Fiscal Note

BILL # SB 1409

TITLE: motion picture production tax credits

SPONSOR: Nelson

STATUS: As Amended by Senate CED

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FISCAL ANALYSIS

Description

Under current law, the state provides individual and corporate income tax credits for qualified expenditures related to: (1) motion picture production, (2) commercial advertisement and music video production, and (3) motion picture infrastructure projects (construction of soundstages and support/augmentation facilities). Certain sales and use tax exemption are also included under the state's motion picture production tax incentives. Individuals and businesses can qualify for these incentives through December 31, 2010.

SB 1409 would repeal the income tax credits and the sales and use tax exemptions by the end of Calendar Year (CY) 2010. The bill would create a new refundable motion picture production tax credit beginning in tax year 2011. While there would be no aggregate cap on the new credit, no production company would be allowed to claim more than $20 million per production. By way of comparison, existing income tax credits are nonrefundable (although unclaimed amounts can be sold or otherwise transferred to other taxpayers) and the total amount approved for all qualifying productions and infrastructure projects is not allowed to exceed $70 million in 2010. SB 1409 would also eliminate the Department of Commerce's post-production approval of the expenditures eligible for the tax incentives.

The amount of the credit would depend on whether a production company uses a new privately-funded production facility. If a privately-funded production facility is used, a company would receive a credit equal to 30% of qualified production expenditures. Otherwise, the amount of the credit with respect to each production would be either 20% or 25%.

Estimated Impact

Beginning in FY 2012, the bill is expected to reduce individual and corporate income tax collections by between $(10) million and $(40) million. The impact in future years could grow depending on the development of the state's motion picture industry. The revenue loss would be in addition to the estimated $(8) million in existing movie tax credits already included in the General Fund baseline. The precise response of the motion picture industry to tax credit changes is difficult to predict. The creation of a refundable credit and elimination of post-production approval of expenditures is likely to increase usage. At the upper end of the range, tax incentives would be comparable to the current program in New Mexico.

The new credit will also result in an increase in economic activity and some offsetting increase of General Fund revenues. A review of other states' dynamic estimates of movie tax credits suggests that these incentives typically offset about 15% to 20% of the direct revenue loss. At least 1 study has suggested a greater dynamic impact, but that estimate is more speculative.

Analysis

According to the Department of Commerce's annual report of the "Motion Picture Production Tax Incentives Program," the state issued a total of $8.6 million in post-approval incentives in CY 2008. Of this amount, $7.8 million was attributable to income tax credits and $0.8 million to sales and use tax exemptions. Although the CY 2009 annual report will not be due until the end of April, preliminary data suggests that post-approval incentives likely decreased to about $3 million last year. CY 2010 post-approval amounts are expected to be about the same as in CY 2008, or about $8.6 million.

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The amount of the movie tax credits used, as reported by the Department of Revenue (DOR), is generally less than the amount post-approved by Commerce.

The difference between the 2 reports is believed to be largely attributable to timing, since a credit is often post-approved in 1 calendar year but filed for income tax purposes the following calendar year. This analysis assumes that $8 million in credits under the existing incentives program will be carried forward for up to 5 years following the enactment of the new credit under SB 1409.

An extrapolation of the impact of the new credit based on the use of the existing credit is complicated by the fact that there are several key differences between the 2 programs. First, the new credit would be both refundable and uncapped (at the aggregate level). Second, the department would no longer administer the credit, so there would be no certification, pre-approval, or post-approval process.

The Department of Commerce's annual reports indicate that only a small portion of the pre-approved applications for the incentives end up being post-approved. Representatives of the movie industry attribute this in part to the requirement that production must start as early as 60 days after pre-approval. This has been a difficult requirement for some production companies to meet, according to the industry. Based on the existing level of pre-approved spending, coupled with the fact that SB 1409 would neither require any taxpayer to pre-qualify for the incentive nor start the production within a stipulated period of time, it is believed that credit claims would grow by at least $10 million beginning in FY 2012.

The fiscal impact of making the credit refundable as opposed to non-refundable and uncapped versus capped will result in an increase of credit claims. Unlike a non-refundable credit, a refundable credit guarantees a full refund regardless of a taxpayer's liability. As a result, refundability has the potential to significantly increase the use of the credit and could result in a fiscal impact at the upper end of the range.

After New Mexico expanded its movie tax credit in January 2007, the amount of claims increased from $5.7 million in FY 2006 to $15.8 million in FY 2007. The total amount of claims in FY 2008 was close to $40 million. Based on New Mexico's experience with its film tax credit program, a similar increase could occur in Arizona.

