

Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current FIRs (in HTML & Adobe PDF formats) are available on the NM Legislative Website ([www.nmlegis.gov](http://www.nmlegis.gov)). Adobe PDF versions include all attachments, whereas HTML versions may not. Previously issued FIRs and attachments may be obtained from the LFC in Suite 101 of the State Capitol Building North.

## FISCAL IMPACT REPORT

ORIGINAL DATE 3/10/19  
 SPONSOR SCORC LAST UPDATED 3/15/19 HB \_\_\_\_\_  
 SHORT TITLE Film Tax Credit Changes SB 2/SCORCS/aSFC  
 ANALYST Clark/Iglesias

### REVENUE (dollars in thousands)

Estimated Revenue*					Recurring or Nonrecurring	Fund Affected
FY19	FY20**	FY21	FY22	FY23		
(\$100,000.0)	(\$95,000.0)				Nonrecurring	General Fund
\$0	(\$60,000.0)	(\$59,000.0)	(\$98,600.0)	(\$95,900.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

\*The general fund impacts shown are the costs after paying the \$50 million required under the cap.

\*\*The bill allows up to \$110 million (the new aggregate cap) to be paid in FY20 plus an additional \$95 million plus up to \$30 million more contingent on FY19 revenues exceeding the forecast by at least \$30 million; this assumes the \$30 million is received (increasing general fund revenues) and then almost that amount is paid out (decreasing general fund revenues and resulting in no net impact to the general fund compared with the current revenue forecast)

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
<b>Total</b>		Moderate	Moderate	Moderate	Recurring	TRD & EDD Operating Budgets

Parenthesis ( ) indicate expenditure decreases

Relates to or conflicts with HB654, HB527, HB594, SB451, SB151

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Economic Development Department (EDD)

New Mexico Attorney General's office (NMAG)

State Board of Finance (BOF)

## SUMMARY

### Synopsis of SFC Amendment

Senate Finance Committee (SFC) amendment to the Senate Corporations and Transportation Committee substitute for SB2 makes technical corrections to fix issues discovered within the language of the substitute bill.

### Synopsis of Original Bill

Senate Corporations and Transportation Committee Substitute for Senate Bill 2 amends the Film Production Tax Credit Act to pay off the film credit backlog up to set amounts (up to an additional \$195 million by the end of FY20 plus up to an additional \$30 million contingent on FY19 revenues exceeding the forecast), change the annual \$50 million “rolling” cash cap to a \$110 million cash cap, implement a \$100 million “hard” cap for liabilities in excess of the cash cap, and carve out credit payments made to production companies (referred to as “New Mexico film partners”) who purchase or sign a 10-year lease for a qualified production facility from both the cash cap and the liability cap.

For fiscal years FY20 through FY22, if the aggregate amount of claims paid minus the carve-out for film partners is less than the \$110 million cap, the lesser of that amount or \$20 million shall be added to the cap in the immediately following year.

The Economic Development Department (EDD) shall certify a film production company’s budget in a preproduction meeting. To implement the \$100 million hard liability cap, if the total expected claims (minus those to film partners) for any fiscal year would exceed \$100 million, EDD is prohibited from certifying the production company’s budget.

The bill eliminates the tiered system of payouts for mid-size and large productions over two to three years. It also adds another 5 percent increase to the credit value for expenditures made on location more than 60 miles outside of Bernalillo and Santa Fe counties. This credit increase is “stackable” with either of the two existing possible 5 percent increases for filming in a qualified production facility or filming a television pilot or series (those two increases are currently mutually exclusive and remain so in this bill). This results in a maximum possible credit rebate value of 35 percent of qualified expenditures.

The bill also makes a significant number of structural changes to qualifications, reporting, etc. However, all of the provisions of the bill other than paying off backlog credits and increasing the cap apply only to companies that start principal photography on or after July 1, 2019.

