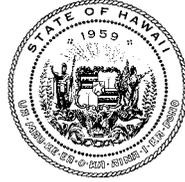


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July 29, 2010

TAX INFORMATION RELEASE NO. 2010-04

Re: Interpretation of “Qualified Production” for purposes of Tax Credit Claims under the Motion Picture, Digital Media, and Film Production Income Tax Credit, HRS § 235-17.

The purpose of this Tax Information Release (TIR) is to set forth the Department of Taxation’s (Department) interpretation of the term “qualified production” for purposes of administering the refundable Motion Picture, Digital Media, and Film Production Income Tax Credit available under Section 235-17, Hawaii Revised Statutes (HRS) (hereinafter “Film Credit”).

I. “QUALIFIED PRODUCTION” WITHIN THE MEANING OF HRS § 235-17.

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

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

See HRS § 235-17(1). Each of the foregoing categories of production activities is considered separate. Each of the delineated production activities discussed above constitutes separate qualified productions that can each independently qualify for separate claims of the Film Credit.

II. SEPARATE AND INDEPENDENT PRODUCTIONS ENTITLED TO SEPARATE AND INDEPENDENT FILM CREDIT CLAIMS.

As discussed above, the categories of production activities set forth in the definition of “qualified production” constitute separate and independent productions, entitling each category to separate and independent Film Credit claims. This interpretation requires that, in order to make separate and independent Film Credit claims, each of the production categories must independently

satisfy all other Film Credit requirements. Other film credit requirements include minimum production activities that must be performed, as well as the Film Credit's per-production cap:

- (d) To qualify for this tax credit, a production shall:
 - (1) Meet the definition of a qualified production specified in subsection (1);
 - (2) Have qualified production costs totaling at least \$200,000;
 - (3) Provide the State, at a minimum, a shared-card, end-title screen credit, where applicable;
 - (4) Provide evidence of reasonable efforts to hire local talent and crew; and
 - (5) Provide 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 and television and digital media industries.

* * * * *

- (j) Total tax credits claimed per qualified production shall not exceed \$8,000,000.

HRS §§ 235-17(d) and (j). Where a separate and independent production satisfies the foregoing requirements, each separate and independent production is entitled to the \$8,000,000 Film Credit cap required by HRS § 235-17(j).

III. A TAXPAYER MAY MAKE TWO SEPARATE CLAIMS FOR THE FILM CREDIT FOR PRODUCTION OF A PILOT, FOLLOWED BY PRODUCTION OF A SERIES PRODUCED IN HAWAII.

Section 235-17, HRS, provides a Film Credit for each qualified production. "Qualified production," as discussed above, is defined to include both the filming of a television series pilot, as well as a single season of a television series. A single taxpayer may make two separate and independent claims for the Film Credit for production of a television series pilot, as well as for the production of the television series resulting from the pilot (assuming the pilot is picked up for full production).

EXAMPLE 1—XYZ Studios, Inc. a California company, shoots a pilot episode in Hawaii. XYZ Studios Inc. forms a subsidiary company, Pilot Productions, LLC, for purposes of filming the pilot episode in Hawaii. Due to risks associated with producing in another State (*i.e.*, Hawaii versus California), as well as the business risks associated with pilot episodes and the likelihood that pilots will not be picked up for a full season of productions, Pilot Productions, LLC is intended to be a special purpose entity for purposes of filming the pilot episode only. After production, XYZ Studios, Inc. learns that the pilot episode is a success and a broadcasting affiliate of XYZ Studios, Inc. orders a full season of the show. XYZ Studios, Inc. does not dissolve Pilot Productions, LLC and rather continues Pilot Productions, LLC as the production entity in Hawaii. Assume further that Pilot Productions, LLC incurs costs in excess of \$200,000 for the pilot episode, and more than \$200,000 in costs for the subsequent series. Assuming the requirements of HRS § 235-17(d) are met for both the pilot and the series, XYZ Studios, Inc. is allowed to make two separate and independent Film Credit claims, totaling not more than \$8,000,000 in credit for the pilot and \$8,000,000 in credit for the series, because both the pilot and the

subsequent series are separate and independent qualified productions entitled to separate and independent Film Credit claims.