The *Tax Foundation* reports that movie production incentives were offered in 44 states in 2009. Twenty-eight of those states offered the incentive in the form of income tax credits. A film tax credit may incentivize a motion picture company to produce a movie in a certain geographical area that would not have occurred absent the state tax incentive. This movie production will result in a certain amount of local spending on labor, materials, structures, and equipment, which in turn will lead to a certain increase in economic activity in the state. The economic impact will translate into new tax revenues for the state. The movie tax credits offered in Louisiana, South Carolina, and New Mexico provide some insight on the possible dynamic impact of the bill.

<u>Louisiana</u>

The Legislative Fiscal Office of Louisiana conducted a study of the state's film and video tax incentives in 2005. Louisiana was the first state in the nation to begin offering movie production incentives in 1992. Using a model specifically developed by Regional Economic Modeling, Inc. (REMI), Louisiana Legislative Fiscal Office Staff determined that the state would recoup between 16% and 18% of the tax revenue it obligated to the program through the transferable tax credit mechanism. The analysis was based on the purchase of goods and services from Louisiana suppliers (including labor) by movie production companies.

<u>South Carolina</u>

An impact analysis of South Carolina's movie production incentives was prepared for the South Carolina Coordinating Council for Economic Development in April 2008. Using IMPLAN, a software tool based on industry-specific input-output tables and multipliers, the study's author concluded that for every dollar in tax rebates given, the state's General Fund would increase by 19¢. The analysis was based on movie companies' spending on supplies and services provided by local firms and their wages paid to South Carolina residents.

<u>New Mexico</u>

The Office of Policy Analysis at New Mexico State University prepared a film tax incentives report for the state's Legislative Finance Committee in August 2008. Using IMPLAN, the study's authors estimated that the state's movie tax

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rebates would generate approximately 15¢ for each dollar paid out by the state. The consulting firm, Ernst & Young, conducted an alternative study of the tax incentive in January 2009. This analysis, which was prepared for the New Mexico State Film Office and State Investment Council, showed that the program earns $0.94 in additional state tax revenue for each $1.00 that is paid out in incentives. This analysis, unlike the previous studies mentioned above, was not only based on film production costs (labor, material, supplies, etc.) but also on capital investments (structures and equipment) and spending on film-related tourism. Under such an approach, the dynamic impact will be greater since it is based on a larger amount of local spending. Implicit in this assumption is that non-production expenditures, such as certain spending by out-of-state tourists, would not have occurred without the movie tax credit.

The analysis by Ernst & Young was based on the assumption that movie production in New Mexico has contributed significantly to tourism spending in the state. Based on a single survey by a private marketing firm, Ernst & Young estimated that film-related tourism accounted for 5.5% of total New Mexico tourism spending in 2008. Such spending would be generated by tourists who visit New Mexico or extend their trip to the state to see film-related attractions. This figure seems speculative since it is unclear how the causal link between a person's decision to visit New Mexico and his watching of 1 or more movies produced in the state could be firmly established. In addition, the Ernst & Young report did not include any information regarding the survey, such as the number of respondents or the design of the questionnaire. The authors of the study acknowledged in their report that film-related tourism spending was the least reliable component included in their analysis.

The Department of Commerce is required to produce an annual report of the existing movie production tax incentives in the state. Part of the report includes estimates of the extent to which the incentives generate economic and fiscal impacts for the state. The most recent report is for CY 2008 and shows that the Department of Commerce estimates that the $8.6 million in post-approved incentives that year generated additional state and local tax revenues of $2.3 million. Thus, for each $1.00 of movie tax incentives post-approved by the Department of Commerce, state and local governments could expect to receive a gain in revenues of about 27¢.

The Department of Commerce's analysis was based on the post-approved amount of in-state spending on motion picture production. The estimated amounts of pre-approved expenditures on motion picture, commercial advertisement and music video production, and infrastructure projects were not included in the analysis. This may understate the Department of Commerce's estimate to the extent that pre-approved (and thus non-qualified) spending may have occurred as a result of the credit. However, it is difficult to determine such amounts and estimates of non-qualified spending are often speculative.

Given the range of studies from different states, SB 1409's estimated feedback effect is in the 15% to 20% range. Although there is a study that shows a substantially larger fiscal feedback effect, it is based on more speculative assumptions with respect to the amount of local spending that can be attributed to the incentive.

Local Government Impact

Each year, incorporated cities and towns receive 15% of income tax collections from 2 years prior. This bill would reduce local government distributions by between $(1.5) million and $(6.0) million beginning in FY 2014.

3/19/10