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FISCAL IMPACT REPORT

ORIGINAL DATE 01/25/11

SPONSOR Keller LAST UPDATED 02/22/11 HB _____

SHORT TITLE Film Production Tax Credit Tracking and Review SB 44/aSCORC/aSFC/aSFI

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	\$200.0	\$200.0	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

LFC estimates, based on discussions with the film division, that payments to performing artists in FY10 were on the order of \$22 million and virtually 100% of that amount would have qualified for the credit. Of the \$22 million in performing artist payments, approximately 80% is paid to non-residents. Imposing withholding at the 4.9 percent rate on this 80% of \$22 million would generate \$900 thousand per year. TRD estimates that the new withholding requirements would likely improve compliance with the income tax owed by performing artists but the revenue gain is uncertain. Estimates in the table reflect the assumption that one-fifth of the amount owed is not currently being paid.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		\$30.0	\$30.0		Recurring	General Fund

(Parenthesis () Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Economic Development Department (EDD)

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of the Senate Floor Amendment

The Senate floor amendment further expands on the “physical presence” test and requires that at least one of the laborers employed by the vendor be a New Mexico resident.

The Film Division estimates that the “physical presence” test alone will restrict film production services brokers’ activities in favor of true resident vendors. Because of the difficulty of verifying physical presence, TRD does not believe that this feature will generate additional economic benefit or change the amount of film production credit. Since the “physical presence” test is itself difficult to verify, it is additionally difficult to verify the New Mexico resident declaration of as few as one employee of the target broker.

Synopsis of SJC Amendment

The Senate Judiciary Committee amendment to Senate Bill 44 as amended eliminates periodic legislative review of the effectiveness of the film production credit as provided in the original bill.

Synopsis of SCORC Amendment

The Senate Corporations and Transportation Committee amendment to Senate Bill 44 imposes the duty of withholding personal income tax on the film production company, not on the personal service corporations. The amendment also modifies the “physical presence” test from one requiring individual determinations by the film division to a uniform standard that requires more than a mail drop or accommodation address.

Synopsis of Original Bill

Senate Bill 44 formalizes the tracking requirements and generally tightens the Film Production Tax Credit. In summary, SB44:

- (1) Provides tracking requirements for the Film Production Tax Credit. Applicants would be required to report to the film division their total wages paid to New Mexico residents, gross receipts taxes paid, the number of New Mexico residents employed, total spending that was not eligible for the credit and total payments to non-residents;
- (2) ~~Provides for review of the Film Production Tax Credit and data collection concerning all aspects of the credit by EDD [eliminated by SJC amendment];~~
- (3) Requires film production companies to submit their application/claim within one year, which allows for the Legislature to budget accordingly;
- (4) Requires mandatory income tax withholding on nonresident actors. Payments to ~~personal service corporations (PSCs)~~ for services of a performing artist would be eligible for credit only if the ~~PSC~~ [film production company] withholds New Mexico income tax at the maximum rate of tax (4.9%);
- (5) Replaces ineffective newspaper ad requirement with posting on Film Division’s website;
- (6) Requires qualifying vendors to have a physical brick-and-mortar presence in the state, thus disallowing out-of-state companies that are merely brokering;
- (7) Clarifies that bonding can be purchased through a New Mexico based insurance agent *or* broker or bonding agent. A film completion bond is a highly specific type of bond and usually obtained through bond companies, not insurance agents;
- (8) Adds “related digital content” to the list of qualifying expenditures. Most of the language in the existing statute, written nine years ago, does not address new types of digital content used during live-action filming.
- (9) Anticipates that EDD will develop and maintain a competent econometric model that “objectively assesses the effectiveness of the film production tax credit.”

The Reporting and Accountability section requires that the Economic Development Department (EDD) shall collect and track specific statistical information for purposes of reviewing and assessing the effectiveness of the Film Production Tax Credit, with support and assistance from the Legislative Finance Committee (LFC) staff and the Taxation and Revenue Department (TRD).

EDD shall create a report for presentation to the Revenue Stabilization and Tax Policy Committee (RSTP) and the LFC that provides an objective assessment and shall report annually to the RSTP and the LFC on aggregate approved tax credits.

