, wherever located, who is authorized or permitted to practice or appear before the Internal Revenue Service or the department of taxation on behalf of a taxpayer; provided that if such individual practices under this section at any time while physically in Hawaii, such person shall be in compliance with relevant professional regulatory affiliations. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-19 Evidence of reasonable efforts to hire local talent and crew.**

(a) Section 235-17(d)(4), HRS, requires as a condition precedent to qualifying for the credit that a production provide to the department of business, economic development, and tourism, evidence of reasonable efforts to hire local talent and crew. A production must provide this evidence prior to submitting the production report for credit certification.

(b) Evidence of reasonable efforts to hire local talent and crew shall be demonstrated as follows:

- (1) The production must provide documentary evidence of having contacted Hawaii chapters of industry unions or guilds, including the date and time of any telephone calls, emails or other contact; the name of the union or guild representative contacted; the name of the production representative initiating contact; and the

- name of the union or guild contacted; or
- (2) The production must provide documentary evidence of the specific means of notifying the public of the production's desire to hire local talent and crew, including copies of any press releases; solicitations; requests for proposals; bids; local newspaper ads; trade journal ads; flyers posted; open casting calls; radio spots; Hawaii film office website or other internet posting; or engagement of local production professionals as references for local talent and crew hires. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118)  
(Imp: HRS § 235-17)

**§18-235-17-20 Evidence of financial or in-kind contributions to educational or workforce development for the local film, television, and digital media industry.** (a) Section 235-17(d)(5), HRS, requires as a condition precedent to qualifying for the credit that a production provide to the department of business, economic development, and tourism, evidence of financial or in-kind contributions or educational or workforce development efforts, in partnership with related local industry labor organizations, educational institutions, or both, toward the furtherance of the local film, television, and digital media industries. A production must provide this evidence prior to submitting the production report for credit certification.

(b) Only one contribution is necessary to fulfill the requirement under this section. However, a production may make multiple contributions.

(c) Contributions required under section 235-17(d) are not refundable, even if a production does not qualify to claim the income tax credit. Contributions are also not considered charitable contributions.

(d) The following contributions will qualify for purposes of the evidence of educational or workforce development contribution required under section 235-17(d)(5), HRS:

- (1) Financial contributions to Hawaii public or charter schools. Financial contributions to Hawaii public or charter schools, at a minimum, equal to the lesser or 0.1 per cent of a production's qualified production costs or \$1,000. Financial contributions must be made specifically to an arts program at a Hawaii public or charter elementary school, middle school, high school, or post-secondary school. It is preferred that the contribution be made to a school in the same neighborhood in which the production takes place. Arts programs may include film/video, radio, performing arts, theater, music, and visual and fine arts.
- (2) In-kind donations to Hawaii public or charter schools. In-kind contributions to Hawaii public or charter schools that have the equivalent monetary value equal

to, at a minimum, the lesser of 0.1 per cent of a production's qualified production costs or \$1,000. Contributions of in-kind property or services must be made specifically to an arts program at a Hawaii public or charter school, preferably in the same community in which production takes place. The in-kind contribution must include production-related property or services, including cameras and sound equipment; editing/post-production equipment; grip/electric equipment; computer hardware/software; props/set dressing; costumes; or other property or services previously agreed to by school administrators.

- (3) Educational program with Hawaii public or charter schools. At least one on-set or post-production internship arrangement with a Hawaii public or charter high school or post-secondary school, preferably in the same community in which the production takes place. The internship must include a cumulative of five hours, at a minimum, of arts or digital media education-related volunteer services, such as teaching acting classes, directing a school play, participating in animated student projects, or giving craft seminars. The internship may be arranged with any cast or crew. The minimum time requirement, at the discretion of the Hawaii Film Office, may be reduced based upon the value of services.
- (4) Educational program with local labor union chapters. At least one on-set craft apprenticeship arranged with one of the local labor union chapters. The apprenticeship must include a cumulative of five hours, at a minimum, of education-related volunteer services, such as giving a craft-related seminar. The apprenticeship may be arranged with any cast or crew. The minimum time requirement, at the discretion of the Hawaii Film Office, may be reduced based upon the value of services.
- (5) FilmHawaii seminar participation with the Hawaii film office. Participation as a speaker in two or more FilmHawaii seminars. Such participation may also be used to offset the minimum five hours of volunteer services required in paragraph (3) or (4), above. Participation in one seminar shall be equal to 2.5 hours of volunteer services.
- (6) Any other evidence of financial or in-kind contributions or educational or workforce development approved by the Hawaii film office. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-21 Disallowance of credit for unpaid expenditures.** Section 235-17(1), HRS, defines qualified



