Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Calderon	Analyst:	Anne Mazur	Bill Number:	SB 740
Related Bills:	See Legislative History	Telephone:	845-5404	Amended Date:	February 23, 2007
		Attorney:	Douglas Powers	Sponsor:	California Film Commission

SUBJECT:	Motion Picture & Commercial Production Wages Paid Or Property Purchased Refundable Credit/Claim For Sales & Use Tax Refund Or Credit In Lieu Of Credit

SUMMARY

This bill would create refundable tax credits based on certain wages paid or amounts paid to purchase or lease certain property used to produce motion pictures or commercials in California.

PURPOSE OF THE BILL

It appears the purpose of this bill is to stem run-away film production by providing a subsidy by way of a tax incentive to produce motion pictures and commercials in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment. The bill specifies that the credits would be operative for taxable years beginning on or after January 1, 2007, and would be repealed on January 1, 2018. The bill also specifies, however, that the amounts upon which the motion picture credit is based does not include any qualified wages paid or incurred for services performed or any qualified property purchased or leased before January 1, 2007. The bill also specifies that qualified production costs for a qualified commercial do not include qualified wages paid or incurred before January 1, 2007.

POSITION

Pending.

Summary of Suggested Amendments

Technical amendments are provided to correct incorrect phrases.

Board Position:			Department Director	Date
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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 that the product produces income using a specialized cost recovery method called the "income forecast" method. Amortized expenses include costs of researching, preparing, producing, recording, and other direct production costs. It also includes an allocation of indirect costs such as utilities, tools, clerical, and equipment rental.

The federal American Jobs Creation Act (AJCA) of 2004 contains provisions that impact the income tax treatment of motion picture productions. Effective for productions commencing after October 22, 2004, and before January 1, 2009, the AJCA permits qualifying film and television productions to elect to deduct certain production expenditures in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances under the income forecast method discussed above. This provision only applies to qualified productions the aggregate cost of which does not exceed $15 million. For this purpose, a qualified film or television production is defined as any production of a motion picture, miniseries, scripted, dramatic television episode, or movie of the week if at least 75% of the total compensation expended on the production is for services performed in the United States. For an episodic television series, only the first 44 episodes qualify under the provision. The AJCA modifies the income forecast method to include certain participations and residuals in the adjusted basis of the property. The AJCA also allows a deduction equal to a portion of the taxpayer’s qualified domestic production activities, including any disposition, lease, rental, or license of qualified film produced by the taxpayer. California has not conformed to these provisions.

Current state and federal laws do not provide any tax credits relating to production of commercials or motion pictures.

THIS BILL

This bill would create two refundable credits. Each credit will be discussed separately.

1. Qualified Motion Picture Credit

This bill would create a refundable franchise tax or income tax credit for a percentage of the wages paid or amounts paid to purchase or lease tangible personal property used in the production of a qualified motion picture, as defined, in California that is allocated and certified by the California Film Commission. The bill would also allow the refundable motion picture credit to be claimed against sales or use tax liability in lieu of the franchise or income tax liability.

<u>Credit Amount</u> – In general. 12% of the "qualified amount" of wages and property during the production period of a "qualified motion picture." **Additional 3% for movie of the week and miniseries.**
<u>Maximum Credit</u> The lesser of – The amount of <u>initial credit allocation</u>; the amount of <u>credit based on actual allowable expenditures on completion</u>; or <u>$3 million</u> per qualified motion picture.

<u>Qualified Wages</u> – Wages and certain fringe benefits paid or incurred by the production company with respect to a qualified individual for services performed on a qualified motion picture in this state.

<u>Qualified Property</u> – Tangible personal property purchased or leased in California that is used primarily in the production of a qualified motion picture.

Qualified Motion Picture Credit

<u>Initial Allocation</u>
Taxpayer's apply to Commission for initial allocation on first-come-first-served basis under Commission regs.

<u>Filming Starts</u>
Taxpayer uses initial allocation for financing and begins filming within 180 days of initial allocation.

<u>Picture Complete</u>
Motion picture completed; taxpayer submits independent audit to Commission; and makes irrevocable election to claim credit

<u>Final Certification</u> – Commission makes final certification of **qualified taxpayer**; **amount of credit** allowed to each; and **notifies** qualified taxpayer, FTB, and BOE.

