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

		ORIGINAL DATE	02/26/11		CS/607&622/aSFC/
SPONSOR	HTRC	**LAST UPDATED**	03/14/11	**HB**	aSFL#1
SHORT TITLE	Film Cap, Restrictions and Actor Withholding			**SB**	
				ANALYST	Golebiewski

REVENUE (dollars in thousands)

Estimated Revenue				Recurring or Non-Rec	Fund Affected
Provisions	FY11	FY12	FY13		
Cap and Distribution Changes		$23,300.0*	$22,000.0*	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)
*See Fiscal Implications

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		*	*		Recurring	Taxation and Revenue Department

(Parenthesis ( ) Indicate Expenditure Decreases)
*See Administrative Implications

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of Senate Floor Amendment

The Senate Floor Amendment to House Bills 607 and 622 reinstates the provision of the HTRC substitute that would make delayed refunds on the film production tax credits ineligible for interest payments by the state. It also adds a provision, similar to the HTRC substitute, which provides for a tiered schedule of payments based on the size of the film tax credit. For credits under $2 million, the credit is paid immediately upon authorization. For credits between $2 million and $5 million, one half of the payment is paid immediately upon authorization and the other half is paid twelve months following that date. For credits over $5 million, the refund will be paid in three equal payments; one is paid immediately upon authorization, one is paid the year following, and the last is paid two years following.

The SFL amendment clarifies that the amount of refunds carried forward to following fiscal years is applied towards the $50 million limit for the fiscal year. The credit claim must be filed timely on a complete tax return, and the secretary of TRD may require credit claims of affiliated persons to be combined into one claim. This addresses the concern that the claims may be divided up to get the refunds earlier (based on the tiered schedule described above).

To address concerns regarding taxpayer uncertainty about the $50 million aggregate limit, the SFL amendment requires TRD to post monthly on the department's website the aggregate amount of credits claimed and processed for the fiscal year.

Fiscal Implications of SFL Amendment

The SFL amendment has fiscal implications based on the provision to tier refunds on credits greater than $2 million. The amendment provides additional positive impacts in FY12 resulting from the delay of some credit refunds. For FY13 and later, estimates indicate the refunds will hit the $50 million cap; the fiscal impacts for these years are equal to the Consensus Revenue Estimating Group's estimates minus the aggregate limit of $50 million, plus $300 thousand resulting from the provisions that require withholding on actor's salaries and limits on certain types of expenditures.

Synopsis of SFC Amendment

The Senate Finance Committee amendment to the Committee Substitute for House Bills 607 and 622 sets $50 million as the aggregate amount of film credit claims that may be authorized for payment in a fiscal year. It also removes provisions of the HTRC substitute that would delay refunds on credits over $1 million. All credit claims authorized for payment in a fiscal year that fall below the aggregate cap of $50 million will be refunded in that year. Other technical adjustments (some shown below under Technical Issues) were made in the SFC amendment to close potential loopholes and to make the definition of a New Mexico resident consistent with the Income Tax Act.

Fiscal Implications of SFC Amendment

The SFC amendment increases the aggregate film credit cap to $50 million and removes the refund carry-forward schedule. This translates to lower fiscal impact estimates; the estimates reflect the Consensus Revenue Group's estimates of the film credit minus the $50 million cap. For the limits on certain types of expenditures and the newly required withholding, the estimates include an additional $300 thousand.

The amendment also carries operating budget impact on the Taxation and Revenue Department but to a lesser extent than the HTRC substitute because of the removal of the refund carryforward.

Synopsis of Substitute Bill

The House Taxation and Revenue Committee Substitute for House Bills 607 and 622 (hereafter referred to as House Bill 607) adds a number of provisions to the film production tax credit. First, House Bill 607 would place a limit of $45 million on the aggregate amount of film tax credits that can be approved by TRD in a fiscal year. It also changes the timing of the payments based on the size of the credit: under $1 million is paid in full during the taxable year in which the refund amount is determined; $1 million to $5 million is divided into two equal allocations – one to be paid in the current year and the other in the taxable year immediately following; over $5 million is divided into three equal allocations – one to be paid in the current year, one in the immediately succeeding year, and one in the year after that. Also, any credit that exceeds $5 million is required to be audited by a certified public accountant licensed in NM.

HB 607 also requires film production companies to submit detailed information on each production and postproduction expenditure to the NM film division of EDD. It adds the businesses representing actors and actresses to the definition of pass-through entity, which translates to the required withholding of an amount equal to the owner's share of net income multiples by the highest Personal Income Tax rate for single individuals.

HB607 limits expenses per vehicle and hotel and excludes funds spent gifts, artwork, jewelry, entertainment, amusement or recreation from eligible expenditures.