The bill clarifies certain definitions that were open to interpretation and has more clearly included television series in the definition of film. It repeals the non-resident crew exception limits for below-the-line crew (off-camera positions providing technical assistance during physical production) and replaces that provision with a flat 15 percent of a production’s New Mexico budget. This provision can increase to 20 percent if sufficient and qualified below-the-line New Mexico residents are not available.

The bill revises the definitions of “direct production expenditure” “and direct postproduction expenditure”, which are what the tax credit is based upon, in several ways. It eliminates the per

diem cap for out-of-state performing artists, eliminates the \$100 cap on the daily expense of leasing a vehicle, allows payment for standard industry craft inventory provided by below-the-line New Mexico crew, allows payments for subcontracted goods and services in certain circumstances, and lifts the limit on the value of permissible gifts from \$25 to \$100. This bill also specifies additional types of excluded expenditures, including goods and services by vendors not subject to state taxation, services by nonresident below-the-line crew, and hidden or other indirect costs not paid directly by the production company or enumerated on its claim and wages by a person not a New Mexico resident who falsely claims to be a New Mexico resident.

The effective date of virtually all provisions of this bill is July 1, 2019, but the provisions of the bill apply to film production companies that commence principal photography on or after July 1, 2019. Existing statutes that are left in place for film production companies that commenced principal photography prior to July 1, 2019 that would conflict with these new provisions are clarified to not apply to these new productions.

## FISCAL IMPLICATIONS

The updated estimate from EDD, working in conjunction with the Taxation and Revenue Department (TRD), for the backlog in total accrued liabilities in FY19 that is or could be filed, processed, and paid within the fiscal year is about \$124 million after paying out the required \$50 million under the cap. The estimate for FY20 is an additional \$157 million, for a combined backlog of \$281 million after paying out the total of \$100 million under the cap for those two years<sup>1</sup>.

The bill restricts the additional amount that may be paid in FY19 to \$100 million above the \$50 million allowed under current law – a nonrecurring cost. The bill allows up to \$110 million (the new aggregate cap) to be paid in FY20, plus an additional \$95 million, plus up to \$30 million more contingent on FY19 revenues exceeding the forecast by at least \$30 million. The FY20 estimates shown are equal to the \$110 million cap minus the current-law \$50 million for a recurring cost of \$60 million along with the nonrecurring cost of \$95 million for additional one-time payments.

The estimates assume the contingency occurs: revenues exceed the forecast by at least \$30 million (increasing general fund revenues) and then almost that amount is paid out (decreasing general fund revenues and resulting in no net impact to the general fund compared with the current revenue forecast). This results in completely clearing out the estimated backlog of credit claims by the end of FY20.

In FY21 and subsequent years, credit claims are assumed to grow quickly. LFC estimates show claims (other than for film partners) exceeding the cap slightly in FY22, but not significantly because the FY22 cap is assumed to increase by about \$12 million added from the prior year. This pushes up the cost rapidly in FY22. However, because the cap is exceeded in FY22, no additional increase in the cap would occur in FY23, resulting in a slight dip in the cost. However, by the end of FY23, the backlog could be as high as \$34 million. The backlog is projected to more than double by the end of FY24 and then hit the hard liability cap sometime in FY25.

---

<sup>1</sup> This FY19 estimate is less than the previous LFC estimate of \$248 million for FY19 because of additional data from EDD on the decline in industry activity in FY18 that is impacting FY19 applications and data from EDD and TRD on the significant time lags from production to filing to processing and approval that push much of the backlog into FY20.

EDD reports its Film Office estimates the industry will continue to grow at roughly 13 percent each year with the passage of this bill. The 13 percent growth includes the New Mexico Film Partners locating to the state.

The table below shows film credit applications approved by TRD by fiscal year. It is important to note this does not represent payouts within a fiscal year, because of the cap and tiered payment system, and it does not represent estimated liability to the state within the fiscal year because of processing delays at TRD that can result in applications filed in one fiscal year and then reviewed and approved in the next. For example, TRD reported at the end of FY18, total estimated cumulative state liabilities were \$179.4 million, including about \$80 million in applications that were filed during FY18 but not yet processed.

