

## TEMPORARY ADMINISTRATIVE RULES

THESE ADMINISTRATIVE RULES ARE TEMPORARY RULES ISSUED PURSUANT TO SECTION 231-10.7, HAWAII REVISED STATUTES.

AS TEMPORARY RULES, THESE ADMINISTRATIVE RULES BECOME EFFECTIVE SEVEN DAYS AFTER PUBLIC NOTICE IS ISSUED. THESE TEMPORARY ADMINISTRATIVE RULES TAKE EFFECT ON OCTOBER 20, 2016.

TEMPORARY ADMINISTRATIVE RULES ARE EFFECTIVE FOR EIGHTEEN MONTHS. THESE TEMPORARY ADMINISTRATIVE RULES WILL EXPIRE ON APRIL 20, 2018.

PERMANENT ADMINISTRATIVE RULES, SUBJECT TO THE PROCEDURAL REQUIREMENTS OF CHAPTER 91, HAWAII REVISED STATUTES (THE HAWAII ADMINISTRATIVE PROCEDURES ACT), ARE SIMULTANEOUSLY BEING PROPOSED FOR FORMAL ADOPTION.

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### DEPARTMENT OF TAXATION

Amendments to Chapter 18-235,  
Hawaii Administrative Rules

### SUMMARY

1. New §§ 18-235-17-01, 18-235-17-02, 18-235-17-03, 18-235-17-04, 18-235-17-05, 18-235-17-06, 18-235-17-07, 18-235-17-08, 18-235-17-09, 18-235-17-10, 18-235-17-11, 18-235-17-12, 18-235-17-13, 18-235-17-14, 18-235-17-15, 18-235-17-16, 18-235-17-17, 18-235-17-18, 18-235-17-19 and 18-235-17-20 are added.

## **Temporary Hawaii Administrative Rules – Table of Contents**

- PAGE 2:** §18-235-17-01 Motion picture, digital media, and film production income tax credit; allowed.
- PAGE 3-5:** §18-235-17-02 Claim for credit; procedures; multiple entities involved.
- PAGE 6:** §18-235-17-03 Claim for credit; costs incurred in more than one taxable year.
- PAGE 7:** §18-235-17-04 Claiming the credit; timing; twelve-month rule.
- PAGE 8-10:** §18-235-17-05 Qualified productions; \$200,000 threshold determination.
- PAGE 11:** §18-235-17-06 Distribution of credit.
- PAGE 12-14:** §18-235-17-07 Prorating qualified production costs between counties in Hawaii; airfare and shipping costs.
- PAGE 15:** §18-235-17-08 Qualified production costs; generally.
- PAGE 16:** §18-235-17-09 Qualified production costs; subject to chapter 235 or 237, HRS; definitions.
- PAGE 17-21:** §18-235-17-10 Qualified production costs; subject to chapter 235 or 237, HRS.
- PAGE 22-24:** §18-235-17-11 Qualified production costs; production services fees.
- PAGE 25-26:** §18-235-17-12 Qualified production costs; credit calculation for fixed equipment costs.
- PAGE 27:** §18-235-17-13 Qualified production costs; imported goods, services, or contracting subject to the use tax.
- PAGE 28:** §18-235-17-14 Qualified production costs; premiums paid to insurers subject to tax under chapter 431, HRS.
- PAGE 29-30:** §18-235-17-15 Independent certification of motion picture, digital media, and film production income tax credit claims; certification opinion; safe harbor.
- PAGE 31:** §18-235-17-16 Shared-card, end-title screen credit.
- PAGE 32:** §18-235-17-17 Evidence of reasonable efforts to hire local talent and crew.
- PAGE 33-35:** §18-235-17-18 Evidence of financial or in-kind contributions to educational or workforce development for the local film, television, and digital media industry.
- PAGE 36-40:** §18-235-17-19 Production company personnel and contractors; required Hawaii tax notice.
- PAGE 41:** §18-235-17-20 Access to production company set and locations; required courtesy visit and press coverage.

**§18-235-17-01 Motion picture, digital media, and film production income tax credit; allowed. (a)**

Beginning July 1, 2013, 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 the State:

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

(b) 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. Any qualified production that conducts business activities in the State 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. [Eff 10/20/16] (Auth: HRS §231-10.7) (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 within the department of business, economic development, and tourism is responsible for prequalification registration. At least one week before principal photography begins, all taxpayers must submit a prequalification registration for each qualified production to the Hawaii film office that must include:

- (1) A proof of registration with State agencies to do business in the State;
- (2) A detailed synopsis of production, including a script if one exists; and
- (3) An estimated budget.