production cost to mean, among other requirements, costs incurred by a qualified production. For purposes of qualifying as a qualified production cost as defined, no income tax credit will be allowed for costs that remain unpaid at the time the production report is filed with the Hawaii film office. Any unpaid production expenditures at the time the production report is filed will not be considered paid or incurred within the meaning of section 235-17(1), HRS. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-22 Production company personnel and contractors; required Hawaii tax notice; safe harbor.**

(a) Any taxpayer filing for prequalification for the income tax credit allowed under section 235-17, HRS, shall provide every nonresident employee, contractor, vendor, loan-out company, or other agent providing goods or performing services in Hawaii with a tax advisory informing such persons of Hawaii tax obligations. The tax advisory under this section shall be provided to all such persons not later than thirty business days after the engagement of the nonresident employee, contractor, vendor, loan-out company, or other agent is consummated.

(b) The tax advisory to be provided shall be any tax advisory made available to the motion picture and television film industry by the department through official pronouncement; or in a form that includes substantially the following:

"The purpose of this Tax Advisory is to provide notice to persons engaged in the motion picture and television film production industry of the potential tax obligations of working in Hawaii.

The Department of Taxation (Department) has asked that this Tax Advisory be provided to persons involved in the motion picture industry while in Hawaii, including crew, actors, directors, writers, producers, or others who conduct activities in Hawaii in the capacity of an employee, vendor, independent contractor, or loan-out companies for income or profit.

INCOME TAX OBLIGATIONS

W-2 Employees--As a general matter, wages earned while working in Hawaii as an employee are subject to Hawaii income tax for the amount of income earned while in Hawaii.

1099 Independent Contractors and Loan-Out Companies--Also as a general matter, income earned in Hawaii while performing services in Hawaii or otherwise conducting business activities as an independent contractor or loan-

out company is likewise subject to Hawaii income tax.

Residency--Income earned from performing services in Hawaii is taxable regardless of residency.

Royalties Exclusion--In certain circumstances, persons, whether W-2 employees or 1099 independent contractors or loan-out companies, may be entitled to an income tax exclusion for income earned as royalties from the exploitation of copyrights.

Relevant Forms--Income tax is reported and remitted by using the proper income tax form. For individual income tax purposes, residents file Form N-11 (Individual Resident Income Tax Return) or Form N-13 (Individual Resident Income Tax Return--Resident Short Form). Nonresidents file Form N-15 (Individual Income Tax Return For Nonresidents and Part-Year Residents). S-Corporations file Form N-35 (S Corporation Income Tax Return). Other Corporations file Form N-30 (Corporation Income Tax Return). Other forms may be necessary depending upon the circumstances.

#### GENERAL EXCISE TAX OBLIGATIONS

W-2 Employees--Persons working or conducting business activities in Hawaii as a W-2 employee are generally not subject to the general excise tax.

1099 Independent Contractors and Loan-Out Companies--Generally, independent contractors and loan-out companies that provide services or other business activities to a production company are considered to be conducting business in Hawaii and are subject to the general excise tax. Because independent contractors or loan-out companies are subject to the general excise tax, these persons must apply for and obtain a general excise tax license. Also, these persons must file a return and pay over general excise tax on the gross proceeds earned in Hawaii.

Relevant Forms--A general excise tax license is obtained from the Department by filing Form BB-1 (State of Hawaii Basic Business Application, Instructions, and Payment Voucher). General excise tax is reported and remitted by filing periodic returns on Form G-45 (General Excise/Use Tax Return), followed by filing Form G-49 (Annual Return & Reconciliation of General Excise/Use Tax Return) at the end of the tax year. Other forms may be necessary depending upon the circumstances.

CONTACT A TAX PROFESSIONAL

The Department suggests that any person affected by this Tax Advisory contact a tax professional familiar with Hawaii tax laws to assist them with any Hawaii tax issues.

