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

SPONSOR Anderson **ORIGINAL DATE** 2/22/19 **LAST UPDATED** 2/27/19 **HB** 594/aHCEDC

SHORT TITLE Certain Film Tax Credit Claims **SB**

ANALYST Clark

APPROPRIATION (dollars in thousands)

Appropriation					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
	$100,000.0				Nonrecurring	General Fund

Parenthesis ( ) indicate expenditure decreases

Relates to or conflicts with HB527, HB654, SB2, SB451, SB151

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of HCEDC Amendment

The House Commerce & Economic Development Committee Amendment to House Bill 594 adds clarifying language, inserting the word "percentage" before "discount" to more clearly note the Taxation and Revenue Department is to accept bids with the highest percentage (not dollar) discount first.

Synopsis of Original Bill

House Bill 594 appropriates $100 million from the general fund to the Taxation and Revenue Department (TRD) in FY20 to pay film tax credit claims. The bill amends the Film Production Tax Credit Act to create a temporary provision requiring TRD to hold an auction for companies with film credit claims to voluntarily submit bids for the percentage discount they are willing to accept on their credit value. TRD would prioritize bids from highest discount to lowest discount and then pay the new, discounted values sequentially up to the amount of the appropriation.

A claimant who is owed a credit and is interested in joining the auction must submit a final bid in writing to TRD by August 1, 2019. TRD would have until August 19, 2019 to finalize the auction process and until September 1, 2019 to pay these claims.

FISCAL IMPLICATIONS

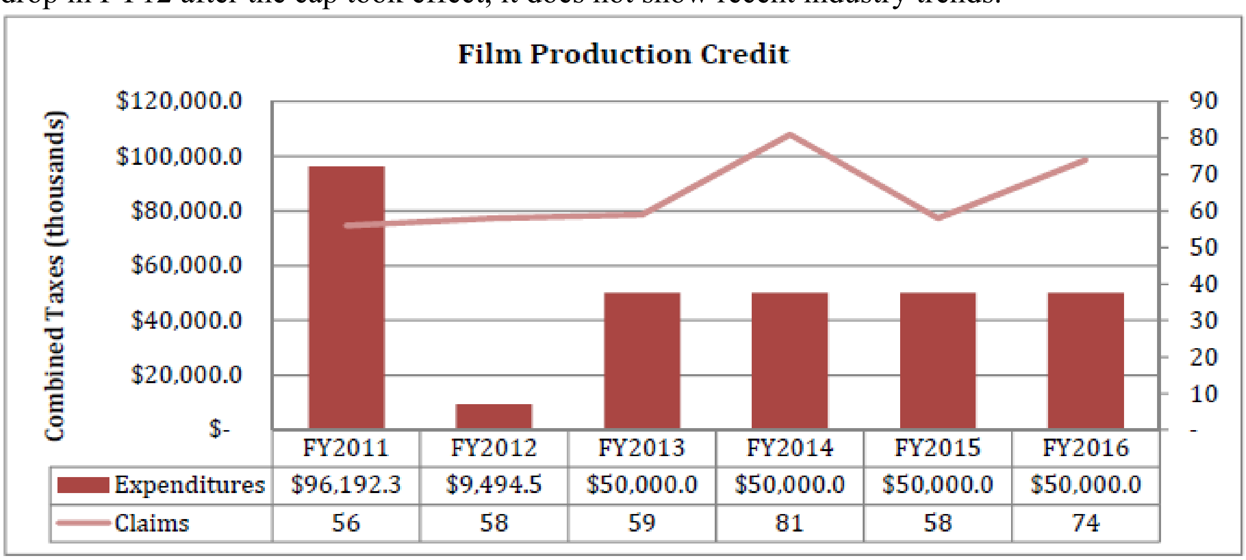
The appropriation of $100 million contained in this bill is a nonrecurring expense to the general fund. Any unexpended or unencumbered balance remaining at the end of FY20 shall revert to the general fund.

The LFC estimate for the backlog in total accrued liabilities in FY19 is about $211 million after paying out the required $50 million under the cap. Applications filed with TRD in FY19 year-to-date are somewhat lower, but there is likely an unknown seasonality effect. Without data to account for this seasonality, the LFC estimate does not make any adjustments to this estimate, which would otherwise shift some liabilities into FY20[1]. Regardless, it is reasonable to assume that if companies decide it is preferable to take credits now at a discount rather than wait, most or all of the appropriated amount would be used.

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 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 estimate is less than the previous LFC estimate of $248 million because of additional data from EDD on the decline in industry activity in FY18 that is impacting FY19 applications.

SIGNIFICANT ISSUES

Because this is a voluntary auction, companies owed film credits may choose to enter the auction and take the value of the credit at a discounted rate or wait and receive the full value of the credit over time as permitted under the $50 million annual cap. It is also important to note the possibility that some companies may offer only slight discounts if waiting for the payments is not a significant deterrent for those particular entities. TRD noted, "It is unpredictable how the bidding mechanism contained in the bill would incentivize claimants of the film credit to forego a portion of the credit they are owed…. [This appropriation] would partially resolve the state of its backlog, however unless the $50 million annual cap is lifted, it can be anticipated that a backlog will continue to build over time after the current backlog is resolved."

EDD provided the following analysis.

> The production companies would have to assess the time value of money and determine if the value is greater with a discount now versus the timetable in which they would be paid out. This bill could clear the backlog, assuming that all liabilities are paid out at a discount. The passage of this bill could send a message to the industry, and other industries alike, that the state has an issue with paying its liabilities. The industry could see the passage of the bill as a slight and reverse course on future investments in the state.

The Department of Finance and Administration provided the following analysis.

> Currently, the state's outstanding film tax credits are considered an unfunded liability, although the outstanding amount has not yet been a material concern of bond ratings agencies. The proposed payment of $100 million of these outstanding film tax credits essentially reduces this existing liability, and thus would likely be considered very positive by bond ratings agencies.

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 for a similar bill.

> EDD is tasked with the reporting the effectiveness of the tax credit. By clearing the backlog (if this bill achieves that through the discounted payments), 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*).

HB594 conflicts with HB654 and SB2, which mostly duplicate each other in permanently removing the credit cap and making significant additional changes.

HB594 conflicts with HB527, which eliminates the credit cap for the current backlog of approved claims and any additional approved claims in FY19 and FY20.

HB594 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.

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		
Clearly stated purpose	✓	
Long-term goals	–	It has some long-term goals, but they are more general than specific
Measurable targets	✘	
Transparent	✓	
Accountable		
Public analysis	✓	Multiple studies have been performed, but increased reporting by film companies and EDD could improve analysis by state agencies and the public
Expiration date	✘	
Effective		
Fulfills stated purpose	✓	The incentive appears effective in attracting film productions to the state and generating local employment in the industry
Passes "but for" test	✓	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
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.