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

SPONSOR Gonzales/Martinez/ Egolf **ORIGINAL DATE** 2/22/19 **LAST UPDATED** 3/08/19 **HB** 527/aHCEDC/aHAFC

SHORT TITLE Payment Of All Approved Film Tax Credits **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
($100,000.0)	($95,000.0)	$0	$0	$0	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

*The general fund impacts shown are the costs after paying the $50 million required under the cap.

Relates to or conflicts with HB594, HB654, SB2, SB451, SB151

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of HAFC Amendment

The House Appropriations and Finance Committee Amendment changes the bill from paying all approved film credits to paying credits up to an additional $100 million above the cap for FY19 and up to an additional $95 million above the cap for FY20. Additionally, if the August 2019 revenue forecast shows FY19 revenues exceeded the February 2019 forecast by at least $30 million, then the $95 million maximum additional payment in FY20 is increased by $30 million to $125 million.

The contingent $30 million additional payment requires $30 million or more in excess revenues, so the table does not score this impact.

Synopsis of HCEDC Amendment

The House Commerce & Economic Development Committee Amendment strikes language in the section heading for repayment of approved film credits, removing the words “at a discount”. The actual provision does not allow for paying credits at a discount, so this is clean-up.

Synopsis of Original Bill

House Bill 527 amends the Film Production Tax Credit Act to create a temporary provision that would remove the $50 million film credit cap for claims approved prior to and in FY19 and once again in FY20, eliminating the backlog for those years. After FY20, the bill would have no effect, reverting to existing statute.

FISCAL IMPLICATIONS

The updated estimate from EDD, working in conjunction with the Taxation and Revenue Department (TRD), for the backlog in total accrued liabilities in FY19 that is or could be filed, processed, and paid within the fiscal year is about $124 million after paying out the required $50 million under the cap. The estimate for FY20 is an additional $157 million, for a combined backlog of $281 million after paying out the total of $100 million under the cap for those two years[1].

The table below shows film credit applications approved by TRD by fiscal year. It is important to note this does not represent payouts within a fiscal year, because of the cap and tiered payment system, and it does not represent estimated liability to the state within the fiscal year because of processing delays at TRD that can result in applications filed in one fiscal year and then reviewed and approved in the next. For example, TRD reported at the end of FY18, total estimated cumulative state liabilities were $179.4 million, including about $80 million in applications that were filed during FY18 but not yet processed.

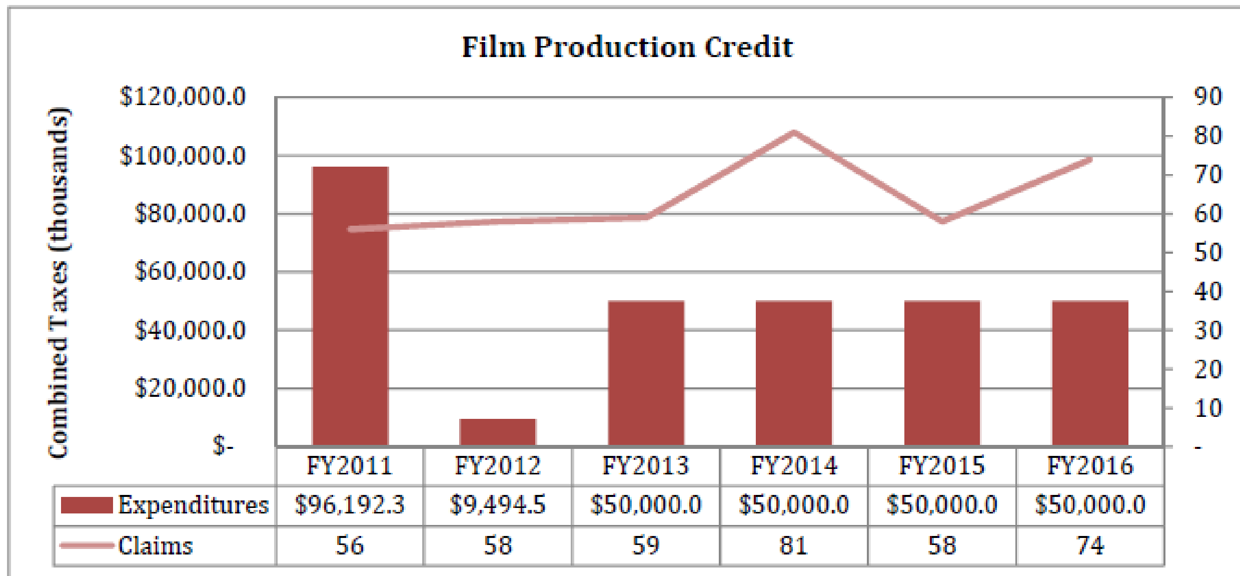
FY12	FY13	FY14	FY15	FY16	FY17	FY18
$ 19,157.23	$ 60,834.81	$ 41,571.67	$ 62,529.77	$ 38,519.35	$ 90,417.61	$ 104,342.17

The TRD approved application data is helpful for historical context, but it is difficult to estimate future liabilities from this data due to delays from the time a film production wraps to the application filing (up to 12 months) and from the time TRD receives an application to approval (often six months or more). It is unknown how many approved applications were filed in a particular year, and the lag would not show recent industry trends.