IV. TWO OR MORE ENTITIES CONTRIBUTING PARTIALLY TO A SINGLE FINAL MOTION PICTURE MAY QUALIFY AS SEPARATE QUALIFIED PRODUCTIONS.

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

The Department will not challenge separate and independent production entities each claiming the Film Credit where more than one entity’s contribution comprise a single final motion picture, so long as the business arrangement has a business purpose and is not solely tax motivated. For example, if a studio simply sets up two production entities in Hawaii without regard to the independence of each entity, treating both entities in substance as a single entity, and fails to demonstrate a business reason for both entities, the Department will disregard such an arrangement and treat the production as being produced by a single entity. However, where it is established by the taxpayers that more than one production entity is materially contributing in part to a single final motion picture; business purposes exist for the entities; the entities are respected separate and apart from one another; and the entities were not created for solely tax purposes, a separate and independent claim for the Film Credit may be claimed by each production entity. Structures previously used for a particular project or similar production in the past will not be taken into account when determining whether the use of more than one production entity was solely tax motivated.

Examples of legitimate nontax reasons for more than one production entity partially contributing to the same final motion picture production include—

Risk mitigation purposes. For example, assume a motion picture will be filmed both on land and on water in the open ocean. The differing risks associated with land-based production units and water-based production units substantially impact business-related decisions relating to potential loss of property or film footage and insurance coverage costs. Having two separate production entities—one for land-based filming and another for water-based filming—will be considered a nontax purpose;

Government requirements. For example, assume a substantial portion of a motion picture’s filming requires filming on government land. Assume further the government requires a separate entity be created to do the filming on government land. Having two separate entities—one for government land production, as required by the government, and another for other production—will be considered a nontax purpose;

Intellectual property development, exploitation, and licensing. For example, assume in a production of a motion picture, special animation software for use in the production will be

developed. In order to exploit the potential intellectual property that will result from the development during production, two production entities are involved—one for ordinary production and the second for developing the intellectual property asset that will be exploited in the future. Coproducing a single motion picture through two production entities for purposes of developing and exploiting intellectual property will be considered a nontax purpose;

Computer-Generated Imagery “CGI” vs. ordinary photography. For example, assume a motion picture production will involve a substantial amount of CGI or other special effects, in addition to ordinary motion picture photography. Delineating the two different types of production activities into separate entities for licensing purposes, human resource management, and future revenue stream management will be considered a nontax purpose;

Preproduction vs. principal photography. For example, if a motion picture has considerable preproduction construction and renovation, and must create elaborate sets for its production; material occupational safety and health issues could impact further production should an accident occur during preproduction; and there is a business need to manage the sets and construction after production, which is intended to be revenue generating, bifurcating the production into separate entities responsible for preproduction vs. principal photography will be considered a nontax purpose;

Any other legitimate nontax business purpose. Any other business purpose may be approved by the Department in a letter ruling. *See Part VI.*

EXAMPLE 2—XYZ Studios, Inc. intends to film a motion picture in Hawaii. In order to complete its production, which is based upon a World War II mission, assume XYZ Studios, Inc. must enter into a lease agreement with the government to film on government property. As part of the lease, the government mandates that a separate entity take full responsibility of all actions that occur on the property. In this example, because XYZ Studios, Inc. is required by the government to have an entity specifically liable for the lease agreement and for all actions that occur on the government property, having two production entities—one filming on government property; the other filming elsewhere—each contributing partially to a single motion picture, is a legitimate nontax reason for the bifurcated production. Both production entities will be considered “qualified productions” within the meaning of HRS § 235-17(l). As separate qualified productions, each will be entitled to separate and independent Film Credit claims with separate tax credit caps; provided that the requirements of HRS § 235-17(d) are met by each and that each Film Credit claim does not exceed \$8,000,000.