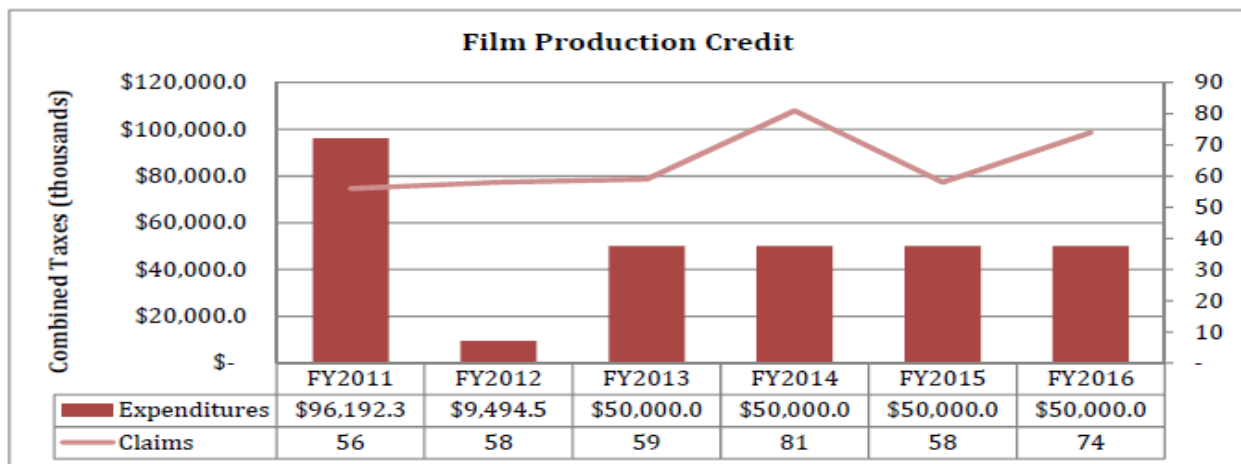
FY12	FY13	FY14	FY15	FY16	FY17	FY18
\$ 19,157.23	\$ 60,834.81	\$ 41,571.67	\$ 62,529.77	\$ 38,519.35	\$ 90,417.61	\$ 104,342.17

The TRD approved application data is helpful for historical context, but it is difficult to estimate future liabilities from this data due to delays from the time a film production wraps to the application filing (up to 12 months) and from the time TRD receives an application to approval (often six months or more). It is unknown how many approved applications were filed in a particular year, and the lag would not show recent industry trends.

To estimate future impacts, LFC staff used TRD data on credit applications received (and booked as accrued liabilities) through the end of FY18. Since only partial data is available for FY19 from TRD, and obviously none for future fiscal years, the LFC projections rely on data from EDD on industry activity and estimated historical averages of delays between the start of production to end of production, to application filing at TRD, to application processing and approval at TRD.

The estimated fiscal impacts beyond FY20 are only an approximation because past film activity eligible for the credit has fluctuated widely from year to year, and impacts for future fiscal years are highly uncertain. Actual industry activity and credit claims could vary significantly in either direction from this scenario.

The table below shows the annual film credit claims. While this is helpful to show the surge to more than \$90 million in credits in FY11, the last year before the cap went into effect, and the drop in FY12 after the cap took effect, it does not show recent industry trends.



See *Appendix A* for additional fiscal implications details, see *Appendix B* for cost per job information and calculations, and see *Appendix C* for a summary of estimated general fund revenues versus costs for the credit.

## **SIGNIFICANT ISSUES**

LFC promotes the principle of transparency, including public reporting, and this bill increases reporting requirements, most notably including reporting of film expenditures by geographic location and any additional information EDD would require to analyze the effectiveness of the credit.

EDD provided the following analysis.