<u>Taxpayer Claims Refundable Credit</u> on franchise tax, income tax, or sales tax return

<u>Qualified Motion Picture</u> In general. A motion picture produced for exploitation in theaters, TV, videotapes, videodiscs, DVDs, or any other digital format or on commercial carriers and at least 75% of the total days spent in principal photography occur wholly in California.
Budget requirements. A feature film, movie of the week or miniseries qualifies if it has a minimum budget of $500,000 and a maximum budget of $75 million.
TV Episode. Also qualifying is a single episode in a single season (not exceeding 22 episodes) of a TV series that is new to California with a minimum budget of $500,000 and a maximum budget of $1.8 million per episode.

<u>Maximum Allocation</u> – An amount equal to an unspecified amount for the 2007 calendar year, plus unused credit allocations.

<u>"Qualified amount"</u> does not include any of the following:

- o Wages paid or incurred for services performed before January 1, 2007.
- o Qualified property purchased or leased before January 1, 2007.

<u>"Qualified motion picture"</u> does not include any of the following:

- o Motion picture produced:
  - for private noncommercial use, such as weddings or graduations,
  - by students made as part of any educational course, or
  - for industrial purposes.
- o News program, current events or public events program, talk show, game show, sporting event, or awards show.
- o Telethon or other production that solicits funds.
- o Reality television program.
- o A feature where 80% or more of the content consists of computer-generated images.
- o Clip-based programming if more than 50% of the content is comprised of licensed footage.
- o Documentary.
- o Variety program.
- o Daytime drama.
- o Strip show.
- o One-half-hour (air time) episodic television show.
- o Any production that falls within the recordkeeping requirements of Section 2257 of Title 18 of the U.S. Code.

<u>"Qualified wages"</u> does not include any of the following:

- o Expenses, including wages, in excess of the first $25,000 paid per person per qualified motion picture for writers, directors, music directors, music composers, music supervisors, producers, and performers, other than background actors with no scripted lines.
- o Expenses, including wages, for legal or accounting services except production accountants.
- o Expenses, including wages, related to new use, reuse, clip use, licensing, secondary markets, or residual compensation, or the creation of any ancillary product, including, but not limited to, a soundtrack album, toy, game, trailer, or teaser.
- o Expenses, including wages, paid or incurred with respect to acquisition, development, turnaround, or any rights thereto.
- o Expenses, including wages, related to financing, overhead, marketing, promotion, or distribution of a qualified motion picture.

"Qualified property" does not include any of the following:

- A story, script, or scenario to be used for a qualified motion picture.
- The literary, dramatic, or musical material upon which the qualified motion picture is based or may be adapted.
- Any rights relating to the two preceding items.

2. Commercial Production Credit

This bill would also create a refundable franchise tax or income tax credit for a percentage of the incremental production costs of producing a qualified commercial in California that is allocated and certified by the California Film Commission.

Commercial Production Credit

Qualified commercial production company applies to Commission for credit allocation.

Application must contain qualified production costs for the base year and the taxable year.

If limit exceeded, Commission aggregates all applications within 120 days of due date and makes pro rata allocation.

Certification – Commission makes certification of **qualified taxpayer**; **amount of credit** allowed to each; and **notifies** qualified taxpayer and FTB.

Taxpayer Claims Refundable Credit on franchise tax or income tax return

Credit amount – 12% of the incremental qualified production costs.

Maximum credit –

The lesser of –$500,000 per qualified production company per calendar year, or the credit allocated by the Commission to the qualified commercial production company.

Incremental qualified production costs – Qualified production costs for the taxable year greater than the qualified production costs for the base year.

Qualified production costs – Costs for tangible property used and services directly and predominantly in the production of a qualified commercial. Costs for qualified wages, technical and crew production costs, certain depreciation, and other specified expenses.

Qualified commercial
A commercial or advertisement composed of moving images and sounds that is recorded on film, videotape, or other digital medium, created for display on a network, regional channel, or cable where 75% of the total production days occur wholly in California.

Maximum allocation – An amount equal to an unspecified amount for the 2007 calendar year, plus unused credit allocations.

Pro rata allocation – If the amount allocable to commercial production companies exceeds maximum amount allowed to be allocated in any year, the Commission is required to make a pro rata allocation of that maximum amount.

"Qualified commercial" does not include any of the following:

- Program length production with an advertising component including a documentary length commercial.
- An infomercial.
- A news or current affairs program.
- Interview or talk program.
- Network promotion (short form content intended to promote other programming).
- Game show, sporting event, or award ceremony.
- Daytime drama.
- Reality entertainment programming.
- Program intended primarily for industrial, corporate, or institutional end users.
- Fundraising or political commercial.
- A program consisting primarily of stock footage.
- A program produced by an organization organized under Section 527 of the Internal Revenue Code, relating to political organization.
- Any production that falls within the recordkeeping requirements of Section 2257 of Title 18 of the U.S. Code.