EXAMPLE 3—XYZ Studios, LLC intends to film a motion picture in Hawaii. As part of the production’s filming, a substantial part of the production photography will occur on the water as part of a fishing story plot. Also, the plot includes a substantial part of filming in the jungle on a neighbor island. Assume further that there exists an increased risk of loss while filming on the ocean. Also, XYZ Studios, LLC is able to obtain insurance policies for the project at more competitive rates to the extent the production’s risk are separated through independent productions. XYZ Studios, LLC

desires to bifurcate the production into water-based production and land-based production through the use of separate production entities. Under the facts of this example, the bases for the bifurcation of the production are legitimate nontax reasons. Both production entities will be considered “qualified productions” within the meaning of HRS § 235-17(1). As separate qualified productions, each will be entitled to separate and independent Film Credit claims with separate tax credit caps; provided that the requirements of HRS § 235-17(d) are met by each and that each Film Credit claim does not exceed \$8,000,000.

EXAMPLE 4—XYZ Studios, LLC intends to film a motion picture in Hawaii. As part of the production’s filming, more than half of the production will be based upon computer-generated images, or special effects, most of which will be produced on a soundstage or computer lab. The remaining portions of the motion picture will be produced through ordinary photography throughout the urban areas of the State. Assume that XYZ Studios, LLC does not have the technology necessary to accomplish its special effects. In order to obtain the images it needs, XYZ Studios, LLC will enter into a complex licensing agreement with another company, as well as further agree with the other company to develop new technology based upon the technology accessed through the licensing agreement. In order to execute a licensing agreement that will not impact the remaining production, as well as to ensure that the additional technology is developed in a manner whereby both XYZ Studios, LLC and the other company manage the results, XYZ Studios, LLC forms two separate production entities to produce the motion picture—one entity for the computer-generated imaging and the other for ordinary principal photography. Under the facts of this example, the bases for the bifurcation of the production are legitimate nontax reasons. Both production entities will be considered “qualified productions” within the meaning of HRS § 235-17(1). As separate qualified productions, each will be entitled to separate and independent Film Credit claims with separate tax credit caps; provided that the requirements of HRS § 235-17(d) are met by each and that each Film Credit claim does not exceed \$8,000,000.

EXAMPLE 5—XYZ Studios, Inc. intends to film a motion picture in Hawaii. As part of the production’s filming, production will occur on Oahu and the Big Island. In order to track expenses to claim the 15% Film Credit for Oahu and the 20% Film Credit for the Big Island, XYZ Studios, Inc. forms two production entities. Assume there is no other purpose for the two production entities other than accounting convenience for the Film Credit. Under the facts of this example, the basis for the bifurcation of the production is not a nontax reason. The Department will treat XYZ Studio, Inc.’s production in Hawaii as a single production because there is no nontax business reason for bifurcating the production.

V. A TAXPAYER MAY MAKE MULTIPLE SEPARATE FILM CREDIT CLAIMS FOR EACH “TELEVISION SPECIAL” FILMED IN HAWAII.

Section 235-17, HRS, provides a Film Credit for each qualified production. “Qualified production,” as discussed above, is defined to include television specials. A single taxpayer may make more than one separate and independent claim for the Film Credit for each production of a

television special.

EXAMPLE 6—XYZ Network, LLC wants to film a week’s worth of television specials on traveling to Hawaii. As part of XYZ Network, LLC’s content, it features specials on different destinations throughout the world. The production is not part of a television series. As part of XYZ Network, LLC’s television specials, it wants to feature each of the main islands in Hawaii as a separate television special—Kauai, Oahu, Molokai, Lanai, Maui, and the Big Island. Under the facts of this example, production of the respective television specials occurring on each of the respective islands will be considered separate and independent qualified productions entitled to separate and independent Film Credit claims. Assuming the requirements of HRS § 235-17(d) are met for each television special (six productions total—one for each main island), XYZ Network is allowed to make separate and independent Film Credit claims, totaling not more than \$8,000,000 in credit each.

VI. LETTER RULINGS ANALYZING PRODUCTION ACTIVITIES.

Motion picture producers seeking to take advantage of the interpretations set forth in this TIR may seek a letter ruling applying the conclusions in this TIR to the facts of a particular motion picture production. Information about letter ruling procedures and required information may be found in TIR 2009-01.

VII. EFFECTIVE DATE

This TIR is effective immediately and applies to any tax year where the statute of limitations remains open for assessment or refund.

For more information about this TIR or the Film Credit, please call (808) 587-1577 or visit the Department’s website at www.hawaii.gov/tax.



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