ADDITIONAL INFORMATION

For additional information-

- Website: [www.hawaii.gov/tax](http://www.hawaii.gov/tax)
- Telephone: (808) 587-1569
- Fax: (808) 587-1584
- Tax Information Release Nos. 2006-02; 2008-02; 2009-05"

(c) "Subject to tax" safe harbor. (a) A taxpayer claiming the tax credit under section 235-17, HRS, that has complied with the terms of this section shall not have a production cost challenged as being disqualified because the tax upon the transaction was unpaid by the person providing the goods or rendering the services that were the basis of the production cost claimed.

(d) A taxpayer that satisfies the following shall be entitled the safe harbor provided in this section:

- (1) The taxpayer must provide the tax advisory required by this section to the vendor or service provider rendering the services that are the basis of the production cost claimed;
- (2) The taxpayer must obtain the acknowledgement of the vendor or service provider that they have received the tax advisory required by this section; and
- (3) The taxpayer must submit to the department of taxation compliance division a report, signed by the taxpayer under the penalties set forth under section 231-36, HRS, setting forth the name, address, identifying number, amounts of gross income or gross proceeds paid to the vendor or service provider for Hawaii-based activity, and any other relevant information requested by the department, prior to filing a tax return claiming the credit under section 235-17.

(e) Section 18-235-17-22(c) is demonstrated as follows:

**EXAMPLE:** XYZ Production Company pays \$1,000,000 for the use of Donna Dancer's loan-out services in filming a qualified production. Under the facts of this example, Donna Dancer's income and gross proceeds are taxable under Hawaii income tax and general excise tax law. Assume further that the invoices billed to XYZ Production Company for Donna Dancer's loan-out services have no line item for taxes being passed on

because it is not uncommon for certain service contracts to not include a pass-on of the general excise tax. Assume that Donna Dancer fails to file and pay the income tax and general excise tax. XYZ has no notice or knowledge of Donna Dancer's failure to comply with her tax obligations. At the time XYZ Production Company and Donna Dancer executed the contract for Donna Dancer's loan-out services, XYZ Production Company included with her contract a copy of a tax advisory discussed in this section. XYZ Production Company obtained Donna Dancer's signature as proof of receiving a copy of the tax advisory. XYZ Production Company also provided the department of taxation with a spreadsheet providing all information required by this rule. Because XYZ Production Company timely complied with the tax advisory and other requirements discussed in this section, XYZ Production Company's claim for Donna Dancer's loan-out costs as a qualified production cost will not be challenged by the department on the basis that the cost was not subject to tax because the tax went unpaid. (Auth: HRS §§ 231-3(9), 235-17(g), 235-118) (Imp: HRS § 235-17)

**§18-235-17-23 Access to production company set and locations; required courtesy visit and press coverage.** (a) All taxpayers filing a production report with the Hawaii Film Office shall allow access to the taxpayer's production set or location at least once during production for a courtesy visit by government officials. Taxpayers are entitled to at least seven days notice of the government's intent to visit the taxpayer's set or locations. The taxpayer is entitled to escort the government officials on the visit and restrict access to any part of the set or location deemed proprietary and that which would result in competitive harm if government officials were allowed to visit. Government officials allowed to participate in the courtesy visit include Hawaii Film Office personnel; department of taxation personnel; state and county film commissioners; legislators; and other governmental officials.

(b) All taxpayers filing a production report with the Hawaii Film Office shall submit to a press conference or agree to at least one press story, broadcast, or print, as agreed by both the production and the Hawaii Film Office, where the taxpayer and any of its representatives shall allow themselves to be interviewed by government officials and the media regarding the qualified production. The press conference or other press story shall be held at a location mutually-agreed upon between the production and the Hawaii Film Office, including the production's set or other location.

(c) The courtesy visit and press requirements of this

section shall be satisfied before the Hawaii Film Office accepts a taxpayer's production report as being complete.

- (d) Nothing in this section shall be interpreted as limiting or restricting the department's authority to access premises or documents, including subpoena power, otherwise allowed.

