DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: Original
POSITION: Oppose

BILL NUMBER: AB 2026
AUTHOR: Fuentes, Felipe
RELATED BILLS: SB 1167 and AB 1069 (Ch. 731, Stat 2011)

BILL SUMMARY: Income taxes: credits: film: extension.

This bill would extend the allocation of the motion picture credits for five years, from July 1, 2015, to July 1, 2020, and also extend the limit on the aggregate amount of credits that may be allocated by the California Film Commission through fiscal year 2019-20.

FISCAL SUMMARY

The Franchise Tax Board (FTB) estimates the revenue loss associated with this measure at $5.1 million in 2014-15, $22 million in 2015-16, and a total loss of $473 million over the later fiscal years. Extending the credit will not significantly impact the Department's costs.

According to the CFC, this bill would require no additional resources above their current level of funding.

COMMENTS

The Department of Finance opposes this bill as it would commit the state to large direct revenue losses in future years, $5.1 million in 2014-15, $22 million in 2015-16, and a total of $473 million in the later fiscal years. Increasing tax expenditures competes against the need to pay down the state's wall of debt and provide for needed reserves.

ANALYSIS

1. Programmatic Analysis

   Under existing state law, there currently exists to July 1, 2015, an allocated tax credit to a qualified taxpayer 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.

   The tax credits provided in this measure are in addition to any deductions allowed for the related expense.

   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.

Analyst/Principal	Date	Program Budget Manager	Date
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Department Deputy Director	Date

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

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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.

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 2014-15 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.

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.

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 CFC's authorization to allocate the film tax credits for five additional years, from July 1, 2015, to July 1, 2020.
- Extend the annual $100 million limit on the amount of credits that may be allocated by five years, through 2019-20.

According to the Author's office this bill would retain film production in California. Financial incentives and competition from abroad are luring film productions and jobs away from this state.

There appears to be no clear indication that the movie industry is in decline in California. Jobs in the industry have grown from 2002 through 2010. According to the Motion Picture Association of America, in 2010-11 the motion picture and television industry was responsible for 191,146 direct jobs and $17 billion in wages in California, including both production and distribution-related jobs. Over 129,000

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of the jobs are production-related. During that period 899 key projects were filmed in the state, including 574 films and 325 TV series. There has been a decline in movie theater jobs which is consistent with improvements in technology and easy access to this media on the internet.

A recent evaluation was performed by the Legislative Analyst of a February 2012 report, *Economic and Production Impacts of the 2009 California Film and Television Tax Credit,* prepared by the staff of the UCLA Institute of Research on Labor and Employment (UCLA-IRLE) which analyzed a 2011 study by the Los Angeles County Economic Development Corporation (LAEDC) concerning the impact of California's film and television tax credit program.

The LAEDC estimates that productions receiving the first $199 million of tax credit allocations generated economic output of $3.8 billion and supported 20,040 jobs with labor income totaling $1.4 billion. For every tax credit dollar it is estimated that $1.13 in tax revenue would be returned to the state--$1.06 from the initial economic impact and $.07 from ancillary production spending activities. The LAEDC study does not take into account the economic and tax benefits of tourism generated by the film industry. Production budget data appears to have been extrapolated from nine projects out of 77 that received the first $199 million of credits. The study projects that the initial increase in production spending had a multiplier effect on economic activity of 2.5 to 1, estimated from an IMPLAN input/output model used in these types of studies. There was an additional assumption that productions that received the tax credit would not have been retained in California otherwise.

The UCLA-IRLE review of the LAEDC study concluded that the overall analysis by LAEDC was reasonable. The review further concluded that sample of nine were not a representative sample of the rest of the tax credits recipients and may have overstated the benefits of the tax credit program. Additionally, the assumption that all production without a credit would leave is untrue. The UCLA researchers estimate that the tax revenue generated would be $1.04 for every dollar of tax credit instead of $1.13 indicated by the LAEDC study.

The Legislative Analyst, commenting on these findings notes the following issues that could affect the results of the LAEDC and/or the UCLA-IRLE studies:

- Unknown assumptions embedded in the LAEDC economic models and their failure to consider the benefits of alternative and public or private uses (which could result in the credit program having significantly less net benefits than shown in the studies).
- In-state film activity that would occur in California without any tax credit (which results in the credit program having less economic and tax net benefits than shown in the LAEDC study).
- In-state economic and employment activity resulting from out-of-state productions (which result in the credit program having less net benefit than shown in the studies).
- Crowding out effects (which result in the credit program having less net benefit than shown in the studies in at least some years).
- Effects of film related tourism (which would likely not result in significant changes in net benefits in most years).