The bill increases the reporting requirements to determine the effectiveness of the tax credit. The bill will require involvement of multiple agencies to share and report information in a timely and effective manner. Staffing at the Film Office may need to be addressed with the anticipated influx of films and reporting the productions actual spend throughout the state. With reporting requirements increasing, the Film Office has indicated software upgrades are needed to ensure accurate and timely reporting.

BOF reported that paying off the film credit backlog, and thus removing this growing, unpaid liability, would likely be considered very positive by bond ratings agencies. The agency also provided the following note.

It is important to consider also that the state's bond ratings are underpinned by strong reserve balances in the general fund. There is a possibility that general fund revenues will decline at some point in time. If for any reason the state dipped into reserves to pay film tax credits, it could end up being a concern for ratings agencies and the investment market. Having a proposed cap could help avoid this situation, although it is difficult to determine to what degree given the uncertainties related to severity, cause, or impacts of any future potential economic downturns.

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. Within the last several years, New Mexico experienced soaring costs for some tax deductions and credits, such as the high-wage jobs tax credit, which rose from annual costs nearly always less than \$10 million to well over \$50 million for two years before the state significantly narrowed the credit. That surge in costs became a cautionary tale for other states and is a good reminder for New Mexico policymakers to carefully consider changes to tax expenditures that could create significant spikes in costs.

## **PERFORMANCE IMPLICATIONS**

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

New Mexico is falling behind other states for evaluating tax incentives. *Pew Charitable Trusts* recently reported 28 other states now perform regular tax incentive evaluations. The primary obstacle for New Mexico, as it was for many other states, is access to taxpayer data for the evaluations, but LFC does not currently have funding necessary for the dynamic modeling software and an additional staff or contract economist to perform these evaluations. Granting access to key data and providing LFC economists with the needed resources would allow a gradual process of evaluating tax expenditures and economic development incentives with the goal of eventually providing a holistic picture of the costs and benefits to the state of each job created in a particular industry – not just the cost of an individual incentive program, but the additive (or stacked) costs of all the incentives available for a particular job, along with estimated additional revenues and other benefits resulting from that job (*see Appendix B: Cost Per Job for calculations and additional discussion*).

### ADMINISTRATIVE IMPLICATIONS

The cash cap combined with the hard liability cap and the carve-out for film partners creates complexities, and this could result in moderate additional administrative impacts on EDD and TRD. It may be necessary or useful for EDD to promulgate rules for how it will administer the hard liability cap in more detail.

### CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This bill relates to SB151, which would provide economists with data access and provide LFC economists with resources needed to regularly evaluate incentive programs such as this (*see Performance Implications for more discussion*).

This bill partly duplicates HB654 but has significant changes. This bill's retention of the cap but at a much higher value and method of paying off the backlog are the most significant differences, although there are many other policy and technical differences.

This bill conflicts with HB527, which pays off the backlog of approved credit claims in FY19 and FY20 in the same manner but makes no other changes.

This bill conflicts with HB594, which appropriates \$100 million to TRD to pay off the backlog through a voluntary bid for discounted payments on credit claims.

This bill conflicts with SB451, which seems intended to make the \$50 million cap a hard cash cap with no backlog accrual.

### TECHNICAL ISSUES

LFC staff note this bill might raise constitutional questions because of phrasing in the anti-donation clause of the New Mexico Constitution. Staff provided a memo to the chairs of HAFC, SFC, and HTRC notifying them of concerns more broadly regarding this type of tax treatment.