The Hawaii film office will review each prequalification registration and issue a prequalification letter to each production that meets the Hawaii film office's requirements. Failure to timely submit a prequalification registration may result in waiver of the credit at the discretion of the Hawaii film office.

(b) Not later than ninety days following the end of the taxable year in which qualified production costs were incurred, all taxpayers must submit a production report to the Hawaii film office that must include:

- (1) A sworn statement identifying qualified production costs incurred during the taxable year;
- (2) Data on the production as prescribed by the Hawaii film office;
- (3) A detailed expenditure report with summary by department and category made on the form prescribed by the Hawaii film office;
- (4) Documentation that the shared-card, end-title screen credit requirement has been met as described in section 18-235-17-16;

- (5) A vendor list, crew list, and confirmation of efforts to hire local talent and crew as described in section 18-235-17-17;
- (6) Confirmation of education or workforce development contributions as described in section 18-235-17-18; and
- (7) Verification of compliance with section 18-235-17-19(a).

(c) The Hawaii film office shall not certify any production costs for which the detailed expenditure report is incomplete.

(d) The Hawaii film office will issue a certificate to the taxpayer certifying the amount of qualified production costs. In order to properly claim the credit, the taxpayer must attach a copy of the certificate to the taxpayer's income tax return, along with any other required forms.

(e) If a taxpayer produces more than one qualified production in a taxable year, the Hawaii film office will issue a separate certificate for each qualified production. In order to properly claim the credit, the taxpayer must attach a copy of each of the certificates received from the Hawaii film office to the taxpayer's return. 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.

(f) It is not uncommon in the motion picture and film production industry for multiple taxpayers to participate in one qualified production. Only one taxpayer may claim the credit under section 235-17, HRS, per qualified production. The Hawaii film office will process prequalification registrations and production reports in the order in which they are received. Any subsequent taxpayer claiming credit for a qualified production for which the credit has already been claimed will be denied the credit.

(g) The \$15,000,000 cap is applied per qualified production, not per taxpayer. If a taxpayer produces multiple qualified productions in one taxable year, that taxpayer may receive total credit at the end of the taxable year in excess of \$15,000,000.

(h) 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 of the Internal Revenue Code of 1986, as amended; provided that costs that remain unpaid at the time the production report is submitted to the Hawaii film office are not qualified production costs. Any unpaid costs at the time the production report is submitted will not be considered incurred. An accrual method taxpayer must claim all qualified production costs in the year in which the cost was properly incurred under section 461 of the Internal Revenue Code of 1986, as amended.

(i) Subsection (h), relating to the claiming of qualified production costs in the year the costs are properly accounted for based upon a taxpayer's accounting method, is not intended to conflict with the definitional requirement of a qualified production contained in section 18-235-17-05. A taxpayer must independently satisfy the \$200,000 qualified production cost definitional requirement in order to qualify for the tax credit under section 235-17, HRS. For additional discussion on the definition requirement of a qualified production, see section 18-235-17-05. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-03 Claim for credit; costs incurred in more than one taxable year.** (a) The credit under section 235-17, HRS, is based on the qualified production costs incurred during each taxable year. A taxpayer with qualified production costs for one production that incurs qualified production costs in more than one taxable year must submit a production report as described in section 18-235-17-02(b) to the Hawaii film office for each taxable year in which qualified production costs are incurred.

(b) If a qualified production incurs qualified production costs in two separate taxable years, then the credit under section 235-17, HRS, for each taxable year will be based upon the qualified production costs incurred in each respective tax year.

