ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Gatto	Analyst:	Jane Raboy	Bill Number:	AB 1435
Related Bills:	See Legislative History	Telephone:	845-5718	Introduced Date:	January 6, 2014
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: California Qualified Film and Digital Media Infrastructure Project and Motion Picture Production Credits

SUMMARY

This bill, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), would do the following:

- Create a credit for investments in a qualified film and digital media infrastructure project.
- Modify the California Motion Picture and Television Production Credit (Motion Picture Credit).

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to encourage investment activity and increase the development of an infrastructure base for film and digital media production within California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, both provisions of this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2014.

ANALYSIS

Existing 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.

FEDERAL LAW

Federal law does not allow a credit for infrastructure investment projects for the film and digital media industry or the motion picture industry.

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For qualified productions commencing after December 31, 2011, and before January 1, 2014, a taxpayer could elect to expense rather than capitalize, up to $15 million of the cost of a qualified film or television production, or up to $20 million in cost if incurred in an eligible area.[1]

STATE LAW

The California Film Commission (Commission) administers the Motion Picture Credit, and authorizes the allocation of credits, establishes program guidelines, application, and certification procedures.

The aggregate amount of credits that may be allocated by the Commission in any fiscal year is equal to the sum of following:

- $100 million in credits for the 2009/2010 fiscal year and each fiscal year thereafter, through, and including the 2016/2017 fiscal year.
- The unused allocation credit amount, if any, for the preceding fiscal year.
- The amount of previously allocated credit not certified.

The credit is allocated by the Commission in the fiscal year that the production begins and is certified by the Commission after the production is completed. A taxpayer is required to apply to the Commission to claim the credit. The Commission is required annually to provide the Franchise Tax Board (FTB), Legislative Analyst's Office, and the Board of Equalization a list of the taxpayers and the tax credit amounts allocated to each taxpayer by the Commission.

For taxable years beginning on or after January 1, 2011, a qualified taxpayer, as defined, may claim a credit for qualified expenditures, as defined, attributable to the production that is equal to either applicable percentage:

- 20 percent of qualified expenditures attributable to the production of a qualified motion picture in California; or
- 25 percent of qualified expenditures attributable to the production of qualified motion picture that is either a television series that relocated to California or an independent film.

A qualified motion picture is defined as a motion picture produced for distribution to the public that is one of the following:

- A feature film with a production budget between $1 million and $75 million.
- A movie of the week or miniseries with a minimum production budget of $500,000.
- A new television series produced in California with a minimum production budget of $1 million licensed for original distribution on basic cable.
- An independent film, as defined.
- A television series that relocates to California with no minimum budget and is produced for any media outlet.

[1] Internal Revenue Code Sec. 181(a).

A qualified taxpayer may sell Motion Picture Credits attributable to an independent film to an unrelated party. The unrelated party is subject to the same requirements as the qualified taxpayer. Prior to the sale of the credit, the qualified taxpayer is required to report to the FTB all required information in the form and manner specified by the FTB.

Motion Picture Credits may not be sold to more than one taxpayer or resold by the purchaser. In the event that both the taxpayer originally allocated a credit by the Commission and a taxpayer to whom the credit has been sold claim the same amount of credit on their tax returns, the FTB may disallow the credit of either taxpayer, as long as the statute of limitations upon assessment remains open.

Like other credits under the CTL, a qualified corporate taxpayer may elect to assign any portion of the credit allowed to one or more affiliated corporations for each taxable year in which the credit is allowed.

THIS BILL

Qualified Film and Digital Media Infrastructure Project Credit

For taxable years beginning on or after January 1, 2014, this provision would create the qualified film and digital media infrastructure project credit (Film and Media Credit). The amount of the credit allocated to a taxpayer for a fiscal year would be specified in a written agreement between the Commission and the taxpayer, and could not exceed 5 percent of the investment amount made in a qualified film and digital media infrastructure project, as defined.

The credit would be allocated by the Commission beginning with the 2014/15 fiscal year, and every subsequent fiscal year thereafter.

The Commission would be required to do the following:

- Negotiate with a taxpayer the credit terms and conditions of proposed written agreements that provide the credit allowed to the taxpayer.
- Inform the FTB of the terms and conditions of the written agreement.
- Inform the FTB of any disallowance, in whole or in part, of a previously allocated credit upon approval of the disallowance by the Committee.[2]

The FTB would be required to do the following:

- Review the books and records of all taxpayers allocated a credit for compliance with the terms and conditions of the written agreement between the taxpayer and the Commission.
- Notify the Commission of a taxpayer's possible breach of the written agreement and provide detailed information regarding the basis for that determination.

