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FISCAL IMPACT REPORT

SPONSOR White **ORIGINAL DATE** 02/22/11 **LAST UPDATED** **HB** 479

SHORT TITLE Reduce Film Production Tax Credit **SB**

ANALYST Golebiewski

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	$6,750.0	$21, 450.0	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to HB 19, SB 169 and SB 568.

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

House Bill 479 reduces the film production tax credit from 25 percent of qualifying expenditures to 15 percent. It also reduces the film production tax credit for films receiving the federal new markets tax credit from 20 percent to 10 percent.

Effective January 1, 2012.

FISCAL IMPLICATIONS

The Consensus Revenue Estimating Group of the state estimates the film production tax credit to be $65 million in FY11 and then to grow at a rate of 5% per year. By reducing the film production from 25 percent to 15 percent, the state would save $9 million in FY12, $28.6 million in FY13, $30.0 million in FY14 and so on. There are estimated feedback effects of the film production credit, however, and assuming that the state receives 25 cents in other revenue for every $1 of the film production credit (see dynamic analysis section below for more details on the 25 cent estimate), that shrinks the gain to $6.75 million in FY12, $21.5 million in FY13, and

so on.

Dynamic Analysis.

Two independent studies were performed in the past few years on the net benefits of the film production credit. The most favorable estimate of the net benefits of the film production tax credit program was produced in the Ernst and Young analysis, though even this estimate indicates the film credit is a net cost to the state. The Arrowhead Center's estimate of the effects of the film credit indicates more substantial net costs to the state.

Table 4. General Fund Impacts Using Film Office Credit 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

Table 5. General Fund Impacts Using Consensus Revenue Group Credit 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)

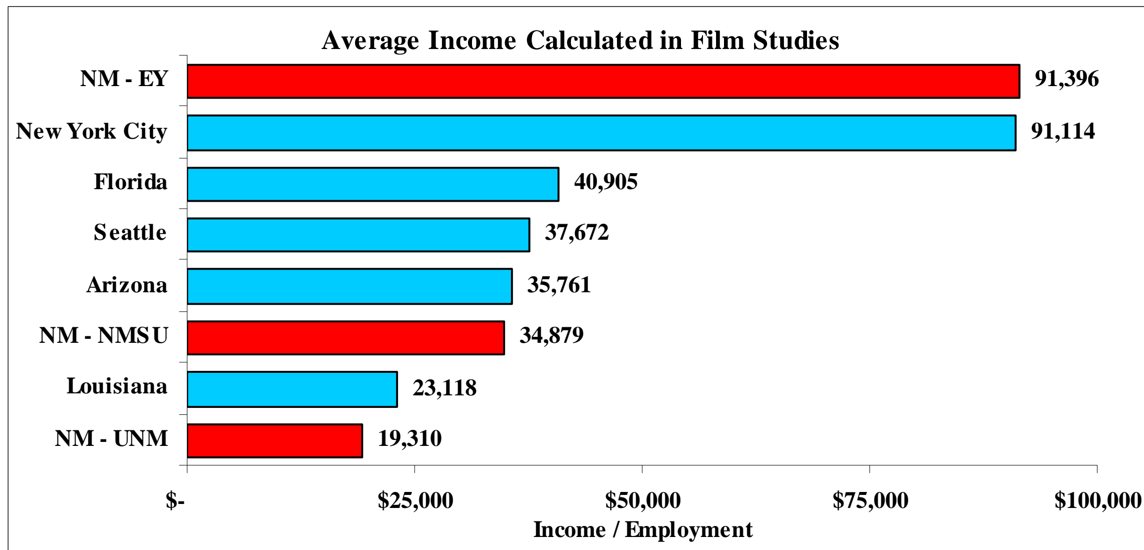
* Dollars in Millions

The two studies on the economic impacts of the New Mexico film industry are dynamic analyses, which consider both the costs and benefits to the state of the film credit. That is, they attempt to capture the consequences of this state tax policy, taking into consideration all of the potential actions and reactions of the state's economic players. The wide disparity between the two studies' results illustrates the complexity of the analysis and the dependence of the results on the choice of assumptions and methods of analysis. In addition, some important questions were not examined by the studies: 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.