**Example:**

XYZ Productions incurs qualified production costs totaling \$400,000 in 2014 and incurs qualified production costs totaling \$500,000 in 2015. XYZ Productions must claim the credit in the two separate taxable years based upon the qualified production costs incurred in each respective taxable year. XYZ Productions must file for the credit once for the 2014 taxable year claiming the credit for the qualified production costs incurred in that taxable year and once for the 2015 taxable year claiming the credit for the qualified production costs incurred in that taxable year. A separate production report must be submitted in the succeeding taxable year to account for qualified production costs incurred in the subsequent taxable year. [Eff 10/20/16] (Auth: HRS §231-10.7) (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) Waiver of the credit due to an untimely claim is final and cannot be appealed. The department has no authority to suspend or waive this provision. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)



**§18-235-17-05 Qualified productions; \$200,000 threshold determination.** (a) Section 235-17(d)(2), HRS, requires that a production have qualified production costs totaling at least \$200,000, among other requirements, in order to qualify for the credit.

(b) Each production must independently meet the \$200,000 qualified production cost threshold imposed by section 235-17(d)(2), HRS. A taxpayer may not combine the qualified production costs of separate productions to meet the \$200,000 qualified productions cost threshold. A taxpayer may combine the qualified production costs of multiple taxpayers associated with a single production to meet the \$200,000 qualified production costs threshold.

**Example 1:**

XYZ Productions is a calendar year taxpayer and begins producing its film in the State on January 1, 2012. During the tax year, the production incurs qualified production costs totaling \$75,000. Because the \$200,000 qualified production costs threshold has not been met, XYZ Productions does not qualify for the tax credit and cannot claim the tax credit.

**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. Because no individual production incurred qualified production costs of at least \$200,000, XYZ Productions cannot claim the credit. This is true even though XYZ Productions incurred qualified production costs in excess of \$200,000 in the aggregate during the taxable year.

(c) If in one tax year a production does not meet the \$200,000 qualified production costs threshold imposed by section 235-17(d)(2), HRS, but incurs qualified production costs in a subsequent tax year that when combined with qualified production costs in the previous tax year satisfy the \$200,000 threshold, the taxpayer may claim the credit under section 235-17, HRS, for the production. To claim the credit the taxpayer must submit a production report to the Hawaii film office as described in section 18-235-17-02(b). The Hawaii film office will issue a certificate to the taxpayer certifying the amount of the qualified production costs for the prior year. In order to properly claim the credit for the prior year the taxpayer must amend its income tax return for that year and attach the certificate to its amended tax return, along with any other required forms.

**Example 3:**

Assume the same facts as Example 1, except that in June of 2013, the same production incurs qualified production costs totaling \$250,000. Total qualified production costs associated with the production now exceed \$200,000. Because the production now has qualified production costs of at least \$200,000, XYZ Productions can file an amended return for 2012 taking into account the \$75,000 in qualified production costs incurred during 2012; provided a timely amended return is filed within twelve months following the close of the taxable year for which the credit may be claimed.

**Example 4:**

Assume the same facts as Example 1, except that in June of 2013, the same production incurs qualified production costs totaling \$75,000. Total qualified production costs associated with the production total only \$150,000. Because the

\$200,000 qualified production costs threshold has not been met, XYZ Productions cannot claim the tax credit.

**Example 5:**

Assume the same facts as Example 4, except that in June of 2014, the same production incurs qualified production costs totaling \$75,000. Because qualified production costs associated with the production now total at least \$200,000, XYZ Productions can file an amended return for 2013 taking into account the \$75,000 in qualified production costs incurred during 2013; provided a timely amended return is filed within twelve months following the close of the taxable year for which the credit may be claimed. XYZ Productions cannot claim the credit for tax year 2012 because the claim for tax year 2012 would not be filed within twelve months following the close of 2012. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-06 Distribution of credit.** Section 235-17(a), HRS, provides that the cost upon which the tax credit is computed is determined at the entity level for partnerships, S corporations, estates, and trusts. The credit cannot be claimed 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 the credit under section 235-17, HRS, shall be made in accordance with Subchapter K, Subchapter J, Subchapter S, or other relevant pass-through entity allocation laws of the Internal Revenue Code of 1986, as amended, to which the State conforms. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-07 Prorating qualified production costs between counties in Hawaii; airfare and shipping costs.** (a) Section 235-17(a), HRS, provides that a taxpayer claiming the credit may prorate its expenditures based upon the amount spent in each county if the population bases differ enough to change the percentage of tax credit. Qualified production costs may be prorated only when costs are incurred in two or more counties of the State. Qualified production costs cannot be prorated between other states or countries and the State.

(b) Proration is not necessary if costs are incurred solely in counties with a population of seven hundred thousand or less. The place where the good or service is consumed determines where the cost is incurred for the purposes of this tax credit.