~~The RSTP shall review the Film Production Tax Credit for its effectiveness at four-year intervals, beginning in calendar year 2012-[SJC amend].~~

FISCAL IMPLICATIONS

Mandatory income tax withholding on actors may generate a positive fiscal impact. The [film production company] ~~personal services corporation~~ would be required to withhold *upfront* and remit to the State of New Mexico income tax at the highest rate on salaries of nonresident actors. This would eliminate the state's risk of having to take legal action against an actor should they fail to file and pay. In addition, since the income tax would be withheld at the highest rate, the burden would be on the actors themselves to file a New Mexico tax return in order to claim deductions against their tax liability. While the impact may be highly variable depending on the specific actors hired for particular films, discussions with EDD indicate that total salaries paid for 2010 activity might have been in the range \$22 million, virtually all of which would qualify for the Film Production Credit despite the limit of \$20 million per film for performing artists. Per film division testimony, principals (headliners) divide remuneration from participation in a film to a "shooting fee" and "backend" participation. The state has nexus to tax the "shooting fee," but does not have nexus to tax the backend participation or residuals. Of the \$22 million in performing artist payments, approximately 80% is paid to non-residents. Imposing withholding at the 4.9 percent rate on this 80% of \$22 million would generate \$900 thousand per year. TRD estimates that the new withholding requirements would likely improve compliance with the income tax owed by performing artists but the revenue gain is uncertain. Estimates in the table reflect the assumption that one-fifth of the amount owed is not currently being paid. (Note: each film is limited to \$5 million in Film Production Credit for all on-screen talent. This represents \$20 million in salaries.)

The requirement of a physical brick-and-mortar presence would have a possible positive fiscal impact since it would increase the use of New Mexico businesses, resulting in additional revenue and additional taxes to the state by way of Gross Receipts Taxes (GRT), personal income taxes, and in some cases, corporate taxes. In addition, the amount of the tax credit would be reduced should the film production company choose to hire an out-of-state vendor ("broker"), which would no longer qualify.

TRD estimates that based on recent experience with Film Production credit claims, EDD/Film Commission, LFC and TRD would require .5 FTE to perform the review required. This is shown as 30.0 in the Operating Budget table.

SIGNIFICANT ISSUES

SB44 formalizes reporting and tracking requirements, allowing for greater transparency and the collection of accurate data that can be used in assessing the effectiveness of the Film Production Tax Credit.

Additionally, the requirement of a physical brick-and-mortar presence supports legitimate New Mexico vendors who have made significant capital expenditures and contribute to our tax base – and was the original intent of the law.

Industry experts have indicated that decreasing or eliminating the credit would virtually destroy the entire fledgling industry in the state. While this would save the General Fund approximately \$65 million in credit costs, it would simultaneously eliminate the taxes and other economic impact of more than \$200 million in expenditures on film production.

ADMINISTRATIVE IMPLICATIONS

The Film Division currently receives and documents most of the statistical data that would be required in the Reporting and Accountability section of this bill; however, reviewing and assessing the effectiveness of the Film Production Tax Credit would require a significant amount of additional administrative support from the Film Division.

Requiring film productions to submit their application/claim within one (1) year would require a minimal amount of additional administrative support from the Film Division, which would include documentation of final expenditure, follow-up with film companies, and assurance that they are in compliance with the deadline.

Requiring mandatory withholding on actors would require a minimal amount of additional administrative support from TRD to ensure that the PIT was held and remitted upfront to the state.

The Film Division, along with TRD, would be jointly responsible for ensuring compliance in the requirement of a physical brick-and-mortar presence. This may require physical visits to vendors.

TRD reports that the term “Physical presence” as applied to the determination of eligibility of vendor payments for credit poses administrative problems. Despite the definition in the bill, determining whether a vendor has a bona-fide physical presence will be difficult for the credit applicants and for the Department to verify. An alternative that might achieve most of the compliance enhancement would be to require that a credit claimant provide the CRS ID number of any vendor on whose payments the credit is being claimed. This would significantly improve the information available to insure compliance.