Any disallowance of a credit approved by the Commission would be treated as a mathematical error appearing on the return. Any amount of tax resulting from the disallowance would be assessed by the FTB.

[2] See the Technical Consideration section of this analysis.

Unused tax credits could be carried forward for up to six years, if necessary, until the credit is exhausted.

The Film and Media Credit would define the following terms and phrases:

- "Commission" means the California Film Commission.
- "Qualified film and digital media infrastructure project" means a film, video, television, or digital media production and postproduction facility located in this state, including any movable and immovable property and equipment related to that facility and any other facility that is a necessary component of the primary facility, and has a minimum unspecified infrastructure budget amount. Movie theaters and other commercial exhibition facilities would be specifically excluded from the definition.

Motion Picture Credit

This provision would modify the Motion Picture Credit for taxable years beginning on or after January 1, 2014, by doing all of the following:

- Limit 20 percent of the qualified expenditures attributable to the production of a qualified motion picture in California to $100 million.
- Reduce the credit for television series that relocated to California from 25 percent to 20 percent of qualified expenditures.
- Allow the Commission to increase the applicable percentage[3] (enhanced applicable percentage) by an additional ______ percentage for the following:

  - ➢ Qualified expenditures attributable to qualified wages paid to California residents or a California business; and
  - ➢ Qualified expenditures made in a rural area or in a city, or unincorporated area for an unspecified unemployment level as collected and published by the Employment Development Department.

- Eliminate the requirement for a qualified motion picture that is a feature to have a maximum production budget of $75 million and would allow any television series produced in California with a $1 million budget to include television series for original distribution on network cable and a pilot television series.
- Set aside _________ dollar amount of credits each fiscal year for television series and qualified motion picture, as defined, allocation in accordance with the rules and regulation developed by the Commission.

In addition, this provision would increase the aggregate amount of credits that may be allocated in the 2015-16 fiscal year and each fiscal year thereafter to an unspecified dollar amount and would extend the Motion Picture Credit indefinitely.

[3] The applicable percentage is 20 percent of qualified expenditures attributable to the production of a qualified motion picture in California, or 25 percent of qualified expenditures attributable to the production of qualified motion picture that is an independent film.

This provision would define a "California Business" as a person, incorporated or qualified to do business within the state that:

- Holds a current California business license, that provides goods or services that provides goods or services under the name that appears on that business license,
- Maintains a place of business within California staffed by the person or an employee of that person for a period of at least six months immediately preceding the date the goods or services were provided, and
- Is a sole proprietorship whose proprietor is a resident of California, a limited liability company whose members are all residents of California or a partnership where all partners are residents of California.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation considerations relating to the Film and Media Credit for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This definition of "qualified film and digital media infrastructure project" uses the term "movable or immovable property or equipment." The customary term used within a franchise or income tax credit statute to identify "movable or immovable property or equipment" is "tangible personal property". The absence of a clearer definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this credit.

The department would be required to review the books and records of all taxpayers allocated a credit for compliance with the terms and conditions of the written agreements entered into between the taxpayer and the Commission. The FTB is responsible for administering and enforcing the PITL and CTL, therefore, reviewing the books and records relating to film and media activities is outside the current expertise of the department.

The definition of the Film and Media Credit lacks a minimum infrastructure budget dollar amount. Absent this information, the FTB would be unable to implement this provision.

Because this credit fails to specify otherwise, the CTL credit would be eligible for assignment. The bill is silent on whether and to what extent an assignee would become a party to the written agreement required to obtain a credit allocation.

TECHNICAL CONSIDERATIONS

On page 3, line 17, page 3, line 39, page 17, line 38, and page 18, line 20, the word "committee" should read "Commission" to correct for a typographical error.

On page 19, lines 3-5, the sentence "For taxable years beginning on or after January 1, 2014, 20 percent of the qualified expenditures attributable to the production of a qualified motion picture in California." is redundant and should be deleted and renumbered.

On page 27, line 18, the phrase "rules identified in or required to implement this section" should read as follows: "rules identified in, or required to implement, this section".

On page 27, line 20, the punctuation mark “,” should follow the word “films”.

