Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Cohn	Analyst:	Marion Mann DeJong	Bill Number:	AB 1830
Related Bills:	See Legislative History	Telephone:	845-6979	Amended Date:	03/31/2004
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SUBJECT: Employer Qualified Wages Paid For Production Of Qualified Motion Picture Refundable Credit

SUMMARY

This bill would create a refundable income tax credit for wages paid in connection with the production of a motion picture in California.

SUMMARY OF AMENDMENTS

The March 31, 2004, amendments deleted the legislative intent language to provide an incentive for motion picture production and replaced it with the actual incentive. This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to stem run-away film production by providing a tax incentive to produce motion pictures in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment. However, the bill specifies that it would be operative for taxable years beginning on or after July 1, 2006, and before January 1, 2012.

POSITION

Pending.

Summary of Suggested Amendments

Technical amendments are needed to change "board" to "Franchise Tax Board" where appropriate. See "Technical Considerations" below.

ANALYSIS

FEDERAL/STATE LAW

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business (e.g., employee wages and benefits). However, when a taxpayer produces or creates a product (e.g., video, film, etc.) the taxpayer will generally incur a great portion of the expenses before the product is ready to produce income. When this happens, the taxpayer is usually required to capitalize those expenses and amortize (recover or deduct) them over the period of time that the product is producing income using a specialized cost recovery method referred to as the "income forecast" method. Amortized expenses include costs of researching, preparing, producing, recording, etc. It also includes an allocation of indirect costs such as utilities, tools, clerical, and rental of equipment.

Board Position:			Department Director	Date
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Current state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake. Generally only the taxpayer that incurred the credit-related expense may claim tax credits.

THIS BILL

This bill would create a refundable income tax credit for wages paid in connection with the production of a motion picture in California. The credit would equal 15% of wages paid to qualified individuals during the production period of a motion picture that is completed and placed in service during the taxable year. Only wages paid for services performed in California on or after January 1, 2006, and before January 1, 2009, would qualify for the credit. For each motion picture, the maximum amount of wages per qualified individual that can be taken into account in computing the credit is $25,000. In addition, none of the wages paid to qualified individuals who receive more than $200,000 for services performed for the motion picture qualify for the credit.

“Qualified individuals” would be individuals who perform services during the production period in an activity related to the production of a qualified motion picture. Wages paid to individuals related to the taxpayer would not qualify for the credit. Wages qualifying for the credit would include:

- W-2 wages paid by the taxpayer to a qualified individual for services performed in California.
- Employee fringe benefits that are allocable to the W-2 wages described above.
- Payments made to an entity (i.e., personal service corporations, payroll service corporation, or any entity receiving wages on behalf of a qualified individual) for services performed in California by qualified individuals.
- Remuneration paid to independent contractors who are qualified individuals for services performed in California.

Costs (including wages) paid for various activities specified in the bill that are unrelated to the production of a motion picture would be excluded from wages that qualify for the credit.

“Production period” would mean the period beginning with approval to proceed with the production project and ending with the date the qualified motion picture is placed in service for purposes of the taxpayer claiming amortization deductions for federal income tax purposes.

Motion pictures qualifying for the credit would be motion pictures as defined similar to the definition of “motion picture” in the Sales and Use Tax Law (Section 6010.6(b)(3) of the Revenue and Taxation Code) that meet all of the following additional requirements:

- The total cost of wages of the motion picture, excluding specific costs, is more than $200,000, but less than $10 million. For purposes of this test, each episode of a television series is considered to be a separate motion picture.
- At least 75% of the total wages of the production are for services performed in California.
- The motion picture is complete and placed in service for purposes of the taxpayer claiming amortization deductions for federal income tax purposes.
- The copyright for the motion picture is registered with the U.S. Copyright Office.

The taxpayer would be required to add the amount of the credit to income in the year the credit is allowed. In the case of a pass-through entity (e.g. partnership, S corporation), the credit is refunded to the partner or shareholder rather than the entity.