Due to the significant differences between the Ernst and Young film study and other studies performed throughout the country (including the analysis done by the Arrowhead Center), the New England Public Policy Center at the Federal Reserve Bank of Boston published an analysis of the various studies in April of 2009. The review identifies potential issues with the Ernst and Young studies in New Mexico and New York, including model calibration, lack of a balanced budget assumption, and amount of economic activity attributable to the film-credit, questionable wage and salary assumptions, and lack of detail in tourism impacts.

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 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. 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 is inconsistent with other studies.



LFC staff compiled their own analysis of the two studies in 2009. The results of the analysis showed that differences in assumptions and time periods explained the rather wide discrepancies between the two studies. However, the LFC analysis came to the primary conclusion that while the Ernst and Young study overstates the financial return to the state, the Arrowhead Center study most likely understates the financial benefit to the state. The 2009 LFC analysis estimated the benefits to the state of the film production credit at approximately 25 cents on the dollar.

SIGNIFICANT ISSUES

TRD:

> The film production tax credit is the most generous economic development incentive offered by the state. The credit amounts to 25 percent of most expenditure undertaken by film production companies operating in the state. This amount is not a return of taxes due, but rather a rebate based on expenditures. Proponents of the tax credit cite the increased level of economic activity in the state associated with the credit. However, most studies of the issue have concluded that the return of state dollars associated with the credits is significantly less than credits paid out, even when "multiplier" effects are taken into account. Although proponents have argued that there are benefits to the state's economy beyond state revenues, those benefits accrue to private individuals. Since the state is not in a position to subsidize all businesses, this appears to violate the equity principle of good tax policy which argues that different businesses should be treated in a similar manner. Although the state has provided other tax relief to other targeted populations, the rate of subsidy has generally been lower and the time frame for which a subsidy is offered has been shorter

EDD:

According to the Film Office of the Economic Development Department, film production companies would not film in New Mexico with a film production tax credit of 15 percent of qualifying expenditure. They estimate that New Mexico would lose 2 thousand direct jobs in the film industry and potentially thousands of jobs indirectly. They note that between 10 thousand and 14 thousand students are currently enrolled in film programs in New Mexico, and they would have to leave the state to find jobs in the film industry. The Film Office also mentions the loss of income to New Mexico businesses that provide services to the film industry.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 19, SB 169 and SB 568 have to do with containing the costs of the film production tax credit.

TECHNICAL ISSUES

TRD:

It is not clear if the new rate will be effected based on date of expenditure or credit claims/approvals. The Department would need transition rules for those taxpayers that have not yet applied for the credit but are already in production.

OTHER SUBSTANTIVE ISSUES

TRD:

New Mexico's current 25 percent credit rate is one of the highest in the western region. If lowered to 15 percent, the rate will still be higher than that of several states. Several states have either reduced or eliminated their film production incentives in response to budget pressures.

State:	**Credit Rate:**	**Notes:**
Oklahoma	35% - 37%	$5 million cap
New Mexico	**25%**	
California	20%	
Washington	20%	
Idaho	20%	Contingent on funding
Utah	20%	$1 million minimum spend required
Oregon	10%/20%	10% on payroll, 20% on purchases
New Mexico	**15%**	
Wyoming	12% - 15%	
Texas	5% - 15%	
Colorado	10%	Below the line costs only
Montana	9%	
Nevada	0%	
Arizona	0%	Repealed program last year

It should also be noted that even in the tough economic environment of today, some states, like New York and New Jersey, are proposing to increase their film incentives.

ALTERNATIVES

- 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 least 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, bring 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.

JAG/mew

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

1. ***Adequacy:*** *revenue should be adequate to fund government services.*
2. ***Efficiency:*** *tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
3. ***Equity****: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.*
4. ***Simplicity****: taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
5. ***Accountability/Transparency:*** *Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc