# DEPARTMENT OF FINANCE BILL ANALYSIS

**AMENDMENT DATE:** July 13, 2011
**POSITION:** Oppose

**BILL NUMBER:** AB 1069
**AUTHOR:** F. Fuentes
**RELATED BILLS:** SBX3 15 (Calderon, Stats. 2009 Ch. 09X3-17)

**BILL SUMMARY: Income Taxes: Credits: Film: Extension**

This bill would extend the California Motion Picture Tax Credit for five years from July 1, 2014, to July 1, 2019.

**FISCAL SUMMARY**

The Franchise Tax Board (FTB) estimates the revenue loss associated with this measure at $11 million in 2013-14, $49 million in 2014-15, and $83 million in 2015-16.

At the time this analysis was prepared, the Legislative Analyst's Office (LAO) had not determined the extent to which the study requirement would impact their costs.

According to the California Film Commission (CFC), this program would continue to be administered within existing resources. The Commission currently spends $326,000 per year administering this program.

According to the FTB, implementation would not significantly impact the department's costs.

**COMMENTS**

**Finance is opposed** because this bill would commit the state to future tax losses in years in which there is a projected budget deficit.

Extending the film credit at this time would commit the state to revenue losses of $11 million in 2013-14, $49 million in 2014-15, and $83 million in 2015-16. This is not consistent with the Governor's multi-year goal to maintain a balanced state budget.

| Analyst/Principal | Date | Program Budget Manager | Date |
|---|---|---|---|
| (0724) R. Lawrence | | Mark Hill | |

| Department Deputy Director | Date |
|---|---|

| Governor's Office: | By: | Date: | Position Approved_______ |
|---|---|---|---|
| | | | Position Disapproved |

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## ANALYSIS

A. Programmatic Analysis

**Under existing federal law**

The cost of motion picture films, sound recordings, copyrights, books, and patents are eligible to be recovered using the income forecast method of depreciation. In lieu of capitalizing the cost and recovering it through depreciation, taxpayers may elect to deduct up to $15 million ($20 million if the production expenses are incurred in certain distressed areas) of the cost of any qualifying film and television production, commencing prior to January 1, 2012, in the year the expenditure is incurred.

Qualified film productions are eligible for the domestic production activities deduction. This provision allows a 9-percent deduction (when fully phased in) of so-called "qualifying production activities income (QPAI)." The deduction is phased in at 3 percent in 2005 and 2006, 6 percent in 2007 through 2009, and 9 percent in 2010 and thereafter.

- With respect to film productions, QAPI refers to the net income from the license, sale, exchange, or other disposition of any "qualified film" produced by the taxpayer.
- The deduction is limited for a taxable year to 50 percent of the W-2 wages paid by the taxpayer with respect to domestic production activities during such taxable year.
- The law contains special rules in determining the W-2 wage limit for non-corporate business entities, like partnerships and S corporations
- The deduction is generally allowed for purposes of the Alternative Minimum Tax (AMT).

A "Qualified Film" is any motion picture film or video tape (but not sexually explicit films as defined in 18 U.S. Code Section 2257), including television programming, in which at least 50 percent of the total production compensation constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

No credit is allowed for motion picture production.

California conforms to the use of the federal income forecast method of depreciation for the recovery of costs of motion picture films, sound recordings, copyrights, books, and patents, with modifications.

California does not conform to the federal expensing provision for film and television production or the federal domestic production activities deduction.

**Under existing state law**

The tax credit to a qualified taxpayer is for 20 percent of qualified expenditures, attributable to the production of a qualified motion picture, and 25 percent of qualified expenditures attributable to the production of a qualified motion picture where the motion picture is a television series relocated to California or an independent film, as defined, in California.

A "Qualified Taxpayer" means a taxpayer who has paid or incurred qualified expenditure and has been issued a credit certificate by the CFC.

A "Qualified Expenditure", means amounts paid or incurred to purchase or lease tangible personal property used within this state in the production of a qualified motion picture, and payments for services performed within the state in the production of a qualified motion picture.

A "Qualified Motion Picture" is one produced for general distribution to the public, and includes feature films with budgets between $1 million and $75 million, movies of the week with a minimum budget of $500,000, and new television series with a minimum production budget of $1 million.

It is required that 75 percent of the production days take place within California, or 75 percent of the production budget be incurred for payment for services performed within the state and the purchase or rental of property used within the state. In addition, the production of the qualified motion picture must be completed within 30 months from the date on which the qualified taxpayer's application is approved by the CFC.

This credit is allocated in the fiscal year that the production begins and is certified by the CFC after the production is completed.

A qualified taxpayer may, in lieu of claiming the credit allowed by this provision, make an irrevocable election to apply the credit amount against qualified sales and use taxes imposed on the qualified taxpayer.

