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Testimony of Thomas J. Smyth, CEcD
Before the
Committee on Economic Development and Technology
Committee on Higher Education
Friday, March 12, 2010 1:15 p.m. Conference Room 016
On

HB 2382 HD 1, Relating to Digital Media

Chairs Fukunaga and Tokuda, Vice Chairs Baker and Sakamoto, Committee Members:

I continue to support the intent of this bill. As amended, many of my earlier objections to its companion, SB2355, have been addressed. However, I am still concerned with the relative complexity of the bill in comparison to the different, but also complex issues in the present Enterprise Zone Partnership.

My major concerns deal with the following:

1. Charging an initial application fee and an additional fee for processing the qualified labor and infrastructure costs changes the very nature of the EZ approval process. It is challenging for a state agency to handle fees, presumably paid by check, and even more challenging to ensure that the fees go into the Film Office Special Fund. If the application was to be made on-line the fees could be collected through the e-Hawaii system managed on contract by HIC. That will take some time to set up but it is clearly the best fastest and safest way to process fees. Administrative Rules will need to be prepared.

2. I do not know how the penalty fees will be handled, as DBEDT has no experience with that type of activity. They have no way of knowing if the taxpayer willfully has submitted a fraudulent application unless there is an investigation, subpoena of records, including tax returns and other business proprietary documents. It would be a lengthy and expensive process.

3. It is not clear to me what the purpose of Section 3 (p. 15, lines 8-9) is intended to do. It amends the entire EZ Chapter 209E, HRS, Sections 1-14, by inserting a "Part I Enterprise Zones" and nothing else. Since chapter 209E is already entitled "State Enterprise Zones," I cannot determine the purpose of this change. Apparently, Section 2 creates a new part just to cover the Digital Media Subzones, and they would not be listed elsewhere in the chapter, making it very difficult to fully understand. It should be noted that none of the EZ income tax credits are listed in Chapter 235, nor are the EZ GET exemptions in Chapter 237.

4. The definition of "Hawaii resident" (p.21, lines 10-20), appears straightforward, but given the nature of the film industry it is not clear if that person has to physically stay in the state for 12 consecutive months or could go elsewhere on a "shoot" from time to time.

5. The notion that DBEDT can determine whether to “enter into an agreement” with an applicant as it must consider if the applicant might have gone somewhere else if the tax credit were not there, is one of the most perplexing aspects of the economic development profession. And if the determination of economic success is added to the decision, the probability of any sort of accuracy is very low. There are many examples of projects that started, or almost started here, that did not make it. “Final Fantasy - the movie” comes to mind. All thought it would be a sure success; given the popularity of the game. It was not!

As stated in my earlier testimony, the current DBEDT staff is struggling to learn the intricacies of the existing EZ Partnership and, in my opinion as the former EZ Partnership manager, they would not be able to handle the very complex and somewhat subjective definitions and new tax credits in this bill, even with support from the equally challenged staff now handling film marketing and permitting issues. There are presently only two part-time persons handling the EZ administration and both have other duties.

Again, as I have stated before, this tax credit structure is more like the “Attractions and educational facilities tax credit,” or “Ko Olina Tax Credit” (§235-110.46, HRS) than those credits provided in now in EZs. The lengthy criteria, definitions, along with the extensive validation and subjective eligibility determinations, are so different that even with the two full time staff that I feel are needed to implement this program, I doubt that DBEDT can get it started in less than two years. That means that the $100,000 base investment that must be made before July 1, 2011 will not be able to be processed since the Administrative Rules that must be developed will likely not be in place by that date.

I suggest that a stand-alone infrastructure development tax credit like that for Ko Olina be used, rather than trying to fit it into the existing EZ program.

Thank you for the opportunity to provide comments.

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT & TOURISM

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Statement of
THEODORE E. LIU
Director
Department of Business, Economic Development, and Tourism
before the

SENATE COMMITTEES ON ECONOMIC DEVELOPMENT AND TECHNOLOGY, AND ON HIGHER EDUCATION

Friday, March 12, 2010
1:15 p.m.
State Capitol, Conference Room 016

LATE

in consideration of

HB 2382 HD1
RELATING TO DIGITAL MEDIA

Chairs Fukunaga and Tokuda, Vice Chairs Baker and Sakamoto, and Members of the respective Committees.

The Department of Business, Economic Development, and Tourism (DBEDT) offers the following comments and concerns regarding HB2382 HD1, cautioning that the measure in regards to the establishment of a new digital media incentive, the manpower required to manage the program and its potential fiscal impacts require further discussion. Though valid in concept, we have concerns as to managing such an initiative, which would require additional staffing in DBEDT to support the mandate.

In addition, Part II, Section 6 of the measure revises Section 201-113, Hawaii Revised Statutes to repurpose the Hawaii television and film development fund into a film office special fund specifically to enhance operational resources of the Hawaii film office. We request the committee consider the more encompassing language of a creative media development fund, which addresses funding for film branch operations as a priority, as well as supporting the scope of Hawaii's creative industries development, encompassing film, television, digital media, music, arts and culture. In relation to this section, we strongly advise against the elimination of the grant program in HRS 201§112-13, (b)(1) as this is an important aspect to spurring growth of our local film and digital productions and was the original core intent of the Hawaii Television and Film Development Special Fund.

We want to assure this committee that the creative industries division and its film branch continue to provide effective management of the statutorily mandated programs, in addition to focusing on the advancement of the collective creative sectors at large. These functions are being serviced and addressed by existing CID staff who have great familiarity and knowledge of these industries and their constituencies. This is not to suggest that additional special fund support for creative industries' film branch operations is not welcomed, but that the statutorily mandated functions continue to be delivered effectively.

In Part II, Section 6, it states that 100% of fees charged relative to all aspects of the digital media credits are deposited into the proposed film office special fund, "provided that the use of moneys from the fund for current and future personnel costs shall be limited to those employees performing specialized duties and assigned solely to the Hawaii film office operations." The certification for tax credits and management of the Enterprise Zone (EZ) program is a primary function of EZ program staff in DBEDT's Strategic Marketing and Support Division. The expertise in terms of creative sector development, which includes digital media falls under the Creative Industries Division (CED). This will necessitate a working collaboration in terms of managing this proposed program between these two divisions, should this measure pass.

It also should be noted that HB 2382 HD1, Section 209E-2, Hawaii Revised Statutes, neglects to specifically state that digital media businesses would now be included as qualified EZ businesses, so long as they are engaged in the activities as defined in this bill.

DBEDT concurs that supporting Hawaii's digital media, film, music, culture and arts sectors is critical to a vibrant creative economy in our state, which is the mission of our Creative Industries Division. Collectively these sectors have contributed $4 billion to the state's gross domestic product in 2008 and are considered leading emerging industries as defined by both the legislature and the administration. Hawaii's digital media infrastructure is a key component to our creative industries division's mission and we are focused on its development which crosses many sectors of the creative economy.

There is no question that our digital sectors are beginning to achieve a critical mass, thanks to education and workforce development programs such as the numerous high school digital media programs, the University of Hawaii's Academy for Creative Media, Kapiolani Community College and Leeward Community College programs in animation, interactive design and digital media production. We have a growing number of entrepreneurs and start-up companies in game design and 3D animation that are now making it possible for Hawaii to compete on a global scale in this lucrative, clean industry.

Thank you for the opportunity to provide these comments.

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LATE

SENATE COMMITTEES ON ECONOMIC DEVELOPMENT & TECHNOLOGY AND HIGHER EDUCATION
TESTIMONY REGARDING HB 2382 HD 1
RELATING TO DIGITAL MEDIA

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 12, 2010
TIME: 1:15PM
ROOM: 016

This measure provides, among other things, the establishment of digital media enterprise zones, as well as digital media infrastructure and workforce development tax incentives.

The Department of Taxation (Department) **opposes** this measure **because of its potential revenue impact**.

I. STRONG SUPPORT FOR THE MOTION PICTURE INDUSTRY

Notwithstanding the Department's opposition to this measure, the Department strongly supports the existing tax incentives for the motion picture industry and the economic activity this incentive has brought to Hawaii. Likewise, the Department also recognizes that additional incentives could help even further with continuing to build up Hawaii's talent and labor forces that provide services to this industry. However, the Department cannot support this measure given the current budget issues, especially since Hawaii currently has a very generous motion picture tax credit under Section 235-17, Hawaii Revised Statutes.

II. OPPOSED TO TRANSFERABLE TAX CREDITS

The Department takes no position on the concept of digital media infrastructure incentives. The Department points out that "zone" incentives, such as enterprise zones, can be effective in concentrating efforts in a particular industry to a particular region for synergistic purposes. However, the Department strongly opposes transferable tax credits.