#### **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
<b>Vetted</b>	x	
<b>Targeted</b> Clearly stated purpose Long-term goals Measurable targets	✓ - x	It has some long-term goals, but they are more general than specific
<b>Transparent</b>	✓	
<b>Accountable</b> Public analysis Expiration date	✓ x	Multiple studies have been performed, but increased reporting by film companies and EDD could improve analysis by state agencies and the public
<b>Effective</b> Fulfills stated purpose Passes “but for” test	✓ ✓	The incentive appears effective in attracting film productions to the state and generating local employment in the industry This incentive is one of only a few that appears to pass the “but for” test – the large presence of the film industry in New Mexico is likely due to the incentive
<b>Efficient</b>	?	The efficiency of the credit is indeterminate at this time; additional analysis of this credit and other economic development incentives for comparison is needed
Key: ✓ Met x Not Met ? Unclear		

## APPENDIX A: FISCAL IMPLICATIONS ADDITIONAL DETAILS

### Other Fiscal Implication Notes

The film tax credit is funded through the corporate income tax (CIT) program. Last year, CIT general fund revenues were approximately \$107 million; however, this was after \$50 million was paid out through this credit for film and television production. It is probable that removing the aggregate cap on this credit would result in lower CIT revenues, which flow to the general fund.

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or be held for future consideration.

This bill may be counter to the LFC tax policy principles 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.



## APPENDIX B: COST PER JOB

There is significant discussion about the costs and benefits to the state of the film credit and how much the state may be paying as an incentive for each job that exists in the industry. Much of the debate centers on job estimates and multipliers to account for indirect and induced jobs, along with whether or not to include estimated tax revenues received by state and local governments, additional indirect costs to the state, and how to estimate those. The first phase of the 2014 film study contracted through EDD estimated the state recoups 33 cents for every dollar it spends through the film credit based on direct jobs in the industry.

The January 2019 *LFC Volume III* contains a cost per job chart that estimated the cost of the film credit at nearly \$29 thousand per job (direct job cost\*) annually, although this was based on data underlying the 2014 film study, so the figure does not reflect the latest data. LFC staff also noted in a recent memo that under the assumption most of the film activity would not occur here but for this credit, the state must continue to pay the annual cost to keep the film jobs in the state.

Note the *LFC Volume III* cost per job chart lists only direct job costs without considering indirect and induced effects because most 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 most consistent way to provide a comparison of a particular job creation program or incentive.

Looking long-term at the total cost for a film industry job, it would be a multiple of the annual cost because the state must pay each year to keep that job. For example, the Job Training Incentive Program (JTIP) is estimated in the same document to have a one-time cost of about \$4,000 per job. Whether that job lasts one, four, or 10 years, the cost for that program to create the job is still \$4,000. Similarly, the high-wage jobs tax credit is shown to have an average cost of \$25.5 thousand, but that job would need to last for at least four years to receive the full credit. However, if one assumes the film credit mostly passes the “but for test,” and the industry would largely not exist without the credit, then the following assumption must be made. To keep a film job for four or 10 years, the cost would be the net present value of the annual cost over that many years, discounted to account for the lower value to the state of a dollar in the future compared with a dollar today.

Based on updated data from EDD released in February 2019, LFC staff estimate the average annual cost per direct job was about \$14 thousand annually in FY17 and FY18 scored against the cap of \$50 million, which restricts the amount paid out each year. EDD estimated the cost per job at \$5,953 for FY17 using a multiplier for indirect and induced jobs. There is nothing wrong with this approach in isolation; in fact, there is validity to using multipliers, but if the primary purpose of arriving at a cost per job figure is to compare the cost-effectiveness of various job-creation programs, then the comparison must be made for direct jobs only unless and until thorough cost evaluations are done for other programs and incentives and multipliers are determined for each (*see Performance Implications for more discussion*).

However, the state accumulated significant additional liabilities beyond the payments made in those years. Scored against the estimated liability accrued in those years, the cost per direct job was about \$39 thousand annually. While a cap remains, there is validity to reporting both cost estimates, because the former is the cost to the state using the modified accrual accounting

system, and there is no obligation in any given fiscal year to pay more than \$50 million. However, the latter accounts for how much the state will eventually have to pay over time (not discounted to net present value) for the jobs that exist today, and this liability will be reflected in the state’s FY18 comprehensive annual financial report (CAFR). If the cap is removed, it would be reasonable to only score the cost per job against the accrued liability since that would also represent the amount paid out. The table below shows these annual and net present value LFC estimates.

