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

SPONSOR Smith **ORIGINAL DATE** 02/08/10 **LAST UPDATED** **HB**

SHORT TITLE Film Production Tax Credit Cap **SB** 235

ANALYST White

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	FY11	FY12		
$0.0	$ 17,200.0	$ 18,900.0	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to HB 52 and SB 248

SOURCES OF INFORMATION
LFC Files
New England Public Policy Center at the Federal Reserve Bank of Boston

Responses Received From
State Investment Council (SIC)
Economic Development Department (EDD) – New Mexico Film Office

Responses Not Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 253 places a cap on the amount of film production tax credits which may be claimed by any one film production. The proposed cap would be set at $2 million for direct production expenditures and $2 million for postproduction expenditures made on or after July 1, 2010. The proposed legislation also adds language intended to strengthen residency requirements for credits which can be claimed as the result of payments of “wages, fringe benefits or fees for talent, management or labor” to a New Mexico resident. Under the provisions of Senate Bill 235 such expenditures would only qualify if made to a person who has been a New Mexico resident “for purposes of the Income Tax Act for at least the previous six months.”

FISCAL IMPLICATIONS

Of the nearly $82 million in film-production tax credits awarded to 53 different productions in FY09, 10 were in excess of $2 million. These 10 credits represented nearly 42 percent of the total dollar amount awarded. Assuming that all of the expenditures related to these credits were for direct production, the state would have been obligated to award approximately $34.4 million less in tax credits during FY09 if a $2 million cap were in place. However given that the proposed legislation implements a separate $2 million cap on both direct production expenditures and postproduction expenditures, such an assumption may be too simplistic.

Data has not been provided by either the Taxation and Revenue Department (TRD) or the New Mexico Film Office regarding what percentage of each credit went toward direct production expenditures and what percentage went toward postproduction expenditures. If we were to assume that each of these 10 productions would have, under the proposed legislation, qualified for both the $2 million direct production credit and the $2 million postproduction credit the state would have been obligated to award approximately $20.1 million less in tax credits during FY09. This amount represents approximately 24 percent of the total amount of credits awarded.

The December 2009 consensus revenue forecast included $71.5 million in film production credits to be paid out in FY11 and $78.7 million to be paid out in FY12. The state paid out almost $80 million, or nearly a third of total corporate income tax receipts in FY09. Using the data discussed above, it can be reasonably inferred that the proposed caps would decrease these amounts by approximately 24 percent. Therefore we can come to the conclusion that if enacted Senate Bill 235 would increase FY11 and FY12 corporate income tax receipts by approximately $17.2 million and $18.9 million respectively.

While the proposed legislation would result in increased corporate income tax receipts, these increases would be partially offset by a probable decline in film activity that existed due to the credit.

Dynamic Analysis. In its analysis of related legislation, House Bill 52 the New Mexico Film Office indicates that it anticipates film industry direct spending of $150 million in FY11 yielding tax credits of $37.5 million. This number is just over half the $71.5 million estimated by the consensus revenue group, made up of economists from DFA, TRD, DOT, and LFC. Using the results of two studies on the benefits of New Mexico's film production tax credit program, the following general fund impacts can be estimated from using both projections.

GF Impacts of Film Production Tax Credit Using Film Office Activity Estimates:

	Ernst & Young	Arrowhead Center
Direct Film Spending	$ 150.0	$ 150.0
Tax Credit	$ 37.5	$ 37.5
Revenue per $ of Credit	0.94	0.14
Revenue from Film Spending	$ 35.3	$ 5.25
Gain/(Loss) to the State	$ (2.3)	$ (32.25)

* Dollars in Millions

GF Impacts of Film Production Tax Credit Using Consensus Revenue Activity Estimates:

	Ernst & Young	Arrowhead Center
Direct Film Spending	$ 286.0	$ 286.0
Tax Credit	$ 71.5	$ 71.5
Revenue per $ of Credit	0.94	0.14
Revenue from Film Spending	$ 67.2	$ 10.01
Gain/(Loss) to the State	$ (4.3)	$ (61.49)

* Dollars in Millions

The two studies that have been conducted on the potential economic impacts of the film industry in New Mexico are examples of "dynamic analysis" and are discussed in great detail in the significant issues section below. This type of analysis attempts to capture the full economic consequences of state tax policies, taking into consideration all of the potential actions and reactions of economic actors in the state. The wide disparity in results of the two studies illustrates how complex this analysis can be and also the difficulty of coming to a consensus on the correct assumptions and methods to use. Notwithstanding all the work done on these studies, they did not address a number of the important factors affecting economic impacts. These include the question of how the state's spending policies are affected by the proposed use of tax revenue, and whether the new workers employed in the film industry are from New Mexico or from another state. Because of the difficulty of deriving results that are reliable and also the difficulty of reaching a consensus on this type of analysis, the LFC has decided not to include dynamic analysis in FIR's. Although it could be argued that this means the LFC FIR's are biased, the alternative would be to introduce uncertainty and questionable results into the FIR's that would make them less reliable and more inconsistent.