"Qualified production costs" do not include costs for any of the following:

- A story, script, or scenario to be used for a qualified commercial.
- Qualified wages paid or incurred before January 1, 2007.

"Qualified wages" do not include wages, salaries, or other compensation for any of the following:

- Writers,
- Directors,
- Music directors,
- Producers, and
- Performers (other than background actors with no scripted lines who are employed by a qualified commercial production company).

This bill contains special rules for both credits that specifically provide that the amount of the credit is to be treated as a separate item of income of the qualified taxpayer that is sourced to California. Additionally, in the case of an S corporation, the credit is required to be claimed and refunded to the shareholders and not the S corporation.

IMPLEMENTATION CONSIDERATIONS

Implementation of these refundable credits would result in significant changes to tax forms, processing systems, and computer systems. Added lines on each return could result in an additional page for each return, in turn requiring additional storage space. Verifying certification for the credits when processing returns would result in a new manual workload. The department has never administered a refundable corporation credit or a credit relating to the motion picture industry; however, administering this bill would be relatively simple as Franchise Tax Board's (FTB) administrative activities would be limited to matching the taxpayer claiming the credits against a list of those qualified taxpayers that were allocated credits by the California Film Commission.

TECHNICAL CONSIDERATIONS

1. On page 7, line 38, strikeout "percent of" and insert "percent or" in lieu thereof.
2. On page 13, line 22, after "23685" strikeout ", and".
3. On page 14, line 14, and on page 33, line 30, after "qualified", insert "commercial".
4. On page 20, line 3, and on page 39, line 24, strikeout "motion pictures" and insert "commercials" in lieu thereof.

LEGISLATIVE HISTORY

AB 777 (Nunez, 2005/2006) would have provided refundable credits identical to this bill. This bill was held in the Senate Revenue and Taxation Committee.

SB 58 (Murray, 2005/2006) would have provided a refundable franchise and income tax credit for certain wages paid or amounts paid to purchase or lease certain property used to produce a motion picture in California. This bill was held in the Senate Revenue and Taxation Committee.

AB 1830 (Cohn, 2003/2004) and AB 2747 (Wesson, et. al., 2001/2002) would have provided a refundable income tax credit for wages paid in connection with the production of a motion picture in California. AB 1830 did not pass out of the Assembly policy committee. AB 2747 did not pass out of 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 did not pass out of the Senate Appropriations Committee.

OTHER STATES' INFORMATION

Numerous states and foreign jurisdictions provide incentives to the motion picture industry. Attached as appendices to this analysis are charts compiled by the California Film Commission summarizing the most significant of these incentives.

Recently enacted, the Oregon legislature established two film production incentives:

- Effective in 2005, the Greenlight Oregon Labor Rebate Fund, which offers productions a rebate of approximately 6.2% on qualified wages. Income taxes withheld from wages on a qualified production are put into a suspense account at the Oregon Department of Revenue, and rebated back to the production when filming in Oregon is completed. Productions must spend at least $1 million on production-related expenses in Oregon to qualify. This rebate also applies to commercial productions, if a company spends at least $1 million on production expenses in the state in a single year.

- A credit is allowed for contributions to the Oregon Production Investment Fund that is certified by the Oregon Film and Video Office. The credit applies to tax years beginning on or after January 1, 2005, for tax credit certifications issued on or after July 1, 2005.

FISCAL IMPACT

The estimated cost to implement this proposal would be approximately $465,000 for modification of the individual and corporate tax systems to accommodate the refundable credits and other automated and manual return processing functions. Estimated annual costs to process returns claiming the credit would be approximately $130,000. It is assumed that FTB's activities to administer this bill would be limited to verifying that the taxpayer claiming the credit or refund is in fact the qualified taxpayer allocated credits by the Commission, and then making or denying the credit or refund as applicable. These costs would increase significantly if an additional line results in one more page for certain tax returns and would require new system programming, forms design, and forms printing. The bill should include an appropriation for the department's costs to implement and administer the credit.

ECONOMIC IMPACT

This bill would result in a loss of state income tax revenue in the amount of the total aggregate amount of credits subject to allocation in any calendar year. The bill has left the amount that may be allocated blank, and therefore, the estimated amount of revenue loss cannot be determined at this time. Without any limit, this bill would result in revenue loss of about $200 million per taxable year.

LEGAL IMPACT

This bill would require taxpayers to produce motion pictures or commercials in the state to qualify for the credit. This requirement may be subject to constitutional challenge under the Commerce Clause of the United States Constitution.