(c) 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.

**Example 1:**

XYZ Productions rents a camera from Oahu Camera Company located in Honolulu county, for use on its movie set located in both Honolulu county and Kauai county. Oahu Camera Company is headquartered in Honolulu county and has no business operations in Kauai county. Use of the camera was divided among the counties accordingly: one-fourth of the use occurred in Honolulu county; three-fourths of the use occurred in Kauai county. The cost of the camera rental may be prorated between the counties based upon the equipment's use in each county because the respective county populations entitle XYZ to different tax credit rates. One-fourth of the cost (the use in Honolulu county) qualifies for the credit at the twenty per cent rate. Three-fourths of the cost (the use in Kauai county) qualifies for the credit at the twenty-five 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 2:**

Assume the same facts in Example 1, except that the cost of the camera rental, which includes the shipping cost, is paid for in Honolulu county and all use of the camera occurs in Kauai county. There is no prorating issue raised by this example because all use of the camera occurred in Kauai county. Therefore, the entire cost of the camera rental qualifies for the credit at the twenty-five per cent rate.

(d) The department will not challenge the prorating of a qualified production cost for airfare, shipping, or other costs of a similar nature, where two counties equally impact said cost; provided that to qualify for this safe harbor, the taxpayer must:

- (1) Divide the total cost in half;
- (2) Apply the twenty per cent tax credit rate to one-half of the cost;
- (3) Apply the twenty-five per cent tax credit rate to the other half of the cost; and
- (4) Claim the credit for the prorated qualified production cost in the amount of the sum of the twenty per cent rate product and the twenty-five per cent rate product.

**Example 3:**

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 seven hundred thousand and the latter having a population of less than

seven hundred thousand. The cost of the total airfare is \$1,000. To qualify for the safe harbor provided by section 18-235-17-06(d), XYZ Productions must divide the total fare (\$1,000) in half (\$500 and \$500). Then, XYZ Productions must take the tax credit at the twenty per cent rate for half of the cost ( $\$500 \times 20\% = \$100$ ), and take the credit at the twenty-five per cent rate for the other half of the cost ( $\$500 \times 25\% = \$125$ ). XYZ Productions' total credit properly allocable for the airfare is \$225.

**Example 4:**

Assume the same facts in Example 3, except that the cost is to transport talent and crew from Los Angeles to Kailua-Kona for a production occurring only in Hawaii county. The prorating safe harbor and this section do not apply to this example. The amount of credit for airfare costs to the State will be determined solely by the destination county. Based upon the facts in this example, the total cost of airfare to transport talent and crew to Kailua-Kona will qualify for the credit at the twenty-five per cent rate. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-08 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 the State that are subject to either:

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

(b) Qualified production costs do not include costs 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.

(c) Rentals and fees for use of State and county facilities and locations may be qualified production costs even though the State and counties are not subject to tax under chapter 235 or chapter 237, HRS, on those rentals and fees.

(d) Any government-imposed fines, penalties, or interest incurred by a qualified production within the State are not qualified production costs. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)



**§18-235-17-09 Qualified production costs; subject to chapter 235 or 237, HRS; definitions.** As used in section 18-235-17-10:

"Fringe benefits" means the following benefits commonly associated with the motion picture and film production industry:

- (1) Unemployment insurance premium costs;
- (2) Workers compensation insurance;
- (3) Union pension and welfare benefits to the extent required by contract between the union and the qualified production; and
- (4) Health insurance.

"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 and includes a makeup artist's equipment and a set designer's construction tools.

"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 qualified production, which serves as a separate entity that constitutes the individual's means of contracting with a qualified production for services rendered by the "above the line" cast or crew member. A loan-out company may employ more than one person.

"Per diem" means an allowance to an employee or contractor, provided through an accountable plan or a nonaccountable plan under section 62(c) of the Internal Revenue Code of 1986, as amended, 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 in The State. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-10 Qualified production costs;** subject to chapter 235 or 237, HRS. A production cost will be considered subject to chapter 235, HRS, or chapter 237, HRS, if the person or entity delivering the goods or performing the services is subject to either tax, regardless of whether the State taxes such person. 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.