The Department is strongly opposed to any provision that allows Hawaii tax credits to be sold, assigned, or transferred. Allowing taxpayers to market or sell their tax credits is fundamentally poor tax policy. Selling tax credits can be subject to abuse and suspect motivation by parties involved.

The Department's fundamental and primary concerns regarding credit transfers are the following:

- The transferability rewards a separate taxpayer unrelated to the taxpayer that generated the credit, which is fundamentally poor tax policy for encouraging behavior and directly rewarding that behavior;

- The Department will be required to chase two taxpayers if the credit is ever disallowed. The Department will be auditing one taxpayer; however recovering the money from a second taxpayer. Bifurcating the compliance and collection efforts amongst two taxpayers for the same transaction will reduce compliance efficiencies and drain resources.

- The Department is not setup to regulate credit transfers. Will the Department be required to establish a "Bureau of Credit Conveyances" in order to track transfers? If this is the case, resources will have to be dedicated to this;

- And, abuse relating tax credit transfer prices will be problematic. The State will be out a $1 when taxpayers will be transferring this $1 for pennies.

III. CONCERN WITH WAGE CREDIT—PREVENT DOUBLE-DIPPING OR REPEAL ROYALTIES EXCLUSION

The Department is opposed to the workforce development credit, which provides a credit for wages paid to digital media personnel, as currently structured.

Under current law, HRS § 235-7.3 exempts all income earned by individuals as royalties for copyrightable subject matter. In the digital media industry, there are numerous individuals that are entitled to exempt their wages from the income tax under this provision. These persons include actors, directors, camera operators—anyone providing copyrightable contributions to a production. Given this current income tax exclusion, the Department opposes the wage credit, which would result in the State essentially financing two incentives for the same dollar—paying for the wages via credit; as well as exempting the wages from income tax. This bill, as written, would result in a double benefit.

To avoid the double-dipping effect, the Department suggests either repealing the income tax exclusion under HRS § 235-7.3 for any person whose wages were financed by the wage credit. Or, preclude the wage credit for any wages that could be exempt under HRS § 235-7.3. Either is sufficient. The Department merely suggests the State shouldn't be paying two benefits for the same dollar.

IV. OPPOSED TO UNDBUDGETED REVENUE LOSS

This measure will result in an indeterminate revenue loss due to the blank amounts.

Notwithstanding the merit of this measure, the Department cannot support the tax provisions in this measure because these tax breaks are not factored into the budget. The Department must be cognizant of the biennium budget and financial plan. This measure has not been factored into either. Given the forecasted decrease in revenue projections, this measure would add to the budget shortfall.

Gabriel Yanagihara, Digital Media and Film Student

Academy for Creative Media, University of Hawaiʻi System

LATE

HB 2382 – Relating To Digital Media
I write in strong support of HB 2382 which will allow the continued growth of our local creative media industry and workforce with hopes that I, along with hundreds of my fellow students, can remain here in Hawaii while having satisfying and successful careers.

I just want to share with you my situation as just one example of the situation the upcoming generation is facing. I was born and raised on Maui where I progressed though the Hawaii Public School system. I was enrolled in every honors program and took as many AP classes as my schedule would allow. Due to my involvement with the honors programs I became good friends with almost everyone in the Honors and AP programs at my high school and met many more from neighboring schools on Maui.

The sad state of affairs is that out of that entire pool of our best and brightest of around 100 students, the number who remained in Hawaii or, to my knowledge, have plans to return to Hawaii after college can be counted on one of my hands. This doesn't have to happen to our newly, and continually growing college level creative community. We have opportunities here, but we must keep them open.

I stayed in Hawaii because I became aware of the Academy for Creative Media (ACM) at the University of Hawaii at Manoa. This program, for which I am eternally grateful for it's approval, has seen amazing growth and is now in full swing. ACM has a very health community of young filmmakers and digital media students who wish to see Hawaii become an International player for film and digital media. This has already been expressed by the creation of local companies founded by ACM graduates like Blue Water Multimedia, HDology, Realspace and Enlight as well as student enthusiasm for the opportunities supplied by Hawaii Animation Studios and Avatar Reality.

I'm sure that other testimonies will go into the business side of things, so I just want to be make this clear. Right now we have this powerful, talented, local workforce being built, but it won't remain here if there is no future for growth. I know this because I will not stay here. I will have little choice but to follow in my friends footsteps in exodus of Hawaii.

Thank you again for the chance to testify today.