To verify the estimated impacts, LFC staff used TRD data on credit applications received (and booked as accrued liabilities) through the end of FY18. Since only partial data is available for FY19 from TRD, and obviously none for future fiscal years, LFC staff relied on data from EDD on industry activity and estimated historical averages of delays between the start of production to end of production, to application filing at TRD, to application processing and approval at TRD. The LFC estimates differed somewhat from the EDD and TRD estimates but were within a similar range.

The table below shows the annual film credit claims. While this is helpful to show the surge to more than $90 million in credits in FY11, the last year before the cap went into effect, and the drop in FY12 after the cap took effect, it does not show recent industry trends.

[1] This FY19 estimate is less than the previous LFC estimate of $248 million for FY19 because of additional data from EDD on the decline in industry activity in FY18 that is impacting FY19 applications and data from EDD and TRD on the significant time lags from production to filing to processing and approval that push much of the backlog into FY20.



	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Expenditures	$96,192.3	$9,494.5	$50,000.0	$50,000.0	$50,000.0	$50,000.0
Claims	56	58	59	81	58	74

The film tax credit is funded through the corporate income tax (CIT) program. Last year, CIT general fund revenues were approximately $107 million; however, this was after $50 million was paid out through this credit for film and television production. It is probable that removing the aggregate cap on this credit would result in lower CIT revenues, which flow to the general fund.

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or be held for future consideration.

This bill may be counter to the LFC tax policy principles of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

EDD provided the following analysis.

> This bill will pay off the backlog that has been created with the rolling credit cap of $50 million a year. When analyzing the "backlog" it is best to look at it through a three tiered approach. The first tier is what has been approved at TRD but not paid due to the cap. The second tier is the productions that are finished but have not yet applied for the tax credit. The third tier is the estimated number of productions and resulting credits that are projected to come to the state and apply for the credit.

> TRD currently carries a backlog of roughly $198 million. The Film Office expects an additional $130 million in credit applications. The EDD economist projects the amount of productions still to come and apply for the credit in this timeframe is between $53 million to $65 million. The projections are based upon the assumption that the film industry will reach $500 million in direct spend in FY19. Currently the industry has spent $244.5 million (from Film Office industry statistics). The backlog, when combining all three components, could range from $381 million to $393 million.
>
> The bill may allow the proper study of the implications of the credit. The passing of this bill could generate more productions and filming in the state. It could attract larger budget films to the state which could generate larger employment number.

The Department of Finance and Administration provided the following analysis.

> Currently, the state's outstanding film tax credits are an unfunded liability, although the outstanding amount has not yet been a material concern of bond ratings agencies. The payments proposed by the bill would likely be considered very positive by bond ratings agencies, as they would eliminate outstanding film tax credits, which are considered an existing liability, and slow any potential accumulation of future outstanding film tax credits (i.e., future unfunded liabilities).

The Pew Charitable Trusts performs significant research and analysis of state tax incentives and accountability, and Pew stated in recent reports, "A well-designed incentive should... protect the state budget from costs that increase quickly and unexpectedly." In presentations regarding this protection, Pew has advocated caps for some incentives to prevent such increases in costs. Within the last several years, New Mexico experienced soaring costs for some tax deductions and credits, such as the high-wage jobs tax credit, which rose from annual costs nearly always less than $10 million to well over $50 million for two years before the state significantly narrowed the credit. That surge in costs became a cautionary tale for other states and is a good reminder for New Mexico policymakers to carefully consider changes to tax expenditures that could create significant spikes in costs.

PERFORMANCE IMPLICATIONS

The LFC tax policy principle of accountability is met with the existing annual reporting provided and detailed studies evaluating the effectiveness and other attributes of the credit.

New Mexico is falling behind other states for evaluating tax incentives. *Pew Charitable Trusts* recently reported 28 other states now perform regular tax incentive evaluations. The primary obstacle for New Mexico, as it was for many other states, is access to taxpayer data for the evaluations, but LFC does not currently have funding necessary for the dynamic modeling software and an additional staff or contract economist to perform these evaluations. Granting access to key data and providing LFC economists with the needed resources would allow a gradual process of evaluating tax expenditures and economic development incentives with the goal of eventually providing a holistic picture of the costs and benefits to the state of each job created in a particular industry – not just the cost of an individual incentive program, but the additive (or stacked) costs of all the incentives available for a particular job, along with estimated additional revenues and other benefits resulting from that job (*see Appendix: Cost Per Job for calculations and additional discussion*).