TECHNICAL ISSUES

TRD reports that the proposal creates a new form of withholding tax for personal services corporations receiving payments on behalf of performing artists. To insure that these payments are processed and credited properly, it would be preferable if they were added to the withholding tax act (Section 7-3 NMSA 1978). See TRD’s discussion under “Alternatives” below.

TRD also requests clarification of another issue: “On page 8, line 4, “Digital content” should be defined. The Department can do this through regulation, but would prefer to adopt a statutory

definition.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB19 proposes a complete repeal of the Film Production Credit. Clearly, if HB19 is enacted, the administrative provisions of HB54 would become moot.

Relates to Senate Bill 169, which provides a per-film limit of \$2 million in production credits and \$2 million credit for in-state post-production expenses.

ALTERNATIVES

TRD discusses an alternative:

The proposal to require income tax withholding by personal service corporations on performing artist payments is similar to HB-211 of the 2008 session. That proposal would have required that eligible payments be made to a “film performing artist entity” (rather than to a “personal services corporation”) and the film performing artist entity would be required to deduct and remit income tax on the payment (rather than requiring that the film performing artist receiving the payment pay New Mexico income tax). HB-211 also amended the Withholding Tax Act by adding a definition of “film performing artist entity.” HB-211 also added a new exemption to the Gross Receipts and Compensating Tax Act for the receipts of a film performing artist entity from another film performing artist entity for services of a performing artist.

In its FIR on HB-211 from 2008, the Department noted the following:

There are two problems in the current Film Production Tax Credit statute that HB-211 would correct. First, typical film industry practice is for the production company to create a “super loan out”, which is an entity that receives all payments for the services of performing artists and then makes payments to the artists directly or to the artists’ PSCs. Thus, the current statute does not reflect the institutional arrangements typical in the film industry. Secondly, the requirement that the performing artist pay New Mexico income tax in order for the production company’s payment for the services of the artist to qualify for the credit makes the production company’s credit contingent on the actions of the performing artist (filing and paying of New Mexico income tax) after the relationship between the production company and the artist has ended. Thus, a production company could have credit amounts previously claimed and allowed reduced because an artist failed to pay New Mexico income tax.

HB 211 addresses these two problems in the current statute by providing the means to flexibly handle various institutional arrangements in the film industry and by requiring income tax withholding on the first payment for the services of a performing artist. Under the statute as amended by HB 211, payments by a production company to its “super loan out” will be subject to gross receipts tax, and payments by the super loan out for the services of a film performing artist will be subject to income tax withholding at the highest rate applicable to single filers (which currently is 4.9%). Through the pass-through entity income tax withholding and reporting rules, the withheld income tax will be credited and reported to the recipients (normally the artists’ PSCs) of payments from the super loan out for the services of performing artists. If the recipient entity pays the performing artist directly, the artist may claim the withholding against his or her New Mexico income tax liability. If there are intervening entities besides the PSC between the super loan out and the performing artist,

each will be subject to the pass-through entity rules for withholding on payments (with a credit for any prior withholding on the payment) and reporting to recipient entities. Because there may be more than one entity between the “super loan out” and the performing artist, a gross receipts exemption for payments between “film performing artist entities” is required to avoid multiple layers (pyramiding) of gross receipts tax on the payments.

The amendments made by HB-211 will help insure that the full amount of both gross receipts and income tax (through withholding) are paid on a timely basis to the Department. Since both taxes will be typically be paid by the “super loan out” created by the production company, there will be many fewer taxpayers for the Department to deal with on each film. The amendments will also provide more certainty to film production companies because their credits will no longer be contingent on the subsequent actions of performing artists.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

EDD/Film Commission reports the following consequences:

- 1) Continuing to allow out-of-state “brokers” to qualify not only results in a larger tax credit, but also discourages the use of legitimate New Mexico vendors who could possibly contribute more to the state’s tax base via GRT, personal income taxes, and in some instances, corporate taxes;
- 2) The state would remain vulnerable without mandatory withholding on nonresident actors;
- 3) The Legislature cannot budget properly without issuing a time limit for films to submit their application/claim.

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