**Example 1:**

ABC Airlines is a commercial airline that flies from Los Angeles, California to Honolulu, Hawaii. ABC Airlines has business operations in the State; 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 the State and is therefore subject to Hawaii income tax and general excise tax. XYZ Productions contracts with 123 Catering to provide plate lunches to its cast and crew for a production taking place in the State. 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 and general excise taxes.

**Example 3:**

Steve Screenwriter, a resident of California with no contacts with the State 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 the State. Steve Screenwriter sells his screenplay to XYZ Productions. The cost of 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 the State and subject to Hawaii income and general excise tax. The cost of Steve Screenwriter's screenplay, though not listed as one of the specific examples of a "qualified production cost" in section 235-17(1), HRS, is a qualified production cost because Steve Screenwriter is subject to Hawaii income and general excise taxes.

**Example 5:**

XYZ Productions, a California-based production company doing business in the State, ships filming equipment from California to the State to produce 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, to ship cameras, set materials, rigging, and other large objects. Both shipping companies have a

presence in the State, as well as on the mainland, and are subject to Hawaii income tax on an apportioned basis and general excise tax. The shipping costs incurred from both FastShip and BigShip are qualified production costs to the extent that those amounts are subject to Hawaii income or general excise taxes.

**Example 6:**

Gus Grip, a resident of California, is hired by XYZ Productions to help film a movie in the State. Under State law, the wages of Gus Grip earned in the State are subject to Hawaii income tax under section 235-4(b), HRS, and section 18-235-4-03. Gus Grip's wages, if earned in the State, are qualified production costs for purposes of the credit under section 235-17, HRS, even if the wages are not subject to withholding pursuant to administrative rule. Employment taxes paid by XYZ Productions in connection with Gus Grip's wages (including Medicare and Social Security taxes) are also qualified production costs.

**Example 7:**

Sam Staff, a resident of California, is a full-time employee of XYZ Productions working out of XYZ's California headquarters. XYZ utilizes Sam Staff to work in the State on-location temporarily. Because Sam Staff is subject to tax on the amount of income earned in the State, the amount of Sam Staff's salary earned while working in the State is a qualified production cost.

**Example 8:**

Lenny Loaner, a resident of California, performs services for XYZ Productions to film a movie in the State through the contracting of Lenny Loaner's loan-out company. XYZ pays fees

to Lenny Loaner's loan-out company for services provided in the State that represent wages or salary for Lenny Loaner. Because Lenny Loaner's loan-out company is subject to Hawaii income tax and general excise tax, the fees XYZ pays to Lenny Loaner's loan-out company are qualified production costs.

**Example 9:**

Assume the same facts as Example 8 except that the income Lenny Loaner's loan-out company receives is royalty income excluded by section 235-7.3, HRS. Because Lenny Loaner's loan-out company is subject to Hawaii income tax and general excise tax due to its activities in the State, the fees XYZ pays to Lenny Loaner's loan-out company are qualified production costs regardless of whether the income is in fact excluded by section 235-7.3, HRS.

**Example 10:**

Gus Grip, a resident of the State, is hired by XYZ Productions to film a movie in the State. XYZ Productions pays Gus Grip wages and gives Gus Grip a per diem allowance while working in the State. Because Gus Grip is subject to Hawaii income tax on the amount of income earned in the State, the amounts of both the wages and the per diem allowance are qualified production costs.

**Example 11:**

Assume the same facts as Example 10 except that XYZ Productions provides Gus Grip with fringe benefits as defined in section 18-235-17-08. Because Gus Grip is subject to Hawaii income tax on the amount of income earned in the State, the cost of fringe benefits XYZ provides to Gus Grip are qualified production costs to the extent the costs are incurred in the State.

**Example 12:**

Molly Makeup, a resident of California, is hired by XYZ Productions to perform for the filming of a movie in the State. XYZ Productions pays Molly Makeup wages and agrees to rent her kit or box from her. Because Molly Makeup is subject to Hawaii income tax on the amount of income earned in the State, the amount XYZ pays for her wages and to rent her kit or box are qualified production costs.

**Example 13:**

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 rent's primary purpose is the production of income, even if the rental income is later used for the church's exempt purposes. The \$1,000 rent payment is taxable under chapter 237, HRS, and therefore qualifies as a qualified production cost under section 235-17, HRS. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-11 Qualified production costs; production services fees.** (a) Qualified production costs may include production services fees; except as otherwise provided in this section.