EDD provided the following information.

> EDD is tasked with the reporting the effectiveness of the tax credit. By clearing the backlog, the department will be able to provide a clear analysis that shows what benefits and what costs can be attributed to the credit going forward. The department has had numerous discussion with LFC staff on how best to show the cost per job and this bill could provide further clarity.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This bill relates to SB151, which would provide economists with data access and provide LFC economists with resources needed to regularly evaluate incentive programs such as this (*see Performance Implications for more discussion*).

HB527 conflicts with HB654 and SB2, which mostly duplicate each other in permanently removing the credit cap and making significant additional changes.

HB527 conflicts with HB594, which appropriates $100 million to TRD to pay off the backlog through a voluntary bid for discounted payments on credit claims.

HB527 conflicts with SB451, which seems intended to make the $50 million cap a hard cap with no backlog accrual.

TECHNICAL ISSUES

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

ALTERNATIVES

Instead of eliminating the cap and paying off the entire backlog of credits at full face value, the bill could structure a voluntary payment system where companies could request the credit sooner if they were willing to take a discounted payment. This would result in a smaller general fund impact, and depending on the discount factor, could still be more beneficial to companies than waiting multiple years to receive the full value.

Does the bill meet the Legislative Finance Committee tax policy principles? 1. **Adequacy**: Revenue should be adequate to fund needed government services. 2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax. 3. **Equity**: Different taxpayers should be treated fairly. 4. **Simplicity**: Collection should be simple and easily understood. 5. **Accountability**: Preferences should be easy to monitor and evaluate

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✘	
Targeted		It has some long-term goals, but they are more general than specific
Clearly stated purpose	✓	
Long-term goals	–	
Measurable targets	✘	
Transparent	✓	
Accountable		Multiple studies have been performed, but increased reporting by film companies and EDD could improve analysis by state agencies and the public
Public analysis	✓	
Expiration date	✘	
Effective		The incentive appears effective in attracting film productions to the state and generating local employment in the industry This incentive is one of only a few that appears to pass the "but for" test – the large presence of the film industry in New Mexico is likely due to the incentive
Fulfills stated purpose	✓	
Passes "but for" test	✓	
Efficient	?	The efficiency of the credit is indeterminate at this time; additional analysis of this credit and other economic development incentives for comparison is needed
Key: ✓ Met ✘ Not Met ? Unclear		

JC/al/sb

APPENDIX: COST PER JOB

There is significant discussion about the costs and benefits to the state of the film credit and how much the state may be paying as an incentive for each job that exists in the industry. Much of the debate centers on job estimates and multipliers to account for indirect and induced jobs, along with whether or not to include estimated tax revenues received by state and local governments, additional indirect costs to the state, and how to estimate those. The first phase of the 2014 film study contracted through EDD estimated the state recoups 33 cents for every dollar it spends through the film credit based on direct jobs in the industry.

The January 2019 *LFC Volume III* contains a cost per job chart that estimated the cost of the film credit at nearly $29 thousand per job (direct job cost*) annually, although this was based on data underlying the 2014 film study, so the figure does not reflect the latest data. LFC staff also noted in a recent memo that under the assumption most of the film activity would not occur here but for this credit, the state must continue to pay the annual cost to keep the film jobs in the state.

Note the *LFC Volume III* cost per job chart lists only direct job costs without considering indirect and induced effects because most of the job creation programs and tax expenditures on the list do not have associated studies estimating indirect and induced effects. Additionally, different assumptions and methodologies can result in substantially different cost estimates, so considering direct costs only – while imperfect – is currently the most consistent way to provide a comparison of a particular job creation program or incentive.

Looking long-term at the total cost for a film industry job, it would be a multiple of the annual cost because the state must pay each year to keep that job. For example, the Job Training Incentive Program (JTIP) is estimated in the same document to have a one-time cost of about $4,000 per job. Whether that job lasts one, four, or 10 years, the cost for that program to create the job is still $4,000. Similarly, the high-wage jobs tax credit is shown to have an average cost of $25.5 thousand, but that job would need to last for at least four years to receive the full credit. However, if one assumes the film credit mostly passes the "but for test," and the industry would largely not exist without the credit, then the following assumption must be made. To keep a film job for four or 10 years, the cost would be the net present value of the annual cost over that many years, discounted to account for the lower value to the state of a dollar in the future compared with a dollar today.