SIGNIFICANT ISSUES

Film-Production Tax Credit. The film production tax credit is a 25 percent refundable credit on most taxable expenditures made in the state. The credit is against either personal income tax or corporate income tax liability and any excess above liability is returned to the taxpayer. Most of the credit to date has been applied against corporate income tax liability.

Governor Gary Johnson in 2002 signed into law House Bill 118 from the 2002 session which created the 15 percent refundable film production tax credit. The credit was scored to cost $1.6 million annually according to the LFC fiscal impact report for HB118 in 2002. The credit was expanded in 2005 to include an additional 5 percent credit that was available through tax year 2008. At the time, TRD calculated the impact of the additional 5 percent credit at $250 thousand. In 2006, the credit was expanded to 20 percent and the additional 5 percent through 2008 and another credit, the filmmaker's tax credit, was repealed. TRD estimated that the cost would be $1.8 million annually. At the time the Film Office reported an economic multiplier of 4. In 2007, the credit was expanded again to 25 percent and made permanent. At that time the fiscal impact for the film credit program was estimated to be $33 million growing to $50 million by FY12. In FY09 the state paid out nearly $76.7 million in film production tax credits

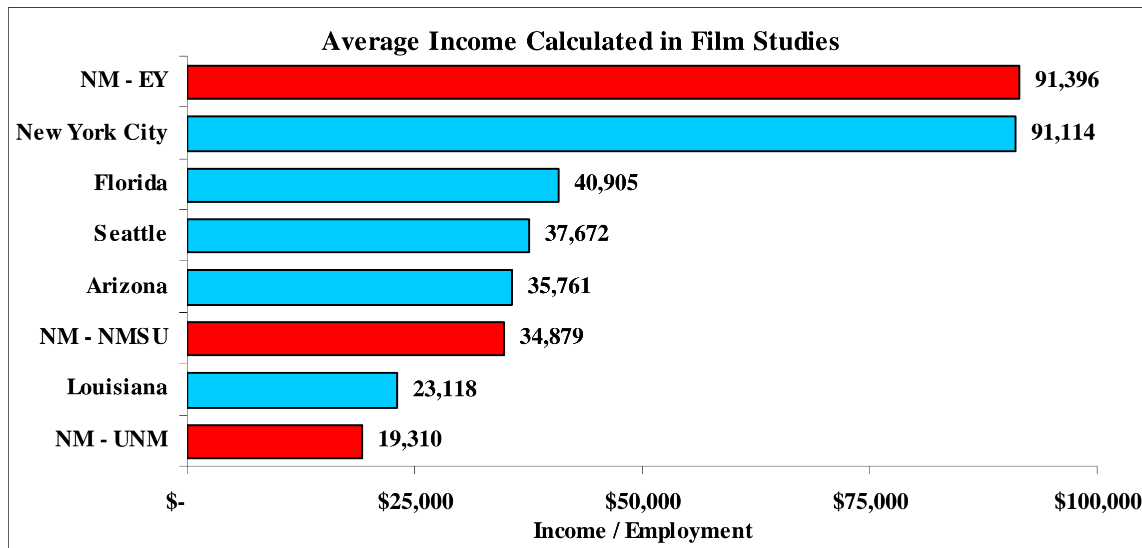
Film Studies. In 2008, after repeated requests for the Film Office to study the impact of the credit on state revenues, the LFC contracted with the Arrowhead Center at New Mexico State University to analyze the impacts of the film credit and the return on the investment to the state. NMSU-Arrowhead looked at the film activity that was eligible for the credit and determined that the additional economic activity from film production generated 14.4 cents for every dollar of

tax credit. The study was similar to other studies around the country in both methodology and results. NMSU has had significant experience estimating economic impacts of various industries in New Mexico.

In the fall of 2008, the New Mexico Film Office in conjunction with the SIC conducted a study of the film production tax credit program that included a survey of film industry participants and a survey by the Department of Tourism on film tourism impacts. This study, conducted by Ernst & Young in Washington, DC, showed only a slight negative return on the state's investment and including local governments a net positive return. According to the study, for each dollar of credit, the state received 94 cents back from the tax generated from additional economic activity and 56 cents went to the local governments.