(b) "Production services fee" for purposes of the credit under section 235-17, HRS, generally means a line item fee charged by a production company to its customer 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:

- (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.

**Example 1:**

XYZ Production Company charges 123 Advertising, its client company, a production services fee of \$5,000, which represents one per cent 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 entity claiming the credit 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 2, except that XYZ Production Company can prove to the Hawaii film office'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; and \$500 in other incidental supplies used in the back



office. 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. 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 it is XYZ Production Company's profit mark-up. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-12 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 the State and subject to either chapter 235 or 237, HRS. Section 235-17(a), HRS, precludes any cost from qualifying if a deduction for the cost is taken under section 179 of the Internal Revenue Code of 1986, as amended.

(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 taxpayer that utilizes fixed equipment in a State film production may claim as a qualified production cost the amount of the depreciation allowance, if any, for the equipment for the taxpayer's taxable year, prorated for the amount of equipment actually used in the State; provided that a deduction has not been taken under section 179 of the Internal Revenue Code of 1986, as amended, with respect to the equipment. The depreciation allowance allowable under State law shall be utilized to calculate the credit amount under this section.

**Example :**

XYZ Production Company has cameras that it ships to the State to film a production for six months. All of these cameras were purchased by the production company prior to production in the State 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 of 1986, as amended, was not taken with respect to the cameras and that depreciation deductions have been taken in 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 the State 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 the State. In this case, because the cameras are used in the State for six months, a \$500 qualified production cost is incurred for purposes of the credit under section 235-17, HRS. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-13 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. Not all business transactions occurring in the State are subject to chapter 237, HRS. In order to ensure a level playing field among business transacted both within and without the State, 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 the State a complementary tax on the use in this State of tangible personal property, services, or contracting imported into the State under chapter 238, HRS (Hawaii use tax law).

(b) Importation of goods, services, or contracting into the State from out of state for use in the State is subject to chapter 238, HRS, capturing the general excise tax equivalent. Effectively, chapter 238, HRS, serves as a substitute for the State's general excise tax under chapter 237, HRS. Because chapter 238, HRS, is a substitute for Hawaii general excise tax, production costs incurred by a qualified production in the State, which would otherwise qualify as a qualified production cost if subject to the general excise tax, are considered subject to tax within the meaning of "qualified production costs" under section 235-17(1), HRS, where the production cost is for an item of tangible personal property, for a service, or for contracting that is subject to the use tax under chapter 238, HRS, and on which the use tax is actually paid. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-14 Qualified production costs; premiums paid to insurers subject to tax under chapter 431, HRS.**

(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 235, HRS. Not all taxpayers conducting business transactions occurring in the State are subject to chapter 235, HRS. In recognition of its unique business structure and place within the community, authorized insurers are subject to tax on insurance premium income under chapter 431, HRS, in lieu of tax under chapter 235, HRS.

(b) Income from insurance premiums is generally subject to tax under chapter 431, HRS, capturing an amount in lieu of income tax. Effectively, chapter 431, HRS, serves as a substitute for the State's income tax under chapter 235, HRS. Because chapter 431, HRS, is a substitute for Hawaii income tax, production costs incurred by a qualified production in the State, which would otherwise qualify as a qualified production cost if subject to the State's income tax, are considered subject to tax within the meaning of "qualified production costs" under section 235-17(1), HRS, where the production cost is subject to the tax on insurers under chapter 431, HRS, and on which the tax is actually paid.

**Example:**

XYZ Productions is filming a qualified production in the State and pays insurance premiums to an insurance company doing business in the State for insurance on XYZ's activities and property associated with the qualified production in the State. The insurance premiums XYZ pays to the insurance company are qualified production costs under chapter 431, HRS. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-15 Independent certification of motion picture, digital media, and film production income tax credit claims; certification opinion; safe harbor.** (a) A taxpayer claiming the tax credit under section 235-17, HRS, that submits to the Hawaii film office a certification opinion as defined in this section, in addition to a production report as described in section 235-17-02(b), not later than ninety days following the end of the taxable year in which the qualified production costs were incurred, shall not have a production cost challenged. A certification opinion is either:

- (1) 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 qualified production costs within the meaning of section 235-17, HRS." 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; or
- (2) 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 qualified production costs within the meaning of section 235-17, HRS, for the taxable year. 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 qualified 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.