FISCAL IMPLICATIONS

The fiscal impact estimates above reflect a variety of modifications prescribed in HB 607. They are dependent on the Consensus Revenue Estimating Group's assumptions about the size of the credit in the current and future years (estimate is $65 million in FY11 and expected to grow at a rate of 5% a year).

The impact is a function of both the cap and the change in distribution based on the size of the credit. The impacts in FY12 reflect the fact that the state will pay less than 100 percent of the credits estimated by the Consensus Revenue Estimating Group, and this amount will also be less than the cap of $45 million. As of FY13, the estimates indicate the state will hit the cap of $45 million and the fiscal impact will be the difference between the credit estimate and $45 million. It should be noted that although some credit payments are pushed into the future, the cap will limit the amount that the state will have to pay in future years for credits accrued today, such that if the film production credit grows at 5 percent per year, the impact of the bill will be positive to the general fund from FY12 on.
The fiscal impacts of this legislation are sensitive to the assumed level of activity, $65 million in FY11 growing 5 percent per year (see first paragraph of this section). Film production activity levels have been very volatile in the recent past. If, for example, the credit claims are significantly higher than those estimated, the increased revenue could be as low as $23.3 million in FY12 (FY12 estimate of $68.25 million minus the cap of $45 million). Film industry representatives assert that production crew capacity constraints may limit much higher activity levels, though.

With regard to the restrictions on vehicle and hotel spending, expenditures on gifts and other luxury goods, and withholding on the film's actors, the fiscal impact estimates are indeterminate. The lack of data on current types of expenditures and the Personal Income Tax liabilities of the film's actors make this estimate highly uncertain.

The estimates reflect an expectation of composition change amongst the types of films that will locate in New Mexico. Smaller films will be more prevalent than large films because of the distribution change proposed in HB 607 and the proposed aggregate approvals of $45 million.

Though, HB 607 introduces a substantial amount of complexity into the administration of the film production tax credit, and it is highly uncertain how film production companies will react.

SIGNIFICANT ISSUES

The film production tax credit has increased substantially from when the credit was first offered. Estimates of the credit were on the order of $1 million for FY03 and in FY10, more than $65 million of tax credits were provided to the film industry. Creating a cap for the film production credit provides legislative control over the aggregate size of the credit, in comparison to the current state in which the film production companies control the aggregate size of the credit. Without a cap, if the credit continues growing even at a 5 percent per year pace, it will hit $100 million by the end of the current decade. However, it should be noted that the Economic Development Department estimates the aggregate amount to be $55 million in FY11 and $57 million in FY12, which are both less than the cap imposed by HB 607.

The timing of the distribution as proposed in HB 607 is also likely to have an effect on the attractiveness of the film production tax credit. The effect of this provision will be dependent on the discount rate of the film companies (that is, they may value dollars in the future less than dollars today), and on the size of the "queue" that is formed when the cap is hit in a taxable year.

The audits of companies that claim more than $5 million in film production credits will ensure compliance with the requirements of the credit proactively, and would limit the misuse of the credit. Other provisions of HB 607 limit the expenditures on luxury items so that the state is not subsidizing frivolous expenditures.

Finally, the classification of a "personal services business", which is understood to be an actor or actress's agent, as a "pass-through entity" would require the company to withhold on income paid to the actor or actress. This would make the individual assume the burden of proof that he or she did not owe tax, as opposed to the alternative in which income is not withheld and TRD has to prove that the individual owed the tax.

ADMINISTRATIVE IMPLICATIONS

HB 607 adds substantial complexity to the administration of the film production tax credit and is likely to produce an additional operating budget impact, perhaps on the order of $80 thousand, or 1 FTE for TRD.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This bill relates to HB 19, SB 169, SB 568, HB 632 and others relating to the film production tax credit.

TECHNICAL ISSUES

Section I should also clarify how the credits are to be applied to tax liability, and whether the cap applies to these credits. Section I, Subsections 1–3 make explicit reference to refunds, but do not address how the credit should be handled with regard to the use of the credit against any Personal Income and Corporate Income Tax liability.

Because a taxpayer can receive refunds sooner if they report a smaller amount claimed, there is a concern about the potential to split one big claim down into two or more small claims. Thus, language is needed to insure that, for purposes of section 1(E), all refund claims associated with a particular film production project are to be combined.

It would be helpful to add a brief statement to the overall cap to clarify that it includes credits from the current year and any carried forward credits.

ALTERNATIVES

This section, similar to FIRs on other film bills such as HB 19, reports information on statutes and legislation in other states that relates to incentives for film production.

Various other states have recently enacted 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, 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.

- Other states have recently increased their film production incentives. Utah recently instituted a similar film production credit as current New Mexico incentives: 25 percent of expenditures. In the last year, Louisiana increased their film credit to 30 percent of expenditures.

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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