DEPARTMENT OF TAXATION  
PROPOSED HAWAII ADMINISTRATIVE RULES

TITLE 18

DEPARTMENT OF TAXATION

Chapter 237

General Excise Tax Law

**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 237-2.**

**§18-237-2-01 "Business", "engaging in business"; motion picture industry loan-out entities; defined and distinguished.**

(a) Section 237-2, HRS, defines conducting or carrying on business or engaging in business to include all activities (personal, professional, or corporate), engaged in or caused to be engaged in with the object of gain or economic benefit either direct or indirect, excluding casual transactions. Businesses that constitute loan-out entities in the motion picture or television film industry are considered to be doing business in Hawaii, provided sufficient nexus is otherwise present as defined under chapter 237, HRS, and relevant Hawaii case law, such that the loan-out must register to do business in Hawaii and remit and pay over general excise tax owed on gross proceeds earned or received in Hawaii. For purposes of this section, "loan-out" has the same meaning as in section 18-235-17-10, HAR. This section and the requirement that a loan-out register to do business and remit and pay over general excise tax owed on gross proceeds earned from Hawaii applies regardless of where the loan-out entity is organized or domiciled.

(b) Section 18-237-2-01, HAR, is illustrated as follows:

**EXAMPLE 1:** Holly Wood is a high paid, above-the-line actress who is a resident of California. Because of the high-dollar value of her contracts to perform in various motion picture projects, her ability to organize her business affairs distinct from her personal affairs, the ability to exploit her intellectual property, and for pension purposes, she has organized her acting services through the use of a loan-out corporation. She has formed a qualified subchapter S corporation. Through Holly Wood's loan-out corporation, the corporation executes an immediate contract with the production company, which in turn obligates Holly Wood, as an employee of the loan-out S corporation, to perform the acting services on the loan-out corporation's behalf for the production company pursuant to the contract. For purposes of Holly Wood's loan-out relationship with the production company and for tax

purposes, the loan-out is considered an independent contractor or vendor of services. Because Holly Wood has elected to organize her acting affairs through the use of a loan-out entity that is separate and distinct for general excise tax purposes the loan-out is considered doing business or engaging in business in Hawaii for the filming in which she participates while in Hawaii. Holly's loan-out will have to register to do business in Hawaii with the department of taxation and remit and pay over the general excise tax on proceeds earned in Hawaii for the privilege of doing business in Hawaii.

**EXAMPLE 2.** Assume the same facts as in Example 1, except that Holly Wood has elected to be an independent contractor for her loan-out entity rather than an employee of the loan-out entity. Because Holly has elected to be considered doing business directly with her loan-out, which in turn is doing business for the production company, Holly has added an additional layer of general excise tax and Holly herself—as well as the loan-out entity—are required to register to do business in Hawaii with the department of taxation and remit and pay over the general excise tax on proceeds earned in Hawaii for the privilege of doing business in Hawaii.

**EXAMPLE 3.** Mike Rophone is a boom mic operator for a production company. Mike Rophone is a below-the-line staffer for the production company who is paid wages that are reported on a Form W-2 for federal and state tax purposes. Because Mike Rophone is an employee and is not considered engaging in business for purposes of chapter 237, HRS, and is otherwise exempt from the general excise tax under section 237-24(6), HRS, Mike Rophone is not subject to Hawaii general excise tax law. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-2)

**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 237-9.**

**§18-237-9-01 General excise tax licenses; motion picture industry.** Any person who has gross income or gross proceeds of sales that are subject to general excise tax under chapter 237, HRS, must apply for and receive a license as a condition precedent to engaging or continuing to engage in business in Hawaii. Application is made on the department Form BB-1 or BB-1X for an amended form. A \$20 fee must also be provided. The requirement to register for a general excise tax license includes production companies or vendors seeking to do business with production companies that will have gross proceeds in Hawaii. The requirement to obtain the general excise tax license and submit the fee applies to any production company in Hawaii that will receive gross proceeds or gross income taxable under chapter 237, HRS, and loan-out companies, as defined under section 18-235-17-10, providing goods or services to production companies in Hawaii. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-9)



**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 237-13.**

**§18-237-13-01.01 Imposition of tax on manufacturers; motion picture industry.**

(a) Section 237-13(1), HRS, levies and assesses a privilege tax on account of business and other activities in the State measured by gross income or gross proceeds from business on every person engaging or continuing within the State in the business of manufacturing, including the compounding, canning, preserving, packing, printing, publishing, milling, processing, refining, or preparing for sale, profit, or commercial use, any article, substance, or commodity.

(b) A motion picture or television film production company is considered to be in the business of manufacturing for Hawaii general excise tax purposes under chapter 237, HRS; provided the production company will be selling, licensing, leasing, profiting, or otherwise exploiting the motion picture or television film product for profit. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-13(1))

**§18-237-13(6)-10 Imposition of tax on service business; motion picture industry; loan-outs.**

(a) Section 237-13(6), HRS, levies and assess a privilege tax on account of business and other activities in the State measured by gross income or gross proceeds from business on every person engaging or continuing within the State in a service business or calling.

(b) A loan-out entity, as defined under section 18-235-17-10, HAR, providing services to a motion picture or television film production company in the capacity as an independent contractor or vendor is considered a service business or calling for Hawaii general excise tax purposes under chapter 237, HRS. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-13(6))

**§18-237-13(6)-11 Imposition of tax on the rental or leasing of tangible personal property; rental of personal property out-of-state; taxable.**

(a) Section 237-13(6), HRS, levies and assesses a privilege tax on account of business and other activities in the State measured by gross income or gross proceeds from business on every person engaging or continuing within the State in a service business or calling.

(b) The business of renting or leasing tangible personal property for use in Hawaii is taxable under chapter 237, HRS. To the extent there is sufficient nexus under United States and Hawaii law, which includes a taxpayer's property within the taxing jurisdiction, the out-of-state rental or leasing of tangible personal property bound for Hawaii for use in Hawaii is subject to chapter 237, HRS.

(c) If the property is used in more than one state, the taxpayer may allocate the gross income from the lease or rental of personal property by using any reasonable method of allocation

that clearly, fairly, and properly reflects the gross income to the various states; provided that the allocation method is documented. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-13(6))

**PROPOSED ADMINISTRATIVE RULES APPLYING HRS § 237-18.**

**§18-237-18-01 General excise tax rate for services provided to a motion picture production; half per cent rate.** (a) Section 237-18(c), HRS, provides that the tax rate of one-half of one per cent shall apply to the gross income or gross proceeds earned through the activity of a person engaged in a service business or calling; provided the services contribute to the manufacture of a product that consists in part of the value of the services provided.

(b) A loan-out, as defined under section 18-235-17-10, HAR, that provides services to a motion picture or television film production company considered a manufacturer under section 18-237-13-01.01, HAR, shall be entitled to the one-half of one per cent tax rate for the assessment of the loan-out's general excise tax on gross income or gross proceeds under chapter 237, HRS, earned from services provided to a motion picture or television film production.

(c) The one-half of one per cent tax rate under section 237-18(c), HRS, shall only apply to service vendors that are providing services to a production company where the motion picture film product consists in part of the services provided.

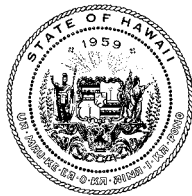
(d) Notwithstanding the provisions of this section, all requirements of section 235-18(c), HRS, must be satisfied by all participants in order for the one-half of one per cent tax rate to apply.

(d) Section 18-237-18-01, HAR, is illustrated as follows:

**EXAMPLE 1:** Assume the same facts as provided in Example 1 contained at section 18-237-2-01(b), HAR. Holly Wood's acting services provided to the production company are distinct and identifiable components of the film because her personal contributions can be discerned in the final product produced. Because Holly Wood's contribution to the film product (her distinct acting) consists in part of the value she provided to the production company, which is a manufacturer under these facts because the film product will be exploited for profit, Holly Wood's loan-out subchapter S corporation will qualify for the lower one-half of one per cent tax rate on its gross income or gross proceeds from doing business in Hawaii for the production company.

**EXAMPLE 2:** XYZ Food Services is a catering company that provides food and catering services to Hawaii production companies. XYZ Food Services prepares its own food, as well as sells pre-made foods to the productions. XYZ Food Services is not entitled to calculate its Hawaii general excise tax liability at the one-half per cent rate because it is not a service business or calling taxable under section 235-13(6), HRS. XYZ Food Service is conducting business as a manufacturer or seller of tangible

personal property and is not entitled to the lesser one-half per cent general excise tax rate allowed under section 237-18(c), HRS. (Auth: HRS § 231-3(9), 237-8) (Imp: HRS § 237-18)



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September 17, 2009

## **TAX ADVISORY**

### **POTENTIAL HAWAII TAX OBLIGATIONS FOR PERSONS WORKING IN THE MOTION PICTURE AND TELEVISION FILM PRODUCTION INDUSTRY**

The purpose of this Tax Advisory is to provide notice to persons engaged in the motion picture and television film production industry of the potential tax obligations of working in Hawaii.

The Department of Taxation (Department) has asked that this Tax Advisory be provided to persons involved in the motion picture industry while in Hawaii, including crew, actors, directors, writers, producers, or others who conduct activities in Hawaii in the capacity of an employee, vendor, independent contractor, or loan-out companies for income or profit.

#### **INCOME TAX OBLIGATIONS**

***W-2 Employees***—As a general matter, wages earned while working in Hawaii as an employee are subject to Hawaii income tax for the amount of income earned while in Hawaii.

***1099 Independent Contractors and Loan-Out Companies***—Also as a general matter, income earned in Hawaii while performing services in Hawaii or otherwise conducting business activities as an independent contractor or loan-out company is likewise subject to Hawaii income tax.

***Residency***—Income earned from performing services in Hawaii is taxable regardless of residency.

***Royalties Exclusion***—In certain circumstances, persons, whether W-2 employees or 1099 independent contractors or loan-out companies, may be entitled to an income tax exclusion for income earned as royalties from the exploitation of copyrights.

***Relevant Forms***—Income tax is reported and remitted by using the proper income tax form. For individual income tax purposes, residents file Form N-11 (Individual Resident Income Tax Return) or Form N-13 (Individual Resident Income Tax Return—Resident Short Form). Nonresidents file Form N-15 (Individual Income Tax Return For Nonresidents and Part-Year

Residents). S-Corporations file Form N-35 (S Corporation Income Tax Return). Other Corporations file Form N-30 (Corporation Income Tax Return). Other forms may be necessary depending up the circumstances.

### **GENERAL EXCISE TAX OBLIGATIONS**

***W-2 Employees***—Persons working or conducting business activities in Hawaii as a W-2 employee are generally not subject to the general excise tax.

***1099 Independent Contractors and Loan-Out Companies***—Generally, independent contractors and loan-out companies that provide services or other business activities to a production company are considered to be conducting business in Hawaii and are subject to the general excise tax. Because independent contractors or loan-out companies are subject to the general excise tax, these persons must apply for and obtain a general excise tax license. Also, these persons must make a return for and pay over general excise tax on the gross proceeds earned in Hawaii.

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The Department suggests that any person affected by this Tax Advisory contact a tax professional familiar with Hawaii tax laws to assist them with any Hawaii tax issues.

### **ADDITIONAL INFORMATION**

For additional information—

Website: [www.hawaii.gov/tax](http://www.hawaii.gov/tax)

Telephone: (808) 587-1569

Fax: (808) 587-1584

Tax Information Release Nos. 2006-02; 2008-02; 2009-05

HAR § 18-235-17-22 LOAN-OUT COMPANY/SERVICE PROVIDER SAFE HARBOR REPORT

<b>Loan-Out Company Paid</b>	<b>Federal ID # / SS#</b>	<b>Arrive HI</b>	<b>Depart HI</b>	<b>Gross Receipts Paid</b>
Loan-Out Name	FEIN	Date	Date	<b>AMOUNT</b>
Talent Name	SSN			
Address 1				
Address 2				
Address 3				

**Total** **\$** **- AMOUNT**

I declare, under penalties set forth in section 231-36, HRS, that this schedule and statement has been examined by me and, to the best of my knowledge and belief, is a true, correct, and complete statement of the entities, dates, and amounts set forth in this schedule, made in good faith, for the periods stated, pursuant to Hawaii General Excise Tax Law, Chapter 237, HRS.

\_\_\_\_\_  
Name

\_\_\_\_\_  
Date

\_\_\_\_\_  
Title