The aggregate amount of credits that may be allocated by the CFC in any fiscal year is equal to the following:

- $100 million in credits for the 2009-10 fiscal year and each fiscal year thereafter, through and including the 2013-14 fiscal year.
- The unused allocation credit amount, if any, for the preceding fiscal year.
- The amount of previously allocated credit not certified.

Tax credits are allowed for taxable years beginning on or after January 1, 2011, in which the CFC issues a credit certificate. In accordance with rules and regulations promulgated by the CFC, qualified taxpayers must comply with audit requirements prior to the issuance by CFC of the credit certificate.

The credit is disallowed if the taxpayer fails to provide the copyright registration number required by the CFC and until this requirement is met.

Any credit unused in a taxable year because it is in excess of the taxpayer's tax liability can be taken over a period of six taxable years or until the credit is exhausted, whichever occurs first.

In the case where the credit allowed exceeds the taxpayer's tax liability, a qualified corporate taxpayer may elect to assign any portion of the credit allowed to one or more affiliated corporations for each taxable year in which the credit is allowed.

For credits attributable to an independent film, the qualified taxpayer is permitted to sell a credit to an unrelated party. The unrelated party is subject to the same requirements as the qualified taxpayer.

The qualified taxpayer is required to report to FTB prior to the sale of the credit all required information in the form and manner specified by FTB.

Credits may not be sold to more than one taxpayer nor may the credit be resold by the purchaser to another party. In the event that both the taxpayer originally allocated a credit by the CFC and a taxpayer to whom the credit has been sold both claim the same amount of credit on their tax returns, FTB may disallow the credit of either taxpayer, as long as the statute of limitations upon assessment remains open.

FTB is authorized to prescribe rules, standards, procedures, and the like to implement this aspect of the provisions. The Administrative Procedures Act requirements regarding regulations do not apply.

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Annually, the CFC is required to provide the FTB with a list of qualified taxpayers and the tax credit amounts allocated to each qualified taxpayer by the CFC.

**This bill would**

Extend the California Motion Picture Tax Credit for five additional years from July 1, 1014, to July 1, 2019.

Specify that the aggregate amount of the credit that could be allocated by the CFC in any fiscal year would be limited to $100 million through 2018-19.

Require the Commission to provide the LAO with all specified application materials sent to the film commission including but limited to the following: expenditures by applicants by type of production, sales and use tax paid, evidence that the credit was necessary, the list of all the members of the commonly controlled group or the combined reporting group, the number who applied for the credit, the number who received the credit, qualified wages paid, and other pertinent information.

Require the LAO to conduct a study to assess the total economic activity generated by productions that have received a tax certificate and were allocated a tax credit. The study will be reported to the relevant Assembly and Senate committees on revenue and taxation. The State Board of Equalization, the FTB, the Employment Development Department, and other relevant agencies are authorized to share any information necessary with the LAO.

Make technical amendments suggested by the FTB and delete duplicative provisions in the Revenue and Taxation Code.

Take effect immediately as a tax levy.

**DISCUSSION**

This bill requires the CFC to provide information and all application materials, whether relevant or not, to the LAO to conduct an economic impact study. Without confining the request to documents that may be relevant to the study this requirement would merely result in a burdensome workload for no useful purpose. No due dates have been provided for submission of materials, or for completing the study, nor has the scope of the study been clearly defined. It may be more appropriate to complete a study prior to extending the sunset date to determine the economic impact of the film credit and if it is effective in preserving or increasing California's market share of productions.

B. Fiscal Analysis

The FTB estimates the revenue loss associated with this measure $11 million in 2013-14, $49 million in 2014-15, and $83 million in 2015-16.

At the time this analysis was prepared the LAO had not determined the extent to which the study requirement would impact their costs.

According to the CFC, this program would continue to be administered within existing resources.

According to the FTB, implementation would not significantly impact the department's costs.

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| Code/Department Agency or Revenue Type | SO LA CO RV | PROP 98 | FC | 2011-2012 | FC | 2012-2013 | FC | 2013-2014 | Fund Code |
|---|---|---|---|---|---|---|---|---|---|
| | | | (Fiscal Impact by Fiscal Year) (Dollars in Thousands) | | | | | | |
| 1104/Corp Tax | RV | No | | -- | | -- | U | -$11,000 | 0001 |
| 1730/FTB | SO | No | ------------------- No/Minor Fiscal Impact ------------------- | | | | | | 0001 |
| 0520/Secty BT&H | SO | No | ------------------- No/Minor Fiscal Impact ------------------- | | | | | | 0001 |
| 0130/Joint Exp | SO | No | --------------------- See Fiscal Analysis ---------------------- | | | | | | 0001 |