The credit would be denied unless the taxpayer substantiates by adequate records or sufficient evidence that the wages were paid and that the wages qualify for the credit. In addition, the credit would be denied if the taxpayer fails to provide the copyright registration number or fails to attach certification that the taxpayer is the one taxpayer entitled to amortize and deduct the movie production expenses for federal income tax purposes. If more than one taxpayer is entitled to amortize and deduct movie production expenses (e.g., due to a cost-sharing arrangement that is not treated as a partnership for tax purposes), an agreement stating which one taxpayer will claim amortization for purposes of the credit must be attached to the return in order to satisfy the "one taxpayer" requirement.

The credit would be allowed for taxable years beginning on or after July 1, 2006, and before January 1, 2012. Motion picture productions completed prior to the taxpayer’s first taxable year beginning on or after July 1, 2006, would qualify for the credit. However, for these motion pictures only wages paid on or after January 1, 2006, would qualify for the credit and the credit would be claimed on the taxpayer’s tax return for the first taxable year beginning on or after July 1, 2006.

IMPLEMENTATION CONSIDERATIONS

Implementation of this refundable credit will result in significant changes to tax forms, processing systems, and computer systems. Since this bill has a delayed operative date, it is anticipated that these changes can be implemented during the department’s normal annual system update. However, the department has never administered a refundable corporation credit, or a credit relating to the complex movie industry. Unforeseen issues may arise as this credit is implemented. In addition, the department has identified the following additional considerations:

- This credit is allowed to one taxpayer, but is based upon wages paid by many taxpayers (contractors and subcontractors actually producing the motion picture) during the production period of a motion picture. Taxpayers must share wage information with the taxpayer entitled to federal amortization deductions for the motion picture to determine if the motion picture qualifies for the credit and to compute the credit amount. Without this sharing of wage information, the credit cannot be implemented. However, according to the sponsors of this bill, industry practices and production contracts will be modified to require the sharing of this information. Thus, according to the sponsors, determining if a motion picture qualifies and computing the credit amount should not be a problem. Further, the enhanced substantiation requirement is intended to preclude assertions by the qualified taxpayer that they are unable to obtain the necessary wage information but should still be entitled to claim this credit.

- The definition of “production period” may be difficult to implement without clarification of who gives approval to proceed with the production. It is unclear to department staff whether this is a definitive event that can be specifically identified as occurring on a particular calendar date. If it is a definitive event, staff can be trained to understand the commencement date of the production period. However, if it is a subjective event that cannot be specifically identified as occurring on a particular calendar date, then disputes are likely to occur between taxpayers and the department.

TECHNICAL CONSIDERATIONS

The term “board” when used in the Personal Income Tax Laws and the Corporation Tax Laws generally refers to the Board of Equalization and not the Franchise Tax Board. The term “board” should be changed to ”Franchise Tax Board” on page 8, lines 10 and 16, and on page 18, lines 29 and 33 of the bill.

LEGISLATIVE HISTORY

AB 2747 (Wesson, et. al., 2001/2002) was identical to this bill. AB 2747 failed to pass the Senate Appropriations Committee.

AB 484 (Kuehl, 1999/2000), as amended July 14, 1999, would have provided a refundable income tax credit for wages paid in connection with the production of or musical scoring for certain television programs or motion pictures. As enacted, AB 484 (Stats. 1999, Ch. 699), created the Film California First Program within the Technology, Trade, and Commerce Agency to assist in the underwriting of actual costs incurred by production companies filming in California.

AB 358 (Wildman, 1999/2000) would have provided a refundable income tax credit for wages paid in connection with television programs or motion pictures similar to AB 484. AB 358 was held in the Senate Appropriations Committee.