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

(c) It is the taxpayer's responsibility to provide all relevant information to the taxpayer's independent tax practitioner.

(d) The cost of the certification opinion shall be the responsibility of the taxpayer. The cost of the certification opinion is a qualified production cost for the taxable year the certification opinion relates to; provided the cost is subject to taxation under chapter 235 or chapter 237, HRS.

(e) Inclusion of a certification opinion with the production report does not preclude the department from auditing and adjusting the tax credit amounts claimed.

(f) As used in this section:

"Independent tax practitioner" means a tax practitioner that 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 on behalf of a taxpayer and that is in compliance with relevant professional regulatory affiliations. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-16 Shared-card, end-title screen**

**credit.** (a) Section 235-17(d)(3), HRS, requires that a production provide the State, at a minimum, a shared-card, end-title screen credit. A shared-card, end-title screen credit is provided by:

- (1) Including in the end credits of each qualified production the phrase "Filmed on location on the Island of \_\_\_\_\_ in Hawaii with the assistance of Hawaii Production Tax Credits administered by the Hawaii Film Office and the Department of Taxation" and a logo provided by the Hawaii film office; and
- (2) Including in each qualified production distributed by digital video disc, Blu-ray disc, digital download, or other media for the secondary market, a Hawaii promotional video approved by the Hawaii film office.

(b) A production must submit a still shot, frame grab, finished copy of the qualified production in a media format acceptable to the Hawaii film office, or other documentation that the Hawaii film office may require. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)



**§18-235-17-17 Evidence of reasonable efforts to hire local talent and crew.** (a) Section 235-

17(d)(4), HRS, requires that a production provide to the department of business, economic development, and tourism, evidence of reasonable efforts to hire local talent and crew.

(b) Evidence of reasonable efforts to hire local talent and crew means:

- (1) Documentary evidence of having contacted State 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) 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. [Eff 10/20/16]  
(Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-18 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 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.

(b) Only one contribution is necessary to satisfy the requirement under section 235-17(d)(5), HRS. However, a production may make multiple contributions.

(c) Refundable contributions do not satisfy section 235-17(d)(5), HRS. Any term allowing for refundability disqualifies a contribution from satisfying section 235-17(d)(5), HRS, including refundability contingent only upon a production failing to qualify to claim the credit under section 235-17, HRS.

(d) Contributions do not satisfy section 235-17(d)(5), HRS, if a charitable deduction is taken for the contribution under section 170 of the Internal Revenue Code of 1986, as amended, or under conformity to such section.

(e) Contributions are not qualified production costs.

(f) The following contributions qualify for purposes of section 235-17(d)(5), HRS:

- (1) Financial contributions to State public or charter schools totaling at least 0.1 per cent of a production's qualified production costs or \$1,000, whichever is higher. Financial contributions must be made specifically to an arts program at a State public or charter elementary school, middle school, high school, or post-secondary school, preferably to a school in the same

- community 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 contributions to State public or charter schools totaling at least the equivalent value of 0.1 per cent of a production's qualified production costs or \$1,000, whichever is higher. Contributions of in-kind property or services must be made specifically to an arts program at a State 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, such as 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 programs provided to State public or charter schools consisting of at least one on-set or post-production internship arrangement with a State 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 total of at least eight hours 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 programs provided to local labor union chapters consisting of at least one

on-set craft apprenticeship arranged with one of the local labor union chapters. The apprenticeship must include a total of at least eight hours 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) Hawaii Film seminar participation with the Hawaii film office consisting of participation as a speaker in two or more Hawaii Film seminars. Such participation may also be used to offset the minimum eight hours of volunteer services required in paragraph (3) or (4). Participation in one seminar shall be equal to two hours of volunteer services; and
- (6) Any other financial or in-kind contributions or any other educational or workforce development approved by the Hawaii film office. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-19 Production company personnel and contractors; required Hawaii tax notice.** (a) Any taxpayer claiming 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 the State with a tax advisory informing such persons of State tax obligations and obtain acknowledgement that the advisory was received. The tax advisory under this section shall be provided to all such persons not later than thirty business days after engaging the nonresident employee, contractor, vendor, loan-out company, or other agent.