ARGUMENTS/POLICY CONCERNS

This bill provides that the Commission would allocate credits to a qualified taxpayer based on information required to be included with the taxpayer's application and certify the allowed credits upon completion of the motion picture or commercial in accordance with rules and regulations promulgated by the Commission. Because the bill would require the Commission to certify the allowed credit prior to being claimed on a franchise or income tax return, FTB administration of the credit would be limited to verifying that the taxpayer claiming the credit or refund is in fact the qualified taxpayer allocated credits by the Commission, and then making or denying the credit or refund as applicable. In this regard, administration of the credit would be relatively simple. FTB currently administers the low-income housing credit and the natural heritage preservation credit, both of which are allocated by a designated agency, in this manner. However, if the allocation certification feature were eliminated or if the bill is amended to require FTB to examine returns subsequent to the taxpayer claiming the credit or refund, such examinations would be lengthy, complex, and costly.

Unlike other allocated tax credits, such as the low-income housing credit and the natural heritage preservation credit, this credit does not specifically restrict the taxpayer able to claim the credit for the expenses of producing the motion picture or commercial to the owner (or owners) of the motion picture or commercial.

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APPENDIX
SUMMARY OF CURRENT MOTION PICTURE PRODUCTION INCENTIVES OF OTHER STATES

STATE	INCENTIVE	DESCRIPTION
ARIZONA	**TRANSFERABLE TAX CREDIT**	• **20% transferable** income tax credit on in-state production expenditures on projects spending $3 million or more (10% when spending under $3 million.) • **50%** sales and use tax rebate on purchase or lease of tangible property on productions spending $1 million or more. • To qualify, a production must hire a minimum of AZ residents.
CONNECTICUT	**TRANSFERABLE TAX CREDIT** **WAGE TAX CREDIT**	• **30%** transferable tax credit on qualifying production costs (**25%** credit on productions spending less than $1 million) • **25%** nontransferable credit on wages of Connecticut residents.
FLORIDA	**FILM INDUSTRY REBATE PROGRAM**	• **15%** reimbursement of qualified Florida expenditures for productions spending at least $850,000. • Funded at $20 million per year. Capped at $2 million per project.
GEORGIA	**INVESTMENT TAX CREDIT**	• **9%** Transferable income tax credits on all costs spent in Georgia, plus: • **3%** credit on wages paid to GA residents, plus: • **2%** credit for TV productions that spend more than $20 million annually, plus: • **3%** credit for productions in distressed areas.
HAWAII	**REFUNDABLE TAX CREDIT**	• **15%** tax credit on qualified production costs. • **20%** tax credit if production takes place in a county with a population of less than 700,000. • Capped at $8 million per project
ILLINOIS	**TRANSFERABLE WAGE TAX CREDIT**	• **20%** transferable income tax credit on Illinois production spending, plus: • **15%** credit on Illinois wages for employees from geographic areas of high employment or poverty.

Source: California Film Commission (March 2007)

APPENDIX
SUMMARY OF CURRENT MOTION PICTURE PRODUCTION INCENTIVES OF OTHER STATES

STATE	INCENTIVE	DESCRIPTION
LOUISIANA	**TRANSFERABLE TAX CREDIT** **EMPLOYMENT/LABOR TAX CREDIT** **SALES & USE TAX EXCLUSION**	• **25%** transferable tax credit on Louisiana spending **(**if spending exceeds $8 million, otherwise 10% credit) plus: • **10%** credit on total aggregate payroll of Louisiana residents (excluding salaries in excess of $1 million) plus: • **4%** sales and use tax exclusion
MAINE	**WAGE TAX REBATE**	• **10%** wage rebate on non-residents; • **12%** rebate on wages of Maine residents
MARYLAND	**WAGE REBATE** **SALES TAX EXEMPTION**	• Wage rebate up to $12,500 per eligible employee for projects spending over $500,000. Funded at $6.8 million per year. • Sales tax exemption
MASSACHUSETTS	**TRANSFERABLE EMPLOYMENT CREDIT** **PRODUCTION TAX CREDIT**	• **20%** of Mass. payroll (excluding salaries over $1 million) plus: • **25%** on all in-state production costs (excluding payroll) if half the production shoots in state. • Capped at $7 million per project
MICHIGAN	**PRODUCTION REBATE**	• Graduated scale for in-state spend: **12%** for $200,000 – 1 million in spending **16%** for $1 – 5 million in spending **20%** for $5 – 10 million in spending Total program spending $7 million per year.
MINNESOTA	**PRODUCTION REBATE**	• **15%** Rebate of qualified production costs. • Program capped at 1.7 million

