Fiscal Note

BILL # SB 1409

TITLE: motion picture production tax credits

SPONSOR: Nelson

STATUS: Senate Engrossed

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FISCAL ANALYSIS

Description

Beginning in tax year (TY) 2011, SB 1409 provides individual and corporate income tax credits for motion picture production and related infrastructure projects. The Senate Engrossed version of SB 1409 provides several changes to an earlier version of the bill for which a fiscal note was issued March 19, 2010. Under the Senate Engrossed version of the bill, there will be an annual aggregate credit cap of $70 million, whereas the earlier version included no credit cap. In addition, the Senate Engrossed version also lowers the credit per individual motion picture production from $20 million to $15 million, while simultaneously reducing the percent of production expenditures that qualify for the credit from a range of 20% to 30% to a range of 17.5% to 25%. Finally, the Senate Engrossed version allows the existing credit for infrastructure projects that is scheduled to expire at the end of TY 2010 to continue. The infrastructure credit is capped at $10 million annually (as a part of the overall $70 million limit) and would no longer be transferable.

Estimated Impact

The Senate Engrossed version of SB 1409 is expected to reduce individual and corporate income tax collections by between $(10) million and $(40) million, beginning in FY 2012. 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 range of the revenue loss is expected to be the same as under the earlier version of the bill. As discussed in more detail below, although the Senate Engrossed version provides certain limits to the credit, these changes are not believed to materially affect the main "cost drivers" of the bill, which are the same as under the earlier version of SB 1409: (1) credit refundability and (2) elimination of the post-production approval process.

The ESI Corporation has also produced a fiscal analysis of the bill. They estimate that the bill would result in the direct loss of $(9.1) million in General Fund revenue due to the production tax credit, which is comparable to the low-end of the JLBC Staff range. ESI, however, believes that the film industry will generate $9.3 million in revenues to offset the cost of the tax credits.

JLBC's analysis, however, suggests that the offsetting revenues would probably be $2.8 million rather than $9.3 million and would not offset the revenue loss from the production credits.

ESI also provided an estimate of the infrastructure credit. After adjusting for the $10 million tax credit in the bill, rather than using the $5 million credit assumed in the ESI analysis, a new facility does not appear to generate enough offsetting revenue to offset the cost of the infrastructure credit.

Analysis

The Senate Engrossed changes are not believed to be enough to materially affect the previous fiscal impact estimate under the earlier version of the bill.

First, the cost estimate under the earlier version was considerably less than the annual aggregate cap of $70 million under the Senate Engrossed version. This suggests that the aggregate cap would not reduce the cost of the bill, as previously estimated. Second, the reduction in the per-production credit cap and qualifying percentages are not significant enough to materially affect the fiscal impact. Third, the 2 provisions that were believed to primarily affect the fiscal impact of the

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previous version of the bill – the creation of a refundable credit and the elimination of post-production approval of movie-related expenditures – are retained in the Senate Engrossed version of SB 1409. (See original SB 1409 Fiscal Note.)

ESI Analysis

The ESI Corporation has developed an estimate of the fiscal impact of SB 1409 on the behalf of a client seeking to build a motion picture and recording studio in Arizona. The ESI analysis examined both the bill's production as well as infrastructure credit.

Production Credit

ESI estimates that the tax credit will generate a net revenue gain of $200,000 in terms of production expenses and excluding infrastructure investment. This estimate reflects:

- A revenue loss of $(9.1) million in new production tax credits based on $60 million in production spending. At $(9.1) million, the ESI estimate is comparable to the low-end of the JLBC direct revenue loss.
- A gain of $9.3 million in tax revenue associated with the related film production.

The $9.3 million gain in tax revenue appears overstated for several reasons:

- The $9.3 million in new revenue includes General Fund, non-General Fund and local taxes. In comparison, the $(9.1) million revenue loss accrues solely to the state's General Fund.
- The ESI estimate reflects taxes generated from all self-employed in the film production industry in Arizona, not just the self-employed associated with the films receiving the production credits.

JLBC Staff has re-estimated the ESI revenue projection assuming the following:

- Production spending would equal $75 million, which includes $60 million from the ESI estimate plus another $15 million for directly related self-employed spending.
- A General Fund effective tax rate of 3.74% is applied against production spending. This adjustment provides an estimate of all the new General Fund tax revenue that would be generated by film production, which can then be directly compared to the General Fund revenue loss associated with the tax credit. The 3.74% tax rate was derived by comparing the state's $6.4 billion in General Fund revenues as a percent of the state's total Gross Domestic Product (or an estimated 3.7%).
- The secondary impacts associated with direct production spending (the "dynamic impact") would increase by the overall revenue impact by 25%. The original Fiscal Note used a dynamic estimate of 15-20% based on studies in other states.

These revisions would lower the tax revenue generated by new film production from $9.3 million to $2.8 million. When compared to a revenue loss of $(9.1) million in new credits, SB 1409 would result in a net overall revenue loss of $(6.3) million.

Infrastructure Credit

The ESI analysis also assumes that SB 1409 will result in the construction of a proposed movie and recording studio. The total construction cost is estimated to be $93.2 million over a 2-year period. According to ESI, the new movie studio would qualify for an infrastructure credit equal to the total credit cap of $5.0 million. The same analysis shows that the direct, indirect, and induced impacts of the proposed construction project will generate total tax revenues of $6.0 million. With a revenue loss of $(5.0) million and project-related revenues of $6.0 million, ESI estimates that the facility would generate net new revenues of nearly $1.0 million.

The Senate Engrossed version of the bill, however, provides a $10 million rather than a $5 million credit, which would change the impact of the ESI analysis to nearly a net loss of $(4.0) million.

JLBC Fiscal Notes do not usually address one-time construction impacts as part of the fiscal impact as there is no guarantee that a facility will actually be built. In addition, the ESI estimated revenue loss is understated as their $6 million production-related revenue includes receipts for non-General Fund sources. In addition, their dynamic estimate may overstate the secondary impacts associated with a one-time construction project.

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.

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