(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) requires 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 (long form) or Form N-13 (short form). Nonresidents or part-year residents file Form N-15. Corporations file Form N-30 and S-Corporations file Form N-35. Partnerships and multi-member limited liability companies file Form N-20. Other forms may be necessary depending upon the circumstances.

#### GENERAL EXCISE TAX OBLIGATIONS

Hawaii levies a gross receipts tax called the general excise tax (GET) on the gross income of anyone engaging in business in Hawaii. Generally, the GET is 4% (4.5% in the City and County of Honolulu) of all gross proceeds or gross income received from doing business in Hawaii. The rate is 0.5% on certain wholesaling activities.

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.

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.

Relevant Forms: A general excise tax license is obtained from the Department by filing Form BB-1. General excise tax is reported and remitted by filing periodic returns using Form G-45, followed by filing the annual reconciliation return using Form G-49 after 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: [tax.hawaii.gov](http://tax.hawaii.gov)
- Telephone: (808) 587-1530
- Fax: (808) 587-1584
- Hawaii Administrative Rules 18-235-17"

(c) A taxpayer claiming the tax credit under section 235-17, HRS, that has complied with the terms of subsection (d) shall not have a production cost challenged 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) To use the safe harbor under subsection (c), the taxpayer must:

- (1) Prove to the Department compliance with subsection (a); and
- (2) Verify, using the department of taxation tax license search, that all vendors and service providers obtained proper tax licenses.

(e) The safe harbor under subsection (c) is not available to a taxpayer that has notice or knowledge that any person providing goods or rendering services that were the basis of the production costs claimed has failed to comply with the person's tax obligations.

**Example 1:**

XYZ Production Company pays \$1,000,000 for the use of Donna Dancer's loan-out services in filming a qualified production. Donna Dancer's income and gross proceeds are taxable under Hawaii income tax and general excise tax law. The invoices billed to XYZ Production Company for Donna Dancer's loan-out services have no line item for taxes passed on. Donna Dancer fails to file and pay the income tax and general excise tax. XYZ Production Company has no notice or knowledge of Donna Dancer's failure to comply with her tax obligations. At the time XYZ and Donna Dancer executed the contract for Donna Dancer's loan-out services, XYZ Production Company included with her contract a copy of the tax advisory discussed in this section. XYZ Production Company verified, using the department of taxation tax license search, that Donna Dancer



has a general excise tax license. XYZ Production Company also obtained Donna Dancer's signature as proof of receiving a copy of the tax advisory. Because XYZ Production Company timely complied with the requirements of 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 tax went unpaid.

**Example 2:**

Assume the same facts as Example 1, except that XYZ Production Company did not verify, using the department of taxation tax license search, that Donna Dancer has a general excise tax license. XYZ Production Company's claim for Donna Dancer's loan-out costs as a qualified production cost may be challenged by the department because XYZ Production Company failed to meet the requirement in section 18-235-17-19(d)(2). [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

**§18-235-17-20 Access to production company set and locations; required courtesy visit and press coverage.** (a) All taxpayers submitting a production report to 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 or that access to 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 personnel; State and county film commissioners; legislators; and other government officials.

(b) All taxpayers submitting a production report to 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, and may be held at the production's set or other location.

(c) The courtesy visit and press requirements of this section must 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. [Eff 10/20/16] (Auth: HRS §231-10.7) (Imp: HRS §235-17)

DEPARTMENT OF TAXATION

These temporary rules relating to Chapter 18-235, Hawaii Administrative Rules, were submitted to the Governor for approval on May 20, 2016. As is required by section 231-10.7, Hawaii Revised Statutes, these temporary administrative rules are also being proposed for formal adoption pursuant to Chapter 91, Hawaii Revised Statutes.

Public notice was given statewide in the Honolulu Star Advertiser, the Garden Island, the Maui News, West Hawaii Today, and the Hawaii Tribune-Herald newspaper on October 13, 2016.

The temporary adoption of chapter 18-235, Hawaii Administrative Rules, as amended, shall take effect seven days after public notice is issued. Pursuant to section 231-10.7, Hawaii Revised Statutes, these rules shall be effective for eighteen months from their effective date.

/s/ Maria E. Zielinski/s/  
MARIA E. ZIELINSKI  
Director of Taxation

APPROVED:

/s/David Y. Ige/s/  
DAVID Y. IGE  
Governor  
State of Hawaii

Dated: September 8, 2016