<b>Film Credit: Estimated Costs Per Direct Job</b>		
	<b>Scored Against \$50 Million Cap</b>	<b>Scored Against Accrued Liability</b>
Annual Cost Per Direct Job	\$14,016	\$38,676
Net Present Value Cost, 7.25% for 4 Years	\$47,208	\$130,268
Net Present Value Cost, 7.25% for 10 Years	\$97,314	\$268,532

However, it is also important to note what these numbers represent and how incentive programs may be stacked for different industries. These estimates, along with those shown in the *LFC Volume III*, are the costs per job of an individual job creation program or incentive. They do not reflect the total cost to the state of that job. Therefore, to directly compare the cost of the film credit with another incentive program, or to compare any other two incentive programs, creates an incomplete picture of total costs unless the incentives represent the majority or entirety of the state benefits provided to that industry.

For example, for the film industry, the film credit typically represents the bulk of the benefit from the state. There is some money provided through the Film Crew Advancement Program, and occasionally a company such as Netflix will receive an award of Local Economic Development Act (LEDA) funding, but these amounts are relatively insignificant compared with the cost of the film credit.

However, New Mexico has focused on recruiting various types of manufacturing companies to the state over the years and has created a wide array of available incentives, most of which can be stacked on top of each other. For example, a manufacturer can also receive LEDA and JTIP funds but can also receive the high-wage jobs tax credit, the investment credit, tax exemptions through industrial revenue bonds, and a host of narrower industry-specific incentives within the broader manufacturing category. The state currently has no way to properly analyze the total cost of creating a manufacturing job.

Therefore, while the state should strive for progress toward better understanding the costs and benefits of these incentives, a direct comparison between the cost of the film credit and the cost another incentive should note the significant caveats associated with such comparisons.

## APPENDIX C: GENERAL FUND REVENUES VERSUS COSTS

There is seemingly consensus the state of New Mexico receives less in general fund tax revenues from the film industry than it pays annually for the film credit, with estimates ranging from 33 cents to 56 cents of general fund revenues from the film industry for every dollar the state spends on the credit. Below are some key points regarding this issue.

- Phase 1 of the 2014 film study performed under contract for EDD concluded film production activity has produced an estimated \$0.33 in state tax revenues for each \$1.00 of credit claims granted.
- A 2019 film study performed under contract for The International Alliance of Theatrical Stage Employees (IATSE) determined if the cap were removed, for every \$1.00 of credit claims granted, New Mexico would receive \$0.41 in additional tax revenue.
  - The study arrives at this conclusion despite assuming that increased film industry activity will result in increased tax revenues completely unrelated to the industry, such as severance tax revenues.
- A 2019 report by the EDD Film Office did not directly determine a ratio of revenues to credit claims, but estimated personal income tax and gross receipts tax revenues generated by the industry (including a multiplier to represent indirect and induced impacts) for the state totaled \$28.2 million in FY17.
  - Based on the \$50 million paid by the state in that year, this would result in \$0.56 in state tax revenues for each \$1.00 of credit claims granted.
  - The assumptions used to estimate the revenues generated seem relatively conservative, but adding a multiplier effect always introduces debate. Additionally, it is important to note there are always additional costs to the state for incremental workers that move to New Mexico as a result of higher employment in this, or any, industry. While this would not significantly change the above calculations, it is important to consider if viewing costs and benefits holistically.

It is also important to note the eventual cost to the state for the film credit, including backlog liabilities that are generated due to the cap, has recently significantly exceeded \$50 million per year. Comparing the estimated tax revenues generated by the industry with the amount paid under the cap is valid when considering the cash cost of the credit, but there is also validity to comparing the tax revenues with the total liabilities accrued in a given year, which recently exceeded \$100 million per year. Removing the cap changes the situation so that the total accrued liabilities would equal the amount paid in cash, making that the only valid comparison.