Source: California Film Commission (March 2007)

APPENDIX
SUMMARY OF CURRENT MOTION PICTURE PRODUCTION INCENTIVES OF OTHER STATES

STATE	INCENTIVE	DESCRIPTION
MISSISSIPPI	**PRODUCTION REBATE** **SALES TAX EXEMPTION**	Tiered rebate for in-state expenditures • **20%** on the first $1 million of local spend **25%** on the next $4 million spend **30%** on local spend over $5 million, plus: • **10%** rebate for payroll of out-of-state workers • **7%** Sales tax exemption for most production purchases.
MONTANA	**REFUNDABLE TAX CREDIT**	• **12%** refundable tax credit on up to $50,000 in wages paid to Montana residents. • **8%** credit on total in-state spending.
NEW JERSEY	**TRANSFERABLE TAX CREDIT** **LOAN PROGRAM**	• **20%** transferable tax credit on in-state production spending if 60% of total production shoots in state. • Loan guarantee program up to $1,500,000 • Sales tax exemption
NEW MEXICO	**PRODUCTION TAX REBATE** **INTEREST FREE LOAN**	• **25%** rebate on qualifying in-state production and postproduction expenditures • Interest free loan up to $15 million • Job training funds
NEW YORK	**REFUNDABLE TAX CREDIT**	• **10%** refundable tax credit of qualified expenditures, funded at $60 million per year. • City of New York offers the same incentive with a refundable tax credit equal to **5%** of qualified expenditures capped at $37.5 million for 3 years
NORTH CAROLINA	**REFUNDABLE TAX CREDIT**	• **15%** refundable tax credit on qualifying in-state production expenses including wages. $7.5 million maximum refund per project.

Source: California Film Commission (March 2007)

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SUMMARY OF CURRENT MOTION PICTURE PRODUCTION INCENTIVES OF OTHER STATES

STATE	INCENTIVE	DESCRIPTION
OKLAHOMA	**REBATE PROGRAM**	• **15%** of eligible in state costs. Capped at $5 million per year. • Sales tax exemption on tangible property and services
OREGON	**PROD. INVESTMENT FUND** **VENDOR REBATE** **LABOR REBATE**	• **10%** rebate on in Oregon costs, capped at $250,000 per film production • **10%** rebate with participating vendors. • **6.2%** rebate on Oregon wages.
PENNSYLVANNIA	**INCOME TAX REBATE**	• **20%** tax rebate of qualified Pennsylvania costs including wages when productions spend 60% of production costs in-state ($10 million annual cap) • **6%** sales tax exemption
PUERTO RICO	**PRODUCTION PROJECT TAX CREDIT**	• **40%** transferable labor tax credit (paid to Puerto Rican residents). At least 50% of the shooting must take place in Puerto Rico.
RHODE ISLAND	**TRANSFERABLE TAX CREDIT** **INVESTOR TAX CREDIT (non transferable)**	• **25%** tax credit for all Rhode Island spending. Production must spend at least $300,000. • Investor will receive **15%** tax credit for budgets between $300,000 and $5 million. For budgets over $5 million, investor will receive **25%** tax credit.
SOUTH CAROLINA	**TRANSFERABLE TAX REBATES**	• **20%** rebate of total payroll for employees who are subject to South Carolina withholding, if in-state spending is at least $1 million. Plus: • **7%** sales tax exemption for purchases of in-state goods and services. Plus: • **30%** rebate program for in-state purchases/rentals. • Capped at $28 million annually.
UTAH	**REFUNDABLE TAX CREDIT**	• **10%** of Utah production spending. Plus: • **2%** rural Utah credit • (maximum $500,000 per production)

Source: California Film Commission (March 2007)

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SUMMARY OF CURRENT MOTION PICTURE PRODUCTION INCENTIVES OF OTHER STATES

STATE	INCENTIVE	DESCRIPTION
WASHINGTION	**PRODUCTION REBATE**	• **20%** rebate of qualified production expenses and wages. • Capped at $6 million per year.
WISCONSIN	**REFUNDABLE TAX CREDIT**	• **25%** refundable tax credit for in-state expenditures. • **25%** non-refundable wage credit up to the first 25,000 in wages.
WYOMING	PRODUCTION REBATE	• **15%** rebate on in-state expenditures if at least $500,000 is spent. • Capped at $1 million per year.

Source: California Film Commission (March 2007)