Based on updated data from EDD released in February 2019, LFC staff estimate the average annual cost per direct job was about $14 thousand annually in FY17 and FY18 scored against the cap of $50 million, which restricts the amount paid out each year. EDD estimated the cost per job at $5,953 for FY17 using a multiplier for indirect and induced jobs. There is nothing wrong with this approach in isolation; in fact, there is validity to using multipliers, but if the primary purpose of arriving at a cost per job figure is to compare the cost-effectiveness of various job-creation programs, then the comparison must be made for direct jobs only unless and until thorough cost evaluations are done for other programs and incentives and multipliers are determined for each (*see Performance Implications for more discussion*).

However, the state accumulated significant additional liabilities beyond the payments made in those years. Scored against the estimated liability accrued in those years, the cost per direct job was about $39 thousand annually. While a cap remains, there is validity to reporting both cost estimates, because the former is the cost to the state using the modified accrual accounting

system, and there is no obligation in any given fiscal year to pay more than $50 million. However, the latter accounts for how much the state will eventually have to pay over time (not discounted to net present value) for the jobs that exist today, and this liability will be reflected in the state's FY18 comprehensive annual financial report (CAFR). If the cap is removed, it would be reasonable to only score the cost per job against the accrued liability since that would also represent the amount paid out. The table below shows these annual and net present value LFC estimates.

Film Credit: Estimated Costs Per Direct Job		
	Scored Against $50 Million Cap	Scored Against Accrued Liability
Annual Cost Per Direct Job	$14,016	$38,676
Net Present Value Cost, 7.25% for 4 Years	$47,208	$130,268
Net Present Value Cost, 7.25% for 10 Years	$97,314	$268,532

However, it is also important to note what these numbers represent and how incentive programs may be stacked for different industries. These estimates, along with those shown in the *LFC Volume III*, are the costs per job of an individual job creation program or incentive. They do not reflect the total cost to the state of that job. Therefore, to directly compare the cost of the film credit with another incentive program, or to compare any other two incentive programs, creates an incomplete picture of total costs unless the incentives represent the majority or entirety of the state benefits provided to that industry.

For example, for the film industry, the film credit typically represents the bulk of the benefit from the state. There is some money provided through the Film Crew Advancement Program, and occasionally a company such as Netflix will receive an award of Local Economic Development Act (LEDA) funding, but these amounts are relatively insignificant compared with the cost of the film credit.

However, New Mexico has focused on recruiting various types of manufacturing companies to the state over the years and has created a wide array of available incentives, most of which can be stacked on top of each other. For example, a manufacturer can also receive LEDA and JTIP funds but can also receive the high-wage jobs tax credit, the investment credit, tax exemptions through industrial revenue bonds, and a host of narrower industry-specific incentives within the broader manufacturing category. The state currently has no way to properly analyze the total cost of creating a manufacturing job.

Therefore, while the state should strive for progress toward better understanding the costs and benefits of these incentives, a direct comparison between the cost of the film credit and the cost another incentive should note the significant caveats associated with such comparisons.

APPENDIX: GENERAL FUND REVENUES VERSUS COSTS

There is seemingly consensus the state of New Mexico receives less in general fund tax revenues from the film industry than it pays annually for the film credit, with estimates ranging from 33 cents to 56 cents of general fund revenues from the film industry for every dollar the state spends on the credit. Below are some key points regarding this issue.

- Phase 1 of the 2014 film study performed under contract for EDD concluded film production activity has produced an estimated $0.33 in state tax revenues for each $1.00 of credit claims granted.

- A 2019 film study performed under contract for The International Alliance of Theatrical Stage Employees (IATSE) determined if the cap were removed, for every $1.00 of credit claims granted, New Mexico would receive $0.41 in additional tax revenue.

  - The study arrives at this conclusion despite assuming that increased film industry activity will result in increased tax revenues completely unrelated to the industry, such as severance tax revenues.

- A 2019 report by the EDD Film Office did not directly determine a ratio of revenues to credit claims, but estimated personal income tax and gross receipts tax revenues generated by the industry (including a multiplier to represent indirect and induced impacts) for the state totaled $28.2 million in FY17.

  - Based on the $50 million paid by the state in that year, this would result in $0.56 in state tax revenues for each $1.00 of credit claims granted.

  - The assumptions used to estimate the revenues generated seem relatively conservative, but adding a multiplier effect always introduces debate. Additionally, it is important to note there are always additional costs to the state for incremental workers that move to New Mexico as a result of higher employment in this, or any, industry. While this would not significantly change the above calculations, it is important to consider if viewing costs and benefits holistically.

It is also important to note the eventual cost to the state for the film credit, including backlog liabilities that are generated due to the cap, has recently significantly exceeded $50 million per year. Comparing the estimated tax revenues generated by the industry with the amount paid under the cap is valid when considering the cash cost of the credit, but there is also validity to comparing the tax revenues with the total liabilities accrued in a given year, which recently exceeded $100 million per year. Removing the cap changes the situation so that the total accrued liabilities would equal the amount paid in cash, making that the only valid comparison.