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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** 02/23/11 **LAST UPDATED** **HB**

**SHORT TITLE** Film Production Tax Credit Cap **SB** 169

**ANALYST** Golebiewski

## REVENUE (dollars in thousands)

| Estimated Revenue | | | Recurring or Non-Rec | Fund Affected |
|---|---|---|---|---|
| FY11 | FY12 | FY13 | | |
| | $17,400.0 | $24,000.0 | Recurring | General Fund |

(Parenthesis ( ) Indicate Revenue Decreases)

**Relates to** SB 44, SB 169, SJM 15, HB 19

**SOURCES OF INFORMATION**
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

**SUMMARY**

Senate Bill 169 establishes a cap of 2 million dollars on the film production tax credit for direct production expenditures and 2 million dollars for postproduction expenditures. This cap applies to expenditures made on or after July 1, 2011. Senate Bill 169 also requires that "direct production expenditure" be to a person who has been a New Mexico resident for at least the previous 6 months.

**FISCAL IMPLICATIONS**

TRD:

> Percentage of film credits amount that were approved over the two million dollars cap proposed in this bill was calculated using historical film approval data. The future credits were reduced by that percentage to estimate the fiscal impact. Assuming an average 3-month lag between the date of expenditure and the credit paid, the first year fiscal impact is reduced by about 25%.

The cap could affect the decision of film production companies to locate in New Mexico and may therefore affect other general fund revenues, but the effect of the cap is not straightforward.

It is likely to affect film producers differently based on the size of productions and of related expenditures. Consistent with other bills proposing film production tax credit modifications, the estimates were adjusted to reflect feedback effects of 25 cents on each dollar of the film credit (see dynamic analysis below). However, under SB 169, it may be larger since those with the largest expenditures are those less likely to locate in New Mexico.

**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:**

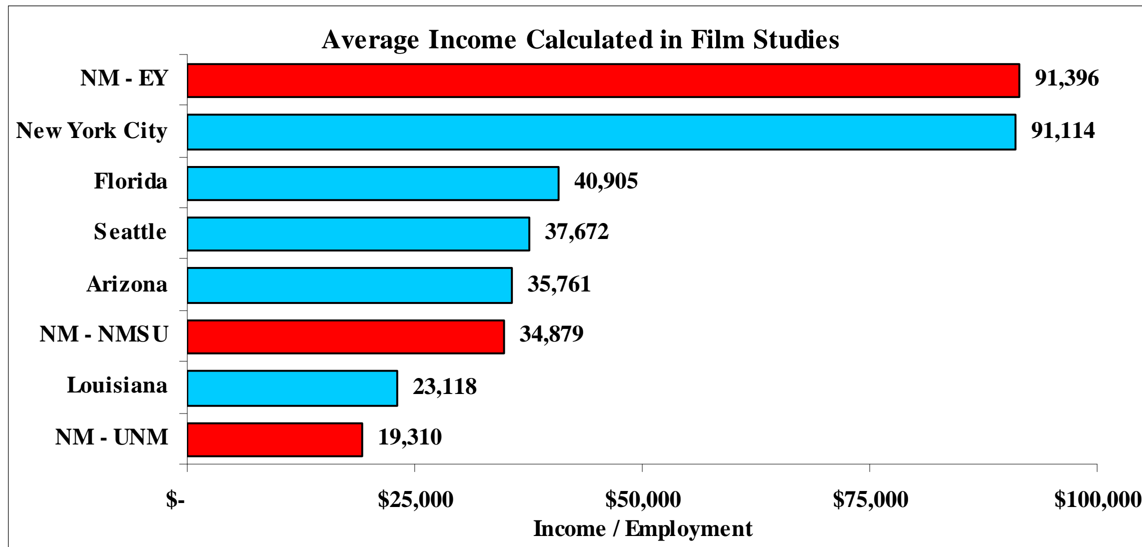
| | Ernst & Young | Arrowhead Center |
|---|---|---|
| **Direct Film Spending** | $ 286.0 | $ 286.0 |
| **Tax Credit** | $ 71.5 | $ 71.5 |
| **Revenue per $ of Credit** | 0.94 | 0.14 |
| **Revenue from Film Spending** | $ 67.2 | $ 10.01 |
| **Gain/(Loss) to the State** | $ (4.3) | $ (61.49) |

* 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, 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.

## TECHNICAL ISSUES

TRD:

There is no effective date which makes it effective June 17, 2011, creating a window before July 1, 2011 where there is no cap in effect.

## ADMINISTRATIVE IMPLICATIONS

TRD:

This bill would require additional audit work for those productions that begin prior to July 1, 2011 and go beyond the July 1, 2011 inception date. The auditor will not only have to verify vendors but also transaction dates and separate the transactions made before the cap and those made after the cap. In addition, it is difficult to determine when a person has established residency for the purpose of the six-month requirement.

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