AB 1062 (Battin, 1997/1998) would have expanded the Manufacturers’ Investment Credit to allow the credit for costs associated with certain activities relating to teleproduction and other postproduction services. AB 1062 was later amended to provide a sales or use tax exemption for teleproduction and other postproduction property. AB 1062 died because it failed to pass to the second house by the constitutional deadline.

OTHER STATES’ INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the credit allowed by this bill. The laws of these states were reviewed because their tax laws are similar to California’s income tax laws.

In 2001, *Congress* considered two bills, Senate Bill 1278 and House Resolution 3131, that would have provided a credit equal to 25% of the first $25,000 of labor costs incurred for the production of motion pictures in the U.S. No action was taken on either bill once they were assigned to committee.

In 2003, *Congress* considered House Resolution 715 that was basically the same as Senate Bill 1278 and House Resolution 3131. No action was taken on this bill once it was assigned to committee.

Canada provides a refundable income tax credit for a percentage of Canadian labor costs related to motion picture production. Additionally, most Canadian provinces provide a similar credit that matches the national credit. The two credits can equal up to 22% of Canadian labor costs.

Hawaii provides an income tax credit of up to 4% of costs incurred in Hawaii for production of motion pictures and television series.

New Mexico provides a refundable tax credit equal to 15% of direct production expenses for films made in New Mexico.

FISCAL IMPACT

Since the author has indicated that this bill will not move this year, the department's costs to administer this bill will not be determined at this time. It is anticipated that the department would incur significant costs to modify corporate systems to allow for a refundable credit and to address noncompliance issues.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of this bill is estimated to be as shown in the following table:

Revenue Impact of AB 1830, as Amended March 31, 2004 For qualified wages beginning on or after January 1, 2006 For tax years beginning on or after July 1, 2006 $ Millions				
2005-6	2006-7	2007-8	2008-9	2009-10
-$0	-$15	-$115	-$70	-$15

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The revenue impact of this credit would depend on the amount of qualified wages paid beginning on January 1, 2006, and through December 31, 2008. Qualified wages is estimated as the product of the number of employees in the film/video industry, the average weekly wage, the number of workweeks per year, the $25,000 wage cap, and the $10 million production cost cap. In addition, qualified wages are adjusted downward (4%) for movies started in 2005 but completed in later years.

The amount of qualified wages for the 2007 tax year is projected to be $469 million derived as follows:

> 18,469 qualified employees X $1406 Average Weekly Wage X 50 Weeks X 37.3% Adjustment Factor X 0.96 = $469 million qualified wages

The adjustment factor of 37.3% includes the $25,000 wage cap, the $10 million production cost cap, the addition of credit to income, and the requirement that 75% of total movie wages must be qualified wages.

The amount of credits generated for the 2007 tax year is projected to be $70 million as follows:

> $469 million qualified wages X 15% credit rate = $70 million

This amount of generated credit is further adjusted for cash-flow reductions in estimated tax payments throughout the year to arrive at the fiscal-year estimates above.

The Film and Television Action Committee (FTAC) provided an estimate for the amount of wages that would qualify under this bill. For the year 1998, FTAC estimated that total wages for qualified projects would be approximately $1.429 billion, about 12% of the wages paid to California employees in industry SIC 781 (Motion Picture and Video tape Production). Based on the weekly wage data $1,456 from the Employment Development Department (EDD), employment in qualified projects is estimated at 19,632 persons. This level of employment is assumed to grow at the same rate as EDD indicates it grew from 1998 to 2003. From 2004 onward, employment is assumed to grow at 2.3% annually. Average weekly wages for the future years are assumed to grow at the same rates as the Consumer Price Index (CPI).

ARGUMENTS/POLICY CONCERNS

Under existing state law, credits are only available to the taxpayer that paid or incurred the expense that provided the basis for the credit. This credit would allow a taxpayer to claim a tax credit for wages paid or incurred during the production of a motion picture, regardless of whether the taxpayer actually directly paid the wages.

LEGISLATIVE STAFF CONTACT

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