The Legislative Analyst concludes that while the total effect of these issues is impossible to quantify, the net benefit would likely be negative in a given fiscal year, and the estimate of job gains resulting from the credit program is overstated. By the Legislative Analyst's estimate, the projected state and

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local tax revenue return for every credit dollar would be under one dollar and perhaps well under a dollar for many years and would result in a net decline in state revenues.

Finance concurs with the Legislative Analyst's evaluation of this issue. The assumptions underlying the LAEDC model, the basis of the study, remain a mystery. Without specific details about the underlying assumptions of the LAEDC model it is difficult to determine if the estimated economic impact of the California's film and television tax credit program is accurate.

Given the size of the movie industry, and the number of productions that have been been completed in California without receiving the credit, it seems likely that a sizable portion of the credit is being allocated to productions that would have been made in California, even without the credit. In addition, if a company moves their production activities to another state, California could still benefit economically from that production. Because a large segment of the skilled professionals in this industry reside in California, it is likely that some Californians would be hired to work on the out of state production and California would benefit. In a recent report on film industry tax incentives by the Massachusetts Department of Revenue, it was determined that between 50 percent and 60 percent of wages for Massachusetts film productions were paid to California residents. The Massachusetts study also concluded that of those wages paid to non-residents, only about 8 percent to 9 percent were spent in the state. In the case of California, this implies that a large share of wages earned by out of state productions would return to California. The LAEDC study did not take into account the potential benefits of productions moving out of California as they assumed the state would lose 100 percent of the economic impact of that production. It seems likely that, on net, the credit produces a drain on the state's General Fund.

SB 1167 (Calderon, 2011-12) which is the same as this bill is awaiting its first hearing.

Chapter 731, Statutes of 2011 (AB 1069, Fuentes) extended the CFC's requirement to allocate the tax for one additional year, until July 1, 2015, and extended the limit on the aggregate amount of credits that may be allocated through to 2014-15.

2. Fiscal Analysis

The FTB estimates the direct revenue loss associated with this bill at $5.1 million in 2014-15, $22 million in 2015-16, and a total loss of $473 million over the later fiscal years.

This proposal authorizes an additional $100 million in movie credits each year, and extends the program through fiscal year 2019-20. FTB's estimate of the timing of the usage of these credits is based on initial data for the amount of credit currently being allocated and certified by the CFC by taxable years. FTB Assumes that 80 percent of the certified credits was allocated to major production companies and the remaining 20 percent was allocated to small independent film companies. Of this amount, it was assumed that major production companies would use 80 percent of the credit and carryover the other 20 percent to future years. However, FTB estimates that the smaller film companies would use 90 percent with a carryover of 10 percent. This higher usage rate reflects the ability of the smaller companies to sell their certified credits.

According to the FTB, the estimate shows a small 2014-15 impact which is the result of the way the program operates. State law currently provides $600 million in credits that are intended to be distributed at $100 million a year through 2014-15. The film commission, however, awarded $200 million in credits during its first year. As a result, the final $100 million is expected to be awarded

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in 2013-14. Thus, this analysis assumes that, if this proposal is adopted, the first $100 million in awards would be made in 2014-15 rather than 2015-16. The small 2014-15 revenue impact reflects the fact a few approved projects are completed very rapidly, making credits available for use on the 2014 tax returns.

According to the FTB, extending the credit will not significantly impact the Department's costs.

According to the CFC, this bill would require no additional resources above their current level of funding.

Code/Department Agency or Revenue Type	SO LA CO RV	PROP 98	FC	(Fiscal Impact by Fiscal Year) (Dollars in Thousands) 2012-2013	FC	2013-2014	FC	2014-2015	Fund Code
1104/Corp Tax	RV	No	U	--	U	--	U	-5,100	0001
1730/FTB	SO	No		----- No/Minor Fiscal Impact -----					0001
0520/Secty BT&H	SO	No		----- No/Minor Fiscal Impact -----					0001