Due to the significant differences between the Ernst and Young film study and a number of other studies performed throughout the country including the analysis done by the Arrowhead Center, the New England Public Policy Center (NEPPC) at the Federal Reserve Bank of Boston published an analysis of the various studies in April of 2009. The analysis questions various aspects of Ernst and Young studies performed in New Mexico and New York, including model calibration, lack of a balanced budget assumption, the amount of economic activity actually attributable to the film-credit, questionable wage and salary assumptions, and lack of detail surrounding the compilation of tourism impacts. The analysis states that "although some of the methodological choices made by the E&Y authors are legitimate, there are several problems with the studies that lead us to question the accuracy of their findings." The summary also states that "… some of the decisions of the E&Y authors—such as the failure to include a balanced budget requirement—cannot be easily justified."

Several other states and cities have studied the film industry's impact on the local economy. The Ernst and Young study shows a much greater impact than any other readily available study. The key differences between the Ernst and Young study and other studies, including the other studies done by NMSU-Arrowhead and UNM-BBER are the assumptions regarding average wages, and the inclusion of capital expenditures and tourism. It is hard to compare the latter two components of the Ernst and Young study (tourism and capital expenditures) with other studies. The tourism component adds one-third of the return on investment making it a crucial piece of the conclusion that the credit nearly pays for itself. The comparable components are the assumptions about compensation. The chart below shows the assumptions about direct film production activity for various studies. The Ernst and Young study has an average income equivalent to New York City which seems incongruous with other studies particularly ones done by the in-state research groups, BBER and Arrowhead.



Based upon both studies results and methodologies, LFC staff compiled their own analysis of the two studies in 2009. The results of the analysis showed that a number of differences in assumptions and time periods were to blame for the rather wide discrepancies between the two studies. However the LFC analysis came to the primary conclusion that while the Ernst and Young study undoubtedly overstates the financial return to the state, the Arrowhead Center study most likely understates the financial benefit to the state. The 2009 LFC analysis came to the conclusion that on a purely apples to apples comparison of the two studies the actual return to the state from the film production tax credit was roughly 25 cents for every dollar.

The most important conclusion that can be made as a result of all of the various analyses performed by the NEPPC at the Boston Fed, Ernst and Young, the Arrowhead Center, and LFC staff, is that the overall financial return to the state is negative. Even using the most positive of all the studies performed the state is still losing 6 cents for every dollar it pays out in film credits. Therefore in order to validate the continued use of the film production tax credit as an economic development tool, significant positive externalities, or non-financial benefits, must be proven to accompany the film industry in New Mexico. This represents a conscious policy decision that must be made regarding whether or not the positive externalities provided to the state by the film industry outweigh the financial loss.

OTHER SUBSTANTIVE ISSUES

Film production tax credits may be claimed on payments of “wages, fringe benefits or fees for talent, management or labor” to a New Mexico resident. Under the statute in question the current requirements of New Mexico residency are solely that an individual be a resident for purposes of the Income Tax Act. This type of residency can be obtained very easily, sometimes in as short a time period as one day, without an individual actually living for any substantial length of time in the State. The proposed legislation increases these residency criteria by requiring these individuals to have been a resident “for at least the previous six months.”

ALTERNATIVES

Various other states have recently enacted various changes to their film production tax credit statutes in order to maximize benefits to their respective economies including:

- Prioritizing productions in poverty areas. Illinois provides an additional 15 percent credit for labor expenditures by the employment of residents in geographic areas with high unemployment and poverty. Texas provides an additional 2.5 percent for filming in underused or economically distressed areas. New Mexico could roll back the credit to 20 percent but provide a 5 percent incentive for productions in poverty areas, census tracts with high poverty, etc.

- Providing an incentive to a production that provides a "brand" or "image" to New Mexico. To someone outside the state, it may be difficult to know which movies were filmed in New Mexico. The tie to tourism would be improved. People visit Hollywood, because that has become a "brand" or 'image'. Georgia provides an additional 10% tax credit when productions place the Georgia logo (Georgia Peach) on movie trailers, posters, and credits of the film.

- Requiring a minimum percentage of the production occur in the state. Massachusetts and Maryland require that at east 50 percent of the production's filming must occur in the state in order to be eligible for the credit, Pennsylvania requires 60 percent, while Puerto Rico requires 50 percent of the principal photography OR if less than 50 percent, the production must spend at least one million dollars ($1M) in payment to Puerto Rico residents, Wisconsin requires 35 percent.

- Requiring productions to be "headquartered" in the state. Tennessee provides a rebate of 17 percent, however, if the production is headquartered in the state then an additional 15 percent is allowed, bringing the total credit to 32 percent.

- Capping the amount per production or a cap on the amount the state pays out annually. A cap per production may allow more productions to occur in the state, thereby employing more crew year round instead of blowing the whole annual cap on just a handful of productions.

- Prioritizing digital media, pre- and post production, and sound production. Build the industry vertically instead of just horizontally. Provide an additional incentive for local musicians, symphonies, etc.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Leaving the program in place without a cap will result in the General Fund paying out an estimated $36.1 million in additional tax credits over the next 2 fiscal years.

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