LEGISLATIVE HISTORY

AB 286 (Nazarian, 2013/2014) would expand the Motion Picture Credit definition of qualified motion pictures by removing the cap on the production budget for feature films, limit the maximum amount of qualified expenditures for motion picture features to $75 million, and the amount of credits allocated each fiscal year. This bill was not passed by the house of origin by the constitutional deadline.

AB 1189 (Nazarian, 2013/2014) would extend the Commission’s authority to allocate and certify the Motion Picture Credit by five years, until July 1, 2022, and would increase the aggregate amount of credits awarded from $800 million to approximately $2.2 billion. This bill was not passed by the house of origin by the constitutional deadline.

AB 2026 (Fuentes, Chapter 841, Statutes of 2012) extended the Commission’s authority to allocate and certify the Motion Picture Credit from July 1, 2015, to July 2017.

AB 1069 (Fuentes, Chapter 731, Statutes of 2011) extended the Commission’s authority to allocate and certify the Motion Picture Credit from July 1, 2014, to July 2015.

ABX3 15 (Krekorian, Chapter 10, Statutes of 2009) and SBX3 15 (Calderon, Chapter 17, Statutes of 2009) established the Motion Picture Credit and required the Commission to administer a Motion Picture Credit allocation and certification program.

SB 1167 (Calderon, 2011/2012) would have extended the Commission's authority to allocate and certify the Motion Picture Credit two additional years, until July 1, 2017, and would have also extended the limit on the aggregate amount of credits that may be allocated through the 2016/2017 fiscal year. SB 1167 was held in the Senate Appropriations Committee.

SB 1197 (Calderon, 2009/2010) would have revised the rules for allocating the Motion Picture Credit, and would have clarified the changes to the provisions of the bill that are administered by the Commission. SB 1197 was held in the Senate Revenue and Taxation Committee.

OTHER STATES’ INFORMATION

The states reviewed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Michigan allows a qualified film and digital media infrastructure project credit equal to 25 percent of the base investment expenditures for the project, provided the taxpayer enters into an agreement with the Michigan Film Office (Film Office), including the Department of Treasury, by September 30, 2015. The Film Office is authorized to allocate $20 million in tax credits per taxable year. To qualify, a taxpayer is required to invest and expend at least $250,000 after December 31, 2008. The taxpayer may not file for a credit until at least 25 percent of the base investment in the project has been expended. Any unused credits may be carried forward up to ten years.

Review of *Florida, Illinois, Massachusetts, Minnesota*, and *New York* found no comparable tax credits.

FISCAL IMPACT

This bill would impact the department's audit program, tax forms, and systems. As the bill continues to move through the legislative process, costs will be identified for both credits and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

The department is unable to determine the revenue impact of this bill because several dollar and percentage amounts critical to the calculation of the credits have been left blank.

LEGAL IMPACT

The Film and Media Credit would allow a credit for digital media production and postproduction facilities located within California and under the Motion Picture Credit this bill would allow a credit for qualified expenditures attributable to the production of a qualified motion picture in California. This bill could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to improperly favor in-state activity over out-of-state activity. On August 28, 2012, (*Cutler* v. Franchise Tax Board), the Court of Appeal issued a unanimous opinion holding that California's Qualified Small Business Stock statutes were unconstitutional. Specifically, the Court of Appeal held that the statutory scheme's requirement of a large California presence in order to qualify for an investment incentive discriminated against interstate commerce, and therefore violated the federal dormant commerce clause. While no court decision has yet invalidated, as a general matter, state income tax credits that provide an incentive for in-state activity, i.e., facilities located in-state, property placed in service, or in-state production expenses etc., targeted tax credits such as the ones proposed by this bill may be subject to constitutional challenge.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that this bill would increase infrastructure project investment activity and target at-risk motion productions that are most likely to leave the state, permitting California to remain competitive.

Opponents: Some may argue that the cost of increased tax incentives targeted to the film industry may exceed the benefit of developing a strong infrastructure base for film and digital projects.

POLICY CONCERNS

This bill would allow a credit for infrastructural expenditures that are currently deductible as business expenses. Generally, a credit is allowed in lieu of any other deduction or credit in order to eliminate multiple tax benefits for the same item of expense.

This bill lacks a sunset date for the Film and Media Credit and would eliminate the sunset date for the Motion Picture Credit. Sunset dates generally are provided to allow periodic review of the effectiveness of a credit by the Legislature.

LEGISLATIVE STAFF CONTACT

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