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F I S C A L   I M P A C T   R E P O R T

SPONSOR Maestas **ORIGINAL DATE** 1/24/18 **LAST UPDATED** 2/5/18 **HB** 113

SHORT TITLE Remove Film Tax Credit Annual Cap **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue*					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
($12,000.0) - ($26,000.0)	($44,000.0) - ($94,000.0)	($40,000.0) - ($153,000.0)	($42,000.0) - ($194,000.0)	($52,000.0) - ($174,000.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

*The annual revenue loss from the film credit is accounted for as a separate line item in the analysis of the consensus revenue estimating group, directly impacting revenue estimates

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	Minimal	Minimal	Minimal	Minimal	Nonrecurring	Taxation and Revenue Department

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 113 removes the film credit cap (set at $50 million) for film projects commencing and related expenditures occurring on or after January 1, 2018. The bill also removes, for those projects and expenditures, any speed-up of payments for larger projects that are to be split evenly into two or three payments over as many years. Current statute sets up a queue for those payments so that if the annual $50 million cap is not reached in a given fiscal year, payments to be made in subsequent years may be sped up and paid out early until the cap is reached.

There is no effective date of this bill, but the provisions of the bill apply to expenditures made on or after January 1, 2018 when the principal photography related to those expenditures commences on or after January 1, 2018.

FISCAL IMPLICATIONS

This bill would presumably impact the film cap for FY18 assuming qualifying expenditures are made during the second half of the fiscal year.

The bill has two competing impacts on revenues. The first is positive for the general fund, by removing the ability for the Taxation and Revenue Department (TRD) to speed up payments to be made in future fiscal years (for productions beginning on or after January 1, 2018) up to the amount of the cap. The bill sets those future payments at definite times, not to be adjusted.

The competing impact is negative for the general fund, by removing the cap for productions moving forward. If the number and value of production expenditures increases over time, this could create a negative general fund impact by allowing more than $50 million annually to be expended on the credit.

Key Notes. The range of estimates shown in the revenue table shows the significant negative general fund impact of the bill, using assumptions of mild to moderate growth from two possible starting points: the average of the possible credits accumulated from FY11 through FY15, and the higher level of possible credits accumulated in FY17. What this also shows is that, under existing statute, if expenditure and credit levels continue at the FY17 level, New Mexico will begin to amass huge future liabilities, significantly extending the timeframe over which those liabilities would be paid. If this liability continues to grow at a rapid pace, it could also cause the industry to slow its growth or pull back due to concerns over timing for repayment. This is a significant issue that should be discussed in detail at the appropriate interim committee(s) and possibly addressed through any desired legislation in the next 60-day session.

A determination is needed from TRD to discover whether the agency would incorporate new expenditures and payments that do not fall under the cap into the total bucket of payments that is used to measure the $50 million cap for prior expenditures and payments. If new payments do not add to the cap, this would require TRD to speed up payments that would have been made in future fiscal years into FY18 until the cap is reached.

The TRD impact estimate for FY19 is negative $50 million, that number growing by an additional $10 million negative impact in each subsequent year. These also represent ballpark numbers, and their methodology is below. The numbers in the tables on the first page represent LFC staff interpretation of these estimates and other data supplied in TRD's analysis along with the continued requirement for large productions to receive their credits over two or three years and the prior assumption that future productions might not contribute to the cap for older productions.

> The estimated fiscal impacts are only an approximation because past film activity eligible for the credit has fluctuated widely from year to year. TRD reviewed information published by the New Mexico Film Office (NMFO) to estimate the fiscal impacts of the proposed legislation. The film tax credit reimburses up to 30 percent of production expenditures. During FY17, NMFO estimated that approximately $505.9 million was

> spent on film production. Because the credit reimburses operating expenses, and not tax, the tax expenditure for FY17 could have been over $151.8 million. For the period FY11 through FY15, NMFO reported direct spend amounts ranging from $162 million to $387 million. The corresponding tax expenditures for those years could have been $48.6 million to $116 million. NMFO does not estimate future film industry investments in New Mexico, but the trend indicates an increasing level of investment. Therefore, the fiscal impact is unknown.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

The Pew Charitable Trusts performs significant research and analysis of state tax incentives and accountability, and Pew stated in recent reports, "A well-designed incentive should... protect the state budget from costs that increase quickly and unexpectedly." In presentations regarding this protection, Pew has advocated caps for some incentives to prevent such increases in costs.

Even at this late date, there is still controversy whether the film production tax credit returns more to the state and local governments in additional tax revenue than the static cost of the credit paid by the general fund. The January 2018 *LFC Volume III* contains a cost per job created chart that estimates the cost of the film credit at nearly $29 thousand per job (direct cost*), annually. In order to create and retain an average job in the film industry, the state must pay that amount through the credit every year or risk potentially losing the job. Looking long-term at the total cost for a film industry job, it would be a multiple of the $29 thousand. For example, the Job Training Incentive Program (JTIP) is estimated in the same document to have a one-time cost of $4 million. If that job lasts four years, the cost for that program to create the job is still $4 million. However, to keep a film job for four years, the cost is $115.6 thousand.

> * Note the *LFC Volume III* cost per job chart lists only direct costs without considering indirect and induced effects as the vast majority of the job creation programs and tax expenditures on the list do not have associated studies estimating indirect and induced effects. Additionally, different assumptions and methodologies can result in substantially different cost estimates, so considering direct costs only – while imperfect – is currently the best way to achieve an apples-to-apples comparison.

TRD provided the following analysis.

> The film and television tax credit refunds up to of 30 percent of expenditures of film and television productions made in New Mexico. Under current law, the amount of subsidy to the industry is capped at $50 million. This tax credit is one of the largest tax expenditures

in present law. The state increment of the gross receipts tax is 5.125 percent; thus, for the state to generate $50 million in gross receipts tax revenues, the film industry would have to generate almost $1 billion of taxable gross receipts. The NMFO statistics, beginning in FY03, indicate that the largest direct spend by the film industry was $506 million during FY17. Thus, New Mexico has never recouped sufficient tax revenues to fund this tax credit on a revenue neutral basis.

Removing the aggregate cap could reduce general fund revenue dramatically. The current tax credit is funded by the corporate income tax (CIT) program. Last year, CIT collections were approximately $170 million; $100 million was paid out as tax year liabilities: $50 million specifically for film and television production and another $50 million in other refunds (other refundable credits as well as overpayment refunds). It is probable that removing the aggregate cap on this credit would result in sharply lower CIT revenues which flow to the general fund.

PERFORMANCE IMPLICATIONS

The LFC tax policy principle of accountability is met with the existing annual reporting provided and detailed studies evaluating the effectiveness and other attributes of the credit.

ADMINISTRATIVE IMPLICATIONS

There is a minimal administrative impact. Updates to systems and forms will be necessary. Most costs can be absorbed in conjunction with annual updates for each tax year.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✘	
Targeted		
Clearly stated purpose	?	Not explicitly stated
Long-term goals	✘	
Measurable targets	✘	
Transparent	✓	
Accountable		
Public analysis	✓	Multiple studies have been performed
Expiration date	✘	
Effective		
Fulfills stated purpose	✓	The incentive is effective in attracting film productions to the state and generating local employment in the industry
Passes "but for" test	✓	This incentive is one of only a few that clearly passes the "but for" test – the film productions and jobs would largely not exist but for the existence of the incentive
Efficient	?	The efficiency of the credit is debatable
Key: ✓ Met ✘ Not Met ? Unclear		

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